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The Economy of Azerbaijan 2021: An upswing from Economic Rebound with the Risks in Scenario

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Introduction

The year 2020 posed an unprecedented challenge to the World economy with the outbreak of the Covid-19 pandemic shrinking the global GDP by 6,7%¹ and bringing worldwide severe economic repercussions. Thanks to the massive vaccination program, global economic recovery was experienced in 2021 and economic growth has been sustained largely with the revival of demand for goods and services. On the other hand, supply shortages with respect to the demand, increasing energy and food prices, supply chain problems trigger higher inflation rates in most countries. Moreover, the widespread of Omicron variant in the second half of 2021 produced uncertainties about global economic growth in the following period.

Notwithstanding the continuation of pandemic-related negative consequences, the scaling up of vaccination process, entrepreneurial support, a relatively favorable state of the global economy, and loosened quarantine restrictions contributed to economic recovery in 2021 in Azerbaijan leading to a growth in oil as well as the non-oil sector of the economy. The recovery has been stronger than expected on the back of rising oil and gas prices. GDP growth accelerated to 4.8 percent year-on-year in the period January to September 2021 (EBRD, 2021), particularly by a non-oil sector. Foreign economic activities of Azerbaijan were being developed with the increasing rate of crude oil price and expansion of non-oil exports to the trade partners owing to the economic upswing in them. Foreign trade turnover in the previous year accounted for 33.9 billion US dollars. The nation's trade surplus reached the value of 10.5 bln US dollars surging 3,5 times compared to 2020² and Italy, Turkey, Russia, China, Germany, Israel and Ukraine were the top trading partners. The year 2021 is accompanied by a 61.6% and 46.6% increase in total exports and non-oil exports respectively. It is noteworthy to mention that in 2021 non-oil exports amounted to the record level of 2,7 billion US dollars exceeding the pre-pandemic level. Exports more than tripled year on year in December 2021. Imports also rose by 24% year on year in December further stimulated by an increase in domestic demand. The economy is projected to generate a positive balance of foreign trade in 2022 with the continuation of current circumstances. Although, based on the initial forecast of EBRD, GDP was expected to constitute 4% growth in real terms, according to the State Statistical Committee the figure is 5.6%. The country's GDP made up 54.6 bln US dollars that indicate an increase by one fifth in a year³. On the other hand, the year 2021 marks a 40% rise in the average inflation rate with 6.7% in comparison to 2020. In addition, rising energy prices coupled with the relaxation of quarantine heated the retail market exerting more pressure on prices.

Economic recovery is in continuation process in which the non-hydrocarbon sector acts as the main driver with a strong contribution of the oil and gas sector as well coupled with the

¹ <https://www.statista.com/statistics/1240594/gdp-loss-covid-19-economy/>

² <https://customs.gov.az/en/>

³ https://www.stat.gov.az/source/system_nat_accounts/

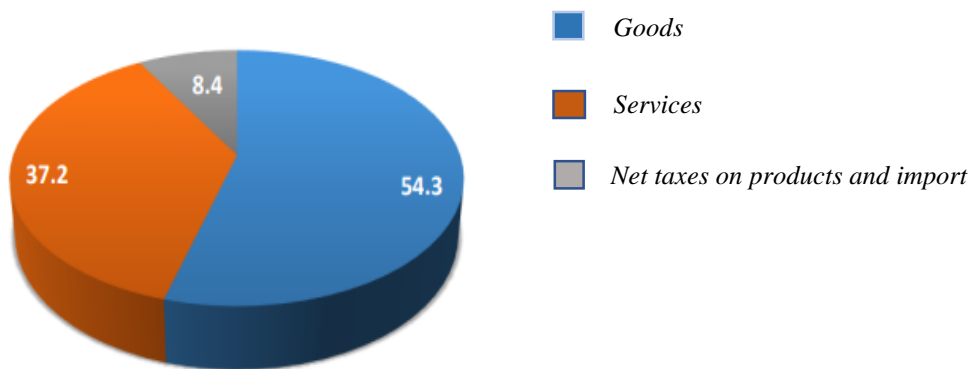
rising demand for, and price of, oil that can further strengthen overall economic performance, however risks in the scenario are vivid.

