

# The World Bank in Azerbaijan Country Snapshot



An overview of the World Bank's work in Azerbaijan

October 2017

AZERBAIJAN	2016
Population, million	9.8
GDP, current US\$ billion	38.2
GDP per capita, current US\$	3914
Life Expectancy at birth, years (2016)	70.8

## At a Glance

- The Azerbaijan economy declined 1.7% (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as production volumes were cut in line with the OPEC agreement. On the upside, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors.
- Annual inflation remained high at 13.9% in June 2017, driven mainly by an increase in government-controlled tariffs for electricity, water, and gas, and in domestic food prices, reflecting higher demand in Russia for Azerbaijani food.
- Although the economy is expected to recover in 2018, the immediate challenge for the Government is to safeguard macroeconomic stability to support economic recovery and poverty reduction. Another challenge is to improve the business environment and government transparency to enable the further diversification of the non-oil economy.
- Azerbaijan and the World Bank celebrated the 25th anniversary of their partnership in 2017. The Bank is working with the Government and its development partners to support the country on a path to sustainable, inclusive, and diversified development.

## Country Context

Azerbaijan is in the process of redefining its medium-term development strategy in the face of a new, constitutionally mandated vice president position and some critical challenges stemming from the fall in oil prices, high inflation, and the crisis in the financial sector.

The Government is trying to address these challenges by accelerating reforms to improve the environment for private sector development. In December 2016, it launched a Strategic Roadmap for the development of the national economy and 11 key sectors. These strategy documents set medium- and long-term goals for reforms and sustained development.

Azerbaijan is trying to benefit from regional connectivity initiatives to boost transit and trade. In particular, the country is one of the sponsors of the East–West and North–South transport corridors. Construction of the Baku–Tbilisi–Kars railway line, which will connect the Caspian region with Turkey, is expected to be completed in 2017. The Trans-Anatolian Natural Gas Pipeline (TANAP) and Trans-Adriatic Pipeline (TAP) will deliver natural gas from Azerbaijan's Shah Deniz gas field to Turkey and Europe.

Social conditions continue to be a major source of concern, although poverty is relatively low in Azerbaijan (4.9% in 2015 measured at the national poverty line). Nominal wage growth of 5% in the first half of 2017 was not sufficient to compensate for higher prices. Households continue to experience a decline of their real purchasing power, especially for imported consumption items such as food, which undermines future poverty reduction.

## The World Bank and Azerbaijan

The Country Partnership Framework (CPF) 2015–20 for Azerbaijan was endorsed by the Board of Directors on July 21, 2015. It is a joint strategy of the World Bank Group (WBG) aiming to support Azerbaijan on its path toward sustainable, inclusive, and private sector–led growth. Currently, the CPF is undergoing a mid-term review that, among other outcomes, will identify an investment program for the next three years.

The CPF is underpinned by the Systematic Country Diagnostic (SCD) for Azerbaijan, the WBG’s comprehensive analysis of the country’s economic conditions, challenges, and constraints in the short and longer term.

The Bank program in Azerbaijan is helping to address a selected set of those constraints. It is also well aligned with Azerbaijan’s own development priorities and the WBG’s global twin goals of reducing poverty and boosting shared prosperity. The program has two main focus areas: (i) public sector management and service delivery and (ii) economic competitiveness.

The Bank is also supporting the country to strengthen public resource management, facilitate public service delivery, improve the quality of environmental assets, improve selected infrastructure networks, increase the country’s financial inclusion, reduce the regulatory burden on the private sector, and bolster economic activities in rural areas.

### Key Engagement

Azerbaijan is one of the oldest oil producing countries in the world, predating the Soviet era. The country has also been developing its natural gas sector rapidly over the past decade. Proven natural gas reserves are on the order of 1,000 billion cubic meters (bcm), with the Shah Deniz field making up the largest share. The Southern Gas Corridor (SGC) Program will increase production at Shah Deniz from about 10 bcm to roughly 26 bcm, enabling Azerbaijan to more than triple its annual exports from 6.5 to 22.5 bcm.

### WORLD BANK PORTFOLIO

No. of Projects: 10  
Lending: \$2,526.2 Million  
IBRD: \$2,349.4 Million  
IDA: \$176.8 Million

Revenues in Azerbaijan from gas production and transportation will be substantial, especially in light of declining oil production, and will enable the Government to enhance its asset base and sustain economic growth in the medium and long term. The Government has indicated a strong commitment to the project, given its relevance to the country’s strategic priorities of integrating with international energy markets, strengthening its transit position in international trade, ensuring long-term revenues from increasing gas production, and improving transparency and accountability in public resource management.

TANAP is part of the SGC Project and will help transport natural gas from the Shah Deniz field to Turkey. Bank participation in TANAP adds value by bringing advice and experience in the application of international good practices with regard to environmental and social issues, including citizen/stakeholder engagement, as well as fiduciary issues that collectively help TANAP enhance the quality of project implementation. In addition, the Bank’s role as a mobilizer and catalyzer of finance from other partners strengthens the ongoing collaboration with the European Commission, EBRD, and the European Investment Bank (EIB) in SGC development, and also the new, rapidly developing collaboration with AIIB in financing high-priority infrastructure projects in accordance with the Co-Financing Framework Agreement between AIIB and the World Bank.

