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ACRONYMS

CBA The Central Bank of the Republic of Azerbaijan
ILO The International Labor Organization
BCI The Business Confidence Index
IMF The International Monetary Fund
FDI Foreign Direct Investment
WEO World Economic Outlook
SSC The State Statistics Committee
SCC The State Customs Committee
FED The Federal Reserve System
EME Emerging Market Economy
AE Advanced Economy
OECD The Organization for Economic Cooperation and Development
CCI The Consumer Confidence Index
CPI The Consumer Price Index
APPI The Agricultural Producer Price Index
NEER The Nominal Effective Exchange Rate
OPEC The Organization of the Petroleum Exporting Countries
Yoy Year over year
REM Real Effective Exchange Rate
RSM Real Sector Monitoring
IPPI The Industrial Producer Price Index
GDP Gross Domestic Product
WTO The World Trade Organization
FX Foreign exchange
NDA Net Domestic Assets
NFA Net Foreign Assets
EXECUTIVE SUMMARY

Safeguarding macroeconomic and financial stability in the country was the main priority of the CBA during 2021. Since the second half of the year, overall macroeconomic stability was maintained despite rising inflationary pressures, driven by external and internal cost factors.

In 2021, inflationary pressures elevated across major countries of the world, mainly explained by pandemic-related temporary supply-demand mismatch, rapid rise in global commodity prices, supply chain disruptions and high transportation-logistic expenses. Cost factors of foreign origin directly and indirectly translated to domestic price hike.

On the backdrop of considerable deterioration of the external background of inflation, the monetary policy of the CBA was oriented towards easing the effect of cost factors of inflation by managing adequate monetary condition and inflation expectations. The exchange rate stability paved the way to significant neutralization of inflation coming from the external environment. The Central Bank strived to strengthen the downward effect of the monetary policy on inflation through the quantity and value of money. Necessary corrections were made to the interest rate corridor parameters in light of updated macroeconomic forecasts and the balance of risks.
I. GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

1.1. Global economic trends

The year of 2021 was marked with the global economic recovery and higher inflationary pressures. Thus, eased epidemiologic restrictions and realization of deferred demand had a positive effect on economic growth, and the recession of the previous year was replaced with economic growth. Rising energy and food prices, supply chain disruptions resulted in higher than expected lingering inflation in most countries. Spread of the new Omicron variant of COVID-19 starting from second half of the year triggered global economic growth related uncertainties.

Global economic activity. According to the IMF WEO January 2022, global economic activity was estimated at 5.9% in 2021. Over the year, the dynamics of economic activity indicators varied. While the CCI on OECD countries reached the pre-pandemic level in first half of the year, it started to decline on the backdrop of rapid spread of new COVID-19 variants and inflationary pressures in second half. The BCI maintained growth over the year and surpassed the pre-pandemic level.

Graph 1. Business and Consumer Confidence indexes in OECD countries

Source: OECD

According to IMF WEO January 2022 Update, economic growth is projected at 4.4% in 2022 which is 0.5 pp down compared the October WEO. The main reasons include a slow recovery pace in the USA and China, the world’s two largest economies, Omicron-led uncertainties, high energy cost and supply chain disruptions. Inflation may dwell longer due to supply chain breaks and high energy prices. However, inflation is expected to gradually subdue
in 2022 as supply and demand imbalance recedes and the monetary policy in major economies react adequately.

Economic growth forecast for 2022 on AEs was revised down by 0.6 pp relative the October WEO, due to changes in monetary and fiscal policies, and lingering supply chain breaks.

The highest contributors to inflation were rising energy, food and car prices. Unemployment decreased to 3.9% in December 2021, the lowest rate since February 2020.

Over the year, the Dow Jones increased by 20%, the S&P 500 by 34.8%, and the Nasdaq by 22.5%. In December 2021, industrial production in the USA increased by 3.7% on annual, the weakest indicator since March.

The FED kept interest rates stable at 0-0.25%. Amid persistent high inflation, the US Government and the FED announced that they would wind down the stimulus program in 2022.

The IMF estimated economic growth in the euro area to stand at 5.2% in 2021, up vs the October WEO (5%). The Outlook set the 3.9% economic growth forecast for the euro area for 2022.

In December, 12-month inflation in the euro area was 5%, the highest annual inflation rate of recent 30 years. High inflation is attributable to rising
prices of oil and natural gas and the chronic disruption in supply chain.

In December 2021, industrial production Yoy increased by 1.6%. Unemployment in the euro area was 7%, the lowest rate of recent years. The highest inflation was in Spain (14.1%), Italy (9.2%) and France (7.5%), while the lowest inflation was in Holland (2.7%) and Germany (3.2%). During the year, the FTSE Eurotop index increased by 23.1%. In 2021 the ECB left the policy rate unchanged.

