Summary on situation of the monetary policy on the first six months of 2003

1. Execution of the monetary policy

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

The success achieved on the economy of the country continued in the first six months of the year 2003 as well. The established macroeconomic stability became irreversible and even deeper. These all prove the effectiveness and properness of the economical policy and its main component – the money-and-credit and exchange policy.

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

The inflation rate was 0.5% in the first six months of 2003. But it constituted 1.9% in the same period of the previous year.

The researches carried out according to the inflation model prove that the price change of food products 86.5%, the price changes of non-food products 10.75% and the price change of services 2.75% influenced the alteration of prices.

The alteration of prices was related 70% to the monetary factors, 12.7% to the non-monetary factors and 17.3% to the seasonal factors.

The real amount of the gross domestic product as a main economical indicator has increased by 10.1% against to 8.4% of the same period of the previous year.

6.2% industrial and 3.1% agricultural product growth rates were achieved as compared to the same period of the previous year.

The increase of the share of private sector as an important term for the country with the market economy proceeded as well. Over 70% of the GDP, as well as 54.2% of the industrial product, 99% of the agricultural commodities, 87.7% of the capital investment, 67% of the communication services, 56.1% of the freight forwarding were performed by non-government sector during the first six months of 2003.

The amount of the capital investment as a main guarantee factor of the future economical development increased 64.4% constituting 7.2 trillion manats, since 6084.6 billion manats (1240 million USD) or 84.5% of this was foreign investment.

Observation of positive declines in the foreign trade balance of Azerbaijan during the recent years proceeded. The foreign trade turnover increased by 36.3% constituting 1717.8 million dollars during the months of January-May. The share of the export was 857.8 million dollars, and the import amounted to 860 million dollars. The appearance of negative balance of the foreign trade in the amount of 2.2 million dollars was related to the import of the investment oriented commodities according to the realization of oil contracts.

Improvement of population’s welfare proceeded. The average wage rose up to 373.5 thousand manats (76.1 USD) and its real growth constituted 20.8% by July 1, 2003 as compared to the same period of the previous year. In its turn, the increase of population’s income was the guarantee factor of the real sector’s development, enhancing the purchasing capacity.

Declines in the world economy. Opposite declines were observed during the first six months of 2003 in the economy of the USA. So, in January the orders for long-term products increased by 3.3% in defiance of the analysts’ expectations. Simultaneously, the size of the property sale rose in the second-hand market. From another side, the number of appealers for the unemployment compensation increased rapidly. Generally, the process of diminishing of the economical growth rate begun in the fourth quarter of the year 2002 continued in the beginning of the year 2003. In February orders for the long-term products decreased 1.2% again. Simultaneously, the lack of state budget reached an astronomic level – 96.3 billion USD in February. The volume of new living apartments’ construction decreased 11% and the volume of
their sale decreased 8.1% as well. The amount of property sale also decreased 4.3% in the second-hand market. It should be noted that all of these appeared on the background of the lowest rates of hypothec credits since 1960. The volume of retail business increased by 0.5% in June. Deficit of the foreign trade’s balance reached 41.8 billion USD on May. The amount of reserves in the stores didn’t go up in defiance of forecasts, but on the contrary, decreased 0.2%. The amount of industrial production increased only by 0.1%.

The FRS decreased the discount rate from 1.25% to 1% in order to augment economical activity in the country by the end of June. According to this fact the analysts make optimistic forecasts on the USA economy.

Opposite declines are observed in Europe, as well. Though production activity index was slightly increased in the beginning of the report period, the fact that it is still below 50 is annoying. The foreign trade of Euro region had a negative balance in defiance of the expected in the beginning of the first six months of the year. It was related to the increase of oil prices in one hand and increase of the euro rates in the other.

As forecasted for the year 2003, share of the deficit of the state budget in the GDP will be 3.9% in Germany, 3.8% in France, which is more than the limits defined for the Euro region countries. Germany decreased the expected economical growth from the forecasted 1.5% to 1% taking into account negative declines in the European economy. Simultaneously, the IMF also decreased its forecast upon Germany. So according to the forecasts of the IMF the growth rate of the GDP will be at zero level during 2003 and it will not exceed 1.5% during 2004. The IMF also decreased its forecast from 2.3% to 1.3% regarding the economical growth of the Euro region for 2003.

