The Ministry of Education of Azerbaijan Republic

Impact of free-floating exchange rate to Azerbaijan economy

Author: Ulkar Guliyeva

Supervisor: Fakhri Mammadov

UNEC SABAH

Azerbaijan State University of Economics

JUNE 2018

Table of Contents

Acknowledgements

Firstly, it is a great pleasure to express my profound gratitude towards my thesis supervisor Prof. Fakhri Mammadov in order to provide me with continuous encouragement and truly insightful support through the process of writting this thesis. I am also thankful to my family especially my father for his aspiring guidance, friendly advice, invaluably criticism during the project work. I am extremely grateful to my groupmates for sharing their illuminating views on a numerous issues regarding to this project too.

Abstract

This thesis involves searching all exchange rate regimes, the rules imposed in their determination and influences of them to various kind of countries. The main goal is discovering impacts of freely floating exchange rate regime to the economy of Azerbaijan and alterations occurring after the transition to this system. Thus, firstly analyzing exchange rate systems, the difference of them in different countries, opportunities and threats are largely and comprehensively showed. Secondly, policies realized in this sphere by Azerbaijan after its independence period, gaining or losing value of manat in front of foreign currencies in different periods are notified. Finally, it is concluded with clarifying possible impacts that are able to be observed in the framework of our country in upcoming years. Thus, it is crucial to get aware of feasible innovations coming together with this system.

Introduction

For years world countries have been using different kind of exchange rate systems according to their specifications of economies. Emerging nations literally differ with their fixed exchange rate regimes whereas developed ones basically are imposing floating system. Thus, fixed exchange rates are determined through the full support or interventions of government, however, freely floating rates form in market basing on the fluctuations of demand and supply. Floating exchange rate as a vital part of our work is regulated relative to various type of hyphothesis (supply and demand, monetary and asset price theory).

Countries are definetely different from one another for determination rules of these exchange rates and durability of their money in contrast to foreign currencies . Because, regardless of the specification of legislative enacment realised by governments money fluctuates in an international trade consistent with increasing volume of export and imports recently. If nations had applied the same exchange rates they would encounter with systematic problems with regard to this circumstance (like having unique monetary policy, the same methodology in managing money). After escaping from "Gold standarts" countries pegged their currencies to USD through "Bretton Woods" but this system still was not effective to economy. Some countries` Central Banks are attending in a liberal market in an attempt to impact the value of exchange rates and it is called managed float system. However, currently a vast majority of countries have already transformed to freely floating exchange rate standard. This system has specific opportunities and threats. Thus in order to accomplish economic prosperity, control the level of inflation and employment without being influenced by outside factors it is an ideal preference. From the other side it is almost the best way to eliminate a disequilibrium in balance of payment, get an advancement in international trade, benefit from inner policy and etc. Besides merits there are some drawbacks like absence of investment, vulnerability in economy and etc. This kind of benefits can create good situation for businesses and investors in turn as a return from transaction with foreign currencies.

When it comes to Azerbaijan, after gaining its independence (after 1990) Azerbaijan has accomplished lots of opportunities in implementing successful monetary policy and correct exchange rate regime. Thus, economic stagnation and fluctuations on macroeconomic indicators in 1990s have been replaced with enhancement and sufficient increases on (GDP, unemployment rate). Thus, tremendous amount of inflation (1662%) happened in 1994 is eliminated by putting money away circulation and enforcing restrictive monetary policy by National Bank. After 1995 government had realized legal measurements in order to rebuild destructed economy. 2005 was notified as a golden period with building "BTC" and giving large amount of contribution to the economy of Azerbaijan. Considering the fact of over-depending from oil products export, Azerbaijan started to live its magnificent and most flourish period after 2005 and manat as its domestic currency gained more value than expected against to other foreign currencies and continued until 2015 with small fluctuations. We undergone devaluation 2 times repeatedly and manat lost its value by 49.6% (CESD press “2017 Outlook”) in 2015. It was indispensable inclination for us to pass to floating exchange rate in which these rates would be regulated according to the rules of liberal market. At first due to increases on overall prices inflation reached two-digit limit and social, economic, cultural life exposure harmful and damaged consequences. Right now situation is satisfactory because of high level of oil prices, low inflation rates (4%), sufficient amount of foreign reserves (approximately 40 mlrd USD) and stable exchange rates of manat in currency markets observed for months (1.70$). Although devaluation is unavoidable action, relying on an amount of foreign reserves CBAR absolutely has a capability to make interventions and prevent manat to lose its value by this way.

It is undeniable fact that we can keep increases occurring in non-oil sector again in anticipated years. Through decreasing over-dependency from import materials, Azerbaijan has a strong capacity to change its direction from importer to exporter . Thus, because of being in the intersection of mild and subtropical climate types, seasonal patterns enable us to serve in this sphere successfully and increase demand to our products in world market. It means inreasing exchange rates of manat and restructing its value.

Chapter 1: Theoretical and Conceptual Framework

1.1 Analysis of different exchange rate systems

There are lots of countries in the world that are applying different kinds of exchange rate systems depending on the specifications of their economies. Exchange rates are governed by the level of demand and supply. However, governments have a capability to manage them with several ways. Alternative systems of exchange rates are defined according to the participation of governments in the currency markets. Three various exchange rate systems are considered different based on their characteristics. Thus, exchange rates are prescribed by the fluctuations in demand and supply curve without the intervention of the government and currency levels can be changed by the ifluence of government. At last, governments may look to settle the estimations of their monetary forms, either through support in the market or through administrative approach (like imposing certain regulatory policies).

Fixed Exchange Rates

In a fix exchange rate system, the exchange rate between two monetary forms is set by government approach. There are a few systems through which settled exchange rates might be kept up. Whatever the system for keeping up these rates, all settled exchange rates share some critical highlights.

In a standard commodity system, countries have to adjust their value to their respective currencies in relation to a particular product or group of products. With the value of each fixed currency in terms of the commodity, the currencies are relative to each other. For a considerable length of time, the estimations of numerous monetary forms were settled with respect to gold. Assume, for instance, that the cost of gold was settled at $15 per ounce in the USA. This would imply that the legislature of the United States was focused on trading 1 ounce of gold to any individual who gave over $15. Now assume that the exchange rate between the English pound and gold was £3 per ounce of gold. With £3 and $15 both exchanging for 1 ounce of gold, £1 would trade for $5. Nobody would pay more than $5 for £1, on the grounds that $5 could simply be traded for 1/3 ounce of gold, and that gold could be traded for £1. What's more, nobody would offer £1 for under $5, in light of the fact that the proprietor of £1 could simply trade it for 1/3 ounce of gold, which could be traded for $5. Practically speaking, actually currency values could differ marginally from the levels suggested by their ware esteems due to the costs associated with trading monetary forms for gold, however these varieties are slight. Under the gold standard, the amount of currency was directed by the amount of gold in a nation. If, for instance, the United States ensured to trade dollars for gold at the rate of $15 per ounce, it couldn't issue more currency than it could move down with the gold it possessed.

The gold standard was an automatic and self-regulating system. Assume that at the fixed exchange rate inferred by the gold standard, the supply of a nation's money surpassed the demand. That would infer that spending streaming out of the nation surpassed spending streaming in. As inhabitants provided their currency to make outside buys, nonnatives securing that money could recover it for gold, since nations ensured to trade gold for their currencies at a settled rate. Gold would in this way stream out of the nation running a shortage. Given a commitment to exchange the nation's currency for gold, a diminishment in a nation's gold property would compel it to decrease its money supply. That would decrease total demand in the nation, bringing down wage and the price level. Yet, both of those occasions would expand net export in the nation, completely removing the deficit in the level of balance payments. Balance would be accomplished, yet at the cost of a temporary economic decline. A nation with a surplus in its balance would encounter an inflow of gold. That would support its supply and increment total demand. That, thusly, would cause higher prices and higher Gross domestic product. Those occasions would diminish net exports and correct the surplus in a balance, yet again at the cost of changes in the local economy.

As a result of this inclination for imbalances in a nation's balance of payments to be remedied just through changes in the whole economy, countries started relinquishing the highest quality level in the 1930s. That was the time of the Great Depression, within which trade was came to a standstill. World War II made the shipment of merchandise to a great degree unsafe recommendation, so exchange stayed insignificant during the war. As the war came to the end, delegates of the United States and its partners met in 1944 at Bretton Woods, New Hampshire, to form another system through which international trade could be financed after the war. The framework was to be one of settled exchange rates, yet with substantially less accentuation on gold as backing for system. As of late, various nations have set up currency board arrangements, which are a sort of commodity standard, settled exchange rate in which there is unequivocal administrative sense of duty regarding exchange domestic currency for a predetermined foreign currency at a settled rate and a money board to guarantee satisfaction of the legitimate commitments this game plan involves. In its least complex frame, this kind of plan suggests that domestic currency can be issued just when the money board has an identical measure of the foreign currency to which the local currency is pegged. With a currency board arrangement, the nation's capacity to direct autonomous fiscal approach is seriously restricted. It can make holds just when the currency board has an abundance of foreign currency. On the off chance that the money board is short of foreign currency, it must curtail holds.

Argentina built up a money board in 1991 and settled its currency to the U.S. dollar. For an economy tormented in the 1980s with falling real GDP and rising inflation, the currency board served to reestablish trust in the administration's responsibility regarding adjustment strategies and to a reclamation of monetary development. The currency board appeared to function admirably for Argentina for the majority of the 1990s, as inflation died down and development of real Gross domestic product got. The disadvantages of a money board are basically the same as those related with the gold standard. Looked with a diminishing in consumption, investment, and net exports in 1999, Argentina couldn't utilize money related and monetary strategies to attempt to move its total demand curve to right side. It surrendered the framework in 2002.

