

- *GDP growth settled at 2.2 percent in 2019, as oil production continued to stagnate.*
- *Inflation remained low.*
- *Trade surplus narrowed in December, as export growth declined.*
- *Fiscal position strengthened despite a surge in current expenditures.*
- *Credit growth moderated in December but remained relatively high.*

The economy grew by 2.8 percent year-on-year in December and by 2.2 percent in 2019. Hydrocarbon output picked up in December, as natural gas production remained strong, bringing the growth rate for the year to 27.7 percent. In contrast, oil production declined by 3.3 percent in 2019. Non-energy GDP growth leveled at 3.5 percent month-on-month (m-o-m) in December. Growth in agriculture settled at 7 percent, while services recorded a solid expansion during 2019: ICT grew by 15.9 percent, hospitality – by 6.4 percent, and trade – by 3.6 percent. This brought the overall growth for 2019 to 2.2 percent. On the demand side, investment growth picked up in December, particularly in the non-oil economy (where investment increased by 3.6 percent in 2019), but for the year remained anemic and was lower than in 2018. Consumption was supported by a boost in real incomes that grew by 5 percent for the year.

CPI inflation came in at 0.5 percent m-o-m in December, influenced by a seasonal hike in food prices. Prices of services, in contrast, moderated for the same period. As a result, annual inflation softened to 2.4 percent, from 2.7 percent in November. Food prices were up 4 percent yoy whereas non-food and services inflation remained low at 1.2 and 1 percent yoy, respectively.

The Central Bank of Azerbaijan (CBA) further loosened its monetary policy in January 2020. With inflation within the target range of 4±2 percent, the CBA lowered the interest rate to 7.25 percent in January, from 7.5 percent in December. Additionally, the CBA continued to curb liquidity absorption operations, despite considerable market demand. It offered just AZN 100 million in deposit auctions and halved the stock of short-term notes in January 2020, as compared to end-2019.

The trade surplus narrowed in December owing to slowing export. Exports declined by 13.5 percent yoy in December, largely driven by lower oil exports (by 16 percent yoy) reflecting subdued oil production. With this, exports have been contracting on annual basis in four of the last five months. For 2019 overall, exports

went up by 0.9 percent, bolstered by a spike in natural gas and non-oil exports. Imports posted 9.7 percent yoy growth in December, as higher budget spending and investment supported demand. Excluding monetary gold purchases, imports were up by 8.4 percent in 2019. As a result, the merchandise trade surplus in 2019 declined to 12 percent of GDP (from 17 percent a year earlier).

The exchange rate remained at 1.7 AZN/USD amid low demand in FX market. The State Oil Fund (SOFAZ) sold USD 6.6 billion in the FX market in 2019, 2.1 percent more than in 2018. This was sufficient to meet the FX demand of the economy as well as an increase in CBA reserves of 11 percent yoy (to USD 6.3 billion) in 2019. In January, SOFAZ sold USD 300 million, nearly half of the planned amount, as demand for FX was exceptionally low at the beginning of the year.

Strong revenues allowed for significant expansion in fiscal spending and a slightly stronger fiscal position in 2019. Improved revenue collection from non-oil sector, especially VAT, excises and customs, boosted state budget revenues by 8 percent yoy in 2019. State budget spending increased by 7.4 percent yoy in 2019, with 95.8 percent of the budgeted expenditures being executed. Current spending rose by 17.3 percent yoy, reflecting higher wages, pensions and social benefits while capital spending was 4.7 percent higher (yoy) in 2019. This brought the state budget deficit to 0.25 percent of GDP in 2019, a small improvement from 0.4 percent in 2018. The consolidated budget (including SOFAZ) expenditures increased by 0.5 percent in 2019, within the limit defined by the fiscal rule. Consolidated budget revenues, on the other hand, surged by 9 percent yoy, due to higher SOFAZ revenues from asset management and improved non-oil sector collections. Overall, the consolidated budget surplus amounted to 9 percent of GDP in 2019, which boosted SOFAZ's assets by USD 4.8 billion, to USD 43.3 billion.

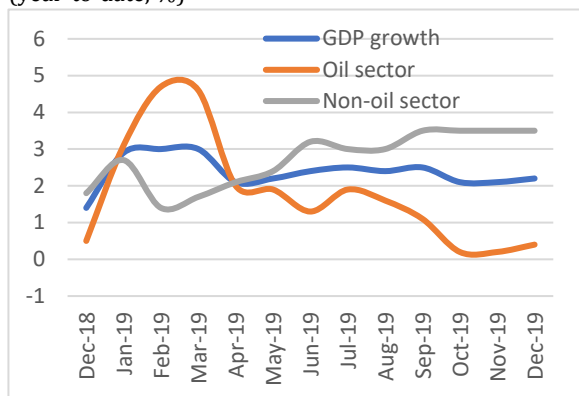
Credit growth moderated in December. After a surge in November due to household FX debt restructuring based on the Presidential Decree from February 2019, credit growth moderated in December. Still, on an annual basis, credit expanded at a healthy 17.5 percent. Dollarization of credit continued to decline and stood at 35 percent in December 2019. Overdue loans decreased further to 8.3 percent of total outstanding loans, a 3.9 pp drop yoy. Deposits increased by 13.1 percent yoy in 2019, with the share of FX deposits declining from 65 to 61 percent yoy, due to higher interest rates in local currency. During December, the transition of supervisory functions of liquidated regulator (FIMSA) to CBA was finalized.

