The Economy of Azerbaijan in 2017 (Comprehensive Analysis)

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Table of Contents

INTRODUCTION

1.GENERAL MACROECONOMIC OVERVIEW

1.1. Macroeconomic Environment

1.2. Monetary Policy

1.3. Balance of Payments

1.4. Foreign Public Debt

1.5. Foreign Trade

2.REAL SECTOR OVERVIEW

2.1. Main Trends in Oil and Gas Sector

2.2. Main Trends in Non-oil Sector

2.2.1. Non-oil industry

2.2.2. Agriculture

2.2.3. Construction

2.2.4. Tourism

3. MAIN TRENDS IN PUBLIC FINANCE SECTOR

3.1. State Budget

3.2. State Oil Fund

4. DEVELOPMENT TRENDS OF THE BANKING AND FINANCIAL MARKETS

4.1. Banking Sector

4.2. Insurance Market

4.3. Securities Market

5. BUSINESS ENVIRONMENT AND INSTITUTIONAL REFORMS

Introduction

The heavy reliance on resource revenues (oil and natural gas) makes Azerbaijan comply with global market conditions, presenting huge challenges to development. The Azerbaijan economy had been hit by the sharp decline in global oil prices since mid-2014 leading to a crisis of the national economy. In mid-2015, the government embarked on decisive steps towards helping promote the economic growth and conduct effective reforms. On December 6, 2016, the Strategic Roadmap for 10 priorities on the national economy and on the main sectors of the economy was approved. Higher oil prices in 2017 boosted and rescued oil revenues, easing the economic tension across the nation. Therefore, it is of great interest to explore the essential processes of the country’s economy, particularly in the non-oil sector, in 2017 and unveil major development trends compared to previous years. To this end, a group of experts at Baku Research Institute have produced this Bulletin.

The Bulletin aims to see the economic processes of Azerbaijan‘s economy by various sectors for 2017 and reveal the economic developments by comparing them with those in previous years.

The Bulletin has revealed trends on the basis of the grouping of statistical detail and comparisons, quoting various reports and statistical data provided by a number of ministries and other government organization.

Section 1 begins with a general review of macroeconomic conditions, containing macroeconomic indicators for 2017 and changes compared with the previous year and exploring the status of the country’s balance of payments and foreign trade.

Section 2 reflects the real sector of the economy, focusing on main trends within the non-gas and non-oil sectors.

Section 3 details the economic processes and main trends within the finance and banking sector, also focusing on the state budget and SOFAZ income and expenditures. In particular, the banking sector’s current status and measure out of the crisis facing the sector might be of interest. It then highlights progress made in the insurance and securities markets.

Finally, Section 4 lists the government’s steps in 2017 to improve the business environment and push institutional reforms.

1. **GENERAL MACROECONOMIC OVERVIEW**

1.1. Macroeconomic Environment

Azerbaijan's Gross Domestic Product (GDP) decreased by approximately 4% in 2016 following the higher economic growth over the past decade, yet it was possible to prevent the country's economy from falling into recession in 2017. The country's economy saw 0.1% growth during this period over 2016, including 2.7% growth recorded in non-oil GDP versus a 5.4% decrease in non-oil GDP in 2016.

Table 1.1: Changes in the Dynamics of Main Macroeconomic Indicators

Indicators	2016	2017
Nominal GDP (in millions of AZN)	59987.7	70135.1
Non-oil nominal GDP (in millions of AZN)	39403.1	44061.9
Non-oil sector's contribution to GDP (%)	65.8	63.0
GDP deflator (%)	114.6	116.0
Real GDP growth (fall) (%)	- 3.8	0.1
Real non-oil GDP growth (fall) (%)	- 5.4	2.7
Growth (fall) in the industrial sector (%)	0.4	- 4.2
Including		
Mining	0.7	-4.6
Manufacturing	-1.4	-1.8
Growth (fall) in agricultural sector (%)	2.6	4.2
Growth (fall) in construction sector (%)	-27.6	-1.5
Growth (fall) in trade sector (%)	1.5	2.5
Growth (fall) in information and communications sector (%)	4.5	6.6
Growth (fall) in transport sector (%)	-0.5	8.5
Growth (fall) in catering and tourism sector (%)	0.1	5.9
Consumer Price Index (CPI)	112.4	112.9
Fixed capital investments, (in millions of AZN)	14903.4	15550.8
Fixed capital investments, growth (fall) (%)	-21.7	-2.6
Industrial sector's contribution to GDP (%)	37.4	40.1
Agricultural sector's contribution to GDP (%)	5.6	5.6
Construction sector's contribution to GDP (%)	9.5	10.0
Trade sector's contribution to GDP (%)	10.3	10.4
Information and communications sector's contribution to GDP (%)	1.8	1.6
Transport sector's contribution to GDP (%)	6.8	6.8
Catering and tourism sector's contribution to GDP (%)	2.4	2.3

Source: State Statistical Committee (SSC)

In the last 3 years, when the national currency lost its value by 2 times, the highest inflation rate was recorded in 2017 and the inflation index was 12.9%. Runaway inflation does not allow stopping a tight monetary policy and as a result, the restoration of economic activity, including of investing activity delays. On the other hand, a runaway inflation doesn't allow restoring confidence in the national currency. In comparison with the last year, the specific weight of the foreign currency deposits in the aggregate deposits in the banking sector decreased by 3% in 2017. But this index is still high and share of foreign currency deposits in the total deposit portfolio was 72.3% in 2017.

At the same time, a runaway inflation shows that the efforts of the Central Bank of Azerbaijan (CBA) to reduce liquidity in the economy and to control inflation in this way since 2015 were ineffective last year. Though the nominal volume of GDP increased by AZN 11.1 billion and reached AZN 70.1 billion from AZN 59 billion, the volume of the monetary base decreased AZN 2 billion to AZN 9.5 billion from AZN 11.5 billion. If there is an inflation in the economy in conditions of tightening the cash resources of the banking sector through liquidity restriction transactions (deposit auctions and issue of notes) of the Central Bank along with the decline in the share of monetary base in nominal GDP from 19.5% to 13.5%, first of all it shows that the potential of real sector is too limited. If real sector isn't the main channel to absorb the liquidity in the financial sector, it is too hard to eliminate the inflation expectations of businesses and households and to get price stability in the economy. Economy's inflation potential is high, not deflation and its disadvantage is that promotion through monetary policy does not give impetus the growth of investments, in this case business prefers to use long-term money carefully. Because according to the business, risk of runaway inflation forces central banks to always carry out expensive monetary policy and in that case, the growth of economic activity and expansion of business profits due to the expansion of demand does not seem realistic.

One of the notable factors in terms of macroeconomics is that the contribution of non-commercial sectors was more crucial than the contribution of commercial sectors in the stabilization of economic growth in 2017. The real economic decline rate accelerated both in the mining and the processing industries in 2017 compared to 2016 and the economic decline rate was 4.6% in the mining industry (0.7% growth in 2016) and 1.8% in the processing industry (1.4% decline in 2016) in that year. 4.2% growth was observed only in agriculture from the commercial industry (2.6% in 2016).

5.9% growth in tourism and public catering (0.1% in 2016), 2.5% in trade (1.5% in 2016), 8.5% in transport sector (0.5% decline in 2016), 6.6% in information and communications sector (4.5% in 2016) from non-commercial sectors were recorded in 2017. But considering the 27% decline in this sector in 2016, the decline ceased in the sector.

Fixed capital investment declined by 2.6%. Given the decline was about 22% in the previous year, the sharp decline in the dynamics of real amount of investments in economy has significantly slowed.

In 2017, 54.3%, or AZN 8.45 billion, and 45.7%, or AZN 7.1 billion, of investments in fixed capital were, respectively, provided by oil and non-oil sectors. Compared to 2016, investments in oil sector dropped to AZN 150 million (1.7%) and investments in non-oil sectors increased by AZN 800 million (12.6%).

Additionally, about AZN 6.9 billion (44.6%) and AZN 8.6 billion (55.4%) of investments in the fixed capital were respectively provided by domestic and foreign sources. In nominal phrase, domestic investments increased by AZN 900 million and foreign investments declined by AZN 250 million compared to 2016.

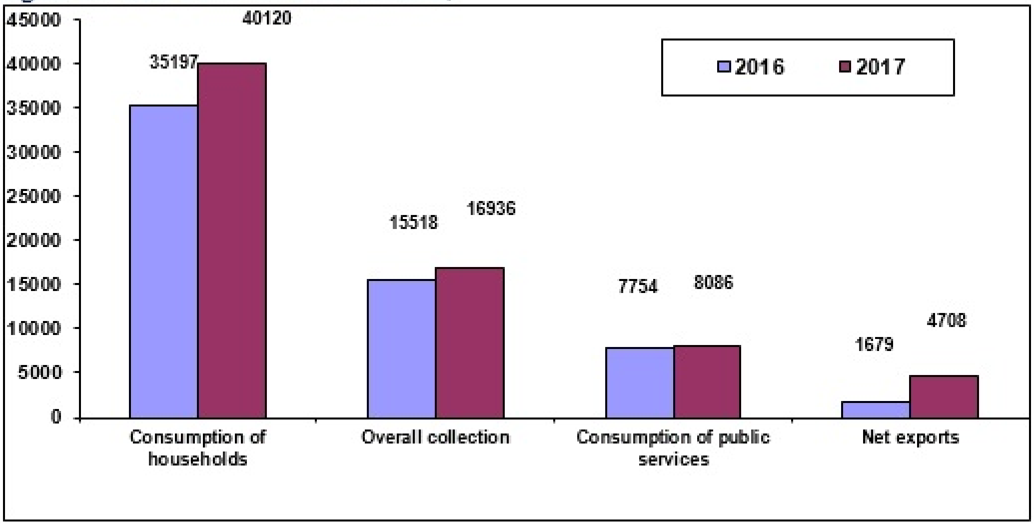
The stabilization in investment was mainly due to the public sector, households and banking sector. Investments of state in the fixed capital increased 7.9% by state budget, 30.8% by extra-budgetary funds, 13.7% by bank loans and 16.7% by households. But growth of investments in fixed capital couldn’t be restored due to the 12.2% decline in investments of enterprises and organizations. Enterprises and organizations dominate these investments and therefore the dynamics of their investments is the main factor affecting the volume of investments in the economy. In 2017, 63.4% of investments in fixed capital was provided by enterprises and organizations. 54% (57% in 2016) of investments was provided by mining industry, 10% (7% in 2016) by remaining industries, 11.2% (9.2% in 2016) by transport industry, 5.7% (4.6% in 2016) by house construction and 0.2% (0.1% in 2016) by catering and tourism sector.

In addition, capital investment in mining sector decreased by 9.2% compared to the previous year and accounted for 64.7% in utilities sector (related with electricity and gas supply), while 46.1% in catering and tourism sector, 40.5% in manufacturing sector, 21.7% in housing construction sector, 17.6% in agricultural sector, and 9.2% in transport sector.

Indeed, when viewed from the internal and external factors, the core role in preventing the economic downturn was peculiar to the latter factor.

Analysis of the GDP structure may be considered as the best source for assessing the role of external factors in economic growth (or economic downturn). In terms of consumption, GDP is derived from consumption of households, consumption of public services, overall collection and net exports.

Figure 1.1: GDP Structure (*AZN millions*)



Consumption of households covers the cost of food, non-food and services throughout the year. According to statistical data, consumption of households in nominal terms rose by AZN 4.9 billion, or 13.9%, in 2017. Considering the level of consumer prices (12.9%), the real increase in household consumption was around 1%.

The main reason for an increasing impact of the population consumption on GDP was the decline in real incomes of households. Thus, as a result of the decline in the population's nominal income growth rate (8.3%) from the inflation level (12.9%) in 2017, real incomes of households had slid by 4%.

At the same time, the consumption of state services nominally stood at AZN 332 million (4.3 percent), while total revenue hit AZN 1.4 billion. The growth rate of both the consumption and production indices of the economy, despite the increase in manat (9.1%), led to a decline in bot items. As a result, the real decline in the there elements that formed the domestic demand could not contribute to the economic growth. It is worth noting that 98% of the total revenue is associated with the collection of fixed assets (buildings, installations and equipment) (excluding replacement of major circulating assets).

Consumption of government services is individual and collective, with the exception of the cost of expenditures and other costs (including income from government services) in terms of economic classification of budget expenditures.

Foreign demand – net exports – increased by 3 times, or AZN 3.1 billion to AZN 4.7 billion.

1.2. Monetary Policy

The provision of the country's macroeconomic stability has been highlighted as the main task in the *Statement of the Central Bank on main directions for monetary policy for the year of 2017*. Implementation of this task envisages rapid response to inflation risks, regulation of money supply, conducting strict monetary policy, and to ensure the stability of the national currency.

The rising oil prices in global markets improved the foreign economic position of Azerbaijan in 2017. The deficit of balance of payments has been replaced with the surplus in the volume of 1.97 billion US Dollars in 2017. The deficit of $ 539.2 million recorded in current account balance in 2016 has become a positive balance of $ 1.7 billion in 2017.

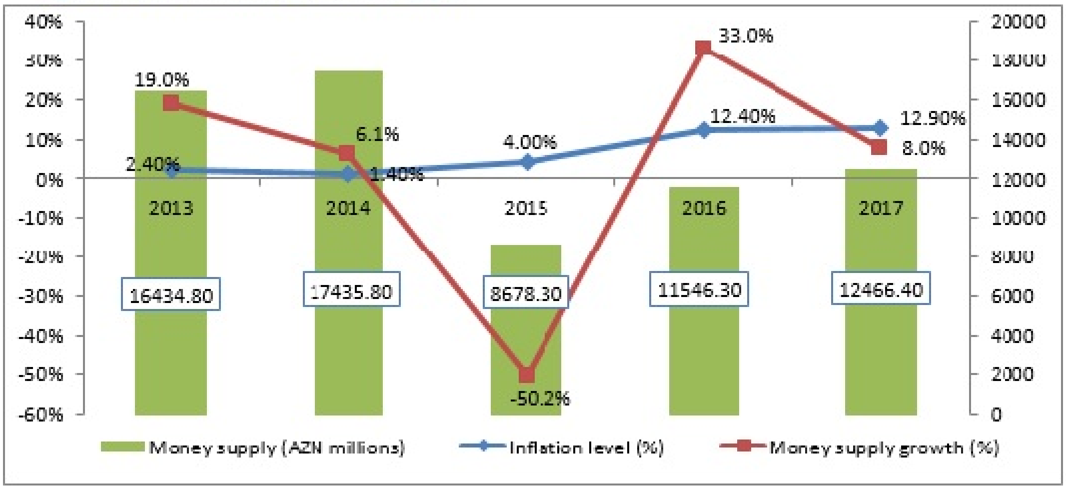
The decline trend for the official rate of the manat starting from February 21, 2015 continued until the beginning of 2017 and its official rate was recorded at a record level of 1.92 manats per dollar for 2 February of the same year. In the subsequent periods, a stability has been achieved for national currency rates resulting from improvement of the balance of payments and administrative measures of the Central Bank, against the background of the increase in oil revenues. Despite the Central Bank announced a transition to floating exchange rates on December 21, 2015, it continued to regulate the manat's exchange rate by administrative measures. For this, it has tightened the money supply in the market on the one hand and involved the free cash flow in the hand of banks through market instruments, while restricting them to be directed into currency market. The Central Bank eliminated the foreign exchange cash and non-cash exchange rate (+ 4%) against the official exchange rate on January 12, 2017. Thus, the exchange rate of manat has been strengthened by 4% since the beginning of the year, thereby posing reducing effect on inflationary expectations and dollarization.

In 2017, a total of 99 currency auctions have been conducted by the Central Bank related to the organization of currency sales of the State Oil Fund. During the year, the Fund’s foreign exchange sales totaled $ 3597.8 million, which is 26.3% less than in 2016.

The total volume of the currency market in 2017 has dropped compared to the previous year. Thus, the volume of currency transactions in USD decreased by 5.8% to USD 15.72 billion, while the volume of transactions with the euro decreased by 5.4% to 2.45 billion euros compared to 2016. 83% of transactions in the currency market were conducted in US dollars and 17% in other currencies during the given period.

Money supply that was reduced to two times in 2015, which was the year of devaluation has been rising again in the following years, and the process has continued in 2017. Compared to 2016, the money supply increased by 8% last year to 12.5 billion manat. Thus, the volume of money supply reached the level of 2012 (see *Figure 1.2*)

Figure 1.2: Dynamics of Money Supply

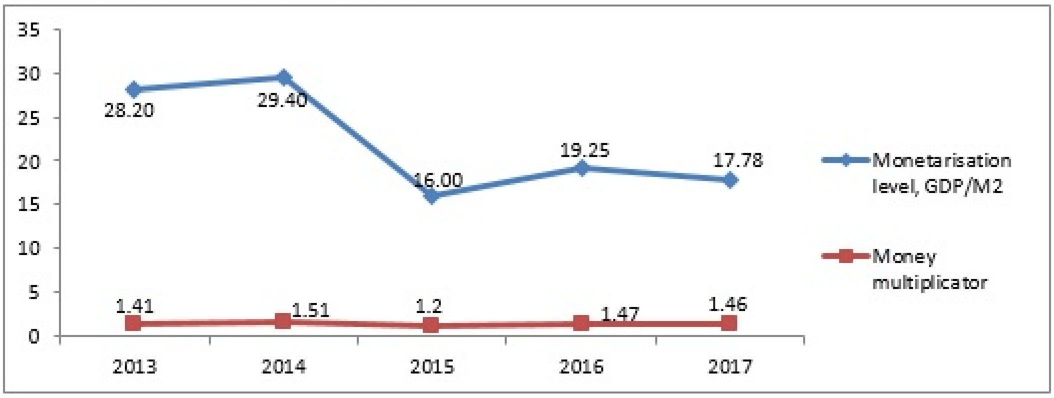


Source: CBA

The rising money supply have not been able to solve the problem of money supply with the economy. While the level of monetization (the ratio of M2 monetary aggregate to GDP) was 19,3% in 2016, it has declined slightly in 2017 to 17.8%. However, it was around 29% during the pre-devaluation period and even down in 2015, even down to 16% (*Figure 1.3*).

