CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

MONETARY POLICY REVIEW

January – June

2024 № 2

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ACRONYMS

AE	Advanced economy
APPI	Agricultural Producer Price Index
BCI	Business Confidence Index
CBA	Central Bank of the Republic of Azerbaijan
CCI	Consumer Confidence Index
CLI	Composite Leading Indicator
CPI	Consumer Price Index
EME	Emerging market economy
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign direct investment
FED	Federal Reserve System
FX	Foreign exchange
GDP	Gross Domestic Product
ILO	International Labor Organization
IMF	International Monetary Fund
IPPI	Industrial Producer Price Index
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
PMI	Purchasing Managers' Index
REER	Real Effective Exchange Rate
RSM	Real Sector Monitoring
SCC	State Customs Committee
SSC	State Statistics Committee
WEO	World Economic Outlook

EXECUTIVE SUMMARY

In the first half of 2024 safeguarding price stability was the top priority for the Central Bank of the Republic of Azerbaijan. The monetary policy environment was marked with multilateral effects of global economic developments on the national economy.

The stabilization of prices in global commodity markets, relative drop in average weighted inflation in trade partners and the return of international shipping costs to pre-pandemic levels dampened inflation. Annual inflation decreased owing to the anti-inflationary policy pursued over the period and the nominal effective exchange rate.

Despite geopolitical tensions and climate changes the international situation was favorable for Azerbaijan. High global prices of major export products were accompanied by an improvement in external sector indicators and an increase in strategic foreign exchange reserves.

Over the period the monetary policy was oriented towards regulating inflation through the monetary condition. Monetary policy tools served to the neutralization of the effects of autonomous factors on the monetary condition and enhancing the transmission of interest rate decisions. Monetary policy decisions were taken into consideration of the comparison of the actual and forecasted inflation with the target band (4±2%), the stabilization of inflation expectations and changes in the balance of risks. Efforts to improve the monetary policy operational framework continued throughout the period.

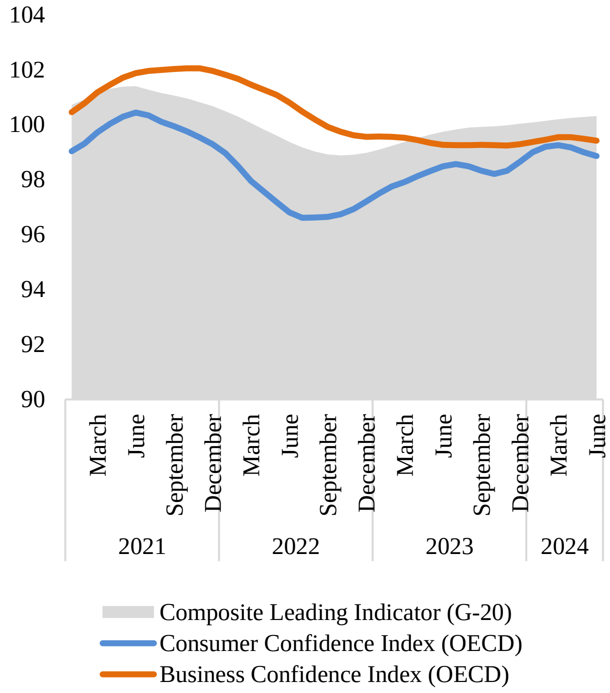
I. GLOBAL ECONOMIC ENVIRONMENT

1.1. Global economic trends

In H1 2024 global economic growth persisted despite geopolitical tensions and geoeconomic fragmentation. Inflation waned at lower-than-expected rates in AEs, complicating the monetary normalization. The likelihood, that inflation will rise, and interest rates will remain high for a longer period driven by trade tension and political uncertainties, elevated.

Global economic activity, producer and consumer behaviors varied. The CCI and the BCI across OECD countries were prone to falling. However, the Composite Leading Indicator (CLI) which stands for economic activity of the G-20 increased.

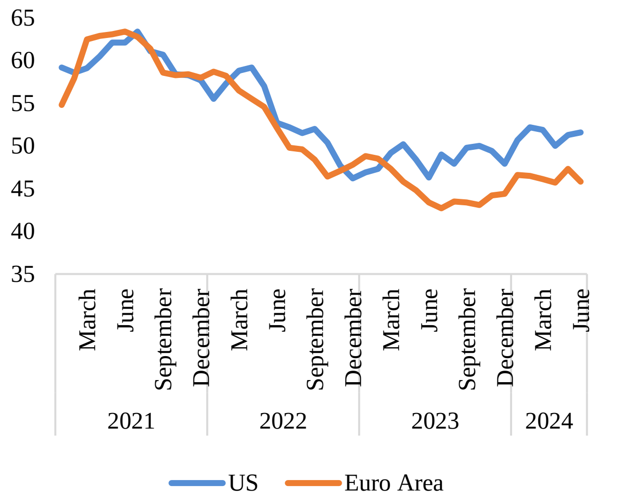
Chart 1. Global economic activity indicators



Source: OECD

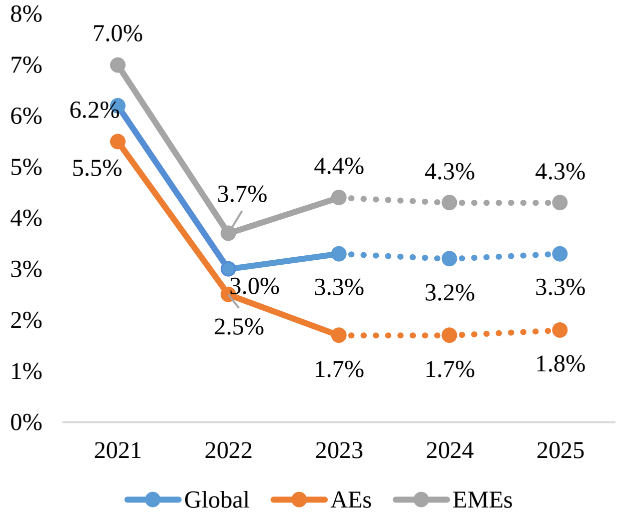
The Purchasing Manager's Index (PMI) which indicates economic trends in the manufacturing sector, increased in the U.S. and decreased in the euro area. The dynamics of the index also reflects businesses' expectations regarding future production levels.

Chart 2. Purchasing Manager's Index (PMI)



Source: Markit Economics

Chart 3. Economic growth projections, %



Source: IMF, WEO July 2024

Global economic trends translated to forecasts of international institutions. The IMF in WEO July 2024 left global economic growth forecast unchanged at 3.2% vs the April forecast. The global economic growth forecast for 2025 was revised up by 0.1 pp to 3.3%.

The IMF in its July forecast left economic growth forecast for AEs unchanged at 1.7% and 1.8% for 2024 and 2025 respectively vs the April release.

Economic growth forecasts for 2024 were revised down by 0.1 pp for the US and by 0.2 pp for Japan and up by 0.2 pp for the UK and by 0.1 pp for the euro area compared with the previous release.

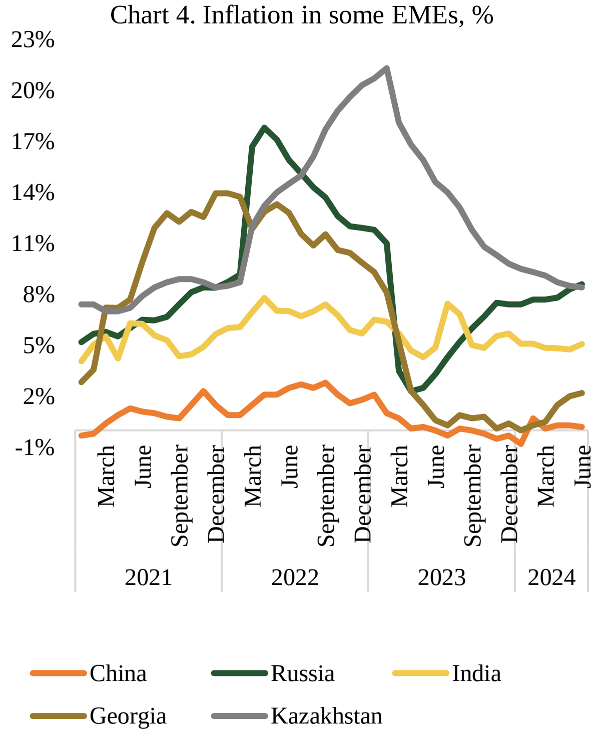
The IMF WEO July 2024 revised up economic growth forecast for EMEs by 0.1 pp to 4.3% both for 2024 and 2025 compared with April forecast. Economic growth will stand at 5.4% (0.2 pp upward revision) for Asia, 3.2% (0.1 pp upward revision) for Europe, at 1.9% (0.1 pp. downward revision) for Latin America, at 2.4% (0.4 pp downward revision) for Middle East and Central Asia and at 3.7%

(0.1 pp downward revision) for Sub-Saharan Africa in 2024.

The IMF in WEO July 2024 left global inflation for 2024 unchanged at 5.9% as in April forecast. The 2025 global inflation forecast was revised down by 0.1 pp to 4.4% compared with the April forecast.

Inflation in EMEs is expected to be higher than in AEs (and to decrease at a slower pace). The July release revised inflation forecast for AEs up by 0.1 pp both for 2024 and 2025 to 2.7% and 2.1% respectively compared with the April forecast, since both in 2024 and in 2025 inflation is expected to decrease at a slower pace. The forecast for EMEs was revised down by 0.1 pp for 2024 and by 0.2 pp for 2025 to 8.2% and 6% respectively.

