CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

MONETARY POLICY REVIEW

January – March

2024 №1

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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 Q1 2024, the CBA implemented its monetary policy in line with the 'Statement of the Central Bank of the Republic of Azerbaijan on main directions of the monetary policy for 2024'. The policy of the CBA was oriented towards safeguarding macroeconomic stability.

Over the reporting period, the global environment was influenced by persistent geopolitical tensions, international trade route challenges, as well as price volatility in global commodity markets and inflation in partner countries.

Throughout the period, the annual inflation rate decreased due to external and internal factors. The year-over-year drop in commodity prices, a fall in average inflation in partner countries compared to peak rates, and ongoing appreciation of the nominal effective exchange rate of the manat pulled inflation down.

Over the quarter, monetary policy decisions were taken considering stabilized inflation expectations and changes in the balance of risks. Monetary policy tools were applied in response to the developments across various segments of financial markets and changes in banking system liquidity. The active use of monetary policy tools contributed to the movement of short-term interest rates in the interbank money market within the CBA's interest rate corridor. Efforts continued to improve the monetary policy operational framework and enhance interest rate transmission mechanism in light of strategic challenges.

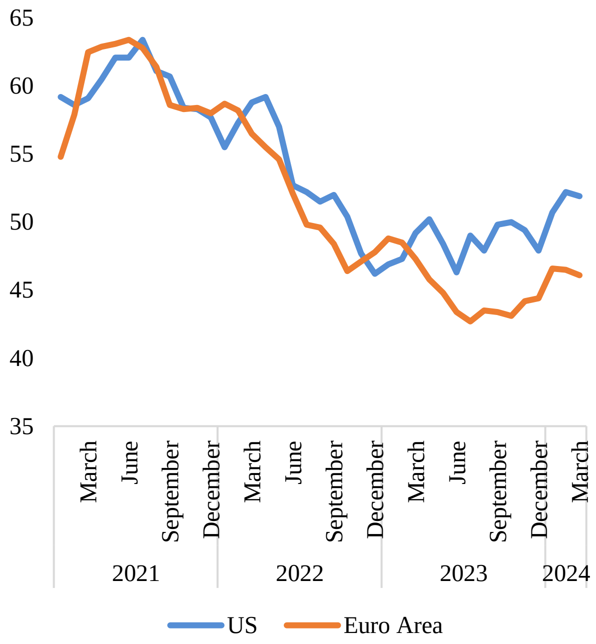
I. GLOBAL ECONOMIC ENVIRONMENT

1.1. Global economic trends

The global economy continues to wrestle with rising geopolitical tension. Due to the factors like geopolitical fragmentation, economic activity remains low compared to historical indicators. Monetary policy easing by central banks in the current year, as inflation goes down, is expected to have an upward effect on global growth.

Amid the adaptation of the global economy to geopolitical tension the indexes capturing global economic activity tended to rise in Q1 2024. The Purchasing Manager’s Index (PMI) has increased both in the USA and the euro area since early this year. Despite current challenges, growth of the index indicates that businesses are optimistic about their future production levels.

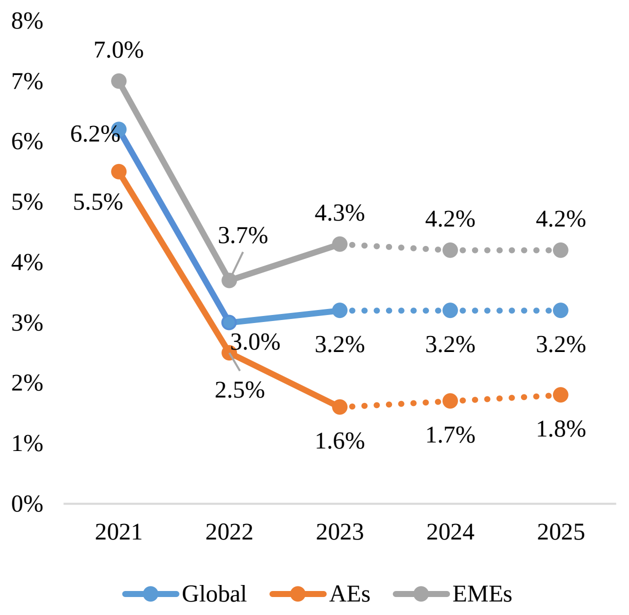
Chart 1. Purchasing Manager's Index (PMI)



Source: Markit Economics

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

Chart 2. Economic growth projections, %



Source: IMF WEO April 2024

The IMF WEO April forecasted 1.7% economic growth in AEs for 2024, up by 0.2 pp compared with the January forecast. The same forecast for 2025 was left unchanged at 1.8%.

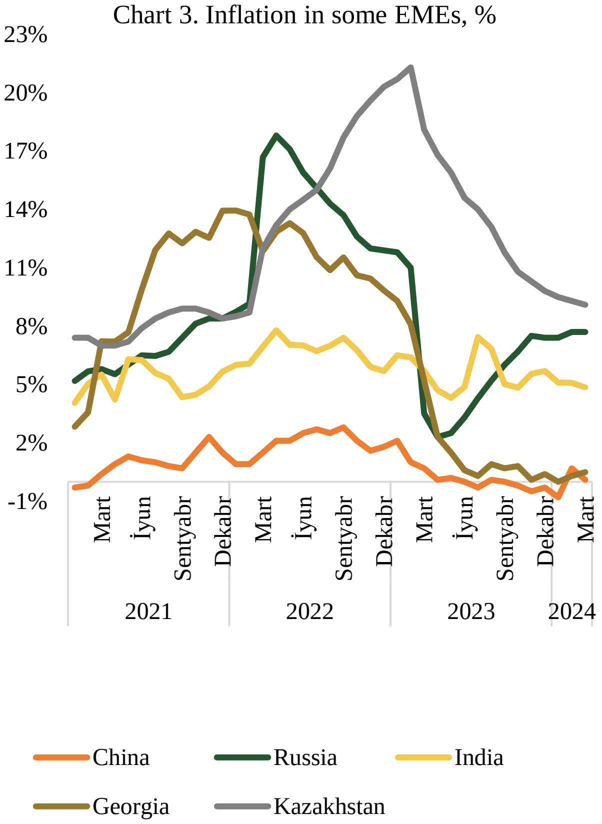
Economic growth forecasts for 2024 were revised down by 0.1 pp for the euro area and the UK, up by 0.6 pp for the USA and left unchanged for Japan compared with the previous forecast.

The IMF WEO April 2024 revised up economic growth forecast for 2024 for EMEs by 0.1 pp to 4.2% and left unchanged at 4.2% for 2025 compared with the January forecast. Economic growth was forecasted at 5.2% in Asia (left unchanged), at 3.1% in Europe (upward revision by 0.3 pp), at 2.0% in Latin America (upward revision by 0.1 pp), at 2.8% in Middle East and Central Asia (downward revision by 0.1 pp) and at 3.8% in Sub-Saharan Africa (left unchanged) for 2024. Forecasts for 2025 were revised up by 0.1 pp in Asia, by 0.3 pp in Europe, down by 0.1 pp in Sub-Saharan Africa, and left unchanged for Middle East and Central Asia as well as Latin America.

The IMF WEO April forecasts 5.9% global inflation in 2024, up by 0.1 pp compared with the January forecast. Global inflation forecast for 2025 was revised by 0.1 pp to 4.5%.

The IMF WEO April left the inflation forecast for AEs unchanged both for 2024 and 2025 compared with the January forecast. In AEs inflation is forecasted to decrease by 2 pp to 2.6% in 2024 and stand at 2% in 2025. The same forecast for EMEs was revised up by 0.2 pp both for 2024 and 2025.

Chart 3. Inflation in some EMEs, %



Source: National Statistic Offices

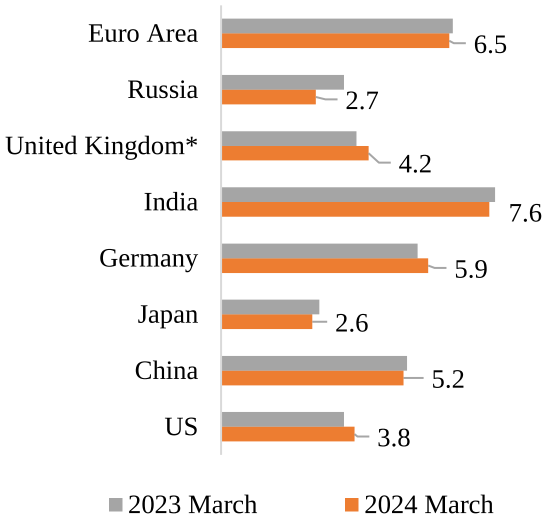
The IMF forecasts that in countries with inflation targeting quarterly headline inflation will be 0.5 pp higher than the target (or the median of the target) in Q3 2024. Inflation in AEs is expected to revert to target rates faster than in EMEs. The median difference between actual and target inflation is forecast to be as small as 0.3 pp across AEs in Q3 2024.

The drop in core inflation globally will weigh on the drop in headline inflation. In 2023, the fall in headline inflation was driven by the slide in global food and energy prices. Global core inflation dropped slightly on an annual basis. Whereas core inflation decreased by 0.2 pp in 2023, it is expected to decrease by 1.2 pp. in 2024. Main factors behind the decline in global inflation vary across countries. However, the IMF in its release, still specifies tight monetary policy by central banks and persistent drops in global commodity prices, in particular energy prices as the main drivers of the decline in inflation.

According to the report, inflation in AEs is expected to revert to the pre-pandemic (2017-19) average rate in 2025 and drop to average 2%. However, in EMEs the return of inflation to the average pre-pandemic rate of 5% was expected about a year ago though.

In Q1 2024, unemployment year-over-year decreased in China, Japan, India, the euro area and Russia, but increased in the USA, Germany and the UK.

