



**CENTRAL BANK**  
OF THE REPUBLIC OF AZERBAIJAN

# **MONETARY POLICY REVIEW**

*JANUARY-SEPTEMBER 2021*

*No 3*

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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 Economies
AE	Advanced economies
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	Nominal Effective Exchange Rate
OPEC	The Organization of Petroleum Exporting Countries
Y.o.y.	Year over year
REER	Real Effective Exchange Rate
RSM	Real Sector Monitoring
IPPI	The Industrial Producer Price Index
GDP	Gross domestic product
WTO	World Trade Organization
FX	Foreign exchange
NDA	Net domestic assets
NFA	Net foreign assets

## **EXECUTIVE SUMMARY**

*Over 9 months of 2021 the Central Bank implemented its monetary policy on the background of recovery in global and national economies, accelerated vaccination in major countries of the world, high global prices for main export products, improved indicators of the balance of payments, and activated non-monetary external and domestic cost factors of inflation.*

*Monetary policy decisions were taken in light of the dynamics of inflation, the nature of factors that translate to inflation, changes in the balance of risks of inflation, medium-term inflation forecast and expectations.*

*Monetary policy decisions were oriented towards containing potential push effect of monetary factors of inflation on the level of prices and returning it to the target band through relative tightening of the monetary condition, and corrections were made to the interest rate corridor parameters. To effectively manage liquidity in the economy the Central Bank adequately used various market operation tools. Amid the favorable balance of payments, equilibrium in the FX market was the key factor to contain inflation. Drop in dollarization in the economy continued over the reporting period as well.*

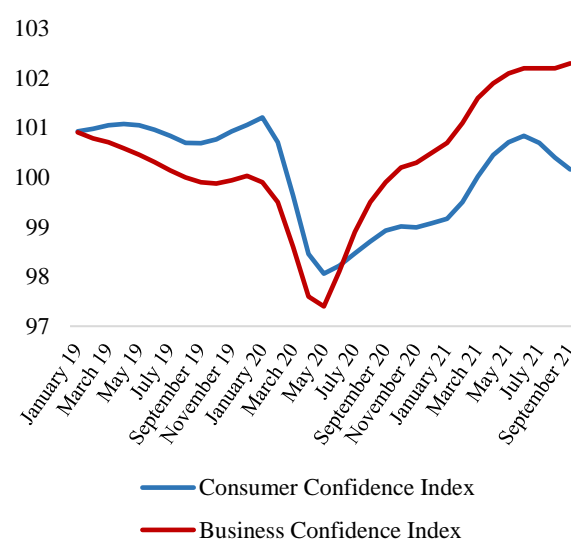
# I. THE GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

## 1.1. Global economic trends

*Amid optimistic expectations due to massive vaccination since early year, the global economy has been under recovery over 9 months of 2021. Removal of epidemiologic restrictions revived deferred demand and supported economic growth. However, supply still lags behind demand pushing high inflation rate in most countries.*

**Global economic activity.** The 2020 recession was followed by the entry of the global economy to the recovery pace. Economic activity indicators in OECD countries (over 62% of the global economy) grew over 9 months of 2021. The Business Confidence Index (BCI) across the OECD countries has already exceeded the pre-pandemic level. Albeit reaching the pre-pandemic level in H1 of the year, the Consumer Confidence Index (CCI) lagged in Q3 amid rapid spread of new strains of the COVID-19.

Graph 1. Business and Consumer Confidence indexes in OECD countries



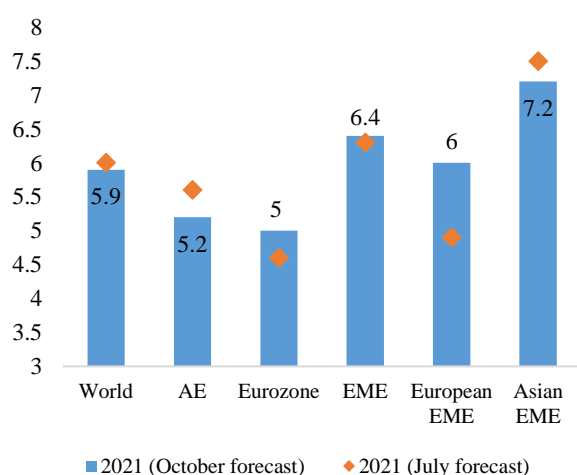
Source: OECD

International organizations are revising global economic growth outlook across country groups diversely in light of recent trends. The IMF in WEO October 2021 projects 5.9% growth of the global economy in 2021 (0.1 pp down in comparison to the previous outlook), 4.9% in 2022. The IMF revised down the global economic outlook for 2021 by 0.1% due to translation of disruptions in the supply chain to economic activity in AEs, as well as lingering epidemiologic restrictions in low income EMEs. The growth outlook for low income EMEs was revised down by 0.6 p.p. in comparison to July forecast, attributable to a low rate of vaccination there.

Economic growth outlook was revised up on some commodity exporting EMEs.

Beyond 2022, medium term global growth is projected to be around 3.3%.

Graph 2. Economic growth forecasts, %



Source: IMF

The IMF October Update projects 6% economic growth in the **USA** (1 p.p. down in comparison to the previous outlook). The fact that the projection for the US economy was revised down is put down to large reductions in warehouse stock in Q2 2021, partial supply disruptions and weak consumption in Q3.

Annual inflation in the USA exceeded market expectations (5.3%) in September 2021 and increased to 5.4%, the highest level of recent 13 years. The highest price rise was in rent fees, food, new automobiles and energy products. The unemployment rate in the USA

decreased to 4.8% in September 2021, down by 0.4 p.p. compared to the previous month.

Over 9 months the Dow Jones increased by 13.1%, the S&P 500 by 31.2%, and the Nasdaq by 12.8%. In September industrial production in the USA decreased by 1.3% vs the previous months, and y.o.y. increased by 4.6%.

To accelerate post-pandemic recovery the US Government will continue broad incentive policy measures for the rest of 2021. The US Fed kept interest rates stable at 0-0.25% over the past period of the year.

The IMF projects 5% economic growth in the **euro area**, up in comparison to the July release (4.6%).

In September, 12-month inflation in the euro area was 3.4%, the highest annual inflation since September 2008 – the global financial crisis. In August industrial production in the euro area y.o.y. grew by 5.1%, 0.4 p.p. up compared to market expectations. In September 2021, the unemployment rate was 7.4%, the lowest rate since April

2020. The highest unemployment rate was in Spain (14.6%), Italy (9.2%) and France (7.7%), while the lowest was in Holland (3.1%) and Germany (3.4%). The FTSE Eurotop increased by 14%. Over the past period of the year, the ECB left the policy rate unchanged.

The IMF projects 2.4% economic growth in **Japan** in 2021, down in comparison to the July outlook (2.8%). In September 12-month inflation in Japan was 0.2%, the first month when deflation lasting since the pandemic outbreak was replaced with inflation. In September 2021, inflation was 2.8% justifying market expectations. In September, industrial production y.o.y. decreased by 2.3%. The Nikkey has gained 7.8% since early year. The Bank of Japan left the refinancing rate unchanged at negative 0.1%.

The IMF revised down economic growth projection for the **United Kingdom** in 2021 by 0.2 p.p. to 6.8% (7% in July outlook). According to the IMF, economic activity in the UK will not return to the prepandemic level until the end of 2022.

In September, annual inflation in the UK was 3.1%, down compared to market expectations (3.2%). Main price hike was in transportation-logistics, tourism and food. In August industrial production y.o.y. increased by 3.7%. In August 2021, unemployment was 4.5% (the same as market expectations). The Bank of England left the refinancing rate stable at 0.1%.

The IMF WEO October projects 6.4% economic growth in EMEs in 2021. The projection was revised up by 0.1 p.p. compared to the July outlook, mainly due to better expectations in some pandemic-affected commodity exporters and higher than expected domestic demand in Emerging European Countries. Economic growth projection in Emerging Asian Countries was revised down due to weaker than expected economic recovery, in particular, weaker growth in ASEAN countries. In 2021 economic growth is projected to be 7.2% in Emerging Asian Countries (7.5% in July outlook), 6% in Emerging European Countries (4.9% in July outlook), 6.3% in Latin America and the Caribbean (5.8%



in July outlook), 4.1% in the Middle East and Central Asia (4% in July outlook), 3.7% in Sub-Saharan Africa (3.4% in July outlook).

The **Chinese** economy grew by 4.9% in Q3 2021. Industrial production in the country y.o.y. increased by 3.1% in September 2021. Unemployment was 4.9%, the lowest since December 2018. Annual inflation was 0.7% in September 2021, lower than market expectations (0.9%). The IMF WEO October projects 8% economic growth in China in 2021 (8.1% in July outlook).

The IMF projects 4.7% economic growth in **Russia** in 2021, higher than the July projection (4.4%). In August 2021, unemployment was 4.4%, lower than market expectations (4.5%), the lowest unemployment rate since August 2019. Although the CCI was prone to recovering over the period, it is still negatively zoned. Despite being in a positive zone in summer, the BCI fell back to a negative zone again in September. Annual inflation was 7.4% in Russia in September 2021, higher than the Central Bank's 4% target and market

expectations (7.1%). Industrial production y.o.y. increased by 6.8% in September 2021. Over the period the Russian ruble appreciated by 2.1% against the USD. The Bank of Russia tightened the monetary policy in light of inflation expectations, and shifted the interest rate from 4.25% to 7.5%.

