

PECULIARITIES OF THE STABILIZATION POLICY IN AZERBAIJAN UNDER THE FINANCIAL CRISIS

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Macroeconomic situation in Azerbaijan depends significantly on prices and plans of the main point of the country's oil and gas export. So:

– in high prices and rates conditions in the world market of energy resources profit of current account on balance of payments of the country which is becoming a pressuring factor on the nominal rate of national currency. The attempts of Central Bank (CB) of Azerbaijan to slow down the rates of national currencies consolidations within active mechanisms of monetary–credit regulations, more specially, within either targeting of the amount of money in circulations (according to M2), or targeting of the nominal rates of the national currency makes it purchase redundant currency masses on the market. This leads to the increase, on one hand of gold and foreign exchange reserves of CB, on the other hand to the increase of the amount of money in the circulation which boosts inflation processes and specifies the growth of the real effective rates of national currency.

Moreover, with the growth of prices and rates in the world energy resources market, takes place the growth of inflation imported into the country. This forces CB which provides constant monitoring of the inflation rates in the country to take more measures about its' reduction – more specifically provides further consolidation of the national currency rates:

– in the years of adverse extra economic conjuncture – slump in level of prices and rates in the world markets of energy resources becomes a necessity:

- appropriate corrections and reduction of budget expenditures;
- extra injections on currency market with the purpose of elimination of devaluation of national currency;
- reduction of level of gold and foreign exchange reserves of the country.

Because of this in accordance with estimation of some international financial institutes and mainly International Monetary Fund (IMF) the quality of the conducted budget and macroeconomic policy is low in Azerbaijan today. In the period of 2005–2008 the macroeconomic balance in the country was upset – passing ahead of overall demand over overall supply speeded up inflation processes.

The main channels of transmission of global crisis on Azerbaijan economy were:

- slump in prices for oil on world markets (besides reduction of liquidity in economy, world prices cut has its influence also on export of other spheres, in particular metallurgy, chemical industry);
- high level of financial liberalization (since 2007 limits on operations with currency have been taken in Azerbaijan);
- reduction of foreign refinancing of banks in the result of crisis.

In these conditions CB and Azerbaijan government had to accept not ordinary arrangements for stabilization in economy.

The present model of CB's monetary policy had two–stage structure: the first stage with classical instruments of monetary policy was directed on maintenance of stability of consumer prices in economy; the second stage included the mechanisms of countercyclical macro prudential regulation. The essence of the last mechanism is the regulation of capital adequacy norms by banks and compulsory reservation.

An effective use of this model let CB to neutralize some negative consequences of crisis on the economy of the country. The prudential norms were defined to maintain liquidity enough and create additional reserves on potentially problematic credits. The conditions of assets classification were tightened, price ratio of total credit guarantee was increased. The norms of risks were revised and toughen with the purpose of regulation of credit risks.

The main purposes of Azerbaijan Central Bank's policy in crisis period included provision of financial system with liquidity, maintenance of overall demand and stability of financial system. For this purpose a wide range of measures have been used:

- CB 6 times changed refinancing rate and collar limits on operations in open market towards decrease. In the result of this refinancing rate decreased from 15 % to 2%, consequently high collar limit fallen from 20 to 7%. Standards of mandatory reservation on internal source of funds attraction were decreased from 12 to 0,5% and on external sources of funds attraction were abated at all. In the result *net volume of "liquidity injections"* to economy in the years of crisis amounted approximately 2 bln. USD. Banks received 730 mln. USD of this sum at the expenses of reduction of required reserves.

- Activation of discount window of Central Bank in general was oriented towards support of liquidity of backbone companies – State Oil Company and banks aiming at timely external debt service;

- Mortgage fund extended its operation, this is immediately showed itself on the price stabilization in immovable property market and increase of activity in this market (prices stabilization played important role in financial position of banking sector, because immovable property was a mortgage for the half of loan portfolio).

All of these measures strengthened financial stability of banking sector. So, liquidity of banking sector is very high today, quick liquidity consist of 80%, while accepted minimum standard is 30%. Long-term liquidity also is remaining favorable. Results of stress-testing conducted by Central Bank indicated that, even in case of the most unfavorable scenarios of macroeconomic situation developments banking system is able to survive after strong shocks and absorb arising losses.

