

ARMENIA:

**MONETARY POLICY AND
ECONOMIC GROWTH
"MONETARY POLICY AND
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TATEVIK AZATYAN**

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“Armenia: Monetary policy and economic growth” is an electronic periodical which aims to analyse and briefly represent the overall view and trends of monetary policy and economic growth of RA.

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YEREVAN 2018

THE MONETARY POLICIES OF THE NEIGHBORING COUNTRIES OF RA AND THE COMPARISONS WITH RA

1. DESCRIPTION OF GEORGIA'S MONETARY POLICY STRATEGY

Author Tatevik Azatyan

The main objective of the monetary policy of the National Bank of Georgia is to maintain price stability. The National Bank of Georgia follows the inflation targeting regime in the conduct of its monetary policy. This regime implies the announcement of an inflation target in advance. In the long-run, the desired level of inflation in Georgia is 3%. It should be noted that developing countries tend to have higher level of inflation, which is mainly caused by rapid growth in productivity. For example, in some European countries in 2016, the inflation rate fluctuated between 0.9 and 3.7 %. Great Britain - 0.9 %, Sweden - 1.2 %, Hungary -1 %, Poland - 0.5 %, Czech Republic - 0.8 %, Norway 3.7 %:

However, at the recent stage of economic development in Georgia, the gradual reduction in inflation target was appropriate. Hence, from 2018 onwards, the inflation target of the National Bank of Georgia was reduced to its long-run level of 3%. According to tough estimates, inflation in Georgia is conditioned by high productivity growth in tradable sector- 2% (in comparison with non-tradable sector). As productivity growth slows down, the National Bank of Georgia will gradually decrease the inflation target. In the long-run, the desired level of inflation is defined at 3%.

In the chart 1.1, annual average inflation trends in 2010-2017 are presented.

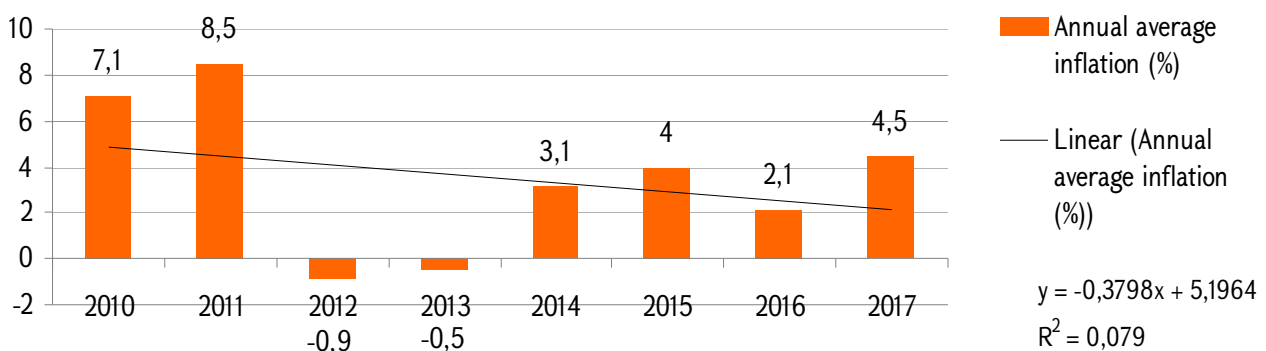


CHART 1.1. Annual average inflation trends in 2010-2017 in Georgia (%)*

Source: <https://www.nbg.gov.ge/index.php?m=2>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank)

1.1. GEORGIA'S MONETARY POLICY TRANSFER MECHANISM

In order to maintain price stability, the NBG uses short-term interbank interest rates (up to 7 days) for operational targets. By defining the monetary policy rate, NBG tries to influence short-term interest rates on the interbank market. Consequently, this effect is forwarded to short-term and then

long-term interest rates on commercial banks, and ultimately affects the aggregate demand in the economy. In particular, the tendency of refinancing rate fluctuation in Georgia in 2010-2016 is presented in Chart 1.2.

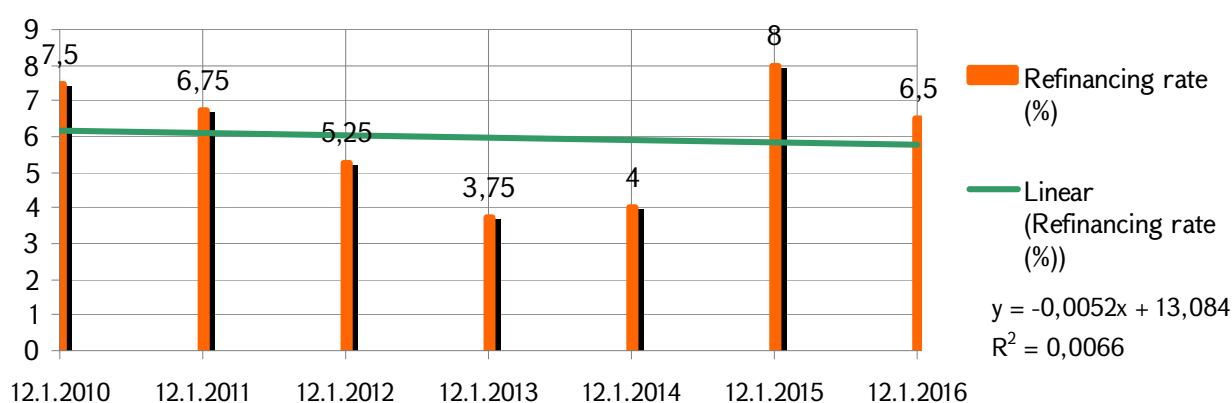


CHART 1.2. Refinancing rate (%) 2010-2016 *

Source: <https://www.nbg.gov.ge/index.php?m=2>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank)

The main instrument of the NBG monetary policy is one-week refinancing loans, which are provided to commercial banks on auction basis. The trend of this instrument fluctuation is shown in Chart 1.3. NBG also uses other instruments such as one month open market operation, open market operations with certificates of deposit and treasury securities, overnight loans and overnight deposits, minimum reserve requirements and other instruments. How the monetary policy instruments are more efficient, the social value of the price stability is lower. Consequently, NBG is constantly working on improving monetary

policy instruments and increasing the effectiveness of the money transfer mechanism.

NBG is the only provider of short-term liquidity in the Georgian lary market. The liquidity forecasting group estimates the short-term liquidity deficit in the banking system over the weekly basis. In 2010 April, the NBG introduced a new policy instrument - guaranteed refinancing loans. With this policy instrument, local commercial banks can get loans without auction. The guaranteed refinancing loan interest rate is defined as the monetary policy rate plus 1.5 percentage points.

