TABLE OF CONTENTS

Executive Summary ............................................................................................................. 4

I Global economic processes and the national economy ..................................................... 5

1.1 Trends in the world economy .......................................................................................... 5

   Box 1: Public and private sector debt ............................................................................... 6

   Box 2: Pessimistic scenario for the world economy ....................................................... 14

   Box 3: Economic activity expectations ........................................................................... 15

1.2 Macroeconomic processes in Azerbaijan ...................................................................... 16

   1.2.1 External sector ........................................................................................................ 17

      Box 4: Price for Azery Light crude oil ...................................................................... 18

      Box 5: Remittances ..................................................................................................... 19

   1.2.2 Aggregate demand ................................................................................................. 21

      Box 6: Ascending middle class .................................................................................. 22

      Box 7: Small and medium entrepreneurship access to finance in Euro zone ............. 24

   1.2.3 Aggregate supply .................................................................................................... 25

   1.2.4 Macroeconomic equilibrium .................................................................................. 29

      Box 8: Commercial real estate market ....................................................................... 33

      Box 9: Unemployment in the US ................................................................................ 35

II Monetary and exchange rate policy .................................................................................. 36

2.1 Forex market and exchange rate of manat ..................................................................... 36

2.2 Monetary policy instruments ......................................................................................... 38

   Box 10: Reserve requirements in China ........................................................................ 40

2.3 Money supply ................................................................................................................ 41

   Box 11: Seasonal factors in money base ....................................................................... 42

2.4 Institutional base of the monetary policy ...................................................................... 44

Charts and tables .................................................................................................................. 46
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBA</td>
<td>Central Bank of Azerbaijan</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labor Organization</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>SAR</td>
<td>the South African Republic</td>
</tr>
<tr>
<td>SSC</td>
<td>State Statistics Committee</td>
</tr>
<tr>
<td>DGCc</td>
<td>Developing countries</td>
</tr>
<tr>
<td>DDCs</td>
<td>Developed countries</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
</tr>
<tr>
<td>APPI</td>
<td>Agricultural Producer Price Index</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium entrepreneurship</td>
</tr>
<tr>
<td>NEER</td>
<td>Nominal Effective Exchange Rate</td>
</tr>
<tr>
<td>OG</td>
<td>Output Gap</td>
</tr>
<tr>
<td>OPEC</td>
<td>Organization of the Petroleum Exporting Countries</td>
</tr>
<tr>
<td>REER</td>
<td>Real Effective Exchange Rate</td>
</tr>
<tr>
<td>RSM</td>
<td>Real Sector Monitoring</td>
</tr>
<tr>
<td>PPI</td>
<td>Producer Price Index</td>
</tr>
<tr>
<td>NFES</td>
<td>National Fund for Entrepreneurship Support</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
</tr>
</tbody>
</table>
The Central Bank of the Republic of Azerbaijan conducted monetary policy in the environment of uncertainties in the world economy, severe sovereign debt problem in advanced countries, and high uncertainty in the world financial and commodity markets in 2011. High oil prices in the world market had positive effect on the external position of the country. Strategic foreign exchange reserves of the country continued to increase which furthered economic sustainability of the country, capable to fully neutralize potential macroeconomic risks. The economic growth continued and utterly stemmed from the non-oil sector.

In 2011 the Central Bank kept the factors affecting macroeconomic and financial stability under control and conducted an adequate policy. The Central Bank targeted a single-digit level of inflation, a stable exchange rate of manat, development and sustainability in the banking – financial sector under the declared key directions of the monetary and financial stability policies. In the environment of high global commodity prices and expanded aggregate demand, the Central Bank conducted anti-inflationary monetary policy during the 2011 and maintained inflation in a single-digit level. The exchange rate of manat – the main factor of the macroeconomic stability remained stable. The banking sector was highly sustainable and access to financial resources expanded. Credit to the economy boosted.

In the result of all of that credit rating of the country upgraded.
1. Global economic processes and the national economy

1.1. Trends in the world economy

In 2011 the world economy continued to grow and risks related to severe sovereign debt problems mainly in advanced countries increased. Financing conditions throughout the world hardened, indices declined in financial markets and capital inflows to developing countries decreased. Developed countries witnessed high unemployment and disharmony in fiscal consolidation programs. Private demand weakened in the aftermath of exhausted financial intermediation, downgrade of large banks’ ratings, lesser financial sustainability of large real sector companies and amplified sovereign debt problem.

While the world economy enjoyed higher-than-expected growth early in 2011, starting from the second quarter meltdown trends were observable. Slowdown in the global economic growth was particularly sharp in the forth quarter.

The main factor, hindering the growth in the world economy, was the amplification of the sovereign debt problem in advanced economies. This problem decreased the business confidence, and triggered further imbalance between investments and savings.

Chart 1. Real GDP growth (percent, quarter over quarter, annualized)

Source: IMF

The economic growth rate considerably depleted in DDCs during the year. According to estimations of the IMF, the growth is expected to drop to 1.6 percent from 3.2. percent in 2011 compared to the previous year, the key reason for which is the critic level of the debt problem in
Euro zone, negative impact of low bank financing to the real sector, drop in economic activity and fiscal impulses. The ratio of total public debt to GDP is 88 percent in Euro zone, 102 percent – in the USA and 233 percent in Japan.

**Box 1: Public and private sector debt**

McKinsey Global Institute analyzed debt statistics of 15 countries that take ¾ of the world economy. These countries include G7, Greece, Spain, Portugal, South Korea, China, India, Russia and Brazil. The total public and private debt of these countries exceeds the GDP by 3 times and constitutes USD 136 trln, out of which 31 percent or USD 42 trln falls to the share of the USA. England and Japan are the countries with highest debt in the world and their debt is 5 times more than GDP. Russia has the least debt (72 per cent of the GDP). The heaviest debt burden in the public sector is observed in Japan, the heaviest debt burden in the financial sector goes to England, that of the real sector – in Spain, households – Finland. The population with the heaviest debt burden live in the G7 countries. Per capita total debt in these countries makes USD 145,000.


