CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN

MONETARY POLICY REVIEW

January – June 2018

The main goal of this quarterly review is to release analyses of current macroeconomic developments and information on the monetary policy implemented by the Central Bank of the Republic of Azerbaijan to broad public.

Baku – 2018

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ACRONYMS

CBA	Central Bank of the Republic of Azerbaijan
ADB	The Asian Development Bank
EBRD	The European Bank for Reconstruction and Development
ILO	The International Labor Organziation
IMF	The International Monetary Fund
NBCI	Non-Bank Credit Institution
FDI	Foreign Direct Investments
SSC	The State Statistics Committee
DGCs	Developing countries
DDCs	Developed countries
OECD	The Organization for Economic Development
CPI	Consumer Price Index
APPI	Agricultural Producer Price Index
SME	Small and Medium sized Enterprises
NEER	Nominal Effective Exchange Rate
OPEC	The Organization of the Petroleum Exporting Countries
REER	Real Effective Exchange Rate
RSM	Real Sector Monitoring
IPPI	Industrial Producer Price Index
NFES	The National Fund for Entrepreneurial Support
UNCTAD	The United Nations Conference of Trade and Development
GDP	Gross Domestic Product
WTO	World Trade Organization

EXECUTIVE SUMMARY

Macroeconomic stability in Azerbaijan continued strengthening in the first half of 2018, below the target range inflation kept decreasing, the balance of payments remained in surplus and economic activity was still positive.

Higher non-oil export capacity and favorable global oil prices were accompanied with improved external sector indicators. Export of goods and services and money remittances also maintained positive behavior. On the backdrop of improved external sector indicators strategic foreign exchange reserves continued increasing.

Revival trends started last year continued. The main factors that contribute to economic activity include higher foreign demand and government investments, and improved consumer confidence indicators amid rising real income of the population. The monitoring of real sector by CBA also suggests that economic activity boosted year on year. Main non-oil sectors posted economic growth.

The CBA implemented the monetary policy oriented towards strengthening macroeconomic stability, in light of monetary policy's pass-through capacity while taking policy decisions.

The monetary condition changed to neutrality underpinning economic growth without distortion of price stability. Base money broadened, the refinancing rate was reduced. The dynamics of money supply was shaped under the influence of the fiscal sector and changes in the banking sector's liquidity position. Reduction of interest rates on liqudity operations by the CBA had a downward effect on the money market.

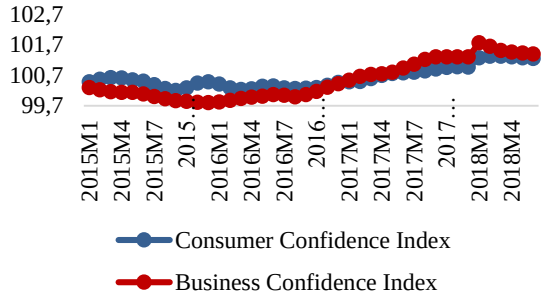
I. GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

1.1 Global economic trends

Global economic activity indicators continued improving. Higher economic activity weighed on global trade and the dynamics of investment flows. Yet global economic growth is still subject to certain risks.

Global economic growth was higher compared to previous years, evident from the dynamics of consumer and business confidence indexes on the OECD countries.

Graph 1. Business and Consumer Confidence indices in OECD countries



Source: OECD

The business confidence index dropped, due to weaker growth rate of the economy.

Economic activity in DDCs is higher than potential in general. Broader fiscal stimuli render additional support for economic activity in DDCs. The growth rate of economic expansion is reaching its highs in DDCs, that are going through a two-year growth phase, due to further fiscal stimuli despite tightened monetary policy.

Difference among economic growth rates in the USA, Japan and Europe, leading DDCs, is deepening. According to rough estimations[1], in Quarter II GDP increased by 2% and 1.5% in the USA and the Eurozone respectively and decreased 0.6% in Japan.

Economic activity was inequal across DGCs, owing to rising oil

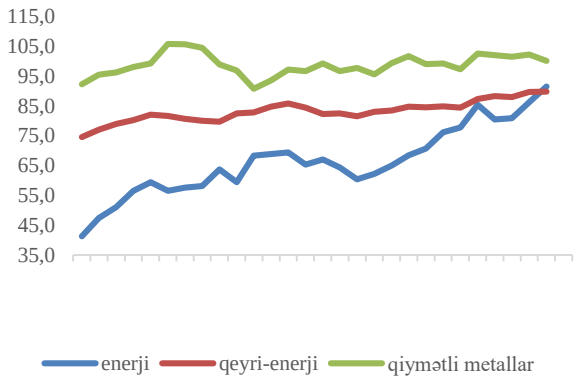
[1] 23 July 2018 estimations by JP Morgan

prices, changes in expectations related to protectionism in trade and geopolitical uncertainties. GDP in China is estimated to increase by 7.4% in Quarter II. In Quarter I 2018 economic growth was 1.3%, 2% and 1.9% in Russia, Turkey and CIS countries respectively.

Employment. According to recent estimations by the ILO, the global unemployed are numbering 192.7 million persons (5.6% of global unemployment). Despite rise in labor force, global unemployment is expected to decrease to 5.5% by the year end particularly owing to higher economic activity in DDCs. In June unemployment in the USA was 4%, higher than market expectations. Unemployment was lower than market expectations in Japan in May (2.2%). It was 8.4% in the Eurozone in May.

Changes in global commodity prices and inflation. According to the World Bank's recent Commodity Markets Outlook, over 5 months of 2018 energy prices rose by 17.6%, non-energy prices by 6.3%, and precious metal prices by 2.8%.

