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<th>Description</th>
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<tbody>
<tr>
<td>CBA</td>
<td>The Central Bank of the Republic of Azerbaijan</td>
</tr>
<tr>
<td>ADB</td>
<td>The Asian Development Bank</td>
</tr>
<tr>
<td>ASEAN</td>
<td>The Association of Southeast Asian Nations</td>
</tr>
<tr>
<td>EBRD</td>
<td>The European Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>ILO</td>
<td>The International Labor Organization</td>
</tr>
<tr>
<td>IMF</td>
<td>The International Monetary Fund</td>
</tr>
<tr>
<td>NBCI</td>
<td>Non-bank credit institution</td>
</tr>
<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
</tr>
<tr>
<td>SSC</td>
<td>The State Statistics Committee</td>
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<tr>
<td>SCC</td>
<td>The State Customs Committee</td>
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<tr>
<td>FED</td>
<td>The Federal Reserve System</td>
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<tr>
<td>EME</td>
<td>Emerging Market Economies</td>
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<td>AE</td>
<td>Advanced Economies</td>
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<tr>
<td>OECD</td>
<td>The Organization for Economic Cooperation and Development</td>
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<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
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<tr>
<td>APPI</td>
<td>Agricultural Producer Price Index</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium entrepreneurs</td>
</tr>
<tr>
<td>NEER</td>
<td>Nominal Effective Exchange Rate</td>
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<tr>
<td>OPEC</td>
<td>The Organization of the Petroleum Exporting Countries</td>
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<td>REER</td>
<td>Real Effective Exchange Rate</td>
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<td>RSM</td>
<td>Real Sector Monitoring</td>
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<tr>
<td>IPPI</td>
<td>Industrial Producer Price Index</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>WTO</td>
<td>The World Trade Organization</td>
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</table>
EXECUTIVE SUMMARY

The main target of the CBA’s monetary policy in 2019 was to maintain price stability in the national economy.

Being within the target band (4±2) the inflation rate both led to certainty in economic conditions and underpinned economic activity. A stable exchange rate, the monetary condition, the dynamics of administrative prices and low inflation expectations had a stabilizing, while revived consumption and high global food prices had an upward effect on inflation. Inflation in Azerbaijan, much lower than that in trade partners had a downward effect on the REER of the manat.

In 2019 the CBA implemented its monetary and exchange rate policy on the backdrop of favorable international conjuncture, the balance of payments surplus and rising strategic foreign exchange reserves. The Foreign trade balance was in surplus, rise in exports prevailed over the growth rate of non-oil import, less monetary gold. Improved external sector indicators factored in supply and demand in the FX market.

The monetary condition was eased by decreasing cost of money and increasing the size of money. In light of regularly updated macroeconomic forecasts and the balance of risks the CBA continued reducing the refinancing rate on a stepwise basis. Money supply was regulated to suffice to cover demand of the economy for money and maintain uninterrupted payments. To influence the monetary policy’s ultimate and interim targets the Bank adequately applied monetary policy tools and expanded the maturity range of sterilization tools.

Macroeconomic stability translated to economic activity in the reported year as well. Ongoing economic activity was high in non-oil trade in particular. The Bank’s RSM findings confirm that economic activity is high.
I. GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

1.1. Global economic trends

*World GDP has fallen to its lowest rate since the financial crisis due to long-standing trade and geopolitical tensions and traditional unsolved problems in certain EMEs. On the other hand, low unemployment in many countries, US – China trade deal, Brexit related agreement and quantitative easing by central banks of most countries in H2, 2019 created positive expectations for 2020.*


Economic growth in AEs y/y decreased by 0.5 pp to 1.7% in 2019.

