

# Outcomes of Azerbaijani Economy in 2018

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## 2018 ECONOMIC OUTCOMES

### (macroeconomic, monetary, and financial results)

#### Introduction

In 2015-2016, Azerbaijan faced a deep economic crisis brought on by a sharp fall in the world market price of oil and the country's rapidly shrinking oil revenues, but in 2017 it was generally able to avoid a deepening of the crisis. In 2018, thanks to advantageous conditions in the world oil market and oil prices of over 60 USD per barrel, the growth of the country's oil revenues generated a lot of interest its economy. Although the data reflecting Azerbaijan's social and economic development in 2018 have not yet been released in full, the BRI Economics Team has prepared this report on last year's macroeconomic situation based on the corresponding data released by government agencies so far.

The purpose of this bulletin is to briefly evaluate the economic outcomes of 2018 and to point out some strong tendencies, especially in the areas of monetary and budgetary policy. This report is not comprehensive, covering only the most important macroeconomic processes.

The data used in the preparation of this report was collected from statistics and reports released by the State Statistics Committee (SSC), the Central Bank, the State Customs Committee (SCC), the Finance Ministry, and other agencies.

The main conclusions of the BRI Economics Team's study of last

year's macroeconomic situation are the following:

- Last year, real GDP growth was only 1.4% despite maintaining monetary and financial stability, serious growth in oil revenues compared to 2017, a positive balance in foreign trade of 8 bln USD, growth of the overall budget by 4.7 bln AZN, 29.1% growth in state expenditures compared to 2017, and 80% growth in state investments;
- With the growth of oil revenues, Azerbaijan's economic dependence on the oil sector is deepening: 1) the non-oil sector's contribution to GDP rose from 34.2% in 2016 to 41.5% in 2018; 2) over the reporting period, the share of state budget revenues coming directly from the oil sector was 59.8%; 3) the oil and gas sector accounted for 91.2% of the country's total exports;
- Although in 2018, using the state budget and other channels, the government invested most of its oil revenues in the economy, this was not enough to end the crisis in the construction sector or to have any serious effect on overall economic growth;
- The growth in oil revenues provided for the growth of the Azerbaijan's foreign currency reserves;
- Despite recent improvements in the business environment, promotion of investment, and the growth of state investments, the fall in the economic growth rate by 2% shows the need for more serious economic reforms.

## **2018 Macroeconomic Outcomes**

According to the State Statistics Committee's (SSC) data, Azerbaijan's gross domestic product (GDP) in 2018 was 79,797.3 mln AZN. Compared to 2017, the real GDP growth rate was 101.4%, while the GDP deflator was 112.2%. According to the SSC's data, 58.5% of GDP was generated by the non-oil sector, while the oil sector accounted for the remaining 41.5%. Compared to the previous year, the non-oil sector's added value grew 1.8%, while in the oil sector it grew 0.6%.

GDP per capita was 8,126.2 AZN, or 4,780.1 USD, a growth in real terms of 0.5% compared to 2017.

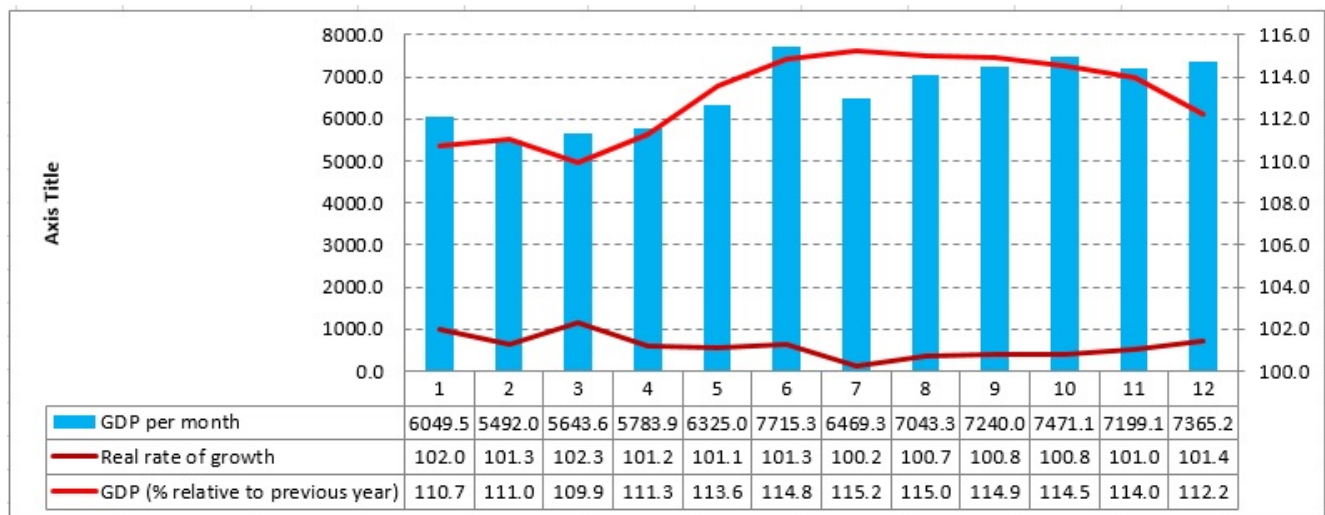
**Table 1**

**Macroeconomic factors of Azerbaijan's social and economic development, 2018<sup>1</sup>**

Indicators	2018	in comparison with 2017, %
Gross domestic product (mln AZN)	79797.3	<b>101.4</b>
Non-oil sector's contribution to GDP	46671.3	101.8
GDP per capita (AZN)	<b>8126.2</b>	<b>100.5</b>
Industrial production (mln AZN)	47659.5	101.5
Non-oil industry's contribution	10047.9	109.1
Fixed capital investment (mln AZN)	17238.2	95.6
Fixed capital investment in the non-oil sector only	11289.3	122.0
Fixed capital investment in non-oil industry only	2704.9	123.0
Agricultural production (mln AZN)	7010.0	104.6
Shipping sector (mln tons)	229.9	101.5
Passenger transport sector (mln passengers)	2002.8	101.5
Information and communications services (mln AZN)	1881.2	109.3
State revenues (mln AZN)	22411.2	135.7
State expenditures (mln AZN)	22718.9	129.1
Budget deficit (mln AZN)	307.7	x
Nominal national income (mln AZN)	53688.6	109.2
Nominal income per capita (AZN)	5467.4	108.2
Credit installments (as of Dec. 1, 2018) (mln AZN)	12564.2	102.8
Consumer price index	x	<b>102.3</b>

(Source: State Statistics Committee)

