MONETARY POLICY REVIEW

JANUARY- JUNE 2019

CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN
# TABLE OF CONTENTS

**ACRONYMS**

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive summary</td>
<td>3</td>
</tr>
<tr>
<td>I. Global economic environment and the external sector</td>
<td>4</td>
</tr>
<tr>
<td>1.1. Global economic trends</td>
<td>4</td>
</tr>
<tr>
<td>1.2. Azerbaijani external sector developments</td>
<td>11</td>
</tr>
<tr>
<td>II. Macroeconomic developments in Azerbaijan</td>
<td>14</td>
</tr>
<tr>
<td>2.1. Aggregate demand</td>
<td>14</td>
</tr>
<tr>
<td>2.2. Aggregate supply and employment</td>
<td>17</td>
</tr>
<tr>
<td>2.3. Inflation</td>
<td>20</td>
</tr>
<tr>
<td>III. The monetary and exchange rate policy</td>
<td>24</td>
</tr>
<tr>
<td>3.1. The FX market and the exchange rate of manat</td>
<td>24</td>
</tr>
<tr>
<td>3.2. Monetary policy tools</td>
<td>26</td>
</tr>
<tr>
<td>3.3. Money supply</td>
<td>29</td>
</tr>
<tr>
<td>Graphs and tables</td>
<td>31</td>
</tr>
</tbody>
</table>
ACRONYMS

CBA  The Central Bank of the Republic of Azerbaijan
ADB  The Asian Development Bank
ASEAN The Association of Southeast Asian Nations
EBRD The European Bank for Reconstruction and Development
ILO  The International Labor Organization
IMF  The International Monetary Fund
NBCI Non-bank credit institution
FDI  Foreign direct investment
SSC  The State Statistics Committee
FED  The Federal Reserve System
EME  Emerging Market Economies
AE   Advanced Economies
OECD The Organization for Economic Cooperation and Development
CPI  Consumer Price Index
APPI Agricultural Producer Price Index
SME  Small and medium entrepreneurs
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
GDP  Gross Domestic Product
WTO  The World Trade Organization
EXECUTIVE SUMMARY

In Half I, 2019 the CBA’s monetary policy was oriented towards safeguarding macroeconomic stability. The final target of the monetary policy was to maintain inflation at a 4±2% range.

Annual inflation was below the target band center. Despite wider aggregate demand and an upward effect of certain non-monetary factors on prices, behavior of bilateral and nominal effective exchange rates, as well as the implemented monetary policy conditioned low inflation. Inflation in Azerbaijan was much lower than in that of trade partners, which supported competitiveness having a downward effect on the REER of the manat.

The CBA implemented its monetary and exchange rate policy on the backdrop of favorable conjuncture, a balance of payments surplus and rise in strategic foreign exchange reserves. There was surplus in foreign trade, 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 forex market.

Monetary easing continued, contributing to economic growth safeguarding macroeconomic stability. The CBA made critical corrections to the interest rate corridor parameters of its liquidity operations in light of recent macroeconomic forecasts and reduced the refinancing rate on a step-by-step basis. Money supply was regulated so that to suffice to cover demand of the economy for money and maintain uninterrupted payments.

The Bank adequately used the monetary policy tools at its disposal to effectively manage liquidity in the economy and the banking system. Demand for CBA’s sterilization operations was high due to lingering excess liquidity in the banking system. Lower outstanding amount of funds attracted through deposit auctions and issue of notes had an upward effect on money supply.

Macroeconomic stability positively translated into economic activity. In the first half of the current year economic growth continued, economic activity was high in non-oil trade in particular.
I. GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

1.1. Global economic trends

Global economic growth continued at a moderate pace in HI, 2019. Trade wars and geopolitical tensions, low business confidence, Brexit related uncertainties had a downward effect on global economic growth. However, the US – China trade deal expectations and predictions that the Fed will not tighten the policy in the short horizon led to positive thinking about the global economic condition.

Global economic growth. In the first half of 2019 global economic activity indicators varied. The OECD business confidence index kept dropping, while the consumer confidence index was prone to increasing (see the Graph).

Economic activity weighed in on global trade and investments. The size of global trade decreased by 0.5% in QI, 2019. Slowdown is mainly observable in emerging Asian markets. The main reason...
for global trade slowdown are the China–US trade war and stronger protectionist trends.

