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Azerbaijan's Economy in 2026: Expectations and Challenges

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Abstract

This research evaluates the risks and challenges of Azerbaijan's socio-economic development during the 2026 reporting year, within the geopolitical context of the Venezuelan political crisis and other potential events (such as the Russia-Ukraine war, Israel-Iran confrontation, and US-China trade tensions) amid oil price volatility. According to international sources (IEA Oil 2025, EIA), oil prices are expected to stabilize within the \$51-66 range in 2026 due to oversupply, though short-term risks may cause temporary increases. For instance, while an increase in Venezuela's daily oil production from 1 million to 2 million barrels could impact prices, it is anticipated that Venezuela will not have a significant market impact this year due to limited technological, financial, and time-related constraints regarding production expansion. In this context, to ensure the sustainability of socio-economic development, Azerbaijan must focus on economic diversification and replacing oil revenues with alternative income sources.

Keywords: GDP, budget revenues, budget expenditures, economic development, oil prices.

INTRODUCTION

Forecasts for the Azerbaijani economy in 2026 demonstrate discrepancies between local and international assessments. While local official authorities maintain an optimistic outlook, international organizations such as the International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD), and the Asian Development Bank (ADB) anticipate more moderate growth. Independent analyses, including research by the Center for Economic and Social Development (CESD), predict limited development against the backdrop of global and regional challenges. The government expects economic growth to reach 2.9%, primarily driven by the non-oil sector. For 2026, state budget revenues are projected at 38.609 billion AZN (28.8% of GDP), with expenditures at 41.704 billion AZN (31.1% of GDP), resulting in a projected deficit of 3.095 billion AZN (2.3% of GDP). The current year's budget is based on a projected oil price of \$65 per barrel, which is considered a maximalist approach. While wages and pensions are expected to increase in nominal terms, an inflation rate of 4.8% is anticipated to limit real growth. This analysis has been conducted based on academic literature and official sources.

1. Literature review

This literature review has been prepared based on the sources utilized. The literature focuses primarily on themes of oil dependency, diversification, fiscal policy, social expenditures, and economic growth within the Azerbaijani economy. With a significant portion of the sources comprising the works of Vugar Bayramov, the review analyzes the challenges and potential Azerbaijan faces as a resource-rich country. Common themes include oil shocks, fiscal management, international integration, and sectoral development. This review has been synthesized within the context of perspectives and challenges for the 2026 budget and establishes a historical and theoretical foundation for the current year's state budget. The literature review is categorized into the following areas:

1.1. Oil Dependency and Economic Diversification

The primary objective of this research is to examine the vulnerability of Azerbaijan's oil-dependent economy to shocks and the necessity for diversification. Bayramov and Orujova (2017), analyzing the impact of oil price shocks in resource-rich Turkic countries (Azerbaijan, Kazakhstan, Turkmenistan), emphasize the low levels of economic and export diversification. These nations are characterized as subsidized economies where state expenditures and consumption are financed by resource revenues, creating significant susceptibility to external shocks. As a means of recovery, specific diversification strategies are recommended.

Bayramov V. and Abbas G. (2017), investigating oil shocks in the Caspian Basin, highlights the critical importance of diversification policies for subsidized economies. The authors state that effective management of oil revenues would enhance economic stability. Furthermore, Bayramov (2016), in an analysis of the 2015 Azerbaijani economy, underscores new opportunities for diversification (development of non-oil sectors) while demonstrating the negative impact of falling oil prices on GDP.

Analyzing the efficient utilization of oil revenues, Bayramov (2009) recommends budget transparency and diversification to end dependency. Bayramov et al. (2011) examine the management of resource revenues in resource-rich Central Asian and Caucasian countries (using Azerbaijan as a case study), emphasizing the role of oil funds and investments.

Perspectives and Challenges for the 2026 Budget: As oil price volatility is expected to persist, the budget should allocate more investment toward non-oil sectors (e.g., SMEs, tourism). Challenge: A decline in oil revenues may increase the budget deficit, at the same time, diversification has the potential to stimulate growth.

1.2. Fiscal Policy and Economic Growth

Academic sources examine fiscal policy through various lenses, analyzing its impact on growth. Kudrin and Knobel (2017) investigate fiscal policy as a source of economic growth, evaluating the multiplier effect of the structure of government spending (e.g., prioritizing education and healthcare). The authors demonstrate that budget changes in Russia between 2011 and 2017 had a negative impact on growth (an annual loss of 0.3%); however, they suggest that a shift toward productive expenditures could enhance growth.

Idrisov and Sinelnikov-Murilev (2013), analyzing fiscal policy and economic growth, recommend the optimization of tax and expenditure structures. Alekberov (2005) and Khankishiyev (2002) explore the role of the unified budget system and the budget process within the Azerbaijani context, emphasizing the effectiveness of budget classification.

Barro (1991), analyzing economic growth across 98 countries, shows that the initial level of human capital (education) is positively correlated with growth, whereas government consumption expenditures are negatively correlated. Bose et al. (2007) conduct a disaggregated analysis of public expenditures in developing countries, stating that capital expenditures (investment) stimulate growth, while current expenditures have a negative impact.

Born et al. (2013) investigate currency regimes and fiscal multipliers, finding that the government spending multiplier is larger under fixed exchange rate regimes. Baldacci et al. (2008) analyze the impact of social spending on human capital and growth, demonstrating that social investments (education, healthcare) indirectly bolster growth in developing countries.

1.3. Social Policy and Human Capital

Bayramov et al. (2021), conducting an analysis of social policies in Azerbaijan, recommend the further development of social expenditures. This aligns with the findings of Baldacci et al. (2008), where social spending stimulates growth through the enhancement of human capital.

Perspectives and Challenges for the 2026 Budget: Increasing social expenditures (healthcare, education) will ensure social stability; however, while this creates a budgetary burden, it will support long-term economic growth through the advancement of human capital in the future.

1.4. International Integration and Sectoral Development

Bayramov (2008) compares the WTO accession processes of CIS countries and analyzes pathways toward European integration. Bayramov (2010) investigates the advantages and disadvantages of Azerbaijan's accession to the WTO, noting the benefits of export liberalization alongside the potential losses for non-competitive sectors.

Bayramov et al. (2023) analyze the economic impacts of the "Belt and Road Initiative" on the South Caucasus and Central Asia, stating that infrastructure investments will stimulate growth.

Sectoral Analysis: Bayramov and Hasanov (2017) compare the development of SMEs in Azerbaijan, emphasizing their economic role and recommending policies to support their growth. Bayramov et al. (2011) examine the tourism sector, noting its diversification potential (accounting for 8% of global exports). Bayramov (2014) conducts an evaluation of sectoral policies by analyzing competitiveness in Azerbaijan.

Perspectives and Challenges for the 2026 Budget: WTO integration may increase exports, yet it remains necessary to protect domestic sectors. The "Belt and Road Initiative" will contribute to the economic development of Azerbaijan and other South Caucasus nations, stimulating the growth of infrastructure investments. In the long term, supporting the development of the tourism sector and SMEs will ensure the growth of the non-oil sector.

1.5 Conclusion

The findings presented above recommend policies focused on diversification, productive expenditures, and integration for Azerbaijan's 2026 budget. While oil dependency remains the primary challenge, social and sectoral investments create significant prospects. A balanced approach within the budget—stabilizing revenues while optimizing expenditures—can effectively support economic growth. The sources synthesized here bridge resource management and growth theories.

Literature regarding Azerbaijan's budget system and economic development emphasizes the role of unified budget mechanisms. Alekberov (2005), analyzing the integration of the budget system into the state's socio-economic development, highlights its importance in the efficient allocation of resources and its contribution to growth, while noting the necessity for diversification. Khankishiyev (2002) explores the budget process and classification, emphasizing the significance of the planning and execution stages. In modern literature, CESD (2025) analyzes economic expectations for 2026, focusing on reducing oil dependency. The ADB Strategic Document (2025-2029) prioritizes green development and sustainable growth. The IEA "Oil 2025" report forecasts the global oil market and discusses the supply-demand balance. Other sources, such as IMF projections (2025), cover inflation and growth dynamics, while the EIA (2025) addresses oil prices. These literatures integrate fiscal stability, diversification, and global influences to shape the context of perspectives and challenges for Azerbaijan's 2026 budget.

The growth of the Azerbaijani economy in 2026 is projected at 2.9%, with GDP expected to reach 134.1 billion AZN. This is slightly lower than the 3.0% forecast for 2025. The non-oil sector is projected to reach 101.7 billion AZN (5% growth), while the oil and gas sector is expected to stand at 32.4 billion AZN (an 11.0% decline). CESD (2025) notes that the non-oil sector serves as the engine of growth, though oil dependency (comprising 90% of exports) remains a constraint. The ADB Strategic Document (2025-2029) recommends green development (e.g., renewable energy), which could support long-term growth. International forecasts (IMF, EBRD) indicate a range of 2.5–3.0%, influenced by the global slowdown (such as declining demand in China).