In 2021 economic growth in Japan is estimated at 1.6%, down vs the October WEO (2.4%). The WEO January predicts 3.3% economic growth in Japan in 2022. In December, 12-month inflation was 0.8%, the highest rate since December 2019. Unemployment was 2.7% in December 2021, higher than expectations. In December industrial production Yoy increased by 0.4%. In December 2021, unemployment stood at 4.1%. Over the year, the Bank of England increased the policy rate from 0.1% to 0.25%.

According to the WEO January Update 2021, growth in EMEs is estimated at 6.5% in 2021. The January Update revised down economic growth forecast for EMEs by 0.3 pp to 4.8%, mainly due to real estate crisis in China and expectation that the monetary policy will have a negative impact on domestic demand in Brazil and Mexico to fight inflation. Economic growth forecast was revised up on certain raw material
exporting EMEs. Weaker than expected economic recovery on emerging Asian markets, in particular, weaker economic growth outlook in ASEAN countries, pushed revision down of their economic growth outlook for 2022. In 2022 emerging Asian markets are expected to grow by 5.9% (6.3% in October WEO), emerging European markets by 3.5% (3.6% in October WEO), Latin America and the Caribbean by 2.4% (3% in October WEO), the Middle East and Central Asia by 4.3% (4.1% in October WEO) and Sub-Saharan Africa by 3.7% (3.8% in October WEO).

The Chinese economy is estimated to grow by 8.1% in 2021. According to the latest IMF outlook, in 2022 the Chinese economy is predicted to grow by 4.8%, 0.8 pp down vs October WEO. The reasons include swings in Chinese housing market, the strict anti-COVID policy and geopolitical tensions. In December 2021, annual inflation dropped to 1.5%, lower than 2.3% in November, the highest rate of recent 15 months and market expectations (1.8%). Industrial production increased by 4.3% in 2021. In December, unemployment stood at 5.1%, the highest rate of recent 5 months.

The WEO January 2022 estimates 4.5% economic growth in Russia in 2021, down vs October WEO (4.7%). Russia will grow by 2.8% in 2022. In December 2021, annual inflation in Russia was 8.4%, the highest rate in Russia since 2016, more than twice as much the Bank of Russia’s 4% target. In December 2021, the unemployment rate dropped to 4.3%, in line with market expectations. This indicator is the lowest unemployment rate since August 2019. In December, industrial production Yoy increased by 6.1%. The Russian ruble nearly remained stable against the USD. The Bank of Russia tightened the monetary policy in light of inflation expectations, and increased the policy rate from 4.25% to 8.5% stepwise.

In 2021, economic growth in Turkey is expected to be 9.5% (the World Bank). In December 2021, industrial production increased by 14.4% on annual basis, higher than market expectations (11.2%). Production of
durable consumer goods increased by 13.9%, machinery and equipment by 22%, and energy products by 6.9%. Unemployment decreased to 11.2% in December. 12-month inflation was 36.1% (market expectations 30.6%) in December 2021, the highest inflation rate since September 2002. In 2021 the Turkish lira depreciated by 73.4% against the USD. In H1 the Central Bank of Turkey shifted the policy rate to 19% from 17% and reduced up to 14% in H2.

According to the WEO January Update, global trade is estimated to grow by 9.3% in 2021 (forecast in previous report was 9.7%). In line with revival in global economic activity global trade is expected to grow by 6% in 2022 (previous forecast 6.7%) in 2022.

**Prices in commodity markets and global inflation.** Global commodity prices rose in general amid uncertainties triggered by new COVID-19 variants. According to the World Bank’s Commodity Markets Outlook, in 2021 energy prices hiked by 76.8%, non-energy prices by 20.2%, and food prices by 17.4%. The gold price decreased by 4.7% in 2021.

According to the Food and Agriculture Organization of the United Nations (FAO), food prices hiked to a 10-year high, but relatively slowed down in December. In 2021 global food prices hiked by 23.1%. The largest price hike was in butter, sugar, flour and dairy products.

The average Brent oil price was $70.93 per barrel in 2021, 64.72% higher than the average price for 2020 ($43.1). The Energy Information Administration (EIA) forecasts $75 in 2022 and $68 in 2023 per barrel for Brent oil price.
The inventory level is one of the key factors that translate to the rise in oil prices. Lower than those in 2019, current oil inventories push prices up. However, reinstatement of restrictions due to new COVID-19 variants will both reduce demand for oil and slow down price rise. High extraction within OPEC++ and activation of shale oil producers in the USA may also lead to lower prices.

According to the Oil Market Report of the International Energy Agency (IEA), in 2022 oil consumption will increase by 3.3 mln b/d to the pre-pandemic 99 mln b/d.

