S T A T E M E N T

of the Central Bank of the Republic of Azerbaijan on main directions of the monetary and financial stability policy for 2014

The modernization strategy and the successful socio-economic policy pursued over the recent 10 years under the leadership of President Mr Ilham Aliyev yielded high economic growth dynamics, which rapidly transformed to inclusive development, social welfare and high living standards amid sustainable macroeconomic stability. As a result, Azerbaijan has become a middle income country in a short time horizon, in terms of per capita GDP the country moved forward by 100 rankings.

The year of 2013 is successfully ticking away leaving behind the ten year bright period of development and prosperity. The economy, which launched a high growth rate since early XXI century, has been successfully growing over recent 5 years on the background of the global economic and financial crisis. Whereas advanced countries are still challenged by the crisis, Azerbaijan is implementing new strategic objectives aimed at sustainable growth. The country is ranked among top ten countries in terms of macroeconomic sustainability indicators. The national economy has reached high employment level. Hundred thousands of jobs were created accross the country and socio-economic growth of regions accelerated.

In 2013 the Central Bank targeted macroeconomic and financial stability – the vital prerequisites of balanced growth, attained the key targets – low inflation, a stable exchange rate and the banking and financial sector sustained. Financial intermediation in the country deepened and diversified.

In 2014 economic growth and development in the country are expected to continue amid volatile global conjuncture, and high domestic economic activity. The Central Bank will extensively foster new strategic objectives faced by the domestic economy and strive to neutralize potential risks coming from the global economy, preserving its policy principles in 2014. In the year to come the Central Bank will continue its policy aimed at macroeconomic stability, maintenance of financial sustainability and stability of the banking sector, as well as deepening of the financial intermediation.

1. Activities of the Central Bank in 2013

In 2013 the Central Bank implemented goals and functions under its legal mandate. The Central Bank, being the macroeconomic stability institution, maintained macroeconomic stability – the key prerequisite of balanced growth in the economy, utilized stabilizing and

promotional capacity of the monetary policy in response to the economic cycle. In parallel, the Bank introduced flexible financial stability management tools to regulate risks and overheating in the banking sector. To contribute to the diversification of the economy the Central Bank was actively involved in the implementation of the government's economic policy in the current year, promoting financial deepening in the banking sector and development of the financial infrastructure. The Central Bank implemented about 40 various institutional development oriented projects to more effectively fulfill its objectives and functions.

1.1. Global economic environment

In 2013 global economic growth was lower than expected, and growth rates varied accross regions. The world economy continued rebalancing, in countries with high debt burden structural policies were conducted, aimed at rebalancing economic growth between public and private demand.

The tightening budget policy in the USA, the euro area and other power centers had a considerable effect on global economic growth. **Fiscal consolidation** measures are focused on boosting budget sustainability through elimination of critical debt and deficit. Tax policies are directed at shifting tax burden from production to consumption. However, in 2013 most central banks eased the **monetary policy** to mitigate the containing impact of considerable public spending cuts on economic growth and employment.

Central banks of a number of countries declared that their policies will be modified in response to lower unemployment. In current year 54 out of 64 central banks decreased key interest rates. The International Monetary Fund (IMF) predicts y.o.y. 0.1 – 0.3 percent lower LIBOR rate accross currencies in 2013.

However, accommodative monetary policies are far from being accompanied by high credit supply in all countries. Advanced economies still face weaknesses and structural challenges in financial and banking sectors. Moreover, slack structural transformation directed at private sector activation has a downward effect on recovery of lending of financial institutions.

Given the processes, the IMF made several corrections to global growth predictions over the year. According to the Fund's recent **outlook,** global economic growth is expected to be 2.9 percent in 2013, which is 0.2 p.p. lower compared to 2012. This decline stems from sluggish growth rates across developing economies. As of the end-year GDP in 28 countries is expected not to hit the pre-crisis level.

