




Azerbaijan

Highlights

- **Economic growth has subsided in 2023 and non-oil sector growth has moderated.** Lower energy prices, declining oil production and slow growth in the non-oil sector led to gross domestic product (GDP) growth of less than 1 per cent on the year in the first seven months of 2023.
- **There is growing support for information technology (IT) sector development and the digitalisation of the economy.** New tax legislation provides incentives for employees and companies in the IT industry. At the same time, capital market development is benefiting from a new digital platform that enables online securities issuance by market participants.
- **Important steps are being taken to develop the Middle Corridor trade route and promote renewable energy.** Azerbaijan is engaging with Kazakhstan and Georgia to coordinate the development of the Middle Corridor for cross-border energy transmission and non-oil goods, and the authorities are promoting major initiatives on the production and transmission of renewable energy.

Key priorities for 2024

- **Further investment in the non-oil sector is crucial to the sustainable diversification of the economy.** The authorities should encourage the diversification of the country's economic structure by strengthening the regulatory framework on competition and reducing the state's footprint across the economy.
- **The legislative and regulatory frameworks for the renewable energy market need improvement.** Recent reforms to reduce monopolies in the electricity market are welcome, but legal tools to control monopolistic entities in this market should be strengthened further. The authorities should also devise legislation for all types of renewable energy and improve the regulatory framework to attract foreign investors.
- **Enhancing the capacity of the Middle Corridor could play a crucial role in economic diversification.** The authorities should enhance the institutional capacity of domestic state-owned infrastructure companies along the Middle Corridor and step up collaboration with other countries along the corridor to unify tariffs and simplify customs procedures.

 Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	2.5	-4.2	5.6	4.6	1.5
Inflation (average)	2.6	2.8	6.7	13.9	10.3
Government balance/GDP	8.9	-6.4	4.1	6.0	1.0
Current account balance/GDP	9.1	-0.5	15.1	29.8	16.3
Net FDI/GDP [neg. sign = inflows]	2.9	1.8	3.8	6.0	4.8
External debt/GDP	47.2	55.7	43.6	31.5	n.a.
Gross reserves/GDP	13.0	14.9	12.9	11.4	n.a.
Credit to private sector/GDP	18.7	20.1	18.4	15.1	n.a.

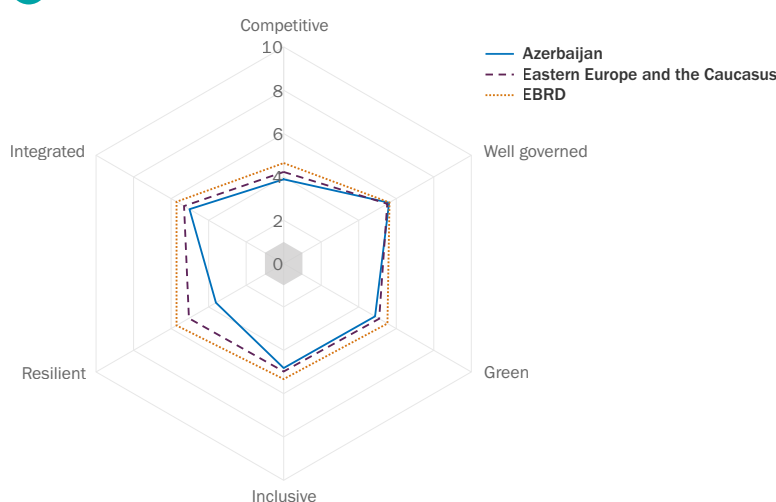
Macroeconomic developments and policy response

The strong economic growth of the past two years has started to slow. GDP grew 4.6 per cent in 2022, driven by strong growth in the non-oil and gas sector (9 per cent year on year), which benefited from large foreign-currency inflows as the high global prices of oil and gas boosted export revenues. However, the economy slowed in the second half of 2022 as global energy prices moderated and inflation reduced growth in real incomes. GDP growth decelerated sharply to 0.7 per cent year on year in January to July 2023. In a similar pattern to the previous year, output in the oil and gas sector fell 2.2 per cent, while non-oil sector output increased 3.4 per cent in the first seven months of the year, although the latter was well below the growth rate of 2022. Net money inflows increased almost sixfold in 2022, mostly from Russian citizens of Azerbaijani origin, but the pace of inflow growth has slowed markedly in 2023. Although oil and gas revenues declined 7.6 per cent in the first three months of 2023, the current-account balance maintained a large surplus on the back of rising gas exports and an oil price above pre-war levels.

