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## Book

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## **The national currency rate of Azerbaijan: after the presidential elections**

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## **Abstract**

The subsequent destiny of the national currency's (manat) exchange rate (after the presidential election in the Republic of Azerbaijan, April 11, 2017) is one of the main topics of public debate in recent weeks, as well as the main focus of the mass media. The main issue that disturbs public opinion is that following the election, changes in the exchange rate policy of state institutions can cause another devaluation of the manat. Given the relevance of the topic as the election date approaches, the Center for Economic and Social Development has decided to re-evaluate the prospects for the national currency's exchange rate. It should be noted that, in line with the economic conjuncture, the Center regularly publishes expert advisory materials on the "manat" exchange rate.

## **Introduction**

One of the most severe consequences of global conjuncture for the economy of Azerbaijan since the end of 2014 has been the more than twofold depreciation of the national currency (against the US dollar). As a result, all social groups, including business people, faced serious losses, and there was a high rate of import infection in the country, which had a direct impact on the social welfare of the population. In parallel, the debt of the population and businesses in foreign currency increased, which made the socio-economic situation even more difficult.

The sharp devaluation of the national currency, which steadily appreciated during the second decade of independence, led to the creation of an exchange rate risk syndrome in society. Both economic entities and citizens of the country are constantly living with this fear. As a result, exchange rate syndrome has become an important parameter of public decision-making.

Another important point is that the institutions responsible for the exchange rate policy have poor use of communication capabilities, poorly coordinated information, and sometimes even announcements which creates contradictory signals. As a result, the public reputation of the institutions implementing the exchange rate policy was shaken significantly.

Given the above mentioned reasons, the social concern is understandable. The purpose of the research is to strengthen the information provision in this area and to evaluate the perspectives for the national currency. Within the framework of the study, the current situation on foreign exchange markets (demand and supply), current trends of monetary, fiscal policy, external and internal factors, as well as temporary and fundamental factors were analyzed. In summary, the exchange rate forecast for the near and medium term is presented.

## I. Existing situation in foreign exchange markets

### 1.1. Dynamics of exchange rate of national currency.

An exchange rate risk in Azerbaijan was observed in the third quarter of 2014. As 92.4%<sup>1</sup> of Azerbaijan's state revenue comes from oil, the sharp drop in world oil prices that same year significantly decreased the foreign currency flow to the country. Thus, in 2013, when Azerbaijan exported oil, oil products and natural gas in the equivalent of \$ 22.2 billion, the corresponding figure for 2015 was \$ 9.8 billion, which translates to a 55.8% decline over two years<sup>2</sup>. Thus, a deficit in the balance of payments occurred<sup>3</sup>. As a result, a pressure on the "manat" on foreign exchange markets was formed lead to the currency being downgraded twice in 2015 (February 21, 2015<sup>4</sup>, December 21, 2015<sup>5</sup>). The process of depreciation of the national currency continued in the subsequent period and significant volatility on the foreign exchange markets was observed. In January 2017, the Central Bank announced a transition to a full floating rate regime and subsequently announced that the process was over in October<sup>6</sup>. In February-April 2017, the manat appreciated compared to the US dollar due to a number of factors: oil price hikes, shrinking foreign exchange markets, and declining imports. During the next 12 months (April / 2017-April / 2018), the exchange rate showed a stable dynamic (1 USD = 1.7 manat)<sup>7</sup>.

Apparently, no change has been made to the official exchange rate in recent months. Nevertheless, public concern is rising. The reasons for this are: the increase in the volume of currency sold by the State Oil Fund of the Republic of Azerbaijan in currency auctions held by the Central Bank in January, compared with February of the current year; a significant increase

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<sup>1</sup> Dövlət Gömrük Komitəsi, "Azərbaycan Respublikası Xarici Ticarətinin Gömrük Statistika - 2014", baxış tarixi: 04.04.2018, səh: 12

[http://customs.gov.az/modules/pdf/pdfolder/27/FILE\\_13E5D9-5D24EC-989630-28E2C5-2920CB-BF089C.pdf](http://customs.gov.az/modules/pdf/pdfolder/27/FILE_13E5D9-5D24EC-989630-28E2C5-2920CB-BF089C.pdf)