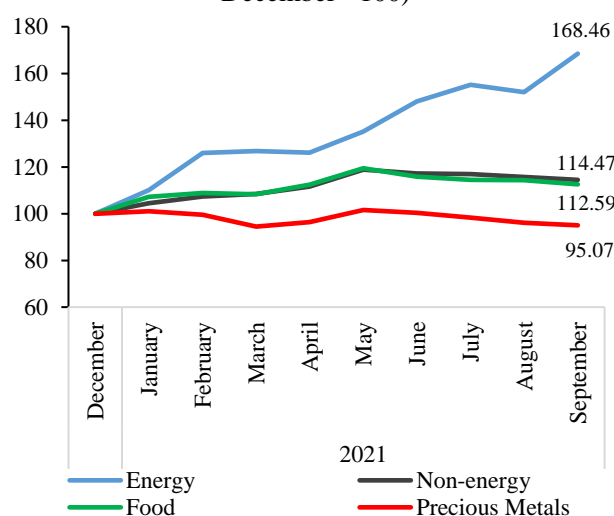
The **Turkish** economy is projected to grow by 9% in 2021. In September 2021, 12-month inflation in Turkey stood at 19.6% (market expectations 19.7%), the highest inflation rate since March 2019. Industrial production y.o.y. increased by 13.8%, higher than market expectations (10.5%). Production of durables (20.5%), interim products (15.4%), machinery and equipment (8.3%), nondurables (9.8%) and energy products (9.3%) increased. Unemployment decreased by 0.3% vs the previous month to 11.5% in September. The Turkish lira depreciated by 20.9% against the USD. The Central Bank of Turkey shifted the interest rate to 19% from 17% over the period and reduced to 18% by the end of Q3.



According to the IMF's recent update, global trade is expected to grow by 9.7% in 2021 (the same as in the previous outlook), and by 6.7% in 2022 (previous outlook 7%) in line with the projected broader global recovery.

**Prices in commodity markets and global inflation.** Over the past period of 2021, commodity prices went up in the world market. According to the World Bank's Commodity Markets Outlook, in January-September 2021, energy prices hiked by 68.5%, non-energy prices by 14.5%, and food prices by 12.6%, while prices for precious metals decreased by 4.9%. The price for gold dropped by 8.3% over 9 months of 2021.

Graph 3. Commodity price index (2020 December = 100)

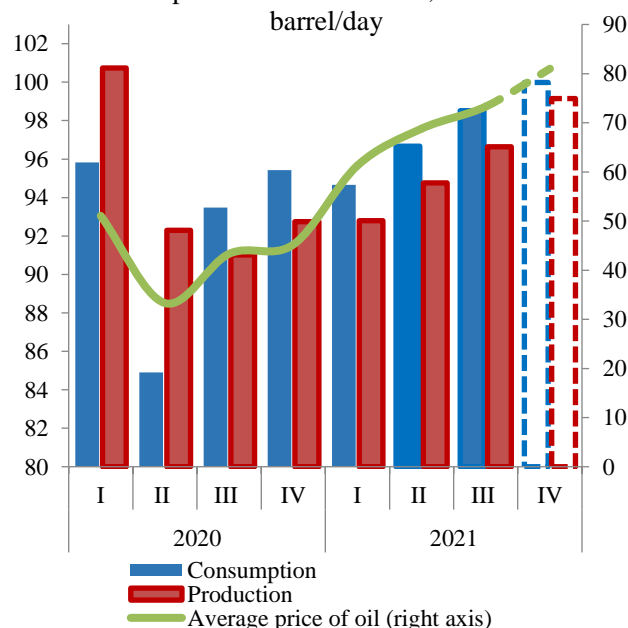


Source: World Bank

Food prices shoot up according to the UN Food and Agriculture Organization; world food prices have increased by 18% since early year and by 32.8% over recent one year. The largest increase was observed in butter, sugar, flour and meat products.

The average Brent oil price was \$67.9 per barrel, 57.7% higher than the average price in 2020 (\$43.1). Given recent trends, international organizations revise up oil price projection. The IMF in its recent release increased the oil price forecast by \$1 to \$66 for the current year. According to World Bank's October Update, the oil prices are forecasted to average \$70 in 2021 and \$74 in 2022.

Graph 4. World oil market, million barrel/day



Source: Energy Information Administration (EIA)

Oil price hike is mainly attributable to expected positive results of vaccination and higher than expected economic activity in the world. Conservative decisions within the OPEC++ also support the current dynamics of prices. On the backdrop of rising global demand, oil reserves, which increased during the pandemic, have been declining dramatically since early year. According to the Oil Market Report-October 2021 of the International Energy Agency (IEA), as of end 2021 oil consumption is expected to exceed the pre-pandemic level increasing by 5.4 mln barrel/day as of end-2021 and by 3.3 mln barrel/day as of end-2022 (3.1 mln barrel/day in June Outlook). High oil extraction in the USA and OPEC++ in 2022 and rise in oil supply is expected to put pressure on oil prices.

The natural gas price has surged in Europe over recent months. As of end-September, the natural gas price reached \$1200 per 1,000 cubic meters. According to experts, the rise in gas futures prices in Europe is attributable to a low occupancy rate in Europe's gas storage facilities,

restriction of supply by main suppliers and high LNG demand in Asia.

High transportation-logistic expenses and longer delivery period are one of the main reasons for intensification of global inflation. According to Freightos, in September of the current year transportation cost per container y/y increased by more than 4 times, while the period of delivery of raw materials and final products increased by about two times. The Baltic Dry Index, the index of transport of dry bulk materials, has reached its highest level since 2008. All this displays that the crisis triggered by the COVID-19 in a supply chain protracted.

On the backdrop of the rapid rise in global commodity prices and lingering problems in the global supply chain inflationary pressures have considerably jumped in both AEs and EMEs. The base effect of a year ago also weighs on inflation. High food and oil prices lead to import of inflation and high foreign trade deficit in some EMEs. Exchange rate depreciation in certain countries also intensify price pressures. The IMF in

October Update recommends central banks to follow temporary inflationary pressures and avoid tightening the policy until there is more clarity on underlying price dynamics. Moreover, authorities should be prepared to act quickly if the recovery strengthens faster than expected or inflation rises higher than expected. Inflation is expected to return to pre-pandemic rates in most countries beyond 2022.

**Risks.** According to the IMF WEO October 2021, risks posed by the pandemic to the global economy remain high. Main risks relate to possible tightening of global financial conditions amid more lasting inflationary pressures. In general, risks posed by the current macroeconomic and epidemiological situation are as follows:

- Disruptions in the global supply chain are accompanied by longer than expected breaks in supply, which further accelerates inflations in most countries;
- Economic growth may slow down since the monetary and fiscal policy

stepped to the phase of contraction due to high inflation.

Amid stronger global inflation, central banks will have to make prudent decisions taking a balanced position between fighting inflation and financial risks and support for economic recovery in the period to come.

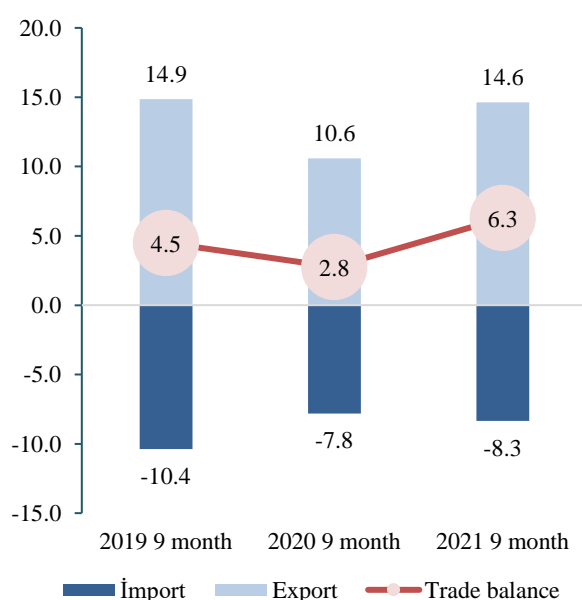
Ongoing rise in commodity prices may slow growth in energy importing countries and weaken food security in low-income countries. Risks to the global economy also include unfavorable weather conditions, additional supply restrictions and spread of new COVID-19 strains.

## 1.2. External sector developments of the Azerbaijani economy

*Over 9 months of 2021, the external economic position of Azerbaijan shaped in the environment of high global oil prices, elevated economic activity in partner countries and wider non-oil export.*

According to the State Customs Committee (SCC), over 9 months of 2021, foreign trade turnover amounted to \$23 bln. – export \$14.6 bln.(63.5%), import \$8.3 bln. (36.5%). Foreign trade surplus made \$6.3 bln., y.o.y. up by 2.3 times as much.