Chart 4. Unemployment rate, %



** The numbers for the UK pertain to February.*

Source: Trading Economics

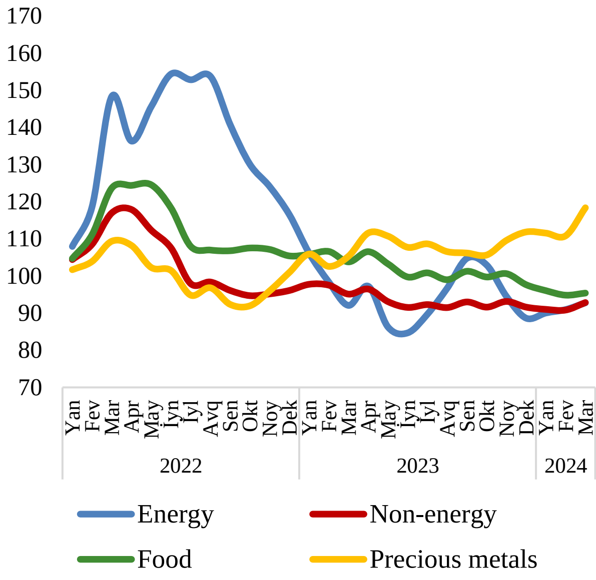
According to the May 2024 OECD report, the imbalance between supply and demand in labor markets decreased, and unemployment is in or around historical lows.

1.2. Global commodity markets

In Q1 2024, global prices affected by the factors such as international trade route challenges, ongoing monetary tightening globally, and climate changes varied across various commodities. In the upcoming period geopolitical conflict hotbeds remain relevant as the main risk factor weighing on commodity prices.

Geopolitical tensions, restrictions on some international freight routes and climate change were the core factors to affect commodity prices. According to the World Bank Commodity Markets Outlook April 2024, while the total commodity price index increased by 3.5% in the first quarter of 2024, y.o.y. it decreased by 0.3%. Price indexes increased by 4.7% on energy prices and by 1.3% on non-energy prices. Prices for certain non-alcoholic beverages posted the highest growth. The El Niño climate phenomenon, which seriously damaged the cocoa and coffee production, significantly weakened supply channels and caused 30.6% increase in their respective prices. However, food prices slided by 2.3%.

Chart 5. Global commodity indices
(2021 december=100)



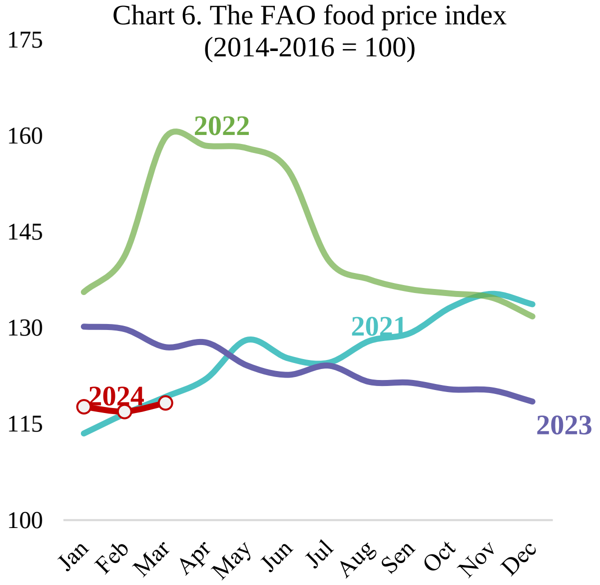
Source: World Bank

Gold prices also hiked slightly. According to the WB, the precious metal index, driven by gold prices, increased by 6.8% in March monthly. This significant rise in gold prices is attributable to dramatic increase in demand for safe assets amid geo-economic uncertainties. Gold prices, forecasted to slightly slide in medium run, will be far ahead of the prices in 2015-2019.

The food price index released by the UN FAO decreased by 0.8% in Q1

2024. Over the period vegetable oil prices increased by 6.8% and dairy products by 4.6%. In recent years, the significant increase in grain production has become the focus of concern. In 2023-2024 with global grain production nearing record highs, Russia and Ukraine's sharp increase in exports caused the grain price index to drop 9.7% quarterly. In general, the FAO food price index that has been falling since last year is approximating to the lows of last three years.

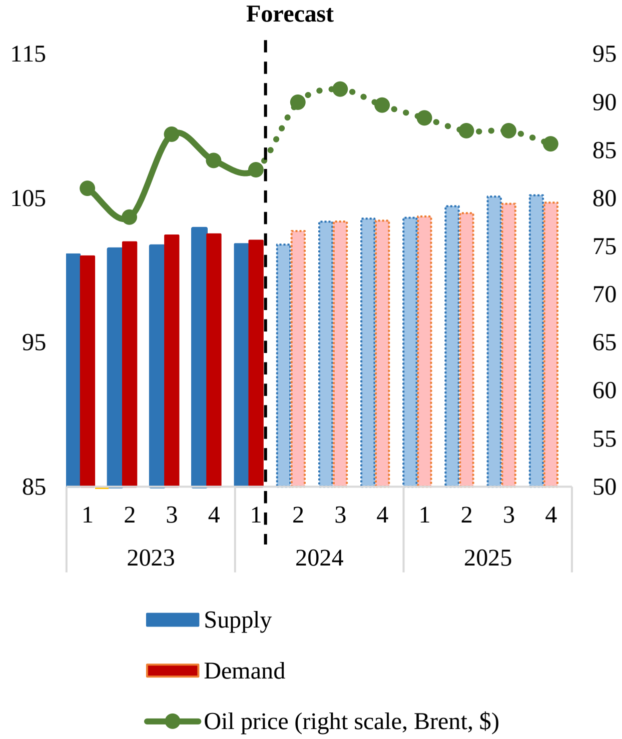
Chart 6. The FAO food price index (2014-2016 = 100)



Source: FAO

Oil prices, that slightly dropped at the end of 2023, posted growth in January-March 2024. The average Brent oil price was around $81.8/b in Q1 2024, down by 0.5% compared with the average of previous year indicator ($82.2).

Chart 7. Dynamics of demand and supply in the global oil market, mln. barrel (daily)



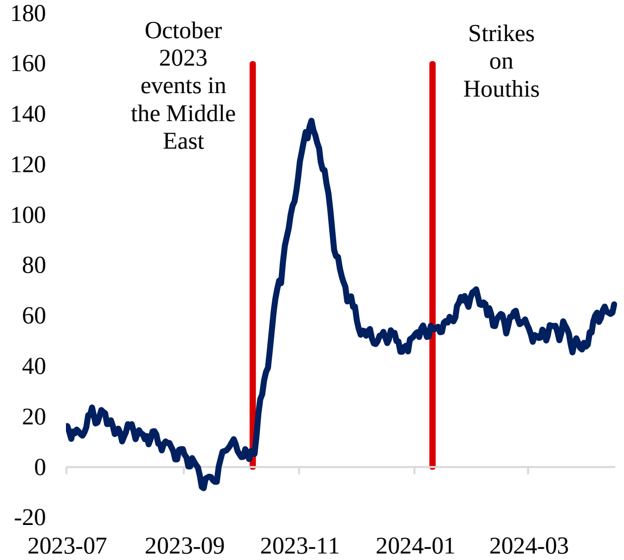
Source: The US Energy Information Administration (EIA)

The US EIA in its April release forecasts oil prices remain high this year. The average Brent oil price is expected to be $89/b in 2024 ($82 in January forecast), and $87 in 2025 ($79 in January forecast). The main reason for upward revision of forecasts for upcoming periods is attributable to the further flaring up of conflicts in the

Middle East region, particularly threats and impediments to international freight transportation in the Red Sea. Moreover, oil output cuts by OPEC+ countries are considered critical in pushing energy prices.

The expansion of green energy opportunities, the US channeling about 70% of liquid gas exports to Europe, and mild winter paved the way to lower demand for natural gas in Europe. Consequently, natural gas reserves in storage remained higher and prices dropped. The average gas price for 1000 cubic meters on the Dutch TTF gas index amounted to €289 (down by 33% compared with the average indicator for 2023 (€429)).

Chart 8.The geopolitical risk index, 2010-2019 = 0



Source: World Bank

The WB in its recent release forecasts a slight slide in global commodity prices in 2024-2025. The report focused on main risk factors likely to weigh on prices – rising geopolitical tension, possible global supply chain disruptions, and negative effects of climate change are the core factors to increase uncertainties in the expected dynamics of commodity prices.

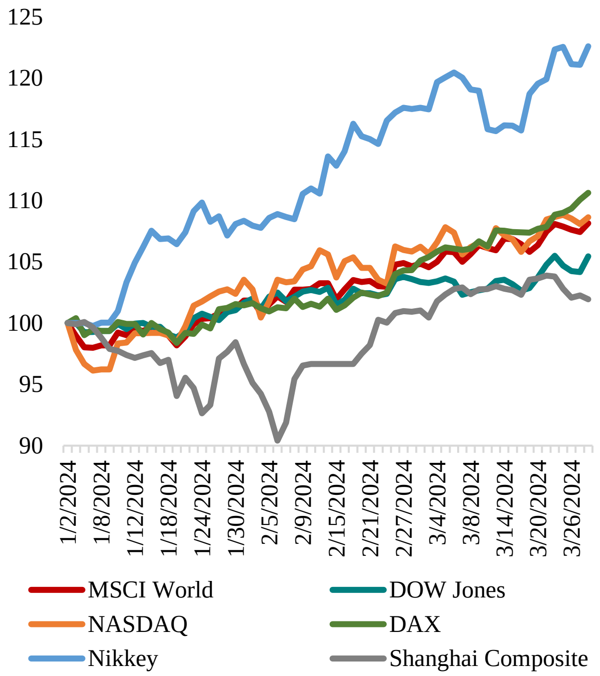
1.3. Global financial markets

The global financial system was resilient in first quarter of 2024. Financial markets posted positive dynamics over the quarter amid rising expectations related to soft landing for the global economy and investors' anticipations of interest rate drops in the upcoming quarters. Even though worrisome short-term risks in the financial system have subdued, certain medium-term risks remain.

