

**Yusif Taryel MAMMADOV**

## **THE ROLE OF MONETARY POLICY OF THE CENTRAL BANK IN ECONOMIC DEVELOPMENT**

### **Summary**

Monetary and credit policy consists of a system of actions of the Central Bank (CB) for flexible management and stabilization of economic processes. The main goal of the MoB's monetary policy is to create a fertile financial environment in the country in order to achieve economic growth, opening new jobs and full employment of the population while keeping inflation under control. In order to achieve these goals, the Ministry of Finance makes extensive use of money supply regulation. Because the money supply is considered an important factor in the stability of prices and the balancing of general supply and demand. In other words, the increase in money supply without real goods in circulation is one of the main causes of inflation. In general, the Central Bank tries to form such optimal price limits that both the interests of the producer and the consumer are reconciled, and economic growth occurs. For this, the Central Bank aims to create a single-digit inflation level. There is no zero-inflation economy in modern economic systems. Because when the prices fall below the limit, the producer cannot get enough profit and his interest in production decreases. In developed countries, annual inflation of 3-4 percent is used to stimulate economic growth.

**Keywords:** Central Bank, credit policy, inflation, economic development

---

JEL: E 00; G 29

UOT: 33

DOI: <https://doi.org/10.54414/BAIF3641>

---

### **Intradaction**

It is important to adapt the money supply to the economic conditions for the stable development of the economy. In order to increase investment activity and create revival in the economy during the crisis, the Central Bank increases the money supply by stimulating credit operations of commercial banks. This leads to an increase in solvent demand. As a result, prices increase and create financial interest in increasing the volume of production. In order to overcome the stagnation in the construction sector after the world crisis in 2008, the CBA pursued the same goal in issuing mortgage loans: mortgage loans will increase the demand for housing. This will create a price increase and turn housing construction and other areas related to it into a profitable area, creating conditions for investment and an increase in the number of built apartments. As a result, prices will stabilize, and housing demand will improve. However, the CBA considers it useful to

increase the price increase until the time when the growth of production prevails in relation to the rate of price growth. In this case, inflation can play the role of a production stimulation tool.(2)

It is impossible for the market economy to rise continuously in a straight line. For him, ups and downs are characteristic, figuratively speaking, like waves in the sea. This is completely normal. However, the main issue here is to avoid sharp fluctuations (volatility) and maintain rhythm. Otherwise, the economic processes will go out of control, as if creating a storm effect in the sea. Solving this issue is one of the central tasks of the monetary policy of the Central Bank. In order to avoid storms in the economy, the CBA implements measures aimed at increasing the credit operations of banks in the conditions of low prices and unemployment, and reducing them in the case of high inflation. The Central Bank mainly uses the following

mechanisms to regulate the money supply and credit operations of banks:

**1. Open market operations.** Open market operations (OPE) include the purchase and sale of banks with securities issued by the state, with securities issued by the CBA itself, as well as with foreign currency. The Central Bank regulates the money supply in the economy. Thus, the Central Bank gives money in exchange for the securities it buys from commercial banks. With this, banks obtain additional funds and increase the money supply in circulation by lending it. When the central banks sell the securities, the opposite process takes place and the money goes out of circulation. In the open market operations of the Central Bank, repo and reverse repo operations are the main tools used in the flexible regulation of money supply. Repo refers to the operation of selling securities to commercial banks by the Central Bank and buying them back after the pre-agreed period. This operation is carried out in order to reduce the volume of money in circulation in the short term.(3)

Reverse repo is an operation that involves buying securities from commercial banks by the Central Bank and selling them back after a pre-agreed period. The purpose of reverse repo is to increase the money supply in circulation in the short term.

**2. Accounting (interest) rate instrument.** MB increases and decreases loan interest rates of commercial banks with the discount rate. Accordingly, credit and money supply increases and decreases. MB provides loans to commercial banks at a certain interest rate. Commercial banks put their interest on the interest of these loans and give them to other economic entities. When the discount rate is high, the loan interest of the commercial bank also increases. This reduces the demand for credit and ultimately reduces the money supply. When the discount rate goes down, the opposite process happens. It should be noted that interest rates play the role of the value of money. The demand for money also varies depending on the interest rate. Depending on the level of interest on loans, monetary policy is called cheap and expensive. The higher the interest rate, the more expensive the loan. In times of unemployment

and depression, the Central Bank implements a policy of cheap money (low-interest credit). For this, the Central Bank buys securities, lowers the required reserve ratio and the discount (interest) rate, and increases the money supply. During the world financial crisis of 2008, the Central Bank pursued such a policy. In the conditions of rising inflation, in order to reduce it, an expensive monetary policy is implemented and the money supply is reduced. In an expensive monetary policy, the Central Bank sells securities and reduces the money supply by raising reserve requirements and the discount (interest) rate.(3)