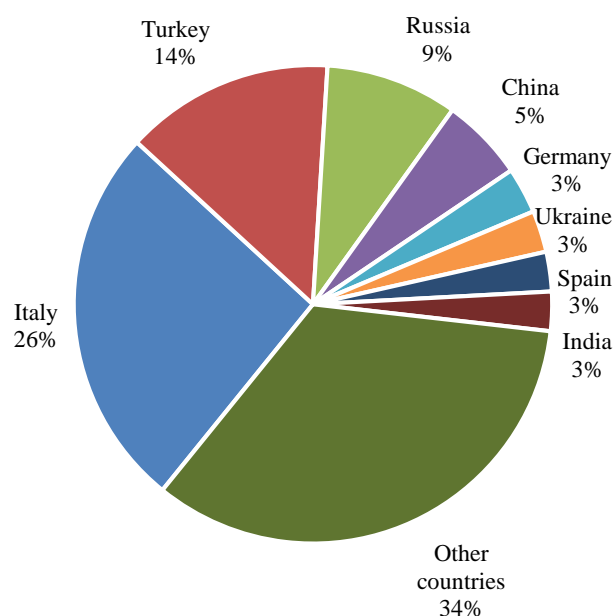
Graph 5. Trade balance, USD bn.



Source: SCC

Azerbaijan traded with 182 countries over the period.

Graph 6. The main countries in trade, 2021 9 month



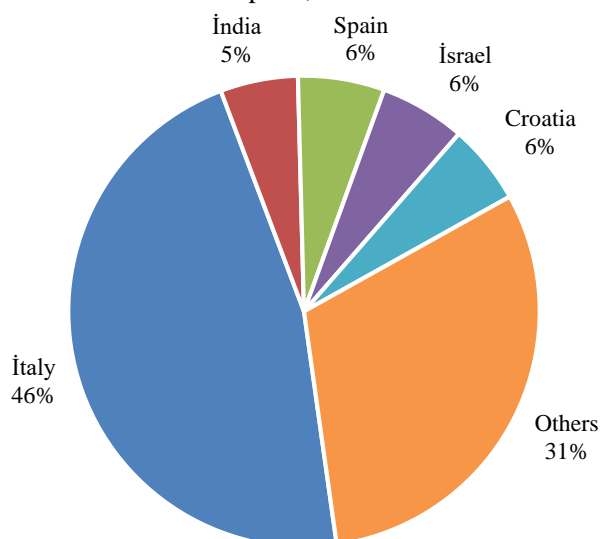
Source: SCC

Italy, Turkey, Russia, China, Germany, Ukraine and Spain account for over half of trade turnover. Italy takes the highest share in trade turnover as in previous periods.

Export increased by 38.3%, nonoil export by 41.1%. The value of export increased by 31% on crude oil, by 2.2 times on oil products and by 57.6% on natural gas.

46% of crude oil and oil products was exported to Italy, 6% to Spain, 6% to Israel, 6% to Croatia and 5% to India.

Graph 7. Crude oil and oil products exports, %

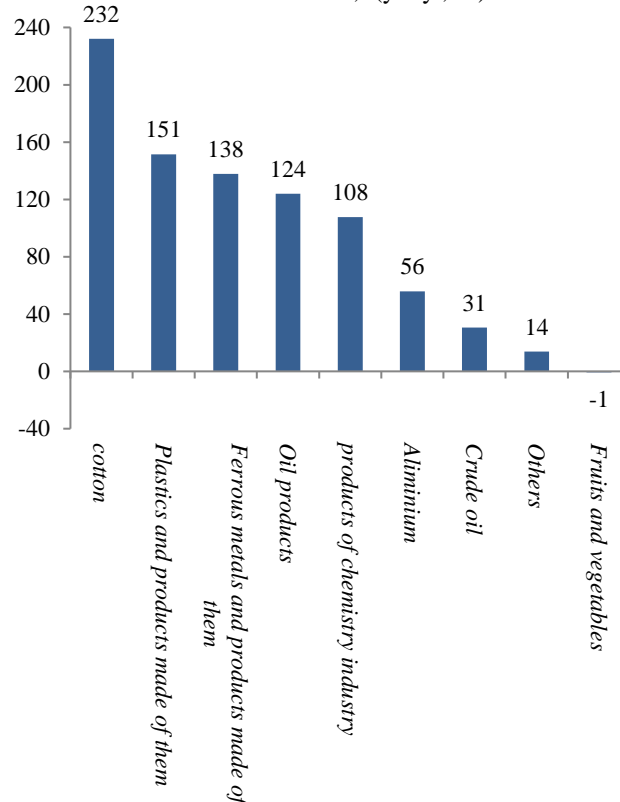


Source: SCC

Main export partners on natural gas were Turkey, Georgia, Italy, Greece and Bulgaria. Turkey accounts for 41% and Georgia for 9.5% of natural gas export.

The value of export increased by 2.4 times on ferrous metals and products, 3.3 times on cotton yarn, 2.5 times on plastics and products, 2.2 times on chemical products and 56% on aluminum.

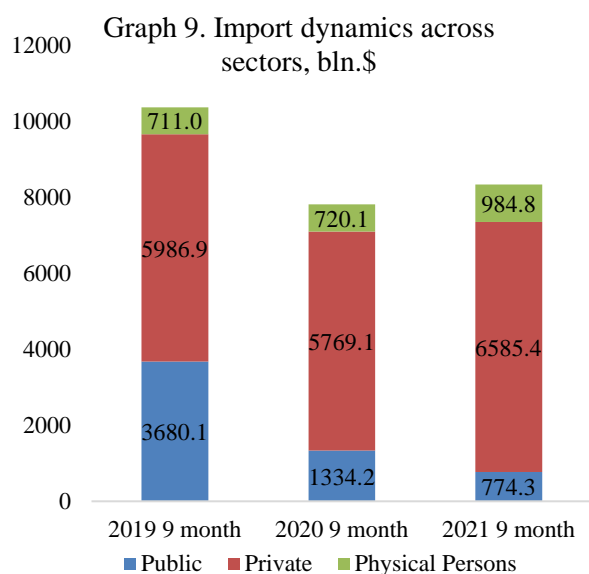
Graph 8. Change in export of commodities. 2021 9 month, (y.o.y., %)



Source: SCC

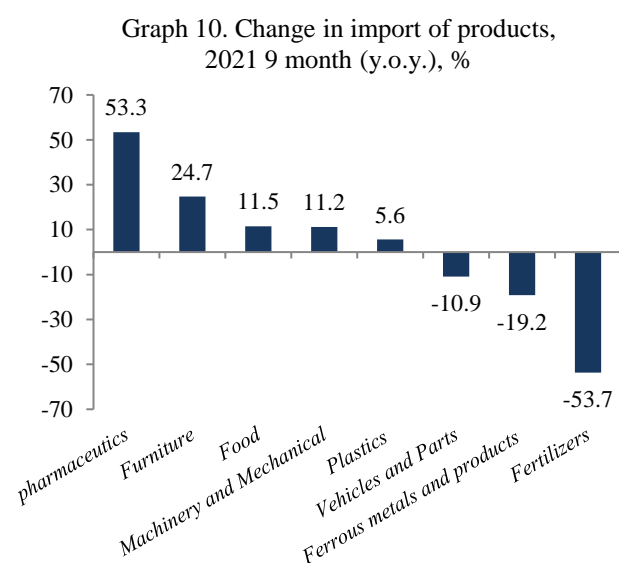
In general, non-oil products were exported to Russia (32.4%), Turkey (25.1%), Switzerland (9.6%), Georgia (6.7%), and USA (3%).

Commodity import increased by 6.7%. Commodity import decreased by 42% to \$0.8 bln. in the public sector, increased by 14.1% to \$6.6 bln. in the private sector and by 36.8% to \$1 bln among individuals.



Source: SCC

Import increased by 53.3% on pharmaceuticals, by 24.7% on furniture, by 11.5% on food products, by 11.2% on machinery and mechanisms, by 5.6% on plastics and products, and decreased by 53.7% on fertilizers, by 19.2% on ferrous metals and products, and by 10.9% on vehicles and their parts.

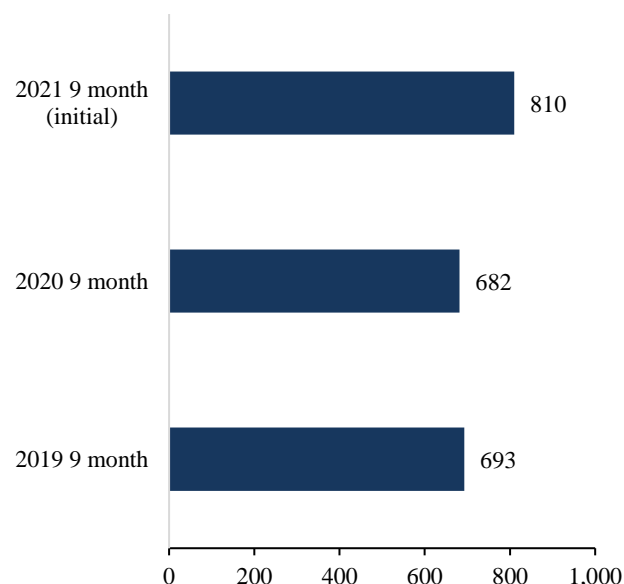


Source: SCC

Russia accounts for 17.3%, Turkey for 15.7%, China for 13.9%, Germany for 5.8%, USA for 4%, Italy and Ukraine for 3.9% of imported products.

