COVID-19 and the fall in world oil prices hit the Azeri economy hard.

CPI inflation inched up in March.

The Central Bank of Azerbaijan (CBA) continued to tightly manage the exchange rate and expand liquidity absorbing operations.

Merchandise trade surplus narrowed sharply by the end of Q1-2020.

COVID-19 crisis exacerbated existing weaknesses in banking system, prompting the CBA to close 4 banks.

Soaring SOFAZ transfers kept budget in significant surplus in Q1-2020, as COVID-19 related spending pressures increased.

GDP growth moderated to 1.1 percent year-on-year (yoy) in Q1-2020, as the COVID-19 containment measures resulted in economic contraction in March. GDP shrank by about 2 percent yoY in March, reflecting declines in both oil/gas and non-oil/gas sectors. Energy GDP contracted by 2 percent yoY in March and is expected to decline even more steeply in the second quarter, as Azerbaijan adheres to the oil production cuts from May 1, per the OPEC+ agreement. Non-energy GDP slowed to 3.5-percent growth in the first quarter, falling by 1 percent yoY in March, from an exceptionally high 9 percent growth in February, as businesses were ordered shut and borders were closed for passenger traffic. Construction and hospitality plummeted in March, declining by 14 percent each since the start of the year. Retail trade turnover growth softened from 3.1 percent in January-February to 1.2 in January-March. Slower growth was also recorded across other sectors, except for ICT which grew by almost 18 percent in the first quarter, bolstered by an increased reliance on the ICT services during the lockdown. On the demand side, investment shrank by 4 percent yoY in real terms in March, owing to a significant fall in non-oil/gas investment. Consumption growth slowed, as shopping malls, small stores and markets closed due to the national lockdown. Sales of non-food items declined the most, while purchases of food items rose slightly due to stockpiling ahead of the lockdown. Enforcement of strict quarantine measures intensified in April, as evident from the decline in mobility across the country (based on the Yandex mobility index). The government eased some restrictions recently (confirmed by an increase in mobility), reviving some business activity in May.

Trade surplus narrowed as exports plummeted in March. Exports fell by 6.2 percent yoY in Q1-2020 owing to 28 percent yoY drop in March, on top of a 40 percent yoY decline in February. The trend was driven by a 32-percent yoY nosedive in oil exports in March, reflecting a 40-percent plunge in oil prices. In contrast, non-oil exports grew by 6 percent yoY in March. Imports (excluding monetary gold) continued to expand, by 6 percent yoY in March, which brought import growth to 8 percent yoY in Q1-2020. As a result, the trade surplus was almost wiped out in February and March. The State Oil Fund’s (SOFAZ) revenues dropped to USD 312 million in April, less than a half the amount recorded in March, suggesting further sharp contraction of exports.

CPI inflation edged up in March but remained low. Consumer prices rose by 1 percent month-on-month (mom), pushing the annual inflation to 3.3 percent, within the central bank’s target range of 4±2 percent. Food inflation, 2.2 percent mom in March and 4.6 percent annual, was the primary cause for the CPI increase. In addition to stockpiling before the lockdown, food prices also rose due to higher demand during the Nowruz holidays in late March. Non-food and services inflation stayed flat in March.

The manat remained stable in March-April, as elevated FX demand was met by increased SOFAZ sales. SOFAZ sold USD 531 million in April, in addition to USD 1.9 billion it sold in March. By end-April SOFAZ had sold half of its annual planned amount in the FX market. Real exchange rate appreciated by 3.1 percent in March, owing to a large depreciation in major trade partners’ currencies. The CBA reserves plateaued at USD 6.4 billion in February-April.

Weak balance sheets in some banks were further strained by the COVID-19 pandemic. Credit to economy shrank by 0.4 percent mom in March while household manat deposits dropped by 10 percent. Overdue loans rose by 7 percent in March, compared to February, and reached 8.9 percent of total loans. On April 24, the CBA announced anti-crisis measures which included regulatory forbearance for banks, insurers and capital market participants until January 1, 2021. Households can restructure their mortgage loans without worsening of their credit history; while restructured loans of businesses would preserve exante quality (as of March 1, 2020). However, these measures put strains on some banks’ already weak balance sheets. In fact, on April 27, the CBA introduced temporary administrations in 4 banks and subsequently revoked their licenses (their share in the sector’s assets was 4.7 percent and in the loan portfolio 7 percent).

Skyrocketing SOFAZ transfers kept budget in surplus in Q1-2020; however, implementation of the COVID-19 mitigation plan will push expenditures up. Budget receipts soared by 44 percent yoY in the first quarter as the proceeds from the higher SOFAZ FX sales were transferred to the budget. Budget spending rose by 4 percent yoY in the first quarter, reflecting a 42-percent rise in current spending while capital spending halved. Overall, the budget surplus increased to 14 percent of GDP. However, the ongoing crisis has put revenues under strain, with revenue collection by the Customs Service declining by 5.5 percent yoY in April. By early May, AZN 114 million were paid as unemployment benefits to individuals and another AZN 138 million to firms for the payroll assistance and financial support.
Table 1: Selected macroeconomic indicators

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<tbody>
<tr>
<td>Real GDP growth, in %</td>
<td>2.8</td>
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<td>-3.1</td>
<td>0.2</td>
<td>1.5</td>
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<td>Inflation, period average, in %</td>
<td>1.4</td>
<td>4.0</td>
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<td>12.9</td>
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<td>Current Account Balance, in % of GDP</td>
<td>13.6</td>
<td>-0.4</td>
<td>-3.6</td>
<td>7.1</td>
<td>12.9</td>
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<td>excluding oil, in % of GDP</td>
<td>-17.9</td>
<td>-20.1</td>
<td>-25.7</td>
<td>-24.3</td>
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<td>Fiscal balance, in % of GDP</td>
<td>2.7</td>
<td>-4.8</td>
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<td>8.9</td>
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<td>SOFAZ assets, in USD billion</td>
<td>37.1</td>
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<tr>
<td>Central Bank reserves, in USD billion</td>
<td>13.8</td>
<td>5.0</td>
<td>4.0</td>
<td>5.3</td>
<td>5.6</td>
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Source: State Statistics Committee, Ministry of Finance, Central Bank of Azerbaijan, World Bank staff calculations

Figure 1. GDP growth contracted in March as COVID-19 containment efforts were introduced (year-to-date, %)

Figure 2. CPI slightly picked up in Q12020 (yoy, %)

Figure 3. Foreign trade surplus started to collapse as COVID-19 and oil price slump affected exports (yoy, %) (USD billion)

Figure 4. CBA reserves leveled at US$6.4 bln, while SOFAZ assets dropped by US$2 bln in Q1-2020 (yoy, %)

Figure 5. Soaring SOFAZ transfers kept state budget in surplus in Q1-2020 (% of GDP)

Figure 6. Credit growth softened as pressure on some banks’ weak balances increased (yoy, %)

Source: State Statistics Committee
Source: State Customs Committee
Source: Central Bank of Azerbaijan
Source: Central Bank of Azerbaijan
Source: Ministry of Finance