The natural gas price sharply increased over the reporting year. The natural gas price surged by 6.5 times as much to $1200 per m3 in Europe in December. Rising demand for natural gas, high LNG prices in Europe and Asia, supply delays due to disruptions in global trade and cold weather conditions paved the way to price hikes in 2021.

High transportation and logistics expenses and longer delivery periods are one of the reasons for intensification of global inflation. In September 2021 the Baltic Dry Index, the index of transport of dry bulk materials, reached its highest level since 2008. Though dropped in the last quarter of the year, the index is still higher than the pre-pandemic level. The IMF recommends the reduction of tariffs and removal of trade barriers to eliminate problems in supply chain and its pass-through to inflation.

According to WEO January 2022 Update, in 2022 supply chain disruptions and high energy prices may have an upward effect on inflation. Pandemic triggered uncertainty increases the risk of persistence of inflation expectations.

Recovery of the balance between demand and supply and an adequate
response of monetary policies in AEs to these developments may gradually subdue inflation in 2022. Inflation is predicted to stand at 3.9% in AEs and at 5.9% in EMEs in 2022.

**Risks and policy recommendations.** According to WEO Update, January 2022, global risks have entered a downside phase. However, delay in vaccination may lead to emergence of new COVID-19 variants, likely to pose new risks for the global economy. As advanced economies lift policy rates, risks to financial stability and capital flows, exchange rates and fiscal positions may emerge in EMEs.

In general, the IMF classifies risks resulting from current macroeconomic and epidemiologic situation as follows:

- Difficulties in fighting the virus with the emergence of new strains due to global unequal flow of the rapid and effective vaccination program, adopted as the main way out of the pandemic;
- The threat of rising labor cost to elevate inflation;
- Persistent global supply chain disruptions accompanied by longer than expected breaks;
- Translation of the economic growth slowdown in China to global expectations through commodity exporters and EMEs;
- Failure of the tighter monetary policy in the USA to bring inflation back down to the 2% medium-term goal to yield proper results due to supply disruptions and wage pressures and impact of the disruptions on markets;

Persistent rise in commodity prices may slow growth in energy importing countries and weaken food security in low-income countries. Most EMEs are expected to increase policy rates in response to rising inflation. Other risks to the global economy include economic and political risks triggered by global climate change and geopolitical tensions.

The IMF in its recent outlook considers effective monetary policy communication a key tool for central banks in fighting overreactions in financial markets. In accordance with the recommendations of the Fund, central
banks should accurately determine the level of intervention to markets. As financial shortages dwell in a number of sectors, complications of the tight monetary policy may yield hard consequences. Amid the uncertainty created by the Omicron variant central banks should effectively use macro prudential tools targeting vulnerable areas. Countries should continue the policy to curb inflationary pressures, prioritize health and social expenses, at the same time, orient fiscal support towards most pandemic-affected areas.
1.2. External sector developments of the Azerbaijani economy

In 2021 the external position of Azerbaijan shaped on the backdrop of the realization of non-oil export potential and rising prices for main export products.

According to the SCC, foreign trade turnover amounted to $33.9B – export $22.2B (65.5%), import $11.7B (34.5%). Foreign trade surplus made up $10.5B, Yoy up by 3.5 times. Forecasts suggest that if current trends linger, foreign trade will be in surplus in 2022 too.

Source: SCC

Azerbaijan traded with 188 countries over the year.

Graph 5. Trade balance, USD bn.

Graph 6. Main trade partners, 2021

Source: SCC

Italy, Turkey, Russia, China, Germany, Israel and Ukraine account for over half of trade turnover. Italy accounts for the highest share as in previous years.

Export increased by 61.6%, non-oil export by 46.6%. The value of export increased by 41.2% on crude oil, by 2.2 times on oil products and by 2.5 times on natural gas.

Though decreased by 4% in Q1 2021, oil export posted growth from the Q2 onward. Non-oil export has been growing at a high rate since early year.
1.2. External sector developments of the Azerbaijani economy

Monetary Policy Review ● January - December 2021

46% of crude oil and oil products was exported to Italy, 7% to Israel, 6% to Croatia, 5% to Germany and 4% to Portugal.

Non-oil products were mainly exported to Russia ($0.9B or 32.4%), Turkey ($0.7B or 25%), Switzerland ($0.2B or 8.3%), Georgia ($0.2B or 5.8%), and USA ($0.1B or 2.8%).

Commodity import increased by 9.1% - it decreased by 33.8% to $1.2B on the public sector, increased by 15.1% to
$9.1B on the private sector, and by 37.8% to $1.4B on individuals.

Import increased by 40.1% on pharmaceuticals, by 22.7% on furniture, by 17.6% on food products, by 12.1% on plastics and products, 8.4% on machinery and equipment, by 54.8% on fertilizers, by 13.3% on vehicles and parts, and by 8.3% on ferrous metals and products.