Contained global aggregate demand, sensitivity to external and internal shocks, and volatile capital flows worsened economic growth prospects in a number of developing economies. On this backdrop, growth forecast for the global trade – one of the paramount factors of global economic growth – was shifted 0.2 p.p. (2.9 percent) for the current year.

The current global economic growth rate does not suffice to raise **employment**. According to the International Labor Organization, unemployment is numbering over 200 million persons, 73 million out of which are the young. Employment is expected to hit the pre-crisis level after 2015.

Global financial and investment flows are heading towards developing countries amid problems in economic growth, accommodative monetary policies and low interest rates in advanced economies. The Asian region has a significant share among the recipient countries of global investment inflows.

As of the end-current year foreign direct investments are predicted to jump 7 percent and reach USD 1.5 trillion, which still falls below the pre-crisis level (USD 2 trillion). Further growth and geographic directions of global financial and investment flows depend on the term of accommodative monetary policies in developed countries.

Amid restricted global aggregate demand, global commodity prices dropped 1.6 percent, food prices 6.6 percent, while the average oil price (USD 110) declined 3 percent over 11 months of 2013.

1.2. The process of economic development in Azerbaijan

ECONOMIC GROWTH. *In 2013 aggregate domestic demand remained high, economic growth was primarily driven by the non-oil sector.*

Over current 11 months real GDP rose 5.7 percent, including 9.5 percent rise in the non-oil sector. Country's economic growth rate surpasses average growth rate accross the world (3.6 percent) and the CIS (3.4 percent). The Azerbaijani economy scales USD 70 billion (67th in the world). As a result of the active diversification policy the share of the non-oil sector in GDP increased to 56 percent.

In 2013 all components of internal demand had an upward effect on economic growth. 10 percent rise in **government budget spending** in the current year factored in high domestic demand. Populations' final consumption expenditures climbed 15 percent. **Investments,** which trigger the **diversification,** rose 15 percent in 11 months, including 8 percent rise in investments to the non-oil sector. The non-oil-sector accounts for over 70 percent of investments.

According to the CBA survey among real sector enterprises and households, the **Business and Consumer Confidence Indexes** are high. This tendency relates to companies' high sales and new commodity and service orders, and optimistic expectations of enterprises and the population. Prices in the real estate market reach the pre-crisis pevel, which also indicates growth in economic activity and income level.

EXTERNAL ECONOMIC POSITION. *In 2013 Azerbaijan maintained a favorable foreign position, non-raw material export demonstrated expansion, investment inflows*

accelerated and foreign exchange reserves further accumulated in uncertain global economic environment.

Azerbaijan remains the CIS leader in terms of the current account balance to GDP ratio (over 15 percent). Over 11 months surplus of the foreign trade balance constituted USD 12.3 billion and export prevailed over import 2.3 times as much. Growth in **foreign investments** channelled to the economy made 31.2 percent over 11 months.

Amid surplus of the balance of payments strategic foreign exchange reserves rose 8.5 percent in current 11 months and surpassed USD 50 billion. The country is holding the position of being among top 20 countries in terms of the reserves to GDP ratio. The CBA **foreign exchange (FX) reserves** rose 18 percent and approximate USD 14 billion. High FX reserves are accompanied with the country's improved **Net International Investment Position**.

WELL-BEING. High economic activity in the non-oil sector positively affects **employment** as well. Over 80 thousand new jobs were created in the country in current year, of which 75 percent is permanent. Regions account for 73 percent of newly created jobs. Currently, unemployment in Azerbaijan is close to 5 percent – the desirable level for advanced economies.

In current 11 months an **average monthly salary** in the country rose 6.8 percent, while **per capita money income** grew by 6.5 percent. Over the one fifth of money income of the population is **channelled to savings.** The poverty level in the country falls below 6 percent.

