CENTRAL BANK OF THE REPUBLIC OF AZERBAIJAN

MONETARY POLICY REVIEW

January – March 2017

The main goal of this publicly disclosed quarterly review is to present the analysis of current macroeconomic developments and information on the monetary policy implemented by the Central Bank of the Republic of Azerbaijan to broad public.

Baku – 2017

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ACRONYMS

CBA	The Central Bank of the Republic of Azerbaijan
ADB	The Asian Development Bank
EBRD	The European Bank for Reconstruction and Development
ILO	The International Labor Organization
IMF	The International Monetary Fund
NBCI	Non-bank credit institution
FDI	Foreign direct investment
SSC	The State Statistics Committee
DGCs	Developing countries
DDCs	Developed countries
OECD	The Organization for Economic Cooperation and Development
CPI	The consumer price index
APPI	The agricultural producer price index
SME	Small and medium-sized enterprises
NEER	The nominal effective exchange rate
OPEC	The Organization of Petroleum Exporting Countries
REER	The real effective exchange rate
RSM	The Real Sector Monitoring
IPPI	The industrial producer price index
NFES	The National Fund for Entrepreneurial Support
UNCTAD	The United Nations Conference of rade and Development
GDP	Gross Domestic Product
WTO	The World Trade Organization

EXECUTIVE SUMMARY

The global economic situation surfaced favorable patterns for the country economy in Quarter I, 2017. Relative rise in global oil prices and high economic activity in partner countries contributed to the balance of payments (BoP).

The CBA underpinned macroeconomic stability by discharging functions under its mandate. The Bank implemented anti-inflationary monetary policy – effectively managed emission sources, optimized the volume of money supply and pursued an adequate interest rate policy. The Bank also gave consideration to the effect of excess money supply on the FX market while regulating money supply.

The CBA continued to improve the monetary policy's strategic frame. The exchange rate has become more flexible since current January after critical preparatory efforts. The Bank introduced a new FX auction mechanism, and removed the limit on exchange rate spreads in cash and cashless FX market. The USD/AZN exchange rate that was highly volatile at the beginning of the of flexible FX policy implementation, gradually was replaced by stability in the FX market.

In total, accomplished policy measures and improved BoP yielded initial positive patterns in macroeconomic stability in Quarter I, 2017. The manat stopped depreciating against the USD and even slightly strengthened on the backdrop of the rebalancing in the FX market. High inflation expectations slowed down in such an environment; the monthly inflation rate has been sliding since January. As of the end-quarter it became possible to increase money supply without detriment to macroeconomic stability.

I. GLOBAL ECONOMIC ENVIRONMENT AND THE EXTERNAL SECTOR

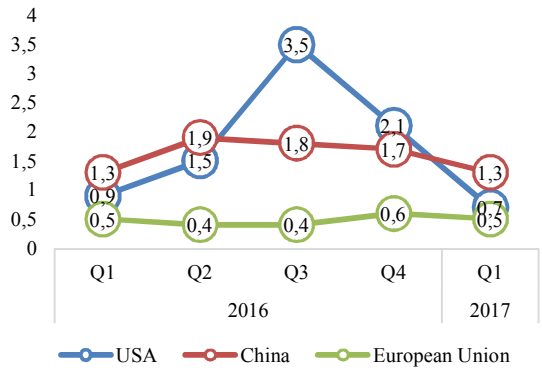
1.1 Global economic trends

The global economy continued to grow in Quarter I, 2017 due to kick-off of a long awaited cyclic recovery in international trade, processing and investment flows. Despite high global geopolitical tensions, the recovered activity in trade and industry, and apparent expansion in financial markets encouraged global growth.

Global economic growth. The economic growth rate varied across DDCs being affected by cyclic and seasonal factors. It decreased in the USA by 1.4 p.p. to 0.7% compared to the previous quarter, the lowest indicator of recent three years. Low economic growth is mainly attributable to private investments and shrunk public and private sector consumption.

Producers' high confidence in future growth of aggregate demand was accompanied by partial expansion of production. Inflation considerably jumped over the quarter along with slack economic growth and consumption. In February a twelve-month inflation rate increased to 2.7%, the highest indicator since 2012.

Graph 1. Quarterly economic growth (quarter on quarter)



Source: preliminary data from relevant statistic institutions

Economic growth in the UK decreased by 0.4 p.p. and made 0.3% compared to the previous quarter, in aggregate low, though better compared to the relevant indicator of 2016. Net exports growth related predictions for 2017 are positive in

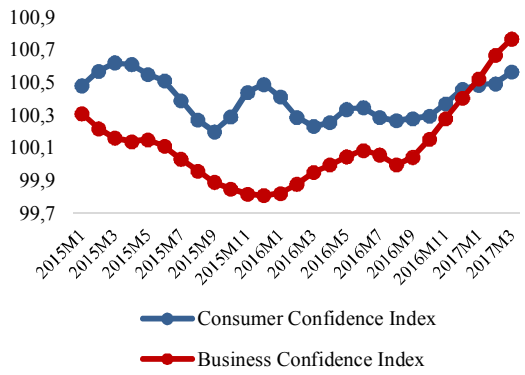
Japan, unemployment dropped to as little as 2.8%. Stronger domestic demand led to rapid growth in the euro zone, particularly in Germany and Spain. The consumer confidence indicator of recent years and investments rose by 0.9%, still economic growth was relatively low– 0.3%.

Economic growth varied across DGCs too. It was relatively high in China, slowed down in India, and was in its historical lows in Brazil. Early in March the Chinese government announced its new 6.5% target for GDP growth and 3% target for inflation. According to official data, in Quarter I, 2017 economic growth was 6.9% (y/y), while processing industry rose 3.2%.

Albeit IMF's 1.4% prediction, Russia set a 2% official economic growth rate for 2017. In total activity was weak in commodity exporters. Geopolitical factors gravely hinder growth in the Middle East.

Business and consumer confidence indices increased in OECD countries. The index, sliding since 2015 (Chart 2), has remained stable over recent 7 months. The business confidence index increased by 0.8%, while the consumer confidence index increased by 0.3% y/y.

Graph 2. Business and Consumer Confidence indexes in OECD countries



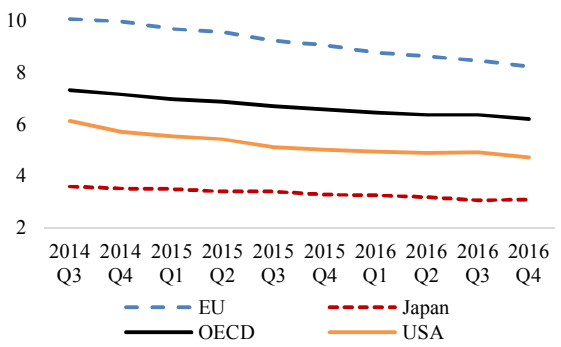
Source: IMF

Global employment. According to recent data from the ILO, the number of the unemployed is 197.7 mln throughout the world, which means that global unemployment equals to 5.7%. As of end-2017 this indicator is expected to increase to 5.8%, while the number of the

unemployed will increase to 201.1 million. The young account for 35% (71 mln) of the total unemployed.

The burden of overdue loans in most part of Europe hinders the recovery of total production and employment. The expected employment in the USA is close to its full capacity.