Chart 4. Inflation in some EMEs, %

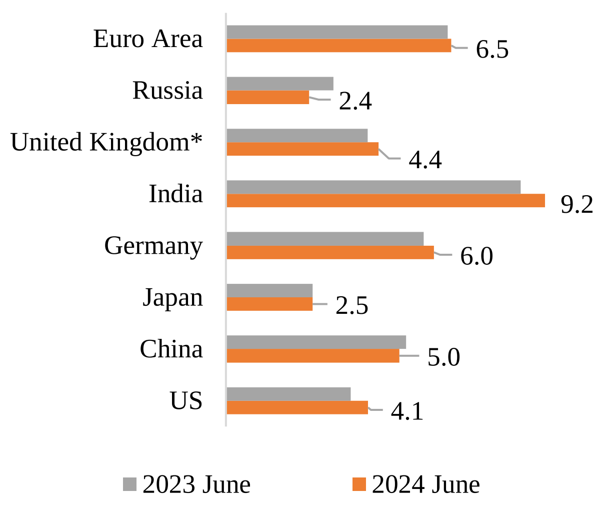


Source: National Statistic Offices

According to the IMF's July report, the ongoing price hike in the service sector and the slowdown in the decrease of commodity prices have further decelerated the reduction of global inflation. Consequently, most central banks were cautious in their decisions regarding interest rate cuts due to increasing external risks.

In H1 2024 the unemployment rate also varied across countries. In June unemployment decreased in China and Russia, increased in the US, the UK, the euro zone, including Germany and remained stable in Japan year-over-year.

Chart 5. Unemployment rate, %



** Data for the United Kingdom pertains to May*

Source: Trading Economics

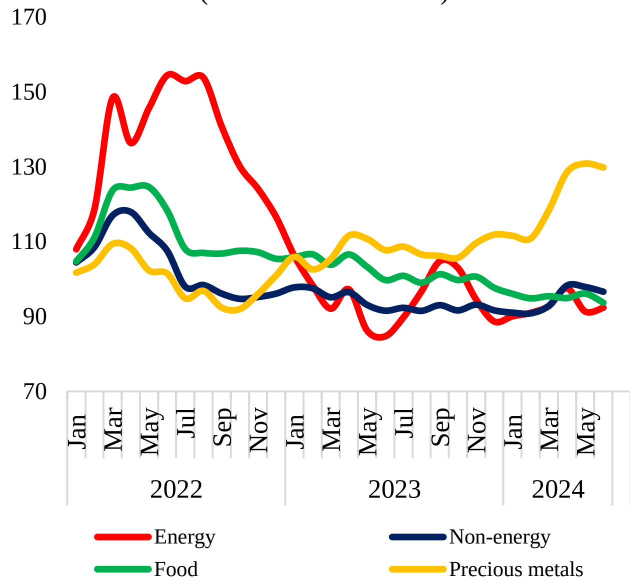
According to the OECD Employment Outlook July 2024, overall employment is higher than the pre-pandemic period and the OECD unemployment rate is around its lows since 2001. However, new job creation rates slowed down.

1.2. Global commodity markets

In H1 2024 lingering geopolitical tension worldwide, global shipping challenges, and changes in the global trade balance weighed on the dynamics of commodity prices. The price slides of previous periods halted, and prices hiked for some products.

In the first half of 2024 overall commodity prices increased year-over-year amid complex supply condition and rising industrial production. According to the World Bank Commodity Markets Outlook July 2024, in June the total commodity price index increased by 4.6% compared with the early year. Price indexes increased by 4.2% on energy products and by 5.4% on non-energy prices.

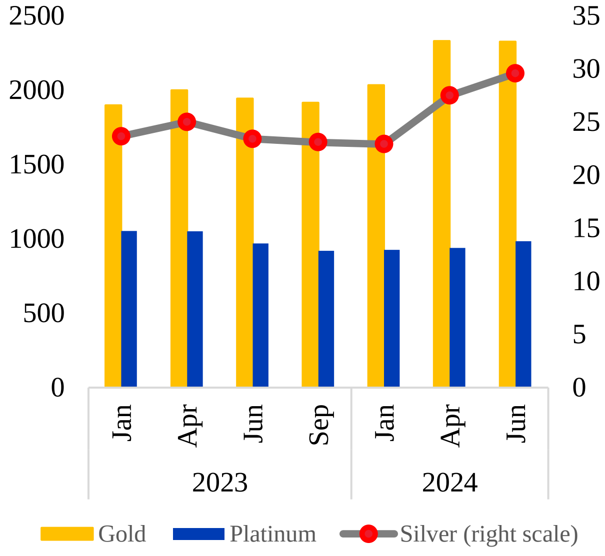
Chart 6. Global commodity price indices
(2021 december = 100)



Source: World Bank

The highest price hike was in alcohol-free beverages. Climate changes, which seriously damaged the cocoa and coffee production, significantly weakened supply channels, and caused 54.7% increase in their respective prices. Tea prices soared primarily due to transportation disruptions in the Red Sea and seasonal factors affecting production in the second quarter.

Chart 7. Gold, silver and platinum prices
US$/toz

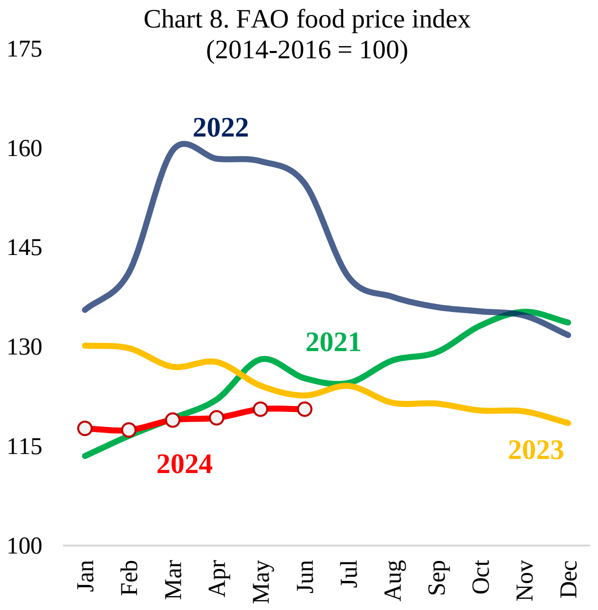


Source: World Bank

Prices for precious metals jumped in H1 2024. According to the WB report, whereas the precious metal index, driven by gold prices, slightly decreased in June monthly, it increased by 16% compared the early year. This significant rise in gold prices is attributable to high procurements by central banks amid geo-economic tensions.

The World Bank's fertilizer price index in June 2024 was lower by 1% compared with the beginning of the year, attributable to lower input costs and better production prospects.

While the Food Prices Index released by the UN FAO remained unchanged in June 2024 compared with May, it increased by 1.1% compared with the beginning of the year. In January-June 2024 prices for dairy products increased by 7.6%, while the grains price index decreased by 6.2%. The grain price slide is attributable to the ongoing harvest season in the Northern Hemisphere. The slight improvement in production prospects in some major exporting countries like Kazakhstan and Ukraine led to a drop in prices. Vegetable oil indices increased by 3.1% in July compared with the previous month, the highest indicator since March 2023. The rise on the product group was 7.8% compared with the early year and 13.8% compared with June 2023. The increase in palm oil prices in June was driven by the revival of global demand, which was based on price competitiveness. The rise in soybean and sunflower oil prices continued due to high demand in the bioenergy sector in the Americas and the declining supply in Black Sea region countries.



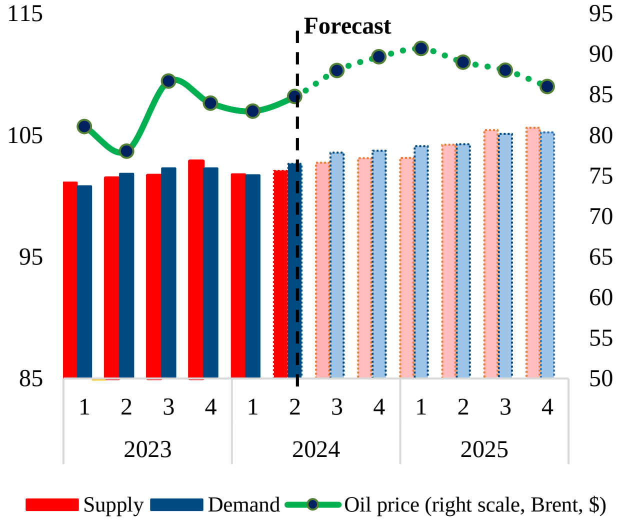
Source: FAO

In June 2024, the Sugar Price Index decreased by 11.1% compared with the early year, and by 21.6% compared with June 2023. Brazil is a market leader in sugar exports. The depreciation of the Brazilian real against the US dollar stimulated sugar exports, which led to a decline in sugar prices.

In general, according to the FAO, despite a consecutive three-month increase, the food price index in June was 2.1% lower year-over-year.

Oil prices increased amid rising geopolitical tension and OPEC+ production cuts. The IMF reports that the oil prices index increased by 9.9% compared with the early year. According to the US EIA June Outlook, oil prices are expected to rise in the upcoming period of the current year. The Brent oil price is expected to average $86.4/b ($84.2 in the previous outlook) in 2024 and $88.4 ($85.4 in the previous outlook) in 2025. The upward revision of forecasts is attributable to persistent uncertainties and OPEC+ production cuts on the backdrop of rising tension in the Middle East and attacks on international shipping in the Red Sea. According to the EIA, despite OPEC+ production cuts, production is high in non-OPEC+ countries. Oil and liquid fuel production is expected to increase by 0.6 m/b per day in 2024 as countries such as the USA, Canada, Guyana, and Brazil increase oil production.

Chart 9. Dynamics of demand and supply in the global oil market, mln. barrel (daily)



Source: The US Energy Information Administration (EIA)

The EIA forecasts that, due to lower natural gas prices in H1 2024, natural gas production in the US is expected to decrease slightly in 2024. Additionally, the average price of Henry Hub natural gas per million British thermal units is projected to rise from $2.10 in H1 2024 to an average of $2.90 in H2 2024.

