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## **The Azerbaijani manat's devaluation: what are next steps?**

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On December 21, the Central Bank of Azerbaijan abandoned its dollar peg, allowing Azerbaijani Manat (AZN) to nose-dive by almost a half.

After the Central Bank relinquishing control of its exchange rate, the quoted exchange rate was announced 1.55 against US dollar. It is the Azerbaijani Manat's weakest record over the last 20 years.

Azerbaijan – an economy rich in energy in the post-Soviet era – has enjoyed impressive economic growth and stability over the past decade. During the last decade, the Azerbaijani Manat versus the US dollar rate exchange was 0.7850 AZN = 1 USD. In the February 2015, after the first devaluation, the rate exchange was 1.05 AZN = 1 USD. The sharp decline in the oil prices has significantly affected the oil revenues and inflow of the foreign currency.

The severe exploitation of the Central Bank reserves, accumulated for the last 10 years, during the last year and spending 589 million only in November 2015, has left the Government of Azerbaijan with no choice but abandoning its fixed exchange-rate policy, pegging AZN to USD.

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The Center for Economic and Social Development (CESD) is scrupulously monitoring the situation in the exchange market. CESD is concerned about the social and economic back-splash of the new exchange rate. In his interview to the local Media outlets, Mr. Vugar Bayramov, the Chair of the Board, calling it 'expected measures', has stated “in order to reduce a negative effect in fall in the exchange rate of Azerbaijani Manat, an indexation of wages is necessary”. This concern derived from the increase of the prices for food and basic need service costs.

Also, the head of CESD is concerned about the bank loans in USD. “There is a need for new mechanisms on repayment of USD loans, because problems are expected in repayment of the loans in USD taken by the general population'.CESD is working on reforms related to public finance, increasing the export potential of the country, restructuring the governmental agencies, taking all barriers for the small and medium enterprises. The following measures will let the country to tackle the problems generated by the devaluation:

(a) Reforms regarding banks, mortgage and bank loans:

- Preparing and implementing new templates for returning loans received from private banks in foreign currencies. The Central Bank should compensate a share of the costs in AZN generated by the devaluation; otherwise the payment duration for the loans in foreign currencies should be extended, as it was done in Russia following the global financial crisis. Taking into account that the devaluation rate of AZN is 98%, compared to the currency exchange rates before the devaluation of 21st February 2015, compensation in the shares of these loans by the Central Bank is vital. Since the income of the general credit debtors are received in AZN, their ability to The Azerbaijani manat’s devaluation: what are next steps?

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pay back the loans will sharply decline. Moreover, as it happened in Russia following the Global Financial Crisis, the debt, which emerged from the difference between the old and new exchange rates, can be compensated by the Central Bank by providing the private banks with additional resources and extending the payment period. This method will generate an incentive for banks to lower the loan rates; so far, the banks did not indicate any will to lower the loan rates or other serious discounts for the customers. The banks alone cannot solve the problem and hence the set of steps by the government should be taken.

- The indexation of the general population savings in the banks. For the time being, the 20% share of AZN savings in the bank accounts, which overall is 7 billion, is equal to 1,4 billion AZN. This means that 1,4 billion AZN belonging to the general population has lost its value twice, compared to the previous year. As it was done in Kazakhstan after the devaluation, the Central Bank of Azerbaijan should prepare the template for indexation of these savings and implement it. This will increase the trust toward the local currency and mass exchange of the savings will not take place.

- In order to save the liquidity of the banks, inhibitory measures should be implemented. The devaluation of AZN will lead to the increase of the loans with problems, and in turn, the banks' debt obligations to the foreign financial institutions will increase in AZN. Following this idea further, the Central Bank of Azerbaijan should take measures in order to increase the capacity of the private banks to get the resources from centralized credit resources. This will give a chance

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to 'fragile banks' to avoid bankruptcy.

(b) Reforms regarding the social sphere:

- The indexation of the salaries, pensions, health insurances and scholarships, based on the real forecasted inflation rates. Considering Azerbaijan importing most of its consumer goods from abroad, the price for the basic need services will increase. It is vital to prepare and implement templates for indexation of the salaries, pensions and other income sources of the general population
- The indexation should cover all the priority directions of social expenditures.
- The mortgage loans targeting the social concerns of the general population should be indexed and optimized.

(c) Reforms regarding the business sector:

- The elimination of illegal barriers in and interventions to business, which prevents the improvement of the sector
- The complete elimination of monopolies in foreign trade
- Simplifying the process of getting business loans for businessmen and increasing the transparency for these type of credits
- Improving the mechanisms in the area of giving subsidies to key business areas, including

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farmers

- The elimination of all barriers that prevent businessmen to enter the market
- The implementation of subsidies policy to the non-oil sector

(d) Reforms regarding the consumption market

- Determining the dollar and manat expense segments of imported goods and the regulation of prices such that the inflation is the direct result of price increase in only the goods imported with foreign currency.
- Optimizing the price regulation of strategic food products
- Strengthening the regulation against market manipulation and broadening the scope of monitoring

Our analysis shows that, the realization of the business offers above will allow the economy to minimize the negative effects of the policy of floating currency by contributing to the price regulation in consumption market, preserving the real growth rate in people's income, stimulating exports in non-oil sector and increasing the flow of foreign currency into the country.

(e) Reforms for increasing the export potential of the country:

- The elimination of artificial barriers and monopolies in foreign trade in order to increase the non-oil export potential. In a floating exchange rate regime, the exchange rate of manatis determined by the supply of foreign currency inflows. That is to say, the increase in foreign currency inflows will result in higher supply of foreign currency, and therefore decrease the pressures on national currency. Currently, an increase in foreign currency inflows are dependent

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on the elimination of barriers in foreign trade.

-The acceleration of Azerbaijan's accession to the WTO in order to increase export potential.

The accession to the aforementioned organization can lead to liberalization of foreign trade turnover of the country, as well as to increased foreign currency inflows.

-The acceleration of the proses of delegating foreign trade services to ASAN service, and development of the digitalization of import-export transactions

(f) Reforms regarding the structural changes:

- The elimination of identical authorities and the acceleration of integration process of government authorities. Reducing the number of government authorities will lead to lower government expenditure, and to improved management. This will directly affect to money turnover.

- Improving the classification of expenditure in government budget, along with preparation and application of new expenditure mechanisms.

- The optimization and minimization of indirect subsidy templates.

In addition the above mentioned steps, in the previous years, analyzing the ongoing trends and forecasting the negative consequences produced its Anti-Crisis strategy, first in Azerbaijan. The Strategy was partially adopted by the Government of Azerbaijan, back then.

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