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ACRONYMS

USA – the United States of America
CBA – the Central Bank of the Republic of Azerbaijan
ILO – International Labour Organisation
IMF – the International Monetary Fund
SAR – the South African Republic
SSC – the State Statistics Committee
CPI – Consumer Price Index
APPI – Agricultural Production Price Index
NEER – Nominal Effective Exchange Rate
OPEC - Organization of the Petroleum Exporting Countries
REER – Real Effective Exchange Rate
RSM – Real Sector Monitoring
IPPI – Industrial Production Price Index
GDP – Gross Domestic Product
WTO – World Trade Organisation
Introduction

The Central Bank of the Republic of Azerbaijan continued its policy within 9 months of 2010 in the environment of vulnerable and unequal regional recovery of the global economy, high volatility in financial and foreign exchange markets, high prices for energy resources in the world market and endurance of growth in the country economy.

The monetary policy pursued by the Central Bank and measures to protect macroeconomic stability jointly with the government played a key role in maintenance of a one-digit inflation and continuation of economic growth in the country.

The Central Bank provided its exchange rate policy in the environment of expansion of supply channels in the foreign exchange market, exchange rate of manat against the USD preserved its stability during the period. Volume of money supply having kept pace with economic growth market operations and sterilization of the Central Bank neutralised factors having a downward effect on money supply.

Nothwithstanding increase of the global and internal macroeconomic environment the Central Bank has always focused on preventive neutralisation of potential risks.
I. Global economic processes and national economy

1.1. Trends in the world economy

Though within the first half of the current year recovery rate in the world economy outran expectations, summer months witnessed relative slowdown of the process. Thus growth rate of the world industry production, retail commodity turnover and the world trade declined. Decrease of governmental support measures for economy is indicated to be the primary reason for slowdown of economic activity. According to initial assessment of the IMF global economic growth in the first half of the year made 5.2%.

Economic growth in developed countries constituted 3.5% in the first half of the year. Revival of external demand factors triggered higher growth in industry sectors in developed countries of Asia (except Japan) if compared with pre-crisis period.

Production in Japan and Eurozone still remains low as compared with the pre-crisis period. Fiscal stimulation in Japan and revival in the global trade has accelerated growth in production since Quarter 4 of 2009, however in Quarter 2 of 2010 economic activity has considerably slowed down. Despite considerable economic activity in Eurozone in Quarter 2 of the current year Quarter 3 witnessed decrease of economic growth again.

Currently one of the key specifics of the global economy revival is in its sectoral asymmetry. Thus revival in corporate sector being more vivid is weak in financial sector. Key countries to cause the asymmetry are Eurozone and the USA.

Key reasons for asymmetry are primarily delivery of fiscal support measures to production as well as unresolved problems in financial sector and more intensive transfer from one country to another one.

During the period some countries pursued hardened, others softened economic policy. Moreover, the policy of various countries to maintain economic growth through exchange rate is accompanied with increase of dissatisfaction (the foreign trade indices and employment

Chart 1. General conjuncture indices (c. p. y.)

Source: WTO, WLO and IMF

Though volume of productions in the USA is accompanied with revival, it is still vulnerable and since Quarter 2 of 2010 economic activity has considerably decreased.

Source: European Automobile Manufacturers Association
Within August – September 11 countries hardened monetary policy (including Georgia, India, Sweden, Serbia and Indonesia), whereas 7 countries softened the policy (including Belorussia, SAR and Iseland).

