STATEMENT
OF THE CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN
ON MAIN DIRECTIONS OF THE MONETARY AND FINANCIAL STABILITY POLICY
FOR 2020 AND MEDIUM TERM

The main target of the monetary policy of the Central Bank in 2019 was to maintain price stability in the national economy. Low and stable inflation is the prerequisite of maintaining living standards of the population, shaping favorable environment for business activities, improving access of the population and businesses to finance and credibility of the national currency.

Owing to target oriented economic policy and structural – institutional reforms under the leadership of Honorable Mr President Ilham Aliyev economic activity remained positive and balance of payments surplus contributed to rise in strategic foreign exchange reserves in 2019.

Being within the target band (4±2) the inflation rate both led to certainty in economic conditions and underpinned economic activity.

The Central Bank's active monetary and exchange rate policy was critical in price stability and inflation expectations. To neutralize a number of main internal and external inflation factors and support economic activity and employment, consistent normalization of the monetary condition allowed generating balanced results in growth and stability.

In 2020, the monetary policy of the Central Bank will orient towards reinforcing price stability results and anchoring inflation at a low single-digit level. At that, the Bank will focus on critical external and internal factors that translate to economic dynamics and price stability in particular. The Bank will consider rising global food prices, price dynamics of energy carriers, lending growth, especially consumer loans, pass-through channels of the budget policy and funding sources of fiscal deficit to price stability and other factors in its monetary policy.

The Central Bank will take overwhelming measures to strengthen financial stability, develop the financial sector and increase real sector access to finance from 2020 onward. Introduction of macro prudential tools in parallel with application of best practices based supervisory framework will protect the financial sector from systemic risks. Financial sector stability and development will have a positive effect on both economic growth and pass-through capacity of the monetary policy.

The Bank will further improve forms and methods of the communication policy, the main monetary policy tool, aided by its higher role in inflation expectations.

At the same time, main factors for both economic growth acceleration and safeguarding macroeconomic and price stability will depend on close coordination of various economic policy directions and critical structural – institutional reforms.

I. THE MONETARY POLICY IN 2019

1.1. Monetary policy environment

Positive trends in Azerbaijan's external and internal balance continued on the backdrop of complicated global economic environment. The balance of payments was in surplus, and revived aggregate demand had an upward effect on economic growth.

Slowdown in global economic activity started in Quarter II, 2018 continued in 2019. According to the IMF, **global economic growth** dropped to historical lows since the global financial crisis. Higher trade and geopolitical tensions are negatively weighing in on business confidence, global trade and industrial production. Amid rising uncertainties, economic activity slowdown is synchronic in advanced (AE) and emerging market economies (EME).

In 2019, the IMF revised **global economic growth outlook** down four times by total 0.5 pp to 3%. The Fund lowered economic growth forecast by 0.3 pp to 1.7% in AEs and by 0.6 pp to 3.9% in EMEs. Slowdown in AEs stemmed from US-China trade tensions, Brexit related uncertainties and stagnation in some industrial sectors. The policy of reduction of interest rates by central banks contained slowdown in economic activity to some extent. Average economic activity across Azerbaijani trade partners is expected to be 1.3% in the current year.

Low economic activity is translating to **global trade** and investments. According to the October release of the World Trade Organization (WTO), global economic trade is forecast to stand at 1.2% as of end-2019, 1.4 pp down vs the April release.

Prices for commodities, strategic for Azerbaijan, in **global commodity markets** were prone to rising. Global food prices y/y increased by 9.5% in November. The Brent oil gained 28% in the global market, average price per barrel $64.2. Slow growth of global demand (mainly in EMEs), technological innovations used in oil extraction and utilization of energy carriers factor in low oil prices. Agreement of OPEC and non-OPEC members to roll over production cuts and sanctions against certain large oil producers had an upward effect on oil prices.

In general, global conjuncture was favorable for Azerbaijan; although average oil price was low year-on-year, positive trends remained in the **balance of payments**.

Current account in the balance of payments (BoP) was in surplus ($4 B or 11.6% of GDP over 9 months), stemming from positive surplus of foreign **trade balance**. In January – November foreign trade surplus was $5.9B. Non-oil export increased by 16.3% surpassing non-oil import growth (7.1%), less monetary gold. Positive trends in the balance of services, primary and secondary income continued. Touristic services remained in surplus.

Over 9 months of 2019 deficit of **capital and financial account** y/y decreased by 7.2 times to $344M, attributable to decrease in trade loans and advance payments.