Investors' expectation of monetary easing in global markets decreased on the backdrop of persistent inflationary developments. Central banks of AEs left policy rates unchanged in the first quarter to curb the inflation which remains higher than the target. In Q1 2024, the FED left the policy rate unchanged at 5.25%-5.50%, the highest rate of recent 23 years, the ECB at 4.5%, the Bank of England at 5.25%, and the People's Bank of China at 3.45%. However, central banks do not rule out decreasing policy rates in the upcoming quarters if inflation reaches the desired rate. The Bank of Japan abandoned negative interest rate policy for the first time since 2007 and pulled the policy rate out of the negative zone by raising interest rates in response to rising inflation and significant wage increases at large companies. Investors focused on the effects of the Bank of Japan's decision to tighten the monetary policy on global capital flows and the exchange rate of the Japanese yen when other central banks ease the monetary policy. The Swiss National Bank decreased the policy rate by 25 basis points becoming the first central bank among AEs to lower policy rates this year.

In Q1 2024, global financial markets sustained in general, the markets posted positive trends. Consequently, core stock indices grew in stock exchanges: the NASDAQ appreciated by 9%, Dow Jones by 5%, FTSE Eurotop by 9%, DAX by 11%, Nikkei by 21%, and MSCI World by 8%. The Shanghai Composite posted weaker growth (2%), driven by real estate crisis in China.

Chart 9. Trends in stock exchanges
(December 2022=100)



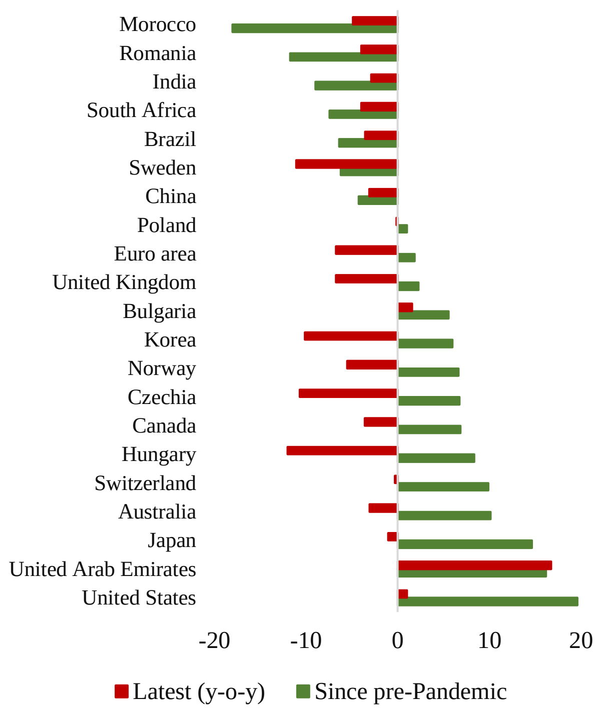
Source: Bloomberg

The price of Bitcoin rose by 61% in Q1 2024 and exceeded the USD 70,000 level for the first time.

According to the IMF WEO April 2024, since last October financial markets followed positive dynamics amid steady decline in global inflation and expectations that monetary policy will be eased. Interest rates decreased and stock prices increased on a global scale leading to the loosening of global financial condition.

During the quarter investors and central banks expected the quantitative easing in the upcoming quarters. However, if global inflation remains above targets longer, it may lead to unmet expectations and financial market instability. In general, most financial institutions sustained amid high interest rates. The IMF analyzed that, short-term financial stability risks, including factors likely to have an adverse effect on global growth decreased during the quarter.

Chart 10. Housing price real growth rate,
(percent, year-over-year)



Source: IMF

Although real estate prices have decreased in most countries, they remain higher than pre-pandemic levels. Housing price slides were attributable to high mortgage interest rates and were more pronounced in the AEs (2.7%) compared to the EMEs (1.6%). While the sustainability of the household debt burden is at a satisfactory level globally, the risk of default on mortgage loans is still considered relevant.

Price volatility across most assets hit the multi-year low, indicative of rising optimism that the era of global interest rate rise is ending. However, if unexpected inflation shocks suddenly change investors' expectations, it can trigger prices to move in the same direction between positively correlated markets and sharp tightening of financial conditions.

In its latest release, the IMF specified certain risks and policy recommendations likely to impact global growth and the financial system. The report first highlights that, the rising debt burden of public and private sectors both in AEs and EMEs can eventually increase risks. Moreover, ongoing and fast growth of the private lending market, which operates under a restricted prudential supervision (the market established outside the banking sector that lends to medium-sized entrepreneurs and grows fast) may lead to systemic risks. Cyberattacks, amid rising digitalization, technological development and heightened geopolitical tensions are a significant concern for macro financial stability. As policy priorities, the IMF highlights gradual monetary easing by central banks once they are satisfied that inflation is steadily moving towards the target, boosting efforts to prevent debt defaults, standing ready to apply various solutions, applying more proactive supervisory and regulatory approach, strengthening the national cybersecurity strategy, including effective regulatory and supervisory frameworks and developing the cyber incident reporting system.

II. INTERNAL MACROECONOMIC CONDITION

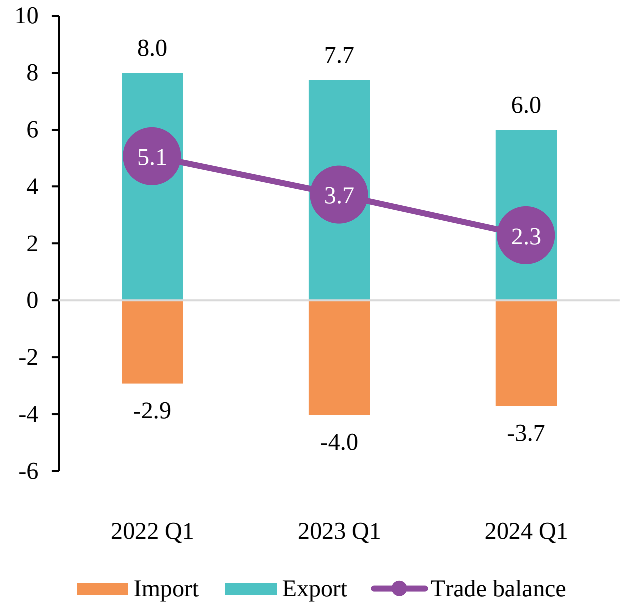
2.1. External sector

In Q1 2024, foreign trade, the primary balance of payments component, was in surplus. The current account is forecasted to be in surplus under a baseline scenario by the end-year.

According to the SCC, foreign trade turnover amounted to $9.7B – export $6B (61.7%), import $3.7B (38.3%). Foreign trade surplus stood at $2.3B.

The EU accounted for 36.9%, the CIS countries for 13.7% and other countries for 49.4% of total trade turnover in the first quarter of 2024.

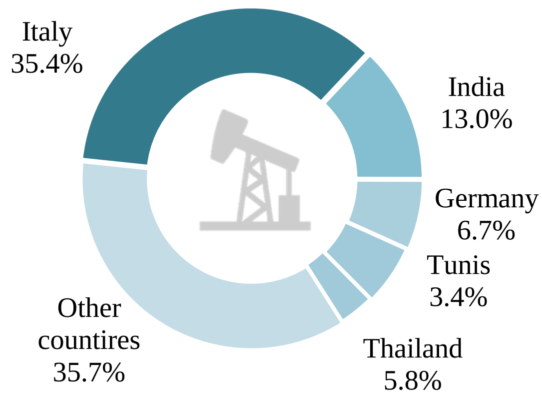
Chart 11. Trade balance, $ billion



Source: SCC

Italy, Türkiye, Russia, China, India, Germany, Thailand, Georgia, the USA, and Bulgaria accounted for over half of trade turnover.

Chart 12. Countries to which crude oil and oil products are exported in 2024 Q1 (%)

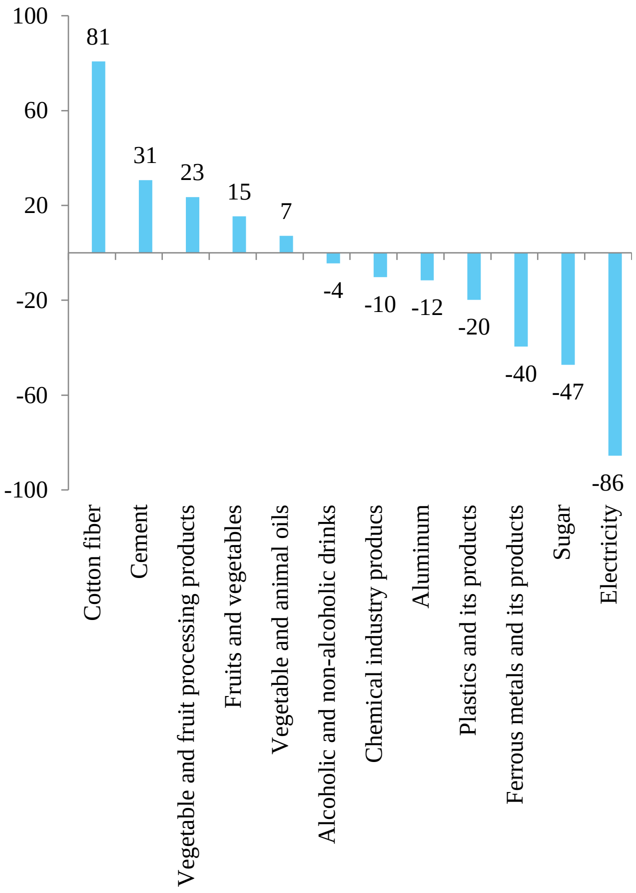


Source: SCC

The value of the oil-gas export amounted to $5.3B – $3.5B for crude oil and $1.8B for natural gas.