Generally, the level of monetization has not been more than 30% even during the period of high oil revenues in Azerbaijan. We should not for the comparison that the level of monetization of economies in developing countries is not less than 45-50%, and it even passed over the 100% limit in some developed countries. Besides being low, the money multiplier was not exposed to critical changes in previous year and remained at the level of 2016. This indicates a limit of money supply for creating monetary funds in the economy.

Figure 1.3: Monetization Level of the Economy



Source: CBA

Statistical figures show that banks are currently pursuing a policy of obtaining more profitable earnings than providing money for the economy. According to official statements of Financial Market Supervision Chamber, the banks invest some of the money at their disposal as an alternative to the securities and the regulative market instruments of the Central Bank. If the banks contributed 1,3% of their assets to securities in 2016, this figure has been raised to 9% by the end of 2017. It is mainly about the *contribution to short-term notes of Central Bank*. For instance, the Central Bank placed 49 times 28-day short-term notes (in some cases 27 or 29 days) at the Baku Stock Exchange in 2017. Although the annual interest rate of the notes raised to 14.9% at the beginning of the year, it steadily declined by 10.01% to the end of the year. In the first four months of the year, the demand did not meet the supply, but since May the demand of banks has exceeded the supply 4-5 times. The banks have earned about $ 45 million in 2017 through the notes. This is one of the methods of obtaining passive earnings by banks.

Another method is deposit auctions organized by the Central Bank every week. In total, 61 deposit auctions were held in 2017 and the banking sector earned about 48.5 million manat interest incomes through the auctions. While the interest rate on auction at auction was close to 15% at the beginning of the year, this figure dropped to 10.01% by the end of the year. The demand throughout the year overwhelmed the supply several times unless some auctions are considered.

Overall, in 2017, banks *have deployed approximately one fourth of their assets to other financial institutions, including banks*. However, in 2016 this figure was 24.3%, and devaluation was around 4%. All of this leads to a high risk in the real sector, an increase in troubled loans, and a lack of reliable customers, not to the real sector that banks need more than it needs to invest in open market and deposit operations and other banks, which the Central Bank regulates for the money supply.

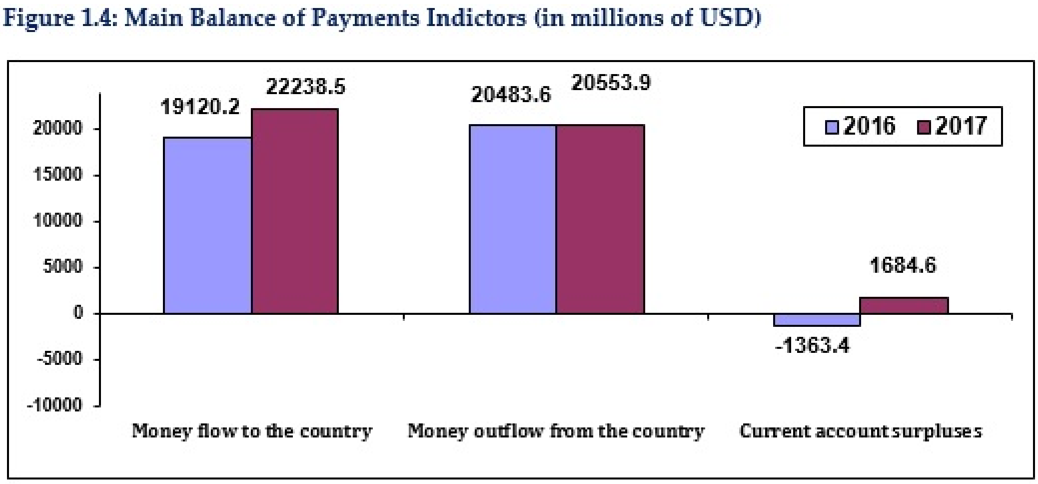
Despite the stability of the national currency's exchange rate, the Central Bank *has not hastened to softening its monetary policy due to the high inflation pressure* in 2017. Although *the reserve requirements* are one of the monetary policy tools used by the Central Bank, no softening has been made in this area in 2017. At the same time, the Central Bank raising its record high to 15% in 2016, has kept this rate unchanged in 2017.

In general, **framework instruments** consisting of short-term borrowing and settlement instruments served to manage short-term liquidity of banks and were carried out at rates set by the Central Bank. To attract funds, the interest rate corridor of frame transactions (1-7 days REPO) was lower and operations with placement of funds (1-7 days counter-REPO) with the upper limit of the interest rate corridor. The low interest rate corridor had to be changed due to the high demand for notes in the auctions and the securities market. On June 22, the interest rate corridor declined from 12% to 10%. The upper limit of interest corridor (18%) was kept constant.

1.3. Balance of Payments

The detailed effects of external factors affecting macroeconomic conditions are more apparent with a detailed analysis of the balance of payments.

Figure 1.4: Main Balance of Payments Indictors (in millions of USD)



AZN 1.685 billion surplus was achieved in the current balance of payments in 2017, while AZN 1.363 billion deficit was registered in previous year. The proceedings to the country within the framework of current accounts increased by AZN 3.118 billion (16.3%). AZN 1.8 billion of this increase was ensured for the account of oil and gas sector, and AZN 1.3 billion was secured due to non-oil sector. The increase in the oil and gas sector was due to an increase in the average crude oil price in the world market by about 30% compared to the previous year. The $300 million portion in the growth in the non-oil sector was formed at the expense of commodity exports. Revenue from service delivery enhanced by $300 million, and rebounds (mainly remittances sent abroad) have been expanded by $500 million.

Foreign assets of the country within the framework of the financial account increased by $ 5.419 billion and foreign liabilities increased by $ 5.218 billion, thus it was resulted in about $ 200 million surplus to the financial account. Generally, while considering the currency receipts to the country in the volume of $ 387.8 million under the balancing item, the positive balance of $ 1.971 billion has been recorded in the balance of payments as the summary of current accounts balance and financial account. However, the deficit of balance of payments was $ 539 million in 2016 and more than $ 11 billion in 2015. There was no problem for the Central Bank to maintain stability of the national currency during the year under favorable terms of the balance of payments, but against the beginning of 2017, the rate of the manat to the US dollar was 4%.

It is particularly important to emphasize that the toughening of the government's capital flows in the improvement of the balance of payments played an important role. For example, according to the Decree of the President of the Republic of 10 February 2017, the import-export regulations were amended. According to that amendment, the consignment should be paid within 180 days of the export value (after the sale of the goods (works and services) in the geographical distribution of the value of the exported part of the export value).

Detailed analysis of the balance of payments shows more clearly the perfect impact of external factors on the macro-economic environment.

Because of uncertainty in the preceding period, exporters have doubts that certain items of export revenues can be exported for various reasons (such as tax evasion) and there is no doubt that the government's decision is for that reason. Consolidation is provided under the "trade credits" item of net assets in the balance of payments account in the export balance. Net assets on "trade credits" in 2016 was amounted to $ 4.7 billion. In 2017, the figure dropped by more than 2 times to $ 2.171 billion. Decrease to $ 1. Thus, the 180-day limitation implies that exporting companies have been forced to return the exported funds to the country, and as much as possible, most of the assets owned by the residents, who had been consigned to trade accounts during the year, were returned to the country.

There are two more points in the balance of payments for 2017:

1) In the form of direct investments, the balance of assets in

foreign currency (external liabilities) decreased by more than 50% (about USD 1.7 billion) to USD 2.866 billion made up;

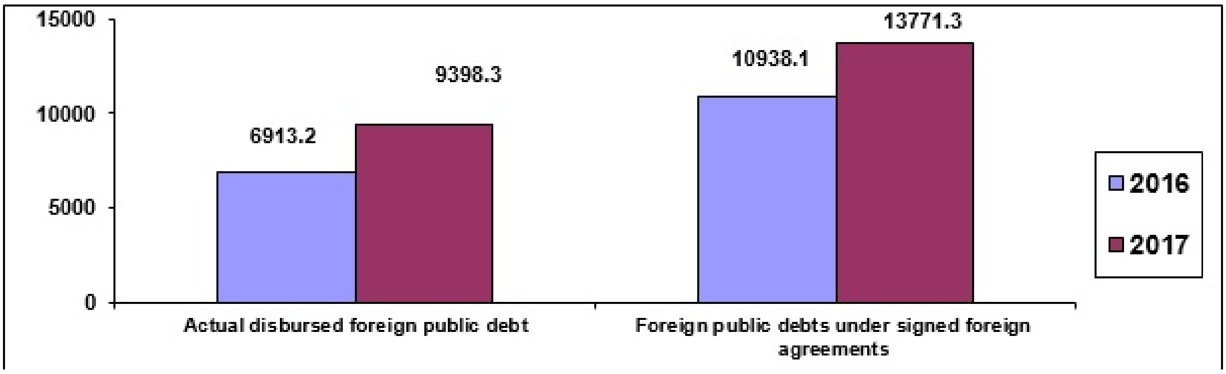
2) Instead, the balance of funds (external liabilities) in the portfolio of investment portfolios increased almost 6-fold and amounted to $ 2.588 billion. The dollar reached. The main reason for this increase is the debt of Azerbaijani oil and gas projects (mainly the Southern Gas Corridor) associated with the issue of securities.

1.4. **Foreign Public Debt**

There was a significant increase in foreign public debt in 2017. Thus, according to the Ministry of Finance, foreign debt to the beginning of the year amounted to $ 6.913 billion, while it was $9.398 billion, thus increasing by 36%, or $2.485 billion, during the year. Subsequently, the ratio of external debt to GDP increased from 20.4% to 22.8%. Undoubtedly, although this limit is still significantly lower than the International Monetary Fund's risky estimate for developing countries (40%), two factors raise concerns about foreign debt:

- *the rate of debt increase is extremely high, and this is evidenced by an increase of one-third of the external debt over the year;*
- *Azerbaijan is a country with high dependence on external factors, and 95% of its currency revenues depend on natural resource revenues. The high volatility of commodity markets around the world is a source of constant concern for the government even at the present level of external debt.*

Figure 1.5: Azerbaijan's Foreign Public Debt (in millions of USD)



One of the nuances bearing attention is that in recent years, the Azerbaijan government has never signed debt agreements at the level of the upper limit of foreign debt defined by the law on state budget. For example, while in 2016 the loan agreements at the level of 25% of maximum indebtedness limit were signed, this indicator was 100% (respectively 50% in 2015, 87.3% in 2014, and 49.3% in 2013).

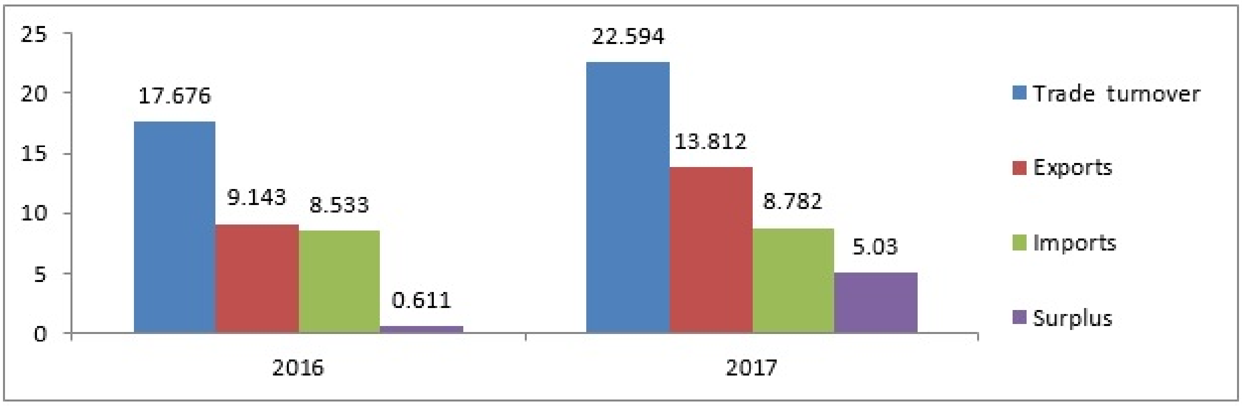
According to presented official statistics, less than 50% of the utilized actual foreign public debt ($ 4.2 billion) is repayable in the next 10 years (until 2027).

1.5. Foreign Trade

The rise of oil prices in global commodity markets and the continuation of this trend in 2017 also contributed to the improvement of the situation of the foreign trade of Azerbaijan, which is dependent on oil. According to the Central Bank, Brent oil price increased by 21% last year. The average price of natural gas in this period was 20.5% higher than the corresponding figure in 2016[i]. Generally, both exports and imports increased, and the growth rate of export growth over import growth has significantly increased the positive trade balance in foreign trade. Despite the increase in the non-oil sector's exports, the sharp increase in the oil sector's export value resulted in a decrease in non-oil share in total trade.

Foreign trade turnover increased by 27.8% in 2017 compared to 2016 and rose from $17.676 billion to $ 22.594 billion. This is the highest level of the last 3 years. Starting from the second half of 2014, the world prices for oil in global commodity markets began to decline, which had a negative impact on the volume of foreign trade turnover that dominated this raw and demonstrated a downward trend in 2014-2016. In 2013, foreign trade turnover dropped to $31.616 billion in 2014 and $ 20.646 billion in 2015, while $34.688 billion in 2013 (see Figure 1.6).

Figure 1.6: Foreign Trade Turnover (in millions of USD)



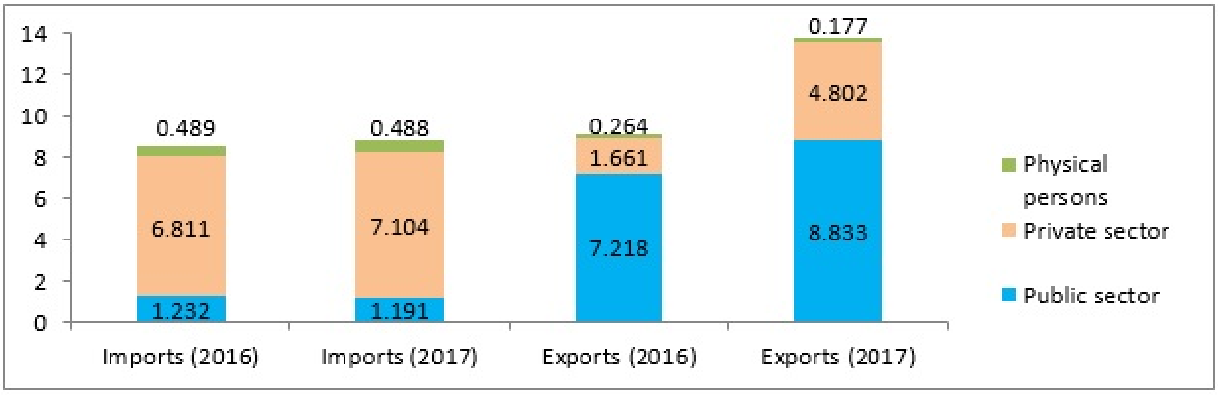
Source: State Cusroms Committee

In 2017, the increase in foreign trade turnover has led to a significant increase in exports. Such an increase in oil and oil products that pushed roughly 90-95% of exports, led to an increase in exports in value terms. In 2017, the volume of export turnover increased by 51.1% from $9,143 billion to $ 13,812 billion in 2016. Exports have dropped more than 2 times as a result of the tendency to decline in exports in 2014-2016, but has been replaced by an increase in 2017.

The key participant in export trading operations was the state, while the private sector for imports. The share of public sector in exports was $ 7.2 billion in 2016 hitting $ 8.8 billion in 2017. In spite of the rise in exports from the public sector, its share declined from 79% to 64%. The export of oil and petroleum products, the backbone of exports, by public sector increased. The private sector saw increases in both the volume and share. Private sector exports tripled from $ 1.7 billion to $ 4.8 billion. The reason for such a serious increase is the formalization of some petroleum product exports on behalf of the private sector. The volume and share of physical persons in exports declined (see *Figure 1.7*).

In 2017, import growth was insignificant. Imports rose by 2.9% from $ 8.533 billion to $8.782 billion over the previous year.

