STATEMENT OF THE CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN ON MAIN DIRECTIONS OF THE MONETARY AND FINANCIAL STABILITY POLICY FOR 2022

The purposeful policy pursued in 2021 under the leadership of President of the Republic of Azerbaijan, Mr. Ilham Aliyev, the negative effects of the COVID-19 pandemic on the country's economy have been minimized. Despite the new wave of pandemics, economic activity has resumed and higher-than-expected economic growth has been achieved due to initial and effective anti-crisis measures, massive vaccination and gradual easing of social isolation restrictions, as well as the gradual adaptation of economic entities to situation.

In 2021, maintaining the macroeconomic and financial stability in the country was one of the main priorities of the Central Bank of the Republic of Azerbaijan. Although inflationary pressures have intensified since the second half of 2021 as in most countries around the world, in general, macroeconomic stability has been achieved. Taking into account the determining role of external and internal non-monetary drivers of inflation in the context of a significant deterioration of the external background of inflation, the monetary policy of the Central Bank of Azerbaijan is aimed at mitigating the impact of these factors by managing monetary conditions and inflation expectations.

In 2021, the formation of a positive trade condition and balance of payments surplus of the country against the background of high oil prices and a significant increase in non-oil exports allowed to maintain the stability of the national currency and build up strategic foreign exchange reserves by the end of the year. In the environment of equilibrium of the foreign exchange market, exchange rate stability created conditions for a significant balancing of inflation pressures coming from the external environment.

In 2021, maintaining confidence in the financial-bank system, minimizing risks, increasing management capacity in the financial sector and resistance to shocks were set as the main priorities of the Central Bank's financial stability policy. The implemented regulatory policy and risk-based supervisory framework allowed the financial sector, including various segments of the financial markets, to continue to operate uninterrupted. .

In 2021, expanded access of the real sector to financial resources was achieved. Amid the pandemic, double-digit business lending growth and high activity in the securities market have expanded opportunities for financing economic growth, and the depth of the financial sector has increased over the year.

In 2022, the monetary policy of the Central Bank will be oriented towards ensuring sustainable price stability in the country, returning inflation to the declared target range and sustainable anchoring it in this level. According to the baseline forecasts, inflation, which is highly volatile and is formed due to external non-monetary drivers, is expected to hit the upper limit of the target range by the end of next year.

The forecasted surplus balance of payments, a significant increase in transfers from the State Oil Fund of the Republic of Azerbaijan to the state budget in 2022 will support the eqilibrium of the domestic foreign exchange market and the stability of the national currency.

In 2022, the Central Bank will continue to focus on maintaining the financial sector stability, expanding financial inclusion, increasing the depth of insurance and capital markets, ensuring the safe, uninterrupted and sustainable operation of the national payment system.

One of the main priorities of the Central Bank in 2022 and in the medium term will be to expand the efficiency and coverage of communications.This will allow for effective management of the expectations of business entities , as well as further enhance the effectiveness of macroeconomic coordination.

I. MONETARY AND FINANCIAL STABILITY POLICY IN 2021

1.1. Monetary policy environment

In 2021, the Central Bank's monetary policy was implemented in the context of recovery of economic activity and rising inflationary pressures in most countries, high inflation imports and favorable oil prices, return to domestic economic growth, fiscal and financial stability.

In 2021, there was **a process of recovery in the global economy** against the backdrop of mass vaccination against COVID-19 in the world, a gradual easing of quarantine restrictions in different countries. Despite the new wave of pandemics, economic activity in groups of countries that have a significant share of the global economy has exceeded the pre-pandemic level.

According to recent updates of the International Monetary Fund (IMF) released in October, global economic growth is expected to be 5.9% in 2021. Global trade is projected to grow 9.7% this year.

Inflationary pressures rose in most countries in 2021, mainly due to a temporary pandemic mismatch of supply and demand, rapid increases in global food prices, disruptions in the value chain, and rising transportation and logistics costs. In November, annual inflation was 3.4 times higher than the target in the United States, 2.5 times in the Eurozone, 2.1 times in Russia, 1.5 times in Kazakhstan, 2.1 times in Belarus, 2.1 times in Ukraine, 4.2 times in Georgia and 4.3 times in Turkey. Taking into account the latest trends, the IMF has raised its inflation outlook for the end of 2021 for both advanced economies (AEs) and emerging market economies (EMEs).

