AZERBAIJAN

Table 1	2023
Population, million	10.2
GDP, current US$ billion	72.7
GDP per capita, current US$	7134.4
School enrollment, primary (% gross)[a]	99.8
Life expectancy at birth, years[a]	73.5
Total GHG emissions (mtCO2e)	53.1

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent WDI value (2022).

Economic growth rose to 4.3 percent in H1 2024, driven by the non-hydrocarbon sector supported by public investment. Annual inflation fell to 1.1 percent as external pressures subsided. External and fiscal surpluses narrowed due to slowing energy prices. In the medium term, growth is estimated to hover around 2.5 percent as oil production continues to decline. Risks to this outlook are balanced.

Key conditions and challenges

Azerbaijan's continued reliance on hydrocarbons as a major source of export and fiscal revenue remains its main vulnerability. Declining oil production, oil price volatility, and the global transition away from fossil fuels are challenges to long-term growth prospects.

Private sector development is constrained by the economy's large state footprint, an uneven playing field for companies, shallow financial markets, and a weak human capital base.

Global mitigation efforts, resulting in declining fossil fuel demand and fuel prices, can lead to substantial reductions in Azerbaijan's resource rents. Carbon border adjustment measures could adversely impact the country's economy further. Azerbaijan's role in hosting COP29 in November 2024 may provide an opportunity to boost climate mitigation and adaptation efforts. Phasing out distortionary fossil fuel subsidies would substantially reduce carbon emissions while fostering private investment in renewable energy, contributing to boosting the economy in the long run.

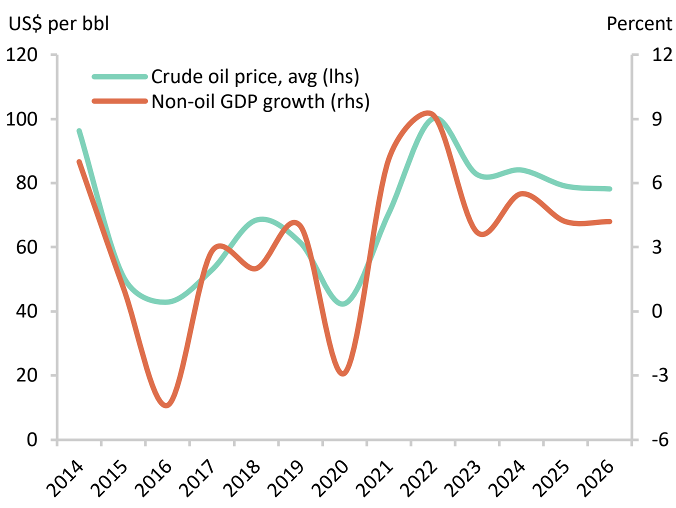
Recent developments

Growth rose to 4.3 percent in real terms in H1 2024, compared with 1.1 percent in 2023. Hydrocarbon sector growth remained lackluster at 0.4 percent in real terms as decline in crude oil production offset expansion in natural gas production. Bolstered by fast real growth in the construction sector (18.4 percent, yoy), which is fueled by public investment in reconstruction, non-hydrocarbon sector activity expanded by 6.9 percent in H1 2024. Other drivers of economic activity included real growth in transportation (15.4 percent, yoy), ICT (12.2 percent, yoy), and hospitality (10.2 percent, yoy). On the demand side, investment growth gained momentum (9.4 percent, yoy in real terms) due to greater public investment, and consumption growth remained robust. The official unemployment rate fell to 5.4 percent by end-June, from 5.6 percent in December 2023.

Annual inflation fell to 1.1 percent in June 2024 as external pressures subsided and Nominal effective exchange rate appreciated, further supporting the disinflation process. Inflation remained below the Central Bank's target range (4+/-2 percent), prompting a cut in the policy rate by 75 basis points to 7.25 percent, in three steps over six months in 2024.

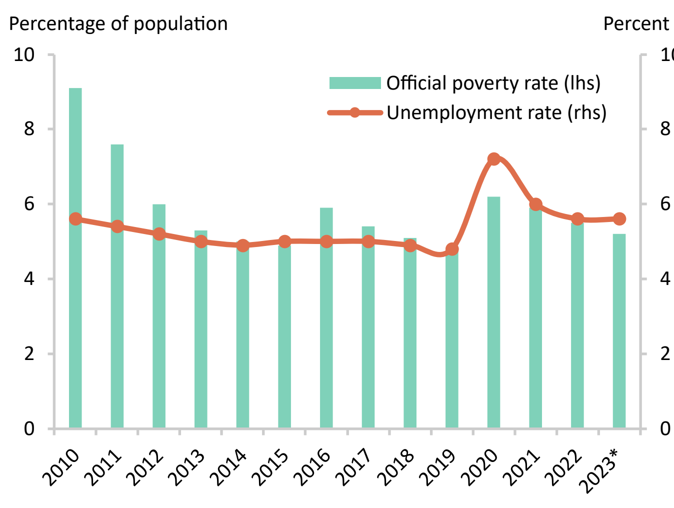
The fiscal balance recorded a surplus of 10.3 percent of GDP in H1 2024, compared with 18.1 percent in H1 2023. This is due to an increase in expenditure and a fall in hydrocarbon revenue. Revenue fell by 11.1 percent (yoy), due to lower hydrocarbon sector receipts caused by lower prices. Tax collection in the non-hydrocarbon sector grew by 8.6 percent in real terms. Expenditure increased by 13.5 percent (yoy) in real terms, propelled

FIGURE 1 Azerbaijan / Non-oil GDP growth and oil price



Sources: State Statistical Committee and World Bank.