On the backdrop of BoP surplus strategic foreign exchange reserves increased by 13.7% since the early year to $50.9B, higher than GDP. Assets of the SOFAZ exceeded $40B, for the first time in the history. Central Bank's **foreign exchange reserves** increased by 11% to $6.2B.

Country's assets ($111B) on the **international investment position** exceed liabilities ($54B) by more than two times, attributable to high international credibility of Azerbaijan and its role as an international creditor.

Economic activity maintained positive dynamics. Over 11 months real GDP increased by 2.1%. 3.5% non-oil growth stemmed from trade. The non-oil industry grew by 14.8%, agriculture by 7.1%.

The Bank's real sector monitoring (RSM) confirms high economic activity. In November 2019 the **business confidence index** on the non-oil industry, trade and services bettered relative to both the early year and year-on-year. Though lower than potential, capacity utilization has been rising over recent quarters, mainly due to large enterprises.

Economic growth is driven by external demand and consumption component of domestic demand. **Consumption** is driven by money income of the population and the dynamics of credit investments. Nominal income of the population increased by 7.4% over 11 months driven by social reform packages conducted in several phases, much higher than annual inflation. On this backdrop consumer confidence indicators improved. Another component of domestic demand – **investments** made up AZN12.8B over 11 months, non-oil investments increased by 3.5%.

Budget expenses were one of critical factors of domestic demand – state budget expenses y/y increased by 2.6%, and current expenses by 12.5%.

1.2. Monetary policy and its results

The ultimate target of the monetary policy in 2019 was to maintain inflation within the announced target band. Over the year, inflation in Azerbaijan was within the target band, one of the lowest in the CIS and partner countries. The policy started in 2018 to move the monetary condition close to neutral continued.

According to official statistics, in November 12-month **inflation** was 2.6%, lower than the target band center. Prices for 8.8% of products in the consumer basket remained unchanged, prices for 15.4% decreased over the recent year. Price hike for 46.4% of products was below 2%.

Price indices across food products with considerable share in the consumer basket increased by 4.8% annually. Stronger hike trends in global food prices are one of the critical factors to affect domestic **food inflation** via inflation import. On the other hand, seasonal factors had an upward effect on prices for certain local agricultural products.

Reduced annual hike rates on non-food products and services (1% and 0.9% respectfully) contained overall inflation.

In general, revived consumption and high global food prices had an upward, while a stable exchange rate, the monetary condition, the dynamics of administrative prices and low inflation expectations had a stabilizing effect on inflation.

Average annual **core inflation,** calculated by excluding goods and services, whose prices are regulated by the government and seasonal agricultural products, was 2.4% over 11 months of 2019.

In 2019, actual dynamics of inflation and rebalancing in the FX market minimized **inflation expectations**. According to Central Bank's RSM findings, households' inflation expectations are low and stable for upcoming 12 months. 3-month inflation expectations on non-oil processing and services are close to actual inflation.

As a key anchor of macroeconomic and financial stability, the national currency was one of the stable currencies in the currency group not only in the region, but also among EMEs, the **exchange rate** being a key stability anchor.

Supply exceeded demand in the domestic foreign exchange balance; the exchange rate of the manat was under appreciation pressures. Foreign exchange supply was mainly supported by balance of payments surplus, oil revenues used for fiscal purposes and dedollarization trends.

Buy-sell exchange rates set by banks were close to the official one. An official exchange rate is based on average weighted exchange rate in the interbank market. The size of **foreign exchange operations** in the interbank market increased by 15%.

The non-oil **real effective exchange rate** of the manat depreciated by 2% over 11 months of 2019. Inflation in Azerbaijan, much lower than that in trade partners, both had a downward effect on the REER of the manat and supported its competitiveness. The REER of the manat has depreciated over 33% since 2014.

The monetary condition was eased by **decreasing cost of money** and **increasing the size of money** in light of macroeconomic stability, and neutralization of a number of internal and external factors of inflation.

The Central Bank discussed interest rate corridor parameters 8 times in 2019 and decided to shift the **refinancing rate** to 7.5% from 9.75%. In general, the refinancing rate has been decreased by two times since early 2018.

Expanded **money supply** also was critical in neutralization of the monetary condition. Money base in manat has increased by about 23% since early year. Broad money supply in manat (M2 money aggregate) increased by 13.8% over 11 months.

Monetary condition easing has a downward effect on interest rates. Average interest rates on new deposits and savings attracted in manat since early 2018 have decreased by 2.9 pp, and average interest rates on loans by 3.4 pp. Interest rates in the government securities market respond to the dynamics of interest rate corridor parameters of the Central Bank.