1.3. Global financial markets

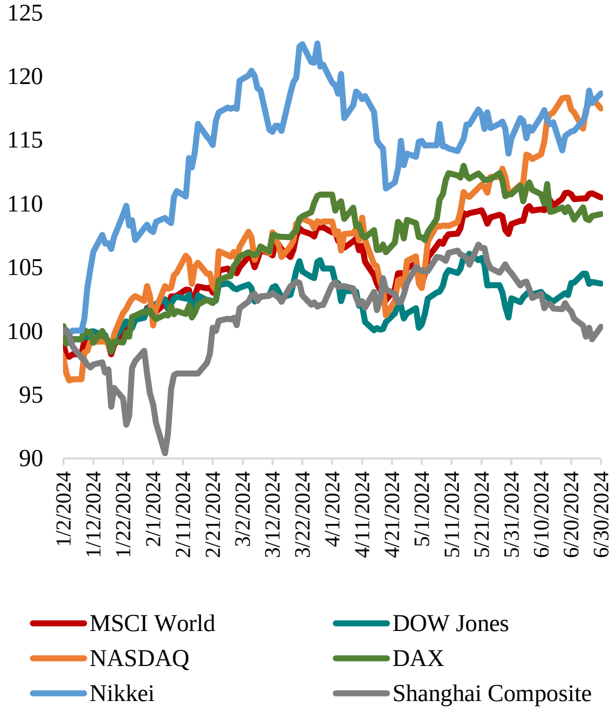
The global financial system sustained in H1 2024. Despite the tight monetary policy by leading central banks, markets underwent a positive dynamic amid higher-than-expected corporate revenues.

In H1 2024 global inflation was much lower than the peak rate, core inflation decreased at a slower than expected pace and is still higher than the target in most countries. High uncertainty related to inflation expectations forced central banks of AEs to be more cautious in their decisions related to monetary easing. Consequently, during six months most central banks worldwide left policy rates unchanged at high rates. Despite national currency depreciation in EMEs, central banks continued easing policy rates as inflation approached to the target band.

In H1 2024 the US Fed left the policy rate unchanged at 5.25%-5.50%, the Bank of England at 5.25%, and the People's Bank of China at 3.45%. On the backdrop of significant decrease in inflation in the current year expected to reach the target in the upcoming year the ECB shifted the policy rate to 4.25% from 4.5%. The Bank of Japan abandoned long-standing negative interest rate policy and pulled the policy rate out of the negative zone by raising the interest rate from -0.1% to 0.1% in response to rising inflationary pressures. In general, central banks do not rule out decreasing policy rates in upcoming periods if inflation reaches the target band.

Global financial markets posted positive dynamics. High financial indicators of leading high-tech companies worldwide surged global financial market indices. Higher than expected corporate profits increased stock prices, leading to rising key stock indices on stock exchanges.

Chart 10. Dynamics of the stock market
(2023 december = 100)



Source: Bloomberg

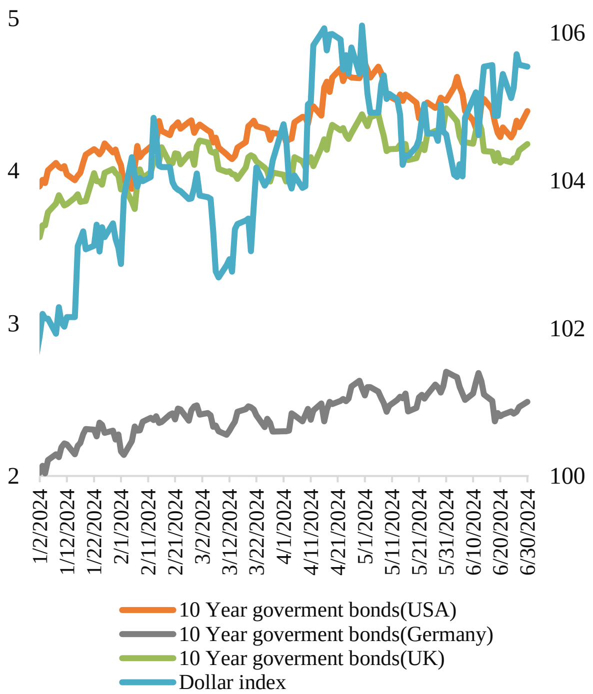
The NASDAQ appreciated by 17%, Dow Jones by 4%, FTSE Euro top by 9%, DAX by 9%, Nikkei 19%, and MSCI World by 11%. In the Borsa Istanbul the XU100 (BIST100) appreciated by 44%. The Shanghai Composite Index slightly changed (0.3%) driven by weak growth of the Chinese economy and drops in property stocks.

The Bitcoin appreciated by about 48% and surpassed $70 thousand several times in the H1 of 2024.

According to the IMF WEO July 2024, currencies of EMEs sustained despite depreciation pressures. At the same time, net capital has been outflowing from EMEs since the second quarter showing a certain sensitivity to changes in the expected policy rate in the US.

In general, despite the rise in long-term profitability, the report specifies that, high corporate estimates keep the financial condition moderated.

Chart 11. Dollar index and yield on 10-year government bonds in advanced economies



Source: investing.com

The report also addresses several risks likely to weigh on the global financial system. Lower than expected monetary easing in the US and other AEs and persistent global economy-related uncertainties may increase volatility in financial markets.

II. INTERNAL MACROECONOMIC CONDITION

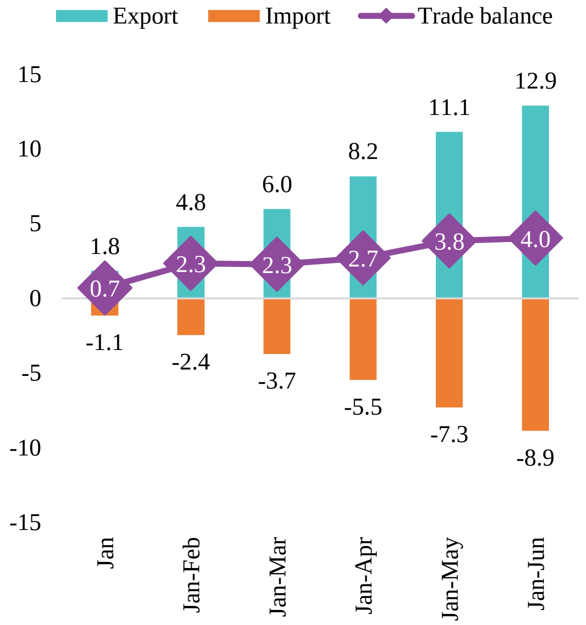
2.1. External sector

In H1 2024, foreign trade, the primary balance of payments component, was in surplus. The current account balance is forecasted to be in surplus under a baseline scenario by the end-year.

According to the SCC, foreign trade turnover amounted to $21.8B – export $12.9B (59.3%), import $8.9B (40.7%). Foreign trade surplus stood at $4B.

The EU accounted for 39.2%, the CIS countries for 14.2% and other countries for 46.6% of total trade turnover.

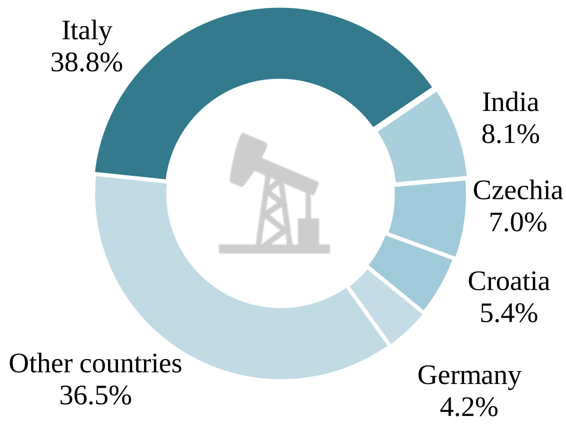
Chart 12. Trade balance, $ billion



Source: SCC

Italy, Türkiye, Russia, China, Germany, India, Australia, Czechia, the USA, and Croatia accounted for over half of trade turnover.

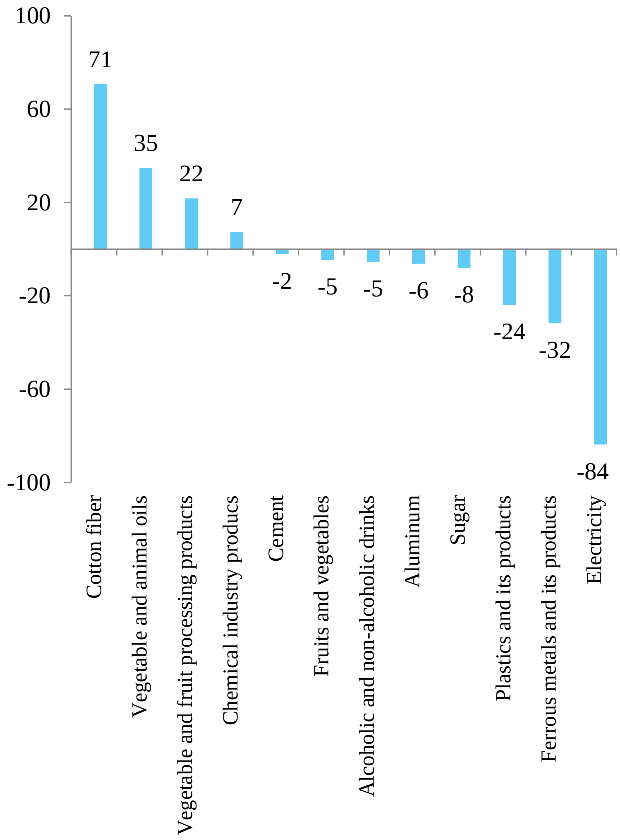
Chart 13. Countries to which crude oil is exported in 2024 H1 (%)



Source: SCC

The value of the oil-gas export amounted to $11.3B – $7B for crude oil and $4.1B for natural gas.