According to the IMF, in 2019 the US economic growth rate y/y decreased by 0.6 pp to 2.3%. Economic activity indicators varied in the country. Unemployment in the USA was 3.5% in December (0.1 pp lower than predicted), historical low of recent 49 years. Moreover, the Dow Jones index posted 23.8%, and the S&P 500 30.6% growth over recent 12 months. 2019 also was the year of weak investments and industrial productivity. The industrial production index decreased over the year. On this backdrop, surge in household spending and lending by the end of the year and rising financial indices triggered financial crisis expectations by certain economic experts. Nevertheless, ongoing fiscal stimulus, such as tax cuts, completion of US-China ‘Phase 1’ trade deal and lower geopolitical tensions give positive signals to recovery of the US economy. Amid low economic growth the US FED has spent 8 meetings dedicated to interest rates since early 2019 decreasing them from 2.25-2.5% to 1.5-1.75% stepwise; the rates were left unchanged at 5 and cut at 3 meetings.
According to the IMF, the economic growth rate in the euro area was 1.2%, y/y down by 0.7. In Germany economic growth decreased by 1 pp, and by 0.4 and 0.6 pp in France and Italy respectively. In general, the IPI decreased in the region. Unemployment in the euro area stood at 7.4%, the lowest rate since 2008. On this backdrop, the FTSE Eurotop 100 index posted 26% growth over recent 12 months. The ECB continued QE in 2019 and set the interest rates at 0.50% and 0.25% at its 18 September meeting. The ECB restarted net purchases as part of the asset purchase program (APP) at a monthly pace of €20B from November onward. Conclusion of the Brexit agreement end-January and flexible transition to a new system is expected to underpin economic activity by pushing consumer confidence.

The IMF estimates 1% real GDP growth in Japan in 2019. Rise in consumption tax rate in October 2019 and low exports to China, in particular, had a downward effect on economic growth. Production and consumer confidence dropped too. This notwithstanding, the Japanese Nikkei posted 18.4% growth over the year. The Japanese government is striving to support aggregate demand and economic growth by means of fiscal stimulus, increasing spending. Despite slowdown in growth rate, unemployment in Japan was 2.2% in December 2019, the lowest rate of recent 25 years.

The real GDP growth in the UK was 1.3% in 2019, the lowest rate since 2010 (source: IMF). Low global economic growth rate reduced demand for UK exports, while policy decisions related uncertainties had a negative impact on business investments in the country. Nevertheless, unemployment stood at 3.8% as of end-year, the lowest rate since early 1975. The UK pound sterling gained against the USD over Q4, 2019 with a low no-deal Brexit risk (appreciation was 3.5% over the year).

Growth in EMEs stood at 3.7% in 2019, y/y down by 0.8 pp. Growth rate in emerging Asian markets y/y decreased by
0.8 to 5.6%, while this indicator was 1.8% in emerging European markets. Economic growth rate stood at 0.1% in Latin America and the Caribbean, 0.8% in the Middle East and Central Asia, 3.3% in Sub-Saharan Africa in 2019 (source: IMF).

![Graph 1. Business and Consumer Confidence indices in OECD countries](image)

Source: OECD

Chinese economic growth decreased to 6.1%, y/y down by 0.5 pp (source: IMF), stemming from both weak imports and exports due to trade wars. As of end-2019 the unemployment rate is estimated to stand at 3.6%, historical lows for China. Economic growth slowed down in other developed Asian countries, like Korea, Hong Kong, and Singapore due to economic situation in China. Amid slowed down economic growth the National Bank of China lowered medium-term lending facility rate to 3.25% from 3.3% in 2019.

According to IMF estimations, economic growth in Russia was 1.1% in 2019 (2.3% in 2018). However, the IPI increased across the country. In December, unemployment was 4.6%. Portfolio investment flows to the Russian government bond market, Russian economy related positive expectations and the Fed’s interest rate decisions resulted in 11.8% appreciation of the RUB against the USD. The Central Bank of Russia implemented accommodative monetary policy amid slowed down inflation and economic growth. The policy rate was reduced by 75 basis points over recent three months of the year.

Turkey left the recession behind with 0.9% economic growth in Q3, 2019. Economic growth in Turkey is estimated to stand at 0.3% in 2019, y/y down by 2.5 pp.  