Figure 1.7. Participants in Foreign Trade (in billions of USD)



Source: DCC

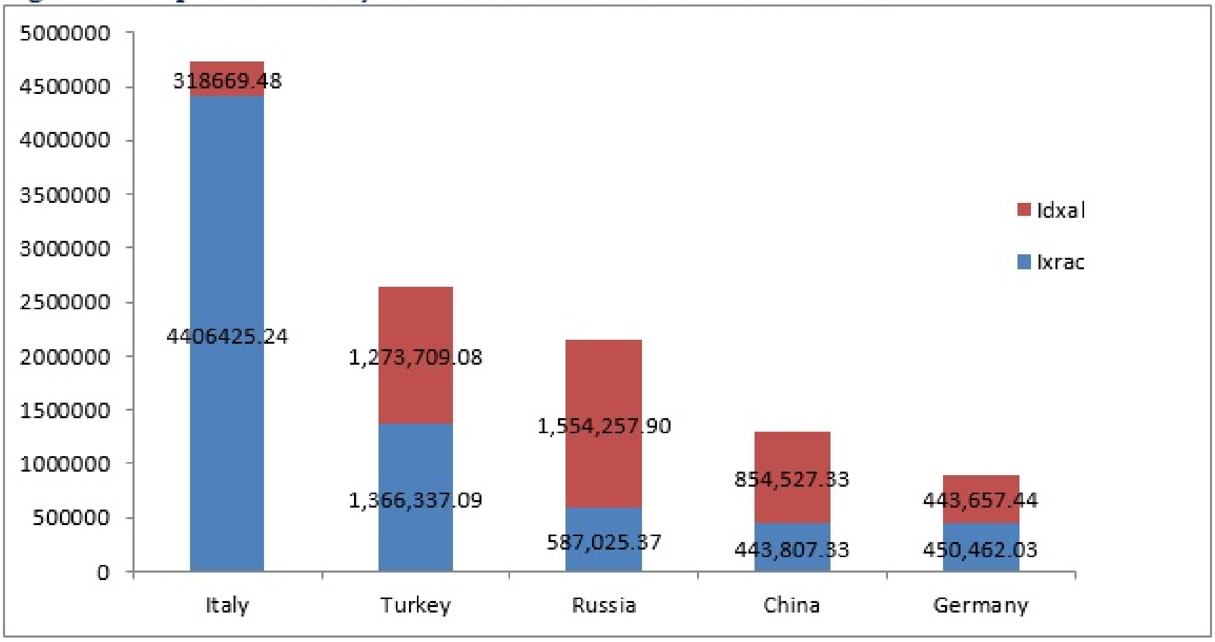
The volume of predominant private sector in imports rose from $6.8 billion to $7.1 billion in 2016-2017, and its share touched 80.9% from 79.8%, while the volume of the state sector fell from $1.23 billion to $1.19 billion, and its share dropped from 14.4% to 13.6%. ***The decline in the share of the public sector is due to the Presidential Decree signed in 2016, on suspension of purchase of imported goods (works, services) by state-financed organizations by January 1, 2018***. There was no significant change in the volume and share of goods imports by physical persons (see Figure 1.7).

Notwithstanding the government's steps to promote non-oil sector, it was impossible to reduce the share of oil sector in aggregate exports, preserving an upward trend over in the reporting period. The share of oil sector increased from 86.24% in 2016 to 88.62% in 2017. The reason for this growth is the rise in the volume and price of oil products. Thus, compared to the previous year, the physical volume of crude oil reached 27.2 million tons from 20.9 million tons (increased by 30%). Crude oil rose from $ 6.5 billion to $ 10.7 billion (+64.6%). In this regard, the share of crude oil increased from 71.4% to 77.52%. The share of natural gas fell from 10.62% to 8.64%, and oil products from 4.48% to 2.46%. However, the statistical value of natural gas went up from $ 970.6 million to $ 1.2 billion. The statistical value of oil products fell from $ 409.7 million to $ 339.2 million. (see Figure 1.6)

The statistical value of the non-oil sector in 2017 increased from $ 1.26 billion to $ 1.57 billion in comparison with the previous year, while its share in total exports fell from 13.76 percent to 11.38 percent. The decline in the share of the non-oil sector is due to the non-oil sector (24.6%) outpacing the oil sector (55.2%). ***The bulk of non-oil sector exports constituted fruits and vegetables***, with their share in total exports falling from 4.08% to 3.64% in 2017. Aluminum and its products (0.85%), plastics and articles thereof (0.73%), ferrous metals and articles thereof (0.60%), chemical products (0.58%) are included in the top five goods exports. Exports of electricity, fruits and vegetables, tea, alcoholic and non-alcoholic beverages and chemical products in non-oil sector increased in 2017 compared to 2016, while those of sugar, cotton yarn, ferrous metals and manufactures thereof declined.

The number of Azerbaijan’s trade partners was 187 in 2017 (186 in 2016). Azerbaijan’s top five trade parters in 2016-2017 were Turkey, Russia, Italy, Germany and China. ***The concentration of Azerbaijan’s foreign trade partners increased. 46.6% of the total trade turnover fell to the top five partners in 2016 and their share rose to 51.8% in 2017. More than 82% of foreign trade turnover accounted for 10% of foreign trade partners. (see Figure 1.8.)***

Figure 1.8: Top Five Azerbaijan Partners in 2017 (in millions of USD)



Source: DCC

More than half (53.4%) of foreign trade turnover were exported through stationary transport, ie through pipelines. The second largest transportation burden fell to the share of motor transport (25.3%). 11.4% of the carriages were made by rail, 4.9% by air, and 2.5% by sea. Compared to 2016, he cost of transportation through stationary transport, by land and air transportation increase, while that of transportation by sea and railway transport decreased.

2. **REAL SECTOR OVERVIEW**

Out of AZN 70135.1 million GDP in 2017, AZN 26073.2 million, or 37.2%, came from oil sector, while AZN 44061.9 million, or 62.8%, from non-oil sector, with respective decrease by 5.0% in oil sector, but increase by 2.7% in non-oil sector in 2016.

2.1. Main Trends in Oil and Gas Sector

In 2017, Azerbaijan produced 38688.9 thousand tons of crude oil, a decrease of 2345.6 thousand tons from 2016 (*Table 3.1*).

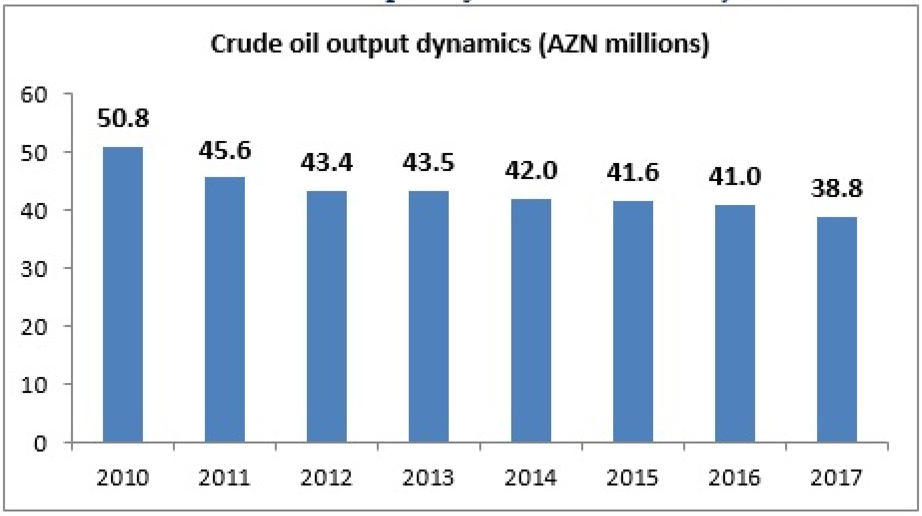
Table 2.1: 2016-17 Crude Oil Output Indicators in Azerbaijan (thousand tons)

	2017	2016	Increase or Decrease (-) in 2017 Over 2016
Crude Oil Output, Total	38688.9	41034.5	-2345.6
Including:			
SOCAR	7427.1	7522.4	-95.3
Under ACG Contract	28906.4	31020.3	-2113.9
Condensate Output (under Shah Deniz Contract)	2355.4	2491.8	-136.4

Source: Azerbaijan's Energy Ministry

2017 saw falling crude oil output from at both fields operated by Azerbaijan state energy firm SOCAR and by BP under the production sharing agreements (PSAs) as can be seen in Table 3.1. Output at the Azeri, Chirag and Guneshli (ACG) oilfields operated by BP fell by 7 percent. Overall, **oil output in Azerbaijan has continued in a downward trend in recent years**. Azerbaijan crude oil peaked in 2010 at 50.8 million tons, with falling output level in next years (*Figure 2.1*).

Figure 2.1: 2010-17 Crude Oil Output Dynamics in Azerbaijan (AZN millions)



Crude oil and condensate production in Azerbaijan recorded output losses of 12 million tons, nearly a 23.6 percent decrease over the past seven years as can be seen in Figure 3.2. The decline was due to the falling output produced under the PSAs, falling to 31.3 million tons in 2017 from 42.3 million tons in 2010.

Azerbaijan exported 32.9 million tons of oil in 2017, including 31.3 million tons coming from the ACG oil fields by the BP-operated Azerbaijan International Operating Company (AIOC) and 1.6 million tons produced at the SOCAR-owned fields, the country's Energy Ministry said. Plus, SOCAR processed 5.8 million tons of oil at its refineries.

Azerbaijan produced 28.6 billion cubic meters (bcm) of natural gas (including associated gas) in 2017, down 769.4 million cubic meters, or 2.6%, compared with 2016. Of this , 6.1 bcm came from SOCAR, while 12.3 bcm produced at the ACG and 10.2 bcm Shah Deniz field, both operated by BP.

Table 2.2: 2016-17 Natural Gas Output in Azerbaijan (million cubic meters)

	2017	2016	Increase or Decrease (-) in 2017 Over 2016
Natural Gas Output, Total	28597.9	29367.3	-769.4
Including:			
SOCAR	6089.1	6266.7	-176.0
Under ACG Contract (associated gas)	12340.7	12425.7	-85.0
Under Shah Deniz Contract	10168.1	10674.8	-506.7

Source: Azerbaijan's Energy Ministry

In 2017, Azerbaijan's gas exports through all pipelines totaled 8.5 bcm (6.3 bcm to Turkey and 2.2 bcm to Georgia). And Azerbaijan imported 349.3 mcm from Russia and 1760.6 mcm from Iran during this period.

Domestic consumers received 12168.6 mcm of natural gas in that same timeframe, an up 380.1 mcm over the previous year, while 1.9 bcm were injected into the country's underground gas storage facilities. Approximately 8 bcm of associated gas were used to maintain pressure and maximize oil recovery in oil fields.

The Azerbaijan Government and the State Oil Company of the Republic of Azerbaijan (SOCAR), together with British energy major BP, Chevron, INPEX, Statoil, ExxonMobil, TP, ITOCHU and ONGC Videsh on 14 September 2017 signed the amended and restated agreement on the joint development and production sharing (PSA) for the Azeri, Chirag fields and the Deep Water Portion of the Guneshli Field (ACG) in the Azerbaijan Sector of the Caspian Sea. When the original contract was signed in 1994 it was dubbed "the Contract of the Century." The arrangement was initially due to run until 2024 but has been extended until the end of 2049 as a result of negotiations between the Azerbaijan government and the BP-led consortium.

Following completion of the contract, the new ACG participating interests are as follows:

- BP – 30.37%;
- AzACG (SOCAR) – 25.00%;
- Chevron – 9.57%;
- INPEX – 9..31%;
- Statoil – 7.27%;
- ExxonMobil – 6.79%;
- TP – 5.73%;
- ITOCHU – 3.65%;
- ONGC Videsh Limited (OVL) – 2.31%.

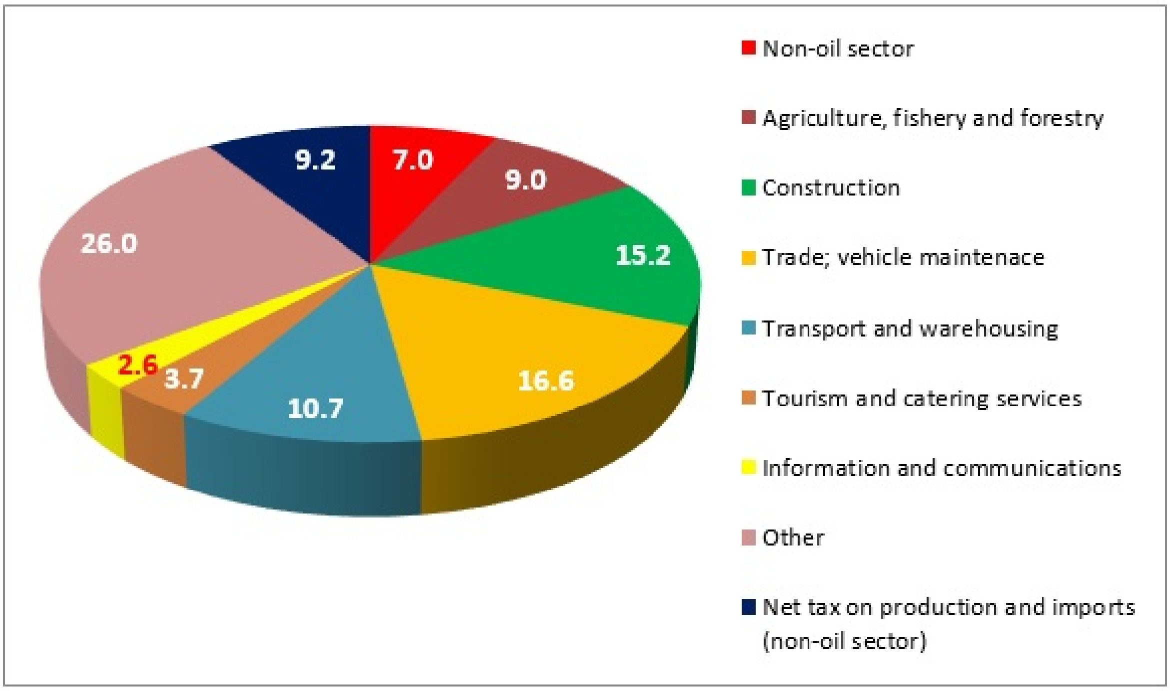
Under the amended and restated agreement, SOCAR increased its equity share in the ACG PSA from 11.65% to 25% and Azerbaijan's direct share in the revenues from oil exports amounted to 75%. As part of the contract, the international co-ventures will pay a bonus of $3.6bn to Azerbaijan, and during the next 32 years, there is the potential for more than $40bn capital to be invested in the ACG oil field.[ii] The new contract is effective until the end of 2049.

2.2. Main Trends in Non-oil Sector

As mentioned earlier added value in the amount of AZN 44061.9 was created in the country's non-oil sector in 2017. The 2.7% actual increase was recorded compered to the previous year.

The distribution of added value in the non-oil sector is as following: 7.0% non-oil industry, 9.0% agriculture, forestry and fishing industry, 15.2 construction, 16.6 trade and maintenance/repair of transport vehicles, 10.7% transportation and warehousing business, 3.7% accommodation of tourists and catering 2.6% information and communication technologies, 9.2% net taxes on import and goods in non-oil sector and the remaining 26.0% other fields of non-oil sector. (*Figure 2.2*).

Figure 2.2: Sectoral Structure of 2017 Non-Oil GDP (% of Total)



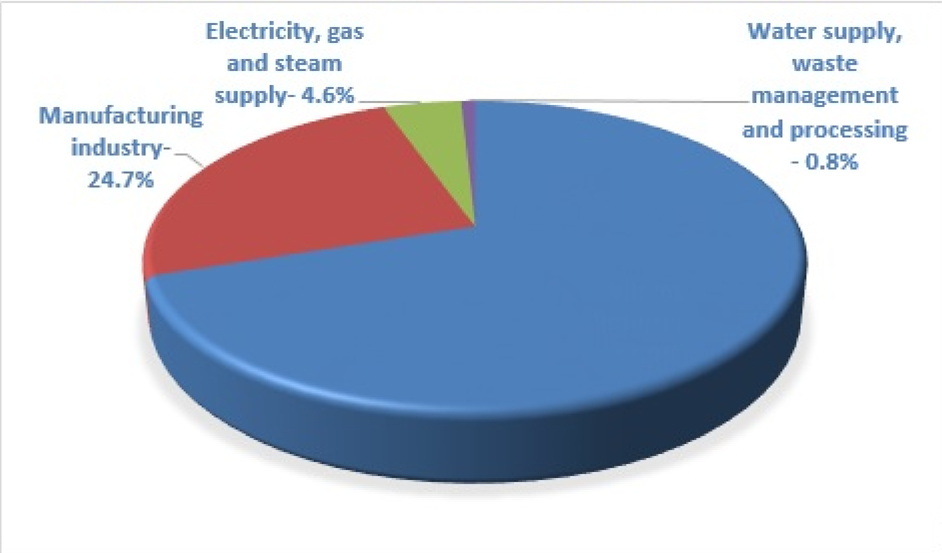
Source: Ministry of Economy

According to the SSC, there were increases of 4.2% in agriculture, forestry and fishing industry, 2.5% in trade and transport vehicles maintenance/repair, 8.5% in transportation and warehousing business, 5.9% in accommodation of tourists and catering, 6.6% in information and communication technologies and decrease of 1.8% in non-oil industry and 1.5% in construction sectors.

<u>2.2.1. Non-oil industry</u>. The face value of gross industrial production in the country was AZN 39562.8 million in 2017 (AZN 32300.2 million in 2016). According to the SSC, actual overall industrial production decreased by 4.2% in 2017 over 2016. The share of industrial production in 2017 was as following: AZN 27662.6 million (69.9%) for mining industry, AZN 9771.9

million (24.7%) for processing industry, AZN 1833.2 million (4.6%) for electricity, gas and steam production and supply and the remaining AZN 295.1 million (0.8%) for water supply, waste management and processing (see *Figure 2.3*).

Figure 2.3: 2017 Industrial Production Structure (% of Total)

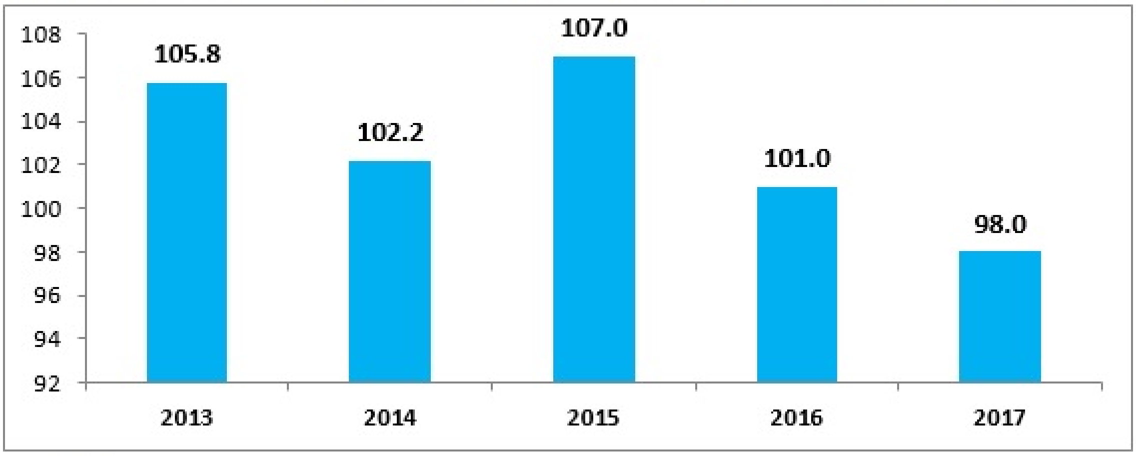


According to the SSC, 6.7% of overall GDP of country was created in non-oil sector in 2017 including 2.0% in non-oil mining industry and 4.7% processing industry.