3. Mandatory reserves norm (MEN). MEN is the compulsory deposit of a certain part of the deposits attracted by commercial banks in the Central Bank. At this time, the credit resources of the commercial bank are reduced to the required reserve. When reserve requirements are raised, the lending capacity of the banking system is further reduced. ME is also the control mechanism of the Central Bank over the commercial bank. ME performs the function of insurer in fulfilling the bank's obligations to its customers. Mandatory reserves act as a guarantee when banks face problems in paying deposits. Deposit payment problems undermine confidence in the banking system. The establishment of the Deposit Insurance Fund of the Central Bank of Azerbaijan has increased trust in banks. Now, deposits in the amount of 30,000 manat are insured at 12%.

The Central Bank also uses exchange rate regulation to ensure financial stability and promote economic activity. Exchange rate is the value of any foreign currency expressed in national currency. For example, 1USD = 0.80 AZN. The exchange rate affects inflation. This effect occurs mainly through import prices. When the exchange rate of the national currency rises compared to foreign currencies, import prices fall. When the exchange rate of the national currency decreases compared to foreign currencies, imported goods become more expensive. For example, let's assume that the price of any imported product is 1000 US dollars, and the exchange rate of 1 dollar to the manat is 0.9 AZN (1 AZN=1.11 dollars). In this case, the price of the imported goods in manat will be  $1000 \times 0.9 = 900$  manat. If the manat

strengthens against the dollar, for example, if the exchange rate of 1 US dollar falls from 0.9 manat to 0.8 manat, then the price of imported goods will decrease by  $1000 \times 0.80 = 800$  manat. If the dollar exchange rate rises from 0.9 manat to 1 manat, the price of imported goods will rise from 900 manat to 1000 manat. The greater the specific weight of imported goods in domestic consumer goods, the greater the effect of the exchange rate on the general inflation level. Therefore, the exchange rate policy of the Central Bank is aimed at the development of domestic production and the export orientation of the economy, while ensuring an acceptable level of inflation. If the Central Bank leaves the exchange rate of the manat completely to the discretion of the market, the manat will strengthen even more compared to foreign currencies, let's say 1 dollar = 0.5 manat, which will encourage imports. The main factor contributing to this is oil revenues. The emergence of such a paradoxical situation in economics is called the Holland syndrome. The term Dutch syndrome was first introduced to the economic lecture by The Economist magazine in the 1950s when describing the negative impact of the large amount of foreign exchange earnings obtained from gas exports on the Dutch economy. Holland syndrome is an effect caused by the flow of foreign currency into the country as a result of the increase in the production and export of natural resources. This effect is called a disease because an increase in the domestic currency supply increases the real value of the national currency. Overvaluation of the local currency (for example, 1 Dollar = 0.5 manats) makes imported goods cheaper in local currency and makes exports meaningless. This leads to the comparative advantage of foreign production over domestic production. As a result, interest in local production dies, jobs are closed and unemployment increases. This is not in accordance with the objectives of the monetary policy of the Central Bank. Therefore, the Central Bank considers it important to change the exchange rate of the manat based on the supply and demand of currency, but taking into account the priority of financial stability, it announced that it will not allow sharp volatility of the exchange rate in the statement "On the

main directions of monetary and financial stability policy for 2011". Also, in the long term, the Central Bank will continue the process of transition to flexible exchange rate regimes to ensure more effective inflation targeting. Thus, in the world experience, flexible exchange rate regimes are considered the main condition for strengthening the control of money.(9)

In 2023, the policy of the Central Bank on the financial sector will be focused on such directions as protecting financial stability, supporting business through the expansion of financial intermediation, and deepening financial and capital markets. All this will enable the role of the financial sector in economic growth to increase further. Work will be continued in the direction of digitization and increasing the level of use of modern payment system infrastructure.

In order to ensure financial stability, the main direction of policy and reforms for 2023 will be the continuation of the process of adapting the prudential regulation and control framework of the banking sector to international standards (Basel II, Basel III). Strengthening of management in banks and adaptation to international standards, including development of corporate management potential, strengthening of risk management systems, and development of human resources will be encouraged.

