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# **CESD Research Brief: Should we expect a change in the rate of Azerbaijani manat in context of high demand for US dollar?**

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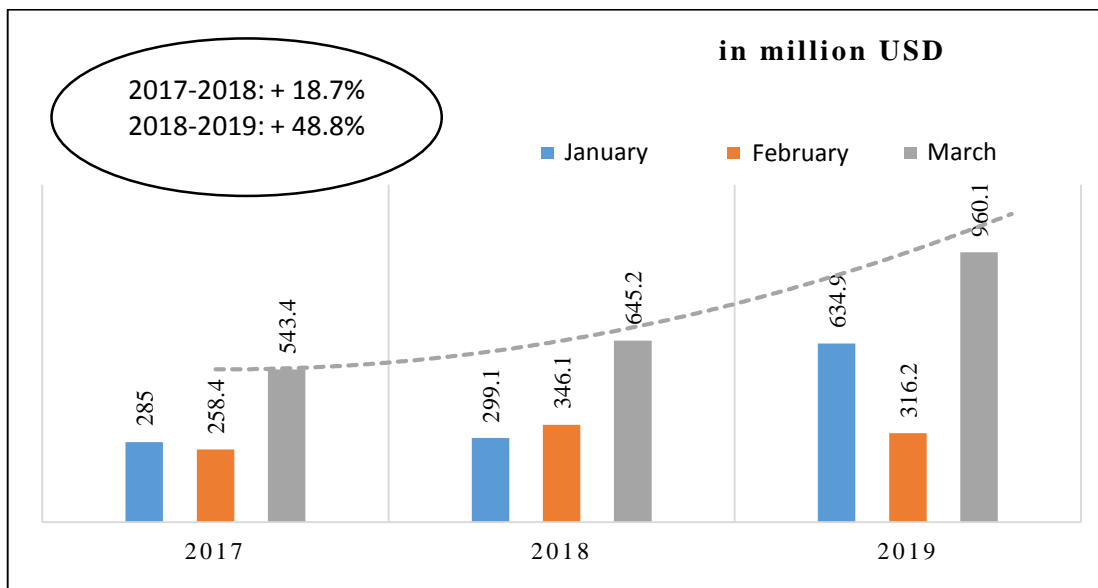
**Baku, March 2019**

## Dynamics of currency markets

In January-February of 2019, activity in foreign exchange markets has further escalated. According to the information provided by the State Oil Fund of Azerbaijan (SOFAZ), during the corresponding period 951 million US dollars were sold, including 634.9 million<sup>1</sup> in January and 316.2 million<sup>2</sup> in February. This is 47.2% higher than the same period of the previous year [see diagram 1].

It should be noted that since the second half of 2016, SOFAZ is the only organization offering foreign currency in auctions organized by the Central Bank. From the approved forecast budget of the Fund for 2019, it is clear that the entity will spend about 11.6 billion manat, which is about 6.8 billion US dollars<sup>3</sup>. In other words, the Fund can sell foreign currency worth 568 million USD on average per month.

**Diagram 1: Currency sales of SOFAZ**



**Source: SOFAZ, 2018**

As can be observed, the sale of foreign currency by SOFAZ has increased for three consecutive years. The current year's growth is even more remarkable (48.8% increase in currency sales) and leads to certain questions. Thus, the purpose of this article is to seek answers to the following questions that concern society:

- What are the reasons behind the increased demand for foreign currency?
- Will the process continue to persist?

