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MANAGEMENT OF FOREIGN EXCHANGE RESERVES IN AZERBAIJAN

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***Summary.** The management of foreign exchange reserves plays a crucial role in protecting the economic stability. This article provides an overview of foreign exchange management in Azerbaijan, focusing on Azerbaijan's unique challenges, strategies and opportunities. It examines the current status of Azerbaijan's reserves, including their composition, adequacy and performance, and explores the various factors influencing resource management decisions. Factors affecting reserve levels such as oil prices, trade balance, and foreign debt are analyzed and performance evaluated. In addition, it identifies potential opportunities for optimizing resource management in Azerbaijan, taking into account the country's economic strengths and strategic goals. Through a comprehensive analysis of the management of Azerbaijan's foreign exchange reserves, it aims to contribute to a deeper understanding of the dynamics shaping the country's economic stability and resilience in the global arena.*

***Keywords:** Foreign exchange reserves, Risk management, Economic stability, Currency fluctuations, Central bank intervention.*

Introduction. Azerbaijan maintains foreign exchange reserves to ensure financial stability, support the national currency and reduce external risks. Azerbaijan's foreign exchange reserves consist of various assets held by the Central Bank of Azerbaijan (CBA) and other state institutions. These reserves usually include foreign currencies, gold and other liquid assets denominated in foreign currencies. The composition of Azerbaijan's reserves reflects its trade relations, investment strategies and monetary policy goals.

Aim of this research is to comprehensively analyze the management of foreign exchange reserves in Azerbaijan, with a focus on understanding the current state, challenges, and opportunities for optimization. By delving into the intricacies of foreign exchange reserve management, this study seeks to provide valuable insights. Primary objective is to assess the current state of Azerbaijan's foreign exchange reserves, including their composition, adequacy, and activity. By analyzing relevant data and indicators, such as reserve levels, import cover ratios, and liquidity, this research aims to provide a clear picture of the country's reserve management framework. Another key objective is to identify the challenges and opportunities associated with managing foreign exchange reserves in Azerbaijan. This involves examining factors such as exchange rate volatility, economic diversification efforts, and global market dynamics to understand the implications for reserve management.

Foreign exchange reserves play an important role as a buffer against external shocks and uncertainties in the global economy. Having adequate reserves, Azerbaijan can strengthen investor confidence, reduce currency volatility and maintain macroeconomic stability. During economic downturns or financial crises, foreign exchange reserves give policymakers the flexibility to intervene in foreign exchange markets, stabilize exchange rates, and manage liquidity conditions. [12]. This stability creates a favorable environment for investments, promotes economic stability and increases the overall attractiveness of Azerbaijan as a destination for foreign capital. Foreign exchange reserves play an important role in facilitating international trade by ensuring the availability of foreign currency for import payments and financing [11]. As an oil exporting country, Azerbaijan is highly dependent

on imports for various goods and services, including machinery, equipment and consumer goods. Foreign exchange reserves allow trade operations to run smoothly, reduce the risk of supply disruptions, and support a country's economy. In addition, adequate reserves can strengthen Azerbaijan's bargaining power in negotiating trade agreements and accessing favorable trade terms with international partners. Foreign exchange reserves contribute to the fiscal stability of Azerbaijan by providing a stable source of income for the government. Income from reserve assets, such as interest payments and returns on investments, can supplement domestic revenues and support public spending priorities, including infrastructure development, social programs and investment projects. In addition, foreign exchange reserves serve as a strategic asset that can be used to finance strategic initiatives, respond to emergencies, and meet liquidity needs during economic stress.

International Monetary Fund conducts regular assessments of Azerbaijan's reserve adequacy and its economic implications. These assessments provide valuable insights into the country's reserve management practices and their effectiveness in safeguarding against external vulnerabilities. SOCAR's financial statements offer valuable information on its role in managing foreign exchange reserves and its impact on the overall economy. Moreover, empirical analyses have investigated the relationship between foreign exchange reserves and economic growth in Azerbaijan. Understanding how changes in reserve levels impact economic performance is essential for formulating effective reserve management policies and promoting sustainable development. Studies have examined the effectiveness of capital controls and other policy measures in managing foreign exchange reserves and external debts. Policies aimed at regulating capital flows and enhancing reserve adequacy play a critical role in safeguarding the country's external financial position. Additionally, research has explored the impact of external factors, such as changes in global oil prices, on Azerbaijan's foreign exchange reserves. Given the country's heavy reliance on oil exports, fluctuations in oil prices can significantly affect reserve levels and necessitate adaptive reserve management strategies. Studies have emphasized the importance of maintaining adequate reserve levels to mitigate external vulnerabilities and safeguard against economic shocks. This study employs different approaches to analyze the management of foreign exchange reserves in Azerbaijan. One of the primary research methods utilized in this study is the analysis of the import cover ratio, which assesses the adequacy of foreign exchange reserves in relation to a country's imports. By examining the import cover ratio over time, this study evaluates the sufficiency of Azerbaijan's reserve holdings to meet its import requirements and safeguard against external vulnerabilities. Data on imports and foreign exchange reserves are obtained from official sources.