Graph 2. Commodity price index, 2017=100



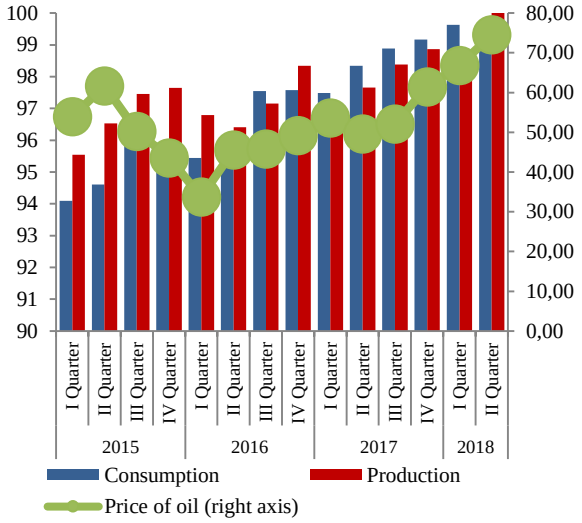
Source: World Bank

Agricultural products posted the highest growth of non-oil commodity prices (7.8%) – prices for beverages increased by 10.4%, grains by 16%.

The price for gold dropped by 3.4% over the first half of the year.

Rise in energy prices stemmed from high oil prices. The Brent oil price continued rising in 2018, and as of the end first half jumped by 16.8% compared to the early year.

Graph 3. World oil market, production-consumption, thousand barrels/day



Source: Energy Information Agency (EIA)

The oil price dropped by 3 dollars/barrel on expectations that the OPEC could boost output prior to its meeting with other countries including Russia on 22 – 23 June. Albeit this price change, in June and over two preceding months the average oil price was over 70 dollars/barrel.

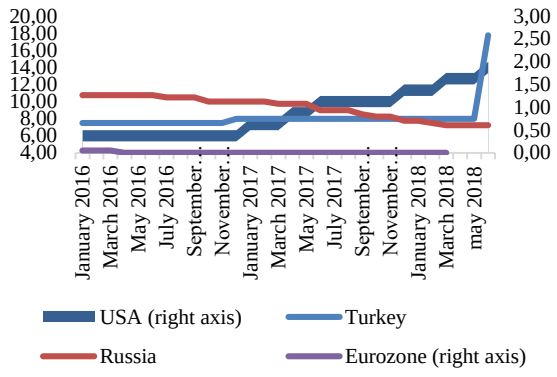
In general, the average Brent oil price was $71 over the first half (y/y up by 33.8%).

In upcoming months oil prices are expected to react to US sanctions on Iran, output dynamics in Venesuela and Libya, and how other OPEC members and Russia may influence the output in addition to global economic activity.

Higher energy prices had an upward effect on inflation in DDCs and DGCs. High inflation in the USA also resulted from new job creation in addition to global commodity prices. Core inflation in DGCs increased on the backdrop of the pass-through capacity of the depreciated exchange rate and high impact of oil prices.

Global financial markets and the monetary policy. Over the reported period gradual ongoing exit from the tight monetary policy in leading economic power centers and changes in investment flows in response factored in global financial conditions.

Graph 4. Key rates of central banks

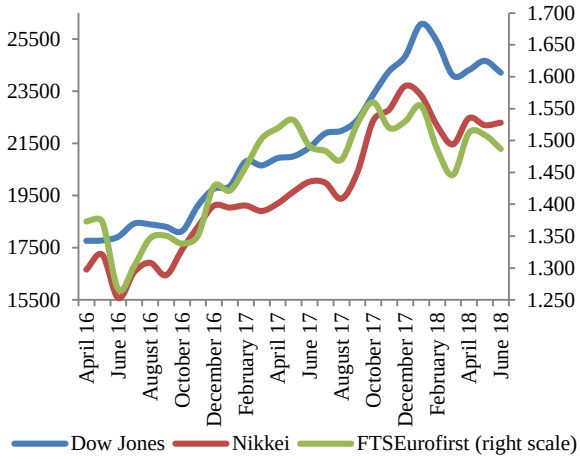


Source: http://www.global-rates.com

The USA continued tight monetary policy amid higher inflation and new jobs creation. After increasing the benchmark rate 3 times in 2017 (April, June and December) the US Fed increased the rate two more times in 2018, it was last increased 0.25 p.p. to 1.75-2% target range. The FED has sent a signal that it may increase the rate in the remaining part of 2018 and in 2019 again.

The tight monetary policy in the USA reroute international capital flows from DGCs to DDCs. Also volatile developed stock markets elevated demand for lower risky assets.

Graph 5. Dynamics of financial indexes



Source: Reuters

The ECB is expected to keep the present policy rate at least until summer 2019 and continue to purchase assets, flagging that an accommodative monetary policy will be kept going. According to the program to be completed at the end of 2018, purchase of assets is expecetd to be gradually decreased from €30 billion to €15 billion.

In general, financial conditions in DGCs were supportive. However, the financial condition, accompanied by the shrunk spread, revaluation in certain markets and low volatility, is undergoing changes. Central banks in DGCs, like Argentina, India,

Indonesia, Mexico, and Turkey increased policy rates due to exchange rate and inflationary pressures. Currencies of developing big Asian countries maintained the same level as in February, while the Chinese yuan partially depreciated.

The USD appreciated against major currencies – 2.5% against the euro, 20.9% against the Turkish lira, 17.5% against the Iranian rial, and 1.4% against the Chinese yuan. In July the REER of the USD strengthened 5% compared to February.

The cryptocurrency market also was volatile. The price for Bitcoin (XBT) dropped by 50% to $5890 from its historical highs – $20000 (70% down) in June. Prices for other cryptocurrencies, like Ethereum, XRP (Ripple) and Litecoin followed the same behavior.

Forecasts. In its Global Economic Outlook updated in July the IMF kept optimistic global economic growth forecasts for 2018-19.

DDCs are expected to grow by 2.4% in 2018 and 2.2% in 2019, 0.1 p.p. lower compared to the April report, due to lower than expected potential economic growth lingering in the Eurozone and Japan for several months.

Table 1. Economic growth forecasts

	2018	**2019**
Global	**3,9**	**3,9**
DDCs	**2,4**	**2,2**
USA	2,9	2,7
Euro zone	2,2	1,9
Japan	1	0,9
DGCs	**4,9**	**5,1**
Russia	1,7	1,5
China	6,6	6,4
CIS	2,3	2,2

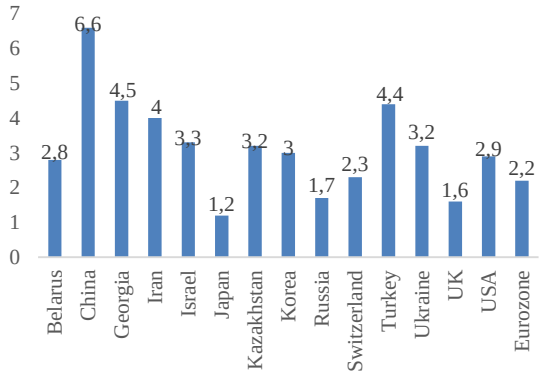
Source: IMF, GEO, July update, 2018.

