

Central Bank of the Republic of Azerbaijan

REPORT
ON ACCOMPLISHMENT OF MAIN GOALS AND
FUNCTIONS in **2019**

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Introduction

Macroeconomic stability and positive economic activity dynamics was safeguarded in Azerbaijan in 2019 as a result of purposeful economic policy and structural – institutional reforms conducted under the leadership of Honorable President Ilham Aliyev, balance of payments surplus pushed the rise in strategic foreign exchange reserves.

Discharging its mandated functions the Central Bank of the Republic of Azerbaijan rendered necessary support for safeguarding macroeconomic stability. Over the year the main target of the Central Bank's monetary policy was price stability. Being within the 2019 target band inflation positively translated into economic activity creating certainty in business and investment environment. Consistent monetary easing allowed to generate balanced results in growth and stability to support economic activity and employment.

1. ACCOMPLISHMENT OF GOALS

The goal of the Central Bank is to maintain price stability, organize and ensure operation of interbank centralized and other non-licensed payment systems, and support banking system stability within the authorities established by the legislation.

1.1 Maintaining price stability within the authorities established by the law

In 2019 the final target of the monetary policy was to maintain twelve-month inflation within the announced band (4 ± 2). Over the year inflation in Azerbaijan maintained within the target band was the lowest in the CIS and trade partner countries.

According to official statistics, twelve-month inflation was even below the target band median (2.4%). Prices for 7.5% of products remained unchanged and prices for 16.7% dropped. Price hike for 47.5% of products was below 2%.

Price index by food products with the considerable share in the consumer basket increased by 4.2% on an annual basis. Stronger trends for global food price hikes are one of the factors to weigh in on domestic food inflation via imported inflation. Global food price indices hiked by 12.5% over the year – prices for meat products increased by 17.9%, dairy products by 17%, vegetable oils by 31% and sugar by 6%.

Low annual price increase for non-food products and services (1% and 0.9% respectively) had a containing effect on total inflation. Low non-food inflation is attributable to high aggregate demand driven by domestic production and import and depreciated national currencies of certain trade partners. No increase in administrative prices factored in low rate price hike for services.

In general, revived consumption and hiked global food prices had an upward, while a stable exchange rate, a monetary condition, the dynamics of administrative prices and low inflation expectations had a stabilizing effect on inflation.

Average annual core inflation calculated by excluding swings in regulated prices and prices for seasonal agricultural products was 2.3% in 2019.

Actual dynamics of inflation and balanced FX market maintained minimum level of inflation expectations. According to real sector monitoring by the Central Bank, households' inflation expectations for upcoming 12 months were low and stable. Three-month inflation expectations on non-oil processing and services were close to actual inflation.

Forecasts suggest that, inflation will remain within the target band (4±2%) in 2020, if current macroeconomic trends linger.

1.2 Organization and ensuring operation of interbank centralized and other non-licensed payment systems and support for banking system stability

Stable and reliable operation of payment systems was one of the priorities for the Central Bank. Interbank centralized payment systems, the key components of the National Payment System (NPS), launched and managed by the Bank maintained uninterrupted operations in 2019.

Total size of payments via the Real Time Gross Settlement System (AZIPS) and the Low Value Payments Clearing and Settlement System (LVPCSS) for small size and reiterating payments, the core components of the NPS, amounted to AZN 259B (3.2 times of GDP) , 57 mln transactions. The size of payments in the NPS by commercial banks y/y increased by 8% to AZN 143B, the number of transactions y/y increased 62% to 56 mln transactions.

Preventive measures in payment systems kept implemented to avoid rising cyber threats in global e-environment in 2019 as well.

Expansion of the infrastructure of the Government Payment Portal (GPP) continued in 2019. 13 central executive power institutions (Ministry of Justice, Ministry of Finance, Ministry of Taxes, Ministry of Economy, Ministry of Emergency Situations, Ministry of Education, Ministry of Internal Affairs, Ministry of Foreign Affairs, State Social Protection Fund under the Ministry of Labor and Social Protection of the Population, State Customs Committee, State Migration Service, State Committee on Property Issues, Food Safety Agency), 4 utility enterprises (“Azersu” OJSC, “Azerishig” OJSC, “Azeristiliktechizat” OJSC, “Azerigaz” PA), 5 landline and mobile communication operators (“Aztelekom” LLC, Baku Telephone Communications LLC, Azercell Telecom LLC, “Azerfon” LLC, Bakcell LLC), Electronic Licensing Portal, 97 judicial bodies over the ‘E-court’ portal, 14 insurance companies via the Compulsory Insurance Bureau, Deposit Insurance Fund, Mortgage and Credit Guarantee Fund, State Examination Center, Food Security Agency, Baku Transport Agency, higher education institutions (Azerbaijan State University of Economics, Baku Slavic University, Azerbaijan State Academy of Art, Azerbaijan Technical University, the Sumgayit State University) and National Certification Services Center are integrated to the GPP.