According to initial data, money remittances to the country y.o.y. increased by 18.8% to \$810 mln.

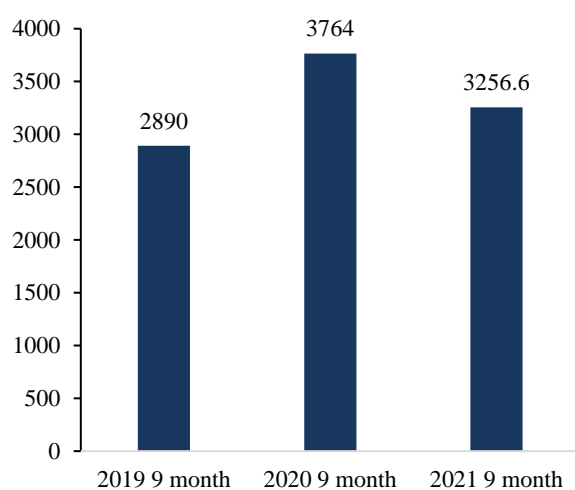
Graph 11. Inflow of remittances, mln.\$



Source: CBA

Capital inflows from foreign enterprises and organizations kept on over the reporting period. According to the SSC, FDIs amounted to AZN 3.3 bln. equivalent (34.1% of total investments)

Graph 12. Foreign investments, mln. manat



Source: CBA

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

Strategic foreign exchange reserves continued to exceed the internationally accepted adequacy norms. As of end-period strategic FX reserves sufficed for 41-month import of goods and services (taking import of goods and services for 6 months of 2021). Strategic reserves exceeded money supply in manat (M2) by 4 times (M2 money aggregate as of 01.10.2021). Strategic reserves ratio to GDP exceeded 100%.



## II. MACROECONOMIC DEVELOPMENTS IN AZERBAIJAN

### 2.1. Aggregate demand

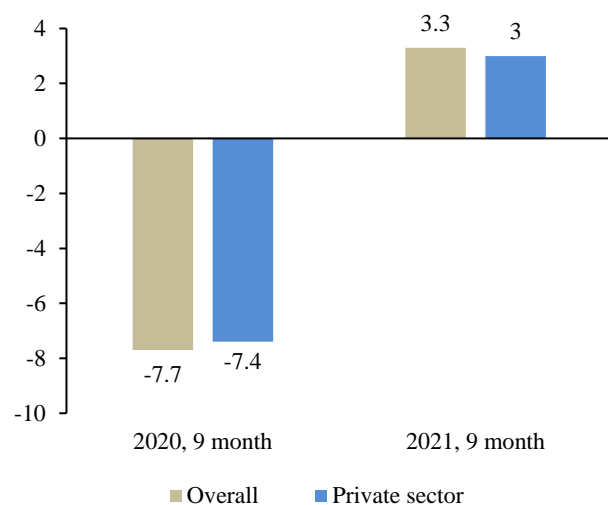
*Over 9 months of 2021 aggregate demand was mainly driven by consumer demand.*

**Consumption expenditures** increased in January-September 2021.

Goods and services sold in the market to meet consumer demand y.o.y. increased by 3.3% in real terms to AZN 36.4B.

Every consumer spent on average AZN 403.7 (y.o.y. up by 8.1%) in January-September.

Graph 13. Change in volume of sales in consumer market, %

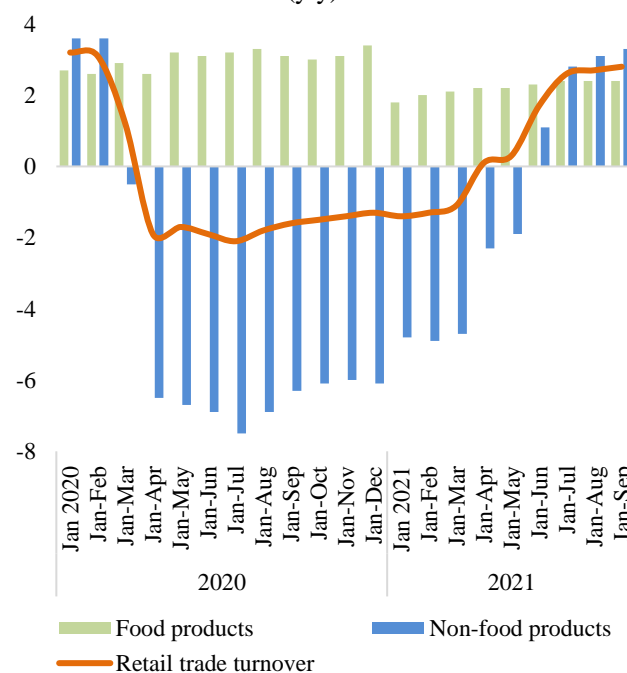


Source: SSC

Easing of pandemic-related isolation measures, rapid increase in the number of vaccinated people, mass event permits etc. contributed to consumer demand recovery.

Retail trade turnover y.o.y. increased by 2.8% to AZN 30.4B. Non-food trade turnover increased more rapidly. Retail trade turnover on food, beverages and tobacco products increased by 2.4% and on non-food stuff by 3.3%.

Graph 14. Growth of retail trade turnover, (y/y) %



Source: SSC

The share of consumer spending on food, beverages and tobacco products in retail trade outlets y.o.y. increased by

0.2 p.p., computers and telecommunication devices by 0.1 p.p., pharmaceuticals and medical devices by 0.4 p.p., fuel by 0.7 p.p.

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

Spending item	Share, %	
	2020 9 months	2021 9 months
Food, beverage and tobacco	53.9	54.1
Textile products and apparel	15.7	15
Electric appliances and furniture	5.7	5.5
Computers, telecommunication devices and others	0.8	0.9
Pharmaceuticals and medicals	1.8	2.2
Fuel	5.3	6
Other non-food items	16.8	16.3

Source: SSC

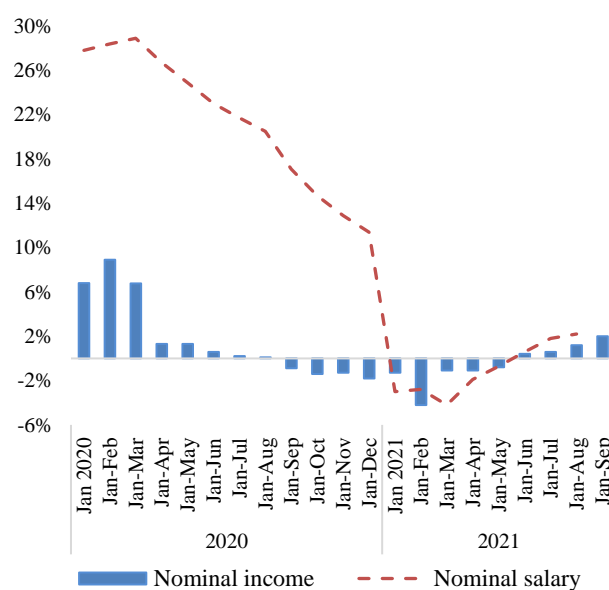
Every consumer purchased on average AZN 182.1 worth of food, beverage and tobacco, AZN154.7 worth of non-food items monthly for private consumption in retail trade.

Catering turnover y.o.y. increased by 15.9%. The value of paid services supplied to the population increased by 4.6% in real terms to AZN 5.4B. Per capita paid services consumption y.o.y.

increased by AZN 44.4 to AZN 539.5 in nominal terms.

Consumer activity was driven by income of the population that resumed positive dynamics in the first half of the year. According to the SSC, in January-September 2021 income of the population increased by 2% to AZN 42.3B in nominal terms. Per capita money income was AZN 4219.3. Population's disposable income increased by 1.2% to AZN 37.9B.

Graph 15. Growth dynamics of incomes and salaries, (y/y) %



Source: SSC

Recovered lending activity also contributed to consumer demand. Loans to households increased by 18.2% to AZN 7.9B.