Table 1. Refinancing rate in different countries, in 

<table>
<thead>
<tr>
<th>Country</th>
<th>01.01.10</th>
<th>01.04.10</th>
<th>01.07.10</th>
<th>01.09.10</th>
</tr>
</thead>
<tbody>
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<td>USA</td>
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<td>0.25</td>
<td>0.25</td>
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<tr>
<td>Eurozone</td>
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<td>Japan</td>
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<td>Turkey</td>
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<tr>
<td>Norway</td>
<td>1.75</td>
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<td>2.0</td>
</tr>
<tr>
<td>Russia</td>
<td>8.75</td>
<td>8.25</td>
<td>7.75</td>
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<tr>
<td>Kazakhstan</td>
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<td>7.0</td>
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<td>Georgia</td>
<td>5.0</td>
<td>5.0</td>
<td>6.25</td>
<td>7.0</td>
</tr>
</tbody>
</table>

Source: web-pages of appropriate central banks

During the period the countries like Iseland, Greece, Portugal, Ireland, Great Britain, France etc. instituted cost saving measures despite weak revival trends. In tote, cost saving measures cover increase of certain tax rates, staff reduction, pay cuts of public sector employees or pay-raise freee for the following years, pension age rise and pensions decrease, considerable reduction of the military budget, levying additional taxes on banks etc.

Commodity prices have started to enjoy price hike since Quarter 3 and price hike made 17.4% within 9 months as compared with the relevant period of the previous year. Price hike is primarily due to revival of economic activity. Thus, increase in demand resulted in increase of prices for a number of non-ferrous metals. Food prices index increased by 18% as compared to the similar period of the previous year, and by 13.4% within last three months. This is primarily due to reduction in productivity in wheat exporting countries due to bad weather conditions.

Box 1. In order to eliminate impact of the crisis, most world countries pursue the policy of support for aggregate demand. It is clear that such a policy leads to a large budget deficit. Existing economic growth being vulnerable on the one hand and incremental debt burden on the other hand forced governments to make a choice. Necessity to economise budget money is due to scarcity of further softening opportunities of fiscal policy. Notwithstanding weak revival trends Spain, Greece, Portugal, Ireland, Great Britain, France and other countries decided to provide fiscal restraint measures. In tote, fiscal restraints cover increase of certain tax rates, staff reductions, pay cuts of public sector employees or pay-raise freee for the following years, pension age rise and pensions decrease, considerable reduction of military budget, levying additional taxes on banks etc.

According to the IMF researches, fiscal consolidation (restraint) is crucial for sustainable economic growth in long run. However, it slows down economic growth in a short run. Thus:

- budget deficit to GDP ratio decrease by 1 basis point reduces economic growth by 0.5% basis point and increases employment level by 0.3% basis point;
- when softening monetary policy this negative effect slightly decreases. However, interest rates being close to 0 effect increases again.

When approaching dilemma of fiscal consolidation or enduring stimuli measures, defenders of the former prevail. Currently, the IMF is sharing the position.

Source IMF

Chart 3. Dynamics of global price indices

Source: IMF
OPEC countries’ decrease of oil production in September have caused price rise for crude oil per barrel since April.

Recession in the economy starting with Quarter 2 and risk of non-sustainability of economic revival having considerably affected financial markets triggered volatility. As a result of regulatory measures targeted at maintenance of price stability in Europe the situation in financial markets has relatively stabilized since Quarter 3. The Japanese Yen exchange rate against the USD having climbed the peak over 15 years resulted in decrease of competitiveness of Japanese goods in the world markets. Economic growth in the USA going down in Quarter 2 as well negatively affected financial markets.

The IMF revised up global forecast for 2010. According to the latest forecast, global economic growth in the current year will make 4.8%. This exceeds average growth of the first years of 5 post-crisis periods within the last 30 years. This fact demonstrates that despite the deepest nature of the fading away economic crisis revival occurred comparatively earlier.

