

Summary on situation of the monetary policy on the nine months of 2003

1. Execution of the monetary policy

The National Bank conducted the monetary policy related to the maintenance of the acceptable level of the inflation, stability of national currency rate, currency reserves meeting international standards, strengthening of the national banking system and improvement of money supply in the economy during the nine months of 2003 as well and achieved the targets.

Macroeconomic situation. As a result of the purposeful economical and monetary policy the macroeconomic stability was retained in Azerbaijan during the nine months of the year 2003 as well.

The **inflation rate** was 0.3% in the first quarter of 2003 whereas it constituted 1.4% in the same period of the previous year.

The researches carried out according to the inflation model prove that the price change of food products 92.7%, price changes of non-food products 5.9% and price change of services 1.4% influenced the alteration of prices.

The alteration of prices was related **53.2% to the monetary factors, 9.5% non-monetary factors and 36.4% seasonal factors.**

The **real amount of the gross domestic product** as a main economical indicator had increased by 10.5% against to 9.8% of the same period of the previous year.

5.8% industrial and 5% agricultural product growth rates were achieved as compared to the same period of the previous year.

The increase of the share of the private sector as an important term for the country with the market economy proceeded as well. Over 70% of the GDP, as well as 53.5% of the industrial product, 99% of the agricultural commodities, 87.9% of the capital investment, 68.6% of the communication services, 53.3% of the freight forwarding were performed by the non-government sector during the nine months of 2003.

The amount of the capital **investment** as a main guarantee factor of the future economical development increased 70.9% constituting 12.1 trillion manats, since 9.8 trillion manats (1991.7 million USD) or 81% of this was constituted by foreign investment.

The observation of the positive inclinations in the **foreign trade balance** of Azerbaijan during the recent years proceeded. The foreign trade turnover increased by 40.6% as compared to the same period of the previous year and reached 3029.1 million USD during the months of January – August of 2003. The export amounted to 1470.5 million USD and the import amounted to 1558.6 million USD. The appearance of the negative balance of approximately 88.1 million USD in the foreign trade was due to the import of the investment oriented products related to the realization of the oil contracts.

The improvement of the **population's welfare** continued. The average salary rose up to 377.6 thousand manats (76.9 USD) by October 1, 2003 and its real growth constituted 19.1%. In its turn the increase of population's income was the guarantee factor of the real sector's development, enhancing the purchasing capacity.

Inclinations in the world economy. The opposite declines were observed in the economy of the **USA** during the nine months of 2003. So, the orders for the long-term products increased by 3.3% in January, it decreased 1.2% again in February. Simultaneously, the number of appealers for unemployment compensation abruptly increased. On the other hand, the lack of the state budget reached an astronomic level – 96.3 billion USD in February. The volume of the new apartments' construction decreased 11% and their sale decreased 8.1% as well. The volume of property sale also decreased 4.3% in the **second-hand** market. It should be noted that all these appeared on the background of the lowest rates of hypothec credits since 1960. The amount of the reserves in stores didn't go up in defiance of the forecasts, but decreased 0.2%. The volume of retail increased by 0.5%. The volume of the industrial production increased only by 0.1% in June. Defisit of the current operations' balance rose up to record-breaking level – 138.7 billion

USD (5.14% of the GDP) in the second quarter of 2003. Whereas the deficit of trade balance of the USA rose up to 40.3 billion USD in July. Gross import's volume reached its highest level (126.5 billion USD) since September 2000, on the background of the import of consumer commodities and raw materials for the industry. Despite that, as a result of "the slight dollar" policy the volume of export increased a little. But it was less than the growth rate of the import. According to the information of the Trade Ministry of the USA construction expenses increased by 0.2% in July constituting the highest level since the beginning of the year. Simultaneously the growth rate's indicator of industrial offers reached the doubled value (1.6%) instead of the forecasted one.

The amount of the retail business increased by 0.5% in August as compared to July, which is less than expected (1.4%-1.5%). Business activity index for the services sector remained unchanged at the level of 65.1 during August. The fact of the index being higher than 50 shows that the business activity is at the normal level. The Consumer Confidence Index fell down to 87.7% as compared to the previous month in the USA in September.