Increase of unemployment was observed during the report period in Germany. From another side the business environment index determined by the IFO – the authorized research institute of the country increased to 88.9% from 87.4% on February, though the analysts forecasted it to fall till 87.2. This fact inspires hope that the economical growth rate of the German economy will accelerate. So the correlation is observed between the dynamics of the GDP and this indicator which has a great forecast potential. Simultaneously, the business expectations index determined by the ZEW – the economical researches’ centre of Germany increased rapidly in the beginning of July and went up to 41.9 from 21.3. The analysts think that increase of optimism at the business sphere in Germany is related to the fall of the euro rates.

Unemployment reached the highest level (9.1%) since 1993 in France. At the same time, consumption expenses decreased 0.2% in France. The volume of industrial production decreased 1.4% in France and 1.6% in Italy being totally opposite to the forecasts in May.

In order to stimulate the economical growth in England the Central Bank decreased the discount rate from 4% to 3.75% in the beginning of February and decreased it till 3.5% in July. This is the lowest level during last 48 years. Decrease of the discount rate is usually followed by the decrease of pound sterling rate.

Influenced by deflation processes the profitableness of 10-year state loans decreased to the lowest level during its history in Japan. The continuation of the decrease of last six years’ wholesale turnover has been observed in Japan during the first six months of 2003, as well. Meanwhile the government tries to prevent the deflation pressure by implementing structural reforms in the country and re-constructing the banking system.

Changes of the exchange rate of USD against other leading currencies of the world were in different directions. Though the rate of USD decreased 3.3% against the euro, 1.6% against Swiss frank, 1.8% against Russian ruble, it increased by 2% against English pound sterling and 0.6% against Japanese yen.

The processes in the economy of the leading countries have results in the stock indexes of these countries. Generally, main stock indexes decreased during the first six months of the year. So the Dow-Jones average displaying the average price of the 30 biggest industrial companies in the New-York Stock Exchange decreased 2.35%, the Nikkei index determined on the base of the stocks of the top 225 biggest companies in the Tokyo Stock Exchange decreased 6%. Decline
rate of the stock indexes was sharper in Europe. So the FTSE Eurotop 100 calculated on the base of stock prices of the 100 biggest companies of Europe decreased 9.8% and the DAX 100 index - the average of stocks of 100 biggest companies in the German Stock Exchange decreased 12.8%.

The average price of the Brent oil in the world market was 28.3 USD in the first six months of 2003. After the beginning of military operations in Iraq the price of oil in world market declined downtrend in defiance of the expected. But the price of oil still remains high. By the end of the report period the price of oil constituted 27.3 USD which is 40% more than considered in Azerbaijan state budget for 2003.

2. Dynamics of the money-and-credit indicators

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

The monetary base of manat increased by 16.4% constituting 1989.5 billion manats by July 1, 2003 as compared to the same period of the previous year. The growth rate of the money in correspondent accounts and obligatory reserves stock was higher than the growth rate of the money in turnover as compared to the same period of the previous year.

Broad monetary aggregate (M-2) increased by 4.1% constituting 2208.6 billion manats.

As compared to the beginning of the year monetary multiplier-the ability of the banking system to create money, increased by 2.8%. Reconstruction of the banking system, development of the banking infrastructure, and especially measures taken to improve the payment system resulted in the positive dynamics of this indicator.

Share of cash in the structure of money supply decreased 7.8% point as compared to the same period of the previous year. It was related to the increase of non-cash amount by 84.7%, whereas the cash amount increased only by 12.5% as compared to the same period of the previous year.

The amount of credit investment increased by 21.6% constituting 2909 billion manats as compared to the same period of the previous year. Excepting the credits of “Aqrarkredit” organization the growth rate of the credits was 30.1%.

The amount of long-term credits increased by 10.0% and that of short-term credits increased by 26% as compared to the same period of the previous year.

88.6% of credits were accrued by banks and 11.4% of these were accrued by other credit organizations.