Chart 14. Changes in export of some products in 2024 H1 (y.o.y., %)

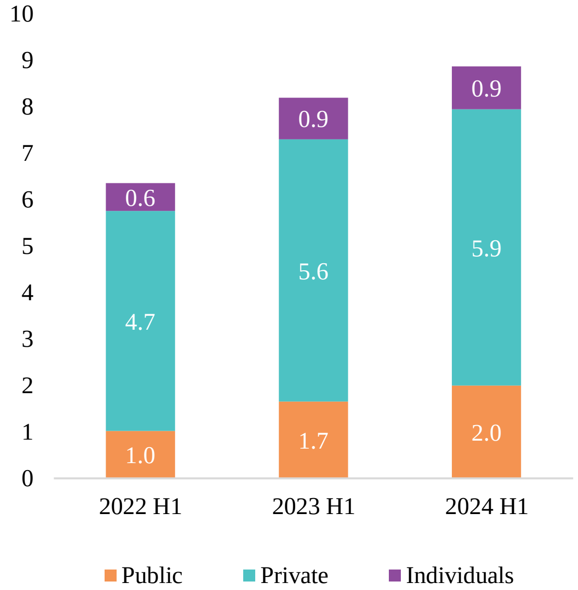


Source: SCC

Non-oil-gas export amounted to $1.6B. The main share of total non-oil-gas exports includes fruits and vegetables, plastic products, chemical products, cotton fiber, aluminum and products, and electricity.

In general, in January-June 2024, the main export partners were Italy (36.4%), Türkiye (15.5%), India (4.4%), Russia (4.3%) and Czechia (3.8%).

Chart 15. Dynamics of imports by sectors, billion $

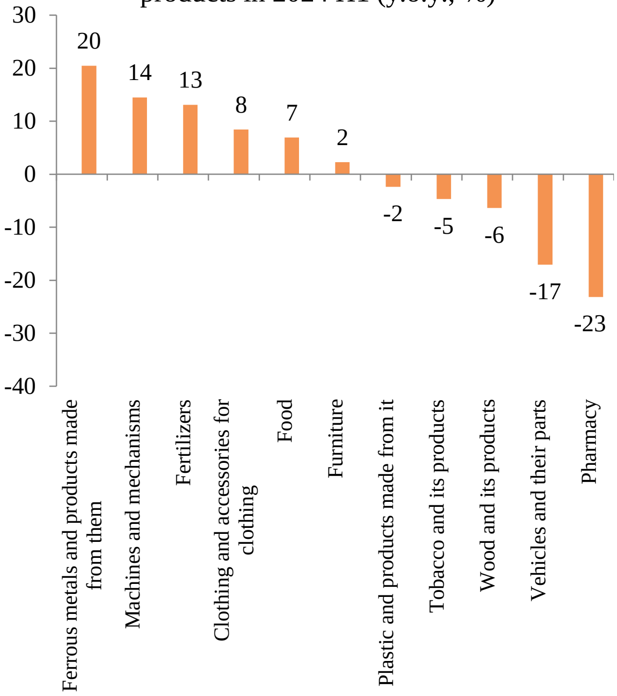


Source: SCC

Commodity imports amounted to $8.9B – the public sector accounted for 22.6%, the private sector for 67% and individuals for 10.4% of total commodity import.

Import of machinery and equipment, food, vehicles, ferrous metals, pharmaceuticals, plastic, wood and products, clothes, furniture and parts, tobacco products and fertilizers prevailed in total imports in the first half of 2024.

Chart 16. Changes in imports of some products in 2024 H1 (y.o.y., %)



Source: SCC

China accounted for 18.4%, Russia for 18.2%, Türkiye for 12.4%, Australia for 6.7%, Germany for 4.3%, Iran for 3.2%, the USA for 3.1%, Italy for 2.4%, the Republic of Korea for 2.3% and Turkmenistan for 2.1% of total imported products.

According to preliminary data, remittances to the country continued to surpass the pre-pandemic level.

Capital inflows from foreign enterprises and organizations continued over the reporting period. According to the SSC, total investments from external financial sources amounted to AZN1.5B. FDIs accounted for 19.2% of total investments.

Investor funds from the UK, the USA, Türkiye, Japan, Switzerland, Russia, Norway, Iran, India, the UAE, and France accounted for 94.8% of total foreign investments.

If current trends persist, the current account of the balance of payments is estimated to be in surplus in 2024. As in the previous year, in 2024 the balance of payments of Azerbaijan will be influenced by the global geopolitical situation, global prices on main export products, macroeconomic stance in trade partners, and the non-oil gas export potential.

The strategic FX reserves still exceeded internationally accepted adequacy norms. As of end-June 2024, strategic FX reserves were sufficient for 37-month worth of import of goods and services (considering the import of goods and services for Q1 2024). Strategic reserves exceeded broad money supply in manat (M2) by 3.4 times (M2 money aggregate as of 01.07.2024)

2.2. Economic activity

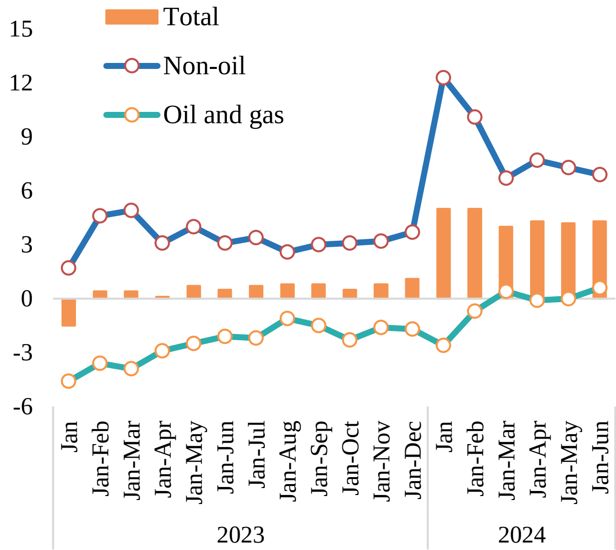
In H1 2024 economic growth continued and driven mainly by the non-oil and gas sector.

Economic growth. According to the SSC, GDP increased by 4.3% in real terms and reached nominal AZN59.5B in January-June 2024 year-over-year. Per capita GDP stood at AZN5840.7.

Oil-gas value added increased by 0.6% to nominal AZN20.7B. 14.4 million/ton crude oil (y.o.y. down by 4.9%), 19.1 billion cubic meters natural gas (y.o.y. up by 5.3%) was extracted over the period.

Non-oil-gas value added y.o.y. increased by 6.9% in real terms and reached nominal AZN38.8B. Production in the non-oil-gas industry increased by 7.4%.

Chart 17. Economic growth, (y.o.y., %)



Source: SSC

Agriculture grew by 0.2%. Livestock products increased by 2.1%, and plant products decreased by 1.4%.

The high growth dynamics continued in services sector. Transport and warehousing grew by 15.4%, freight and passenger transport increased by 4% and 8.2% respectively. The volume of cargo transported by vehicles owned by the non-public sector increased by 5.5%, the sector accounted for 78% of total transported cargo.

Table 1. GDP structure, weight, y.o.y. %

Sectors	2023 6 months	2024 6 months
Industry	-1.8%	0.9%
Construction	9.2%	18.4%
Agriculture, forestry, and fishery	3.4%	0.2%
Trade, repair of vehicles	3.1%	3.3%
Transport and warehousing	-11.2%	15.4%
Tourism and public catering	32.6%	10.3%
Information and communication	12.9%	12.2%
Other	1.8%	3.5%
Net taxes on products and import	6.3%	8.3%

Source: SSC

The construction sector posted the highest growth – it grew y.o.y. by 18.4%. This growth stemmed from reconstruction efforts in liberated areas.

The value added in information and communication sector y.o.y. grew by 12.2%, tourism and catering by 10.3%.

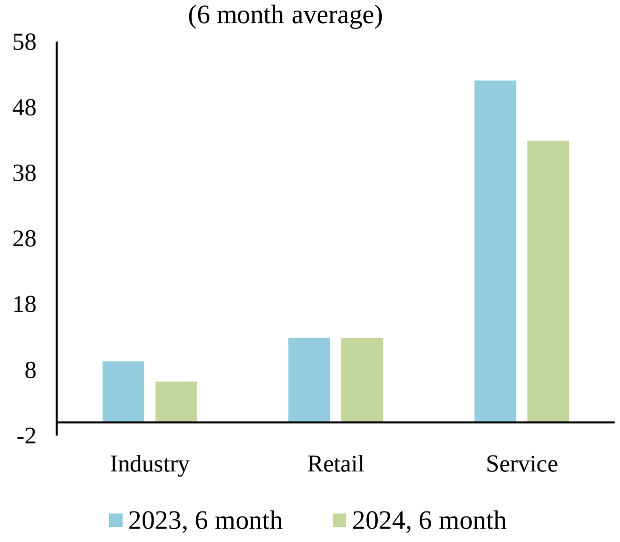
CBA's real sector survey results confirm that economic activity continues. Over nine months of 2024, the BCI exhibited varied dynamics across different sectors but ultimately remained in the positive zone overall.

The non-oil BCI remained in a positive zone. The BCI was higher in chemical industry, machine building, construction, and metallurgy sub-sectors.

The trade BCI remained the same year-over-year. The BCI is higher in electric appliances and household goods, and relatively weak in vehicles.

While the BCI in services slightly declined year-over-year, it remained high in general. The Index remained positively zoned in all service sub-sectors.