Managed Float Systems

Governments and central banks frequently look to increase or diminishing their exchange rates by purchasing or offering their own particular currencies. Trade rates are sans still free to float, yet governments attempt to impact their values anymore. Government or national bank interest in a floating exchange rate system is known as a managed float. Nations that are applying floating exchange rate system mediate in currency market with the purpose of lifting or lowering the value of their domestic currency. Normally, the aim behind such intercession is to avoid sudden vast swings in the estimation of a country's money. Such intercession is probably going to have just a little effect, assuming any, on trade rates. Generally, $1.5 trillion worth of currencies changes hands each day on the planet; it is troublesome for any one office—even an organization the measure of the U.S. government or the Fed—to drive noteworthy changes in exchange rates. In any case, sometimes governments or central banks can impact their trade rates.

Assume the cost of a nation's money is rising quickly. The nation's administration or national bank may look to hold off further increments so as to keep a noteworthy diminishment in net export. A declaration that a further increment in its exchange rate is unsatisfactory followed by the sales that country's currency level by central bank keeping in mind the end goal to cut its exchange rate down, can now and again persuade different members in the currency market that exchange rate won't rise further. That adjustment in desires could decrease demand for and increment supply of the currency, in this manner accomplishing the objective of holding the exchange rate down. A few financial specialists trust that much of the time floating exchange rates are desirable over fixed exchange rates. Drifting exchange rates consequently change in accordance with financial conditions and enable a nation to hose the effect of shocks and outside business cycles. This eventually prevents the likelihood of having an adjust and crisis of balance of payment. A floating exchange rate system additionally enables the nation's money related arrangement to be authorized to seek after different objectives, for example, balancing out the nation's employment rate and prices. In any case, floating exchange rates represent a few dangers. A floating exchange rate standard isn't as steady as a settled exchange rate. On the off chance that currency movements, there could be fast valuing or devaluing of a currency. This could hurt the nation's imports and fares. Provided the fact that the money's esteem increments too definitely, the nation's fares could turn out to be too exorbitant which would hurt the nation's employment rates. In the event that the currency's esteem diminishes too definitely, the nation will be unable to bear the cost of essential imports. This is the reason managed floating system is more attractive to some of the countries. A nation can get the advantages of a free floating exchange rate system yet at the same time has the choice to intercede and limit the dangers related with a free movement of currency. In the event that a currency's esteem increments or abatements too quickly, the central bank can mediate and limit any hurtful impacts that may come about because of the radical vacillation.

Free-Floating System

In a free-floating system, governments and central banks don't take an interest in the market for foreign exchange. Governments may control securities exchanges to anticipate extortion, yet stock esteems themselves are left to float in the market. The U.S. government, for instance, does not mediate in the share trading system to impact stock prices. The idea of a totally free-floating system is a hypothetical one. Practically speaking, all administrations or central banks intercede in currency markets in an attempt to impact trade rates. A few nations, for example, the U.S.A, mediate to just a little degree, with the goal that the thought of a concept of a free-floating exchange rate system approaches what really exists in the United States. A free-floating system has the benefit of acting naturally controlling. Market powers additionally limit quick movements in demand and supply. Assume, for instance, that a sensational swing in world inclinations prompted a strongly expanded interest for products and services manufactured in Canada. This would build the interest for Canadian dollars, raise Canada's exchange rate, and make Canadian products more expensive for foreigners to purchase. As a result, floating exchange rate system operates as a cushion to protect an economy from the effect of worldwide occasions. The essential trouble with free-floating exchange rates lies in their capriciousness. Contracts amongst purchasers and merchants in various nations must not just figure with conceivable changes in costs and different components within the lives of those agreements, they should likewise think about swapping exchange rates. An agreement by a U.S. wholesaler to buy a specific amount of Canadian timber every year, for instance, will be influenced by the possibility of alteration in exchange rates between the Canadian dollar and the U.S. dollar. Fluctuating trade rates make global exchanges more hazardous and eventually the cost of business carried out with different nations. The monetary forms of a large portion of the world's real economies were permitted to float freely following the crumple of the Bretton Woods framework in 1971. The Bretton Woods Conference occurred in July 1944 and a sum of 44 nations met. The Meeting built up the “IMF” and the World Bank, and it set out rules for a fixed exchange rate. The framework set up a gold cost of $35 per ounce, and taking an interest nations pegged their currency to the dollar. Modifications of give or take 1% were allowed. The dollar turned into the hold money through which national banks did mediation to alter or balance out rates.

The principal substantial break in the system showed up in 1967, with a keep running on gold and an assault on the English pound that prompted a 14.3% devaluation. President Richard Nixon took the United States off the gold standard in 1971. By late 1973, the framework had fell, and taking an interest monetary forms were permitted to float freely.

Contingent upon the administration's particular macroeconomic goals and how built up the economy is, pure float exchange rates can be a good alternative. They take into consideration self-sufficient financial approach as far as controlling interest rates, which is essential for key destinations, for example, inflation and development. Be that as it may, there are some noticeable risks to consider, including the dangers of capital flight and worldwide exchange solidness. For this situation, settled exchange rates might be more proper for creating economies.

Hybrid exchange rate system

Nations regularly have a few vital exchanging accomplices or are troubled of a specific money being excessively unstable over a broadened timeframe. They would thus be able to peg their money to a weighted normal of a few monetary standards (otherwise called a currency basket). For instance, a composite money might be made comprising of 100 Malaysian ringgit, 100 Japanese yen and one Singapore dollar. The nation making this composite would then need to keep up saves in at least one of these monetary standards to mediate in the foreign exchange market. A famous and broadly utilized composite currency is the SDR, which is a composite money made by the Universal Fiscal Reserve (IMF), comprising of a settled amount of U.S. dollars, Chinese yuan, euros, Japanese yen, and English pounds.

In a crawling peg framework a nation settles its exchange rate to another money or bushel of currencies. This settled rate is changed every once in a while at occasional interims with a view to taking out exchange rate instability to some degree without forcing the requirement of a settled rate. Crawling pegs are balanced moderately, in this way staying away from the requirement for interferences by the central bank (however it might at present do as such keeping in mind the end goal to keep up the settled rate in case of unnecessary vacillations).

Currency substitution is the most extraordinary and inflexible way of settling exchange rates as it involves receiving the currency of another nation set up of its own. The most well-known illustration is the eurozone, where 19 European Association (EU) part states have embraced the euro (€) as their regular currency (It is called euroization). There are comparative cases of nations embracing the U.S. dollar as their local currency (dollarization): English Virgin Islands, Caribbean Netherlands, East Timor, Ecuador, El Salvador, Marshall Islands, United Conditions of Micronesia, Palau, Panama, Turks and Caicos Islands and Zimbabwe.

Settlement of Floating exchange rates:

There are four speculations that clarify how floating rates are set. The main hypothesis (the demand and supply hypothesis) is known as a flow hypothesis since it thinks about how the demand for and supply of a local money over some stretch of time brings about a specific level for the exchange rate. The other three hypotheses (the monetary theory, the asset price theory, and the portfolio balance theory) are called stock speculations, since they ponder the measure of money accessible at a specific time and people groups' readiness to hold the currency.

- Supply and Demand Theory:

  This theory expresses that the exchange rate is the crossing point of the supply of residential currency (appeared as the supply bend) and its demand (appeared as the demand bend). The supply of local money is controlled by imports and the demand is dictated by sends out. This theory holds that foreign exchange rates are at a balance level on the off chance that they create a steady current record adjust. A country with a trade deficit will encounter a decrease in its foreign exchange reserves, which eventually brings down, or devalues, the estimation of its own currency. On the off chance that a money is underestimated, its country's exports turned out to be more reasonable in the worldwide market while making imports more costly. After a transitional period, imports will be constrained down and outflows will rise, in this way settling the exchange adjust and bringing the money towards balance.

- Monetary Theory:

This hypothesis joins money supply and prices to the level of exchange rate. An expansion in money supply prompts an increment in costs (inflation). As indicated by the fiscal hypothesis, the exchange rate is the proportion of prices in two nations, so an expansion in value causes the exchange rate to be reset. Consider two nations X and Y. At the point when the currency supply in every nation rises, the costs in every nation rise. On the off chance that the development of currency supply in X is more noteworthy than the development of currency supply in Y, at that point X encounters a higher inflation rate than Y. Basing on the Purchasing Power Parity, it is just value relatives that demonstrate the proportion of the prices in national monetary standards of an identical items (basket of goods and services are included) in various nations.

- Asset Price Hypothesis:

The hypothesis expresses that currency is a benefit similarly as land or securities or gold. The want to hold a specific sort of advantage is driven by the impression of the benefit's future esteem. On the off chance that the esteem is probably going to rise, individuals will need to purchase the advantage now and offer it at a higher value in order to make a benefit. Then again, in the event that they figure the advantage's esteem will drop, every one of those holding the benefit now will begin offering the advantage (selling) dreading a more prominent decrease in cost sooner rather than later. In this way, the advantage's present engaging quality is an element of what the market trusts its esteem will be in future. At the end of the day, future desires choose current purchase/selling choices. This is genuine notwithstanding for money. On the off chance that the market trusts that the residential money will ascend in esteem, everybody will begin getting it. In the event that the present exchange rate is 6.34/$, and the desire is that the yuan will increase in value throughout the following a half year. Members will begin buying the yuan and this will drive up demand. Since demand rises, the yuan will escalate against the dollar, and the exchange rate will settle at 5.34/$.

1.2 The difference among the exchange rates applied by different countries

For what reason does money change? Since the relative estimations of various resources vary. Peg the currency to any one, and it will remain steady with respect to that one, however it will differ significantly contrasted with others. There's no chance to get around that: it's about free market activity (supply and demand). Regardless of what you do, money will vacillate. The best way to prevent it from fluctuating is to prevent the whole world from changing in any capacity. No surprising climate, no consumable assets, no adjustments in populace, no adjustments in design, no progressions in innovation, no alterations in medicinal care, no adjustments in labor rates – no progressions of any kind. However, it is impossible practically therefore countries impose different exchange rates for themselves. For example, Saudi Arabia is the world's biggest exporter of raw petroleum so the raw petroleum costs is a vital determinant of the Saudi Middle Eastern economy. Same is the situation with India with regards to materials or rice and Azerbaijan according to its oil and oil materials. Attributable to these differing factors an autonomous money is key for each country.