AEs underwent positive changes in economic growth, while EMEs underwent lower than expected economic activity. Out of leading AEs, economic growth indicators were better than expected in the USA and Japan, and negative factors affecting the growth since 2018 in the euro zone disappeared.

According to the US Bureau of Economic Analysis, the US economy grew by 2.1% in QII 2019, 1.8% up from market expectations. One of the main factors with a negative effect on economic growth is the China–US trade tension and tit-for-tat response. Nevertheless, halt in monetary policy tightening, higher employment and productivity supported the US economic growth. Unemployment in June increased by 0.1% to 3.7%, higher than 3.6% market expectation. In May 2019 unemployment hit 49-year low in the USA (3.6%).

The economic growth rate stood at 1.1% in the euro zone in QI, 2019. Weak economic growth was in processing. In the environment of lower unemployment and higher real salaries slowed down economic growth stems from adverse balance in trade and lower aggregate demand. In response to lower economic activity Germany, France and Italy announced their plans to introduce tax exemptions and increase public spending. Moreover, the ECB unveiled its plan to provide banks with cheap loans from September onward. The unemployment rate in the euro zone decreased by 0.1% vs the previous month to 7.5%, lower than market expectations, the lowest unemployment rate in the euro zone since July 2008.

The GDP growth rate in the UK y/y was 1.2%, 0.6 p.p. lower than in QI. Economic growth was driven by services and production. Stagnation in the construction sector continues.

The GDP growth in Japan in QII stood at 1.2%. Main factors to have a
positive effect on economic growth include lower import and higher public spending. The Japanese government announced that it will continue fiscal stimulus measures meanwhile contributing to economic growth. Unemployment was 2.3% in Japan in June 2019, slightly lower than the 2.4% market expectation.

Economic growth rates are uneven across EMEs. Though better than expected in China in QI, economic growth indicators increased by 6.2% on annual in QII, justifying market expectations (6.2%). In QI, 2019 the unemployment rate decreased by 0.13% compared to the previous quarter to 3.67% in China, the lowest rate in the history of China. Economic activity is weak in other Asian and Latin American countries as well. In QI economic activity was 0.5% and 1.1% in Russia and the CIS respectively, activity decreased by 2.6% in Turkey. Unemployment was 4.4% in Russia in June (lower than market expectations (4.5%)) – the lowest unemployment rate in Russia since 1992. In April unemployment in Turkey decreased by 1.1% versus the previous month to 13%.

*Changes in global commodity prices and inflation.* According to the WB’s recent Commodity Markets Outlook, in HI 2019 the consumer price index behaved differently across commodity groups.

Though hiked up to 13% over first 5 months, energy prices cheapened in June up to the early year level – non-energy commodity prices hiked by 2.6%, food prices by 2.3%, precious metals by 7.6%.

![Graph 3. Commodity price index (2010=100)](image)

*Source: World Bank*
Cereals hiked most out of non-energy commodities (8.1%). The price for gold increased by 11.1%.

Rise in energy prices stemmed from high oil and low natural gas prices. As of end-June the Brent oil price increased by 24.5%. In general, average Brent oil price was $66.2 in HI, 2019. OPEC and non-OPEC members decided at their meeting of 2 July 2019 to extend agreement on decrease in output by the end-March, 2020.

The EIA in its recent release notes that global oil reserves increase by 0.2 mln b/d in HI, 2019. The Agency is predicting a balanced oil market in HII, 2019 and expects the average Brent oil price to stand at $67 per barrel.

Rising energy prices over the first 6 months had an upward effect on inflation in a number of oil importing AEs and EMEs. Due to lower than expected rise in aggregate demand, core inflation fell below the target in certain AEs (the USA) and remained below the target in others (the euro zone, Japan). In most EMEs core inflation was below its historical low (except for Argentine, Turkey and Venezuela).

Global financial markets and the monetary policy. Though market rates

\[ \text{Graph 4. World oil market, production-consumption, million barrels/day} \]

Source: EIA

According to WB June 2019 Global Economic Prospects, Saudi Arabia is the driver of the decrease in oil supply. This country pushed decrease in output to 1 mln b/d compared to the end of 2018. While Russia decreased output by 200 thousand barrels. However, production in the USA keeps increasing and the country is still the world’s largest oil producer.
varied across countries, in general, the global financial condition eased. Over the period central banks took 281 monetary policy decisions – 51 on decrease, 17 on increase and 213 on leaving stable\(^1\).