Dedollarization continued amid low inflation and rebalanced FX market. Dollarization on savings of individuals shifted to 54.1% from 62.5% early year.

To manage liquidity effectively in the economy and in the banking sector the Central Bank adequately used **monetary policy tools** at its disposal and diversified maturity of its sterilization tools starting to issue 84, 168 and 252 day notes from September onward, very critical in terms of supporting interest rates in a short-term period of the yield curve. Albeit dropped interest rates, supply considerably exceeded demand, due to still large **structural surplus** in banking system liquidity.

The Bank attached great importance to effective communication of the monetary policy. The **schedule** of disclosure of monetary policy decisions of the Management Board of the Central Bank went public in advance. Under the schedule in question, the Bank published press releases with related analytic comments per policy decision, aided by regular press conferences, released quarterly Monetary Policy Reviews, and highlighted its activities on its web site. The Bank opened official Twitter and YouTube accounts, and more actively releasing prompt information on its main activity directions on these interactively managed modern platforms activated its communication. The goal of more information openness is to make the implemented policy more understandable and boost Central Bank credibility.

1.3. Financial stability and financial sector development

Financial stability safeguarding covered banks, non-bank credit institutions, capital and money markets, and the insurance system in 2019. Despite a number of lingering fragilities in the balance of systemic risks, the financial sector stability was safeguarded in parallel with lending recovery.

Several banks received capital injections as part of **banking sector restructuring in 2019** and prudential norms were changed to make the risk management system more effective. Overall, financial sector restructuring has not completed so far.

602 thousand citizens were compensated and loans of more than 300 thousand citizens were restructured with respect to implementation of the Decree of the country leadership dated 28 February 2019 on ‘Additional measures on **resolving problem loans of individuals**’. The citizens has already received AZN 644.5M worth of compensation. As of the recent date, AZN242.3M worth of loans of 123.1 thousand persons has been restructured under privileged conditions (1% for five years). Amount

of fines and penalties written off within the frames of the Decree surpassed AZN205 M, loans of 42 thousand debtors were fully closed. Implementation of the Decree had a positive effect on the quality of **bank assets**. The share of NPLs of the sector in the portfolio in November decreased by three pp vs end-2018. However, problem loans are still one of the financial system fragilities.

Capital adequacy, one of the **financial stability** indicators was 22.6%; the ratio of liquid assets to total deposits was 40% as of the end-period.

The Bank continued consistent efforts to cover various target groups and regions to raise **financial literacy** and released Search Engine stimulating use of financial services in the current year.

Credit investments have increased by 16.1% since early year, mainly due to 21% rise in loans to households (50.4% of the lending portfolio).

Savings of the population, one of the key bank resources have increased by 3.7% to AZN8.7B since early year. 84.4% of deposits are protected by the Deposit Insurance Fund. Non-completion of financial sector restructuring slows down improvement of the deposit insurance system.

Efforts for the financial market improvement covered advancement of clearing and settlements with **securities,** attraction of foreign investors, promotion of issue of new financial tools via securitization, as well as optimization of the tariff regime. The size of trade in the secondary market for government securities increased by 4 times, 38% at the secondary market for corporate bonds and by 81% at repo operations.

Works were under way to develop and improve oversight of the **insurance sector** and protect consumer rights. Assets of the sector have increased by 13.5% since early year. Insurance payments y/y increased by 8.6%.

1.4. Payment systems

Stable, uninterrupted and safe operation and development of payment systems was one of the main activity directions of the Central Bank in 2019.

The number of payments made via the **National Payment System (NPS)** over 11 months of 2019 increased by 41%, the size of payments was 3.3 times of GDP.

The Bank continued efforts to expand the capacity of the **Government Payment Portal** (GPP) launched to collect budget payments and payments for mass services in a centralized manner. Currently, this infrastructure hosts 12 central executive power bodies, 4 utilities, 5 landlines and mobile operators, 106 judicial authorities, 18 insurance companies, 1438 municipalities and other entities of social importance. Today payments for over 550 services across institutions integrated to the GPP are collected over the Portal. Payments for the said services can be made at 30 banks and over 2500 branches and departments of the Azerpost LLC, about 1300 payment terminals in cash and cashless manner. The number of transactions processed in the Portal increased by 24%, and the size by 27%.