Table 2. The IMF forecast on the world economy

<table>
<thead>
<tr>
<th>Economic growth, compared with the previous year, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
</tr>
<tr>
<td>2008</td>
</tr>
<tr>
<td>World</td>
</tr>
<tr>
<td>Developed countries</td>
</tr>
<tr>
<td>USA</td>
</tr>
<tr>
<td>Eurozone</td>
</tr>
<tr>
<td>Developing countries</td>
</tr>
<tr>
<td>China</td>
</tr>
<tr>
<td>CIS</td>
</tr>
</tbody>
</table>

Export, compared with the previous year. %

World
The global economic growth is forecast to be 4.2% in 2011. In toto, in 2011 economic growth is assumed to be lower both in developed and developing countries against 2010. This is due to endurance of slowdown of revival started in Quarter 2 of 2010 in Half 1 of 2011.

Thus, during the period the global economy witnessed overall upward trend, however during recent months there occurred uncertainties that negatively affected various segments of financial markets.

**1.2. Macroeconomic processes in Azerbaijan**

Economic activity in the country was formed, on the one hand, in the environment of the state support for aggregate demand, on the other hand, through protection of increase of aggregate supply during the period. Relative improvement of the global environment and partial restoration of external funding sources positively affected domestic economic growth during the period.

**1.2.1. External sector**

Effects of the crisis on the global economy being over improvement trends in external position of the country continued.

According to the SSC, in January – August, 2010 foreign trade turnover constituted USD17,9 billion, of which USD13,9 billion fell into share of export and USD4 billion to import.

If to compare with the relevant period of the previous year, 5% increase of import against 6% export triggered 2 times as much surplus of external trade balance. Thus, surplus in external trade balance during the period equalled to USD9,9 billion.

If to compare with the relevant period of the previous year share of export in GDP shifted from 33% to 43%, and the share of import decreased from 15% to 12%.

Crude oil, white sugar, tea and vegetable oils are taking rapid upward trend in export.
Of import goods with observable upward trend examples are wheat, raw sugar, metal pipes and surfactants.

This displays increase in opportunities to import more commodities and services through less export during the reporting period.

During the reporting period remittances and capital flows dynamics had a rising effect on currency inflows to the country other than export.

The volume of inflows of remittances in January – August of the current year increased by 22% if compared with the similar period of the previous year.

According to the SSC, the volume of foreign investments to the country economy within 9 months of the current year constituted AZN 1,4 billion which 49% exceeds the indicator of the relevant period of the previous year.

The balance of payments surplus in the reporting period displays growth of strategic foreign exchange reserves of the country. Strategic foreign exchange reserves of the country having increased by 37% within the past period of 2010 became USD 27.9 billion according to the results.
of 9 months that is sufficient for three-year-goods-and-services-import.

Source: CBA

Foreign exchange reserves of the CBA having increased by 6% within 9 months of the current year exceeded USD 6 billion as at 31.09.2010, which is sufficient to fund 8 month-goods-and-services-import.

1.2.2. Aggregate demand

All components of aggregate demand, including final consumption expenditures, investments and external demand had a rising effect on economic growth within 9 months of the current year. Net export’s contribution to economic growth is much more than other sectors. Thus, of 4.1% economic growth 1.7 basis points were due to net export¹.

1.2.2.1 Final consumption expenditures.

Final consumption expenditures were one of the key factors of economic growth within 9 months of 2010.

Households consumption. Nominal money income of the population having increased by 10% reached AZN 2016 per capita level or on average AZN 224 per month within the 9 months of the current year. The population having directed about 70% of income to consumption spent it on purchase of goods and services. Final consumption expenditures of the population having increased by more than 16.5% in nominal expression equaled to AZN 12.6 bln or 43% of GDP as compared with the similar period of the previous year. Average monthly salary throughout the country having increased by 6.6% made AZN 319 that contributed to maintenance of high share of final consumption in GDP.

¹ Initial data by 9 months
Salary income of hired labor during the period equaled to 21.4% of total income of the population.

Parallel increase of credit exposures, including household exposures in January through September of the current year had a rising effect on the demand. As of 01.10.2010 credit to economy increased by 6.3%, including 13.3% increase in consumer loans.