Russia accounts for 17.7%, Turkey for 15.8%, China for 14%, Germany for 5.4%, Ukraine for 4%, the USA for 3.8% and Italy for 3.6% of imported products.

Services also underwent positive trends. The value of operations by foreign citizens with bankcards Yoy increased by 3 times to $1.3B (Source: https://ereforms.gov.az).

At the same time, satellite telecommunications and optical satellite services, also play an important role in the diversification of service exports. Hence, the AzerSpace OJSC exported $45.3M worth of services to 41 countries.
1.2. External sector developments of the Azerbaijani economy

According to initial data, money remittances to the country Yoy increased by 3.6% to $1.1B.

**Graph 12. Inflow of remittances, mln.$**

<table>
<thead>
<tr>
<th>Year</th>
<th>Remittances (mln.$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>934</td>
</tr>
<tr>
<td>2020</td>
<td>1094</td>
</tr>
<tr>
<td>2021</td>
<td>1133</td>
</tr>
</tbody>
</table>

*Source: CBA*

Capital inflows from foreign enterprises and organizations continued over the reporting period. According to the SSC, FDIs amounted to AZN4.3B (26.9% of total investments).

**Graph 13. Foreign investments, mln. manat**

- 2019: 5189
- 2020: 5117
- 2021: 4332.7

*Source: SSC*

The UK, Turkey, Switzerland, the USA, Japan, Malaysia, France, Norway and Iran account for the significant share of the capital investments by foreign countries and international organizations.

Strategic foreign exchange reserves still exceed the internationally accepted adequacy norms. Strategic FX reserves sufficed for 41 months’ import of goods and services (taking import of goods and services for 9 months of 2021). Strategic reserves exceeded money supply in manat (M2) by 4 times (M2 money aggregate as of 01.01.2022). Strategic FX reserves nearly equate to annual GDP.
II. MACROECONOMIC DEVELOPMENTS IN AZERBAIJAN

2.1. Aggregate demand

In 2021 aggregate demand was driven by the recovery of consumer demand supported by the rise in income of the population.

Consumption expenditures increased. According to the SSC, the value of commodities and services sold in the consumer market exceeded the pre-pandemic both nominally and really.

Goods and services sold in the market to meet consumer demand increased by 3.7% in real terms to AZN53B on Yoy basis. The private sector accounts for 96.4% of the goods sold and services supplied by economic agents (49.8% individual entrepreneurs).

Every consumer spent on average AZN440.5 in the consumer market (Yoy up by AZN40.1) over the reporting year.

Rapid vaccination and concurrent easing of social isolation measures was aided by recovered consumer demand.

Retail trade turnover Yoy increased by 3.2% to AZN44.2B in real terms. Non-food trade turnover increased faster and reached pre-pandemic levels. Retail commodity turnover on food products, beverages and tobacco products increased by 2.5%, and non-food trade turnover increased by 3.9%.

Source: SSC

Graph 14. Change in sales of consumer market

Nominal volume of sales, bln. manat
Real growth of sales, % (right scale)
2.1. Aggregate demand

Conventionally, consumers spent most of their funds (54.3%) on food, beverages and tobacco products in retail trade outlets. Related expenses Yoy increased by 2.5% - by 2% on textile products, apparel and shoes, by 24.8% on pharmaceuticals and medicals, by 3.9% on fuel, and by 3% non-food staff.

Table 1. The share of spending items in trade outlets, %

<table>
<thead>
<tr>
<th>Spending item</th>
<th>Share, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2020</td>
</tr>
<tr>
<td>Food, beverage and tobacco</td>
<td>54</td>
</tr>
<tr>
<td>Textile products, apparel and shoes</td>
<td>16</td>
</tr>
<tr>
<td>Electric appliances and furniture</td>
<td>5.4</td>
</tr>
<tr>
<td>Computers, telecommunication devices and others</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Source: SSC

Every consumer purchased on average AZN367.8 worth of food, beverage and tobacco (Yoy up by AZN32.2 in nominal terms) in retail trade – AZN200 on food, beverages and tobacco products, and AZN167.8 on non-food staff.

Catering turnover Yoy decreased by 23.2%. The value of paid services to the population increased by 4.8% in real terms to AZN7.8B. Per capita paid services consumption Yoy increased by AZN72.7 to AZN774.4 in nominal terms.

Return of nominal income and nominal wages to positive growth dynamics was one of the main factors that weighed on consumer behavior. According to the SSC, money income of the population increased by 2.6% nominally to AZN57.2B. Per capita money income was AZN5708. Population’s disposable income increased by 1.5% to AZN51.3B.
Lending activity also positively translated to consumer demand. Loans to households increased by 28.3% to AZN8.6 B.

