- *The economy expanded by 0.4 percent year on year (yoy) in the first quarter of 2023.*
- *Robust growth in the non-energy sector outweighed contraction in energy sector.*
- *Inflation remained high, at 13.7 percent in March. In response, CBAR increased the policy rate by 25 basis points, to 9 percent.*
- *The trade surplus surged to 20 percent of GDP in March, fueled by high energy prices.*
- *The budget recorded a deficit in March as current expenditures increased.*
- *Credit growth picked up in March.*

The economy expanded by 0.4 percent (year-over-year, yoy) in March and in Q1 2023, held back by a decline in crude oil production. The energy sector contracted by 4 percent (yoy), primarily due to a 7 percent (yoy) decline in crude oil production that offset a 3.3 percent (yoy) increase in natural gas production. The non-energy sector expanded by 4.6 percent (yoy) in March. Construction (32 percent, yoy), ICT (12.5 percent, yoy) and hospitality (16.7 percent, yoy) picked up compared to February. On the other hand, growth rates in the non-oil manufacturing (1.8 percent, yoy), retail trade (2.3 percent, yoy), and transport sectors (-4.3 percent, yoy) slowed. On the demand side, investments increased by 16.2 percent (yoy), primarily supported by the energy sector, and mostly on the Shah-Deniz gas field. Non-energy investments fell by 4.9 percent (yoy) in March due to a slowdown in public investment execution. High frequency indicators point to a recovery in consumption in March, which was possibly affected by the Novruz holidays. For instance, small payments increased by 18.7 percent (mom) in March and credit card transactions rose by 15.6 percent (mom). Money transfers continued to slow in March, declining by 5 percent (mom), while remaining twice as high as last year.

Inflation decreased slightly but remained elevated. In March, annual inflation went down to 13.7 percent from 14.1 percent recorded in February. Food inflation, which stood at 16.9 percent in March, is showing signs of easing, with a monthly increase of 1.3 percent (mom) in March, compared to 1.8 percent (mom) in February. This is consistent with the continued decline in global food prices. After rising in February (by 2 percent mom) due to an increase in tariffs on passenger transportation, service inflation slowed markedly to 0.2 percent (mom) in March. Non-food inflation rose by 0.3 percent (mom) in March, compared to 0.4 percent (mom) in February, largely due to an increase in the cost of imported goods.

To address persistently high inflation, the CBAR raised the policy rate by 25 basis points to 9 percent in early May. Inflation remained elevated as cost drivers remained strong, with Agriculture PPI increasing 11.8 percent in Q1 2023 and a recent rise in administrative tariffs. Accommodative fiscal policy, such as increases in minimum wages and social benefits, bolstered domestic demand.

The trade surplus rose from 16.8 percent of GDP in February to 20 percent of GDP in March, fueled by energy exports. Exports rose by 60 percent (yoy) in March, supported by energy exports (69 percent yoy), which increased due to high energy prices. Non-energy exports fell slightly (2 percent yoy) due to a decline in petrochemical exports. The increase in exports offset a substantial increase in imports (44 percent yoy), driven by imports of machinery, transport vehicles, and metals.

The manat exchange rate remained unchanged at 1.7 AZN/USD amid sluggish FX demand. SOFAZ's FX sales increased by 7.7 percent (mom) in March, but remained 27 percent lower than a year ago. According to CBAR, in the first four months of 2023, FX supply exceeded demand in almost all auctions. The real effective exchange rate appreciated by 8.8 percent (yoy) in March. Low FX demand enabled the CBAR to build up reserves, and, by end-April, reserves stood at USD 9.1 billion, or 5.1 months of imports. SOFAZ reserves also increased by 9 percent in Q1 2023 compared to end-year 2022, reaching USD 53 billion (68 percent of 2022 GDP).