Demand enduring its growth displays itself in increase of retail trade turnover and paid services to the population. In 9 months retail trade turnover increased by 8.3%, including 12% retail trade turnover on non-food products as compared with the similar period of the previous year. Paid services to population increased by 11% during the period.
Government and public organisations. Government’s consumer expenditures have been primarily shaped through spendings on commodity and services from the state budget. In January – August of the current year salaries, pensions and allowances of the population made up 32% of the budget expenditures about half of which was directed at social protection and social security.

1.2.2. Investment expenditures. Investment to the economy from all sources in January–September of the current year increased by 15.2% and made up AZN 6.2 bln as compared with the same period of the previous year.

Bank loans shared a crucial role in promotion of non-oil sector along with public investments. Thus, investment oriented bank loans increased by 16.5% as compared with the similar period of the previous year.

1.2.3. Aggregate supply

Within 9 months of the current year nominal GDP increased by 4.1% and in nominal expression it made up AZN29.3 billion. Both real growth rate and the GDP deflator (15.6% in the reporting period) had an incremental effect on the nominal GDP. In the reporting period real economic growth in oil and gas sector made up 2.7%, and 5.2% in non-oil sector respectable. Of 67% of created value added falls into the share of production and 33% to services.

 Tradable sectors\(^2\). GDP growth mainly sourced from activity in the tradable sector. Thus, 60% of GDP was the share of tradable

\(^2\) Tradable sector incorporates agriculture and industry.
sectors that contributed 2.1 basis points to the overall growth.

Growth in industry triggered growth in the tradable sector. Decrease in agriculture equaled to 3.4%, of which 9.2% was due to decrease in plant-growing, including 33% in grain production. Oil-gas industry was the key player in industrial growth. Crude oil production increased by 1.9%, natural gas production by 14.4% as compared with the similar period within the reporting period.

Gold production paralleled oil and gas production and 1.4 ton gold having been extracted within the past period of the current year was sent for purification.

*Non-tradable sectors*[^1]. Growth was observed in all areas of non-tradable sector in January – September of the current year.

Of non-tradable areas the highest growth rate was registered in services and communication.

[^1]: Non-tradable sector incorporates construction, transport, communication, catering, hotel services etc.
**Economic growth expectations.** According to forecasts of the Government, the Central Bank as well as international institutions in the nearest horizon economic growth in the country is expected to continue. The IMF in the latest disclosed regional economic outlook mentioned endurance of economic growth by Azerbaijan in the rest part of the current and next years.

![Chart 23. Expectations (3 months moving average), %](chart)

**Note:** Taking into account the assumption that monitoring results can be undergo of seasona adjustment, to smooth fluctuations it has been used moving average method.

Source: CBA

The Fund forecasts growth for non-oil sector in 2010 and 2011 accordingly at 5.6 and 5% level\(^4\). To note, Real Sector Monitoring (RSM) conducted by the CBA indicates optimistic expectations on economic activity. Thus, under the findings of RSM since the beginning of the year production by industry and sale expectation index by trade tend to be incremental.

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\(^4\)Source: IMF, [www.imf.org](http://www.imf.org) / regional economic outlook

**Box 2. Indicators of economic cycles.** In order to provide information and analytic materials for implementation of goals and functions set for the Central Bank, obtain and evaluate prompt information on status of the economy the Central Bank of Azerbaijan has been conducting monitoring of the real sector since April 2008. Monitoring is realised through monthly surveys reflecting evaluation of changes in 6 factors of economic activity (actual production or sale), expected production or sale, order for product (service), commodity reserves, price expectations, employment expectations. The monitoring conducted cover up to 200 operational enterprises of processing industry, services, construction and trade of long-term use articles. Enterprises respond to the survey as increased (+1), decreased (-1), not changed (0). Built upon relevent findings of the survey business activity index is calculated. This index enables to forecast turning points of economic growth in a short run (tendencies of increase or decrease). Overall responses are aggregated based upon weights established in accordance with the number of employees. The index value range is [+100; -100]. Index equaling to +100 stands for upward business tendencies and its unexceptional observance in all enterprises. Index being -100 stands for downward tendency that is unexceptionally obeserved in all enterprises.

