- *Economic activity expanded robustly in February owing to a strong non-energy sector performance.*
- *Annual inflation further slowed in February to 0.7 percent.*
- *The Central Bank of Azerbaijan (CBA) cut the policy rate in response to slowing inflation.*
- *The trade surplus widened in February, supported by energy exports.*
- *The budget recorded a deficit equivalent to 2.6 percent of GDP in February.*

Economic growth picked up markedly in February to 5 percent (yoy), boosted by strong expansion in non-energy sector activity. Crude oil production stabilized at 598 thousand barrels per day in February, similar to January, while natural gas production expanded by 3 percent (yoy). The non-energy sector grew by 8 percent (yoy) in February. High growth was supported largely by construction and non-energy manufacturing. The construction sector expanded by 33 percent (yoy) in February on the back of increased public investments in reconstruction. Meanwhile, non-energy manufacturing grew by 18.9 percent (yoy), supported by solid expansion in chemicals, construction materials, and metallurgy. Growth in hospitality and ICT was also robust, while agriculture output edged down.

On the demand side, investment declined by 6 percent in February, dragged down by a 9.5 percent fall (yoy) in energy sector investment. Non-energy sector investment inched down by 1 percent (yoy) in February after expanding by 34 percent (yoy) in January. High-frequency indicators point to robust consumption growth, with small payments and credit card transactions increasing by 15.3 and 13 percent (mom), respectively.

Annual inflation slowed to 0.7 percent (yoy) in February. CPI inflation rose by 0.6 percent (mom) due to a 0.7 percent (mom) increase in food prices. Growth in food prices decelerated to 0.3 percent (yoy) in February. Non-food prices edged up by 0.1 percent (mom), while service prices remained flat in February.

The CBA cut the policy rate in March in response to low inflation. On March 28, the CBA cut the policy rate by 25 basis points to 7.5 percent citing inflation remaining within the target interval, inflation expectations having stabilized, and risks to the inflation outlook being more balanced. The CBA kept its annual inflation forecast for 2024 unchanged at 5.3 percent but hinted that, if low inflationary pressures continue, it could be revised down.

The trade surplus widened in February, bolstered by robust hydrocarbon export growth. Exports increased by 11 percent (yoy) in February, driven largely by a 19.3 percent (yoy) increase in hydrocarbon exports. In contrast, non-hydrocarbon exports fell by 36 percent (yoy) in February against a backdrop of a high base effect (due to sizable electricity exports recorded a year ago). Imports increased by 5.3 percent (yoy) in February. As a result, the cumulative trade surplus widened to 21.3 percent of GDP in February compared to 13 percent of GDP in January.

During 2023, the current account surplus moderated to 11.5 percent of GDP while financial outflows fell sharply. The current account surplus eased due to: (i) a fall in the foreign trade surplus as exports fell due to energy exports amid solid increase in imports; (ii) widening service balance deficit owing to increased service imports from the energy sector; and (iii) a sharp fall in remittances from Russia, which dropped by 65 percent (yoy) in 2023. On the other hand, the primary income deficit declined markedly as profit repatriation by natural gas companies slowed and tourism inflows increased by 81 percent (yoy) in 2023. The financial account deficit also declined in 2023 as capital repatriation by natural gas firms fell by 70 percent (yoy).

The exchange rate remained stable at AZN 1.7/USD, while FX demand cooled somewhat in February. SOFAZ sold USD 498 million in February, 40 percent higher than in February 2023. On the other hand, FX demand eased considerably compared to January, when SOFAZ sold USD 921 million. CBAR reserves remained unchanged at USD 11.6 billion by end-March.

The state budget recorded a deficit amid a marked increase in spending. Budget revenues increased by 63 percent (yoy) in February, aided by a 2.4 times (yoy) increase in hydrocarbon sector revenues. A large increase in hydrocarbon revenues was due to a 2.6 times (yoy) increase in SOFAZ transfers in February to fund a substantial increase in spending. Budget spending increased by 60 percent (yoy) and was broad based. Capital spending saw a larger rise, posting a 2.5 times (yoy) increase due to a surge in public investment in reconstruction, while current spending picked up markedly (40 percent yoy). The budget deficit amounted to 2.6 percent of GDP in February.

Credit to economy increased robustly in February, while there was some decline in foreign currency deposits. Banks' credit portfolio expanded by 1.1 percent (mom) in February aided by a 1.2 percent (mom) increase in business loans and a 0.9 percent (mom) increase in consumer loans. On the other hand, the deposit portfolio contracted by 1.2 percent (mom), driven by a 4.3 percent (mom) fall in FX deposits, while manat (AZN) deposits grew by 1 percent (mom). As a result, deposit dollarization fell from 42 percent in January to 40 percent. in February. Bank profits expanded by 35 percent (yoy) in February.

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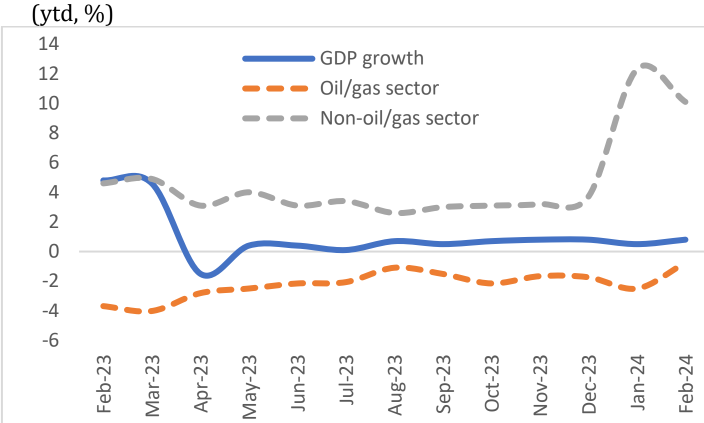
Figure 1. Growth picked up strongly in February aided by the non-energy sector