The budget recorded a deficit in March. Budget expenditures decreased by 1.3 percent (yoy) in nominal terms in March. This was driven by a decline in public investments (40 percent yoy) as execution slowed. On the other hand, current spending increased by 5.6 percent (yoy) mainly due to an increase in public sector salaries and social benefits. Budget revenues increased by 1.1 percent (yoy) in nominal terms in March. Non-energy sector revenues surged by 66 percent (yoy), supported by strong tax collection due to high inflation and robust growth in the non-energy sectors, as well as strong customs revenues due to the recovery in imports. In contrast, energy sector revenue fell in March by 45 percent (yoy) due to a 27 percent (yoy) decline in SOFAZ transfers to the budget, and a high base effect stemming from high profit taxes on natural gas production recorded a year ago. Overall, the budget balance recorded a deficit of 1.6 percent of GDP in March, reducing the budget surplus in Q1, 2023 to 5.7 percent of GDP.

Credit to the economy accelerated in March. The loan portfolio expanded by 1.5 percent (mom), up from a 0.4 percent (mom) growth in February. The increase in loans was broad-based, with both business and consumer loans increasing by 1.2 percent (mom). The deposit portfolio fell by 1.8 percent (mom) in March, primarily due to a 10 percent (mom) decline in corporate FX deposits. In contrast, household deposits grew by 0.5 percent (mom), supported by a 1.3 percent (mom) increase in manat deposits. Bank profits rose by 70 percent (mom) in March, while remaining 19.2 percent lower than a year ago.

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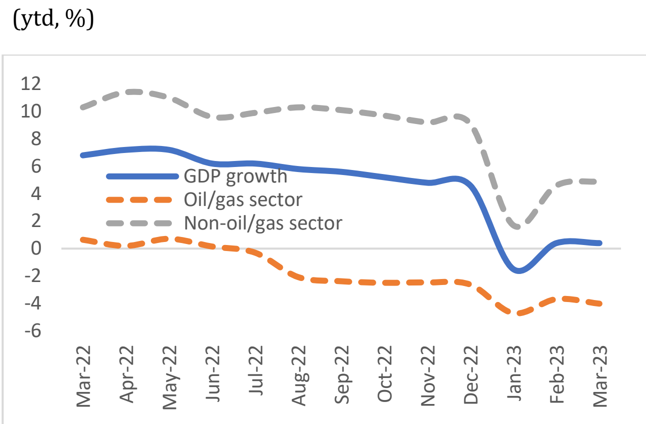
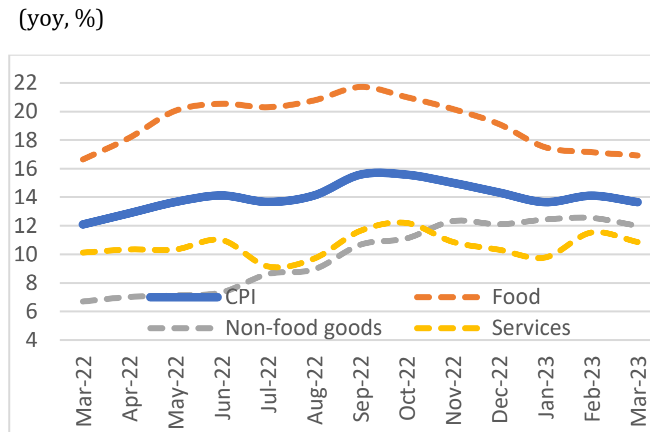
Figure 1. The economy expanded slightly in Q1 2023 held back by the energy sector