To expand the coverage of digital payments throughout the country as part of the implementation of the 'State Program on expansion of digital payments in the Republic of Azerbaijan in 2018-2020' the Bank continued efforts on the **projects** on launch of the 24/7/365 Instant Payments System, introduction of ISO20022 standards, creation of Blockchain based digital identification system. The Bank started to issue the Azerbaijan Student Card that allows changing radically financial behavior of the young generation and combines both a student card and payment functions, jointly with the Ministry of Education for the first time in the country. The Bank analyzed possibilities for expansion of digital payments in the transport sector and delivered proposals to related authorities. To boost interest in digital payments the Bank conducted lotteries and many awareness campaigns.

To create a legal basis for development of **innovative solutions** banks made and approved changes to the legislation on distant account opening and contactless mobile payments.

Card infrastructure continued to be developed. The number of payment cards reached 7.5 M pcs, ATMs – 2.6 thousand pcs, POS-terminals – 65.2 thousand pcs. Contactless cards account for 18.1% of payment cards. The number of ATMs y/y increased by 2.2%, contactless POS-terminals by 35%. The size of all kinds of cashless payments by all facilities increased by 57%, including 93% rise in the size of e-trade operations. The share of cashless payments across the country has increased from 8% to current 20% over recent five years.

The Bank attached importance to **effective oversight of payment systems** and changed the normative base of legal importance to establish a procedure on distant account opening. The Central Bank regularly monitored activities of international card organizations and money transfer systems in the occupied territories, analyzed products and services applied in the payments ecosystem, maintained an active dialogue with the banking sector on development of digital banking services and prevention of possible risks, as well as on the 'Base banking services package' project.

II. MAIN DIRECTIONS OF THE MONETARY AND FINANCIAL STABILITY POLICY FOR 2020 AND MEDIUM TERM

The year of 2020 is considered a critical strategic horizon in terms of transition to a new economic growth model. Main priorities for macro economic and macro prudential policies for the period will again include safeguarding price and financial sector stability and financial sector development.

The Central Bank will contribute to creation of favorable conditions for economic growth and improvement of social welfare via macroeconomic and financial stability.

The monetary policy will be the key in maintaining critical conditions for sustainable economic growth and further focus on price stability, a vital element of business environment, social stability and competitiveness. The Bank will seek to improve the monetary policy regime to expand opportunities to affect inflation.

The financial sector sustainability will be strengthened, financial intermediation and financial markets developed.

2.1. Macroeconomic forecasts

The Central Bank will implement its monetary policy for the year to come and in the medium term in light of macro-forecasts on global and internal economic trends.

Global economy is expected to continue with certain slowdown in 2020 and medium term. The IMF in its October release forecasts 3.4$ **global economic growth** in 2020, 0.2 pp down from the early year forecast. International trade restrictions and geopolitical situation will factor in economic activity in 2020 too. Economic growth is forecast to stand at 1.7% in AEs and 4.6% in EMEs. Growth forecast on EMEs has been revised down by 0.3 pp vs the early year.

Leading countries are expected to employ stimulating capacity of the monetary policy to support economic activity. Probability for central banks of the main global powers, including the USA to reduce interest rates is high.

Economic growth in Azerbaijani trade partners is expected to make 2.4% with relative acceleration. Amid current uncertainties, a wave of new sharp volatilities in financial markets of partner countries is expectable.

Prices in global commodity markets are forecast to behave differently. The IMF predicts $57.9[1] oil price in 2020, down compared to the previous year. Expectations in drop on demand for oil products allow saying that oil prices are unlikely to peak to historical highs in medium and long term. However, sanctions against certain oil exporters and the policy of output regulation by the OPEC+ will have an upward effect on oil prices in the upcoming year too. The World Bank forecasts 5.6% price hike for metals and 0.6% hike for agricultural products in 2020.

According to the WTO, in 2020 the growth rate of **global trade** will stand at 2.7%, 0.3 pp down compared to the previous forecast.

Base scenario forecasts indicate that positive trends attained on external and internal balances will be maintained.

[1] Average price for Brent, Dubai Fateh and West Texas oil

Azerbaijani **external sector** will be driven by the dynamics of global oil prices, developments in trade partners, low import dependence and high export potential amid global uncertainties in 2020. Simulations on various oil price scenarios display that **current account** will be in surplus in 2020 in case the oil price implied in the state budget realizes. As in previous years, current account surplus will be driven by external trade balance in the upcoming year too. Positive trends are expected to remain in both the non-oil trade balance and services and primary income balances.