In this context, in some countries, central banks are tightening monetary policy in response to inflationary pressures. Since the beginning of the year, central banks have decided to raise the key interest rate by 108 times.

In 2021, there was a significant rise in **global commodity prices**. The situation in world markets was affected by the steady recovery of global demand, on the one hand, and the narrowing of opportunities to expand production in line with demand due to anti-epidemic restrictions, on the other. According to the latest data of the World Bank (WB) on commodity markets, in November 2021, compared to the same period last year, prices rose by 2.1 in the energy sector and by 24.7% in the non-energy sector. According to the FAO, global food prices rose 27.3% in November on a year-on-year basis. Deteriorating climatic conditions in a number of food exporters also have an increasing effect on global food prices.

Rising transportation and logistics costs and extended delivery times are one of the main reasons for the intensification of inflation in the world. In November of 2021, the cost of transportation of a container increased more than 4 times compared to the same period last year, and the delivery time of raw materials and final products almost doubled (*source: Freightos.com*).

The conservative increase in supply under the OPEC ++ deal compared to the high growth in demand for oil amid increasing global economic activity had a boosting effect on **oil prices**. The average price of Brent oil in the past period of 2021 was $71 a barrel, 65% higher than the average price of last year ($43). Rising energy prices are accelerating inflation in energy-importing trading partner countries.

Azerbaijan's foreign economic position in 2021 was formed in the context of the realization of the country's export potential of non-oil products and rising prices for export products. In January-October of the current year, the average annual growth of the export price index was 46.9%. Over 11 months of 2021, the foreign trade balance surplus increased by 2.8 times compared to the same period last year and amounted to $9.4B. Non-oil exports increased by 44% and non-oil imports by 9%. **Over 9 months, current account of the balance of payments** showed a surplus of $3.9B or 11% of GDP.

In the context of surplus balance of payments, the country's **strategic foreign exchange reserves** increased by 4.4% ($2.2 B) over 11 months and exceeded $53 B, while the Central Bank's reserves increased by 10.2% and exceeded $7B.

In 2021, amid continued stimulating macroeconomic policies and expanding external demand, the gradual relaxation of social isolation measures created conditions for a recovery in **aggregate demand**. Over 11 months y/y, retail trade turnover increased by 3%, consumption of paid services increased by 4.6%. Rising demand for domestic services also played a role in the increase in consumption due to the spending of savings during the period of strict quarantine, the restoration of credit activity, as well as the restrictions on travel abroad. The consumer confidence index has improved significantly in recent quarters.

Government demand has remained as one of the main sources of aggregate demand. In 11 months, the ratio of state budget expenditures to GDP exceeded 27.6%.

The recovery in aggregate demand is accompanied by an increase in aggregate supply. Over 11 months of 2021, the gross domestic product increased by 5.3% in real terms; by 6.4% on the non-oil and gas sector. **Economic growth** in the non-oil and gas sector mainly stems from the tradable sector. The non-oil and gas industry grew by 20.9% and agriculture by 3.8%.

Surveys conducted by the Central Bank within **real sector monitoring** also confirm that economic activity is growing. According to the monitoring, the average business confidence index for 11 months of the year in the non-oil industry, trade, service and construction sectors has significantly improved compared to the same period of the last year. Average sales expectations in trade and demand expectations in services were in the positive zone for 11 months of the current year. The level of capacity utilization of non-oil industrial enterprises has increased significantly compared to the same period last year.

1.2. The monetary policy in 2021 and its consequences

The monetary policy of the Central Bank in 2021 was formed taking into account the dynamics of inflation and the deterioration of the external background, the nature of the drivers affecting inflation - their temporary or permanent nature, changes in the balance of inflation risks, medium-term inflation forecast and expectations.

According to official statistics, annual **inflation** in November (November 2021 compared to November 2020) was 11.1%. Average annual inflation was 6.2% in January-November.