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1 OECD Economic Outlook, November, 2019
In November, unemployment decreased to 13.3% with a parallel rise in the IPI. Though single-digit in September, inflation was 11.8% in December. The Turkish lira depreciated by 11% due to geopolitical tension and US sanctions. Nevertheless, the Central Bank of Turkey shifted the policy rate to 12% from 14% in December.

Trade tensions, global economic slowdown and policy uncertainties weigh in on global trade and investments. Global trade grew by 1% in 2019, y/y down by 2.7 pp (source: IMF). According to the United Nations Conference on Trade and Development (UNCTAD), global FDIs y/y dropped by 1% shifting to $1.39T from $1.41T. Investment flows receded in Europe and advanced Asian regions.

Commodity markets. In 2019, global commodity prices were prone to rising. According to the WB’s recent Commodity Markets Outlook (CMO), energy prices hiked by 5.9% in 2019. Non-energy prices hiked by 3.8%, food prices by 7%, precious metal prices by 17.9%. The price for gold rose by 18.5% in 2019.

The Food and Agriculture Organization of the United Nations (FAO) also confirms food price hike. According to the FAO Food Price Index, food prices hiked by 12.5% in 2019. Over the recent year global food prices hiked by 17.9% on meat products, 17% on dairy products, 31% vegetable oils and 6% on sugar.

Energy price swings mainly stemmed from oil price changes and natural gas price slides. According to the WB’s commodity price data, the natural gas index dropped by 40.5% in 2019.
1.1 Global economic trends

Average Brent oil price was $64.2 in 2019, y/y down by 10.6%. A weak rise in global demand (in EMEs in particular), innovations in oil extraction and utilization of energy carriers decrease oil prices. Extension of oil output cut agreement by OPEC and non-OPEC members and sanctions against certain large oil producers have an upward effect on oil prices. According to the January IEA Oil Market Report, oil demand is forecasted to be 1.2 mln. b/d in 2020. IMF, WB and IEA forecast average $58, $59 and $65 oil price in 2020.

**Forecasts and risks.** In the WEO January 2020 update the IMF revised the global economic growth outlook down to 3.3% for 2020 (0.3 pp down vs the January 2019 release) (0.1 on AEs, 0.5 on EMEs).

Economic growth in AEs is forecast to be 1.6% in 2020 and 2021 (down by 0.1 pp. for 2020 and stable for 2021 vs the October 2019 release). Economic activity in the USA is expected to gradually slow down amid weaker fiscal stimuli.

**Table 1. Economic growth forecasts**

<table>
<thead>
<tr>
<th></th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>World</strong></td>
<td>3.3</td>
<td>3.4</td>
</tr>
<tr>
<td><strong>AE</strong></td>
<td>1.6</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>USA</strong></td>
<td>2</td>
<td>1.7</td>
</tr>
<tr>
<td><strong>Euro area</strong></td>
<td>1.3</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Japan</strong></td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>EME</strong></td>
<td>4.4</td>
<td>4.6</td>
</tr>
<tr>
<td><strong>Russia</strong></td>
<td>1.9</td>
<td>2</td>
</tr>
<tr>
<td><strong>China</strong></td>
<td>6</td>
<td>5.8</td>
</tr>
</tbody>
</table>

*Source: IMF, Global Economic Outlook, January 2020*

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2 Average crude oil spot price for Brent, Dubai Fateh and Western Texas
Economic growth in EMEs is forecast to make 4.4% in 2020 and 4.6% in 2021 (down by 0.2 pp vs the October 2019 release).