- Sell rate – this is the rate at which we offer foreign currency in return for domestic currency. For instance, in the event that you are going to Canada, you would trade your money for Canadian dollars at the offer rate.
- Buy rate – this is the rate at which we purchase foreign currency from explorers to trade into local currency. For instance, in the event that you were coming back from America, we would trade your dollars over into euros at the purchase rate.
- Occasion currency rate or visitor rate – another term for an offer rate.
- Spot rate – This is referred to all the more formally as the 'interbank' rate. It is the rate banks or expansive budgetary organizations charge each other when exchanging critical measures of foreign currency. In the business, this is some of the time alluded to as a 'spot rate'. It isn't the tourist rate and you can't purchase currency because of current circumstances, as you are purchasing generally little measures of foreign currency. In regular day to day existence it is the same as the contrast amongst wholesale and retail costs. The rates appeared in money related daily papers and in communicate media are typically the interbank rates.

If all of the globe use the same currency there would be some problematic issues with regard to the effects of this circumstance:

* Combined monetary policy - a distinction in money enables every individual nation to have autonomous financial strategies. Take Japan for instance: Japan's economy relies

upon sends out, so Bank of Japan has a motivator to devaluate their currency to support the economy. In the event that Japan utilizes the US Dollar, the estimation of their outlays will be dictated as the importing country; which isn't great.

* Ways of managing money - every individual nation varies in culture, and in addition ways of managing money. Take Greece for instance: they adore optional spending. If they try to adapt for their trade partners, all clients of that currency should alter the financial arrangement to take into account all nations. The outrageous inverse of Greece would be Germany. German economy does not do much optional spending. So if/since they share a similar money, one fiscal approach won't fit them both.

* Macroeconomic occasions - Envision if every one of us utilizes the US Dollar, and after that 9/11 happened. There would likewise be no thought of a "emerging market", since all nations will utilize a similar currency and will be under the same money related strategy being managed by a similar central bank. Everything comes down to money related approach, really. Nations like directing their own financial arrangements to have the capacity to fit their flow monetary wellbeing, their monetary drivers, and their expansion targets.

Knowing the estimation of your home money in connection to various foreign currency causes financial specialists to analyze resources valued in foreign dollars. For instance, for a U.S. investor, knowing the dollar to euro exchange rate is important while choosing European investments. A declining U.S. dollar could expand the estimation of foreign investment, similarly as an expanding U.S. dollar esteem could hurt the estimation of your foreign investment.

Consider that the Canadian dollar is emphatically related to the cost of oil. Thusly, as the cost of oil goes up, the Canadian dollar has a tendency to acknowledge against other significant monetary standards. This is because of the way that Canada is a net oil exporter; when oil costs are high, Canada has a tendency to harvest more prominent incomes from its oil trades, giving the Canadian dollar a lift on the outside exchange market.

Another great illustration originates from the Australian dollar, which is decidedly corresponded with gold. Since Australia is one of the world's greatest gold makers, its dollar tends to move as one with value changes in gold bullion. Along these lines, when gold costs rise altogether, the Australian dollar will be valuable against other significant monetary forms. In 2018 one U.S. dollar has the purchasing power of approximately 62.02 rubles in Russia. Imagine that in the United States, a glass of orange juice costs one U.S. dollar. In Russia, in the event that you are parched and need to buy a glass of orange juice, what amount would it be a good idea for you to have? Since we are looking at a similar thing from the crate of goods the two nations have, you ought to have what might as well be called one U.S. dollar in Russia's money, or 62.02 rubles.

This distinction in price is because of the way that exchange rates reflect both the neighborhood economic situations and the accountings of traders about the general prospects of an economy. For instance, when money merchants foresee that a country will experience an episode of inflation, making their currency less profitable, they are probably going to offer their property of that money, much the same as some other ware. (The term product ordinarily alludes to essential merchandise that are by and large effectively substitutable for some other of its kind. Metals, for example, gold or aluminum, or essential substances, for example, oranges or cows, are thought about items.)

Central banks purchase or sell their nearby monetary forms to modify the exchange rate; this can be gone for settling an unstable market or accomplishing a noteworthy change in the rate in floating exchange rate system. Gatherings of national banks, for example, those of the G-7 countries (the United States, Germany, Italy, Japan, Canada, France, and the United Kingdom), regularly cooperate in facilitated intercessions to build the effect. An intercession is short-term and does not generally succeed. An unmistakable case of a fizzled intercession occurred in 1992, when agent George Soros led an assault on the English pound. The money had entered the European Exchange Rate Mechanism in 1990; the ERM was intended to constrain currency instability as a lead-in to the euro. Soros trusted that the pound had entered at an unnecessarily high rate, and he mounted a deliberate assault on the money. The Bank of Britain was compelled to debase the money and pull back from the ERM. The fizzled mediation cost the U.K. Treasury an announced £3.3 billion. However, in a fixed exchange rate the currency is pegged to another one. Money pegs make security between trade partners and can stay set up for quite a long time. For instance, Denmark's krone has been pegged to the euro since 1982 and the Hong Kong dollar has been pegged to the U.S. dollar since 1983.

As an exporter, China profits by its moderately weak currency , which makes its outcomes generally more affordable contrasted with sends out from contending nations. China pegs the yuan to the dollar in light of the fact that the U.S.A is China's biggest import accomplice at $478.8 billion in 2016. The steady exchange rate in China and a frail yuan likewise advantage particular organizations in the United States. In 2015, 18% of China's exports were to the U.S.A. For instance, strength enables organizations to take part in long haul arranging, for example, creating models and putting resources into the production and bringing in of products with the understanding that expenses won't be influenced by currency changes. The frail yuan additionally benefits significant shippers, for example, Walmart Stores, Inc. what's more, Target Organization. For these and different retailers, the reserve funds acknowledged from less expensive Chinese imports in dollars can significantly affect all that really matters. Net revenues in the retail part are ordinarily in the low single digits.

Countries are different for their exchange rates and the major reason behind it is related to some crucial factors:

- Inflation Rates

Changes in inflation rates sometimes results in changes in exchange rates. A nation with a lower infilation rate than another's will see a gratefulness in the estimation of its currency. The costs of goods and services grow up at a slower rate where the inflation is low. A nation with a reliably lower-grade inflation rate displays a rising currency esteem while a nation with higher infilation regularly observes devaluation in its money and is typically joined by higher interest rate.

- Interest rates

Changes in interest rates influence currency esteem and dollar exchange rate. Inerest rates, forex rates, and inflation are altogether corresponded. Increments in interest rates make a nation's money acknowledge in light of the fact that higher loan fees give higher rates to banks, in this way drawing in more outside capital, which causes an ascent in exchange rates. For example, increase in Switzerland interest rates will bring about good returns on saving accounts and in turn demand for Swiss franc,as well as appreciation of Switzerland currency by foreign investors.

- Balance of Payment

A nation's present record reflects balance of trade and profit gained from foreign investment. It comprises of aggregate number of exchanges including its outlays, imports, obligation, and so forth. A deficiency in current record because of spending a greater amount of its currency on bringing in items than it is gaining from its exporting products causes depreciation. Balance of payments vacillates exchange rate of its local currency.

- Government Liability

A nation with government obligation is less inclined to gain outside capital, prompting infilation. Foreign financial specialists will offer their securities in the open market if the market predicts government debt inside a specific nation. Accordingly, a decline in the estimation of its exchange rate will take after. For instance, Iceland encounter with debt challenge in 2008, caused a quick fall in the estimation of the Icelandic money. Other example, if markets dreaded the US would default on its obligation, foreign financial specialists would offer their property of US securities. This would cause a fall in the estimation of the dollar.

- Terms of Trade

The terms of exchange is the proportion of export costs to import costs. A nation's terms of trade enhances if its export prices ascend at a more prominent rate than its imports costs. This outcomes in higher income, which causes a higher interest for the nation's money and an expansion in its currency's esteem. This brings about appreciation of exchange rate.

- Political Security and Execution

A nation's political state and financial execution can influence the powerness of its currency. A nation with a generally safe of political turmoil is more appealing to foreign financial specialists. An expansion in foreign capital prompts the thankfulness in the estimation of the nation's money, yet nations inclined to political strains are probably going to see a deterioration in the rate of their currency.

The greater part of exchange rates you will encounter are adaptable exchange rates. That is, the rate of exchange can rise or decrease in view of financial variables. These circumstances can change every day, frequently by little portions amid your trek. Flexible exchange rates between monetary forms are dictated by an outside exchange market, or "forex" for short. These business sectors direct the costs by which financial specialists are obtaining one currency with another, with the expectations of profiting when that country's currency picks up quality. For a case of an floating exchange rate, take a gander at the movements between the United States and Canada. In April 2017, one U.S. Dollar was worth $1.28 Canadian Dollars. Amongst April and August 2017, the esteem dropped by almost eight cents, making the Canadian Dollar somewhat more grounded in return. In any case, by the start of 2018, the American Dollar recaptured quality. In the event that you took a get-away to Niagara Falls, Canada in May 2017, your American Dollars would have been worth $1.37 Canadian Dollars, giving you all the more purchasing power. However, in the event that you took that same outing in September 2017, your American Dollars would have just been worth $1.21 Canadian Dollars each - a noteworthy misfortune in money quality.