Chart 18. Business confidence index, (6 month average)



Source: RSM findings-based CBA estimations [1]

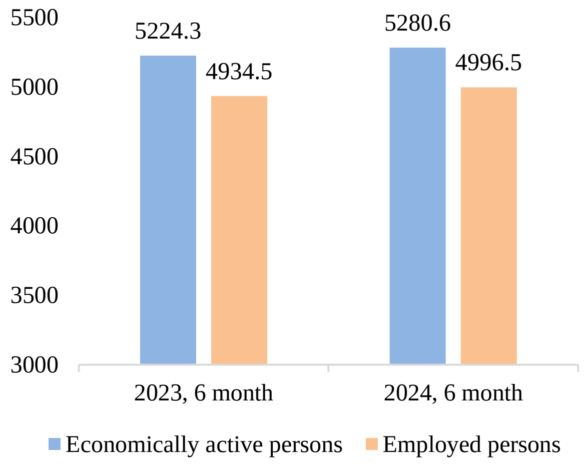
[1] *Industrial BCI = (output – final goods inventory + production expectations)/3*

Services BCI = (business condition + actual demand + demand expectation)/3

Employment. As of 1 July 2024, total labor force was 5280.6 thousand persons, employed population numbered 4996.5 thousand persons.

As of 1 June 2024, the number of hired employees 1749.4 thousand persons. Thus, 893.1 thousand persons were engaged in the public sector, while 856.3 thousand persons in the non-public sectors.

Chart 19. Dynamics of economically active and employed persons (in thousands)



Source: SSC

As of 1 July 2024, the number of registered unemployed persons was 213.6 thousand persons, out of which 44.5% were women. The number of the unemployed decreased by 1.8% compared to the end of the previous year.

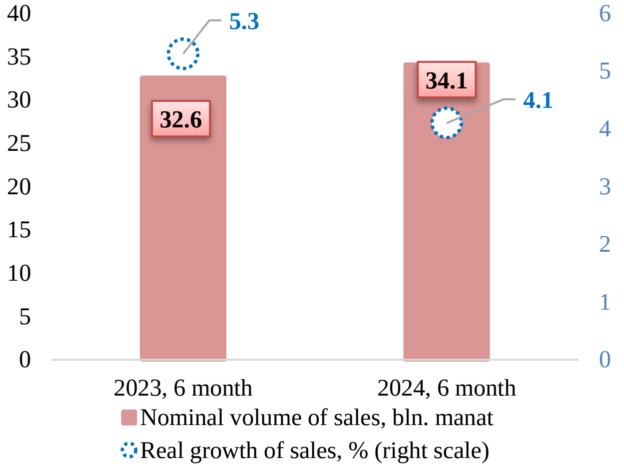
Results of real sector surveys conducted by the CBA indicate that employment expectations of economic agents surpassed average indicators of the previous year in trade and services in H1 2024.

Aggregate demand. Aggregate demand components continued to support economic growth in January-June 2024.

Aggregate demand expanded mainly due to consumer demand. Goods and services sold in the market to meet consumer demand y.o.y. increased by 4.1% in real terms to AZN34.1B. Every consumer spent on average AZN557.9 monthly (y.o.y. up by AZN22.4).

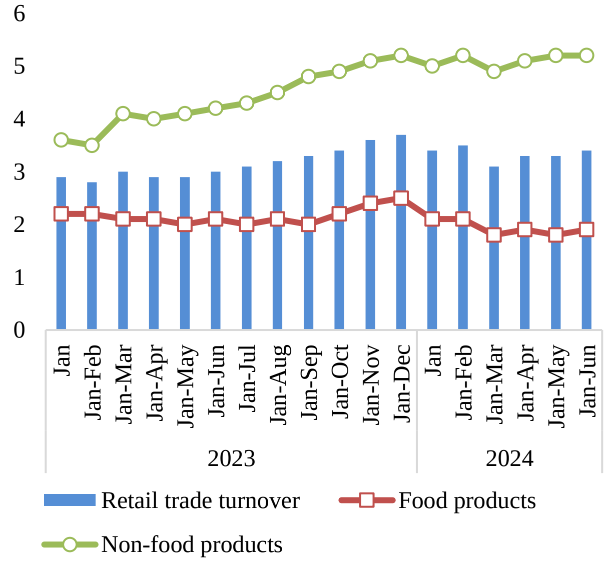
Trade BCI = (actual sale – changes in goods inventory+ sale expectations)/3

Chart 20. Change in volume of sales in consumer market



Source: SSC

Chart 21. Growth in retail trade turnover, (y.o.y., %)

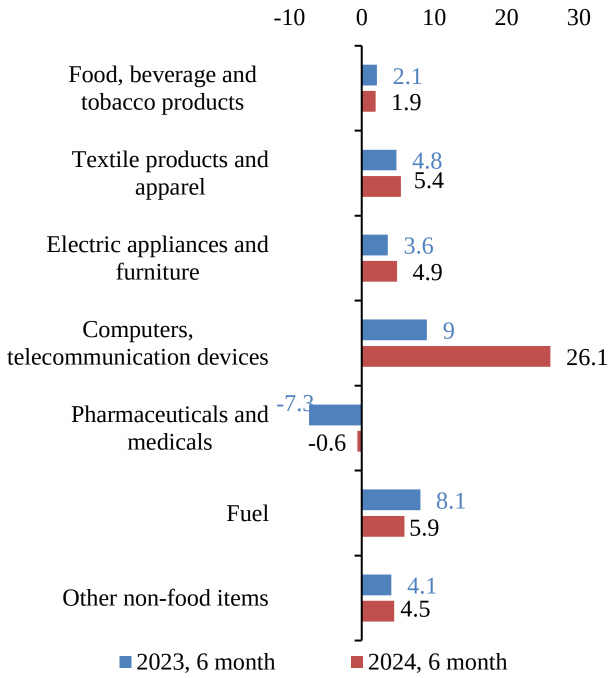


Source: SSC

Retail trade turnover y.o.y. increased by 3.4% in real terms and reached AZN27.3B. Retail commodity turnover on food products, beverages and tobacco products increased by 1.9%, and non-food trade turnover increased by 5.2%.

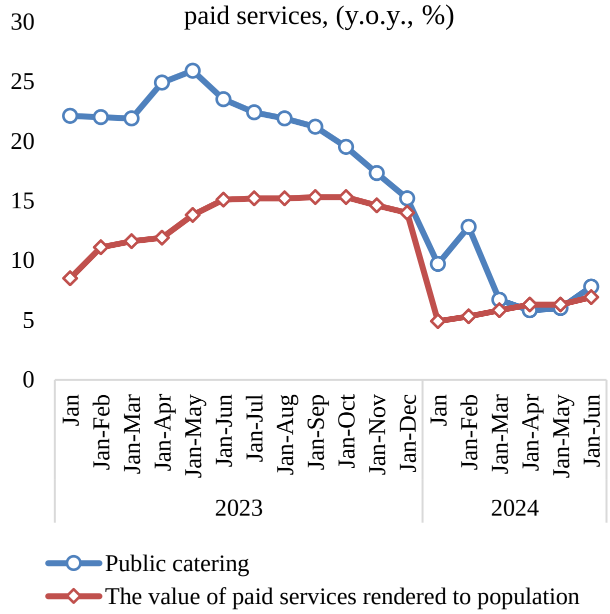
Consumers' pharmaceutical expenses in retail trading network decreased year-over-year and increased on other spending items during the first six months. Furthermore, the growth rate of expenses on food, beverages, tobacco products and fuel slightly decreased year-over-year.

Graph 22. Growth of spending items at trade turnover, %



Source: SSC

Chart 23. Dynamics of public catering and paid services, (y.o.y., %)



Source: SSC

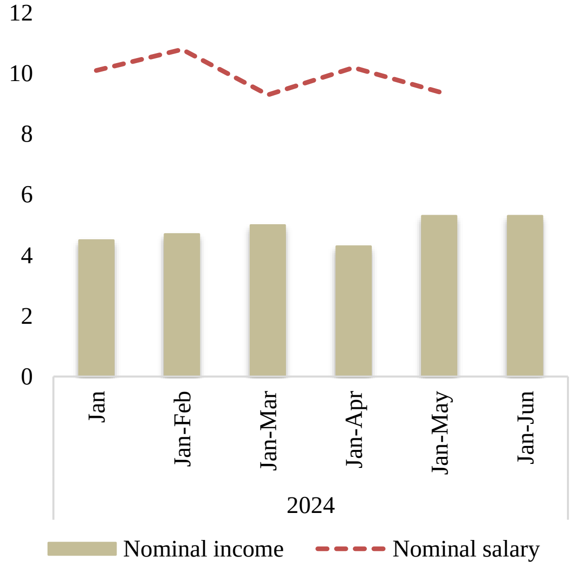
Every consumer spent, on average, AZN445.7 worth of goods (y.o.y. up by 3.1%) per month in retail trade – 55.2% on food, beverages, and tobacco products.

Over the reporting period, public catering turnover y.o.y. increased by 7.8% in real terms. The value of paid services to the population y.o.y. increased by 6.9% in real terms to AZN5.8B. Per capita paid services consumption y.o.y. increased by AZN47 to AZN572.4 on average in nominal terms.

The growth dynamics of income of the population both in real and nominal terms was one of the main factors contributing the rise of consumer demand.

According to the SSC, money income of the population increased by 5.3% and reached AZN39.9B in nominal terms. Per capita money income was AZN3913.5. Population's disposable income increased by 5.1% and reached AZN35.1 B. Average monthly nominal salary of hired employees y.o.y. increased by 9.4% to AZN1003.3 in January-May 2024.

Chart 24. Growth dynamics of incomes and salaries, (y.o.y., %)



Source: SSC

Lending dynamics also weighed on the consumer demand. For the end of first half of 2024, loans to households increased by 9.4% compared to the beginning of the year.

