

# bne:Invest in Azerbaijan

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## Azerbaijan, Germany seek to deepen commercial ties

The Azerbaijan Export and Investment Promotion Foundation (AZPROMO) hosted a German-Azerbaijani business forum on October 22, in collaboration with the German-Azerbaijani Chamber of Commerce (AHK Azerbaijan). The event was attended by a visiting delegation from the German federal state of Rhineland-Palatinate.

The focus of the event was on increasing German investment in the energy sector in Azerbaijan, as well as helping to diversify trade away from the oil and gas sector – a key aim of the Azerbaijani government. Germany is an important destination for Azerbaijani exports, accounting for 8.8% of the country's total exports in 2014, worth €2.7bn, but



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the majority (€2.3bn) comprised of oil exports. Meanwhile, Germany is an important provider of machinery, motor vehicles, and iron and steel products to Azerbaijan, and exported €782mn worth of such goods to the Caucasian country in 2014. "Germany ranks as the world's second largest exports, but we have a current account deficit with Azerbaijan, and we intend to increase our exports," Florian Schroeder, head of AHK Azerbaijan, told the audience present at the business forum.

Meanwhile, Rufat Mammadov, AZPROMO's president, noted that more than 183 companies with German capital are registered in Azerbaijan.

"So far, these companies have invested \$475mn in fixed assets in Azerbaijan, of which \$345 was in non-oil sectors... Trade turnover in the first

eight months of 2015 reached \$1.5bn, but there remains untapped potential," he said.

In addition to commerce, Germany has been advising the Azerbaijani government through the German Organisation for International Cooperation (GIZ) in areas such as economic diversification, improving the regulatory environment, building a need-oriented vocational training system, enhancing exports, and legal and judicial reform.

Furthermore, German development bank KfW has been working with Azerbaijan since 2002 to support the private banking sector. KfW continues to contribute to microfinance in Azerbaijan through Accessbank and to stabilising the Azerbaijani banking sector through the German-Azerbaijani Fund (GAF). To date, GAF has given out 40,000 loans to private companies in Azerbaijan, totalling €130mn. ●



# Top story



## Economic headwinds face victorious ruling party

The New Azerbaijan Party, chaired by President Ilham Aliyev, won the November 1 parliamentary elections by a landslide, a victory many had anticipated. An economy buffeted by the regional headwinds promises to be main issue the new government has to deal with, though it will have been cheered by the European Bank for Reconstruction and Development's latest forecast that Azerbaijan will lead the region in GDP growth in 2015.

According to the EBRD's latest Regional Economic Prospects report, released on November 5, growth in its Central and Eastern European/Commonwealth of Independent States region is expected to slow to just 0.2% this year, down from 1.8% in 2014, with growth improving to 1.6% in 2016. These forecasts are unchanged from May,

but they mask regional differences. The bank says countries further to the east are being weighed down by the Russian recession and weak oil and other commodity prices, while regions further to the west will benefit from a Eurozone upturn and the impact of accommodating European Central Bank monetary policies.

In the Eastern Europe/Caucasus region, Azerbaijan came out top, with the EBRD raising its GDP growth forecast for 2015 to 3.0% and 2.5% in 2016. Low single-digit growth is likewise expected in Armenia (2.3% in 2015 and 2.0% in 2016) and Georgia (2.5% and 2.6%).

In its explanation, the EBRD noted that Azerbaijan's liquidity position remains strong and debt



levels low, while the manat's devaluation has taken some of the pressure off the economy. "Assets of the State Oil Fund and the central bank's foreign exchange reserves collectively represented approximately 56% of the 2014 nominal GDP and 26 months of imports at the end of the first half of 2015. By end-2014, public and publicly guaranteed debt was low at around 15% of GDP," the bank said. "In February 2015, after almost two decades of stable exchange rate, the central bank devalued the manat against the US dollar by 25%. This helped to contain pressure on the fiscal and external balance, but led to balance sheet concerns in the banking sector."

In an October report, rating agency Moody's Investors Service agreed that the devaluation had eased the pressure from lower oil prices on the public finances and the balance of payments, which is credit positive. However, it noted that a weaker manat will lead to higher inflation, which in turn impairs private households' purchasing power, and thus adversely affects GDP growth, which is credit negative.

