

- *Azerbaijan's economy continued to contract in July, despite non-energy activity showing signs of recovery.*
- *Energy GDP remained depressed, as oil production was restricted by OPEC+ quotas.*
- *Slight pickup in energy prices and volumes increased export revenues, turning merchandise trade balance to surplus in July.*
- *CPI inflation remains low and the manat tightly managed.*
- *Announced 2021 budget envisages fiscal consolidation and plans for 35 USD/bbl oil price.*

**The economy continued to shrink in July, though at a slower pace than in June, dragged down by lower oil production.** GDP fell by an estimated 3.4 percent year-on-year (yoy) in July, compared to 7.4 percent yoy in June, bringing growth in the year to July to -2.8 percent. Daily oil production increased by 1 percent in July compared to June, but hydrocarbons value added still declined by almost 17 percent yoy. This brought the contraction in energy output in the first seven months of 2020 to 4.5 percent, driven by a 15-percent decline in daily oil production in compliance with OPEC+ quotas, which was only partially offset by a 10 percent increase in natural gas output. Looking ahead, OPEC+ has started to ease some members' production quotas in early September, which has led to a slip in oil futures prices.

**In contrast, non-energy output registered positive growth for the first time since February, growing at 2.4 percent yoy in July.** This was driven by a one-off surge in construction output, which almost doubled yoy in July, reflecting the completion of several healthcare facilities financed by the government. The contraction in other sectors leveled, except for tourism which slid further in July due to travel restrictions. On the demand side, investment surged by 14 percent yoy in July, reflecting a strong rebound both in public and private investments. Small-payment transactions (5.4 percent yoy increase) and operations with payment cards (3.8 percent yoy increase), point to a pickup in consumption in July but moderating wage growth, stagnant credit, and declining transfers from abroad could be a drag on the recovery.

**COVID-19 infections started declining in August and the government has gradually relaxed mobility restrictions.** Average daily new infections declined to 147 in August, three times lower than in July, and have stabilized since. Average test positivity rates has also fallen from 6 percent in July to 2.3 percent in August. Subsequently, the authorities have gradually lifted many mobility restrictions, allowing resumption of activity of some service sectors and travel to regions from the Baku metro area. Mobility has increased in Baku from 44 percent of pre-COVID levels in end-July to 80 percent in end-August.

**Inflation edged down in July due to continuing food price deflation.** CPI inflation slowed to 2.7 percent yoy in July, from 3.1 percent in June, still within the lower bound of the central bank's target range of 4±2 percent. Food prices dropped by 0.7 percent month-on-month (mom) in July, which brought annual food inflation down to 4.4 percent. Non-food and services inflation also declined slightly, to 1.4 and 1.3 percent yoy, respectively.

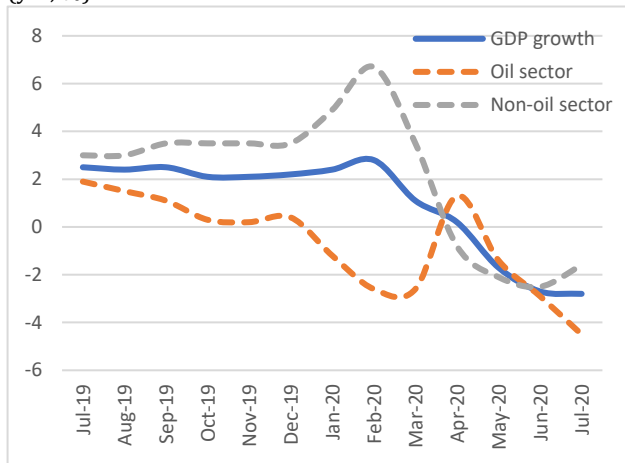
**The country registered a trade surplus of USD 534 million in July, after deficits in May and June, amid a surge in hydrocarbon exports.** Imports recovered on a monthly basis (11 percent mom increase) but exports doubled in July. This was driven by oil and gas exports (150 percent mom increase) due to some recovery in energy prices and a surge in natural gas export volumes to Turkey. On the other hand, non-energy export dropped by 35 percent mom. As of end-July, the trade surplus stood at 13.7 percent of GDP, which is significantly lower than in 2019. This is driven by a 27 percent ytd decline in energy exports, offset only partly by a 30-percent ytd contraction in imports (excluding monetary gold), reflecting weak domestic demand.