Economic growth is forecast to increase compared to 2019. According to official forecasts, in 2020 **real economic growth** rate is expected to be 3%, including 3.8% rise on the non-oil sector. Structural transformations in the country economy aided by safeguarding macroeconomic stability and ongoing radical institutional reforms will be one of the factors to influence the economic growth speed and inclusiveness. The reforms in question push high labor and capital productivity, the vital factors for economic potential, and introduction of new technologies.

Public demand will be critical in economic growth. The oil price taken more conservative compared to the previous year is the factor to support fiscal sustainability looking forward. The goal of the changes to the **fiscal rule** made during development of the 2020 state budget is to strengthen fiscal stimuli to economic growth. Budget expenditures are forecast to increase by 6.8% compared to 2019 and current expenditures will increase by 39.3%. More use of internal borrowing to fund budget deficit, much higher compared to the previous year, would be very important in terms of both safeguarding macroeconomic stability and financial markets development.

According to the Government's official forecast, in 2020 **inflation** will stand at 4.6%, the level likely to contribute to increase in real income of the population.

In general, realization of the said forecasts for 2020 will depend on effective coordination of all directions of the macroeconomic policy and minimization of effects of possible external shocks with the actions plan developed for the year ahead.

2.2. The monetary policy framework for 2020

The priority goal of the monetary policy for 2020 and medium term will be to maintain price stability within the authorities of the Central Bank. The Bank will maintain absolute priority of price stability over other goals and objectives of the monetary policy in the year to come too. Information openness will be one of the main principles of the monetary policy.

Price stability is a prerequisite of favorable economic environment for consumers and businesses. Low inflation provides stable purchasing power of the national currency. The trustworthy policy due to price stability allows entrepreneurs and households to develop their medium term investment and consumption plans with confidence. Stable and low inflation prevents depreciation of income and savings, stimulates national currency denominated long-term savings and decreases dollarization and interest rates, boosting internal investment and pushing economic development. As a key element of social stability, low inflation protects consumption of low-income population and hinders deepening of income inequality.

The **upmost monetary policy target** for 2020 will be to maintain inflation within the 4±2% target band. The target was set on annual, i.e. recent twelve-month change of the consumer prices index. To hit the target the Central Bank will adequately use all tools and mechanisms in its arsenal focusing on consistent and result oriented monetary policy decisions.

The dynamics of the exchange rate of the manat will be of the key conditions for low inflation next year. Upward effect of depreciated manat on prices is estimated to be higher than the downward effect of appreciated manat.

The Central Bank will allow the exchange rate of manat to base upon **macroeconomic fundamentals** within the frames of the current exchange rate. The main factor to set long-term dynamics of the exchange rate of the manat will be the state of the BoP, likely to respond to external shocks and capital flows. Accordingly, the Bank will always monitor price swings on main export products and capital flows, as well as the behavior of nominal and real effective exchange rates, and focus on their translation to the economy and financial markets. Diversification of foreign exchange supply sources and effective regulation of foreign exchange supply and demand by the government will act as the main guarantor for long term rebalancing in the FX market in the upcoming period.

The Central Bank reserves the right to intervene the FX market to smooth supply and demand and will maintain contained size and number of **interventions to the FX market** next year taking into account trends driven by fundamental and conjuncture factors. The Bank will promote liquid, transparent and self-regulatory FX market and regularly share with the broad public information on the size of interventions and foreign exchange reserves.

Money supply will be regulated in light of economic growth and inflation forecasts, as well as developments in financial markets and the banking sector's liquidity position. The Bank will also focus on boosting banking system's money creation capacity and regularity of payments.

To hit the ultimate goal of the monetary policy the Central Bank will actively use interest rates on its operations. As in previous years, the Bank will take a decision on **interest rate corridor parameters** that rest upon macroeconomic stance and changes in the risks balance, and model estimations based forecasts next year too. Monetary policy related issues will be discussed 8 times in 2020 too. The Central Bank will employ the current model bag and forecasting facility in monetary policy decision making. Various scenario forecasts will base upon the global situation, real sector developments, information on possible effect of decisions on budget – tax and other directions of the economic policy. The Bank will consider the factors like monetary policy transmission, attractiveness of national currency denominated savings along with the prospects of hitting the inflation target and not allowing credit investments to lead to inflation when regulating interest rate corridor parameters. Various internal collegial bodies in place in the Central Bank will allow effective coordination of monetary policy decisions with financial stability and the financial sector's development policy.