The ECB stopped net asset purchases noting it will leave interest rates unchanged and continue accommodative monetary policy at least through the end of 2019. The Bank of Japan announced that it will pursue an accommodative monetary policy supporting the lowest interest rate.

Global economic developments translated into leading fund indices – the Dow Jones index posted 14.6%, S&P500 15.4%, Nikkei 6.2%, FTS Eurofirst 300 13% and the Shanghai index 19.4% growth. Some experts think that rise in fund indices is not based on real economic activity.

Currency indices in EMEs strengthened against the USD, back to the level of mid-2018. Tight monetary policy in the countries that underwent the sharpest pressure in Half II last year (Turkey and Argentine) and efforts of their

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\(^1\) Source: [www.centralbanknews.info](http://www.centralbanknews.info), [www.cbrates.com](http://www.cbrates.com), [www.countryeconomy.com/key-rates](http://www.countryeconomy.com/key-rates)
governments resulted in slowdown in sharp depreciation of their currencies against the USD in Half I, 2019.

Expected changes to interest rates in the USA and the Fed’s signal that ‘it will be patient in rate hikes’ resulted in depreciated USD against the Japanese yen and the Russian ruble. In the first half of 2019 the USD returned to the September 2018 level against these currencies. Lingering Brexit-related uncertainties in the UK weighed on volatility of the pound sterling. The euro depreciated by 0.8% amid failure of the Italian economy to meet expectations and trade pressure.

The cryptocurrency market also remained volatile. Bitcoin that cost $3405 early February increased to historical high – $12806, up by 3.76 times. Prices for other currencies like Ethereum, Ripple and Litecoin followed the same behavior over the year.

**Forecast and risks.** In the World Economic Outlook July 2019 update the IMF revised global economic growth outlook down to 3.2% (0.1 p.p. down vs the April release)

Economic growth in AEs is forecast to stand at 1.9% in 2019 and 1.7% in 2020. (up by 0.1. p.p. in 2019 and stable in 2020 vs the April release). Economic activity in the USA is expected to gradually slow down amid weaker fiscal stimuli.

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<th>Table 1. Economic growth forecasts</th>
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<td>World</td>
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<td>Euro zone</td>
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<td>Japan</td>
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<td>EME</td>
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<td>Russia</td>
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<tr>
<td>China</td>
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<tr>
<td>CIS</td>
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Source: IMF
1.1 Global economic trends

Economic growth in EMEs is expected to stand at 4.1% in 2019 and 4.7% in 2020 (down by 0.3 p.p. and 0.1 p.p. vs the April 2019 release).

Economic growth forecast in Azerbaijani trade partners’ remains optimistic.

Average economic growth forecast for Azerbaijani trade partners is 0.8% in 2019 (non-oil export weighted), likely to positively translate to both trade and investment flows by the Azerbaijani non-oil sector.

According to estimations of international organizations risks to the global economy increased in Half I, 2019: trade and technology pressures, geopolitical tensions, deflationary pressures etc. The China-US trade wars, the US measures against Chinese Tech companies and threat of tariffs against Mexico if the latter does not prevent migrant flow, lingering Brexit-related uncertainties threaten global growth. At the same time, currency pressures in developing Argentine and Turkey, wars in Lybya and Yemen, US sanctions against Venezuela and Iran, geopolitical situation in the Persian Gulf are main risks to the global economy.
1.2 Azerbaijani external sector developments

Higher non-oil export, still favorable oil prices in the global oil market and developments in main trade partners weighed in on the external economic position of Azerbaijan.

According to the State Customs Committee (SCC), foreign trade turnover increased by 27.6% to $17 B – exports $9.98 B (58.7%), imports $7.02 B (41.3%). Foreign trade surplus amounted to $2.96 B.

Azerbaijan traded up with 177 countries over the period. The EU accounts for 38% of trade turnover.

Italy accounts for 46%, Switzerland 17%. Germany 14%, and Spain 7% of trade ties with the EU.

CIS countries account for 13% of trade turnover – Russia 65%, Ukraine 19%.