Work will be continued in the direction of facilitating access to bank loans for business subjects. In order to increase financial inclusion and depth in the country, work should be continued in the direction of promoting supply factors, including increasing the effectiveness of the creditors' rights protection system, providing long-term financing sources, and improving risk transfer and distribution mechanisms. In order to increase healthy demand for loans by encouraging demand, first of all, it is required to realize conditions such as exiting the informal economy and accelerating transparency, improving corporate governance in business entities, and developing independent accounting and auditing institutions.

The development of agent banking will also contribute to increasing access to financial services and improving the quality of financial



services in the country. The legal and regulatory framework for the development of alternative financing will be continued.

The implementation of the strategy of phased transition to Solvency 2 standards will be continued within the framework of adaptation of the regulation and control framework in the insurance sector to international principles and advanced standards. Development of human resources and management potential in the insurance sector, formation of a consumer protection framework in accordance with advanced international practices, development of the sector's market infrastructure, digitization of the insurance sector and formation of various digital services will be implemented. However, in order to increase insurance literacy, educational and promotional activities will be continued on a wider and more intensive scale.

Cooperation with international financial organizations will be continued in the direction of improving the legal framework and operational infrastructure of the capital market, as well as removing the obstacles that exist in the ecosystem and limit effective financing from the capital market. It is planned to implement measures to adapt the control framework and corporate management to international standards in investment companies. Work will be continued on promoting the activity of investment funds on improving financial intermediation in the capital market and creating opportunities for direct participation of banks in the capital market. In order to develop the infrastructure of the capital market, it is planned to build a centralized trade and depository system and to electronicize the process of issuing securities. In order to promote the financing of Small and Medium Business (SME) subjects from the capital market, measures will be taken to create a guarantee and subsidy mechanism for corporate bonds issued by them. Ensuring the Central Bank's privileged membership in the IOSCO (International Organization of Securities Commissions), establishing relations with global custodians in order to increase access opportunities for foreign investors to the capital market, adapting the regulatory framework for derivative financial instruments to international standards, as well as

implementing educational events with companies and the population. It is intended.

Ensuring the safe, uninterrupted and continuous operation of the national payment system will be one of the important priorities in 2023. Increasing the effectiveness and efficiency of mutual information exchange in the financial infrastructure, including the full implementation of the ISO20022 international standard is envisaged. In order to develop innovative non-cash payments, it is planned to apply API standards on the open banking model within the framework of the application of international standards. Strengthening the level of cyber security in the payment infrastructure will also be taken into account.(9)

Measures will be continued to improve the institutional environment in order to form a competitive, innovative and accessible payment environment, develop the digital ecosystem, and expand the scope of digital payments. Within the framework of the mentioned measures, such as expanding the possibilities of accepting public transport fares in cities and regions through innovative payment tools (bank cards and mobile banking solutions), expanding the scope of POS-terminals in economic entities, creating possibilities of accepting QR code payment solutions in places where it is not possible to install POS-terminals. projects are taking place. Also, measures to increase financial literacy on digital payments, encourage businesses and the population to actively use digital payment services, and strengthen the potential of human resources in this direction will also be continued.

Taking into account the importance of the future development of the rapid payments system for monetary policy and financial mediation, the evaluation of the possibilities of the application of the Central Bank's Digital Currency (MBRV) in the medium term will be continued in several directions: I. clarification of the policy, goal and target for the application of digital currency; II. involvement of interested parties in the process; III. formation of the legislative framework; IV. the potential of using new generation technology; V. level of readiness of the market. Concept documents related to MBRV will be communicated openly and in detail.

In 2023, the monetary policy will be aimed at ensuring macroeconomic and financial stability in the national economy, first of all, bringing inflation closer to the target framework, increasing the role of the financial sector in economic development, and for this purpose, conducting reforms in the monetary sphere and the financial sector. The realization of the set goals will depend to a significant extent on the effectiveness of the coordination between macroeconomic policy institutions.

In 2023, the main objective of the monetary policy will be to ensure the dynamics of inflation towards the target range ( $4\pm 2\%$ ). Achieving this goal will mainly depend on non-monetary factors - the prices of world food and energy carriers, the state of recovery in the demand-supply chain, the state tariff policy in the next year and the macroeconomic policy framework.

The final goal of the monetary policy remains the control of inflation within the  $4\pm 2\%$  corridor. According to the latest updated inflation forecasts, inflation will move towards the upper interval of this range from the second half of 2023 under the conditions mentioned in the base forecast.

