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Devaluation of Azerbaijani National Currency; Causes and Consequences

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Starting from February 21st, 2015, the official exchange rate of the dollar to the manat, Azerbaijani national currency, has been set at 1.05 manat, which is 33.86 percent more than the exchange rate set before the beginning of the weakening process of the rate. Azerbaijani national currency has been depreciated against US dollar the first time since 2006.

Central Bank of Azerbaijan has had face an dilemma to depreciate manat since the sharp dropping of crude oil price in the world market in fall of 2014; either going sharp depreciation or having gradual devaluation. In fact, Central Bank has announced that sharp depreciation would not be in the government's agenda in the near future. Just 2 days after the Central Bank's governor's official declaration on not going to sharp depreciation, national currency of Azerbaijan has lost its value against to major foreign currencies by 33.86 %. Manat's rate dropped to 1.05 from 0.78 against to US dollar.

Indeed, the sharp devaluation of the manat on February 21st 2015 was broadly in line with movements in other emerging economies. As it is, the sudden fall in the currency has undermined credibility to Central Bank and the banking system —counteracting the government's avowed aim of boosting growth by improving external competitiveness.

The question here is that why sharp depreciation not gradual depreciation, as Central Bank has before promised, has happened. And again, why 34 % devaluation not 12-15 % which has before promised by Central Bank?

Even though the Government of Azerbaijan promised gradual devaluation, but in effect slow depreciation would be a supportive tool to reach goals the government has listed out. Gradual depreciation would increase Central Bank's intervention cost in addition to would increase budget revenues in manat term so much. Devaluation percentage less than 30.0 % would not be enough to cover the state budget's current

an potential deficits as long as the price of crude oil in the world market is low. Therefore, Central Bank has took drastic step to have sharp and deep devaluation of the national currency.

According to the CESD assessment, main reason of the sharp and deep depreciation of the manat are as followings;

- 1. Fiscal reason.** Due to sharp decline of oil price, current revenue flow to the state budget has been started declining. 53.4 % or 10.3 billion manat of the state budget will be generated by the State Oil Fund of Azerbaijan Republic (SOFAZ). According to the 2015 state budget law, non-oil sector's contribution to the state budget will be 35.0 % of total revenues. Remaining 11.6 % of the budget's revenue will be directly generate through oil and oil products' export. It means 65.0 % of the state budget's revenues in 2015 will be generated through oil money.

Although the Azeri monthly oil export has not been exaggeratedly declined, income from exporting crude oil has been dramatically decreased due to dropping of oil price. Azerbaijan exported 2,122 million tones oil in total in January, 2015. Average price for Azerlight, Azerbaijani oil, was \$ 49,53 US per barrel last month. After a sudden decline in oil prices in the world market in 2014 Azerbaijan oil export declined by 326 thousand tones or 13.4 % in January, 2015 compared to previous month.

As an oil exporter country, Azerbaijan started feeling effects of a sharp fall in oil revenue after oil price decline in the world market owing to decline of the country's oil income. In spite of the fact that Azerbaijan was able to reduce share of oil industry both in public revenues and in the country's Gross Domestic Product (GDP), Azerbaijan is still heavily dependent on oil and natural gas export revenues.

Oil income in January, 2015 declined by 35.0 % compared previous month although the export volume dropped only by 13.4 % in the indicated period. In January 2015, Azerbaijan exported almost the volume of oil in June 2014. If the country received only \$ 760 million US in January 2015, but income was \$ 1.76 billion US in June 2015. It confirms that dropped oil price in the world market has dramatically decreased Azerbaijan's revenues: in spite of the fact that he same amount export in January 2015 with June 2014 but income was 2.31 time less last month (Note that, gross income implies the currency entering to the country from sale of oil included with AIOC oil revenues. Profit after deducting costs from revenues defined the amount of oil in value. This is sharing in accordance with the production sharing funds between the Government of Azerbaijan and AIOC).

The oil price in the 2015 state budget is US 90 \$ per barrel, but average price for January was less than US 50 \$ per barrel and average price for the first 2 months is expected to be around \$ 56 US per barrel.

Meanwhile, direct oil contribution to the state budget is 2.27 billion manat. With previous exchange rate, the government of Azerbaijan has to transfer \$ 2.91 US oil money to the state budget. But after the devaluation, only \$ 2.15 billion US oil money is needed. This defiantly means that depreciation of the national currency will support to save \$ 760 million US oil money only in direct oil income contributions.

Above mentioned facts show that there is deficit in monthly state budget lines. Forecasts both on oil price and oil revenue are not optimistic. Devaluation is a tool for the government to cover manat deficit in the state budget.

- 2. Saving SOFAZ's money.** Manat's appreciation against to the dollar will aid to SOFAZ to some extent to save its reserves. SOFAZ's 2015 income is \$13,136 billion US if average crude oil price in the world market is \$ 90 US per barrel during year. Meanwhile, the expenditure will be 11, 814 billion manat (\$ 15,146 billion US with previous exchange rate of the manat and \$ 11.251 billion US with new exchange rate) in 2015 according to the official law on the State Oil Fund. The very important fact is that SOFAZ's revenue is in US dollars but its expenditure is in Azerbaijani manat. Then manat's devaluation will give an advantage to the Oil Fund to save \$ 3,895 billion US oil money (\$ 15,146 billion US- \$ 11,251 billion US) only in 2015.