Non-oil-gas export amounted to $673.7M. The main share of total non-oil-gas exports includes fruits and vegetables, plastics and products, chemical products, cotton fiber, aluminum and products, and electricity.

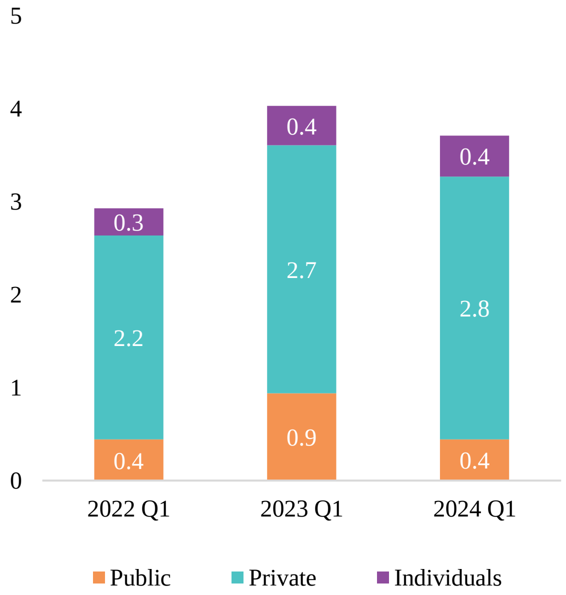
Chart 13. Changes in export of some products in Q1 2024 (y.o.y., %)



Source: SCC

In general, in January-March 2024, the main export partners were Italy (33.2%), Türkiye (15.5%), India (7.6%), Germany (4.0%) and Russia (3.8%).

Chart 14. Dynamics of imports by sectors, billion $

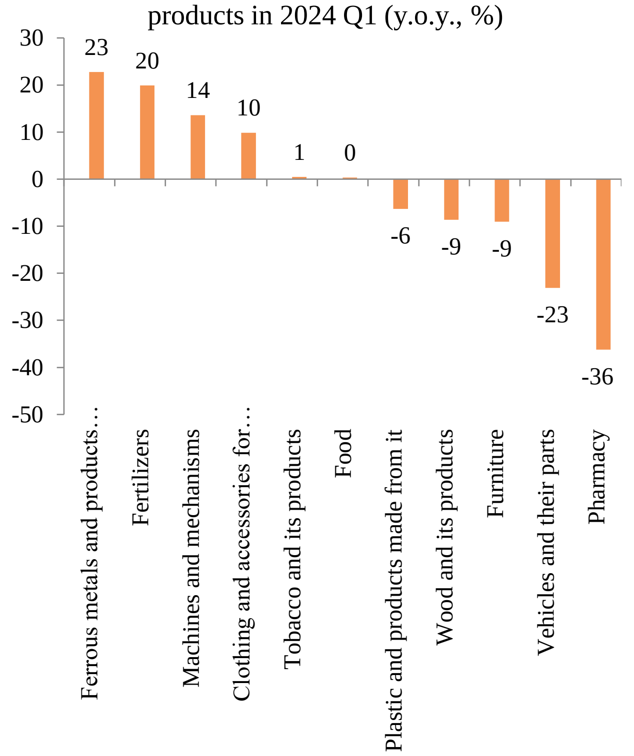


Source: SCC

Commodity imports amounted to $3.7B – the public sector accounted for 12%, the private sector for 76.1% and individuals for 11.9% 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 quarter of 2024.

Chart 15. Changes in imports of some products in 2024 Q1 (y.o.y., %)



Source: SCC

China accounted for 20.0%, Russia for 17.8%, Türkiye for 14.5%, Germany for 4.9%, the USA for 4.1%, Iran for 3.5%, Italy for 2.9%, Belarus for 2.6%, the Republic of Korea for 2.4% and Turkmenistan for 2.2% 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 AZN784.4M. FDIs accounted for 20.6% of total investments.

Investor funds from the UK, the USA, Türkiye, Switzerland, Japan, Russia, Norway, Iran, India and France accounted for 96.4% 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 well. As in the previous year, the 2024 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-March 2024, strategic FX reserves were sufficient for 33-month worth of import of goods and services (considering the import of goods and services for 2023). Strategic reserves exceeded broad money supply in manat (M2) by 3.3 times (M2 money aggregate as of 29.03.2024).

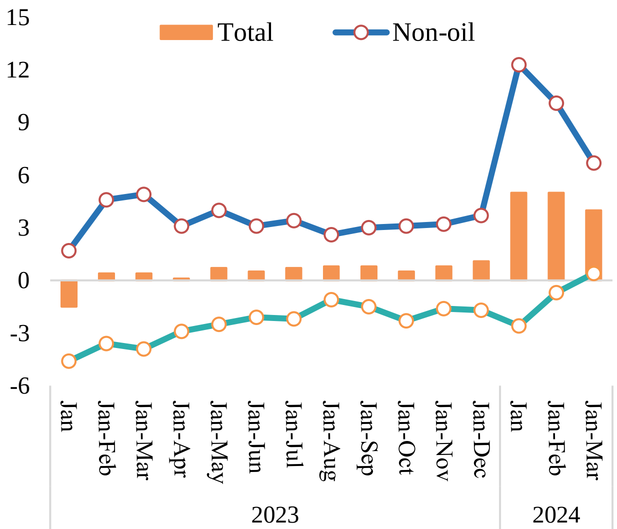
2.2. Economic activity

In Q1 2024, economic growth continued. Main aggregate demand components, including investment demand supported this growth.

Economic growth. According to the SSC, GDP increased by 4% in real terms to nominal AZN29.1B in Q1 2024. Per capita GDP stood at AZN2856.5.

Oil-gas value added increased by 0.4% to nominal AZN10.4B. 7.2 million/ton crude oil (y.o.y. down by 6%), 9.7 billion cubic meters natural gas (y.o.y. up by 5.4%) was extracted over the period.

Chart 16. Economic growth, (y/y) %



Source: SSC

Non-oil-gas value added y.o.y. increased by 6.7% in real terms to nominal AZN18.7B. Production in the non-oil-gas industry increased by 7.8%.

Agriculture grew by 1.1%. Livestock products increased by 1%, and plant products increased by 2.9%. The growth rate of plant products year-over-year increased.

The high growth dynamics continued in services. Transport and warehousing grew by 17.3%, freight and passenger transport increased by 4.7% and 6.9% respectively. The volume of cargo transported by vehicles owned by the non-public sector increased by 5.3%, the sector accounted for 76.4% of total transported cargo.

The value added in information and communication y.o.y. grew by 10.4%, and tourism and catering by 10.2%.

The share of service sectors in the GDP structure increased in Q1 2024.

Table 1. GDP structure, weight, %

Sectors	2023 3 months	2024 3 months
Industry	47.5	39.3
Construction	5	5.9
Agriculture, forestry, and fishery	2.6	2.9
Trade, repair of vehicles	9	9.7
Transport and warehousing	5.4	6.8
Tourism and public catering	1.9	2.4
Information and	1.5	1.7
Other	17.6	20.4
Net taxes on products and import	9.5	10.9

Source: SSC

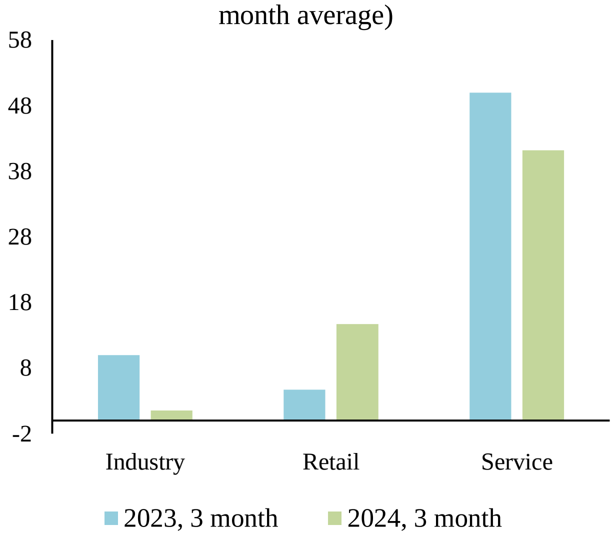
CBA's real sector survey results confirm that economic activity continues. In the first quarter of 2024, the BCI exhibited varied dynamics across different sectors but ultimately remained in the positive zone overall.

The non-oil BCI remained in a positive zone. The BCI was higher in chemical industry, machine building, construction, and production of other non-metal products sub-sectors.

The trade BCI was positively zoned and rose year-over-year. The BCI was higher in furniture and electric appliances sub-sectors and relatively weak in vehicles and household goods.

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 17. Business confidence index, (3 month average)



Source: RSM findings-based CBA estimations [1]

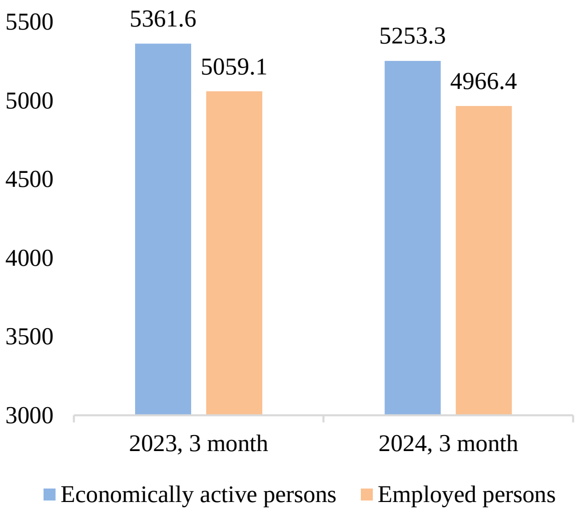
Employment. As of April 1, 2024, total labor force was 5253.3 thousand persons, employed population numbered 4966.4 thousand persons.

