



AZERBAIJAN	2017
Population, million	9.8
GDP, current US\$ billion	40.7
GDP per capita, current US\$	4,184
Life Expectancy at birth, years (2017)	71.8

At a Glance

- Azerbaijan's economy had a very modest recovery in 2017. Benign public financing, improved confidence, and a favorable external environment supported non-oil economic growth, but this was offset by an OPEC-led decline in oil production.
- Going forward, growth is expected to strengthen, driven mainly by a fiscal stimulus, a rise in hydrocarbon prices, and an increase in gas exports.
- High inflation adversely affected household income and reduced real purchasing power. In 2017, an increase in the minimal cost of living and nominal average wages by 11.6% and 6%, respectively, was not sufficient to compensate for higher prices.
- As a result, poverty likely increased in 2017 and was probably worsened by the 50% cut in the coverage of the country's most important social assistance program.

Country Context

Azerbaijan held presidential elections on April 11, 2018, in which the incumbent, Ilham Aliyev, was reelected. He assumed office on April 17, 2018 and is obligated to appoint a prime minister within 30 days. A new cabinet is expected to be appointed within the same period. The new Government will be expected to continue important economic reforms to ensure sustained, inclusive, and equitable growth.

The main challenge facing Azerbaijan is to preserve the reform momentum generated by the economic shock of 2015–16 and strengthen institutions to increase the economy's resilience to future external shocks. However, progress on the structural reform agenda to stimulate private sector participation and job creation remains limited. Moreover, an effective social protection system aimed at poor and vulnerable households is needed to reduce poverty.

The economy had a modest recovery in 2017. Benign public financing, improved confidence, and a favorable external environment supported non-oil economic growth, but this was offset by a decline in oil production.

Going forward, growth is expected to strengthen, driven mainly by a fiscal stimulus, a rise in hydrocarbon prices, and an increase in gas exports. Social conditions remain a major source of concern, as real wages and spending on social protection programs declined in 2017. There were signs of recovery in Azerbaijan's financial sector in 2017, supported by the stabilization of the manat exchange rate and growth across the non-oil sectors.

The World Bank and Azerbaijan

The Country Partnership Framework (CPF) 2015–2020 for Azerbaijan was endorsed by the Board of Directors on July 21, 2015. It is a joint strategy of the World Bank Group (WBG) which aims to support the country on its path to sustainable, inclusive, and private sector-led growth.

Currently, the CPF is undergoing a mid-term review that, among other outcomes, will identify an investment program for the next three years.

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

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

Azerbaijan's economic transformation since independence has required, among other measures, the development of a modern financial sector with a sound payment system, licensed and regulated financial institutions, legal and regulatory frameworks in line with international standards, and key public institutions.

Moreover, economic growth and the shared prosperity agenda have required the rapid development of vibrant and innovative financial products to serve the needs of the corporate and small and medium enterprise sectors and provide Azerbaijani citizens with access to key financial services.

WORLD BANK PORTFOLIO

No. of Projects: 9
Lending: \$2,526.2 Million
IBRD: \$2,349.4 Million
IDA: \$176.8 Million

The World Bank has worked with the authorities to reform the country's financial institutions and develop financial sector infrastructure. Initial Bank support helped create a credit registry, establish a national payments system, and develop a privatization strategy. Later, the Financial Services Development Project (2005–10) helped transform Azerpost into a modern postal and financial services operator.

The most recent Bank support aimed at deepening the financial sector through the development of modern capital markets and new financial instruments to finance businesses and households. The Bank provided lending support under the Capital Markets Modernization Project and complementary technical assistance through the Financial Sector Modernization Project 1.

New legislation, designed in line with international standards, established new requirements for market operators and protection for investors.

In 2017, the World Bank launched a new technical assistance project under the Swiss State Secretariat for Economic Affairs (SECO)-funded Financial Sector Modernization Project 2. The project supports a range of advisory, knowledge-sharing, and capacity-building activities through five components: improving the legal, institutional, and regulatory frameworks for financial markets; enhancing the bank resolution framework; enhancing the deposit insurance framework; advancing market conduct supervision and consumer protection for financial services; and facilitating the resolution of nonperforming loans (NPLs).

Recent Economic Developments

The Azerbaijani economy had a very modest recovery in 2017, as a rebound in the non-oil economy was offset by a contraction in the oil sector due to substantial OPEC-led cuts in oil production and capacity constraints. The non-oil sector rebounded by 2.7% year-on-year (y-o-y), supported by benign public financing, stronger external demand, and improved confidence in response to recovering oil prices. On the downside, and despite higher oil prices, oil GDP contracted by 5% y-o-y.