According to the SSC's monthly data, nominal GDP was at its lowest level in February at 5.5 bln AZN, and reached a high in June of 7.7 bln AZN (*figure 1*). Figure 1 shows how, over the course of the year, the GDP deflator fluctuated between 110-115%: in particular, the deflator's indicators were highest when the world market price of oil was up from May to October. While the rate of real growth began the year in January at 102.0%, it had fallen to 100.2% in June, followed by another period of growth to end the year at 101.4%



**Source: SSC**

Over the course of the year, industry's share of newly created added value was 44.2%; trade and transportation maintenance accounted for 9.6%; construction for 8%; shipping and storage for 6.3%; agriculture, forestry, and fishing for 5.3%; tourism and catering for 2.2%; and information and communications for 1.6%; with other sectors accounting for the remaining 15.0%. Net taxes on goods and imports accounted for 7.8% of GDP. 1.3 mln AZN

**Over the past 3 years, the non-oil oil sector's share of GDP has continued to contract.** In 2018, the non-oil sector generated 46,671.3 mln AZN, or 58.5%, of nominal GDP. The non-oil sector's share of GDP, therefore, as continued to shrink over the past 3 years: this indicator, at 65.8% in 2016, dropped to 58.5% in 2018, a fall of 7.3% (table 2). This means that the oil sector's share of GDP has grown by the same amount. This is related to the rise of the world market price of oil.

Table 2

## Dynamics of main macroeconomic indicators, 2016-2018

Indicators	2016	2017	2018
Nominal GDP, <i>mln. AZN</i>	59987.7	70135.1	79797.3
<i>Nominal GDP from non-oil sector, mln AZN</i>	39403.1	44061.9	46671.3
Non-oil sector's share of GDP, %	65.8	63.0	58.5
GDP deflator, %	114.6	116.0	112.2
Real GDP growth (reduction), %	- 3.8	0.1	1.4
Real GDP growth (reduction) in non-oil sector, %	- 5.4	2.7	1.8
Industrial sector growth (reduction), %	0.4	- 4.2	1.5
Including:			
Extraction industry	0.7	-4.6	0.4
Refinement industry	-1.4	-1.8	7.9
Agricultural sector growth (reduction), %	2.6	4.2	4.6
Construction sector growth (reduction), %	-27.6	-1.5	-9.0
Trade and vehicle maintenance sector growth (reduction), %	1.5	2.5	3.0
Information and communications sector growth (reduction), %	4.5	6.6	9.3
Shipping and storage sector growth (reduction), %	-0.5	8.5	7.8
Tourism and catering sector growth (reduction), %	0.1	5.9	7.6
Consumer price index	112.4	112.9	102.3
Fixed capital investments, mln AZN	14903.4	15550.8	17238.2
Fixed capital investment growth (reduction), %	-21.7	-2.6	-4.4
Industrial sector share of GDP, %	37.4	40.1	44.2
Agricultural sector share of GDP, %	5.6	5.6	5.3
Construction sector share of GDP, %	9.5	10.0	8.0
Trade and vehicle maintenance sector share of GDP, %	10.3	10.4	9.6
Information and communications sector share of GDP, %	1.8	1.6	1.6
Shipping and storage sector share of GDP, %	6.8	6.8	6.3
Tourism and catering sector share of GDP, %	2.4	2.3	2.2

(Source: State Statistics Committee)

According to the SSC's data, industry generated over 47.7 bln AZN in 2018, a growth of 1.5% relative to the previous year. The extraction sector accounted for 73.0% of industrial production; the oil-refining sector for 22.2%; electricity, gas, and steam production, distribution, and supply for 4.1%; and water supply and waste water treatment and management accounted for 0.7%. The non-oil industry sector grew 9.1% while the refinement industry grew 7.9%. The contraction of the refinement industry observed in 2016-2017 has therefore been reversed.

In contrast to industry, ***the contraction of Azerbaijan's construction sector not only continued, but actually accelerated.*** While the construction sector shrank by 1.5% in

2017, the rate of contraction rose to 9.0% in 2018. This is due to the 4.4% drop in capital investment relative to 2017. According to the SSC's figures, 17,238.2 mln AZN was invested in fixed capital in 2018, a 4.4% drop compared to 2017. This is said to be due to the drop in investments in the oil sector. Investments in the non-oil sector grew by 22.0%, including a 23.0% rise in investments in non-oil industry.

According to the State Customs Committee's (SCC) data, [\[i\]](#) in 2018 Azerbaijan's turnover in foreign trade was 30,923.6 mln USD, of which exports accounted for 19,458.6 mln USD, or 62.9%, while imports accounted for 11,465.0 mln USD, or 37.1%. There was a positive balance in foreign trade of 8.0 bln USD.

***In the reporting year, the oil and gas sector accounted for 91.2% of total exports.*** The non-oil sector's share of total exports was 8.7%, or 1,689.2 mln USD. In 2018, Azerbaijan exported 15.7 bln USD of crude oil (80.8% of total exports), 1.5 bln USD of natural gas (7.7% of total exports), and 520.6 mln USD of oil products (2.7% of total exports). The oil and gas sector accounted for 91.2% of total exports.

According to the SCC's data, out of a total of 11.5 bln USD of imports in 2018, food products accounted for 1.37 bln USD (12.0%); machines, mechanisms, and electrical devices and equipment for 2.6 bln USD (22.6%); ferrous metals for 1.2 bln USD (19.5%); and vehicles and spare parts accounted for 945.5 mln USD (8.3%).

## **Monetary Policy**

In the Central Bank's statement [2018 and the mid-year objectives of monetary policy](#), the main priorities are to strengthen the durability of macroeconomic stability and to continue the policy of minimizing expected inflation. With the refinance rate falling, by relaxing monetary (credit) policy the Central Bank was able to reduce to a minimum the factors, including foreign ones, strengthening the inflation brought about by the administrative measures applied to stabilize the

national currency.

According to the Central Bank's statement, the level of inflation, showing a tendency to fall, reached single digits in 2018. According to the State Statistic Committee's data, last year's average inflation was 2.3%. The average inflation for food prices was 1.7%, for non-food products it was 2.7%, and for services it was 2.7%. But according to its statement, the Central Bank set a target of around 6-8% for inflation. At the midpoint of 2017, the level of inflation was 12.9%. At that time the rise in food prices actually reached 16.4% (figure 2).