The most prominent increase in non-oil mining industry was recorded in gold mining: 6390.8 kg of gold was extracted in 2017 which is 3.4 times more than 2016 (1895.0 kg respectively).

The production in processing industry of the country decreased first time in the recent years: The products in the value of AZN 9.77 billion was manufactured in processing industry in 2017 which is merely 98.0% of the value manufactured in 2016. It should be noted that the overall prediction in processing industry, respectively, increased by 5.8% in 2013, 2.2% in 2014, 7.0% in 2015 and 1.0% in 2016, compared to the previous year (*Figure 2.4*).

Figure 2.4: Production Indexes in Azerbaijan Manufacturing Industry over Previous Year (%)

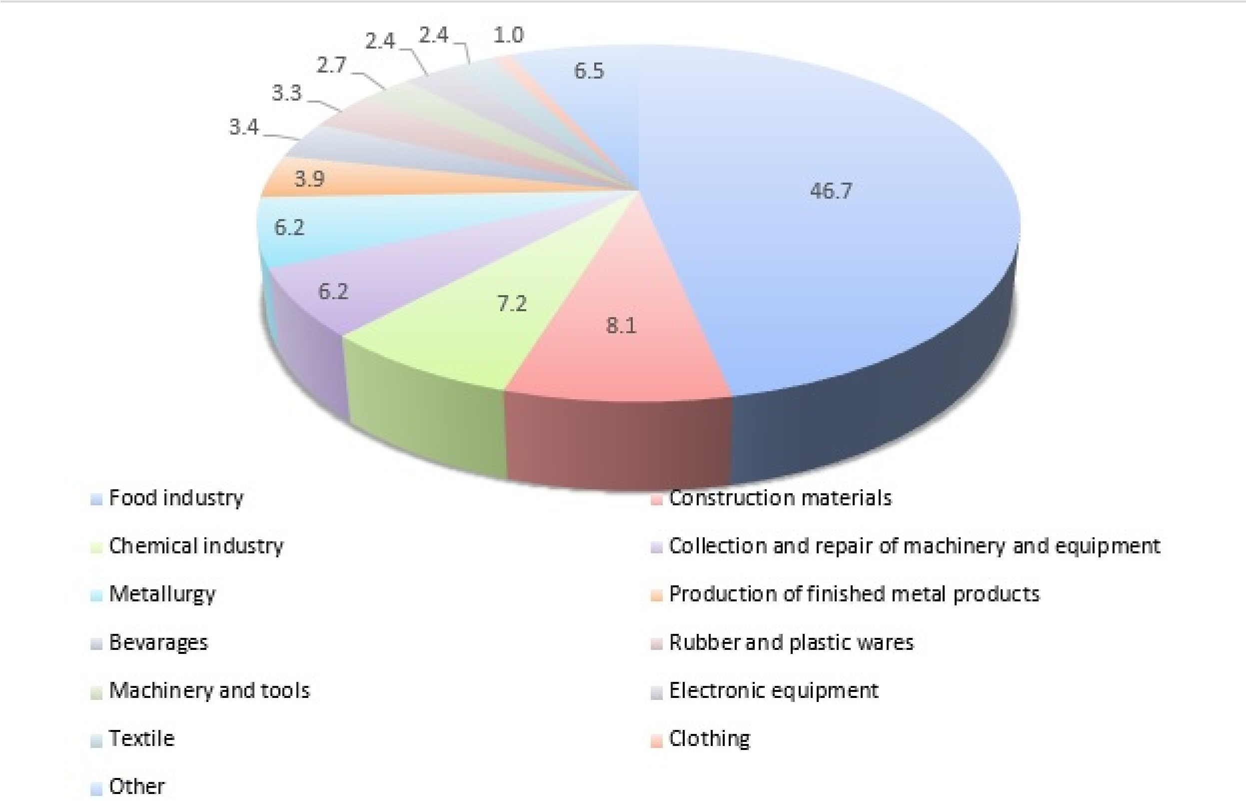


Source: SSC

60 percent of processing industry products were produced in two main sectors correspondingly: food industry with AZN 3293.1 million, or 33.7%, and iol processing industry with AZN 2727.3 million, or 27.9%.

If, excluding the oil industry production then it is obvious that the value of non-oil industry production was 7044.6 million AZN in 2017. Thus, **the share of non-oil industry in the overall industrial production was just 17.8%** in 2017.

The structural shares/distribution of non-oil processing industry was as following: food industry – AZN 3293.1 million (46.7%); manufacturing of construction materials – AZN 567.9 million (8.1%); chemical industry – AZN 504.5 million (7.2%); installation and repair of machines and equipment – AZN 438.2 million (6.2%); metallurgy – AZN 434.3 million (6.2%); manufacturing of finished metal products – AZN 275.3 million (3.9%); beverages – AZN 241.0 million (3.4%); manufacturing of rubber and plastic products – AZN 231.7 million (3.3%); machines and equipment – AZN 192.5 million (2.7%); manufacturing of electrical equipment – AZN 172.0 million (2.4%); textile industry – AZN 171.8 million (2.4%); clothing – AZN 71.1 million (1.0%); other – AZN 451.2 million (6.5%) (see *Figure 2.5*).



There were increases in the manufacturing of following products in 2017 compared to the 2016: farm products – 2.5 times, manufacturing of rubber and plastic products – 71.7%, manufacturing of construction materials – 46.6%, textile industry – 44.7%, manufacturing of machines and equipment – 42.9%, wood processing – 34,7%, manufacturing of electrical equipment/appliances – 34.6%, musical instruments, sport's products and medical equipment production – 32.0%, manufacturing of electronic and optical products – 25.5%, beverage products – 17.2%, furniture production – 16.2%, clothes manufacturing – 15.5% and just 1.0% increase in production of food products. There was decrease in the productivity of following areas compared to the 2016: automobile and trailer production – 98.8%, installation and repair of machines and equipment – 44.4%, manufacturing of ready-made metal products – 12.0%, metallurgy industry – 8.7%, leather and shoe production 4.7%, production of printing products – 2.4%.

In natural terms of production products, the most important increase was recorded in production of ready cotton fabrics in

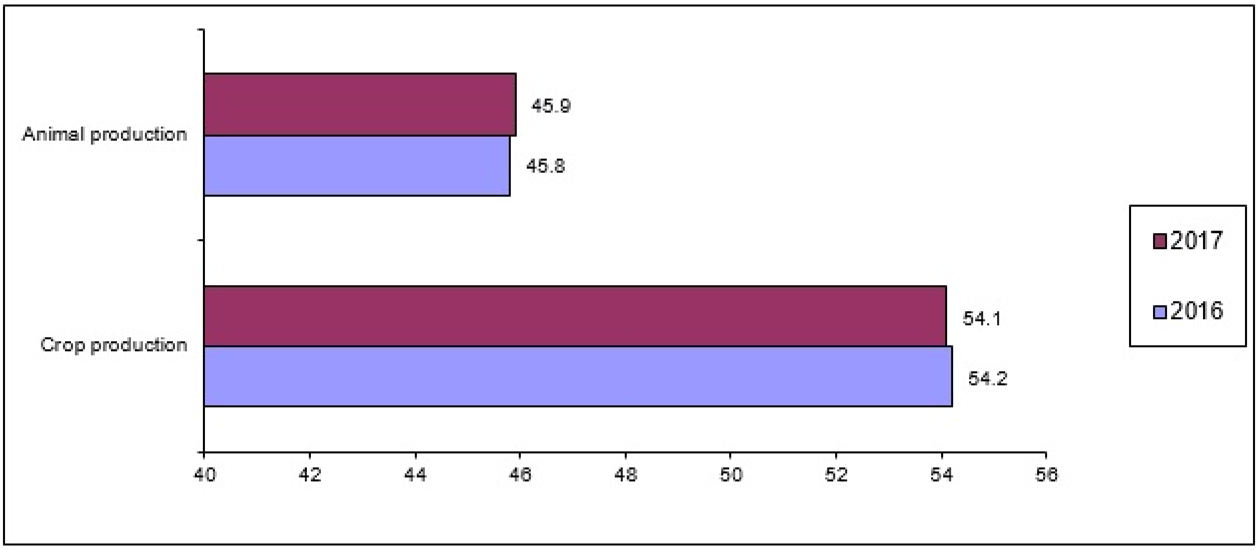
2017: the production increased from 1.7 million m^2 in 2016 to 16.6 million m^2 in 2017 i.e. 9.8 times.

As a part of non-oil sector development activities in 2017 the works related to the setting up of Sumgait Chemical Industrial Park, Pirallahi Industrial Park, Minghachevir Industrial Park and industrial quarters in Neftchala, Sabirabad, Hajigabul and Masally was continued.

The producers' price index of processing industry was 130.3% in 2017 compared to 2016. The respective indices were 116.1% in food industry, 143.9% in manufacturing of construction materials, 139.0% in textile industry, 143.9% in manufacturing of tobacco products, 130,9% in chemical industry, 138.3% in metallurgy, 96.7% in beverage industry and etc.

2.2.2. Agriculture. According to the official statistics, 2017 was a successful year for agrarian sector. So that, 4.2% increase in overall production of agriculture and namely 2.7% in cattle-breeding and 6.1% in crop production were recorded compared to the previous period.

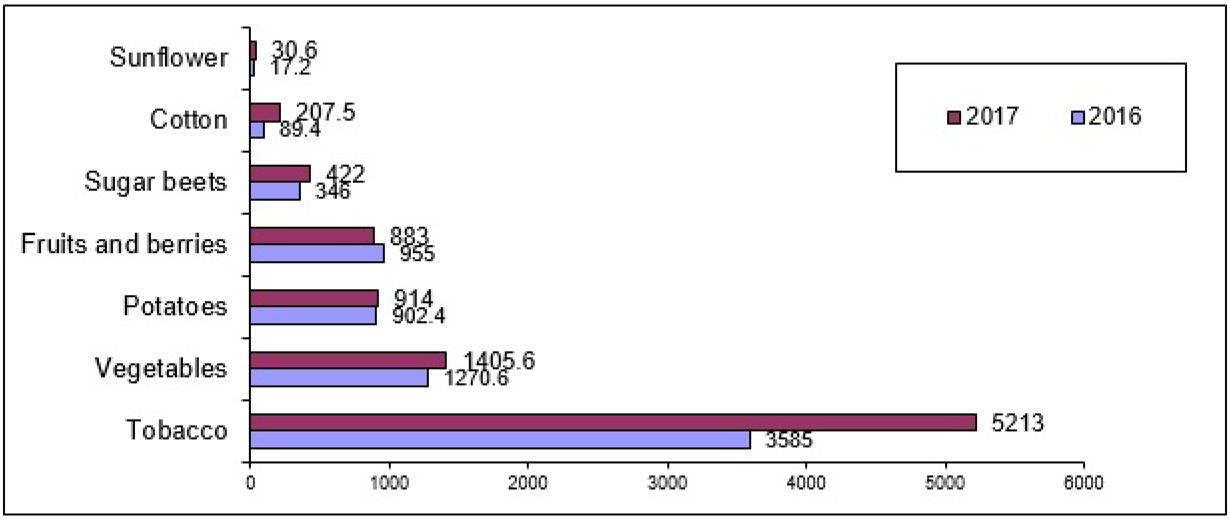
Figure 2.6. General Structure of Agricultural Production, % of Total



There was not any major change observed in the product structure of agriculture during the year. Approximately the 54% of gross product of the sector was produced in crop production in 2016-2017.

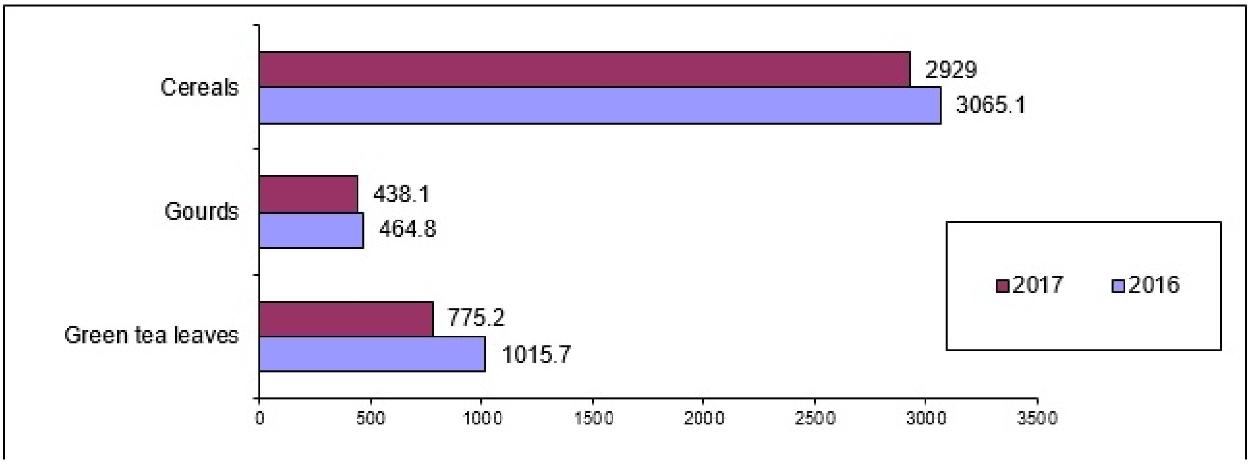
By paying close attention to the dynamics of production scales of each sectors’ products, it is easy to identify that the highest increase was in the production of technical crops. The increases in 2017 were as following compared to the 2016: cotton production 2.4 times, sunflower production 78.1 percent, tobacco leaves 45.4 percent, sugar beet production 22 percent. Moreover, there were 8.2 percent increase in fruit and berry production and 1.3 percent increase in potato production.

Figure 2.7: Main Crop Products on the Increase (thousand tons)



However, it was not possible to stop the decreases in production of some types of products. So that stocking up of green tea leaves decreased 23.7%, cereal crops production decreased 5.2% and the production of gourds decreased 5.7% during the analysis period.

Figure 2.8: Some Crop Products on the Decrease (thousand tons)



One of the pressing problems of agriculture sector in Azerbaijan in 2017 is the low level of productivity as was in previous periods. For example, the productivity of cereal crops (29.8 metric centners per hectare) further decreased relative to the 2016 (30.6 metric center per ha.) and on average was more than two times less of that in developed countries. Furthermore, crop productivity per hectare decreased correspondingly slightly more than 20 percent in tea farming, around 35 percent in sugar beet production and 10 percent in cotton lay in.

According to the official statistics there was mainly increase in the production of livestock products. Thus, the increases were correspondingly 2.2 percent in meat production, 0.7 percent in dairy products, 6.7% in egg production and the cocoon production increased 3.5 times.

2.2.3. Construction. According to the SSC, the value of capital investments from all financial sources was AZN 16777.5 million in 2017: of this, AZN 8635.5 million (51.5%) were foreign investments and AZN 8142.0 million (48.5%) internal financial sources.

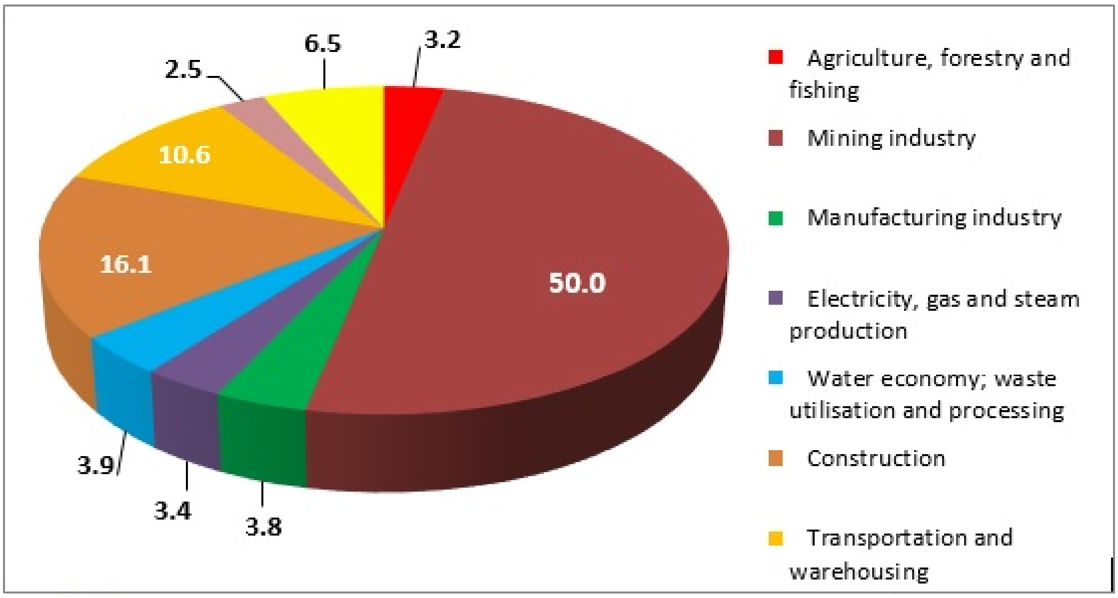
The use of fixed capital funds was as following: AZN 12563.0 million (74.9%) for the construction of production/manufacturing facilities, AZN 3283.7 million (19.6%) for the construction of service sector facilities and the remaining AZN 930.8 million (5.5%) for the construction of residential buildings.

