



## AZERBAIJAN

### Highlights

- **Economic recovery is under way.** The main driver of the recovery is the non-hydrocarbon sector but the oil and gas sectors are starting to contribute strongly too, with the rising demand for, and price of, oil, supported by an expected gradual increase in oil quotas.
- **A new reform vision has been developed.** The “Azerbaijan 2030” strategy outlines the main directions and priorities of sustainable socio-economic development. A draft strategy of socio-economic development in 2021-25 accompanies the vision.
- **A new regulatory framework to support renewable energy is in place.** It outlines the framework for foreign investment and specifies incentives for private investors.

### Key priorities for 2022

- **Diversifying the economy would enhance its resilience to shocks.** This includes continuously improving the business environment to support private-sector development, as well as pursuing commercialisation and governance reforms in the state sector to increase efficiency. Considering the current regional disparities in the country, a balanced territorial approach is essential.
- **Implementing the “Azerbaijan 2030” vision and the accompanying strategies needs to go hand in hand with enhancing public administration capacity.** Public agencies and ministries need to be properly staffed, their expertise enhanced and the operational framework strengthened to effectively transform the long-term vision into socio-economic development of the country.
- **The authorities should continue to develop a sustainable and competitive energy market with a sound regulatory framework and institutions.** The new regulatory framework for renewables, which sets the groundwork for increased participation of the private sector, should be used as a stepping stone for greening the energy sector.

### Main macroeconomic indicators %

|                                      | 2017 | 2018 | 2019 | 2020 | 2021<br>proj. |
|--------------------------------------|------|------|------|------|---------------|
| GDP growth                           | 0.2  | 1.4  | 2.5  | -4.3 | 4.0           |
| Inflation (average)                  | 12.9 | 2.3  | 2.6  | 2.8  | 4.4           |
| Government balance <sup>1</sup> /GDP | -1.3 | 5.5  | 9.1  | -6.5 | -1.8          |
| Current account balance/GDP          | 4.1  | 12.8 | 9.1  | -0.5 | 7.8           |
| Net FDI/GDP [neg. sign = inflows]    | -0.7 | 1.7  | 2.9  | 1.8  | -0.8          |
| External debt <sup>2</sup> /GDP      | 22.8 | 19.0 | 18.9 | 20.7 | n.a.          |
| Gross reserves <sup>3</sup> /GDP     | 13.1 | 11.9 | 13.0 | 14.9 | n.a.          |
| Credit to private sector/GDP         | 16.7 | 16.3 | 18.7 | 20.1 | n.a.          |

<sup>1</sup> Includes central government and main extrabudgetary funds, including operations of the oil fund and the social protection fund.

<sup>2</sup> Public and publicly guaranteed external debt outstanding.

<sup>3</sup> Excluding assets of the State Oil Fund (SOFAZ).

### **Covid-19: macroeconomic implications**

**The economic recovery in 2021 is being driven by the non-oil and gas sectors.** After being hit by a triple shock – the Covid-19 pandemic, a slump in oil prices and the flare-up of the conflict over Nagorno-Karabakh – Azerbaijan's gross domestic product (GDP) declined by 4.3 per cent in 2020. A strong contraction in the oil and gas sector of 7.2 per cent was balanced by a softer decline in the rest of the economy, which was helped by the government's extensive support package. Non-hydrocarbon sectors started to recover in 2021, posting 6.2 per cent year-on-year growth from January to September 2021. However, overall GDP growth, estimated at 4.8 per cent year-on-year in the same period, continues to be weighed down by lower oil and gas production on the back of the Organization of the Petroleum Exporting Countries (OPEC) oil production cut. Exports, which are dominated by hydrocarbons, remained at the 2020 level in real terms from January to August 2021 (year-on-year). Monetary policy was loosened in 2020 as demand remained tightly constrained and inflation low. However, in spite of currency stability, increasing global price pressures are pushing inflation from an average of 2.8 per cent in 2020 up to 8.5 per cent in September 2021.

**Large assets of the State Oil Fund of Azerbaijan (SOFAZ) helped to weather the crisis.** Lower oil revenues on the back of the price slump and the production decline turned external and fiscal surpluses to deficits in 2020. The current account balance turned from a surplus of 9.1 per cent of GDP in 2019 to a small deficit of 0.5 per cent in 2020, while the fiscal balance went from a surplus of 9.1 per cent in 2019 to a deficit of 6.5 per cent in 2020. However, Azerbaijan's public debt remained low at 23.4 per cent of GDP in 2020 despite the ensuing gaps, as funding needs were met domestically by drawing on the large assets of SOFAZ. International reserves remained relatively stable, at US\$ 7.0 billion in September 2021, covering almost eight months of imports.