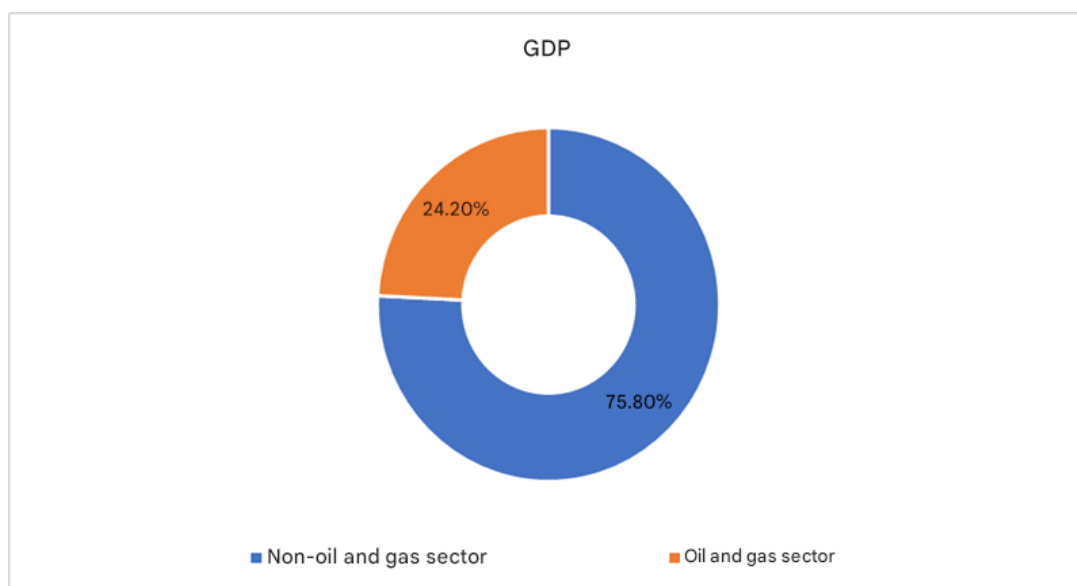
Macroeconomic Indicators for 2026

Maintaining the development dynamics of previous years, the Azerbaijani economy produced 116.3 billion AZN in Gross Domestic Product (GDP) during January–November 2025, representing a 1.6% increase

compared to the same period of the previous year. Value-added in the non-oil and gas sector of the economy grew by 3.2%, which directly confirms the expansion of the non-oil sector. During the first eleven months of 2025, positive growth was recorded in the execution of both the state and consolidated budgets; during this period, consolidated budget revenues reached 43.8552 billion AZN, exceeding the forecast by 6.1% or 2.526 billion AZN. State budget revenues amounted to 35.6256 billion AZN, which was 324.6 million AZN or 0.9% above the forecast. Meanwhile, consolidated and state budget expenditures during the same period were executed at 36.7843 billion AZN and 31.4147 billion AZN, respectively. In 2025, strategic foreign exchange reserves—the foundation of macroeconomic stability—reached 83.5 billion USD, while external public debt accounted for only 6% of GDP.

In 2026, GDP is expected to increase by 2.9% in real terms, reaching 134.1 billion AZN, with the share of the non-oil and gas sector within the GDP projected to rise to 75.8%. According to forecasts, GDP in the oil and gas sector is expected to decrease by 2.4% in real terms, while non-oil and gas GDP is projected to grow by 5% in real terms, reaching 101.7 billion AZN. For the current year, the price of "Azeri Light" crude oil has been set at \$65 per barrel.

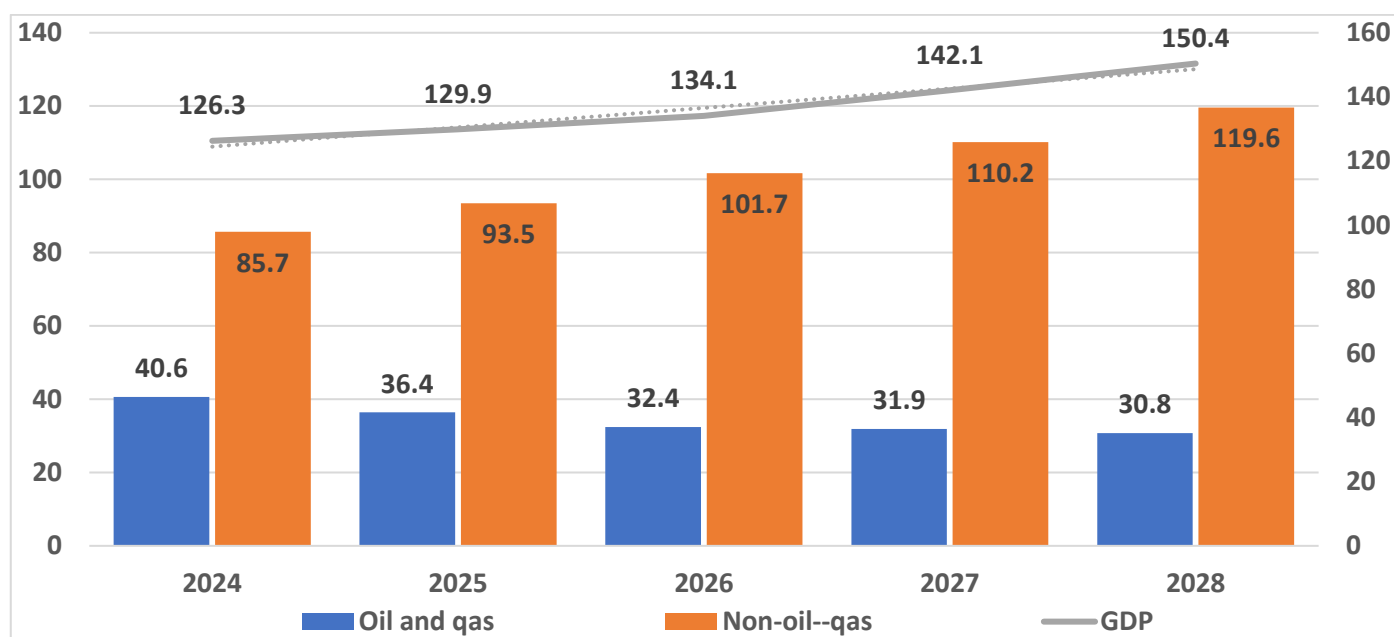
Figure 1. Shares of the oil-gas and non-oil-gas sectors in GDP for 2026, in percentages



Source: Chamber of Accounts of the Republic of Azerbaijan

By 2028, the volume of GDP is expected to increase to 150 billion AZN, with the specific weight of the non-oil and gas sector projected to rise to 80%.

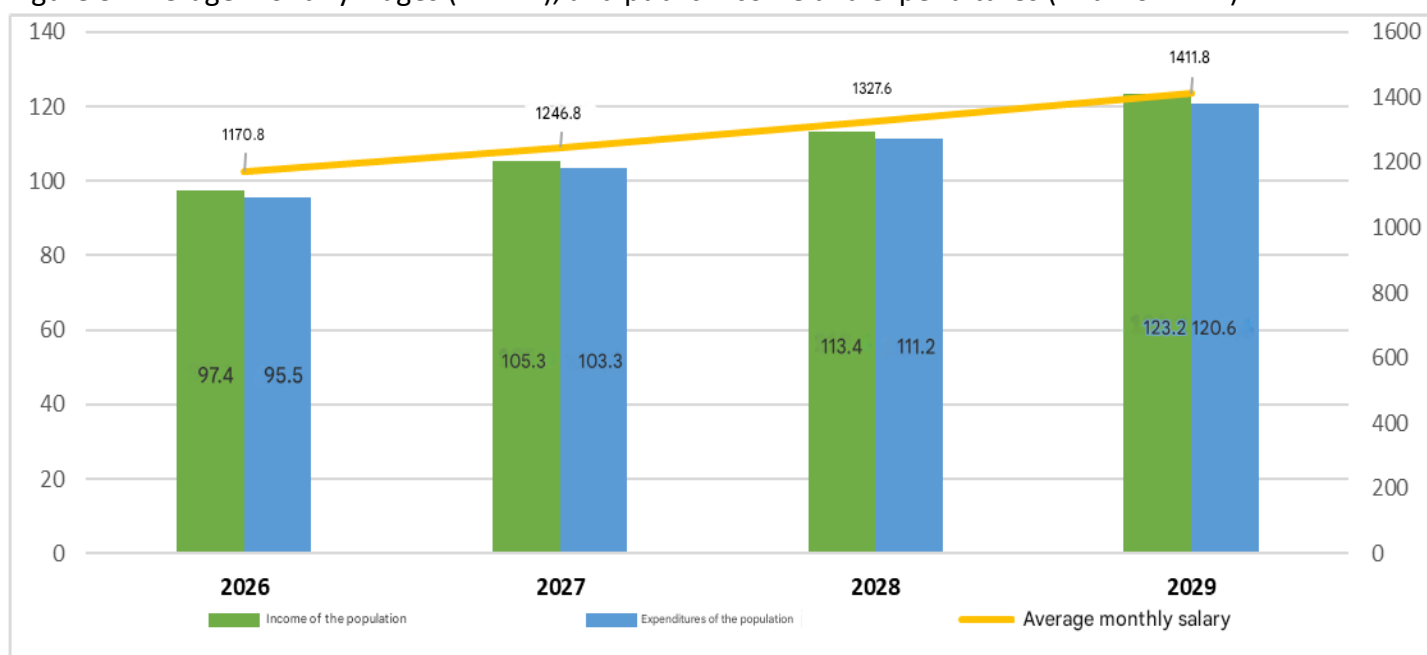
Figure 2. GDP for the years 2024–2028, in billion AZN