Positive expectations were particularly observed in chemical, construction materials production and weaving subsections, positive expectations in trade were observed in segments of sale of furniture and household appliances. Service sector shares parallel tendencies. The highest positive expectations belong to communication and hotel subsectors. Such positive expectations manifested themselves in decrease of unrealised commodity reserves in industry and trade.

In toto, findings of RSM conducted by the CBA demonstrate increase in a number of
enterprises with incremental production, and risen turnover.

**1.2.4. Macroeconomic equilibrium**

Amidst enhancement of inflation trends in the world economy, revival of seasonal factors and aggregate demand the policy of the Government and the Central Bank secured macroeconomic stability in the country. According to analyses, measures taken during the period positively affected change of total output deficit.

**1.2.4.1. Consumer Price Index:** Inflation in September of the current year was 3.6% against beginning of the year and 6.2% against the similar period of the previous year. Seasonal monthly deflation observed in May through July was replaced with price rise from August.

![Chart 24: Average annual inflation factors](chart24)

Source: CBA

During the period average annual inflation made 5.2%, of which 2.8 basis points were due to price rise of food products, 1.5 basis points – non-food products and 0.9 basis points – price hike of services.

![Chart 25: Dynamics of prices for food products within 9 months, in %](chart25)

Source: CBA calculation on the base SSC datas

Average annual inflation on food products equaled to 5.7% and 6.3% against the beginning of the year.

![Chart 26: Dynamics of prices for non-food products within 9 months, in %](chart26)

Source: CBA calculation on the base SSC datas

Average annual inflation on non-food products equaled to 2% and 1.1% against the beginning of the year. During the period prices on services cheapened 0.9% against the beginning of the year, average annual was 5.8%.
Thus, decompositional analysis of inflation displays that prices primarily hiked through price dynamics of food products within 9 months of the current year. Seasonal factors, including sharp increase in prices for grain crops in the world market were key in price hike of food products. One of the key factors for price rise of non-food products was price hike of some imported construction materials due to forest fires in Russia.

Econometric calculations made at the CBA identified that 26.5% of average annual inflation observed within 9 months was formed under the influence of monetary factors and 73.5% under the effect of non-monetary factors.

Low level of base inflation once more emphasizes that the share of seasonal factors and inflation import is high in consumer price rise.

In September base inflation was 2.9% against the beginning of the year and 4.5% against the similar period of the previous year. Average annual base inflation in 9 months was 2.9%.

5 Base inflation is defined as inflation adjusted from changes in prices for commodities regulated by the government and seasonal factors.
As of the end of the reporting period non-oil IPPI increased by 1.5% on annual average.

**Chart 30: Non-Oil IPPI, average annual, %**

Industrial production price index changed with various rates in separate sectors of industry. For instance, average annual increase of production prices was 30.9% on metallurgy, 10.2% on chemical industry.

**Chart 31: Change dynamics of IPPI in various areas, in %**

Source: CBA calculation on the base SSC datas

Real estate prices. According to "MBA LTD" Estimation and Consulting Company, no significant change was observed in dynamics of prices for property on segments of the real estate market (primary and secondary housing markets, land market, cottages, non-residential object) and rent fees during 9 months of the current year. As of the end of September price reduction in primary and secondary markets accordingly was 6.5% and 1.6% against the beginning of the year. Revival of mortgage lending from the middle of previous year was among the factors having a rising effect on demand in the real estate market, especially in the secondary property market. From that time up today 3604 persons received mortgage loans amounting to AZN 148 million, including the number and amount of mortgage loans issued within 9 months respectively being 1785 and AZN 71 mln.