Country's ***international ratings*** *further improve amid dynamic growth. In the recent Global Competitiveness Report Azerbaijan moved up to the 39th place having improved 7 rankings. Also the country advanced 10 rankings and moved up to the 8th place in the world in terms of macroeconomic stability and sustainability.*

1.3. Implementation of the monetary policy

INFLATION. *In 2013 prices remained stable in the country, and the actual inflation level kept within the target. According to the World Economic Forum, Azerbaijan is one of the top 7 countries with low inflation rates.*

Albeit two-digit growth in the non-oil sector, and high consumption and investment demand, in 11 months of 2013 average annual **inflation** was only 2.3 percent. Relativley low world food prices, a reasonable growth rate of the money supply and a stable exchange rate of manat factored in the low level of inflation. The high level of country's food supply through domestic production has a stabilizing effect on prices as well. Inflation on food products with the significant share in the consumption basket was only 2.2 percent.

Average annual **core inflation**[1] (0.7 percent) 1.6 p.p. fell below total inflation, which displays that contribution of monetary factors to price hike is low. Despite corrections made by the Tariff Council to tariffs of certain products in current December, as of end-2013 average annual inflation is expected to remain within prediction.

Over the recent year average weighted inflation in country's foreign trade partners was 2 p.p. above internal inflation. As of the end-year internal inflation is predicted to fall below average inflation rate expectations on the CIS, developed countries and accross the world. Amid the stable exchange rate, low inflation compared to **inflation in partner countries** played the key role in maintenance of competitive (price) advantage of the non-oil sector.

EXCHANGE RATE POLICY. *Large surplus in the balance of payments and the Central Bank's exchange rate policy framework affected the exchange rate of manat in past year*.

In 2013 the Central Bank implemented the exchange rate policy within the **corridor,** targeting the bilateral USD/AZN exhchange rate.

The Central Bank avoided higher appreciation of manat amid large surplus of the **balance of payments** and using part of forex revenues for socio-economic growth objectives. The Bank purchased USD 2.1 billion worth **foreign exchange** for the purpose. Accordingly, over the period the exchange rate of manat strengthened against USD only 0.08 percent. The stable exchange rate was of key factors, which affected macroeconomic and financial stability, as well as competitiveness of the economy. Stable **manat,** being the most stable and reliable regional currency, is actively used in frontier trading.

MONEY SUPPLY. *The Central Bank implemented a neutral monetary policy in 2013 on the backdrop of low inflation and high economic growth in the non-oil sector.*

In 2013 the **monetary policy** maneuvered between high domestic demand and inflation. Given the actual inflation level, the Central Bank shifted the refinancing rate to 4.75 percent from 5 percent early year to allow some decrease in interest rates and thus, underpin economic growth of the non-oil sector. Open market operations and reserve requirements were also employed to regulate money supply and bank liquidity. Monetary policy decisions were of factors influencing interest rates in the banking sector.

Broad money supply (M3) rose by 9 percent in 11 months, whose structure continued to improve. Over the period non-cash money supply climbed 12.2 percent, the dollarization indicator (the share of foreign currency savings and deposits in broad money supply) went down 1 p.p..

Institutional base of monetary management over the year contributed to adequate policy decisions. The Bank regularly investigated conditions to improve the strategic frame for the monetary and financial stability policy, as well as introduce a more flexible exchange rate

[1] is adjusted from swings in prices for regulated commodities and services and seasonal factors.

policy, and amplified the research base, which allows evaluate the pass-through mechanism of monetary policy decisions to the economy.

The Bank developed econometric analysis and used simulation techniques, enabling to assess and forecast economic growth, inflation and employment. Stress tests employed in financial stability assessment were further improved. Introduction of the e-statistics and analytic reporting system (ESAS) ensured reception, and automated handling of statistic reports and their dissemination to internal and external users in an electronic format. The Bank's surveys encompass up to 400 real sector enterprises and over 4000 households.

1.4. Maintenance of financial stability

PRUDENTIAL POLICY. *In 2013 the Central Bank continued measures to protect confidence in the banking sector, minimize risks in the system, enhance management capacity, and elevate sector's sustainability. The risk-based prudential supervision framework was significantly strengthened.*

The Bank continued to implement the supervisory regime, which allows formulate a new supervisory framework and maintain financial stability given the **Basel III** standards. The Central Bank introduced a new conceptual frame for Risk-based Banking Supervision to improve supervisory tools and ensure banking system's stable and sound development. The Bank effected task-oriented arrangements to improve the legal base for corporate governance, tailor risk management to modern challenges and cover operational risks with the capital requirement.