<sup>2</sup> Dövlət Gömrük Komitəsi, "Azərbaycan Respublikası Xarici Ticarətinin Gömrük Statistika - 2015", baxış tarixi: 04.04.2018, səh: 12

[http://customs.gov.az/modules/pdf/pdfolder/28/FILE\\_5ACDFE-6ABB50-5D07D4-9B4D06-DD4FB9-22847A.pdf](http://customs.gov.az/modules/pdf/pdfolder/28/FILE_5ACDFE-6ABB50-5D07D4-9B4D06-DD4FB9-22847A.pdf)

<sup>3</sup> Mərkəzi Bank, №01(214), Statistik Bülleten-01/2018, səh: 7

[https://www.cbar.az/assets/4523/STAT%C4%B0ST%C4%B0K\\_BULLETEN\\_2018\\_YANVAR.pdf](https://www.cbar.az/assets/4523/STAT%C4%B0ST%C4%B0K_BULLETEN_2018_YANVAR.pdf)

<sup>4</sup> Mərkəzi Bank, Azərbaycan Respublikası Mərkəzi Bankının bəyanatı, 21.02.2015

<https://www.cbar.az/releases/2015/02/21/statement-of-the-central-bank-of-the-republic-of-azerbaijan/>

<sup>5</sup> Mərkəzi Bank, Azərbaycan Respublikası Mərkəzi Bankının bəyanatı, 21.12.2015

<https://www.cbar.az/releases/2015/12/21/statement-of-the-central-bank-of-the-r-azerbaijan/>

<sup>6</sup> Report.az, "Mərkəzi Bank: Tam üzən məzənnə rejiminə keçid artıq təmin olunub", 03.10.2017

<https://report.az/maliyye/merkezi-bank-tam-uzen-mezenne-rejimine-kecid-artiq-temin-olunub/>

<sup>7</sup> Mərkəzi Bank, AZN rates, USD/AZN, baxış tarixi: 04.04.2018

<https://en.cbar.az/other/azn->

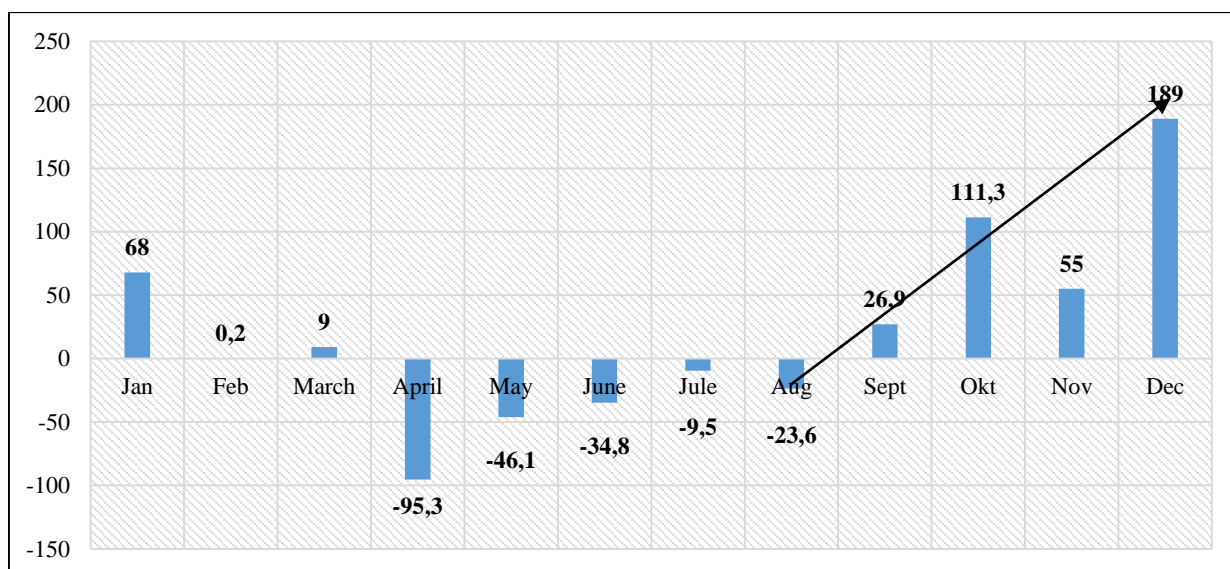
<rates?act=betweenForm&from%5Bday%5D=4&from%5Bmonth%5D=1&from%5Byear%5D=2017&to%5Bday%5D=4&to%5Bmonth%5D=4&to%5Byear%5D=2018&rateID=usd>

in imports in January-February compared to the corresponding period of the previous year; and mass media's as well as local exports focus on the topic. Note that the points mentioned in the following sections will be discussed more widely.