As it is known in accordance with IMF methods, currency rate policy which is realized in various countries is classified as following:

- *rigid fixation* (national currency rate is fixing rigidly in ratio to one of the leading world currencies and CB of the country is bounded to support exchange rate of national currency by means of currency interventions);

- *flexible fixation* (the sense of this is in controlling national currency rate by CB without rigid fixation, but in the frame of certain "collar"). There are *usual flexible fixation, actual stabilization, horizontal collar, sliding linkage* types of flexible fixation;

- *floating currency rate* (it has types: *controlled floating* and *free floating*). When it is *controlled floating* the currency rate is defined mainly by the market, on the basis of demand and supply and CB impacted on the rate formation only when it is necessary, by conducting currency interventions in market. When it is regime of *free floating* national currency rate formed by the market and impact of CB on the market by currency intervention takes place in exclusive cases.

- *other regimes of rate controlling* (all types of currency rate policies which are not referred to other categories refer here).

In Azerbaijan, as it is in many countries with developing financial markets and specific structural characteristics of economy manat to dollar exchange rate is significant "nominal anchor" to support macroeconomic stability. In other words, among all possible intermediate money indicators the rate of manat is the most controlled and predictable guideline for achievement of aims of money policy like price stability and financial system.

In the whole as guides of money-credit policy one of the following three indicators may be chosen – exchange rate, money volume and percent rate. It is impossible to target all these indicators simultaneously. In this case fixation of exchange rate does not allow central bank to operate percent rate. Besides, as per Mandella-Flemming model, while passing to floating currency rates system under condition of high mobility, international movement of capital efficiency of fiscal policy as macroeconomic regulator is falling significantly. In this case, money-credit policy became the most efficient tool to impact on issue and employment level in economy.

As more the growth of monetization of GDP, financial market deepening and complication, capital market developing and elimination of structural distortions in transition economy the demand for money became unstable and percent rate is going to be main bench mark for participants of economy activity. Fixation of exchange rate in this case does not allow central bank to operate by percent rate.

On the basis of above-mentioned, Central Bank of Azerbaijan basing on the principle of evolutionary modification of monetary policy regime de facto conducts rate policy in the regime of linkage to USD, although de jure currency basket consisting of USD and euro is serving as operational bench mark. There are serious basis for this. The matter is that, the year of 2009 is appeared to be the period when excessive manat volatility could bring to destabilization of financial sector. But standard use of currency basket provides for synchronization manat rate movement in ration to USD and Euro with movement of cross-rate of USD to euro.

Such policy allows to central banks gradually refuse from one-sided fixation of rate to USD, to support flexibility of the rate and smoothly change over other monetary bench marks (in the first place percent rate on interbank market). However, this demands corresponding conditions in the economy. The decision of rate stability support was made on the basis of analysis of macroeconomic factors.

The following arguments showed the need in conducting devaluation of manat:

- This permits to improve foreign-trade balance in the conditions of price falling for exported goods.
- Defense de-facto of fixed rate brings to significant loss of gold currency reserves.
- Devaluation of monetary unit allows to exporters to get additional liquidity.

From other side, there were serious arguments for keeping stability of exchange rate.

- Payment balance – basic monetary basis of rate stability – it remains stable and does not give basis for devaluation. Currency reserves in this case cover money volume in national currency fully. The countries, which faces growing deficit of payment balance and danger of complete loss of currency reserves resort to devaluation.

- In the condition of reduction of global demand and contraction of external markets, a positive effect of devaluation on export may be enough limited. As regards to the problem of import curb, its volume in non–oil sector decreased even without devaluation.

- Devaluation will not assist to quick import replacement because of limited unloaded producing capacity.

- Under conditions of high unit weight of imported packaging, materials and semi–manufactured articles in the production of local goods (as per some investigations from 40% to 60% depending on fields of industrial manufacture) devaluation of manat may disrupt its external competitiveness.

- The growth of inflation and consequently decrease of real assets and capital price, impoverishment of population could be the result of devaluation.

- While current scales of dollarization of the loans (46%) 2/3 dollar loans were issued to sectors of economy which did not receive income in foreign currency. Consequently, devaluation could influence to financial position of these sectors, causing acute impairment of the ability to pay on bank loans.

- Acute devaluation could bring to panic among population and sharp outflow of funds from the banks, intensifying liquidity problem. At the same time, floating devaluation would strengthen uncertainty, causing dollarization and further pressing on currency reserves.

- Devaluation could increase expenses on foreign debt servicing and debt burden of the banks.

In long term perspective Central Bank of Azerbaijan is orienting towards gradual transmission to regime of flexible exchange rate. In post crisis period the flow of foreign capital and exported oil incomes have grown. This may bring to overheating of the economy because of increase of money emissions in the condition of fixed currency rate. Therefore, flexibility of rate policy is very significant in the long–term plan for concentration of monetary policy on achievements of target indicators of inflation.

The article analyses the peculiarities of the stabilization policy in Azerbaijan.