Graph 3. Unemployment (quarterly, %)

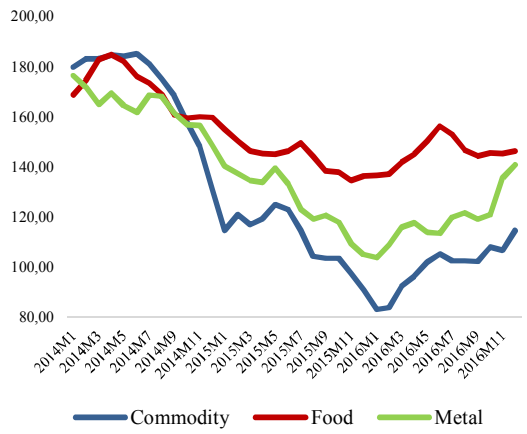


Source: OECD

Global commodity prices, that rose in Half II, 2016, remained stable over the reported period. The commodity price index published by the IMF rose by 4% over first two months of 2017 and relatively regressed by the end-Quarter I, leaving the index unchanged compared to early year. Food prices witnessed the same pattern – the index rose by 4.5% over first two months, and regressed by 3% as of end-March. Accordingly, food prices increased by 1.2% over recent 3 months.

Prices for non-fuel commodities hiked – prices for agricultural products hiked by 3%, while metal prices rose by 6%.

Graph 4. Price indices (2005=100)



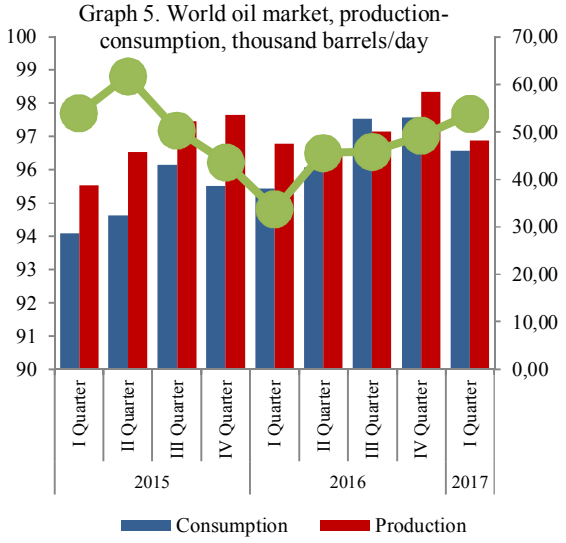
Source: IMF

Having hiked by about 16% over recent 6 months oil prices remained relatively stable. The OPEC and other major oil producers' agreement to limit production contributed to this price hike. On the

other hand, high global aggregate demand and economic revival related predictions also affected the rise from bottom prices of 2016.

Prices for natural gas also hiked along with the rise in oil prices. Prices for gas in the USA, Europe and Japan were by 19% higher than in August.

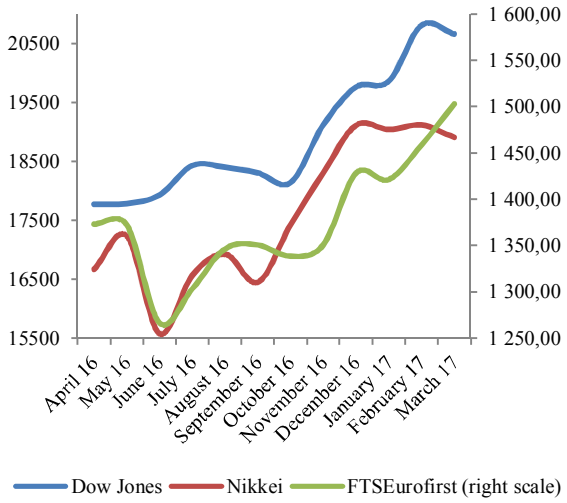
Graph 5. World oil market, production-consumption, thousand barrels/day



Source: EIA

Global financial markets and the monetary policy. Deregulation in the US financial system, high investments and fiscal expansion forecasts revived financial markets. Consumer confidence and business environment surveys suggest that confidence in the economy is reaching the pre-crisis level.

Graph 6. Dynamics of financial indexes



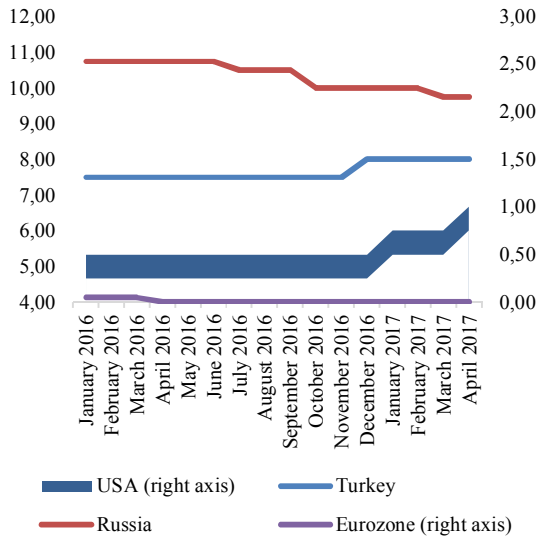
Source: Reuters

The US Fed raised its benchmark interest rate in December 2016 and March 2017, which is accompanied by gradual strengthening of the dollar. The REER of the dollar has appreciated by 3.5% since August, while the euro and the Japanese yen depreciated over the same period.

Out of DGCs, the refinancing rate was decreased by 75 p.p. to 12.25% in Brazil, while it was increased by 50 points in Mexico. The refinancing rate was reduced by

25 points to 9.75% in Russia due to faster than expected economic growth and inflation nearing the 4% target. The interest rate is planned to be further decreased in Half II, 2017.

Graph 7. Key rates of central banks



Source: Central banks of relevant countries

In some DGCs the exchange rate hugely depreciated over recent months (particularly in Turkey and Malaysia), while it relatively appreciated in the group of commodity exporters. Overall, the USD depreciated by 1.4% against the euro, by 7.6% against the ruble, and by 1.6% against the pound, appreciated by 3.5% against the Turkish lira and remained stable against the Chinese yuan in Quarter I.

Forecasts and risks. International organizations predict higher growth for the short run. For instance, the IMF in its recent Global Economic Outlook predicts 3.5% economic growth in 2017 and 3.6% in 2018, 0.4 and 0.5 p.p. higher than the indicators for 2016 respectively. Fast growth stems from high global investments affected by increased investments to infrastructure and equity in China and related rise in production of consumer products.

DDCs are expected to grow by 2% in 2017 and 2018 in response to the revival in global processing industry since the end-2016. The USA is expected be the fastest growing economy due to the accommodative fiscal policy – 2.3% in 2017 and 2.5% in 2018. The target interest rate is expected to increase by 75 points in 2017 and 125 points in 2018 to 3% in 2019.

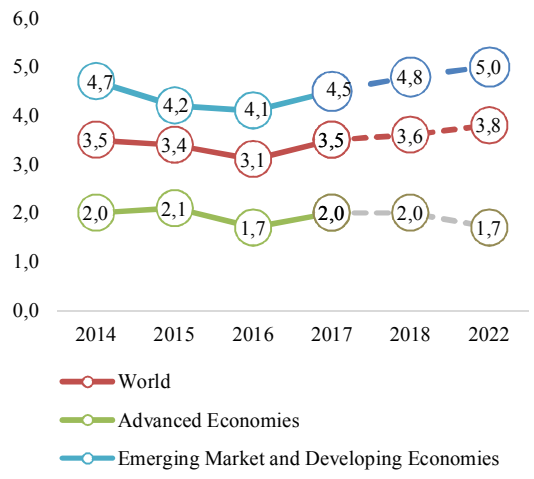
Relative revival is expected to linger in the euro zone in response to the accommodative fiscal policy, favorable financial conjuncture, cheap euro and fiscal expansion in the USA. On the other hand, uncertainties, like a number of upcoming critical elections, and future relations with the UK expose the economy to potential risks.