## 1.2. Demand and supply in foreign exchange markets

It is clear from the Central Bank's report that starting from September 2017, the net sale of cash foreign currency began to increase (see Figure 1). Apparently, in the first months of the fixed exchange rate, the supply of cash on currency markets increased. Starting from September the demand position has increased again. The net cash foreign currency sales in the last month of the year increased 7 times to \$ 189 million compared to September.

**Figure 1: Net cash foreign currency sale for 2017 (million USD)**



**Source: Central Bank of the Republic of Azerbaijan, 2018**

In general, as a result of exchange rate stability, sales of net currency decreased 17 times in 2017 compared to 2016. The volume of foreign currency sales of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) in 2017 was 26.3% less than in the previous year<sup>8</sup>.

Starting from the beginning of 2018, demand growth on the currency markets has accelerated. As a result, SOFAZ increased the offer on currency auctions. According to the fund, the volume of monthly foreign exchange sales in the first quarter of 2018 was as follows:

<sup>8</sup> Central Bank Of The Republic Of Azerbaijan, "Monetary Policy Review, January – December 2017", baxış tarixi: 05.04.2018, səh: 21-22  
[https://en.cbar.az/assets/4519/MPR\\_%C4%B0V\\_rub\\_2017\\_english.pdf](https://en.cbar.az/assets/4519/MPR_%C4%B0V_rub_2017_english.pdf)

*January / 2018: \$ 299.1 million<sup>9</sup>*

*February / 2018: \$ 364.1 million<sup>10</sup>, an increase compared to the previous month: 21.7%*

*March / 2018: \$ 647 million<sup>11</sup>, an increase compared to the previous month: 77.7%*

Thus, for the first three months of the current year the total volume of SOFAR's foreign exchange sales amounted to 1310.2 million US dollars, which is 65.1% or \$ 516.8 million more than for the corresponding period of the previous year. Noting that in January-March 2017, the Fund sold a total of \$ 793.4 million in foreign currency<sup>12</sup>. The increase in demand for foreign currency creates certain pressure on the exchange rate. In such a situation, the exchange rate stability depends on volume of the currency supply.

The main source of foreign currency supply in Azerbaijan is SOFAZ. The Fund's revenues are in foreign currencies, but the majority of expenditures are done in the national currency. In order to fulfill obligations, the Fund is selling foreign currency in auctions. The expenditures of the Oil Fund in national currency for 2018 are 9.5 billion manats<sup>13</sup>. This is 50.8% more than in the previous year. Thus, in 2017, the fund's expenditure on the "manat" was 6.3 billion<sup>14</sup>. If we take the current account with the current rate, the Oil Fund should sell foreign currency at approximately \$ 5.59 billion in trades during the year, with a monthly nominal value of \$ 465 million in 2018. This is 55% more than in 2017 (the Oil Fund's foreign exchange sales for the year 2017 was \$ 3.6 billion<sup>15</sup>). Thus, the increase in the amount of the offer on foreign exchange auctions is a factor that weakens the pressure on the "manat" in order to execute increased expenditure commitments of SOFAR.

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<sup>9</sup> State Oil Fund of the Republic of Azerbaijan, "Statement on foreign exchange sales", 02.02.2018

[http://www.oilfund.az/en\\_US/news/1362/100/Valyuta-satisi-ile-bagli-aciqlama.asp](http://www.oilfund.az/en_US/news/1362/100/Valyuta-satisi-ile-bagli-aciqlama.asp)

<sup>10</sup> State Oil Fund of the Republic of Azerbaijan, "Statement on foreign exchange sales", 05.03.2018

[http://www.oilfund.az/en\\_US/news/1370/100/Statement-on-foreign-exchange-sales.asp](http://www.oilfund.az/en_US/news/1370/100/Statement-on-foreign-exchange-sales.asp)