At the same time, in the face of fiscal consolidation initiatives, the public demand drives the vulnerable economic growth in DDCs except for the US. The countries, that provided significant and moderate fiscal consolidation in 2011, reduced the ratio of budget deficit to GDP respectively by 2 and 0.5 percent.
Table 1. The key trends of the fiscal policy in 2011 (budget deficit/GDP, %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant fiscal consolidation</td>
<td>Russia</td>
<td>-3.5</td>
<td>0.5</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Germany</td>
<td>-4.3</td>
<td>-1.1</td>
<td>3.2</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td>-7.1</td>
<td>-5.7</td>
<td>1.4</td>
</tr>
<tr>
<td></td>
<td>Spain</td>
<td>-9.3</td>
<td>-8</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>Great Britain</td>
<td>-9.9</td>
<td>-8.6</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>Mexico</td>
<td>-4.3</td>
<td>-3</td>
<td>1.3</td>
</tr>
<tr>
<td>Moderate fiscal consolidation</td>
<td>USA</td>
<td>-11</td>
<td>-9.5</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Canada</td>
<td>-5.6</td>
<td>-4.9</td>
<td>0.7</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>-4.5</td>
<td>-3.9</td>
<td>0.6</td>
</tr>
<tr>
<td></td>
<td>India</td>
<td>-8.9</td>
<td>-8.5</td>
<td>0.4</td>
</tr>
<tr>
<td></td>
<td>China</td>
<td>-2.3</td>
<td>-2</td>
<td>0.3</td>
</tr>
<tr>
<td></td>
<td>Brazil</td>
<td>-2.8</td>
<td>-2.6</td>
<td>0.2</td>
</tr>
<tr>
<td></td>
<td>SAR</td>
<td>-5.1</td>
<td>-4.9</td>
<td>0.2</td>
</tr>
<tr>
<td>Fiscal expansion</td>
<td>Japan</td>
<td>-9.3</td>
<td>-10</td>
<td>-0.8</td>
</tr>
</tbody>
</table>

Source: IMF, Fiscal Monitor

According to the forecast of the IMF, the economic growth is expected to decline by 1.1 basis points in DGCs in 2011 and constitute 6.2 percent. The decline primarily stemmed from deterioration of the external environment and weak internal demand. According to estimations, the highest growth in DGCs is observed in China (9.2 percent) and India (7.4 percent). In total, the analysis of the economic dynamics of the past 4 years suggests that, the global economic crisis caused significant drop in economic growth rates in the both group of countries. During 2008-2009 DGCs (excluding Central and Eastern European countries) escaped the crisis with higher speed and already in 2010 53 percent of these countries managed to move their economies up to a potential level.

Source: IMF
DDCs’ debt burden equals to their GDP, and DGCs accumulated large volume savings – this fact leads to the global imbalance. Global “rebalancing” urges DDCs to partially replace public demand with the private one in aggregate demand and forces DGCs to replace external demand with the internal one. However, there are a number of obstacles on the way to the global “rebalancing”. The factors that slow down the “rebalancing” include high maintenance expenses of infrastructure in DDCs, high unemployment, and weakening of public sector agents due to the crisis.

In the second half of this year, approximately 100 European banks out of 300 largest had their ratings downgraded, which significantly deteriorated the access of the private sector to finances. In 2011 Italy’s rating was downgraded by 3 and that of Portugal by 3 times. The most negative case was observed in Greece. Thus, the Greece’s rating was downgraded by 3 times which is 2 steps above the default.

**Chart 3. Change in country ratings – Fitch Ratings**

![Chart 3. Change in country ratings – Fitch Ratings](image)

*Source: Fitch Ratings*

In 2011 one of the key problems faced by the world economy was the high level of unemployment. The unemployment level was 8.6 percent in DDCs, which is 2.8 basis points
higher than the pre-crisis level (compared to 2007). Currently, one in five young persons in Europe, half of the youth in Spain and Greece, one fifth of those in transition economies are unemployed. 29 percent of the unemployed in the USA have been unable to find a job for over a year. Since it is time consuming to find a job, employees qualification goes down, which leads to both short- and long-term decline in efficiency in the economy.

According to the ILO’s estimations, the world economy is in need of 600 millions new jobs in the upcoming 10 years. Young manforce’s qualifications need to be raised, and education and training conditions need to be improved and respond to modern challenges.

In DGCs, particularly in Asia annual surplus of current operations balance to the amount of 4 percent of the GDP lays the basis to partially replace the external demand with the internal demand. However, weak development of infrastructure and the financial system and a low level of inclusiveness of the economic growth hinder “rebalancing”. At the same time, according to the estimations of the IMF experts, 10 percent increase in access to financing may raise SME investments by 2 percent, and easier access of households to financing may trigger rise in private consumption to the amount of 5 percent of the GDP. If financial integration reaches the world average, it may drop the surplus of current accounts by 1 percent of the GDP. In the second half of 2011 the investment inflows to DGCs dropped by 45 percent.

**Chart 4. Investment flows to DGCs (billions of US dollars)**

![Chart 4. Investment flows to DGCs (billions of US dollars)](image)

*Source: IMF*
In the environment of low global economic growth, the activity in commodity markets declined. Although the commodity prices increased 12 percent in the first half of 2011, it declined 5 percent in the second half. Food prices index decreased 8 percent in 2011.

**Chart 5. Dynamics of price indices (2005=100)**

Because of the pessimistic forecast of global economic prospects in 2012, the demand for commodity goods is expected to drop. Particularly, the slowdown in economic growth in China and Euro zone will negatively affect the global commodity demand as two thirds of the growth in the global commodity demand goes to China.

Food prices are forecast to decline 12 percent (EIU) and commodity prices 14 percent in 2012. In 2011 the average price for Brent crude oil was USD 111 per barrel. Amid a relative drop in the global demand, increased political and military risks in the Middle East and North Africa conditioned high oil prices.

In 2011 demand for oil increased approximately by 1 percent compared to the previous year and equaled 89 millions barrel/day. According to forecasts, in 2012 – 2016 demand for oil will respectively reach 90.3 - 95 millions barrel/day. However, it should be mentioned that remained risks trigger uncertainties in the oil market.

**Source: IMF**
In the second half of 2011, smooth recovery of the world economy and ascending inflationary pressures forced central banks to tighten the monetary policy. However, in the second half due to increased default risks, deteriorating economic environment and decrease in inflationary pressures (food inflation as well) there emerged easing or neutral monetary policy decisions. A complicated situation urged some central banks to take non-standard decisions.

On eight of December 2011 the European Central Bank took a number of non-standard monetary policy decisions to eliminate the sovereign debt problem, processes in financial markets and potential risks. This includes launch of issue of longer term – 3 year loans to banks with the refinancing framework, and expansion of the list of securitization. Henceforth, banks will be entitled to include loans to the real sector as securitization for refinancing. The required reserve norm was also shifted from 2 to 1 percent.

In general, the key goal of the latest policy change is to prevent the deterioration of conditions of real sector access to financing as a result of weakening financial intermediation in Europe.