After the February devaluation, the banking sector moved to restructure more than \$600mn worth of foreign currency-denominated loans, and all but halted mortgage lending. The value of restructured loans might seem manageable, but "loan restructuring by the banks will take some time to be reflected in their numbers", according to James Watson, director of financial institutions at rating agency Fitch.

Meanwhile, the real estate sector is reporting a 30% drop in turnover this year because of the decline in mortgages. And consumers and investors are fretting about a second devaluation of the national currency after comments from officials, while they are refraining from purchases that are

not essential. "There is a bigger demand for dollars these days, because people are afraid of a second devaluation," a bank treasurer who asked to remain unnamed told bne IntelliNews. "If the central bank lets the manat float freely, I expect it to devalue by a further 50% against the dollar."

Azerbaijan is new to currency volatility; the February devaluation ended a four-year peg to the dollar. Since then, the currency has been artificially maintained against an undisclosed basket of foreign currencies, which experts have estimated to include the dollar (approximately 78%), the euro (20%) and other currencies.

The ruling New Azerbaijan Party has not yet revealed how it is going to tackle the economic problems, although it has been speaking about a general set of reforms it is targeting – including fiscal responsibility, economic diversification and rural development – for the better part of the past year. Analysts urge more clarity from the governing party about its agenda for economic reform, because consumers and businesses in Azerbaijan are being left in the dark, and anecdotal evidence indicates that consumer confidence is low.

If government policies weather the economic storm in the medium term, 2019 will bring some welcome respite. That is because the Shah Deniz 2 offshore gas field is set to start exporting gas to Turkey then, and later Europe, through a network of interconnected pipelines in what has been called the Southern Gas Corridor.

If past experience is anything to go by, this will give an incredible boost to the Azerbaijani economy. The last time Azerbaijan inaugurated an oil pipeline, the Baku-Tbilisi-Ceyhan pipeline, its GDP growth shot up to 41.7% in the first quarter of 2007. ●



**Table 1: Real GDP Growth**

(In per cent; EBRD forecasts as of 5 November 2015)