Source: Ministry of Finance of the Republic of Azerbaijan

In the base scenario provided by the Ministry of Economy, the average annual inflation rate is projected at 4.8% for 2026 and an annual average of 4.3% for the 2027–2029 period. In connection with the rise in economic activity, the real growth rate of public income is forecast at 3.4% this year and an annual average of 3.7% for 2027–2029. Corresponding to the income growth, the real growth rate of public expenditures is projected at 3.5% for the next year and an annual average of 3.6% for the 2027–2029 period (Ministry of Finance of the Republic of Azerbaijan).

Figure 3. Average monthly wages (in AZN), and public income and expenditures (in billion AZN)



Source: Ministry of Finance of the Republic of Azerbaijan

The fact that inflation exceeds the growth of public income will lead to an increase in public expenditures, as well as a decrease in purchasing power and real income. Specifically, compared to the previous year, a nominal income of 100 AZN in the current year $= 100 / (1 + 0.048) = 95.42$ AZN. Consequently, it will be possible

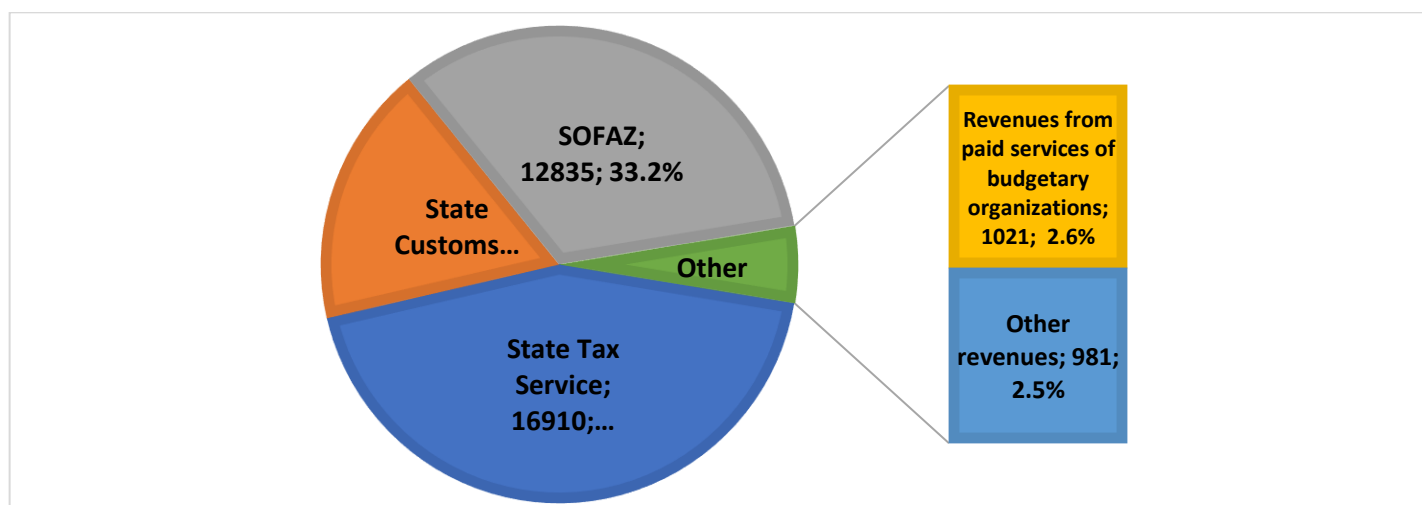
to purchase fewer goods and services with the same amount of money. A 3.5% nominal increase in expenditures will force households to spend more due to rising prices, leading to reduced savings, increased debt, or a transition to lower-quality alternatives.

Budget Revenues

The state budget revenues for 2026 have been approved at 38,609,000.0 thousand AZN, and expenditures at 41,703,600.0 thousand AZN (including centralized revenues of 37,850,192.0 thousand AZN and local revenues of 758,808.0 thousand AZN). State budget revenues for 2026 are projected to be 38.609 billion AZN, which represents a 0.75% increase compared to 2025.

In 2026, compared to the previous year, the following revenue trends are projected: personal income tax at 2.379 billion AZN (a 19.6% or 390.3 million AZN increase in absolute terms); corporate profit tax at 6.58 billion AZN (a 3.7% or 236 million AZN increase in absolute terms); and VAT at 9.216 billion AZN (a 10.7% or 890.1 million AZN increase in absolute terms). Within VAT, import VAT is expected to reach 4.75 billion AZN (a 4% or 182 million AZN increase). Furthermore, simplified tax is projected at 429 million AZN (a 5.9% or 24 million AZN increase), road tax at 394.4 million AZN (a 1.76-fold or 251.6 million AZN increase), and customs duties at 1.818 billion AZN (a 0.44% or 8 million AZN increase). Revenues from paid services of budget-funded organizations are forecasted at 1.021 billion AZN (a 16% or 141 million AZN increase). The upper limit of the transfer from SOFAZ (State Oil Fund of the Republic of Azerbaijan) is set at 12.835 billion AZN (an 11.4% or 1.646 billion AZN decrease), while mining tax is projected at 151 million AZN (a 5.6% or 9 million AZN decrease). Revenues for the targeted budget fund determined by the relevant executive authority are expected to be 250 million AZN (a 26.5% or 90 million AZN decrease).

Figure 4. Structure of Budget Revenues, in million AZN and percentages



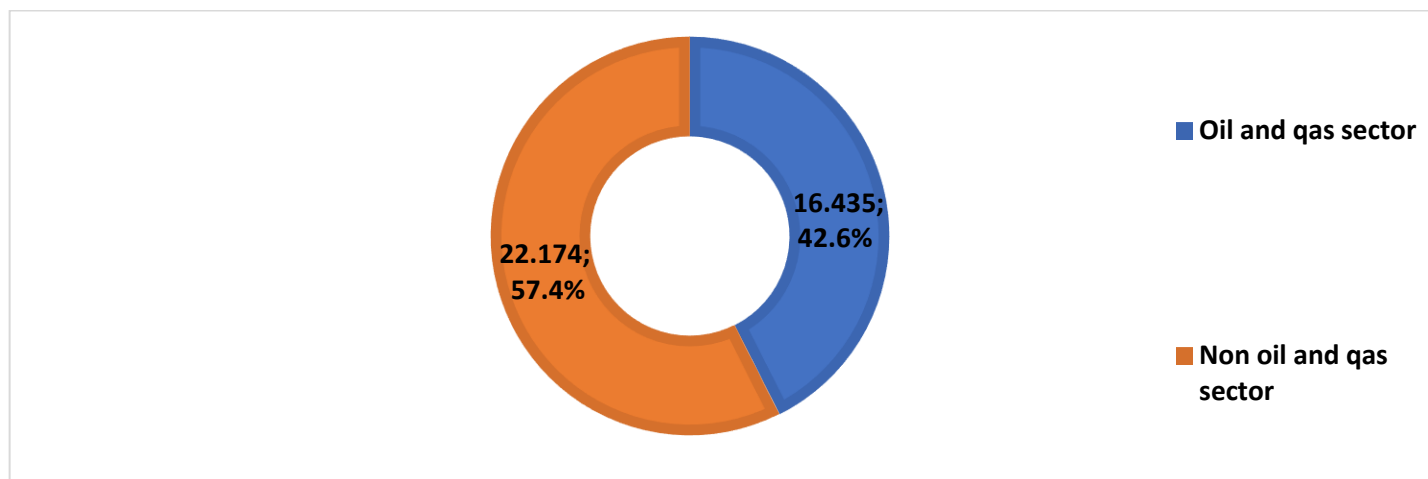
Source: Chamber of Accounts of the Republic of Azerbaijan

Budget revenues will be comprised of the following: 43.8% (or 16.910 billion AZN) through the State Tax Service, 33.2% (or 12.835 billion AZN) from SOFAZ, 6.862 billion AZN through the State Customs Committee, 2.6% (or 1.021 billion AZN) from paid services of budget-funded organizations, and 2.5% (or 981 million AZN) through other receipts.