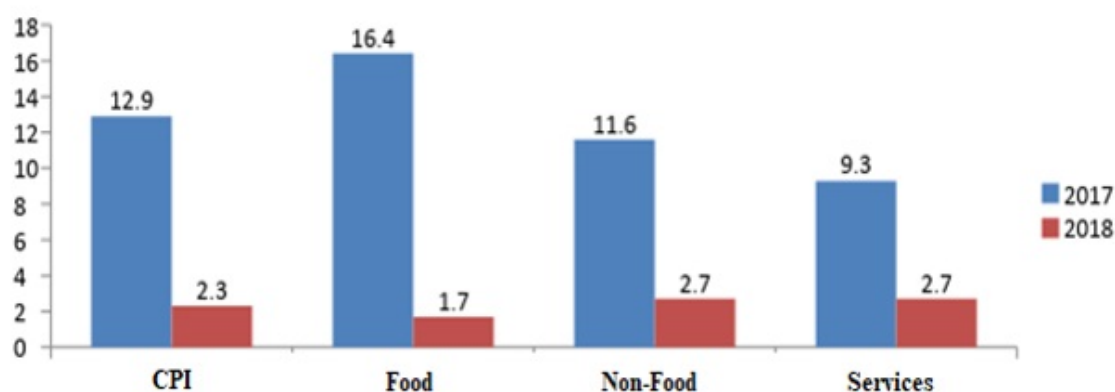


Figure 2. Average annual inflation, %

According to official data, out of a total of 521 type of goods and services, the price of 121 fell and the price of 40 remained unchanged. Of the prices of products that rose, 90% of them went up no more than 5%. Not including goods and services whose prices are regulated by the state, nor the seasonal fluctuations of the prices of agricultural produce, the average annual basic inflation rate in 2018 was 1.8%.[\[ii\]](#)

***The primary cause of the lowering of inflation was the stability of the exchange rate of the national currency.*** Despite the announcement of a transition to a floating exchange rate, in the reporting period the average daily exchange rate with the US dollar was 1.7000 AZN. The exchange rates set by banks for the sale and purchase of foreign



currencies were close to official rates. Over the period, the average daily rate at commercial banks for purchase was 1.6965, while for sale it was 1.7023 AZN. The difference between official rates and commercial banks' rates for purchase was 0.2% (0.0035 AZN), while for sale it was 0.1% (0.0023 AZN). In its reports and statements, the Central Bank said that the official exchange rates were based on the average rate of exchange between banks (*taking into account auctions and other operations at Bloomberg*).[\[iii\]](#) But since March 3, the average exchange rate with the dollar has remained unchanged at 1.7000 AZN. In world markets, the US dollars' rate of exchange with other currencies fluctuated significantly. It is clear from all this that the national currency's exchange rate is being regulated administratively. The presidential order of June 17, 2018, called "A Strategic Road Map for the Perspectives of the Azerbaijan Republic's National Economy," extending the deadline to complete the transition to a floating exchange rate from 2017 to 2020, is proof that administrative measures have been taken to regulate the rate.

Last year, out of the 40 foreign currency exchange rates calculated by the Central Bank, 28 rose in relation to Azerbaijan's national currency, 11 fell, and one remained unchanged. Over the period, according to the official exchange rate for the year, the Azerbaijani manat's value grew by 0.01% relative to the dollar, 28.6% relative to the Turkish lira, 16.9% relative to the Russian ruble, 4.1% relative to the Euro, and 5.9% relative to the British pound.[\[iv\]](#)

Due to the rise in the price of oil on the world market, ***the Azerbaijani manat was under pressure to strengthen in 2018.*** Excluding a few months, supply on the foreign currency market exceeded demand. The growth of demand for foreign currency observed particularly in April, August, and December, was due to psychological expectations after the currency of some trading partners fell sharply in value. In April, the volume of sales of USD was 545.7 mln USD, and in August it was 542.7



mln USD. In other months, however, the volume of sales of USD fluctuated between 150-230 mln USD.[\[v\]](#) The currencies of Azerbaijan's main trading partners lost value against the dollar in April, with the Russian ruble's official exchange rate falling 8.3% and the Turkish lira by 2%. In August, the value of the Russian ruble fell another 9.2%, while the Turkish lira fell 33%. The rise in sales of the dollar in December (584.2 mln USD) was related to the fulfillment of budget obligations at the year's close. The total volume of dollar sales in 2018 was 3.41 bln USD, approximately double the volume sold in 2017 (1.76 bln USD).

***With the value of the manat under no threat of falling, the Central Bank had the opportunity not only to preserve its foreign currency reserves, but even to expand them.*** Last year, the Central Bank's foreign currency reserves reached 5.62 bln USD, a growth of 287.9 mln USD, or 5.4%. Management of the reserves accounted for 115 mln USD, another  $\frac{1}{3}$  of the total is funds returned by banks in swap transactions, and the rest came from services which the Central Bank provided to international organizations.[\[vi\]](#)

According to the Central Bank's data,[\[vii\]](#) growth was observed in both cash and non-cash foreign currency transactions in 2018. The volume of transactions on the non-cash foreign currency market was equivalent to 25.4 bln USD. During the period, 83.3% of transactions on the non-cash currency market were carried out in dollars, and 16.7% were carried out in other currencies. 33% of non-cash transactions were carried out on the interbank foreign exchange market, while 67% were carried out on the internal foreign exchange market. Banks' regulation of their foreign currency position accounted for 53.5% of dollar transactions on the interbank foreign exchange market. The volume of foreign currency transactions on the internal foreign exchange market was equivalent to 17 bln USD, and 77% of those transactions were made in dollars. On the internal foreign exchange market, 93% of foreign currency transactions were carried out by legal entities. ***The rate of***

***growth in banks' foreign exchange cash transactions reached a 5-year high.*** During this period, the volume of dollar exchanges rose 56% compared to 2017, reaching 5.4 bln USD. The growth was mostly due to sales. Compared to the previous year, dollar sales doubled, while purchases rose 17.5%. After steadily falling for 4 years, the rate of growth of the Euro exchange turnover final rose last year by 32%, reaching 964.2 mln EUR.[\[viii\]](#)

***The State Oil Fund's sales of foreign currency rose sharply.*** In 2018, the State Oil Fund of the Azerbaijan Republic's (SOFAZ) sales of foreign currency, at auctions held twice a week by the Central Bank, totaled 6,460.4 mln USD.[\[ix\]](#) This is a growth of 79.6% relative to the same period in 2017. For comparison, in 2017 SOFAZ sold 3,598.1 mln USD and in 2016 it sold 4,586.5 mln USD.[\[x\]](#) ***Last year, the fund's foreign currency sales were greater than in previous years due to the growth of its transfers to the state budget.*** In 2016, the fund transferred 7.6 bln AZN to the state budget, in 2017 the figure was 6.1 bln AZN, and in 2018 10.96 bln AZN was transferred.