Figure 3.a **Equilibrium in the Foreign Exchange Market**

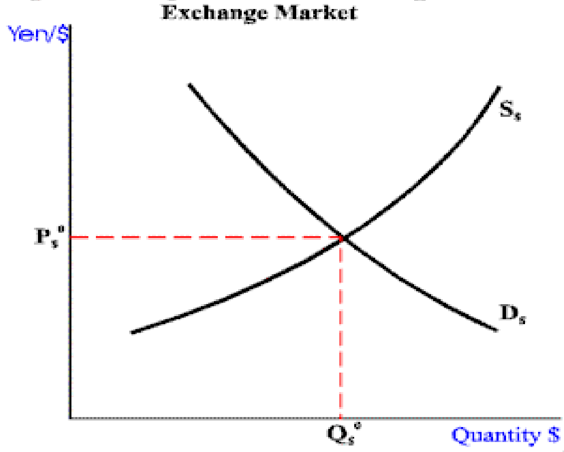


Figure 3.b **Increased Supply of Dollars Lowers the Value of the Dollar**

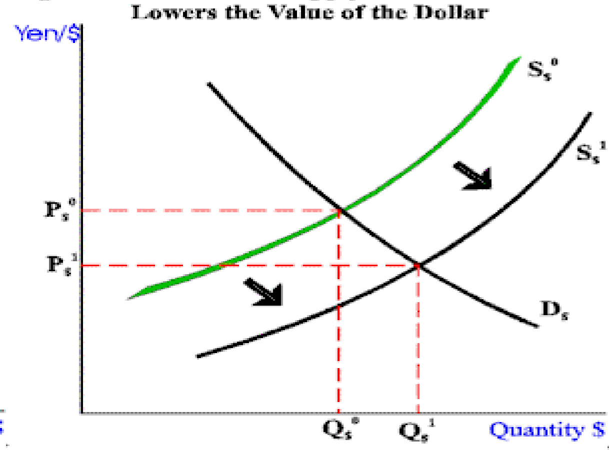
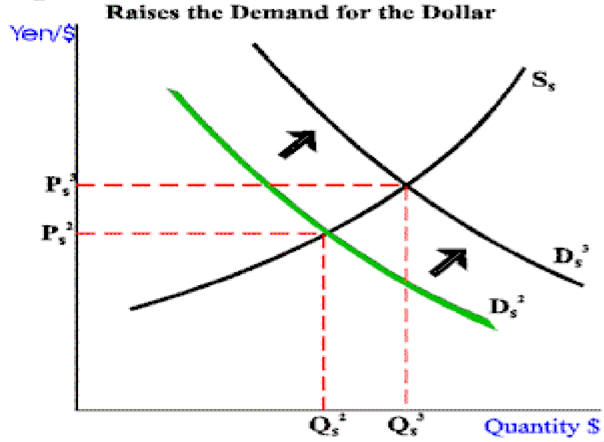


Figure 3.c **Increased U.S. Interest Rates Raises the Demand for the Dollar**



Source: Exchange rates/ http://www.economicsonline.co.uk/Global_economics/Exchange_rates.html

Changing the direction of topic from European or mostly developed countries to the emerging nations in which situation is likely different from other ones for several specified things, it would be appropriate to think about oil exporters. The focal Asian territory of Kazakhstan is an oil exporter. At the point when oil's cost is high, its exchange rate additionally has a tendency to be high, making its other fares uncompetitive. Like numerous oil exporters, Kazakhstan pegged its exchange rate to the dollar of USA. The Kazakh national bank kept up an exchange rate of around 185 tenge to the dollar.

This functioned admirably while the cost of oil was high. A national bank can generate its own money, through selling the tenge and purchasing dollars to keep up the peg was no issue. However, the sharp oil value decay beginning in the last quarter of 2014 put downwards weight on the exchange rate: to keep up the tenge inside its band, the Kazakh national bank sold U.S. dollars to purchase its own particular cash, logically depleting Kazakhstan's dollar holds. Further, Kazakhstan's near neighbor Russia – a kindred oil exporter and key trading accomplice – floated the ruble in the fall of 2014, inducing Kazakhstan to stick to this same pattern. On July 2015, the national bank enlarged the exchanging band to +13/ - 15 around 185 to the dollar. Be that as it may, without much of any result: the exchange rate stayed under pressure. On August 2015, the Kazakh national bank floated the tenge. The tenge's dollar exchange rate standard immediately fell pointedly, lessening organizations' profit expressed in dollars. Import costs rose, powering local inflation; the Kazakh national bank hosed this by raising interest rates, which achieved 17 percent in early 2016. Experts communicated worries about the strength of the Kazakh managing an account area, while legislators seriously censured the national bank's Senator. After three months, the Representative was replaced.

In any case, truth be told, Kazakhstan's turn to floating rates demonstrated helpful over the long haul. The national bank ignored routinely offering dollars in November 2016, securing the nation's valuable FX reserves. In spite of this, ahead of schedule in 2016 the tenge balanced out at around 336 to the dollar. It has stayed there ever since. In parallel with this, the Kazakh national bank has logically decreased interest rates since May 2016. The adjustment of the exchange rate, yet at a much lower level, has energized import-send out exchange, empowering Kazakhstan to develop rapidly from a shallow subsidence and got a steady economy.

1.3 Opportunities and threats of free floating exchange rate system

In some case clarifying as pure float, a free floating exchange rate is an adaptable exchange rate framework exclusively dictated by volatilities of demand and supply of foreign and local money. Clean float are a consequence of free enterprise or free market financial aspects. Clean float system is, hypothetically, the most ideal approach. It enables nations to hold their money related freedom, which essentially implies they can center around the interior parts of their economy, and control inflation and joblessness without agonizing over outside factors. Be that as it may, we should think about outside crisis, for example, oil value rises or capital flights, which can make it difficult to keep up a simply clean floating exchange rate framework. Actually, none of the monetary standards of created nations have a spotless currency, as they all have some level of help from their comparing central bank, thus have a managed float. Truth be told, since most nations mediate in FOREX to some degree now and again, these can be considered managed floating frameworks. Some financial experts say that, floating exchange rates are desirable over settled exchange rates. As clear floating rates naturally modify, they empower a nation to hose the effect of shocks and outside business cycles, and to prevent the likelihood of having a balance of payment emergency. Nevertheless, in specific circumstances, settled trade rates might be best for their more noteworthy strength and assurance. That may not really be valid, considering the result of nations that endeavor to keep the costs of their currency "high" in respect to others, for example, the UK or the Southeast Asia nations before the Asian money emergency.

The level headed discussion of settling on a decision amongst settled and floating exchange rate administrations is put forward by the Mundell– Fleming model, which contends that an economy (or the legislature) can't all the while keep up a settled exchange rate, free capital development, and an autonomous financial strategy. The essential contention for a floating exchange rate system is that it enables fiscal strategies to be valuable for different purposes. Under settled rates, fiscal strategy is focused on the single objective of keeping up floating rate at its reported level. An arrangement of floating exchange rates leaves fiscal strategy producers allowed to seek after different objectives, for example, balancing out employment or costs. There are some positive and negative sides of freely floating exchange rate system. Firstly, let`s talk about the beneficial sides of free floating exchange rate framework applied in different countries:

One of the greatest merits of floating exchange rate framework is that there is no compelling reason to keep surplus reserves since this framework does not require fake gratefulness or devaluation of the money through deal or buy of an outside or household money.

Programmed balance of payment modification – Balance of payments disequilibrium will have a tendency to be redressed by an adjustment in the exchange rate standard. For instance, if a nation has a balance of payment shortfall then the currency ought to devalue. This is on account of imports will be more prominent than sends out significance and the supply of sterling on the outside trades will increment as importers sell their pounds to pay for the imports. This will drive the estimation of the currency of country down. The impact of the deterioration ought to be to make your exports less expensive and imports more costly, in this manner expanding interest for your products abroad and diminishing interest for outside products in your own nation, accordingly managing the adjust of installments issue. From the other hand, surplus on the balance of payment ought to be dispensed with by a valuation for the money.

Liberating inner strategy – With a pure floating exchange rate system, balance of payment uncertainty ought to be redressed by an adjustment in the outside price of your own money. Nevertheless, with a fixed rate, curing a deficiency could include a general deflationary strategy bringing about offensive outcomes for the entire economy, for example, joblessness. The floating rate enables governments opportunity to seek after their own inward strategy destinations, for example, development and full work without outside imperatives.

Nonappearance of crisis– Settled rates are frequently characterized by emergencies as tension builds on a money to degrade or revalue. The way that, with a floating rate, such changes are programmed should remove the component of emergency from global relations.

Flexibility – After the year of 1973 there were extraordinary changes in the example of world exchange and a noteworthy change in world financial aspects because of the OPEC oil shock. A few nations with a settled exchange rate would have caused real issues like being uncompetitive given their inflation rate. The floating rate enables a nation to re-alter all the more adaptably to outer shocks.

Lower outside trade saves – A nation with a settled rate more often needs to hold a lot of foreign currency so as to plan for a period when they need to guard that settled rate and these currencies have an opportunity costs.

Advances International Trade- The arrangement of adaptable trade rates does not allow trade control and advances free trade. Limitations on global exchange are expelled and there is free development of capital and cash between nations.

International Investment cannot Advanced by Settled Rates- The contention that long haul international investments are energized under settled exchange rate framework isn't legitimate. Both the loan specialists and borrowers can't anticipate that the exchange rate will stay stable over a long stretch.

When it comes to deteriorations appearing after imposing of this kind of exchange rate system we should talk about:

Vulnerability – The way that a currency changes in an incentive day by day brings flimsiness or vulnerability into exchange. Sellers might be uncertain of how much money they will get when they offer (sell) abroad or what their cost really is abroad. Obviously the rate changing will influence price and along these sells. Essentially merchants never know the amount it will cost them to import a given measure of outside products. This vulnerability can be diminished by supporting the foreign exchange danger on the forward market.

Absence of investment – The vulnerability can prompt an absence of an investment inside and also from abroad.

Absence of discipline in monetary administration – Since inflation isn't rebuffed there is a threat that legislatures will follow inflationary financial approaches that will bring about increasing level of inflation for the economy. Finding an inflation target should help beat this.

Does a floating system consequently cure a shortage? – UK encounter shows that a floating exchange most likely does not naturally cure a balance of payment shortfall. Much relies upon the value versatility of interest for imports and fares. The Marshall-Lerner condition says that a deterioration in the exchange rate will help to enhance the BOP if the entirety of the value versatilities for imports and fares is more than one.

Inflation – The floating exchange system can be inflationary. Aside from not rebuffing inflationary economies, which, in itself, energizes expansion, the float can bring about inflation by permitting import costs to ascend as the exchange rate falls. This is, without a doubt, the case for nations, for example, UK where we are depended on imports of nourishment and crude materials.