Average annual **core inflation** calculated excluding regulated prices, as well as seasonal product price changes, was 3.9% in January-November 2021.

Inflationary pressures increased across all subgroups of goods and services. In November, the food price index rose 14.9% y/y. Average annual food inflation in January-November amounted to 7.4%. Historical analysis of seasonal factors shows that cumulative deflation of food products has been observed on average at 3.4% in May-September each year over the past 10 years, while inflation was 2.3% in the corresponding season of this year. **Food inflation** has been severely affected by rising global food prices. In particular, the rise in prices for butter and vegetable oils, sugar and dairy products, as well as bakery products was significantly affected by global food prices. According to the FAO, in November, world prices rose 23.2% year on year for flour products, 19.1% for dairy products, 51.4% for butter and oils and 36.4% for sugar.

In November, annual inflation was 7.1% on non-food products and 9.1% on services. Among non-food products, the highest annual increase was recorded on fuels (20%) and construction materials (12.9%). Inflation on services was significantly affected by the dynamics of prices and tariffs regulated by government.

The producer price index as a whole also showed an upward trend. In October, compared to the same period last year, the producer price index in the manufacturing industry increased by 29.9%, and the agricultural producer index by 14.4%. The foregoing shows that the impact of external and internal cost factors to prices differs across sectors of the economy. The lag in the growth rate of the producer price index for agricultural products from the level of food inflation indicates a high level of inflationary imports of food products. The main reasons for this process, which experts already call "agroinflation", were the increase in global demand, drought, anti-COVID restrictions, increased production, fuel, fertilizer and logistics costs. At the same time, the annual growth of the price index for domestic freight transportation by road by 11.7% per year, along with an increase in transport costs, also contributed to the growth of producer prices in the country.

In general, inflationary pressures have recently increased due to **external factors** that play a decisive role in the formation of prices. The effects of rising global commodity market prices and icreasing inflation in trading partners, supply chain disruptions and rising transportation costs were more significant and persistent than expected. For these reasons, the average annual increase in the import price index in January-October this year was 21.4%. Domestic expenditure factors, especially the liberalization of regulated prices, account for ¼ of annual inflation. The role of monetary factors in shaping the dynamics of inflation is significantly lower. The adopted macroeconomic framework and the stability of the exchange rate which is the main anchor of price stability, supported by the balance of payments surplus, substantially neutralized inflationary imports.

The actual dynamics of inflation over the past year has been a key factor in determining **inflation expectations**. Over the past 12 months, inflation expectations have tended to grow in all monitored fields of the real sector. According to the December survey, 82% of households expect inflation, including 29% expecting higher inflation. Rising inflation expectations have the potential to accelerate the transformation of costs into prices by increasing demand.

In the past period of 2021, **the exchange rate** of the manat against foreign currencies was formed in accordance with the supply-demand ratio in the foreign exchange market. Although demand at foreign exchange auctions increased in January as a result of expectations from the indirect effects of external processes, since February, demand has declined and stabilized. Improved expectations amid a surplus balance of payments and an increase in strategic foreign exchange reserves during the reporting period also had a stabilizing effect on the foreign exchange market. In the past year, supply exceeded demand in 70% of currency auctions held by the Central Bank.

The official AZN/USD exchange rate was set on the basis of the average exchange rate on interbank transactions. Buy/sell exchange rates set by banks were formed in a trajectory close to the official one.

Base money in manat increased by 5.3% in 11 months of 2021. During the period, the surplus in the state budget and the dynamics of the single treasury account had an anti-inflationary effect, supporting the low rate growth of the base money.

Decisions related to **interest rate corridor parameters** were made taking into account the impact of global processes on the country's economy, aggregate demand and economic recovery rate, assessment of the actual and expected level of inflation, and the balance of risks from external and internal inflation. To support the recovery of economic growth, the discount rate was reduced by 16 stages from the beginning of 2018 to December 2020, from 15% to 6.25%. However, in the first half of 2021, a break was taken mainly in response to external developments, and from the second half of the year in response to accelerating inflation in September, October and December, the discount rate was increased three times to 7.25%.