While keeping open both closed-market and open-market operations, last year the Central Bank was only able to employ open-market operations. In 2018, in order to regulate the money supply and control banks' recent excess liquidity, the Central Bank carried out 55 deposit auctions and 51 securities placement auctions to attract liquid assets. Through deposit operations funds were attracted for 14 days, and securities were placed for 28 days. Banks raised 54 mln AZN through the deposit auctions, and almost 90 mln AZN from the interest on the sale of notes.[\[xi\]](#)

***Over the course of the year, the Central Bank's refinance rate fell from 15.0% to 9.75%.*** The refinance rate fell in stages thanks to the Central Bank's policy of relaxing monetary (credit) policies. On February 12, the refinance rate fell from 15% to 13%, later dropping to 11% on April 10, and to 10%

on June 14, finally reaching 9.75% on October 30. In this period, the interest rate corridor's upper limit was lowered from 18.0% to 11.75%, while the lower limit fell from 10.0% to 7.75%. Despite the lowering of the interest rate corridor, demand was 2.6 times greater than supply in deposit auctions, and 2.4 times greater in banknote auctions. This is due to the excess liquidity resulting from weakening credit.[\[xii\]](#)

***Last year, the reserve requirement remained unchanged.*** The last time the reserve requirement changed was on March 3, 2016. At that time, the reserve requirement was set at 1.0% for foreign currency obligations, 0.5% for AZN and precious metals obligations, and 0 for obligations in the non-resident finance sector and for settlements with international financial institutions. Over the reporting period, required reserves grew from 141.2 mln AZN to 163 mln AZN.

***Last year the supply of money grew.*** Last year the manat's monetary base grew 11.7%, reaching 9,545.7 mln AZN by the end of the period. Over the course of the year, the broad money supply (M2) grew 17.5% to 14,643.6 mln AZN. In the breakdown of the manat money supply (M2), cash grew 15%, manat savings of individuals grew 24.1%, and the manat deposits of legal entities grew by 42.9%.

The 50.1% growth in the demand for savings and deposits in AZN, as well as 10.4% for temporary savings and deposits, can be explained by ***the population's confidence in the currency's stability and the banks' durability.***

***Despite the promotion of cashless transactions, the amount of cash in circulation grew.*** Last year the amount of cash in circulation rose 2.8%, reaching 8.4 bln AZN. This is the highest amount since 2014 (10.9 bln AZN). Despite this growth, over the course of the year, the share of cash in circulation in the monetary base fell from 82.5% to 81.1%.

The Central Bank regulated the growth of the money supply through deposit auctions and treasury note auctions. In the

reporting period, the amount of money temporarily removed from circulation through deposit auctions and treasury note auctions fluctuated between 1.7-1.8 bln AZN.

***The national currency's stability led to a reduction in the level of dollarization in the banking sector.*** A reversal of dollarization was observed both in new credit installments and new deposits. In 2018, the share of loans in foreign currencies fell from 40.9% to 38.0%, while the share of general deposits fell from 72.4% to 65.3%. The drop occurred both in the population's savings deposits, as well as in the deposits of non-financial institutions. The share of foreign currencies in the population's deposits fell from 66.5% to 62.5%, in financial institutions' deposits it fell from 82.4% to 72.9%, and in the deposits of non-financial institutions it fell from 74.7% to 66.4%. Currently, the highest level of dollarization is in the deposits of financial institutions.[\[xiii\]](#)

With the goals of restricting the flow of foreign currency out of the country and stabilizing the foreign exchange market, amendments were made to the Central Bank's February 26, 2018 decision #4/1, called "The Azerbaijan Republic's rules for carrying out operations in foreign currency by residents and non-residents." These amendments strengthened the demands regarding foreign currency operations by residents and non-residents. At the same time, the changes extended the deadline for making a customs declaration on imported goods and for presenting documents to the bank reflecting the export of services from 180 days to 270 days.

## **The State of Budget Execution**

**At the midpoint of 2018, amendments were made in the state budget projections.** On December 1, 2017, a law was signed, called "On the 2018 state budget of the Azerbaijan Republic." According to that law, state revenues were projected at 20,127.0 mln AZN, while expenditures were 21,047.0 mln AZN,

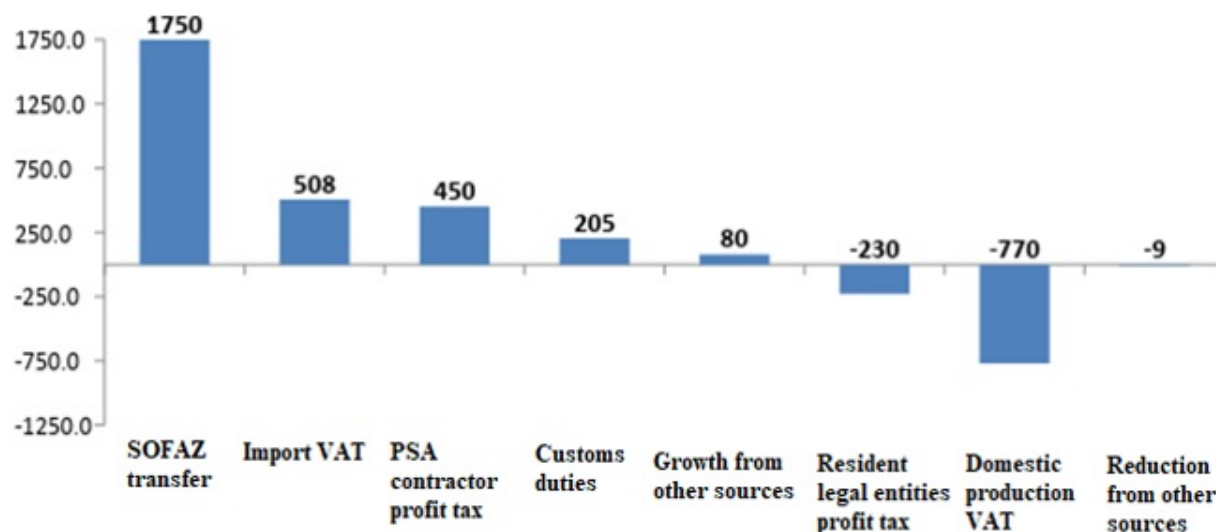
meaning that the state budget's projected deficit was 920.0 mln AZN.

Over the course of the year, SOFAZ's transfers to the state budget were projected at 9,216.0 mln AZN, or 45.8% of total projected revenues. It was decided that, compared to 2017, the transfer from SOFAZ to the state budget would grow by 3,116.0 mln AZN, or 51.1%. Overall, compared to 2017, state revenues were projected to grow in 2018 by 3,361.0 mln AZN, or 20%. Of this growth, 3,156.0 mln AZN, or 94%, was a direct contribution from the oil sector.

It must be noted that the 2018 state revenue projections were based on an average oil price of 45 USD per barrel for the year. But with a world market price of over 60 USD per barrel in the first half of 2018, the government decided to increase its projections for state revenues and expenditures. On June 29, 2018, new legislation altered the existing law, "On the 2018 state budget of the Azerbaijan Republic," projecting state revenues of 22,149.0 mln AZN and expenditures of 23,100.0 mln AZN. As a result, the increase in projected revenues was 1,983.0 mln AZN, and in expenditures it was 2,014.0 mln AZN. After these amendments, the budget deficit's upper limit rose to 951.0 mln AZN.