Over the reporting year, despite recovery of the positive growth dynamics across all sectors except for construction and revival of consumer demand, uncertainties triggered by the spread of new COVID-19 variants and elevated inflation weighed on the CCI as evidenced in CBAR survey ‘Households financial behavior and intentions’ that reflect consumers expectations for the future. Note that this indicator rests upon ‘Family’s financial condition expectation’, ‘Expectation on country’s economic standing’, ‘Savings probability’ and ‘Unemployment expectations’ surveys among various income households.

**Government spending** was crucial in supporting domestic demand. State budget expenditures were AZN27.4 B.¹

Social spending (compensation for employees, pension and social allowances, medicine and food) accounted for 37.6% of actual state budget expenditures (AZN10.3B), Yoy up by AZN642.9M, or 6.7%.

**Investment expenditures.**

According to the SSC, AZN16.1B worth of funds were invested to the economy. Investment to the non-oil and gas sector amounted to AZN10.4B. The public sector accounted for 46.6% and the private sector for 53.4% of total investments.

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73.1% of investments stemmed from internal, 26.9% from external sources.

Source: SSC

Funds of enterprises and organizations prevailed in total investments (54.7%). Population’s personal funds increased slightly year over year.

Source: SSC
2.2. Aggregate supply and employment

Economic activity saw a boost in response to wider domestic and foreign demand and economic growth surpassed the pre-pandemic level.

**Economic growth.** According to the SSC, GDP increased by 5.6% in real terms to nominal AZN92.9B. Per capita GDP made AZN9269.3.

Oil and gas value added increased by 1.8%, its nominal value was AZN35B. The mining sector extracted 34.5 m/t crude oil and 32.6 bln/m³ natural gas. Oil extraction Yoy increased by 0.1%, gas extraction increased by 23%. Total cost of production in oil products Yoy increased by 2.6% in real terms.

Non-oil value added Yoy increased by 7.2% in real terms and its nominal value was AZN57.8B. The oil-gas sector accounted for 37.8%, while the non-oil sector accounted for 62.2% of GDP.

Non-oil output increased by 18.9%. Output increased by 29.8% in production of shoes, by 8.3% on computers, electronic and optic products, by 54% on tobacco products, by 2.3% on production of beverages, by 24.8% on production of furniture, by 26.5% on paper and cardboard, by 80.6% on construction materials, by 13.4% on oil products, by 10.2% on food products, by 16.9% on metallurgic products, by 21.3% on production of vehicles, trailers and
semitrailers, and by 25.5% on chemical products. Moreover, production of apparel decreased by 21.7%, installation and repairs of machinery and equipment by 9.1%, electric appliances by 11.2%, and printing products by 45.2%. Amid high demand for pharmaceuticals due to the pandemic and launch of local enterprises, production of pharmaceuticals increased by 88%. Reconstruction in liberated areas had an upward effect on rise in construction materials production.

Yoy growth in agriculture was 3.4%, including 2.8% growth on animal products and 4% on plant products.

Table 3. GDP structure, weight in percentage

<table>
<thead>
<tr>
<th>Sectors</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>33.7</td>
<td>42.5</td>
</tr>
<tr>
<td>Construction</td>
<td>7.7</td>
<td>5.9</td>
</tr>
<tr>
<td>Agriculture, forestry and fishery</td>
<td>6.9</td>
<td>5.9</td>
</tr>
<tr>
<td>Trade, repair of vehicles</td>
<td>11.5</td>
<td>10.1</td>
</tr>
<tr>
<td>Transport and warehousing</td>
<td>7.1</td>
<td>6.9</td>
</tr>
<tr>
<td>Tourism and catering</td>
<td>1.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Information and communication</td>
<td>2</td>
<td>1.8</td>
</tr>
<tr>
<td>Other</td>
<td>20.2</td>
<td>17.2</td>
</tr>
<tr>
<td>Net taxes on products and import</td>
<td>9.7</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: SSC

In general, all sectors posted economic growth in the GDP structure, except for construction.

Table 4. GDP growth rate on sectors, weight in percentage

<table>
<thead>
<tr>
<th>Sectors</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industry</td>
<td>-5</td>
<td>4.1</td>
</tr>
<tr>
<td>Construction</td>
<td>-8.7</td>
<td>-2</td>
</tr>
<tr>
<td>Agriculture, forestry and fishery</td>
<td>1.9</td>
<td>3.3</td>
</tr>
<tr>
<td>Trade, repair of vehicles</td>
<td>-1.3</td>
<td>5.3</td>
</tr>
<tr>
<td>Transport and warehousing</td>
<td>4.6</td>
<td>16.0</td>
</tr>
<tr>
<td>Tourism and catering</td>
<td>-58.9</td>
<td>34.2</td>
</tr>
<tr>
<td>Information and communication</td>
<td>0.6</td>
<td>6.1</td>
</tr>
<tr>
<td>Other</td>
<td>-0.9</td>
<td>5.1</td>
</tr>
<tr>
<td>Net taxes on products and import</td>
<td>-2.9</td>
<td>8.6</td>
</tr>
</tbody>
</table>

Source: SSC

CBA’s real sector survey findings confirm that the economic activity elevated over the reporting year. The BCI varied across sectors and months.