<sup>1</sup> ARDNF, Valyuta satışı ilə bağlı açıqlama (2019-cu ilin yanvar ayı üzrə), 06.02.2019  
<https://www.oilfund.az/fund/press-conference/news-archive/1382>

<sup>2</sup> ARDNF, Valyuta satışı ilə bağlı açıqlama" 13.03.2019  
<https://www.oilfund.az/fund/press-conference/news-archive/1387>

<sup>3</sup> ARDNF, Azərbaycan Respublikası Dövlət Neft Fondunun 2019-cu il büdcəsi haqqında Azərbaycan Respublikası Prezidentinin Fərmanı (28.12.2018), 28.02.2018  
<https://www.oilfund.az/fund/documents/fund-budget/68>

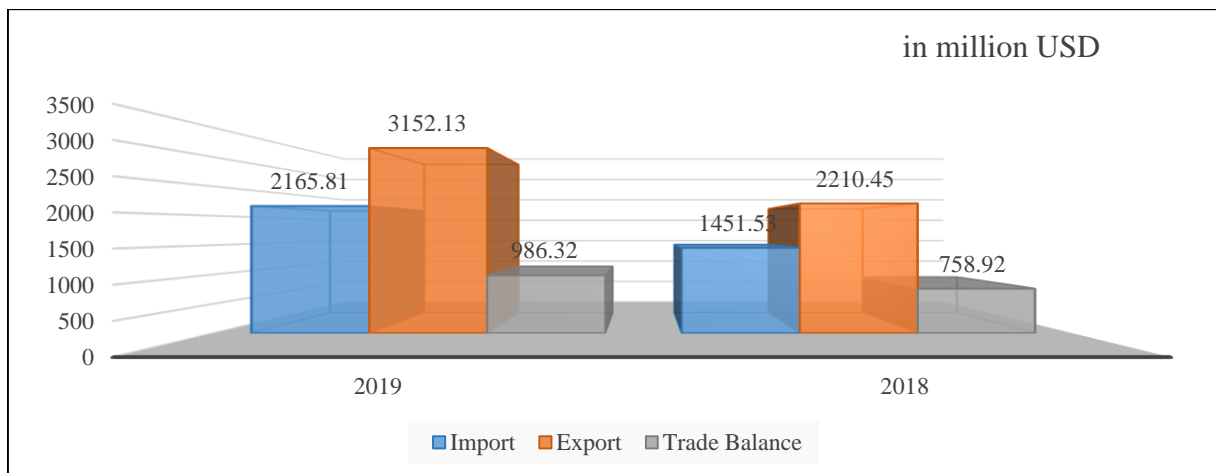
- Can these events lead to a depreciation of the manat?

It should be noted that the Central Bank of the Republic of Azerbaijan claims that the exchange rate of the "manat" has been formed on currency markets – by the forces of demand and supply, although in practice a controlled exchange rate regime is currently applied in Azerbaijan<sup>4</sup>. This fact is reflected in the stable rate of the manat against the US dollar (1 USD = 1.7 manat) over the past two years starting from April 2017.

### Reasons for increasing demand for foreign currency

Analysis of the current situation shows that the main factor behind increasing demand in foreign exchange markets is importation. Fiscal expansion and stable exchange rate have been promoting imports throughout the past two years. As a result, the volume of imports is continuously increasing. Imports were further boosted during the first months of 2019. According to the information provided by the State Customs Committee, imports increased by 49.2% or 714 million USD in January-February of this year compared to the same period of the last year [see diagram 2].