The Central Bank decision of 25 July 2012 to shift banks' capital requirement up to AZN 50 million accelerated capitalization in the system. Over 16 months upon the decision, aggregate bank capital increased by 57 percent or AZN 1.2 billion and the number of private banks with over AZN 100 million capital shifted to 8 from 3. Currently, the **capital of banks,** owning over 95 percent of assets of the system and deposits of the population, exceed AZN 50 million.

At the same time, banks with 5 percent share in banking sector assets need additional time to meet the capital requirement. Thus, to maintain financial stability, the Central Bank extended the capital adjustment period until 1 January 2015.

Over the year banks increased their **internal financial sustainability capacity,** and considerably progressed in dealing with unsatisfactory assets. The **protection system of the financial services consumers' rights** was enhanced to elevate banking system confidence; access of the population and entrepreneurs to personal loan data was eased through introduction of e-signature.

A series of events were carried out jointly with banks, international organizations and public entities within a special **financial awaraness of the population** project**.** Trainings on enhancement of financial skills were held for various target groups, and special publications disseminated. Modern intellectual tools in enhancing financial literacy were developed as well.

SUSTAINABILITY OF THE BANKING SYSTEM. *The quality of bank assets, liquidity and profitability increased, and high capital adequacy on the banking sector maintained over 2013. Adaptation to the Bazel III standards resulted in high financial provisioning and risk buffers in banks.*

The **capital adequacy ratio** for the banking sector is 17.6 percent against the 12 percent norm, which exceeds the international requirement about twice as much. The banking system remains highly liquid, banks' liabilities and settlements are met continuously. Results of the past 11 months suggest that the banking sector's instant liquidity ratio exceeds the threshold about twofold. Currently, the share of **overdue loans** of the real sector and the population in the banking system is 5.3 percent, half of which is covered by banks' reserves.

Financial results of the banking system were satisfactory, and the number of profitable banks increased. ROA accounts for 2 percent, ROE 15 percent.

FINANCIAL INTERMEDIATION. *Financial intermediation of the banking sector continued to further deepen and the resource base of the system widened in 2013.*

Banking system **assets** rose by 22 percent, including 25 percent increase in lending over 11 months of the current year. The size of loans to **regions** increased by 31 percent and loans to the private sector by 25 percent. The share of long-term loans in banks' credit portfolios increased up to 79 percent. Consumer loans were in high demand, with up to 37 percent increase over 11 months of the current year.

Interest rates are prone to declining. Over the past 1 year interest rates on deposits and loans in manat decreased by around 1 p.p. on average. Apart from the refinancing rate, reduction of maximum threshold on insured deposits to 10 percent from August 1 by the Board of Custodians of the Azerbaijan Deposit Insurance Fund had an effect on interest rates.

High confidence in the banking system was maintained among the population. **Deposits** of the population grew by 25.5 percent (32 percent in regions) to AZN 6.4 billion, 70 percent of which are insured deposits. Currently the number of depositors in the country exceeds 3 million. **Reimbursement of deposits** of the population left in Soviet banks continued. As of early December, 2013, up to AZN 600 million worth funds were already repaid on 1621.7 thousand deposit accounts.

The banking sector continued to attract resources from external sources. However, the share of external debt liabilities in bank resources is at an acceptable level (19 percent).

Regional coverage of the financial sector maintained a steady growth, 41 bank branches and 12 bank divisions opened, and the number of non-bank credit institutions increased to 146

from 139. Currently, the number of operating bank branches and bank divisions is 691 and 142 respectively, half of which is in regions.