The UK economy is forecast to grow by 2% in 2017 and 1.5% in 2018. Japan is expected to grow by 1.2% in 2017 due to high net exports.

Economic growth outlook for European DGCs is high for 2017. Growth in this peer group is expected to remain at 3% in 2017 and increase to 3.3% in 2018. Growth in Turkey is forecast to reach 2.5% in 2017 due to high net exports and fiscal accommodation.

Economic growth in DGCs is predicted to increase to 4.5% in 2017 and to 4.8% in 2018 (4.1% in 2016).

Graph 8. Global economic growth, annual



Source: IMF, Global Economic Outlook, April, 2017

This growth is driven by commodity exporters that left behind acute crisis and reforms when commodity prices slumped and are stabilizing and, stable growing India. Relative slowdown in Chinese growth reduces total growth pace of this peer group countries.

Forecasts related to trade partners of Azerbaijan y/y improved. Non-oil export weighted growth on them is expected to stand at 1.7% in 2017. Russia is expected to grow to 1.4%. To note, the country in question slacked by 3% over the previous 2 years. High demand in Russia due to

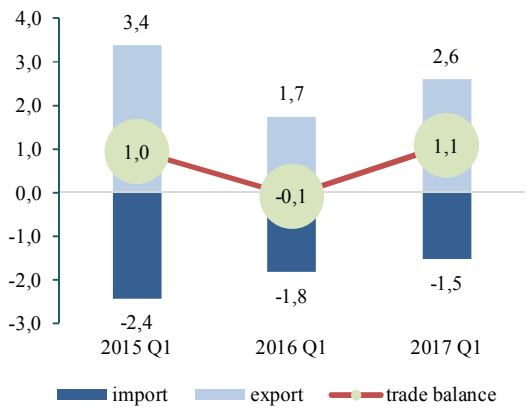
high confidence in the economy, improving financial environment and rising oil prices contribute to economic revival, likely to spread to other countries in the region through investment and trade channels.

1.2 Azerbaijani external sector developments

High global oil prices, relatively improved economic situation in partner countries as well as the import substitution and export promotion policy weighed on the foreign economic position of Azerbaijan.

According to the State Customs Committee (SCC), foreign trade turnover amounted to USD 4.1 billion: exports USD 2.6 billion and imports USD 1.5 billion. Import y/y decreased by 17% and export increased by up to 50% resulting in trade surplus (USD 1.1. billion).

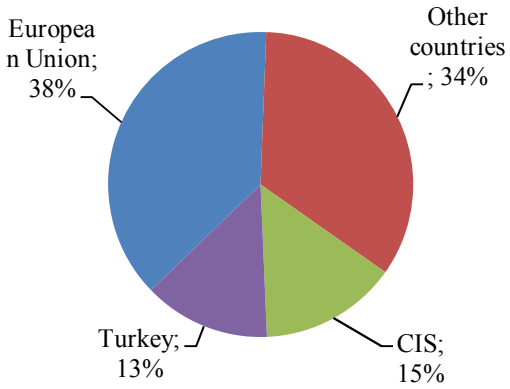
Graph 9. Trade balance, USD bn.



Source: SCC

Azerbaijan traded up with 149 countries.

Graph 10. Main trade partners, 2017 Q I, %



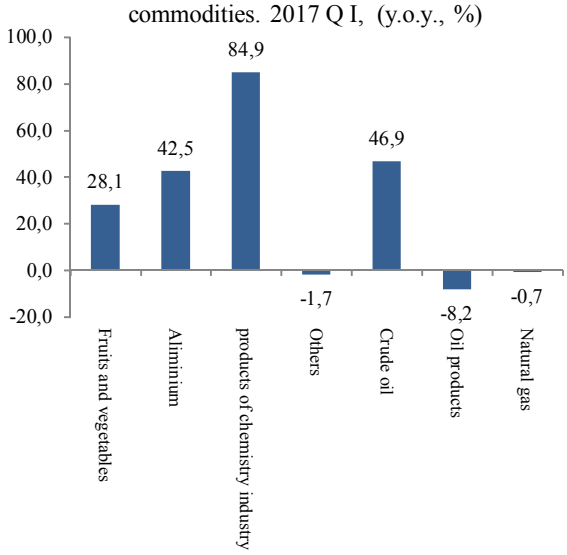
Source: SCC

EU countries account for 38% of trade turnover: Italy 39%, Germany and Portugal 12%, France 8%.

CIS countries account for 15% of trade turnover: Russia 63%, Ukraine 23%.

Other countries account for 39% of trade ties: China 20%, Taiwan 12%, Israel 11% and Georgia 9%.

Graph 11. Change in export of commodities. 2017 Q I, (y.o.y., %)



Source: SCC

Export of commodities increased by 49% mainly due to the oil sector, which takes a considerable share of exports. Exports increased by 46.9% on crude oil.

Exports of fruits and vegetables, aluminum, and chemical products posted growth: fruits and vegetables 28.1%, aluminum 42.5%, and products of chemical industry 84.9%.

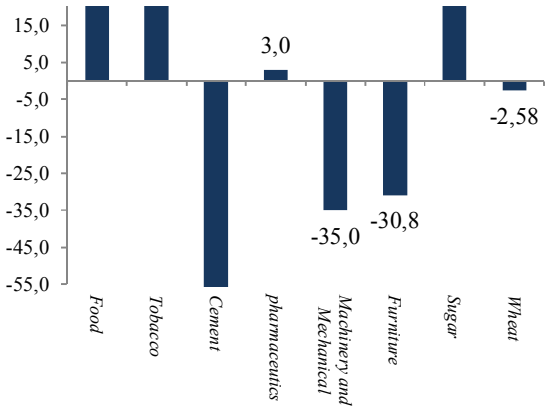
Key export partners were Italy (20.7%), Turkey (11.8%), Portugal (6.9%), Taiwan (6.5%), and Israel (5.7%).

Import of commodities decreased by 17%, and import on the public sector dropped by 23.4%.

Russia accounts for 19.7%, Turkey 16.1%, China 9.8%, Germany 4.9%, the USA 4.9%, Italy 4.1% and Great Britain 3.7% of imported products.

Imports increased on food products, tobacco, wood products, while it decreased on cement, machinery, vehicles and spare parts and furniture.

Graph 12. Change in export of products, 2017 Q1, (y.o.y.), %

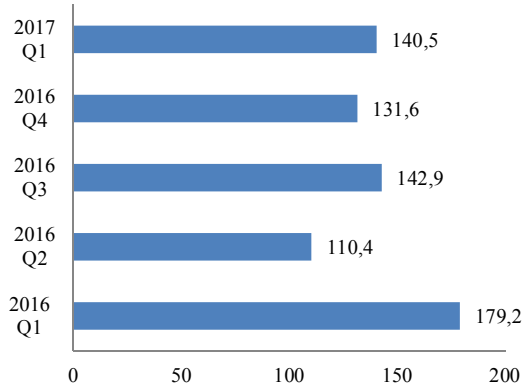


Source: SCC

The economic situation in trade partners affected dynamics of remittances to the country along with

non-oil exports. According to initial data, remittances constituted USD 140.5 million over three months.