<sup>11</sup> State Oil Fund of the Republic of Azerbaijan, "Statement on foreign exchange sales", 05.04.2018

[http://www.oilfund.az/en\\_US/news/1372/100/Statement-on-foreign-exchange-sales.asp](http://www.oilfund.az/en_US/news/1372/100/Statement-on-foreign-exchange-sales.asp)

<sup>12</sup> State Oil Fund of the Republic of Azerbaijan, "News archive", baxış tarixi: 05.04.2018

[http://www.oilfund.az/?page=xeberler-arxivi&hl=en\\_US&date=2017](http://www.oilfund.az/?page=xeberler-arxivi&hl=en_US&date=2017)

<sup>13</sup> State Oil Fund of the Republic of Azerbaijan, "SOFAZ 2018 budget approved", 29.12.2017

[http://www.oilfund.az/en\\_US/news/1351/100/SOFAZ-2018-budget-approved.asp](http://www.oilfund.az/en_US/news/1351/100/SOFAZ-2018-budget-approved.asp)

<sup>14</sup> State Oil Fund of the Republic of Azerbaijan, "SOFAZ revenue and expenditure Statement for January-December 2017", 08.02.2018

[http://www.oilfund.az/en\\_US/news/1366/100/Azərbaycan-Respublikası-Dövlət-Neft-Fondunun-2017-ci-il-üezre-gelir-ve-xərclərinə-dair-məlumat.asp](http://www.oilfund.az/en_US/news/1366/100/Azərbaycan-Respublikası-Dövlət-Neft-Fondunun-2017-ci-il-üezre-gelir-ve-xərclərinə-dair-məlumat.asp)

<sup>15</sup> Central Bank Of The Republic Of Azerbaijan, "Monetary Policy Review, January – December 2017", baxış tarixi: 05.04.2018, səh: 22

[https://en.cbar.az/assets/4519/MPR\\_%C4%B0V\\_rub\\_2017\\_english.pdf](https://en.cbar.az/assets/4519/MPR_%C4%B0V_rub_2017_english.pdf)



## II. Global economic factors

### 2.1. Current price of oil on world markets and forecasts for the near future.

For Azerbaijan, which is rich in hydrocarbon resources, the national currency rate is shaped not by the background of local economic conjuncture, but rather by the impact of global challenges (world oil prices). Reforms with the aim of reducing oil dependence of the economy, including the manat, have not yet been solved. As a result, in the first two months of 2018, 88.9% of exports were composed of the sale of oil, oil products and gas. Thus, one of the key factors that should be considered when forecasting the exchange rate for the next months is oil price.

In the first quarter of this year, the world market price of oil is considered to be favorable for the exchange rate of the manat. Thus, the government forecasted a surplus in the balance of trade and the balance of payments with a benchmark of \$ 45 per barrel of oil. Over the past three months, the average market price of Azerbaijani oil was more than \$ 67 per barrel, or 48.8% more than the forecast. As a result, SOFAZ has gained an additional \$ 0.5 billion in revenues compared with the budget forecast [*see: Section 3.3: Changes in strategic currency reserves*]. Currently, this means more than the average monthly foreign exchange demand of Azerbaijan.

No significant change in price will occur in the coming months, according to forecasts by international organizations, for oil. Thus, the US Energy Information Administration predicts a price of \$ 62.13 per barrel of Brent oil in 2018<sup>16</sup>. According to the International Energy Agency's expectations, the price of Brent crude will be \$ 67 per barrel this year<sup>17</sup>. The World Bank recently updated its oil price forecast for October 2017. The organization believes that the average price for oil in 2018 will be \$ 56<sup>18</sup>.