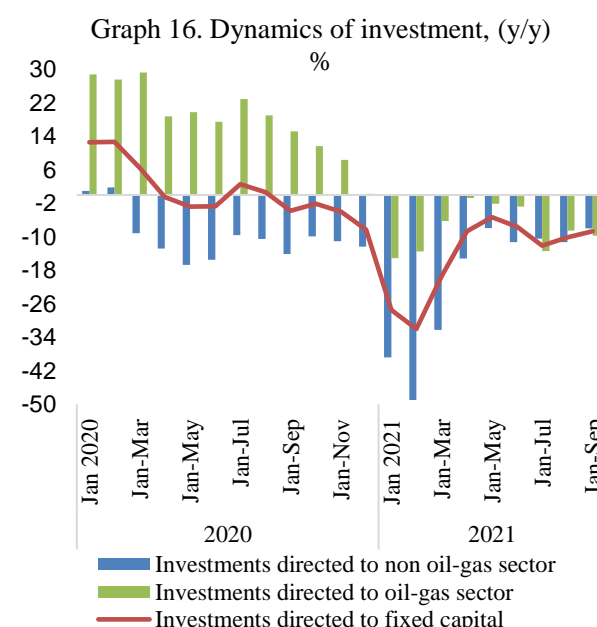
Recovery of economic activity in most sectors and revival of consumer demand weighed on the CCI too. The CCI indicator generated from findings of the “Households financial behavior and intentions survey” held in Q3 2021 considerably improved in comparison to the previous quarter. To note, this indicator rests upon surveys ‘Family’s financial condition expectation’, ‘Expectation on country’s economic standing’, ‘Savings probability’ and ‘Unemployment expectations’ conducted among various income households..

**Government spending** was substantial to support domestic demand. State budget expenditures amounted to AZN 17.7B over 9 months of 2021.<sup>1</sup>

Social spending (compensation for employees, pension and social allowances, medicine and food following the economic classification) accounts for 43.2% (AZN 7.7B) of actual state budget spending (y.o.y. up by 6.7%)

**Investment expenditures.** According to the SSC, AZN 9.6B was channeled to the economy. AZN 5.5B

worth of funds were channeled to the non-oil and gas sector. The public sector accounts for 39.6% and the private sector for 60.4% of total investments.



Source: SSC

65.9% of investments stemmed from internal, 34.1% from external sources.

Table 2. Investment sources, %

	2020 9 months	2021 9 months
<i>Funds of enterprises and organizations</i>	59.9	56.9
<i>Bank loans</i>	6.5	6.3
<i>Budget funds</i>	22.3	22.3
<i>Off-budget funds</i>	1.8	-
<i>Personal funds of population</i>	6.1	7.1
<i>Other funds</i>	3.4	7.4

<sup>1</sup> <http://www.maliyye.gov.az>

*Source: SSC*

Funds of enterprises and organizations prevailed in total investments (56.9%). Personal funds of the population and other funds increased year over year.

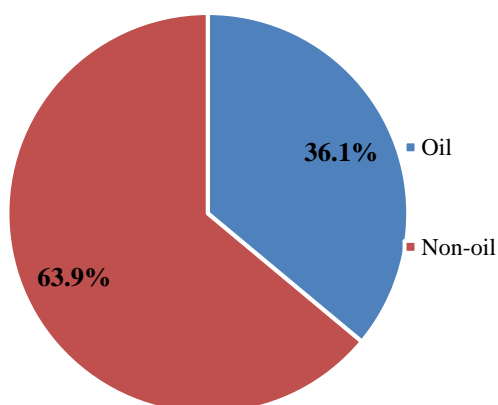
## 2.2. Aggregate supply and employment

*Economic activity intensified in line with the expansion of domestic and foreign demand.*

**Economic growth.** According to the SSC, GDP y.o.y. increased by 4.8% in real terms to nominal AZN 62.9B. Per capita GDP was AZN 6279.

Oil and gas value added increased by 1.4% to AZN 22.7B (36.1% of GDP). The mining sector extracted 25.8 m/t crude oil and 23.4 bln/m<sup>3</sup> natural gas. Oil extraction y.o.y. decreased by 0.7% and gas extraction increased by 19.3%. Cost of production in oil products y.o.y. increased by 17.7%.

Graph 17. Sectoral growth of value added, %

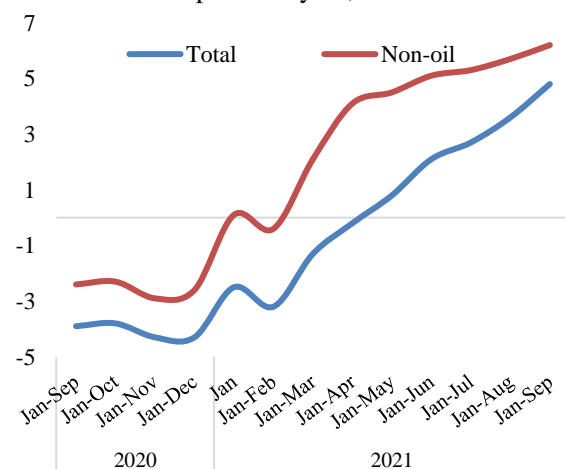


Source:SSC

Non-oil and gas value added y.o.y. increased by 6.2% in real terms to nominal AZN 40.2B (63.9% of GDP).

Non-oil industrial output increased by 19.6%. Non-oil output posted growth by 42% in shoemaking, by 13.6% on computers, electronic and optic devices, by 56.9% on tobacco products, by 65.4% on installation and repairs of machinery and equipment, by 3.4% on beverages, by 1.9% on furniture, by 28.6% on paper and cardboard, by 53.9% on electric appliances, by 72.2% on construction materials, by 17.7% on oil products, by 9.3% on food products, by 15.6% on metallurgic products and by 16.1% on chemical industry.

Graph 18. Economic growth, in comparison to corresponding period of previous year, %



Source:SSC

Production of garments decreased by 13.2%, printing products by 42.8%, vehicles, trailers and semitrailers by 11.8%. Amid high demand for pharmaceuticals due to the pandemic and establishment of local enterprises production of pharmaceuticals increased by 88%.

Y.o.y. growth in agriculture was 5%, including 2.6% growth on animal products and 7.3% on plant products.

*Table 3. GDP structure, share %*

Sectors	2020 9 months	2021 9 months
Industry	34.7	40.1
Construction	6.3	5.2
Agriculture, forestry and fishery	7.6	6.9
Trade, repair of vehicles	11.4	10.3
Transport and warehousing	7.4	7.1
Tourism and catering	1.3	1.1
Information and communication	2	1.8
Other	19.1	18.4
Net taxes on products and import	10.2	9.1

*Source:SSC*

Central Bank's real sector survey findings confirm that economic activity

has elevated. The BCI varied across all sectors.

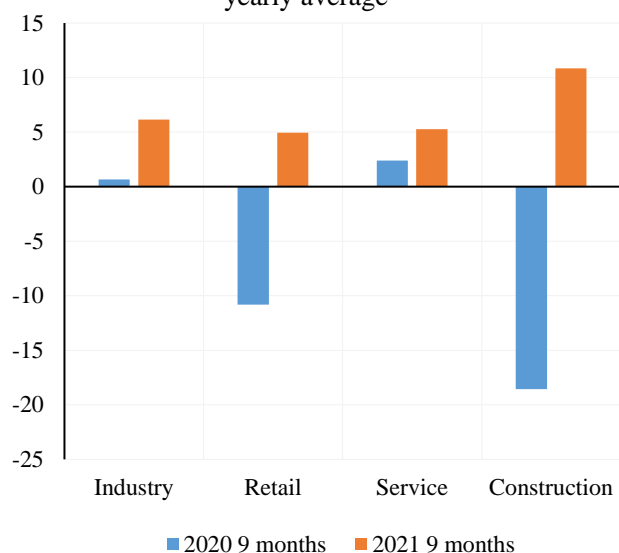
The BCI in the industry was positively zoned over 9 months of 2021. Production of chemicals, metallurgy, construction, plastics, food and beverages, non-metal mineral products contributed to this outcome. The BCI on machine building was negatively zoned in Q3. The BCI y.o.y. improved in all components of the industry, except for machine building.

The BCI in trade has improved considerably over 9 months compared to the corresponding period of the last year.. The BCI increased at a higher rate in electric home appliances and household goods.

The BCI in services exhibited positive dynamics y.o.y. Except for postal services and transportation, the BCI in other service areas was higher compared to the corresponding period of the last year. According to RSM findings, services in general and hotels in particular were one of the most pandemic-affected sectors.

Rise in the BCI in construction kicked-off in Q2 continued in Q3 too. The BCI was higher year over year.

Graph 19. Business confidence index, yearly average



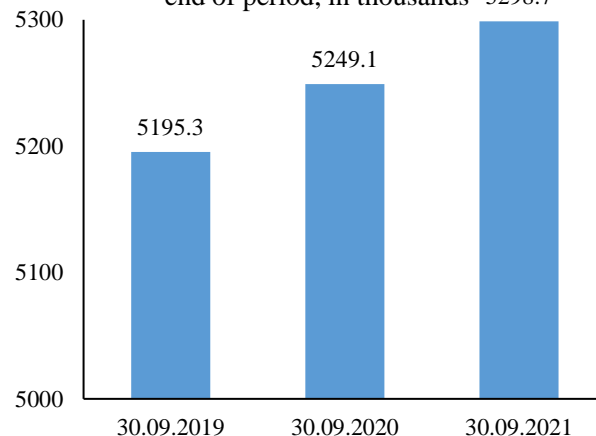
Source: RSM findings based CBA estimations<sup>2</sup>

**Employment.** As of 1 October 2021 labor force numbered at 5298.7 thousand persons, y.o.y. up by 49.6 thousand persons. The number of employed population was 4978.3 thousand persons, y.o.y. up by 93 thousand persons.