	Actual			Current forecast		EBRD Forecast in May 2015		EBRD Forecast in May 2015	
	2014	2015	2016	2015	2016	2015	Change May-Nov.	2016	Change May-Nov.
<b>EBRD Region<sup>1</sup></b>	<b>1.8</b>	<b>0.2</b>	<b>1.6</b>			<b>0.2</b>	<b>0.0</b>	<b>1.6</b>	<b>0.0</b>
<b>Central Europe and the Baltic states<sup>1</sup></b>	<b>3.1</b>	<b>3.0</b>	<b>2.9</b>			<b>3.0</b>	<b>0.0</b>	<b>3.0</b>	<b>-0.1</b>
Croatia	-0.4	0.9	0.5			0.5	0.4	0.5	0.0
Estonia	2.9	2.0	2.8			2.2	-0.2	3.0	-0.2
Hungary	3.7	2.9	2.1			2.6	0.3	2.3	-0.2
Latvia	2.4	2.3	3.1			2.3	0.0	3.1	0.0
Lithuania	3.0	1.7	3.0			2.7	-1.0	3.2	-0.2
Poland	3.3	3.4	3.3			3.4	0.0	3.4	-0.1
Slovak Republic	2.5	3.1	3.2			2.8	0.3	3.3	-0.1
Slovenia	3.0	2.3	2.0			2.0	0.3	2.3	-0.3
<b>South-eastern Europe<sup>1</sup></b>	<b>1.4</b>	<b>1.6</b>	<b>1.6</b>			<b>1.6</b>	<b>0.0</b>	<b>2.5</b>	<b>-0.9</b>
Albania	2.2	2.3	3.3			2.5	-0.2	3.0	0.3
Bosnia and Herzegovina	1.0	2.8	3.0			2.5	0.3	3.0	0.0
Bulgaria	1.5	1.8	2.0			1.0	0.8	1.5	0.5
Cyprus	-2.5	1.0	1.7			0.5	0.5	1.5	0.2
FYR Macedonia	3.5	3.5	3.5			3.5	0.0	3.7	-0.2
Greece	0.7	-1.5	-2.4			0.0	-1.5	2.0	-4.4
Kosovo	0.9	2.0	3.0			2.5	-0.5	3.5	-0.5
Montenegro	1.8	3.0	4.0			3.0	0.0	3.7	0.3
Romania	2.8	3.5	3.7			3.0	0.5	3.2	0.5
Serbia	-1.8	0.5	1.8			0.3	0.2	1.8	0.0
<b>Eastern Europe and the Caucasus<sup>1</sup></b>	<b>-1.9</b>	<b>-5.1</b>	<b>1.4</b>			<b>-3.5</b>	<b>-1.6</b>	<b>1.9</b>	<b>-0.5</b>
Armenia	3.5	2.3	2.0			-1.5	3.8	1.0	1.0
Azerbaijan	2.8	3.0	2.5			1.5	1.5	1.5	1.0
Belarus	1.6	-3.5	-1.0			-2.5	-1.0	0.0	-1.0
Georgia	4.8	2.5	2.6			2.3	0.2	2.6	0.0
Moldova	4.6	-2.0	0.0			-2.0	0.0	1.5	-1.5
Ukraine	-6.8	-11.5	2.0			-7.5	-4.0	3.0	-1.0
<b>Turkey</b>	<b>2.9</b>	<b>3.0</b>	<b>2.8</b>			<b>3.0</b>	<b>0.0</b>	<b>3.0</b>	<b>-0.2</b>
<b>Russia</b>	<b>0.6</b>	<b>-4.2</b>	<b>-1.2</b>			<b>-4.5</b>	<b>0.3</b>	<b>-1.8</b>	<b>0.6</b>
<b>Central Asia<sup>1</sup></b>	<b>6.0</b>	<b>3.8</b>	<b>3.9</b>			<b>3.9</b>	<b>-0.1</b>	<b>4.3</b>	<b>-0.4</b>
Kazakhstan	4.3	1.2	1.5			1.5	-0.3	2.0	-0.5
Kyrgyz Republic	3.6	5.0	3.9			3.0	2.0	3.1	0.8
Mongolia	7.8	3.3	5.0			4.0	-0.7	3.0	2.0
Tajikistan	6.7	5.0	4.5			3.8	1.2	3.8	0.7
Turkmenistan	10.3	8.5	8.5			9.5	-1.0	10.0	-1.5
Uzbekistan	8.1	7.5	7.2			7.0	0.5	7.2	0.0
<b>Southern and Eastern Mediterranean<sup>1,2</sup></b>	<b>2.3</b>	<b>4.0</b>	<b>4.0</b>			<b>4.0</b>	<b>0.0</b>	<b>4.3</b>	<b>-0.3</b>
Egypt	2.2	4.2	4.3			4.0	0.2	4.2	0.1
Jordan	3.1	2.8	3.5			3.6	-0.8	3.9	-0.4
Morocco	2.4	4.9	3.8			4.6	0.3	5.0	-1.2
Tunisia	2.3	1.0	3.0			2.8	-1.8	3.6	-0.6
<b>Average EEC, CA, Russia</b>	<b>1.1</b>	<b>-3.1</b>	<b>0.0</b>			<b>-3.0</b>	<b>-0.1</b>	<b>-0.3</b>	<b>0.3</b>
<b>Average CEB, SEE, SEM ED, Turkey</b>	<b>2.5</b>	<b>3.0</b>	<b>2.9</b>			<b>3.0</b>	<b>0.0</b>	<b>3.2</b>	<b>-0.3</b>

<sup>1</sup> Weighted averages. The regional average growth rates in 2015 and 2016 are based on new weights. These weights correspond to countries' nominal GDP values in PPP US dollars in 2015. Weights used in the May 2015 issue of the Regional Economic Prospects were based on the 2014 nominal GDP values in US dollars.

<sup>2</sup> EBRD figures and forecasts for Egypt's real GDP reflect the fiscal year, which runs from July to June. These are also used in the regional averages.



## PASHA Bank



### PASHA Bank represents Caucasus at tech-heavy Sibos in Singapore

Just like in past years, PASHA Bank was the only participant from the Caucasus to attend the Sibos 2015 conference and expo in Singapore between October 12 and 15.

Organised by financial software provider SWIFT, Sibos is one of the largest financial services events in the world, and attracted a record number of participants this year – 8,200 delegates, representing the world's leading banking groups, financial institutions and financial technology companies. This year's edition was the second largest Sibos event in its 37-year history, and focused on the disruptive role of technology and new business models in finance, the growth of Asia as a financial centre, integrating financial market infrastructure, standardisation, and the cost of compliance.