***With these budget amendments, the growth of revenues would come from the contributions of the oil and gas sector, as well as foreign economic activities, but projected contributions from the non-oil sector were actually lowered.*** Despite this overall growth in projected expenditures, the changes regarding the respective sources of these contributions deserve special attention. With the new amendments, the total projected state revenues from profit taxes on resident legal entities were lowered by 230.0 mln AZN, while the projected contributions from VAT on goods and services were lowered by 770.0 mln AZN. At the same time, the transfer from SOFAZ was raised by 1,750.0 mln AZN, the contributions from profit taxes from profit sharing agreements (PSAs) with contractors grew by

450.0 mln AZN, the contributions from VAT on imported goods went up by 508.0 mln AZN, and customs duties were projected to increase by 205.0 mln AZN (*figure 3*).



**Figure 3. Shifts in the sources of 2018 state revenues**

As seen here, the overall amount of contributions to state revenues from various sources grew 3.0 bln AZN compared to initial projections, while the contributions from other revenue sources decreased by 1.0 bln AZN. While the oil sector (2,200.0 mln AZN) and foreign economic activities (725.0 mln AZN) are directly responsible for the growth, the reductions occurred primarily in the profit taxes and VAT from domestic legal entities.

After the amendments, therefore, the 2018 state budget's projected revenues were higher than the 2017 projections by a total of 5,383.0 mln AZN, or 33%. According to the projections, the oil sector's direct contributions to the state budget were expected to grow by 5,356.0 mln AZN, which is nearly equal to the projected revenue growth in its entirety. Compared to the 2017 state budget projections, contributions from the State Customs Committee (SCC), in the adjusted 2018 projections, were expected to grow by 800.0 mln AZN, while the tax revenue which the Tax Ministry expected to collect from the non-oil sector was predicted to fall

somewhat.

According to the adjusted 2018 state budget projections, direct contributions from the oil sector were expected to account for 13,346.0 mln AZN, or 61% of state revenues, including 10,966.0 mln AZN, or 50% of the total, to be transferred from SOFAZ.

***As a result of the amendments, over half (57.0%) of the growth in state spending is earmarked for 3 state companies.*** The adjustments raised state expenditures relative to the initial projections by 2,014.0 mln AZN. This growth supplemented the allocations for “economic activity” by 1,144.6 mln AZN (57.0%), plus a further 270.0 mln AZN (14.0%) for investment spending, 166.5 mln AZN for defense spending, 145.9 mln AZN for social protection and guarantees, 99.0 mln AZN for agriculture, and 42.0 mln AZN for education. The additional 1,144.6 mln AZN for “economic activity” is allocated in its entirety to 3 state companies: the State Oil Company of the Azerbaijan Republic (SOCAR) will receive 963.2 mln AZN, with 100 mln AZN going to the Azerbaijan Railways, and the remaining 81.4 mln AZN allocated for Azerenergy, the state electric company.

**The execution of the 2018 state budget.** According to the Finance Ministry’s operational data, [\[xiv\]](#) the 2018 state revenues were 22,411.3 mln AZN, expenditures were 22,718.9 mln AZN, and the budget deficit was 307.6 mln AZN.

**State revenues.** 2018 state revenues exceeded the projected amount (22,149.0 mln AZN) by 262.3 mln AZN, or 1.2%.

Transfers from SOFAZ accounted for 10,959.0 mln AZN, or 48.9%, of total state revenues; funds collected by the Tax Ministry accounted for 7,417.6 mln AZN, or 33.1% (including 4,975.5 mln AZN [22.2%] from the non-oil sector); the SCC’s contributions totaled 3,434.4 mln AZN (15.3%); pay services provided by state agencies accounted for 466.4 mln AZN (2.1%); and the remaining 134.3 mln AZN came from various other sources



(figure 4).

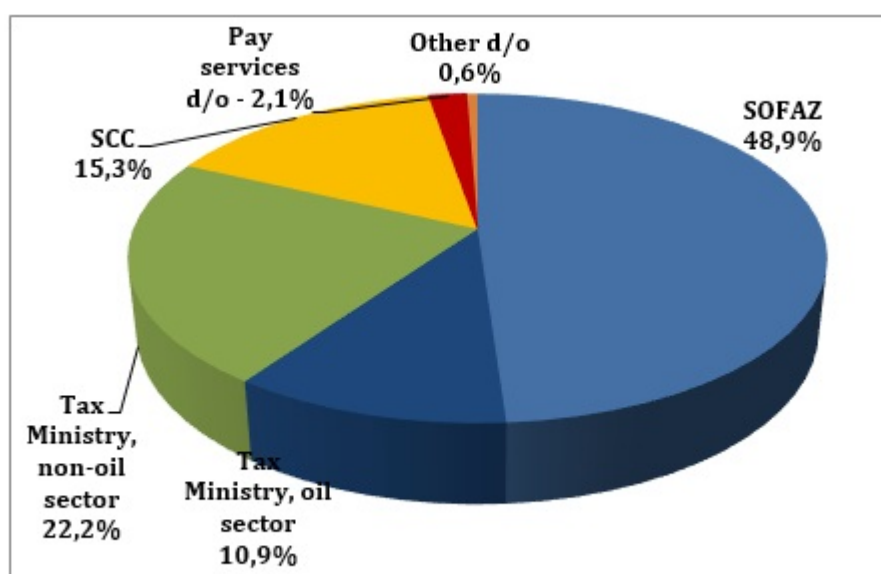
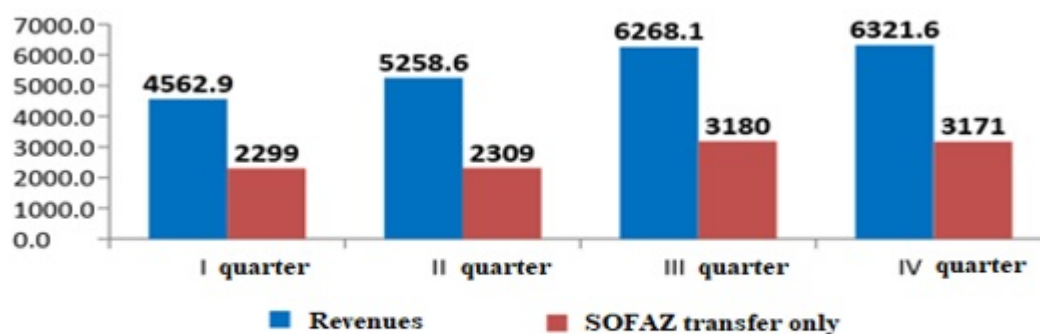


Figure 4. 2018 state revenue breakdown, % of total (Source: Finance Ministry)

According to preliminary data, **the oil sector directly accounted for 13,401.1 mln AZN, or 59.8 % of total state revenues in 2018**. Transfers from SOFAZ accounted for 10,959.0 mln AZN, while the remaining 2,442.1 mln AZN came from taxes collected by the Tax Ministry from the oil sector (i.e. SOCAR's payments and payments made by foreign contractors according to PSAs).