AZN 8448.6 million, or 50.4%, of capital investments went to the oil sector and the remaining AZN 8328.9 million, or 49.6%, to the non-oil sector.

According to the SSC’s information the distribution share of capital investments in 2017 was as following: AZN 8.37 billion (49.9%) for oil and natural gas extraction, AZN 2.7 billion (16.1%) for construction, AZN 1.77 billion (10.6%) for transportation and warehousing business (see *Figure 2.9*).

The fixed investments were realized as the following as seen from the Figure above: processing industry – AZN 638.3 million (3.8%), water supply, waste management and processing – AZN 657.1 million (3.9%), electricity, gas and steam production, distribution and supply – AZN 568.0 million (3.4%), agriculture, forestry and fishing industry – AZN 538.4 million (3.2%), public management and defense – AZN 414.4 million (2.5%), trade and transport facilities’ repair/maintenance – AZN 263.4 million (1.6%), accommodation of tourists and catering – AZN 199.0 million (1.2%), medical and social services for the public – AZN 191.5 million (1.1%), information and communication – AZN 153.9 million (0.9%), education – AZN 90.0 million (0.5%), etc.

Figure 2.9: Structure of 2017 Spending on Capital Investment by Economic Activities, % of Total

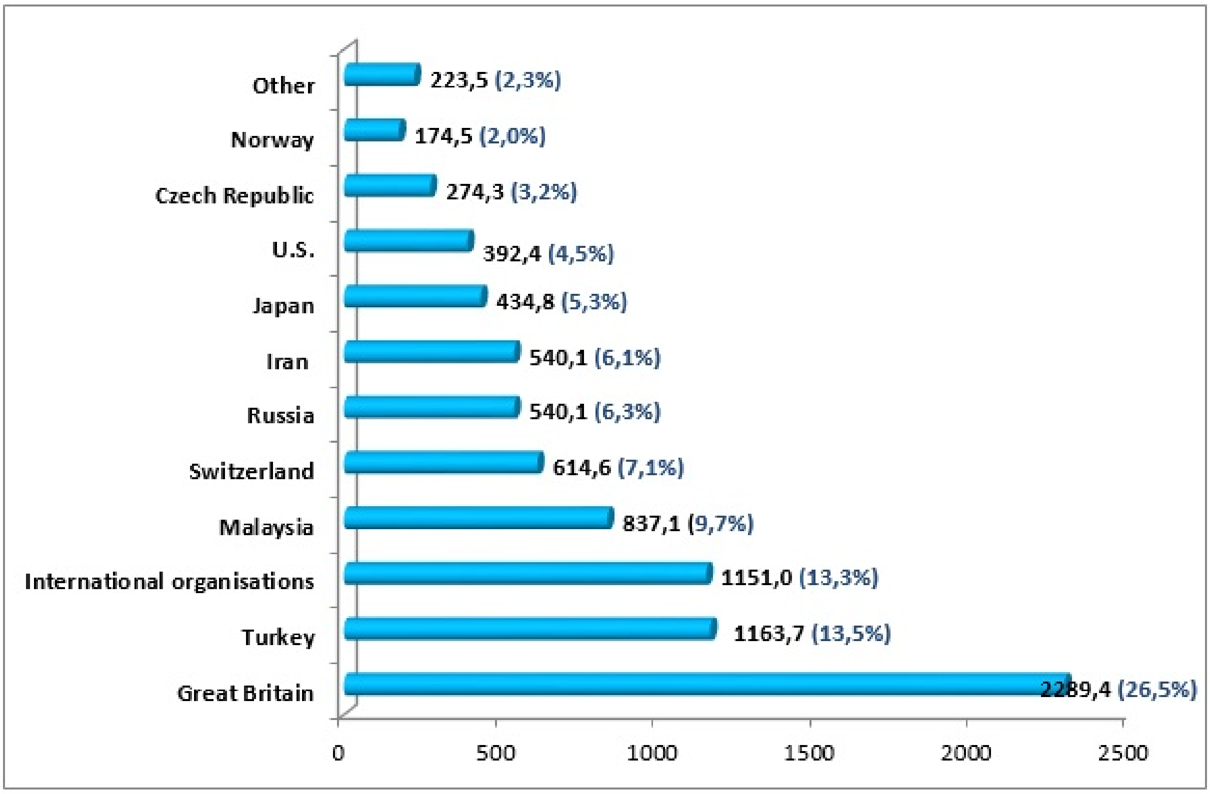


Source: SSC

Processing industry sector investments were as following: production of food products – AZN 154.9 million, oil products refining – AZN 82.0 million, chemical industry – AZN 79.3 million, furniture production – AZN 54.3 million, manufacturing of finished metal products – AZN 46.6 million, manufacturing of construction materials – AZN 39.6 million, clothing – AZN 26.8 million, beverages – AZN 26.2 million.

According to the SSC's information foreign direct investment into the country's economy/capital investment was 8635.5 million AZN in 2017. The following are top three countries in terms of foreign direct investment into country's economy: Great Britain – 2289.4 million AZN (26.5% of overall FDI), Turkey – 1163.7 million AZN (13.5% of overall FDI) and Malaysia – 837.1 million AZN (9.7% of overall FDI). Almost half of FDI into the Azerbaijan's economy in 2017 – 49.7% belonged to the enterprises of these three countries. (See *Figure 2.10*). It should be noted that these three countries had the same positions in the previous year – 2016.

Figure 2.10: Amount of 2017 Foreign Fixed Investment (AZN millions) by Countries, with Share of Total (%) in Brackets



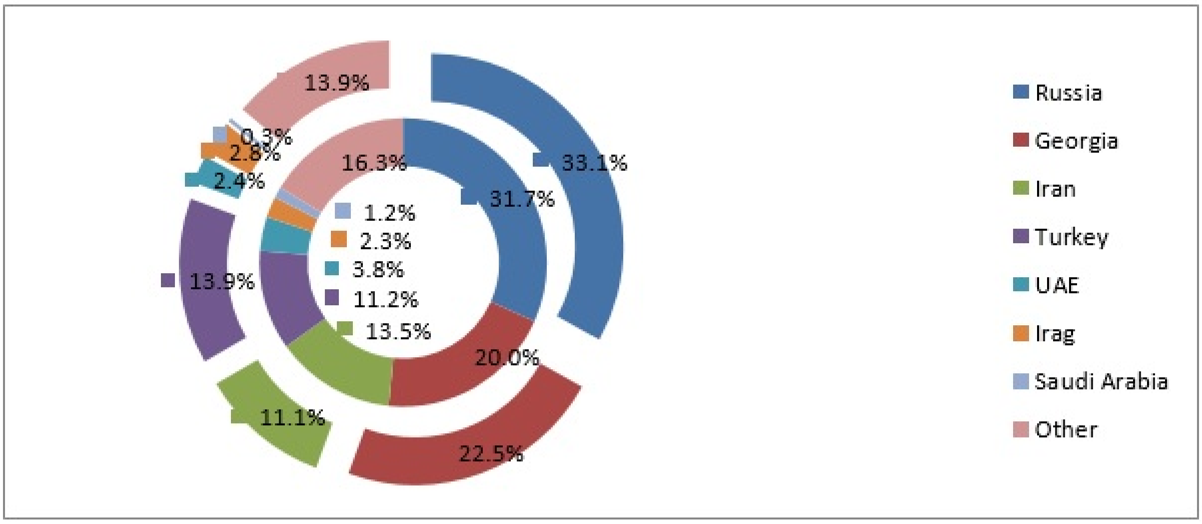
As obvious from the above figure the amount of total investment of different International Financial Institutions as a loans into the country's economy in 2017 was AZN 1151.0 million which is AZN 145 million more than 2016.

In addition to the countries mentioned in Figure 3.7 there were other countries such as Germany (AZN 90.7 million), India (AZN 57.2 million), Saudi Arabia (AZN 43.6 million) (South) Korea (AZN 26.0 million) that made investments into Azerbaijan's economy in 2017.

2.2.4. Tourism. After the slowdown in tourism sector in 2015 the *revival* was observed in 2017. The number of *travel agencies* and *tour operators* increased 24.6% compared to 2016 and reached 339. The *revenues* of these companies increased 11.6% and reached 41 million AZN. The number of *incoming and outgoing tourists* serviced by travel agencies was 63413 which is 17.5% more than in 2016. The number of *incoming* tourists were 13455 and *outgoing* ones were 49968. The growth rate of incoming tourists prevails over the outgoing tourists. The number of incoming tourists increased 50.1% though, the number of outgoing ones increased only 10.9% in 2017.

Overall, the *number of foreigners and stateless persons arrived in Azerbaijan* were 2 million 696 thousand 700 person and the *number of Azerbaijani citizens who left the country* were 4 million 108 thousand 900 persons in 2017. The number of incoming tourists increased 19,9% and the number of local citizens who traveled aboard decreased 4% in 2017 compared to 2016. The incoming tourists mainly preferred *air* (42,7% and *automobile* (40,4%) transportation. The most of outgoing tourists preferred *automobile transportation* (63,7%) and few preferred *air transportation* (20%).

Figure 2.11: Number of Foreigners and Stateless Persons in Azerbaijan Arriving in 2017



The share of purposeful tourism among the incoming tourists to Azerbaijan increased approximately 20% in 2017 than in 2016. The main purposes of local tourists going abroad were *recreation, entertainment* (25.7%), *business* (31,8%), *visiting relatives and friends* (14.3%) and *medical treatment* (4.6%).

The shares of incoming tourists based on source countries in 2017 were as following: 31.7% – *Russian Federation*, 20% – *Georgia*, 13.5% Iran, 11.2% Turkey. However, the shares of the same source countries in 2016 were respectively: 33.1%, 22.5%, 11.1% and 13.9%. Annual increase in the numbers of incoming tourists were as below: Russian Federation – 14.8%, Georgia – 6.3%, Iran – 46%. The number of incoming tourists from Turkey decreased 3.6% in the same year (2017). Despite this increase, the shares of Russian Federation and Georgia among tourists decreased and the shares of Iran and Turkey increased. The share of Saudi Arabia increased from 0.3% to 1.2% and UAE's share from 2,4% to 3,8%. The number of incoming tourists from these two countries increased respectively 4.5 and 2 times *(see Figure 2.11).*

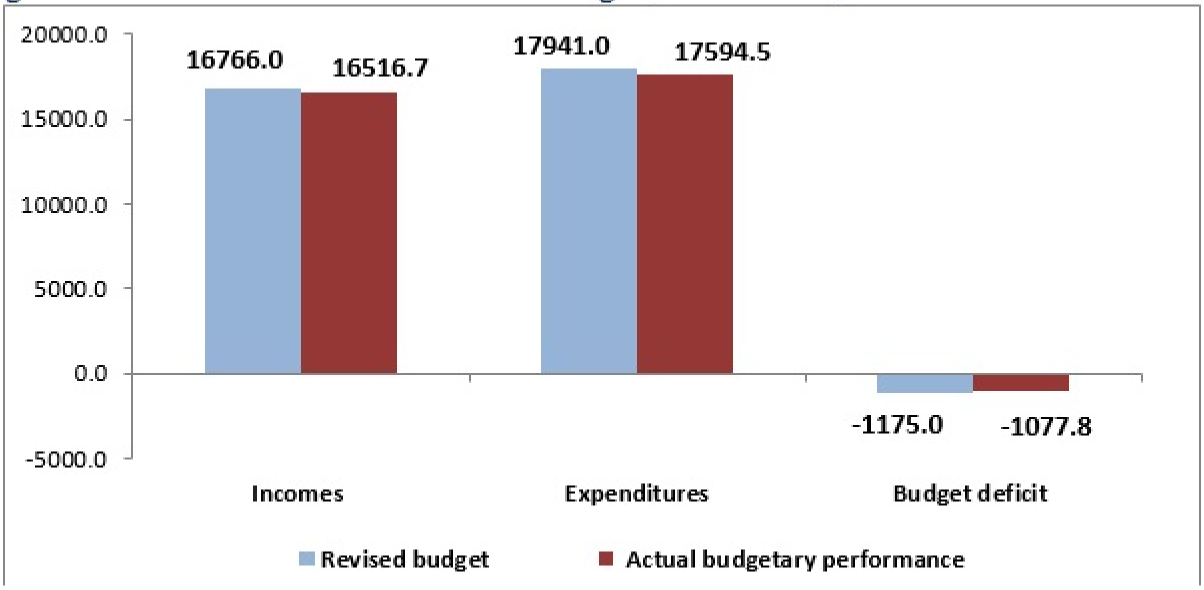
3. **MAIN TRENDS IN PUBLIC FINANCE SECTOR**

3.1. State budget

The Law of Azerbaijan Republic on the state budget dated December 16, 2016 approved the state budget income in amount of AZN 16255.0 million, expenditures in amount of AZN 16900.0 million and ceiling amount of AZN 645.0 million for the budget deficit in 2017. The state budget was revised in June 2017 and amendments were made to it: the law dated June 30, 2017 approved the state budget income in amount of AZN 16766.0 million, expenditures in amount of AZN 17941 million and ceiling amount of AZN 1175.0 million for the budget deficit.

The Law of Azerbaijan Republic on the execution of the state budget for 2017 dated May 31, 2018 approved the state budget income in amount of AZN 16516.7 million, expenditures in amount of AZN 17594.5 million and ceiling amount of AZN 1077.8 million for budget deficit (see *Figure 3.1*).

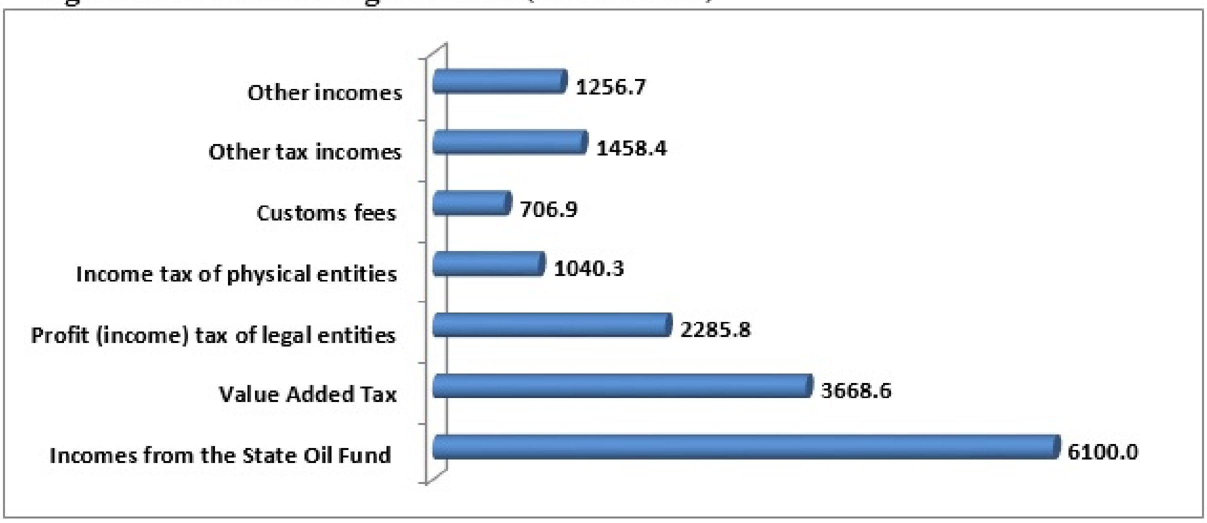
Figure 3.1: Basic Parameters for 2017 State Budget (*AZN millions*)



State budget revenues. According to the Government's report, 47.7%, or AZN 7884.0 million, of state budget income were directly from oil sector and 52.3%, or AZN 8632.7 million, from non-oil sector in 2017.

AZN 6100.0 million (36.9%) of state budget income for 2017 were paid by SOFAZ. The state budget income were formed from the following sources: Value Added Tax (VAT) – AZN 3668.6 million (22.2%), income tax of juridical entities – AZN 2285.8 million (13.8%), income tax of physical entities – AZN 1040.3 million (6.3%), custom duties – AZN 706.9 million (4.3%), excise tax – AZN 612.6 million (3.7%), simplified tax – AZN 371.4 million (2.2%), other tax and incomes (see *Figure 3.2*).