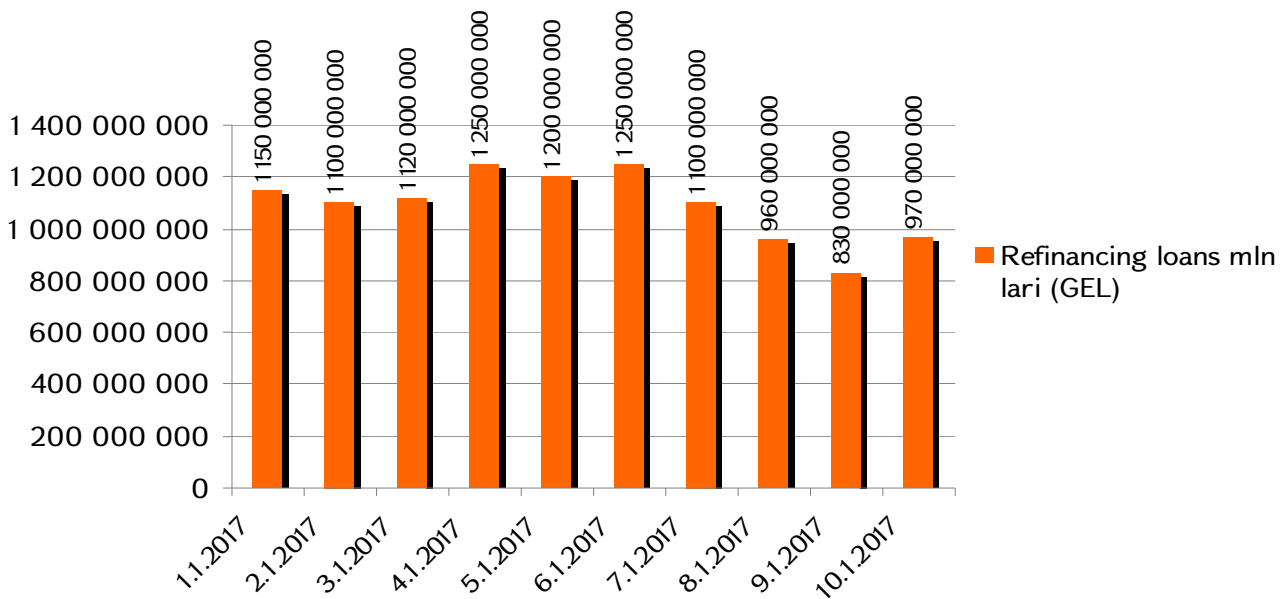


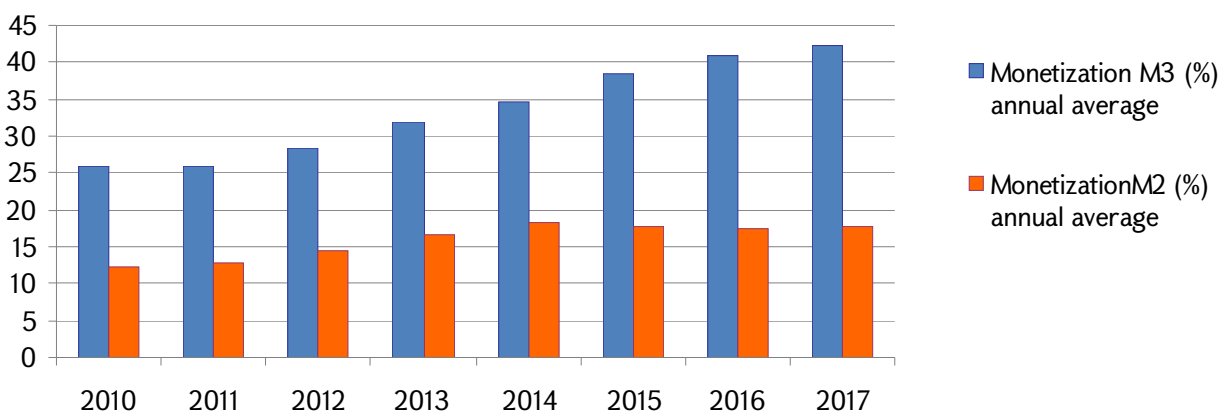
CHART 1.3. Refinancing loans mln. lari *

Source: <https://www.nbg.gov.ge/index.php?m=2>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank)

The average increase in the level of monetization improves the effectiveness of monetary policy, which is one of the main objectives of the NBG. Recently, the NBG has initiated a number of measures aimed at increasing the monetization level and increasing public confidence in the national currency. Nevertheless, it is a long process

that requires financial and economic stability to change the behavior of economic agents. The trends of monetization level are presented in Chart 1.4. In order to compare the effectiveness of instruments used in monetary policy, the Chart 1.5 has been built.



**CHART 1.4. Annual average levels of monetization(%) (M3, M2)
National Bank of Georgia***

Source- <https://www.nbg.gov.ge/index.php?m=2>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank)

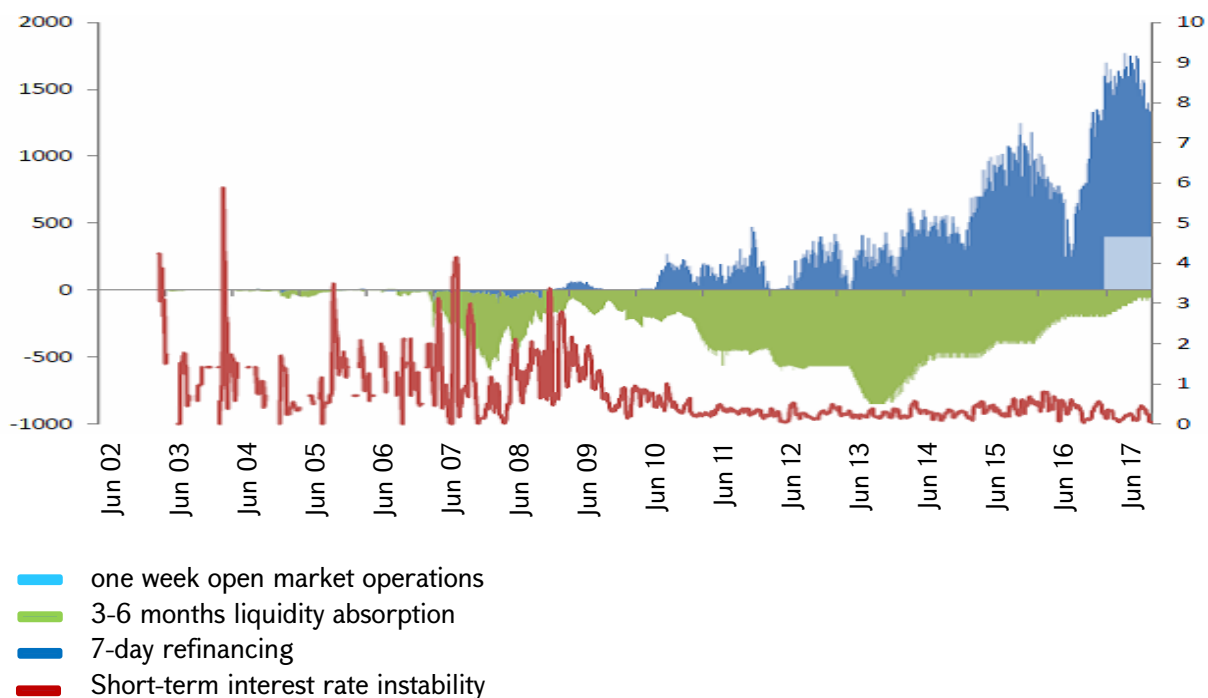


CHART 1.5. The effectiveness of monetary policy instruments

Source: <https://www.nbg.gov.ge/index.php?m=2>, <https://www.cba.am/EN/SitePages/Default.aspx>

A diagrammatic analysis of the two-week view of the effectiveness of monetary instruments shows that 7-day refinancing and one week open market operations are most effective, and the other two

instruments show unstable behavior. One of the direction of impact of the monetary policy interest rate on the aggregate demand is the exchange rate, the fluctuation trends are presented in Chart 1.6.

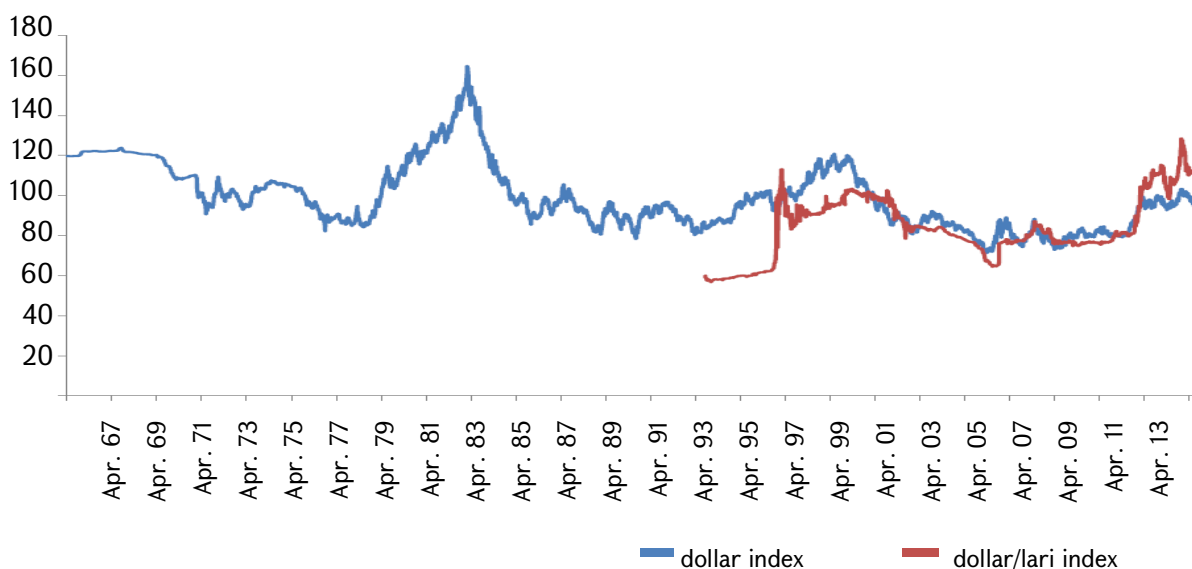


CHART 1.6. Exchange rate fluctuations

Source: <https://www.nbg.gov.ge/index.php?m=2>

1.2. COMPARISONS WITH RA

As for the relative description of monetary policy in Armenia and Georgia in comparison we briefly present it below.