**Excluding SOFAZ's transfers, state revenues came out to 11,452.3 mln AZN**, which is 97.5 mln AZN, or 0.85%, short of the government's current expenses (11,549.8 mln AZN).

The state accrued 20.8% (4,562.9 mln AZN) of its revenues in the first quarter, 23.5% (5,258.6 mln AZN) in the second quarter, 28.0% (6,268.1 mln AZN) in the third quarter, and the remaining 28.1% (6,321.6 mln AZN) in the fourth quarter (figure 5).



**Figure 5. State revenues by quarter, mln AZN**  
*(Source: Finance Ministry's operational data)*

SOFAZ transferred 2,299.0 mln AZN (21.0%) to the state budget in the first quarter, 2,309.0 mln AZN (21.1%) in the second quarter, 3,180.0 mln AZN (29%) in the third quarter, and 3,171.0 mln AZN (28.9%) in the fourth quarter. This means that SOFAZ's contributions accounted for 50.4% of state revenues in the first quarter, 43.9% in the second quarter, 50.7% in the third quarter, and 50.2% in the fourth quarter.

In 2018, real state revenues grew by 5,894.6 mln AZN, or 36.0%, compared to 2017 revenues (16,516.7 mln AZN). In 2018, compared to the previous year, the transfer from SOFAZ to the state budget grew by 4,859.0 mln AZN, or 79.7%; funds collected from the oil sector by the Tax Ministry grew by 662.8 mln AZN, or 37.3%; the SCC's contributions grew by 825.6 mln AZN, or 31.6%; and funds from service fees charged by state agencies grew by 100.3 mln AZN, or 27.4% (*figure 6*).

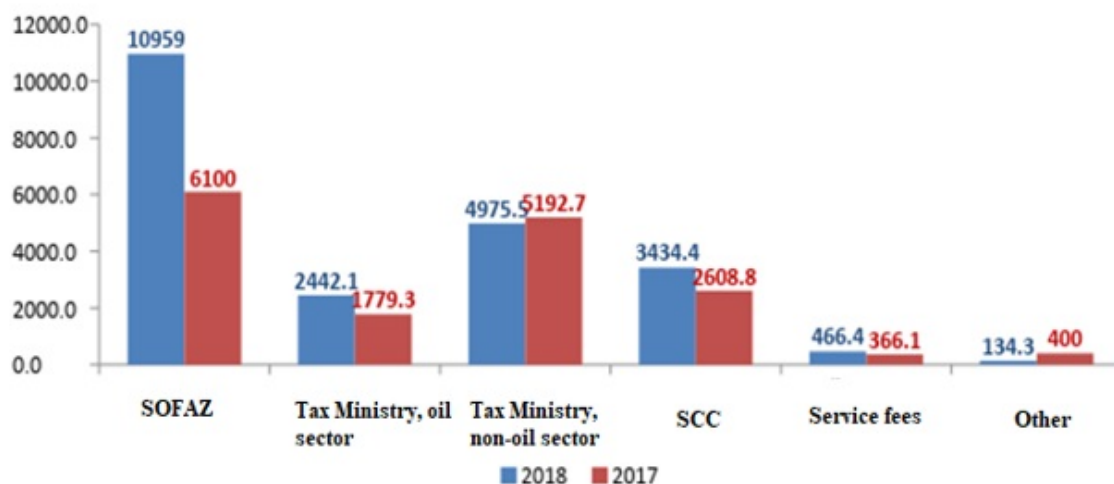


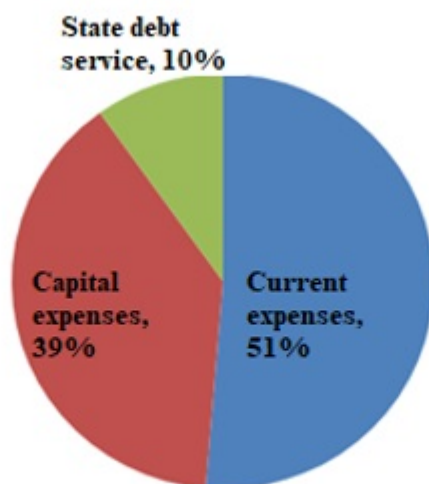
Figure 6. Comparison of state revenues in 2017 and 2018  
(Source: Finance Ministry's preliminary executive data)

Despite overall growth, compared to 2017, ***funds collected by the Tax Ministry from the non-oil sector decreased in 2018 by 217.2 mln AZN, or 4.2%, and uncategorized contributions also fell by 265.7 mln AZN, or 66.4% (in 2017, the Central Bank transferred 250.0 mln AZN of its profits to the state budget, but in 2018 it did not transfer anything, which explains the sharp fall in uncategorized revenues).***

***The oil sector's contributions, therefore, accounted for 5,521.8 mln AZN, or 86.0%, of the overall growth in state revenues in 2018, while 12.8% of the growth came from foreign economic activity.***

**State expenditures.** According to the Tax Ministry's operational data, state expenditures in 2018 totaled 22,718.9 mln AZN, which is 381.1 mln AZN, or 1.6%, lower than projected.

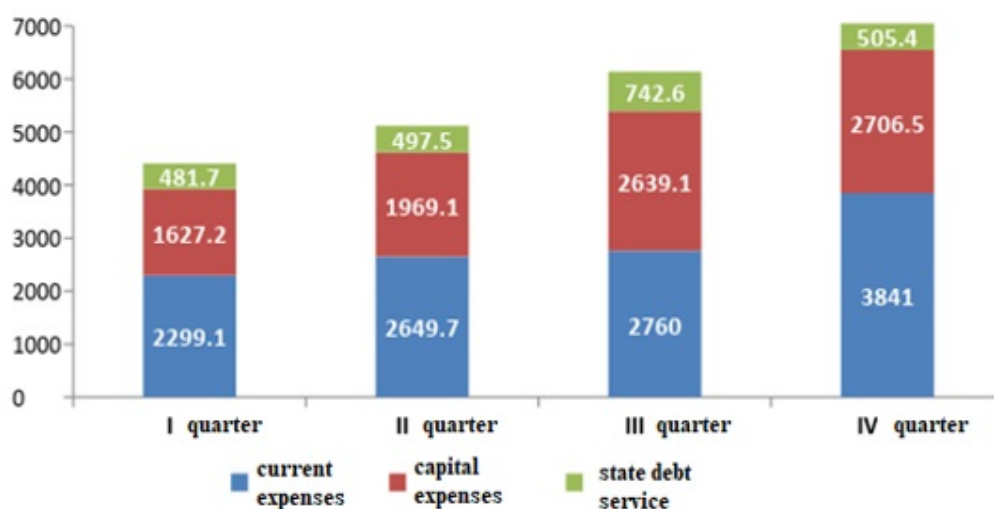
State spending included 11,549.8 mln AZN (50.8%) for current expenses; 8,941.9 mln AZN (39.4%) for capital expenses; and 2,227.2 mln AZN for servicing state debt and obligations (figure 7).