In the current year, the specific weight of state budget revenues in GDP is projected to be 28.8%, while the specific weight of non-oil-and-gas revenues in the corresponding sector's GDP is expected to be 21.8%. The decrease in the ratio of state budget revenues to GDP this year is explained by the faster growth rate of GDP compared to budget revenues.

Of the state budget revenues projected for 2026, 16.435 billion AZN is attributed to the oil and gas sector, while 22.174 billion AZN falls to the share of the non-oil and gas sector.

Figure 5. State budget revenues by sector, in billion AZN and percentages



Source: Chamber of Accounts of the Republic of Azerbaijan

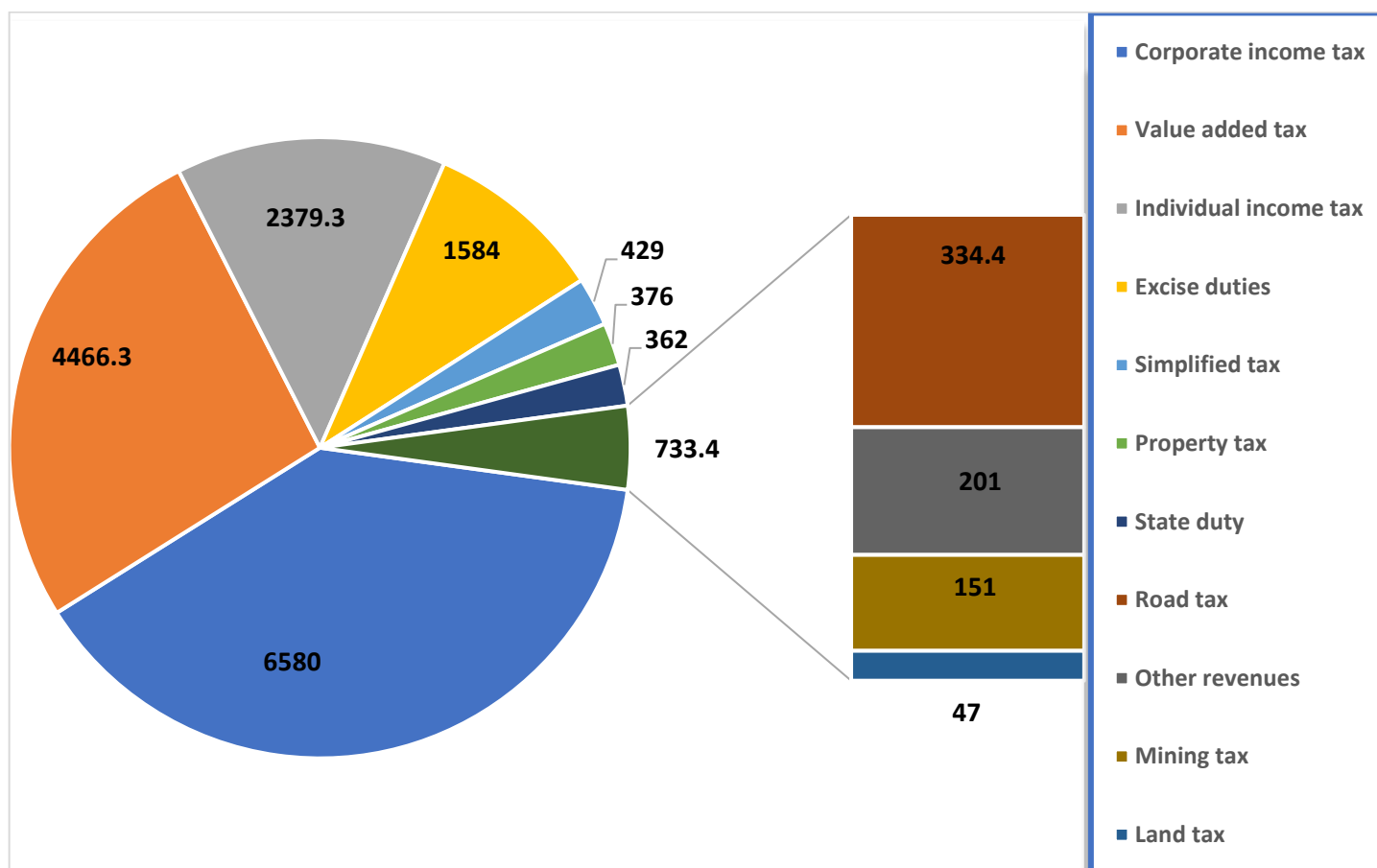
In the current year, compared to the previous year, revenues from the oil and gas sector (including the transfer from the State Oil Fund) are expected to be 1.876 billion AZN or 10.2% lower, while revenues from the non-oil and gas sector are projected to be 2.129 billion AZN or 10.6% higher.

Table 1. Revenue receipts by specific categories under the State Tax Service, in million AZN

	2025	2026
Personal income tax	1989	2379,3
Profit (income) tax of legal entities	6344	6580
Value added tax	3758,2	4466,3
Simplified tax	405	429
Excises	1655,7	1584
Property taxreal estate tax	392,6	376
Mining tax	1600	151
Land tax	46,7	47
State duty	390	362
Road tax	105,8	334,4
Other revenues	253	201
Total	15500	16910

Source: Chamber of Accounts of the Republic of Azerbaijan

Figure 6. Revenue receipts by specific categories under the State Tax Service for 2026, in million AZN



Source: Chamber of Accounts of the Republic of Azerbaijan

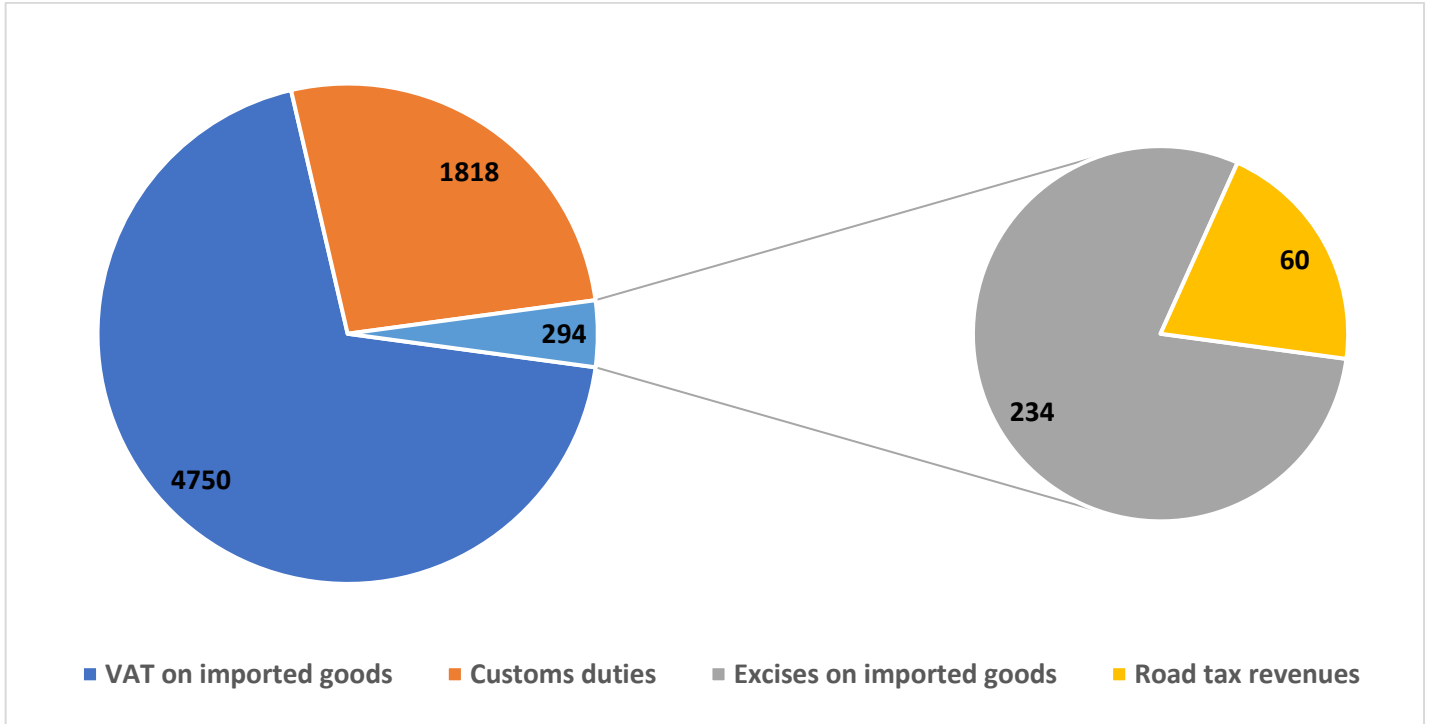
In 2026, revenue receipts through the State Tax Service are projected to reach 16.910 billion AZN, representing an increase of 9.1% or 1.410 billion AZN compared to the previous year. According to the analysis by the Chamber of Accounts, no significant risks are expected in the realization of projected revenues for certain sources under the State Tax Service for the current year, and tax elasticity is anticipated to increase across several revenue streams.