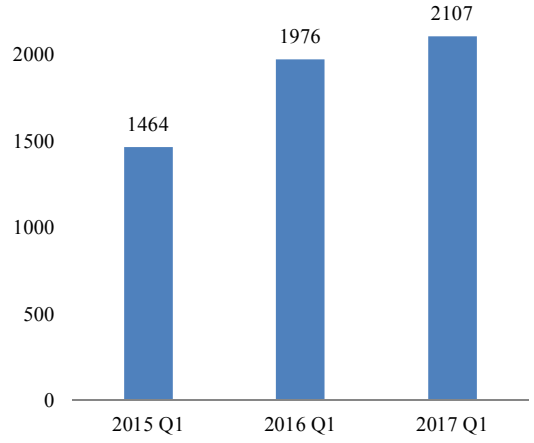
Graph 13. Inflow of remittances, m $



Source: CBA

During the given period FDI inflows by foreign enterprises and organizations continued too. According to the SSC, direct investments from foreign sources amounted to AZN 2.1 billion equivalent (66.2% of total investments). The growth rate of FDIs was 6.6%.

Graph 14. Foreign investments, m manat



Source: SSC

Investors from Great Britain, Turkey, Russia, Iran, the USA, Malaysia, Iran and Sweden account for major part of investments to fixed capital stock among foreign countries and international organizations.

Strategic foreign exchange reserves were maintained at a critical level. As of end-Quarter I, 2017 they sufficed to cover 28 month import of goods and services and exceeded the sovereign debt by 4 times.

II. MACROECONOMIC PROCESSES IN AZERBAIJAN

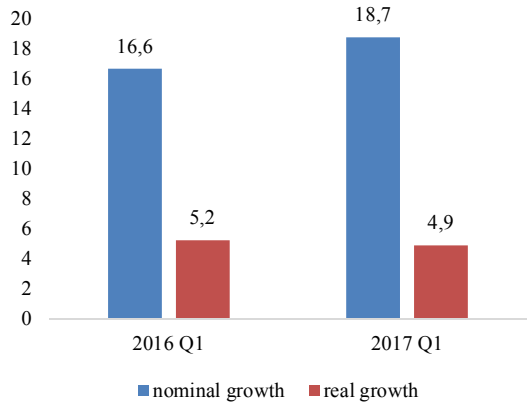
2.1. Aggregate domestic demand

Economic growth was mainly driven by domestic demand as before.

According to the SSC, ***final consumption expenditures*** y/y increased by 18.7% in nominal terms, while the real growth rate of consumption expenditures was 4.9%.

The nominal size of final consumption expenditures amounted to AZN 9.9 billion, 87.2% of household income. Average consumer purchased on average AZN 347.8 worth of commodities and services monthly (y/y rise AZN 41.3).

Graph15. Dynamics of final consumption over previous year, %,



Source: SSC

The size of goods and services sold in the consumer market to meet consumer demand increased by 1% to AZN 10.1 billion.

Retail trade turnover increased by 1.6% to AZN 7.9 billion. Retail trade turnover on non-food products amounted to AZN 3.9 billion.

Consumers spent 51% of their funds on food, beverage and tobacco at trade outlets.

Table 1. Share of spending items in trade outlets over 3 months of 2017, in %

Spending item	Share, %	
	2016 Q1	2017 Q1
Food products, beverage and tobacco	50.5	51

Knitwear, clothing and shoes	16.9	17.7
Electric appliances and furniture	6.3	6.1
Computers, telecommunication equipment and others	0.8	0.8
Pharmaceuticals and medicals	1.3	1.3
Fuel	5.8	4.9
Other non-food stuff	18.4	18.2

Source: SSC

Average consumer monthly purchased on average AZN 138.8 worth of food, beverage and tobacco and AZN 133.6 worth of nonfood items for private consumption in retail trade.

A portion of non-food products was purchased via e-trade. Purchases via e-trade network increased by 1.7 times (y/y).

Catering turnover rose by 0.6%, and paid services to the population fell by 1.4%.

Consumer demand was driven by the rise in population's nominal income. In January – March, 2017 population's money income increased by 6.7% in nominal terms. Per capita income increased by 5.5%, while population's disposable income increased by 6.9% to AZN 10.4 billion.

Nominal average monthly salary y/y increased by 5.9% to AZN 499.9 in January – February.

Bank loans to households, one of the components of consumer demand, dropped by 7.9%. The retail consumer lending portfolio constituted AZN 5.4 billion.

The population channeled AZN 318 million (2.8%) of income to savings.

Government expenditures were one of the critical factors of domestic demand. According to the Ministry of Finance of the Republic of Azerbaijan, state budget expenditures amounted to AZN 3.9 billion[1].

Following the economic classification 41.8 % (AZN 1636 million) of state budget expenditures were channeled to social spending

[1] *Source: http://www.maliyye.gov.az/*

(the salary fund, pension and social allowances, drugs and food), y/y rose 14.6% or AZN 209 million.

Investment expenditures. Investment to the economy y/y increased 3% to AZN 3.2 billion. AZN 2.2 billion worth of investments were channeled to the oil, while AZN 968 million were channeled to the non-oil sector. Public sector accounts for 25.4%, and private sector accounts for 74.6% of total investments.

33.8% of funds channeled to fixed capital stemmed from domestic, while 66.2% from foreign sources.

Table 2. Investment sources, %

	2016 Q1	**2017 Q1**
Funds of enterprises and organizations	85.7	75.2
Bank loans	6	10.6
Budget funds	4.6	8.5
Off-budget funds	0.6	0.6
Population's own funds	3	4.7
Other foods	0.1	0.4

Source: SSC

Funds of entities and organizations prevailed in total investments (75.2%).

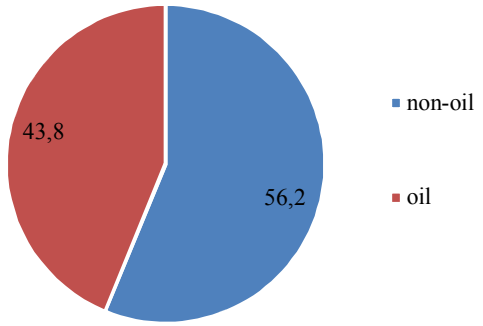
2.2. Aggregate supply and employment

The economic growth changed accordingly to aggregate demand.

Economic growth. According to the SSC, GDP made up AZN 15.2 billion in nominal terms. Per capita GDP made AZN 1570.

The mining industry extracted 9.5 million tons of crude oil, and 4.8 million m3 of natural gas. Oil extraction dropped by 9.9%, while gas extraction rose by 0.9%.

Graph 16. Sectoral economic growth, %

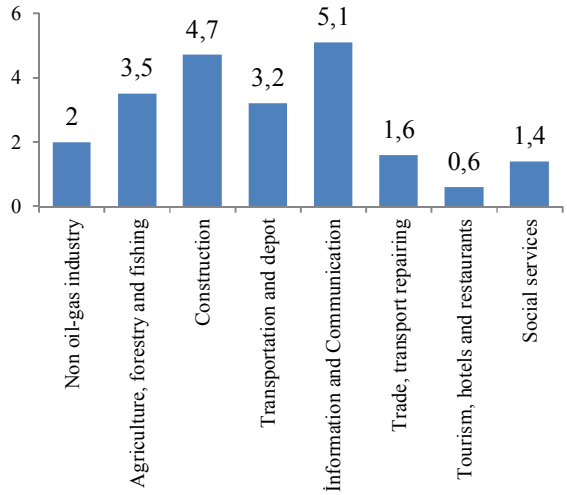


Source: SSC

The value added in the non-oil sector y/y increased by 2.4% to AZN 8.6 billion (56.2% of GDP).