According to Taleh Kazimov, Chairman of the Executive Board of PASHA Bank, "Sibos is where the future of the financial industry is shaped, and is a key event for PASHA Bank, as it allows us to

directly engage with the international financial community. With PASHA Bank being the only financial institution of Azerbaijan and the wider region to attend Sibos, we are in a unique position among our peers to learn the best practices from around the world and to introduce them in our own operations. During the course of the event, we will hold a host of business meetings with the leading banks in Europe, America and Asia to establish new ties and expand existing relationships, and this will help to develop export opportunities for businesses in Azerbaijan and across the region."

Technology took centre stage at this year's edition, as SWIFT's innovation arm, Innotribe, devoted a full day of the four-day conference to discussing cryptocurrency bitcoin's underlining technology, with financial industry veterans like Blythe Masters, former executive at JP Morgan, and Oliver Bussmann, UBS Chief Information Officer, attesting to its potential.

"In Singapore, it has been a lot about technology,



a lot about the shift from West to East, a lot of enthusiasm around China and the internationalisation of the renminbi," according to Alain Raes, SWIFT CEO for Asia-Pacific, Europe, the Middle East and Africa. "Technology is clearly the high-light of the week," he concluded.

The last day of the conference was dedicated to Asian markets as future hubs for global finance, days after SWIFT had announced that the renminbi had taken over the yen as the fourth most used currency for global payments.

Meanwhile, panels on other topics, such as standardisation, had more pessimistic outlooks. "I'm not holding my breath to see any less fines anytime soon," Markus Schultz from Wolfsberg Group told the audience at a standardisation panel, referring to sanctions for compliance transgressions. SWIFT's chief marketing officer, Christian Sarafidis,

closed the panel on standards by speaking about the much-touted ISO 20022 standard, and its implementation across the financial services industry.

Lastly, this year's edition dealt with financial market structure integration. Yves Mersch, member of the executive board at the European Central Bank (ECB), argued that European financial markets had managed to reach higher integration levels after the implementation of settlement system Target 2 Securities, adding that more harmonization would be achieved through new EU initiatives such as the Capital Markets Union. Mersch added that the ECB is seeking to improve the way collateral is managed by improving existing measures and by introducing a pan-European collateral management system to replace the existing national systems.

Next year, the Sibos conference will be held in Geneva, Switzerland. •



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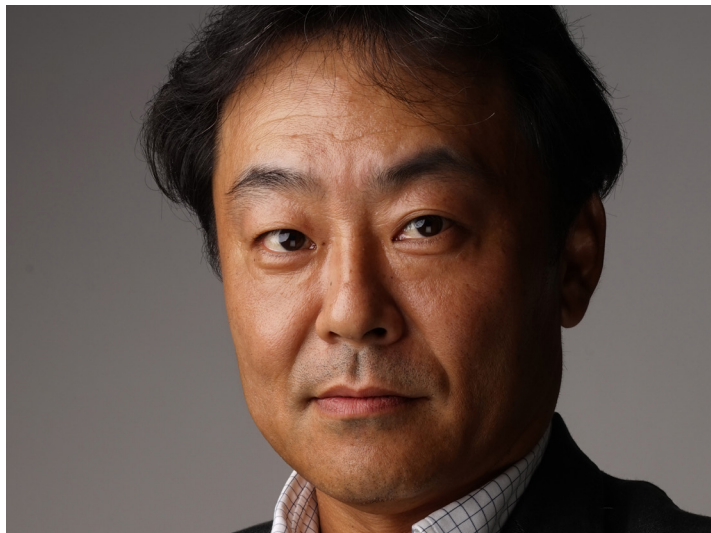


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# Interview



## Sony sees Azerbaijan as promising market for consumer electronics

At a media event held in Baku on November 3, Japan's Sony Corporation announced that it would be seeking to expand aggressively in Azerbaijan in the coming years. A first step in this expansion will be the three-fold increase in the number of its outlets in Azerbaijan by April 2016, but the company will also seek to enhance customer experience, strengthen customer support and introduce physical displays of products.

Sony's operations in Azerbaijan are overseen by Sony Middle East and Africa – a Sony subsidiary that is based in Dubai. Satoru Arai, Head of Sony Middle East and Africa, explained to bne Intellinews in a written interview what factors have prompted Sony to bet on Azerbaijan.