Table 1: Selected macroeconomic indicators

	2014	2015	2016	2017	2018	2019e.
Real GDP growth, in %	2.8	1.1	-3.1	-0.3	1.4	2.2
Inflation, period average, in %	1.4	4.0	12.4	12.9	1.9	2.7
Current Account Balance, in % of GDP	13.6	-0.4	-3.6	4.1	11.4	8.5
excluding oil, in % of GDP	-17.9	-20.4	-25.6	-24.5	-25.8	
Fiscal balance, in % of GDP	2.7	-4.8	-1.1	-1.4	5.9	8.9
SOFAZ assets, in USD billion	37.1	33.5	33.4	36.0	38.5	43.3
Central Bank reserves, in USD billion	13.7	5.0	3.9	5.3	5.6	6.3

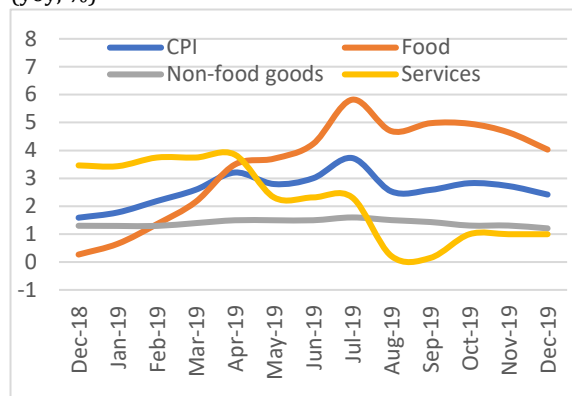
Source: State Statistics Committee, Ministry of Finance, Central Bank of Azerbaijan, World Bank staff calculations

Figure 1. GDP growth settled at 2.2 percent
(year-to-date, %)



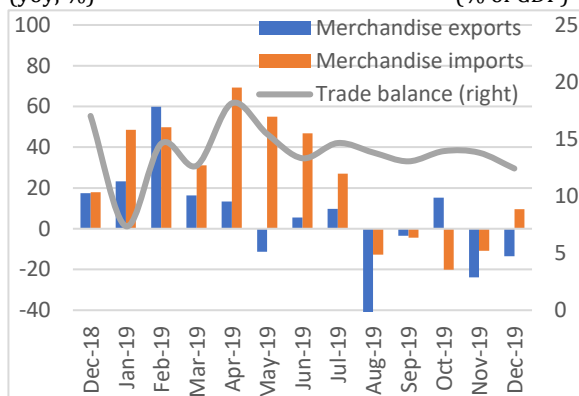
Source: State Statistics Committee

Figure 2. CPI softened to 2.4 percent
(yoy, %)



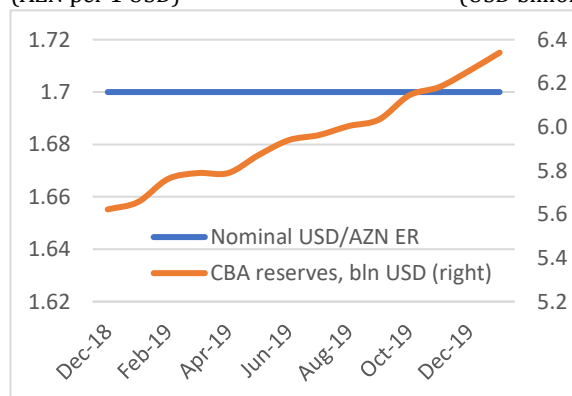
Source: State Statistics Committee

Figure 3. Foreign trade surplus softened
(yoy, %) (% of GDP)



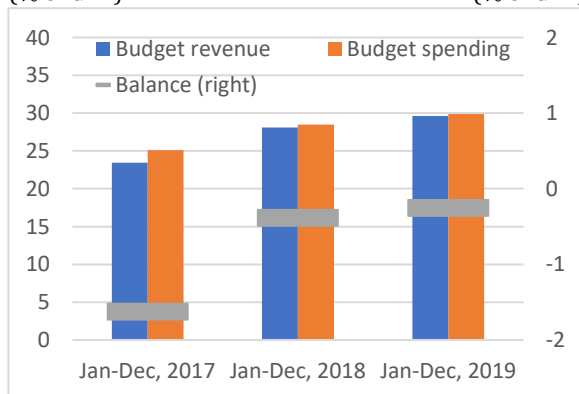
Source: State Customs Committee

Figure 4. CBA reserves exceeded US\$6.3 billion
(AZN per 1 USD) (USD billion)



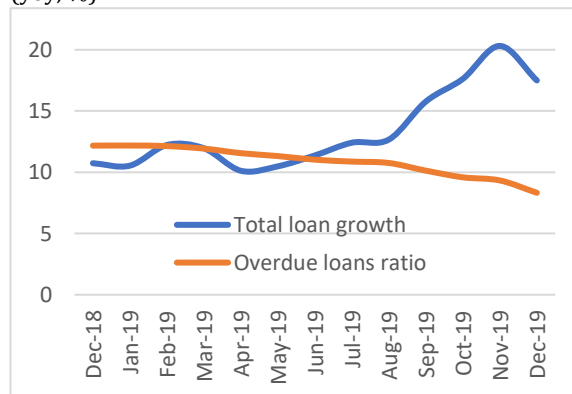
Source: Central Bank of Azerbaijan

Figure 5. State budget recorded a small deficit.
(% of GDP) (% of GDP)



Source: Ministry of Finance

Figure 6: Credit to economy moderated.
(yoy, %)



Source: Central Bank of Azerbaijan