PASHA Holding

Azerbaijan Economy in the January-March period of 2021

Non-oil economy started the recovery phase in the first quarter of 2021:

- The overall economy contracted by 1.3% mainly due to 7.3% fall in the oil sector output. Production of crude oil was 5.3% lower compared to the first quarter of 2020. It fell by 6% m-o-m to 3 mln. tonnes in March. The decrease in production is mainly related to the realization of Azerbaijan's commitment to the OPEC+ deal. Meanwhile, natural gas production increased by 12%;
- Coming to the non-oil GDP, it increased by 2.1% and accounted for 63.7% of the total GDP. The non-oil sector grew by 3.5% if the COVID-19 affected tourism stripped out. Tourism sector experienced a 50.3% downfall due to travel restrictions constraining non-oil GDP growth;
- Non-oil manufacturing is the highest growing industry in the economy (16.9%), which is mainly thanks to the effect of ''whitening'' and realization of public investment on specific segments of the industry, like chemicals, metallurgy, and pharmaceuticals. In the meantime, construction sector expanded by 4.8% y-o-y. Reconstruction work in the liberated territories is expected to support the revival in the construction sector.

Inflation jumped into the upper interval of the Central Bank's target range:

- The price level increased by 0.9% in March and annual inflation stood at 4.1%. It was slightly higher than Central Bank's target band (2%-6%) center 4%;
- Prices of 85.4% of the products & services (428 out of 501) included in the consumer basket increased on a y-o-y basis, 7.8% decreased, and 6.8% remained unchanged. Price increase of 62.1% (311) of items is less than the headline annual inflation of 4.1%;
- If decomposed into the consumer basket, food prices went up by 4.8%, non-food prices 3.7%, and services by 3.4% y-o-y. The contribution of food, non-food products, and services to the annual headline inflation made 2.1, 0.9, and 1.1 percentage points (total 4.1%), respectively;
- Administrative price increases (gasoline and water supply related services) and seasonal factors had an inflationary effect in the first quarter.

Despite decreased oil exports trade balance yielded a surplus equivalent to 14.4% of total GDP:

- In the first quarter of 2021, total exports decreased by 1.6%, and imports fell by 4%. Ultimately, trade surplus increased by 2.4% and accounted for $1607 mln.;
- The decrease in exports is mainly related to crude oil exports. Exports of crude oil decreased by 24.4% in nominal terms, while it fell by 7% in real terms. Meanwhile, natural gas exports more than quadrupled y-o-y in real terms. Increase in revenues from natural gas exports (5.4x) enabled to offset 82.2% of the decrease from crude oil exports.;

- The main contributors to import decline were transportation & spare parts, metals and fuels:
  - Imports of transportation & spare parts fell by 35.5%, while automobile imports rose by 0.3% in volume and lowered by 6.9% in value;
  - Imports of metals decreased by 39.6%, driven by ferrous metal products;
  - Imports of fuels fell by 41.1%, an indicator of stagnation in the passenger transportation sector;
  - Pharmaceutical product imports rose by 33.1%, while imports of food products increased by 27% constituting the major part of the consumer goods imports;
- During the analyzed period, non-oil exports rose by 16.9% y-o-y, amounting to $502 mln., equivalent to 19.8% of total imports;
- In spite of the trade surplus CBAR reserves declined slightly reaching USD 6356.2 mln. which is 0.2% or USD 13.2 mln. lower compared to end-2020;
- The assets of SOFAZ, as of end of March 2021, decreased by 1.8% compared to end-2020 and stood at USD 42761.3 mln. or 96% of total GDP. The decrease in assets is mainly related to fall in gold prices and depreciation of currencies in the investment portfolio against US dollar.

Loans and deposits grow in line with insurance premiums:

- In the first quarter of 2021, the total assets of the banking sector increased by 1.5% making 32.5 bln. AZN. Securities portfolio (9%↑) and cash (23%↑) were the main drivers of the rise. Gross loans increased by 1.4%;
- Business loan portfolio expanded by 1%, mainly driven by loans to individual entrepreneurs (12.9%↑). In the meantime, loans to households increased by 2.4%, including 4.4% rise in mortgages. Consumer loans expanded by 0.5%;
- NPL amount has seen a 2.8% increase compared to the end of 2020. The total NPL ratio stood at 6.2% that is 0.1 p.p. higher than 2020 year-end;
- The deposit base experienced a rise of 0.7% and made 23.8 bln. AZN. Demand deposits saw an increase at the rate of 1.6% and time deposits contracted by 0.7%, amounting to ₼9.5 bln. NFCs' deposits were the main driver of the rise in total deposits, which expanded by 2.7%. Households' deposits contracted by 0.4%;
- The dollarization rate of the total deposit portfolio stood at 55% falling by 1.4 p.p. compared to Dec 2020. The dollarization rate for time deposits fell by 2.4 p.p., while demand deposits experienced a 0.5 p.p. dollarization decrease compared to Dec 2020. In Jan-Mar 2021, foreign currency sold by CBAR stood at $1479.9 mln., 46.6% lower y-o-y;
- Return on equity of the banking sector was 12.3% (Jan-Mar 2020: 13.8%), calculated as the ratio of total net profit to the end of March equity. Interest income decreased by 1.3%, while non-interest income fell by 1.8% y-o-y;
- In the first quarter of 2021, total insurance premiums increased by 3.4% y-o-y;

- Gross premiums accounted for ₼249 mln. Life insurance premiums constituted 27.6% of the market including 18.3% share of endowment in total premiums. Compulsory segment drove the rise in life insurance growing by 32.9%;
- Non-life insurance expanded by 4.1% mainly driven by 13.6% increase in compulsory segment, particularly real estate (33.6%).

CBAR decided to maintain the refinancing rate at 6.25% at the April MPC meeting:

- The decision was similar for both bounds of the interest rate corridor as lower bound and upper bound remained constant at 5.75% and 6.75%, respectively. The policy rate decreased by 125 bps since the beginning of 2020;
- CBAR stated that there was no significant change that would affect inflation outlook. In addition, Central Bank mentioned that inflation is expected to remain inside the target at the year-end;
- According to CBAR, recent movements of inflation is related to non-monetary factors such as administrative price changes and seasonal factors;
- CBAR stated that recovery of aggregate demand has not reached a level above supply, thus not affecting inflation:
- According to CBAR, recent contraction in monetary base is related to budget surplus and the base will increase as the surplus will turn into deficit through the remaining part of the year. Central Bank noted that nominal and real interest rates experienced a slight fall since the last meeting;
- According to Central Bank, changes in short and medium-term forecast horizon of risk balance and its impact on inflation will affect the next interest rate decision.