Setting the refinancing rate trajectory in light of the inflation target and timely and adequate monetary policy decision-making should allow minimizing probability of inflation deviation from the target. On the backdrop of non-realization of internal and external risks and non-occurrence of unexpected changes in the market, the Central Bank will provide maximum support for full employment and economic growth with a **neutral interest rate policy** without losing control over inflation. In case of activated inflation risks, the interest rate policy may be toughened. In general, excess monetary policy accommodation vs the cost and value of money may lead to large-scale negative results. Growth in aggregate demand ahead of growth opportunities for the economy to expand production may lead to inflation. With this in mind, the Central Bank will take a conservative approach during risk evaluation and decision-making.

To hit the inflation target, the Central Bank will promptly use **monetary policy tools** at its disposal and flexibly correct their quantitative parameters depending on whether interim targets are attained.

The Central Bank's **standing facilities and open market operations** will allow the banks to effectively manage liquidity. The Bank will contribute to both activation of the money market and shaping the yield curve with its monetary policy tools. Taking into account their role in financial market deepening and boosting the effectiveness of the monetary policy transmission mechanism, the Central Bank will actively use various maturity notes it issues. Efforts to improve the liquidity monitoring and forecasting system will continue. In general, the Bank will strive to optimize the tools arsenal and elevate monetary policy transmission effect, and take measures to increase opportunities to influence market rates. Short-term tools will support formation of short-term interest rates in the interbank money market within the interest rate corridor, while long-term tools should allow regulation of structural liquidity in the banking sector. The Bank will keep investigating the ways for increasing the effect of short-term interest rates on long-term rates. Monetary tools will also target optimization of flow of funds in the economy and enough flexibility of liquidity against changes in demand for money.

The Central Bank will again focus on boosting transparency and **effective communication of the monetary policy**. As part of the information openness policy the Bank will provide maximum prompt and fully open data related to the goal, principles, measures and consequences of the monetary policy, as well as assessing the economic situation and growth outlook.

Clear communication of decisions and intentions by the Central Bank is a powerful tool to manage inflation expectations, which influence both the dynamics of current inflation and interest rates in the economy. Low inflation expectations make the economy more resilient against internal and external risks, and create a favorable condition for economic growth and social welfare. The Central Bank will seek to **stabilize inflation expectations** of households and businesses and adjust them to the inflation target with its communication.

The Central Bank will make public monetary policy decisions with relevant comments **under the previously disclosed schedule**, aided by regular press conferences (4 times a year) (Annex 1) and release information on the reasons for decisions and taken steps for market participants immediately after the decision is taken and attach importance to expanding the coverage of communication channels.

A number of global and country specific **risks** may hinder inflation target hitting.

Global risks primarily relate to possible oil price swings amid lower than expected global economic growth, lingering protectionist trends and geopolitical tensions. The global Economic Policy Uncertainty Index has peaked. In addition, lower return on long-term securities compared to short-term notes and high threats in the financial system of AEs elevated crisis expectations. Another external risk source includes ongoing price hike in global food markets, and potential inflation resulting from inflation in trade partners and changes in foreign exchange rates.

Internal risk factors include high money supply due to fiscal activity and fiscal deficit, inflationary expansion of consumer loans and asymmetry of expectations.

Maintaining inflation within the target band in light of the risk balance and potential for the effect of non-monetary factors will depend to a considerable extent on approaches to various economic policy directions. In the environment of higher uncertainties on all directions of the economic policy, in particular effective **coordination** on the fiscal and monetary policy may allow to minimize negative impact of external shocks and safeguard the balance in the FX market. Avoiding pro-cyclicality in the fiscal policy and adequate application of fiscal rules will be prerequisites of effective management of internal risk factors and sustainability of price stability. On the other hand, structural institutional reforms under way should improve the competitive environment, critical to sustain price stability.

2.3. Monetary policy directions for medium run

The Central Bank will continue improving the monetary policy regime and boosting opportunities to influence inflation in 2020.

The Central Bank will continue efforts to transit to **inflation targeting** on a stepwise basis as part of the **monetary policy strategy improvement.**

Measures to **activate the money market** should allow short-term interest rates in the interbank market to become monetary policy's alternate anchor in the end, enabling the Central Bank to attain its inflation target by making corrections to the policy rate. The Bank will continue its active performance to contribute to synchronic movement of short-term interest rates to the interest rate corridor in the interbank market. Formation of the interest rate based operational framework by the Central Bank will provide additional support for money market activation.

Fiscal system's sustainability and stability, healthier and deeper **financial and banking sector,** expansion of **cashless payments,** less **dollarization,** and highly **effective** macroeconomic **coordination** will accelerate transition to inflation targeting.