If this type of risks are divided into categories for various people traders encounter with these problematic issues:

Initially consider a business that imports tennis rackets into the USA. Assume one thousand tennis rackets obtained from a provider in Japan costs 200,000 Japanese yen. At the present exchange rate of 50 JPY/$, it will cost the shipper $4,000 dollars or $4 per tennis racket. The shipper discovers that transportation, protection, publicizing, and retail expenses will keep running about $4 per tennis racket. On the off chance that the market cost for this kind of tennis racket is $10, he will make a $2 benefit for every racket if all rackets are sold.

Assume the shipment is planned to happen in three months and that installment for the shipment require not be set aside a few minutes. We should accept the merchant holds up to change over cash until the point when the installment is made and that in three months the Japanese yen has acknowledged to another estimation of 47 JPY /$. The shipment cost in yens continues as before at JPY 200,000, yet the dollar estimation of the shipment ascends to $4,255 or $4.26 per tennis racket. Expecting the same $4 of additional expenses and a $10 last deal value, the merchant will now make just $1.74 benefit per tennis racket, if all rackets are sold. While this is as yet a benefit, it is around 13 percent not as much as anticipated that when the choice related to purchasing was made three months previously. This is a case of the hazard a merchant faces due to an adjustment in the currency esteem. Obviously, beyond any doubt the currency esteem could have altered in the contrary course. Had the JPY esteem ascended to 56 JPY/$, the shipment esteem would have taken a toll just $3,571, or $3.57 per racket, producing a benefit of $2.43 per tennis racket. For this situation, the money moves in the shipper's support. In this way an unstable exchange rate will here and there prompt more prominent misfortunes than anticipated, and at different circumstances, to more prominent increases.

There are a few techniques to shield oneself from this sort of money hazard. The merchant could have traded money at the time the arrangement was struck and held his 200,000 JPY in a Japan bank until the point that payment is realized. Notwithstanding, this includes a significant extra opportunity cost since the assets must be accessible in advance and stay unusable while they are held in a Japanese financial balance. On the other hand, the shipper might have the capacity to discover a bank willing to compose a forward trade contract, settling exchange rate today for a trade to be made three months from now.

Regardless, it ought to be certain that floating exchange rate changes either increment the danger of misfortunes in respect to plans or increment the expenses to ensure against those dangers.

If we look at the circumstance from the point of investors view:

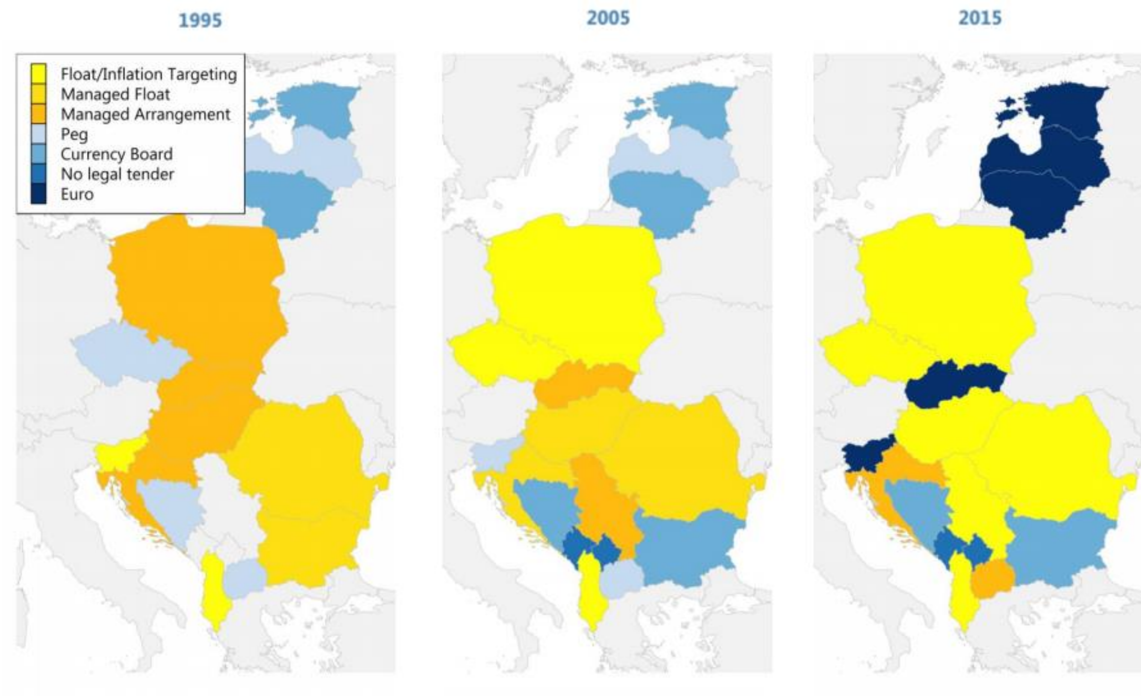
Unstable exchange rates additionally make exchange rate crisis for global financial specialists. Think about the accompanying illustration. Assume in September 2005, a U.S. citizen chooses to invest (i.e., spare) $20,000 for the following year. Given that the U.S. dollar had been debilitating as for the Danish krone for quite a while and since the return on money was marginally higher in Denmark at 3.15 percent contrasted with the 1.76 percent return in the United States, the financial specialist chooses to put the $20,000 into the Danish account. At the season of the deposit, the exchange rate sits at 4.80 kr/$. In September 2006, the investor trades out and changes over the cash back to U.S. dollars. The exchange rate in September 2005 was 6.26 kr/$.

The rate of return works out to be negative, which implies that as opposed to profiting on the foreign account, this financial specialist really loses $317. Had he kept the $20,000 in a U.S. account, he would have had an ensured return of 1.76 percent, acquiring him $352. By investing money in foreign account, the investor subjected himself to exchange rate hazard. The dollar suddenly appreciated amid the year, bringing about a misfortune. Had the dollar stay settled in an incentive amid that same time, the foreign return would have been 2.25 percent, which is bigger than that acquired in the United States.

In this way fluctuating exchange rates make it more troublesome for financial specialists to know the best place to contribute. One can't simply imagine what the interest rate is crosswise over nations however should likewise hypothesize about the exchange rate change. Influence the wrong figure about the trade to rate development and one could lose a significant amount of money.

There are some approaches to support against exchange rate hazard. For instance, with deposits, a financial specialist can buy a forward contract or enter a prospects market. In these cases, the financial specialist would arrange to offer Danish krone later on when the deposit is relied upon to be changed over back to dollars. Since the future exchange rate is foreordained on such an agreement, the rate of return is ensured too. Along these lines the danger of floating exchange rates can be decreased. Nevertheless, for long term investment, for example, FDI, these kinds of courses of action are more troublesome and expensive to execute.

When looking at the circumstance by getting aware of the effects of free floating exchange rate systems on an economic effect they impact long-term economic output through a lot of ways. They increment the expenses of international transactions, and they seem to decrease the volume of worldwide trade. Floating rates may cause inefficient movements of resources crosswise over areas of the economy, and they increment vulnerability about the future levels of exchange rates, which may prevent sufficient investment. From the other side, floating exchange rates free national banks to adopt monetary policy attempted to maintain the level of inflation and yield. This improved financial steadiness may energize gainful investment and raise the long-run level of monetary yield. It isn't conceivable to identify any particular impact of floating exchange rate unpredictability or the sort of exchange rate administration on the level of economic yield (output) or the long-run development rate. The information demonstrate that long-run financial yield is affected by numerous other more vital elements than the exchange rate administration. Over 2 decades some of the European countries have shown incredibly significant alteration by transmitting to floating exchange rate as seeing from the map indicated below.



Source: Exchange Rate Regimes in Emerging Europe/
https://www.imf.org/external/region/BAL/rr/2017/033017.pdf

Chapter 2: Research

2.1 Monetary policy and exchange rate systems in Azerbaijan after gaining independence

Azerbaijan had been under the power of Soviet Union for several years and this occupation in a real sense brought about severe consequences as well as adversities in terms of economic, social, political and cultural life of the country. Returning back to our rooted history, first independency period, Azerbaijan was the first in the Muslim world, starting with the banknotes of 25, 50, 100 and 250 manat sections that were placed available for use in 1919. There are words "Azerbaijan government" on the front-side of the banknote; its face esteem and the date of issue are appeared in the our own national language. Undergoing independence of SSSR again in 1920, the second cash outflow in Azerbaijan was executed in 1920 in the interest of the Azerbaijan Soviet Communist Republic. Inside this outflow a first banknote - 1000 rouble (in a major organization), at that point 5 (in 2 varieties), 100 (in 2 varieties) and 1000 (in a little configuration).

Despite all difficulties, Azerbaijan encounter with, we gained our independence one more time again at the end of 20th century and national cash was put into circulation. Along these lines, creation and issuing domestic currency was established with the dispatch of the National Bank at the Pronouncement of Leader of the Republic of Azerbaijan dated 11 February, 1992 on Foundation of the National Bank of Azerbaijan" and issue of the national money into flow at the Declaration of Leader of the Republic of Azerbaijan from 15 July, 1992 on Issue of the National Cash into Course.

Generally, since picking up its autonomy in 1991, Azerbaijan has begun to execute market-oriented change approaches. The change to the new political-monetary request has not been smooth, however full of with political calamities and military clashes. The

World Bank ordered Azerbaijan as a war-torn nation with a semi-democratic political regime. The direction of the post-Socialist change in Azerbaijan can be generally separated into three phases:

1. Recession Period (1991-1994)
2. Restructuring Period (1995-2005)
3. Oil Boom Period (after 2005)

- Recession Period

The principal years of autonomy had been much troublesome for the Republic of Azerbaijan from both politic and financial sides. In this way, the years 1991-1994 are named as the primary time frame, subsidence period or relapse period in financial improvement of Azerbaijan by various scientists. Sadly, this time of Azerbaijan economy has not been examined independently through recognizing all reasons for the financial decay. Subsequent to recapturing its autonomy, Azerbaijan focused to change its financial framework toward market economy which required privatization and progression in all fields of the economy. But, Azerbaijan looked with genuine political and financial subsidence amid the underlying years of the autonomy. Besides, fall of Soviet Association caused to the demolition of monetary ties with other post-Soviet nations, loosing of nation's offer in those business sectors and inaccessibility of appropriations from the focal government.