Figure 3.2: 2017 State Budget Incomes (*AZN millions*)

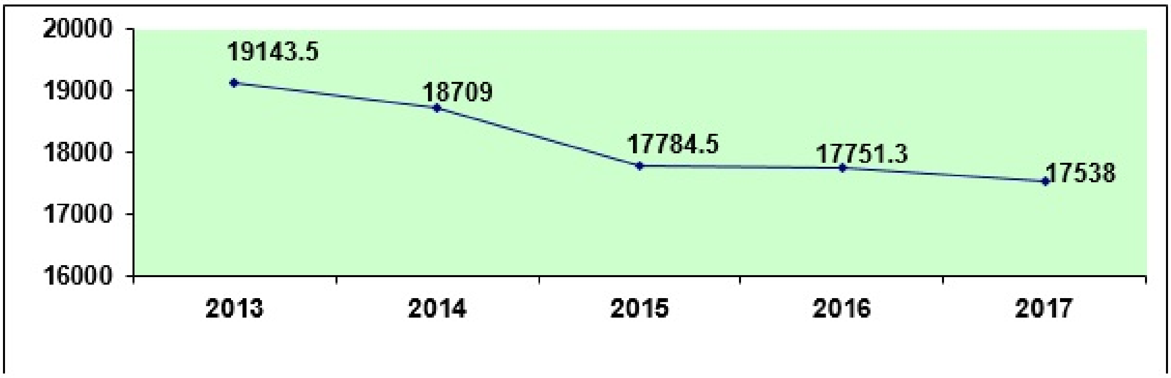


The main tendencies observed in the execution of state budget in 2017 are as following:

- *The prognosis on incomes of state budget was executed at 98.5% (i.e. 1.5% less);*
- *The incomes of state budget were AZN 989.0 million, or 5,6%, less in the reporting year than in 2016;*
- *The amount of incomes of the state budget in USD equivalent in 2017 (9596.5 million) was the lowest indicator recorded since 2008 and 12.5% (10969.2 million) less than in 2016;*
- *The amount of transfers from SOFAZ and their shares in the total amount of state budget continued to drop: the amount (AZN 6100.0 million) of transfer from SOFAZ to the state budget in the reporting year was AZN 1515.0 million less than in 2016. Correspondingly, the share Fund's transfers in the state budget dropped to 36.9%;*
- *Even though, the dependency of the state budget on direct incomes from oil and gas sector slightly decreased, the overall dependency level is still remaining high;*
- *The amount of tax incomes into the state budget from non-oil sector in 2017 decreased by AZN 216.1 million, or 4.0%, than in 2016;*
- *If, excluding SOFAZ transfers, the incomes of the state budget (AZ 10416.7 million) were not sufficient to finance the budget's current expenditures (AZN 10906.1 million).*

State budget expenditures. The government's restrictive fiscal policy was continued in 2017 and as a result the decrease in state budget expenditures which started since 2015 continued in previous year as well (see *Figure 3.3*).

Figure 3.3: 2013-17 State Budget Expenditures (AZN *millions*)

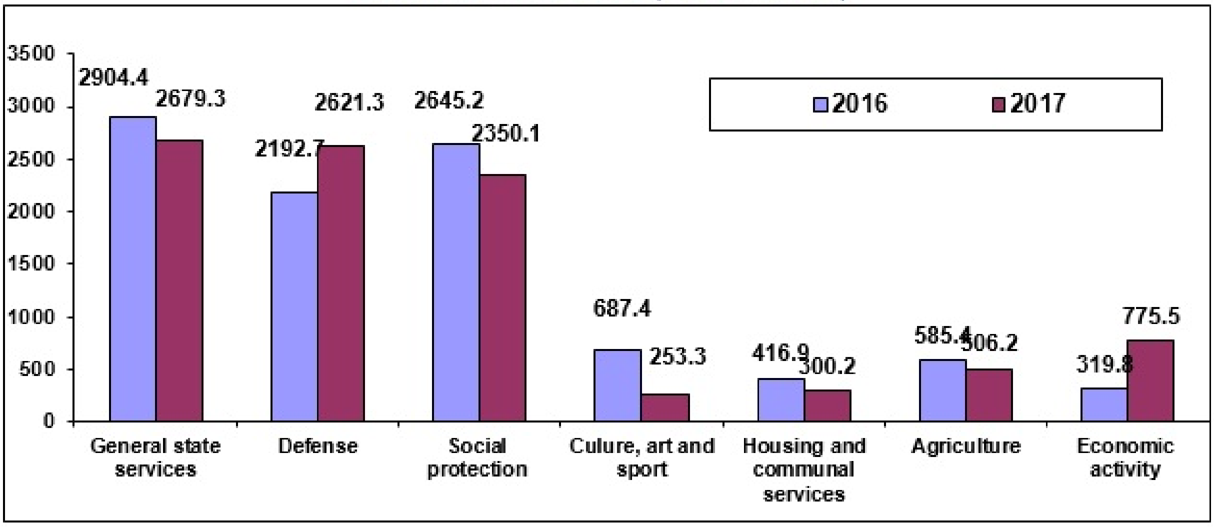


As shown in the above figure, the highest expenditure amount of state budget in recent years was recorded in 2013 and the amount of budget expenditures in that year were slightly higher than AZN 19.1 billion (with the exchange rate at the time it was equal to USD 24.5 billion). The amount of budget expenditures in 2017 was AZN 17.59 billion (around USD 10 billion) which is decreased AZN 1.6 billion, or 8.4%, over 2013 and AZN 156.8 million, or 0.9%, over 2016.

The budget deficit in execution of expenditures was the sign of restrictive fiscal policy adopted by the government. Thus, the approved amount of state budget expenditures in 2017 was AZN 17.94 billion. However, the amount of actual execution was AZN 351 million (2%) less.

The correlation ratio of the state budget expenditures in 2017 to the GDP ratio fell to 25% compared to the 29.5% in 2016. Although there was notable growth in some expenditures, some faced sharp decreases (see *Figure 3.4*).

Figure 3.4: Comparison of Various State Budget Line Expenditures for the Past Two Years (AZN millions)



It is obvious that there is serious decrease in public service expenditures and the main reason of this is decrease in service expenditures due to public debt service costs. Thus public debt service costs in 2017 was AZN 1.5 billion which is AZN 225.4 million (15%) less than in the previous year. Moreover, there were decreases of AZN 295.1 million (11%) in social and defense expenditures, AZN 434.1 million (slightly less than 70%) in culture and sport, AZN 116.7 million (28%) in housing and communal services, AZN 79.2 million (13.5%) in agriculture expenditures. In return, there were increases of AZN 428.5 million (19.5%) and AZN 455.7 million (2.4 times) in economic expenditures.

Since the clear allocation and application directions were not in the state budget document submitted to the Parliament the amount of expenditures significantly increased. Thus, AZN 812.4 million, or 5%, of all budget expenditures was spent in 2017 by utilizing the items of “expenditures related to the reforms”, “service sectors such as utilities, communication services and other activities which are not included into the main budget sections”.

The government by using state budget significantly increased the public debt service costs. Overall, around AZN 6 billion were spent for government guaranteed financial obligations using the state budget functional item “general public service expenditures” and “Guarantee Fund”. This was 8.6% of GDP.

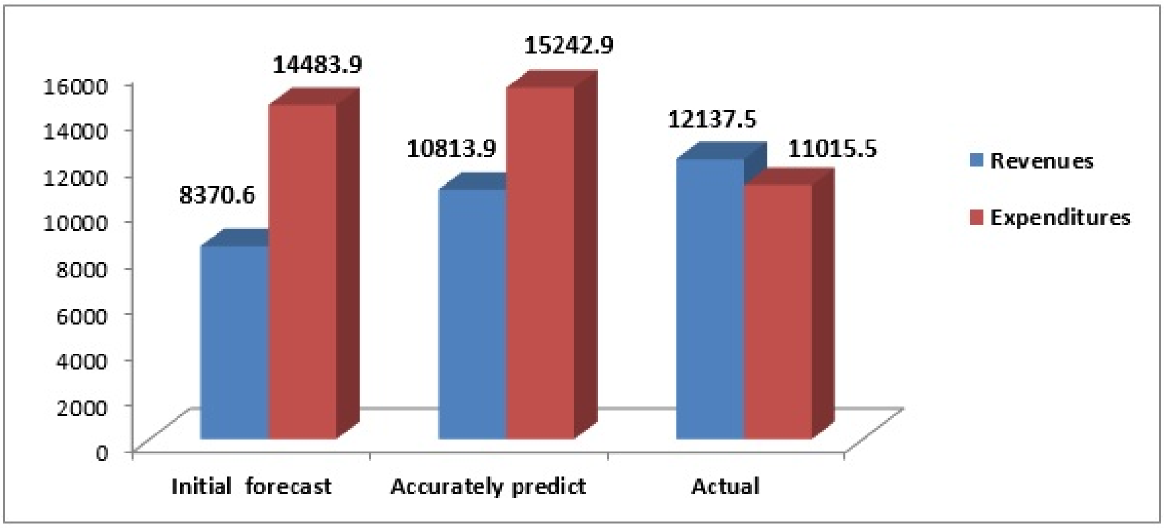
The recorded budget deficit is the highest in last five years. The actual amount of budget deficit in 2017 was AZN 1077.8 million. The share of budget deficit in GPD was 1.45%.

3.2. State Oil Fund

The decree of President of Azerbaijan Republic dated January 10, 2017 approved the SOFAZ’s budget revenue amount of AZN 8370.6 million and expenditure amount of AZN 14483.9 million for 2017. There were amendments to the Fund’s budget revenue and expenditures: respectively the revenue amount was AZN 10813.9 million and expenditure amount AZN 15242.9 million.

The decree of President of Azerbaijan Republic dated July 17, 2018 approved the execution amounts for Fund’s budget revenues and expenditures, respectively, AZN 12137.5 million and AZN 11015.5 million for 2017 (see *Figure 3.5*).

Figure 3.5. 2017 SOFAZ Revenues and Expenditures (AZN millions)



<u>The incomes of Fund</u>. The stabilization and rise of oil price in global markets in 2017 significantly increased SOFAZ revenues compared with 2016: its revenues stood at USD 7065.5 million 2017, which is USD 1174.4 million USD or 19.9% higher over previous year.

It should be noted that there was significant decrease in the revenues of the Fund in 2015 and 2016 due to the sharp fall of global oil prices: even though the revenues of the Fund in 2014 was USD 16.2 billion, it was USD 7.7 billion in 2015, and fell further to USD 5.9 billion in 2016.

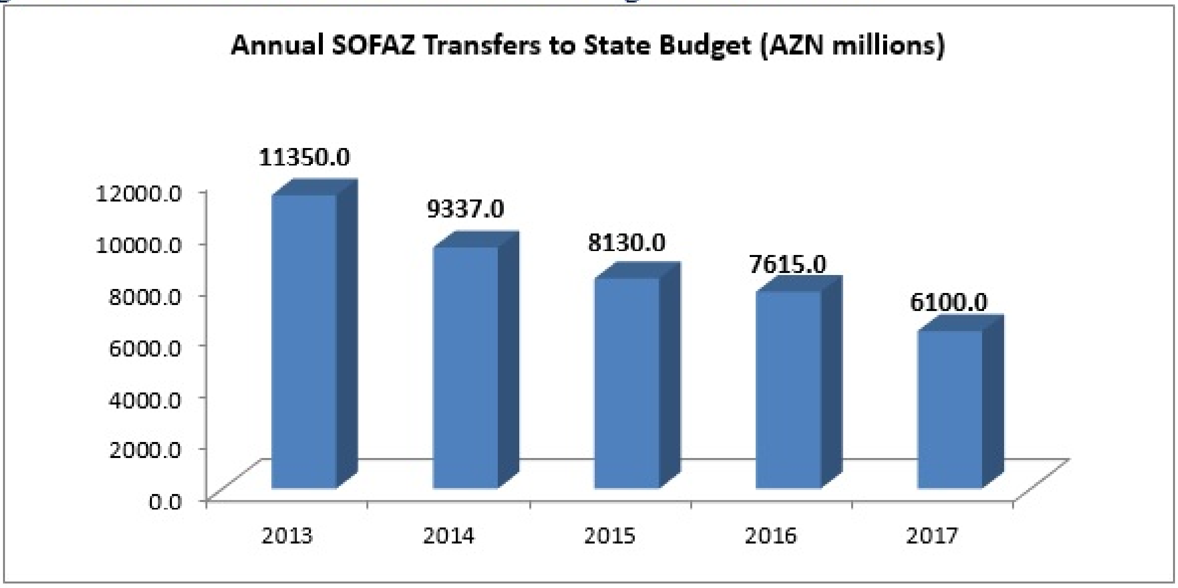
90.9% of the Fund’s revenues in 2017 came from the sale of profit oil and gas, 8.9% from managing SOFAZ’s assets.

The expenditures of the Fund. The amount of budget expenditures of the Fund in 2017 was AZN 11015.5 million which is 72.3% of estimated expenditures. In other words, the expenditures of the Fund was AZN 4229.4 million less than expected. It was attributable to lower spending on some expenditure lines of the Oil Fund’s assets than originally estimated: since transfer to the Central Bank were executed at 52.7% (AZN 3.95 billion versus AZN 7.5 billion), financing the “Baku-Tbilisi-Kars railway” construction project at 12.4% (AZN 20.6 million versus AZN 165.8 million), Financing the “State Program on the Education of Azerbaijani Youth abroad at 58.0% (AZN 17.0 million versus AZN 29.3 million); And despite AZN 496.2 million were projected to finance in 2017 the share of the Republic of Azerbaijan in Southern Gas Corridor projects, no transfer according to this direction of expenditures had been made. As a result, ***the Fund’s actual expenditures were AZN 1122.0 million, or 10.2%, less*** than its revenues as compared to its original expenditures estimated to be AZN 4.4 billion, or 41%, more than its revenues.

In order to ensure macro-economic stability, it was first time envisaged that since the Fund had been established AZN 7.5 billion to be transferred from Fund to the country’s Central Bank in 2017. However, at the beginning of 2017 it was possible to restore the stability of country’s economy which was disrupted in 2015 and as a result only 52.7% i.e. AZN 3.95 billion of initially envisaged amount was actually transferred from the Fund.

The amount transferred from the Fund to the state budget in 2017 was AZN 6100.0 million. It means that **the amounts of SOFAZ payments to the state budget has continued to drop year by year** since 2013 (see *Figure 3.6*).

Figure 3.6: Annual SOFAZ Transfers to State Budget (AZN millions)



<u>Reserve Funds</u>. There was an increase in the value/volume of reserve assets of Fund in 2017 compared to the previous year: the value of reserves at the end of year was USD 35806,5 million which is USD 2659.5 million or 8.0% more than in the end of 2016 (USD 33147,0 million).

4. DEVELOPMENT TRENDS OF THE BANKING AND FINANCIAL MARKETS

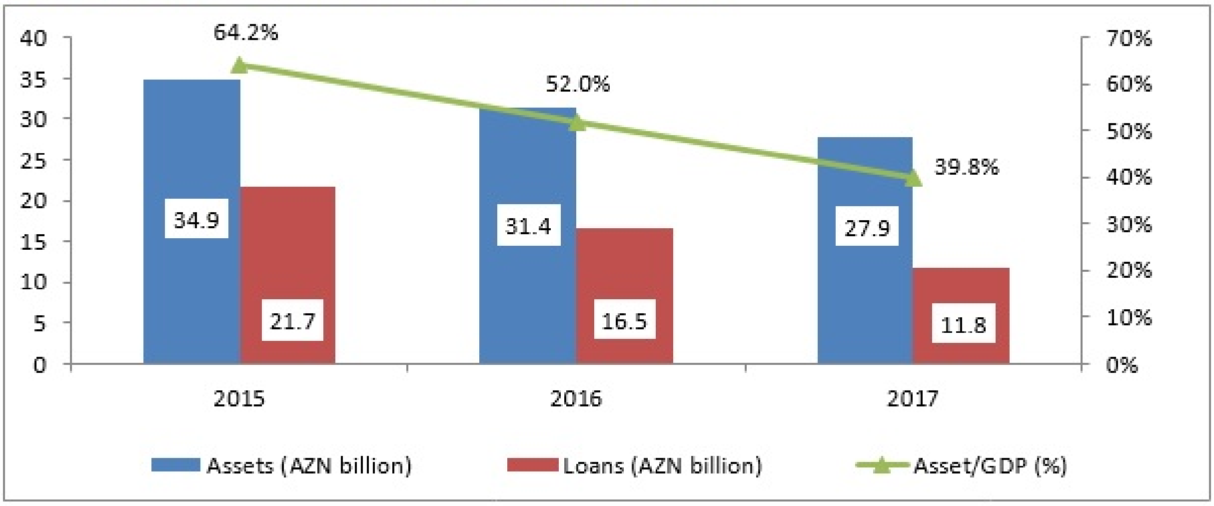
4.1. Banking Sector

<u>Processes in the banking sector</u>. In 2017, the banking sector remained relatively stable and continued attempts to recover from the so-called ‘resuscitation’ compared to 2016. Analysis of statistical data and analytical balance of banks found out that active lending by these institutions have not yet been recovered, and financing the economy and population continued to weaken during this period.

The decline in banks’ deposits and lending has led to

deterioration of their assets. Statistical data provided by the Central Bank of Azerbaijan and the Financial Market Supervisory Authority of the Republic of Azerbaijan shows that the decline in the banks' assets continued in 2017 after the devaluation. Last year, the banks' assets decreased by 11.2% to AZN 27.9 billion from AZN 31.4 billion. In 2015, the bank assets hit a historic record nearing AZN 35 billion. The main reason for the notable growth (38.6%) was the revaluation of foreign currency assets as a result of the depreciation of the nominal exchange rate of manat. *(Figure 4.1).*

Figure 4.1: ***2015-17*** **Banking Sector Assets (*AZN billion*)**



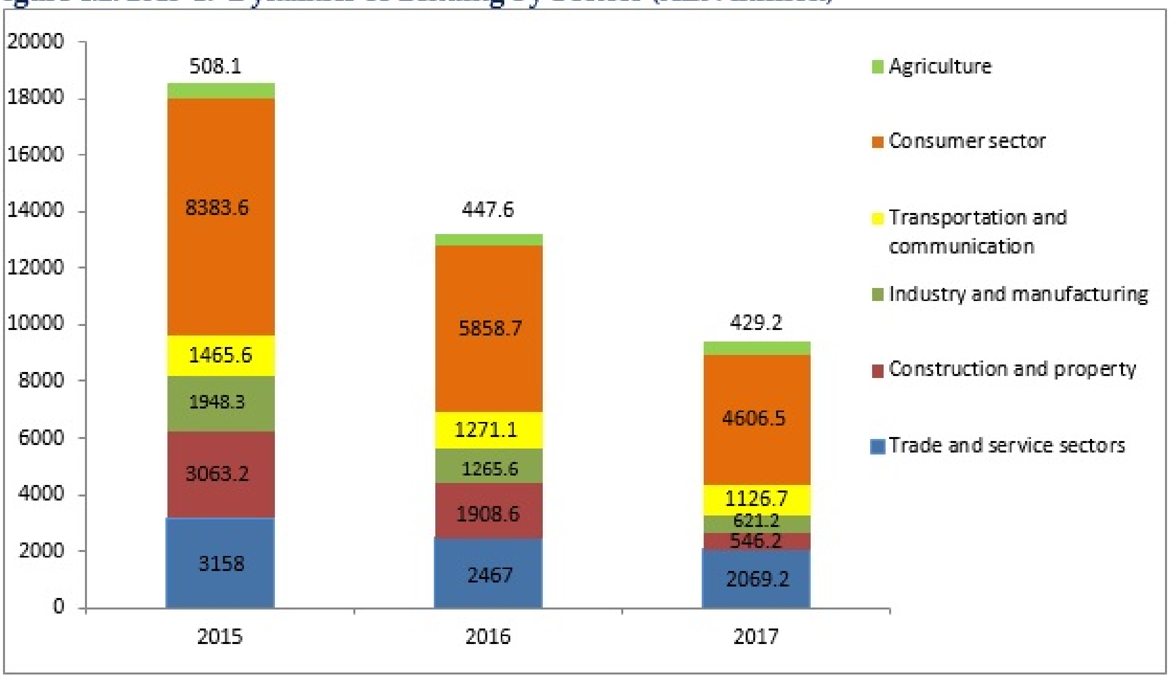
Sources: CBA; FIMSA

Although the decline in nominal GDP against the background of the dollarization of the banking sector significantly increased the share of banking assets in GDP (64.2%) in 2015, this growth has not been long-term and durable. This share fell to 52% in 2016 and to 39.8% in 2017. The negative impact of the deterioration of the banks' assets on loans continued in 2017, with total lending falling by 28.5% to AZN 11.8 billion in the country.