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

Services BCI = (business condition + actual demand + demand expectation)/3
Trade BCI = (actual sale – changes in goods inventory+ sale expectations)/3

As of March 1, 2023, hired labor was 1727.2 thousand persons – 899.7 thousand persons were engaged in the public and 827.5 thousand persons in the non-public sectors.

Chart 18. Dynamics of economically active and employed persons (in thousands)



Source: SSC

22.5% of hired labor in enterprises and organizations are engaged in production.

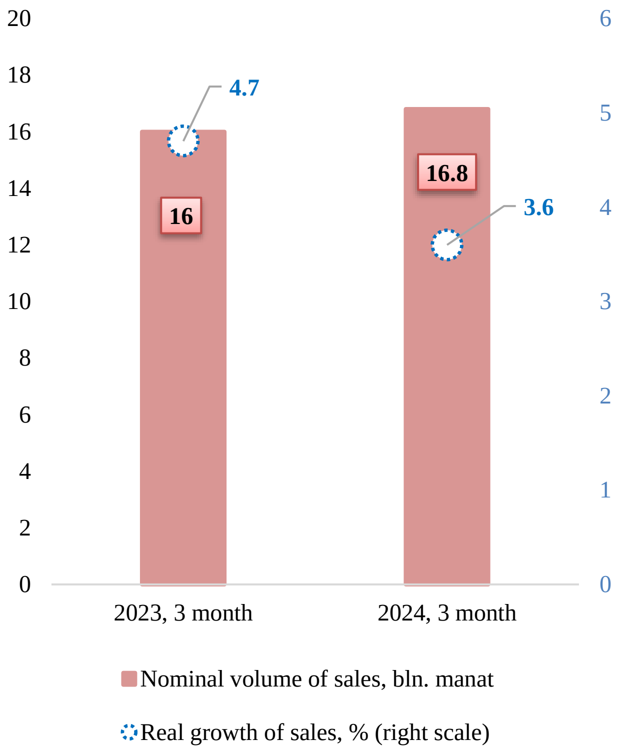
As of April 1, 2024, the number of registered unemployed persons was 209.8 thousand persons, out of which 43% were women. The number of the unemployed decreased by 3.6% compared to the end of the previous year.

Results of RSM by the CBA indicate that employment expectations of economic agents surpassed average indicators of the previous year in trade and services in Q1 2024.

Aggregate demand. Aggregate demand continued to expand and supported economic growth in January-March 2024.

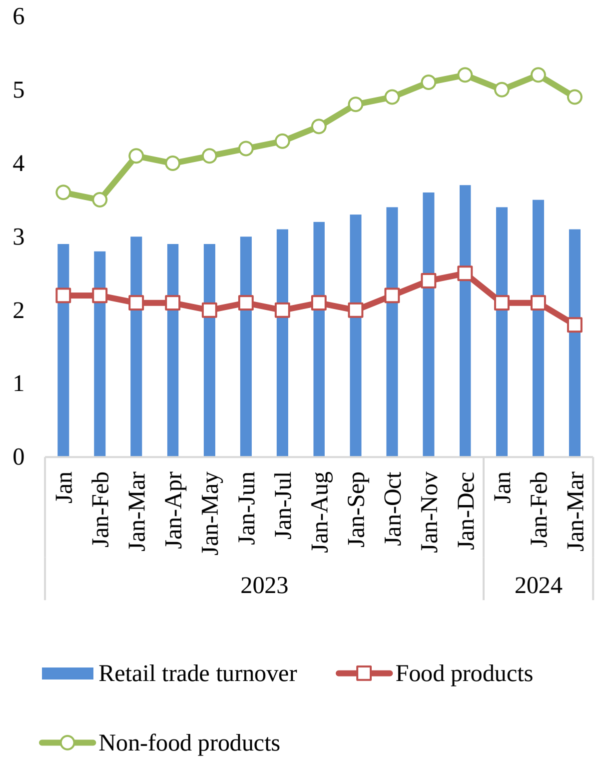
Aggregate demand expanded mainly due to consumer demand. Goods and services sold in the market to meet consumer demand y.o.y. increased by 3.6% in real terms to AZN16.8B. Every consumer spent on average AZN548.3 monthly in the consumer market (y.o.y. up by AZN20.9).

Chart 19. Change in volume of sales in consumer market



Source: SSC

Chart 20. Growth in retail trade turnover, (y/y) %

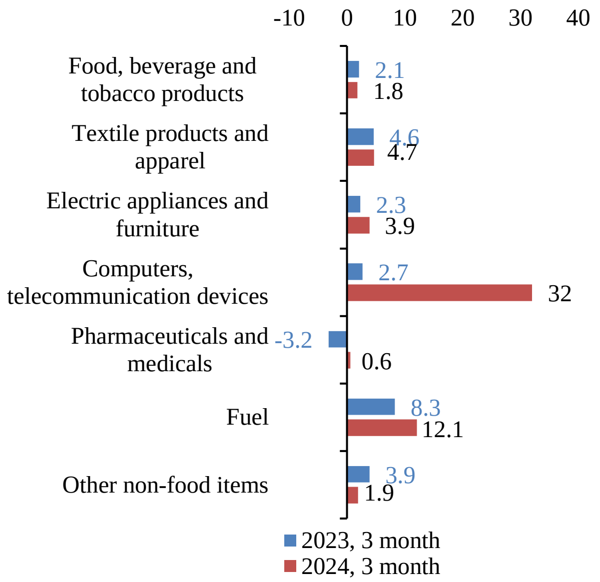


Source: SSC

Retail trade turnover y.o.y. increased by 3.1% in real terms to AZN13.5B. Retail commodity turnover on food products, beverages and tobacco products increased by 1.8%, and nonfood trade turnover increased by 4.9%.

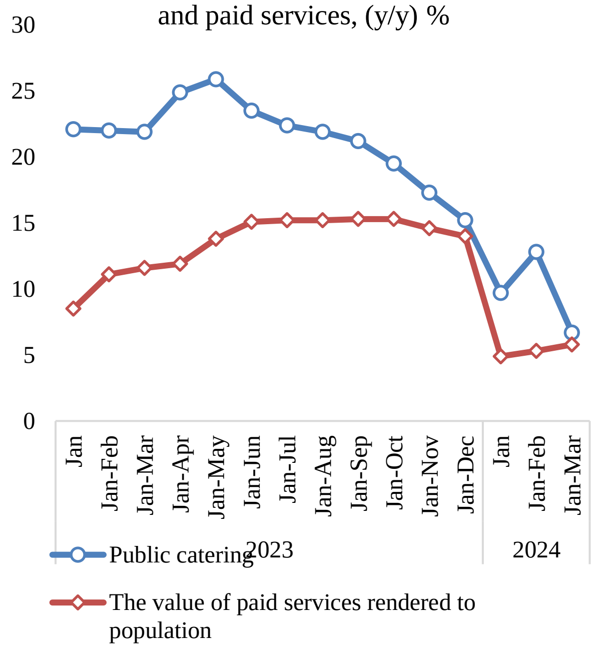
In Q1 2024, consumers' expenses in retail trade outlets decreased year-over-year for the purchase of food, beverages, and tobacco products as well as other non-food products, while expenses increased for other spending items.

Graph 21. Growth of spending items at trade turnover, %



Source: SSC

Chart 22. Dynamics of public catering and paid services, (y/y) %



Source: SSC

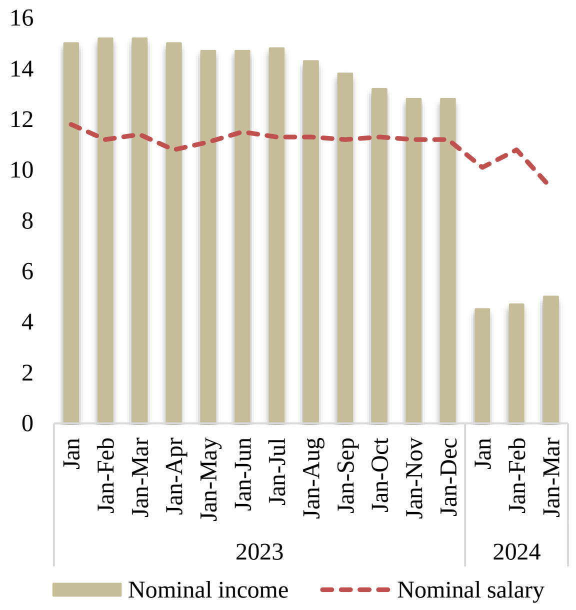
Every consumer spent, on average, AZN440.9 worth of goods (y.o.y. up by 2.9%) per month in retail trade – 56% on food, beverages, and tobacco products, and 44% on non-food stuff.

Over the reporting period, public catering turnover y.o.y. increased by 6.7% in real terms. Paid services to the population y.o.y. increased by 5.8% in real terms to AZN2.8B. Per capita paid services consumption y.o.y. increased by AZN20.2 to AZN277.6 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 in the rise of consumer demand.

According to the SSC, money income of the population increased by 5% to AZN19.4B in nominal terms. Per capita money income was AZN1905.4. Population's disposable income increased by 4.8% to AZN17.1B. Average monthly nominal salary of hired labor y.o.y. increased by 10.8% to AZN946.8 in January-February 2024.