While the BCI in the industry dropped by the end-year, it was positively zoned over the year, in particular driven by the production of chemical products, metallurgy, construction, plastics, food products and beverages, non-metal mineral products. The BCI improved
relative to the previous year across all sectors, except for machinery, food products and beverages.

 Whereas the BCI weakened on trade by the end-year, in general it improved relative to the previous year. The BCI grew at a higher rate in the trade of electric appliances and houseware.

 The BCI on services followed positive dynamics relative to 2021. The BCI Yoy was higher in the areas other than the postal service and healthcare. Negatively zoned on transportation, tourism and hotels in 2020 the BCI gradually shifted to a positive zone in 2021.

 Whereas the BCI in construction weakened by the end-year, it was higher than previous year exhibiting positive dynamics.

\[
\text{Graph 20. Business Confidence Index (yearly average)}
\]

Source: RSM findings based CBA estimations²

**Employment.** As of 1 January 2022 labor force was numbering 5303.9 thousand persons, Yoy up by 51.4 thousand persons. The number of employed population was 4988.2 thousand persons, Yoy up by 111.6 thousand.

The number of hired labor was 1704.9 thousand persons as of 1 January 2022, Yoy up by 0.1%: those involved in the public sector was 905.7 thousand, non-public sector 799.2 thousand.

² *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*
*Construction BCI = (orders received for execution + staff number changes expectations)/2*
24% of the hired labor in enterprises and organizations was involved in production: 7.6% in processing, 7.4% in construction, 3.6% in agriculture, forestry and fishery, 1.9% in mining, 1.9% in water supply and waste management.

Source: SSC
2.3. Inflation

In 2021 accelerated inflation in the world and in main trade partners, as well as the effect of cost factors with high pass-through capacity weighed on the inflation rate, in particular on the dynamics of food prices.

**Consumer Price Index (CPI).**

According to the SSC, in 2021 12-month inflation made 12% (December 2021 vs December 2020). Average annual inflation was 6.7%.

Graph 22. 12-month and average annual inflation, in %

As in previous years over the reporting year, food price hike made more contribution to overall inflation. Annual food inflation was 15.8%, average annual food inflation was 8.1% in December.

Rising world food prices had a severe impact on food inflation via imports. In particular, world food prices had a significant effect on the rise in prices for butter, vegetable oils, sugar and dairy products, as well as flour products.

Non-food prices have risen by 7.7% over recent one year. Average annual non-food inflation was 5.1%. The highest annual price hike was on fuel (20%) and construction materials (13.5%).

Services prices hiked by 10%. Average annual service inflation was 5.8%. Service inflation was mainly driven by liberalization of government regulated prices and tariffs. Over the year prices for cold water supply and sewerage service increased by 2 times, natural gas supply by 27% and power supply by 12.5%. In addition, prices increased by 30.1% for air transport services, by 12.3% for catering services, by 9.7% for rents and by 7.7% for medical services.
Food prices contributed 6.9 pp, non-food prices 1.8 pp, change in prices and tariffs for services 3.3 pp to annual inflation. Apparently, the contribution of the price hike of non-food stuff and services to total inflation increased compared to previous years.

Graph 23. Contributions components of CPI, %

Source: SSC, CBA

The diffusion index – a measure of the change in dynamics pertaining to the number of goods and services with rising and falling prices in the consumer basket was variable 3.

Graph 24. Diffusion index, %

Source: SSC data-based CBA estimations

Of the 519 items of goods and services included in the consumer basket, the prices for 316 or 61% increase in the range of 4-12% annually. In 45% of rising prices, the price increase was less than 8%. Prices for 2.5% of products and services in the basket decreased.

Source: SSC, CBA

3 The index is calculated as (increasing-decreasing)/(decreasing+unchanged).
2.3. Inflation

Average annual core inflation calculated by excluding swings in regulated prices and prices for seasonal agricultural products was 4.2% in 2021.

The dynamics of actual inflation over recent months weighed on inflation expectations. According to December surveys, 82% of households expect inflation. 28.6% expect the inflation rate to be higher.

Analysis of inflationary factors suggests that over half of direct and indirect price hike relates to factors of foreign origin. In 2021 import prices hiked by over 21%. High import prices in their turn are attributable to hiked global commodity prices, high transportation-logistic expenses, and historical highs of inflation of recent decades in partners.