Economic growth in DGCs will react to oil prices, appreciation of the USD, import tariffs imposed by the USA against trade partners and geopolitical conflicts. Economic growth forecasts were left unchanged as in April report. Growth in DDCs is

expecetd to stand at 4.9% and 5.1% in 2018 and 2019 respectively. Recovery in commodity exporters is expected to continue over upcoming 2 years.

Economic growth outlook for trade partners of Azerbaijan is optimistic too.

Graph 6. Economic growth in trade partners of Azerbaijan



Source: IMF, GEO, July update, 2018.

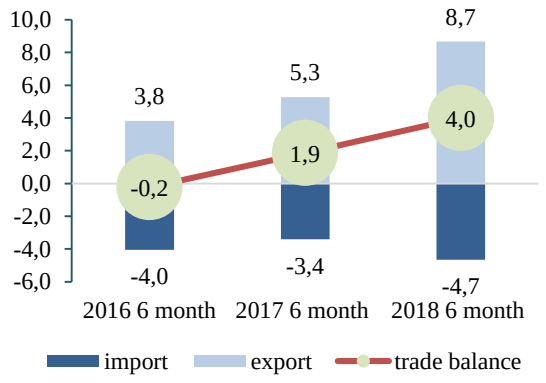
Economic growth in Azerbaijani trade partners is expected to stand at 3.3% (non-oil export weighted) on average in 2018, possibly to have positive influence on both non-oil trade and investment flows.

1.2 Azerbaijani external sector developments

The external economic position of Azerbaijan was shaped under higher non-oil export potential, and developments in the global economy and main trade partners.

According to the State Customes Committee (SCC), foreign trade turnover made up $13.3 billion – export accounted for $8.7 billion (65%) and import $4.7 billion (35%).

Graph 7. Trade balance, USD bn.

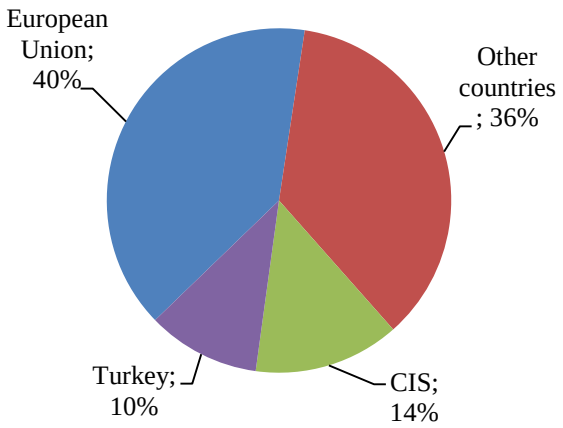


Source: SCC

Foreign trade surplus YOY increased over twofold to $4 billion. Export prevailed over import by 85%.

Azerbaijan traded up with 167 countries.

Graph 8. Main trade partners, 2018 I half, %



Source: SCC

The EU accounts for 40% of trade turnover – 39% Italy, 13% Germany, 8% the Czech Republic and 6% Portugal.

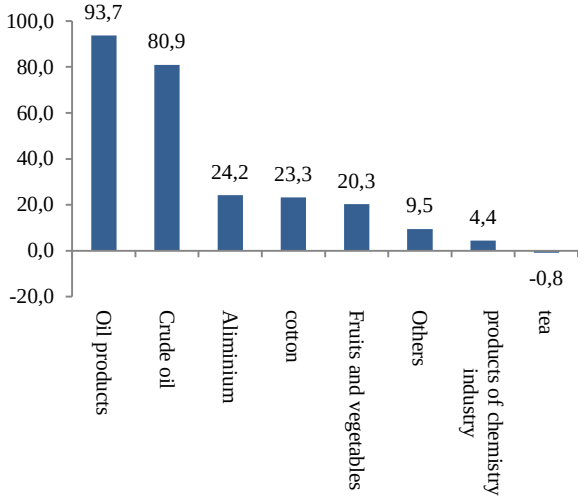
CIS countries account for 14% of trade turnover – 62% Russia, 19% Ukraine.

Other countries account for 36% of trade ties – Israel (15%), Taiwan (11%), China (11%) and USA (10%).

Commodity export increased 64.4%, driven by the oil sector – the

value of export rose 81% on crude oil and 94% oil products.

Graph 9. Change in export of commodities. 2018 6 month, (y.o.y., %)



Source: SCC

Non-oil export also posted growth – aluminium 24.2%, fruit and vegetables 20.3%, cotton yarn 23.3%, and chemicals 4.4%.

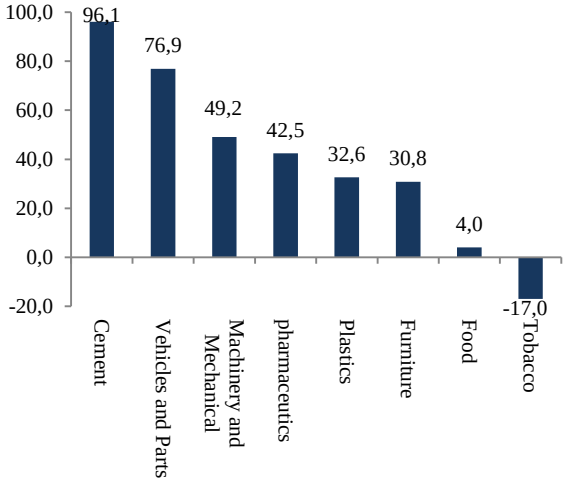
Main export partners include Italy (22%), Israel (8.2%), Turkey (7.5%), Taiwan (5.9%), Indonesia (5.3%).

Commodity import increased 36.7% – import on the public sector increased 83.2% to $0.7 billion and 29.7% to $ 3.6 billion on the private sector.

