• COVID-19 pandemic and subsequent lockdown led to a collapse in non-energy activity in April; the removal of restrictions in May resulted in some recovery but also a spike in new infections
• CPI inflation moderated in April
• Trade surplus improved in April as decline in imports outweighed contraction in exports
• Credit to economy declined as four banks were closed and economic activity halted in April
• The state budget registered a deficit in April as tax collection declined.

The COVID-19 pandemic and subsequent lockdown led to a collapse in Azerbaijan’s non-energy activity in April. The hydrocarbon sector expanded in April, as oil production slightly increased ahead of the start of the OPEC+ agreement on May 1, while the expansion in gas production continued. However, GDP declined by 2.6 percent year-on-year (yoy) in April, as activity in the non-energy sectors collapsed by 13 percent yoy. Overall, in January-April 2020 output was only 0.2 percent higher than a year earlier, with energy sector output increasing by 1.5 percent, while the non-oil/gas economy shrank by 0.8 percent. The contraction was widespread: hospitality crashed by 31 percent, construction by 13 percent, retail trade by 2 percent. Agriculture and ICT remained the only bright spots; while agriculture output recorded a robust 3.8 percent growth, ICT services’ expansion softened, as compared to the first quarter. Strict lockdown measures led to a significant decline in demand in April. Investment tumbled by 11 percent yoy, mostly due to shrinking private investment, particularly in non-energy sectors. This brought the investment decline year-to-date (ytd) to 0.5 percent. Consumption was affected by the extended holiday season, compounded by labor income and remittances decline.

High-frequency indicators point to a sharp decline in oil production in May, but also some recovery in non-oil sectors. Oil production was cut as of May 1 in line with the OPEC+ agreement. On the other hand, economic activity in the non-oil sectors rebounded as quarantine restrictions were lifted. However, the rapid increase in new infections prompted the government to re-introduce the weekend curfew in early June.

CPI inflation moderated to around 3 percent yoy in April and May. Food prices eased in April compared to March, bringing annual food inflation to 4.8 percent. Weak demand negatively affected service prices, resulting in their deflation in April and softening in annual services inflation to 1.3 percent. Non-food inflation also slightly decelerated, though remained stable at 1.4 percent in annual terms.

Trade surplus improved in April, as decline in imports outweighed contraction in exports. In April, exports declined by 19 percent yoy, mainly due to a 18-percent yoy drop in oil and gas exports. Non-energy exports also collapsed by 36 percent yoy, as external demand remained subdued. The fall in imports was even more pronounced in April – 47 percent yoy. This brought the decline in exports to 11 percent yoy and in imports to 26 percent yoy (or 4 percent yoy without monetary gold imports) since the start of 2020. As a result, the trade balance improved to 22 percent of GDP in January-April.

The exchange rate remained stable at 1.7 AZN/USD in May, with notable moderation in FX demand. FX sales by the State Oil Fund (SOFAZ) fell by 37 percent in May, as compared to April, and amounted to USD 334 million (40 percent below the monthly limit). The Central Bank of Azerbaijan (CBA) continued its liquidity absorbing operations to limit pressures on the manat. The real exchange rate appreciated by 7 percent in April, as currencies of trade partners weakened. The CBA reserves remained stable at USD 6.4 billion in May.

Credit to the economy declined in April, as the CBA withdrew the operating licenses of four banks. Nevertheless, the stock of credit was up by 16 percent yoy at the end of April. In Q1-2020 bank credit was dominated by business loans, while consumer loans fell. In April, overdue loans stood at 8.1 percent, a 3-percentage point (pp) improvement compared to a year earlier. Dollarization of deposits also declined by 2 pp yoy and stood at 62 percent. Both FX and local currency deposit portfolio have been shrinking since the start of the year, due to the late extension of the full deposit insurance coverage (enacted on April 27 and effective till December 2020), deteriorated sentiments and closure of 4 banks.

The state budget registered a deficit in April, which likely increased in May. State budget receipts declined by 15 percent (yoy) in April mainly due to lower SOFAZ transfers. Non-oil revenues remained flat in April (yoy) thanks to robust tax collection while revenue collection by the Customs Service was down by 5.5 percent yoy. At the same time, spending was down almost 8 percent yoy, resulting in a state budget deficit of AZN 250 million in April. The deficit likely increased in May, as revenue sources remained under pressure while spending is expected to have increased with disbursements of COVID-related support payments. Specifically, the Ministry of Finance reported it allocated AZN 533 million to COVID support measures, including wage subsidies, direct payments to companies and one-time payments to jobless people. Exceptionally high SOFAZ FX sales in March kept the state budget balance positive in the first four months.

On June 6, OPEC+ agreed to extend the oil production cut of 9.6 million barrels/day until the end of July. Azerbaijan adheres to the agreement and decreased its crude oil output to 554,000 bbl/day in May, from 640,300 bbl/day in April. Even though the Brent oil price doubled since its lows in April, futures oil prices remain below the Azerbaijan’s BOP and fiscal breakeven levels.
Table 1: Selected macroeconomic indicators

|----------------------|-------|-------|-------|-------|-------|-------
| Real GDP growth, in %| 2.8   | 1.1   | -3.1  | 0.2   | 1.5   | 2.2
| Inflation, period average, in %| 1.4   | 4.0   | 12.4  | 12.9  | 1.9   | 2.9
| Current Account Balance, in % of GDP excluding oil, in % of GDP | 13.6  | -0.4  | -3.6  | 7.1   | 12.9  | 9.1
| Fiscal balance, in % of GDP | 2.7   | -4.8  | -1.3  | -1.4  | 5.9   | 8.9
| SOFAZ assets, in USD billion | 37.1  | 33.5  | 33.4  | 35.8  | 38.5  | 43.3
| Central Bank reserves, in USD billion | 13.8  | 5.0   | 4.0   | 5.3   | 5.6   | 6.3

Source: State Statistics Committee, Ministry of Finance, Central Bank of Azerbaijan, World Bank staff calculations

Figure 1. GDP further contracted in April, driven by collapse in non-energy activity (year-to-date, %)

Figure 2. CPI inflation moderated in April (yoy, %)

Figure 3. Foreign trade surplus increased as fall in import outpaced that in export (% of GDP)

Figure 4. Manat was stable, CBA reserves flat, while SOFAZ assets declined (AZN per 1 USD) (USD billion)

Figure 5. Despite registering a deficit in April, state budget was in surplus ytd (% of GDP)

Figure 6: Credit to economy is moderating (yoy, %)

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

Prepared by: Nadir Ramazanov, Sr. Economist
Olena Bogdan, Economist