Table 2. Revenue receipts under the State Customs Committee (SCC), in million AZN

	2024	2025	2026
VAT on imported goods	4609,1	4568,0	4750,0
Customs duties	1790,7	1810,0	1818,0
Excises on imported goods	204,4	185,0	234,0
Road tax revenues	44,4	37,0	60,0
TOTAL	6648,7	6600,0	6862,0

Source: Chamber of Accounts of the Republic of Azerbaijan

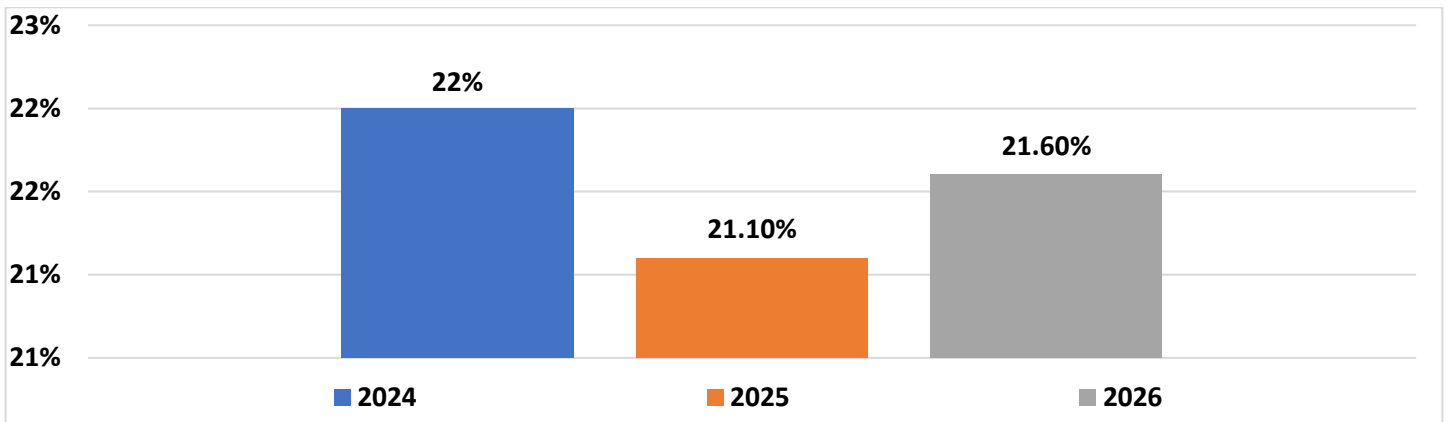
Figure 7. Revenue receipts under the State Customs Committee (SCC) for 2026



Source: Chamber of Accounts of the Republic of Azerbaijan

Revenue receipts through the State Customs Committee are projected to increase by 4% or 262 million AZN compared to the previous year, including a 4% or 182 million AZN increase in VAT on imported goods, a 26.5% or 49 million AZN increase in excise taxes applied to imported goods, and a 62% or 23 million AZN increase in road tax receipts; consequently, imports are forecast to rise during the reporting year. For the current year, the volume of imports is expected to rise to 31.8 billion AZN, and the application of exemptions and concessions in this sector is anticipated to have a reducing effect on receipts. The ratio of revenues to be secured through the State Customs Committee to the total import volume for the current year is projected to be 0.5 percentage points higher than in the previous year.

Figure 8. Specific weight of receipts through the State Customs Committee (SCC) in imports, in percentages



Source: Chamber of Accounts of the Republic of Azerbaijan

The projected growth in VAT through the State Customs Committee is expected to be driven by the increase in imports and the non-extension or cancellation of certain exemptions. The primary reasons for the increase in excise taxes include the raising of several existing excise rates, as well as higher excise rates for the import of

vehicles older than 7 years from their production date, and the inclusion of certain new products in the list of excisable goods.

Budget Expenditures

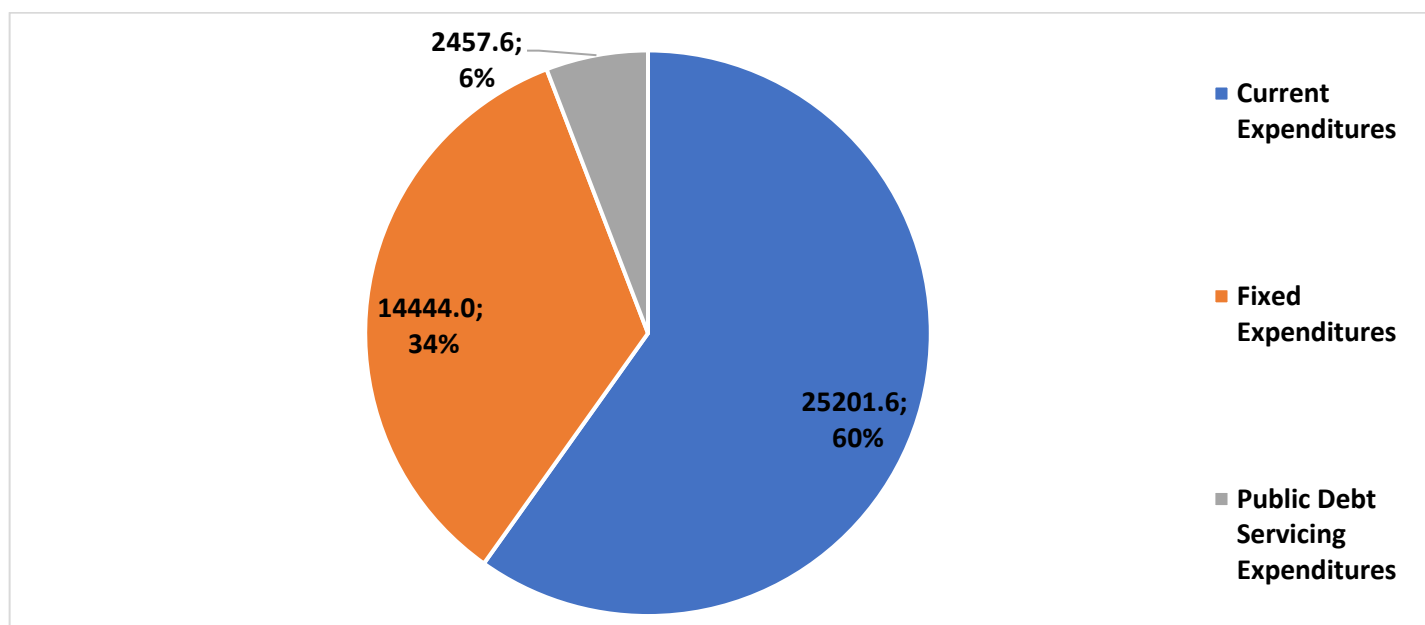
Budget expenditures have been approved in the amount of 41.704 billion AZN (including centralized expenditures of 40,943,945.0 thousand AZN and local expenditures of 759,655.0 thousand AZN). This represents a 0.7% increase or 296 million AZN more compared to the previous year. The specific weight of state budget expenditures in GDP is projected to be 31.1%. State budget expenditures are grouped into three directions based on the economic classification of expenditures: current expenditures, capital expenditures, and expenditures related to state debt servicing.

Current Expenditures: 25.2016 billion AZN is allocated to keep the state apparatus operational, ensure social protection, and maintain public services (education, healthcare).

Capital Expenditures: 14.0444 billion AZN is projected to cover expenses related to special defense-purpose projects and measures, the reconstruction and restoration of liberated territories, state-based capital investments, and other construction, restoration, reconstruction, major repairs, and various capital purchases.

State Debt Servicing: 2.4576 billion AZN has been allocated for expenses related to servicing the state debt.

