Summary on situation of the monetary policy on the first nine months of 2007

1. Macro economical situation and global economic processes

National Bank hold policy supporting protection of currency and financial stability, as well as realization of budget-investing policy within January-September of 2007. Wide range of economical processes within the country and abroad effected to the obligations fulfillment of monetary policy.

Macro-economical situation. Development in leaps, beginning a few years ago continued in current year. Economical growth upon the end of 2007, III quarter results was 27.1 %, as well as in oil sector 43.5%, and in non-oil sector 8.9%. Within the period, it was possible to achieve increase of industrial production for 27%, agricultural production 4.1%, investing in construction 15.1%, transport of goods 19.2%, and communication services 19.9%, goods turnover 14.9 %, paid services 33.1%.

One of the important conditions for a country with market economy role of private sector in economy is being increased. During January-September of 2007 more than 80 % of GDP, as well as 78.4% of industrial production, agricultural production entirely, investing in solid capital 56.1%, transport of goods 66.9% fell to the share of non-governmental sector.

Inflation in nine months of the current year caused by such factors as traditional factors, communal sector held in the frame of structure reforms and several imported food products (sugar, wheat etc.), and rise of prices in world market. Inflation rate in September of 2007 stand for 11% related to the December of previous year. Within the period rise in the prices of goods was 7.9%, nonfoods 7.4 % and services 23.9%. Rise in price of food products effected by fruits and vegetables, nonfood products by construction and agriculture materials and services by communal and public services.

Recently positive tendencies occurred in foreign trade balance of Azerbaijan continued gradually. Record in oil price in the world market and dynamic development in non-oil sector resulted in improvement of country foreign balance. Foreign trade turnover stand for 7406.6 million USD. The share of export in total amount was 3991.9 USD and import 3414.7 USD.

Improvement in social status of the population continued periodically. Therefore, that average monthly salary increased by 177.6 AZN and growth rate was 28.2%.

Inclinations in world financial and food markets.

Processes in the economies of leading countries reflected financial market indicators.

Within the reporting period, it has been occurred USD rate reduction related to main currencies of the world. Therefore, USD exchange rate decreased 8.2% relate to EURO, 5.5% relate to RUR, 5.3% relate to CHF, 4.7% relate to GBP, 3.5% relate to KZT, 16% relate to TRY, and 2.6% relate to JPY.

We have to mention that within the period it was decided to reduce Federal Stock System rate from 5.25% to 4.75%, and increase Europe Central Bank main interest rate from 3.5% to 4%. Main fund indexes rate increased within the reporting
period. Therefore, Dow Johns index reflecting average price of more than 30 large-scale financial companies was 12.2%. NASDAG index calculating in the basis of shares of 100 large-scale high-technology companies was 11.3%, FTSE Euro top 100 index, calculating in the basis of stock prices of 100 large-scale companies of Europe was 4.9%, average stock price of 100 large-scale companies sold at an German Fund Exchange auction- DAX index increased for 19.1%, but Nikkei Index, calculating in the basis of 225 large-scale companies stock prices auctioned in Tokio Fund Exchange decreased by 1.4%. The average price of Brent oil in the world market constituted 67.4 USD during the nine months of 2007, which was 55.6USD more than (21.1 %) that of the nine months of 2004.

Within the reporting period the gold continued increase in price. As well as, the price of gold unit stands for 606.9 USD in he beginning of the year, but by the end of September, this figure increased by 21.4% (or 129.8 USD) and was 736.7 USD. Main reason of such increase in the price of gold was growing interest to the gold as investing object, by investors, as a result of uncertainty around nuclear programs.

2. Monetary policy

**Institutional development of the monetary management.**

In relation with high economical growth, in circumstances of increase money demand within 9 months of 2007, National Bank defined such goals as protection of currency stability, meet needs of the economy to money, as well as protection of stability in banking-financial system. According to experience, the most important priority of the Central Bank is to prevent negative influence of highly increased oil incomes to currency stock markets, financial system and to the national currency. Taking into consideration such point, within the period National Bank protected manat`s stability, sterilizing surplus part of oil incomes in currency stock market, same as previous year.

As a result of quick halt of considerable difference between demand and supply in currency stock market strengthening rate in current year was 2.3%. We have to note that this process occurs more quickly in other neighbor oil countries. According to the held analyses, without interference to the market by the National Bank, manat would be stabilized with double figured rate from the beginning of the year. The National Bank influenced manat exchange rate, in the way of regulating demand and supply in currency stock markets. Within 9 months, interference of the National Bank to the financial markets was purchase directed and stands for 1131 million USD. Only as a result of this interference prevented abruptly strengthen of manat`s exchange rate.

Within the mentioned period nominal effective rate of manat characterized its average exchange, decreased in comparison with the main trade partner countries` currencies. As well as, 2.2% for general trade turnover, for import 1.9%, and export 2.3%, in September of 2007, relate to December 2006.