1. Macroeconomic Environment

1.1 Gross Domestic Product

The nation's real GDP in 2021 demonstrated growth. In figures, it grew by 5.6% compared to 2020 recovering to pre-covid levels that made up 92.9 billion manats based on current prices. Along with, GDP per capita surged 5.1% equal to the value of 9269.3 AZN or 5452.5 US dollars (4272 US dollars in the previous year). This growth is mainly attributed to the accelerated vaccination program, revival of the international economy and eased quarantine restrictions. Figure 1 plainly illustrates the sectoral production structure of GDP in percentages.

Figure1: GDP structure Azerbaijan, 2021



Source: Ministry of Economy, Azerbaijan

As can be seen, the fraction of goods amounts to more than half of the total. Economic growth remained strong at the end of the year led by the non-energy sectors. In monthly comparison, although the energy sector contracted by 5,5 % in December, non-energy sectors continued to grow by 13.6% compared to 11.3 percent year-on-year growth in November which is mainly driven by transportation, hospitality, ICT, retail trade and construction. In 2021, while output was restricted with OPEC+ quotas and agreements with partner countries that reduced energy production capacity, the energy sector showed positive dynamics and expanded by 1.8%, which took the proportion of 37.8% in GDP. In the meantime, the non-energy sector saw 7.2%(62.2% of GDP) growth led by services and manufacturing. From the demand side, consumption recovery was strong. The Periodic growth rate within the year is depicted in figure 2.

Figure 2: Growth rate, GDP.

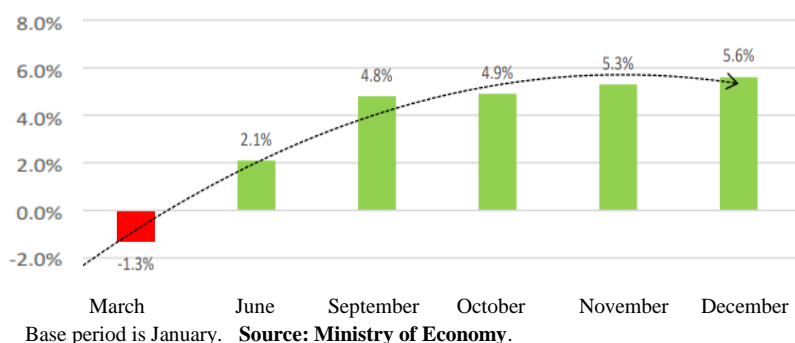


Table 1: Sectoral growth rate of GDP in 2021 with % on a comparative basis

Sectors	2020	2021
Industry	-5	4.1
Construction	-8.7	-2
Agriculture, Forestry, Fishery	1.9	3.3
Trade, Transportation repair	-1.3	5.3
Transportation	4.6	16
Tourism	-58.9	34.2
ICT	0.6	6.1
Others	-0.9	5.1
Net taxes on products and import	-2.9	8.6

Source: State Statistical Committee

Surging dynamics of growth in 2021 towards the end of the year are encapsulated in figure 2, and table 1 indicates the accelerated revival of non-oil sectors. The monitoring survey of the Central Bank further proves the growth in economic activities (Monetary Policy). In addition, consumer market and retail trade turnover experienced 3.7% and 3.2% in 2021 increased correspondingly in contrast with 2020.