Figure 9. Directions of state budget expenditures in 2026, in million AZN and percentages



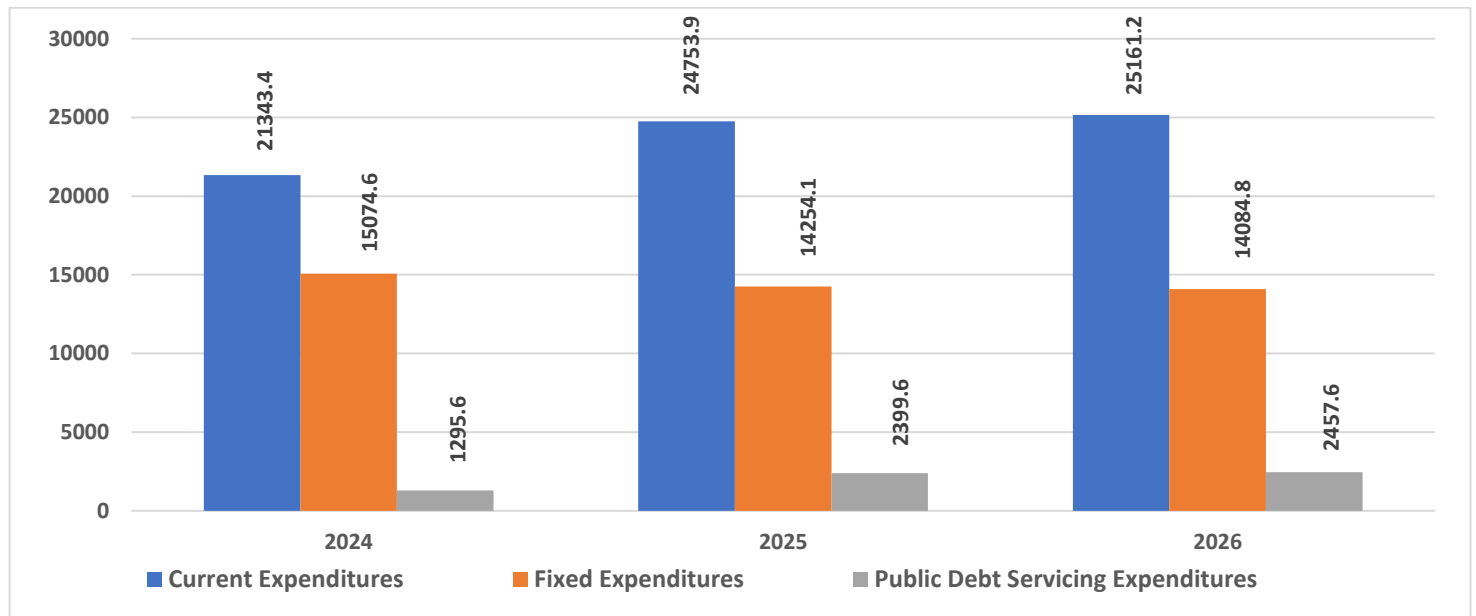
Source: Chamber of Accounts of the Republic of Azerbaijan

In the 2026 state budget, capital expenditures are projected to account for 33.7% of total budget spending. The breakdown of capital expenditures is as follows:

- 3 billion 500 million AZN for the financing of social and infrastructure projects in the liberated territories;

- 4 billion 500 million AZN for strengthening the country's defense capabilities and improving the material and technical provision of the armed forces;
- 2 billion 700 million AZN for state-based capital investment (investments) expenditures;
- 2 billion 86.4 million AZN for construction, restoration, reconstruction, major repairs, and various capital purchases;
- 1 billion 258 million AZN for other expenditures;
- In the current year, compared to the previous year, a 1.6% increase in current expenditures and a 2.4% increase in state debt servicing expenditures are projected, while capital expenditures are expected to decrease by 1.2%.

Figure 10. Amount of current, capital, and state debt servicing expenditures for 2024–2026



Source: Chamber of Accounts of the Republic of Azerbaijan

In the current year, an increase is planned for 9 categories of the functional classification, while a decrease is projected for 3 categories. Among the sectors, the highest specific weight is expected to belong to the "Defense and National Security" sector, which is projected to rise to 20.9% of total budget expenditures. The highest increase in absolute terms is also forecasted for this sector. The most significant decrease in absolute terms—520.9 million AZN or 6.2%—is planned for the "Economic Activity" sector. This is primarily attributed to the projected decrease in expenditures for the reconstruction and restoration of liberated territories, as well as reduced spending on transport and communication.

Table 3. Comparison of state budget expenditure distribution by functional classification for 2025–2026, in AZN and percentages

Sections of the functional classification	Years		Increase / Decrease -	
	2025	2026	million manat	with interest
General state services	5261,7	5518,0	256,3	4,9
Defense and national security	8396,3	8717,6	321,3	3,8
Judicial power, law enforcement and prosecutor's office	3192,0	3336,3	144,3	4,5
Education	4937,3	5016,4	79,1	1,6
Health	1993,6	2024,3	30,7	1,5
Social protection and social security	4751,7	4873,0	121,2	2,6

Culture, art, information, physical education, youth policy and other similar activities	621,8	632,1	10,4	1,7
Housing and communal services	369,9	334,5	-35,4	-9,6
Agriculture	1203,8	1226,5	22,7	1,9
Environmental protection	414,2	415,8	1,6	0,4
Economic activity	8377,5	7856,6	-520,9	-6,2
Expenditures not attributed to the main sections	1887,8	1752,5	-135,2	-7,2

Source: Chamber of Accounts of the Republic of Azerbaijan

In terms of the functional classification of budget expenditures, increases are projected compared to the previous year as follows: **256.3 million AZN** or **4.87%** for **general public services**, **321.3 million AZN** or **3.8%** for **defense and national security-related expenses**, **79.1 million AZN** or **1.6%** for **education-related expenses**, and **30.7 million AZN** or **1.6%** for **healthcare-related expenses**.

The 2026 state budget expenditures by **economic classification** will cover the following directions:

Compensation of employees (Labor costs): 10 billion 247.3 million AZN or 24.6%;

Purchase of goods (works and services): 7 billion 75.8 million AZN or 17%;

Interest payments: 1 billion 380.6 million AZN or 3.3%;

Payment of subsidies: 1 billion 71.4 million AZN or 2.6%;

Grants and other payments: 3 billion 308.1 million AZN or 7.9%;

Social payments: 3 billion 436.9 million AZN or 8.2%;

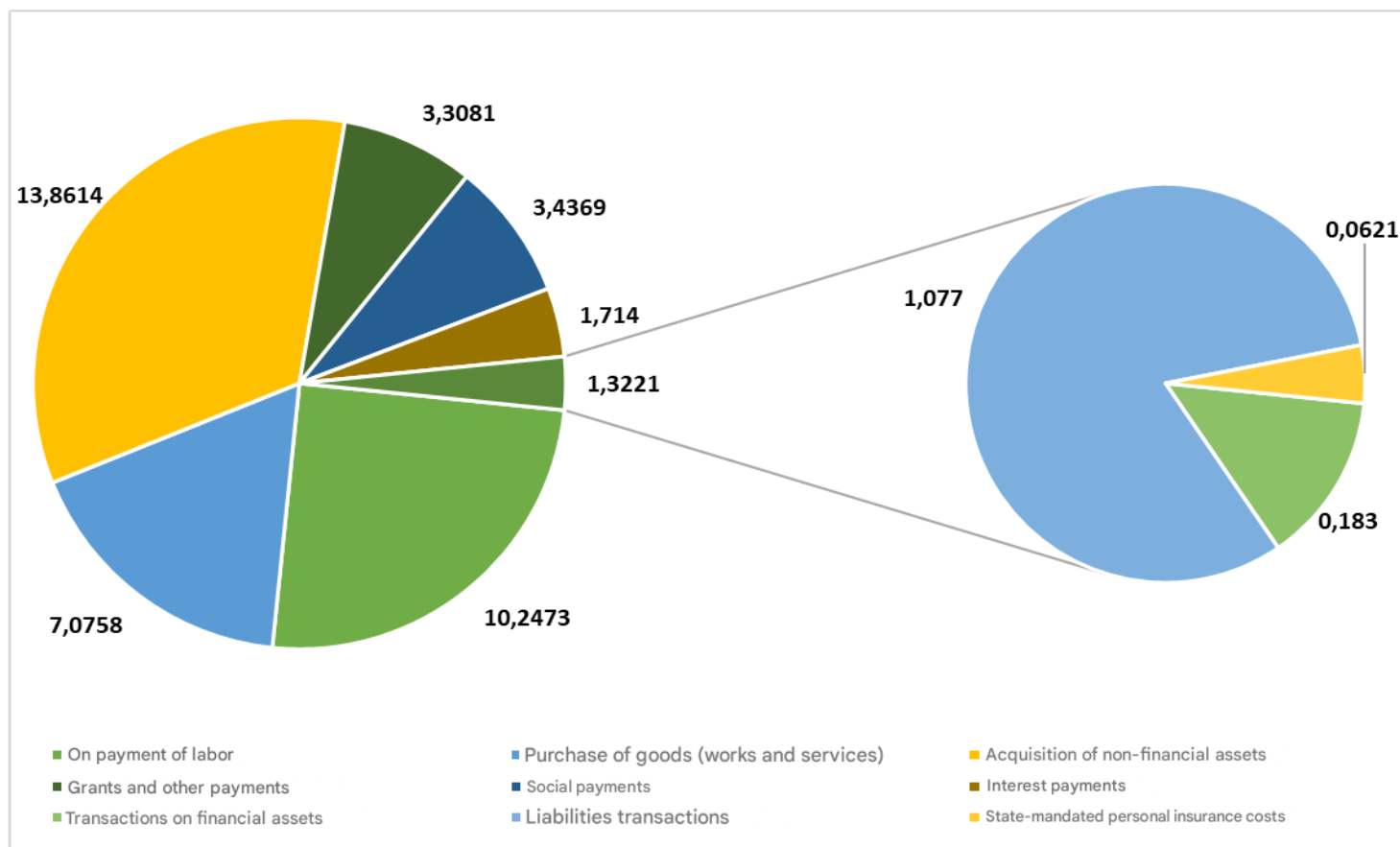
Acquisition of non-financial assets: 13 billion 861.4 million AZN or 33.2%;