Starting from June 2006 Central bank of Armenia within the scope of the Law on Central Bank of Armenian officially adopted new framework of inflation management' moving to the strategy of inflation targeting.

The transition to the inflation targeting

strategy in Georgia was done in 2009. As in Georgia, the primary goal of the CBA is prices stability,

The CBA coordinates the primary goal with the Government of Armenia, According to the monetary policy, the policy is aimed at minimizing the deviations between the targeted 4% and the inflation forecast.

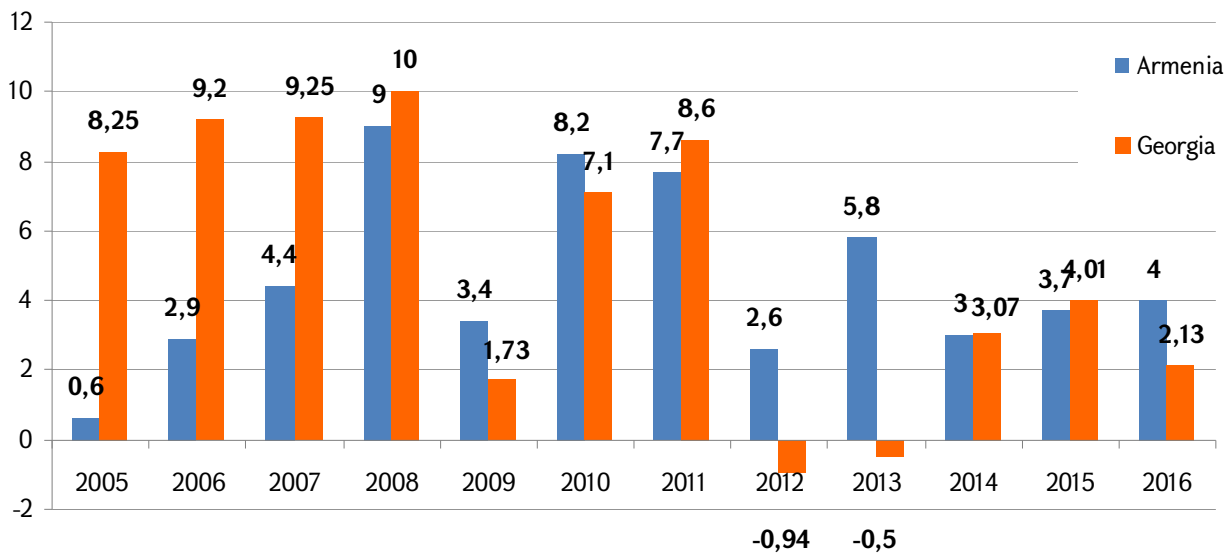


CHART 1.7. Annual average inflation levels in Armenia and in Georgia (%) in 2005-2016*

Source: <https://www.nbg.gov.ge/index.php?m=2> , <https://www.cba.am/EN/SitePages/Default.aspx>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

Both countries are in the general field of regulation set by the Basel Committee on Banking Supervision. Inflation levels of two countries in 2005-2016 in comparison is presented in Chart 1.6. If the Central Bank estimates that the forecasted inflation deviates from the target, it begins to change the monetary policy interest rates of instruments. The instruments are:

- refinancing rate.

- deposit rate
- lombard repo rate.

In terms of the instruments used, the refinancing rate is applied in both countries. The same instruments that are used in both countries are also the minimum reserve requirements and the lombard repo.

In 2016, the Central Bank of Armenia implemented an expansionary monetary policy, gradually reducing the refinancing

rate. In December, the refinancing rate was set at 6.25%, dropping by 2.50 percentage points, as compared to previous December. In 2017 this indicator was 6.00%. Along with the weakening of monetary conditions, the financial market rates have dropped dramatically, reflecting the efficiency of transfer. In the same period the National Bank of Georgia has fixed 6.75%, and in the middle of 2017 it lifted by 0.5 points and set it 7.25%.

In 2014 year the depreciation of the Georgian lara and the Armenian dram in November-December showed the differences between the mechanism and counteraction of the central (national) banks in both countries. When the drams started to depreciate over the mentioned months, the Central Bank of Armenia dramatically increased the reserve norm of foreign currency deposit of commercial banks (in drams). With this decision, the CB has effectively created an artificial deficit of AMD. At the same time, the regulator launched an aggressive sale of the dollar at the expense of its foreign currency reserves. As a result, the dram depreciated only by 20%, the lowest in the region, which helped to mitigate the social risks. However, there was no less expensive price against of it- slower economic growth, a reduction in foreign exchange reserves (covering the import of three months, which is the so-

called "red line") and hindering export growth.

What happened in Georgia? 2014 year In November-December the Georgian lara began to weaken by almost 60% depreciating against its dollar at its lowest point. This situation puts social and political pressure on the government of the country and the National Bank of Georgia. It was expected that the latter would intervene and stop the devaluation of the lara, selling part of its dollar reserves but that did not happen. The argument was as follows: The exchange rate is floating, and it must be set by the market: Exchange rate stability is not the ultimate goal of the regulator.

As a result, the economic activity continued to remain relatively high; the exporters gained from local currency depreciation, and the foreign exchange reserves remained unaffected and remained relatively high.

Meanwhile, individuals and local companies suffered most, most of them had dollar loans. These steps of the central banks of the two countries have definitely not been correctly or inaccurate, this is a matter of perspective, difference between social and political expectations.

2. DESCRIPTION OF IRAN'S MONETARY POLICY STRATEGY

Authors: Liana Ananyan, Meri Melqonyan

Iran's monetary policy framework does not provide the CBI adequate tools to keep inflation low and stable.

This is evidenced by unstable inflation fluctuations over the years. The CBI

requires greater independence and market-based instruments to sustain low and stable inflation.

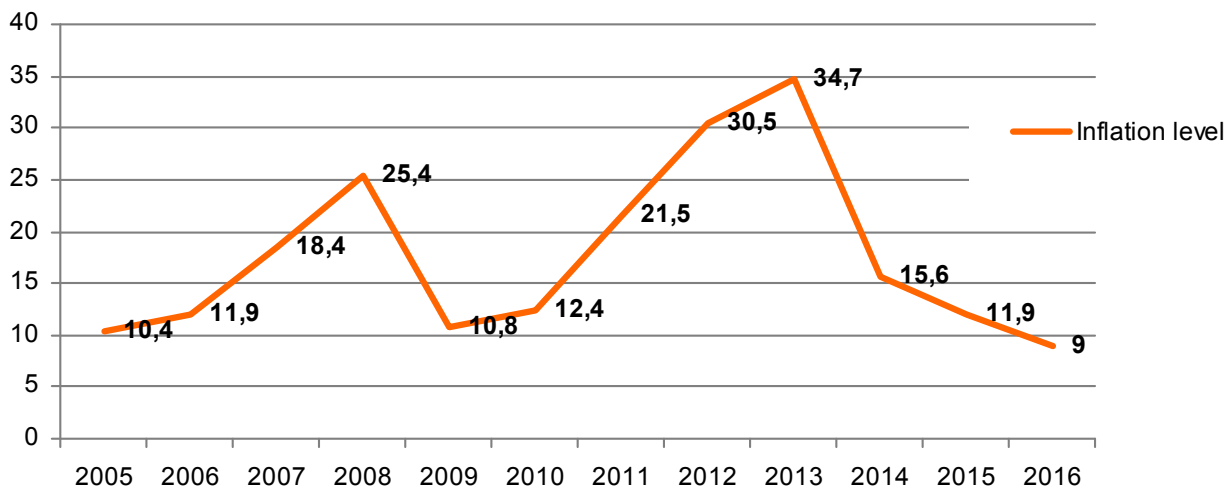


CHART 2.1. The inflation rate of Iran (%) in 2005-2016*

Source: https://www.cbi.ir/default_en.aspx

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

2.1. IRAN'S MONETARY POLICY TRANSFER MECHANISM

The main objectives of macroeconomic policies, in general, and monetary policies, in particular, are price stability, economic growth and a favorable employment level. Since it is hard for policy makers to achieve the ultimate goal directly, therefore, determining intermediate objectives and introducing appropriate instruments are deemed necessary. On this basis, two different monetary policy instruments are being utilized: direct instruments (with no reliance on market conditions) and indirect instruments (market-oriented):

✓ *Direct Instruments*

- Banking profit rates - With the implementation of Usury-free Banking Law and the introduction of contracts with fixed return and partnership contracts, the regulations pertaining to determination of profit rate or expected rate of return on banking facilities and the minimum and maximum profit rate or expected rate of return, as is stipulated in the by-law of the Usuryfree Banking Law, are determined by the Money and Credit Council (MCC).