It should be noted, however, that the increase in daily oil production and the number of operating wells in the US over the past few weeks, and the differences between key players in global trade (China and the US) will have a negative impact on oil prices<sup>19</sup>. However, the

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<sup>16</sup> U.S. Energy independent Administration, "SHORT-TERM ENERGY OUTLOOK", 06.04.2018  
<https://www.eia.gov/outlooks/steo/>

<sup>17</sup> International Energy Agency, "Oil market report", baxış tarixi: 07.04.2018  
<https://www.iea.org/oilmarketreport/omrpublic/>

<sup>18</sup> World Bank, "World Bank Commodities Price Forecast (nominal US dollars)", 26.10.2017, səh: 1  
<http://pubdocs.worldbank.org/en/678421508960789762/CMO-October-2017-Forecasts.pdf>

<sup>19</sup> Bloomberg.com, "Oil Trades Below \$63 as Investors Weigh U.S.-China Trade Tension", 09.04.2018  
<https://www.bloomberg.com/news/articles/2018-04-09/oil-holds-loss-as-crude-bulls-flee-on-u-s-china-trade-tension>

tension observed in international politics, especially in the Middle East, is likely to prevent a sharp decline in prices.

In general, analysis of the forecasts by international organizations shows that the probability of oil prices in 2018 being higher is more likely than according to the forecasts of the Azerbaijani government. This can lead to the formation of a positive conjuncture for the rate of the "manat".

## **2.2. Changes in exchange rates for major foreign trade partners of Azerbaijan**

One of the factors that affects the foreign exchange markets in Azerbaijan is the economic changes in the country's key foreign trade partners. The second largest foreign trade partner of Azerbaijan and the neighboring state, Turkey, saw a drop in its currency value in the first three months of this year by 7.3% (01.01.2018: 1USD = 3.77 TRY, 06.04.2018: 1USD = 4.066 USD<sup>20</sup>).

Factors such as Turkey joining the military operations in Syria and Iraq, the tense relations with the European Union and the United States may have a negative impact on the country's economy, including its national currency. Although higher oil price has formed a favorable condition for the national currency of Azerbaijan's largest trading partner, Russia, the deepening of sanctions imposed on Russia and the diplomatic blockade, due to the Skripal scandal that emerged between the United Kingdom and Russia last month, the "ruble" has been losing some value. As a result, the ruble lost 3.7% against the US dollar in March of the current year (28.02.2018: 1USD = 55.7RUB, 30.03.2018: 1USD = 57.76RUB)<sup>21</sup>. At present, the main risk for the Russian national currency is the volatility in oil price and expansion of the current sanctions in place.

It should be noted that Russia and Turkey are one of the most popular destination for Azerbaijani workers. Economic dynamics in these countries, including the national currencies, have a significant impact on Azerbaijani remittances. Taking into account the current situation, the flow of remittances from both countries can be diminished, which, in turn, can negatively affect the volume of the supply in the currency markets.

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<sup>20</sup> TÜRKİYE Cumhuriyet Merkez Bankası  
<http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

<sup>21</sup> The Central Bank of the Russia Federation, "Dynamics of the official exchange rates"  
[https://www.cbr.ru/eng/currency\\_base/dynamics.aspx?VAL\\_NM\\_RQ=R01235&date\\_req1=01.01.2018&date\\_req2=07.04.2018&rt=1&mode=1](https://www.cbr.ru/eng/currency_base/dynamics.aspx?VAL_NM_RQ=R01235&date_req1=01.01.2018&date_req2=07.04.2018&rt=1&mode=1)

### III. Internal factors

#### 3.1. Foreign trade balance

The volume of imports in the first two months of 2018 has significantly increased compared to the previous year. According to the State Customs Committee, in January-February imports of goods and services worth \$ 1451.5 million were imported to Azerbaijan<sup>22</sup>, which is 49.3% more than in the corresponding period of 2017 [see Figure 2]. As you can see, the volume of imports has increased in all three areas: access to state, private sector and individuals.

**Table 1: Import indicators for January-February, comparatively**

| <b>Years</b>          | <b>2017</b>        | <b>2018</b>        | <b>Dynamics in 2018 compared to 2017</b> |
|-----------------------|--------------------|--------------------|--|
| <b>Sectors</b>        | <b>Million USD</b> | <b>Million USD</b> |  |
| <b>Public sector</b>  | 102.6              | 303                | 3 times ↑                                |
| <b>Private sector</b> | 814.8              | 1069.2             | 31.2% ↑                                  |
| <b>Individuals</b>    | 54.6               | 79.3               | 45.2% ↑                                  |
| <b>Total</b>          | 971.6              | 1451.5             | 49.3% ↑                                  |

**Source: State Customs Committee of the Republic of Azerbaijan, 2018**

Along with the main reasons, specific factors also played a role in the growth of imports. The positive effect of the stability of the national currency increases economic activity as well as the purchasing power, which can be highlighted as part of the main reasons. The Specific factors can be characterized as follows:

1. The abolition of restrictions imposed on imports from the state fund at the end of last year is one of the main reasons for the increase in imports from the public sector<sup>23</sup>.