In 2021, the demand and supply mismatch amid global mass anti-
COVID-19 vaccination, gradual easing of lockdown measures in particular countries and large-scale fiscal-monetary stimulus programs triggered unprecedented inflationary pressures in most countries. Last year inflation considerably exceeded targets in main trade partners – compared to the target annual inflation was higher by 2.4 times in the USA, by 2.6 times in the euro area, by 2.1 times in Russia, by 1.7 times in Kazakhstan, by 2 times in Belarus, by 2 times in Ukraine, by 4.6 times in Georgia and by 7.2 times in Turkey.

The Baltic Dry Index, the index of transport of dry bulk materials, had risen since 2008 and peaked in September 2021. Though slightly decreased last quarter of the year, the index is still higher than the pre-pandemic level.

Rising producer prices amid the lingering pandemic and ongoing effects of liberalization of government-regulated prices also influence cost factors of inflation. The effect of government-regulated prices on annual inflation is estimated to exceed 20%.

The current macroeconomic stability platform served as a factor to curb inflation. The favorable balance of payments, stable exchange rate of the national currency and its anti-inflationary role, and the conservative monetary policy were the key elements of the platform.

According to base scenario-based forecast, annual inflation will range from 6.6% to 7.1% in 2022. Downward forecast of inflation in 2022 relative the previous year is mainly explained by the slowdown of rise in global commodity prices and moderating inflation in partner countries, as well as expected effects of monetary policy tightening. If other conditions remain stable and current trends continue, inflation may enter the target band after Q1 2023. Inflation forecast will be regularly updated depending on inflation factors.

**Producer Price Index.** According to the SSC, in December the APPI grew by 17% over the recent 12 months. Prices increased by 10.4% on animal and by 24.4% on plant growing products on annual basis. In parallel, the PPI on forestry increased by 1.9%, and by 3.3% on fish and other fishery products.
In December, the IPPI increased by two times as much on annual, mostly due to the mining industry (up by 2.4 times). The IPPI grew by 2.3 times on oil-and-gas products, and by 18.1% on non-oil products. Price hike in the mining industry mainly relates to a year over year rise of the oil price in world markets.

The PPI on processing increased by annual 29.5%. The highest price hike was in the production of oil products (55%), chemical industry (44%), and metallurgy (42%).

Graph 28. Annual PPI change, current year, %

Source: SSC

In 2021, transportation service prices increased by 5.8% on annual. The cost of freight transportation increased by 2.3% and passenger transportation by 24.2%. Price hike in freight transportation mainly relates to price hike in vehicles (11.3%). Rise in passenger transportation is put down to annual 28% rise in passenger transportation by air. Moreover, prices for postal and courier services increased by 1.9%, while they remained unchanged for communication services.
II. THE MONETARY AND EXCHANGE RATE POLICY

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

In 2021, the exchange rate of the manat against foreign currencies was formed in accordance with the supply-demand ratio in the foreign exchange market. Huge balance of payments surplus was aided by wider supply in the FX market, which underpinned the main price stability anchor – the exchange rate stability.

The value of operations in the FX market varied across segments of the market over the reporting year.

Cashless transactions in the FX market Yoy increased by 7.4% to $27.8B equivalent\(^4\): 86.4% in USD and 13.6% in other currencies. The Interbank FX market accounts for 29.7% and the Intrabank FX market for 70.3% of operations.

99.5% of operations in the Interbank FX market was denominated in USD, 0.5% in EUR. Currency operations in the Interbank FX market were mainly conducted over the Bloomberg platform.

Intrabank FX market operations made $19.5B equivalent (80.9% in USD). Legal entities account for 95.2% of the foreign currency operations in the Intrabank FX market.

Cash currency traded by banks Yoy decreased by 21.5% to $4B equivalent (85% in USD). Drop in cash FX trading is attributable to dedollarization.

![Graph 29. Net sale of cash FX by banks in 2021, mln.manat](image)

Source: CBA

Positive zone stands for sell, negative zone for buy operations.

---

\(^4\) Including operations in the USD, the euro, the pound, the Russian ruble
The CBA continued to organize auctions to arrange the sale of foreign currency provided by the State Oil Fund of Azerbaijan Republic (SOFAZ). Market participants were informed on auction parameters via the Bloomberg terminal prior to auctions. The Bank held a total of 99 currency auctions in 2021. Though increased in January due to expectations triggered by indirect effects of developments in the external environment, demand in the FX market has decreased and stabilized since February. Better expectations resulting from persistent rise in world oil prices had an additional stabilizing impact on the FX market. The CBA’s intervention in the FX market was purchase-oriented and amounted to $245 M.

The official exchange rate of the manat was set on the basis of the average exchange rate on interbank transactions in 2021 (both auction and over-the-counter on the Bloomberg platform). The average official AZN/USD exchange rate was AZN1.7 in 2021. Buy-sell exchange rates set by banks were close to the official one. Commercial banks’ average buy/sell rate was 1.6993/1.7024. The difference between the official exchange rate and average daily buy rates was AZN0.0007 and sell rates AZN0.0024.