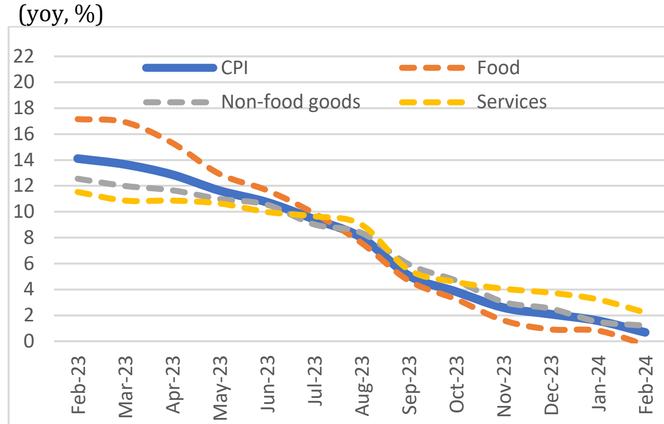
(ytd, %)



Source: State Statistics Committee

Figure 2. Annual inflation slowed to 0.7 percent

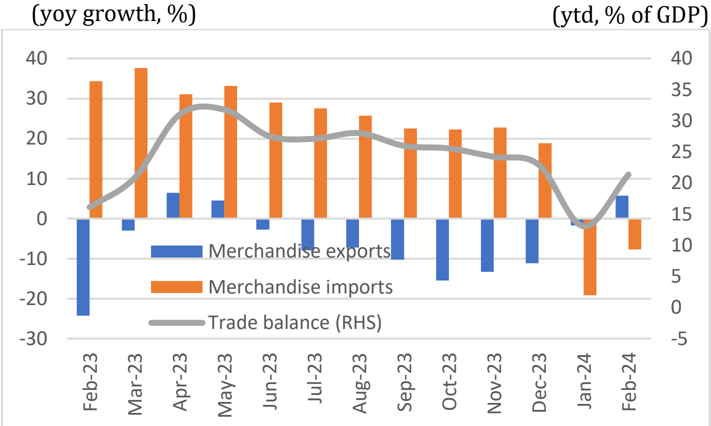
(yoy, %)



Source: State Statistics Committee

Figure 3. The trade surplus widened in February due to high energy exports

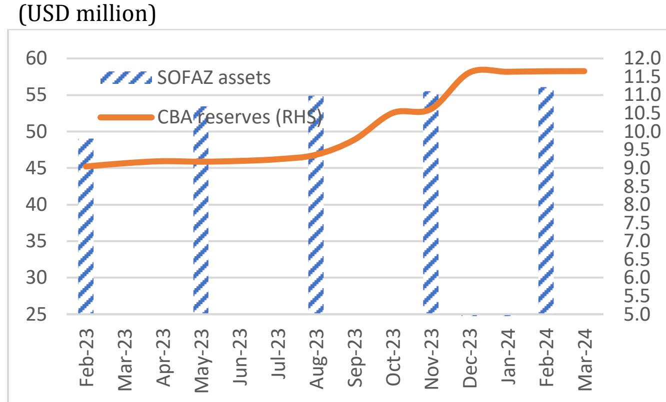
(yoy growth, %) (ytd, % of GDP)



Source: State Customs Committee

Figure 4. CBA reserves plateaued in February

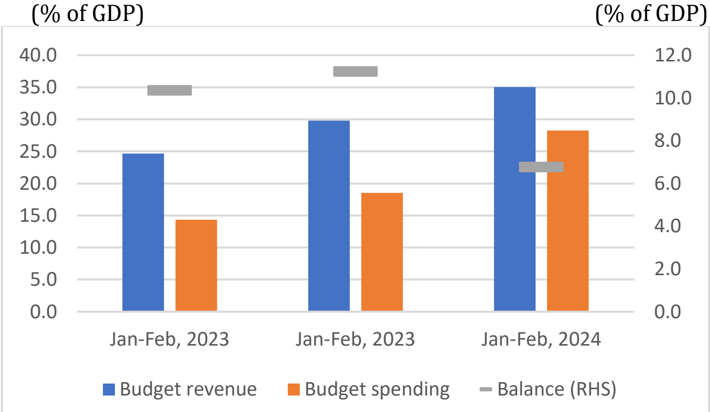
(USD million)



Source: CBA

Figure 5. The budget recorded a deficit in February as spending increased

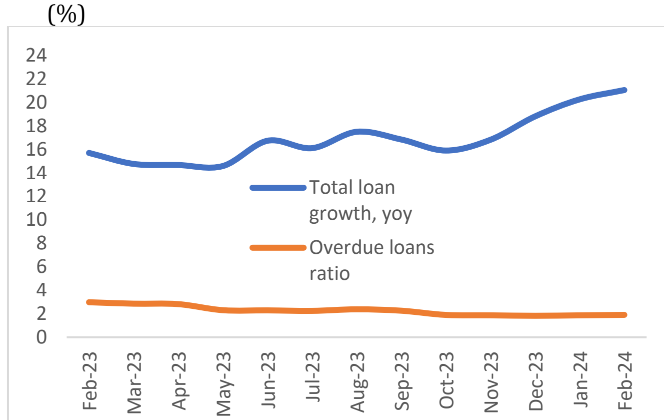
(% of GDP) (% of GDP)



Source: Ministry of Finance

Figure 6. Credit to the economy is growing robustly

(%)



Source: CBA

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