Mortgage loans financed by the Azerbaijan Mortgage Fund (AMF) and from banks' own resources reached AZN 750 million. Mortgage loans increased by 35 percent, including social mortgage loans by 33 percent in 2013. As a result, families, which purchased apartments through mortgage loans, outnumbered 20 thousand. Besides, funds from the state budget, and resources attracted from markets significantly contributed to mortgage financing.

Over 60 percent of mortgage loans granted by the AMF was financed through long-term debt funds attracted from the financial market. The size of resources, the AMF attracted from the market, was AZN 300 million. Two significant institutional development projects were carried out in order to simplify mortgage lending and make bank's mortgage activities more efficient. The Electronic Mortgage System and Electronic Payment and Clearing System were launched for automation of mortgage lending procedures, repayments on credit liabilities, and related clearings and settlements.

FINANCIAL INFRASTRUCTURE. *The development of the modern payment infrastructure contributed to widening of cashless and electronic payments in the country.*

The stability and development of the **payment systems** were maintained over the past period of the current year, the size of electronic payments surpassed GDP twofold having increased by 10 percent.

The number of public entities integrated to the **Government Payment Portal** increased**.** This Portal was developed on the basis of the Centralized Information System on Mass Payments and allows make online budget payments. Up-to 1200 payment locations enabled the population to pay utility fees, as well as public charges both in cash and over the Internet and via ATMs.

Development of the **card infrastructure** accelerated, and the number of payment cards equalled to 5.5 mln pieces over the past period of 2013. Year-over-year increase in the number of payment cards was 9 percent, ATMs – 8 percent, and the volume of cashless operations through POS-terminals 1.8 percent.

The Central Bank, jointly with relevant public institutions, elaborated a package of proposals, aimed at increasing incentives on cashless payments to **upscale cashless settlements** in the country. Expansion of cashless payments is the key in increasing the resource base of the banking sector and loan supply to the economy, decreasing the value of credit resources and strengthening investment activities in the non-oil sector.

The Central Bank also continued efforts to implement the project on launch of the fully automated Cash Center to **effectively manage cash funds** over the current year.

2. Main directions of the monetary and financial stability policy for 2014

The Central Bank will pursue its monetary and financial stability policy for 2014 given the long-term development targets and macroeconomic features of the upcoming year. One of the fundamental conditions of the economic diversification and transformation of high economic growth to well-being is to maintain macroeconomic and financial stability, as well as financial inclusiveness – wide-scale access to financial resources.

With these targets, the Central Bank will pursue a flexible monetary and exchange rate policy in the medium-term, including in 2014 and focus on improvement of the policy framework and the exchange rate regime. The Central Bank will implement necessary anti-inflationary measures using the tools at its disposal with a view to supporting maintenance of price stability in 2014. When implementing the anti-inflationary policy, demand and cost factors of inflation will be taken into account. The Bank will attach special importance to further development of coordination between the monetary and macroeconomic policies, and strengthening the empirical base of monetary management.

The macro- and micro-prudential policy will be oriented at management of overheating in the banking system via systemic regulation and individual supervision to ensure financial stability. The Basel III standards will be tailored to the local environment, and development of counter-cyclical banking supervision continued.

Within the policy oriented at further financial deepening, the banks' business model will be aligned to new strategic development targets, while promoting reduction of interest rates. More efforts will be taken to further develop and deepen the banking-financial infrastructure, and the cashless settlements system.

2.1. Global economic environment expectations for 2014

International financial institutions and leading think tanks predict continuance of global economic growth in 2014. The recent IMF Outlook, released in October, 2013 suggests that global economic growth for 2014 is likely to be 3.6 percent, which is 0.2 percent lower compared to growth forecasts in July, but 0.7 percent higher relative to forecasts of 2013. Analytics do not exclude that factors restricting global economic growth might weaken gradually with fragile economic revival shifting to an active phase.

In the environment of impartial elimination of existing risks, international financial institutions recommend country spesific stimulating policies be continued to achieve ongoing economic growth. The continuing easy monetary policy in advanced economies might pave the way to smooth fiscal consolidation while supporting economic growth. However, an

unconvential monetary policy is deemed to be ineffective for a long span, the only advantage of which is to gain time for deep structural reforms.

