

**'Approved'**

By Resolution of the Management Board

of the Central Bank

of the Republic of Azerbaijan

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Minutes No. 56

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**Methodological Guidelines  
for Forecasting and Policy Analysis System**

## **1. General Provisions**

These Methodological Guidelines determine the essence, phases and management structure of the Forecasting and Policy Analysis System used to prepare analytical materials for the meetings of the Monetary Policy and Financial Stability Committee of the Central Bank of the Republic of Azerbaijan (hereinafter referred to as the "CBAR").

## **2. Definitions and Acronyms**

2.1. The definitions and acronyms used herein shall have the following meanings:

2.1.1. FPAS – the Forecasting and Policy Analysis System;

2.1.2. FPAS Group – a group formed from employees of the Analytical Unit as part of the Forecasting and Policy Analysis System;

2.1.3. MPFSC – The Monetary Policy and Financial Stability Committee;

2.1.4. Members of the MPFSC – a collegial body composed of the Management Board of the CBAR and relevant executives of the CBAR;

2.1.5. Analytical Unit – departments of Monetary Policy, Statistics and Research;

2.1.6. Non-structural models - econometric models that allow the variables to interact between themselves without restrictions;

2.1.7. DSGE – Dynamic Stochastic General Equilibrium model;

2.1.8. QPM – Quarterly Projection Model;

2.1.9. Monetary policy decision - a set of decisions on the parameters of the interest rate corridor and the intermediate and operational targets of monetary policy.

## **3. Purpose and Essence of the Forecasting and Policy Analysis System**

3.1. As in the experience of leading central banks, the main purpose of creating FPAS in the CBAR is to provide analytical support to the MPFSC decision-making process on monetary and exchange rate policy.

3.2. The use of FPAS allows to analyze the economic processes taking place in the global environment, in partner countries and the current macroeconomic situation in Azerbaijan, to forecast the main indicators characterizing it (inflation, output gap, economic growth, aggregate demand components, the current account balance, etc.) on possible development scenarios.

3.3. The FPAS business processes consist of 5 phases and begin 5 weeks prior to the MPFSC meeting. The first 3 phases cover a period of 4 weeks. During this period, analysis results and forecast scenarios are prepared and presented to MPFSC members in a presentation format. The last 2 phases of the FPAS fall on the 5th week. In these phases, MPFSC meetings are held, decisions are made and announced to the public.

3.4. Continuous and timely execution of business processes by phases and weekly work distribution within the FPAS is of serious importance, and deviation from the established schedule is contrary to the essence and purpose of the FPAS.

## 4. Business Processes in FPAS

4.1. Business processes implemented in FPAS include the following phases:

4.1.1. Phase 1 (Week 1): preparing the content of the presentation. In this phase, the FPAS Group Coordinator prepares the content of the presentation (relevant topics for coverage) to discuss with the MPFSC, considering the economic processes taking place in the country's economy, the global environment and partner countries. The content is first discussed and finalized by the Analytical Unit staff. Then the FPAS Group Coordinator presents the content of the presentation to MPFSC members for feedback via e-mail on the 3rd business day of the relevant week. The MPFSC members can provide feedback and suggestions on the content by the end of that week.

4.1.2. Phase 2 (Week 2): identifying assumptions and scenarios. At this stage, the FPAS Group develops assumptions and parameters of the baseline scenario on factors that do not depend on the CBAR activity (oil price and production volume, state budget parameters, prices on world commodity exchanges, inflation in the partner countries, economic growth, etc.). After discussions in the Analytical Unit, the risks that may hinder the implementation of the baseline scenario are identified. Based on the risks, alternative scenarios (pessimistic and optimistic) can be developed. The prepared assumptions, baseline and alternative scenarios are presented to MPFSC members for feedback by the FPAS Group Coordinator on the 3rd working day of the relevant week. After discussion, assumptions and scenarios are adopted by consensus by MPFSC members. In parallel, at this stage, the databases of econometric models and the information needed for analysis begin to be updated.

4.1.3. Phase 3 (Weeks 3 and 4): conducting analyses, developing forecasts. Based on the content, assumptions, and scenarios agreed upon during the first 2 phases, members of the FPAS Group conduct appropriate analyses and prepare forecasts of macroeconomic indicators. According to discussions within the Analytical Unit, updates and clarifications on the analyses and forecasts are made. Proposals for monetary policy decisions are prepared based on the final results.

4.1.4. Phase 4 (Week 5): holding a meeting of the MPFSC. The prepared presentation and materials are submitted to the MPFSC members at least 1 working day prior to the date of the meeting. The Analytical Unit supervisor or the head of one of the departments of the Unit makes a presentation at the meeting. The MPFSC meeting is held over 2 days. On the first day of the meeting, the presentation and relevant qualifying questions are discussed, and on the second day, monetary policy proposals are discussed. Taking into account the recommendations of the MPFSC, the Management Board of the Central Bank makes a decision on monetary policy. Minutes of the MPFSC meetings are drawn up and the decision is documented by minutes.

4.1.5. Phase 5 (Week 5): announcing the decision to the general public. The monetary policy decision is communicated to the public through a press release on the CBAR's official website on a pre-determined date and time. Every year a press conference is held on the decisions according to the schedule announced in advance in the statement on the main directions of the monetary policy.

4.1.6. The week during which the MPFSC decision is taken is considered a "quiet week" for officials representing the CBAR in terms of monetary and exchange rate policy.

During this week no relevant public communication is made before the decision is announced.

## **5. Forecasting Process in FPAS**

5.1. The forecasting process shall consist of three phases: nowcasting, short-term forecasting and medium-term forecasting.

5.1.1. In the nowcasting phase, after the end of the period, but before the official statistics are published, the necessary macroeconomic indicators are estimated using alternative data.

5.1.2. Using the results of nowcasting, short-term (quarters 1-3) forecasts of indicators are made through non-structural models.

5.1.3. Medium-term forecasts are produced by incorporating both the nowcasting and short-term forecasting results into the basic DSGE or QPM models.

## **6. FPAS Management and Structural Issues**

6.1. The FPAS Group shall consist of employees of the departments that are part of the Analytical Unit. The coordination function of the Group is carried out by deputy director or division head of either the Monetary Policy department or the Research department.

6.2. The FPAS Group members shall have access to all analytical and statistical data used in the FPAS process, as well as econometric models.

6.3. Necessary measures to eliminate deviations from the FPAS schedules are agreed upon with the supervisor of the Analytical Unit or the heads of departments included in the Unit.

## **7. Closing Provision**

These Guidelines shall come into force from the date of signing.

**Governor of the Central Bank**

**Taleh Kazimov**