Other countries account for 49% of trade ties – Turkey, (23%), China (15%), India (8%) and Israel (7%).

Over the reported period exports increased by 15.2%, non-oil export by 15.7% driven by the oil sector with a significant share in exports. The value of
export rose 10.4% on crude oil and 1.8 times on natural gas.

Main export partners included Italy (28.1%), Turkey (12.4%), China (6.9%), India (6.3%), Germany (5.7%), and Israel (5.5%).

Export of cotton fibre (2.6 times), chemicals (48.6%), cotton yarn (47.3%) and fruits and vegetables (15.1%) increased.

Commodity import increased by 50.5%: import on the public sector increased by 3.8 times to AZN2.8 B and 4.6% to AZN3.8 B on the private sector. High import on the public sector is driven by purchase and delivery to Azerbaijan of gold by the SOFAZ.

Switzerland accounts for 14.4%, Russia 14.3%, Turkey 9.7%, China 8.5%, USA 5.9%, Canada 5.6%, and Germany 4.7% of imported products.

Import y/y increased by 12.2% on food products, including 37.2% on wheat, 13.5% on fruits and vegetables, 6.5% on plastic mass and products and pharmaceuticals by 8.7% and decreased on ferrous metals and products, furniture, and tobacco.
Money remittances to the country amounted to $495.4 M.

Capital investment from foreign enterprises and organizations kept flowing. According to the SSC, the size of FDIs amounted to AZN1757.2 M equivalent (28.7% of total investments).

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

Strategic foreign exchange reserves amounted to $49B, sufficient for 33-month import of goods and services (taking into account the balance of payments indicators for the yearend of 2018).
II. MACROECONOMIC DEVELOPMENTS IN AZERBAIJAN

2.1. Aggregate demand

Economic growth was driven by domestic demand factors.

Consumption expenditures kept increasing.

Goods and services sold in the market to meet consumer demand y/y increased by 2.6% in real terms to AZN22.8B. 96% of goods sold and services supplied by economic agents was offered by private businesses (47.1% private entrepreneurs).

Every consumer purchased on average AZN383.8 worth of goods and paid services monthly (y/y up by AZN14.6).

Retail trade turnover increased by 2.8% to AZN18.0B. – food 2.8%, nonfood 3.1%.

Consumers spent 49.8% of their funds on food, beverage and tobacco at retail trade outlets (y/y up 2.5%). Expenses increased by 3% in knitwear, clothes and shoes, 2.9% in electric appliances and furniture, 4.3% in telecommunication and computer equipment, 3.4% in other foodstuff.

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

<table>
<thead>
<tr>
<th>Spending item</th>
<th>2018 6 months</th>
<th>2019 6 months</th>
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<tbody>
<tr>
<td>Food, beverage and tobacco</td>
<td>49.6</td>
<td>49.8</td>
</tr>
<tr>
<td>Knitwear, clothes and shoes</td>
<td>18.1</td>
<td>18.0</td>
</tr>
<tr>
<td>Electric appliances and furniture</td>
<td>5.8</td>
<td>5.9</td>
</tr>
<tr>
<td>Computers, telecommunication devices and others</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Pharmaceuticals and medicals</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Fuel</td>
<td>5.7</td>
<td>5.5</td>
</tr>
<tr>
<td>Other non-food items</td>
<td>18.9</td>
<td>18.8</td>
</tr>
</tbody>
</table>

Source: SSC
Every consumer purchased on average AZN150.9 worth of food, beverage and tobacco and AZN152.3 worth of non-food items monthly for private consumption in retail trade.

Catering turnover y/y rose by 3.6%. Entities accounted for 40.8%, private entrepreneurs 59.2% of catering turnover in the private sector. The value of paid services to the population increased by 1.5% to AZN4.1B in real terms. Per capita paid services consumption y/y increased by AZN 15.3 in nominal terms.

Consumer demand was driven by rise in nominal income of the population – it increased by 6.6% to AZN27.4B in nominal terms, per capita income rose by 5.7% to AZN2768.6. Disposable income increased by 5.8% to AZN 25.1 B.

Nominal average monthly salary of hired workers in the economy y/y increased by 7.9% to AZN583.7. Salary of employees was AZN471.9 in public entities and AZN730.3 in private entities.