Amid low inflation expectations, an accommodative monetary policy is primarily recommended to avoid the risk of slack in economic growth rates of developing economies. However, developing economies should also be well-prepared to sharp volatility in capital flows. Use of adequate regulatory tools and control over capital movements, financial sector restructurization and further structural reforms may neutralize overheating effects of economic stimuli.

In total, economic performance in trade partners of Azerbaijan and prices in global commodity markets may be volatile in 2014. Global oil prices substantially factor in the country's balance of payments. The recent IMF outlook suggests that the average world price of oil per barrel is likely to be USD 101.4 in 2014.

2.2. Forecasts for the country economy

Surplus of the balance of payments of Azerbaijan will endure in a medium-run and in 2014. CBA projections suggest that current account of the balance of payments is expected to demonstrate substantial **surplus** (15 percent of the GDP), and foreign exchange reserves keep growing.

Amid favorable foreign economic stance, the planned socio-economic policy will ensure economic growth of the country next year too. While domestic demand is still driving economic growth, the diversification strategy requires a more active contribution of external demand to economic growth, expanding the non-oil export.

The economic growth rate (5.2) of Azerbaijan for 2014 is projected to exceed the average growth rate of the world and CIS by 2-2.5 p.p.. The non-oil sector is expected to post double-digit growth next year as well. Public investments will significantly contribute to domestic investment activities. High employment, increase in real income of the population, and consumer loans will support positive dynamics of consumer demand.

Gradual substitution of domestic demand by the external one, and diversification of export are amongst the strategic objectives. **Export-oriented economic growth** in the non-oil sector, supported primarily by domestic and external investments eventually will lead to high sustainability of the state budget and the balance of payments. The export-oriented growth model implies markedly high share of the trade sector in economic growth and employment.

Accordingly, **macroeconomic sustainability** and **stability** are of vital importance. In this regard, stabilization of 2014 **state budget** expenditures, and optimization of the portion of oil revenues transferred to the budget are in full adequacy with new strategic challenges. Amid

volatile global oil prices it allows gradually optimize structural impact of world markets on the country economy.

Hence, the **fiscal maneuvering** policy of Azerbaijan, which successfully completed the most active cycle of the budget policy, allows for maintenance of budget sustainability and new quality economic growth. To that end, the quality of economic growth will be conditioned by higher contribution of private and external demand to the structure of aggregate demand in 2014.

2.3. Monetary policy and macroeconomic stability

Monetary policy directions for the upcoming year were elaborated given macroeconomic forecasts of 2014, common objectives of the economic policy, and the necessity to improve the strategic framework of the monetray policy.

MONETARY POLICY FRAMEWORK. Price stability is critical in central bank support for sustainable economic growth. This fact considered, the Central Bank will continue activities on the introduction of monetary policy conditions, enabling more flexible management of inflation.

Gradual implementation of these conditions in a medium-run will enhance possibilities to apply a more flexible exchange rate regime. A flexible exchange rate regime is the key factor in elevating options of impact on money supply and interest rates. However, it requires development of relevant macroeconomic and structural factors ensuring pass-through of interest rates to, and higer financial deepening of the economy.

In total, the Central Bank will try to effectively balance the monetary policy between economic growth and price stability, and regulate financial sector overheating in 2014. However, the level of inflation will be set as the key target. At the same time, monetary and macroprudential policies will be synchronized in line with recent global trends.

INFLATION FORECAST. Single-digit low inflation was set as an acceptable target of the macroeconomic policy for 2014. Taking this fact into account, the Central Bank will provide substantial support to **make the government's inflation forecasts come true** via its monetary policy. For this purpose, the Central Bank will make efforts to influence the core inflation through regulatory tools at its disposal.

Government-regulated tariffs and prices, demand factors of inflation, price dynamics in the world market, as well as the change of price level and exchange rates in partner countries are the key factors which may affect inflation in 2014.