Chart 23. Growth dynamics of incomes and salaries, (y/y) %



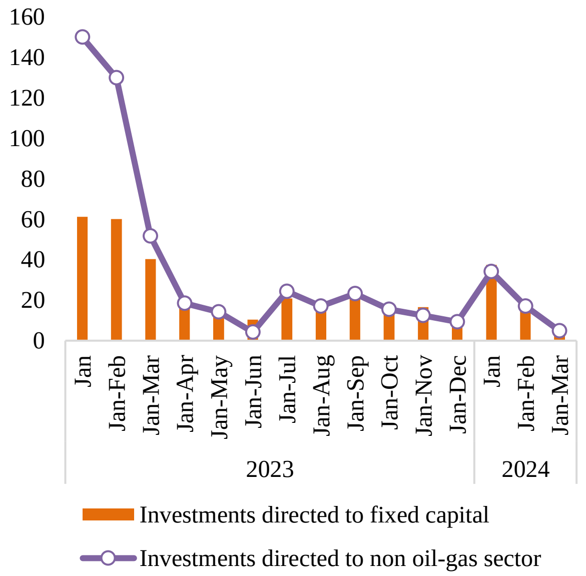
Source: No SSC indicator available for recent months

Lending dynamics also weighed on the consumer demand. Over the quarter, loans to households increased by 3.3% year-over-year.

Government spending was critical in supporting domestic demand. State budget expenditures amounted to AZN8.4B (y.o.y. up by 28.1%) in Q1 2024. AZN4967.1B (59%) of state budget expenditures were channeled to current expenses, AZN2357.5M to capital expenses (28%), and AZN1088M (13%) to state budget serving expenses. [2]

Investment demand also posted growth, along with consumer demand. According to the SSC, funds invested to the economy y.o.y. increased by 4% (AZN3.8B). Investment in the oil-gas sector y.o.y. increased by 2.7% and investment in the non-oil-gas sector increased by 4.8% in real terms.

Chart 24. Dynamics of investment , (y/y) %



Source: SSC

AZN146.2M (3.8% of total investments) out of AZN2.5B worth funds channeled to the non-oil-gas sector was used in the non-oil-gas industry. The public sector accounts for 54.6% and the

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

non-public sector for 45.4% of total investments.

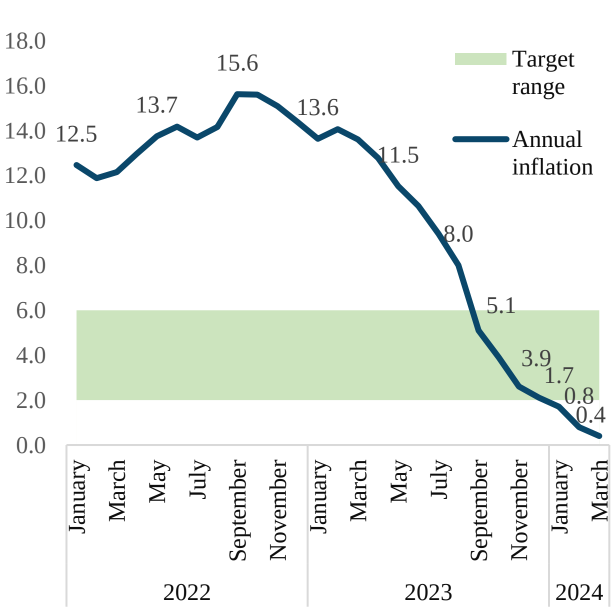
79.4% of total investments stemmed from internal and 20.6% from foreign sources. Funds of enterprises and organizations prevailed in total investments (50.5%).

2.3. Inflation

In Q1 2024, annual inflation continued to decline, facilitated by eased inflation in trade partners and the ongoing anti-inflationary policy.

Consumer price index (CPI). According to the SSC, annual inflation stood at 0.4% in March 2024 (March 2024 vs March 2023). Average annual inflation stood at 1% (January-March 2024 vs January-March 2023).

Chart 25. Annual inflation %

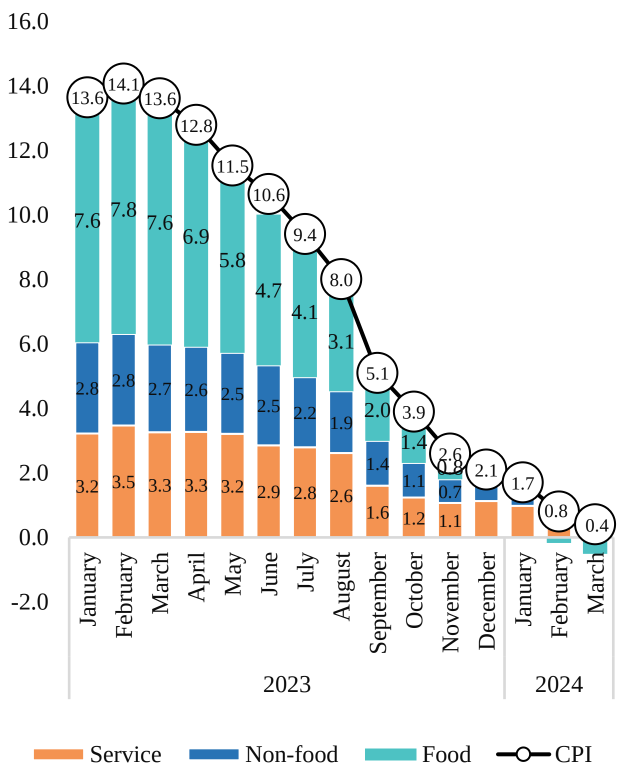


Source: SSC

Deflation was recorded in food products in March. Annual deflation was 1.1%, and average annual deflation was 0.3% in March. In March non-food prices y.o.y. hiked by 1.1%. Average annual non-food inflation was 1.4%. In March annual service inflation was 2.2%, and average annual service inflation was 2.5%.

Annual inflation y.o.y. decreased by 13.2 pp, driven by the drop in food (8.1 pp), service (2.6 pp), and non-food (2.5 pp) inflation.

Chart 26.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 1% in March 2024. Average annual core inflation was 1.5% in March 2024.

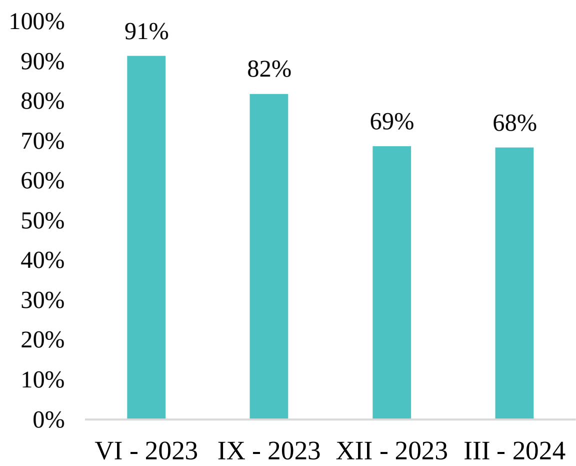
Chart 27. Change of core annual inflation, in %

Source: SSC

Annual inflation decreased under the influence of both external and internal factors. According to the World Bank, the commodity price index decreased by 0.3% on an annual basis, and by 2.4% on non-energy prices in March. According to the FAO, the food price index decreased by 7.7% annually in March. The appreciation of the nominal effective exchange rate of the manat (2.7% in Q1 2024) made additional contribution to the decline in inflation.

The dynamics of actual inflation weighed on inflation expectations of households. Ongoing surveys suggest that the share of households expecting inflation decreased from 91% in 2023 to 68% in March 2024.

Chart 28. Households expecting inflation %



Source: CBA

Generally, upside and downside risks of inflation balance each other. The inflation forecast for 2024 was revised down in April – if current conditions remain unchanged, in 2024 annual inflation is expected to be within the target band (4±2%).

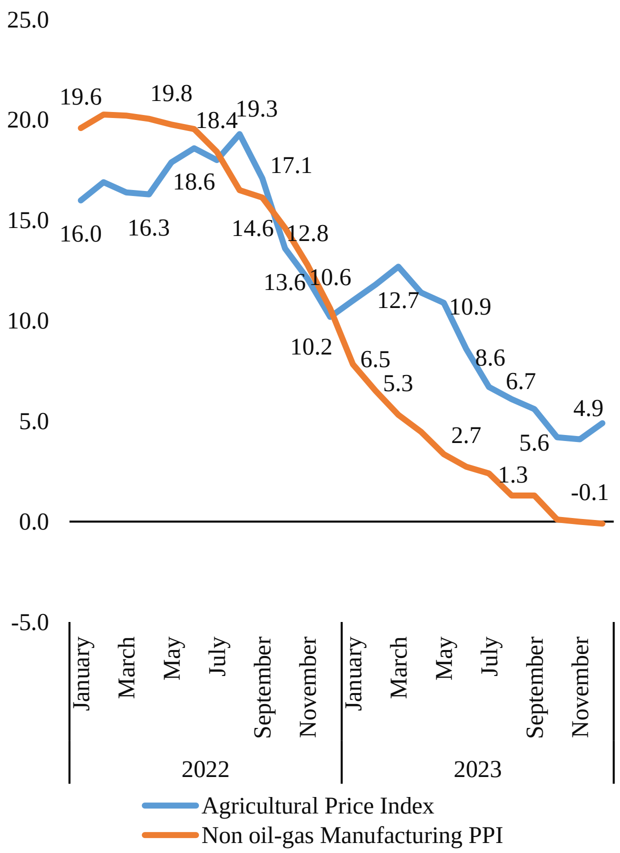
Producer Price Index. According to the SSC, APPI y.o.y. increased by 3%

in March. The price for plant growing products decreased annually by 1.4%, and prices for livestock products increased by 7% annually.

In March 2024, the IPPI increased by 7.2% annually. The oil-gas IPPI increased by 8.4% and the non-oil gas IPPI increased by 0.9%.