Russia accounted for 16.9%, Turkey 16.3%, China 10.4%, Germany 7.3%, USA 4.8%, Ukraine 4.2% and Italy 3.4% of imported products.

Imports rose on major components – 96.1% on cement, vehicles and parts 76.9%, ferrous products 56.4%, machinery and mechanisms 49.2%, pharmaceuticals 42.5%, dropped on tobaco and sugar by 17% and 3.1 times respectively.

Graph 10. Change in import of products, 2018 6 month, (y.o.y.), %

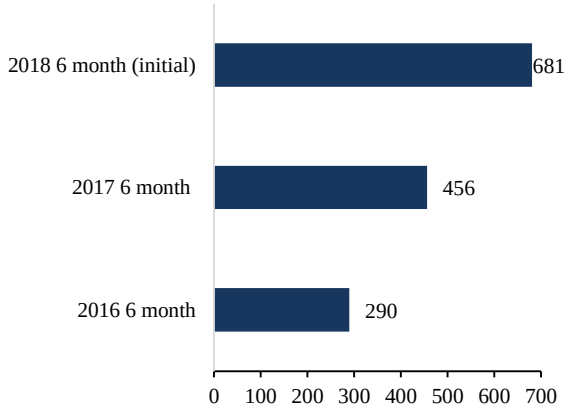


Source: SCC

The situation in economic partners weighed in on the dynamics of money remittances along with non-oil exports. According to rough

estimations, money remittances made up $ 681 million.

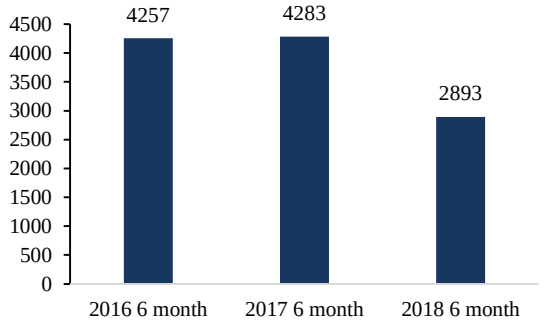
Graph 11. Inflow of remittances, mln.$



Source: CBA

Investments to fixed capital stock by foreign entitites and organizations kept flowing. According to the SSC, FDIs amounted to AZN 2.9 billion equivalent (45.7% of total investments).

Graph 12. Foreign investments, m. manats



Source: SSC

The UK, Turkey, Switzerland, Malaysia, the Czech Republic, Japan, the USA, Russia and Iran accounted for major part of investments to fixed capital by foreign countries and international organizations.

Positive developments in the external sector translated into the dynamics of foreign exchange reserves. Amid the improved balance of payments (BoP), strategic foreign exchange reserves increased by 5.6%, sufficient for 35-month import of goods and services, exceeding the sovereign debt by 3 times.

II.MACROECONOMIC DEVELOPMENTS IN AZERBAIJAN

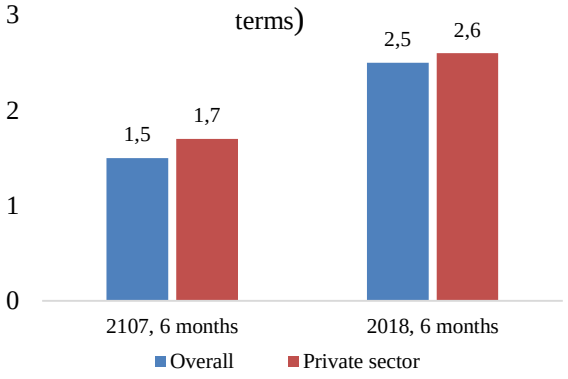
2.1. Aggregate demand

The dynamics on domestic demand's key elements weighed on economic growth, particularly, on non-oil economic activity.

Consumption expenditures. Consumption expenditures kept increasing in the first half of 2018.

Goods and services sold in the market to meet consumer demand y/y increased by 2.5% in real terms to AZN 21.7 billion. 96% of goods sold and services supplied by economic agents was offered by private entrepreneurs.

Graph 13. Dynamics of consumption market, over previous year % (in real terms)



Source: SSC

Every consumer purchased on average AZN 369.2 worth of goods and paid services monthly (YOY up by AZN 17.2).

Retail trade turnover increased by 2.5% to AZN 17.1 billion – food trade turnover by 1.9%, while non-food trade turnover by 3.1%.

Consumers spent 49.6% of their funds on food, beverage and tobacco at retail trade outlets (YOY up 1.9%). Expenses YOY increased by 3.1% in clothes and shoes, 2.8% in electric appliances and furniture, 1.9% in telecommunication and 3.6% other non-food staff.

Table 2. The share of spending items in trade outlets, %

Spending item	Share, %	
	2017 6 months	2018 6 months
Food, beverage and tobacco	50.1	49.6
Knitwear, clothes and shoes	18.1	18
Electric appliances and furniture	5.9	5.8
Computers, telecommunication devices and others	0.7	0.7
Pharmaceuticals and medicals	1.3	1.3
Fuel	4.8	5.7
Other non-food staff	19.1	18.9

Source: SSC

Every consumer purchased on average AZN 144.6 worth of food, beverage and tobacco and AZN 147.1 worth of non-food items monthly for private consumption in retail trade.

Catering turnover rose by 4.8% during the first half of 2018. Entities accounted for 40,8%, and private entrepreneurs 59,2% of catering turnover in the private sector. The value of paid services to the population increased 2.5% to AZN 3.9 billion. Per capita paid services consumption YOY increased by 4% in nominal terms.

Consumer demand was driven by rise in nominal income of the population – it increased by 9.3% to AZN 25.7 billion YOY terms. Per capita income rose by 8.3% to AZN 2623.8, while disposable income increased by 9.8% to AZN 23.7 billion.

Nominal average monthly salary of hired workers in the economy YOY increased by 4% to AZN 541. Salary of employees in public entities was AZN 421.5 and in private entities was AZN 703.9.

Domestic demand was also driven by gradual recovery of bank lending. Loans to households, one of the consumer demand components, increased by 4.7% - as of end-June the households' loan portfolio exceeded AZN 4.8 billion.