According to estimations of international organizations and experts, risks in the global economy are increasing despite recent lower protectionism trends: geopolitical tensions, in particular US-Iran tension, uncertainties in internal policy decisions, natural disasters to be triggered by climatic changes and higher social unrest in many countries. Particularly, rising geopolitical tension between the USA and Iran may reduce oil production and global investments. Moreover, rising social tensions in many EMEs may challenge reforms and lead to lower than expected economic growth. At the same time, slowdown in the largest economies of the world – the USA, euro area and China in 2019 creates risks for 2020 as well. Hence, stagnation in any of these economies may weaken economic outlook in other countries through trade ties, commodity prices and financial channels.
1.2. Azerbaijani economy’s external sector developments

In 2019, Azerbaijani external economic position remained favorable driven by favorable global oil prices and wider non-oil exports.

According to the SCC, the foreign trade turnover increased by 7.7% to $33.3B – $19.6B (59%) export, $13.7B (41%) import. Foreign trade surplus amounted to $6B.

The EU accounts for 39% of trade turnover – Italy 46%, Germany 13%, Switzerland 11% and France 6%.

The CIS accounts for 14% of trade turnover – Russia 66%, Ukraine 18%.

Other countries account for 47% of trade ties – Turkey (29%), China (14%), Israel (9%) and India (7%).

Exports increased by 0.9%, non-oil export by 15.7%. The value of export decreased by 5.8% on crude oil, 11.1% on oil products and increased by 57.9% on natural gas.

Main export partners include Italy (28.7%), Turkey (14.6%), Israel (6.8%)
India (4.9%), Germany (4.8%) and China (3.8%).

Non-oil exports peaked to $1.95B driven by high import of cotton fiber (54.1%), chemical products (31.7%), cotton yarn (27.4%), aluminium (14.1%) and fruits and vegetables (8.3%).

Commodity import increased by 19.2%: import on the public sector increased by 56.8% to AZN4.1B, and by 4.1% to AZN8.5B on the private sector. High public sector import is driven by purchase and delivery to Azerbaijan of gold bullions by the SOFAZ.

Russia accounts for 16.8%, Turkey 12.1%, China 10.5%, Switzerland 9%, USA 5.6%, Germany 5.2%, and Ukraine 3.4% of imported products.

Import increased by 20% on food products, including 65.3% on wheat, 18.1% on fruits and vegetables, 9.8% on plastic mass, 2.2% on pharmaceuticals and decreased on ferrous metals and products, furniture and tobacco.

Main non-oil export partners include Russia ($690.6M), Turkey ($401.8M), Switzerland ($179M), Georgia ($159.1M) and Ukraine ($50.6M).

Commodity import increased by 19.2%: import on the public sector increased by 56.8% to AZN4.1B, and by

Source: SCC
Positive tendencies continued in the services sector as well. 3.2 mln. tourists from 196 countries visited Azerbaijan in 2019 (y/y up by 11.3%). Russia accounts for 29.4%, Georgia for 22.9%, Turkey for 10%, Iran for 8.1%, Saudi Arabia for 3.4%, UAE for 2.2% and India for 2.1% of tourists visiting Azerbaijan.

Azerspace OJSC exported services to 27 countries in 2019 (satellite telecommunication and optical satellite services) and y/y increased its income by 70% to $43.4M.

According to initial data, money remittances to the country amounted to $934M in 2019.

Capital investment from foreign enterprises and organizations kept flowing. According to the SSC, FDIs amounted to AZN5.2B equivalent (30.2% of total investments).

Great Britain, Luxembourg, Turkey, Russia, Iran, USA, Japan, Malaysia, Switzerland, Norway and France accounted for major part of capital investments by foreign countries and organizations.

Strategic foreign exchange reserves amounted to $51.1B, surpassing GDP.
II. MACROECONOMIC DEVELOPMENTS IN AZERBAIJAN

2.1. Aggregate demand

*Economic growth was driven by domestic demand in 2019.*

*Consumption expenditures* kept increasing. Goods and services sold in the market to meet consumer demand y/y increased by 3.6% in real terms to AZN50.7B. 96% of goods sold and services supplied by economic agents were offered by private businesses (49.5% private entrepreneurs).

Every consumer utilized on average AZN426.2 worth of goods and paid services (y/y up by AZN20.9)

Food retail trade turnover y/y increased by 3.2%, nonfood by 4%.