**Figure 7. Breakdown of 2018 state spending (% of total)**

According to the Finance Ministry's data, 31.7% of state expenditures, or 7,196.6 mln AZN, went toward social programs (salary payments, pensions and social benefits, medicine and food expenses). This is a growth of 505.9 mln AZN, or 7.6%, compared to 2017.

In the first quarter, 4,408.0 mln AZN was spent, or 19.4% of the year's total expenditures; 5,116.3 mn AZN (22.5%) was spent in the second quarter; 6,141.7 mln AZN (27.0%) in the third quarter; and the remaining 7,052.9 mln AZN (31.0%) in the fourth quarter (*figure 8*).

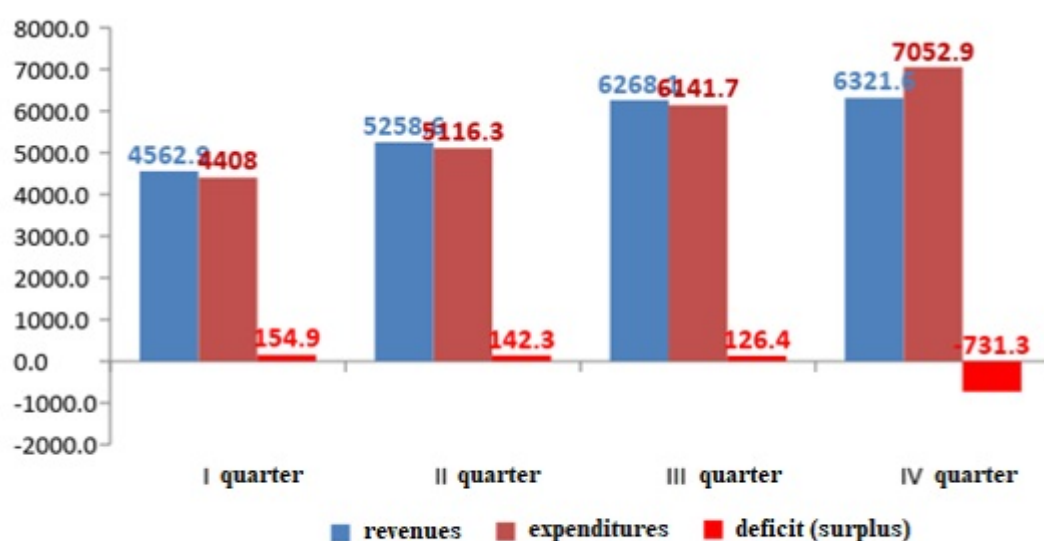


**Figure 8. Execution of 2018 state expenditures by quarter, mln AZN** (*Source: Finance Ministry's operational data*)

***In 2018, state spending grew relative to 2017 by 5,124.4 mln***

**AZN, or 29.1%.** According to these calculations, current expenses grew in 2018 by 643.7 mln AZN, or 5.9%; capital expenses grew by 3,767.1 mln AZN, or 72.8%; and debt service grew by 713.5 mln AZN, or 47.1%. That means that most of the growth in state spending in 2018 – 73.5%, or 3,767.1 mln AZN – went to capital expenses, i.e. investment activities. Another 13.9% (713.5 mln AZN) of the growth in state spending went to servicing the state debt, and 12.6% (643.7 mln AZN) went to current expenses.

**Budget deficit. In 2018, the state budget deficit was 307.6 mln AZN.** According to the operational data on budget execution, revenues exceeded expenditures in the year's first three quarters by 154.9 mln AZN in the first quarter, 142.3 mln AZN in the second, and 126.4 mln AZN in the third, resulting in a budget surplus totalling 423.6 mln AZN by the end of the third quarter (*figure 9*).



**Figure 9. 2018 budget deficit (surplus) by quarter, mln AZN**

In the final quarter, however, expenditures exceeded revenues by 731.3 mln AZN, resulting in a budget deficit of 307.6 mln AZN at the end of the year. This is 32.3% of, or 643.4 mln AZN less than, the deficit limit of 951.0 mln AZN set by law.

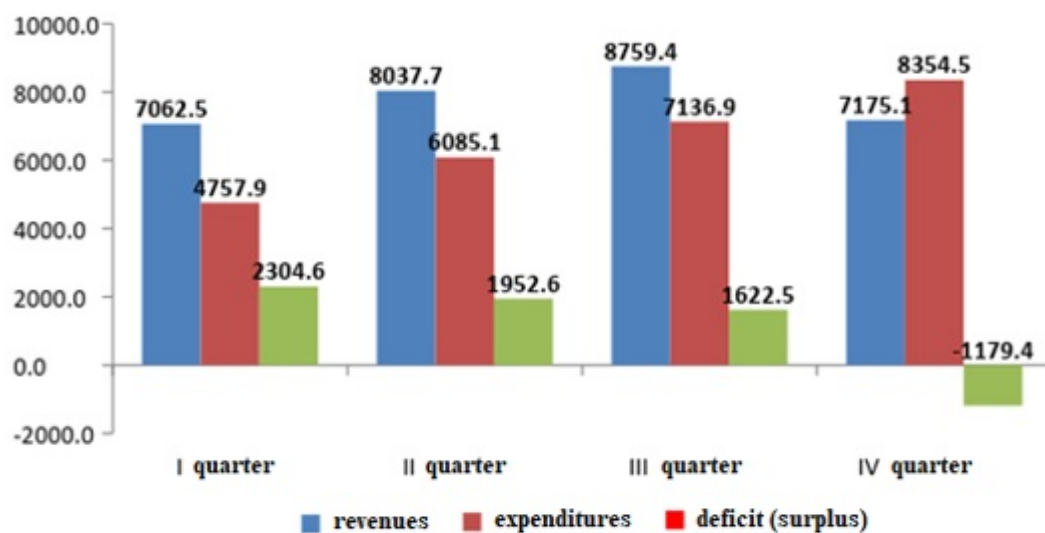
The 2017 state budget deficit was 1,077.8 mln AZN, which means that the deficit was 3.5 times smaller in 2018.