The consumer confidence index (CCI) generated from the 'Financial behavior and intentions of households'

survey continued improving. To note, this indicator rests upon surveys on 'Family's financial condition expectations', 'Expectations on country's economic situation', 'Savings probability' and 'Unemployment expectations' among various income households. Analyses suggest that the CCI has been positively zoned over recent 3 quarters, due to better expectations on country's and family's financial standing, lower unemployment and inflation expectations.

Government expenditures were critical for domestic demand. According to the Ministry of Finance of the Republic of Azerbaijan, in January – June 2018 state budget expenditures made up AZN 9524.3 million. [2]

Following the economic classification, 38.1% (AZN 3625.7 million) of state budget expenditures were channeled to social spending (compensation of employees, pension and social allowances, medicine and food), (YOY up by 3.6%).

Investment expenditures. AZN 6331.7 million worth of investments were channeled to the economy during the Jan-Jun of 2018.

AZN 3505 million worth of funds were invested to the non-oil sector (YOY up by 25.4%). The public sector accounts for 49.8% and the private sector 50.2% of total investments.

54.3% of investments stemmed from domestic, while 45.7% from external sources.

Table 3. Investment sources, share in %

	2017, 6 months	**2018, 6 months**
Funds of enterprises and organisations	70.3	52.8
Bank loans	11.9	14.7
Budget funds	11.4	24.4

[2] *Source: http://www.maliyye.gov.az/*

Off-budget funds	1.3	1.3
Population's own funds	4.6	6.2
Other	0.5	0.6

Source: SSC

Funds of enterprises and organizations prevailed in total investments (52.8%).

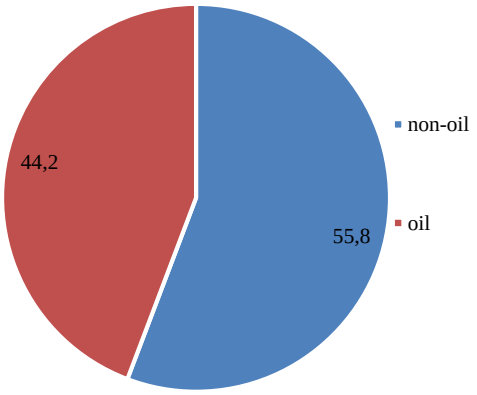
2.2. Aggregate supply and employment

Economic activity started in 2017 remained buoyant in the first half of 2018.

Economic growth. According to the SSC, real GDP increased by 1.3% to nominal AZN 37 billion in 6 months of 2018. Per capita GDP was AZN 3777.6.

The mining industry extracted 19.3 mln ton crude oil and 8.9 billion m3 natural gas. Oil production rose 0.9%, gas extraction dropped 4.9%.

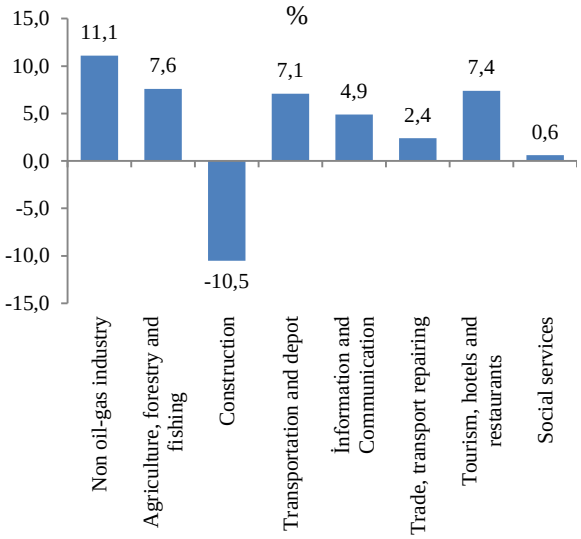
Graph 14. Sectoral economic growth, %



Source : SSC

The value added in the non-oil sector YOY increased by 2% in real terms to nominal AZN 20.6 billion during the first half of 2018 (55.8% of GDP). The non-oil sector posted growth on major fields.

Graph 15. Sectoral growth of economy, to corresponding period of previous year, %



Source:SSC

The non-oil (gas) industry increased by 11.1%.

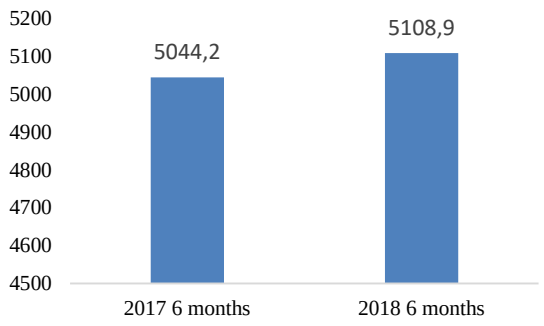
The CBA's RSM related survey findings also suggest that economic activity elevated in the country; indicators bettered across major non-oil sector areas, including food industry, production of construction materials, and machinery. The business confidence index (BCI) on the above areas was positively zoned

and boosted on major service (communication, postal services, transportation, hotels, tourism) and trade (electric appliances, automobiles, houseware) sectors.

Employment. Economically active population were numbering 5108.9 thousand persons (YOY up by 64.7 thousand persons).

According to the SSC, the number of hired labor force YOY increased by 0.1% to 1545.4 thousand persons.

Graph 16. Economically active persons, end of period, thousand



Source: SSC

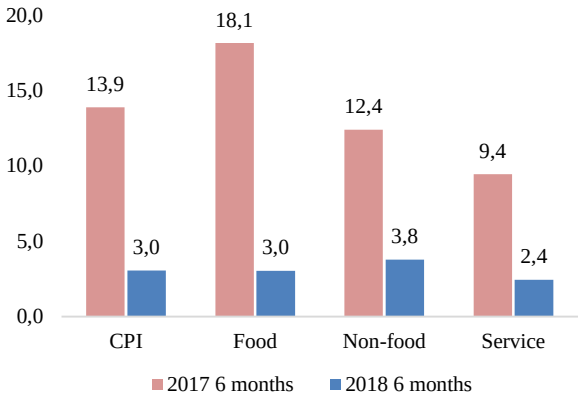
23.3% of hired labor in enterprises and organisations was involved in production, including 7% in construction, 6.8% processing, 3.1% agriculture, 2.2% mining.