Current state of Azerbaijan's resources, their composition, adequacy and activity. Main part of Azerbaijan's reserves consists of foreign currency reserves dominated by major currencies such as the US dollar (USD), euro (EUR) and Russian ruble (RUB). These foreign exchange reserves provide liquidity and flexibility for conducting international trade and financial transactions. It also has significant gold reserves as part of its portfolio of foreign exchange reserves. Gold acts as a hedge against currency depreciation, offering stability and diversification benefits to a portfolio. It also has significant gold reserves as part of its portfolio of foreign exchange reserves. Gold reserves provide a tangible and liquid asset that can be used to maintain confidence in the national currency and support financial stability in times of crisis.

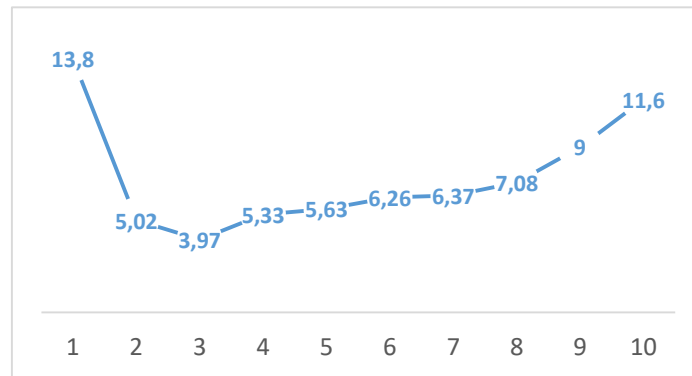
Adequacy of Azerbaijan's foreign exchange reserves is a decisive factor in assessing the country's ability to fulfill foreign obligations, support the national currency and withstand economic shocks. Several measures are commonly used to assess the adequacy of reserves. These include import coverage, external debt coverage, and the ratio of reserves to GDP. Import cover, measured as the number of months of imports that can be financed with available reserves, acts as a key indicator of reserve adequacy [4]. A higher import coverage ratio indicates greater resilience to economic vulnerabilities. In recent years, Azerbaijan has maintained a relatively comfortable level of import coverage and reserves-to-GDP ratio, supported by fiscal policy, export earnings and reserve creation.

Imports in Azerbaijan 2014-2023

2014	9,18
2015	9,21
2016	8,47
2017	8,77
2018	11,46
2019	13,65
2020	10,73
2021	11,7
2022	14,54
2023	17,28

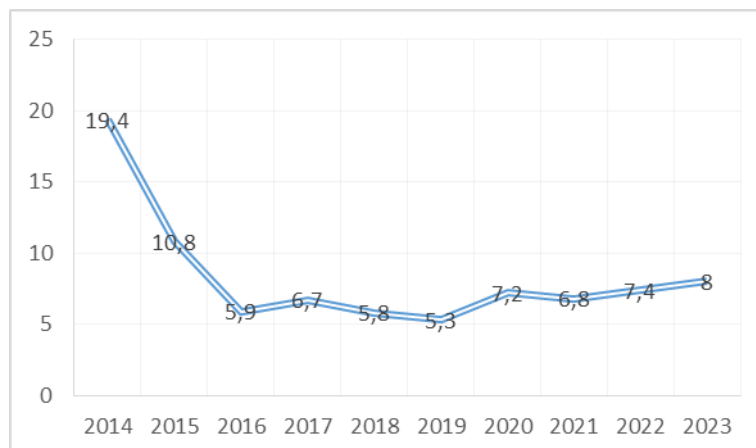
Source: trendeconomy.com

Chart 1. Azerbaijan Foreign Exchange Reserves



Source: Central Bank of Azerbaijan

Chart 2. Azerbaijan's import cover 2014-2023



From 2014 to 2023, the import cover ratio has changed, reflecting changes in Azerbaijan's foreign exchange reserves and import value. In 2015, the sharp decrease in the import cover ratio can be attributed to the devaluation of the Azerbaijani manat, the currency of Azerbaijan [1]. Devaluation reduces the value of foreign exchange reserves in terms of local currency, and causes a decrease in the import cover ratio. In recent years, the overall economic development of the country and its imports have affected the cover ratio. Economic growth, increased export earnings and a favorable trade

balance contribute to the increase in foreign exchange reserves, thereby improving the import cover ratio.