"Azerbaijan's economy is one of the most dynamic and rapidly growing in the region and its business potential demonstrates high benefits for Sony...

The country's population is expected to grow to 11.2mn by 2020, from 9.5mn at the moment. GDP per capita is expected to more than double to \$13,000 by 2020, which would make Azerbaijan an upper middle-income country according to the World Bank classification. Besides, the country has been positioning itself internationally, by hosting events like the 2015 European Games, and, in the coming years, the F1 European Grand Prix in 2016, and the 2017 Islamic Solidarity Games."

While overall economic growth is encouraging, Sony's decision to raise the number of its outlets to 18 by next April, from six at the moment, was also informed by positive trends in consumer electronics and the housing market. "In April, around 175,000 square metres of real estate were commissioned in Azerbaijan, representing a 37% year-on-year increase... More and more Azerbaijanis are moving from joint family homes to nuclear family homes, and we expect this trend to spur the demand for consumer electronics."

The trend will continue, Arai believes, after the Azerbaijani market overcomes the negative effects of the February devaluation of the national currency, the manat, which sent mortgage lending plummeting and affected the real estate market.

The positive trend in home ownership is a consequence of the increasing affluence of the Azerbaijanis, Arai believes. "The number of affluent Azerbaijanis has increased tremendously, and there is also a growing middle class... Our own research shows that Azerbaijanis are brand-conscious and interested in the latest technology; that they are particular about the



design of products, and appreciate unique features," he said. Specifically, music and gaming are very popular in Azerbaijan, and the young Azerbaijani population, 50.7% of which is aged 29 or under, likes to stand out by owning the latest technologies.

With competition in consumer electronics on the rise in Azerbaijan, Sony is betting on top-of-the-line products, like its 4K Bravia flat screen television set, with Android functionality, high resolution audio products, and professional and semi-professional cameras from its Alpha and RX lines to fend it off. Through products such as

these, "Sony will be able to offer consumers a better quality experience than any other consumer electronic brand," Arai wrote confidently.

With regards to the business environment in Azerbaijan, Arai noted that the government "has been working to integrate the country into the global market, attract increased foreign direct investment (FDI), diversify the economy and maintain positive growth". Nevertheless, the Japanese executive would like to see a "further simplification of government rules and regulations for FDI", as this would make Azerbaijan into an even more attractive investment destination. ●

## Celebrating the pilaf

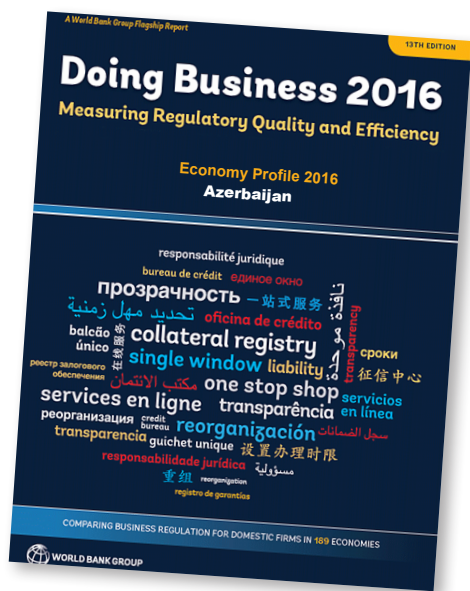
Pilaf, the hearty rice dish that is a staple of numerous cuisines from all over the world, now has its own festival in Azerbaijan. In its second year, the "International Pilaf Festival" promises to gather foodies eager to taste the 40 varieties of Azerbaijani pilaf in Baku in December.

At its simplest, pilaf is rice cooked in a seasoned broth. In some cases, caramelized onion is also added, which gives the pilaf a distinctly brown tinge. And, depending on the country where it is cooked, it can also contain meat, fish, vegetables, pasta and dried fruit. The versatile dish goes under a variety of names – pilav, pilau, pilafi, pulao, palaw, palavu, plov, polov, polo, polu – and finds itself frequently on dining tables in the Balkans, the Middle East, the Caucasus, Central and South Asia, East Africa, Latin American and the Caribbean. It is a staple food and an ethnic dish in the Azerbaijani, Bangladeshi, Balochi, Bukharan Jewish, Cretan, Kyrgyz, Kurdish, Iranian, Pakistani, Swahili, Uyghur, Uzbek, Tajik and Turkish cuisines.

