



Azerbaijan

Highlights

- **Rising gas demand and increasing output in the non-energy sector are supporting post-pandemic economic growth.** Domestic consumption has risen sharply and exports have recorded strong real growth due to high demand for alternative gas supplies to the European market.
- **The authorities are using fiscal and monetary measures to combat the effect of rising prices.** Inflation reached 14.2 per cent year on year in August 2022. The central bank has raised the policy rate, and the government has introduced a series of fiscal policy measures, including rises in the minimum wage, pensions and social assistance, to limit the impact of higher prices on vulnerable groups.
- **Access to financial services was enhanced.** The national postal service, with its wide network of offices around the country, was enabled to act as an agent offering services on behalf of domestic banks. Remote banking services were also introduced, contributing to the digitalisation of the economy.

Key priorities for 2023

- **The strong post-pandemic momentum of the non-oil sector should be steered towards sustainable diversification of the economy, making it more resilient to shocks.** This includes strengthening the competition regulation framework and reducing the state's footprint in many sectors of the economy. Opening up the financial sector to foreign investment would improve access to finance and support investment activity of small and medium-sized enterprises.
- **Anti-corruption efforts should be stepped up.** The recently adopted National Anti-Corruption Strategy should be implemented with clear goals towards transparent and accountable governance. Introducing digital tools to empower citizens to participate in political decisions would be a good step in the right direction.
- **De-carbonising the economy should be a priority.** As part of the "Azerbaijan 2030" long-term development plan, the gradual detachment from dependence on hydrocarbon exports can contribute to diversifying the economy. High revenues stemming from rising energy prices should be used to support investments in green energy and climate mitigation measures.

TABLE Main macroeconomic indicators %

	2018	2019	2020	2021	2022 proj.
GDP growth	1.5	2.5	-4.2	5.6	4.5
Inflation (average)	2.3	2.6	2.8	6.7	12.2
Government balance ¹ /GDP	5.5	8.9	-6.7	4.1	17.1
Current account balance/GDP	12.8	9.1	-0.5	15.2	31.7
Net FDI/GDP [neg. sign = inflows]	1.7	2.9	1.8	3.8	3.5
External debt/GDP	47.1	47.2	55.7	43.7	n.a.
Gross reserves ² /GDP	11.9	13.0	14.9	13.0	n.a.
Credit to private sector/GDP	16.3	18.7	20.0	18.4	n.a.

NOTE:

¹ Includes central government and main extra budgetary funds, including operations of the oil fund and the social protection fund.

² Excluding assets of the State Oil Fund (SOFAZ).

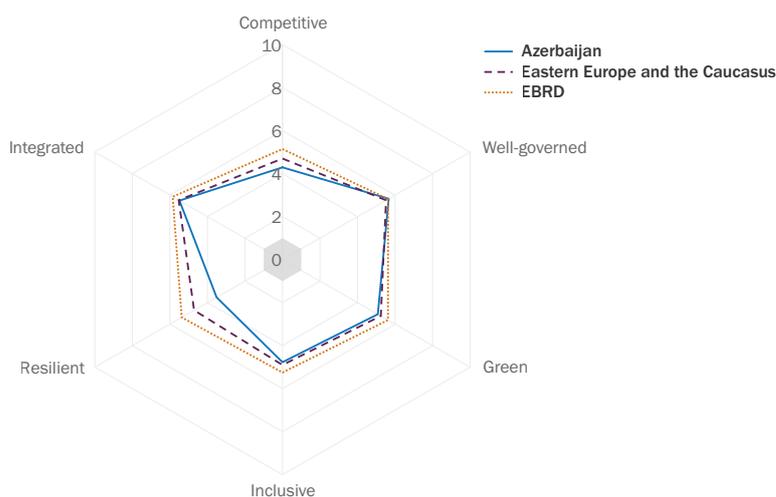
Macroeconomic developments and policy response

Economic growth has been higher than expected on the back of strong performance from the non-energy sectors. After a solid post-Covid-19 recovery of 5.6 per cent growth in gross domestic product (GDP) in 2021, the economy increased by 5.8 per cent year on year in the period January to August 2022, driven by strong growth of the non-oil and gas sector of 10.3 per cent. The oil and gas sectors decreased by 2.0 per cent in the same period, primarily because of oil production declining by 5.2 per cent, although gas production increased by 11.3 per cent. However, exports remain dominated by hydrocarbons, which doubled in nominal terms in the period January to August 2022, generating a large current account surplus driven by high demand for alternative gas supplies on the European market and facilitated by the Trans Adriatic Pipeline, which was completed in 2020.