Given all the above, as well as the pass-through capacity of monetary policy decisions to the economy, the Central Bank will carry out appropriate regulatory measures jointly with the government.

EXCHANGE RATE POLICY. In 2014 the Central Bank's exchange rate policy will be aimed at equilibrium in the foreign exchange market and a **stable exchange rate** of manat. Bilateral USD/AZN exchange rate target within the corridor will remain as an operational framework for the exchange rate policy in the upcoming year as well.

Surplus of the balance of payments will be the main macroeconomic factor to affect the exchange rate of manat. When implementing the exchange rate policy, the Bank will envisage targets of safeguarding non-oil sector competetiveness and financial stability.

The Central Bank will strive to ensure that domestic inflation falls below the inflation in partner countries in order to achieve a favourable level of the Real Effective Exchange Rate.

MONEY SUPPLY. The Central Bank will strive to ensure the optimum level of money supply using tools at its disposal in 2014. Sterilization and liquidity providing tools, at the rates set in line with the interest rate corridor concept, will be used to regulate money supply.

Continuing trends of decline in the growth rate of money supply in 2014 will be amongst the factors affecting inflation. These trends are observed in the environment of stabilization of budget expenditures.

Foreign investments and non-oil export may become new monetary factors influencing money supply, as the diversification strategy is implemented. As a rule, impact of these factors on inflation necessitates sterilization of excess liquidity through securities.

The Central Bank has different options of monetary policy for different scenarios of macroeconomic stance. If the risk of price hikes prevails over projections, necessary anti-inflationary measures will be taken. If the actual inflation rate falls below the projections or in case of any risks to non-oil sector growth, accommodative monetary policy possibilities may be implemented.

MONETARY MANAGEMENT BASE. To strengthen the research base of the monetary policy the Central Bank will develop new intellectual macroeconomic modelling products, and improve the methodological and informational framework of existing models. New researches on economic growth, inflation, and employment will be conducted. At the same time, new diagnostic models on financial stability (risks, overheating and financial bubbles) analysis will be established, and issues on financial intermediation studied.

Possibilities of effective exchange of information with public entities and international organizations will be reviewed within development of economic **statistics** and monitorings of market conjuncture. New sosiologic surveys on the economic cycle and consumer behaviour will be conducted.

Active public **communication** of the monetary and financial stability policy will further enhance credibility of the Central Bank, and develop adequate expectations. The Central Bank will inform the public on its activities through reviews, in line with the principles of the IMF Code of Good Practices on Transparency in Monetary and Financial Policies.

2.4. Financial sector stability and development policy

The Central Bank will continue activites, focusing on banking system stability, development of risk-based banking supervision, further financial sector deepening and promotion of access to financial services next year.

PRUDENTIAL POLICY. The Central Bank will continue its policy aimed at ensuring financial stability and sustainability potential of the banking sector, and minimising dependence on external risks. Under stable macroeconomic circumstances **optimum balance between growth of assets and sustainability targets** in banks will be maintained. Besides financial deepening, compliance of banking sector development with the economic growth rate is a significant priority. Quality parameters of banking sector growth will be monitored and sectoral diversification brought in line with the overall growth trajectory of the economy.

Within this framework particular attention will be paid to risk analyses of growth dynamics of particular loan products, including consumer loans. Preventive regulation of risks related to consumer loans will be prioritized. Overall, maintenance of the optimum role of banks' economic activities in the economic cycle will be constantly evaluated.

The new framework of **risk-based prudential supervision** will enable to pursue a flexible and effective supervisory policy and improve supervisory tools. The Bank will continue activities to cover each type of risks with regulatory requirements, with special focus on risk positions of banks of systemic importance. Measures to enhance banks' institutional capacity, and particularly prioritize risk management will be continued. **Capitalization** will be endured, the quality of capital and expansion of risk coverage will be on focus in the year to come. Operational risks will be appropriately covered with capital, and minimum requirements on risk regulation and management set.