Transactions in financial assets: 183 million AZN or 0.4%;

Transactions in liabilities: 1 billion 77 million AZN or 2.6%;

State compulsory personal insurance expenses: 62.1 million AZN or 0.15%.

Figure 10. Economic classification of state budget expenditures for 2026, in billion AZN



Source: Chamber of Accounts of the Republic of Azerbaijan, 2026

In the current year, state-based capital investment expenditures are projected to reach 2.7 billion AZN, representing an increase of 14.6 million AZN or 0.5% compared to the previous year. Out of this total, 850.0 million AZN will be attributed to projects implemented through foreign loans.

Table 4. Directions of state-based capital investment expenditures

Directions	2026		
	number of projects amount	million manats,	share in amount, %
Infrastructure projects	106	1438,2	53,3
Social projects	69	254,2	9,4
Defense and law enforcement agencies	8	54,8	2
Other projects	11	102,8	3,8
Foreign loans	0	850	31,5
Total	194	2700	100

Source: Chamber of Accounts of the Republic of Azerbaijan

Table 5. Funds allocated for projects implemented on the basis of joint financing with foreign credit organizations, in million AZN

Directions	Approved	Forecast			
	2025	2026	2027	2028	2029
State-based investment (investment expenses)	2685,4	2700	3500	3900	3902,9
including, at the expense of foreign loans	895,9	850	1200	1500	1500

Share in	33,40%	31,50%	34,30%	38,50%	38,40%
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Source: Chamber of Accounts of the Republic of Azerbaijan

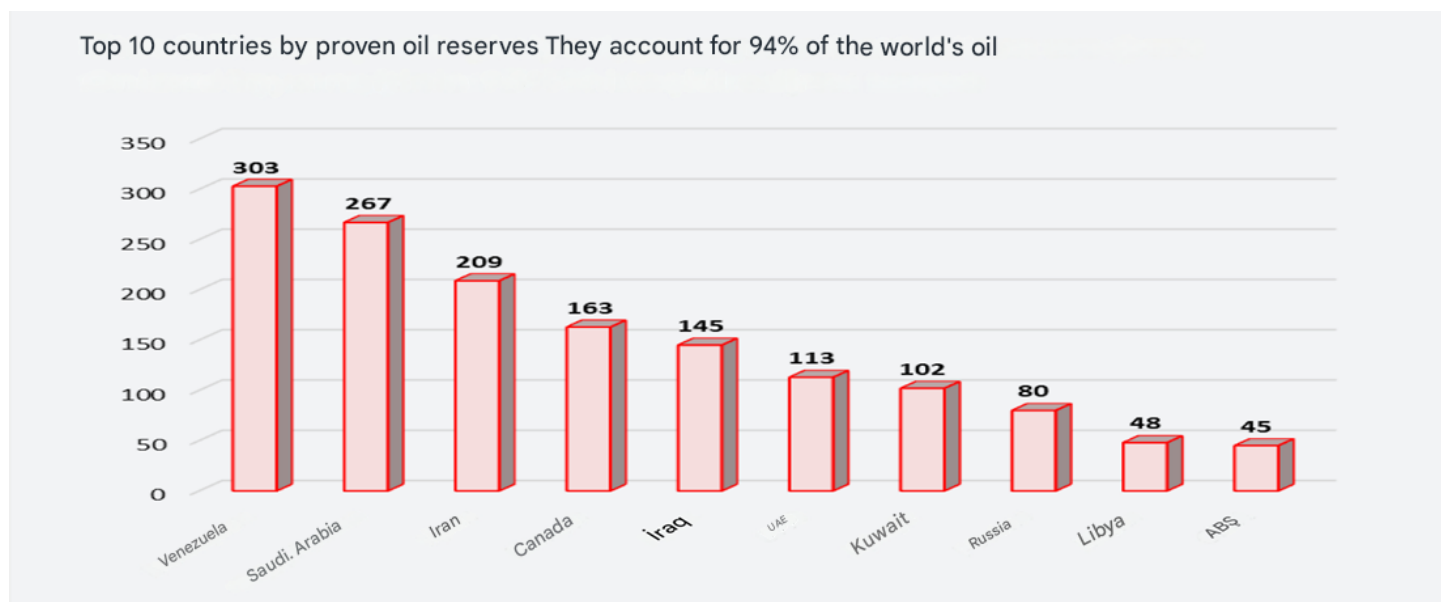
A total of 194 projects are projected to be funded through state-based capital investment (investment) expenditures in the current year. From the forecasted funds, 1.85 billion AZN is allocated as follows: 16.5 million AZN for 5 new projects and 1.8335 billion AZN for 189 ongoing (transitional) projects.

For the reconstruction and restoration of the liberated territories, an allocation of 3.5 billion AZN is planned for 2026, which is 500.0 million AZN or 12.5% less than the approved figures for 2025.

Oil Prices for 2026

The global oil market in recent months has been characterized by an abundance of supply, significantly exceeding demand. According to the International Energy Agency (IEA) forecasts for 2026, production from both OPEC+ and non-OPEC+ countries (specifically the USA, Canada, Brazil, Guyana, and Argentina) is projected to increase by 2.5 mb/d, reaching 108.7 mb/d. In contrast to this supply growth, demand is expected to increase by only 0.93 mb/d, as demand is anticipated to remain weak due to the economic slowdown in major global powers, particularly China and India. Under these circumstances, even tensions in countries with the largest oil reserves, such as Venezuela and Iran, have not significantly impacted world prices (Figure 12). In addition to rising supply, oil prices are also affected by the price cap on seaborne oil shipments imposed by G7 countries and the European Union following Russia's invasion of Ukraine. As of February 1, 2025, this price limit was reduced to \$44. Thus, it can be argued that economic factors are currently exerting a greater influence on oil prices than geopolitical factors.