Liquid reserves in Azerbaijan represent a vital component of the country's financial stability and economic resilience. These reserves consist of readily available assets that can be quickly converted into cash without significant loss of value. Azerbaijan's liquid reserves are managed by the Central Bank of Azerbaijan (CBA), which plays a pivotal role in maintaining the country's monetary and financial stability [3]. The CBA closely monitors liquidity levels to ensure that sufficient reserves are available to address any sudden disruptions in the financial markets or adverse economic conditions. External reserves coverage remains adequate. Recent years have shown better results on most measures of the IMF's Reserve Adequacy Assessment (ARA) metric, which combines data on exports, broad money supply, short-term debt and other investment liabilities.

Central Bank of Azerbaijan (CBA) is responsible for managing the country's foreign exchange reserves and implementing monetary policy goals. The CBA actively monitors global market events, exchange rates and economic indicators to inform its reserve management decisions. CBA engages in various activities to effectively manage the country's foreign exchange reserves, including:



CBA intervenes in the foreign exchange market to stabilize the exchange rate of the national currency, manage exchange rate volatility and support the country's export competitiveness. Currency interventions involve the purchase or sale of foreign currencies to influence exchange rate movements and maintain exchange rate stability [9]. CBA intervenes in the foreign exchange market to stabilize the exchange rate of the national currency, manage exchange rate volatility and support the country's export competitiveness. Currency interventions involve the purchase or sale of foreign currencies to influence exchange rate movements and maintain exchange rate stability [8]. CBA uses risk management practices to mitigate various risks associated with managing reserves, including currency risk, interest rate risk, liquidity risk. Risk management strategies include implementing hedging instruments, stress testing scenarios and contingency planning to protect stocks from adverse market movements.

Role of oil reserves in foreign exchange reserves. The State Oil Company of the Republic of Azerbaijan (SOCAR) occupies an important position in the management of foreign exchange reserves in Azerbaijan, taking into account its important contributions to the country's economy and its participation in various sectors, including energy, finance and international trade. As the largest state-owned enterprise of Azerbaijan and a major player in the global energy industry, SOCAR derives significant revenues from the production, processing and export of oil and gas products. These revenues contribute to the accumulation of foreign exchange reserves in the hands of the Central Bank of Azerbaijan (CBA), constituting a significant source of foreign exchange earnings for the country. SOCAR's activity in the international energy market, including the sale of crude oil, natural gas and petroleum products, creates a flow of foreign currency that strengthens Azerbaijan's reserve position. In addition, SOCAR's investments in projects both domestically and internationally contribute to the country's foreign exchange reserves by increasing export earnings and ensuring revenue streams.

SOCAR works closely with the Azerbaijani government and regulatory authorities to align its business strategies with national economic priorities and goals. Through its participation in policy-making processes, SOCAR contributes to the formulation of macroeconomic policies, energy sector regulations and investment incentives aimed at promoting the sustainability of economic development. In addition, SOCAR's role as a catalyst for economic growth and industrial development extends beyond the energy sector with investments in non-oil industries, infrastructure projects and social

programs aimed at increasing the country's economic stability and reducing dependence on hydrocarbon revenues. By supporting a favorable business environment, encouraging innovation and entrepreneurship, and supporting sustainable development initiatives, SOCAR contributes to Azerbaijan's long-term economic prosperity and accumulation of foreign exchange reserves.

Oil export is an important component of Azerbaijan's exports and constitutes a significant part of the country's total export revenues. Income from oil exports contributes directly to the current account balance, which reflects the balance of trade in goods and services, as well as income inflows and payments from abroad. Revenue from oil exports provides an important source of foreign exchange earnings, which can be used to finance imports of goods and services, support domestic investment, and stimulate economic growth. This foreign exchange inflow contributes to a favorable current account balance, supporting overall economic stability and growth. Oil exports also affect the capital account balance and the accumulation of foreign exchange reserves, as the inflow of oil revenues affects a country's ability to invest abroad and accumulate reserves. Income from oil exports provides a reliable source of foreign exchange earnings for the Central Bank of Azerbaijan. These revenues are added to the country's foreign exchange reserves.