Manat`s real effective rate in September of 2007 (including oil sector) increased 4.9% for general trade turnover, 4.5% for import and 5.1% export, compared to December of 2006.
The real effective exchange rate on the gross trade turnover of the non-oil sector increased by 3.7 %, whereas the export influenced rate increased by 1.8% and the import influenced rate by 4% in September, 2007.

Effective exchange rate indexes are more expedient for estimation of competition ability within long-term period. From this point, it will be advisable to draw attention to the dynamics of effective exchange rate indexes from December 2000. The real effective exchange rate on the gross trade turnover of the oil sector increased by 6.6%, whereas the export influenced rate increased by 4.9% and the import influenced rate by 6.6% during September 2007. The real effective exchange rate on non-oil sector depreciated. Excluding, oil sector real effective exchange rate depreciation was 12.4% relate to gross trade turnover, 10.2% import influenced rate, 22.9% export influenced rate.

Within the long-term period depreciation in the amount of real effective exchange rate is related with increase of inflation rate in main trade partner countries relate to Azerbaijan. Therefore, within the long-term period (2000-2007) manat’s real effective exchange rate cheapened, and this fact proofs that conditions for of foreign trade with main trade partners are suitable.

**Scope of the currency reserves** under the disposal of the National Bank increased by 59.4% or 1168.3 million USD as compared to the beginning of year (1967,3 million USD) and constituted 3135.7 million USD by the end of the nine months of 2007.

Within the passed period of 2007, in the condition of high acceleration of economic growth, increase of **money demand** was ongoing. By the end of September broad money supply (M2) increased by 60.1% and stood for 3421.4 AZN million. From the beginning of the year money supply indicator—monetization coefficient of non-oil economy reached 12.6%.

It has been observed approach of indicators characterized money-creating ability of banking system. As well as money, multiplicator increased by 7.8% and reached 1.38 compared to the same period of the previous year. Speedy development of banking infrastructure in our country and especially implementation of advanced payment systems, enlargement of electron interbank operations, expansion of plastic card circulation, installation of Pos terminals serve as additional stimuli for increase of money-creating ability of banking system. Specific weight of cash money, in broad money supply, decreased by 5% during last year.

**Monetary policy tools.** In the aim of achieving defined the NBA used such tools as open market operations, interest rates, as well as obligatory reserve norms.

NBA continued to use its short-term notes for sterilization of money stock having inflation potential. Within reporting period the NBA has held 38 auctions on localization of notes. Emission’s total figure constituted for 1745 million AZN and sum of placed notes constituted for 1214, 9 million AZN. Within reporting period middle sized profit of the NBA on short-term notes depreciated. So that, in the first auction held in starting period, middle-sized profit rate stood for 12.33%, but in the last auction constituted for 6.2%.

Volume of circulated market on notes was 167.7 million AZN, or 2.1 times more compared with the same period of 2006. Volume of REPO operations within the
reporting period stood for 1074.4 million AZN, for ensuring banks` liquid funds, fulfillment of obligations execution upon correspondent banks in time. The total volume of operations on non-REPO (daily) stood for 37.5 million AZN within the reporting period. Taking into consideration definitely development of the economy, in the aim of conducting more severe monetary policy, the NBA double increased refinancing rate, the main indicator of the percentage corridor from 9.5% to 13%.
The other parameters of the percentage corridor non-REPO rate defined as 19% and REPO rate 5% and have been changed from April 2, 2007.

3. Financial markets

Credit investments. The volume of loaning by the end of September 2007 increased by 86.4% compared to the same period of the previous year, 59% compared to the beginning of the year. Specific weight of loaning in GDP (upon non-oil sector GDP) has been increased by 22.2% from the beginning of the year. Volume of new credits stood for 4531.9 million AZN during January-September, 2007 and this figure is two times more than last year. Sum of new credits within last year considerably exceeded the amount of credit payments. Because of that, net increase of loaning was 1741.7 million AZN and therefore remnant sum of loaning increased by 3756.8 million AZN by 01.10.07. By the end of analyzing period, the volume of given loans by banks in total loaning was 97.4% and by non-bank credit institutions 2.6%.

Credit investments by banks increased by 87.1%, therefore non-bank credit institutions Credit investments by 63.1%.

Because of economic reforms held within last year, it has been observed growth of the private sector role in the economy and in its turn, this phenomenon affected the loaning structure. As well as, specific weight of loans to private sector for loans increased by 91.8%.

Increase in the sum of loaning to the economy within the analyzing period was high upon each economy subjects. Loans of non-financial juridical persons increased by 71% related to the same period of last year and its share in total loaning was 62%. Within the last year sum of credits harnessing to industry and production increased by 67.6% and constituted for 270.1 million AZN, loans to trade and services increased for 74.3% and stood for 988.8 million AZN, sum of credits to agriculture and processing increased by 27.2% constituted for 162.7 million AZN, credits to the transport and communication sectors increased by 37.2% and stood for 278.1. Sum of credits harnessing to construction and property sectors increased by 85.5% and reached by 255.2 million AZN.