<sup>2</sup> Industrial BCI = (output – finished goods stock + production expectations)/3  
 Service BCI = (Business condition + Actual demand + Demand expectation)/3  
 Trade BCI = (actual sale – changes in goods stock + sale expectations)/3  
 Construction BCI = (orders accepted for execution + Expectations on changes in the number of staff)/2

The number of hired labor was 1684.9 thousand persons as of 1 September 2021, y.o.y. up by 0.8%: Of those involved in the public sector were 900.6 thousand, non-public sector 784.3 thousand.

Graph 20. Economically active persons, end of period, in thousands



Source: SSC

23.8% of hired labor in enterprises and organizations was involved in production: 7.5% in processing, 7.5% in construction, 3.5% in agriculture, forestry and fishery, 1.9% in mining, 1.9% in water supply and waste management.

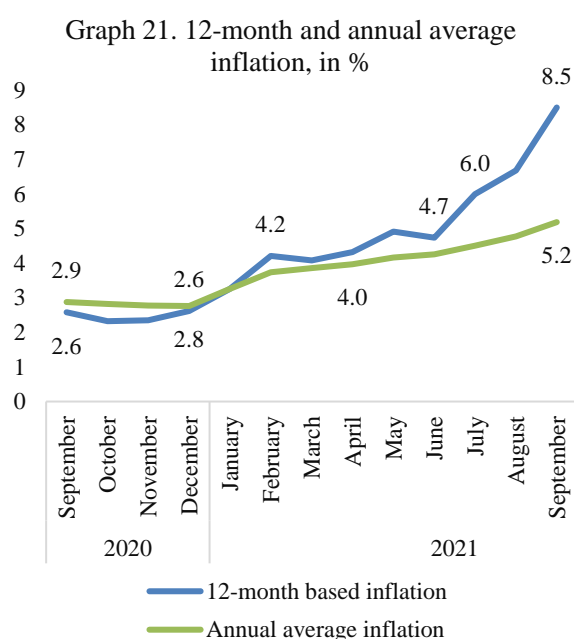


## 2.3. Inflation

*In January-September 2021 inflation increased.*

### **Consumer Price Index (CPI).**

According the SSC, in September, 12-month inflation was 8.5% ( compared to September 2020). Average annual inflation was 5.2% in January-September.



Source: SSC

Food inflation continued to play a key role in overall inflation. However, over the reporting period the effect of non-food and service price hike on inflation has increased. In September, annual food inflation was 10.4%.

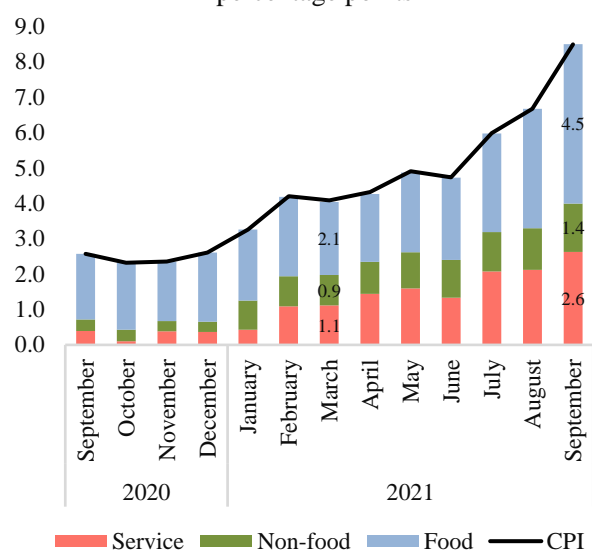
Average annual food inflation was 6% in January-September.

In September non-food prices increased by 0.8% in comparison to the previous month and by 5.9% since the corresponding month of the previous year. In January-September, average annual non-food inflation was 4.4%.

Service prices hiked by 1.5% in September and by 7.9% since the corresponding month of the previous year. . Average annual service inflation was 4.6% in January-September. The dynamics of regulated prices had a considerable effect on services inflation. Prices hiked by 34% in passenger transportation services, by 8.2% in rent fees, by 7.4% in healthcare services and by 7% in catering services.

Food prices contributed 4.5 p.p., nonfood 1.4 p.p., and services 2.6 p.p. to annual inflation change.

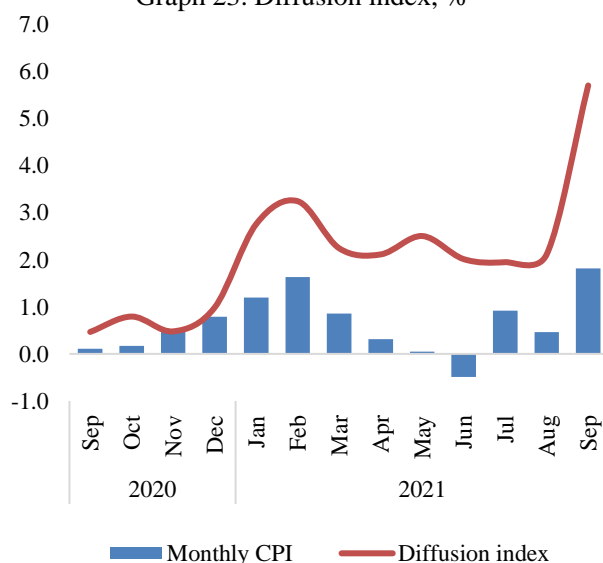
Graph 22. Contributions to CPI, in percentage points



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<sup>3</sup> increased.

Graph 23. Diffusion index, %

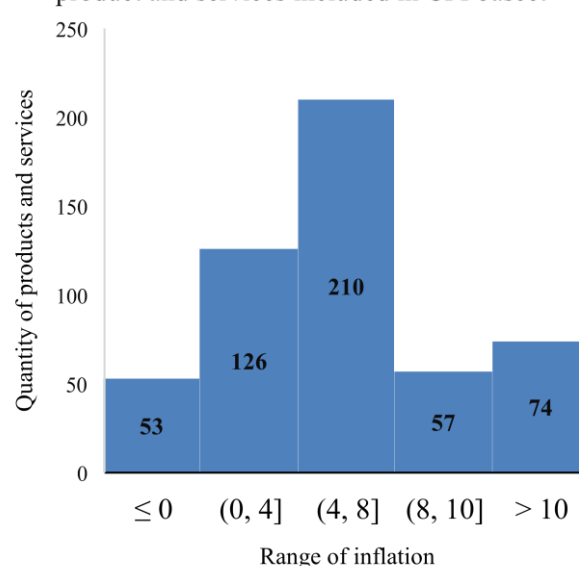


<sup>3</sup> The index is calculated as  $(\text{increasing-decreasing})/(\text{decreasing} + \text{unchanged})$ .

Source: CBA calculations based upon SSC data

Of 519 items of goods and services included in the consumer basket, prices for 210 or 40% increased in the range of 4-8%. In 27% of rising prices, the price increase was less than 4%. The prices for 3% of goods and services in the basket decreased.

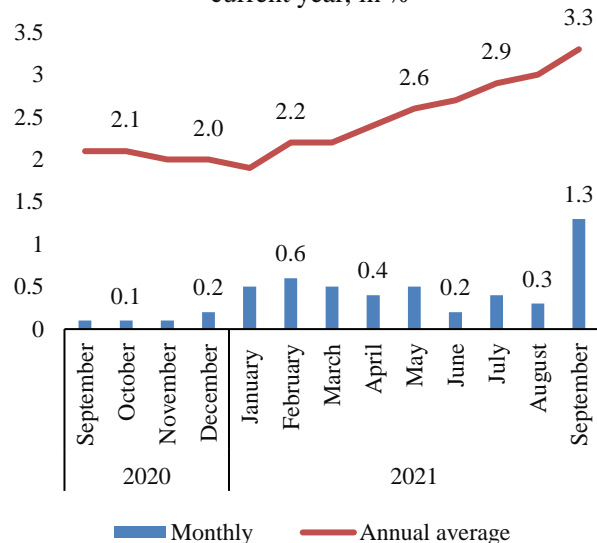
Graph 24. Distribution of annual inflation rate of product and services included in CPI basket



Source: SSC, CBA

Average annual core inflation calculated by excluding swings in regulated prices and prices for seasonal agricultural products was 3.3%.

Graph 25. Change of core inflation in the current year, in %

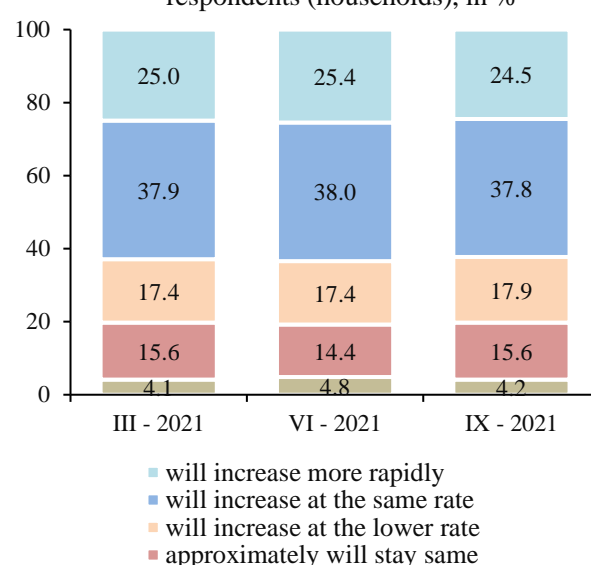


Source: SSC, AMB

In general, inflation was mainly driven by considerable price hike in global commodity markets, high ‘imported inflation’ from main trade partners, and current problems in international supply and logistic chains. Cost factors like liberalization of regulated prices and tariffs also contributed to inflation. The current macroeconomic stability platform contains inflation. The favorable balance of payments, rising oil prices, the stable exchange rate of the national currency and its anti-inflationary role and the conservative monetary policy implemented were the key elements of the platform.