Azerbaijani cuisine includes more than 40 different pilaf recipes. One of the most reputed dishes is a pilaf made from saffron-covered rice, served with various herbs and greens. Traditional Azerbaijani pilaf consists of three distinct components, served simultaneously but on separate platters: rice (warm, never hot), gara (fried meat, dried fruits, eggs, or fish prepared as an accompaniment to rice), and aromatic herbs. The rice is not mixed with the other components even on the diner's own plate.



# Feature



## Doing business in Azerbaijan remains straightforward

The 2016 edition of the World Bank's "Doing Business" survey brought few surprises for Azerbaijan, whose ranking stayed the same as in the previous year's report at 63rd out of 189 economies covered, with a score of 67.8 out of a maximum of 100 – slightly under the average score for Europe and Central Asia (69.8).

As part of an update in its methodology, the "Doing Business 2016" report saw changes and revisions to seven out of the 11 indicators that the World Bank uses to assess how business-friendly countries are. Thus, the new index expands the focus of five indicators – dealing with construction permits, access to electricity, property registration, enforcing contracts and labour market regulation; substantially revises the methodology for the indicator "trading across borders"; and updates the methodology for another indicator, "protecting minority investors".

Azerbaijan's performance in the 11 areas covered by the index is either outstanding, such as in the case of the indicators "starting a business" (ranked 7 in the world), registering property (22), paying taxes (34), protecting minority investors (36) and enforcing contracts (40); or below average in areas like resolving insolvency (84), trading across borders (94), getting credit (109), getting electricity (110), and dealing with construction permits (114).

Azerbaijan's performance in most areas is similar to that in the "Doing Business 2015" ranking, with a few noteworthy exceptions: its ranking for access to credit for companies and for access to electricity have fallen by 4 and 6 positions respectively, while the ranking for protecting minority investors and dealing with construction permits improved by 18 and 24 positions respectively.

The process of starting a business is fairly streamlined in Azerbaijan; it only takes two procedures and three days to set up a company. The cost of doing so is also reduced, at 1.2% of per-capita income. Azerbaijan's accomplishment in facilitating the setup of businesses comes after sustained reforms over the years. For instance, in 2015 Baku abolished the requirement for companies to use a corporate seal; in 2014 it reduced the time to obtain an electronic signature for online tax registration; and in 2013 it introduced online registration services and eliminated pre-registration formalities.

As a result of these changes, the only cost involved in opening a company is obtaining an electronic signature for online registration, which costs between AZN18 (\$17) and AZN80 (\$76),

depending on the type of entity that is registered.

Not the same can be said about obtaining construction contracts – an area in which the country fares well below the regional average. Dealing with construction contracts requires going through 18 procedures that take 203 days, more than triple in frontrunners like the United Arab Emirates, Taiwan, Denmark and Qatar, and cost 4.1% of a property's warehouse value.

Predictably enough, Azerbaijan ranks poorly in this area at 114th in the world – the last but one in Europe and Central Asia, where only Russia lags behind in 119th position. The average regional rank for "dealing with construction contracts" indicator in Europe and Central Asia is 98.

That said, Azerbaijan has been making progress in addressing the bureaucracy around construction permits, as reflected by its climb in the ranking from 138 in the 2015 report to 114 in this year's. This positive development is explained by Baku over the last year establishing a one-stop shop for issuing pre-approvals for project documentation. Before this, in 2013 the country changed its construction code entirely, which contained simplified procedures for the issuance of building permits. As its poor ranking indicates, however, more work needs to be done to facilitate building permits.

Getting credit is one of the two areas in which Azerbaijan's ranking dropped markedly in the last year, to 109 from 105. For this particular indicator, Azerbaijan ranks the lowest in the Europe and Central Asia region, way below the average regional ranking of 51. The country has done little to improve access to credit in recent years; the last reform it did was in 2010, when it established

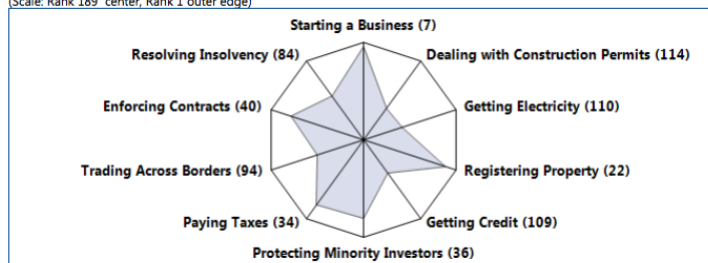
an online platform allowing financial institutions to provide information to, and retrieve it from, the public credit registry.