All areas of the non-oil sector posted growth.

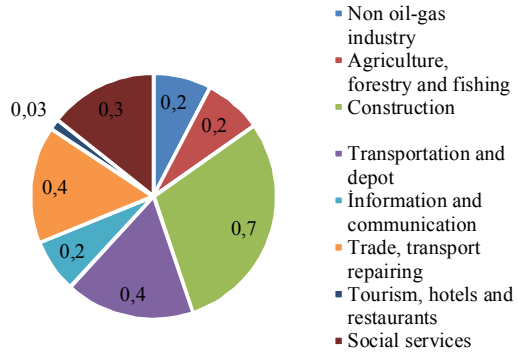
Graph 17. Sectoral growth of economy, to corresponding period of previous year, %



Source:SSC

The non-oil sector grew by 2%.

Graph 18. Share of the sectors in the growth of non oil-gas sector,%

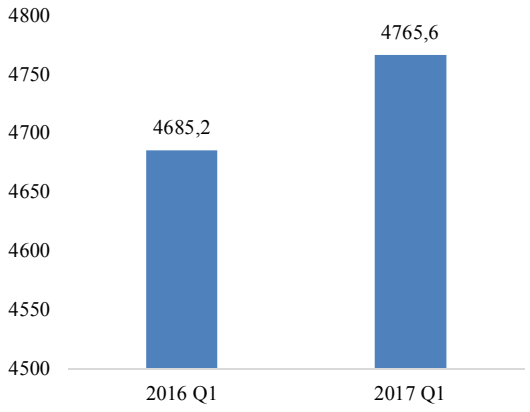


Source: SSC

Employment. As of the end-period the economically active

population was numbering 5018.2 thousand persons. The number of the population involved in jobs increased by 80 thousand persons (95% of economically active population).

Graph 19. Employed persons, end of period, thousand



Source: SSC

According to the SSC, the number of hired labor forces y/y increased by 1.4% to 1515.7 thousand persons as of March 1, 2017.

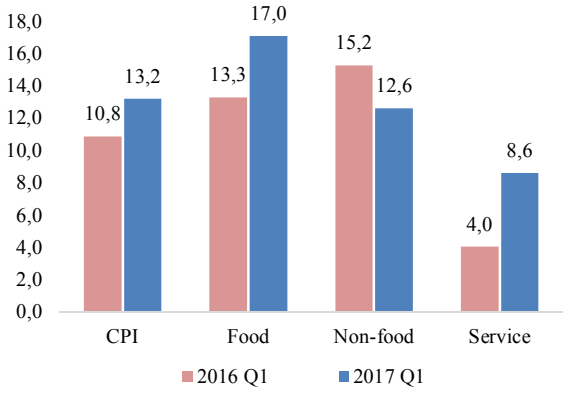
Of the total wage-paid work employed by enterprises and organizations, 22.2 % were involved in production, including construction (6.1 %), processing (6.8 %), mining 92.3%) and agriculture (3.1%).

2.3. Inflation

Average monthly growth rate of prices was prone to declining.

Consumer Price Index (CPI). According to the SSC, the average annual inflation rate was 13.2%. The CPI components - food prices rose by 17%, non-food prices by 12.6%, and services by 8.6% on an annual basis.

Graph 20. Average annual inflation, %

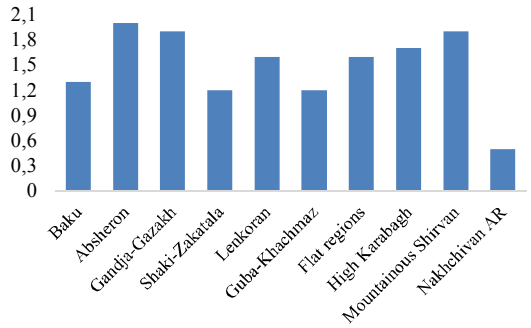


Source: SSC

7.2 p.p. of average annual inflation goes to the share of food, 3.3% to non-food and 2.7 p.p. to services.

Monthly inflation was prone to declining. Inflation in February and March (1.6%) slightly slowed down relative January (2.3%). Monthly inflation in March across regions was close to monthly inflation throughout the country.

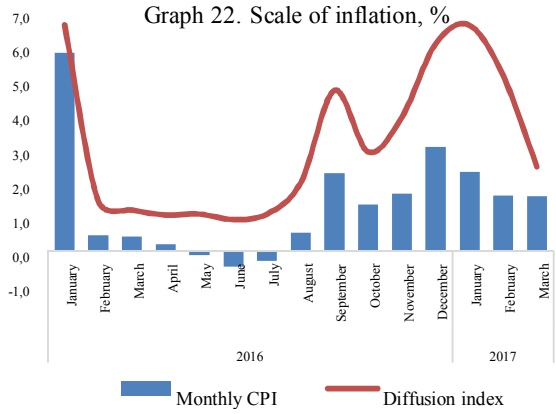
Graph 21. Regional inflation in March, y/y. %



Source: SSC

The diffusion index - a measure of change dynamics pertaining to the number of goods and services with rising and falling prices in the basket of consumer goods - had a downward trend month by month.

Graph 22. Scale of inflation, %



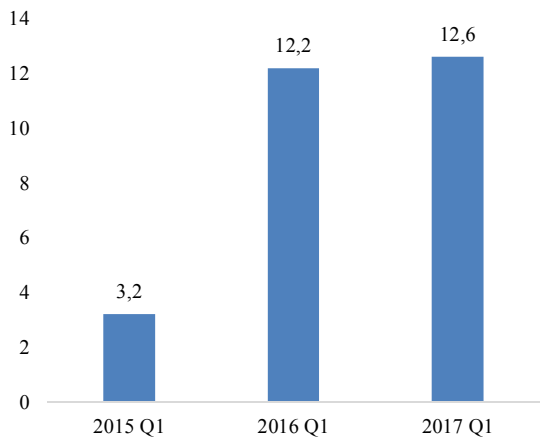
Source: SSC, CBA estimations on the basis of SSC data

Overall, prices of 6 out of 521 items of goods and services declined and remained unchanged for 55 items.

The NEER, inflation expectations, swings in global commodity prices, inflationary processes in partner countries, regulation of prices by the government and domestic demand influenced average annual price changes.

The annual core inflation averaged at 12.6 %, if to skip the items of goods and services, as well as seasonal agricultural products the prices/values of which are regulated by the government.