Savings were also one of the main sources of credits during the period. The savings of natural persons constituted 963.4 billion manats, which is 54.8% more as compared to the same period of the previous year. 44.8% of savings in the banks is due to private banks.

Short-term savings of the natural persons increased by 9.1%, long-term ones increased by 3.8 times as compared to the same period of the previous year. It shows that population’s trust towards the banks have increased.

It should be noted that the analysis of the structure of savings against currencies shows the increase of population trust towards manat. So, the population’s savings in manat increased by 64.7%, whereas the savings in currency increased by 53.7% as compared to the same period of the previous year. This factor establishes a favorable ground to strengthen the role of manat in the economical turnover improving the structure of the money supply.

Downtrend declines were observed in the interest rates of the deposits and savings, as well as the credits and also in the prices of the STSL (Short-Term State Loans) during the report period.

3. Improvement of the monetary management

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

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

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

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

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

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

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

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

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

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

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

From July 1, within the frame of the strategy on the management of the currency reserves of the National Bank for the year 2003, means of 150 million USD from the currency reserves of The National Bank were delivered to the 3 high-rating and reliable foreign managers’ control. Acceleration of the central banks’ profitableness, increase of the expences on the update
process of the information technology systems co-ordinating with modern financial markets and regular improvement of skills and abilities of the employees managing the reserves are the necessities resulted in broad spread tendency of attraction of foreign managers, recently. At the same time, attraction of foreign managers enables the opportunity to use an experience, diversificatethe reserves according to the management methods and etc.

**Tools of monetary policy.** For successful implementation of specified monetary policy

The National Bank regulated the money-market by participation in credit auctions, securities and currency market, as well as by the obligatory reserve norms during the report period.

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

Expansion of employment of **new financial tools** by the National Bank for conducting an effective and adequate monetary policy was ongoing. The **pawn-shop** and overnight credit mechanisms are examples of these tools.

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

The **obligatory reserve norms** were 10% for the short-term deposits and at zero level for the long-term credits during the report period. Investigations show that after the issue of the decree on zero level obligatory reserve norms for long term credits, the growth rate of the long-term credits accelerated. So the long-term credits increased by 3.7 times whereas the short-term credits increased by 18.2% during the past period as compared to the same period of the previous year. Despite the increase wasn’t thoroughly connected to that measure, the specified part of it was mainly due to the decree activated since 01.01.2003.

In addition the practise allowing to gain the STSL using the obligatory reserves was stopped by May 1, 2003 according to the decree of the Management Stuff of the National Bank dated February 27, 2003.

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

4. **Currency-market and exchange rate policy**

**Exchange rate policy.** The alteration of the exchange rate of the national currency at the regime of the floating rates continued during the first six months of 2003 as well. During the period the exchange rate of manat against USD changed 0.5% or 24 manats and decreased from 4917 manats to 4893 manats. Researches, especially analysis by the implementation of the econometric methods show that existing dynamics of manat’s rate set favorable conditions for the improvement of the international competitiveness of the country.

**Situation of the currency market.** Gross amount of the internal currency market increased by 378 million USD or 33.6% constituting 1502 million USD during the first six months of 2003 as compared to the same period of the previous year.

The National Bank maintained the balance in the currency market by regulating the demand and supply, and had influence on the exchange rate of manat. The National Bank’s real interference to the currency market amounted to 40.7 million USD (+2.7%) and was purchase oriented.

**Currency reserves.** During the first six months of 2003 the amount of the official currency reserves under the authority of the National Bank increased by 24.2 million USD and constituted 704.7 million USD by July 1, 2003.

65.4 million USD was transferred to the State Oil Fund of the Republic of Azerbaijan due to the construction of the Baku-Tbilisi-Ceyhan oil pipeline and as the credit and active debts 41.1 million USD was paid to the IMF during the report period. During the period, credits amounted to 52.6 million USD (18.2 million USD within the frame of the PRGF credit program of the International Monetary Fund, 34.4 million USD by the SAC II credit program of the World
Bank) were obtained from the international financial institutions. So, the relative growth constituted 54.2 million USD.

The profitableness gained by the management of the reserves of the National Bank constituted 1.6%.