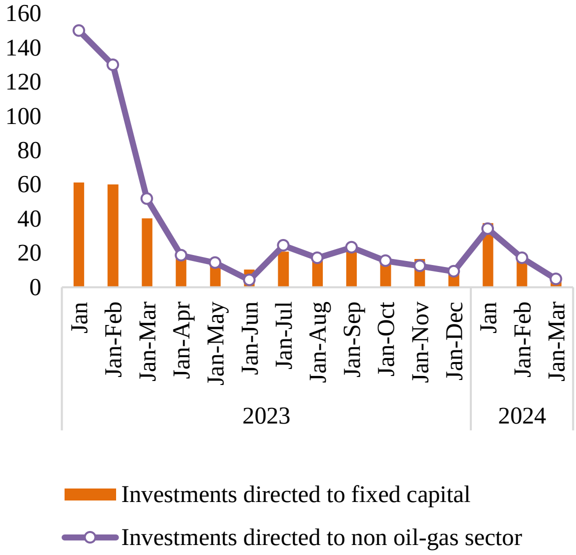
Government spending was critical in supporting domestic demand. State budget expenditures amounted to AZN16.1B (up by 16.7% vs the approved forecast). AZN9833.8B (61.3%) of state budget expenditures were channeled to current expenses, AZN4948M (30.8%) to capital expenses, and AZN1270.3M (7.9%) to state budget serving expenses in January-June 2024.[2]

During the reporting period, investment demand also posted growth, along with consumer demand. According to the SSC, in the first half of 2024 funds invested to the economy y.o.y. increased by 9.4% and amounted to AZN8B. Investment in the oil and gas sector y.o.y. increased by 4.5% and investment in the non-oil and gas sector increased by 12.6% in real terms.

AZN357.1M (4.5% of total investments) out of AZN5B worth funds channeled to the non-oil and gas sector was used in the non-oil and gas industry. The public sector accounted for 56.5% and the non-public sector for 43.5% of total investments.

[2] *https://www.maliyye.gov.az*

Chart 25. Dynamics of investment, (y.o.y.,) %



Source: SSC

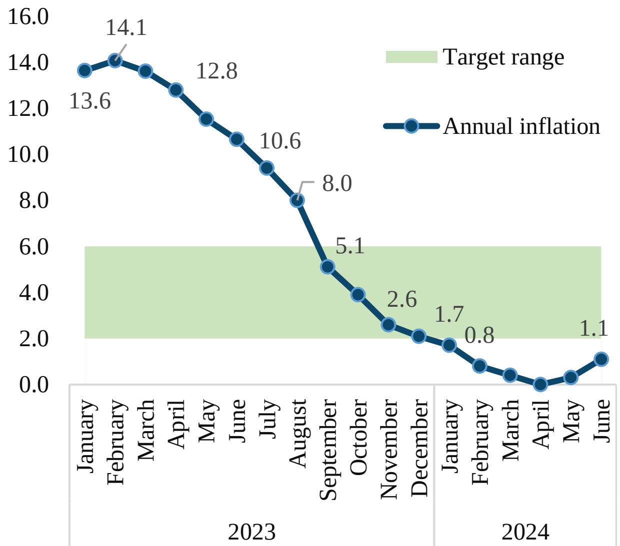
80.8% of total investments stemmed from internal and 19.2% from external sources. Funds of enterprises and organizations prevailed in total investments (56.9%).

2.3. Inflation

In H1 2024 annual inflation was below the target band. Both external and internal factors contributed to the fall of the inflation rate.

Consumer Price Index (CPI). According to the SSC, annual inflation stood at 1.1% in June 2024 (June 2024 vs June 2023). Average annual inflation stood at 0.7% (January-June 2024 vs January-June 2023).

Chart 26. Annual inflation %



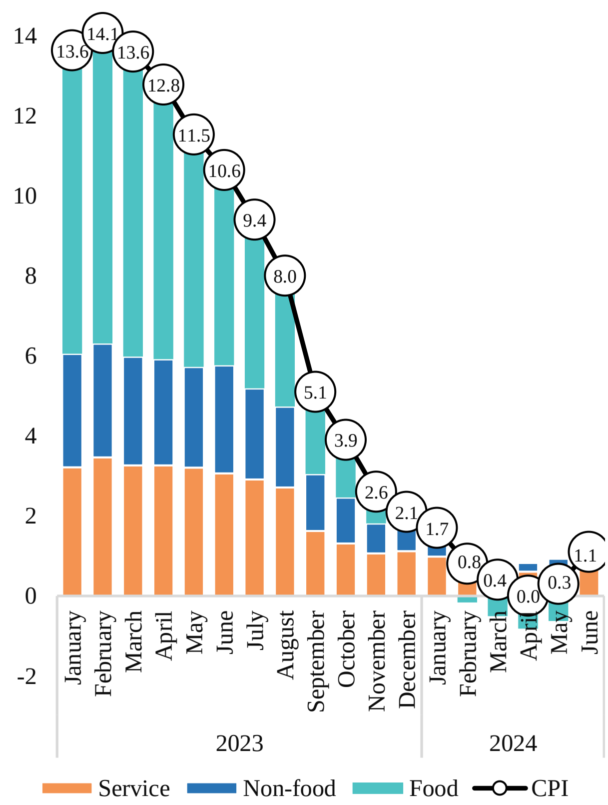
Source: DSK

Whereas annual food inflation stood at 0.2% in June 2024, average annual food prices deflated by 0.6%. In June, non-food prices y.o.y. hiked by 1%.

Average annual non-food inflation was 1.2%. In June annual and average annual service inflation was 2.4%.

Annual inflation y.o.y. decreased by 9.5 pp, driven by the drop in food (4.8 pp), non-food (2.4 pp) and services (2.3 pp) compared to the corresponding period of 2023.

Chart 27. Contributions to CPI, in percentage points

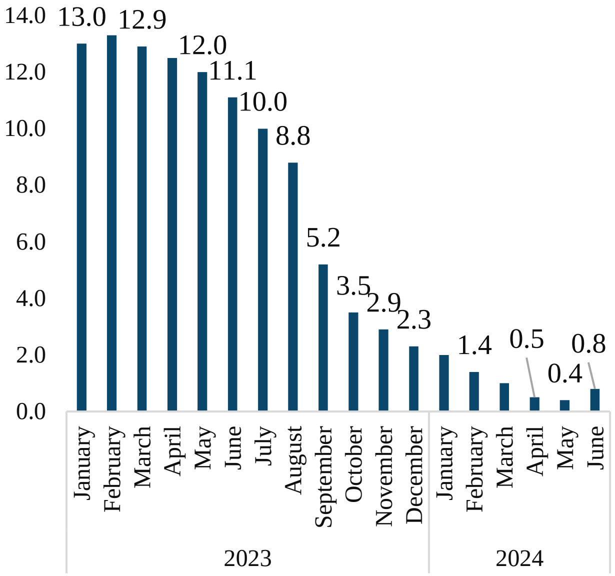


Source: SSC, CBA

Annual core inflation calculated by excluding changes in regulated prices and prices for seasonally volatile agricultural products was 0.8% in June 2024.

Average annual core inflation was 1% in January-June 2024.

Chart 28. Change of core annual inflation, in %



Source: SSC

The external environment of inflation was volatile. According to the World Bank in June 2024, the commodity prices index, including the non-energy prices index increased on an annual basis. While according to the FAO, in June the food prices index decreased on an annual basis. The appreciation of the NEER of the manat (3% over 6 months of 2024) made an additional contribution to the decrease in imported inflation.

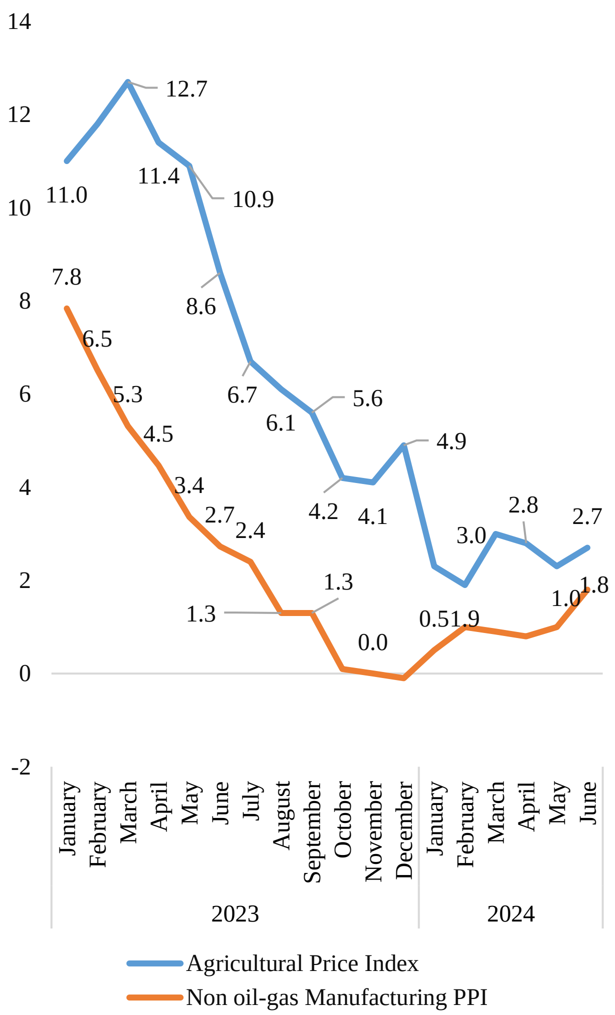
Inflation volatility in partner countries and fluctuations in commodity prices in the global market remain the main external inflation risks. However, persistent tight monetary conditions in leading economies can drive down inflation. Generally, upside and downside risks of inflation balance each other. If current conditions remain unchanged, inflation is expected to be within the target band in 2024 and 2025 (4±2%).

Producer Price Index. According to the SSC, APPI y.o.y. increased by 2.7% in June annually. The price for plant growing products increased annually by 0.7%, and prices for livestock products increased by 4.5% annually.

In June 2024, the IPPI increased by 9.8% annually. The oil and gas IPPI increased by 11.8% and the non-oil and gas IPPI increased by 1.8%.