Graph 23. Annual average core inflation, %



Source: SSC

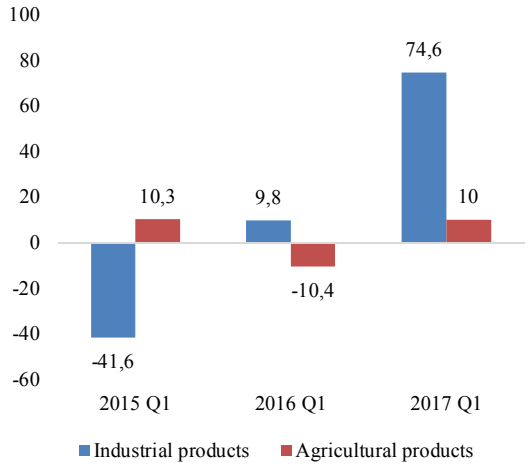
As it was noted, expectations also contributed to swings in consumer prices. Inflation expectations overall heightened under certain cost factors, still certain shortfalls and downward trends were in place. Regular RSM by CBA revealed that price expectations fell on home appliances and furniture and rose on vehicles for upcoming 3 months. They hiked in services – transportation, hotel, healthcare and tourism due to higher demand and dropped on all segments in processing.

According to the SSC, the ***Producer Price Index*** was higher on industrial products. The IPPI y/y increased by 74.6% mostly due to high prices in mining (83.3%). Prices increased by 83.7% in oil and gas extraction and 35% in metal extraction.

The PPI rose by 38.3% in processing industry, and 58.1% for electricity and steam generation, gas

production, distribution and delivery. The highest price hike in processing was in tobacco products and knitting industry (46%), oil processing (50%), the chemical industry (51%) and metallurgy (65%).

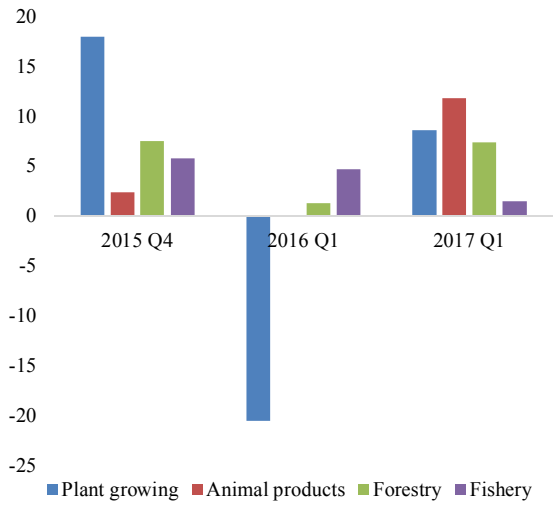
Graph 24.Annual average change in PPI, %



Source: SSC

Agricultural output rose by 10% in PPI driven by price hikes for animal products (11.8%). Prices rose by 7.4% on forestry and 1.5% on fish and fishery products. Prices for plant growing products hiked for the first time over recent four quarters (8.6%) due to price rise in perennials (18.5%).

Graph 25.Agricultural price indices, annual average, %



Source: SSC

Tariffs for transportation services y/y increased by 10.7%, attributable to 12.4% rise in prices for cargo services. Although prices for passenger transportation rose by 3.6%, prices for communication and postal services remained unchanged.

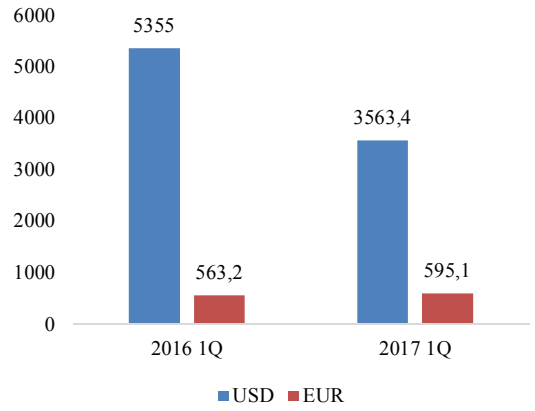
III. THE MONETARY AND EXCHANGE RATE POLICY

3.1. The FX market and the exchange rate of manat

The exchange rate of manat conformed to BoP dynamics on the backdrop of higher exchange rate flexibility.

The FX market diminished in size y/y; USD denominated transactions decreased by 33.5%, while EUR transactions increased by 5.7%.

Graph 26. Turnover in FX market, m. currency unit



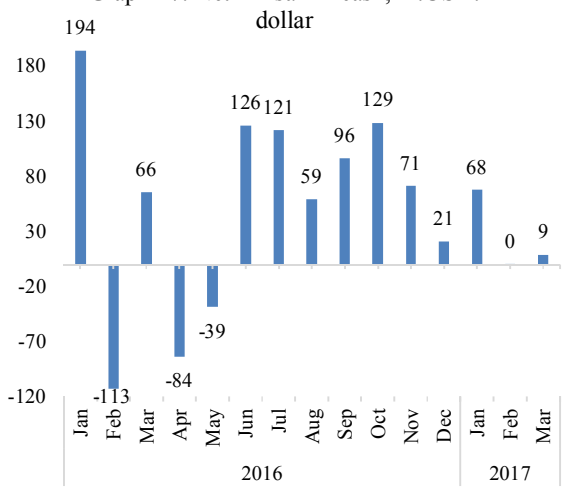
Source: CBA

Transactions in USD accounted for 82.2%, while other currencies 17.8 % of transactions in the FX market.

The Interbank FX market accounts for 28.1%, while the intrabank FX market accounts for 71.9% of currency transactions. 51.7% of USD transactions on the interbank FX market was carried out to control banks' currency positions. 95% of transactions on the intrabank FX market comprise currency sales to legal entities.

The foreign exchange cash segment also downsized. Net cash sold by banks in USD y/y ($147 million in QI, 2016) decreased by 2 times ($77 million in QI, 2017).

Graph 27. Net FX sail in cash, m.USD. dollar



Source: CBA

Complex measures to maintain macroeconomic and financial

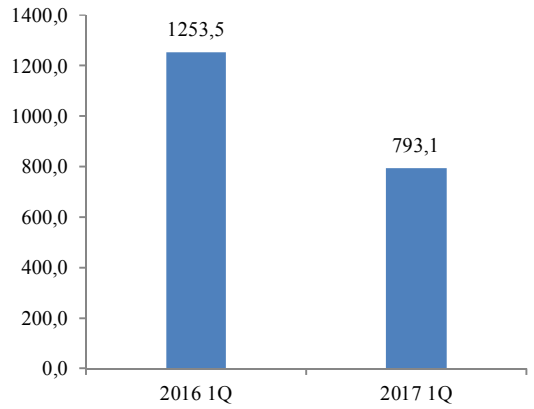
stability, policy decisions to ensure macroeconomic resilience made the exchange rate more flexible. The CBA changed the currency auction mechanism to make the exchange rate more flexible from 12 January 2017 onward. In harmony with these changes auctioned currency is sold at prices quoted by market participants. In other words, the auction completes with the sale of currency from the bank offering the highest to the one offering the lowest price.

The CBA holds currency auctions several times a week upfront informing market participants on auction parameters via Bloomberg terminal.

The CBA scrapped the requirement for banks to buy or sell cash and cashless foreign currency at a range of no more than 4% from the officially set exchange rate on 12 January 2017.

The Bank held $793.1 million worth of total 24 currency auctions to organize currency sales of the SOFAZ (36.7% down y/y).

