Country Context

Since the presidential election in April 2018, the Government of Azerbaijan has undergone significant changes. These include the nomination of a new prime minister and the appointment of several key ministers in charge of education, tax reforms, agriculture and rural development, the environment, and energy. The new Government has been tasked with continuing the reforms initiated in the aftermath of the economic recession of 2016.

Supported by favorable terms of trade and stabilizing oil production, Azerbaijan’s economy expanded by 1.3% in the first half of 2018. As the effects of the 2015 depreciation faded away, annual inflation moderated to 2.3% in the first half of 2018. The overall economic recovery, though modest, is likely to have contributed positively to employment growth. The poverty rate is expected to continue to decline throughout 2018 after the small spike observed in 2016, the year of the economic recession.

Economic activity in Azerbaijan’s main trade partners—Russia, Turkey, and Iran—is expected to slow, which may adversely impact demand for Azerbaijan’s non-oil exports and, in turn, potentially increase pressure on the exchange rate and reduce market confidence in Azerbaijan.

On the domestic side, a major risk is a slowdown in the implementation of structural reforms and an incomplete macro-fiscal policy framework. Structural reforms to improve the business environment, reduce the state’s economic footprint, and advance the rule of law are necessary for Azerbaijan to transition to a new growth model.
The World Bank and Azerbaijan

The Country Partnership Framework (CPF) FY15–20 for Azerbaijan aims to support the country on its path to sustainable, inclusive, and private sector–led growth.

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

Currently, the CPF is undergoing a mid-term review that, among other outcomes, will identify new areas for partnership with the country for the next three years.

The Bank’s program has two main focus areas:

(i) public sector management and service delivery,

(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

Seven percent of Azerbaijan’s population (approximately 623,000 people) is displaced, giving the country one of the highest concentrations of internally displaced persons (IDPs) in the world.

To respond to this challenge, the World Bank and the Government of Azerbaijan have been implementing the IDPs Living Conditions and Livelihood Project since 2012. This project, funded by the World Bank with two loans (an original loan of US$78.5 and additional financing of US$66.7 million), aims to improve the living conditions and economic self-reliance of IDPs. The project is the result of a long history of partnership between the World Bank and Azerbaijan in addressing the needs of IDPs.

The Social Fund for the Development of IDPs is the project’s implementing agency.

The project has several components, including community micro-projects; income-generating activities; the rehabilitation of public buildings; a youth support program; and micro-credits.

The project has benefited about 250,000 people, half of whom are women. Beneficiaries of the livelihood support activities report an average increase of 45% in monthly household income. More than 2,000 young IDPs have found employment after participating in the youth training component.

IDPs who have started a business with support from the project report a 100% success rate. Following project interventions, three quarters of the families living at collective centers rate their housing conditions as good or excellent compared to only 1% at the start of the project.

Almost all project beneficiaries report that they are able to influence development decisions, and there is increased trust between IDPs and their host communities in areas where project activities took place.
**Recent Economic Developments**

Azerbaijan’s economy expanded by 1.3% in the first half of 2018. Improved terms of trade helped revive output in the services sector. Agricultural output expanded by 6.5% year-on-year (y-o-y), fueled by higher exports to the Russia Federation.

The construction sector—the only sector that has not yet recovered to pre-2016 output levels—continued to contract during the first half of 2018, reflecting the completion of works in major gas fields.

Higher oil prices and a stabilization of oil production increased the current account surplus to an estimated 8% of GDP in the first half of 2018.

Although non-oil exports rose by 20% y-o-y, driven by strong agriculture exports, Azerbaijan’s non-oil current account deficit was estimated at above 20% of GDP.

As the effects of the 2015 depreciation faded away, annual inflation moderated to 2.3% in the first half of 2018. In response to declining inflationary pressures and more favorable external conditions, the Central Bank cut the policy rate twice in 2018 from 13 to 10%.

The Government has adopted a new fiscal rule, new procedures for medium-term budgeting, and a new debt management strategy that sets spending growth limits.

The situation in the banking system remains fragile, with some early signs of recovery. Credit growth inched up by 3% in the first half of 2018 after two years of decline.

Although it remains at alarmingly high levels, the nonperforming loan ratio stabilized in the first half of the year.

**Economic Outlook**

In the medium term, Azerbaijan’s economic performance will strengthen, fueled by natural gas exports and a moderate acceleration in domestic demand. Non-oil sector growth, which is expected to average 2.7% in the medium term, will benefit from stabilizing oil prices, rising market confidence, a gradual recovery in investment, and improvements in the banking sector. In the absence of external shocks, inflation is expected to remain below 3%.

If oil prices remain at current levels, the current account surplus is projected to average 10% of GDP through 2020. Import growth is expected to accelerate owing to a further real appreciation of the manat. Fiscal spending will rise steadily, although the Government is likely to remain cautious because of rising uncertainty in global financial markets.

The recently adopted medium-term expenditure framework, fiscal rule, and debt management legislation should support efforts toward budgetary restraint. With the help of stabilizing oil prices, the fiscal balance is projected to remain in surplus over the medium term.

The medium-term outlook presents an opportunity to tackle some of the critical constraints facing private investment. The Government’s response would need to involve reforming the business environment, correcting banking sector fragilities, scaling back the presence of the state in the economy, and promoting fairer competition.

Cuts to social protection spending, as well as a slow economic recovery, will inhibit progress on poverty reduction. Considering current levels of poverty, its eradication will require policies tailored to segments of the population where the incidence of poverty remains sizable.
Project Spotlight

Investing in Opportunities: Empowering Rural Women in Azerbaijan

Investing in rural women yields rich development dividends. Rural women in Azerbaijan are demonstrating this through an innovative women’s economic empowerment pilot under the Second Rural Investment Project.

Launched in April 2018, in five regions, the pilot has mobilized 88 women into six Women Development and Enterprise Groups. In just six months, these groups have collectively saved nearly US$40,000 and started their own enterprises. The pilot project is built on several components:

Building institutions of women for women: Women in neighborhoods were mobilized into groups of 15–20 based on the principle of mutual support. Each group elects a chair and a secretary and follows the norms of democratic governance. Every member is encouraged to contribute to discussions during weekly group meetings.

Gaining access to finance: The women meet each week and save an agreed amount. Their collective savings can be used after six months, allowing funds to accumulate, to gain access to credit and invest in their businesses. Each group is graded based on regular meetings, savings, and record keeping. After six months of savings, the project provides a one-time grant to match their funds.

Disrupting the model to enter the marketplace: Not all groups waited to access their savings as some started businesses with their own resources. Their enterprises include carpet making, cafes, catering, and sewing workshops.

Using their collective voice: The groups have created a vulnerability profile of their communities and identified issues that they wish to address. They are active in supporting the elderly, launching environmental campaigns and cleanups, and highlighting issues to the local government on a regular basis.

Building capacity: Capacity building has been key, including group functioning and record keeping, financial literacy, life skills, business development and management, and health and nutrition. Five business incubators have been launched in the pilot rayons (districts) to provide onsite business development services to these enterprises.