**The manat exchange rate remained stable at 1.7 AZN/USD, even as FX demand picked up since July.** The State Oil Fund (SOFAZ) sold USD478 million in August and another USD272 million by September 10. Central bank's reserves increased to USD6.48 billion by end-August, up by about 4 percent since the start of 2020.

**The fiscal balance remained in deficit in July, while the draft 2021 budget points to fiscal consolidation.** Budget revenues contracted by 5 percent yoy as all taxes (except corporate income tax) remained under pressure. COVID-19-related spending pushed expenditures up by 12 percent yoy in July. The fiscal deficit stood at 7.6 percent of GDP in July, pushing the fiscal balance in the first seven months of 2020 to a deficit of 0.5 percent of GDP. The draft 2021 budget envisages a 6-percent yoy cut in budget spending, while capital spending is projected to be cut by 30 percent yoy. The benchmark price for oil was set at 35 USD/bbl while the SOFAZ transfer is projected to remain flat in the medium-term. The government plans to reduce the non-oil/gas fiscal deficit by 6.4 percentage points by 2024. The fiscal rule is expected to be modified and the new rule is expected to be in place by 2022.

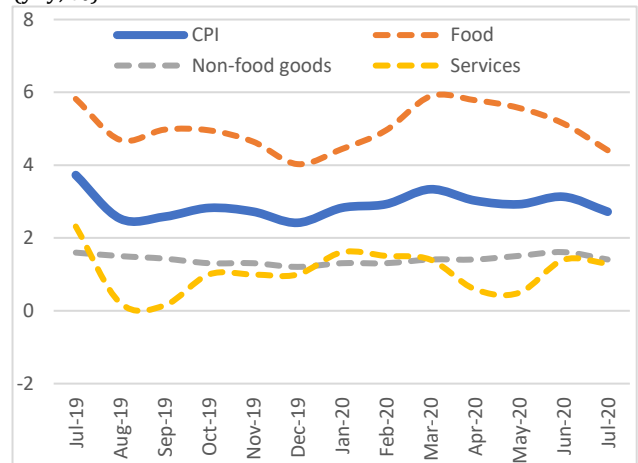
**Credit to economy picked up marginally in July driven by an increase in mortgage loans.** The loan portfolio expanded by 0.2 percent mom in July, as manat mortgage loans rose by 2 percent mom. The share of overdue loans leveled at 7.3 percent of total loans. The decline in deposits slowed as FX deposits fell by 2.4 percent mom and manat deposits rose by 3.3 percent mom. This also led to a 1 percentage point decline in the dollarization rate, bringing it to 59 percent.