The authorities have put measures in place to limit the impact of high inflation. Rising global food and energy prices and supply disruptions led to an acceleration of inflation in Azerbaijan from 12.0 per cent at the end of 2021 to 14.2 per cent in August 2022. Food prices saw the largest increases but prices of services also recorded almost double-digit growth. Strong economic activity and an increase of nominal income by almost 20 per cent in the period January to August 2022 added to inflationary pressures. The Central Bank of Azerbaijan has responded by tightening the refinancing rate five times since the beginning of 2021, to 7.75 per cent in September 2022. In parallel, the government supported vulnerable groups through a package of budgetary measures, including increases in the minimum wage, pension and social allowances, subsidies to flour producers, and value added tax (VAT) exemptions for wheat, wheat flour and bread. Despite these measures, tax revenues have been rising much faster than expenditures since the beginning of the year, generating a significant budget surplus.

Rising energy prices will likely support economic growth in the short term. The growth of the non-oil and gas economy will likely moderate due to slowly decreasing demand, as consumers are faced with high prices, but energy prices and demand for Azerbaijani gas are expected to remain high in the short term, which will support overall economic performance in the second half of 2022. Therefore we expect overall strong GDP growth of 4.5 per cent in 2022, but some moderation to 2.5 per cent in 2023. The main risks relate to persistent inflation, a potential drop in energy prices, and structural weaknesses in the economy. In the coming years, however, Azerbaijan may benefit from additional investments in the gas industry as the European Union tries to diversify away from Russian gas.

CHART Assessment of transition qualities (1-10)



NOTE: Belarus is not included in the EBRD region and respective regional averages.

Structural reform developments

Efforts to fight corruption have increased. In April 2022 the president approved the National Anti-Corruption Strategy for 2022 to 2026. It consolidates and coordinates the anti-corruption efforts of various agencies with different areas of activity. The aim is to increase transparency of government agencies, prevent corruption from flourishing, and strengthen the public accountability of state bodies. Furthermore, the strategy outlines how to improve and digitalise public services, as well as ensure sustainability of anti-corruption measures. In parallel, the authorities launched new portals to encourage citizens' e-participation in decision-making processes and give them a platform to voice their concerns.

Financial inclusion has been strengthened with the launch of the first agent banking model in the country. In March 2022 the Central Bank of Azerbaijan enabled banking products and services to be sold by third parties to offer better access to financial services for the population in areas with little coverage by bank branches. Initially, the services of Access Bank will be delivered through the national postal service, Azerpost, with more banks expected to follow. The offer currently includes micro and agri-loans, as well as consumer loans and debit cards to customers.

The Central Bank of Azerbaijan is promoting digital banking and payments. In November 2021 the central bank developed methodological guidelines for the use of QR code payments. The guidelines will ensure that QR payments provided by banks and non-bank payment organisations are standardised and that contactless payments are accepted more widely, thus providing more affordable payment solutions. In April 2022 the central bank revised and approved the regulation which expands access to remote banking and provides for bank accounts to be opened remotely through digital identification.

The authorities are using tax changes to encourage capital market development. In June 2022 amendments to the tax code to form a favourable tax regime in the capital markets came into force. Dividends and interest income from publicly traded shares and bonds will be exempt from income tax for five years, starting in February 2023. This measure aims to stimulate the issuance of securities on the stock exchange and increase interest in securities traded on a regulated market.

The authorities have boosted the use of renewable energy. Following COP26 in November 2021 the authorities set a target of reducing greenhouse gas emissions by 40 per cent and increasing the share of renewable energy by up to 30 per cent of national energy generation by 2030. The start of construction at the beginning of 2022 on a 240 MW wind power plant and a 230 MW solar power plant was an important step in that direction.

A controversial new media law was introduced. The new law became effective in February 2022. According to the government, the law intends to bring this area into line with international standards, modernise the country's media legislation and improve the professionalism of journalists. However, according to the Council of Europe's Venice Commission, the new law constrains the range of media coverage and activities, thereby limiting freedom of expression. Parts of the law contradict the principles of free, independent, uncensored media and pluralism as the law provides for increased state control and regulation of the media through tighter licensing/registration procedures.