Figure 11. Top 10 countries by proven oil reserves, in billion barrels

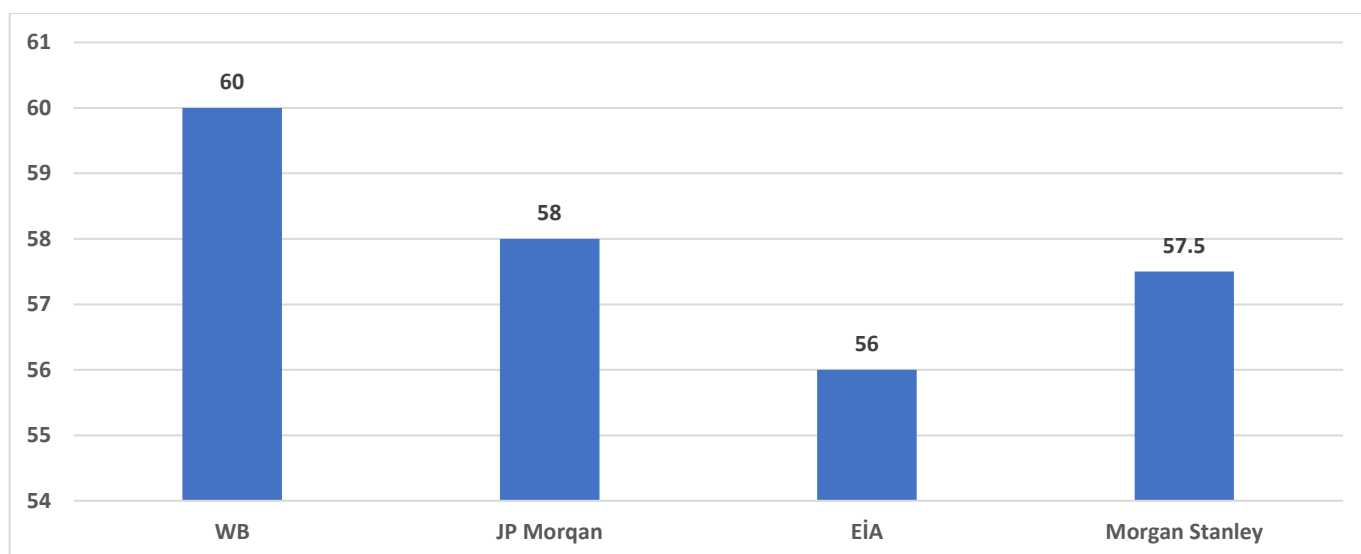


Source: <https://www.bbc.com/russian/articles/cx20p7djzpo>

Brent oil, as a global benchmark, has decreased in price by more than 10% over the last six months and by 44% over the last 13 years, currently trading around 60-61 USD/barrel. This stands in contrast to analytical forecasts: the World Bank expects 60 USD for 2026, JP Morgan 58 USD, the EIA 56 USD, and Morgan Stanley

an average of 57.5 USD (with a minimum of 55 USD in Q2). This discrepancy stems from the uncertainty surrounding supply growth (particularly US shale oil) and the slowdown in demand.

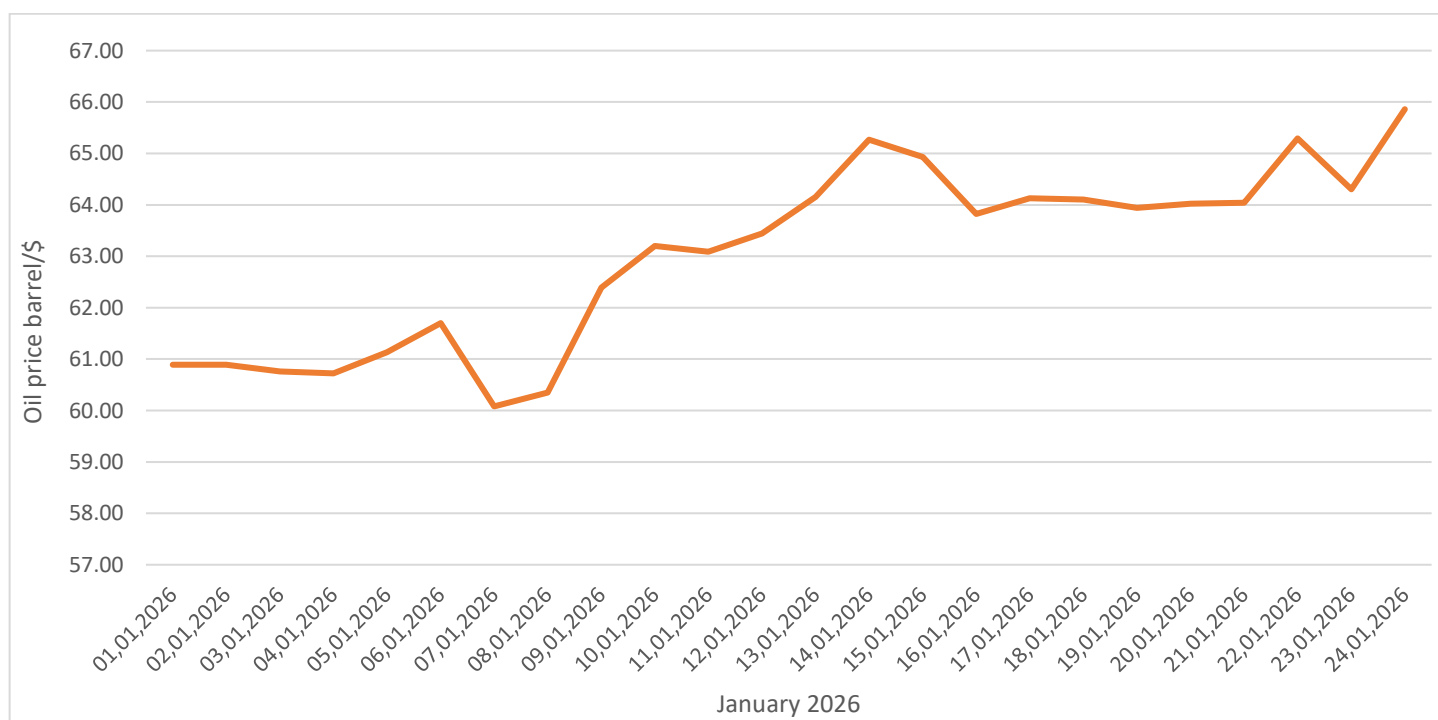
Figure 12. Oil price forecasts for 2026



Source: <https://www.bbc.com/russian/articles/cx20p7djzppo>

As a result, the oil glut appears persistent due to weak economic growth and the impact of the energy transition (electric vehicles); however, a tightening of OPEC+ quotas or an unexpected surge in demand could stabilize prices. Between January 1 and 24 of the current year, the price of Brent oil (Figure 13) remained at or above \$65 for only three days. This dynamics creates budgetary pressures for Azerbaijan as an oil exporter, while simultaneously easing global inflation.

Figure 13. Brent oil price chart for the period of January 1–24, 2026



Source: <https://www.oilcrudeprice.com/brent-oil-price-history/>

As a reminder, the minimum price for Azeri Light crude oil was recorded on April 21, 2020 (\$15.81), while its maximum price was recorded in July 2008 (\$149.66).

Oil Price Forecasting: Central Bank of Azerbaijan VAR Model

The Central Bank of Azerbaijan's (CBA) 4-variable VAR model (Brent spot price, futures prices, global supply, and demand) is based on quarterly data, seasonally adjusted, uses real prices (adjusted for US inflation), and selects optimal lags based on AIC (Akaike Information Criterion) and BIC (Bayesian Information Criterion). The model tests shock effects using impulse response functions and verifies reliability with residual tests, being updated 8 times a year (prior to monetary policy meetings). Forecasting is modeled as follows:

Methodology

A standard VAR (Vector Autoregression) model consisting of four variables is applied in forecasting oil prices. The mathematical form of the model is as follows:

$$x_t = \alpha + \sum_{i=1}^k A_i x_{t-i} + e_t$$

Here, x_t is a 4x1 vector of variables, α is a 4x1 vector of parameters, A_i is a 4x4 matrix of parameters, e is a 4x1 vector of error terms.

Forecasting is processed based on statistical data from the EIA (Energy Information Administration), the U.S. Bureau of Labor Statistics, the Bloomberg platform, and the Energy Institute. The assessment is conducted using quarterly data by year, starting from 1994.

Initially, data on Brent crude oil prices and oil production volumes are seasonally adjusted and converted to real terms using the U.S. Consumer Price Index (CPI). Furthermore, the model is evaluated based on tests for the normal distribution of residuals, heteroskedasticity, and correlation between residuals. Global oil supply and demand data from the EIA, along with inflation forecasts obtained from the Bloomberg platform, are utilized as scenarios within the model.

Conclusion and Recommendations

Analysis of the current year's budget indicators shows that, as in previous years, the budget's dependence on oil and gas revenues remains high. The same applies to transfers from SOFAZ (State Oil Fund of the Republic of Azerbaijan). This indicates a pressing need to develop other sectors of the economy. Considering global realities, the decline in oil revenues, and the deepening of geopolitical and economic risks along with their potential consequences, a transition to a strict austerity regime is necessary. To ensure sustainable economic growth in Azerbaijan in 2026, the following measures are proposed:

1. Protecting short-term and medium-term budget balances from risks;
2. Ensuring long-term financial stability;
3. Creating favorable conditions to make economic growth more sustainable;
4. Analyzing and evaluating the dynamics of budget expenditures and justifying development trends;
5. Improving methods for the efficient use of budget expenditures;
6. Studying the impact of efficient and proper budget utilization on the national economy;
7. Implementing and expanding interconnected measures for the development of agriculture and industry;

8. Reviewing spending standards for budgetary organizations and defining appropriate cost norms and standards to improve the budget process;
9. Limiting SOFAZ transfers exclusively for strategic purposes;
10. Developing the green economy.

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