As indicated by the table 1, Gross domestic product of 1990 is around 2.67 times more than Gross domestic product volume of 1994. Gross domestic product development rate in the principal year of freedom had been negative, however not in critical level. Consequently, included esteem in parts of the economy in 1995 had diminished pointedly in examination with the relating markers of 1990. Then again, add up to volume of fare had diminished in excess of 2.32 times in 1994 in correlation with 1992 for the most part because of the abatement in export of oil and gas and oil items. And this kind of circumstances in turn caused shocks in balance of payments and devaluing of our currency, eventually decrease in exchange rates.

Table 1. Change in main macroeconomic indicators: 1990-1994

Indicators	Years	1990	1991	1992	1993	1994
GDP (mln. USD)		8858.006	8792.366	4991.350	3973.027	3313.739
GDP growth (%)		-	-0.7	-22.6	-23.1	-19.7
Inflation (%)		-	-	46.2	1128	1662.2

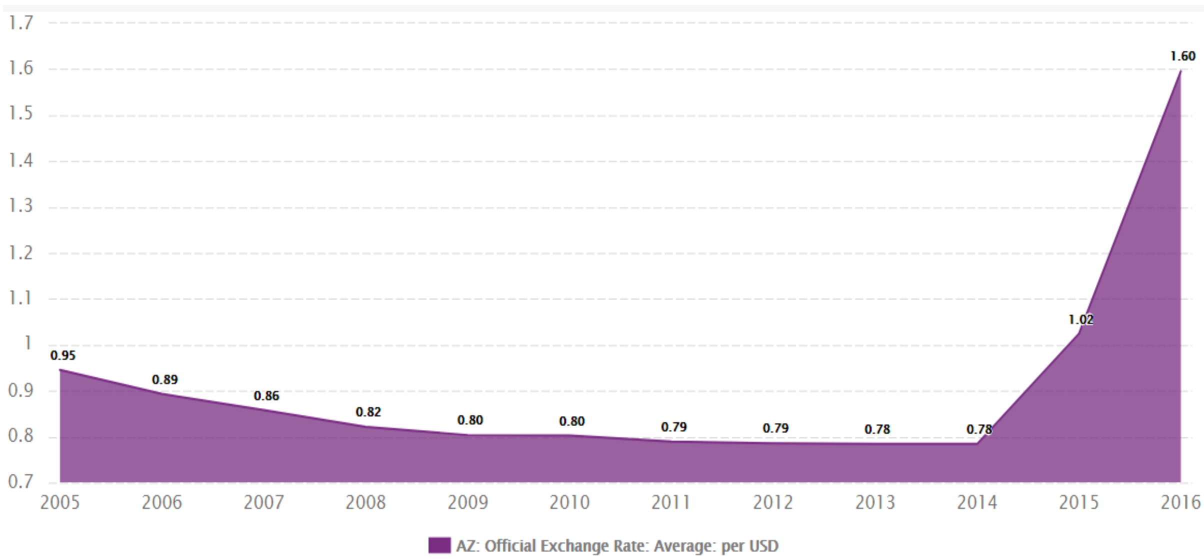
Source: World Bank Database

- Restructuring Period

The fundamental focus of the legislature after 1995 was to rebuild the destructed economy with the impact of subsidence. The vast majority of the researchers consider this period as kept going until 2003 due to the administration change and new financial program toward social-monetary advancement of Azerbaijan's locales, however, searching this period until 2005 would be more appropriate idea. Since, the year of 2005 is marked as a turning point and new page in a history being characterized as an impetus to economic growth and sustainable economy. Azerbaijan began to actualize radical monetary arrangements in 1995 as a team with IMF under its extensive adjustment program due to keep the hyperinflation issue. Accordingly, utilization of exchange rate based conventional projects moved toward becoming exceptionally effective in Azerbaijan to lessen the inflation to one digit level in a brief timeframe period. Along these lines, the nation had lost a noteworthy piece of generation potential as well as looked with extra joblessness issue as far as exiles and IDPs. Oil industry was rebuilt inside the "Agreement of Century" in partnership with outside oil organizations. Because of monetary changes and drawing in FDIs to the oil area of Azerbaijan, recession period was finished and positive monetary development was watched. The inflation rate diminished to 411% of every 1995 from 1662% of the past year. The essential against inflationary measures of the state quit subsidizing the spending deficiency by the National Bank credits. Furthermore, the fundamental driver of hyperinflation was pay of budget deficit through cash printing by National Bank of the nation.

- Oil boom period

Opening of BTC pipeline in 2005 forcefully expanded the oil generation and exportation which implies tremendous incomes from oil which generously changed structure of the nation's economy. In this manner, oil creation had been over 42 million tons after 2007 and even surpassed 50 billion tons in 2009 what's more, 2010 be that as it may, in the resulting years, creation level fell and move toward becoming 43 million tons in 2012 (SOCAR 2013). This period is additionally described by raising the significance of inflation issue in the nation. In this manner, the inflation expanded and moved toward becoming in two digit numbers out of the blue after 1996 which was the aftereffect of fast financial development or over-warming of the economy related with oil generation. Incomes of the State Oil Store of Azerbaijan Republic (SOFAZ) which was built up to amass the incomes from oil and gas creation progressed toward becoming $66.3 billion inside 2001-2011 where $64.1 billion had been picked up inside 2005-2011 (SOFAZ, 2011, p. 11)



SOURCE: WWW.CEICDATA.COM | World Bank https://www.ceicdata.com/datapage/charts/azerbaijan-az-official-exchange-rate-average-per-usd/?type=area&from=2005-12-01&to=2016&width

Let`s look at the situation of exchange rates more comprehensively. As we can see from the table shown above Azerbaijan national currency has experienced an upward trend to the USA dollar due to increasing exportation level of oil products in the world market. In order to impose applicable Monetary Policy, exchange rate, additionally sufficient

Country	Year in which inflation was highest	Maximum annual inflation
Azerbaijan	1994	1788.0
Armenia	1993	10896.2
Czech Republic	1991	52.1
Georgia	1994	8273.5
Hungary	1990	34.6
Kazakhstan	1992	2566.6
Latvia	1992	958.2
Lithuania	1992	1162.6
Turkmenistan	1993	9743

financial stability and economic growth CBAR has an indispensable role.

Source: Stanley Fischer, Ratha Sahay and Carlos A. Végh, 1996, p. 8

Basing on the opinions Stanley Fischer, Ratha Sahay the greatest inflation rate was regularly for twenty-six emerging economies recorded toward the start of the change procedure, when costs and, much of the time, trade controls were increased. As should be obvious from past two tables, nations which have applied fixed exchange rates had littler numbers in most extreme yearly inflation. However, CIS nations that have picked just a flexible exchange rate encountered a hyperinflation. In Azerbaijan mid 90s are portrayed by guaranteeing macroeconomic stability and holding tight money policy approach. It stemmed from the fear of inflation that increasing interest rates results in reduced investment and local consumption (lower economic growth) but increased rate of return to saving and fall in house prices that eventually bring about lower inflation and appreciation of local currency in contrast to other currencies. Asian crisis happened in 1997-1998 impacted lots of CIS countries as well as related to decline in international oil prices diminished income gained from the outlays of oil industry. However, through suitable monetary policy and managing foreign capital inflows in a relevant way Azerbaijan achieved economic growth again. Another period of monetary policy approach has begun in Azerbaijan in 1999. After a financial development in 1999, joined by a significant increment in the demand for money and the speeding up of auxiliary changes, the National Bank has fortified the procedure of "soft" monetary policy. As a result, we can see a reduction in interest rates from 17% of every 1999 to 6.4% out of 2000 and the rate of manat in the managed floating system turned out to be more flexible to United States Dollar (USD).

After the 2003 decisions for administration of Azerbaijan, new president – Ilham Aliyev went to the legislature. He guaranteed to make 600.000 new employments inside the following a long time which had been around achieved. In expansion, the “State

Program on Social-Economic Development of the Regions of Azerbaijan Republic for 2004-2008" was received which focused to diminish the social-monetary advancement hole among the locales of Azerbaijan supporting the territorial advancements, empowering real areas of the districts, creating of fare arranged items, guaranteeing new openings for work and so on (SPSEDR, 2004, pp. 3-4).

In this way, the new pattern in recorded advancement of Azerbaijan economy was not up until now, particularly identified with the development and opening of Baku-Tiblisi-Ceyhan pipeline and in addition sharp increment in oil generation under "the Agreement of Century". Starting from 2004 inflation rates in Azerbaijan witnessed an upward trend regarding with increasing profits gaining from oil products in the money supply and demand surplus due to growing income of population. In 2005 after the decision of the President of Azerbaijan Republic on "Denomination Policy" new money was put into circulation and manat was protected its stability in front of foreign currencies. Increasing truthness of population towards manat showed itself in an increasing level of deposits and savings in M3 by 25.6%.

In terms of managed floating exchange rate system exchange rate of manat became strong against USD dollar by 5.1% in 2006. Although the years of 2007-2008 are characterized as a crisis period Azerbaijan with it effective monetary policy was able to come over this adversity. Therefore, in 2009 exchange rate policy consisted of the vast majority part of monetary policy. Despite the fact that, diminishing level of capital inflows to the country and the physicological impacts of devalvation waves in neighbours exchange rate of manat stabilized. As indicated by the consequences of nine months of 2009 it fell in cost against the US dollar just by 0,26%. In 2010 vital foreign reserves (FR) of the nation expanded by 46 percent and added up to USD 29,8 billion which is adequate for three-year products and services-import. ("Monetary Policy

Review", p. 13-14). The level of dollarization diminished inside the year on account of fixed exchange rate of the manat. Hence, the part of deposits in foreign currency in M3 money aggregate diminished by 6 rate focuses, and the level of all deposits diminished by 10 rate points.