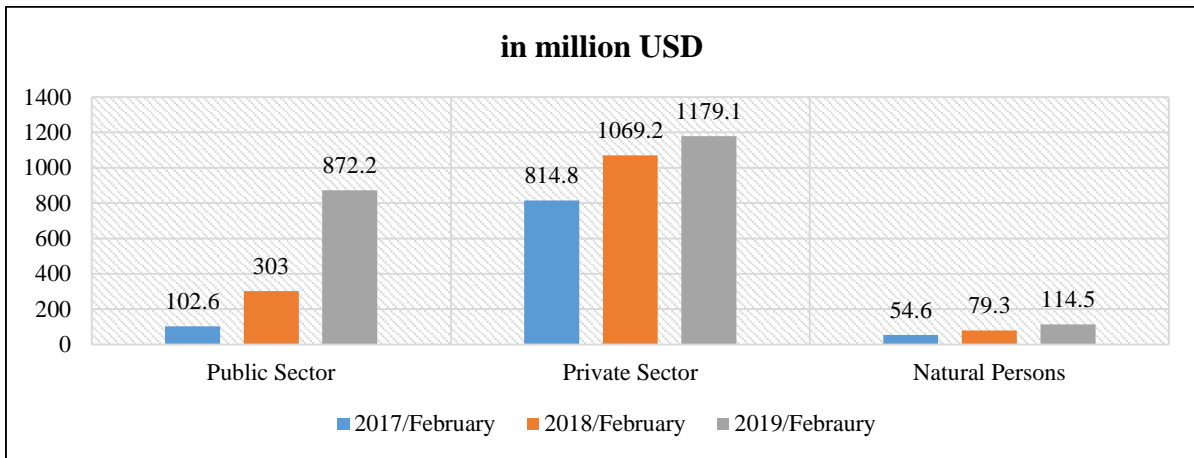
**Diagram 2: Dynamics of foreign trade turnover**



**Source: State Customs Committee of the Republic of Azerbaijan, 2019**

The sharp rise in imports over the first two months of 2019 was mainly driven by the public sector. In January-February of the current year, Azerbaijan imported 2,165.8 million USD worth of goods, of which 872.2 million or 40.2% belonged to the public sector. The volume of imports by the public sector during the first two months of 2019 was 2.8 times or 569.2 million USD higher compared to the same period of last year and 8.5 times more than the same period of 2017 [see diagram 3].

<sup>4</sup>ARMB, Azərbaycan Respublikası Mərkəzi Bankının 2019-Cü İl Və Ortamüddətli Dövr Üçün Pul Siyasətinin Əsas İstiqamətləri Barədə Bəyanatı, baxış tarixi: 31.12.2018, səh 3, <https://uploads.cbar.az/assets/b8204b6da30e6b76600a36009.pdf>

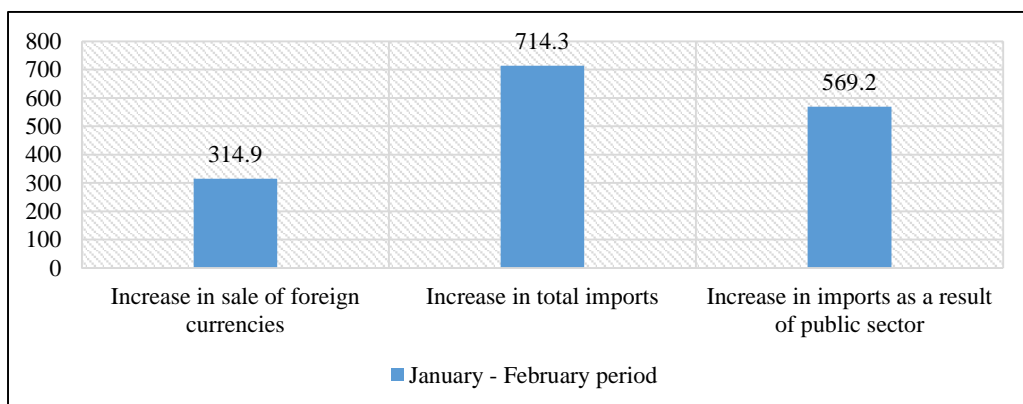
**Diagram 3: Sectoral structure of imports during 2017-2019**

**Source: State Customs Committee of Azerbaijan, 2019**

The sharp increase in budget expenditures (19.6%<sup>5</sup>) and the termination of restriction on imports by the public funds at the beginning of 2018 are the main reasons for the increase in imports by the public sector.

#### **Current situation on other factors that affect the exchange rate of the manat**

Statistical analysis of the current situation shows that in January-February, demand for foreign currencies increased 55.9% less when compared to the growth in imports. This, however, suggests that while the foreign currency demand from importation increased, there is a decline in demand for foreign currencies by the private sector, as well as savings in foreign currency. This is because foreign exchange demand by the public sector was 569.2 million USD more when compared to the preceding year.