Furthermore, the drop in Azerbaijan's access to credit ranking this year reflects a tougher overall economic environment, marked by a decline in lending, the depreciation of the national currency and a slowdown in economic activity. Following a 33% depreciation of the national currency, the manat, since February, banks have all but halted certain types of lending, such as mortgage loans, and have had to work with clients to restructure over 100,000 foreign currency-denominated loans, worth \$600mn.

Rumours of a potential second devaluation to counteract continued external pressures on the manat are making lenders and clients alike very cautious, which in turn will continue to affect adversely lending and access to credit.

Lastly, Azerbaijan also needs to improve companies' access to electricity, an indicator in which the country slid to 110th out of 189 countries ranked, down from 104 the year before. Specific areas in which the country scored poorly are the reliability of supply and transparency of tariff (4 out of 8); the absence of financial deterrents aimed at limiting outages (0 out of 1); and communicating tariffs and tariff changes (0 out of 1). ●

Figure 1.3 Rankings on Doing Business topics - Azerbaijan  
(Scale: Rank 189 center, Rank 1 outer edge)



# Sector



## Azerbaijan bets on the sun and the wind

For three days in mid-November, Azerbaijan's capital becomes the centre for environmental technology and renewable energy companies active in or interested in expanding into the Caucasus. This year's "Caspian Technologies for Environment" promises to bring in new exhibitors from Switzerland, the Czech Republic and Russia, who will showcase disposal and waste recycling equipment, water purification systems and the latest technologies in renewable energy.

The event, which is in its sixth year, reflects Azerbaijan's increasing interest in employing more environmentally friendly technologies and in attracting investors active in this sector. It might seem hard to believe that hydrocarbon-rich Azerbaijan is keen on developing renewable energy, but the country has been tapping into a variety of sources of clean and renewable energies, most notably hydropower, solar, and wind energy in order to mitigate the environmental impact of its power generation sector and to free up oil and gas for exports.

In its pursuit of renewable energy, the Caucasian country has been working with numerous partners, such as the EU and individual countries like Germany for financing and technical assistance. In October, Azerbaijan raised its efforts in renewable energy development, by wrapping up the approvals for a \$428mn offshore wind farm project with a capacity of 200 megawatts (MW).

### Ambitious goals

At the moment, renewable energy accounts for only 2.3% of total energy consumption, and its development will require investment to the tune of \$2.5bn to \$3bn by 2020, as well as regulatory support to increase its competitiveness. But Baku has ambitious goals, and has been gradually promoting renewable projects since 2004, when it first developed a strategy for the renewable sector. In 2009, the country set up a special agency, the State Agency on Alternative and Renewable Energy Sources (SAARES), to regulate the sector, assess sustainable energy potential, shape relevant policies, set tariffs, and facilitate the construction of renewable energy plants.

In May 2014, a long-term restructuring of the Ministry of Energy was finalised, and a new Energy Efficiency and Alternative Energy Sources Department was established. In June, the ministry created an energy efficiency fund and energy efficiency action plan. A month later, SAARES opened the 4MW Surakhany solar power station in Baku.

According to the European Commission, several other similar stations are under construction elsewhere in the country. A national inventory of potential solar power has been compiled, following similar work on wind power in 2013, and production from these two types of renewables



is projected to overtake hydroelectric power generation by 2020.

Meanwhile, the most recent strategy for renewable energy, put forward in 2014, aims to develop the country's potential for solar, wind, geothermal and hydropower so as to generate 20% of electricity and 9.7% of its total energy needs from renewable and clean sources by 2020. In order to achieve those goals, Azerbaijan will have to triple its renewable installed capacity to 2,500 MW by 2020, by tapping mainly into wind energy (800 MW), solar thermal energy (950 MW), and photovoltaic cells (600 MW). Other sources of energy that Azerbaijan is seeking to develop are biogas, biomass, geothermal energy, and small hydropower plants.