In addition to providing significant economic benefits, oil exports also expose Azerbaijan to risks related to oil price volatility. Fluctuations in global oil prices can affect a country's export earnings [2]. Azerbaijan's economy is highly dependent on oil exports, which constitute a significant part of export revenues and state revenues. As a result, fluctuations in global oil prices directly affect the country's income from oil exports. Due to the risks associated with oil price volatility, Azerbaijan has implemented diversification strategies to reduce its dependence on oil exports. The government has invested in non-oil sectors such as tourism, agriculture and manufacturing to diversify the economy and create alternative sources of income. By reducing dependence on oil exports, Azerbaijan aims to reduce the impact of oil price changes on foreign exchange reserves.

Table 2.

Cumulative exchange rate differences

2014	-200
2015	4427
2016	6292
2017	5806
2018	5900
2019	5932
2020	5951
2021	5798
2022	6998

Source: Socar.az

Due to its global operations, SOCAR often carries out international operations in foreign currency. As a result, the company is exposed to exchange rate fluctuations over time, which can lead to gains or losses in its financial position. Data provided by SOCAR on cumulative exchange rate differences from 2014 to 2022 reflect the net impact of these fluctuations on the company's financial position. Based on the data, we observe that SOCAR has experienced a fluctuating pattern of cumulative exchange rate differences over the years. In 2014, the company suffered a cumulative exchange rate loss of -200, which indicates that the change in the exchange rate led to a decrease in the

company's financial position. However, SOCAR has seen significant progress in the following years, with cumulative exchange rate differentials turning positive in 2015 and continuing to increase steadily until 2022. In 2022, the cumulative exchange rate differences equal to 6,998 indicates that SOCAR benefits from a favorable exchange rate. his actions during that period contribute positively to his financial situation.

Potential opportunities for foreign exchange reserves management optimization considering Azerbaijan's economic strength and strategic goals. Azerbaijan's foreign exchange reserves, being an important component of its economic stability, provide liquidity in times of need. Azerbaijan's economy has traditionally depended on the oil and gas sector. Although this sector remains the cornerstone of the economy, there is increasing recognition of the need to diversify the economy to reduce dependence on hydrocarbons and support sustainable growth. Optimizing resource management offers an opportunity to diversify the economy by strategically allocating resources to non-oil sectors such as agriculture, tourism, technology and manufacturing. By investing in these sectors, Azerbaijan can create new sources of income, employment opportunities and economic stability, thereby reducing vulnerability to fluctuations in oil prices and global market dynamics.

A number of economic indicators can affect Azerbaijan's foreign exchange reserves, which reflect the overall health and stability of the economy [10]. Some of the key economic indicators that may affect Azerbaijan's foreign exchange reserves are:

GDP growth rate is a key indicator of economic health and reflects the overall expansion or contraction of the economy [5]. The strong growth of GDP in Azerbaijan contributes to the increase of export revenues, increase of tax receipts and, in turn, the accumulation of foreign exchange reserves. Conversely, sluggish GDP growth or an economic contraction could result in lower export earnings, lower government revenues, and lower investor sentiment, potentially leading to lower reserves.[6]

Balance of trade, which represents the difference between exports and imports, directly affects the availability of foreign exchange reserves. Azerbaijan's foreign exchange reserves are affected by its trade indicators. Changes in export demand, global commodity prices and exchange rates can affect the trade balance and consequently the level of foreign exchange reserves.

Table 3.

Foreign exchange reserves and Oil Fund assets forecast, 2024-2028 (million dollars)

	Foreign exchange reserves	Oil Fund assets	Manat reserve money	Reserves in foreign currency
2024	11,481	52,819	20,725	5,381
2025	11,681	53,205	22,591	5,466
2026	11,881	53,425	24,624	5,213
2027	12,081	53,744	26,840	5,098
2028	12,281	54,424	29,255	4,919

Source: data.imf.org

With a large surplus of the capital account, the total international reserves of the Central Bank increased significantly to 9 billion dollars by the end of 2022 (11.4 percent of GDP, 8.5 months of goods imports next year) and 10 billion by the end of October 2023. reached 5 billion dollars. Reserves of the CBA are supplemented by the liquid part of foreign assets held in the Oil Fund. This liquid portion, which is mainly fixed-income instruments, stocks and gold, accounts for about 75 percent of assets (63 percent of GDP) of USD 49 billion at the end of 2022. The liquid assets of CBA and SOFAZ together are equivalent to 44 months of next year's imports.[7] The combined reserves of the

Central Bank of Azerbaijan (CBA) and the State Oil Fund of Azerbaijan have reached approximately \$55.5 billion by October 2023.

