

Summary on situation of the monetary policy on the first quarter of 2003

1. Execution of the monetary policy

The National Bank conducted the monetary and exchange policy related to the maintenance of the acceptable level of the inflation, the stability of the national currency rate, the currency reserves meeting international standards, strengthening of the national banking system and improvement of money supply in the economy during the first quarter of 2003 and mostly achieved the targets.

The success achieved on the economy of the country continued in the first quarter of 2003 as well. The established macroeconomic stability became irreversible and even deeper. These all proves the effectiveness and properness of the economical policy and its main component – the money-and-credit and exchange policy.

Macroeconomic situation. As a result of the purposeful economical and monetary policy the macroeconomic stability was retained in Azerbaijan during the first quarter of 2003 as well.

The **inflation rate** was 0.5% in the first quarter of 2003. But it constituted 1.5% in the same period of the previous year.

The researches carried out according to the inflation model prove that the price change of food products 90%, the price changes of non-food products 4.5% and the price change of services 5.5% influenced the alteration of prices.

The alteration of prices was related **90% to the monetary factors, 10% to the non-monetary** factors. The monetary factors had a decreasing influence on the inflation level during the accounting period.

The **real amount of the gross domestic product** as a main economical indicator had increased 7.9% against to 4.7% of the same period of the previous year.

The increase of the share of the **private sector** as an important condition of the country with the market economy proceeded as well. Over 70% of the GDP, as well as 54.5% of the industrial product, 99% of the agricultural commodities, 87.4% of the investment, 65.3% of the communication services, 54.1% of the freight forwarding were performed by the non-government sector during the first quarter of 2003.

The amount of the **investment** on the fundamental construction sphere as a main guarantee factor of the future economical development increased 41% constituting 3.1 trillion manats, since 2.7 trillion manats (545.3 million USD) or 85.1% of this was the foreign investment.

The observation of the positive inclinations in the **foreign trade balance** of Azerbaijan during the recent years proceeded. The foreign trade turnover increased by 27.9% as compared to the same period of the previous year and reached 509.4 million USD during the months of January – February of 2003. The export amounted to 235 million USD and the import amounted to 274.4 million USD. The appearance of the negative balance of approximately 39.4 million USD in the foreign trade was due to the import of the investment oriented products related to the realization of the oil contracts.

The improvement of the **population's welfare** continued. The average salary rose up to 367.2 thousand mantas (74.9 USD) and its real growth constituted 19.1%. In its turn the increase of population's income was the guarantee factor of the real sector's development, enhancing the purchasing capacity.

The inclinations in the world economy. The opposite declines were observed during the first quarter in the economy of the **USA**. So, in January the orders for long-term products increased by 3.3% in defiance of the analysts' expectations. Simultaneously the size of property sale rose in the **second-hand** market. On the other hand the number of appealers for the

unemployment compensation increased rapidly. Generally the process of diminishing of the economical growth rate begun in the fourth quarter of 2002, continued in the beginning of 2003. In January The Consumer Sentiment Index dropped to 79, the lowest level since 1993. In February it dropped to 64. In January the production activity index dropped to 53.9 from 55.2. But it is still higher as compared to the European countries.

In February the orders for the long-term products decreased 1.2% again. Simultaneously the lack of state budget reached an astronomic level – 96.3 billion USD in February. The volume of new apartments' construction decreased 11% and their sale decreased 8.1% as well. The volume of property sale also decreased 4.3% in the **second-hand** market. It should be noted that all of these appeared on the background of the lowest rates of hypothec credits since 1960.

The opposite inclinations were observed in **Europe**, as well. Though the production activity index was increased to 49.3 from 48.4 during January, the fact that it is still below 50 is annoying. The activity index in the services sector dropped to 50.2 from 50.6 during the same period. The foreign trade of the Euro region had a negative balance in defiance of the expected on January. It was related to the increase of the oil prices in one hand and increase of the euro rates in the other.

As forecasted for the year 2003, the share of the lack of the state budget in the GDP will be 3.2% in Germany, 3.5% in France, which exceed the limits defined for the Euro region countries. Taking into account the negative declines in the European economy Germany decreased the expected economical growth to 1% from the forecasted 1.5%. In its turn the IMF also decreased its forecast upon the economical growth of the Euro region to 1.3% from 2.3%.

The number of unemployment increased 62 thousand during January in **Germany**. From another side the busyness environment index determined by the **IFO** – the authorized research institute of the country increased to 88.9% from 87.4% in February, though the analysts forecasted it to fall till 87.2. This fact inspires hope that the economical growth rate of the German economy will accelerate. So the correlation is observed between the dynamics of the GDP and this indicator which has a great forecast potential.

