

## **Azerbaijan economy in the first half of 2021**

### **Non-oil economy experienced a strong recovery in the first half of 2021:**

- The overall economy expanded by 2.1% despite a 4.7% fall in the oil sector output. Production of crude oil was 3.7% lower compared to the first half of 2020. It rose by 8.4% on a monthly basis y-o-y to 2.9 mln. tonnes in June. Azerbaijan continued to fulfill its commitment under the OPEC+ deal. Meanwhile, natural gas production increased by 8.8%;
- Coming to the non-oil GDP, it increased by 5.1% and accounted for 64.2% of the total GDP. Manufacturing, transportation and agriculture drive non-oil economic growth;
- Non-oil manufacturing is the highest growing industry in the economy (21.7%), which is mainly driven by machinery & equipment installation and repair, tobacco, textile and construction materials. In the meantime, construction sector contracted by 1.1% y-o-y. Reconstruction work in the liberated territories is expected to generate a revival in the construction sector. Transportation and agriculture grew by 9.9% and 5.7%, respectively. Recent developments in relations with neighbour countries promise further development in the transportation sector. In the agricultural sector, water and land resources of the liberated territories will play an important role in driving growth.

### **Inflation continues moving in the upper part of Central Bank target band:**

- The price level slightly decreased in June compared to the previous month and annual inflation fell to 4.7%, maintaining in the upper interval of the Central Bank's target band (2%-6%);
- Prices of 85.6% of the products & services (440 out of 514) included in the consumer basket increased on a y-o-y basis, 6.8% decreased, and 7.6% remained unchanged. Price increase of 54.9% (282) of items is less than the headline annual inflation of 4.7%;
- If decomposed into the consumer basket, food prices went up by 5.3%, non-food prices 4.6%, and services by 4% y-o-y. The contribution of food, non-food products, and services to the annual headline inflation made 2.3, 1.1, and 1.3 percentage points (total 4.7%), respectively;
- Administrative price increases (gasoline and water supply related services) and higher prices in international food and commodity markets had an inflationary effect in the first half of the year.

### **Commodities drive export growth in the first half of the year:**

- In the first half of 2021, total exports increased by 14.6%, and imports rose by 8%. Ultimately, trade surplus increased by 26.8% and accounted for \$3420 mln.;
- Total exports growth accelerated thanks to the price recovery of crude oil and higher natural gas exports. In spite of the 11.7% fall in the volume (tonne) of crude oil exports, higher prices enabled 7.6% rise in oil export revenues. Meanwhile, natural gas exports increased by 25.8%;

- The main contributors to the rise in imports were machinery & equipment, food products, automobiles and pharmaceutical products:
  - Imports of machinery & equipment increased by 14.8% y-o-y, constituting almost half of the total import growth;
  - Imports of food products rose by 18.7%, driven by wheat (30.2%↑) and oils & fats (51.9%↑). Higher international food prices also contributed to the increase;
  - Automobile imports rose by 69.3% in real terms and 37.1% in value, including 39.3% (67.6% in real terms) increase in car imports;
  - Pharmaceutical product imports increased by 40.2%, constituting a major part of the consumer goods imports combined with food products.
- During Jan-June 2021, non-oil exports rose by 27.5% YoY, amounting to \$1162 mln., equivalent to 21.6% of total imports.
- CBAR reserves increased slightly reaching USD 6455.3 mln. which is 1.3% or USD 85.9 mln. higher compared to end-2020;
- The assets of SOFAZ, as of end of June 2021, increased by 1.2% compared to end-2020 and stood at USD 44104.9 mln. or 94% of total GDP.

**Loans and deposits are approaching the pre-pandemic level; endowment is driving the insurance premium growth:**

- In the first half of 2021, the total assets of the banking sector increased by 3.2% y-t-d making 33.1 bln. AZN. Loans (4.9%↑) and securities portfolio (14.4%↑) were the main drivers of the rise. In the meantime, nostro accounts (22%↓) and deposits at other financial institutions (8.2%↓) contracted. Amount of outstanding Central Bank notes decreased by 20% y-t-d reaching the lowest level of the last 5 quarters, while Treasury securities expanded by 45.3%;
- Business loan portfolio expanded by 3%, mainly driven by loans to individual entrepreneurs (30.9%↑). In the meantime, consumer loan growth accelerated to 7.6% approaching to the pre-pandemic level. Mortgage loan portfolio expanded by 8.4% y-t-d;
- The total NPL ratio stood at 6% that is 0.2 p.p. lower than 2020 year-end. Loss provisions rose to 74 mln;
- The deposit base experienced a rise of 2.1% y-t-d and made 24.2 bln. AZN. Demand deposits saw an increase at the rate of 8.1% and time deposits contracted by 6.9%, amounting to 8.9 bln. The decrease is due to FC time deposits, while NC time deposits grew by 17.2%. NFCs' deposits were the main driver of the rise in total deposits, which expanded by 2.5%. Households' deposits increased by 3.1%;
- The dollarization rate of the total deposit portfolio stood at 51.6% falling by 4.7 p.p. compared to end-2020. The dollarization rate for time deposits fell by 7.9 p.p., while demand deposits dollarization rate decreased by 1.6 p.p. compared to end-2020. In Jan-Jun 2021, foreign currency sold by CBAR stood at \$2766.3 mln., 31% lower YoY;



- Return on equity of the banking sector was 15.1% (Jan-Jun 2020: 16.2%), calculated as the ratio of annualized total net profit to Jun 2021 equity. Lower profit is mainly due to loan loss provisions and higher non-interest expenses. Interest income increased by 5.6% YoY, while non-interest income rose by 31.1% YoY;
- In the first half of 2021, total insurance premiums increased by 11.3% y-o-y;
- Gross premiums accounted for 452.4 mln. Life insurance premiums constituted 42.8% of the market including 31.1% share of endowment in total premiums. Endowment drove the rise in life insurance growing by 25.5%;
- Non-life insurance expanded by 5.7% mainly driven by 10.5% increase in compulsory segment, particularly real estate (24.7%).
- In the auto-insurance market voluntary segment contracted by 15.2%, while premiums from the compulsory segment increased by 5.9%;
- Voluntary health insurance premiums fell by 1.4% amid the countrywide implementation of the compulsory health insurance.

**Central Bank decided to maintain the refinancing rate at 6.25% at the July 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 inflation is mainly based on international commodity prices, administrative prices and price increases in the trading partners. In addition, Central Bank mentioned that monetary conditions preserve disinflationary characteristics;
- According to the latest CBAR forecast, inflation will approach the upper limit of the target interval at the end of 2021;
- Central Bank stated that refinancing rate remained neutral enabling control over monetary factors of inflation;
- According to CBAR, monetary base grew by 4% y-t-d and its path for the remaining part of the year will be based on the dynamics of the state budget expenditures. CBAR stated that strategic reserves of the country rose by 2.7% y-t-d reaching 52.2 bn. USD;
- Central Bank noted that inflation risks, price-setting behavior of firms, inflation expectations and growth pace of aggregate demand will affect the next interest rate decision.



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