The dynamics of actual inflation also weighs on inflation expectations. According to the surveys conducted in September, 80% of households expect inflation, and 24.5% of them expect the inflation rate to be higher.

Graph 26. Expectation of price change over the next 12 months, quarterly, share of respondents (households), in %



Source: AMB

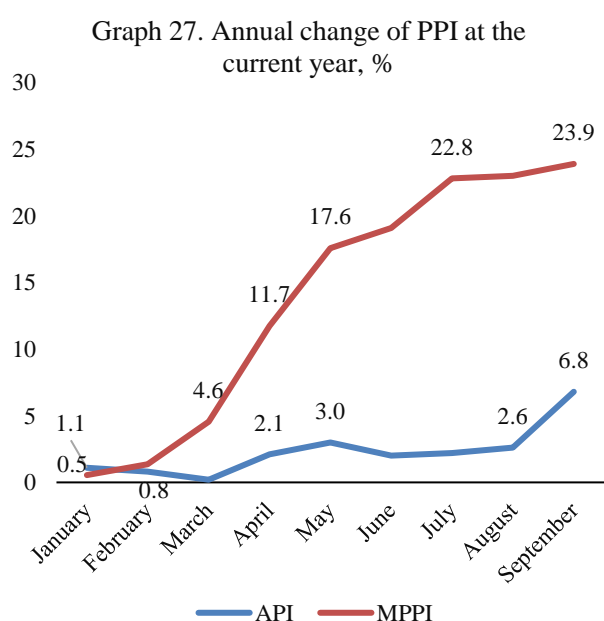
**Producer price index.** According to the SSC, in September the APPI increased by 6.8% over recent 12 months. Prices rose by 4.1% in animal products and by 9.7% in plant growing products on annual. In parallel, the PPI in forestry decreased by 0.6%, and increased by 4.4% in fish and other fishery products. The APPI lagging behind the food inflation rate displays that import

components play a key role in food inflation.

In September the IPPI increased by 59.8% annually, mostly due to the mining industry (up by 72.3%). The PPI increased by 71.2% in the non-oil and gas industry and by 12.1% in non-oil and gas products. Price hike in the mining industry is mainly attributable to dramatic year over year jump in global oil prices.

The PPI in processing increased by annual 23.9%. The highest price hike in processing was in manufacturing of oil products (44%) the chemical industry (41%) and production of metallurgic products (33%).

In September 2021, prices for transportation services increased by annual 6%. The cost of freight transportation increased by 2% and passenger transportation by 28.2%. Increase in prices for passenger transport services is mainly due to a 33% annual increase in passenger transportation prices by air. Prices for postal and courier services increased by 1.8%, while for communication services remained unchanged.



Source: SSC

## II. THE MONETARY AND EXCHANGE RATE POLICY

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

*Over 9 months of 2021, the exchange rate of the manat against foreign currencies was shaped by supply and demand in the FX market. Improved balance of payments underpinned supply in the FX market and the main anchor of price stability – the exchange rate stability.*

Over the reporting period, FX market operations increased, mainly due to expansion of foreign economic ties, in particular foreign trade amid reduction of pandemic-related restrictions.

Cashless transactions in the FX market y.o.y. increased by 1.6% to \$19.2B equivalent<sup>4</sup>: 85.9% in the USD and 14.1% in other currencies. The Interbank FX market accounts for 28.7% and the Intrabank FX market for 71.3% of operations.

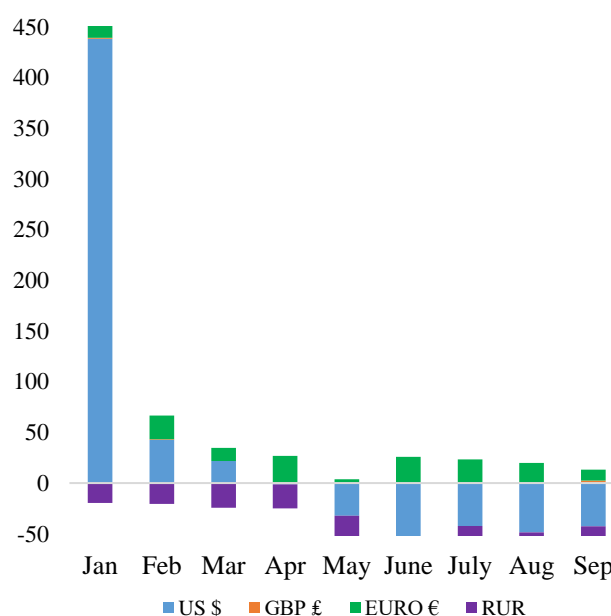
99.3% of operations in the Interbank FX market was denominated

in the USD, 0.7% in the EUR. Currency operations in the Interbank FX market were mainly conducted over the Bloomberg platform.

Intrabank FX market operations made \$13.7B equivalent (80.5% in the USD). Legal entities account for 94.9% of the foreign currency operations in the Intrabank FX market.

Cash currency traded by banks y.o.y. decreased by 35.4% to \$2.7 B equivalent (85.2% in the USD). Banks' buying prevailed over selling currency over recent 6 months.

Graph 28. Net sails of cash FX by banks in 2021, mln.manat



Source: CBA

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

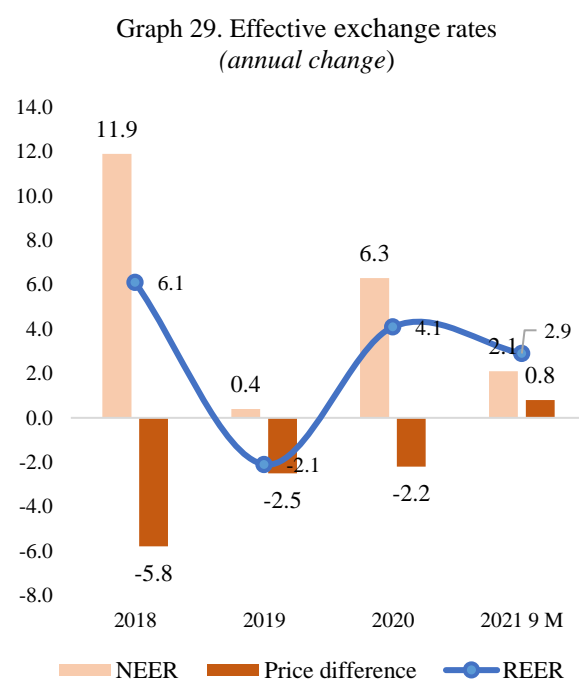
<sup>4</sup> Including operations in USD, EUR, GBP, ruble

The CBA continued currency 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. The Bank held 75 currency auctions over 9 months of 2021. Though increased in January, demand in the FX market has decreased and stabilized since February.

The official exchange rate of the manat was set on the basis of the average exchange rate on interbank transactions (both auction and over-the counter on the Bloomberg platform). The average official AZN/USD exchange rate was AZN1.7. 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 exchange rate of the manat varied against the currencies of trade partners. The exchange rate of the manat appreciated against the EUR, the Turkish lira, the Swiss franc, the pound and the Japanese yen, and depreciated against the Russian ruble, the Ukrainian hryvnia and the Georgian lari.

The dynamics of bilateral exchange rates influenced that of multilateral exchange rates. Total trade weighted non-oil NEER of the manat appreciated by 2.1%, and the REER by 2.9%. A stable exchange rate eased the effects of imported inflation.



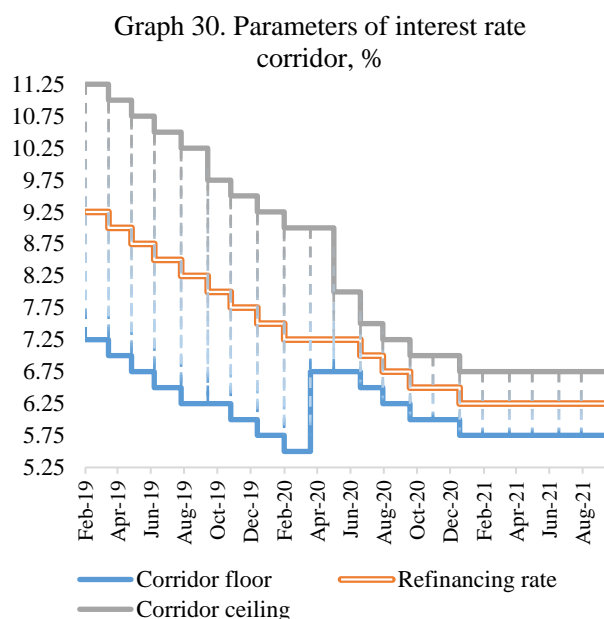
Source: CBA

To note, the REER of manat has depreciated by 28.9% vs end-2014, contributing to the increase of long-term non-oil competitiveness.