Prudential supervisory tools will be continuously **improved** in order to safeguard and further strengthen financial stability. The legal framework will be reviewed to minimize credit risk concentration in banks.

More strengthened measures will be taken to **safeguard** and improve the **quality of credit portfolio**. New regulatory requirements will be set to maintain the balance between repayment ability of the population and consumer lending in order to prevent high leveraging

on consumer loans. The debt-to-income ratio will be used in lending with maximum threshold set by the Central Bank. Moreover, commercial banks will apply the responsible lending policy framework. The policy framework will tighten requirements on compliance with relevant consumer behaviour principles, providing consumers with income relevant products, and disclosure of correct and detailed information on product prices.

Requirements for risk management systems, management competencies, technological and employee potential will be heightened to accelerate bank's **institutional development**. Banks will be encouraged to make business model decisions allowing for not only profitability, but also long-term sustainable development targets.

Measures to **raise financial literacy** of the population, including broad public education campaigns will be continued. Intellectual and electronic resources will be developed. Activities to launch a special massive Internet resource on financial literacy will be initiated.

FINANCIAL INTERMEDIATION. *In 2014 the Central Bank will implement a new actions plan for broader access to financial services.*

Further increase of the banking sector's role in the diversification of the economy will be on focus. The Bank will support adjustment of the lending portfolio structure to expectations of the economy. Credit institutions behavioral models will be promoted to be in harmony with the country's growth model.

The Central Bank will take critical steps on factors affecting the cost value of financial resources for ongoing **drops in interest rates.** Competition in the banking system will be promoted, operational efficiency in banks elevated, other segments of financial market developed, resources of the population and economic subjects channelled to the banking sector upscaled on an ongoing basis. To stimulate declines in interest rates the Central Bank envisages developing new diversification supportive lending tools commensurate with best practices.

All these measures are oriented at expansion of the banking sector's resource base and amplification of the economic and financial conditions to have loans interest rates decreased based upon their effective utilization. The Bank will elaborate a new mechanism for the improvement of interbank market infrastructure to have interest rates decreased and excess liquid resources re-allocated among banks.

The regional network of financial institutions, including activities of non-bank credit institutions and microcredit institutions will be promoted to be expanded in the year to come to **broaden access of regions to financial resources**.

The Bank will continue measures to meet country population's incremental housing needs and deepen their capacity to acquire housing against long term and favorable **mortgage loans** within the **new strategy** to be adopted. The Bank will focus on the development and implementation of various, but effectively integrated housing types, benefiting from

international practices. To supply the market with cheap and comfortable housing, based upon – public – private sector partnership, is critical to that end.

On the other hand, new alternative and supplementary financial sources may be shaped in housing of the population through stimulation of usage of population's savings for their housing purposes in a number of ways. To that end, one of the top priorities is to develop savings – housing – construction banks under best practices. It is strategically critical to involve private investors to mortgage lending to broaden long term financial sources. The Bank will take relevant steps to launch market principles based upon mortgage lending and financing products.

As in previous years, in 2014 expansion of **cashless payments** will be on a priority list. The implied measures are aimed at moving the share of cash in money supply down to the level of advanced economies. Greater importance will be attached to specific stimulating measures. Public institutions will be interfaced to the Government Payment Portal, launched within the Electronic Government project in a continuous manner.

Regions will be promoted to have **broader access to e-banking.** Stimulating measures will endure to promote mass utilization of innovative payment tools and upscale cashless and e-settlements. The Bank will launch elaboration of the legislative base on electronic payment services.

Executive summary

In 2014 the national economy will rapidly grow and outstrip the global economy and the CIS countries in terms of the growth rate. Diversification necessitates a high role of the non-oil export in economic growth along with internal demand. To foster growth and diversification, the Central Bank will maintain macroeconomic and financial stability. The Central Bank will support regulation of inflation within the Government's single-digit level.

In parallel, the Bank will maintain banking sector's financial sustainability and continue activities to further amplify the sector's financial depth and diversify its financial intermediation.