

- *Azerbaijan's economy contracted sharply in May, as both energy and non-energy GDP collapsed.*
- *June recovery is likely to be short-lived as restrictions were re-imposed.*
- *CPI inflation remains low.*
- *With credit growth stagnating and low inflation, the central bank lowered its policy rate in June.*
- *Exports collapsed further in May, as oil production was cut to meet the OPEC+ quota.*
- *State budget remained in deficit in May; large SOFAZ transfers earlier in the year helped keep the budget in surplus in the year-to-May.*

**Azerbaijan's economy contracted sharply in May, as both energy and non-energy GDP collapsed.**

Energy GDP fell by 12 percent year-on-year (yoy) in May, due to a hydrocarbons output cut according to the negotiated OPEC+ quota. Non-energy GDP plummeted 6 percent yoy in May, on top of a 13 percent yoy decline in April. As a result, overall GDP fell by 8 percent yoy in May. This represents a 1.7 percent yoy cumulative decline since the start of the year. The hospitality sector was hit the hardest, almost halving since January. Construction activity collapsed by 14 percent year-to-date (ytd). As the strict quarantine measures were relaxed in May, passenger transport recovered slightly but it remains depressed as ytd transportation fell by 10 percent for cargo and 24 percent for passengers. Trade turnover was down 2 percent ytd, while overall services crashed by 15 percent since January. In contrast, non-energy manufacturing, agriculture and ICT still posted growth, though growth rates moderated markedly. On the demand side, consumption suffered due to remaining mobility restrictions and moderating real incomes, as wage growth slowed and remittance inflow was 60 percent lower yoy in May. Investment, particularly non-energy private investment, dropped by another 11 percent yoy in May.

**The government has re-imposed a strict lockdown since June 21.** The relaxation of restrictions in May triggered a spike in COVID-19 cases in late May and June, prompting strict quarantines in four major urban areas. As a result, the slight pickup in economic activity in May and June has stalled again, with mobility in Baku declining from 85 percent of pre-COVID levels in early June to around 50 percent in early July. Additionally, the OPEC+ agreement was extended till end-July, further depressing Azerbaijan's energy sector.

**Inflation edged down in May, owing to seasonal deflation in food prices.** Consumer prices fell by 0.5 percent month-on-month (mom) in May, bringing annual inflation to 2.9 percent yoy. Food prices declined by 1.3 percent mom in May, due to seasonal factors and slowing food exports. Non-food and services prices were stable.

**The central bank relaxed monetary policy in June.** Citing low inflationary pressures, the Central Bank of Azerbaijan (CBA) lowered its policy rate by 25 basis points, to 7 percent, its first adjustment since January. The CBA also continued to hold deposit auctions with no change in offered amounts, even as they remained oversubscribed.

**The balance of payments (BOP) recorded a deficit of 12.5 percent of GDP in Q1-2020.** The current account surplus narrowed to 6 percent of GDP in Q1-2020 (from 15 percent a year earlier), as exports of both goods and services softened and imports increased. Remittance inflows declined by 13 percent yoy while outflows increased by 37 percent yoy as compared to Q1-2019. Outflows on the financial account also increased, moving the overall external balance to a deficit of USD 1.3 billion or 12.5 percent of GDP, for the first time since 2016. The deficit was financed by Oil Fund reserves.

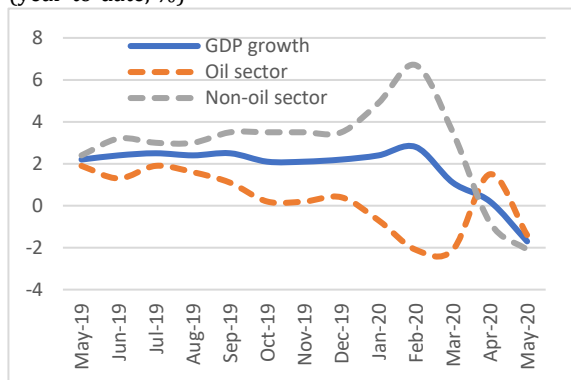
**Similar trends persisted in Q2-2020.** While capital outflows appear to have moderated, the trade balance turned negative in May, for the first time since October 2016. Export crashed by 56 percent yoy, due to a 62 percent yoy decline in oil exports, as oil prices remained depressed and production was cut to meet the OPEC+ quota. Non-energy exports dropped by 15 percent yoy, as external demand plummeted. Imports fell by 39 percent yoy in May (by 10 percent yoy excluding monetary gold), amid declining domestic demand.

**The manat remained stable at 1.7 AZN/USD, as FX demand was met through sales by the State Oil Fund (SOFAZ).** In June, FX sales by SOFAZ amounted to USD 373 million, 12 percent up compared to May and 19 percent up yoy, though still 33 percent less than the monthly limit and only a fifth of the amount sold in March 2020. Slowing economic activity, as well as restrictions imposed by the CBA on FX purchases contributed to moderate FX demand from very high levels during February-April, 2020. CBA reserves were stable in May-June.

**Credit to economy continued to stagnate.** The amount of outstanding loans fell by 3 percent mom in May, mostly reflecting the removal of four closed banks' credit portfolio from the system. Nevertheless, overall credit stock was 12 percent higher yoy. Deposit portfolio was flat in May, as FX deposits shrunk and manat deposits increased. Hence, the dollarization of deposits slightly declined, to 61 percent.