FIGURE 2 Azerbaijan / Official poverty rate and unemployment rate



Source: State Statistical Committee.
Notes: The World Bank has not yet reviewed the official national poverty rates for 2013–2022.*Preliminary.

by a 25.7 percent increase in capital expenditure. Current expenditure rose by 8.8 percent (yoy) in real terms. The 2024 budget was amended in June, with both revenue and expenditure revised upwards. For budgeted revenue, the revision was largely due to an increase in the benchmark oil price from US$60 to US$75; additional expenditure was mostly allocated to the reconstruction program. The substantial fiscal surplus allowed State Oil Fund reserves to increase to US$58bn (equivalent to 80 percent of GDP) by end-June 2024.

Compared with H1 2023, the trade surplus narrowed to 11.5 percent of GDP in H1 2024, with exports declining by 28 percent (yoy) on the back of lower oil and gas prices and a decline in crude oil production; whereas, due to increased public investment, imports increased by 9.4 percent (yoy). Central Bank reserves edged up to USD 11.7 billion (16.2 percent of GDP) by end-June 2024, corresponding to 5.6 months of imports.

Credit to the economy expanded by 12 percent in H1 2024 (yoy) in real terms, with both consumer and business loans increasing by 10 percent. The NPL ratio edged down to 1.7 percent. Deposit dollarization fell to 40 percent.

Outlook

Supported by additional public expenditure on non-hydrocarbon sectors, the economy is projected to expand by 3.2 percent in 2024, faster than previously anticipated. The hydrocarbon sector is projected to decline in 2024–2026, due to falling crude oil production because the major oilfield is aging, whereas natural gas production is expected to stabilize. Non-hydrocarbon sector growth is expected to slow in the medium term, due to the impact of public investment in reconstruction abating; consumption growth is expected to cool further. Without structural reforms to boost private investment, growth is projected to hover around 2.5 percent in the medium term.

Inflation is projected to remain within the Central Bank's target in 2024, despite some increase in H2 2024 due to the government raising fuel prices in June 2024. In the medium term, assuming the absence of major external pressures, inflation will hover around 3.2 percent amid slowing domestic demand.

The fiscal balance is projected to remain in surplus in the medium term, although the surplus will narrow due to rising expenditure, largely on public investment. Rising expenditure is a challenge to compliance with the medium-term targets for the non-hydrocarbon primary fiscal balance.

The external balance is expected to remain in surplus in the medium term because of continuing favorable energy prices. However, a projected fall in surplus is in line with declining crude oil production and rising imports.

Risks to the outlook are balanced. On the downside, geopolitical tensions add to uncertainty, although they could also lead to higher commodity prices. With public investment as the main driver of non-hydrocarbon sector growth, there is a risk that the economy will be increasingly vulnerable to fluctuations in energy prices. This could also divert the focus away from structural reforms needed to support private sector-led growth. In July, Fitch upgraded Azerbaijan's credit rating to BBB- investment grade.

TABLE 2 Azerbaijan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2021	2022	2023	2024e	2025f	2026f
Real GDP growth, at constant market prices	5.6	4.6	1.1	3.2	2.7	2.4
Private consumption	7.0	4.9	4.0	4.1	3.7	3.6
Government consumption	3.8	6.3	8.1	5.1	5.0	4.8
Gross fixed capital investment	-6.0	5.7	9.6	11.4	8.2	6.0
Exports, goods and services	5.6	3.3	-2.9	0.4	0.4	0.4
Imports, goods and services	2.5	3.2	1.9	2.7	2.8	2.8
Real GDP growth, at constant factor prices	5.6	4.6	1.1	3.2	2.7	2.4
Agriculture	3.3	3.4	3.2	3.0	3.0	3.0
Industry	4.1	2.4	-0.9	0.2	0.2	0.2
Services	8.6	8.5	3.8	7.7	6.0	5.1
Inflation (consumer price index)	6.7	13.8	2.1	4.2	3.4	3.0
Current account balance (% of GDP)	15.2	29.7	11.5	8.5	7.4	6.1
Net foreign direct investment inflow (% of GDP)	-4.1	-1.4	-1.1	-1.0	-1.0	-0.9
Fiscal balance (% of GDP)	4.1	5.7	8.1	5.5	3.7	3.0
Revenues (% of GDP)	36.5	31.6	40.7	38.4	35.9	33.9
Debt (% of GDP)	18.2	11.6	21.8	21.9	22.2	23.0
Primary balance (% of GDP)	4.8	6.1	8.4	6.1	4.3	3.5
GHG emissions growth (mtCO2e)	5.2	-2.0	-0.7	1.1	1.1	1.2
Energy related GHG emissions (% of total)	62.7	60.8	60.4	61.2	61.8	62.2

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate, f = forecast.