The Producer Price Index (PPI) in processing increased by 1.9% annually. The food production annual price index decreased by 1.7%.

Chart 29. Annual change of PPI, %



Source: SSC

In March 2024, prices for transport and warehousing decreased by 0.7% annually. Cost of freight transportation decreased by 0.6%, and the price of passenger transportation decreased by 7.2%. The decline in producer prices for passenger transportation is attributable to a decrease in producer prices for foreign passenger transportation by air (11.7%).

In March, postal and courier service prices increased by 0.6% annually. The price index of communication services increased by 0.3% and advertising services increased by 1.6% annually in March, while the price index of ICT services decreased by 0.2%.

House price index. According to the SSC, the house price index increased by 2.2% in Q1 2024 compared with Q4 2023. The price index increased by 3.1% in the primary and by 2.2% in the secondary housing market. Comparing to January-March 2023 the price index increased by 8.1% in the overall housing market, by 7.5% in the primary market and by 8.1% in the secondary market in January-March 2024.

III. Monetary condition

3.1. Monetary policy decisions and tools

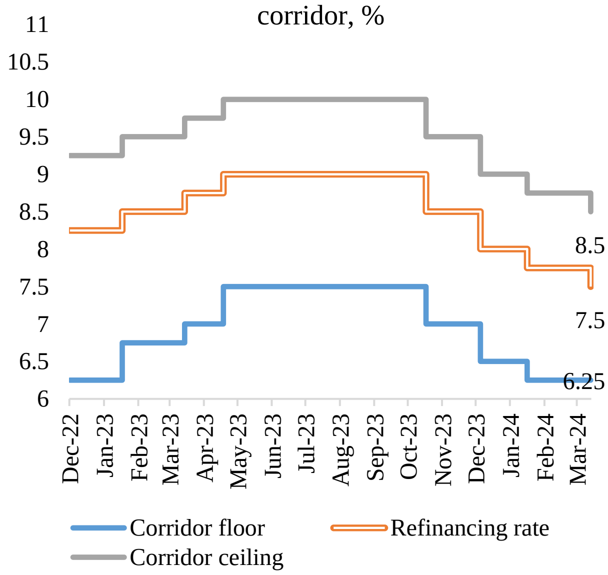
In Q1 2024, the monetary policy was oriented towards regulating inflation through the monetary condition. Over the reporting period, reforms continued to enhance capacity to affect inflation, money market interest rates and banking system liquidity. Monetary policy tools facilitated to neutralizing the influence of non-monetary autonomous factors on the monetary condition and enhancing interest rate transmission.

In January-March 2024 interest rate corridor parameters related decisions were taken in consideration of the comparison of the actual and forecasted inflation with the target (4±2%), the stabilization of inflation expectations and developments across various segments of the financial market.

The CBA Management Board has discussed the interest rate corridor parameters 2 times over the reporting period. Monetary easing kicked-off at the end of the previous year continued. The refinancing rate was shifted to 7.5% from 8%, the ceiling of the interest rate corridor to 8.5% from 9%, and the floor to 6.25% from 6.5% in two steps. The CBA released interest rate decisions under the pre-announced schedule 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 process.

Chart 30. Parameters of interest rate corridor, %



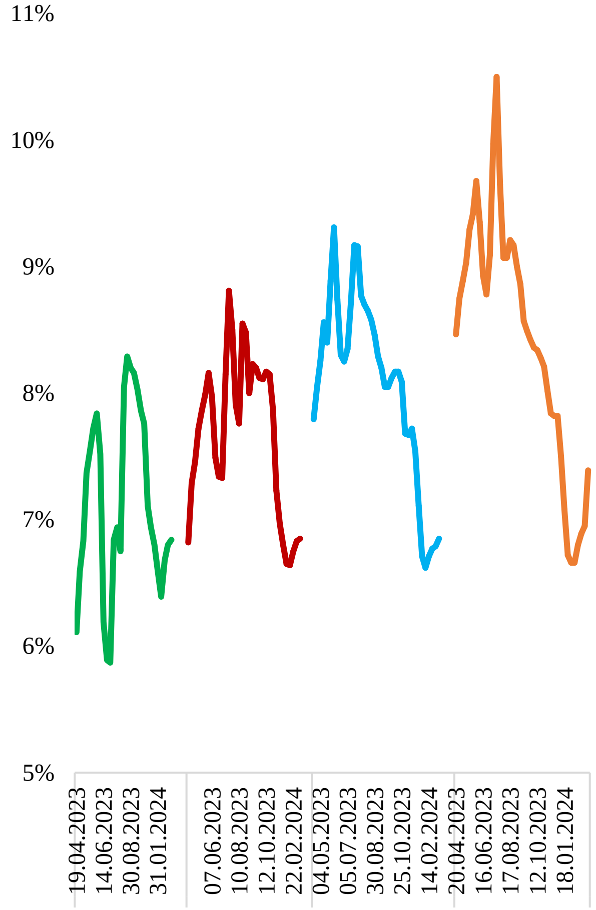
Source: CBA

The CBA continued monetary operations with various duration for liquidity management purpose in Q1

2024. Demand for sterilization tools, especially liquidity absorbing standing facilities by banks was higher. In January-March daily amount of one-day deposit transactions was AZN 1071M.

In addition, 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 29 note auctions have been held over the quarter. Demand prevailed over supply at note placement auctions. As of end-March 2024, total outstanding amount of funds absorbed through notes made AZN1183.5M. Yield at recent auctions was 6.84% on 28-day, 6.85% on 84-day and 168-day, and 7.39% on 252-day notes.

Chart 31.Yield of notes of the various maturities's dynamic



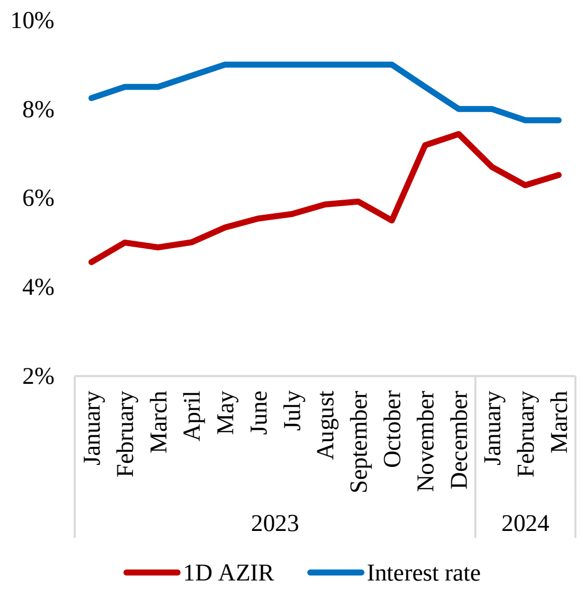
Source: CBA

In January-March 2024, the Bank also conducted seven-day repo operations for liquidity absorbing purposes to regulate interbank money market rates, and operative contain effects of autonomous factors. Yield on this tool at the recent auction was 7.03%. As of the end-period total outstanding amount of repo transactions amounted to AZN59.5M.

To meet banks' liquidity demand, the CBA also conducted one-day reverse repo transactions, a standing facility, three times in February 2024, each amounting to AZN10M along with liquidity absorbing operations.

Money market interest rates continued responding to interest rate corridor changes. In March 2024, the average interest rate on 1-3-day operations (1D AZIR) in the interbank unsecured money market was 6.5%. The spread between the 1D AZIR index and the refinancing rate was shrinking.

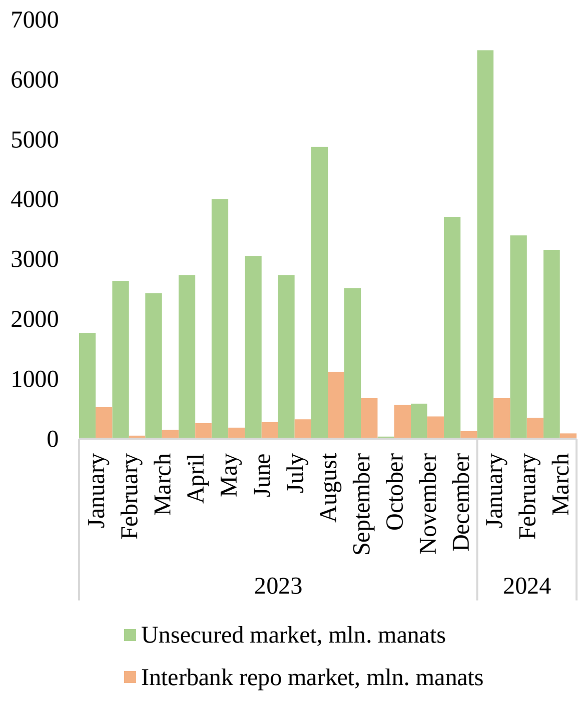
Chart 32. Dynamics of 1D AZIR index



Source: CBA

In January-March 2024, banks concluded AZN13B worth of 501 transactions in the platform launched for unsecured operations in the Bloomberg system. 96% of them were 1–3-day transactions. AZN1.1B worth of 167 transactions were concluded at the interbank Repo market. 40% of interbank Repo operations were 6-8-day transactions. 19% of interbank repo transactions were based on CBA notes.

Chart 33. Interbank money market



Source: CBA

In the first quarter of the year, the application of mandatory reserve norms in the average regime was one of the factors that had a positive effect on the flexible 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 positeve effect on effective management of liquidity by banks and interbank market activity.

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.