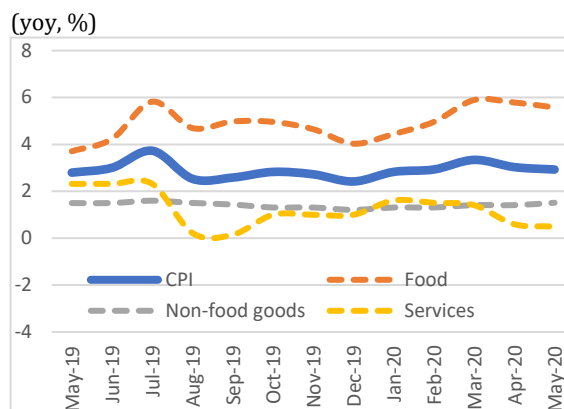
**The state budget remained in deficit in May.** Budget revenues were down by 36 percent yoy in May, mainly due to lower SOFAZ transfers, even though the revenue collection by the Customs Service increased by 2 percent yoy in May. Meanwhile, monthly budget spending declined by only 4 percent yoy, resulting in a budget deficit of AZN 1.1 billion in May. Consequently, the budget surplus in the year to May sharply narrowed to AZN 1.1 billion or 4 percent of GDP ytd, from 10 percent of GDP a month earlier.

**Figure 1. GDP continued to fall in May, as both energy and non-energy economy deteriorated (year-to-date, %)**



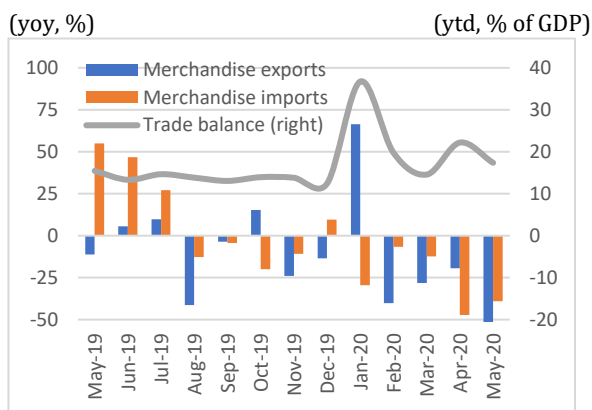
Source: State Statistics Committee

**Figure 2. CPI inflation remains low**



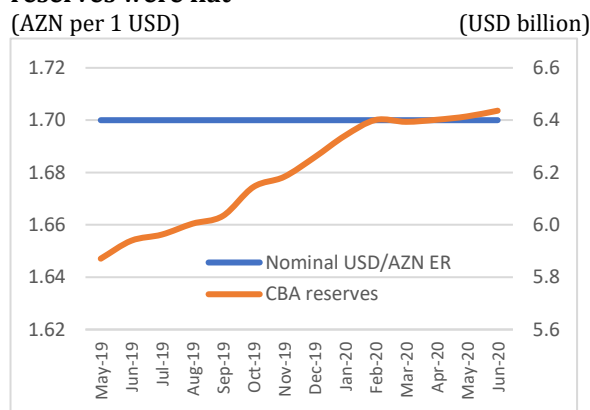
Source: State Statistics Committee

**Figure 3. Export collapsed further in May**



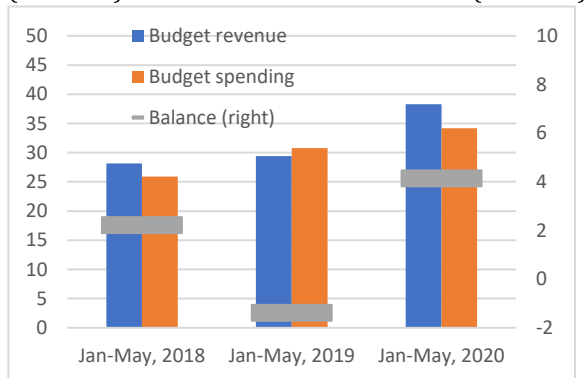
Source: State Customs Committee

**Figure 4. The manat was stable while CBA reserves were flat**



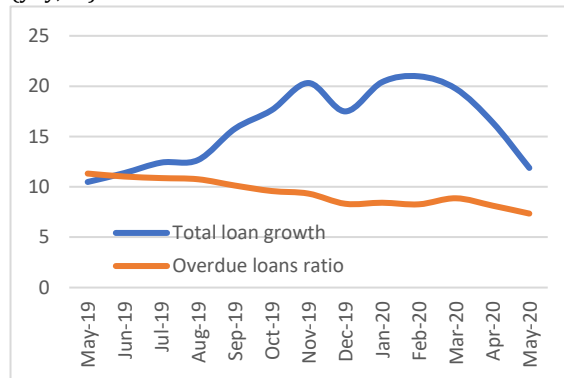
Source: Central Bank of Azerbaijan

**Figure 5. Budget remained in deficit in May but was in surplus ytd**



Source: Ministry of Finance

**Figure 6. Credit growth to economy continued to fall**



Source: Central Bank of Azerbaijan