The exchange rate of the manat varied against the currencies of trade partners. It appreciated against the euro, the Turkish lira, the pound and the Japanese yen, and depreciated against the Swiss franc, the Ukrainian hryvnia and the Georgian lari.

The dynamics of bilateral exchange rates influenced that of multilateral exchange rates. In general, total trade weighted non-oil NEER of the manat appreciated 12.1%, and the REER by 12.4%.

![Graph 30. Effective exchange rates (annual change)](image)

Source: AMB

To note, the REER depreciated by 22.4% relative end-2014.
3.2. Monetary policy tools

In 2021, monetary policy tools were applied in light of the trajectory of inflation, macroeconomic forecasts and targets, and the balance of risks on inflation.

The Management Board of the Central Bank discussed interest rate corridor parameters 8 times in 2021. The Bank took interest rate corridor parameters related decisions considering recent macroeconomic forecasts and trends, significant deterioration of the external background of inflation, factors with a push effect on prices in the balance of risks, as well as domestic non-monetary factors.

In the first half of 2021, the CBA took a pause in making changes to the refinancing rate. Starting from the second half of the year the Bank took a decision to increase the refinancing rate three times in a row – in September, October and December from 6.25% to 7.25% in response to accelerating inflation. The ceiling of the interest rate corridor was shifted to 8.25% from 6.75% and the floor to 6% from 5.75%. The decisions served to strengthen downward effects of monetary factors on inflation. The CBA made interest rate related decisions public under a pre-announced schedule and with relevant analytical comments.

The CBA continued various term market operations to manage liquidity in the economy effectively.

The Bank held 38 note auctions in 2021. Long-term notes (84-, 168-, 252 day) were issued at 3 and 28-day notes at 35 of them. In general, total outstanding amount of sterilization via notes was AZN200M as of end-2021.

Source: CBA
Demand prevailed over supply at auctions on placement of notes; as a result, yield on these tools was close to the floor of the interest rate corridor (6.01%).

Notes issued by the CBA were used as collateral in the REPO market and had a positive effect on the activation of the money market. The value of the corporate REPO market Yoy increased by 4.2 times to AZN5.8B, while the size of the interbank REPO market increased by 1.7 times to AZN1.2 B.

Reserve requirements were left unchanged and being applied on an average basis allow banks to flexibly manage the liquidity. Monitoring findings display that banks’ cumulative balances on correspondent accounts with the CBA significantly exceeded total funds to be maintained as required reserves.
3.3. Money supply

In 2021, the dynamics of money supply has changed over the months. Having fallen since early year money supply increased mainly due to high budget expenditures from a treasury account by the end-year.

Money base in manat increased by 32.2%. However, excluding term deposit operations with certain systemically important banks, money base increased by 14.8% to AZN15.6 B as of end-period.

Table 5. Money aggregates, billion manat

<table>
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<th>01.01.22</th>
<th>Growth rate (%)</th>
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<tr>
<td>M0</td>
<td>10.8</td>
<td>10.9</td>
<td>1.6</td>
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<tr>
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<td>17.9</td>
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<td>M2</td>
<td>20.3</td>
<td>23.9</td>
<td>17.6</td>
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<tr>
<td>M3</td>
<td>29.2</td>
<td>34.6</td>
<td>18.7</td>
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Cash in circulation, a structural element of base money in manat increased by 4%, stock of correspondent accounts in manat doubled excluding deposit operations with certain banks.

Broad money supply in manat increased by 17.6% to AZN23.9B as of end-year. Cash in circulation, demand and term deposits in the structure of money supply in manat (M2) performed differently.

Cash in the structure of broad money supply increased by 1.6% (45.8% of M2), manat denominated demand savings and deposits increased by 35.8% (40.3% of M2) and term deposits increased by 35.3% (13.8% of M2).

Cash ratio (M0/M2) decreased by 7.2 percentage point to 45.8%.

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5 Cash money outside the banking system, cash in bank ATMs and cash offices
Manat denominated deposits of legal entities increased by 50.1%, and savings of individuals increased by 35.4%.

Broad money supply (M3) increased by 18.7% to AZN34.6B as of year-end period. 9.4% rise in Net Foreign Assets and 34.7% rise in Net Domestic Assets contributed to the change in broad money supply.

In 2021 dollarization of deposits was prone to decreasing. The share of foreign currency denominated savings and deposits in total savings and deposits decreased by 2.8% to 45.4% as of end-of-December. The share of deposits in M3 money aggregate amounted to 31.1% as of end of year.

The share of foreign currency in deposits of legal entities had decreased by 5.9 pp since early 2021 to 52.2% as of end-period. Dollarization of savings of individuals had decreased by 9.8 pp since early year to 41% (the lowest indicator since 2015).
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