Today, payments for over 590 services, including over 500 public services (taxes, duties, administrative fines etc.) are paid at about 2500 payment points of the Azerpost LLC, the Nakhchivanpost LLC and 30 banks, over 1000 payment terminals in cash and in a cashless form over Internet resources of the portal, banks’ e-banking services by payment cards and bank accounts. In 2019 the system processed total AZN 3.3B worth 49 million payment transactions. The size of processed transactions y/y increased by 34% (AZN 832M), the number of transactions by 31% (11.6 million transactions).

The card infrastructure kept developing. Business continuity of the Interbank Card Center (ICC) launched to domestically handle data on operations among service centers using payment cards issued in the country was maintained. 39.7 mln card operations were conducted over the ICC in 2019 (AZN 1336M, \$10.3M, €3M). The size of operations in AZN y/y rose by 35%, by 85% in USD and by 51% in EUR.

The number of payment cards issued in the country was 7.5 mln. pcs, ATMs 2712 pcs, POS-terminals 67681 pcs. The size of domestic payment card transactions y/y increased by 32% to AZN 22.3B. The share of cashless settlements in domestic payment card operations increased by 58% to AZN 4.8B (21%).

Reports collected from main executive institutions in 2019 to monitor and assess the implementation of the actions specified in the 'State Program on Expansion of Digital Payments in 2018-2020' approved by Decree No.508 of the President of the Republic of Azerbaijan dated 26 September 2018 were submitted to the Center for Analysis of Economic Reforms and Communication. A final report to be developed by the Center will be delivered to the President of the Republic of Azerbaijan.

The Central Bank is implementing projects on launch of the 24/7/365 Instant Payment System, introduction of ISO20022 standards, creation of a blockchain based digital identification system and optimization of the tariff policy on payment services as part of implementation of the State Program to expand the scope of digital payments in the country. The Bank also takes ongoing actions to promote digital payments; as the coordinator of the State Program the Bank supports prompt implementation of the actions specified in the Program within the frames of close cooperation with the main executive institutions.

2. DISCHARGE OF FUNCTIONS

To attain main goals the Central Bank took necessary efforts to establish and pursue the state's monetary and exchange rate policy, organize cash circulation, regularly set and announce the exchange rate of manat against foreign currencies, regulate and control currency, develop reporting balance of payments (BoP) and participate in development of the forecast BoP, maintain and manage international gold – foreign exchange reserves at its disposal, compile consolidated (both public and non-public) foreign debt statistics and international investment balance and discharge other functions under the legislation.

2.1 Setting and implementation of the state's monetary and exchange rate policy

In 2019 the monetary and exchange rate policy was implemented in accordance with the "Statement of the Central Bank on main directions of the monetary policy for 2019 and medium term". Monetary policy decisions were taken in light of analysis of macroeconomic developments and updated macroeconomic forecasts. The Bank focused on consistent and results-based decisions.

BoP surplus allowed to maintain stability in the domestic FX market. As a main anchor of macroeconomic and financial stability the exchange rate of the national currency was one of sustainable currencies. Supply prevailing over demand over most months of the reported year had a downward effect on inflation expectations and dollarization.

The monetary condition was eased by decreasing cost of money and increasing the size of money in light of macroeconomic stability, oriented towards supporting economic growth by safeguarding macroeconomic stability.

The Central Bank discussed interest rate corridor parameters 8 times in 2019, the refinancing rate was shifted to 7.5% from 9.75% stepwise – the floor of the corridor was shifted to 5.75% from 7.75% and the ceiling to 9.25% from 11.75%. In general, the refinancing rate has been reduced by 2 times since early 2018.

Expansion of money supply also was critical in monetary condition's approaching neutrality. Money base in manat increased by 23.7%, broad money supply in manat (M2 money aggregate) increased by 24.5%. In general, money supply was regulated to suffice to cover the demand of the economy for money and maintain uninterrupted payments.

Monetary easing is gradually translating to high lending, longer maturity of loans and low average interest rates on new loans. Interest yield on government securities and CBA notes is also dropping.

Dedollarization continues amid low inflation and the rebalanced FX market. Dollarization of savings of individuals decreased to 52% from 62.5% of early year.

