



Azerbaijan Economy 9M14: Slower, but Solid

Azerbaijan | Economy

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The slowdown in growth continued in the 3Q: a contraction of agro output and falling oil extraction combined to leave GDP growth at 2.5% y/y in 9M14. The weak agricultural activity undermined non-oil GDP, which retreated from 10.4% y/y growth in 9M13 to 6.0% y/y in 9M14. Oil GDP fell 2.0% y/y on lower oil extraction and refinery activity in the first half of the year. Falling oil prices have affected both exports and budget revenues. However, international reserves remain strong and the government is ready to revise the budget if the oil price changes significantly. The government's cautious position is reflected in its draft 2015 budget, which is based on oil at US\$ 90/bbl, with the government willing to adjust it further in the event of continued oil price weakness.

Shrinking agro output and a construction slowdown weigh on GDP growth

A spring drought and slower construction activity undermined growth in 9M14. The GDP growth rate fell to 2.5% y/y (5.4% y/y in 9M13) as agro output shrank 3.7% y/y (4.9% y/y growth in 9M13) and the expansion of construction activity slowed to 7.0% y/y from 30.0% y/y in 9M13. As a result, growth of non-oil GDP fell from 10.4% y/y in 9M13 to 6.0% y/y in 9M14. The agricultural sector's underperformance will weigh on annual GDP growth in 2014, in our view. On the other hand, construction activity could pick up by the end of the year as current construction projects are completed and drive annual growth up. The EBRD, IMF, World Bank, and Azeri government all recently cut 2014 GDP forecasts (EBRD: 3.5%, IMF: 4.5%, World Bank: 4.5%, government: 3.6%), but they remain above the 9M actual growth rate of 2.5% y/y, which confirms our view of a slight acceleration by the end of year.

Oil GDP is on the path to stabilization

Oil extraction and refinery activity, which contracted in the first half of the year, has already stabilized. While there is no reason to expect further fall in oil extraction for the rest of the year, refinery output is set to accelerate as recently upgraded units at the major refinery are being utilized. This trend has already been reflected in 3Q with oil GDP contraction improved from 3.9% y/y in 6M14 to 2.0% y/y in 9M14. With further gains in 4Q, we expect marginal contraction in oil GDP for the whole 2014.

Non-oil external balance improves as a result of the slower growth

The current account balance retreated slightly (down 1.0% y/y in the 1H), but remained robust. Increased oil and gas imports (construction-related) and flat exports were the main drivers. In contrast to the oil and gas sector, the non-oil external balance improved to a US\$ 3.9bn deficit in 1H14 from US\$ 4.7bn in 1H13. As a result, the non-oil C/A deficit improved from 24.3% of non-oil GDP in 1H13 to 19.0% in 1H14, while the overall ratio of C/A surplus to GDP fell to 17.4% in 1H14 from 18.4%.

9M budget surplus to fade in the 4Q

Azerbaijan managed to generate a 7.0% consolidated budget surplus in 9M14 (5.9% in 9M13) as actual expenditures came in at 86.0% of budgeted numbers. We do expect 4Q spending to accelerate and revenues to fall as oil prices remain at current lower levels. We don't, however, expect a budget deficit as outlined in the original 2014 budget document (3.1% of GDP). The government has already published its draft 2015 budget for discussion. The document is based on oil at US\$ 90/bbl compared to US\$ 100/bbl in 2014 (Azeri light averaged US\$ 108.2/bbl in 9M14), with an 8.7% deficit.

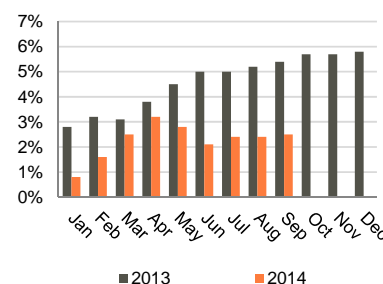
Ekaterina Gazadze

Head of Research | egazadze@gt.ge | +995 322 401 111 ext.3760

Alim Hasanov

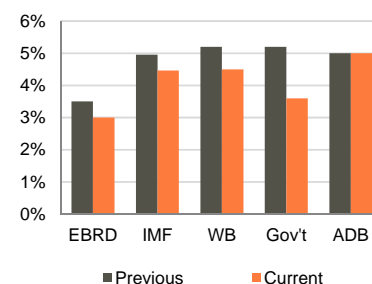
Economist | ahasanov@gt.ge | +994 12 404 8944

Figure 1: GDP growth



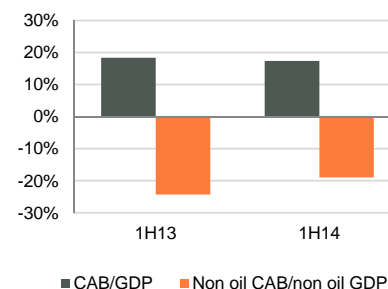
Source: AzSTAT

Figure 2: GDP forecasts, 2014



Source: EBRD, IMF, WB, Ministry of Finance, ADB

Figure 3: Current account balance



Source: AzSTAT, CBAR



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Head of Research

Ekaterina Gazadze | egazadze@gt.ge

Economist

Eva Bochorishvili | evabochoishvili@gt.ge

Economist

Alim Hasanov | ahasanov@gt.ge

Senior Associate

Giorgi Nakashidze | gnakashidze@gt.ge

Senior Associate

Giorgi Iremashvili | giremashvili@gt.ge

Analyst

David Kutidze | dkutidze@gt.ge

Analyst

David Niniklashvili | dnikelashvili@gt.ge

Address: 79 D. Agmashenebeli Avenue, Tbilisi 0102, Georgia

Tel: + (995) 32 2401111

Email: research@gt.ge