Generally, after the completion of large-scale military operations in Iraq flat process of the growth rate of the GDP begun since the second quarter of 2002 stopped. The main factor giving a push to this was the increase of the gross consumption and investment caused by taxes knocked down and the government expenses went up. The FRS decreased the discount rate from 1.25% to 1% in order to augment economic activity in the country by the end of June. Softening of fiscal and monetary policy was expressed in the increase of stock prices, in the decrease of percentage rates and in the fall of USD rate.

Opposite inclinations were observed in **Europe**, as well. Though production activity index was increased in the beginning of the accounting period, the fact that it is still below 50 is annoying. Foreign trade of the Euro region had a negative balance in defiance of expected in the beginning of the year. It was related to the increase of the oil prices in one side and increase of the euro rates from another.

As forecasted for the year 2003, the share of the lack of state budget in the GDP will be 3.9% in Germany, 3.8% in France, which exceeds the limits defined for the Euro region countries. Taking into account the negative declines in the European economy Germany decreased the expected economical growth to 1% from the forecasted 1.5%. So according to the forecasts of the IMF the growth rate of the GDP will be at zero level during 2003 and will not exceed 1.5% in 2004 in this country. Simultaneously the IMF also decreased its forecast upon the economical growth of the Euro region to 0.5% from 1.1% for 2003.

Number of unemployment increased during the accounting period in **Germany**. From another side the business environment index determined by the **IFO** – the authorized research institute of the country went up, though the analysts forecasted its fall down. This fact inspires hope that the economical growth rate of the German economy will accelerate. So a correlation is observed between the dynamics of the GDP and this indicator which has a great forecast potential. Simultaneously business expectations index determined by the ZEW - the economical researches' centre of Germany increased rapidly in the beginning of July and went up to 41.9 from 21.3. In July for the first time during last 3 years the volume of the industrial production increased 2.4% as compared to June. In September assurance factor of the German investors reached its 14-months maximum (60.9).

Unemployment reached the highest level (9.1%) since 1993 in **France**. Simultaneously, consumption expenses decreased 0.2% in France. The volume of the industrial production decreased 1.4% in France and 1.6% in Italy displaying total opposition to the forecasts of May.

For the stimulation of the economical growth in **England** the central bank decreased the discount rate from 4% to 3.75% in the beginning of February and to 3.5% in July. This is the lowest level during last 48 years. A decrease of discount rate is usually followed by the decrease of pound sterling rate.

Government tries to prevent the deflation pressure by implementing structural reforms and re-constructing the banking system in Japan. Cooperative and financial patterns need tough

reforms here. But taking into account the improvement of the foreign trade situation and increase of stocks, the economical growth rate is estimated to be at a significant level in the years 2003 and 2004.

Changes on **exchange rate of USD** against other leading currencies of the world were downtrend. The rate of USD decreased 9.9% against the euro, 3.7% against English pound sterling, 6.6% against Japanese yen, 4.4% against Swiss frank and 4.2% against Russian ruble.

Processes in the economy of leading countries have results in stock indexes of these countries as well. Generally the main stock indexes increased during the nine months of the year. So the *Dow-Jones average* displaying the average price of 30 biggest industrial companies in the New-York Stock Exchange increased by 12.5%, the *Nikkei index* determined on the base of the stocks of the top 225 biggest companies in the Tokyo Stock Exchange increased by 21.2%.

Rise of stock indexes was observed in Europe, as well. So the **FTSE Eurotop 100** calculated on the base of stock prices of the 100 biggest companies of Europe increased by 1.6% and the *DAX index* - the average of the stocks of the 100 biggest companies in the German Stock Exchange increased by 14.9%.

The average price of Brent oil in the world market was 28.3 USD during the nine months of 2003.

As it is obvious **from the sketch** after the beginning of military operations in Iraq the price of oil in the world market declined downtrend in defiance of expected. But it still remains high.

2. Dynamics of money-and-credit indicators

According to the main directions of the monetary policy, goals on the rate of inflation and exchange-value of manat against foreign convertible currencies were achieved due to chasing of amounts of the monetary program parameters.