Consumers spent 50.7% of their funds on food, beverage and tobacco at retail trade outlets (y/y up 3.2%). Expenses increased by 4.1% in knitwear, clothes and shoes, 3.2% in electric appliances and furniture, 2.9% in telecommunication and computer equipment, 4.6% in other nonfood stuff.

**Table 2. Share of spending items in trade outlets, %**

<table>
<thead>
<tr>
<th>Spending item</th>
<th>Share, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2018</td>
</tr>
<tr>
<td><em>Food, beverage and tobacco</em></td>
<td>50.3</td>
</tr>
<tr>
<td><em>Knitwear, clothes and shoes</em></td>
<td>17.8</td>
</tr>
<tr>
<td><em>Electric appliances and furniture</em></td>
<td>6.1</td>
</tr>
<tr>
<td><em>Computers, telecommunication devices and others</em></td>
<td>0.7</td>
</tr>
<tr>
<td><em>Pharmaceuticals and medicals</em></td>
<td>1.3</td>
</tr>
<tr>
<td><em>Fuel</em></td>
<td>5.9</td>
</tr>
<tr>
<td><em>Other non-food items</em></td>
<td>17.9</td>
</tr>
</tbody>
</table>

*Source: SSC*

Every consumer purchased on average AZN168 worth of food, beverage and tobacco and AZN163.4 worth of non-
food items monthly for private consumption in retail trade.

Catering turnover y/y rose by 6.7%. Entities accounted for 42.3%, private entrepreneurs 57.7% of catering turnover in the private sector. The value of paid services to the population increased by 3.1% to AZN9.6B in real terms. Per capita paid services consumption y/y increased by AZN40.1 in nominal terms.

Consumer demand was driven by rise in nominal income of the population – it increased by 7.4% to AZN57B in nominal terms, per capita income rose by 6.5% to AZN5758.6. The population’s disposable income increased by 7.1% to AZN52.5B.

Over the reported year nominal average monthly salary of hired workers in the economy y/y increased by 16.6% to AZN634.8. Salary of employees was AZN516.5 in public entities and AZN759.7 in private entities.

Loans to households, one of the consumer demand components, increased by 22%. The households’ loan portfolio reached AZN7.7B as of end-year.

**Government expenditures** were critical for domestic demand. State budget expenditures made up AZN24.4B over the period (y/y up by 7.4%).

AZN13.5B (55.4%) of state budget expenditures were channelled to current expenditures, AZN9.4B (38.4%) to capital expenditures, AZN1.5B (6.2%) to expenditures of public debt and liabilities.

**Investment expenditures.** AZN17.2B worth of investments was channeled to the economy. AZN11.7B worth of funds were invested in the non-oil sector (y/y up by 1.9%). The public sector accounts for 48.3%, while the private sector for 51.7% of total investments.

69.8% of investments stemmed from domestic, while 30.2% from external sources.

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3 http://www.maliyye.gov.az
Table 3. Investment sources, %

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds of enterprises and organizations</td>
<td>52.7</td>
<td>52</td>
</tr>
<tr>
<td>Bank loans</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>Budget funds</td>
<td>25.8</td>
<td>28.3</td>
</tr>
<tr>
<td>Off-budget funds</td>
<td>1.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Population’s own funds</td>
<td>8.2</td>
<td>5.7</td>
</tr>
<tr>
<td>Other funds</td>
<td>0.7</td>
<td>0.8</td>
</tr>
</tbody>
</table>

Source: SSC

Funds of enterprises and organizations prevailed in total investments (52%).
2.2. Aggregate supply and employment


Economic growth. According to the SSC, real GDP increased by 2.2% to nominal AZN81.7B. 41.4% of GDP was produced in the industry and 5.7% in agriculture. Per capita GDP was AZN8247.