The Central Bank adequately used its monetary policy tools to effectively manage liquidity in the economy and the banking system. The Bank held 53 deposit auctions to attract available funds in the national currency and 55 auctions on issue of notes in 2019. Diversification of duration of sterilization tools with the issue of notes with 84-, 168-, 252-day maturity from September 2019 onward is important in terms of supporting formation of interest rates in the short-term period of the yield curve. Despite dropped interest rates over the period, demand being much higher than supply indicates that the banking sector still has huge structural liquidity surplus.

The Central Bank focused on effective communication of the monetary policy in 2019 too. The Bank made public a schedule for dissemination of monetary policy decisions of the Management Board for 2019 in advance, under which a related press-release per policy decision was published accompanied with comments, in parallel with regular press-conferences. Quarterly Monetary Policy Reviews went public, Central Bank's activities were highlighted in details on its website. The Central Bank launched official pages on Twitter and YouTube; communication became more active by disseminating prompt information on its main areas of activity on these modern interactive platforms. The aim of high openness of information is to increase the understanding of the policy pursued.

2.2 Organization of cash circulation, issue of monetary units to and withdrawal from circulation

The Central Bank covered demand of the economy for cash in full, adequately and in time in 2019 under Part II, Article 19 of the Constitution of the Republic of Azerbaijan and the 'Law of the Republic of Azerbaijan on the Central Bank of the Republic of Azerbaijan'.

The Central Bank withdrew AZN 7.7 B or 423 mln. pcs of monetary units from and issued AZN 9.7 B or 507 mln. pcs of monetary units into circulation. In general, money in circulation increased by 24.4% (AZN 2B or 83.7 mln pcs) to AZN 10.4B as of the end-year.

The Bank issued to circulation 1200 pcs of commemorative coins dedicated to the 100 year anniversary of Azerbaijan Central Banking and the Baku State University; and 20 year anniversary of the State Oil Fund in 2019.

The 'Clean money in circulation' policy adopted to improve the quality of money in circulation kept going, AZN 7.7B worth currency withdrawn from circulation was processed in automated systems and reissued to circulation; AZN 1.3B worth unfit currency was withdrawn from circulation. AZN 10.5M worth currency was replaced by the 'Public service offices' created at the Central Bank.

In 2019 the Bank detected, withdrew from circulation and delivered to law-enforcement bodies 890 pcs of counterfeit currency by all denominations, y/y down by 21%.

The number of counterfeit banknotes per 276000 pcs of banknotes was 1, considerably low compared to relevant indicators of other countries (the rate on the Georgian lari is 1 fake currency per 17000 pcs, 1 fake currency per 150000 pcs in Russia, 1 fake currency per 30000 pcs of banknotes in the euro area). The Central Bank continued concerted efforts with commercial banks, institutions providing cash services and law-enforcement agencies as part of anti-counterfeiting and held workshops for 400 employees of commercial banks as part of anti-counterfeiting awareness measures.

In general, the Central Bank prioritized modern cash management, optimum and safe management of national currency denominated reserves, advanced mechanisms of control, diversification of risks, and high quality currency in circulation over the year.

2.3 Regular setting and announcement of the official exchange rate of manat against foreign currencies

In 2019 the exchange rate of manat was in line with BoP trends responding to supply and demand in the FX market.

In 2019 supply prevailed over demand in the domestic FX market, the exchange rate of the manat was under the pressure of appreciation. Currency supply was mainly driven by surplus of the BoP, oil revenues used for fiscal purposes and dedollarization trends.

As in previous years, the status of the BoP was a key fundamental macroeconomic factor to shape the external value of the national currency. Current account was in surplus, mainly stemming from trade surplus (\$6B). High non-oil export potential and favorable oil prices translated to improved external sector indicators. Average oil price was \$64.2. Despite being lower than the average price for 2018, it sufficed for trade surplus. Non-oil export increased by 15.7% and exceeded the growth rate of non-oil import (6.6%), less monetary gold. Service balance kept improving along with the trade balance, and the dynamics of remittances from abroad had an upward effect on foreign currency receipts.

The average daily exchange rate of manat was 1.7 ₸/\$ over the year. The official exchange rate of manat based upon average weighted exchange rate in the interbank market. The size of currency operations in the interbank market increased by 19.4%.

Buy-sell exchange rates set by banks were close to the official one in 2019. Commercial banks' daily average buy rate was 1.6978 ₸/\$, while sell rate – 1.7022 ₸/\$.