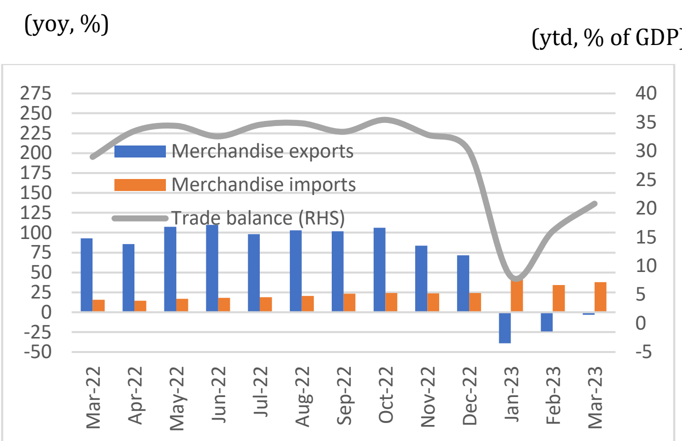
Source: State Statistics Committee

Figure 2. Inflation eased but remained elevated in March



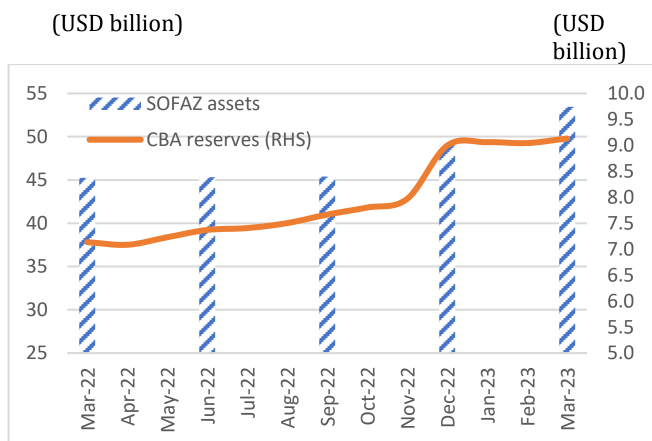
Source: State Statistics Committee

Figure 3. The trade surplus rose markedly, fueled by energy exports



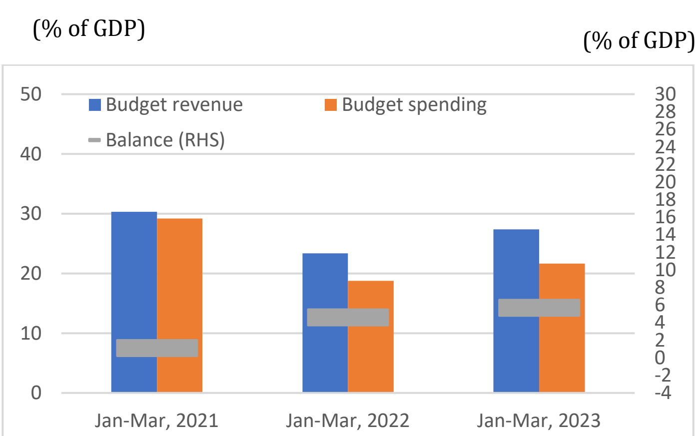
Source: State Customs Committee

Figure 4. CBA and SOFAZ reserves climbed in March



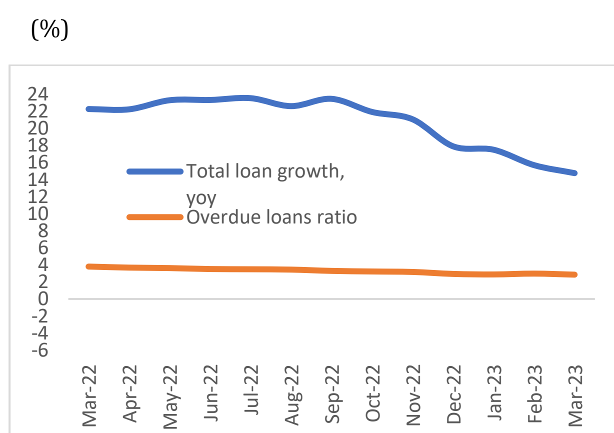
Source: CBA

Figure 5. The state budget recorded a deficit in March, while remaining in surplus in Q1 2023



Source: Ministry of Finance

Figure 6. Credit growth continued to slow



Source: CBA