Monetary base of manat increased by 24.2% constituting 2100.7 billion manats by October 1, 2003 as compared to the same period of the previous year.

The **broad monetary aggregate (M-2)** increased by 31.7% constituting 2325.4 billion manats.

The monetary multiplier - the ability of banking system to create money increased by 6.7% as compared to the same period of the previous year. Reconstruction of banking system, development of banking infrastructure, and especially improvement of payment system resulted in positive dynamics of this indicator.

Share of the cash in the **structure of the money supply** decreased 6% **point**. It is related to the increase of the non-cash amount 75.3%, whereas the cash amount increased only 22.3% as compared to the same period of the previous year.

Dollarisation level of the economy decreased as compared to the same period of the previous year. The share of deposits and savings on foreign currency in the total amount of savings decreased 4.4% **point** and in the M-3 it decreased 0.4% **point**.

The amount of **credit investment** increased by 27% constituting 3089.7 billion manats during the nine months of 2003 as compared to the same period of the previous year. Growth rate of credits constituted 35.4%, excluding the credits of "Aqrarkredit" organization.

The savings were one of the main sources of credits during the period as well. **Savings of natural persons** increased 52.9% constituting 1052.6 billion manats as compared to the same period of the previous year. The 42.4% of the savings attracted by banks fell to private banks' share.

Short-term savings of population went up by 5.9% and long-term ones went up by 3.4 times as compared to the same period of the previous year. It indicates the increase of the population's trust towards the banks.

It should be noted that the analysis of the structure of savings against the currencies show the increase of the population's trust towards manat. As compared to the same period of the previous year the **population's savings in manat** increased by 37.7%. This factor establishes a

favorable base to strengthen the role of manat in the economical turnover improving the structure of money supply.

Downtrend declines were observed in percentage rates of deposits and savings, as well as credits. So average percentage rates of short-term credits in manat decreased by 1.2% **point** and that of the long-term credits decreased by 4.3% **point** as compared to the same period of the previous year.

During the accounting period the amount of **Short-Term State Loans (STSL)** increased by 7.1% or 4.9 billion manats constituting 149.9 billion manats (7.1% of monetary base) on October 1, 2003. The average profitableness of the STSL decreased to 7.69% by the end of the accounting period as compared to the 11.57% in the beginning of the year.

3. Improvement of monetary management

Institutional improvement of monetary management The institutional improvement of the monetary management was also kept in the focus for the successful fulfillment of duties of the monetary policy.

Much was done to form a **perfect research base** - one of the most important elements of the monetary management mechanism. The use of equilibrium models of the inflation and money market in practical implementation of the monetary policy was continued. Consequently, econometric model of the exchange rate of manat has been established. This model is the first model (upon macroeconomic importance and specification) of the econometric analysis established in Azerbaijan which allows complex investigations of the factors influencing the long-term dynamics of manat's rate. The created models allow making long-term economical forecasts. Simultaneously, the establishment of real sector's model started.

Researches on **inflation aiming**, analysis of percentage rates in the money market of the country, improvement matters of the non-oil sector, monetary aspects of the nonpayment problem in energetics sphere, factors influencing the cash turnover and monetary and macroeconomic aspects of non-official economic activity has been completed.

Within the research of the **inflation's aiming** regime specific features and principal priorities of the regime has been analyzed and its future implementation opportunities in Azerbaijan were evaluated.

Within the frame of researches on the analysis of dynamics of the percentage rates in the money market of the country, factors influencing the percentage rates were complexly estimated and possibilities to increase the effectiveness of the discount rate in the transmission mechanism of the monetary policy were investigated.

Diversification process in the country economy was investigated and proposals for the improvement of its spatial structure were introduced at the researches on the improvement matters of the non-oil sector.

At the research upon *monetary aspects of the nonpayment problem in the energetics system*, influence of the nonpayment problem to the money turnover has been investigated and possible changes in the structure of money and monetization level of the economy were evaluated in the case of solution of the nonpayment problem.

Analysis of results on the non-official economical activity was carried out in the monetary and macroeconomic context under the terms of transient economy. The essence and reasons of the non-official economy, as well as evaluation and measurement methodology of the non-official economy were investigated and the scale of that was estimated in this document.