*Source: Economic Intelligence Unit, IMF*
In total, in 2011 the global economic dynamics was mostly affected by fiscal impulses compared to the monetary policy. Both policy impulses were primarily oriented at tightening.

**Chart 7. Monetary policy decisions by central banks**

![Chart 7](image)

*Source: DataStream; Central Bank of Brazil; Reserve Bank of India; CEIC.*

**Chart 8. Fiscal and monetary policy impulses**

![Chart 8](image)

*Source: IMF, GS Global ECS Research*
The major risk factor for 2012 is estimated to be the possible global recession stemming from Euro zone. Failure of the policies pursued by countries, particularly by Europe and the USA on employment, sovereign debt and unsustainable financial sector is considered to be the most crucial risk faced by the world economy in 2012-2013.

**Chart 9. Economic risk map**

*Source: World Economic Forum*

Persistent fiscal imbalance, sharp income inequality and probability of the risks emerging from volatile commodity prices and their negative impact on the world economy are on the top. In 2012, the lingering sovereign debt crisis, insufficient measures taken by Europe may result with default in some countries. The possible wave of default may trigger economic imbalance both within and beyond the region. Moreover, considerable public budget cut in the USA may cause high unemployment, further drop in confidence of households and enterprises, delays in bank payments on the real estate market and emergence of new problems in the overall banking sector.
Negative impulses of the downturn in the economic growth in Europe and the USA can be mostly felt in DGCs and economies in transition. Decline in export to DDCs may trigger recession in developing countries of Asia, particularly those of Eastern Asia.

According to the IMF, the world economy faces three group of policy challenges to prevent the above mentioned risks:

- strengthen macroeconomic policy coordination;
- improve the design of the fiscal policy to boost its effect on employment and private demand;
- identify exact boundaries between macroprudential and monetary policies.

**Box 3: Economic activity expectations**

The McKinsey Global Institute’s global survey suggests that the economic situation has most deteriorated in Europe compared to the past 6 months. Over 50 per cent of respondents in the region, 44 percent in South America and 36 percent in Asia think that the economic situation has deteriorated over the past 6 months. The institution tried to study the way the internal situation will change in the following 6 months. The most optimistic expectations were observed in Asia. Over 43 per cent of respondents in Asia think that in upcoming 6 months the economic activity will improve, while every second respondent in Europe and every third respondent in North America think that the situation will deteriorate. 58 percent of households in China think that they will increase their income in the upcoming year. This indicator is 33 percent in the US, 22 percent in England and 23 percent in France.


Given elevated recession risks in the world economy and lower-than-expected results of the measures taken, the IMF made a downward revision to global outlook for 2012. According to the IMF Outlook, the activity will decelerate in major DGCs amid shrinkage of the economic growth, at the same time most DDCs will be capable to minimize severe recession. Fiscal consolidation in Euro zone and contraction of banks channels of the real sector financing will lead to economic downturn.

**Table 2 Global economic forecast by IMF**

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012(f)</th>
<th>2013(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economic growth, annual percentage change</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World</td>
<td>3.8</td>
<td>3.3 ↓</td>
<td>3.9 ↓</td>
</tr>
<tr>
<td>DDCs</td>
<td>1.6</td>
<td>1.2 ↓</td>
<td>1.9 ↓</td>
</tr>
<tr>
<td>USA</td>
<td>1.8</td>
<td>1.8</td>
<td>2.2 ↓</td>
</tr>
<tr>
<td>Euro zone</td>
<td>1.6</td>
<td>-0.5 ↓</td>
<td>0.8 ↓</td>
</tr>
<tr>
<td>DGCs</td>
<td>6.2</td>
<td>5.4 ↓</td>
<td>5.9 ↓</td>
</tr>
<tr>
<td>China</td>
<td>9.2</td>
<td>8.2 ↓</td>
<td>8.8 ↓</td>
</tr>
<tr>
<td>CIS</td>
<td>4.5</td>
<td>3.7 ↓</td>
<td>3.8 ↓</td>
</tr>
<tr>
<td>Export, annual percentage change</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---------------------------------</td>
<td>----------</td>
<td>----------</td>
<td>----------</td>
</tr>
<tr>
<td></td>
<td>DDCs</td>
<td>5.5</td>
<td>2.4 ↓</td>
</tr>
<tr>
<td></td>
<td>DGCs</td>
<td>9.0</td>
<td>6.1 ↓</td>
</tr>
<tr>
<td>Consumer prices, annual percentage change</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>DDCs</td>
<td>2.7</td>
<td>1.6</td>
</tr>
<tr>
<td></td>
<td>DGCs</td>
<td>7.2</td>
<td>6.2 ↑</td>
</tr>
</tbody>
</table>

*Source: IMF*

To proceed with the policy of 2011, the IMF recommends the following measures for DDCs:

- resolve “sustainability and growth” dilemma in a balanced manner;
- increase regional and global cooperation;
- find new ways to support private initiatives.

The IMF policy recommendations for DGCs, given the processes, are as follows:

- support the financing of public debts;
- ensure moderate fiscal expansion;
- more focus on human capital.

The countries with fiscal space\(^1\) are recommended to pursue accommodative fiscal policy\(^2\) to stimulate demand.

In general, the processes occurred in 2011 stipulate a number of uncertainties for upcoming years. However, since no decline are expected in food prices, particularly in energy prices, our country may realize the export potential under favorable conditions.

### 1.2. Macroeconomic processes in Azerbaijan

The country economy continued growing in the environment of favorable external position and expanded domestic demand. The support for the economy by the government, ongoing structural and institutional reforms positively affected the dynamics of the economy. In the face of certain global threats, macroeconomic stability was maintained during the year.

---

\(^1\) Fiscal space – countries with additional budget resource (high budget surplus and fiscal buffer)

\(^2\) Accommodative fiscal policy – use of fiscal stabilizator and short time policies in countries with fiscal space
1.2.1. External sector

The external position of the country experienced positive dynamics in 2011. Average annual oil price reached its historical high level and export significantly increased.

According to the SSC, foreign trade turnover was USD 33.1 billions in the previous year, of which USD 24.6 billions falls to the share of export and USD 8.5 billions to import.

![Chart 10. Trade balance (million US dollar)](chart)

Source: SSC

In 2011 export and import increased 32 and 49 percent respectively and surplus of foreign trade balance reached USD 16 billions. This surplus was USD 2.4 billions or 18 percent higher than previous year.