Loans to households, one of the consumer demand components, increased by 9.1%. The households’ loan portfolio exceeded AZN5.8B in June.

The consumer confidence index (CCI) generated from the June 2019 ‘Financial behavior and intentions of households’ survey continued improving. To note, this indicator is based on surveys among various income households ‘Family’s financial condition expectation’, ‘Expectation on country’s economic standing’, ‘Savings probability’ and ‘Unemployment expectations’. Analyses suggest that the CCI y/y increased by 2.7 times as much in June due to better expectations on country’s and family’s financial standing, and lower unemployment expectations.

**Government expenditures** were critical for domestic demand. State budget expenditures made up AZN10951M (y/y up by 15%).

Following the economic classification, 52.5% (AZN5750M) of state budget expenditures were channeled to social spending (compensation for
employees, pension and social allowances, medicine and food) (y/y up by 22.5%).

**Investment expenditures.**
AZN6131,6 M worth of investments were channeled to the economy in H1, 2019. AZN3772,7M worth of funds were invested to the non-oil sector (y/y up 5.1%). The public sector accounts for 46.6%, while the private sector for 53.4% of total investments.

71.3% of investments stemmed from domestic, while 28.7% from external sources.

Table 3. Investment sources, %

<table>
<thead>
<tr>
<th></th>
<th>2018, Jan-Jun</th>
<th>2019, Jan-Jun</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Funds of enterprises and organizations</strong></td>
<td>52.8</td>
<td>56.7</td>
</tr>
<tr>
<td><strong>Bank loans</strong></td>
<td>14.7</td>
<td>6.8</td>
</tr>
<tr>
<td><strong>Budget funds</strong></td>
<td>24.4</td>
<td>27.7</td>
</tr>
<tr>
<td><strong>Off-budget funds</strong></td>
<td>1.3</td>
<td>1.4</td>
</tr>
<tr>
<td><strong>Population’s own funds</strong></td>
<td>6.2</td>
<td>7.0</td>
</tr>
<tr>
<td><strong>Other funds</strong></td>
<td>0.6</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Source: SSC

Funds of enterprises and organizations prevailed in total investments (56.7%).
2.2. Aggregate supply and employment


Economic growth. According to the SSC, real GDP y/y increased by 2.4% to nominal AZN37.8B. 44.6% of GDP was produced in the industry. Per capita GDP was AZN 3828.1.

The value added in the oil sector increased by 1.3%. The mining industry extracted 18.8 m/t crude oil, 12.0 bln/m3 natural gas. Oil production y/y increased by 3%, while gas extraction increased by 35%.

The value added in the non-oil sector y/y increased by 3.2% in real terms to nominal AZN22.3B (59% of GDP).

Most non-oil sectors posted growth. The non-oil and gas industry, agriculture, information and communication posted the highest growth.

The non-oil and gas industry y/y posted 16.8% growth.

Output y/y increased by 20% in food production, 51.2% in the textile industry, 83.6% in production of automobiles, trailers and semi-trailers, 2.2 times in production of furniture, 30.8% in production of rubber and plastic mass, 30.4% in the chemical industry, 65.2% in production of beverages, and 14.2% in production of tobacco.

Production of durables y/y increased by 52.8%, non-durables by 24.7%, means of production by 36%, and energy products by 1.2%.

Agricultural production y/y increased by 13.1%, including 2.9% on
animal products and 25.6% on plant growing.

Graph 15. Sectoral growth of economy over 6 months of 2019, to corresponding period of previous year, %

The CBA’s RSM related survey findings suggest that economic activity indicators improved on industry, trade and services, including non-oil industry, textile, machinery, production of plastic and food products vs the early year. Activity in these sectors translated into rise in overall business confidence index (BCI). Though still negatively zoned in construction, the BCI improved vs the early year and y/y.

Employment. As of the end June economically active population amounted to 5167.9 thousand people. (y/y up by 59 thousand).

According to the SSC, the number of hired labor y/y increased by 2.9% to 1590.7 thousand as of 1 June 2019.

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

Source: SSC

23.4% of hired labor in enterprises and organizations was involved in production: 7.2% in processing, 7.2% in construction, 3.1% in agriculture, forestry
and fishery, 2.2% in mining, 1.9% in water supply and waste management.