2.3. Inflation

Annual inflation kept falling, stabilizing to a single-digit level, one of the most critical factors supporting rise in population's real income.

Consumer Price Index (CPI). According to the SSC, average annual inflation was 3%. CPI components – food prices changed 3% on annual average, non-food prices 3.8%, and services 2.4%.

Graph 17. Average annual inflation, %

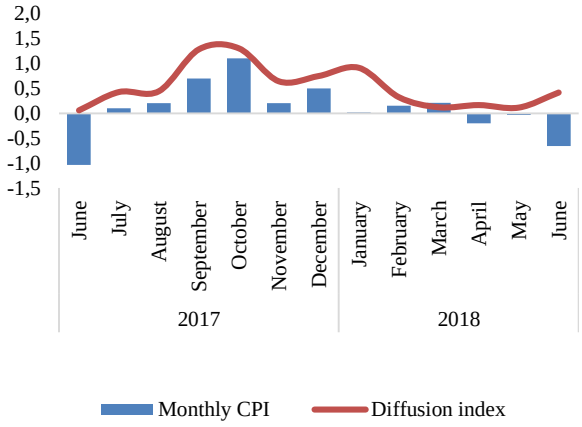


Source: SSC

Food prices account for 1.3%, nonfood 0.9%, and services for 0.8% of average annual inflation.

The diffusion index – a measure of change dynamics pertaining to the number of goods and services with rising and falling prices in the basket of consumer goods also decreased compared to early year.

Graph 18. Scale of inflation, %



Source: SSC, CBA estimations based upon SSC data

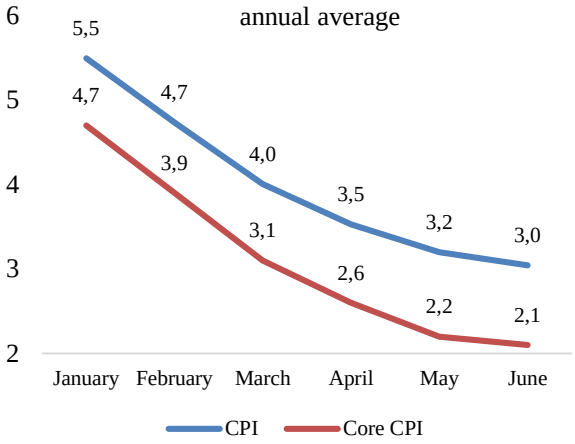
Prices for 166 out of 521 items of goods and services declined and remained unchanged for 56 items.

Lower inflation is driven by stronger NEER of manat, optimal management of money supply, dropped inflation expectations and seasonal factors, which altogether neutralized the downward effect of global commodity prices, including global food prices and inflationary processes in trade partners on domestic inflation. Whereas global food prices

have increased since early year, this indicator dropped in June, 2018.

Average annual core inflation calculated by excluding the goods and services, whose prices are regulated by the government and seasonal agricultural products, was 2.1%.

Graph 19. Consumer Price Index, 2018, annual average



Source: SSC

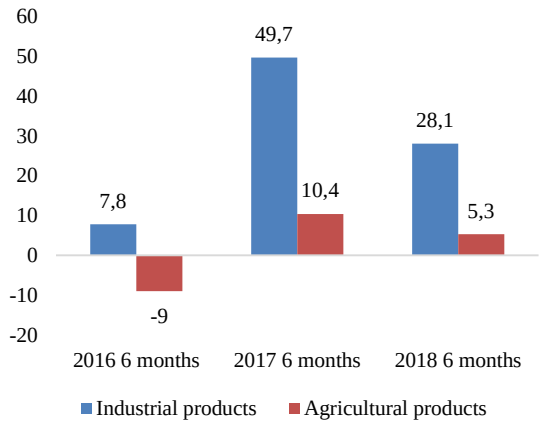
As mentioned, expectations were one of the factors that contributed to swings in consumer prices. Monitoring of households and real sector entities suggest that inflation expectations remained in historical lows of recent years. According to regular RSM by the CBA, price expectations in trade declined across all areas for upcoming 3 months, mainly in the automobile segment. Overall price expectations decreased in services across all areas, mostly in transportation, hotels and healthcare. In processing industry price expectations fell in food and beverages, metallurgy and other non-metal mineral products. And rose in construction materials, chemical industry, machinery, plastic mass and weaving. Expectations elevated in the construction sector in general.

Producer price index (PPI). According to the SSC, during the 6 months of 2018 the GDP deflator, that measures price swings in all domestically produced goods and services, was 14.8%, mainly owing to rising global oil prices.

The PPI changed mostly on industrial products. The IPPI YOY increased by 28.1%, driven by upswings in mining and electricity, gas and steam generation (36.2% and 34.2% respectively).

Price hike was 13.8% in processing – tobacco (32.8%), polygraphy (26.3%), oil processing (21.8%), production of automobiles and towing vehicles (13.3%).

Graph 20. Average annual change in PPI, %



Source: SSC

The APPI increased by 5.3%, driven by price hikes in plant growing (6.1%) – prices for yearlings hiked by 7.5%, for animal products by 4.5% – beef 4.7%, lamb 4.4%, for forestry (1.5%), and fish and fishery products 7.5%.

Transportation tariffs decreased 2%, attributable to 2.8% slide in cargo services. Whereas prices for passenger transportation increased by 2.3%, those for communication and postal services decreased by 0.3%.

III. THE MONETARY AND EXCHANGE RATE POLICY

3.1. The FX market and the exchange rate of manat

During the first half of 2018 the FX market operated in a self-regulatory mode and the exchange rate of manat against foreign currencies formed according to BoP trends.

The size of transactions increased in FX market's both segments – the cash and cashless currency markets due to rising foreign trade turnover.

Cashless transactions amounted to $14.4 billion equivalent[3] – 87% in USD and 13% in other currencies.

The Interbank FX market accounts for 49.2% and the Intrabank FX market 50.8% of cashless transactions.

53.3% of USD denominated transactions in the Interbank FX market related to regulation of banks' currency position. Interbank market operations mainly are conducted over Bloomberg platform.