Given the transitory nature of the impact of external factors on the current high inflation rate, monetary policy will maintain flexibility between price stability and economic growth and employment objectives. However, if the situation deviates from the mentioned base scenario, it may be necessary to switch the monetary policy to a stricter regime. Effective management of inflation expectations will focus on increasing public confidence in the implemented policy. The policy response will facilitate investment-business activation, support economic growth and employment by removing uncertainties and mistrust of politics that may arise.

The predicted oil prices in 2023, the growth dynamics of non-oil exports, as a result the surplus balance of payments and the increase in transfers from the Oil Fund to the state budget based on the approved state budget will support exchange rate stability, which is the main anchor of price stability, by ensuring balance in the foreign exchange market. Preservation of balance in the foreign exchange market makes it

urgent to accelerate reforms in the direction of diversification of sources of foreign currency income in the next year and in the medium-term period as well.

Another intermediate target of monetary policy, the money supply will be adjusted taking into account the economy's demand for money, economic growth forecast and inflation. Changes in the structure of the money supply due to the impact of digitization processes will also be taken into account during the adjustment of the money supply. In order to influence the money supply, the balance of banks' manat correspondent accounts with the Central Bank will be used as an operational benchmark.

In 2023, the Central Bank will adequately use all the tools and mechanisms in its arsenal to achieve operational goals. Decisions on the quantitative parameters and duration of the instruments will be made promptly depending on the liquidity position of the banking system. Regular assessment of the structural surplus (or deficit) of the banking system will continue. A liquidity monitoring and forecasting system will be used to assess the effects of autonomous and non-autonomous factors on liquidity. Flexible use of monetary policy instruments in accordance with the nature of macroeconomic processes will support the effective functioning of the transmission mechanism, as well as macroeconomic and financial stability.

Decisions on interest rate corridor parameters will be made taking into account updated macroeconomic forecasts, transmission of external and internal cost factors to inflation, inflation expectations and changes in risk balance. At this time, the principle of implementation of counter-cyclical monetary policy will be taken as a basis. The discussion of the interest rate corridor in the Board of Directors of the Central Bank is planned to be organized in 2023, as in previous years, in accordance with the previously announced schedule (Appendix 1).

The Central Bank will also take into account the interruptions and characteristics of the transmission mechanism when making monetary policy decisions. The time lag (lag) between the impact of monetary policy decisions on real economic variables (aggregate demand,

production, inflation) can take several quarters. In the conditions of uncertainties related to the structural change in the economy, the impact interval may be extended a bit.

In order to increase the possibilities of influencing inflation, the improvement of monetary policy will be implemented within the framework of the conditional phased transition strategy to the hybrid inflation targeting regime in the long term. For this, initially, the necessary preparations for the transition to the new regime will be carried out, and the realization of the basic conditions will be the main priority.

In the medium-term perspective (2023-2026), within the framework of creating basic transition conditions to the new monetary policy regime, the Central Bank, together with the government, will expand the government securities market and form an active money market, limit the cash-shadow economy, diversify supply channels in the foreign exchange market, and strengthen effective macroeconomic coordination. will operate in such directions.

Strengthening the analysis and forecasting potential of the Central Bank will also play an important role in improving the monetary policy framework. In this direction, work will be carried out in the direction of building the Forecasting and Policy Analysis System (FPAS), modernizing the model bag for medium and long-term forecasting, expanding the range of forecast indicators, quantitatively and qualitatively improving the statistical database necessary for analysis and forecasts. Improvement of surveys on financial behavior and economic expectations, deepening of survey-based analytical analyzes are planned within the framework of strengthening statistical and analytical work on real sector enterprises and households.(9)

Increasing the effectiveness of communication policy in managing expectations will be one of the important elements of monetary policy in the upcoming strategic period. Within the framework of the information openness policy, the objective, principles, measures and results of the monetary policy, as

well as the evaluation of the economic situation and the prospects for development, will be provided for public disclosure of maximum operative and fully open information. Due to the development of communication technologies and the pandemic, digital tools will be used more widely in communication. On the basis of the adopted new strategy, work will be carried out constantly in the direction of expanding the scope of communication. It is also planned to continue educational work on economic and financial topics for various target groups.