Moreover, the CBI can intervene in determining these rates both for investment projects or partnership and for other facilities extended by banks.

- Credit ceiling – According to Article 14 of the Monetary and Banking Law of Iran, the CBI can intervene in and supervise monetary and banking affairs through limiting banks, specifying the mechanisms for use of funds and determining the ceiling of loans and credits in each sector.

✓ **Indirect Instruments**

- Reserve requirement ratio: Reserve requirement ratio (RRR) is one of the CBI's indirect instruments of monetary policy. Banks are obliged to deposit part of their liabilities in the form of deposit with the CBI. Through increasing/decreasing this ratio, the CBI contracts/expands the broad money. According to Article 14 of the Monetary and Banking Law of Iran, the CBI is authorized to determine RRR within 10 to 30 percent depending on banks' liabilities' composition and field of activity.
- CBI Participation Papers: Appropriate implementation of monetary policies by the CBI is done through open market operations, which provide the required flexibility in liquidity management and intervention in the money market. Following the implementation of the Usuryfree Banking Law, tailoring

appropriate Sharia-based instruments for the development of open market operations in the context of liquidity management and affecting money and capital market became a necessity. Utilization of bonds, owing to its fixed interest rate nature, is prohibited according to Islamic Sharia; however, utilization of participation papers and investors' partnership in economic activities and payment of profit is encouraged. According to the 3rd FYDP Law, the CBI was authorized to issue participation papers through the MCC approval. However, based on the 4th FYDP Law, issuance of Participation Papers by the CBI is authorized upon the approval of the Parliament. By using this instrument, the CBI could affect broad money (M2) through monetary base, thereby controlling the rate of inflation.

- Open deposit account (ODA): One of the bold measures taken for the efficient utilization of indirect monetary instruments in the framework of the Usury-free Banking Law is to allow banks to open a special deposit account with the CBI. Regulation on ODA was approved by the MCC at the end of 1377 (1998/99). The main objective of this plan was the adoption of appropriate monetary policies to control liquidity through absorption of banks' excess resources. The CBI pays profit to these deposits on the basis of specific rules.

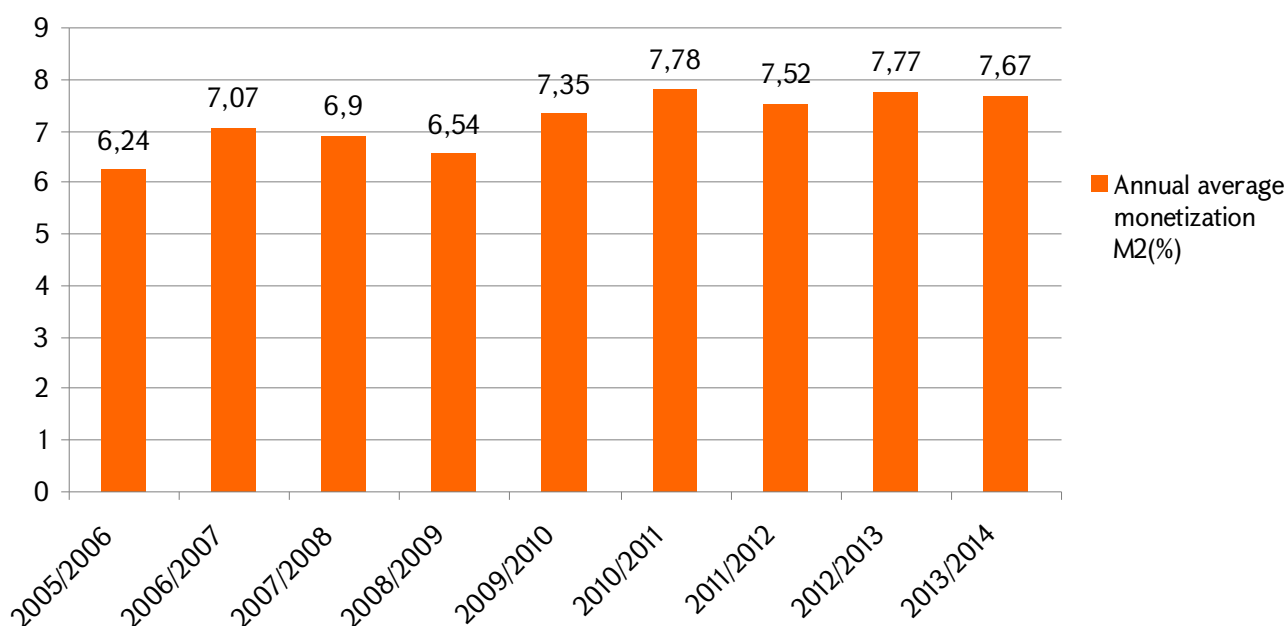


CHART 2.2. Annual average monetization M2(%)*

Source: https://www.cbi.ir/default_en.aspx

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

In 2005-2014 there is no significant fluctuation in the level of monetization that can be testified by CBY's regulation of M2 aggregate according to GDP trends.

In 2017, the US dollar-rial ratio, published by the Central Bank of Iran, is as follows (see Chart 2.3):

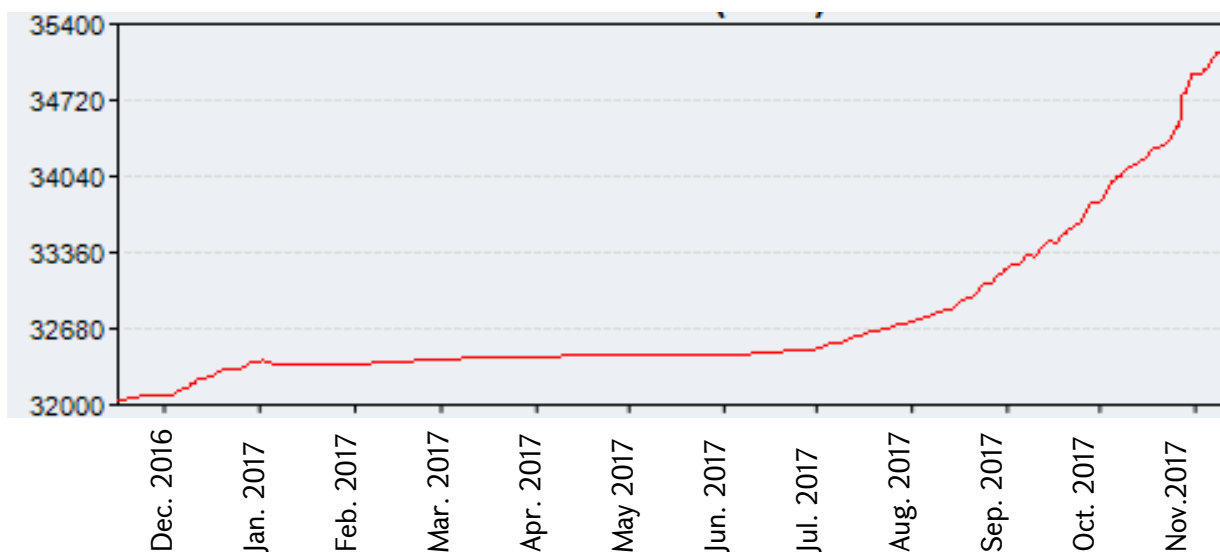


CHART 2.3. Dollar-Rial ratio

Source: https://www.cbi.ir/default_en.aspx, <https://www.cba.am/EN/SitePages/Default.aspx>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

2.2. COMPARISONS WITH RA

The principles of Islam apply to banking systems in many Islamic countries. The Koran prohibits the "Reba", which means that it does not accept the concept of interest, and therefore considers any interest as "reba".

Its meaning is that money can not be considered a commodity and should only be used in production. That is why the unique feature of the Islamic banking system is that deposits and loans do not have a fixed interest rate. Throughout the world, national banking systems gradually strive for modern banking services. Banking systems in the countries that will stay away from this tendency will be left out of competition.

In this sense, the Iranian banking system is also trying to keep up with modern banking technology so that it can survive in the third millennium.¹ The bases for the implementation of the measures announced by the Central Bank of Iran, which are conditioned by this circumstance, are not transparent, which creates difficulties in comparison with other countries (including RA).

In this respect, it is difficult to make comparisons in terms of the peculiarities of the monetary policy of the Republic of Armenia as it is inexpedient in terms of the difference between religious denominations.