The value-added in the oil sector increased by 0.4%. The mining sector extracted 37.4 m/t crude oil, 24.5 bln/m3 natural gas. Oil production y/y decreased by 3.3%, while gas extraction increased by 27.7%.

The value added in the non-oil sector y/y increased by 3.5% in real terms to nominal AZN50.4B (61.7% of GDP).

Most non-oil sectors posted growth. The non-oil and gas industry, agriculture, information and communication and tourism posted the highest growth. The non-oil and gas sector grew by 14.3%.

Output y/y increased by 10.8% in food production, 33.2% in the textile industry, 51.8% in production of computers, electronic and optic products, 29.5% in production of furniture, 20.6% in production of pharmaceuticals, 22% in production of rubber and plastic mass, 25.6% in the chemical industry, 41.4% in production of beverages, 80.7% in production of tobacco products.

Production of durables y/y increased by 41.8%, non-durables by 15.8%. Production of industrial products accounts for 88.6% and supply of industrial services for 11.4% of total production.

Agricultural production increased by 7.2%: 3.5% on animal products and 11.7% on plant growing.
2.2 Aggregate supply and employment

The CBA’s RSM survey findings suggest that the Business Confidence Index (BCI) was positively zoned across industry, trade and services. Economic activity indicators y/y improved in trade and services – in production of plastic ware, construction materials, food and beverages (non-oil industry); electric and home appliances, furniture and household goods (trade); and tourism, hotels and healthcare (services). Though still negatively zoned in construction, the BCI has improved vs the previous year.

**Employment.** As of the end-2019 economically active population numbered 5190.1 thousand (y/y up by 57 thousand).

According to the SSC, as of end 2019 the number of hired labor y/y increased by 3.2% to 1645.4 thousand; those involved in the public sector was 914.9 thousand, non-public sector 729.4 thousand.

\[\text{BCI in industry} = \frac{(\text{production} - \text{product inventory} + \text{production expectations})}{3}\]
\[\text{BCI in trade} = \frac{(\text{actual sale} - \text{goods inventory} + \text{sale expectation})}{3}\]
24.2% of hired labor in enterprises and organizations was involved in production: 7.6% in construction, 7.5% in processing, 3.3% in agriculture, forestry and fishery, 2.1% in mining.

According to CBA RSM survey employment expectations of enterprises increased in trade, services, industry and construction.
2.3. Inflation

Inflation was below the center of the announced annual target band in 2019. Low single-digit inflation contributed to the rise in the real income of the population.

**Consumer Price Index (CPI).** According to SSC data-based estimations, 12-month inflation was 2.4% in December 2019 (y/y), below the center of the band announced by the CBA (4±2%). Annual inflation peaked in July 2019 (3.6%).

![Graph 12. 12-month based inflation, in % (CPI change to same month of previous year)](image)

Source: SSC, CBA estimations

Price index across food products with a considerable share in the consumer basket increased by 4.2% on an annual basis. Higher than the center of the target band food inflation stems from price hikes in the global food market along with wider aggregate demand. Annual price hike on non-food stuff and services, other inflation components, considerably falls behind the center of the band (1.0% and 0.9% respectively). Low non-food inflation is attributable to the rise in domestic production driven aggregate demand and depreciated national currencies in certain partner countries. Stable administrative prices also factor in low non-food and service inflation.

Food prices account for 1%, non-food 0.6%, and services for 0.8% of average annual inflation.

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5 According to SSC, average annual inflation was 2.6%.
2.3 Inflation

Monetary Policy Review ● January-December 2019

The diffusion index \(^6\) – a measure of change in dynamics pertaining to the number of goods and services with rising and falling prices in the consumer basket decreased in December. Prices for 87 out of 520 items of goods and services dropped and remained unchanged for 39 items. Price hike for 47% of products was below 2%.

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

\(\text{Graph 13. Components of annual inflation, } \%\)

\(\text{Graph 14. Scale of inflation, } \%\)

\(^6\) The index is computed as (increased-decreased)/(decreased+not changed).
Updated forecasts display that inflation will remain within the target band (4±2%) in 2020, if current macroeconomic trends linger.