The unemployment reached the highest level (9.1%) since 1993 in **France**. Simultaneously the consumption expenses decreased 0.2% in France.

The central bank decreased the discount rate from 4% to 3.75% in order to stimulate the economical growth in **England** in the beginning of February. This is the lowest level during the last 48 years.

Influenced by the deflation processes the profitableness of the 10-year state loans decreased to the lowest level 0.76% during its history in **Japan**. The continuation of the decrease of the last six year's wholesale turnover has been observed in Japan during the first quarter of the year 2003, as well. But the surplus of the foreign commerce in February increased 20.4% as compared the same period of the previous year. The increase of industrial production and activity index at the services sphere were also observed in January.

The changes of the **exchange rate of USD** against other leading currencies of the world were in different directions. Though the rate of USD decreased 3.3% against the euro, 1.6% against Swiss frank, 1.8% against Russian ruble, it increased by 2% against English pound and 0.6% against Japanese yen.

The processes in the economy of the leading countries have the results in the stock indexes of these countries. Generally the main stock indexes decreased during the first quarter of the year. So the *Dow-Jones average* displaying the average price of the 30 biggest industrial companies in the New-York Stock Exchange decreased 2.35%, the *Nikkei index* determined on the base of the stocks of the top 225 biggest companies in the Tokyo Stock Exchange decreased 6%. The decline rate of the stock indexes was sharper in Europe. So the **FTSE Eurotop 100** calculated on the base of stock prices of the 100 biggest companies of Europe decreased 9.8% and the **DAX 100 index** - the average of the stocks of the 100 biggest companies in the German Stock Exchange decreased 12.8%.

The average price of **Brent oil** in the world market was 30.8 USD in the first quarter of the year 2003. After the beginning of the military operations in Iraq the price of oil in the world market declined downtrend in defiance of the expected. By the end of the accounting period the price of oil was 26.35USD, which is 35.1% more than considered in Azerbaijan state budget for the year 2003.

2. Dynamics of money-and-credit indicators

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

The **monetary base of manat** increased by 16.4% constituting 1806 billion manats by April 1, 2003 as compared to the same period of the previous year.

The **broad monetary aggregate (M-2)** increased by 16.5% constituting 1946.6 billion manats.

The ability of banking system to create money - the monetary multiplier increased by 4.2% as compared to the beginning of the year. Though the monetary multiplier was still small, the reconstruction of the banking system, development of the banking infrastructure, and especially improvement of the payment system resulted in the positive dynamics of this indicator.

The share of the cash in the **structure of the money supply** decreased 2.4% point as compared to the same period of the previous year. It is related to the increase of the non-cash amount 32.8%, whereas the cash amount increased only by 13.1% as compared to the same period of the previous year.

The amount of the **credit investment** increased by 14.3% constituting 2731.8 billion manats as compared to the same period of the previous year. Besides the credits of "Aqrarkredit" organization the growth rate of the credits was 24.3%. The amount of the long-term credits increased by 7.58% and that of the short-term credits increased by 16.9% as compared to the same period of the previous year.

88.23% of credits were accrued by banks and 11.77% of these were accrued by other credit organizations.

The savings were one of the main sources of the credits during the period as well. The **savings of the natural persons** were 896.2 billion manats, which is 48.3% more than that of the same period of the previous year. The 42.8% of the savings in the banks is due to the private banks.

It should be noted that the analysis of the structure of the savings against the currencies shows the increase of the population's trust towards manat. As compared to the same period of the previous year the **population's savings in manat** increased by 27.1%. This factor establishes a favorable base to strengthen the role of manat in the economical turnover improving the structure of the money supply.

The average percentage of the credits in manat given to the legal persons decreased to 16.1% from 20.3% of the first quarter of the previous year and that of the credits in the foreign currency decreased to 12.8% from 16.3%.

During the accounting period the amount of the **Short-Term State Loans** increased by 14.3% or 20 billion manats constituting 160 billion manats (8.9% of monetary base) by April 1, 2003. The average profitability of the STSL decreased to 8.1% by the end of the quarter as compared to the 11.57% in the beginning of the quarter.

3. Improvement of the monetary management

Institutional improvement of monetary management The institutional improvement of the monetary management was also kept in the focus for the successful fulfillment of duties of the monetary policy.

Much was done to form a **perfect research base** - one of the most important elements of the monetary management mechanism. The use of the equilibrium models of the inflation and money market in the practical implementation of the monetary policy was continued. Simultaneously the establishment of the real sector and exchange models started. The created models allow to make the long-term economical forecasts.