The banks' assets became impracticable and the interests of customers in dollar loans fell due to the increase in the problem loans after the devaluation, and the process continued in 2017. For example, the lending fell on the trade and service sectors 16.1%, on the construction and property sectors 71.4%, on the industry and manufacturing sectors 50.9%, on the transportation and communication sectors 11.4%, on the agriculture and processing sectors 4.1%, and on the consumer loans 21.4% (*Figure 3.8*).

The share of the lending in the banks' assets continued to decline. In 2016, the share of loans in the banks' assets was 52.3%, but fell to 41.5% in 2017. This means that if in 2016, AZN 52.3 per AZN 100 owned by the banking sector would be invested in the lending of the economy, but last year, that figure fell to AZN 41.5. Of particular note was 73.5% recorded five years ago (*Figure 4.2*).

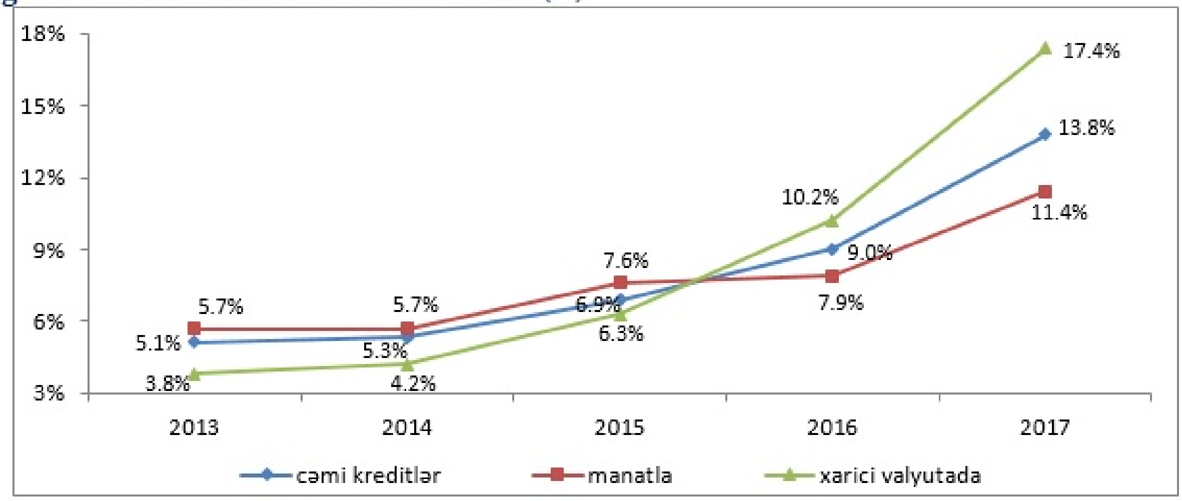
Figure 4.2. 2013-17 Dynamics of Lending by Sectors (AZN million)



Source: CBA

The overdue loans that made the banks' assets impracticable, limited lending and caused to be closed some banks, ***continued to increase*** last year. According to the Central Bank of Azerbaijan, , the share of the problem loans in the total loans rose from 5.1% in 2013 to 9% in 2016 and to 13.8% in 2017. This is now a critical limit for the banking sector. The problem with the repayment of the loans in the foreign currency is deeper. It has been impossible to repay 17.4 manat per 100 manat of the dollar loans by the banks. The data of the international institutions differs from an official data. For example, according to Fitch Rating, the share of the problem loans in Azerbaijan is 20% (*Figure 4.3*).

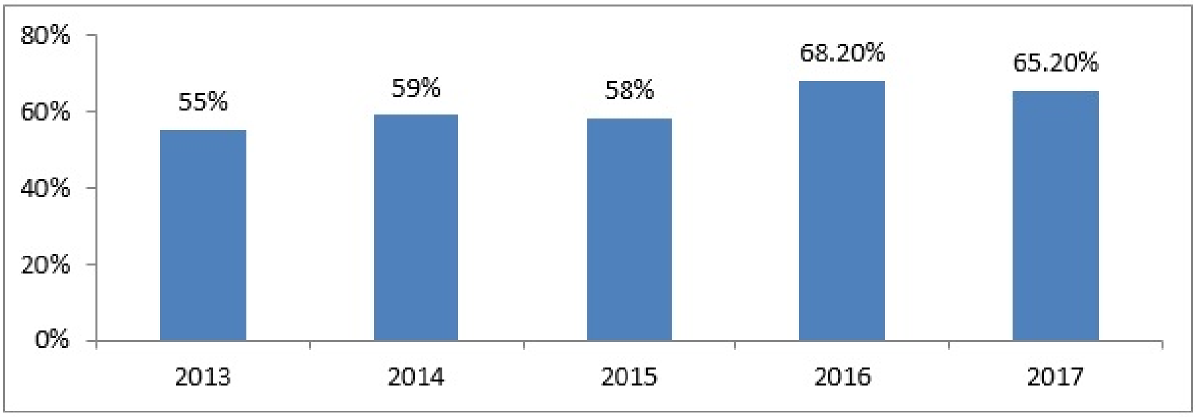
Figure 4.3: 2013-17 Share of Overdue Loans (%)



Source: CBA

The concentration observed in the banking sector after the devaluation te**nded to slacken in 2017**. During 2013-2016, the market share of five banks in the banking sector increased from 55% to 68.2%, but falling to 65.2% in 2017 (*Figure 4.4*).

Figure 4.4: 2013-17 Market Share of Top Five Banks (%)



Sources: CBA; FIMSA

The [Herfindahl–Hirschman Index], an index widely deployed internationally to assess industry concentration, displays the concentration of 1382.3 in the banking sector according to results of 2017, which is a medium concentration level. Notably, a Herfindahl index of 0 to 1,000 is commonly interpreted as an industry with *low concentration*, 1,000 to 1,800 percent with *medium concentration* and 1,800 to 10,000 percent as *highly concentration*.

The reason for the concentration is the closure of banks, prompting individuals and companies to redeposit their funds in supposedly most reliable and largest banks. After a momentary recess, last year two steps were taken in the declining of the banks. Firstly, in April 2017, two banks “Atabank” OJSC and “Caspian Development Bank” OJSC decided to merge and began to run as “Atabank” OJSC. At the end of the year, the license of “Demirbank” OJSC was revoked by a rule of the Board of Directors of the Financial Market Supervisory Authority dated December 22, 2017. The reason for this decision is that the aggregate capital of the banks was lower than the minimum amount of a capital defined to the banks and the adequacy ratio of the aggregate capital was less than three per cent intended by the legislation, as well as the failure to fulfill liabilities to the creditors. Thus, the number of the banks decreased to 30. However, in 2015, their number rebounded to 45 (*Figure 4.1*).

The closure of the banks led to a decrease in the number of their branches and employees. Last year, the number of such branches fell from 569 to 509. The number of the bank departments increased from 11 to 142. The number of the employees fell from 16947 to 16171 during this period.

Table 4.1: Changes in Number of Banks

Banks	2014	2017	Change (+ increase, - decrease)
Number of banks	**32**	**30**	**- 2**
Banks with foreign capital, including:	15	15	0
with the share of foreign capital ranging from 50 to 100 percent	*6*	*8*	*+2*
with the share of foreign capital not exceeding 50 percent	*9*	*7*	*- 2*
local branches of foreign banks	*2*	*2*	*0*
Local bank branches	569	509	- 60
Local bank departments	131	142	+ 11
Number of employees	16947	16171	-776

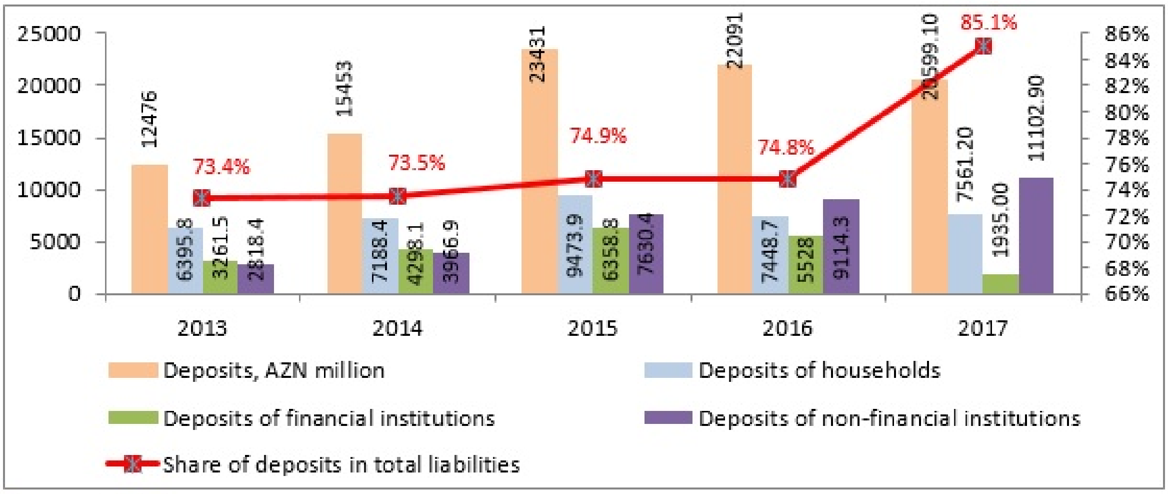
Sources: CBA; FIMSA

Last year, another negative event observed in the banking sector was the decline in the volume of the deposits. The volume of the deposits decreased 6.8% to AZN 20.6 billion as compared to 2016.

In general, ***the dependence of the banks*** on the deposits has increased despite of the reduction of the deposit market over the past five years. In 2013, although the share of deposits in total liabilities was 73.4%, it reached to 74.8% in 2016, and to 85.1% at the end of 2017. The reason for this is gradually the rejections of the banks from the foreign liabilities and the restriction of the banks' abilities to run on tick from the credit institutions (*Figure 4.5*).

According to the official data, the foreign liabilities of the banks decreased from $5.3 billion to $1.6 billion in 2013-2017.

Figure 4.5: 2013-017 Dynamics of the Volume of Deposits and Share of Banking Sector Liabilities



Source: CBA

Reduced trust in the banking sector in the aftermath of the closure of the banks and the sharp decreasing annual profitability on the foreign currency deposits have led to the reduction in deposits as a whole. The total deposits have fallen, but in 2017, there has been an increase in the population deposits. The volume of deposits in 2017, increased by 1.5% to AZN 7.6 billion from AZN 7.5 billion in 2016, largely due to the deposits in local currency. A 67% increase in local currency deposits in exchange for a 15.5% decline in foreign currency deposits led to an increase in total deposits during this period. Growth in local currency deposits and it high annual profitability have secured a stable rate of the national currency in recent months. For example, at the end of 2017, placed for one year, the average annual interest rate of the foreign currency deposits is 2.6%, while this figure reaches 12.1% in local currency deposits.

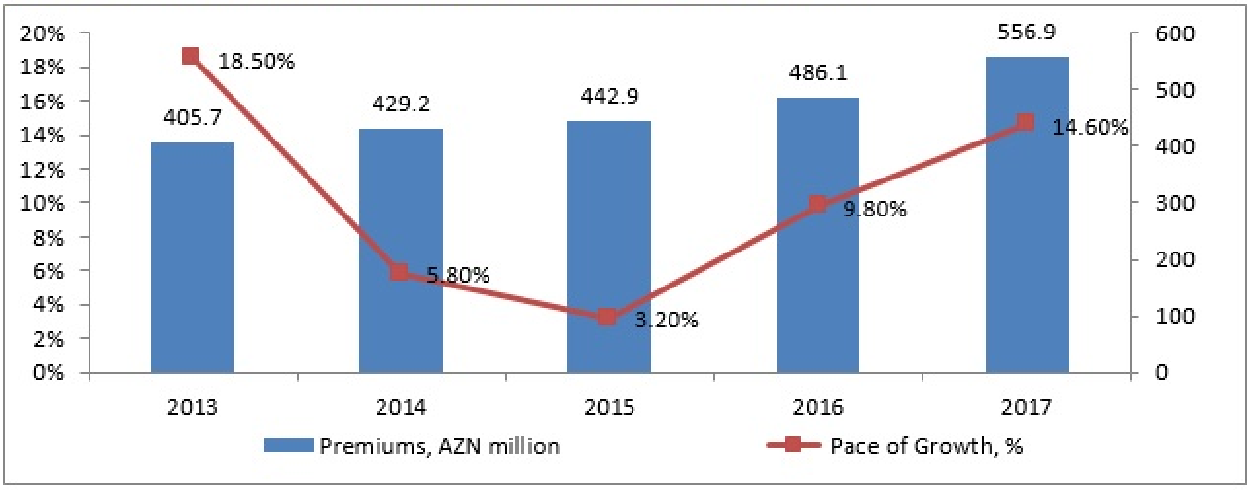
After the devaluation, last year rapidly a dollarization of the banking sector was replaced by a counter-dollarization. In 2016-2017, the share of the foreign currency loans in the total lending fell from 47.3% to 40.9%, while the share of the foreign currency deposits in the total deposits fell from 77.6% to 72.4%. The counter-dollarization mainly happened in the population deposits fell from 81.3% to 66.5%. While the share of the foreign currency deposits in the financial institutions' deposits decreased from 88.4% to 82.4%, in the non-financial deposits increased from 63.4% to 74.7%.

4.2. Insurance Market

Through 2017, the Azerbaijan insurance market continued to grow. The insurance sector's net written premiums reached AZN 556.87 million in 2017, marking a 14.6%, or AZN 70.79 million, increase over the 2016 level. Nerveless, the share of total premiums in the Azerbaijan Gross Domestic Product (GDP) dropped to 0.79% from 0.80%.

Despite the impact of the devaluation in 2015, the domestic insurance market is reported to have preserved an upward trend over the past five years (*Figure 4.6*).

Figure 4.6: 2013-17 Insurance Sector Net Premiums, Pace of Growth



Source: FIMSA

Some insurance companies closed, while others merged after the currency collapse.

Some insurance companies closed, while others merged after the currency collapse. Since the number of domestic insurance companies decreased throughout the period. There were 21 companies present on the Azerbaijan insurance market at the end of 2017, compared to 25 companies in previous years. Rulings by the Board of Directors of the Financial Market Supervision Authority of Azerbaijan (FIMSA) revoked the insurance licenses held by "Alfa- Sığorta Insurance Company"

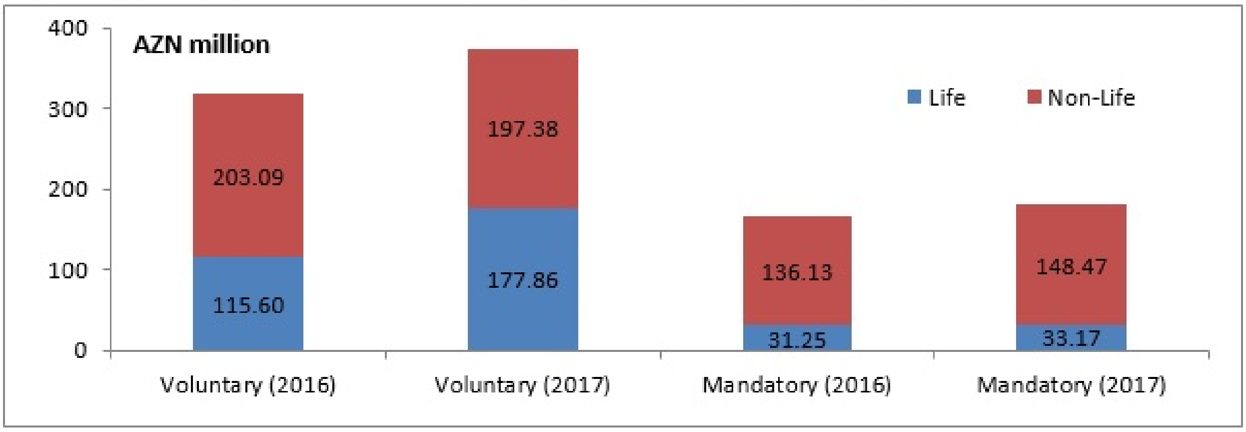
JSC on August 26, 2016, “Azerqarant Sığorta Insurance Company” JSC, “Buta Sığorta” JSC and “International Insurance Company” JSC on December 29, 2016, and “Başak-İnam Insurance Company” JSC on October 6, 2017. FIMSA reported its ruling stemmed from the insurance company having a solvency margin below the required statutory minimum, as evidenced by the insurers’ supervisory returns and financial statements after the devaluation. Moreover, FIMSA in 2017 licensed “Nakhchivan Insurance Company” JSC to operate on the market.