As part of the Bank’s overall engagement in the energy sector, the Bank supports the Government in developing and implementing a program on mainstreaming the Extractives Industry Transparency Initiative (EITI) practices into the public reporting system. This concurrent program will be implemented in parallel with the TANAP project.

## Recent Economic Developments

The Azerbaijani economy contracted by 1.3% (year-on-year) in the first half of 2017, driven by a decline in oil GDP (7.2%) as production volumes were cut in line with the OPEC agreement. On the upside, and despite continued banking sector distress, the non-oil economy expanded by 1.7% for the first time in over a year, supported by the strong performance of the agriculture and manufacturing sectors.

Annual inflation remained high at 13.9% in June 2017, driven mainly by the increase in administratively controlled tariffs for electricity, water, and gas, and in domestic food prices, reflecting higher demand in Russia for Azerbaijani food. Citing inflationary pressures, the Central Bank of Azerbaijan continued to tighten the monetary policy stance in the first half of 2017 by scaling up liquidity absorption operations.

The current account recorded a surplus of 4.4% of GDP in the first quarter of 2017, driven by exports and a continued import contraction. Non-oil exports increased by 11% amid rising external demand for agriculture products. The manat has appreciated by 4.4% against the U.S. dollar since end-2016, reflecting its stronger external position and increased liquidity absorption operations.

The troubled financial sector continues to exert a negative impact on the economy. Credit contracted by 15.6% in the first half of 2017, and the quality of assets continued to deteriorate. Per official statistics, the nonperforming loan ratio reached 13% in June 2017 compared to 9% at end-2016. Although manat deposits grew in the second quarter of 2017, the client deposits (corporate and household) shrank by 4.4% during the first seven months of 2017.

Fiscal policy was expansionary in the first half of 2017 on the back of public investment. Despite this, the consolidated fiscal balance (including balances of the Oil Fund, the social protection fund, and the Nakhchivan government) recorded

a surplus at 0.3% of GDP in the first half of 2017, as increased investment was more than offset by higher-than-expected revenue. The non-oil deficit was 22% of GDP for the first half of 2017.

## Economic Outlook

Azerbaijan's economy is projected to contract by 1.4% in 2017 despite the increase in oil prices. Oil production will remain muted, while the recovery of the non-oil economy is unlikely to offset this effect, given the modest planned budget and ongoing banking sector distress. Inflationary pressures are likely to persist, as the Government has increased gasoline prices and food prices are expected to rise by the end of 2017 due to seasonal factors.

The economy should expand from 2018 onward, supported by an acceleration of oil GDP as the Shah Deniz gas field—one of the largest gas fields in the world—begins production. Non-oil output will continue to grow at a slow pace due to limited credit growth and the weak business environment.

The Government revised the 2017 budget, increasing expenditure against improved revenue prospects. The bulk of the spending increase will be used to capitalize the Azerbaijan Deposit Insurance Fund with AZN 500 million. However, the implementation of some public investment programs may be delayed. The consolidated fiscal balance is projected to reach a surplus of 4.6% of GDP, whereas the non-oil deficit is expected to be 16% of GDP in 2017.

Despite increased social spending, recent developments and the slow recovery of the private sector are not conducive to poverty alleviation in the short term. A large number of households remain vulnerable to falling back into poverty. The reduction in public investment and consumption in 2016 may reduce household welfare through decreasing employment, especially for those employed in the construction sector.

## Project Spotlight

### Water Users Associations Development Support Project



Jabbar Asadov is a farmer in Bahramtepe, Imishli, benefiting from improved on-farm irrigation.

The agriculture sector is a key component of Azerbaijan's non-oil economy, with the potential for competing on internal and external markets. Although the sector accounts for only 7% of GDP, it provides income and employment for about 40% of the country's workforce.

In addition, the Government sees the sector, which has been growing at an average annual rate of 6% in the past few years, as a priority in the context of food security. The combination of favorable natural conditions and an established base for exports creates opportunities in the sector for growth, private sector investments, and trade opportunities. However, several bottlenecks need to be resolved to realize these opportunities. One of the most pressing constraints lies in the irrigation subsector.

The Azerbaijan Amelioration and Irrigation Open Joint Stock Company (AIOJSC), with World Bank financing, successfully implemented the Irrigation Distribution System Management and Improvement Project (IDSMP), which piloted an approach to build the capacity of Water Users Associations (WUAs) to take over the management and rehabilitation of the on-farm irrigation and drainage (I&D) systems. Under this project, 22 WUAs covering 52,000 hectares and benefiting 48,000 water users have been rehabilitated, resulting in an average increase of 23% in yields, a return to actual irrigation of more than 5,000 hectares that had fallen out of irrigated cultivation, and shifts to higher-value crops such as fruits and vegetables.

The Water Users Associations Development Support Project (WUAP) builds on this approach. Under the new project, an estimated 770,000 water users and farmers in 379 WUAs covering an irrigated area of 910,000 hectares in 27 rayons (regions) will benefit from the institutional capacity building work of the project, and around 75,000 water users in 34 WUAs covering an irrigated area of 85,000 hectares in 15 rayons will have substantial benefits from irrigation network rehabilitation.



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