In 2012 to avoid extensive strengthening exchange rate and kill negative effects on intensity of the nonoil area the CBA cleaned USD 1584 million worth cash throughout the year. Subsequently, manat reinforced against USD at a direct rate, just 0.19%. The trade rate strength of the national money decidedly influenced the macroeconomic condition and budgetary part strength in the nation. Over the previous years different nations have made revisions to exchange administrations because of worldwide or regional monetary procedures. Some countries chose fixed exchange rate regime otherwise the rest preferred floating or intermediate system.

In any case, this question is still of intrigue: which exchange rate is satisfactory – settled or flexible exchange rate, or an intermediate one? It's implied that the reply to this inquiry relies upon macroeconomic specifics of a nation, inflation history, institutional condition and so on. For example, 8 out of 30 oil sending out nations apply floating, 9 managed float and 13 settled rates.

Notwithstanding, general nation experience demonstrate that the most debilitating and least secure exchange rate is the moderate exchange rate. In the event that the elective stay isn't discovered, the economy turns out to be less flexible to monetary shocks. This thought has various strategy suggestions. In the event that a nation is willing to go to a floating system from a settled one, this change ought to be snappy. As it were, it isn't deliberate to wait in a long-run moderate administration. The worthy approach is that terms and conditions for change ought to be guaranteed however much as could reasonably be expected previously, while a physical change ought to be finished in a short run. An exchange rate is a significant macroeconomic variable from competitiveness point of view of a nation. Nation hones demonstrate that the settled exchange rate administration is successful in controlling and bringing down inflation. In parallel, the training additionally demonstrates that a floating exchange rate is proficient to frame a price rise spongy of the economy.

After economic enhancement 2015 was the time of slack worldwide monetary development, sharp drops in worldwide commodity costs, diminished foreign exchange reserves in various nations. Oil costs dove to chronicled lows of the previous decade. Sharp increase in foreign exchange demand is clarified by high dollarization. Drop in oil costs in worldwide product markets, and the influxes of cheapening in our primary exchange accomplices elevated desires of the devaluation of the national money in the nation activating high dollarization.

The Administration Leading body of the CBA chose to set the exchange rate of USD against AZN at AZN 1.05 starting at 21 February 2015. The CBA additionally moved towards pegging national money to a double currency basket, containing USD and EUR. The new condition required fitting of the FX market and the exchange rate of Manat to new oil costs and the Board of Directors at CBA took a choice to move to a floating exchange rate on 21 December 2015, which actuated arrangement of the new exchange rate of Manat to the conjuncture in the FX market. All this situation related to devaluation of Azerbaijan currency stemmed from decreasing level of oil prices across the globe.

2.2 The situation observed in our country after the passage to free floating exchange rate

From the second half of 2015, energy prices in the world market began to decline rapidly and deepened the ongoing international political and economic crisis in the world in a long run. According to China's State Statistical Office, which is one of the world's major economic centers, the country's economy grew by 6.8% in 2015, which is the lowest since 1990. On January 18, President of France Francois Hollande announced an action plan to remove his country from the "extraordinary economic situation." After the transition to the "floating exchange rate" of national currencies in the post-Soviet space, they began to lose their values. This situation shows itself in dropping value of ruble several times. On the other hand, immediately after the military confrontation between Russia and Georgia in the post-Soviet space in 2008, oil prices immediately fell sharply and fell from $ 150 to $ 36 a barrel over a short period of time. At that time, serious stagnation and even resuscitation were observed not only in oil producing countries, but also in developed economies of the world. However, this process did not take long, and afterwards the prices stabilized. Right now the price of “Azeri light” oil rise to 75.95 USD dollar.

In the conditions of a long-lasting deep economic crisis all over the world, Azerbaijan managed to keep the national manat stable, maintaining macroeconomic stability. Not only did Azerbaijan, any country in the world, nor any serious financial-economic institution predict that energy prices will fall so low. Azerbaijan is an oil exporting country and, of course, a substantial part of the state's financial system is formed by revenues from energy resources exports. In a situation where the oil price fell 4 times, the financial flow to the country sharply decreased and it was necessary to keep the manat's rate fixed at the expense of reserves. How long could this situation continue? Can the government of Azerbaijan allow the financial resources to be exhausted?

Therefore, after the second devaluation happened in our country in December 2015 Azerbaijan has dropped a corridor of exchange rate and let the nation's manat to float freely. Furthermore, almost a year ago, the devaluation of the national currency and the transition to "floating exchange rate" had taken place in the region's major trading partner countries. This has had a negative impact on the formation of imbalances in Azerbaijan's foreign trade relations and the flow of investment into the country's economy. Moreover, Azerbaijani manat was heavily reinforced against dollar and euro, which was not a positive one. Even in the case of the depreciation of the euro against the dollar, it was not possible to keep the national currency rate stable. The Central Bank had previously managed to save the manat by selling foreign reserves. More than a year ago, from July 2014 to December 2015, reserves dropped from $ 15.2 billion to $ 5.1 billion. After the devaluation, the dollar was worth $ 1.55 compared to $ 1.05 per dollar on December 18, and $ 0.78 per dollar in February. When oil prices fell to the lowest level after 11 years, the Central Bank decided to adopt a "floating exchange rate regime" to improve the balance of payments, maintain a level of strategic reserves and increase international competitiveness of the national economy.

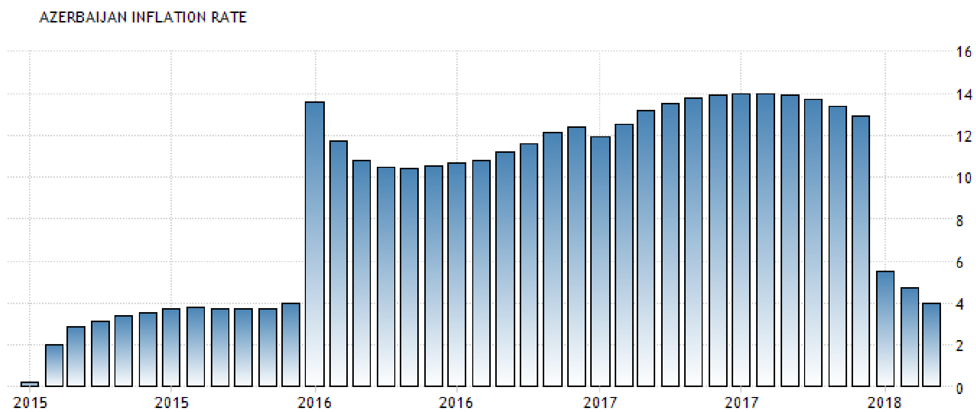
I would also like to note that it is wrong to consider devaluation as a damaging one. International practice, the experience of individual countries shows that devaluation can trigger the dynamic development of the country's economy and the banking and financial system at a later stage, although it is an anxiety-generating event in the population. In any case, anxiety emerged shortly after the first devaluation in February last year and the country's financial market did not face special difficulties. On the other hand, devaluation expanded the maneuvering capacity of the Azerbaijani government and created opportunities for additional measures in the social sphere.

(Paul 2006) He thinks the devaluation could have a positive impact on economic growth if the company operates internally or externally. In the event of devaluation, firms are starting to increase their product abroad, thus increasing revenue when they are transformed to the local currency. This profit leads to a higher level of R & D costs and innovations, which, in turn, reduces the marginal cost of production in domestic markets. Thus, the prices in both the country and the foreign market are falling down. Simply, (Harris, 2001) mentions that currency devaluation can lead to growth through increasing in firms' profit and reduction in prices. Demand for domestic goods rises up and the production cost decreases. So, the producers drop prices down in the market.

It was a right decision for the Azerbaijani government to switch to the "floating exchange rate" regime after the neighboring countries. This step has been further supported by the state budget, and it helps to increase the competitiveness of domestic products (Experts of Moody's international rating agency).

Additionally, new prices have been determined to goods. Some expensive medicines in pharmacies were also scarce. According to the December devaluation, there have been prospects in black market. At that time most banks did not convert any dollar into manat. Generally, Manat lost 98%.

However, it is most likely beneficial and effective for the countries who are not over-depended on import also have a sufficient export potential. Although it was an inclination that Azerbaijan should go devaluation in order to save SOFAZ 's money and reserves of Central Bank, this devaluation caused deteriorations for an economic growth like increasing level of overall prices and diminishing income gained from oil industry in the short-term. As shown from the table inflation witnessed a significant increasing level after 2015 and until 2018 started to decrease.



Source: tradingeconomics.com/ Statistical Committee of Republic of Azerbaijan

As you see in a long run economy start to return back to previous level and right now annual inflation is 4%. Since Azerbaijan's abnormal state of dependence on oil produts, the economy performed seriously during this time. Accordingly, the CBAR has sought after a strict monetary policy through raising the interest rates of the manat from 9.5% to 15% (on 14 September 2016) (and 18% until 2018) and limiting the manat base by around 600 million manats in the main quarter of 2017 in order to collect money from cirulation as a legislative enacment against inflation. And other reason in increasing interest rates applied to deposits and bonds was related to an improvement of confidence towards national currency. Regardless of all these, currency market tension proceeded and manat deteriorated step by step, because of money auctions held by the Central Bank.

There happened adjustments in foreign exchange reserves and it is unquestionable that after 2015 related to efforts on stabilizing exchange rate of manat to other currencies there happened considerable decreases in foreign exchange reserves. CBAR had no sufficient reserves in order to make interventions and with 8 billion USD it changed situation for just a year through imposing certain exchange rate which brought about significantly lower fluctuations in currency market. After 2017 foreign reserves have been restored thanks to increasing oil prices and powerful monetary policy. High non-oil exports and rising global oil prices made foreign economic position of Azerbaijan more powerful in 2017, however, still the situation is not as same as in the past. After the execution of the floating exchange rate strategy, SOFAZ restores the foreign exchange reserves and provide commercial banks with foreign currency through auctions. Changing to a floating exchange rate has decidedly influenced entitities with the perspective of manat. Monetary Authority has used a few approach instruments with a specific end goal to lessen precariousness in financial markets, accomplish the adjustment of the manat and re-back its believability.

