

- *Economic growth was solid in January 2022 led by non-oil/gas sectors.*
- *Inflation continued to climb in January particularly for food items.*
- *External trade surplus soared in January owing to rising energy revenues.*
- *Credit to economy was stable in January.*
- *State budget was in large surplus in January reflecting strong revenues and expenditure restraint.*
- *The war between Ukraine and Russia poses significant risks to Azerbaijan's outlook.*

Economic growth was solid in January, led by the non-oil/gas sectors.

The economy grew by 5.8 percent year on year (yoy) in January. While energy sector growth continued to be subdued at 0.6 percent yoy, non-energy sectors kept expanding robustly by 8.8 percent yoy. Non-oil/gas manufacturing grew by 24 percent yoy and transportation by 18.4 percent yoy. Services also continued to recover with retail trade expanding by 3.3 percent yoy, hospitality more than doubling yoy (from a low base), and ICT growing by 10.6 percent yoy. Agriculture turned to growth, 2.7 percent yoy, after three months of consecutive contraction. Construction was the only sector in decline, contracting by 7.9 percent yoy, in January. On the demand side, consumption kept growing, as evidenced by a strong 55 percent yoy increase in debit and credit card transactions. On the other hand, investment was down by 11.1 percent yoy in January, with both public and private non-energy investment contracting.

Recorded COVID-19 cases have declined since end-February and the authorities lifted restrictions. By early March, daily recorded COVID-19 cases were almost ten times lower than during the Omicron peak in mid-February. On March 5, the government eased several pandemic restrictions including lifting limitations on mass gatherings.

Inflation continued to climb in January, propelled by persistently rising food prices. CPI inflation increased by 1.6 percent month on month (mom) in January, pushing yoy inflation to 12.4 percent the same month. Food inflation rose 2.6 percent mom to reach 17 percent yoy in January. Non-food and services inflation stood at 6.1 and 11.1 percent yoy respectively in January. The Central Bank of Azerbaijan (CBA) has not changed its policy rate since January 28, 2022.

The trade surplus surged in January, owing to high energy exports. Energy exports nearly doubled yoy in January, due to higher energy prices and increase in natural gas production. Non-energy exports also picked up strongly, posting 61.1 percent yoy growth in January driven by exports of petrochemical products. Imports rose by 23.8 percent yoy in January, in line with the recovery in domestic demand and higher import prices. The trade surplus amounted to USD 2.1 billion or 38.8 percent of GDP in January.

The manat remained stable at 1.7 AZN per USD while FX sales slowed in February. State Oil Fund (SOFAZ) FX sales nearly halved mom in February and were 15.1 percent lower yoy. CBA reserves picked up slightly in February, as compared to January, and stood at USD 7.2 billion.

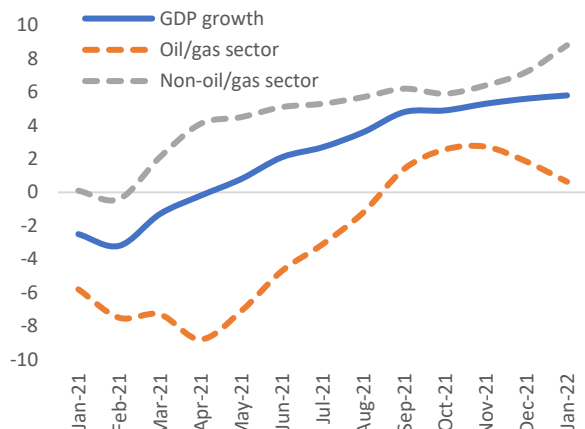
The state budget recorded a large surplus in January. State budget revenues increased by 18.4 percent yoy in January, owing to a 49 percent yoy increase in collection of non-energy revenues, including: VAT collections from domestic consumption rising by 63.9 percent yoy and from imports by 53.6 percent yoy. Budget spending, in contrast, declined by 20.2 percent yoy in January, with current spending falling by 10 percent yoy and public investment plummeting by 70.3 percent yoy. As a result, the budget balance recorded a surplus of 19.1 percent of GDP in January. The consolidated budget surplus amounted to 23.4 percent of GDP benefiting from strong SOFAZ revenues.

Growth in credit to the economy remained stable in January. Loan portfolio slightly rose in January, by 0.7 percent mom. Business loans remained stable while consumer loans posted a 2.2 percent increase mom in January. Deposit portfolio was intact in January, as an increase in foreign currency deposits was offset by a decline in local currency deposits. As a result, dollarization rose slightly to 51 percent in January from 49 percent recorded in December 2021. Bank profits were solid at AZN 58.6 million, more than doubling yoy.

The economy is expected to be adversely impacted by the war between Russia and Ukraine through potential loss of market for Azerbaijan's non-energy exports, access to vital imports, inflation, and the loss of assets. While the country's non-energy exports are relatively small, Russia is the main destination for these exports, accounting for 32 percent of country's total non-oil/gas sector exports in 2021, or 4 percent of total exports (2.5 percent of GDP). The vast majority of these exports are food products and this trade has picked up significantly in the past five years. While there may be opportunities to expand market share on the Russian market if it closes to other exporters, Russian demand may be driven down by the loss of value of the ruble. On the imports side, the country is reliant on wheat imports from Russia and Ukraine which poses potential risks to food security, especially among the poor. In addition, surging global food prices will add to already elevated domestic food inflation. The war and sanctions will also likely erode the value of Azerbaijani investments in Russia and Ukraine, although these do not represent a significant share of GDP.

