

## Persistent drop in oil prices has taken its toll

### General Information



<b>GDP</b>	USD75.2bn (World ranking 68, World Bank 2014)
<b>Population</b>	9.5mn (World ranking 90, World Bank 2014)
<b>Form of state</b>	Republic
<b>Head of state</b>	Ilham ALIYEV (President)
<b>Next elections</b>	2018, presidential



### Strengths

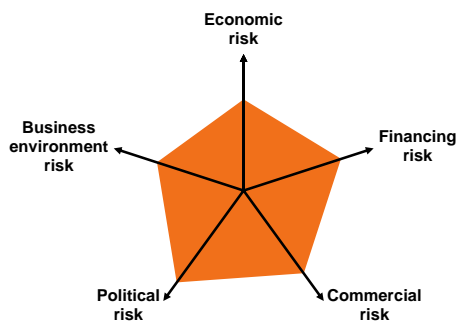
- Ample natural resources in the hydrocarbon sector
- Low public debt
- Substantial foreign currency assets in the State Oil Fund

### Weaknesses

- High regional political instability
- Relatively poor regional relations, in particular the conflict with Armenia over the Nagorno Karabakh enclave
- Authoritarian political regime
- Weak government effectiveness and slow progress of structural reforms
- Loose monetary and fiscal policies in the past
- Huge dependence on hydrocarbon sector creates considerable external vulnerability
- Exchange rate risk
- Significant corruption and weak protection of property rights
- Weak banking system

### Country Rating

**C3**



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Italy	28% 1	16% Turkey
France	8% 2	14% Russian Federation
India	6% 3	8% Germany
Indonesia	6% 4	7% United States
Germany	6% 5	7% China

By product (% of total)

Exports	Rank	Imports
Petroleum and products thereof	91% 1	10% Road vehicles
Gas, natural and manufactured	2% 2	9% Iron and steel
Vegetables and fruits	1% 3	8% Other industrial machinery, parts
Sugar products and honey	1% 4	8% Specialised machinery
Non-ferrous metals	1% 5	5% Electrical machinery, appliances

Source: UnctadStat (2013)

### Vulnerabilities unfolded

With ample natural resources in the hydrocarbon sector, Azerbaijan is highly dependent on mineral products – which account for about 45% of GDP, 70% of fiscal revenue and 93% of goods exports. This has made the economy very vulnerable to external shocks. The lasting drop in global oil prices since mid-2014 and marked currency depreciations in competitor countries with regard to foreign trade have been such shocks that have hit economic growth, budget revenues, the balance of payments, the manat (AZN, the local currency) and foreign exchange (FX) reserves.

Real GDP growth decelerated to +2.8% in 2014 and +1.1% in 2015, down from +5.8% in 2013 and an average annual +13% in 2004-13. The fiscal deficit surged to about -7% of GDP in 2015, after -0.4% in 2014 and ten years of large surpluses before that. And the current account surplus dwindled away in 2015 after nine years of double-digit surpluses (in % of GDP). FX reserves of the Central Bank of Azerbaijan (CBA) fell from a peak of USD16.7bn in May 2014 to USD5.6bn in January 2016, mainly due to CBA interventions to defend the exchange rate and capital flight. To fight this rapid fall in reserves, the CBA devalued the AZN in February 2015 and again in December when it also shifted from a pegged to a floating exchange rate regime, and introduced capital controls in January 2016.

### Downturn will continue in 2016...

Going forward, Euler Hermes expects GDP to grow barely in 2016 (+0.5%). The fiscal deficit is forecast at -5% of GDP in 2016 while the current account is likely to post a small deficit of -1% of GDP. Both public debt and total external debt should rise to around 30% and 40% of GDP, respectively, but this is still moderate as compared to peers. Having lost about half of its value since end-2014, the AZN stood at about 1:1.60 against the USD at the time of writing and is expected to remain under pressure for as long as uncertainty remains on the length and severity of the oil price slump. This implies a rise in inflation to a forecast average 10% in 2016.

### ...but SOFAZ provides substantial buffer

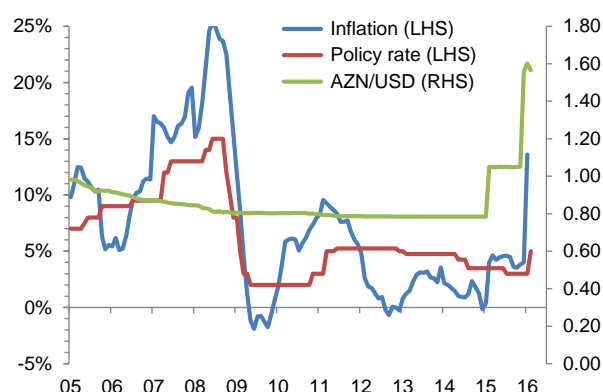
Nevertheless, Azerbaijan remains well-placed to withstand the current downturn, thanks to large FX reserves held by the State Oil Fund of Azerbaijan (SOFAZ). These stood at USD33.6bn at end-2015, compared to total external debt of around USD12bn. Combined FX reserves of the CBA and SOFAZ cover more than 25 months of imports. Moreover, Azerbaijan's authorities have sought technical assistance from the IMF which should help to strengthen their policy response.

### Key economic forecasts

	2014	2015	2016f	2017f
GDP growth (% change)	2.8	1.1	0.5	2.0
Inflation (% end-year)	-0.1	4.0	9.0	3.0
Fiscal balance (% of GDP)	-0.4	-7.0	-5.0	-3.0
Public debt (% of GDP)	15.9	20.0	30.0	32.0
Current account (% of GDP)	14.1	0.3	-1.0	1.0
External debt (% of GDP)	20.8	30.0	40.0	40.0

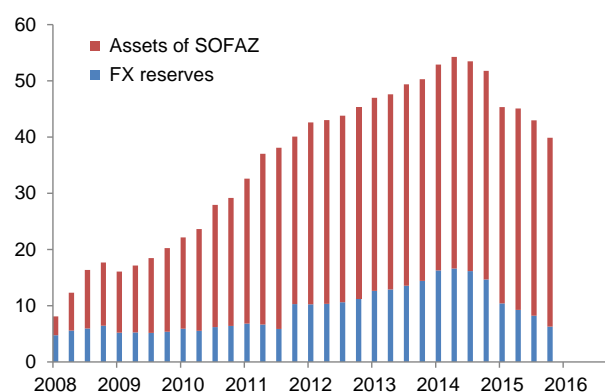
Sources: National sources, IHS, Euler Hermes

### Monetary policy interest rate (%), inflation rate (y/y, %), and exchange rate



Sources: CBA, IMF, Euler Hermes

### Foreign exchange reserves and assets of State Oil Fund (SOFAZ) (USD bn)



Sources: SOFAZ, IMF, Euler Hermes

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