<sup>22</sup> "Azərbaycan Respublikası Xarici Ticarətinin Gömrük Statistika, hesabat dövrü: 01.01.2018-28.02.2018", baxış tarix: 05.04.2018, səh: 5

[http://customs.gov.az/modules/pdf/pdffolder/71/FILE\\_67E1D8-18EF53-B956B7-C06B0C-8B6AA8-F12094.pdf](http://customs.gov.az/modules/pdf/pdffolder/71/FILE_67E1D8-18EF53-B956B7-C06B0C-8B6AA8-F12094.pdf)

<sup>23</sup> Prezident.az, "İcra hakimiyyəti orqanlarının və dövlət büdcəsindən maliyyələşən təşkilatların fəaliyyətində satınalmaların səmərəliliyinin artırılması ilə bağlı əlavə tədbirlər haqqında Azərbaycan Respublikası Prezidentinin Fərmanı", 15.09.2016

<http://www.president.az/articles/21083>

- Despite the fact that the application of the decree would increase for a further period, this change did not occur, and the volume of imports from the budget increased 3 times.
2. The overall budget expenditures, in particular the investment costs, were enhanced. Thus, as predicted expenditures of the state budget of 2018 (2018 forecasted expenditures of the state budget: 21,041 billion manats<sup>24</sup>) was 19.6% more than last year (expenditures of the state budget in 2017 amounted to 17.6 billion manats<sup>25</sup>). More than 3.5 billion pounds.
  3. Investment expenditures from the state budget have increased. As such, while state budget investment expenditures will be 2.5 billion manats in 2017, they will increase by 4.82 billion manat or 93 percent in 2018. Thus, compared to the previous year, the demand for budgetary resources on currency markets has increased. Because, in particular, a substantial portion of the invested funds are directed to the import of goods and services from abroad.

Along with the above, public debt service costs of the state budget also created demand for foreign currency in the domestic market. In 2018, the expenditure of the budget for the above mentioned purpose, was forecasted at 37.8% or 621 million manat more. 71.1 percent of growth will be directed to the fulfillment of obligations arising from the restructuring of the international debt obligations of the International Bank of Azerbaijan by the government and by agreement with the creditors. In other words, at least 442 million manats will be directed to the purchase of foreign currency<sup>26</sup>.

Thus, in comparison with 2017, demand on the currency markets will be higher in the current year due to budgetary funds. At the same time, the shortage of exchange rate risks will lead to an increase in imports in the coming months. Thus, throughout the year, imports will remain one of the main factors pressuring the national currency.

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<sup>24</sup> Azərbaycan Respublikasının 2018-ci il dövlət büdcəsi haqqında Azərbaycan Respublikasının Qanunu, 01.12.2017, səh: 1

[http://www.maliyye.gov.az/sites/default/files/Qanun\\_budce\\_2018\\_0.pdf](http://www.maliyye.gov.az/sites/default/files/Qanun_budce_2018_0.pdf)

<sup>25</sup> The Ministry of Finance of the Republic of Azerbaijan, "Information (operative) on the execution of the state budget for 2017", 12.01.2018

<http://www.maliyye.gov.az/en/node/2119>

<sup>26</sup> Azərbaycan Respublikası Maliyyə Nazirliyi, "Azərbaycan Respublikasının 2018-ci il dövlət və icmal büdcələri üzrə layihələrin təqdimatı", baxış tarixi: 05.04.2018, səh: 43

<http://www.maliyye.gov.az/sites/default/files/Budce-19.10.2017.pdf>

### 3.2. Current changes in monetary policy

At the beginning of the year, the Central Bank issued a statement on the implementation of a conservative monetary policy for 2018. The bank will try to exploit inflationary pressures and weaken exchange rates throughout the year, using the most diverse tools<sup>27</sup>. However, in the fiscal policy for 2018, certain expansion is observed. However, the Central Bank forecasts a surplus of the balance of payments if the barrel of oil stays at US \$ 45<sup>28</sup>. The average price per barrel of crude oil Brent crude for the past three months was 66.8 US dollars<sup>29</sup>. As we can see, the price of oil in the first quarter of the year was 48.4% more than the fiscal forecast showed. Thus, the surplus of the balance of payments is higher than forecasted over the year.