**Chart 32: Price change in housing market, %, (2008 dec=100)**

Source: "MBA LTD" Consulting and Assessment agency

1.2.4.4. Agricultural production price index (APPI): APPI increased on average annual by 2.8%. In September APPI increased on average annual by 6.1% against the beginning of the year.
1.2.4.5. **Inflation forecast.** According to the CBA forecast, annual average inflation is expected to remain one-digit as of the year end of 2010. This forecast is in harmony with forecasts of international organisations. According to the latest regional report of the IMF average annual inflation in Azerbaijan is forecast to be 5.5% and 6% in the current year and next years.

Under the findings of RSM conducted by the CBA forecast for price rise in overall economy is stable.

Price index forecast on trade is in negative zone. In industry these expectations follow lower growth rates unlike service sector. Index on construction sector having left the negative zone is close to neutral point.

Thus, sharp increase of prices for grain crops in the world market, enhancement of inflational trends in key trading partners increased pressures of inflation import. However, inflation level is one-digit and under official forecast will preserve the level by the end of the year.

1.2.4.6. **Employment.** Increase of employment level was observed during the period. As of 1 October of the current year, the number of economically active population was 4341.3 thousand, of them 4082.4 thousand are engaged in economy and various sectors of social area. The number of employed population on overall economy increased by 0.3% within past 9 months. The number of hired labor is being increased during recent months. For instance, the number of hired labor increased by 0.2% in August.
Observations provided by the CBA in up to 300 enterprises within the framework of real sector monitoring also demonstrate increase of employment.

In monitored enterprises the number of staff increased by 7.6% within 9 months.

Chart 36. Expectation of Employment

According to the CBA monitoring, expectations on employment in trade and services are positively zoned.

II. Monetary and exchange rate policies

During the past period of the current year in accordance with key directions of monetary policy declared by 2010 the Central Bank targeted its performance at maintaining reasonable level of inflation, protection of exchange rate stability, endurance of stable development in banking-financial sector, coverage of demand of the economy for money.

2.1. Foreign exchange market and exchange rate of manat

Within 9 months of the current year the Central Bank provided its exchange rate policy in the environment of supply channels expansion on the foreign exchange market. While the Central Bank provided sale oriented interventions in the same period of the previous year, it sterilized currency amounting to USD972.5 mln. within 9 months of the current year.

If to compare with the same period of the previous year decrease in demand for foreign currency in the foreign exchange market reveals itself in decrease in cash foreign currency inflown to the country by banks and decrease in cash currency sold to population. Thus, during the period the volume of net cash foreign currency inflown to the country by banks and net cash exchange operations was 10.6% less against 9 months of 2009.
Manat strengthened only 0.05% against USD during January – September 2010.

Manat exchange rate having been stable within 9 months of the current year created favorable conditions for non-increase of inflation, external debt burden and dollarisation in the country and support for increase of overall social welfare of the population.

During the past period whereas nominal exchange rate of manat having depreciated against currencies of some trade partnering countries strengthened against currencies of other countries. Dynamics of bilateral exchange rate of manat caused changes in real bilateral exchange rates. In January – September manat depreciated both from nominal and real standpoint against currencies of some countries (Ukraine, Uzbekistan, Kazakhstan, Japan).

<table>
<thead>
<tr>
<th>Country</th>
<th>Nominal bilateral exchange rate index*</th>
<th>Real bilateral exchange rate index</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>100.0</td>
<td>103.0</td>
</tr>
<tr>
<td>Eurozone</td>
<td>112.0</td>
<td>115.0</td>
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<tr>
<td>Great Britain</td>
<td>104.3</td>
<td>106.0</td>
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<td>Turkey</td>
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<td>98.2</td>
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<td>Russia</td>
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<td>Japan</td>
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<td>100.3</td>
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<tr>
<td>China</td>
<td>98.8</td>
<td>100.1</td>
</tr>
<tr>
<td>Belorussia</td>
<td>106.3</td>
<td>103.2</td>
</tr>
</tbody>
</table>

*average annual change of exchange rates of manat against currencies of partner-countries

During the reporting period nominal effective exchange rate on non-oil sector (on total trade turnover) went up by 3.0% which had a contractionary effect on inflation. Inflation in partner countries prevailing over inflation in Azerbaijan had 0.8 basis point decending effect on real effective exchange rate of manat.
During the period real exchange rate on non-oil sector went up by 2.2%.

