

AZERBAIJAN

Recent developments

Table 1 **2018**

Population, million	9.9
GDP, current US\$ billion	46.9
GDP per capita, current US\$	4717
School enrollment, primary (% gross) ^a	106.4
Life expectancy at birth, years ^a	72.0

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent WDI value (2016).

Azerbaijan's economy expanded at a moderate pace in 2018 aided by stable oil production and a modest pick-up in domestic demand, as higher oil earnings boosted fiscal spending and real wages rose.

As natural gas exports rise, economic growth is forecast to accelerate over the medium-term. The uncertain external environment represents the main risk to Azerbaijan's growth prospects, while a sporadic approach to structural reform and the absence of policies targeting the vulnerable could further hinder poverty eradication efforts.

Supported by stable oil production and a modest acceleration in domestic demand, real GDP expanded by 1.4 percent in 2018. While oil production plateaued, the hydrocarbons sector overall posted growth of 1.1 percent thanks to higher exports of natural gas. The non-energy economy expanded by 1.8 percent, reflecting greater dynamism in most economic sectors. The notable exception was construction, which posted a contraction year on year following the completion of a major gas field project. On the demand side, the expansion was mainly driven by consumption, as higher oil and gas prices supported an increase in public spending and real wages. A modest recovery in credit also supported demand. Total investment continued to contract in 2018, though at a more moderate pace, while non-energy sector investment jumped by 22 percent year on year.

Higher oil prices propelled the current account surplus to 15 percent of GDP (a non-energy deficit of 10 percent of GDP) in the third quarter of 2018. Oil exports rose by 44 percent year on year, while non-oil sector exports increased by 12 percent. Imports also rebounded, rising by 25 percent, buoyed by increased government consumption and stronger domestic demand. Foreign direct investment dropped substantially owing to the completion of the gas field project. Moderate capital outflows (mostly from deposits and cash) kept the financial account deficit stable.

International reserves rose to \$5.6 billion, the assets of the State Oil Fund of Azerbaijan reached \$38.5 billion (82 percent of GDP), and the manat remained stable against the U.S. dollar. In contrast, the real effective exchange rate appreciated by 5.5 percent.

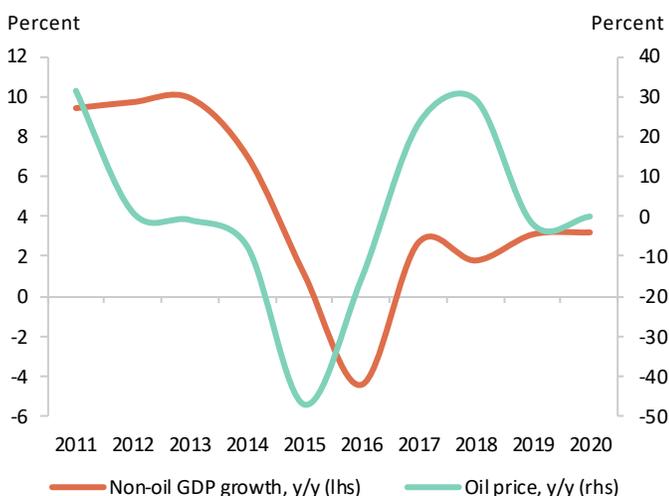
Consumer price inflation decelerated sharply in 2018, falling to 1.6 percent from 7.9 percent in 2017, reflecting modest domestic demand, low external inflationary pressures. In response, the Central Bank of Azerbaijan (CBA) gradually lowered its policy rate to 9.25 percent by February 2019 (from 15 percent in December 2017).

Higher oil revenues helped boost fiscal spending in 2018 (up by 29 percent year on year), mainly through higher public investment. The consolidated budget recorded a surplus of 5.9 percent of GDP (compared to a deficit of 1.5 percent of GDP in 2017), while the non-energy deficit widened to 33 percent of non-energy GDP.

The financial sector showed signs of a fragile recovery. Even though credit growth turned positive in 2018, non-performing loans remain high, profitability is low (with several banks making losses), and many banks are still vulnerable to foreign exchange risk.

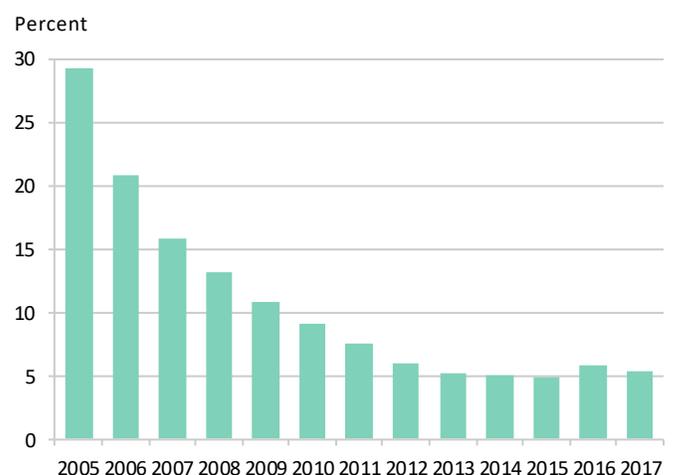
The State Statistical Committee estimates that the national poverty rate fell from 5.9 percent in 2016 to 5.4 percent in 2017. The poverty rate is estimated to have fallen further in 2018 in response to continued economic expansion, low unemployment, rising real wages, and modest inflation.