**Producer Price Index (PPI).** According to the SSC, the GDP deflator, that measures price swings in all domestically produced goods and services, increased by 0.2%.

The PPI mostly changed across agricultural products. The APPI increased by 4.4% - 3.3% on animal products, 5.4% in plant growing. Producer prices increased by 0.6% in forest products, and by 2.9% in fish and other fishery products.

The PPI for industrial products y/y increased by 3.2%, driven by swings in processing (up by 6.9%).

The highest price hike in processing was in production of tobacco (31.4%), bicycles (26.3%) and construction materials (17.8%).

Transportation tariffs decreased by 0.8%. Prices for cargo services dropped by 1.1%, prices for passenger transportation rose by 1.2%. Moreover, the price for postal and courier services increased by 0.1%, prices for communication services remained unchanged.

**Source:** SSC
III. THE MONETARY AND EXCHANGE RATE POLICY

3.1. The FX market and the exchange rate of manat

The exchange rate of the manat against foreign currencies responded to supply and demand in the FX market and the balance of payments trends.

The dynamics of economic agents’ foreign economic operations was a critical factor to contribute to the size of FX market transactions this year too.

Cashless transactions in the FX market y/y increased by 9.4% to $27.8B equivalent\(^7\) – 82.8% in USD and 17.2% in other currencies.

The Interbank FX market accounts for 33.7%, while the Intrabank FX market for 66.3% of cashless transactions.

96% of transactions in the Interbank market was maintained in the USD, 3.7% in the euro and 0.3% in other currencies. Currency operations in the Interbank FX market were conducted over the Bloomberg platform.

Intrabank FX operations amounted to $18.4B equivalent (76.2% USD denominated operations). 91.3% of Intrabank FX market operations was currency operations with legal entities.

Cash currency traded by banks y/y decreased by 17.7% to $5.7B equivalent ($4.5B (78.9%) USD denominated operations).

The CBA continued currency auctions to arrange sale of currency provided by the SOFAZ, held twice a week; informing market participants on auction parameters via the Bloomberg terminal prior to auctions. The Bank held total 101 currency auctions.

The official exchange rate of the 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 AZN1.7. Though

\(^7\) Including USD, EUR, GBP, RUB denominated operations
3.1. The FX market and the exchange rate of manat

varied, buy-sell exchange rates set by banks were close to the official one. Commercial banks’ daily average buy/sell rate was 1.6978/1.7022. Difference between average daily official buy/sell exchange rates and those of commercial banks was 0.1% (AZN0.0022).

AZN appreciated by 11% against the Turkish lira, 2.2% against the euro, 6.8% against the Georgian lari and depreciated by 15.7% against the Ukrainian hryvnia, 11.8% 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 NEER of the manat appreciated 0.4%, while the REER depreciated 2.1%. Depreciated REER is attributable to the fact that inflation in Azerbaijan is much lower than average inflation in trade partners.

Source: CBA

To note, the REER of manat has depreciated 33.6% since end-2014, contributing to non-oil competitiveness.
3.2. Monetary policy tools

Monetary policy tools were applied in view of lower than the center of the target band actual inflation and excess liquidity in the banking system.

The CBA made necessary corrections to its interest rate corridor parameters on liquidity operations in light of macroeconomic trends, revised forecasts, internal and external risks. The Management Board of the CBA discussed interest rate corridor parameters 8 times in 2019 and decided to stepwise shift the refinancing rate to 7.5% from 9.75%, the ceiling of the interest rate corridor to 9.25% from 11.75% and the floor to 5.75% from 7.75%.

To meet the money demand of the economy and effectively manage liquidity, the CBA kept various term open market operations active. Although lending relatively elevated, banking sector liquidity remained in surplus, pushing high demand for CBA’s sterilization operations.

The CBA held 53 deposit auctions on attraction of excess funds in the national currency with 14-day maturity. Total outstanding amount of funds attracted by deposit auctions was AZN250M as of the end-year.