To effectively manage liquidity in the economy, the Central Bank adequately used various **market operations** tools in the current year. Due to excess liquidity in the banking system, the demand for sterilization tools of the Central Bank remained high for all months. In the past period of 2021, the Central Bank held 37 auctions on notes.

Over the past year, the yield on government securities and **interest rates** in the interbank market have been declining. In general, the yield of government securities decreased by 2-5 percentage points depending on the term and formed in the range of 4-7% by the end of the year. Only in recent months, a certain increase in these parameters has been observed. No significant change was observed in nominal interest rates on loans and deposits. In November of 2021, the average interest rate on new loans in manat was 17%, the average interest rate on newly attracted deposits and savings was 8.5%. Rising inflation is accompanied by lower real interest rates.

In 2021, the level of **dollarization** of deposits continued declining. The share of foreign currency deposits and savings included in monetary aggregates in total deposits gradually decreased from 56.4% in the beginning of year to 51% in November. In particular, dollarization of deposits of individuals fell from 50.8% to 41.9% at the beginning of the year, and the dollarization of loans fell from 29.8% to 26.5%, respectively. For the first time since the beginning of 2015, the share of deposits of individuals in manat exceeded deposits in foreign currency.

Effective **communication** of monetary policy based on the principles of strengthening transparency and accountability through the wider use of digital tools was in focus as well. In 2021, under the schedule previously announced to the public, press releases on each policy decision of the Central Bank were published with relevant analytical comments and regular press conferences were held. A monetary policy review was released to the public on a quarterly basis. Activities of the Central Bank were regularly covered through its official website, as well as social networks like YouTube channel, Twitter, Instagram and Facebook. The Central Bank adopted a new medium-term communication strategy.

1.3. Financial stability and financial sector development

In 2021, the Central Bank's financial stability policy is aimed at minimizing the negative effects of the pandemic on the financial sector and maintaining confidence in the financial and banking system. The implemented regulatory policy and risk-based prudential framework ensured the stable operation of all segments of the financial sector. Real sector access to financial resources was expanded.

The banking system maintained its stability and measures were taken to rehabilitate and capitalize the banking sector. **The capital adequacy of the banking sector** exceeded the minimum regulatory requirement by 1.8 times. The sector's **liquidity** ratio was 58.3%, exceeding the minimum demand (30%) by 1.9 times.

Restructuring of loans due to the pandemic continued. Since the beginning of the pandemic, AZN1.3B worth loans of more than 57,000 borrowers have been restructured. Businesses accounted for 87%, individuals for 9% and mortgage for 4% of the restructured amount. It should be noted that in the beginning of 2021, after the mitigation of the pandemic, a positive trend was observed in the payments of the restructuring portfolio. As of 30.11.2021, the balance of the restructured portfolio due to the pandemic amounted to AZN0.7B.

As part of the **phased exit from the regulatory mitigation regime** applied by the Central Bank in connection with the pandemic since the beginning of 2021, it was decided to restore some regulatory requirements and not to continue some concessions. It should be noted that in the context of the expansion of the pandemic, temporary regulatory relaxation limited the negative consequences for economic entities, had a positive impact on protecting the interests of borrowers, maintaining lending and the stable operation of the financial sector.

Works continued to gradually bring the **regulatory framework** for the banking sector in line with international standards (Basel III), as well as to improve risk management in banks. As part of the gradual adaptation of the banking sector to regulatory capital requirements, consideration of market and operational risks when calculating capital ensured the creation of an additional buffer in banks.

Rising economic activity and consumer optimism led to an increase in demand for banking services. Over 11 months, the assets of the banking sector increased by 11.1% and the **loan portfolio** by 15%. Business loans increased by 12.4%, consumer loans by 20.2% and mortgage loans by 16.8%.

The resource base of the banking system continued to expand. Over 11 months, the deposit portfolio of banks (excluding deposits of financial institutions) rose 19.4%, as well as deposits of the population (excluding deposits of individuals engaged in entrepreneurship) increased by 10.4%. Deposits in national currency increased by 30.4%, while deposits in foreign currency decreased by 8.6%.