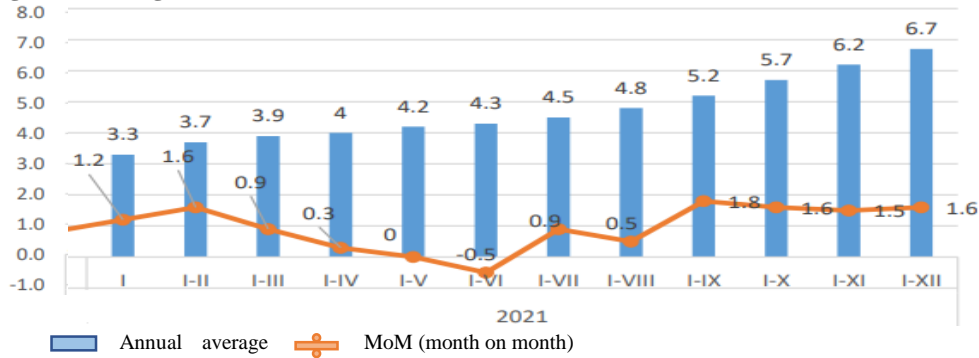
1.2 Inflation

The annual average inflation rate in 2021 accelerated to 6.7% has been driven by food price increases at the international level, the energy price surge and rising level of inflation in the world and trade partners. Electricity and natural gas tariffs were raised and quarantine relaxation heated the retail market, exerting additional pressure on prices (ADB, 2021). Similar to previous years, increasing food prices pushed the inflation rate higher than the other factors. In 2021, food inflation averaged at 8.1% compared to 2020 which is significantly affected by the import factor of foreign goods with increasing prices⁴. On the other hand, the figure accounts for 5.1% for non-food products in the same context. Based on the analysis of the Central Bank, it is deduced that foreign factors are largely responsible for increasing the inflation rate in Azerbaijan. Import prices were subject to more than 21 increase as well that stem from globally rising food prices, shipping and logistics costs and

⁴ <https://www.cbar.az/page-13/monetary-policy-review>

a record level of inflation in partners. Figure 3 shows the changes in the Consumer Price Index (CPI) of the year. The increasingly upward trend is vivid throughout the year that hit the pick in December. Inflation continued to rise in December, driven by increasing food prices, prompting further monetary tightening by the central bank in January (World Bank).

Figure 3: Changes in Consumer Price Index 2021 in %

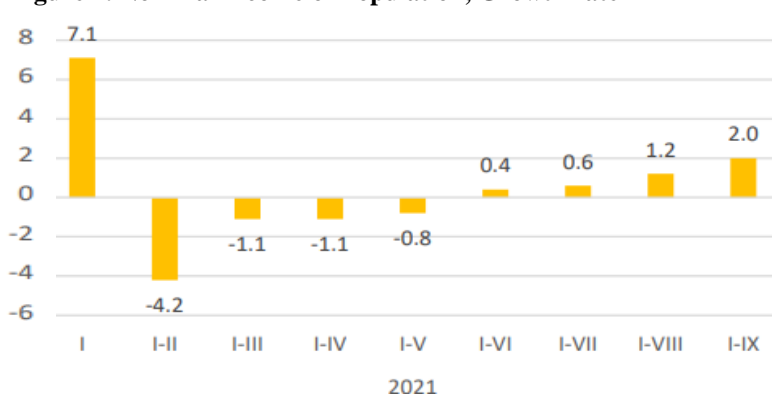


Source: Ministry of Economy, Azerbaijan

CPI inflation rose by 1.6 percent mom (month on month) in December, driven by a 2.6-percent mom increase in food prices. Annual food price inflation increased to 15.6 percent yoy (year on year) in December from 14.7 percent yoy in November. Services prices growth slowed to 0.9 percent mom in December from 1.6 percent mom growth in November. As a result, annual CPI reached 12 percent in December 2021 (compared to December 2020) (World Bank).

The year 2021 is marked with the 2.6% growth in the nominal income of the population compared to the same period of 2020 that hit the value of 57.2 billion manats and per capita income accounted for 5708 manats. The increasing rate of the nominal income in percentages is shown in figure 4. To increase the population’s income on a sustainable basis, state programs are being implemented that support entrepreneurship, employment, social welfare and financial stability.