Source: CBA
3.2. Monetary policy tools

The CBA held 55 auctions on issue of notes along with deposit operations. 28-day notes were issued at 51 of them. The CBA issued notes with longer maturity (84, 168, 252-days) to boost opportunities for sterilization of excess liquidity and support formation of interest rates in the short-term period of the yield curve from September 2019. The Bank held 4 long-term note auctions, attracting AZN120M. Total outstanding amount of sterilization via short-term notes was AZN700M.

On this backdrop interest rates on deposit operations and issue of notes were close to the floor of the interest rate corridor.

Deposit and short-term note operations both sterilize excess money supply and promote money market development contributing to improvement of monetary policy’s operational framework and development of the interbank market.

Return on CBA’s sterilization tools is translating into interest rates on other financial tools becoming an important representative of the money market. At the same time, short-term notes issued by the CBA are being actively used as securitization at the REPO market.

Reserve requirements were left unchanged and 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 with the CBA across all months of 2019 considerably exceeded total funds to be maintained as required reserves.

Graph 19. Volume and yield on notes issued by the CBA

Source: CBA

Supply prevailed over demand by 3.6 times at deposit and 3.4 times at note auctions, attributable to hitherto high excess liquidity in the banking system.
3.3 Money supply

Expansion of money supply was critical in bringing the monetary condition close to neutrality in 2019.

Base money in manat increased by 27.3% to AZN12.2B. Net foreign assets (NFA) account for 26.3% and net domestic assets (NDA) for 73.7% of the base money.

Cash in circulation – a structural element of base money in manat increased by 24.4%, stock of correspondent accounts in manat by 49.2%.

Broad money supply in manat (M2) increased by 24.5% to AZN18.2B as of end-period. M2 monetization \(^8\) y/y increased by 4pp.

Table 4. Money aggregates, bln manat

<table>
<thead>
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<th>01.01.19</th>
<th>01.01.20</th>
<th>Growth rate, %</th>
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<tr>
<td>M0</td>
<td>7.6</td>
<td>9.5</td>
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</tr>
<tr>
<td>M1</td>
<td>12.3</td>
<td>15.4</td>
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</tr>
<tr>
<td>M2</td>
<td>14.6</td>
<td>18.2</td>
<td>24.5</td>
</tr>
<tr>
<td>M3</td>
<td>24.1</td>
<td>28.9</td>
<td>20</td>
</tr>
</tbody>
</table>

Graph 20. Dynamics of M2 according to its composition, %

Source: CBA

Cash, savings of individuals and deposits of legal entities in the structure of money supply in manat (M2) \(^9\) performed differently.

Cash money supply increased by 25%, deposits of legal entities in manat by 18.4% and savings of individuals in manat by 31.5%.

Demand savings and deposits in manat increased by 26.2%, while term savings and deposits increased by 19.9% (weight in M2 - 15.6%).

\(^8\) Money supply to GDP

\(^9\) According to IMF’s Monetary and Financial Statistics methodology.
3.3 Money supply

Broad money supply (M3) increased by 20% to AZN28.9B as of the end-period (y/y up by 5 pp).

Graph 21. Dynamics of money aggregates, m. manat

Source: CBA

Dollarization of bank deposits continued declining – national currency denominated deposits increased by 24.1%, foreign currency denominated deposits increased by 12.9%. The share of foreign currency denominated savings and deposits in M3 money aggregate was 39.1% end-2018 and decreased to 36.8% as of end-2019. The share of foreign currency denominated savings and deposits in total savings and deposits was 54.9% as of end-2019 (57.2% end-2018).

Graph 22. Dollarization, %

Source: CBA

Dollarization varied across individuals and legal entities; dollarization of deposits of legal entities shifted to 65.6% from 66.4% last year, while foreign currency accounted for 52.2% of savings of individuals end-2019 (62.5% early 2019).
Graphs and tables

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