In connection with the withdrawal from the full deposit insurance system, **a new framework of the deposit insurance mechanism** was introduced in accordance with international best practices. According to the new framework, the amount of compensation for protected deposits of individuals has been increased from 30,000 to 100,000 manat. At the same time, deposits of individuals engaged in individual

entrepreneurship (with the amount of compensation set at 20,000 manat) and funds belonging to individuals in the deposit accounts of notaries are also covered by the deposit insurance mechanism. As a result of the introduction of these changes, 99.9% of the total number of depositors are fully protected.

Efforts were continued to create infrastructure elements that serve to expand the insurance market and a consumer protection framework in line with international best practices in the **insurance sector**. Insurance premiums y/y increased by 15% over 11 months - 15% in voluntary insurance and 16% in compulsory insurance. Work continued on the implementation of a joint project with the World Bank on the transition to a framework of risk-based control and regulation in the field of insurance, the full digitalization of existing types of compulsory insurance. The rapid implementation of compulsory insurance payments to the heirs of servicemen killed and wounded during the Great Patriotic War continued this year.

In 2021, the use of **capital market** opportunities to support the access of the economy to funding continued to intensify. Works were actively conducted to improve the operational infrastructure of the capital market, bring its legal framework in line with international standards, as well as support supply and demand in the market. In the current year, the listing requirements were simplified and an incentivizing tariff regime was introduced for investors in order to promote private sector capital market financing initiatives and the listing on the stock exchange. To develop financial intermediation in the capital market and increase financial inclusion, opportunities were created in the securities market to open customer accounts remotely and submit orders electronically and the requirements for margin trading were improved. To develop the infrastructure of the capital market, contacts were established with the Central Depository of Turkey and next year it is planned to introduce a dual listing model between the Baku Stock Exchange and the Istanbul Stock Exchange. In addition, intensive awareness-raising events were organized with market participants to increase financial literacy in the capital market. In 2021, 20 prospectuses with a total amount of AZN535M were approved on the public offering of corporate securities and over 11 months of the year AZN505M were placed on the corporate securities stock exchange. During this period, trade volume increased by 24.3% y/y on the stock exchange and by more than 3.4 times on the repo market.

The sustainable, fast and secure operation of the **National Payment System** was ensured in the past period of 2021. Over 11 months of 2021, the total amount of payments made through the main components of the National Payment System (AZIPS and LVPCSS) was 2.3 times the GDP. Progress in e-banking services continued, and the coverage of the Instant Payment System expanded.

The card infrastructure also continued to expand. The number of contactless payment cards in circulation has doubled compared to 11 months of 2020, and the number of POS-terminals accepting contactless payments has increased by 29%. Over 11 months, domestic non-cash card transactions grew by 75.4% y/y. Thus, the share of non-cash turnover in card transactions y/y increased from 23% to 31%.

Positive dynamics was also observed in **e-banking** indicators, which is one of the main challenges of the modern era. Thus, over 11 months of 2021, the volume of transactions through the Internet and mobile banking y/y increased by 60.5% and 3.8 times, respectively.

The scope of the **Digital Identification System** (DIS) launched by the Central Bank to expand e-financial and banking services is expanding. As of 01.12.2021, 20 banks have been integrated into the DIS platform, more than 1,600 bank accounts have been opened to legal entities and individuals remotely through the system, and 280 payment cards have been obtained.

During the reporting period, the works were carried out in accordance with the Action Plan for the transition of the country's financial system to ISO20022. Application of the standard will allow the creation of single data formats for exchange between participants of payment systems, minimizing risks in operations, reducing the resources spent on automation.

The Central Bank of Azerbaijan has closely followed the research on the **Central Bank's Digital Currency** (CBDC) in the world and the projects implemented in this direction. A framework for cooperation with the central banks of some foreign countries has also been established in order to study the opportunities and preconditions for the application of the CBDC.

To eliminate the obstacles to the development of cashless payments, increase access to cheap and affordable financial services for the population and businesses in any part of the country regardless of place of residence and to expand the use of digital payment services, the **"Digital Payment Strategy of the Central Bank of the Republic of Azerbaijan for 2021-2023"** has been developed and the implementation of the measures envisaged in the Strategy has been started.