External reserves coverage remains adequate. Recent years have shown better results on most measures of the IMF's Reserve Adequacy Assessment (ARA) metric, which combines data on exports, broad money supply, short-term debt and other investment liabilities. Given the expected surplus, reserves are projected to remain strong through 2028, with rising reserves and limited growth in external debt. Supported by high oil prices, the external position is projected to remain strong with a budget surplus and sustained foreign reserve accumulation.

Conclusion. Analysis of Azerbaijan's import cover ratio and foreign exchange reserves over the period from 2014 to 2023 reveals several important findings. Despite initial decline, recent years have seen improvements in the overall economic development of the country, leading to increased export earnings and a favorable trade balance. These factors have contributed to the strengthening of Azerbaijan's foreign exchange reserves, thereby improving the import cover ratio. Economic growth and a favorable trade balance have bolstered the country's financial stability and economic resilience, allowing for a more favorable assessment of its external reserves coverage. CBA's proactive monitoring of liquidity levels ensures that sufficient reserves are available to address any sudden disruptions in financial markets or adverse economic conditions. The recent improvements in most measures of the IMF's Reserve Adequacy Assessment (ARA) metric underscore the adequacy of Azerbaijan's external reserves coverage, providing a strong buffer against external vulnerabilities. Additionally, SOCAR, as a global company, is exposed to exchange rate fluctuations, which can impact its financial position. However, data on cumulative exchange rate differences reflect a positive trend for SOCAR, indicating benefits from a favorable exchange rate environment in recent years. Looking ahead, Azerbaijan's external position is expected to remain strong, supported by high oil prices, a budget surplus, and sustained foreign reserve accumulation.

In conclusion, the prudent management of foreign exchange reserves in Azerbaijan has contributed to the country's economic resilience and financial well-being. By maintaining adequate reserves, implementing effective risk management strategies, and leveraging opportunities for diversification, Azerbaijan can further strengthen its position in the global economy and pursue its strategic goals for sustainable development.

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Azərbaycanda Valyuta Ehtiyatlarının İdarə Edilməsi¹S.M. Məmmədov, ²İ.V.Kərimov

Xülasə. Valyuta ehtiyatlarının idarə edilməsi iqtisadi sabitliyin qorunmasında həlledici rol oynayır. Bu məqalə Azərbaycanın strategiyalarına və imkanlarına diqqət yetirməklə Azərbaycanda valyuta idarəçiliyini öyrənir. O, Azərbaycanın ehtiyatlarının hazırkı vəziyyətini, o cümlədən onların tərkibini, adekvatlığını və performansını araşdırır və resursların idarə edilməsi ilə bağlı qərarlara təsir edən müxtəlif amilləri araşdırır. Neft qiymətləri, ticarət balansı və xarici borc kimi ehtiyat səviyyələrinə təsir edən amillər təhlil edilir və fəaliyyət qiymətləndirilir. Bundan əlavə, ölkənin iqtisadi güclərini və strateji hədəflərini nəzərə almaqla Azərbaycanda resursların idarə edilməsinin optimallaşdırılması üçün potensial imkanları müəyyən edir. Azərbaycanın valyuta ehtiyatlarının idarə olunmasının hərtərəfli təhlili vasitəsilə ölkənin qlobal arenada iqtisadi sabitliyini və dayanıqlığını formalaşdıran dinamikanın daha dərinədən dərk edilməsinə töhfə vermək məqsədi daşıyır.

Açar sözlər: Valyuta ehtiyatları, Risklərin idarə edilməsi, İqtisadi sabitlik, Valyuta dalğalanmaları, Mərkəzi Bank müdaxiləsi

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Управление валютными резервами в Азербайджане¹С. М. Мамедов, ²И.В.Керимов

Резюме. Управление валютными резервами играет решающую роль в защите экономической стабильности. В этой статье представлен обзор валютного управления в Азербайджане с упором на уникальные проблемы, стратегии и возможности Азербайджана. В нем рассматривается текущее состояние резервов Азербайджана, включая их состав, достаточность и производительность, а также исследуются различные факторы, влияющие на решения по управлению ресурсами. Анализируются и оцениваются факторы, влияющие на уровень резервов, такие как цены на нефть, торговый баланс и внешний долг. Кроме того, в нем определяются потенциальные возможности для оптимизации управления ресурсами в Азербайджане с учетом экономической мощи страны и стратегических целей. Посредством всестороннего анализа управления валютными резервами Азербайджана он призван способствовать более глубокому пониманию динамики, определяющей экономическую стабильность и устойчивость страны на глобальной арене.

Ключевые слова: валютные резервы, управление рисками, экономическая стабильность, колебания валютных курсов, интервенции центрального банка.

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