



AZERBAIJAN	2018
Population, million	10.0
GDP, current US\$ billion	46.9
GDP per capita, current US\$	4,780
Life Expectancy at birth, years (2017)	72

At a Glance

- Since April 2018, the Government of Azerbaijan has undergone significant changes. The new Government has been tasked with continuing reforms in key sectors to recover economic growth.
- Azerbaijan's economy expanded at a moderate pace in 2018, aided by stable oil production and a modest pickup 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.

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 in key sectors to recover economic growth.

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. Consumer price inflation decelerated sharply in 2018, falling to 1.6 percent from 7.9 percent in 2017.

Since economic prospects will largely rely on rising gas exports, the projected acceleration in growth in the medium term will be temporary. The country needs 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 public investment management.

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 two years.

The Bank's program has two main focus areas: (i) public sector management and service delivery and (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

On December 19–21, 2018, more than 150 participants from the Government of Azerbaijan, together with representatives of development partners, civil society, the diplomatic community, and academic and research institutions, came together for the Azerbaijan Human Capital Forum.

Recognizing the key role of human capital in growth and development over the long term, the three-day high-level forum was organized in partnership with the Office of the Deputy Prime Minister, Ministry of Education, and Ministry of Labor and Social Protection of the Population.

WORLD BANK PORTFOLIO

No. of Projects: 5
Lending: \$1,042 Million
IBRD: \$1,012 Million
IDA: \$30 Million

The goal of the forum was to support the Government in accelerating investments in human capital as a critical step to boosting more inclusive and sustainable growth. The gathering underscored the importance of enhanced investments in human capital in preparing Azerbaijan's citizens for the challenges and opportunities presented by globalization and technological innovation.

With the confluence of rapid technical change and globalization and the need to engage in the global knowledge economy, investments in human capital will be key to Azerbaijan's ability to collaborate and compete with other nations.

Although forum participants expressed appreciation of the tremendous progress Azerbaijan has made on multiple fronts since its independence a generation ago, they also acknowledged that the current level of human capital and its contribution to the national wealth is not commensurate with the country's income level.

Several recommendations emerged on ways to support Azerbaijan to improve its human capital, including the need to increase public spending on health and education, improve the access and quality of early education, narrow the learning gap, increase the access to tertiary education and reform vocational training, reduce out-of-pocket expenditure in health, strengthen the primary health care system, do more to identify vulnerable households, and expand the social safety nets that target poverty.

Recent Economic Developments

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 (y-o-y) following the completion of a major gas field project.

Higher oil prices propelled the current account surplus to 15 percent of GDP in the third quarter of 2018. Oil exports rose by 44 percent y-o-y, 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. International reserves rose to US\$5.6 billion, the assets of the State Oil Fund of Azerbaijan reached US\$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.

Higher oil revenues helped boost fiscal spending in 2018 (up by 29 percent y-o-y), mainly through higher public investment. The financial sector showed signs of a fragile recovery.

Even though credit growth turned positive in 2018, nonperforming loans remain high and many banks are still vulnerable to foreign exchange risk.

Economic Outlook

Due primarily 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 consumer price 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.

Implementation of a relatively stringent fiscal rule (that caps spending increases to 3 percent per annum) will further bolster the fiscal accounts. The surplus on the consolidated budget is expected 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 specific segments of the population where poverty remains highest.

Project Spotlight

Highway 3 Project - Road Maintenance Reforms



The new motorway maintenance enterprises are responsible for routine, winter, and emergency maintenance works.

The aspiration to become a major regional economic player and international transit hub prompted Azerbaijan in the mid-2000s to invest in the upgrading of its main road network to motorway standards.

Although the oil windfall of recent decades and generous financing from international financial institutions have substantially facilitated implementation of this objective,

modernizing ineffective road management and maintenance practices inherited from the Soviet era has proved a challenging task.

As such, the World Bank is supporting the Government of Azerbaijan in implementing motorway maintenance reforms through the **Third Highway Project**. The reforms envisage a transition from the heavily fragmented, territory-based management of the motorways network to corridor-based operation and maintenance.

During the first phase of institutional changes, the Bank project helped to establish seven new regional entities in charge of motorway maintenance. After the successful implementation of this phase, the project introduced performance-based contractual relations between the Road Agency and motorway maintenance entities.

The new motorway maintenance enterprises are responsible for routine, winter, and emergency maintenance works, and there are plans to open periodic maintenance services to ensure open competition. The motorway enterprises currently perform a standard set of routine road maintenance and operation activities, such as monitoring and patrolling, cleaning, pavement maintenance, drainage, signalization and signage.

Going forward, the enterprises will be fully responsible for meeting the newly established contractual service standards and performance indicators. Although payments to maintenance enterprises will be made regardless of their inputs, they will be held responsible for maintaining measurable service levels and penalized for each case of non-compliance. Proper implementation of the new business model is expected to help maintain the viability and technical soundness of Azerbaijan's roads and improve traffic safety.



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