II. MONETARY AND FINANCIAL STABILITY POLICY FOR 2022

The monetary policy of the Central Bank will be aimed at ensuring the dynamics of inflation towards the target range in the context of significant uncertainties in the external environment and its stable anchoring in this range in the medium term.

The framework of policies and reforms will be strengthened to ensure sustainable stability in the financial sector, support the sustainable and stable operation of various segments of the financial markets, strengthen the role of the financial and banking sector in the economy, and expand cashless payments.

2.1. Macroeconomic forecasts and expectations

Given the high level of uncertainty in the external environment, economic growth in the country is expected to continue next year.

Global economic growth is expected to continue in 2022 amid the risks and growing uncertainties posed by new strains of the COVID-19 virus. According to the October report of the International Monetary Fund, the global economy is projected to grow by 4.9% in 2022. The process of economic growth in developed and developing

countries is expected to take place at different rates, depending on the scope of vaccinations, the duration of the restrictions and the sustainability of stimulus measures. Economic growth is projected at 4.5% in developed countries and 5.1% in developing countries. Inflationary pressures are expected to continue if the rapid realization of the deferred demand does not coincide with the increase in supply. Through various stimulus programs, fiscal support and monetary policy are expected to change depending on economic growth, employment and inflation processes.

Growth in **world commodity prices** is expected to slow relatively as global supply expands. It is possible that the growing problems of global warming will affect world food prices next year as well.

World oil prices will continue to grow next year under the influence of global economic activity, geopolitical factors and decisions made within OPEC ++. The consensus price for 2022 by major think tanks (IMF, World Bank, US Energy Agency, Standard Chartered, Fitch, Barclays, etc.) is $70.9 a barrel, including $64.5 a barrel by the IMF. In general, global oil demand is projected to continue growing in 2022.

The dynamics of global commodity prices will remain one of the factors influencing **inflation processes in the world.** It is not ruled out that inflation will be high in 2022 in a number of developed and developing countries. This is mainly due to pressures from global food prices and rising energy prices for importers.

Despite short-term disruptions in the global logistics chain, **global trade** is projected to grow by 6.7% in 2022. Service trade is expected to recover at a slower pace than trade in goods.

In 2022, the expansion of global demand and the dynamics of oil prices, the macroeconomic situation in trade partners, the dynamics of non-oil exports will be the main factors affecting **the balance of payments of Azerbaijan**. It is estimated that in 2022, the current account of the balance of payments of oil at a price of even $ 50 is expected to have a surplus of about 4% of GDP.

The growth in the real sector of the Azerbaijani economy, which began this year, is projected to continue in 2022. According to official forecasts the real **economic growth** rate in 2022 is expected to be 3.9%, including 4.9% in the non-oil sector. Easing of social isolation measures, continuation of stimulating macroeconomic policies, gradual acceleration of private investment growth, implementation of rehabilitation work in the territories liberated from Armenian occupation, counter-cyclical fiscal policy and macroeconomic stability form the basis of economic growth forecasts.

In 2022, **government demand** will also play an important role in supporting economic activity. In 2022, state budget expenditures are expected to increase by 4.7% compared to 2021. From next year, implementing a non-oil fiscal deficit reduction strategy with improved fiscal rule and resumption of implementation is essential to ensure long-term financial sustainability.

2.2. Main directions of monetary policy for 2022

In 2022, the main goal of the monetary policy will be to ensure the dynamics of inflation towards the target range (4 ± 2%). Achieving this goal will depend mainly on non-monetary factors - global food and energy prices, the recovery in the supply-demand chain, the state tariff policy and macroeconomic policy framework for the next year.

The ultimate monetary policy target is to maintain inflation within the 4 ± 2% target band. According to the latest updated inflation forecasts, inflation will move to the upper range of this range from the second half of 2022 under the conditions outlined in the baseline forecast.

Given the temporary nature of the impact of external drivers on the current high inflation rate, monetary policy will maintain flexibility between price stability, economic growth and employment goals. However, if the situation deviates from this basic scenario, it may be necessary to tighten monetary policy. Effective management of inflation expectations will focus on increasing public confidence in policy. The policy response will lead to investment and business activism, support economic growth and employment by eliminating potential uncertainties and mistrust in policy.