According to RSM survey by the CBA, in QII, 2019 employment expectations of enterprises increased in trade and industry vs the previous quarter.
2.3. Inflation

In HI, 2019 inflation was within the announced annual target band. A low single-digit inflation rate was a critical factor to support the rise in real income of the population.

Consumer Price Index (CPI). According to the SSC, average annual inflation was 2.5%. CPI components – food prices changed 2.7% on annual average, non-food prices 1.3%, and services 3.2%.

12 month inflation was 2.9% in June 2019 (y/y CPI change), within the target band announced by the CBA (4±2%). Annual price hike on food and services (4.3% and 2.3% respectively) also was within the band, while non-food prices increased by 1.3%. In general, the highest inflation was in April (3.1%).

Graph 17. Average annual inflation, %

Food prices account for 1.1%, non-food 0.6%, and services for 0.8% of average annual inflation.

Source: SSC

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

Source: SSC, CBA calculations
2.3 Inflation

Prices for 114 out of 520 items of goods and services declined and remained unchanged for 50 items. Price hike for 68% of products was below 2%.

Despite an upward effect on prices due to higher aggregate demand and other non-monetary factors, the dynamics of bilateral and nominal exchange rates, inflation expectations below actual inflation, and the monetary policy contributed to maintenance of inflation within the target band.

Average annual core inflation calculated by excluding the goods and services such as seasonal agricultural products or goods whose prices the government regulate, was 2.7%. Higher than total inflation average annual core inflation is put to the fact that price limit for gas has increased.

Expectations were one of the factors that contributed to swings in consumer prices. They remain stable amid low actual inflation. According to CBA RSM, in January–June 2019 price expectations dropped in processing, and increased in trade and services for upcoming 3 months. Price expectations decreased in production of construction materials, textile, machinery, plastic mass and non-metal mineral products, and increased on food, chemistry and metallurgy.

CBA monitoring among 4250 households displays that high inflation expectations decreased in January – June 2019, remaining in the lows of recent years.

Source: SSC, CBA estimations based upon SSC
Surveys suggest that only 2.3% of respondents in June expect high inflation in upcoming 12 months. 35.4% of respondents expect the prices to follow the same level in upcoming 12 months, 38.3% expect the prices to increase at a lower level, 20.8% expect them to remain nearly the same and 3.3% expect them to slide.

Seasonal factors are expected to have a downward effect on food inflation in July and August. Inflation will remain within the target (4±2%) as of end-2019.

*Producer Price Index (PPI)*. According to the SSC, the GDP deflator, that measures price swings in all domestically produced goods and services, was 0.1% in January – June 2019.

The PPI mostly changed across industrial products. The IPPI y/y increased by 6.7%, driven by processing (up by 9%).

The highest price hike in processing was in production of tobacco (29.1%), jewellery, musical instruments, sport and medical equipment (28.9%), and bicycles (28.8%).

The APPI increased by 1.9%, driven by price hikes in animal products 4.2%, prices slided by 2.3% in plant growing. The APPI remained unchanged in forest products and increased by 3.4% in fish and other fishery products.

Transportation tariffs decreased by 2.2%. Prices for cargo services dropped 1.9%, prices for passenger transportation
dropped by 1.1%. Moreover, the price for postal and courier services increased by 0.1% and prices for communication services remained unchanged.
III. THE MONETARY AND EXCHANGE RATE POLICY

3.1. The FX market and the exchange rate of manat

Supply and demand in the FX market and the exchange rate of manat against foreign currencies responded to BoP trends in HI, 2019.

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 amounted to $12.1 B equivalent\(^2\) – 81.4% in USD and 18.6% in other currencies.

The Interbank FX market accounts for 34.4%, while the Intrabank FX market for 65.6% of cashless transactions.

94% of transactions in the interbank market was maintained in the USD, 5% in the euro and 1% in other currencies. Currency operations turnover in the FX market is mainly formulated at the expense of operations conducted over the Bloomberg platform.

Intrabank FX operations amounted to $8B equivalent (75% USD denominated operations). 91.1% of operations in the Intrabank FX market was currency operations with legal entities.

Cash currency traded by banks amounted to $2.7B equivalent ($2.1B (77.8%) USD denominated operations).