**Figure 1. The economy contracted by 3 percent in July, even as non-energy activity started to pick up (ytd, %)**



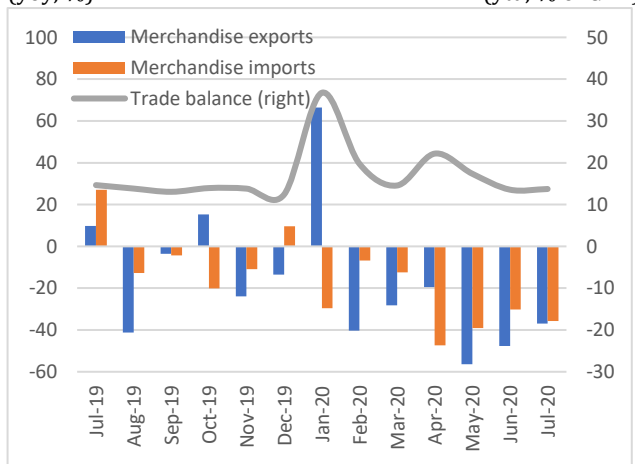
Source: State Statistics Committee

**Figure 2. CPI inflation declined in July, driven by food price deflation (yoy, %)**



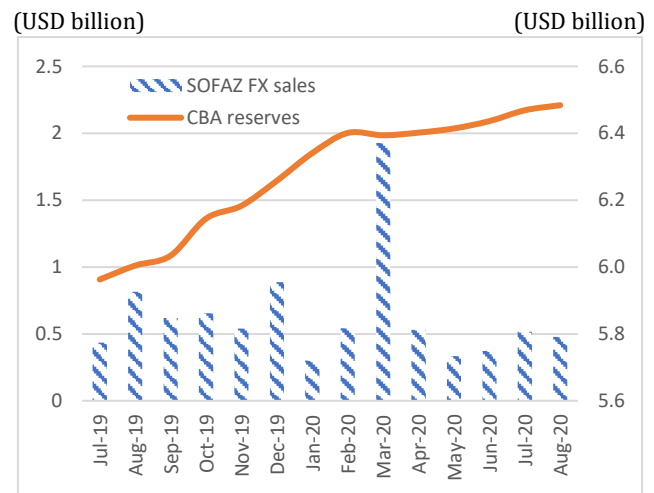
Source: State Statistics Committee

**Figure 3. The trade balance returned to surplus in July, driven by hydrocarbon exports (yoy, %) (ytd, % of GDP)**



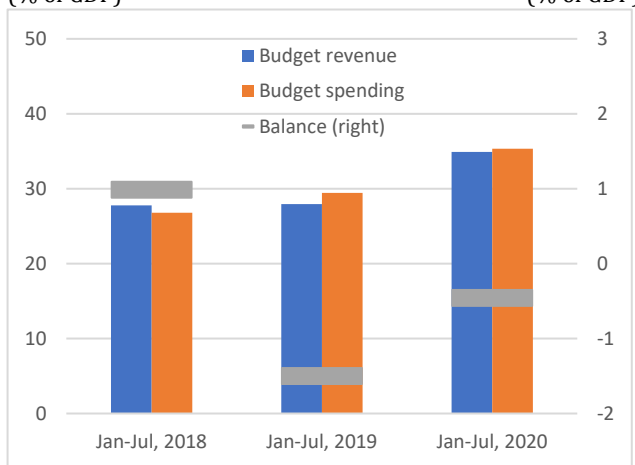
Source: State Customs Committee

**Figure 4. CBA reserves increased in July and August (USD billion)**



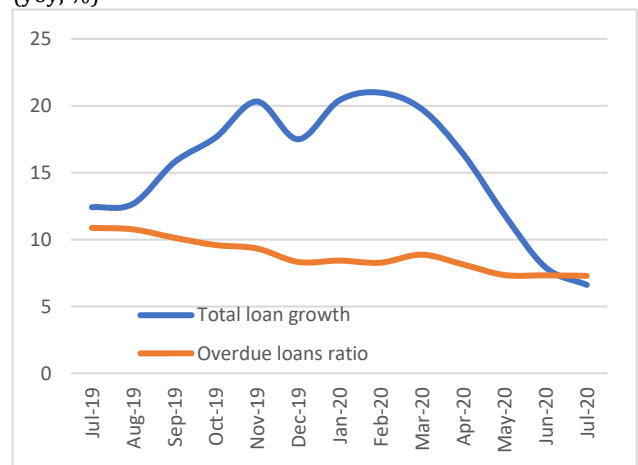
Source: Central Bank of Azerbaijan

**Figure 5. The state budget remained in deficit in July, with sharp increase in spending (% of GDP)**



Source: Ministry of Finance

**Figure 6. Credit to economy recovered slightly in July, while overdue loans plateaued (yoy, %)**



Source: Central Bank of Azerbaijan