Although the Central Bank is implementing a tight monetary policy in 2018, the liquidity requirement of the fiscal sector results in an increase in the monetary base<sup>30</sup>. Which resulted in an increase of 24.6% over the corresponding index of January 2018 compared to the same period last year<sup>31</sup>. The expansion of the monetary base with the manat can be one of the main factors that increase the demand for foreign currency. However, the demand deposits increased by 24.2% over the same period. This gives enough ground to highlight that trust towards the national currency is slowly recovering even at a weaker pace. In other words, the pressure caused by the expansion of the monetary base in terms of manats weakens as a result of a strengthening of confidence.

One of the other factors influencing the dynamics of the currency markets in 2018 is the Central Bank's accounting policy. With the decision of 12 February 2018, the bank reduced its interest rate by 2 percentage points to 13%. Relevant variations have been identified from the upper limit of the interest rate corridor (from 18% to 16%) and lower limits (from 10% to

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<sup>27</sup> "Azərbaycan Respublikası Mərkəzi Bankının 2018-ci il Və Ortamüddətli Dövr Üçün Pul Siyasətinin Əsas İstiqamətləri Barədə Bəyanatı", baxış tarixi: 05.04.2018

<https://www.cbar.az/assets/4472/NEW-beyanat-28.12.2017.pdf>

<sup>28</sup> "Azərbaycan Respublikası Mərkəzi Bankının 2018-ci il Və Ortamüddətli Dövr Üçün Pul Siyasətinin Əsas İstiqamətləri Barədə Bəyanatı", baxış tarixi: 05.04.2018, səh: 4

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<sup>29</sup> World Bank, "World Bank Commodities Price Data", 06.04.2018

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<sup>30</sup> "Azərbaycan Respublikası Mərkəzi Bankının 2018-ci il Və Ortamüddətli Dövr Üçün Pul Siyasətinin Əsas İstiqamətləri Barədə Bəyanatı", baxış tarixi: 05.04.2018, səh: 2

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<sup>31</sup> Mərkəzi Bank, №01(214), Statistik Bülleten-01/2018, səh: 14

[https://www.cbar.az/assets/4523/STAT%C4%B0ST%C4%B0K\\_BULLETEN\\_2018\\_YANVAR.pdf](https://www.cbar.az/assets/4523/STAT%C4%B0ST%C4%B0K_BULLETEN_2018_YANVAR.pdf)

8%). The central bank's decision was explained by the following factors such as stabilization in the currency markets, the balance of payments, as well as profits in foreign trade, and the decline in inflation. The goal is to support economic activity<sup>32</sup>. During the preparation of this report, the Central Bank announced its decision to lower the interest rate (*Note: On 10 April 2018, the Board of Central Bank made a decision to lower the interest rate from 13% to 11%*)<sup>33</sup>. Theoretically, the weakening of the interest rate policy has increased the access to loans in manat but there has been no increase in the loan portfolio of the banks due to the fact that the actual level of risk in the real sector is high. In comparison with the end of last year, the volume of net loans of the banking sector decreased by 1.9% or 184 million manat in February<sup>34</sup>. Thus, the change in interest rates does not seem to have any serious consequences for the money market. At the same time, the recent decision on the interest rates indicates the absence of the challenging environment for the local currency – manat.

### **3.3. Change of strategic currency reserves**

As mentioned above, SOFAZ's revenues for 2018 are set at US \$ 45 per barrel. According to the Ministry of Finance's calculations, the change in the price of one barrel of oil in the amount of US \$ 5 per barrel in 2018 may cause an increase or decrease of approximately \$ 467 million (794 million manat) for SOFAZ during the year<sup>35</sup>.