Exports of pipes, sugar beet, aluminum, vegetables and potatoes were high. The highest growth in the non-oil export was in sectors like chemistry (2.2 times), metallurgy (1.7 times) and fruits-and-vegetables (1.6 times). According to the IMF estimations, the share of the non-oil export of Azerbaijan in that of the world has approximately increased by 2 times over 10 years (Source: World Economic Review and IMF estimations, 2011).
Import of fertilizers, vegetables, reinforcements, polyethylene, cement and automobiles were high in 2011. Particularly import of commodity goods exceeded 1 billions dollars as domestic demand accelerated. Two third of the import goods were automobiles, mechanisms and vehicles which is related to a large-scale investment project in the economy.

**Box 4: Price for Azery Light brand oil**

According to the SOCAR, the average price for BTC FOB Ceyhan Azerbaijani oil was USD 113.7 last year. The highest price was observed in April (126.2), and the lowest in January (97.7). The highest average price over the last 4 years was in the previous year, the price being USD 51 or 1.8 times per barrel higher compared to the depth of the crisis – 2009. In 2009 and 2010 the price for Azery Light brand oil was below 100 dollars during all months of the year. In 2011 the price was above 100 dollars in all months except for January.

![BTC FOB Ceyhan Azerbaijan oil price, barrel/dollar](source: www.socar.az)

Major import and export commodities gained both quantitatively and in terms of amount. Certain commodities, having quantitatively decreased, increased in amounts.

Prices for the Azerbaijani export commodities surge more rapidly than those of imports, which display increase in opportunities to import more commodities and services through less export, in other words, improved trade conditions.

Besides export, dynamics of remittances and capital flows from abroad also had an upward effect on FX flows to the country.

According to the most preliminary data, in 2011 the volume of inflows climbed 32 percent and made USD 1.8 billions compared to the previous year.
According to the SSC, the foreign investments inflows increased 3.2 percent and reached USD 3.2 billions.

Box 5: Remittances

Remittances are important income sources for the population in a number of countries of the Middle East and Central Asia. Tajikistan is on the first place according to the remittance to the GDP ratio (33 per cent). In Kyrgyz Republic this ratio is 31 percent. In total, the average world indicator is 4.5 percent. The remittances-to-GDP ratio in Azerbaijan is below 4 percent. 80 percent of remittances on the CIS countries comes from Russia.

Source: IMF, Middle East and Central Asia outlook, October 2011
In 2011 strategic foreign exchange reserves of the country increased by 36 percent and became USD 40 billions, which is sufficient for three-year commodities and service import.

**Chart 12. Sufficiency of strategic foreign exchange reserves (million US dollars)**

Source: CBA

The CBA’s foreign exchange reserves increased by 64 percent and exceeded USD 10 billions, sufficient to finance one-year commodities and services import.

**Chart 13. Strategic foreign exchange reserves (percent of GDP)**

Source: CBA
The strategic foreign exchange reserves to GDP ratio approximates 65 percent. In general, high growth rate of strategic foreign exchange reserves decreases vulnerability of the economy to possible external crisis impact and forms a robust macroeconomic buffer.

1.2.2. Aggregate demand
In 2011 all components of the aggregate demand, including final consumption expenditures, investments and external demand positively affected the economic growth. During the year, increase in income of the population and domestic investments, as well as favorable external position revived all demand components of the GDP.

1.2.2.1 Final consumption expenditures. Final consumption expenditures mostly contributed to the economic growth in 2011.

Households’ consumption. Per capita nominal money income of the population during the reporting period increased by 18.1 percent against 2010 and made AZN 3384 or AZN 282 on monthly average. The population directed roughly 63.4 percent of the income to final consumption on purchase of commodities and services. Final consumption expenditures of the population have increased by 8.4 percent in nominal terms and made AZN 19.4 billion or equaled to 38.7 percent of the GDP.

Chart 14. Money income of the population (billions manats)

Source: SSC

Average monthly salary increased by 8.3 percent and made AZN 356.6 (USD 453.4) that contributed to maintenance of the high share of final consumption in the GDP.
Parallel step-up in loans to households also had an upward effect on demand. Thus, loans to households rose by 21.9 percent in 2011 (by commercial banks and NBCIs).

**Box 6: Ascending middle class**

According to OECD researches, any person whose daily income makes USD 10-100 on PPP belongs to a middle class. According to estimations of McKinsey & Co, currently the middle class is numbering 1.9 billions persons throughout the world, this number will go up to 4.8 billions in 2030. Estimations suggest that 90 percent of the middle class boost will fall to the share of Asia. Present 0.5 billions numbering middle class of Asia will increase up to 3.2 billions persons in 2030. The number of the middle class in Europe and North America will roughly be the same.

*Source: McKinsey, Resource Revolution: Meeting the world’s energy, materials and water needs.*

Demand continued to grow and contributed to the retail trade turnover and services to the population.

**Chart 15. Changes in wage and final consumption of the population (year on year, %)**

*Source: SSC*
Retail trade turnover increased by 10.2 percent, whereas retail trade turnover on non-food products rose by 28.2 percent in 2011. Growth in services to the population constituted 7.8 percent. According to the official data, industry and trade stocks are diminishing amid economic activity.

The Real Sector Monitoring conducted by the Central Bank also indicates boosting demand in the country. According to the results of the monitoring, actual sales in trade of durable goods (automobile, furniture etc) and industry are up, whereas balances of commodity stocks are down. The similar tendency is observed in services. Thus, average service demand index prevailed over the previous year’s level roughly 2 times as much.

*Government and public organizations.* Government’s consumption expenditures have been primarily shaped through spending on commodities and services from the state budget. In January – November of the reporting year salaries, pensions and allowances of the population made up 30.6 percent of the budget expenditures.

**1.2.2 Investment expenditures.** Investment to the economy from all sources in 2011 made USD 12.8 billions having increased by 27.3 percent, which equals 25.5 percent of the GDP. It includes 19.7 percent increase in foreign investments.
76.8 percent of investment was directed to the non-oil sector. In total, investments to the non-oil sector exceed the previous year’s level by 39.4 percent. In the non-oil sector, the growth rate of investments to machinery and equipment, communications and chemistry was particularly high. The RSM conducted by the Central Bank also display high economic activity in the country. Thus, the number of respondents indicating “investments are up” jumped 15 basis points according to the results of the survey.

Bank loans played a crucial role in investment activity in the non-oil sector along with public investments. Thus, investments financed through bank loans increased by 37.5 percent against the previous year.