Intrabank FX operations amounted to $7.3 billion equivalent (78% USD denominated). 94.2% of operations in the Intrabank FX market was currency operations with legal entities.

Cash currency bought and sold by banks amounted to 3.2 billion USD equivalent ($2.5 billion (78%) USD denominated operations).

The CBA continued currency auctions to arrange sale of currency provided by the SOFAZ. The auctions are held twice a week and market participants are informed on auction parameters by the Bloomberg terminal prior to auctions.

The CBA held 49 auctions in January – June 2018, worth of total $2974.4 million.

[3] *Including USD, EUR, GBP, Russian ruble transactions*

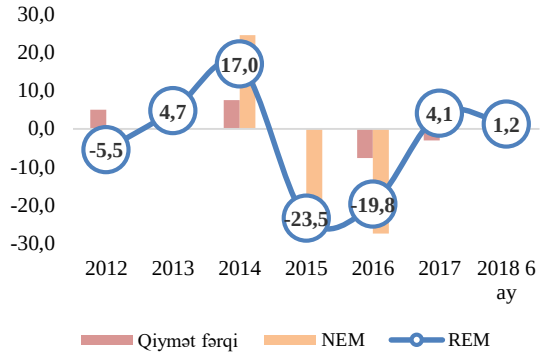
The official exchange rate of manat was set on the basis of the average exchange rate on interbank transactions (both auction and non-auction on the Bloomberg platform).

The average daily AZN/USD exchange rate was AZN 1.7001. Buy-sell currency exchange rates set by banks were close to the official rate. Commercial banks' average daily buy rate was 1.6957, while sell rate was 1.7022 manat. The difference between official buy exchange rates and those of commercial banks was 0.3% (0.0044 manat), and sell rates was 0.1% (0.0021 manat).

AZN gained 0.01% against the USD, 17.3% against the Turkish lira, 2.4% against the euro, 2.5% against the pound and 8.1% against the Russian ruble.

Dynamics of bilateral exchange rates influenced that of multilateral exchange rates. Total trade weighted non-oil REER appreciated 1.2%.

Qrafik 21. REM-in dəyişməsi,%-lə (2000=100)



Source: CBA

4.9% appreciation of the NEER had an upward, while inflation differences in partner countries had a downward effect on the REER.

The REER of manat has depreciated 35.4% since end-2014, contributing to non-oil sector competitiveness.

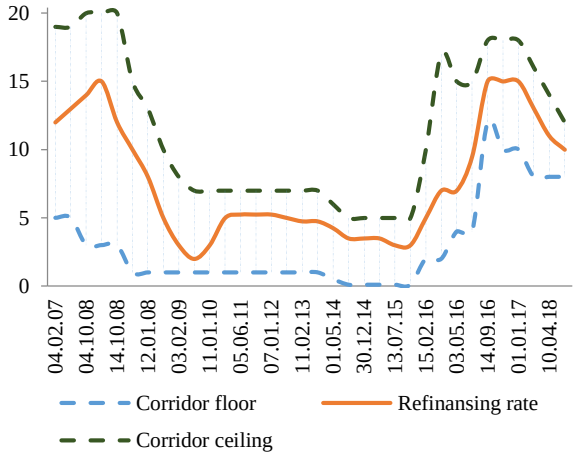
3.2. Monetary policy tools

Monetary policy tools were employed in light of stabilization of inflation on a single-digit level, stronger macroeconomic stability, developments in financial markets, and the pass-through capacity of the monetary policy.

Stronger macroeconomic trends and inflation stabilized on a single-digit level paved the way to balanced loosing of the monetary condition. Over the period the CBA made necessary corrections to the parameters of the interest rate corridor in light of recent macroeconomic developments and updated forecasts. The Bank has discussed interest rate corridor parameters since early year taking decisions on reducing the policy rate to 10% from 15% in phases, over the same period the floor of the interest rate corridor was shifted to 8% from 10% and the ceiling to 12% from 18%.

To meet the money demand of the economy and effectively manage liquidity, the CBA kept various term (up to 7 days, 14 and 28 day) standing facilities and open market operations active. Although lending activity was higher over 6 months, banking sector liquidity was still in surplus, contributing to high demand for CBA's sterilization operations.

Graph 22. Parameters of interest rate corridor

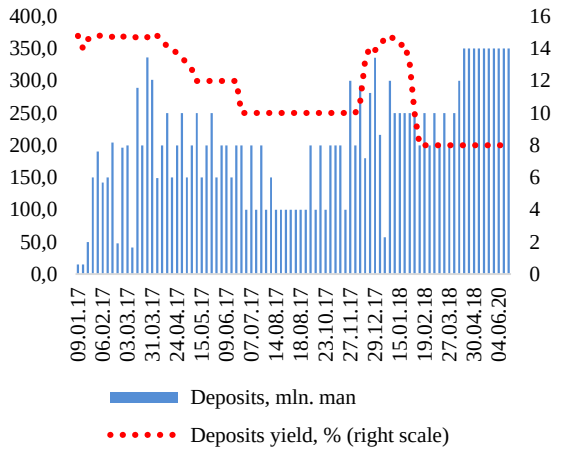


Source: CBA

During the 6 months of 2018 the CBA held 28 deposit auctions on sterilization of exsess reserves in the national currency and 25 auctions on placement of notes. Maturity of deposit operations was 14 days, while

notes were placed for 28 days. Total outstanding amount of funds attracted at deposit auctions and notes placed amounted to AZN1.7 billion as of the end-period.

Graph 23.Volume and yield of Central Bank's deposits

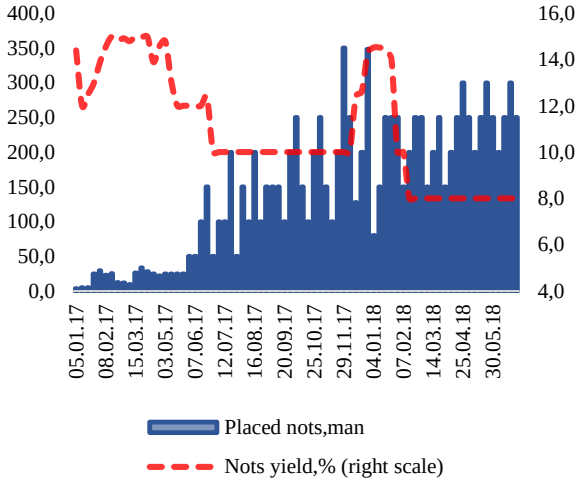


Source: CBA

AZN700 million worth of funds were accumulated at deposit auctions, while AZN1 billion via note issuing. Outstanding amount of funds attracted via deposit auctions and placement of notes decreased by 12.3%.