The forecast for oil prices in 2022, the dynamics of growth of non-oil exports, as a result, a positive balance of payments and an increase in transfers from the Oil Fund to the state budget according to the approved state budget will support **exchange rate stability**, which is the main anchor of price stability. Maintaining equilibrium in the foreign exchange market makes it urgent necessity of accelerating reforms to diversify foreign exchange income next year and in the medium term.

Another intermediate goal of monetary policy, the **money supply** will be regulated by the economy's demand for money, economic growth forecast and inflation. Changes in the structure of the money supply under the influence of digitalization processes will also be taken into account when regulating the money supply. The balance of banks' manat correspondent accounts with the Central Bank will be used as an operational benchmark to influence the money supply.

To achieve its operational goals, in 2022 the Central Bank will adequately use all the **tools** and mechanisms in its arsenal. Decisions on the quantitative parameters and duration of instruments will be made depending on the liquidity position of the banking system. Regular assessment of the structural surplus (or deficit) of the banking system will be continued. A liquidity monitoring and forecasting system will be used to assess the impact of autonomous and non-autonomous factors on liquidity. The flexible use of monetary policy instruments in accordance with the nature of macroeconomic processes will support the effective operation of the transmission mechanism, as well as macroeconomic and financial stability.

Decisions on the **interest rate corridor parameters** will be made in light of updated macroeconomic forecasts, transmission of external and internal cost factors to inflation, inflation expectations and changes in the risk balance. In this case, the

principle of counter-cyclical monetary policy will be taken into account. As in previous years, the discussion of the interest rate corridor in the Board of the Central Bank will be organized in 2022 in accordance with the previously announced schedule (Annex 1).

The Central Bank will also take into account logs and features in the **transmission** mechanism when making monetary policy decisions. The time lag between the impact of monetary policy decisions on real economic variables (aggregate demand, production, inflation) can take several quarters. In the face of uncertainty about structural change in the economy, the impact break may be somewhat longer.

Improving monetary policy to increase its ability to influence inflation will be carried out as part of a **conditional, phased transition strategy to a long-term hybrid inflation targeting regime**. Necessary preparations will be made for the transition to the new regime, and the realization of the basic conditions will be a top priority.

In the medium term (2022-2026), as part of creating the **basic conditions for the transition** to a new monetary policy regime, the Central Bank will work with the government to expand the government securities market and form an active money market, limit the cash and shadow economy, diversify supply channels in the foreign exchange market and strengthen effective macroeconomic coordination.

Strengthening the Central Bank's **analysis and forecasting capacity** will also play an important role in improving the monetary policy framework. In this regard, work will be done to establish the Forecasting and Policy Analysis System (FPAS), modernize the model bag for medium and long-term forecasting, expand the range of forecast indicators, and improve the quantitative and qualitative database required for analysis and forecasting. As part of the strengthening of statistical and analytical work on real sector enterprises and households, it is planned to improve surveys on financial behavior and economic expectations, and deepen survey-based analytical analysis.

Improving the effectiveness of communication policy in managing expectations will be one of the important elements of monetary policy in the coming strategic period. As part of the information openness policy, the maximum operative and fully open information on the purpose, principles, measures and results of monetary policy, as well as the assessment of the economic situation and development prospects will be made public. Due to the development of communication technologies and the pandemic, **digital tools will be more widely used** in communication. Based on the adopted new strategy, works will be carried out to expand the sphere of communication. It is also planned to continue awareness-raising works on economic and financial issues for various target groups.

2.3. Main directions of financial stability policy and financial sector development in 2022

In 2022, the Central Bank's financial sector policy will focus on safeguarding financial stability, supporting business by expanding financial intermediation, and deepening financial and capital markets. All this should further enhance the role of the financial sector in economic growth. Works will also continue to increase the use of digitalization and modern payment system infrastructure.

The main policy and reform direction for 2022 to ensure financial stability will b, first of all, the continuation of the process of **bringing the framework of prudential regulation and supervision of the banking sector in line with international standards (Basel II, Basel III).** Strengthening the management of banks and bringing them in line with international standards, including the development of corporate governance capacity, strengthening risk management systems, human resource development, will be encouraged.