**Box 7: Small and medium entrepreneurship access to financing in Euro zone**

The ECB and the EC conducted a survey among 8316 SMEs in Eurozone in August through October, 2011. The survey discovered that financial stance of SMEs had deteriorated. 9 per cent of the survey participants mentioned that they had their turnover declined, 40 per cent – labor expenses had gone up, and 15 per cent profit drop. Deteriorated financial standing of SMEs hinder their access to financing. The survey results suggest that if in previous years banks positively responded to 9 out of 10 SME loan applications, currently this number is 7.

**Source: ECB, Monthly bulletin, December 2011**
1.2.3. Aggregate supply

In 2011 the GDP growth was 0.1 percent in real terms and exceeded AZN 50 billion in nominal terms. During the reporting year the oil-and-gas sector posted 9.8 percent drop whereas the non-oil sector posted 9.4 percent increase. Notwithstanding real decline, the scale of the oil-and-gas sector in the nominal GDP climbed 4.9 billions manat.

68 percent of the value added was due to the share of production and 32 percent - to services.

Economic growth. The real GDP growth stemmed from the activity in the non-oil sector. Thus, roughly 50 percent of the GDP was the share of the non-oil sector and the sector made a 4.2 percentage points contribution to the overall growth.

Chart 18. Economic growth (%)

Source: SSC

All segments of the non-oil sector, except transportation, posted growth in the previous year. The highest growth rate goes to hotels and restaurants, construction, industry and communications. Growth in the industry mainly sourced from the food industry, metallurgy, machinery and chemistry. The high growth observed in agriculture occurred both in production of plant growing and in livestock.
In 2011 crude oil production dropped by 10.5 percent, while natural gas production dropped by 2.2 percent. Respectively 1.8 ton gold and 1.2 ton silver were extracted from gold and silver mines in 2011.

Source: SSC

Source: SSC
Economic growth expectations. According to forecasts of the Government, CBA as well as international institutions, the economic growth is expected to endure in the country in the nearest horizon. The IMF, in the recently released economic outlook, suggests that the economic growth in Azerbaijan shall continue in the current and following years. The Fund predicts 3.7 and 1.9 percent economic growth in the country respectively for 2012 and 2013, including 5.5 – 6 percent growth in the non-oil sector in both years\textsuperscript{3}. In general, the UN, the IMF, the EBRD and the WB forecasts suggest average 3.5 percent economic growth in Azerbaijan.

Chart 21. Economic growth expectations in 2012 (%) 

![Chart 21. Economic growth expectations in 2012 (%)]

Source: Reports of appropriate international institutions

The Real Sector Monitoring (RSM) conducted by the CBA also confirms optimistic expectations over economic activity. According to the results of the RSM, demand expectation index on production and supply expectation on services have been prone to growing since the beginning of the year. Positive expectations were particularly observed in chemical, construction materials production and textile subsections. The highest positive expectations in services belong to communication, hotel and transport subsectors. Such positive expectations resulted in the decrease of stocks in industry and trade.

\textsuperscript{3}Source: BVF, www.imf.org / Republic of Azerbaijan—Staff Report for the 2011 Article IV Consultation
Expectations

In general, findings of the RSM conducted by the CBA demonstrate increase in the number of enterprises with incremental production and risen turnover and sustainability of this growth.

According to the CBA estimations, output gap (gap between the potential and actual levels of the GDP) shifted from -4% in 2010 to -0.6% in 2011. In 2012 this indicator is expected to be positively zoned being equal to 0.5 percent.

Chart 23. Output gap, %

Source: CBA

In 2012 the aggregate demand is expected to accelerate and result with positive output gap.
1.2.4. Macroeconomic equilibrium

Macroeconomic stability was maintained in the country with the backdrop of amplified inflationary processes in the world industry and revival of the aggregate demand. Inflation primarily sourced from external factors during the year.

1.2.4.1. Consumer Price Index (CPI): In 2011 average annual inflation made 7.9 percent, which was mainly affected by rise in prices, particularly food prices in international commodity markets. The average annual inflation on non-food products was 2.6 percent, and 1.2 per cent against the beginning of the year. Prices on services gained 5.1 percent against the year launch, with average annual being 4.7 percent.

Chart 24. Food prices in Azerbaijan and the world (year on year, %)

Source: CBA estimations on the basis of SSC data

In general, the decomposition analysis of inflation suggests that prices primarily hiked from rise in food products. Thus, 5.7 percentage points of the average annual inflation in 2011 relates to increase in price of food products, 0.7 percentage points – non-food stuff, and 1.5 percentage points in increase in services. According to the IMF estimations, every 10 percent change of the world food prices triggers 3.2 percent change in that of Azerbaijan (Source: IMF).
During the reporting year, money supply (+2.4 percent), inflation in partner countries (+2.5 percent) and seasonal factors (+1.9 percent) had an upward effect on prices, while change in nominal effective exchange rate had a downward effect (-1.2 percent).

In 2011 average annual core inflation\(^4\) was higher against the previous year, which added up to overall inflation.

\(^4\) Core inflation is defined as inflation adjusted from changes in prices for commodities regulated by the government and seasonal factors.
Over the past 12 months the core inflation made 3.7 percent, total inflation on consumer prices was 5.6 percent. In Quarter II of 2011 prices decreased, which is put down to downward seasonal factors inherent for the period.

**Chart 27. Domestic and foreign CPI (%)**

*Source: SSC*

The inflation in trade partners surpassed that of Azerbaijan by 1.7 basis points. According to the initial data from the IMF, average annual inflation was 10.3 percent in the CIS, and 7.2 percent in DGCs in 2011.

**Chart 28. Inflation, (%)**

*Source: IMF, SSC*
Overall, the average annual inflation of the past 3 years in Azerbaijan falls below the inflation in the CIS and oil exporting DGCs. In 2012 inflation is assumed to decline on all country groups which may be related to slide in food prices in the world and stable oil prices (IMF).

1.2.4.2. *Industrial Producer Price Index (IPPI)*: In 2011 the average annual IPPI went up 23.9 percent, which is associated with price increase in major economy sectors. Thus, on average annual producer prices were up by 27.8 percent in the mining industry, 27.1 percent in the textile industry, 20.6 percent in the chemical industry, 13.4 percent in the food industry, 9 percent – in the metallurgy. At the same time, some industrial areas plunged in decline. Production of pharmaceuticals dropped by 1.5 percent and that of electric appliances – 1.8 percent.

### Chart 29. Sectoral inflation (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Agricultural PPI</th>
<th>Non-oil Industrial PPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>-3.9</td>
<td>-2.8</td>
</tr>
<tr>
<td>2010</td>
<td>10.9</td>
<td>3.8</td>
</tr>
<tr>
<td>2011</td>
<td>5.8</td>
<td>1.2</td>
</tr>
</tbody>
</table>

*Source: SSC*

1.2.4.3. *Agricultural Producer Price Index (APPI)*: In 2011 the APPI climbed 10.3 percent on average annual. The price dynamics was 20.3 percent on perennials, 7.3 percent on annual plants, 11.3 percent on livestock and livestock products and 10.6 percent on seafood.