## Overall state revenues and expenditures

According to the Finance Ministry's operational data, the overall state revenues in 2018 were 31,034.7 mln AZN, a growth of 6,958.7 mln AZN, or 28.8%, relative to 2017. Overall state spending was 26,334.4 mln AZN, which is 240.9 mln AZN below the upper limit set by law. Compared to 2017, overall state spending grew in 2018 by 4.6%, or 1,151.4 mln AZN.

***In 2018, there was an overall budget surplus of 4,700.3 mln AZN.*** By comparison, in 2017 there was a deficit of 1,107.0 mln AZN.

In 2018, 22.8% of total state revenues came in the first quarter; 25.9% in the second; 28.2% in the third; and the remaining 23.1% in the fourth. As for total state spending, 18.1% occurred in the first quarter; 23.1% in the second; 27.1% in the third; and the remaining 31.7% in the fourth (*figure 10*).



**Figure 10. Basic parameters of total 2018 by quarter, mln AZN**  
(Source: Finance Ministry's operational data)

As the data in figure 10 show, in the first three quarters overall state revenues exceeded expenditures: by the end of the third quarter there was an overall budget surplus of 5,879.7 mln AZN. In the fourth quarter, however, total revenues fell relative to the previous 2 quarters while

expenses increased. In the final quarter, therefore, overall expenditures exceeded revenues by 1,179.4 mln AZN. As a result, at the end of the year there was a budget surplus of 4,700.3 mln AZN.

## **Outcomes**

The most important things that happened in the economy from a macroeconomic perspective can be summarized as follows:

### **Macroeconomic indicators:**

- Compared to 2017, the real GDP growth rate was 101.4%, while the GDP deflator was 112.2%;
- GDP per capita was 8,126.2 AZN, or 4,780.1 USD, which in real terms is growth of 0.5% relative to 2017;
- The non-oil sector's share of GDP continued to fall for the third year, from 65.8% in 2016 to 58.5% in 2018;
- The refinement industry reversed the downward trend of 2016-2017 and grew 7.9% in 2018;
- The contraction of the construction sector not only continued, it accelerated: this sector shrank by 1.5% in 2017 but by 9.0% in 2018
- In 2018, there was a positive balance of 8.0 bln USD in the total turnover of Azerbaijan's foreign trade;
- In the reporting year, the oil and gas sector accounted for 91.2% of Azerbaijan's total exports, while the non-oil sector accounted for 8.7%.

### **Monetary Policy**

- Last year, the consumer price index (CPI) was 102.3% relative to the previous year. The main factor for the fall of the inflation rate was the stability of the national currency's exchange rate;
- In 2018, the Azerbaijani manat was under pressure to strengthen. Apart from a few months, supply exceeded demand on the foreign currency market;
- With the manat under no threat of weakening, the Central



Bank was able not only to preserve its foreign currency reserves, but to expand them: last year, the Central Bank's foreign currency reserves grew 5.4% to 5.62 bln USD;

- The rate of growth in banks' foreign currency cash exchanges reached a 5-year high;
- In 2018, SOFAZ's sales of foreign currency grew 79.6% compared to the previous year: over the course of the year, the fund sold the equivalent of 6,460.4 mln USD;
- To regulate the money supply and control banks' recent excess liquidity, the Central Bank held 55 deposit auctions to attract liquid assets, and 51 securities placement auctions;
- Over the course of the year, the Central Bank's refinance rate was gradually lowered from 15.0% to 9.75%, the reserve requirements remained unchanged, and the manat's monetary base grew 11.7%;
- Despite the promotion of cashless transactions, the amount of cash in circulation grew by 2.8%;
- The stability of the national currency provided for a decrease in the level of dollarization in the banking sector: in 2018, the share of loans in foreign currency fell from 40.9% to 38.0%, while the share of general deposits in foreign currency dropped from 72.4% to 65.3%.

#### **Execution of the state budget:**

- Due to the high price of oil on world markets and the growth of Azerbaijan's oil profits in the first half of the year, the state budget projections were adjusted midway through 2018: projected state revenues were raised 1.9 bln AZN, while expenses were raised 2.0 bln AZN;
- While the increase in state revenues came directly from the contributions of the oil sector (2,200.0 mln AZN) and foreign economic activity (725.0 mln AZN), projections of profit taxes from resident entities

within the country and VAT were actually lowered by approximately 1.0 bln AZN;

- As a result of the budget amendments, over half (57.0%) of the growth in state spending went to 3 state companies;
- 2018 state revenues exceeded projections by 1.2%, a growth of 36% relative to 2017;
- The oil sector's direct contributions accounted for 59.8% of state revenues;
- Excluding SOFAZ's transfer, state revenues actually fell short of real current expenses by 0.85%;
- Compared to the previous year, funds collected by the Tax Ministry from the non-oil sector actually fell by 4.2% in 2018;
- In 2018, 86% of the growth of overall state revenues compared to 2017 came from the oil sector, while 12.8% came from foreign economic activity.
- 2018 state spending fell short of projections by 1.6%, but grew relative to 2017 by 29.1%;
- Currenty expenses accounted for 50.8% of state spending, capital expenses for 39.4%, and debt service and obligations accounted for 9.8%;
- The budget deficit in 2018 was 307.6 mln AZN, or 32.3% of the upper limit set by law;
- In 2018 there was an overall budget surplus of 4,700.3 mln AZN (by comparison, there was a deficit of 1,107.0 mln AZN in 2017).

## **Conclusions**

- Last year, real GDP growth was only 1.4% despite maintaining monetary and financial stability, serious growth in oil revenues compared to 2017, a positive balance in foreign trade of 8 bln USD, growth of the overall budget by 4.7 bln AZN, 29.1% growth in state expenditures compared to 2017, and 80% growth in state investments;
- With the growth of oil revenues, Azerbaijan's economic

dependence on the oil sector is deepening: 1) the non-oil sector's contribution to GDP rose from 34.2% in 2016 to 41.5% in 2018; 2) over the reporting period, the share of state budget revenues coming directly from the oil sector was 59.8%; 3) the oil and gas sector accounted for 91.2% of the country's total exports;

- Although in 2018, using the state budget and other channels, the government invested most of its oil revenues in the economy, this was not enough to end the crisis in the construction sector or to have any serious effect on overall economic growth;
- The growth in oil revenues provided for the growth of the Azerbaijan's foreign currency reserves;
- Despite recent improvements in the business environment, incentives for investment, and the growth of state investment, the fall in the economic growth rate by 2% shows the need for more serious economic reforms.

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[x] Based on data from the Central Bank and the Baku Stock Exchange

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