Figure 4. Nominal income of Population, Growth rate



Source: Ministry of Economy

The figure displays a surge in the second half of the year in nominal income. Since nominal income is not adjusted for changes in the cost of living owing to inflation, it could be argued

that it may not indicate a satisfactory measure of developing well-being as simultaneously inflation occurred pushing up the prices.

1.3 Exchange rate and Monetary Policy

In 2021, the Central Bank's monetary policy focused on price stability. In the year, the national currency's exchange rate was formulated by the interaction of supply and demand in the currency market. With the surplus in the balance of payments, the expansion of the supply in the currency market maintained the exchange rate stability. The manat remained stable with the rate of 1.7 AZN per USD, while FX demand rose in January. State Oil Fund sold USD 727 million in January (12.7 percent yoy increase). The Central Bank's reserves remained flat at USD 7.07 billion in January while SOFAZ assets amounted to USD 45 billion in 2021, which is 3.4 percent higher than in 2020.

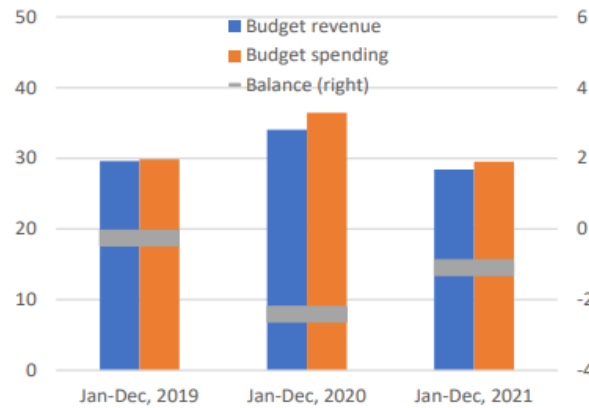
In response to the increasing inflation, CBA raised the policy rate in January. On January 28th, the CBA raised the policy rate from 7.25 percent to 7.5 percent citing rising inflationary pressures from external and domestic sources. The CBA expects inflation to return to the target range of 4±2 percent by 2023. The CBA also stepped-up liquidity absorption operations.

State Budget

Although, the state budget recorded a deficit by end-2021, the overall fiscal balance was in surplus. Budget revenues increased by 50.5 percent yoy in December, driven by higher SOFAZ transfers, surging non-oil/gas revenues (53.6 percent yoy) due to increased non-tax revenues such as transfers from the Public Debt Guarantee Fund and CBA profit, and an increase in tax revenues (11.6 percent yoy). Budget spending rose by 19.1 percent yoy in December, with current spending up by 21.5 percent yoy and capital spending up by 17.2 percent yoy. In cumulative terms, in the year, budget revenues increased by 7 percent yoy and budget spending by 3.8 percent yoy. As a result, the state budget recorded a deficit of 1.1 percent of GDP in 2021. However, the consolidated budget recorded a surplus of 4.2 percent of GDP, driven by high SOFAZ revenues. By the end of February 2022, Brent oil price exceeds 100\$⁵, the highest level since 2014. Azerbaijan's OPEC+ crude oil production quota was up to 668,000 bbl/day in February 2022, higher than the current production capacity. The budget for 2022 is based on an oil price of 50 USD/bb

⁵ <https://oilprice.com/oil-price-charts/>

Figure 5: State Budget as % of GDP.