From other hand CESD's latest assessment show that SOFAZ will earn \$ 4.5 billion US less if crude oil's average price is \$ 60 US per barrel in 2015. Then, the oil fund's total income will \$ 8.636 billion US instead of \$13,136 billion US in 2015. In this case, SOFAZ's income with local currency will be \$ 9,067 billion manat. It means that SOFAZ will be able to reach its 2015 fiscal targets through the devaluation. The Government of Azerbaijan will be also manage to slightly reduce declining ratio of its currency and state reserves.

- 3. Decreasing of declining of Central Bank's reserves.** In the fall of the world prices for oil, the main export product and main source of income for Azerbaijan, this stability has cost the CBAR, who was forced to sell the currency to maintain the exchange rate of the manat, has been quite expensive. Only for August-December 2014 gold and foreign currency reserves of the Central Bank decreased by \$1,435 billion US – \$15,193 billion US to \$13,758 billion US. In January 2015, the CBA has spent on maintaining the exchange rate of the manat another \$1,077 billion US, bringing its reserves fell to the lowest since the spring of 2013 levels. Central Bank's currency reserves haven declined to \$ 12.681 billion US early February, 2015 since the world oil price dropped. Due to intervention costs, CBAR lost its currency reserves only by 8.0 % only during January, the first month of 2015.

Indeed, the demand for US dollar in the country has been dramatically increased after Central Bank's announcement in the Mid of February, 2015 about manat's future devaluation. The resulting panic among lenders led to a large withdrawal of deposit from banks, causing a credit crunch. \$ 3 billion US has been purchased during the last week to the depreciation. Daily dollar demand has reached to \$ 500 million US in certain days the second week of February, 2015. Share of manat deposits in the total deposits has been decreased to 45.0 % from 63.0 % during this period. In case of postponing of the devaluation decision, might result losing of all reserves of Central Bank within certain months.

- 4. Promoting of non-oil export capacity.** Indeed, Azerbaijani national currency has appreciated against to the dollar by February devaluation since 2006 to the Central Bank's last step. However, Azerbaijan's main trade partners' national currencies have depreciated against to dollar. Turkey's national currency by 30.0 % lowered to 2.50 from 1.75 in the last 2 years. Russia's ruble depreciated against dollar more than 2 times in this period lowered to 63 from 30, Georgia's national currency lost its value by 41.0 % and it declined to 2.3 to 1.6 in the same period. Ukraine faced very dramatic currency tragedy in last 2 years: national currency depreciated against to the dollar almost 6 times.

Devaluation in national currencies of Azerbaijani major trade partners make local exporting products much more expensive in dollar terms. More challenges have been observed particularly after ruble's depreciation against dollar since northern neighbor is the main market for Azeri's non-oil products. By depreciating manat against dollar the Government of Azerbaijan targets promoting of non-oil sector export capacity. In fact, 95.3 % of total Azerbaijani export is oil and oil products.

Share of non-oil products in total export is less than 5.0 %. Therefore, economic diversification should be the main priority of the Government of Azerbaijan. Nevertheless, promoting of non-oil export capacity in Azerbaijan is not short-term target, it is more long-term goal. Consequently, we do not expect sharp increasing of non-oil export in the short-term period even though manat's rate has been sharply depreciated.

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- 5. Increasing of Azerbaijani GDP in manat terms.** Azerbaijan's nominal GDP in the first month of 2015 fell by 30.6% against December 2014 and by 17.9% against January 2014. The State Statistics Committee reports that in January 2015 Azerbaijan's GDP totaled AZN 3.631 billion (\$ 4.629 billion) that in comparable prices is by 4.4% more than GDP for January 2014 (AZN 4.423 billion), that is nominal GDP fell by 17.9%. In fact, the State Committee has reported real GDP growth in the first month of 2015. But, according to the State Statistics Committee, GDP was 4.4 billion manat in January, 2014. The Committee also reported that GDP was 3.631 billion manat in the first months of 2015. The official figures confirm that there is 18.0 % decline (3.631/4.4) last month compared to the same in 2014.

Manat's depreciation will increase GDP in manat terms but GDP in dollar terms will decline in up-coming months, too. "Azerbaijan will suffer from a sharp fall in oil prices, because of its high dependence on exports of hydrocarbons. Currency reserves accumulated by the Central Bank and the Oil Fund of the country (the State oil Fund of the Republic of Azerbaijan, SOFAZ. – RBC), will cushion the impact of external threats, however, growth in only one of the non-oil sectors of the economy is unlikely to achieve a sustained increase in General", – stated in the report of the EBRD. The level of GDP growth in Azerbaijan in 2015 in the updated forecast, the EBRD was reduced compared with September by 1.5 percentage points (PP) from 3% to 1.5%. CESD, temporarily, does not forecast real economic growth for 2015 in case of oil price does not increase.

- 6. Boosting of the inflation rate.** The correction in the value of the manat will cause import prices to rise, leading to a sharp increase in inflation. Given the high base year for household consumption—it is officially estimated to have risen by 8.0 % year on year in 2015—there is likely to be a sharp retrenchment in private consumption expenditure in 2015. Central Bank has been pushing the inflation rate to promote local and foreign investments to the country's economy. Taking into consideration of the devaluation level, CESD forecasts 14.0 % inflation rate for 2015.

There are some other reasons such as increasing of cost of importing goods, targeting of further liberalization of the domestic market, why sharp and deep devaluation has been taken place in Azerbaijan. Nonetheless, there is one major question; Is Azerbaijan will go to further devaluation of national currency in 2015?

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