Credits for individuals increased by 2.2 times and stood for 1376.2 million AZN, 3.2% of this sum falls to the share of credits on plastic card operations. Rapidly growth of credits to individuals can be explained with rise of income level of the population, as well as increase of credit service varieties proposed by banks. Recently, starting mortgage loans mechanism served as additional stimulus for increase of credits to individuals. Strengthening of manat rate related to other
currencies and real results of denomination influences currency structure of loaning. In September of 2007, credits in foreign currencies increased by 46.9%, compared to the same period of last year. But increase of credits in manat is 2.4 times. Consequently, specific weight of credits in national currency for total sum exceeded 11.9%. In October 1, 2007 specific weight of credits in foreign currency constituted for 44.3%.

Recently, such factors as extension of capital and deposit base of banks, intensification of financial support of our government to entrepreneurs, as well as taking mortgage crediting mechanism into action served as suitable condition for increasing of long-term crediting. On the end of September 2007, volume of short-term credits increased by 46.1% and long-term credits increased by 2.3 times compared to the same period of the previous year. As a result, within the period specific weight of long-term credits in total crediting structure exceeded 10.8% and constituted for 60.9% in 01.10.2007.

Results of done measures in the direction of social-economic development have an effect on regional structure of credit investment. Enlargement of credit network on regions enlarges opportunities of economic subjects for getting credits in regions. On the end of September 2007, 84% of credit investment falls to the share of Baku city and 16% to the share of other regions.

There was not so deep divergence in average interest rates on credits, in September 2007. In September 2007, average interest rates upon credits with currencies increased by 0.81% related to the same month of the previous year and stood for 17.06% in 01.10.07. Average interest rates of credits with manat, on juridical persons increased by 0.57% related to the same period of the previous year and stood for 15.33%, on individuals this figure stood for 19.98% increasing by 0.06%. Average interest rates on credits with foreign currencies were same as previous year and constituted for 17.15%.

Within this period average interest rates for juridical persons with foreign currencies decreased from 15.02% by 14.64% in September of the previous year, within the reporting period, interest rates for individuals reached 21.78% from 21.67%.

Difference between deposits and credits in manat reached 6.06% in 01.10.2007 from 5.53% in 01.10.2006. Nevertheless, difference between them in foreign currency decreased from 5.68% by 4.46%.

**Deposit market.** Volume of deposits and savings by the end of 9 months of 2007 increased by 60.6% and reached 2900.1 AZN million. Including deposits of juridical persons increase by 47.5% and constituted for 1640.8 AZN million. Therewith, deposits of juridical persons increased 47.5% and reached 1640.8 AZN million.

Increase of individuals’ deposits was ongoing. As well as, deposits of individuals increased by 81.6% and constituted for 1259.3 AZN million. By the end of reporting period 63.3% of derived deposits falls to the share of private banks.

We have to note that besides resident individuals, number of deposit investments by non-resident individuals is increasing rapidly. However, by the end of
September deposits of non-resident individuals increased by 2.6 times compared to the same period of the previous year. Analysis of the structure of deposits upon currencies validates increase of confidence of economic subjects to manat. So that, in comparison with the same period of previous year, house holdings’ deposits in foreign currency increased by 44.4%, however deposits with manat increased by 3 times. This factor improves structure of money supply and creates suitable conditions for strengthening of the role of manat in economic circulation.

**Interbank money market.** During reporting period agreements signed in manat and USD, in Organized Interbank Credit Markets. Total volume of agreements in manat stood for 19,4 AZN million. Average interest rate on signed agreements stood for 15,9%. Within the mentioned period total volume of agreements signed in USD stood for 24,7 USD million and average interest rate was 12,9%. Internal of credits was 3-360 days.

During January-September of 2007, total volume of interbank repository operations with securities of our government according to “bank-bank” scheme stood for 135,2 AZN million. Average income on interbank repository operations was 9,3%. Interval of operations was 1-7 days.

**State short-term securities market.** the Ministry of Finance conducted 38 auctions on replacement of state short-term securities, during nine months of 2007. Volume of announced issues was 212 AZN million, and volume of replaced issues was 144,6 AZN million. Average income in first auction was 10,02% and in last auction this figure constituted for 10,4%. Volume of recurrent market on securities stood for 15,8 AZN million.

**Foreign-exchange market.** Volume of foreign exchange market during January-September of 2007, compared to the same period of the previous year increased by 2 times and was 14 USD billion. 82.6% of foreign-exchange operations realized with USD, 14.9% with Euro, 2.1% with Russian ruble and 0.3% with other currencies. Specific weight of operations with Euro increased by 4% compared to the same period of the previous year.

Consequently, within the passed period of 2007 as a result of monetary policy conducted by the National Bank, have an positive influence on provision of money demands of our economy, protection of rate and financial stability.