#### **References:**

1. Baily, M.N. and Okun, A.M. (1965), *The Battle against Unemployment and Inflation: Problems of the Modern Economy*, 3rd revised edition, W.W. Norton & Co., New York, 1983.
2. Case, A. and Deaton, A. (2020), *Deaths of Despair and the Future of Capitalism*, Princeton University Press, Princeton. Credit Suisse Research Institute (2019),
3. Durrani, A., Rosmin, M. and Volz, U. (2020), "The role of central banks in scaling up sustainable finance – what do monetary authorities in the Asia-Pacific region think?", *Journal of Sustainable Finance and Investment*, Vol. 2 No. 10, pp. 92-112.
4. Financial Times (2020), "Prospering in the pandemic", Friday, 19th June, 2020
5. Foroohar, R. (2019), *Don't Be Evil: How Big Tech Betrayed its Founding Principles – and All of Us*, Currency, New York.
6. Glichrist, S. and Leahy, J. (2002), "Monetary policy and assets prices", *Journal of Monetary Economics*, Vol. 49 No. 1, pp. 75-97.
7. *Global Wealth Report*, Credit Suisse AG, 2019, available at: [www.credit-suisse.com](http://www.credit-suisse.com).
8. Gormez, Y. (2019), "Central bank digital currency: a historical perspective", in Amstad, M., Huang, B., Morgan, P.J. and Shirai, S. (Eds), *Central Bank Digital Currency and Fintech in Asia*, Asian Development Bank Institute, Tokyo, 2019
9. <https://vergiler.az/news/economy/16446.html>

**Yusif Taryel MƏMMƏDOV**

Azərbaycan Respublikasının Prezidenti yanında Dövlət İdarəçilik Akademiyası

## **İQTİSADI İNKİŞAFDA MƏRKƏZİ BANKIN PUL-KREDİT SİYASƏTİNİN ROLU**

### **Xülasə**

Pul-kredit siyasəti iqtisadi proseslərin çevik idarə edilməsi və stabiləşdirilməsi üçün Mərkəzi Bankın (MB) tədbirlər sistemindən ibarətdir. Mərkəzi Bankın pul siyasətinin əsas məqsədi inflyasiyanı nəzarət altında saxlamaqla yeni iş yerlərinin açılmasına və əhalinin tam məşğulluğuna, iqtisadi artıma nail olmaq üçün ölkədə münbit maliyyə mühiti yaratmaqdır. Bu məqsədlərin əldə edilməsində MB pul kütləsinin tənzimlənməsindən geniş istifadə edir. Çünki, pul kütləsi qiymətlərin sabilliyində, ümumi tələb və təklifin balanslaşdırılmasında mühüm amil hesab edilir. Başqa sözlə dövriyyədə arxasında real əmtəə dayanmayan pul kütləsinin artması inflyasiyanın başlıca səbəblərindəndir. Ümumiyyətlə, Mərkəzi Bank elə bir optimal qiymət hədləri formalaşdırmağa çalışır ki, həm istehsalçının və istehlakçının maraqları uzlaşsın, həm də iqtisadi artım baş versin. Bunun üçün Mərkəzi Bank bir rəqəmli inflyasiya səviyyəsinin formalaşdırılmasını hədəfləyir. Müasir iqtisadi sistemlərdə sıfır inflyasiyalı iqtisadiyyat yoxdur. Çünki qiymətlər həddən aşağı düşəndə istehsalçı kifayət qədər mənfəət əldə edə bilmir və istehsala marağı azalır. İnkişaf etmiş ölkələrdə illik 3-4 faizlik inflyasiyadan iqtisadi artımı stimullaşdırmaq üçün istifadə edilir.

**Açar sözlər:** Mərkəzi Bank, kredit siyasəti, inflyasiya, iqtisadi inkişaf

## **РОЛЬ КРЕДИТНОЙ ПОЛИТИКИ ЦЕНТРАЛЬНОГО БАНКА В РАЗВИТИИ ЭКОНОМИКИ**

### **Резюме**

Денежно-кредитная политика представляет собой систему действий Центрального банка (ЦБ) по гибкому управлению и стабилизации экономических процессов. Основной целью денежно-кредитной политики Центрального банка является создание благоприятной финансовой среды в стране для достижения экономического роста, открытия новых рабочих мест и полной занятости населения путем удержания инфляции под контролем. Потому что денежная масса считается важным фактором стабильности цен и баланса общего спроса и предложения. Иными словами, увеличение денежной массы без реальных товаров в обращении является одной из основных причин инфляции. В целом ЦБ пытается сформировать оптимальные ценовые пределы, чтобы интересы производителя и потребителя совпадали. происходит экономический рост. Для этого ЦБ стремится создать однозначный уровень инфляции. В современных экономических системах не существует экономики с нулевой инфляцией. Потому что, когда цены падают ниже предела, производитель не может получить достаточную прибыль и его интерес к производству снижается. В развитых странах годовая инфляция в размере 3-4 процентов используется для стимулирования экономического роста.

**Ключевые слова:** Центральный банк, кредитная политика, инфляция, экономическое развитие.