Works will continue to **facilitate access to bank loans for businesses**. In order to increase financial inclusion and depth in the country, works should be continued to advance supply-side factors, including improving the effectiveness of the lender protection system, providing long-term funding sources, and improving risk transfer and distribution mechanisms. To increase the healthy demand for loans by stimulating demand, first of all, it is necessary to accelerate the exit from the informal economy and increase transparency, improve corporate governance in business entities, and develop independent accounting and auditing institutions.

The development of **agent banking** will also contribute to increasing access to financial services in the country and improving the quality of financial services. Works will continue to form a legal and regulatory framework for the development of alternative financing.

The implementation of the strategy of gradual transition to Solvency II standards will be continued within the framework of bringing the regulatory and supervisory framework **in the insurance sector** in line with international principles and advanced standards. Measures will be taken to develop human resources and management capacity in the insurance sector, form a consumer protection framework in line with international best practices, develop the sector's market infrastructure, digitize the insurance sector and form a variety of digital services. However, awareness-raising and outreach activities to increase insurance literacy will continue on a larger and more intensive scale.

Cooperation with international financial institutions will continue to improve the legal framework and operational infrastructure of the **capital market**, as well as to eliminate the ecosystem barriers that restrict the effective financing of the capital market. Measures will be taken to bring the supervision framework and corporate governance of investment companies in line with international standards. Works will be continued to promote the activities of investment funds to improve financial intermediation in the capital market and to create opportunities for banks to directly

participate in the capital market. To develop the capital market infrastructure, it is planned to establish a centralized trading and depository system and digitalize the securities issuance process. Measures will be taken to establish a mechanism to guarantee and subsidize corporate bonds issued by small and medium-sized businesses (SMEs) to encourage them to raise funds from the capital market. To ensure the Central Bank's privileged membership in IOSCO (International Organization of Securities Commissions) and increase foreign investors' access to capital market, it is also planned to establish relations with global custodians, bring the regulatory framework for derivative financial instruments in line with international standards and hold awaresness-raising events with companies and the public.

Ensuring the safe, uninterrupted and sustainable operation of the **national payment system** will be one of the important priorities in 2022. It is planned to increase the efficiency and effectiveness of mutual information exchange in the financial infrastructure, including the full application of the international standard ISO20022. As part of the application of international standards for the development of innovative cashless payments, it is planned to apply API standards on the open banking model. Strengthening the level of cyber security in the payment infrastructure will also be considered.

Measures will be taken to improve the institutional environment in order to create a competitive, innovative and affordable payment environment, develop the **digital ecosystem** and expand the scope of digital payments. These measures include such projects like expanding the possibility of accepting public transport fares in cities and regions through innovative payment instruments (bank cards and mobile banking solutions), expanding the coverage of POS-terminals in business entities, creating opportunities for accepting QR code payment solutions where POS-terminals cannot be installed. Measures will also be taken to increase financial literacy in the field of digital payments, encourage the active use of digital payment services by businesses and the public, and strengthen human resource capacity in this area.

Given the importance of the future development of the rapid payment system for monetary policy and financial intermediation, the assessment of the medium-term feasibility of the **Central Bank's Digital Currency** (CBDC) will be continued in several areas: i) clarification of digital currency policy, goals and objectives; ii) involvement of stakeholders in the process; iii) formation of the legislative base; iv) potential to use new generation technology; v) level of market readiness. Conceptual documents related to CBDC will be communicated openly and in detail.

In 2022, monetary policy will be aimed at ensuring macroeconomic and financial stability in the national economy, primarily approaching the inflation target, intensifying the role of the financial sector in economic development and, to this end, reforms in the monetary and financial sectors. The realization of the set goals will significantly depend on the effectiveness of coordination between macroeconomic policy institutions.

Schedule of disclosure of monetary policy decisions to public

In 2022, decisions related to the parameters of the interest rate corridor will be publicly disclosed 8 times according to the schedule below:

- January 28
- March 18
- April 29
- June 17
- July 29
- September 16
- October 28
- December 16

Disclosure of decisions will be accompanied by press conferences on January 28, April 29, July 29 and October 28.