Monetary policy tightening continues to curtail inflation, but domestic demand remains strong. Inflation has been easing in 2023, but was still relatively high, at 5.1 per cent year on year, in September 2023, after peaking at 15.6 per cent in October 2022. The authorities have reacted with significant monetary tightening. The Central Bank of Azerbaijan raised the policy rate to 9 per cent in May 2023, its tenth rate rise in the last two years. Robust nominal income growth of around 20 per cent in 2022 has added to the inflationary pressures, although this has slowed since the beginning of 2023. Lending to households has continued to rise, however, up 25.9 per cent year on year between January and July 2023, on top of a 30 per cent increase in 2022. Amid high domestic demand, in the middle of 2023 the government approved an increase in budgetary spending to boost public-sector wages, support the development of territories surrounding Karabakh, and strengthen the country's defence capabilities.

Energy exports will continue to drive short-term growth. The combination of stable energy prices and increasing demand for Azerbaijan's energy products is expected to support high levels of oil and gas revenues, despite declining oil output and rising gas production. This is likely to enable a continuation of current levels of public investment and government expenditure. However, persistent inflation is likely to dampen the real impact of fiscal stimulus and could lead to further appreciation of the real effective exchange rate. We therefore forecast GDP growth of 1.5 per cent in 2023, rising to 2.5 per cent in 2024. The forecast is highly sensitive to movements in global oil prices and to the effects of geopolitical developments on demand for Azerbaijan's gas exports.

Assessment of transition qualities (1-10)



Structural reform developments

The gradual transition to green energy continues. In December 2022 the government signed a memorandum of understanding (MoU) with Georgia, Romania and Hungary on the joint development and transmission of green energy through an electric cable under the Black Sea. The feasibility study on installing the electric cable should be finished by the end of 2023. The shift to green energy sources has been increasingly supported by the authorities through agreements and MoUs with international renewable investors. The Ministry of Energy has also signed an MoU with the European Bank for Reconstruction and Development to receive support for the development of a low-carbon and climate-resilient power sector in Azerbaijan, in line with the country's commitment to the Paris Agreement.

Reforms aimed at creating a competitive electricity market have accelerated. The adoption of a new law on electric power in May 2023 set in motion the gradual deregulation of the electricity sector and should enable the creation of a centralised electricity market. The law will enter into force at the beginning of 2024. The process of establishing an energy market regulator will begin by defining the role of the state and the regulator in 2024. Next steps include the legal separation of the generation, transmission and distribution of electricity, along with the creation of a market operator by July 2025. The final stage of the reform will be the establishment of retail and wholesale markets by the middle of 2028.

New tax legislation is facilitating the development of the IT sector. From January 2023 the new tax code widened the scope of tax exemptions to cover IT sector employees who reside outside the country's technology parks. The new law also exempts external activities conducted by enterprises located within the technology parks from corporate income tax, withholding tax on dividends and property tax.

The authorities have expanded cooperation with trading partners on developing the Middle Corridor. In June 2023 bilateral discussions with Kazakhstan resulted in the signing of an MoU that envisages investment of €5 billion over the next five years to develop infrastructure and enhance the efficiency of the Middle Corridor. At the same time, bilateral discussions with the Georgian authorities are focused on digitalisation as a way of overcoming customs and administrative bottlenecks along this part of the Middle Corridor.

Digitalisation is contributing to capital market development. In December 2022 the Central Bank of Azerbaijan launched an online securities issuance system. Under this system, issuers can avail of simpler online procedures for registering stocks and bonds, getting prospectus approval, safekeeping securities, and listing on the Baku Stock Exchange. Previously, issuers had to submit separate hard copies of the required documentation to the Central Bank of Azerbaijan, the National Depository Centre and the Baku Stock Exchange. This new digital platform is accessible to all market participants, enabling a simpler, faster securities issuance process.

Employment opportunities for women have been broadened. Until recently, women in Azerbaijan faced employment restrictions on around 700 jobs in various sectors, such as transport, energy and agriculture. However, the authorities repealed these restrictions in November 2022, as the jobs were no longer deemed hazardous to women's health. With the support of the World Bank, the authorities adopted a new rule for enhancing occupational safety and health across those jobs that were previously closed to women.