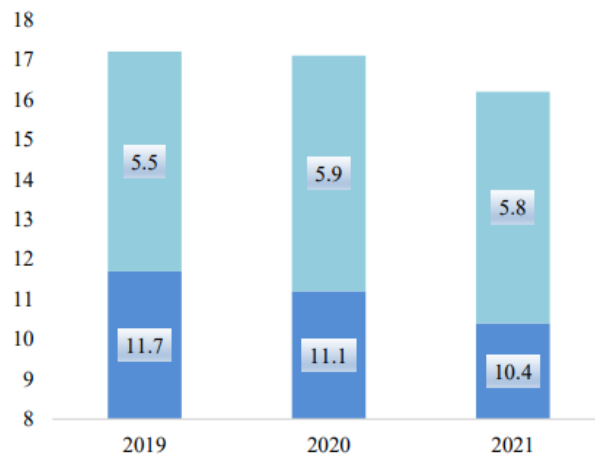


Source: World Bank

Investment Environment

According to the Statistical Committee, investment in capital assets in 2021 totaled 16.1 billion manats of which 10.4 billion manats has been diverted to the non-oil/gas sector. The source of funding of the investments was generated by national means as well as by foreign sources with a proportion of 73.1% and 26.9% respectively. Though not significant, figure 6 provided by the Central Bank implies decreasing investment dynamics in 2021.

Figure 6 Investment dynamics in billions of manats



Source: Central Bank

Employment

On January 1, 2022, the economically active population in the country amounted to 5303.9k which is 51.4k higher compared to the same period of the previous year. The number of employed people in Azerbaijan is 4988.2k with 111.6k increase from the previous year.

Conclusion

At this juncture, post-pandemic economic recovery is being achieved, however, risks remain high accompanied by an increasing inflation rate. An increase in the nominal income⁶ and wages goes hand in hand with the price surge, and in 2021 the economy heavily suffered from imported inflation, that is, inflation occurred due to a rise in prices of imported goods. The CBA increased the policy rate citing rising inflationary pressures from external and domestic sources. However, preventing price increase must be a top priority task of Azerbaijan. Exchange rate dynamics remained stable due to the massive inflow of foreign currency with the positive balance of Azerbaijan's trade turnover. Notwithstanding the positive signs on the upturn of non-oil output, the economic recovery was mainly sustained by, in 2021 hydrocarbon dependency continues to be higher that stipulates the need to enhance further the market-oriented economic structure diversifying the economy. The tourism sector needs strong solutions to further develop. Despite the upswing, challenges in the industry exist with a high degree of pandemic uncertainty and a considerable increase in the number of visitors has not been observed. On the other hand, efforts with the expansion of benefits to businesses and additional social assistance to support the economy continued in 2021. Allocation of 261 million AZN was included in the yearly budget package to fight the pandemic.

Recovery is expected to keep up, but obvious risks hang in the current scenario. Rising prices and demand for oil as well as non-oil and gas sectors will, certainly, continue to reinforce the economic performance. Azerbaijan's GDP is expected to grow 2.5% in 2022⁷ according to Asian Development Bank. World Bank forecasts GDP growth by 3.1% this year and by 2.7% in 2023(World Bank, 2022). Amid the recovery, risks related to geopolitical developments, volatility in commodity prices, the speed of vaccinations and structural fragilities of the economy persist.

Key priorities

- Economic diversification: Miscellaneousness in the economic structure can expand the resilience to shocks through improving the business environment for the private sector while following a balanced territorial approach for the benefit regions.
- Achieving the goals of "Azerbaijan 2030" vision and respective strategies demands the improvement of public administration capacity with proper staff, expertise and strengthened operational framework
- In conjunction with a sound regulatory framework and institutions, a sustainable and competitive green energy market should be increasingly developed,(Country assessment,2021).
- The drawing of investments for the restoration and economic development of the liberated zones which presents great opportunities including agriculture and tourism.

⁶ https://www.sosial.gov.az/post_433900

⁷ <https://www.adb.org/countries/azerbaijan/economy>

In 2021, the government outlined the main directions and priorities for sustainable development until 2030 signing a decree in February 2021 on “Azerbaijan 2030: National Priorities for Socio-Economic Development”. In addition, the country is stepping up efforts to promote renewable energy and digitalization of government services.

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