Simultaneously, the factors influencing the cash amount were investigated thoroughly, correlation and regression dependencies between the cash amount and incomes and expenses of the banking system, as well as between the incomes and expenses of the population were determined.

System of research and monitoring of processes in the international markets, as well as development declines of the world economy under the terms of globalization process proceeded. This sets a favorable condition for the detailed analysis of influence channels of the world

economy to the national economy and macroeconomic aspects of integration of the republic economy to the global one.

Variety of researches has been carried out to create a modeled criteria and variants for the **choice of appropriate tools of the monetary regulation corresponding to the economical situation** according to the development declines of the financial markets. Moreover the base of information and forecasts processing of short- and long-term monetary indicators has been improved in monetary research and forecast sphere.

Important steps were taken to create a **complete information database** to guarantee an effective monetary management. The statistical database on the processes in the world, the CIS region and the country economy has been enriched. The Automated Bank Statistical Accounts Systems began functioning.

Tools of monetary policy. *For successful implementation of specified monetary policy The National Bank regulated the money-market by participation in credit auctions, securities and currency market, as well as by the obligatory reserve norms during the accounting period.*

The National Bank performed refinance of commercial banks on the ground of auctions on the **centralized credits** during the accounting period as well.

Expansion of the employment of **new financial tools** to conduct an effective and adequate monetary policy by the National Bank was ongoing. The **pawn-shop** and overnight credit mechanisms are examples of these tools. 7 **pawn-shop** credits amounted to 5.2 billion manats and 6 overnight credits amounted to 6.1 billion manats were realized.

Discount rate for the centralized credits remained stable - 7% during the period.

The **obligatory reserve norms** were 10% for the short-term deposits and at zero level for the long-term credits during the accounting period. The investigations show that after the issue of the decree on zero level obligatory reserve norms for long term credits, the growth rate of the long-term credits accelerated. So the long-term credits increased by 3.4 times whereas the short-term credits increased by 5.9% during the past period as compared to the same period of the previous year. Despite the increase wasn't thoroughly connected to that measure, the specified part of it was mainly due to the decree activated since 01.01.2003.

In addition the practise allowing to gain the STSL using the obligatory reserves was stopped by May 1, 2003 according to the decree of the Management Staff of the National Bank dated February 27, 2003. This aimed to accelerate the development of the STSL market and to establish conditions for the settlement of the real market percentage rates. The issued decree justified itself and the volume of the potentially useful STSL for the turnover significantly went up in the **second-hand** market.

Actions for the realization of the strategy to set **open market operations** as a main tool of the monetary policy proceeded during the nine months of 2003 as well. Participation of the National Bank in the market of the STSL (short-term state loans) aimed to regulate short-term liquidity in banking system. The National Bank performed the **REPO** and the **reverse REPO** operations depending on the liquidity of the banking system.

4. Currency-market and exchange rate policy

Exchange rate policy. During the period the exchange rate of manat against USD changed 0.3% or 17 manats and by the end of the period 1USD was equal to 4910 manats. For comparison this figure constituted 128 manats (2.7%) at the same period of 2001 and 122 manats (2.5%) at the same period of 2002.

Situation of currency market. Gross amount of the internal currency market increased by 800.8 million USD or 46.6% as compared to the same period of the previous year and constituted 2519.7 million USD during the nine months of 2003.

The National Bank maintained balance in the currency market by regulating the demand and supply, and had influence on the exchange rate of manat. The National Bank's interference to the currency market constituted 3.04% of total turnover and was purchase oriented.

Currency reserves. Official currency reserves under the authority of the National Bank increased and reached 707.4 million USD by October 1, 2003.

Despite that, 65.4 million USD was transmitted to the State Oil Company of Azerbaijan Republic due to construction of the Baku-Tbilisi-Ceyhan oil pipeline and 59.5 million USD was spent for the repayment of the credit and active debts of government to the IMF during the accounting period, the amount of the official currency reserves under the authority of the National Bank increased by 26.9 million USD during the nine months of 2003. This growth was attained mostly due to purchases in the internal currency market.

Relative growth constituted 72.3 million USD considering the credits (52.6 million USD) taken from international financial institutes.