¹ <http://www.sepahbank.ir> and Modern banking in theory and practice, SHELAG HEFERNAN, 2003 page 175-176

3. DESCRIPTION OF TURKEY'S MONETARY POLICY STRATEGY

Authors: Karen Grigoryan, Tonik Shahbazyan, Ani Ghazaryan, Gayane Baghumyan

The main goal of the Central Bank of Turkey (CBT) monetary policy is to maintain price stability. The CBT has been exercising an inflation targeting strategy. CBT functions are:

- Prices stability provision,
- Establishing financial stability,
- Acceptance and maintenance of exchange rate regime,
- Cash withdrawal,
- Payment arrangement,
- Selection of Monetary Policy direction in Turkey,
- 2001-2005, inflation indirect targeting,
- 2006-2009 complete inflation targeting,

- from 2010 till now -financial stability and inflation target.

The TCB uses a combination of monetary instruments to achieve its multiple goals. There are one week repo (short-term repo), interest rates overnight (%), interest rates at liquidity window(%) in Interbank money market and in Istanbul stock exchange repo reverse repo transactions market.

Inflation target in 2015-2019 is 5%, and 5% + / - 2% as the uncertainty band, which is also defined by the Medium Term Expenditure Framework.

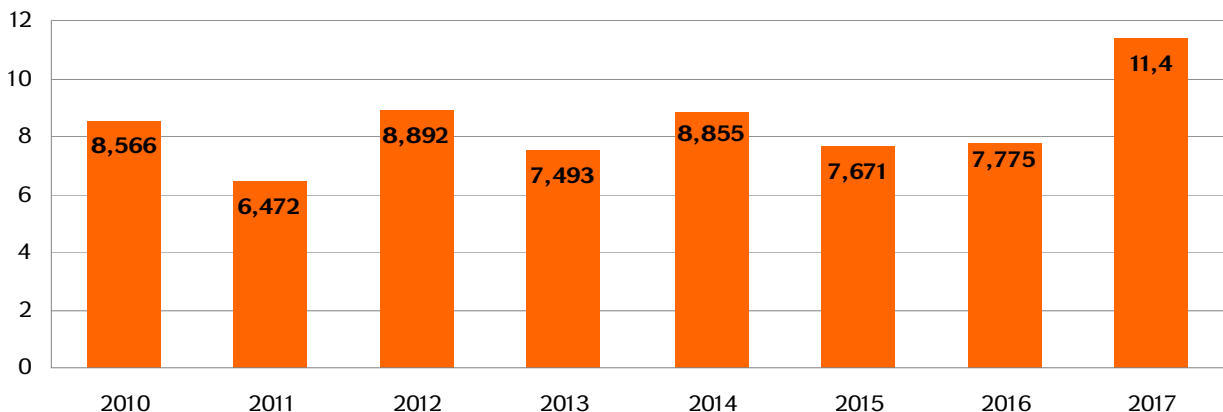


CHART 3.1. Annual inflation trends in Turkey (%) in 2010-2016*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

3.1. TURKEY'S MONETARY POLICY TRANSFER MECHANISM

The main tool used to maintain price stability is the short-term repo rate, which trends can be seen in Chart 3.2. The Central Bank of Turkey tries to influence short-term interest rates in order to affect aggregate demand.

As can be seen, in recent years, the CBT has conducted a relatively mild, then

abruptly restraining monetary policy: This is explained by the CBA's position to protect the exchange rate from the negative effects of recent global uncertainty, the fluctuations of inflation expectations and the negative pricing process. Therefore, the CBT raised the one-week repo and interest rates overnight at 50 and 25 basis points

respectively. Now, the short-term repo rate is 8%, and lending and borrowing overnight rates are 7.25% and 8.50%, respectively. During 2016 the one-week repo has become a major refinancing instrument for CBT.

By the decision of the CBT session in 2018, future monetary decisions will largely be based on inflation expectations.

It is also anticipated that the CBT will continue to pursue a restraining monetary policy.

In 2008-2009 Turkey also did not leave the negative impact of the crisis, after which the CBT also changed its position on monetary policy. The latter adopted the non-conventional monetary policy direction and, in addition to its main objective of ensuring price stability, the financial stability is also emphasized in 2010.

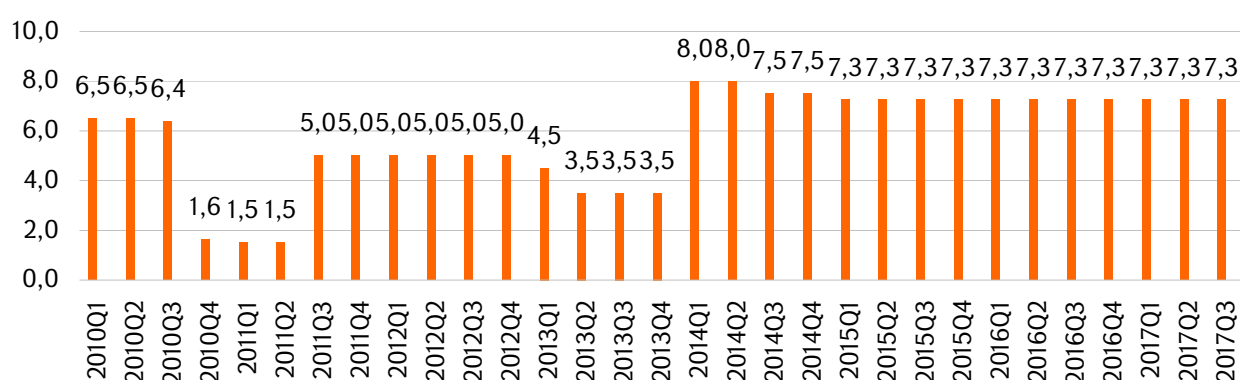


CHART 3.2 Refinancing rate trends (%) in 2010-2017*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

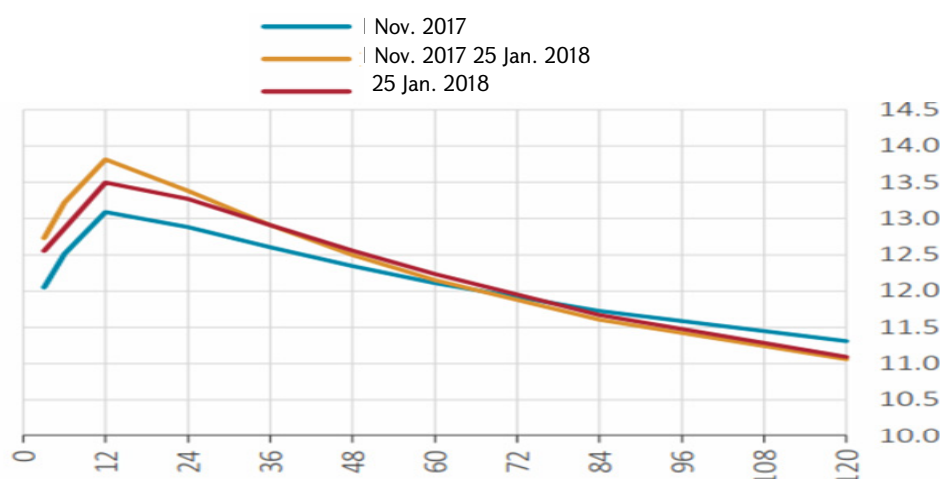


CHART 3.3. Swap yield curve

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

And therefore, there was a need for a new instrument that would enable it to implement monetary and macro-prudential

policies simultaneously. As a new instrument, the Reserve System's mechanism was set up to define the reserve

requirements or to ensure price and financial stability and liquidity in the market. In case of deposits in Turkish lira, the reserve rate is 10.5%, while deposits in foreign currency - 12.0%.

The CBT also uses a number of other

instruments, including foreign currency swap transactions. Due to the recent negative impact of geopolitical risks, the long-term foreign currency swap interest rate has dropped, while mid-term and short-term swap rates have increased.