The CBA continued currency auctions to arrange sale of currency provided by the SOFAZ, held twice a week; market participants were informed on auction parameters by the Bloomberg terminal prior to auctions. The Bank held total 50 currency auctions over 6 months.

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) in HI, 2019 too.

The average daily AZN/USD exchange rate was AZN 1.7000. Though varied, buy-sell exchange rates set by

\(^2\) ABŞ dolları, Avro, İngilis funt sterlinqi, Rus rublu ilə əməliyyətlər daxil olmaqla

Monetary policy review ● January – June 2019
banks were close to the official one. Commercial banks’ daily average buy rate was 1.6976, while sell rate was 1.7020. Difference between official buy exchange rates and those of commercial banks was 0.1% (AZN 0.0024), and sell rates – 0.1% (AZN0.002).

AZN appreciated 9.2% against the Turkish lira, 0.8% against the euro, and 7.3% against the Georgian lari and depreciated 5.1% against the Ukrainian hryvnia, 8.9% against the Russian ruble, and 2.7% against the Japanese yene.

Dynamics of bilateral exchange rates influenced that of multilateral exchange rates. Total trade weighted non-oil NEER appreciated by 0.7, while the REER depreciated by 1.2%. Depreciated REER is attributable to the fact that inflation in Azerbaijan is much lower than average inflation in trade partners.

To note, the REER of manat has depreciated by 33% since end-2014, contributing to non-oil sector competitiveness.
3.2. Monetary policy tools

Monetary policy tools were applied considering the actual inflation rate below the center of the target band and excess liquidity in the banking system.

Continuing low inflation expectations, better external sector indicators and their positive translation to the FX market paved the way to monetary condition easing. Over the period, the CBA made necessary corrections to its interest rate corridor parameters in light of internal and external risks. The Management Board discussed interest rate corridor parameters 4 times in the first half of the year and decided to shift the refinancing rate to 8.5% from 9.75%, the ceiling of the interest rate corridor to 10.5% from 11.75% and the floor to 6.5% from 7.75%.

To meet money demand of the economy and effectively manage liquidity, the CBA continued to keep active various term standing facilities and open market operations. Despite low rate increase in lending, banking sector liquidity was still in surplus, pushing high demand for CBA sterilization operations.

![Graph 23. Parameters of interest rate corridor](image-url)

Source: CBA

The CBA held 26 deposit auctions on attraction of excess funds in the national currency, 26 auctions on issue of notes. Maturity of deposit operations was 14 days, while notes were issued for 28 days. Total outstanding amount of funds attracted by deposit auctions and issue of notes made up AZN950 M.
3.2. Monetary policy tools

AZN250 M worth of funds were attracted at deposit auctions, while AZN700M via note placement. As of end of six months outstanding amount of funds attracted via deposit auctions and issue of notes decreased by 44.4% vs early year having an upward effect on money supply.

As open market operations, interest rates on deposit operations and issue of notes were close to the floor of the interest rate corridor.

Despite lower return on sterilization operations due to reduction of the floor of the interest rate corridor, demand prevailed over supply by 2.7 times at deposit auctions and by 2.4 times at note auctions, attributable to still high banking system liquidity.

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 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 also left unchanged. 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 with the CBA across all months of the period considerably exceeded total funds to be maintained as required reserves.
3.3. Money supply

Money supply was regulated in light of inflation target and demand of the economy for money.

Money base in manat increased by 8.7% to AZN10376.9M as of the year end, driven by budget spending and the liquidity position of the banking system. High outstanding amount of government accounts had a downward effect on money base in QI and an upward effect in QII.

Cash in circulation – a structural element of money base – increased by 9.7%, stock of correspondent accounts in manat by 2.3%.

Broad money supply in manat (M2) increased by 8.1% to AZN 15834.3 M as of the end-period.

<table>
<thead>
<tr>
<th>Table 4. Money aggregates, mln. manat</th>
</tr>
</thead>
<tbody>
<tr>
<td>M0</td>
</tr>
<tr>
<td>01.01.19</td>
</tr>
<tr>
<td>M1</td>
</tr>
<tr>
<td>01.07.19</td>
</tr>
</tbody>
</table>

Source: CBA

Cash, savings of individuals and deposits of legal entities in the structure of money supply in manat (M2) performed differently: cash money supply increased by 10.2%, deposits of legal entities in manat decreased by 8%, while savings of individuals in manat increased by 20.9%.