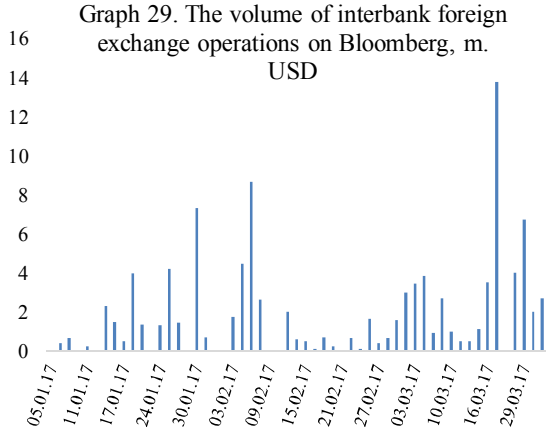
Graph 28. Oil Fund's FX sells, m. USD



Source: CBA

On non-auction days the interbank FX market operated on the Bloomberg platform. The size of out-of-auction interbank FX market transactions amounted to $102.5 million.

Graph 29. The volume of interbank foreign exchange operations on Bloomberg, m. USD

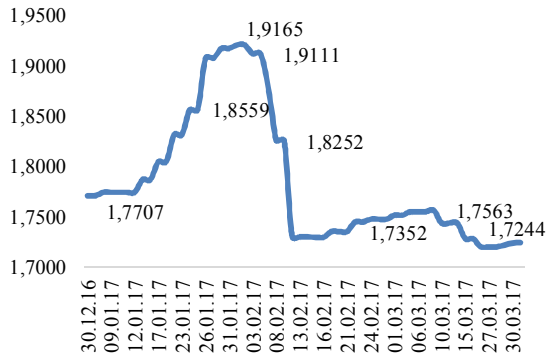


Source: CBA

The official exchange rate of manat was set on the basis of the

exchange rate on interbank transactions (both auction and off-auction). Manat reacted to supply and demand behavior in the FX market with several waves of appreciation and depreciation. The USD appreciated in January and the first half of February and started to depreciate slightly from the second half of February. Whereas as of end-2016 the USD/AZN exchange rate stood at AZN 1.7707, it peaked to AZN 1.9200 on 01.02.17 and plunged to AZN 1.7200 on 27.03.17 as of end-Quarter I, 2017 the USD depreciated by 2.6% against AZN. Average daily USD/AZN exchange rate was AZN 1.7848.

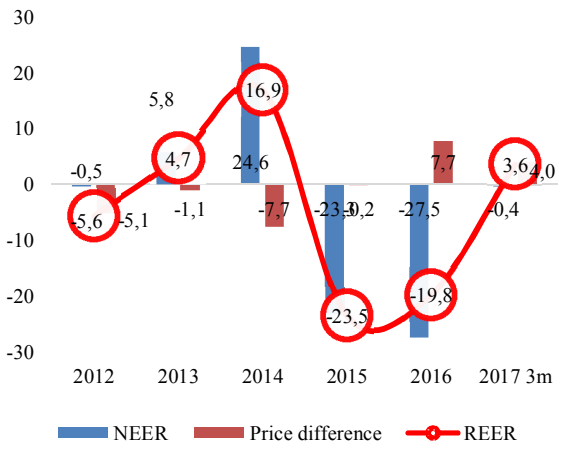
Graph 30. Exchange rate USD/AZN



Source: CBA

Bilateral exchange rates affected multilateral exchange rates. Total trade weighted REER of manat on the non-oil sector appreciated 3.6%.

Graph 31. Dynamics in REER, (2000=100)



Source: CBA

0.4% depreciation of the NEER has a downward effect, while inflation differences in partner countries has an upward effect on the REER.

The new exchange rate regime allows the CBA to maintain a required level of reserves. As of 31 March 2017 CBA's foreign exchange reserves stood at USD 4.433 billion, exceeding internationally set sufficiency standards (coverage of three-month import of goods and

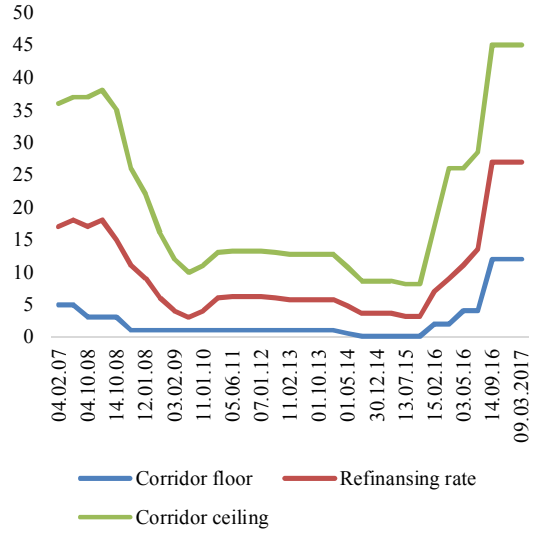
services, ratio of national currency to money supply).

3.2. Monetary policy tools

Monetary policy tools were applied in light of inflation and money supply targets. The CBA endeavored to apply monetary policy tools in the preventive mode given the fact that monetary policy decisions affect inflation with time lags.

The Bank reviewed interest rate corridor parameters on liquidity operations once over the period and the Management Board unanimously decided to leave parameters of the interest rate corridor and the refinancing rate unchanged at its 10 March 2017 meeting in view of initial positive macroeconomic trends and new expectations. The refinancing rate surpassing annual inflation contributed to price stability allowing real interest rates to be positively zoned.

Graph 32. Parameters of interest rate corridor,%

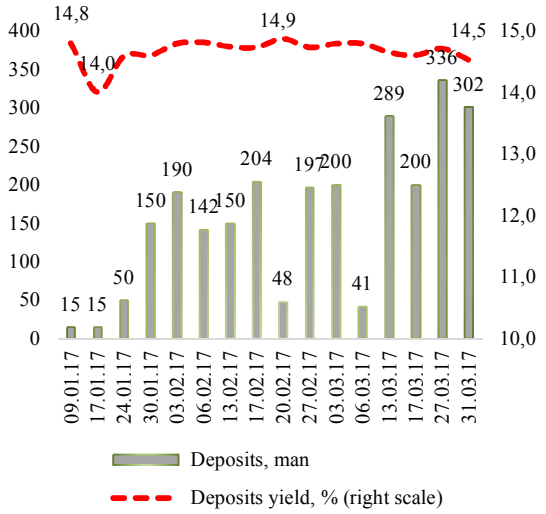


Source: CBA

The Bank used sterilizations more actively and held 16 deposit auctions to attract available funds in the national currency and 12 auctions to place notes. Maturity of deposit operations is 14 days, while notes are placed for the period of 28 days. As of end-quarter total outstanding amount of funds attracted through deposit auctions and placement of notes made up AZN 706.9 million – AZN 637.8 worth of funds attracted via deposit operations and AZN 69.1

million attracted via placement of notes.

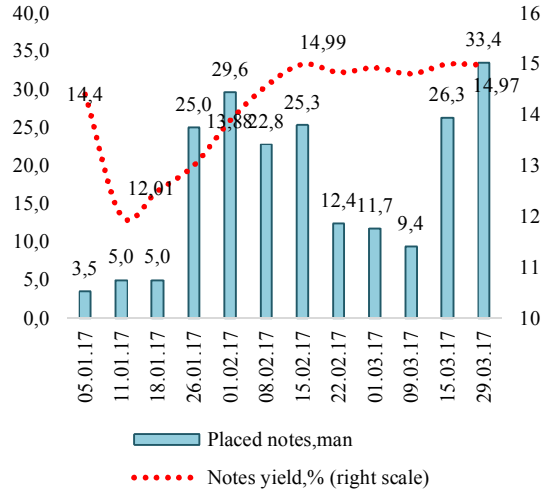
Graph 33. Volume and yield of Central Bank's deposits



Source: CBA

Supply exceeded demand by 18% (at some auctions multifold), that displays that there is excess liquidity available in the banking system. Balance of banks' correspondent accounts with the CBA dropped by 32.8% (AZN 293.1 million) due to sterilizations. The Bank averted additional pressure of banks' excess liquidity on the exchange rate.