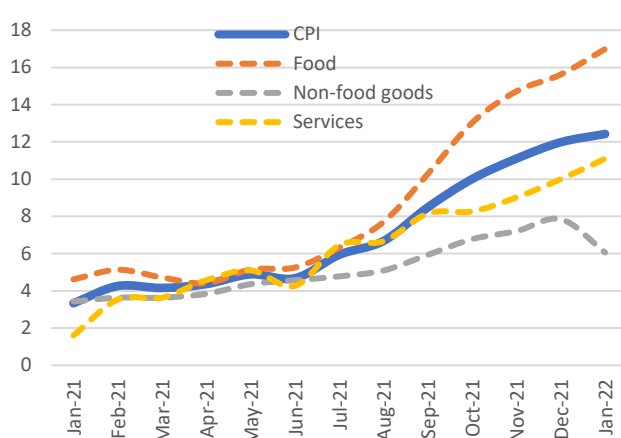
Global energy prices skyrocketed in February supporting fiscal and external balances. Brent oil futures reached 130 USD/bbl in March as energy markets were disrupted by the war. Azerbaijan is abiding by the production quotas agreed with OPEC+ and a potential increase in oil production will depend on OPEC+ decisions and existing production capacity which has been declining in the past decade. On the upside, Azerbaijan's state budget is based on an oil price of 50 USD/bbl and, hence, rising energy prices will provide a windfall to fiscal and external balances.

Figure 1. Economic growth remained solid in January.
(ytd, %)



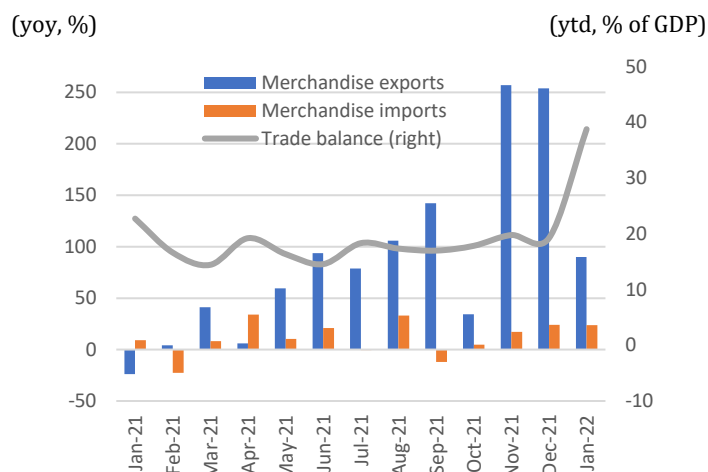
Source: State Statistics Committee

Figure 2. Inflation continued to climb in January.
(yoy, %)



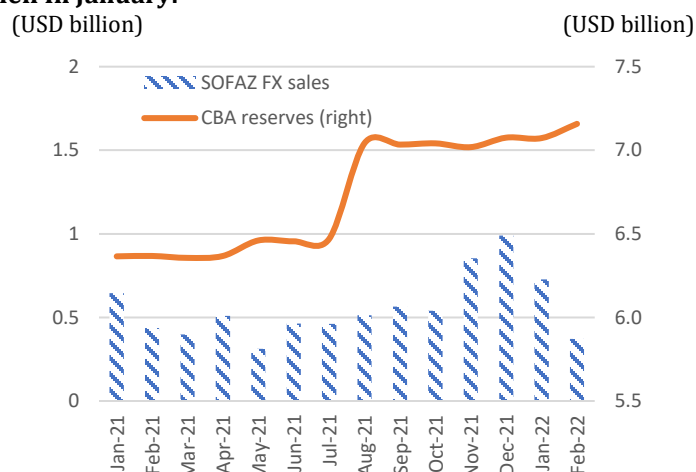
Source: State Statistics Committee

Figure 3. Trade surplus surged in January.



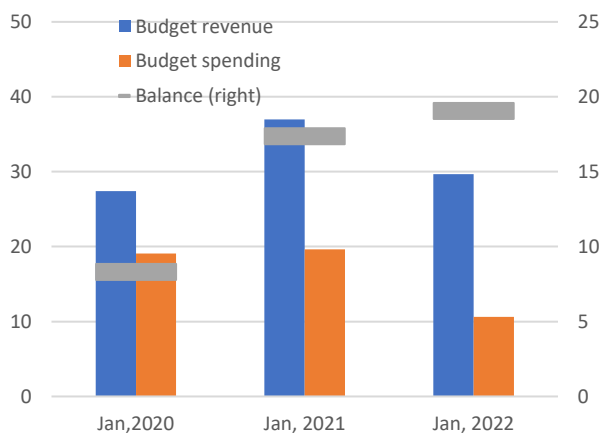
Source: State Customs Committee

Figure 4. CBA reserves stabilized while SOFAZ FX sales fell in January.



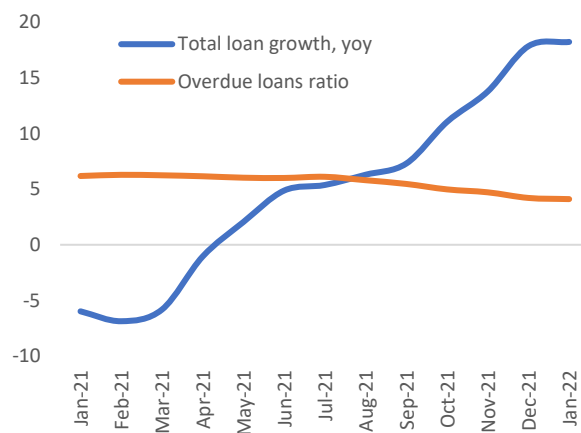
Source: Central Bank of Azerbaijan

Figure 5. State budget recorded a surplus in January.
(% of GDP)



Source: Ministry of Finance

Figure 6. Credit to economy levelled in January.
(%)



Source: Central Bank of Azerbaijan