Chart 40. REER structure, % point

Source: CBA

As compared with the similar period of the previous year nominal and real effective exchange rates grew respectively by 1.5% and 1.7%.

In toto, 9-month-inflation flagged in the country exceeded that of low inflational partners (USA, Eurozone, Great Britain, China, Japan, Israel), fell behind high inflational partners (Turkey, Russia, Kazakhstan, Ukraine, Belorussia, Georgia, Iran). Given non-oil export primarily to high inflational partners, it is possible to note favorable change of real effective exchange rate from competitiveness standpoint by these countries. Thus, during the period REER went down by 1.1%, overall hardening primarily occurred by distant foreign countries.

2.2. Monetary policy tools

No significant changes were made in monetary policy tools during the period. The CBA when taking a decision regarding parameters of monetary policy tools, considered analysis of up to 30 cycle indicators. These include leading, coincidence and lagging cycle indicators. Change of the indicators in question in the latest analyses conducted supported unchangeable maintenance of parameters of monetary policy tools.

In order to support business activity and economic growth the CBA did not alter parameters of interest rate corridor during the reporting period and maintained 2% refinancing rate, corridor floor at 1% and corridor ceiling – 7% level.

During the period required reserve norms did not change and were maintained at 0,5% level. Average term of required reserve norms remaining 1 month both by deposits in manats and in foreign currencies during the
period created favorable conditions for optimum regulation of liquidity by banks.

Table 4. Liquidity balance, in billion manats

<table>
<thead>
<tr>
<th></th>
<th>1 January 2010</th>
<th>1 October 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tools of liquidity injection*</td>
<td>1483.5</td>
<td>1755.2</td>
</tr>
<tr>
<td>Tools of liquidity absorption**</td>
<td>29.5</td>
<td>45.9</td>
</tr>
<tr>
<td>Liquidity balance</td>
<td>1454</td>
<td>1709.4</td>
</tr>
</tbody>
</table>

* Loans to banks by the CBA, SWAPS etc.
** Notes portfolio, REPOS, reserve requirements norms in national and foreign currency.

During the period the Central Bank kept its liquidity window open, balance on operations moved from AZN 1454 mln at the year launch to AZN 1709.4 mln. as of the end of 9 months.

During 9 months of 2010 volume of the CBA notes placed with the market was AZN170 mln., volume of repo operations on framework instruments AZN582 mln. Accordingly volume of the notes in circulation having increased by 2.3 times as much as of the end of the reporting period equaled to AZN18 mln, balance of repo operations totalled to AZN6 mln.

Despite 1.0% average return on notes demand for notes was high and ratio of placed notes to the total issued made 83%.

2.3. Money supply

Within 9 months of the current year money supply kept pace with demand of the economy. Monetary base 13.2% increased against the beginning of the year made AZN5504.6 mln as at 01.10.10.

No sharp volatility was observed in dynamics of the monetary base. This is clearly

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6 This indicator stands for difference between the balance of liquidity granting tools of the CBA and balance of liquidity attraction operations.
seen from standard deviation of the monetary base indicator on the past 9 months.\(^7\)

Growth of monetary base in manat was primarily achieved through the CBA sterilization operations and liquidity injections.

According to calculations, during the period seasonally adjusted monetary base increased by 18.8% against the beginning of the year, and by 32.9% against the same period of the previous year.

Money multiplier showing the ability of the banking sector to generate money had no significant change during the reporting period and as of the end of September made 1.3. Upward trend of money multiplier in recent months is due to relative increase of banks lending activity.