Based on this indicator, we can say that in the first quarter of 2018, the Oil Fund has received an additional \$ 500 million. Although the Oil Fund has not announced its results for the first quarter of the current year, we can conclude that the Fund's assets have expanded over the past three months, referring to the above calculation. It should also be noted that since January 2017, the tendency of the Central Bank to increase its foreign exchange reserves continued in the first quarter of 2018.

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<sup>32</sup> Central Bank Of The Republic Of Azerbaijan, "On changes to interest rate corridor parameters", 12.02.2018 <https://en.cbar.az/releases/2018/02/12/faiz-dhlizinin-parametrlrinn-dyidirilmsi-haqqnda-vp/>

<sup>33</sup> Central Bank Of The Republic Of Azerbaijan, "Faiz dəhlizinin parametrlərinin dəyişdirilməsi haqqında", 09.04.2018 <https://www.cbar.az/releases/2018/04/09/faiz-dhlizinin-parametrlrinn-dyidirilmsi-haqqnda/>

<sup>34</sup> "Bank Sektorunun İcmal Göstəriciləri 28 Fevral 2018-ci İl Tarixinə", baxış tarixi: 06.04.2018, səh: 2 [https://www.fimsa.az/assets/upload/files/Bank%20icmal%C4%B1\\_28%20fevral%202018.pdf](https://www.fimsa.az/assets/upload/files/Bank%20icmal%C4%B1_28%20fevral%202018.pdf)

<sup>35</sup> Azərbaycan Respublikası Maliyyə Nazirliyi, "Azərbaycan Respublikasının 2018-ci il dövlət və icmal büdcələri üzrə layihələrin təqdimatı", baxış tarixi: 05.04.2018, səh: 47 <http://www.maliyye.gov.az/sites/default/files/Budce-19.10.2017.pdf>

As compared to the beginning of the year, foreign exchange reserves increased by 3.2% to 5.5 billion US dollars in March. Taking into account that the source of strategic currency reserves of Azerbaijan is the Central Bank's currency reserves and SOFAZ assets, we can predict that during the first three months of this year, about \$ 600 million or 1.4% growth was recorded. Thus, short-term volatility on the foreign exchange markets has increased the ability to regulate these reserves.

## Results

In the first quarter of this year, the demand for foreign currency in Azerbaijan increased (compared to \$ 516.8 million in the first quarter of 2017). The key factor in increasing demand is the increase in imports. Thus, in January-February 2018, the volume of goods and services imported to the country increased by \$ 480 million. In addition, especially in March, the effects of an early presidential elections in the country were felt in the currency markets. The conclusion that there will be serious economic and political changes in Azerbaijan after the election has supported the buying decisions of the foreign exchange market participants.

The analysis revealed that factors such as the current price of oil on world markets, as well as the forecasted price, the forecasted balance of payments, including foreign trade balance and the possibility of increasing the strategic currency reserves form a supportive conjugation for the national currency of Azerbaijan. However, the rapid increase in imports, the observed depreciation in the currencies of the countries of the region, the rise in the manat base and interest rate increase the pressure on the exchange rate.

Taking into account the fact that oil prices are the main factor, we predict the probability that the rate of the manat will be *"high"* in the post-election months, and the probability of weakening at an *"average"* level. Despite that, the risks in the exchange rate market is still ongoing. The probability of the strengthening of the manat is considered to be impossible under the current exchange rate policy of the Central Bank.

We believe that the following risks for the manat rate in the next months of 2018 are:

1. A sharp decline in oil prices on world markets – the predicted surplus in the balance of payments can, in this case, be replaced with a deficit.
2. Starting large-scale economic and political reforms in the country after the election;

**Effect 1:** Structural reforms may result from the strengthening of the illegal currency flow from the country (the process of withdrawal of money from officials - oligarchs).

**Effect 2:** The Central Bank can apply a full floating exchange rate regime in the first months, which could lead to a depreciation of the "manat", causing a distortion in foreign exchange markets.

3. The exchange rate of the “manat” being dictated not by demand and supply, but rather by decisions of the Central Bank – this is considered the main obstacle for predicting the exchange rate.
4. Involvement of countries like Russia, Iran and Turkey into regional conflict or political and economic blockade - in this case changing economic climate in the region can have a negative impact on the economy of Azerbaijan, including the manat.



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