1.2.4.4. *Real estate prices:* According to the "MBA LTD" Appraisal and Consulting Co, in 2011 there was a slight activity on segments of the real estate market (primary and secondary housing markets, land market, cottages, non-residential object). Over the past year price hike in secondary and primary markets was 8.4 percent and 5.3 percent respectively. However, the price for 1 sq.m residential space falls below the level of 2008 by 14.1 percent in the secondary and by
23.5% in the primary market. While residential rent fees went down 2.4 percent, rent fee for commercial objects went down 5.8 percent. In total, 2011 may be marked as the period of price stabilization in the real estate market.

Chart 30. Price change in the housing market (2008 Dec=100)

Source: "MBA LTD" Appraisal and Consulting Co

Ongoing mortgage lending had an upward effect on the activity in the real estate market, particularly in the secondary market. Over 12 months of 2011 banks issued 95.5 millions manat worth mortgage loans, while the volume of the similar loans financed by the Azerbaijan Mortgage Fund equaled 77 millions manat.

Box 8: Commercial property market

Notwithstanding gradual deterioration of the economic activity and lingering uncertainties with respect to future, the value of commercial property gained 3.5 per cent in Eurozone. While the prices went down by 28 per cent and 11 cent in Greece and Ireland respectively, they hiked over 10 per cent in Austira, Finland and Holland. Meanwhile, rent fees remained nearly unchanged which resulted in high exposition term of real estate against price spike of commercial property.

Over the past quarters quarterly investment to commercial property in Eurozone stabilized on the level of EURO 12 bln, which considerably falls below the EURO 20-30 bln level of 2006 – 2008.

Source: ECB, Financial Stability Review, December 2011
1.2.4.5. Inflation expectations. Inflation in 2012 is expected to be on a single-digit level according to international financial institutions. According to the latest report by the IMF, average annual inflation in Azerbaijan is expected to constitute 7.8 percent. The results of the RSM regularly conducted by the CBA display no significant jump in price expectations in the economy. Late in 2011 the price expectations index is negatively zoned for all segments of the real sector. The index on construction is approximating to the neutral point.

Chart 31. Price expectations index (3 month moving average)

Source: CBA

1.2.4.6. Employment. As of the end of the previous year, the number of economically active population was 4626.1 thousand persons, out of which 4375.2 thousand persons work in the economy and various sectors of the social area. According to the SSC, the number of hired labor was 1360.1 persons, out of which 1323.7 thousand persons are employed with the non-oil sector and 36.4 thousand persons – the oil sector.

The CBA observations within the real sector monitoring in up to 300 enterprises also demonstrate increase in employment. Thus, the staff in the monitored entities went up by 5%.
Box 9: Unemployment in the USA

Certain timeframe is required to restore the jobs lost during any crisis upon the real GDP reaches the pre-crisis level. Estimations suggest that, during the economic crises occurred in the USA from 1948 through 1995, employment started to recover after 3 – 15 months upon the real GDP reached the pre-crisis level. Interestingly, during the 2001 crisis this term increased to 39 months. According to the McKinsey institution, 60 months are required to restore the jobs lost during the current crisis. Given the fact that recession in the US started in December, 2007 and the real GDP reached the pre-crisis level in December, 2010, then in the best scenario pre-crisis employment shall be restored by the end of 2015. Overall, more-than-required time to restore employment is primarily associated with the following:

- The share of labor intensive processing industry has shifted to 11 per cent from 16 per cent over the past 10 years;
- Low mobility of workforce – compared to 1990, the number of those who changed places of their residence shifted to 12 per cent from 18 per cent;
- Companies prefer productivity rather than the number of personnel – in 2010 65 percent of enterprises achieved the same volume of production through fewer personnel;
- Companies opt for part time or temporary jobs rather than full time – nearly 60 percent of enterprises would hire this group of employees in the nearest 5 years.

According to the institution, 21 millions job places are required to reach a full employment level up to 2020 (average annual growth of employment – 1.3 percent). If annually additional USD 200 billions is allocated for infrastructure projects it may trigger 2 mln job places.

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

2. Monetary and exchange rate policy

In 2011 the Central Bank targeted an acceptable level of inflation, prevention of exchange rate volatility of manat and maintenance of stability in the banking-financial system under the declared directions of the monetary policy.

2.1. Forex and the exchange rate of manat

In 2011 the Central Bank pursued its exchange rate policy with a new operational mechanism and expanded supply sources in the forex market.

Thus, the Central Bank has started to provide its exchange rate policy within a corridor through bilateral exchange rate of USD/AZN. Along with being favorable from communication standpoint, this mechanism escalates the Central Bank’s transition to a floating exchange rate regime in the long run.

Supply in the forex market of the country broadened amid a large volume surplus in the balance of payments of the country. However, to prevent significant strengthening of the exchange rate and thus neutralize negative impact on competitiveness of the non-oil sector, the Central Bank sterilized USD 4153.2 millions worth currency.

Chart 33. CBA intervention (millions of US dollars)

Source: CBA
As a result, manat strengthened against USD at a moderate rate – only 1.4 percent. Stability of the national currency had a positive effect on macroeconomic stability and stability of the financial sector in the country.

The nominal exchange rate of manat appreciated against the currencies of major trade partners. The dynamics of the nominal bilateral exchange rate of manat had an effect on change of real bilateral exchange rates. In January through December manat depreciated both in nominal and real terms against the currencies of Georgia and China, only nominally against Japanese Yen and only in real terms against Iranian rial. Manat appreciated both nominally and really against the currencies of the US, Euro zone, Great Britain, Turkey, Russia, Ukraine, Kazakhstan, Israel, Belarus and South Korea. Due to sharp devaluation of Belarus rouble, the bilateral exchange rate of manat against Belarus rouble appreciated by 3 times.