Over the period the manat appreciated by 12.4% against the Turkish lira, 2.3% against the euro, and 7.3% against the Georgian lari; depreciated by 13.6% against the Ukrainian hryvnia, 3.4% against the pound, 10.6% against the Russian ruble and 1.4% against the Japanese yen. Dynamics of bilateral exchange rates influenced that of multilateral exchange rates. Total trade weighted non-oil REER depreciated by 2.1%. Inflation in Azerbaijan being much lower than average inflation in Azerbaijani trade partners, both had a downward effect on the REER of the manat and supported its competitiveness. The REER of the manat has depreciated by 33.6% since 2014.

The Central Bank continued currency auctions to arrange sale of currency provided by the SOFAZ twice a week over the Bloomberg terminal. The Bank held total 101 auctions in 2019. Over the period the SOFAZ sold USD 6 593.7 M, y/y up by 6.4%.

2.4 Currency regulation and control

The Central Bank maintains currency regulation according to the Law of the Republic of Azerbaijan on Currency Regulation.

Currency relations are regulated by the above Law and the following regulations of the Central Bank:

- The 'Regulations on currency operations of residents of the Republic of Azerbaijan in foreign currency and non-residents in national and foreign currencies' approved by the Management Board of the Central Bank on 28 November 2016 to stabilize the FX market within the frames of complex measures oriented towards safeguarding financial stability;
- The 'Regulations on bringing foreign currency into and taking out of the Republic of Azerbaijan by residents and non-residents' approved by the Management Board of the Central Bank on 3 March 2016;

At the same time, under Part 3, Article 2 of the Law of the Republic of Azerbaijan on Currency Regulation, the 'Rule for declaration of the national currency in cash and national currency denominated securities brought into and taken out of the Republic of Azerbaijan by residents and non-residents' approved by Resolution No. 434 of the Cabinet of Ministers of the Republic of Azerbaijan dated 10 October 2018 created a legal basis for taking the national currency from the country without any limits provided that it will be declared.

The regulations in force allow to rebalance the BoP and strengthen illegal and unjustified taking currency out of the country. Analyses suggest that, the introduced currency regime played a positive role in optimization of inflow/outflow of foreign currency to/from the country in 2019. Free currency regime is used during repatriation of foreign investments, transfer of income earned by foreign investors in our country and other payments abroad.

2.5 Storage and management of international gold-foreign exchange reserves at its disposal

In 2019 the Central Bank managed its foreign exchange reserves in line with the strategy and rules for foreign exchange reserve management based upon the principles of safety, liquidity and profitability, the main direction for the annual investment program on foreign exchange reserve management was to conservatively maximize profitability.

To make the management effective, the Central Bank's foreign exchange reserves were invested in liquid and high quality government and corporate debt liabilities in USD, EUR and GBP. As of the end-period official foreign exchange reserves were held with reliable financial institutions – 91% in USD, 4% in EUR, 2% in GBP, and 3% in SDR.

Central Bank's foreign exchange reserves increased by \$ 629,0M to \$ 6.3B as of the end-period. The Bank earned \$163.9M worth income from currency asset management.

2.6 Development of the reporting and participation in development of the forecast balance of payments under the legislation

Compiling of the international standards based BoP continued in 2019, actual and forecast indicators of the BoP were one of the critical information sources for adequate decisions in the macroeconomic policy.

The International Transactions Reporting System (ITRS) allowed to further purify the reporting and accounting system of the BoP, deepen analytics, reconcile indicators and improve forecasting.

The mechanism for the Central Bank to obtain more detailed information of the State Border Service on the persons entering/leaving the country was established as a result of reaching an agreement with the State Statistics Committee, which in parallel allowed to improve tourism statistics within the BoP.

In light of recent macroeconomic trends, the Central Bank regularly updated forecast BoP for 2019, consulted with related authorities on BoP forecasting, sent necessary inquiries to some large state owned enterprises. At the same time the Bank assessed BoP forecast indicators and their pass-through to the FX market.

2.7 Development of country's consolidated foreign debt statistics and international investment balance, summary and dissemination of data

Efforts to collect and summarize data for country's consolidated foreign debt statistics and international investment balance continued in 2019. Relevant authorities regularly delivered to the Central Bank government and government backed foreign debt statistics, and data on foreign debt by the oil-and-gas and non-public sectors.

The Bank obtained indicators on balances of particular foreign debt liabilities as of the beginning and the end of the reported period on foreign debt data delivered by the Ministry of Finance and refined government and government backed foreign debt statistics data. Foreign debt statistics on the banking sector were alternatively assessed by the Central Bank on the basis of digital statistics received from commercial banks.

Consequently, the Bank consolidated and submitted to relevant public authorities the data on foreign debt statistics.