As part of the measures for transition to a new regime, the Central Bank will further elevate its analysis and **forecasting capacity** and **transparency** of its operations. Hıgher quality of forecasting will allow identifying and minimizing differences between expected and targeted inflation. Changes to monetary policy communication will shift public attention from the exchange rate to inflation, supporting price stability by changing expectations. Central Bank's financial and operational independence will be of the factors to contribute to price stability. A new banking legislation should further strengthen institutional grounds for Central Bank responsibility – independence and transparency – accountability.

2.4. Financial sector stability and development

The Central Bank will increase efforts to make the financial sector more resilient to risks and deepen financial intermediation, money and capital markets, and take effective measures to complete financial sector restructuring and regulate problem assets, likely to elevate the role of the financial sector in economic growth.

Prevention of risks accumulation in **systemically important financial institutions** during the **banking system rehabilitation** will be a top priority.

The Bank will attach a particular importance to problem assets as part of **maintaining the quality of banking sector assets.** Accordingly, the Bank will promote use of advanced risk management principles in more effective decrease in the size of problem loans and issue of new loans by credit institutions.

The Bank will focus on maintaining an acceptable level of and creating effective mechanisms to manage **liquidity**. Central Bank's liquidity tools will be critical in safeguarding banking system liquidity. Moreover, greater volume of state securities and development of the interbank credit market will also positively factor in flexible regulation of the liquidity position by banks.

The Central Bank will more tensely **monitor the financial sector** and focus on revealing possible systemic risks and potential crisis probabilities in financial markets, and take related policy measures. The Central Bank will preventively provide stress test based simulation of the status of financial sector against various economic shocks and make relevant interventions to the sector if necessary.

In the year to come the Central Bank will take efforts to **improve the banking supervision framework** and apply risk-based and counter-cyclic prudential regulation. The Bank is planning to launch preliminary pilot works to introduce risk-based supervision based upon a new methodological approach.

The Central Bank will support boosting **internal potential** of banks to manage risks in 2020 too and take measures to introduce corporate governance standards in banks and boost stress-testing capacity.

To increase credibility of the banking system the Central Bank will focus on improving the deposit insurance system. Efforts oriented towards stronger consumer finance protection and higher financial literacy of the population will contribute to increasing confidence in the banking system. The Bank will continue extended financial literacy actions by broadening regional coverage among the population of various target groups. Higher public financial literacy will pave the way to better risk management, better borrowing discipline and wider responsible lending behavior.

The Central Bank will strengthen the role of financial sector in economic growth and further broaden access of economic agents to credits.

In developing financial intermediation, the Central Bank will target formation of an **effective financial system** that effectively funds economic growth and covers all economic agents with wide-range financial products.

The Central Bank will cooperate with the Government to increase **access** of the real sector, SMEs in particular, to cheap and long-term **financial resources.** Prerequisites for business lending in the year to come will include extended application of corporate governance in the non-financial sector and strengthening the mechanism to protect the rights of creditors.

The Central Bank will continue an active dialogue with the banking society with respect to measures to decrease interest rates. More resources for lending by expanding cashless payments in the country, ongoing development of financial markets across all segments, and optimization of operational expenses in banks will have a downward effect on **interest rates** next year as well.

To make financial services more accessible in rural areas, the Bank will promote expansion of the **regional network** of credit institutions and take measures to increase access to banking services by means of the regional network of services of banks, as well as non-bank credit institutions including the postal system.

Higher introduction of innovative financial tools and wider integration of mobile technologies to the banking system will allow the credit institutions to decrease operational expenses; the debtors to decrease waste of time and administrative expenses, which, in its turn, is critical in terms of more rapid access of market players to financial services and cheapening of the price of debt.

The Central Bank will take actions to **activate** money and capital markets taking into account their role in increasing long-term investments to the economy. The Bank will continue optimizing the tariff regime by an active dialogue with market participants and infrastructure providers. The Bank will take related efforts to introduce systems allowing digitalization of investment services, launching e-platforms for deepening of investor – enterprise relations, enabling investors to maintain distant trade. The Bank will take initiatives to shape a favorable tax environment for issuers and investors in the securities market. The Central Bank is planning to take efforts to simplify further the procedure for registration of securities and listing requirements for companies to stimulate supply in capital markets, as well as ease attraction of foreign investors.