FIGURE 1 Azerbaijan / Non-oil sectors influenced by oil price



Sources: The State Statistical Committee of the Republic of Azerbaijan and World Bank staff estimates.

FIGURE 2 Azerbaijan / Poverty headcount rate at the national poverty line



Source: The State Statistical Committee of the Republic of Azerbaijan. Note: The World Bank has not reviewed the official national poverty rates for 2013-17.

Outlook

Primarily owing to rising natural gas exports, economic growth in the medium term is forecasted to average 3.5 percent annually. Non-energy output is projected to expand at around 3 percent annually, supported by domestic demand, as real wages and credit to the economy continue to improve. In 2019, private consumption will receive a temporary boost from increases in the minimum wage and minimum pension. Meanwhile, recent tax reforms and ongoing efforts to reform the customs system—building on Azerbaijan’s strong business reform performance in 2018—could reduce informality and translate into greater economic activity.

The gradual recovery in domestic demand is expected to lift inflation slightly and CPI inflation will hover at about 3 percent through 2022. Monetary policy may be further loosened in the medium term.

With no major decline in oil prices and a boost in gas exports, the current account surplus is likely to remain above 12 percent of GDP over the medium

term. Imports will continue to recover reflecting trends in domestic demand. Capital outflows are expected to remain low.

Implementation of a relatively stringent fiscal rule (which caps spending increases to 3 percent per annum) will further bolster the fiscal accounts. The surplus on the consolidated budget is forecasted to rise to 7 percent of GDP; the non-energy fiscal deficit should decline over the medium-term.

Sustained GDP growth, additional social transfers, and low unemployment levels will translate into further reductions in the poverty rate. However, more significant poverty reduction may require policies tailored to the specific segments of the population where the poverty incidence remains highest.

Risks and challenges

Azerbaijan's economy faces both external and domestic uncertainties. A global economic slowdown or rising geopolitical risks in major oil suppliers could impact

oil prices and hurt Azerbaijan’s growth prospects. Tensions surrounding Azerbaijan’s major trade partners (the Russian Federation and Turkey) could have a contagion effect, spurring renewed capital outflows. Strengthened macroeconomic buffers, as well as a more flexible exchange rate regime, will help limit the impact of the external shocks on the economy.

The main risks to Azerbaijan’s economic prospects are domestic. Because it will rely almost entirely on rising gas exports, the projected acceleration in growth in the medium term will be temporary. Growth in the non-energy economy will remain lackluster without reforms to boost private sector investment, reduce the state footprint, tackle issues of competitiveness, and develop human capital. The notable increases in the 2019 budget allocations for education (up by 13 percent) and health care (by 44.5 percent) are important in terms of improving human capital. But further efforts are needed to align budget spending with development needs, including through strengthening medium-term budgeting and the Public Investment Management system.

TABLE 2 Azerbaijan / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	-3.1	0.1	1.4	3.3	3.5	3.7
Private Consumption	-2.8	2.7	2.8	3.2	3.4	3.7
Government Consumption	-8.1	1.8	3.3	3.1	3.2	3.2
Gross Fixed Capital Investment	-20.0	-5.2	-0.2	1.1	2.6	3.9
Exports, Goods and Services	-2.0	-1.0	1.0	3.6	3.4	3.2
Imports, Goods and Services	-10.0	0.2	2.5	2.7	2.9	2.9
Real GDP growth, at constant factor prices	-3.0	0.1	1.4	3.4	3.5	3.7
Agriculture	2.6	4.7	4.6	4.6	4.6	4.6
Industry	-4.2	-3.7	-1.4	2.3	2.4	2.6
Services	-1.9	6.6	5.5	5.1	5.0	5.2
Inflation (Consumer Price Index)	15.6	7.9	1.6	2.8	3.2	3.3
Current Account Balance (% of GDP)	-3.6	4.1	12.4	12.5	13.1	13.4
Net Foreign Direct Investment (% of GDP)	3.2	2.8	2.4	2.2	2.1	1.9
Fiscal Balance (% of GDP)	0.3	-1.5	5.9	6.5	6.9	7.3
Primary Balance (% of GDP)	1.0	-0.4	7.1	7.5	7.6	7.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.