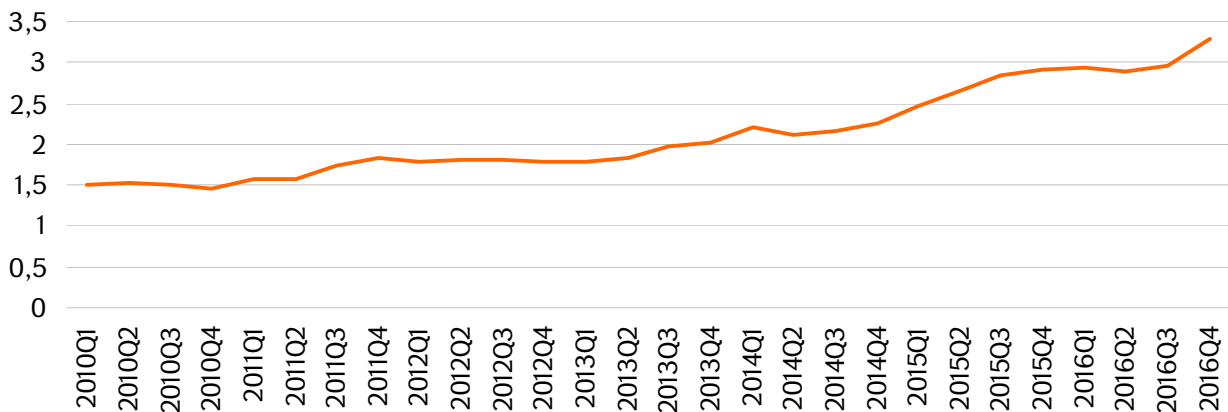


CHART 3.4. Lira exchange rate fluctuation 2010-2017*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

In 2017, the currencies of developing countries have risen in comparison with the US dollar. As for the exchange rate movement, as a result of a series of measures undertaken by the CBT, it has managed to keep it from abrupt fluctuations by mitigating the impact of geopolitical risks. It is noteworthy in the recent years, the

movement of the Turkish Lira M3 aggregate, especially to GDP, which we can be seen in Chart 3.5. By the end of 2017, the M3 totaled 1.68 trillion liras, an increase of 16.1% over the previous year, the largest share of which is term deposits - 11.2%, while demand deposits - 4.3%.

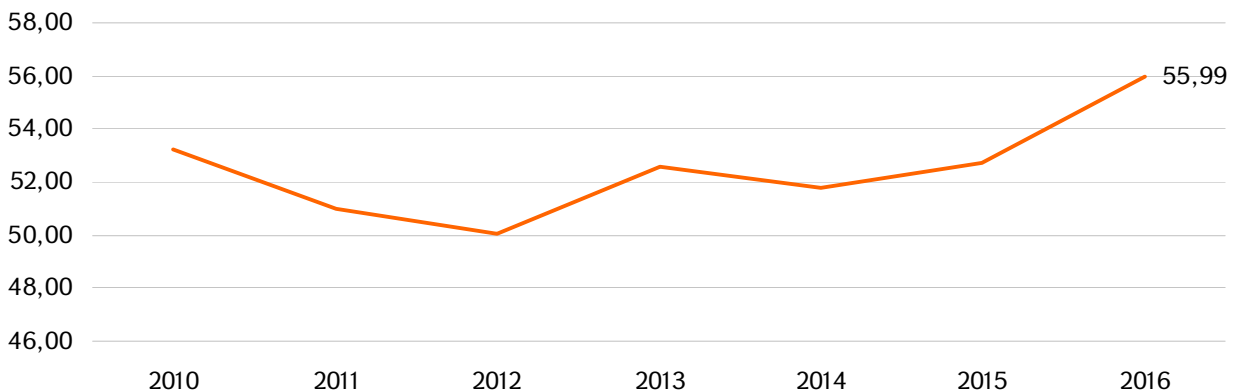


CHART 3.5. The M3 / GDP motion of the Turkish lira (%) 2010-2016*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

Against this background, growth was also observed in the volumes of loans, which can be seen in Chart 3.6. The Central Bank of Turkey also attaches great importance to the transparency of monetary policy implementation. For this purpose, quarterly inflation report is published, announcements, press conferences are periodically implemented.

Minimum number of meetings of CBT sessions is set 8 times, and immediately after each meeting, the monetary decisions are made.

Meetings with real and financial sector representatives are regularly organized, and recently the CBT blog has been issued, which publishes a series of surveys by the bank and CB decisions.

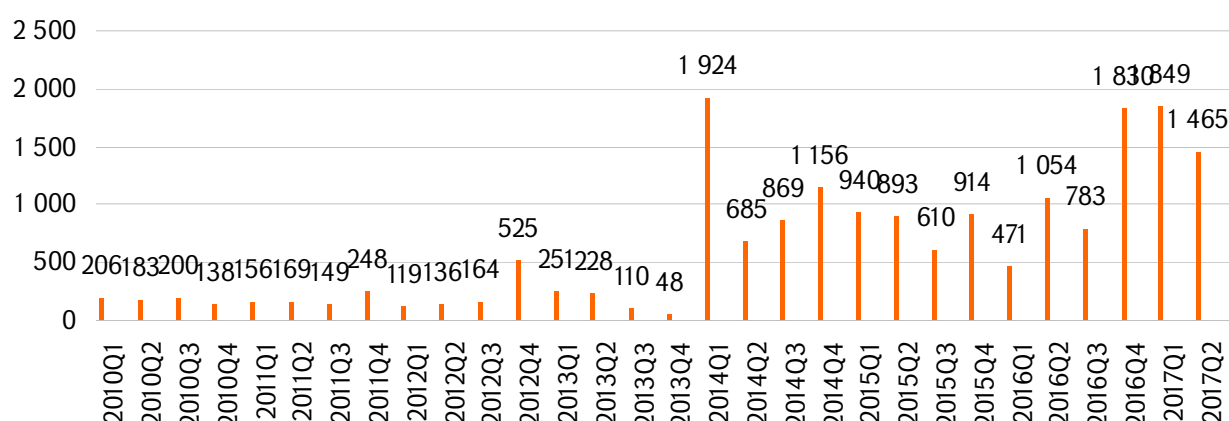


CHART 3.6. Loans (mln. lira) in 2010-2017*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

3.2 COMPARISONS WITH RA

The similarities are clear from the point of view of the monetary policy strategy choice. Both countries have chosen the same monetary policy strategy, ensuring a stable price level. Meanwhile, the target level of inflation in Turkey is $5 \pm 2\%$, in Armenia - $4 \pm 1.5\%$. Both Armenia and Turkey have an interim goal to predict inflation. In terms of the instruments used,

the refinancing rate is applied in both countries. One of the same instruments are the minimum reserve standards and lombard repo. Both countries are in the general field of regulation set by the Basel Committee on Banking Supervision. The comparison of indicators of inflation of two countries in 2007-2016 is shown in chart 3.7.

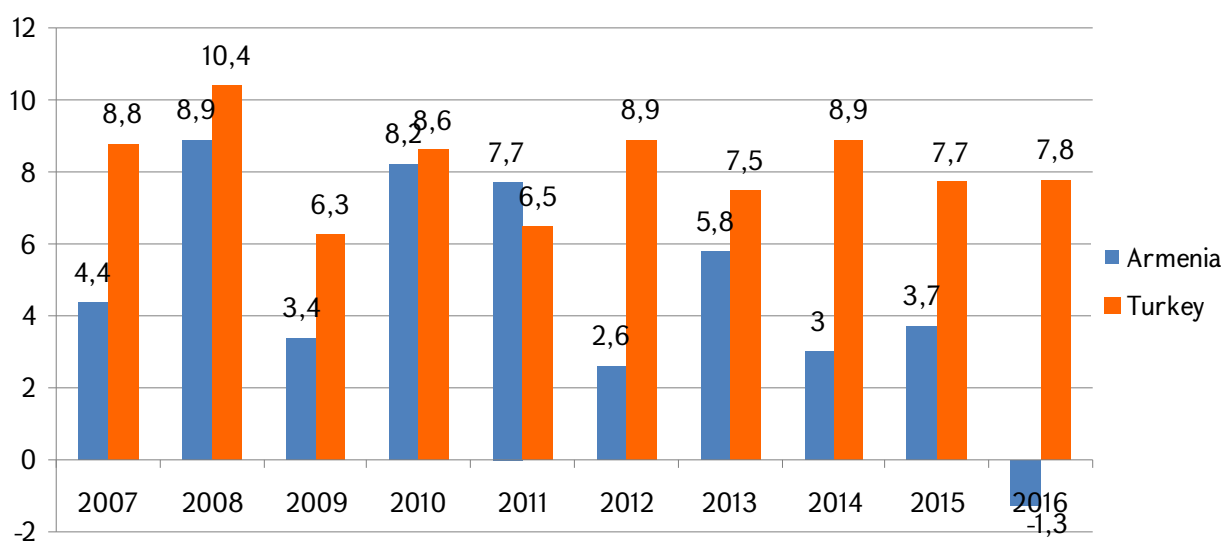


CHART 3.7. Armenia and Turkey inflation rates comparison (%) in 2007-2016*

Source: <http://www.tcmb.gov.tr/wps/wcm/connect/en/tcmb+en>,
<https://www.cba.am/EN/SitePages/Default.aspx>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank)

As it is seen from the chart, unlike the CBT, the CBA succeeds in maintaining inflation at the targeted level, here the deviations are observed only in 2008, 2010, 2011 and 2016. Meanwhile, the deflation was registered by 1,3% in Armenia in 2016, and inflation in Turkey has started to accelerate. It should be noted that international organizations urge the CBT to raise the targeted level of inflation, as it has not been able to achieve the long-term outlook, the CBT has sent distrust and negative expectations to the public, which increases inflationary pressures.

