

The Threat of an Economic Crisis: Risks for Households

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The catastrophic disruption of the global economy brought about by the COVID-19 pandemic has caused an earthquake in world oil markets. The violation of the March 6 agreement between OPEC and Russia to reduce supply in the market pushed oil prices down to \$21, their lowest level since 2001. Even in a number of producing countries, including Russia and the United States, market prices for crude oil have fallen below cost.

After nearly 10 years of rapid economic growth (2005-2014), there is deep concern over what is happening in Azerbaijan, which suffered a severe economic shock only five years ago. On the one hand, the coronavirus has completely obliterated a number of sectors of the economy which employ tens of thousands of people, particularly tourism, food service, and wholesale trade, and on the other hand, with oil accounting for at least 60% of Azerbaijan's budget, the country has suffered serious losses in its foreign exchange reserves due to the sudden 2.5-fold drop in market prices..

In these circumstances, what are the risks for the general population, for households which have not yet recovered from the shock of the sharp 2015 depreciation of the national currency, and given their available resources, what is their level of immunity in the face of another economic crisis?

Households – the foundation of the economy

To understand the state of the economy in any country, one must first look at the state of households, then business, then banks, and finally the government. The economic stability of the three institutional entities depends directly on the well-being and behavior of households.

If households earn well and spend enthusiastically, and the problem of unemployment is not critical, then the business sector will grow. If entrepreneurs and households are in good condition, then banks will generally operate without any problems. If all three of them can stand on their own two feet, develop and grow, the government will not have any problems.

In Azerbaijan, however, at the top of the value hierarchy is the public administration sector – has the state budget grown, have the government's foreign exchange reserves increased, and is the government's foreign debt not too large?

Next, the banks are examined – have problem loans increased or are there banks at risk of closure, can they operate profitably, has the foreign exchange position been violated, etc.?

Then comes business. But here, too, very important questions must be answered. For example, what has been the profitability of the business sector, how has the number of loss-making enterprises changed, has the number of closed companies been more or less than the number of newly opened ones, have business investments increased or decreased, and has the tax burden increased or decreased?

And at last come households. Unfortunately, the condition of households is not analyzed sufficiently in depth. For that there is not even a reliable statistical database. The clearest example of this is the employment situation – at least 65% of the employed population (about 3.2 million people) do not have officially registered jobs and income. Even in the midst of the deep economic crisis now beginning, the government has announced it will not be able to help informal workers due to a lack of official data.

The financial resources and obligations of households

How many households actually have savings in official deposit

accounts today, and how long will these savings allow them to meet their minimum material needs in an economic crisis? How many households are there that, though they do not have an official deposit account, have unofficial cash savings, and how many months can they last in times of deep crisis? How many households overall have no savings and are unable to meet their minimum material needs (including urgent health care expenses) and emergency liabilities (such as credit debt) without government support as they lose their wages and earnings? How have households' capital investments changed, have their investments in financial assets, real estate, and personal property increased or decreased, and how has the number of families earning less than the median per capita income changed recently?

The government does not have the reliable data and analyses necessary to answer all these important questions. The situation at the outset of the current crisis can be assessed, however, based on several indicators, using the 2015 crisis as a reference. For example, if there is no data, one must look at least at the ratio of household savings (deposits) to liabilities (debts) recorded in official sources during economic crises.

Especially in the context of high risk for the exchange rate, the high share of national currency in deposits but foreign currency in loans poses a serious risk to households. Devaluation causes, first of all, a loss in the financial resources of households, and secondly, an added cost in the fulfillment of obligations. In 2015, shortly before the first devaluation, the amount of household debt in the form of loans amounted to 7.7 billion AZN, which was about 20% of total household income at that time (39.4 billion AZN). According to the [2019 figures](#), the loan debts had decreased by 800 million AZN (about 10%) compared to 2015, and accounted for 12% of annual household income (57 billion AZN). It is clear that there has been a significant reduction in credit debt both in absolute terms and in terms of the total income of the

population. In periods of deep economic crisis, a low level of debt is a risk-reducing factor. At the end of 2014, the share of foreign currency in household loans was 25%, but by the [end of 2019](#), this figure was more than halved to 12%. In absolute terms, the population's foreign currency loans decreased from 1.8 billion AZN to 800 million AZN. This fact suggests that if a devaluation occurs, households will suffer fewer losses than in 2015.

The total amount of household deposits in 2014-2019 increased by 1.5 billion AZN (19%), but in dollar terms it fell from 9.2 billion USD to 5.1 billion USD. This demonstrates that, in fact, as a result of the sharp depreciation of the national currency, households have suffered serious losses in financial resources. At the end of 2014, 62% of the population's deposits were in manats, and the government's sudden devaluation decision caused the population's savings to depreciate by 25% in a single day. Today, 47% of household deposits are in the national currency, which means that the amount of savings at risk of devaluation is 15% less than 5 years ago.