2.3 Possible impacts of free floating exchange rate system to the economy of Azerbaijan

Impact of the Central Bank on macroeconomic indicators is carried out by monetary policy. That is, our impact on the exchange rate is not an explicit impact on the market, but an indirect impact. With the mechanism of money supply, we are able to use it as an effective tool to ensure economic stability for a more floating exchange rate regime. Since exchange rates are already determined with the level of supply and demand if the commercial bank offers a higher rate, the auctioned dollar are sold to that bank. This caused a sharp rise in the dollar exchange rate. Once the dollar has risen to a certain level, the population, banks, and other entities with a stock of dollars put up for sale currency reserves. As a result, after the sharp fluctuations, the dollar will have its real value. Before that there was sharp pricing in the currency market. But today is characterized with its stability. If we had gone to devaluation with our trade partners at the same time, wouldn`t encounter with such kind of terrible situation and the level of prices wouldn`t rise immediately as well as in an overall way. Then again, after the passage of the liberal exchange rate, the execution of the national currency had been moderately smoother than anticipated. There has been a time of adjustment to new conditions, and all things being equal, the manat has almost found its value and is keeping its stability. In upcoming years mant still will protect its estimation if there is not any downturn on the price level of major exportation products. Of course, this durability will be on its track in the condition of stable and strong combination of monetary and fiscal policy. Today, the main idea of the government is to limit the imports due to the increase in domestic production. This, of course, is a good idea to reduce capital flow and reduce foreign dependence on the domestic market. However, it should be taken into consideration that in countries with smaller markets like Azerbaijan, the policy of import substitution yields a certain amount of efficiency. That's why our way should be to strengthen more exports. For this, quality and price factor should not be forgotten. For example, food products should be produced in our country and government can determine certain tax to some kind of exports in order to tighten demand towards foreign goods. Azerbaijani organizations traded non-oil items worth $356.4 million in 2018, which is 35 percent higher than in a similar time of 2017. When it comes to the question of how much the exchange rate is in the transition to a full floating exchange rate, we can say that any figure in this area is not justified but it is far from reality. It is difficult to say how much the manat will be cheaper or more expensive in future. This is almost impossible prediction. Because here the current status of the balance of payments does not play a role. The psychological state of the population, the economy's level of dollarization, the behavior of the government, and the level of capital flows are the most important things in the determination of the exchange rate of manat. We just know that for a certain period manat will protect its stability relying on our foreign reserves and a price of oil in the world market. In the future it can be applied two various policy:

1)From one perspective, the legislature may choose to change its present approach and switch its position from saver to financial specialist, to cultivate the economy and enhance real sector. As a prerequisite of this approach, the Monetary Authority would lead an expansionary strategy for the manat, which could build the rate of instability and lessen the exchange rate of the manat against outside monetary standards. While trying to counterbalance such a sharp weakening of the manat in the medium-and long haul, the Monetary Authority may execute countercyclical full scale prudential strategies;

2) Then again, if the administration seeks after an indistinguishable strategies from it does now; in other words, if the Monetary Policy keeps on decreasing the manat base and support the national money by means of similar instruments, the level of consumption and investment would proceed go down. Thus, there would be no advance in the economy and the level of unemployment would be increased.

In anticipated years, the financial condition for Azerbaijan's national currency is evaluated positively. Investigation of key and transitory, household and outside elements influencing the exchange rate of the manat in 2018 demonstrates that factors that emphatically impact exchange markets within years – oil value, balance of payment, financial strategy, money related approach, political condition, and so forth – will be more grounded. Under typical economic situations, this procedure should bring about the valuation for the manat's rate. Be that as it may, depreciatory weights do exist also. As oil is relied upon to keep on being a key factor of balance of payments, this requires an abnormal state of reliance of household currency markets on foreign markets. This relationship implies that residential currency markets are exceptionally vulnerable to outside variances. In this vein, keeping up the current manat exchange rate, without permitting noteworthy appreciation, will be vital keeping to ensure against outside shocks.

Therefore, it is important to increase export potential of country and decrease import in order to complete this stage more successfully. For a long period people was thinking about increasing level of USD against to dollar (1$=2azn). However, through intervention policy of the Central Bank manat still keeps its stability.

Conclusion and suggestions

Although countries transformed to freely floating exchange rate system in an easy way, for Azerbaijan this period was extremely distressing and hard. Because lots of countries were preparing to this situation beforehand through taking powerful legislative rules. As a major example, going devaluation our neighbor country Kazakhstan ensured “tenge” to float freely. We had to take this decision together with our trade partners and neighbours at the same time and decrease level of prices smoothly without affected to economic and physiological behaviour of the population. In other words, until 2015 CBAR had not to sell its foreign exchange reserves in order to keep the value of manat and let our currency to float freely according to the rules of liberal market. In this case, reserves wouldn`t undergo this kind of sharp and drastical decline (down to 5.2mlrd USD) in 2015 and population wouldn`t lose their confidence to manat. After September 16, 2016 CBAR and State Oil Fund allocated 300 million USD to auctions and banks purchased 78 million dollar after 6 days (CESD Press). Week by week banks had already purchased less amount of USD due to physiological factor as in the short term they could predict dynamics of exchange rates. CBAR couldn`t make interventions to the currency with its less amount of reserves in 2016. In every auctions CBAR set up certain but less adjustment to exchange rate of dollar and it stabilised in 1.70 azn. Right now it has more than 40 mlrd $ reserves thanks to oil price increases and later but correct monetary policy. After tight monetary policy, CBAR decreased discount rate to 13% in order to enhance real sector by giving advantageous credits and increase profits from non-oil. In forecasting years state can achieve manat to regain its value by:

1) Implementation of stimulating monetary policy in order to reduce interest rates on loans;
2) liberalization of imports. This will allow reducing inflationary rates as a result of stimulating monetary policy;

3) Increasing the salaries of budget workers, introducing compulsory health insurance and strengthening social benefits to reduce social tension as a result of inflation and depreciation of manat;

4) application of rapid depreciation to stimulate investments in non-oil sector;

5) application of tax on currency exchange rates to reduce currency speculations;

6) stimulating agricultural sector and increasing the number of students studing in this sphere like suggesting scholarships more than other students;

7) directing profits gained from oil sector to human capital;

8) cordinated actions of Monetary Authority (CBAR) and Fiscal Authority (Financial Minister) against to economic difficulties;

9) increasing level of investment to non-oil sector;

10) giving profitable credits and extending tax-free zones to companies who have indispensable role in the exports of non-oil products;

These measures will: (1) increase oil revenues to the real sector; and (2) increase local production and exports in mid-term and strengthen the manat and reduce inflation

References:

1. Baranick M. J, Salayeva. R 2005. The Case of Azerbaijan. Analysis of New and Developing Societal Disputes (page 208-209)
2. Dabrowski.M 2003. Disinflation in Transition Economies, Central European University Press
3. Yunusov. A. 2001. Twenty Years of Independence in Azerbaijan (page 60-77),
4. "Assessment on Real Effective Exchange Rate in Azerbaijan: 2017 Outlook"
5. AR State Statistical Committee, "On foreign trade relations", 09.02.2017 http://stat.gov.az/xeber/index.php?id=3469
6. Report Information Agency, "Supply exceeded demand by more than 5 times on today's currency auction", 09.02.2017 https://report.az/maliyye/bugunki-valyuta-herracinda-teklif-telebati-5-defeden-cox-usteleyib/
7. APA Information Agency, "CBA: The adaptation to the floating exchange rate regime is smoother than expected", 19.01.2017

http://www.apa.az/maliyye_xeberleri/amb-uzen-mezenne-rejimine-adaptasiya-gozlediyimizden-dahasakit-gedir-ekskluziv.html

8. Central Bank of the Republic of Azerbaijan, “Statistical Bulleten 11/2016”, 17.01.2017 http://www.cbar.az/assets/4257/YEKUN_STATISTIK_BULLETEN_2016_NOYABR_SonVersiya.pdf
9. president.az, “Strategic Roadmap of the Republic of Azerbaijan on national economy perspectives”, 21.01.2017 http://azertag.az/store/files/untitled%20folder/_STRATEJI%20YOL%20XERITESI_.pdf
10. Central Bank of the Republic of Azerbaijan, “Official currency reserves”, 18.01.2017 http://www.cbar.az/infoblocks/money_reserve_usd
11. Trend News Agency, “Shahmar Movsumov: Current allocation of SOFAZ assets helps to maintain oil reserves in the long-term”, 27.12.2016 http://az.trend.az/business/2702974.html
12. Central Bank of Azerbaijan: “Review of Monetary Policy” (2000-2016)
13. The exchange rate outlook in Azerbaijan in 2018: Expectations and Challenges http://cesd.az/new/wp-content/uploads/2018/01/CESD_Research_Paper_on_Exchange_Rate_in_2018.pdf
14. Azerbaijanis Struggle After Currency Devaluation https://iwpr.net/global-voices/azerbaijanis-struggle-after-currency
15. 8 Key Factors that Affect Foreign Exchange Rates https://www.compareremit.com/money-transfer-guide/key-factors-affecting-currency-exchange-rates/
16. Types of Exchange Rate Systems | Financial Management http://www.businessmanagementideas.com/foreign-exchange-2/exchange-rates/types-of-exchange-rate-systems-financial-management/17437
17. Impact of Exchange Rate Regimes on Economic Growth

https://digitalcommons.iwu.edu/cgi/viewcontent.cgi?referer=https://www.google.az/&httpsredir=1&article=1350&context=uer

18. Fixed versus Floating Exchange Rates https://saylordotorg.github.io/text_international-economics-theory-and-policy/s27-fixed-versus-floating-exchange.html

19. Why are currency values different from country to country? https://www.quora.com/Why-are-currency-values-different-from-country-to-country

20. The advantages and disadvantages of floating exchange rates http://www.maravipost.com/the-advantages-and-disadvantages-of-floating-exchange-rates-for-the-kwacha/

21. Flexible exchange rate for stable world economyhttps://piie.com/publications/chapters_preview/6277/09iie6277.pdf