It is also obvious that unlike the CBA the CBT's dependence on the government programs is much more. This can be justified by recent activities. When the Armenian dram was depreciated at the end of 2014, the Central Bank of Armenia effectively curtailed the depreciation of the

dram by maintaining tough monetary policy, as well as market operations, it dropped by 20%, which was the lowest in the region. In the case of Turkey, when the lira began to depreciate in 2015-2016, CBT did not change its monetary policy by keeping interest rates at the same level. Moreover, the Turkish government started a policy of subsidizing, which led to more devaluation of lira, about 40% as compared to the beginning of 2015. These two policies have no definite or wrong character, as in the case of Armenia the economic growth slowed down and the foreign currency reserves were reduced, but the socio-economic situation was stable, while in the case of Turkey, the economic growth accelerated and exports reached the highest level in recent years but inflation also reached at its highest level, causing social pressures.

4. DESCRIPTION OF AZERBAIJAN'S MONETARY POLICY STRATEGY

Authors: Karen Grigoryan, Ani Shavarshyan, Svetlana Xaratyan, Inga Ghalayan

The main goal of Central Bank of Azerbaijan is price stability. In 2016, for the first time in 15 years, Azerbaijan registered a two-digit indicator characterizing inflation. In 2010-2016 this indicator was 4.98% on average. In 2016, Azerbaijan's economy was experiencing a stagnant image, an increase in the rate of decline in the economy, which was accompanied by a rise in prices. This was mainly due to the rather passive policy of the government of Azerbaijan in 2015, because even the 2-times devaluation of the national currency wasn't a stimulus for them

and the basis for the restoration of the economy was just the rise of world oil prices. In 2016, the 12.4% inflation was mainly driven by the rise in food prices by 14.7%, in non-food products by 16.7% and in services by 5.8%. Inflation also caused the devaluation environment, which had an impact on the prices of consumer goods.

As an important reason we can also highlight the reduction of commodity mass, which, in its turn, has led to a high level of prices.

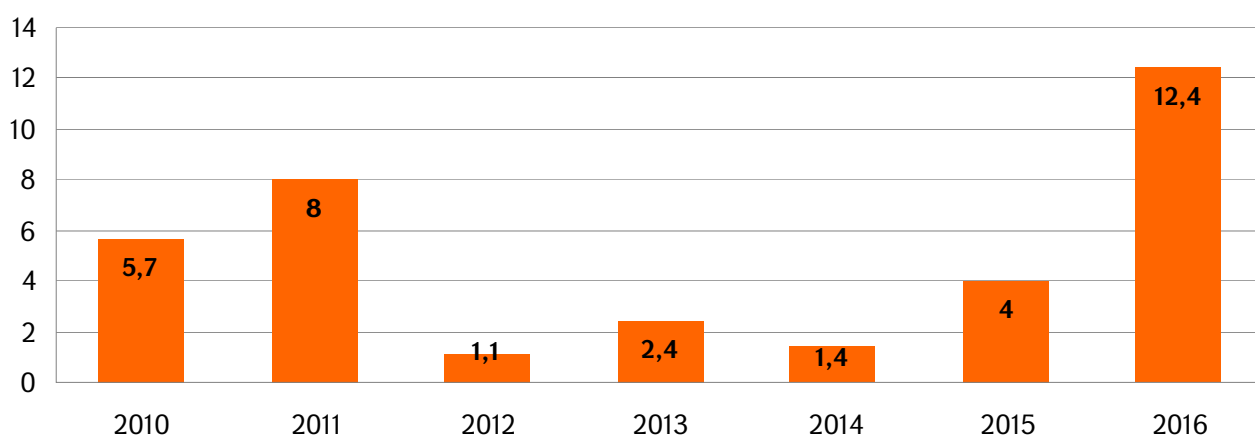


CHART 4.1. Annual inflation(%) of Azerbaijan 2010-2016*

Source: <https://en.cbar.az/>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

4.1. AZERBAIJAN'S MONETARY POLICY TRANSFER MECHANISM

The main goal of the Central Bank of Azerbaijan creates prerequisites for economic growth and other issues.

Azerbaijan is among the countries where the main goal of the Central Bank is price

stability and that is why its main task is to keep prices stable, to ensure the development of the banking and payment systems.

The Central Bank of Azerbaijan uses the M3 aggregate. In 2010-2016, the M3 average was 17,753 million manat.

The highest data for this indicator were registered in November 2014 - 21689.8 million manats (see Chart 4.2).

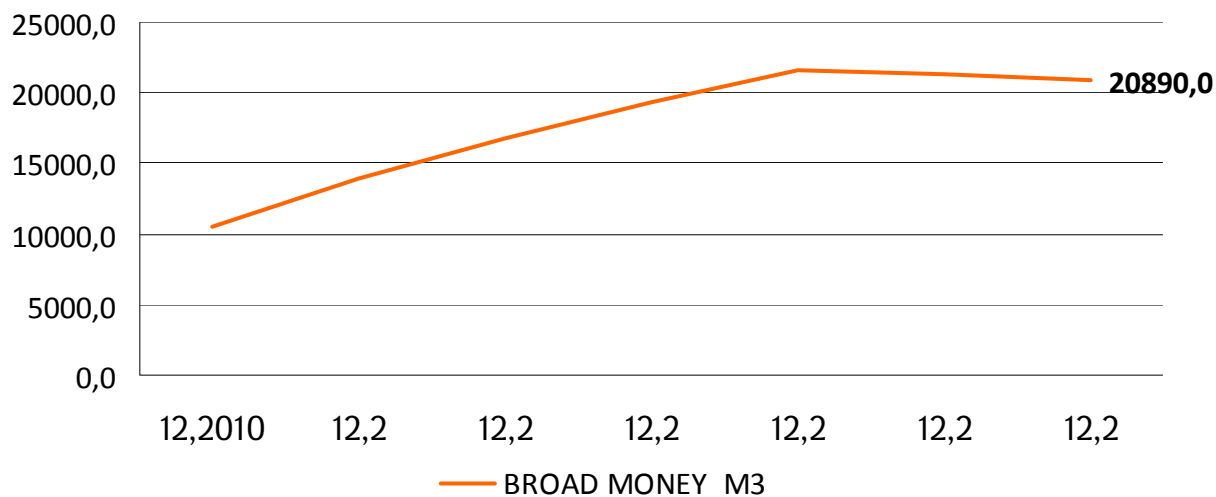


CHART 4.2. M3 aggregate (mln. manat) 2010-2016*

Source: <https://en.cbar.az/>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

The M3 / GDP indicator was 34.6% in 2016. In 2010-2016 this data was 31.9% (see Chart 4.3). At present Azerbaijan's exchange

rate regime is free floating, according to the law adopted on December 21, 2015.

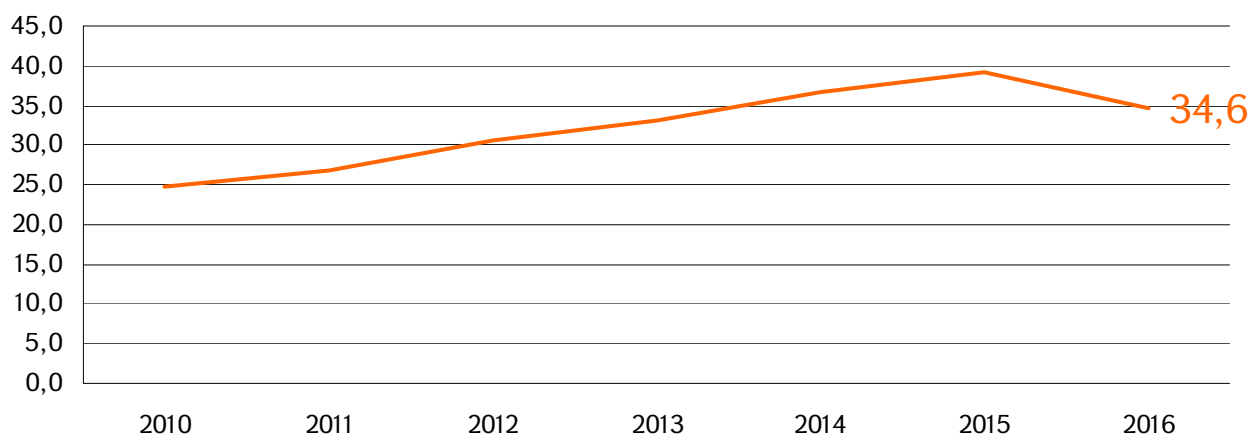


CHART 4.3. Monetary index of Azerbaijan(%) 2010-2016*

Source: <https://en.cbar.az/>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