In June, the Producer Price Index (PPI) for the manufacturing industry increased by 4.6% annually. Annual price index for food production in the manufacturing industry rose by 0.6%.

Chart 29. Annual change of PPI at the current year, %



Source: SSC

In June 2024, prices for transport and warehousing decreased by 3.9% annually. Cost of freight transportation decreased by 5.4%, and the price of passenger transportation decreased by 3.1%. The decline in producer prices for passenger transportation is attributable to a decrease in producer prices for foreign passenger transportation by air (14.7%).

In June, postal and courier service prices increased by 0.6% annually. The price index of communication services increased by 0.3% and advertising services went up by 3.3% annually, while the price index of ICT services decreased by 0.8%.

House price index. According to the SSC, the house price index increased by 2.2% in Q2 2024 compared to Q1 2024.

The price index increased by 3.3% in the primary housing market and by 2.2% in the secondary. Comparing to January-June 2023, the price index increased by 8.6% in the overall housing market, by 8.9% in the primary market and by 8.6% in the secondary market in January-June 2024. In Q2 2024 the price index in the housing market y.o.y. increased by 9.2%, including 10.3% in the primary housing market and 9.2% in the secondary housing market.

III. MONETARY CONDITION

3.1. Monetary policy decisions and tools

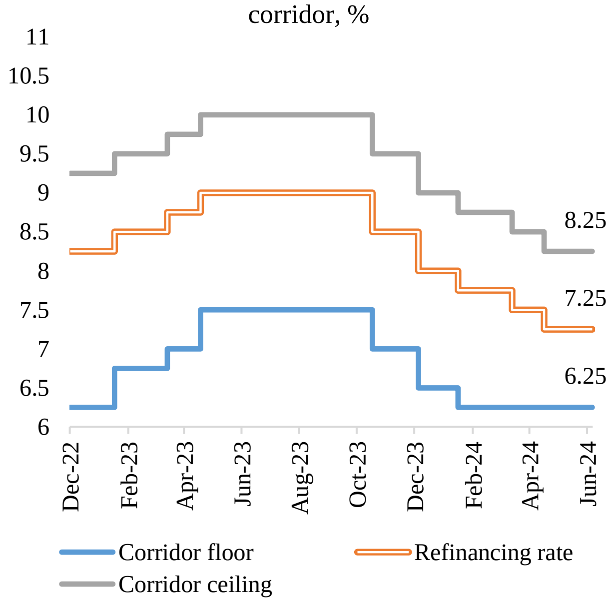
In H1 2024, the monetary policy was oriented towards regulating inflation through the monetary condition. Efforts continued to enhance capacity to affect inflation. Monetary policy tools facilitated to neutralizing the influence of non-monetary autonomous factors on the monetary condition. Tools were applied in response to financial market developments and changes in the banking system liquidity.

In January-June 2024, decisions on interest rate corridor parameters were made taking into consideration the dynamics of inflationary factors, the effect of the factors beyond the monetary policy on the monetary condition and aggregate demand, as well as developments across various segments of the financial market.

The CBA Management Board has discussed the interest rate corridor parameters 4 times over six months of 2024. At the first three meetings dedicated to the monetary policy the refinancing rate was decided to be shifted to 7.25% from 8%, the ceiling of the interest rate corridor to 8.25% from 9%, and the floor to 6.25% from 6.5%. The interest rate corridor parameters were left unchanged at the last meeting. The CBA made interest rate decisions public under the pre-announced schedule through press releases with appropriate analytical comments.

The CBA considered the extent of pass-through of interest rates to interbank money market rates, as well as the nature of monetary policy transmission in Azerbaijan in decision-making.

Chart 30. Parameters of interest rate corridor, %



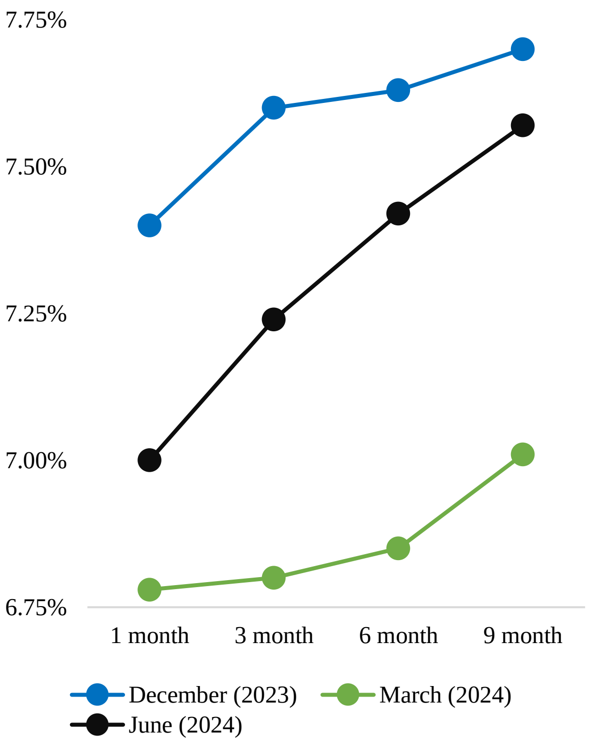
Source: CBA

The CBA continued monetary operations with various duration for liquidity management purposes over the reporting period. Demand for sterilization tools, especially liquidity absorbing standing facilities by banks was higher. In January-June average daily amount of one-day deposit transactions was AZN770M. In Q2 2024 demand for this tool was lower than in Q1 2024. On average 16 banks participated in one-day deposit transactions per operating day.

Furthermore, over the period regular auctions continued as open market operations on the placement of 28-day (1 month), 84-day (3 months), 168-day (6 months) and 252-day (9 months) notes for liquidity absorbing purposes. In general, total 59 note auctions have been held over six months. Demand prevailed over supply at note placement auctions. As of end-June 2024, total outstanding amount of funds absorbed through notes made AZN948.4M, down by 28% compared to the end of 2023.

Yield at recent auctions was 6.98% on 28-day, 7.2% on 84-day, 7.4% on 168-day, and 7.52% on 252-day notes.

Chart 31. Profitability of note auctions



Source: CBA

In H1 2024, the CBA also conducted seven-day repo operations for liquidity absorbing purposes to regulate interbank money market rates, and promptly contain effects of autonomous factors. Yield on this tool at the recent auction was 6.93%. As of the end-period total outstanding amount of repo transactions amounted to AZN15M.

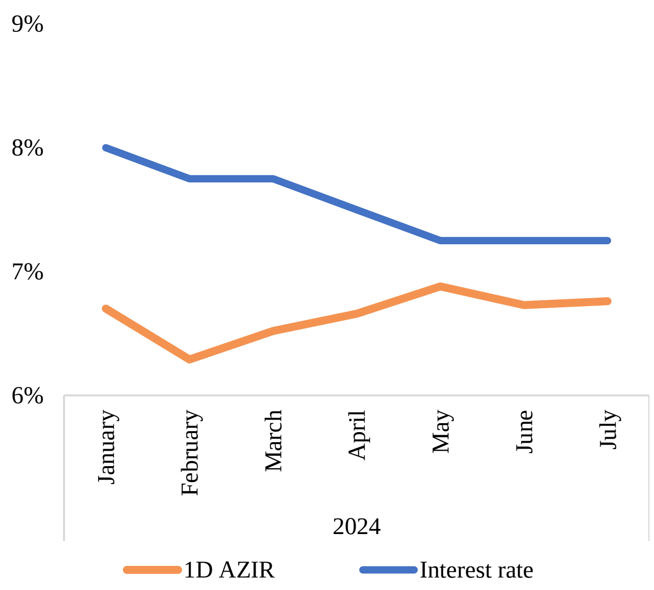
During the reporting period, the CBA set quantitative parameters of monetary policy tools based on liquidity monitoring and forecasting. When determining quantitative parameters of open market operations, the CBA took into account both autonomous and non-autonomous factors affecting liquidity. The liquidity monitoring and forecasting system was improved during the reporting period, taking into consideration the recommendations of international organizations.

To meet banks' liquidity demand, the CBA also conducted one-day reverse repo transactions, as standing facility, each amounting daily to AZN85.8M on average along with liquidity absorbing operations (considering only transaction days).

Money market interest rates continued responding to interest rate corridor changes. In June 2024, the average interest rate on 1-3-day operations (1D AZIR) in the interbank unsecured money market was within the corridor and amounted 6.73%. The spread between the 1D AZIR index and the refinancing rate shrank. Analyses suggest that interest rates on manat deposits of legal entities move in the same direction as interbank rates for certain bank groups. This signifies that the transmission of monetary policy decisions through the interest rate channel has improved.

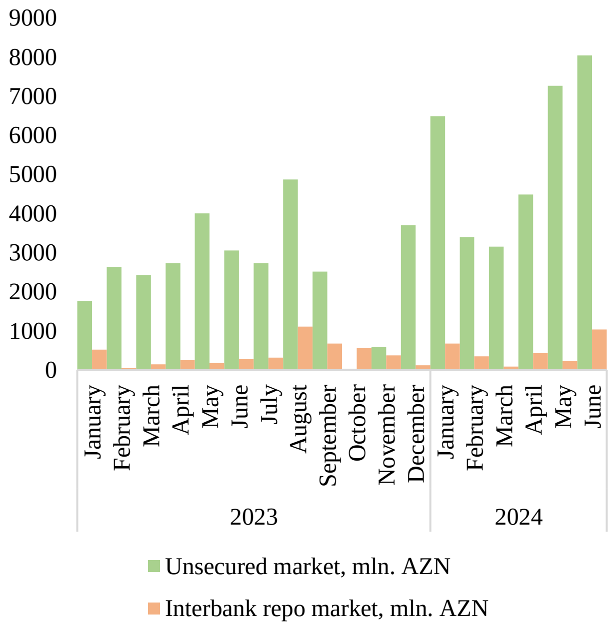
The CBA has been publishing AZIR indices in a new format in the relevant section of its official website since 1 April 2024. For comparative analysis of the 1D AZIR index, its dynamics, changes since the previous month and end of the previous year, as well as analytical data such as maximum and minimum volumes and interest rates over the past year, are provided daily in the corresponding section.