Annual year-end inflation declined from 15.6% in 2016 to 7.9% in 2017. The high inflation rate recorded for food items (9.4% y-o-y) was due to a strong external demand for agricultural products. To curb inflation, the central bank continued to tighten the monetary policy stance by actively absorbing manat liquidity using deposit auction operations and the issuance of notes.

Higher oil prices, sluggish import growth, and expanded non-oil exports helped improve Azerbaijan's balance of payments in 2017. Exports expanded by 50% y-o-y, led by a rise in oil exports, as oil prices recovered (oil exports accounted for 90% of total exports), while imports increased by 3% (compared to a drop in 2016). Non-oil exports increased by 22%, supported by stronger external demand, mainly from Russia. The current account recorded an estimated surplus of 4.3% of GDP in 2017.

The tightening monetary policy, improved external environment, and transfers from the Oil Fund to the central bank helped to maintain a broadly stable exchange rate at 1.7 AZN per U.S. dollar in 2017.

High inflation adversely affected household income and reduced real purchasing power. In 2017, the increase in the minimal cost of living and nominal average wages by 11.6% and 6%, respectively, was not sufficient to compensate for higher prices. As a result, poverty likely increased

in 2017 and was probably worsened by the 50% cut in the coverage of the country's most important social assistance program.

Economic Outlook

Azerbaijan's economy is projected to expand by 1.8% y-o-y in 2018, supported mainly by the fiscal stimulus. Growth is expected to accelerate in the medium term, driven by an expansion of natural gas production, as the main pipeline that will deliver gas to Europe from the Shah-Deniz II field will be operational by end-2018.

Since the OPEC deal has been extended until the end of 2018, Azerbaijan's crude oil output is not expected to decline much further. Moreover, average oil prices will firm up somewhat in 2018 relative to 2017 and are projected to stabilize at robust levels in the medium term. Non-oil GDP growth is expected to accelerate in 2018, fueled by an 83% y-o-y increase in budgeted public investment. Nevertheless, growth in the non-oil economy is expected to remain moderate due to a protracted recovery of the banking sector and a weak business environment.

The Government of Azerbaijan plans a fiscal stimulus in 2018 by boosting capital spending, which will be primarily financed by an increase in budget transfers from the sovereign wealth fund. The consolidated fiscal balance is likely to be slightly positive in 2018 and is estimated to average 1.3% of GDP in the medium term, as oil prices remain firm and gas exports rise.

To contain inflation, the central bank needs to continue tightening monetary policy. Azerbaijan's external sector is expected to continue to improve due to an increase in hydrocarbon production and a continuation of non-oil export growth, supported by a rise in external demand and enhanced government support to exporters of non-oil products. However, spending cuts on social protection, as well as only a moderate economic recovery, are not conducive to poverty reduction.

Project Spotlight

Azerbaijan Third Highway Project



Since 2001, the World Bank has supported construction of more than 600 km of modern highways and 170 km of local roads.

The World Bank has been supporting Azerbaijan to modernize its transport sector as part of the Government's strategy to diversify the economy and enhance its domestic and international connectivity.

The **Third Highway Project** builds on the results of previous Bank-financed projects in the sector and supports upgrading major motorway sections along the M3 (North–South) and M4 (East–West) transport corridors and improving management and maintenance of the motorway network.

The implementation of the project is in an advanced phase. About 90 km of the M4 motorway have been upgraded to four lanes, with improved safety and resilience to landslides where the road passes through the mountainous areas. This investment has helped provide efficient and safer connectivity from Baku, the largest metropolitan area in the Caucasus, to Shamakhi and the northwestern regions of the country and has reduced road user costs by 20%.

It has also helped to boost the rapidly growing tourism sector in the region and improved the access of agricultural producers and farmers to markets. Another investment under the project is for the M3 motorway, which is part of the North–South corridor, where about 50 km of four-lane motorway sections have been constructed, connecting Baku to southern agricultural regions and the Iranian border.

As the Government is completing infrastructure upgrade investments on motorways, the project's institutional modernization component is helping reform and modernize the management of the recently reconstructed 1,600 km motorway network to ensure the sustainability of these large investments. Under the project, the road administration is going through a major transition process to manage the network based on performance and service-level requirements and to focus on the needs of road users with an improved communications strategy.

The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at <http://www.worldbank.org/azerbaijan>



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