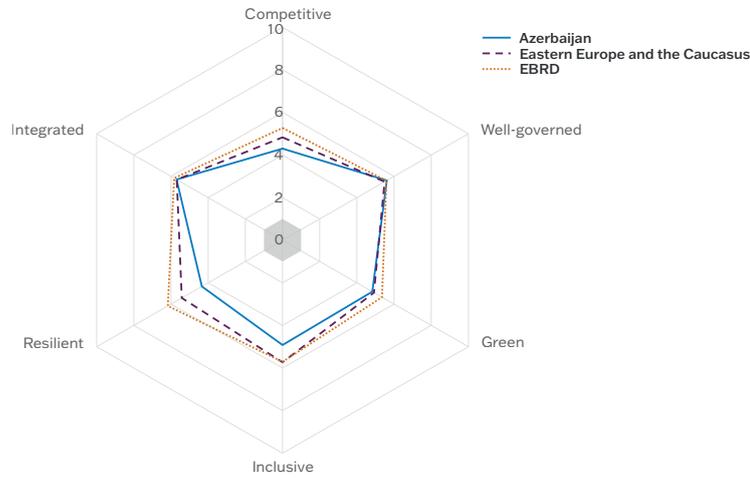
**Recovery is expected to continue but risks remain significant.** Rising demand for, and higher prices of, oil, supported by an expected gradual increase of oil quotas in the coming months, will strengthen the overall economic performance in the second half of 2021. The non-oil and gas economy is expected to stay on the recovery path. On this basis, the economy is forecast to grow by 4.0 per cent in 2021 and 3.2 per cent in 2022. Numerous risks remain, related to structural weaknesses of the economy, geopolitical developments, the speed of vaccinations and possible volatility in commodity prices.

### **Policy response to Covid-19**

**The authorities implemented a crisis response package of economic and social support in 2020.** The package was worth in excess of 4.6 per cent of GDP. It included wage subsidies, support for micro entrepreneurs, extended payment deadlines for various taxes, loans to businesses on preferential terms, state guarantees and subsidised interest rates on the existing loan portfolios of small and medium-sized enterprises (SMEs). The Central Bank of Azerbaijan relaxed capital requirements and risk weights on mortgage loans, introduced a moratorium on late fees and interest rate penalties and suspended inspections of credit institutions. The full deposit insurance scheme was once again extended in December 2020, until April 2021. The upper limit of the insured amount was increased and, to support SMEs, deposits of individual entrepreneurs to a certain threshold have been included in the scheme. Comprehensive social assistance measures bolstered the overall economic support programme.

**Efforts to support the economy continue in 2021.** The 2021 budget allocated another AZN 261 million (0.3 per cent of GDP) to fight the Covid-19 pandemic. Benefits to businesses have been expanded and additional social assistance has been provided. At the beginning of the year, the Central Bank of Azerbaijan lifted some measures introduced in 2020, including resuming inspections of credit institutions and reinstating additional capital requirements for consumer loans.

**Assessment of transition qualities (1-10)**



**Structural reform developments**

**The government has outlined its main directions and priorities of sustainable socio-economic development until 2030.** In February 2021 the president signed a decree on “Azerbaijan 2030: National Priorities for Socio-Economic Development”, outlining a long-term framework of policies and reforms. The framework includes strengthening the connections between society, businesses and the state. It outlines the following key factors for economic recovery: effective and efficient management of the state’s role in the economy via market-oriented reforms, bolstering private institutions, government-friendly business management and further liberalisation of trade practices. The Cabinet of Ministers is expected to prepare a draft strategy of socio-economic development in 2021-25 within nine months of the approval of “Azerbaijan 2030”.

**The authorities are stepping up efforts to promote renewable energy.** A new law on the use of renewable energy sources in the production of electricity, approved in May 2021, was signed by the president in July, together with a presidential decree on implementing the renewable energy law. The law outlines the regulatory framework for foreign investment and specifies incentives for investors in renewable energy source projects in Azerbaijan, including guaranteed off-take and connection, priority in transmission and distribution, and long-term land leases. Additional efforts in the past year to green the economy include publishing an in-depth review of the energy efficiency policy, which will be followed by a national action plan to enhance energy efficiency.

**There is more awareness of the need to enhance digitalisation of government services.** In February 2021 a mobile application of the government portal “myGov” was launched to make public services more accessible. The Central Bank of Azerbaijan also continued its efforts to expand digital payments in the country. Strategic cooperation agreements and a memorandum of understanding were signed with Visa and MasterCard. These include initiatives to support key drivers accelerating the development of the payment market, introducing innovative payment solutions, increasing mobile payments, as well as expanding financial literacy and inclusion.