Graph 34. Volume and yield of notes placed by Central Bank



Source: CBA

Deposit auctions and placement of short-term notes both sterilize excess money supply and contribute to the development of the money market, improvement of monetary policy's operational framework and evolution of the interbank market.

To note, deposit operations and placement of notes – as open market operations – are conducted at interest rates fluctuating between the interest rate floor and the refinancing rate (currently 12%-15%). Deposits were attracted at 14%-14.8%, and notes were placed at 12.01%-14.99%.

The reserve requirement was left unchanged.

Table 3. The reserve requirement, %

	Foreign currency denominated liabilities	*Liabilities in manat and precious metals*	*Funds attracted from non-resident financial sector*
01.05.2011	2	2	2
01.07.2011	3	3	3
01.08.2014	2	2	2
01.03.2015	0.5	0.5	0.5
30.12.2015	0.5	0.5	0.5
03.03.2016	1	0.5	0

Source: CBA

The reserve requirement on liabilities in the national currency and precious metals stood at 0.5%, 1% on foreign currency liabilities, and 0% on liabilities to the non-resident financial sector and settlements with international financial institutions.

Monitoring findings display that banks' cumulative balances on correspondent accounts with the CBA considerably exceeded amounts to be maintained as required reserves every month of the period.

Reserve requirements were applied on the averaging basis, which, in its turn, contribute to the development of the interbank market and allow banks to more flexibly manage liquidity.

3.3. Money supply

The CBA controlled money supply channels in light of inflationary factors making the money base the key operational anchor of the monetary policy.

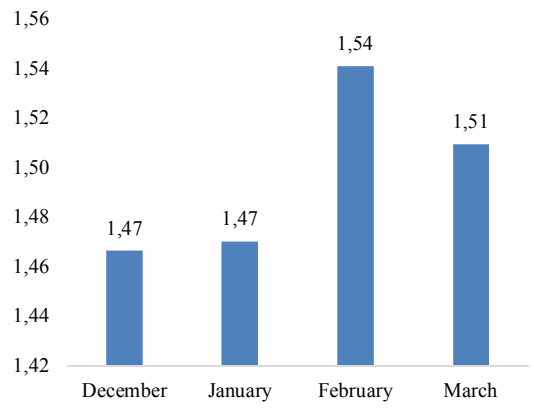
CBA's liquidity operations rested upon the money base target to regulate excess money supply channels, avert additional pressures on the exchange rate meanwhile preventing price hikes.

Money base in manat decreased by 7.4% to AZN 7277.5 million as of the end-quarter. Drivers of the money base - cash money supply in circulation (cash outside the banking system and in bank vaults) decreased by 4.3%, while correspondent accounts in manat dropped by 32.8%.

Money base in manat receded more than money supply relative to the early year, attributable to the high money multiplier (the ability to create money) of the banking system.

The money multiplier in manat increased by 2.7% to 1.51.

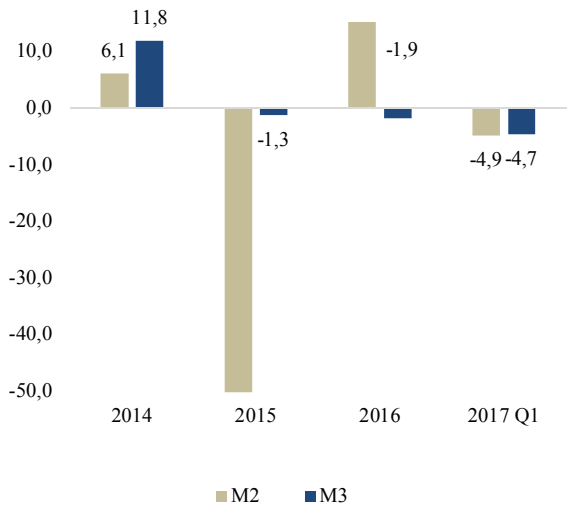
Graph 35. Money multiplier



Source: CBA

Broad money supply in manat (M2) decreased by 4.9% to AZN 10981.9 million.

Graph 36. Change in money supply, %



Source: CBA

Cash stock, savings of individuals and deposits of legal entities in the structure of money supply in manat (M2) performed differently; cash stock decreased by 3.6%, savings of individuals decreased by 2.4%, and deposits of legal entities decreased by 7.6%.

Table 4: Money aggregates, m. manat

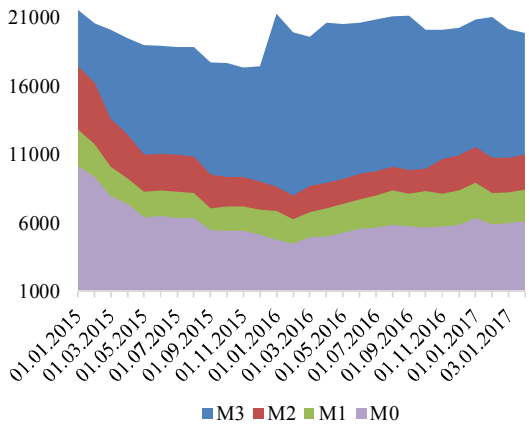
	01.01.16	01.01.17	01.04.17
M0	4 776	6 377	6 145
M1	6 897	8 960	8 411
M2	8 678	11 546	10 982
M3	21 287	20 890	19 903

Source: CBA

Term deposits in manat decreased by 0.6%, while demand deposits decreased by 12.3%.

Broad money supply (M3) decreased by 4.7% to AZN 19902.9 million as of the end-period.

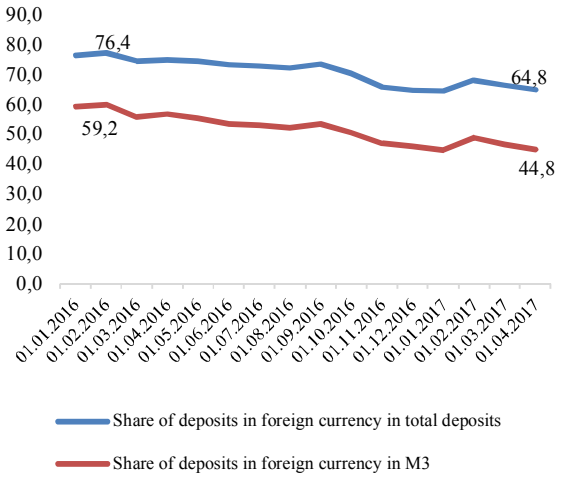
Graph 37. Dynamics of money aggregates, m. manat



Source: CBA

Dollarization of bank deposits underwent minor changes; savings and deposits in foreign currency accounted for 44.7% of M3 aggregate early year, and 44.8% as of the end-quarter.

Graph 38. Dollarization, %



Source: CBA

Whereas foreign currency denominated savings and deposits accounted for 64.4% of total savings and deposits early year, they made up 64.8% as of the end-quarter.

Savings of individuals in manat decreased by 2.4%, and their savings in a foreign currency decreased by 8.4%. Accordingly, dollarization of deposits of individuals decreased to 78.6% (79.6% early year).

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