### 3.2. Monetary policy tools

*Over 9 months of 2021, monetary policy tools were applied in light of changes in actual and forecast indicators of inflation, change in the balance of inflation risks, as well as status of the economy and its medium-term growth outlook.*

The CBA took interest rate corridor parameters related decisions on the backdrop of higher inflation in the economy. The Management Board of the Bank has discussed interest rate corridor parameters 6 times over 9 months of 2021. The Board, at its last meeting in Q3 decided to shift the refinancing rate to 6.5% from 6.25%, the ceiling of the interest rate corridor to 7% from 6.75% and the floor to 6% from 5.75% given the macroeconomic stance and changes in the balance of risks of inflation. The decisions were oriented towards containing inflation by shrinking the aggregate demand components and returning it to its target band through tightening of the monetary condition. The CBA made interest rate related decisions public under a pre-announced schedule and with relevant analytical comments.



Source: CBA

To effectively manage liquidity in the economy, the CBA continued to use various term market operations. Amid high liquidity in the banking system, demand for sterilization operations was high.

84-, 168 and 252-day note auctions were held along with 28-day auctions. Auctions on over 28-day notes were mainly held in January. The Bank held no deposit auction over 9 months of 2021. In general, the CBA held 31 note auctions in January-September 2021. Long-term notes were placed at 3 (84-, 168-, 252-day) and 28-day notes were placed at other 28 auctions. Total outstanding amount of sterilization via



100

The chart displays two data series over time from July 2020 to September 2021. The left Y-axis represents the volume of short-term notes issued in million man (0 to 300). The right Y-axis represents the yield on these notes in percent (5.7% to 7.1%). The volume of notes (blue bars) shows a significant peak in early 2021, reaching nearly 250 million man. The yield (red dashed line) remains relatively stable around 6.5% until late 2020, then drops to a low of approximately 5.7% in early 2021, before rising back to around 6.1% by September 2021.

Date	Notes, mln. man (Left Axis)	Yields on short-term notes, % (Right Axis)
01.07.2020	100	6.5%
08.07.2020	100	6.5%
15.07.2020	100	6.5%
22.07.2020	100	6.5%
29.07.2020	100	6.5%
05.08.2020	100	6.5%
12.08.2020	150	6.5%
19.08.2020	100	6.3%
26.08.2020	100	6.3%
02.09.2020	150	6.3%
09.09.2020	100	6.3%
16.09.2020	100	6.3%
23.09.2020	150	5.9%
30.09.2020	100	5.9%
07.10.2020	100	5.9%
14.10.2020	150	5.9%
21.10.2020	100	5.9%
28.10.2020	100	5.9%
04.11.2020	150	5.9%
11.11.2020	100	5.9%
18.11.2020	100	5.9%
25.11.2020	150	5.9%
02.12.2020	100	5.9%
09.12.2020	100	5.9%
16.12.2020	150	5.7%
23.12.2020	200	5.7%
30.12.2020	150	5.7%
06.01.2021	250	5.7%
13.01.2021	100	5.7%
20.01.2021	120	5.7%
27.01.2021	200	5.7%
03.02.2021	150	5.7%
10.02.2021	100	5.7%
17.02.2021	200	5.7%
24.02.2021	200	5.7%
03.03.2021	150	5.7%
10.03.2021	100	5.7%
17.03.2021	150	5.7%
24.03.2021	100	5.7%
31.03.2021	100	5.7%
07.04.2021	100	5.7%
14.04.2021	100	5.7%
21.04.2021	100	5.7%
28.04.2021	100	5.7%
05.05.2021	150	5.7%
12.05.2021	100	5.7%
19.05.2021	100	5.7%
26.05.2021	100	5.7%
02.06.2021	100	5.7%
09.06.2021	100	5.7%
16.06.2021	100	5.7%
23.06.2021	100	5.7%
30.06.2021	100	5.7%
07.07.2021	100	5.7%
14.07.2021	100	5.7%
21.07.2021	100	5.7%
28.07.2021	100	5.7%
04.08.2021	100	5.7%
11.08.2021	100	5.7%
18.08.2021	100	5.7%
25.08.2021	100	5.7%
01.09.2021	100	6.1%
08.09.2021	100	6.1%
15.09.2021	100	6.1%
22.09.2021	100	6.1%

—

### 3.3. Money supply

*Money supply was managed in line with the demand of the economy in January-September 2021.*

Base money in manat increased by 6.9% to AZN 14.5B as of end-September. Surplus in execution of the state budget and the dynamics of the single treasury account conditioned low pace growth of base money.

Table 4. Money aggregates, billion manat

	01.01.21	01.10.21	Growth rate (%)
<b>M0</b>	10.8	11.0	2.5
<b>M1</b>	17.9	19.3	7.8
<b>M2</b>	20.3	22.4	10.4
<b>M3</b>	29.2	32.2	10.4

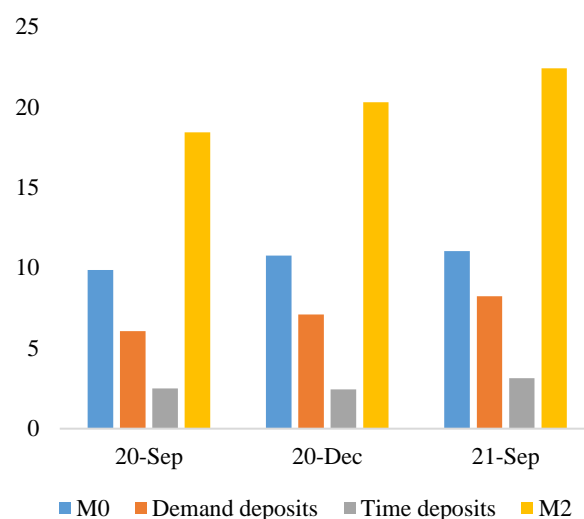
Source: CBA

Cash in circulation, a structural element of base money in manat <sup>5</sup> increased by 2.2%, while the stock of correspondent accounts in manat increased by 39.5%.

<sup>5</sup> Cash money outside the banking system, cash in bank, ATMs and cash offices

Broad money supply in manat increased by 10.4% to AZN 22.4B.

Graph 32. Dynamics of broad money supply



Source: CBA

Cash in circulation, demand and term savings and deposits in the structure of money supply in manat (M2) performed differently.

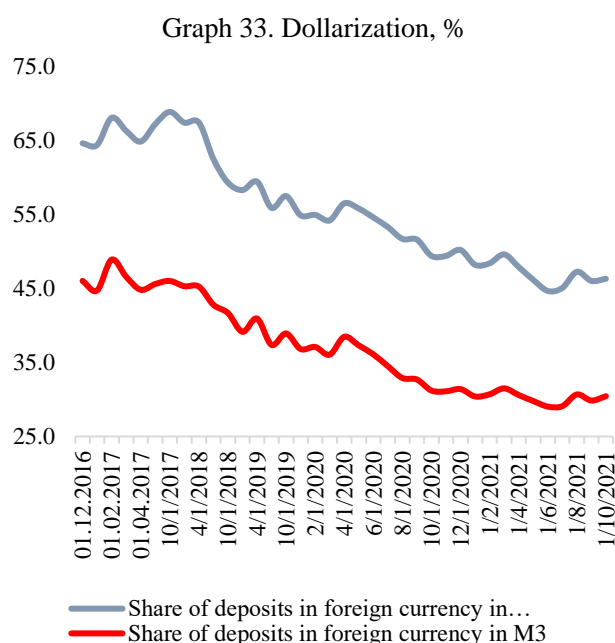
Cash in the structure of broad money supply increased by 2.5% (49.3% of M2), manat denominated demand savings and deposits increased by 16% (36.7% of M2), manat denominated term savings and deposits increased by 28.7% (14% of M2).

Manat denominated deposits of legal entities increased by 21.7%, and

savings of individuals increased by 23.8%.

Broad money supply (M3) increased by 10.4% to AZN 32.2B as of the end-period. NFAs had a 0.8%, while NDAs had a 26.8% upward effect on broad money supply in manat. Out of sub-components of NDAs, CBA's note and deposit auctions made the highest contribution to growth.

Dollarization of savings and deposits kept decreasing. The share of foreign currency denominated savings and deposits has decreased by 1.9 p.p. since early year to 46.3% as of end-September. The share of foreign currency denominated savings and deposits in M3 money aggregate has not changed since early year and made up 30.4% as of end-September.



Source: CBA

The share of foreign currency in deposits of legal entities has decreased by 4.1 p.p. since early year to 54% as of the end-period. Dollarization of savings of individuals has decreased by 7.2 p.p. since early year to 43.6%. Over the reporting period, manat denominated savings prevailed in the structure of savings of individuals for the first time since April.

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