**Diagram 4: Growth in various factors**

<sup>5</sup> ARDSK, 2019-cu ilin yanvar-fevral aylarında ölkənin iqtisadi və sosial inkişafının makroiqtisadi göstəriciləri, 15.03.2019

<https://www.stat.gov.az/news/macroeconomy.php?page=1>

**Source: Central Bank, State Customs Committee, 2019**

One of the reasons why currency market participants are more patient compared to previous years is due to the Central Bank's intensive use of communications opportunities. Adequate response to changes in the context of the exchange rate supports deposits in manat. According to the information by the CB, the volume of deposits in January 2019 increased by 7.7% compared to the same period in 2018. The increase is mainly driven by deposits in the national currency (19.7%). The relevant trend was likewise observed in total deposits<sup>6</sup>. While share of deposits in manat in overall deposits was 26.5% (5.5 billion manat) in January 2018, the corresponding figure increased to 33.5% (7.4 billion manat) for the first month of 2019<sup>7</sup>. Prolonging the law which insured full amount of deposits by March 2020<sup>8</sup> created a positive environment for deposits in manat and will continue to do so during the upcoming months. This creates more favorable conditions for the exchange rate of the manat.

There are also a couple of factors that support the current status quo in the exchange rate policy. These factors include: the price of oil, exports, as well as exports by the non-oil sector. At the moment, both of these factors support the surplus in the balance of payments.

Compared to the beginning of the year, oil price on global markets have increased by 26%. The average price for BRENT crude oil in January was 61.7 USD per barrel<sup>9</sup>. This is 2.8% higher than the forecasts of the government. Note that, while conducting the fiscal calculations for 2019, the price of one barrel of oil was taken as 60 USD<sup>10</sup>.

**Table 1: Exports of crude oil, oil products and natural gas**

	2018		2019		2019 compared to 2018	
	Amount	Statistic Value, million US dollars	Amount	Statistic Value, million US dollars	Amount	Value
Crude oil, in tonnes	3648802.7	1827303.5	5781785.4	2603955.6	+ 58.5%	+ 42.5%
Oil products, in tonnes	217283.8	107007.4	92568.2	48501.4	- 57.4%	- 54.7%

<sup>6</sup> ARDSK, 2019-cu ilin yanvar-fevral aylarında ölkənin iqtisadi və sosial inkişafının makroiqtisadi göstəriciləri, 15.03.2019, səh: 94

[https://www.stat.gov.az/news/source/2019\\_02ay.zip](https://www.stat.gov.az/news/source/2019_02ay.zip)

<sup>7</sup> ARMB, Statistik bulletin, yanvar/2019, baxış tarixi: 18.03.2019, səh: 33

<https://uploads.cbar.az/assets/ae5a24ab5c185a3ccfaf7f251.pdf>

<sup>8</sup> “Əmanətlərin tam sığortalanması haqqında” Azərbaycan Respublikasının Qanununda dəyişiklik edilməsi barədə Azərbaycan Respublikasının Qanunu, 19.02.2019

<http://e-qanun.az/framework/41563>

<sup>9</sup> EİA, Petroleum & Other Liquids, baxış tarixi: 18.03.2019

<https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RB RTE&f=M>

<sup>10</sup> Azərbaycan Respublikasının Maliyyə Nazirliyi, “2019-cu ilin dövlət və icmal büdcələri üzrə layihələrin təqdimatı, baxış tarixi: 18.03.2019, səh: 13

<http://www.maliyye.gov.az/scripts/pdfs/web/viewer.html?file=/uploads/static-pages/files/5bd816166dc9b.pdf>

Natural Gas, Thsnd. m <sup>3</sup>	205048.9	29428.9	2019599.2	212357.7	+ 9.8 dəfə	+ 7.2 dəfə
<b>Total</b>		<b>1963739.8</b>		<b>2864814.7</b>		<b>45.9%</b>