Interest rates on open market operations were set close to the floor of the interest rate corridor amid high structural liquidity in the banking system. Despite lower return on sterilization operations due to reduction of the floor of the interest rate corridor, excess liquidity remains high, since demand prevailed over supply by 2.8 times at deposit auctions and by 2.6 times at note auctions.

Graph 24.Volume and yield of nots placed by Central Bank



Source: CBA

Deposit and short-term notes placement transactions both sterilize excess money supply and promote development of the money market, contributing to the monetary policy's operational framework and extension of the interbank market. As a critical representative indicator, return on CBA sterilization tools influences the

level of interest rates for other financial instruments.

The reserve requriement was left unchanged.

Table 4. Reserve requirement, %

	Foreign currency denominated liabilities	*Liabilities in manat and precious metals*	*Funds attracted from n/resident financial sector*
01.05.2011	2	2	2
01.07.2011	3	3	3
01.08.2014	2	2	2
01.03.2015	0.5	0.5	0.5
30.12.2015	0.5	0.5	0.5
03.03.2016	1	0.5	0

Source: CBA

The reserve requirement on liabilities in the national currency and precious metals stood at 0.5%, on foreign currency liabilities at 1%, and on liabilities to the non-resident financial sector and settlements with international financial institutions 0%. Reserve requirements were still applied on an averaging basis, to allow more flexible management of liquidity by banks. Monitoring findings display that banks' cumulative balances on correspondent accounts of the CBA considerably exceeded amounts to be maintained as required reserves.

3.3. Money supply

Tailored money supply maintained the best possible balance between realization of macroeconomic stability targets and provision of the economy with liquidity.

Money supply was sufficient to meet demand of the economy for money and ensure uninterrupted payments. Base money in manat increased 0.5% to AZN 8588 million as of the end period. Demand for money is still driven by demand of the fiscal sector and the banking system for liquidity. The CBA reduced the stock of sterilization operations which partially compensated the downward effect of fiscal operations on money base.

Cash in circulaton – the structural element of money base – decreased by 4%. Stock of correspondent accounts in manat increased by 2.1 times.

Broad money supply in manat (M2) increased by 4.2% since early year and reached to AZN 12984.7 million as of the end-period.

Table 5. Money aggregates, mln. manat

	01.07.17	**01.01.18**	**01.07.18**	*vs early year %*
M0	6774.4	7490	7173.8	*-4.2*
M1	9263.4	10544	10656.1	*1.1*
M2	11435.9	12466	12984.7	*4.2*
M3	20973	22772	22683.6	*-0.4*

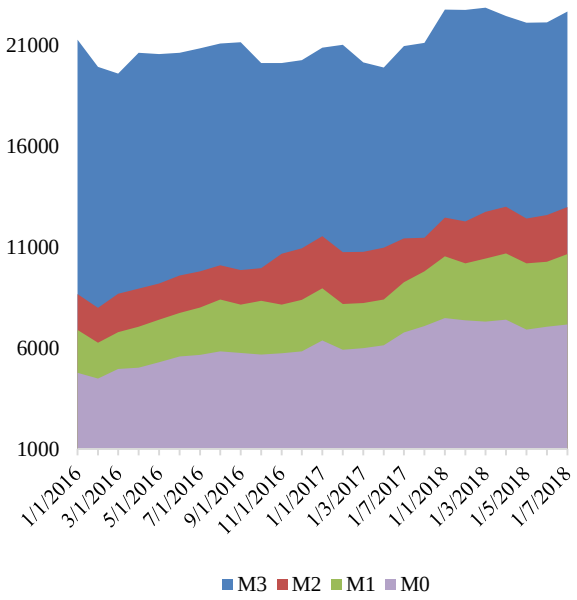
Source: CBA

Cash, savings of individuals and deposits of legal entities in the structure of money supply in manat (M2) performed differently: while cash money supply decreased by 4.2%, savings of individuals in manat increased by 20.4% and deposits of legal entities decreased by 2%.

Demand savings and deposits in manat increased by 14%, while term savings and deposits increased by 21%.

Broad money supply (M3) decreased 0.39% to AZN 22683.6 million as of the end-period.

Graph 25. Dynamics of money aggregates, m. manat

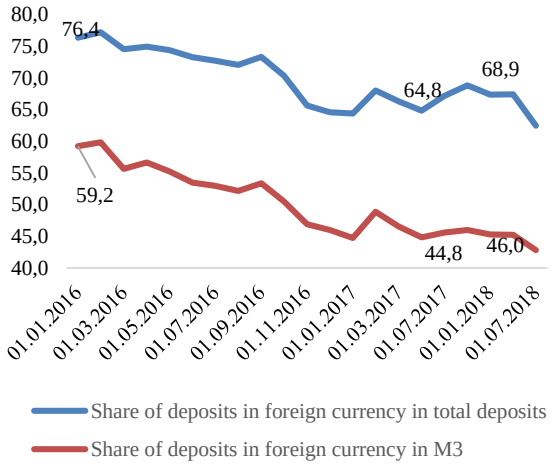


Source: CBA

Dollarization of bank deposits kept decreasing – savings and deposits in manat increased by 10.9%, while foreign currency denominated savings and deposits decreased 5.2%.

The share of foreign currency denominated savings and deposits in M3 money aggregate was 45.3% at the beginning of the perod, and 42.8% at the end-period.

Graph 26. Dollarization, %



Source: CBA

Foreign currency denominated deposits of individuals increased 0.64%. As a result, dollarization on savings of individuals decreased from 66.5% at the beginning of the year to 62.4%.

Graphs and tables

Graphs

Tables

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