Chart 32. Dynamics of 1D AZIR



Source: CBA

Chart 33. Interbank money market



Source: CBA

In January-June 2024, banks concluded AZN32.8B worth of 1389 transactions in the platform launched for unsecured operations in the Bloomberg system. 95% of them were 1–3-day transactions. AZN2.8B worth of 326 transactions were concluded at the interbank repo market. 58% of interbank repo operations were 6-8-day transactions. 9.5% of interbank repo transactions were based on CBA notes. Transactions concluded in both sectors doubled year-over-year.

In the first half of the current year, the implementation of reserve requirement rates in the average regime was one of the factors that had a positive effect on the flexible and effective management of liquidity by banks. Monitoring findings suggest that total outstanding amount of correspondent accounts of banks in both national and foreign currencies with the CBA exceeded total funds to be maintained as required reserves throughout the reporting period.

The CBA's monetary policy had a positive impact on effective management of liquidity by banks, the activity in the interbank market and strengthening of interest transmission.

The CBA will employ monetary policy tools in response to domestic and global situation in upcoming periods too. The CBA will promptly decide on quantitative parameters and duration of the tools depending on regular assessments of the liquidity position of the banking system. Efforts to enhance the monetary policy operational framework will also continue.

3.2. Money supply

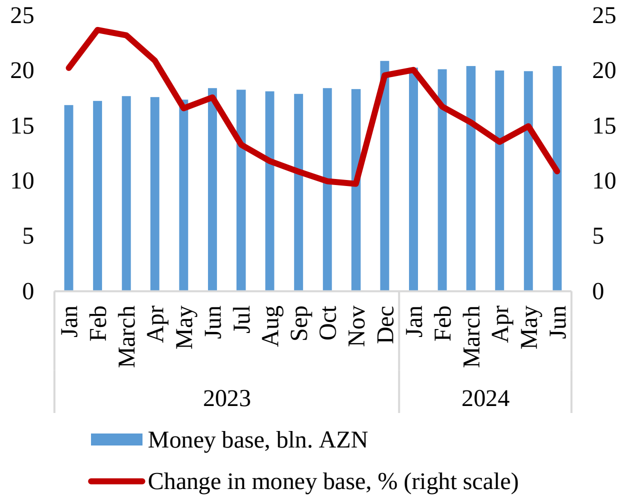
In H1 2024, money supply was managed in accordance with the demand of the economy. The rise in the government budget balance amid budget surplus since the beginning of the year had a downward effect on base money.

Base money in manat decreased by 2.3% to AZN20.4B, driven by the change in the balance of government accounts.

Cash in circulation, a structural element of base money in manat [3] decreased by 0.4% and stock of correspondent accounts in manat decreased by 10.4%.

Money multiplier in manat (broad money supply in manat/base money in manat) increased by 1.6% to 1.72 compared to the early year.

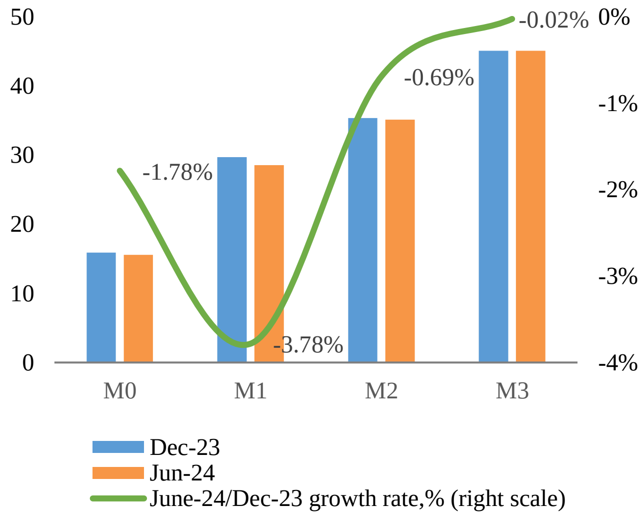
Chart 34. Monetary base and its annual change



Source: CBA

Broad money supply in manat (M2) decreased by 0.7% to AZN35.1B. Broad money supply (M3) did not change significantly and amounted to AZN45.1B.

Chart 35. Money aggregates (bln. Azn)

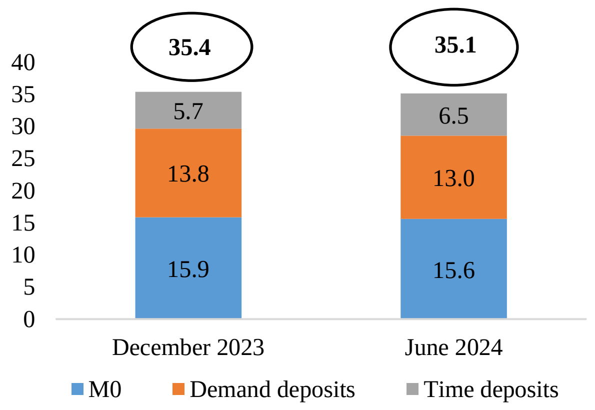


Source: CBA

[3] Cash money outside the banking system, cash in bank ATMs and cash offices

Over the period structural elements of M2 money aggregate grew at different rates. M0 cash money supply decreased by 1.8%, demand savings and deposits decreased by 6.1%, while term savings and deposits increased by 15.4%.

Chart 36. Composition of broad money supply (bln. AZN)

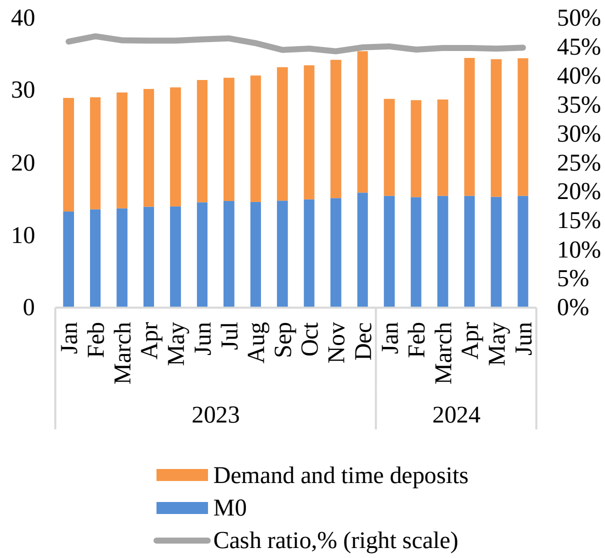


Source: CBA

The weight of cash (M0) in broad money supply in manat (M2) remained nearly unchanged vs the early year.

In H1 2024 foreign currency denominated savings and deposits amounted to AZN9.9B equivalent (33.7% of total savings and deposits). Foreign currency denominated savings and deposits accounted for 22% of M3 money aggregate as of the end-period.

Chart 37. Cash ratio (M0/M2), (bln. AZN)



Source: CBA

The share of foreign currency in deposits of legal entities was 42.6%, and dollarization of deposits of individuals was 33.9%. Dollarization of deposits of households (less savings of non-resident individuals) was 30.3% as of end-period.

The CBA will adequately use the tools at its disposal over the remaining period of 2024 as well to manage money supply more effectively and allow the change of money supply consistent with the monetary policy operational framework.

3.3. The FX market and the exchange rate of manat

In H1 2024, the exchange rate of manat against foreign currencies was determined by supply and demand in the FX market. The balance of payments surplus supported the exchange rate stability, the key price stability anchor.

Cashless transactions in the FX market amounted to $17.8B equivalent[4] - 81% in USD and 19% in other currencies. The Interbank FX market accounted for 28%, the Intrabank FX market for 72% of the operations.

Interbank FX market operations (including operations of the SOFAZ and the CBA) amounted to $4.9B. 98% of the transactions were conducted in USD. Currency operations in the Interbank FX market were conducted over the Bloomberg platform.

Intrabank FX market operations amounted to $12.9B equivalent. 74% of the transactions were made in US dollars. Legal entities accounted for 92% of Intrabank FX market operations.

Cash currency traded by banks amounted to $2.4B (87.5% in USD).

The CBA held 44 currency auctions to sell foreign currency provided by the SOFAZ over six months of 2024.

The official exchange rate of manat against USD was based upon the average exchange rate on interbank transactions (both auction and over-the counter on the Bloomberg platform). The average official USD/AZN exchange rate was AZN1.7. Buy-sell exchange rates set by banks were close to the official rate. Commercial banks' average buy/sell rate was 1.6950/1.7021.

The exchange rate of manat against currencies of trade partners varied over the period. Bilateral exchange rates influenced that of multilateral exchange rates.

[4] *Including transactions with USD, euro, pound, Russian ruble*

Table 2. Bilateral nominal and real exchange rates of manat against currencies of trade partners in H1 2024 (December 2023=100), %

	NEER	**REER**
Russian ruble	96.9	94.4
Turkish lira	111.9	90.7
Euro	101.4	100.5
Chinese yuan	101.6	102.7
Iranian rial	100	87.9
US dollar	100	99.8
Kazakh tenge	98.8	96.0
Belarus ruble	99.3	97.2
Japanese yen	109.8	109.6
Georgian lari	105.3	106.0
Ukrainian hryvnia	109.1	105.8
Swiss franc	103.5	103.2
South Korean won	105.9	106.1
British pound sterling	99.6	99.4
Israeli shekel	101.5	100.5
Non-oil sector (NEER, REER)	**103.0**	**97.6**

Source: CBA

In general, the NEER of manat for non-oil sector appreciated by 3% and the REER depreciated by 2.4%. Inflation in Azerbaijan was lower than the average inflation in partner countries, which had a reducing effect on the REER.

Charts and tables

Charts

Tables

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