Table 3. Bilateral nominal and real effective exchange rate indices of manat against the currencies of the key trade partners in 2011 (%)

<table>
<thead>
<tr>
<th>Currency</th>
<th>Nominal bilateral exchange rate index*</th>
<th>Real bilateral exchange rate index</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>101.6</td>
<td>104.2</td>
</tr>
<tr>
<td>Euro zone</td>
<td>101.9</td>
<td>104.6</td>
</tr>
<tr>
<td>Great Britain</td>
<td>101.7</td>
<td>104.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>124.8</td>
<td>119.3</td>
</tr>
<tr>
<td>Russia</td>
<td>103.7</td>
<td>103.1</td>
</tr>
<tr>
<td>Ukraine</td>
<td>102.2</td>
<td>103.2</td>
</tr>
<tr>
<td>Georgia</td>
<td>95.7</td>
<td>99.1</td>
</tr>
<tr>
<td>Iran</td>
<td>107.4</td>
<td>94.5</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>102.0</td>
<td>100.2</td>
</tr>
<tr>
<td>Japan</td>
<td>94.9</td>
<td>100.9</td>
</tr>
<tr>
<td>Israel</td>
<td>106.3</td>
<td>109.8</td>
</tr>
<tr>
<td>China</td>
<td>97.0</td>
<td>99.3</td>
</tr>
<tr>
<td>Belarus</td>
<td>285.7</td>
<td>136.8</td>
</tr>
<tr>
<td>South Korea</td>
<td>101.7</td>
<td>102.8</td>
</tr>
</tbody>
</table>

*Average monthly change in exchange rate of manat against the currency of the partner-country.
During the reporting period, the non-oil trade weighted NEER (trade turnover weighted) appreciated by 7.1 percent. The difference between the inflation in partner countries and the one in Azerbaijan had a 1.8 basis points downward effect on REER.

As a result, non-oil weighted real effective exchange rate appreciated only by 5.3 percent.

![Chart 34. REER decomposition (%)](chart)

**Source: CBA**

Hence, the Central Bank ensured stable bilateral exchange rate of manat in 2011. The multilateral exchange rate of manat was affected by extreme fluctuations of the bilateral exchange rate as a result of devaluation in a number of partner countries.

### 2.2. Monetary policy instruments

Increase in energy prices in the world market, accumulated foreign exchange revenues of the country, expansion of money supply growth sources related to heightened public demand and expectations on acceleration of the non-oil sector growth made strengthening of control over inflationary factors and their regulation in a preventive regime actual again in 2011. Given the trends in domestic demand and external factors, in 2011 the Central Bank pursued anti-inflationary policy under its mandate.
In the environment of high inflation in 2011 a number of countries of the world started to tighten the monetary policy. The IMF also in its latest releases recommends a tight monetary policy in emerging economies with observable economic overheating. Because of slowdown in the global economic activity and emerging default risks in the second half of 2011, accommodative monetary policy was conducted. This processes resulted in tightened monetary policy in 25 and moderate monetary policy in 23 countries over the last 6 months.

**Chart 35. Cycle indicators (CBA)**

![Cycle indicators graph]

Source: CBA

In the view of revival of aggregate demand, inflation factors and forecasts of the balance of payments, the Central Bank took a decision to move the refinancing rate from 3 up to 5 percent from March 1 and to 5.25% - from May 6. This decision in parallel is aimed at increase in opportunities of the Central Bank to sterilize excess money supply via ensuring an appropriate condition in the financial markets.
To regulate the growth rate of money supply the required reserve norms on banks internal and external liabilities were shifted from 0.5 percent to 3 percent during 2011 in stages.

Box 10: Reserve requirements in China

People’s Bank of China (PBC) applies required reserves more broadly compared to other monetary policy instruments. The reasons are: required reserves enable monetary tightening without additional capital inflows to the country and are more flexible; can serve for macroprudential purposes. Bank reserves in China take 40-50 percent of the Central Bank balance, and 0.3 percent of the GDP of China. China takes one of the first places in the world according to these indicators. Currently, the upper threshold for deposits in the national currency is 21 percent, and for deposits in a foreign currency – 5 percent. PBC pays 1.62 percent for required reserves, no interest is paid for established required reserves on foreign currency liabilities. In some instances the PBC instructs commercial banks to maintain required reserves established for deposits in the national currency in a foreign currency. In 2011 the PBC started to apply dynamic differentiation of required reserve norms. A required reserve norm may vary on a quarterly, even monthly basis for every bank given the share of the bank’s total credit growth in deviation from historical trend, the lending policy of the country, and other prudential indicators like securitization, a leverage ratio, and capital adequacy. Moreover, differentiation may serve for a quasifiscal purpose and the purposes of the bank to develop agriculture. 

Source: “China’s evolving reserve requirements” BİS, November 2011
Under the established monetary policy direction, 1307 millions manat worth notes were issued in 2011 within the framework of sterilization operations. 777 millions manat worth notes were auctioned and 618.5 millions manat worth notes were placed.

**Chart 37. CBA notes (end of period, millions of manats)**

![Chart 37. CBA notes (end of period, millions of manats)](image)

*Source: CBA*

Average yield on notes at the last auction constituted 2.77 percent, while this indicator was 2.20 percent early in the year. As of 1 January 2012, the scale volume of notes in circulation was 50.1 millions manat. The executed REPO transactions jumped 6 times against the previous year and made 40.9 million manat.

### 2.3. Money supply

In 2011 money supply kept pace with the demand of the economy meanwhile being affected by seasonal factors. Thus, the growth rate of money supply further accelerated to the end of the year.

**Chart 38. Monetary aggregates (%)**

![Chart 38. Monetary aggregates (%)](image)

*Source: CBA*
Money base increased by 29.3 percent during the year. Seasonally adjusted money base growth was 31.6 percent comparing to the beginning of the year.

**Chart 39. Seasonal factors' impact on the monetary base**

![Chart 39](chart.png)

*Source: CBA*

**Box 11: Seasonal factors in money base**

The dynamics of money base either increases, or decreases during a year depending on seasons (various months, quarters or seasons of a year). To that end, existing seasonal factors in a time row should be discovered and adjusted. The Hodrick – Prescott (HP) filter is of the most widely used filters for seasonal adjustment in available practice. The HP filter has a very simple calculation technique and ensures seasonal adjustment per indicator. In total, this filter is calculated through minimizing the following formula:

\[
\sum_{t=1}^{T}(y_t - \tau_t)^2 + \lambda \sum_{t=2}^{T-1}[(\tau_{t+1} - \tau_t) - (\tau_t - \tau_{t-1})]^2
\]

where,

- \(y_t\) – the indicator to be seasonally adjusted.
- \(\tau_t\) – smoothed row
- \(\lambda\) – smoothing ratio

The following chart describes actual and seasonally adjusted row via the HP filter row of money base in manat. As is seen from the chart, the seasonally adjusted row is less volatile. The HP filter has estimated the continued deviations in the same month during a number of following years as a seasonal factor and alienated from the dynamics of money base.
During the period broad money supply (M3) increased by 32.1 percent and constituted AZN 13903.2 million, broad money supply in manat (M2) climbed 32.5 percent and made AZN 10997.2 million.