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\(^7\) Standard deviation characterizes deviation of any indicator on the period from average level.
During the reporting period broad money supply (M3) having increased by 10.9% constituted AZN 9390 mln by the end of 9 months, and broad money supply in manat (M2) having increased by 16% made AZN 7156.1 mln.

Dynamics of annual change of M3 money aggregate calculated through various methods is shown in the chart below.

Box 4. **Moving average** is a statistic method applied to time series of an indicator. Main point of this method is in calculation of the indicator as an arithmetical mean of the numbers it has in a certain time period. In general, averaging period is 3 or 6 months.

Example on application of moving average method:

*e.g. monthly time series of conditional A indicator is thus:*

\[ A = (a_1; a_2; a_3; a_4; a_5; .... a_{n-3}; a_n) \]

Sequence of A indicator through 3 month moving average method will be as follows:

\[ A_{\text{moving average}} = ((a_1+a_2+a_3)/3; (a_2+a_3+a_4)/3; .... (a_{n-2}+a_{n-1}+a_n)/3) \]

**Centered moving average** method is calculated in the same way, but in this case arithmetical mean of the number in the row is calculated jointly with the one in the left and right:

\[ A_t = (a_{t-1}+a_t+a_{t+1})/3 \]

The advantage of moving average method is in mitigating volatility of the row through partial smoothing of sharp fluctuations (shocks) occurred in different periods. This method enables to more clearly observe long-term trends, and cycles. The longer averaging period, the more it will be possible to smooth out volatility of the row. This method is, as a rule, applied to longer time series comprising shorter periods (*e.g. annual series of daily return on asset in financial markets etc*). When making analyses, simple, cumulative, weighted, linear moving average methods are utilised.

Increase of money supply in broad sense sourced both from increase in cash in circulation, and increase in non-cash money supply during the period.
Savings and deposits kept growing during the period being a manifestation of confidence of economic subject to the banking sector. This growth primarily sourced itself from growth rate of deposits of individuals.

Thus, deposits of individuals having increased by 19.8% against the beginning of the year made AZN 2798.3 mln. as at 1 October 2010. In tote, growth was observed in all monetary aggregates against the beginning of the year.

Despite growth in money supply, Monetary Condition Index nearly remained stable within 9 months in the environment of slight strengthening of multilateral nominal exchange rate of manat.
16% growth of money supply was accompanied with decrease of interest rates. Thus, interest rates on newly issued loans in manat decreased by 2.8 basis points within nine months of the current year, interest rates on newly attracted deposits in manat decreased by 2.1 basis points. Policy of promotion of deposits interest rate decrease endured during the period. The Trustee Board of the Azerbaijan Deposits Insurance Fund through coordination with the Central Bank decreased the highest annual interest rate from 15% to 12% from 1 June 2010.

Thus, during the period volume of money supply kept pace with economic growth, sterilization and market operations of the Central Bank fully neutralised factors having a decending impact on money supply.
CONCLUSION

Azerbaijani economy preserved dynamics of economic growth in 9 months of 2010, amid existing macroeconomic environment the Central Bank met its targets on monetary policy. Ultimate target of monetary policy - Inflation was on a one-digit level and was primarily affected by processes in foreign markets, inflation in trade partnering countries, and seasonal factors. The Central Bank enduring its soft monetary policy money supply kept pace with economic growth rate.

Amidst surplus of the balance of payments exchange rate of manat against USD remained stable, the Central Bank providing sterilization in foreign exchange markets both balanced foreign exchange market and increased its foreign exchange reserves. Forecast is to have large volume surplus in the balance of payments as of the yearend.

The Central Bank being guided by sustainable economic growth priorities during the rest period of the current year will continue its performance on maintaining exchange rate stability of manat and low level of inflation, as well as on protecting stability and sustainability of the financial sector, supporting economic growth and employment.
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