A fall in the number of insurers has led to increased market concentration. Five companies’ market share surged 67.9% in 2017 compared to 60.9% in the previous period. Pasha Insurance OJSC, Pasha Life Insurance OJSC, Ateshgah Insurance OJSC, Ateshgah Life Insurance OJSC and State Insurance Commerce Company of the Azerbaijan Republic entered the top ten writers of insurance products in 2016, and still remaining the largest writers of insurance on the market in 2017 despite a decrease in their percentage point of market share. The increased market concentration was largely the result of growth in policies written by Pasha Insurance OJSC and Pasha Life Insurance OJSC, part of Pasha Holding, one of the largest investment corporations in Azerbaijan. These companies gained almost 50% of market share, with the percentage point soaring up to 46.8% in 2017 as compared to 36.6% in the previous period, while Ateshgah Insurance OJSC and Ateshgah Life Insurance OJSC, holding the second largest market share during this period, saw a drop of up to 13.9% from 15.9% over the previous year. The market share of State Insurance Commerce Company of the Azerbaijan Republic also shrank (from 8.5% to 7.3%).

Analysis of the statistical date for all lines of insurance found out that **the compulsory insurance sector recorded a decrease in premiums in 2017 despite an increase in aggregate net written premiums, while the voluntary insurance sector continued to see an increase in premiums.** Between 2016 and 2017, total premiums for voluntary insurance rebounded to

17.7%, while those for mandatory insurance by 8.5%. Despite this growth, the voluntary purchase (share) of insurance grew to 65.6% in 2017 from 67.4% in the previous period, while that of mandatory insurance slid to 32.6% from 34.4% (*Figure 4.7*).

Figure 4.7: 2016-17 Distribution and Change in Premiums for Lines of Insurance



Source: FIMSA

The growth in voluntary classes of insurance is the result of the significant increase *Life insurance* recorded in aggregate premiums (53.9%), while *Non-Life* sector saw a modest erosion of 2.8% in premium. All lines of Life insurance recorded increases in premiums. Even *Life insurance* doubled in 2017 over the previous year, while *Disability insurance* increased approximately five times. Non-Life Personal and Property classes saw decreases of 0.6% and 4.6%), respectively.

There were decreases in insurance premiums collected under *Motor insurance* and *Cargo insurance* that covers transits carried out in rail, air (excluding transits carried out in water), which are classified within *Property insurance*. In addition, *crop and livestock insurances* also saw decreases of more than 2 times and approximately three times, respectively, in premium. Employee fraud insurance fees have also increased substantially (two times). *Employee dishonesty insurance* also saw a significant decrease (two times) in premium.

Premiums for compulsory *Life* and *Non-Life* lines of insurances soared up to 6.1% and 9.1%, respectively. Growth in Life sector was largely provided through compulsory insurance from loss of professional working capacity as a result of labor accidents and occupational diseases. Growth in Non-Life sector nevertheless came from *mandatory professional indemnity insurance of auditors* (13.3%), *compulsory real property insurance* (10.8%), *compulsory civil liability insurance associated with the use of the real property* (7.2%), *compulsory insurance of civil liability of motor vehicle owners* (14.2%), *compulsory personal accident insurance of passengers* (6.8%). But *compulsory state personal insurance of military personnel* and *compulsory insurance of employees of judicial and law enforcement bodies* reported decreases of *11.1*% and *0.5*%, respectively, during this period.

In 2017, Azerbaijan introduced new insurance products by amending the legislation in order to improve the insurance industry.

Mandatory health insurance has been introduced. Under Presidential Decree 1181 dated 28 December 2016, a mandatory health insurance pilot project started to run in *Mingachevir, Yevlakh* and *Agdash*.

Several laws in the field of insurance have been amended to stimulate cashless settlements. According to the amendments to the insurance legislation, settlements defined by the law are to be proceeded only cashless.

An insurance mechanism to handle unemployment has been created. On 30 June 2017, the President signed a new Law on Unemployment Insurance. Under the new Law effective from January 1, 2018, the mandatory contributions for unemployment insurance are as follows:

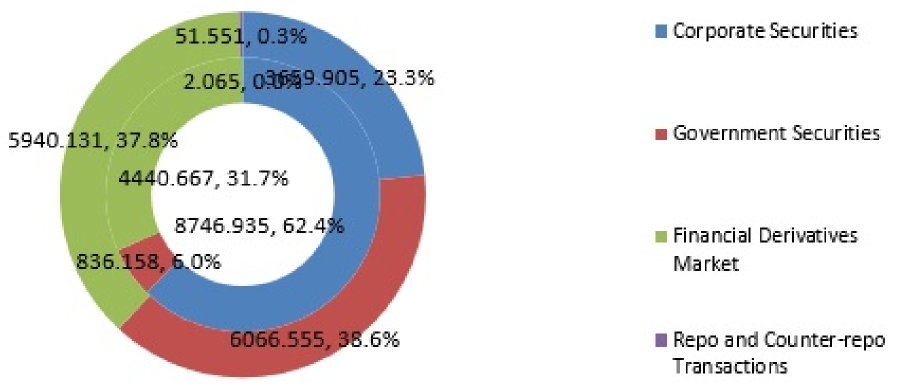
- 0*.5% of the calculated salary fund of the employer (payable by the employer);*
- *5% of the employee's salary (payable by the employee through withholding by the employer).*

The draft budget of the country's unemployment insurance fund effective from January 1, 2018, was adopted on December 1,2017. The fund's revenues and expenditures were approved at AZN 89.04 million. The unemployment insurance premium for each month is paid not later than the 1st of the following month.

4.3. Securities Market

The securities market continued to expand in 2017. Thus, this market was 12% up, compared with 2016, to AZN 15.7 billion during the past financial year. The growth was due to the rapid enlarging of the securities market. *Government securities* market transactions rose 7.3 times, to AZN 6.1 billion, from AZN 836.2 million. With the secondary corporate securities market rising by 2.8 times, the government bonds market rose by 7.3 times. The *financial derivative* market totaled AZN 5.9 billion, marking a 33.8% increase over the 2016 level. *Repo transactions* totaled AZN 51.5 million at the securities market over the reported period, a 25 times increase over the previous period. In that same time frame, *the corporate securities* market went down by 58% to more than AZN 3.7 billion (*Figure 4.8*).

Figure 4.8: 2016-17 Total Securities Market Transactions (*AZN millions*)

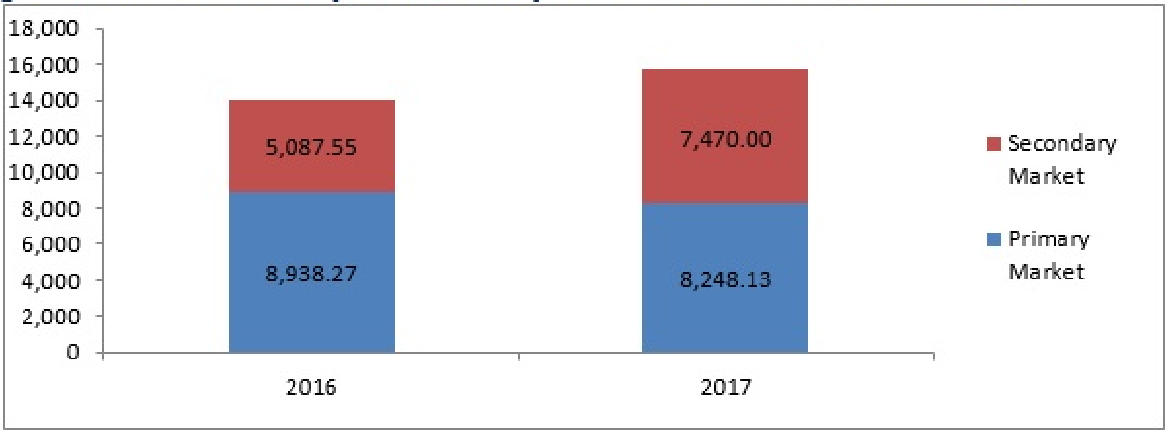


Source: FIMSA

The secondary securities market increased by 47%, yet the primary securities market shrank by 8% in 2017. *Primary corporate bonds market* transactions were 73% down to AZN 2.3

billion, while *primary government securities market* transactions were 8.6-fold up to AZN 6 billion during the reported period. Although the *secondary government securities market* saw a 41% decrease, the secondary *corporate bonds market* saw a 2.8-fold increase in 2017 (*Figure 4.9*).

Figure 4.9: 2016 – 17 Primary and Secondary Market Transactions (*AZN millions*)



Source: FIMSA

<u>Corporate securities</u>. The *equities* and *bonds* segments accounted for 44% and 56% of the corporate securities, respectively. Despite a decline in the total market transactions over the reported period, the *equities* segment of the corporate securities market soared up to 2.2 times. As real sector actors and financial institutions sought to maximize their capital through stock exchange over the reported period, the equities segment of the corporate bonds market transactions increased to AZN 2 billion from AZN 913 million in the previous year. Plus, banks impacted by devaluation played a particular role, by raising funding they needed to meet the capital requirements through the securities market. Overall, the *primary equities market* transactions were 3.3 times up, compared with 2016, to AZN 1.9 billion over the previous reported period, whereas the *secondary equities market* transactions saw a 54% decrease, compared with 2016, to AZN 160 million.

Another segment of the securities market, the corporate bonds market transactions, decreased by 79% over the previous reported period to AZN 1.6 billion due to lack of financing government projects through the local securities market during the reported period. Although primary corporate bonds market transactions saw a decline, secondary corporate bonds market transactions surged. *Primary corporate bonds market* transactions *in local currency* and *in foreign currency* rose 12.4 and 4.2 times, accordingly, to AZN 917 million and 315 million. However, *secondary corporate bonds market* transactions *in local currency* and *in foreign currency* shrank by 96% and 31%, accordingly.

Government securities. The donors that issued government securities on the domestic capital market during the reported period were *the Finance Ministry* (14%) and *the Central Bank of Azerbaijan* (86%). The Finance Ministry's locally-focused borrowing policy, as well as several issues of notes by the Central Bank of Azerbaijan over the reported period with a view to alleviating the pressures on the manat helped put the government securities market on an upward path. Consequently, the government securities market soared up to 48%, while the notes market up to 19.4 times.

The stock exchange had 50 auctions to sell *the Central Bank* notes, resulting a 19.3-fold increase to AZN 5.2 billion *in primary market* transactions. Although there were no transactions on the secondary note market in 2016, it totaled AZN 41 million during the past financial year, with *the average weighted yield* of the note market standing at 10.89%.

Government bonds sold through 45 auctions totaled AZN 795 million, an 89% increase on the previous year. The secondary the government bonds market, however, decreased 69%, compared to the previous period, to AZN 45 million. The average weighted yield of the short-term government bonds in local currency on the primary market made 10.15%, whereas that of the medium-term government bonds made 13.08% over the reported period.

Financial derivatives market. AZN 5.9 billion worth of currency-backed and commodity-backed derivative financial instruments were traded in 2017 at the Baku Stock Exchange's financial derivatives platform, a 33.8% increase on the previous year. The currency-backed and commodity-backed derivative financial instruments accounted for, accordingly, 93% and 7% (up 32.9% and 47.8% compared to the previous year) of the total financial derivative market.

Repo and counter-repo. Repo transactions totaled AZN 51.5 million at the securities market during the past financial year, a 25-fold increase on the previous year. The repo transactions involving government and corporate bonds, respectively, accounted for AZN 30.8 million and AZN 20.8 million.

5. BUSINESS ENVIRONMENT AND INSTITUTIONAL REFORMS

The crisis Azerbaijan's economy faced in 2015 due to the sharp decline in global oil prices once again raised the need to overcome shortly the high dependency on oil revenues. Since mid-2015 many decisions have been taken to improve the country's business and investment environment, encourage investment, support local production, protect the domestic market, and stimulate non-oil exports, with relevant measures under way. Such decisions and measures are numerous, among which are the simplification of licensing terms and procedures for business activities, the partial suspension of inspections of businesses for two years, the subsidies to some agricultural products, the promotion of investment in non-oil sectors (particularly in regions) and application of privileges to non-oil export promotion, the establishment of the Export Support Center "One Window" to nurture export diversification, etc. This is why the rank of Azerbaijan improved to 51 from 65 among 190 economies in the ease of doing business, according to the Doing Business 2018 report.[iii]

On December 6, 2016, Azerbaijan introduced Presidential Decree No. 1138 “On approval of the Strategic Roadmaps on the national economy and on the main sectors of the economy”. The Decree defines roadmaps for 10 priorities.[iv] The roadmaps reflect the main directions of economic and institutional reforms, as well as the measures to improve the business environment, which are expected to be carried out in the coming years. The implementation of the roadmaps started in 2017. The monitoring of the roadmaps has been implemented by the Center for Analysis of Economic Reforms & Communications. The results of the monitoring for the first half year of 2017 and the full year 2017 were made available to the public by the Center.[v]

The establishment of Digital Trade Hub of Azerbaijan represents another move in stimulating Azerbaijan’s non-oil exports. Under the Presidential Decree on February 22, 2017 “On additional measures for strengthening of the position of the Republic of Azerbaijan as a Digital Trade Hub and expansion of foreign trade operations”, the Center for Economic Reforms Analysis and Communication Center was tasked to ensure the creation of a section “Digital Trade Hub of Azerbaijan” on www.azexport.az internet portal, allowing to draw up and sign documents and contracts in electronic form between the persons registered in the Republic of Azerbaijan as tax payer and their foreign business partners, as well as to implement trans-border electronic services in real time regarding the implementation of entrepreneurship activity. Such a section has already been created (https://dth.azexport.az/en), being available in three languages (Azerbaijani, English and Russian).

A Commission for the Regulation and Coordination of Labor Relations was established under the Presidential Decree, dated March 17, 2017, on additional measures in connection with the regulation of labor relations in the country. The Commission’s objective is to further strengthen the social protection of employees in the country, formalize the registration of employer-employee relations, improve mechanisms for monitoring the organization of labor payment, and ensure the effective protection of other labor rights and guarantees of participants in labor relations and implementation of policies coordinated between state bodies in this field. The Commission was tasked to submit proposals on the administration and development of this field, through analyzing the current situation in the domestic labor market and legislation by taking into account international practice on regulating labor relationships.[vi]

Rules under the Presidential Decree, dated April 4, 2017, have been approved to simplify the procedure of electricity supply to existing or built construction facilities, under which entrepreneurs possess an opportunity to supply their existing or to be built construction facilities with electric power of 150 kW generating from the existing 0.4 kV network at ASAN service centers.[vii] Technical conditions for the connection of 150 kW entrepreneurial objects to the existing 0.4 kV electric network will be provided according to three procedures on single window with a total period of 24 days.

“The Action Plan on additional measures to improve the business climate in Azerbaijan and further improve the country’s position in international ratings was approved by the Order of the President of the Republic of Azerbaijan on June 2, 2017.[viii] The implementation of all activities under the new development plan is scheduled for 2017-2020.

On September 15, 2017, the President of the Republic of Azerbaijan, decreed to create a Loan Guarantee Fund to carry out a number of measures to provide state support to entrepreneurs for expansion of access to financial resources.[ix] Under the decree, the Fund was to provide a guarantee for entrepreneurs’ manat loans taken out in authorized banks. In cases and the order determined by the head of state, the Fund was also to provide subsidies on a part of the interest rate on loans. However, on Dec. 25, 2017, the President decreed to establish an Azerbaijan Mortgage and Credit Guarantee Fund CJSC through the merger of the Azerbaijan Mortgage Fund and the Credit Guarantee Fund.[x] According to its statutes, the Fund's major objective is to create a mechanism of providing the population with living space through long-term mortgage lending, assist in attracting local and foreign financial resources for mortgage lending, as well as provide guarantees to entrepreneurs for manat loans taken from authorized banks, and grant subsidies for a part of the interest calculated on these loans.[xi]

The moratorium on inspections of business activities in Azerbaijan under the law "On suspension of inspections of entrepreneurial activities was extended until Jan. 1, 2021 according to the amendments on 31 October 2017.[xii] Inspections of business activities in Azerbaijan under the said Law enacted on October 20, 2015 had been suspended for two years.[xiii]

On November 6, 2017, President Ilham Aliyev decreed to establish a state owned "Azerbaijan Industrial Corporation" Open Joint-Stock Company with a view to increasing efficiency in managing state property, establishing an accountability system based on corporate management principles, achieving the establishment of favorable cooperative relations between state-owned entities, and increasing in production potential through chains of value chain. Under the Decree, the state property acquired in return of troubled assets (debts), taken by "Aqrarkredit" Closed Joint-Stock Company from the International Bank of Azerbaijan (IBA) and belonging to the former, will be transferred to Azerbaijan Industrial Corporation.[xiv]

On December 28, 2017, the President decreed to create an Agency for Development of Small and Medium-Sized Enterprises within the Ministry of Economy. Under the Decree, the Agency is a public legal entity that supports the development and expansion of small and medium-sized businesses in the country, provides a range of services to the SMEs, as well as coordinates and regulates the services of state bodies in this field.[xv] It also envisages the creation of "SME Houses" in a single space within the Agency to provide a range of services (training, consulting, information, innovation, business incubators, finance, etc.) to the SMEs in major districts and cities across the country.

A number of steps were taken in 2017 to create professional unions or associations of local producers and exporters resulting in the formation of several such associations in the country.

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[iv] http://www.e-qanun.az/framework/34254

[v] http://iqtisadiislahat.org/

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