This change is obvious in the chart. manat exchange rate during the period

26/01/2010 -31/08/2017 was \$ 1 = 1.02 manats (see Chart 4.4):

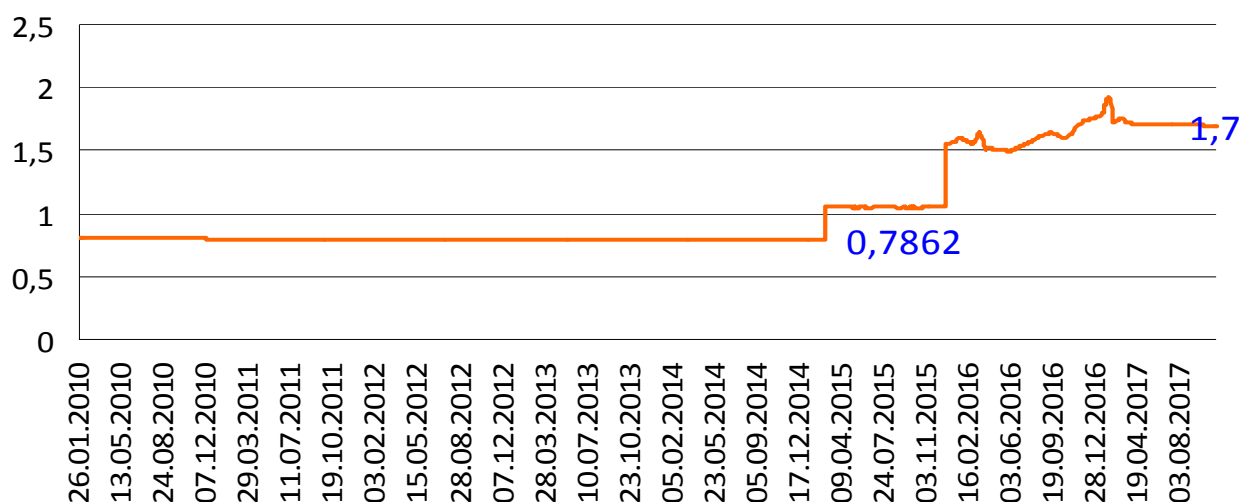


CHART 4.4. Manat-Dollar exchange rate 2010-2017*

Source: <https://en.cbar.az/>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

Changes in Azerbaijan's refinancing rate are reflected in Chart 4.5. As can be seen from the chart, the refinancing rate of Azerbaijan has changed drastically in 2016 - from 3% to 15%.

For the fourth time in 2016, the Central Bank of Azerbaijan has raised the refinancing rate by 5.5 percentage points to

15% for the purpose of strengthening confidence in the national currency (preventing manat depreciation).

And before that, he raised it 9.5% from 7% in the same year. This decision of the Central Bank of Azerbaijan aimed at strengthening financial support to the nonoil sector of the economy.

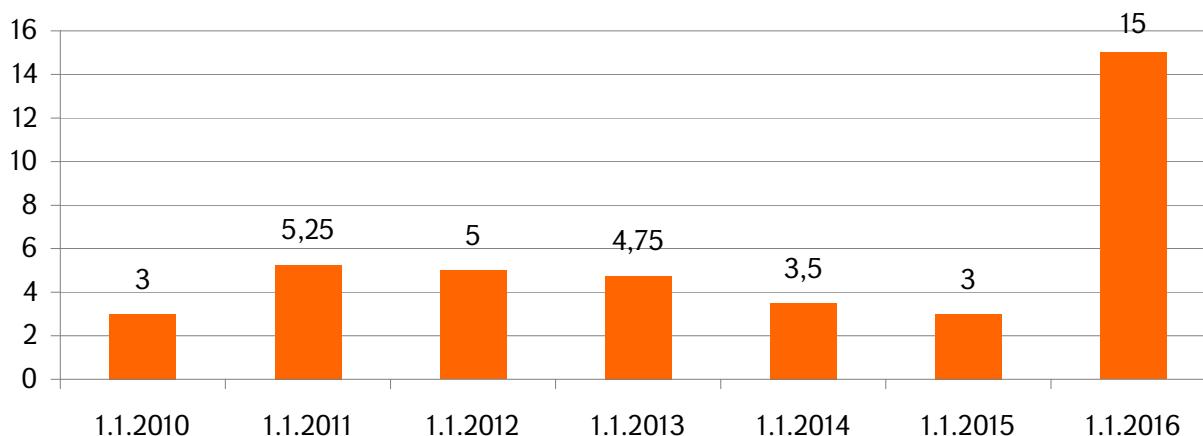


CHART 4.5. Azerbaijan refinancing rate (%) 2010-2016*

Source: <https://en.cbar.az/>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).

4.2. COMPARISONS WITH RA

Armenia's annual inflation rate was -1.3% in 2016, largely due to food products' inflation by 5.0%, non-food products by 0.6% and tariffs in service sector by 0.4%. Currently, the share of foodstuffs in the Armenian consumer basket is 53.4%, non-food products - 15.5%, and services - 30.8%. It should be noted that the minimum consumer basket in Armenia in 2016 was 54753.7 drams, and in Azerbaijan - 108 manat. The bankruptcy of the International Bank of Azerbaijan was also a serious blow to the Azerbaijani economy, with \$ 3,337 billion of foreign liabilities incurred by the state. It was expected that some part of Azerbaijan's GDP growth would be secured by profitability of banks' lending, but Azerbaijan's largest the International bank of Azerbaijan, whose assets constitute 40% of

the total assets of the banking sector of Azerbaijan, the transition of the bank's foreign liabilities to the state, as well as the unstable situation among other banks of the country, postpone the restoration of Azerbaijan's economic stability. The Azerbaijani government has purchased assets of 9.93 billion manat to save the International Bank of Azerbaijan. In addition, the state has invested \$ 1.3 billion and 70 million manat in the bank to ensure liquidity. In 2017, the state invested 600 million manat in the bank to increase the bank's capital, though the bank continued to lose all its resources. The reason for the inconvenience of the International Bank of Azerbaijan was the high interest rates, the depreciation of the manat. Only in 2016 the bank had a loss of 1.74 billion manat.

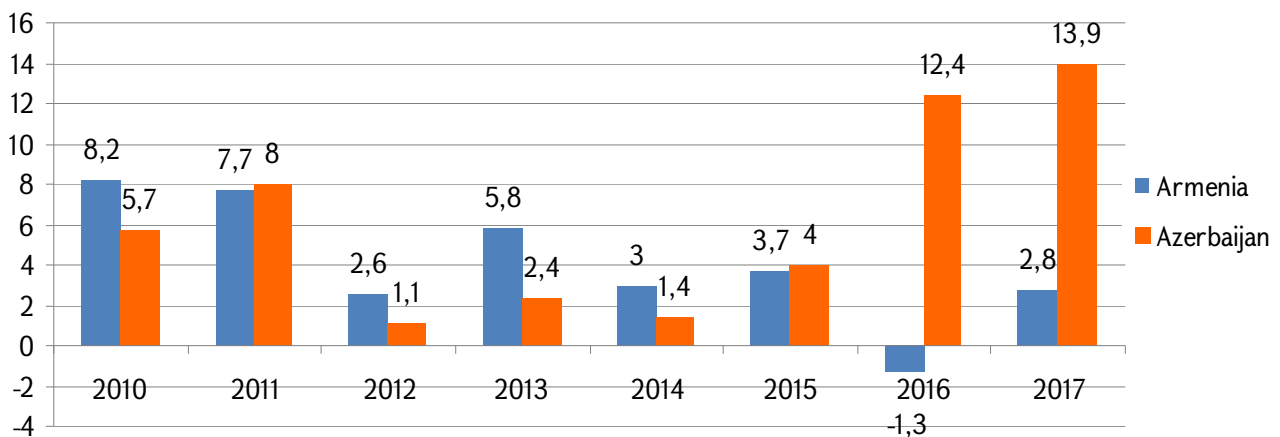


CHART 4.6 Armenia and Azerbaijan inflation comparison (%) in 2016-2017

Source: <https://en.cbar.az/>, <https://www.cba.am/EN/SitePages/Default.aspx>

*The chart was made by the authors using the official statistics provided by official website of the country's central bank (national bank).