Source: State Customs Committee, 2019

The sharp increase in exports can be explained by the significant hike in exports from the oil sector when compared to the same period of last year. The volume of crude oil exported during these two months increased by 58.5% whilst its value rose by 42.5%. There was also a sharp increase in the export of natural gas. The volume of exported natural gas increased 9.8 times compared to the corresponding period of the last year and its value increased 7.2 times. In general, the amount of foreign currency inflows from the oil sector was 45.9% more [see table 1]. Apart from the factors already mentioned, non-oil exports also increased by 16.4% during the reporting period<sup>11</sup>. As a result, a foreign trade surplus equal to 986.3 million USD was formed which is 25.5% more than the same period last year<sup>12</sup>.

Although it was not possible to obtain information on other factors included in the balance of payments, it is clear from the initial disclosure that, according to the official announcement of the Central Bank, there has been a surplus in the balance of payments and the strategic currency reserves of Azerbaijan have grown by 4.1% to 46.6 billion US dollars<sup>13</sup>.

As one can see, the above-mentioned factors allow the managed exchange rate policy to continue at least for the short-run. However, certain state institutions have highlighted their opinions on several occasions that they support the idea of implementing a more liberal exchange rate policy. For example, the Minister of Finance of Azerbaijan expressed its concern about this issue during the budget discussions of 2019. The Minister stated that “The depreciation of the national currencies of our neighboring countries and our major trading partners, on the other hand, decreases the export potential of domestic producers and increases the risk of more imports into the country<sup>14</sup>”. Yet, the other party considers that the weakening of the exchange rate of the manat under existing conditions can create social problems. Considering the publicized official reports, we can expect the Central Bank to switch to floating rate regime in 2020<sup>15</sup>. At the moment, it is apparent that the government is trying to maintain a stable rate of the manat against the US dollar for the current year.

<sup>11</sup> ARMB, Faiz dəhlizinin parametrləri haqqında, 15.03.2019

<https://www.cbar.az/press-release-2165/on-parameters-of-the-interest-rate-corridor>

<sup>12</sup> Azərbaycan Respublikası Dövlət Gömrük Komitəsi, Azərbaycan Respublikası Xarici Ticarətinin Gömrük Statistikası (01.01.2019-28.02.2019), baxış tarixi: 18.03.2019, səh: 12

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<sup>13</sup> ARMB, Faiz dəhlizinin parametrləri haqqında, 15.03.2019

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<sup>14</sup> Report İnformasiya Agentliyi, Maliyyə naziri: “Qonşu ölkələrin milli valyutalarının ucuzlaşması manatın məzənnəsinə təzyiqləri artırır”, 5.11.2018

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<sup>15</sup> İqtisadi İslahatların Təhlili və Kommunikasiya Mərkəzi, Azərbaycan Respublikasında milli iqtisadiyyat perspektivi üzrə Strateji Yol Xəritəsinin icra vəziyyəti, baxış tarixi: 18.03.2019

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**Final notes**

Prognoses show that demand at exchange markets will remain high in the upcoming months of the current year by taking into consideration the approval of sundry projects and increase in budget expenditures including credit concessions.

Under current conditions, an increase in imports is forecasted, especially in the public sector, which indicates that the pressure on the exchange rate will continue.

Even in the case of a spike of demand in currency markets, the current oil price, increase in exports and the partial recovery of trust to the national currency, supports the government in the provision of the current (fixed) exchange rate policy.

The increase in transfers from the Oil Fund to the state budget in 2019 will enhance the Fund's conversion capability in the currency market, which is one of the key factors that eases the pressure on exchange rates.

The strategic currency reserves, which increased on the back of balance of payments surplus, support the potential capabilities for neutralizing short-term fluctuations that may arise from external factors in the context of currency. In other words, exchange rate fluctuations are less probable in the short-term period.

As can be seen from the statistical analysis, the oil price factor maintains its dominance over exchange rates. Therefore, the exchange rate of the manat in the medium and long term will be determined depending on change in oil prices.





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