To increase transparency the Bank will seek to make information more available for market participants meanwhile eliminating information asymmetry. The Central Bank is planning to maintain awareness and promo campaigns, and in-depth inform potential investors on benefits and risks of securities. Adjusting companies' transparency and accountability to today's standards will also factor in wider use of investment tools in capital and financial markets.

The Central Bank will increase efforts to **strengthen normative-legal base** on financial markets. Works on the Law on Securitization Activity will continue aided by development of related regulations. The legal framework on the derivatives market will be tailored to best practices. A dedicated legal framework will be developed to regulate the issue and circulation of notes of international financial institutions. A related legal framework will be revised to promote activities of investment funds.

Taking into account the role of competitiveness in raising the quality of financial services and in promotion of variety of financial products, and eventually innovation, the Central Bank will also focus on **promoting competition in financial markets.** The Bank is planning to take critical steps to support competition in cooperation with international financial institutions.

The Central Bank will prioritize providing additional impulses to the development of other segments of financial markets ensuring effective regulation and oversight of the **insurance sector** and development of compulsory and volunteer insurance.

The Central Bank will work on expanding the coverage of the insurance system, increasing insurance collections, introduction of new insurance tools, improving the insurance system oversight, protection of insurers' rights, promoting legal entities and individuals to use volunteer insurance, and avoiding negative instances in the insurance system. To progress on the above directions, the Bank will **improve the normative-legal base for insurance activities**.

In the year to come **development of** new institutional based **agricultural insurance** will contribute to the development of the agricultural sector, and push long-term investment planning paving the way to diversification of related default risks.

To improve oversight, the Bank will maintain a register of insurers, insurance intermediaries, including foreign insurers and foreign insurance brokers, their representative offices in Azerbaijan, and legal entities assisting in the insurance sector, continue insurance related **promo campaigns** and implement mobile oversight of insurers as part of oversight.

2.5. Development of the digital ecosystem

Development of cashless payments, wider introduction of electronic payment services and innovative payment technologies will be of priority directions of Central Bank activities.

According to the '**State Program on expansion of digital payments in 2018-2020**' approved by Decree of the country leadership, the Bank will continue efforts to expand cashless payment environment among citizens, businesses and public authorities, minimize cash circulation and shape a cashless society in the country.

One of the most important projects to be implemented accordingly will be the launch of the '**Instant payment system**'. The system will allow 24/7/365 full execution of settlements among businesses, individuals and public institutions within 5-10 seconds irrespective location and timing.

The Bank will continue efforts to **improve payment systems related regulatory framework and strengthen their oversight** in 2020. The Central Bank will continue works to have the 'Law on Payment Services and Payment Systems' and related legal acts adopted. The Bank will assess the capacity for introduction of digital payments regulatory testing regime and promote the 'Base banking services package', analyze activities of local and international financial institutions in payments ecosystem and evaluate applied products. The Central Bank is planning to apply new financial inclusiveness related methods, formulate agent banking and payment agent network and establish non-bank payment service providers. To apply innovative solutions in digital banking and digital payment technologies and more promptly manage risks, the Bank will make critical changes to the regulatory framework and promote broader introduction of distant banking services.

The Central Bank will also focus on overall technological development along with launch of modern payment systems. The Bank is implementing a pilot project for the first time in the country on creation of **Blockchain** based Digital Identification System, important for the development of the banking sector. The project will allow automating business processes for opening distant bank accounts by individuals and legal entities to digitalize customer – bank relations. At the same time, the Bank prioritized setting open banking principles and standards to expand the coverage of innovative financial technologies in 2020.

Rapid development of information and communications technologies makes cyber security actual in Azerbaijan as across the globe. Consequently, the Bank will provide **adequate measures against cyber-attacks** in 2020 too.

The Bank will strengthen efforts to raise **awareness** on the use of electronic payment services and continue to teach students of high and higher educational institutions on the use of e-payment services in cooperation with related public authorities.

In general, the Central Bank will strive to realize timely the priorities on boosting sustainability of macroeconomic and financial stability and making access to finance wider in the upcoming strategic period.

The new generation reforms conducted under the leadership of the Honorable Mister President on the new stability platform under way will allow all social groups to benefit from economic growth.

Annex 1

Schedule of disclosure of monetary policy decisions to public

In 2020, decisions related to the parameters of the interest rate corridor will be publicly disclosed 8 times according to the below schedule:

31 January

19 March

1 May

19 June

30 July

18 September

30 October

18 December

Out of the above dates, disclosure of decisions will be accompanied by press conferences on 31 January, 1 May, 30 July and 30 October.