The researches on the **inflation aiming**, on the analysis of the percentage rates in the money market of the country and on the improvement matters of the non-oil sector have been completed. In the research of the **inflation's aiming** regime the specific features and principal priorities of the regime have been analyzed and its implementation opportunities in Azerbaijan were evaluated.

Within the frame of the researches on the analysis of the dynamics of the percentage rates in the money market of the country the factors influencing the percentage rates were complexly estimated and the possibilities to increase the effectiveness of the discount rate in the transmission mechanism of the monetary policy were investigated.

The diversification process in the country economy was investigated and the proposals for the improvement of its spatial structure were introduced at the researches on the improvement matters of the non-oil sector.

The established **system of the research and monitoring** continued to analyze the processes in the international markets, as well as the inclination of the growth in the world economy under the conditions of the globalization process. This sets a favorable condition for the detailed research of the influence channels of the world economy to the national economy and the macroeconomic aspects of the integration of the republic economy to the global one.

Variety of researches have been carried out to create a modeled criterions and variants for the **choice of the appropriate tools of the monetary regulation corresponding to the economical situation** based to the inclinations at the development of the financial markets. Moreover the base of the information and the forecasts processing of the short- and long-term monetary indicators was created and brought to the world standards in the monetary research and forecast sphere.

The important steps were taken to create a **complete information database** to guarantee an effective monetary management. The statistical database on the processes in the world, the CIS region and the country economy has been enriched. The automated Bank Statistical Accounts Systems began functioning.

Three foreign managers have been defined to manage a part of the currency reserves. In the current year the proposals of the chosen managers were taken, the meetings and interviews were held, the parameters and conditions of the portfolio of the every manager were determined and the contracts were prepared. In addition, the depositary bank for the assets to be managed by the managers was selected and invited to the negotiations.

Tools of monetary policy. For successful implementation of specified monetary policy The National Bank regulated the money-market by participation in credit auctions, securities and currency market, as well as by the obligatory reserve norms during the accounting period.

The National Bank performed refinance of the commercial banks on the ground of auctions on the **centralized credits** during accounting period as well.

Expansion of employment of new financial tools by the National Bank for conducting an effective and adequate monetary policy was ongoing. The **pawn-shop** and overnight mechanisms are examples of these tools.

The **discount rate for the centralized credits** remained stable - 7% during the quarter.

The **obligatory reserve norms** were 10% for the short-term deposits and at zero level for the long-term credits during the accounting period. The investigations show that after the issue of the decree on zero level obligatory reserve norms for long term credits, the growth rate of the long-term credits accelerated. So the long-term credits increased by 4 times in the first quarter as compared to the same period of the previous year. Though the increase wasn't connected to that

measure thoroughly, the specified part of it was mainly due to the decree activated on 01.01.2003.

The actions for the realization of the strategy to set the **open market operations** as a main tool of the monetary policy continued during the first quarter of 2003 as well. 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 exchange rate policy

Exchange rate policy. The alteration of the exchange rate of the national currency at the regime of the floating rates continued during the first quarter of 2003 as well. During the period the exchange rate of manat against USD decreased 0.3% or 14 manats and by the end of the period 1USD was equal to 4907 manats. At the same period of the previous year the exchange rate of manat decreased 50 manats or 1.1%.

The real binary exchange rate of manat against USD should be taken into account as an indicator of the international competitiveness of Azerbaijan economy. Calculations show that, though the monthly average nominal rate of manat against USD in March 2003 decreased 2.9% as compared to the December 2001, the real change index was 3.1%. It displays the improvement of the international competitiveness of Azerbaijan during the past period.

Situation of the currency market. The gross amount of the internal currency market increased by 118.1 million USD or 22.6% constituting 641.6 million USD during the first quarter of 2003.

The National Bank maintained the balance in the currency market by regulating the demand and supply, and had influence on the exchange rate of manat. The National Bank's real interference to the currency market was at the amount of 2.9 million USD (0.44%) and purchase oriented.

Currency reserves. In spite of that, 26.8 million USD was transmitted to the State Oil Company of Azerbaijan Republic due to the construction of the Baku-Tbilisi-Ceyhan oil pipeline and 18.2 million USD was spent for the liabilities of the government to the IMF during the accounting period, the amount of the official currency reserves under the authority of the National Bank retained as forecasted and constituted 651.1 million USD by the end of the quarter. It means a relative growth at the amount of 14.8 million USD. The strategic currency reserves of the country have already exceeded 1.3 billion USD.