Demand savings and deposits in manat increased by 4.4%, while term savings and deposits increased by 9.1%.

Broad money supply (M3) increased by 5.1% to AZN 25284.2 M as of the end-period.

Source: CBA
Dollarization of bank deposits continued declining – national currency denominated term deposits increased by 11.7%, while foreign currency denominated deposits increased by compared to the early year. The share of foreign currency denominated savings and deposits in M3 money aggregate was 39.1% at the beginning and 37.4% at the end of the period.

Source: CBA

Dollarization of savings of individuals shifted to 56.5% from 62.5% early year.
**Graphs and tables**

**Graphs**

<table>
<thead>
<tr>
<th>Graph</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Graph 1</td>
<td>Business and Consumer Confidence indices in OECD countries</td>
<td>4</td>
</tr>
<tr>
<td>Graph 2</td>
<td>Industrial production index</td>
<td>4</td>
</tr>
<tr>
<td>Graph 3</td>
<td>Commodity price indices</td>
<td>6</td>
</tr>
<tr>
<td>Graph 4</td>
<td>World oil market, production-consumption</td>
<td>7</td>
</tr>
<tr>
<td>Graph 5</td>
<td>Global financial condition indices</td>
<td>8</td>
</tr>
<tr>
<td>Graph 6</td>
<td>Dynamics of global financial indices</td>
<td>8</td>
</tr>
<tr>
<td>Graph 7</td>
<td>Change of bilateral exchange rates against USD</td>
<td>9</td>
</tr>
<tr>
<td>Graph 8</td>
<td>Economic growth forecasts across trade partners of Azerbaijan</td>
<td>10</td>
</tr>
<tr>
<td>Graph 9</td>
<td>Trade balance</td>
<td>11</td>
</tr>
<tr>
<td>Graph 10</td>
<td>Main trade partners</td>
<td>11</td>
</tr>
<tr>
<td>Graph 11</td>
<td>Change in export of commodities, 2019 6 months</td>
<td>12</td>
</tr>
<tr>
<td>Graph 12</td>
<td>Change in import of commodities, 2019 6 months</td>
<td>12</td>
</tr>
<tr>
<td>Graph 13</td>
<td>Change in volume of sales in consumer market</td>
<td>14</td>
</tr>
<tr>
<td>Graph 14</td>
<td>Sectoral growth of value added</td>
<td>17</td>
</tr>
<tr>
<td>Graph 15</td>
<td>Sectoral growth of economy over 6 months of 2019</td>
<td>18</td>
</tr>
<tr>
<td>Graph 16</td>
<td>Economically active persons</td>
<td>18</td>
</tr>
<tr>
<td>Graph 17</td>
<td>Average annual inflation</td>
<td>20</td>
</tr>
<tr>
<td>Graph 18</td>
<td>12-month based inflation, %</td>
<td>21</td>
</tr>
<tr>
<td>Graph 19</td>
<td>Scale of inflation</td>
<td>21</td>
</tr>
<tr>
<td>Graph 20</td>
<td>Pie of households expecting increase of inflation rate</td>
<td>22</td>
</tr>
<tr>
<td>Graph 21</td>
<td>Average annual change in PPI</td>
<td>22</td>
</tr>
<tr>
<td>Graph 22</td>
<td>Dynamics of REER</td>
<td>25</td>
</tr>
<tr>
<td>Graph 23</td>
<td>Parameters of interest rate corridor</td>
<td>26</td>
</tr>
<tr>
<td>Graph 24</td>
<td>Volume and yield on deposits attracted by the CBA</td>
<td>27</td>
</tr>
<tr>
<td>Graph 25</td>
<td>Volume and yield on notes issued by the CBA</td>
<td>27</td>
</tr>
</tbody>
</table>
Graph 26  Dynamics of money aggregates ----------------------------------------- 29
Graph 27  Dollarization ----------------------------------------------------------------- 30

Tables
Table 1  Economic growth forecasts ------------------------------------------------- 9
Table 2  Share of spending items in trade outlets ------------------------------------- 14
Table 3  Investment sources --------------------------------------------------------- 16
Table 4  Money aggregates ------------------------------------------------------------- 29
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