**Chart 40. Dynamics of M3 money aggregate (%)**

Source: CBA

Both cash, and non-cash growth contributed to jump in broad money supply. The share of cash in broad money supply was 65 percent as of the yearend.

**Table 4. Monetary aggregates (million of manats)**

<table>
<thead>
<tr>
<th></th>
<th>01.01.10</th>
<th>01.01.11</th>
<th>01.01.12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>M0</strong>  (Cash)</td>
<td>4147.8</td>
<td>5455.8</td>
<td>7158.2</td>
</tr>
<tr>
<td><strong>M1</strong> (Cash, demand deposits and savings)</td>
<td>5239.8</td>
<td>6718.9</td>
<td>8824.8</td>
</tr>
<tr>
<td><strong>M2</strong> (Cash, demand and term deposits and savings, in manat)</td>
<td>6169.2</td>
<td>8297.5</td>
<td>10997.2</td>
</tr>
<tr>
<td><strong>M3</strong> (Cash, demand and term deposits and savings in manat and FX)</td>
<td>8469.2</td>
<td>10527.5</td>
<td>13903.2</td>
</tr>
</tbody>
</table>

Source: CBA
Relative strengthening of multilateral nominal exchange rate of manat and growth of the money supply had an easing effect on the Monetary Condition Index during the year.

**Chart 41. Monetary Condition Index**

![Chart of Monetary Condition Index]

\[ M\text{ŞI} = 60 \times (Nc - Nb) + 40 \times (M1c - M1b) \]

*Source: AMB*

Despite the Central Bank decisions to tighten the monetary policy parameters and relatively accelerated inflation, in general the Monetary Condition Index is still accommodative.

### 2.4. Institutional base of the monetary policy

In 2011 the Central Bank continued to improve the macroeconomic management and develop the institutional base of the monetary policy.

The Central Bank kept tailoring the monetary policy mechanism to post-crisis challenges and improving international standardization. Researches were conducted to shape counter-cyclical macroprudential management in Azerbaijan. The Central Bank drafted a strategy on the monetary and financial stability policies on that basis.

The Central Bank evaluated its response function on strengthening of the empiric research system of micro- and macroeconomic environment of monetary, exchange rate and financial stability policies in 2011.

Identification and management of risks have become main priorities to boost the capacity to assess and manage the financial stability. Stress-tests and financial stability indicators identified
strengths and weaknesses of the financial system, and how stable and vulnerable the banking sector is.

The key macro-fiscal parameters of the economy were simulated based upon mathematical-analytical specification of the Dynamic Stochastic General Equilibrium model to strengthen macroeconomic modeling and forecasting.

The way to determine a critical level for inflation in Azerbaijan was in parallel researched during the period, the panel VAR model was being evaluated on the oil exporting countries. Sources of economic fluctuations in oil exporting countries (Azerbaijan, Kazakhstan, Russia and Iran) are being researched to that end.

A research and econometric estimation related to currency shift in Azerbaijan was conducted through utilization of specific econometric techniques. A parallel research singled out the capacity to diversify foreign exchange reserves in Azerbaijan according to geographical location and currency structure.

To foster future researches, a concept was generated to develop intellectual resources. Various projects – Virtual Central Bank Lab, e-library, boost of financial awareness and launch of an economic knowledge portal are to be implemented within this concept.
Charts and Tables used

Charts
Chart 1  Growth in the world economy................................................................. 5
Chart 2  Regional economic growth................................................................... 7
Chart 3  Change in country ratings..................................................................... 8
Chart 4  Investment flows to DGCs.................................................................... 9
Chart 5  Dynamics of price indices.................................................................... 10
Chart 6  Global demand for oil and oil prices.................................................... 11
Chart 7  Monetary policy decisions by central banks........................................... 12
Chart 8  Fiscal and monetary policy impulses..................................................... 12
Chart 9  Economic risk map............................................................................. 13
Chart 10 Trade balance..................................................................................... 17
Chart 11 Remittances....................................................................................... 19
Chart 12 Sufficiency of strategies foreign exchange reserves............................. 20
Chart 13 Strategic forex exchange reserves...................................................... 20
Chart 14 Money income of the population....................................................... 21
Chart 15 Change in wage and final consumption of the population................... 22
Chart 16 Non-food commodity turnover and services to households.................. 23
Chart 17 Investment......................................................................................... 24
Chart 18 Economic growth............................................................................... 25
Chart 19 Growth in the non-oil sector of the economy....................................... 26
Chart 20 Crude oil and natural gas extraction..................................................... 26
Chart 21 Economic growth expectations in 2012.............................................. 27
Chart 22 Expectations..................................................................................... 28
Chart 23 Output gap........................................................................................ 28
Chart 24 Food prices in Azerbaijan and the world.......................................... 29
Chart 25 Average annual CPI........................................................................... 29
Chart 26 Inflation............................................................................................ 30
Chart 27 Domestic and foreign CPI................................................................. 31
Chart 28 Regional inflation.............................................................................. 31
Chart 29 Sectoral inflation............................................................................... 32
Chart 30 Price change in the housing market.................................................... 33
Chart 31 Price expectations index...................................................................... 34
Chart 32 Employment expectations index........................................................ 35
Chart 33 CBA intervention.............................................................................. 36
Chart 34 REER decomposition......................................................................... 38
Chart 35 Cycle indicators............................................................................... 39

46
Chart 36  Interest rate corridor........................................................................................................ 40
Chart 37  CBA notes........................................................................................................................ 41
Chart 38  Monetary aggregates......................................................................................................... 41
Chart 39  Effect of seasonal factors on money base........................................................................... 42
Chart 40  Dynamics of M3 money aggregate....................................................................................... 43
Chart 41  Monetary Condition Index.................................................................................................. 44

Tables
Table 1  Key trends of the fiscal policy in 2011............................................................................... 7
Table 2  Global economic forecast by IMF......................................................................................... 15
Table 3  Bilateral nominal and real exchange rate indexes............................................................... 37
Table 4  Monetary aggregates.......................................................................................................... 43
Azərbaycan Respublikası Mərkəzi Bankı
The Central Bank of Azerbaijan Republic
Tel.: (+99412) 493 11 22
Faks/Fax: (+99412) 493 55 41
http://www.cbar.az
Ünvan: AZ1014, Bakı, R.Behbudov küçəsi, 32
Address: 32 Rashid Behbudov Street, Baku, AZ 1014