Although households now appear more resilient against the risk of devaluation in terms of the structure and volume of savings and liabilities, their potential resilience in an economic crisis is actually weaker. There is plenty of evidence for this. First, there are currently massive job losses as a result of the pandemic, and although macroeconomic conditions worsened in the 2015 crisis by fiscal and monetary indicators, it was more of an oil market crisis and it was not accompanied by a serious downturn in the real sector. On the other hand, in the 10 years leading up to 2015, the large inflow of oil money, cheap imports, and savings in financial and non-financial forms with low inflation made the population more resilient in the face of the crisis. At present, households have to a significant extent lost their immunity to a severe, long-term economic crisis as a result of the sharp depreciation of the national currency in 2015 and high

inflation in 2016-2018. Although there is no in-depth research in this area, there are indicators in the publicly available statistics that demonstrate this. For example, in the three years before the devaluation (2011-2014), the average annual growth rate of household deposits in the financial system was 25%, while in 2016-2019 the average annual growth of deposits was around 4%. It is true that a counter-argument could be made: after the devaluation, a lack of confidence in banks forced the population to keep more of their savings in cash at home. However, this argument could only be justified if there was a significant increase in the monetary indicator M0, i.e. the amount of cash outside banks, including the money supply of the population. The Central Bank's [statistics](#) show that in 2014-2019, the amount of cash in circulation decreased by 5%. In 2009-2014, however, this figure had doubled. In short, before the devaluation there was a rapid increase in both household deposits and the amount of cash held by households, but after the devaluation there was a decrease in unregistered cash savings, and the growth in deposits fell to a minimum.

Crisis symptoms: spending more than earnings

There are conditions in which households spend more than they earn which are largely related to economic development and people feeling confident about the future. Especially in an economy with high and stable earnings, decent and competitive jobs, and a financial system that does not suffer from resource shortages, households see no problem in borrowing to buy property, take vacations, or accumulate jewelry as a form of wealth for the future. They spend more than they earn in the current year by taking out loans.

But in countries with weak economic growth, high poverty, very low incomes, and limited employment, the reason why people's spending exceeds their income is the opposite – households either spend their savings from previous years or borrow from friends, relatives, or banks because they do not have a stable job or source of income able to meet their basic needs.

Sometimes they even take out loans and other forms of debt to pay for medical treatment – because there is no health insurance mechanism.

In 2015-2017, including the year of the devaluation, households suffered overall negative savings of 2.7 billion AZN. However, in the 3 years preceding the crisis ([2011-2014](#)), there had been positive savings of 4.3 billion AZN, i.e. revenues had exceeded expenditures.

Several important causes can be noted explaining households' negative savings for several consecutive years immediately following the devaluation: as a result, additional costs were incurred for foreign currency loans, import inflation increased, income was lost due to a sharp decline in economic activity, people went into debt and spent their savings from previous years.

In any case, the comparison of a number of indicators characterizing household income and expenditure over a period of time before and after the devaluation is a very important source for comparing households' preparedness for the 2015 crisis and the current economic downturn.

Or, while the average annual increase in the number of cars owned by households in 2010-2014 was around 9%, in 2015-2018 the figure was around 2%. At the same time, the fall of the share of new cars (up to 5 years in use) in the total automobile fleet can be considered an indicator of the deterioration of households' financial situation. While in 2014 the share of new cars was 17%, by the beginning of 2019, this figure had fallen sharply to 6%. In absolute terms, the number of cars in use less than 5 years [fell](#) from 187,000 to 72,000. Households are entering an economic cycle that is expected to be intense with these resources and in these conditions.

In such a situation, is the social security portion of the aid package announced by the government enough to insure

households against the crisis as much as possible?

It is clear from the details of the package that the salaries of more than 900,000 public sector employees will be paid in full, regardless of whether they stop working or not. In addition, 215 million AZN of direct financial support will be provided to 300,000 employees (716 AZN each) of private sector enterprises (tourism, food service, and other sectors) which have been shut down entirely by the crisis, while 80 million AZN will go to 300,000 individual entrepreneurs (267 AZN each). Undoubtedly, this amount is quite small in terms of income lost in the event of a prolonged crisis (for example, lasting more than 2 months), as well as in terms of providing a minimal standard of living. In addition, 50,000 people will receive 300 AZN per month for two months of social work, and 200,000 unemployed people will receive an allowance of 190 AZN a month for two months. The same approach applies to both of these categories – it is inevitable that support will continue in a similar way if the crisis is prolonged. In addition, 40 million AZN will be allocated to pay tuition fees for low-income families, as well as 10 million AZN to cover electricity bills. In other words, if we do not take into account the maintenance of salaries of public sector employees, the remaining social security measures will cost about 350 million AZN in direct financial support. Post-crisis assessments will probably show more clearly whether this amount is adequate considering the income lost and whether it is enough to ease the social conditions in which the population will emerge from the crisis.

But from now on one thing is clear – the government's exclusion of informal workers and the unemployed from the statistical register is an approach that aggravates the social situation in Azerbaijan and exacerbates the social consequences of the crisis. The crisis does not distinguish between formal and informal economies – it strikes both. But in such difficult economic circumstances, it is not in the government's interest for the former to receive aid and the

latter to remain helpless. The large number of informal workers without income or work will lead to severe constriction of consumer demand in the country, disrupting the economic cycle. In other words, getting the necessary aid to all people in need who face difficult economic circumstances should not only be seen as a matter of social security – it is also aid that will keep business afloat by stimulating demand. Remember that we are talking about at least 2-2.5 million people with unofficial employment status, as well as more than 1 million non-working, economically inactive people.

In the context of a deep economic crisis, the exclusion of almost 40% of the country's population from the state's social security programs may have serious social consequences.