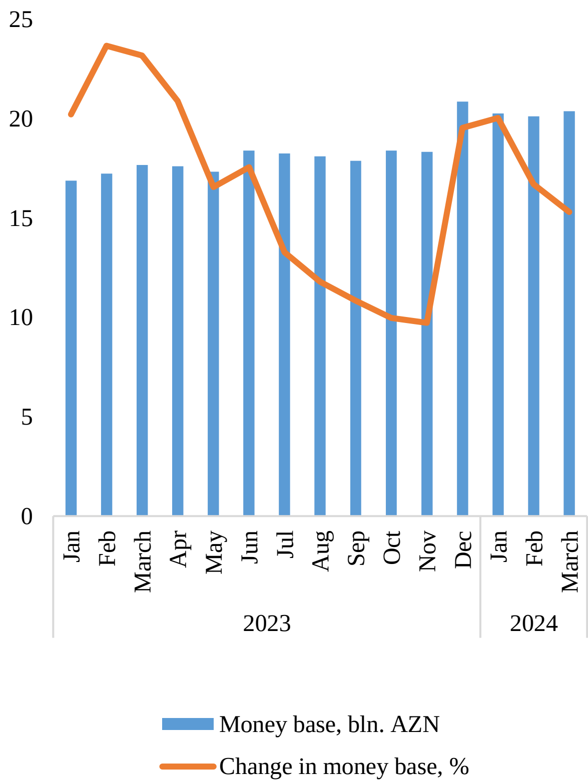
3.2. Money supply

In Q1 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.

In Q1 2024, 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 0.8% and stock of correspondent accounts in manat decreased by 8.5%.

Chart 34. Monetary base and its annual change

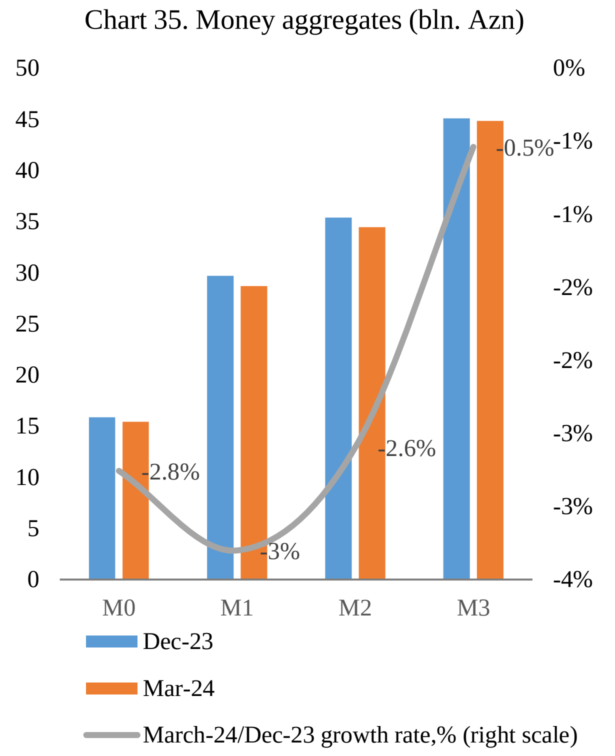


Source: CBA

Money multiplier in manat (broad money supply in manat/base money in manat) has not changed significantly since early year and made 1.69 by the end-year.

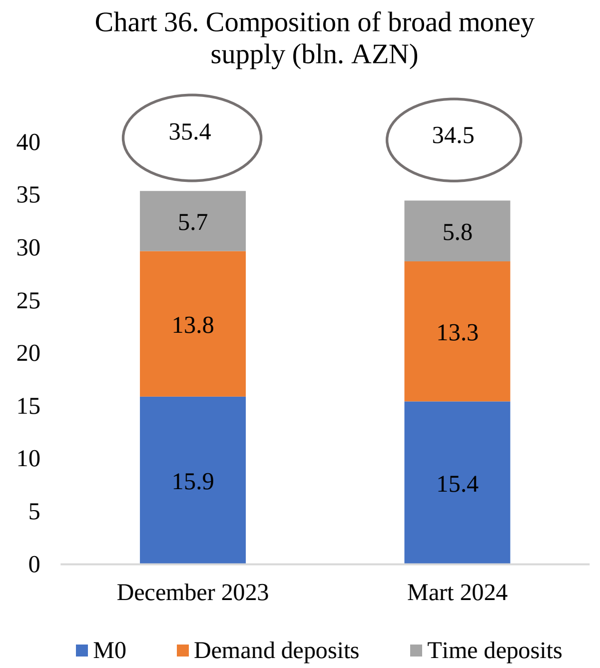
Broad money supply in manat (M2) decreased by 2.6% to AZN34.5B. Broad money supply (M3) decreased by 0.5% to AZN44.8B as of end-quarter.

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



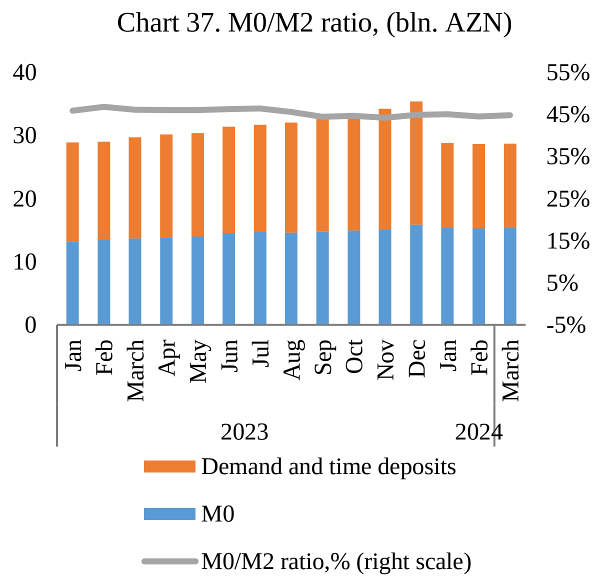
Source: CBA

Over the period structural elements of M2 money aggregate grew at different rates. M0 cash money supply decreased by 2.8%, demand savings and deposits decreased by 3.9%, while term savings and deposits increased by 1.1%.



Source: CBA

The weight of cash (M0) in broad money supply in manat (M2) remained nearly unchanged and made 44.8% at the end of first quarter of 2024.



Source: CBA

As of end Q1 2024 foreign currency denominated savings and deposits amounted to AZN10.4B equivalent (35.3% of total savings and deposits). Foreign currency denominated savings and deposits accounted for 23.1% of M3 money aggregate as of the end-period.

The share of foreign currency in deposits of legal entities was 43.2%, and dollarization of deposits of individuals was 35.1%. Dollarization of deposits of households (less savings of non-resident individuals) was 31.5% as of end-period.

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

3.3. The FX market and the exchange rate of the manat

In Q1 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.

In Q1 2024, cashless transactions in the FX market amounted to $8.9B equivalent[4] - 81% in the USD and 19% in other currencies. The Interbank FX market accounted for 28%, the Intrabank FX market for 72% of the operations.

Over the period interbank FX market operations (including operations of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) and the CBA)) amounted to $2.5B; 97.3% of transactions were conducted in the USD. Currency operations in the Interbank FX market were conducted over the Bloomberg platform.

Intrabank FX market operations amounted to $6.4B equivalent; 74% of transactions were made in US dollars. Legal entities accounted for 92% of Intrabank FX market operations.

Cash currency traded by banks amounted to $1.4B (91.6% in USD).

The CBA held 22 currency auctions to sell foreign currency provided by the SOFAZ.

The official exchange rate of the manat against the 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.

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 the USD, the euro, the pound, the Russian ruble*

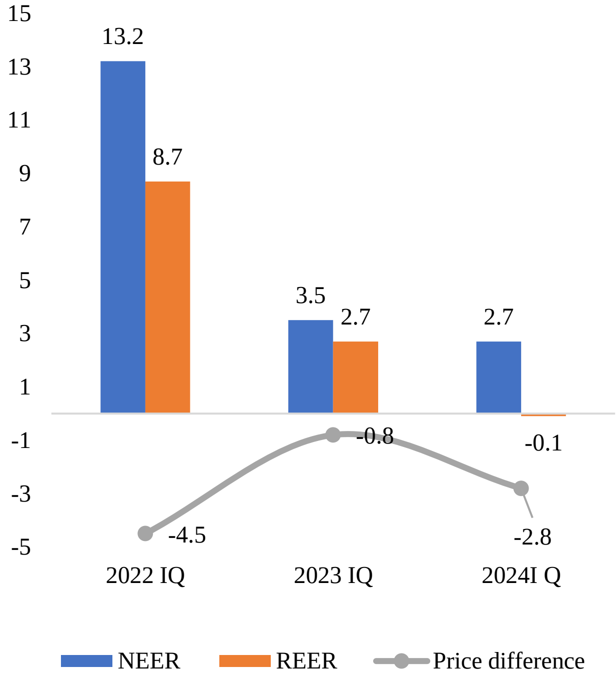
Table 2. Bilateral nominal and real exchange rates of manat against currencies of trade partners in Q1 2024 (December 2023=100), %

	NEER	**REER**
Russian ruble	100.9	100.3
Turkish lira	110.2	97.1
Euro	100.5	100.9
Chinese yuan	100.9	101.9
Iranian rial	100	95.6
US dollar	100	100.3
Kazakh tenge	97.4	96.2
Belarus ruble	99.3	155.2
Japanese yen	104.1	105.1
Georgian lari	100	101.1
Ukrainian hryvnia	104.2	104.3
Swiss franc	102.6	83.2
South Korean won	102.4	88
British pound sterling	99.7	100.5
Israeli shekel	100.9	99.3
Total (NEER, REER)	**102.7**	**99.9**

Source: CBA

In general, the NEER of the manat appreciated by 2.7% and the REER depreciated by 0.1%. Since inflation in Azerbaijan was significantly lower than the average inflation in partner countries, it had a reducing effect on the REER.

Graph 38. Effective exchange rates
(since december of previous year, in %)



Source: CBA

A stronger NEER of the manat functioned as one of the main factors to contain inflation import.

Charts and tables

Charts

Tables

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