## A land of sun and wind

Solar is by far the most promising form of renewable energy in Azerbaijan, for the country gets between 250 and 300 sunny days per year, and has the potential to generate an estimated 115,200 MW of solar power per year, most of which remains untapped. The Kura-Aras lowland area in the Absheron Peninsula is particularly suitable for solar energy, and so is the isolated Nakhchivan exclave.

Developing solar energy would bring jobs and development to these unindustrialised areas, but the relatively high production costs for solar power compared to gas-based thermal power plants in Azerbaijan remains a major hindrance to the sector. While Baku is making strides, it is unlikely to eliminate gas subsidies anytime soon, meaning that cost will continue to remain a hindrance

In addition to the Surakhany solar plant, Baku is working on another solar park on the Absheron Peninsula, with an installed capacity of 25 MW. German consultancy MWV Decon designed this

plant for SAARES, and which will be financed by the Azerbaijani government in an €87.5mn investment.

Other renewable projects that SAARES has proposed upon the German company's recommendation, as part of an 18-month feasibility study that finished in May 2014, are listed in the table below.

Name of the Project	Amount of energy produced (MW)	Budget (Euros)	Investors
Pirakushkul Wind Park	110	165 million	Azerbaijan Gov. KFW Bank
Hovsan Sewage-Gas station	50	75 million	Azerbaijan Gov. POSCO
Absheron Solar Park	25	87,5 million	Azerbaijan Gov. JICA
Sea Wind Park	100	250 million	Azerbaijan Gov. Private investor
1000 House / 1000 power plant	50	80 million	Azerbaijan Gov. Private Investor

In addition to solar energy, wind holds good potential, seeing how the wind speed on the Absheron Peninsula, where the capital Baku is located, exceeds 3 metres a second (m/s) year round, which is perfect for wind power generation. Known as the city of wind, Baku has more than 250 windy days per year.

Wind power has been making the headlines recently, after SAARES submitted a draft project for approval to the Azerbaijani government for the construction of a 200 MW wind farm in the Caspian Sea, in order to generate power to fuel oil and gas exploration activities. If approved, the \$428.5mn project would be commissioned by 2021 and become Azerbaijan's largest wind farm.

But the country will not stop at its 2020 goals, for, according to Jamil Melikov, deputy director of SAARES, the country intends to eventually run on 100% of renewable energy. "Azerbaijan has a potential capacity in renewable energy sources of 12,000 MW, most of which is in solar power – 5,000 MW; wind 4,500 MW; biomass 1,500 MW; geothermal 800 MW, and small hydro 350 MW," he said, noting that the existing installed capacity is a meagre 800 MW. ●



# Economics & finance

## Eurasia faces currency policy challenges

**Chris Weafer of Macro Advisory**

It is a statement of the obvious to say that 2015 has been a difficult year for the economies in Central Asia and the Caucasus. Those that have built their economic and social models on the back of hydrocarbon exports were badly hit with the big drop in the price of oil and gas, while some suffered collateral damage from the Russia recession. Others that didn't have the benefit of hydrocarbons or became too vulnerable to worker remittances from Russia suffered the effects of regional slowdown and a drop in investment flows.

As the year-end approaches, the challenges are set to get worse rather than ease. Most governments in the region now face some critical policy decisions that will impact not only the performance of their respective economies, but also have a big influence on whether they come through the next 12 months with their political position intact or have to deal with social instability and political challenges.

One action looking unavoidable for almost all countries is that they will have to follow the decision by the Kazakh government – which in turn followed the lead of the Russian central bank – and abandon or radically change their currency pegs. That means taking the risk of a free-float, or, at minimum, a more flexible approach to currency management. That, if handled badly, could lead to a hawkish policy response, endanger some banking structures because of

the prevailing high level of dollarization in most economies in the region, and raise the threat of a public anger. On the other hand, if currency action is avoided or delayed, many countries risk a bigger and longer-lasting economic decline.

Azerbaijan and Turkmenistan remain committed to riding out this period of price weakness in the hope that hydrocarbon export revenues will recover. Both are building new gas export capacity, ie. to Europe via the TAP pipeline for the former and via new pipelines direct to China and Iran for the former. Both countries tried to avoid devaluation in 2014, but took action in the first quarter of this year. That is not enough. Turkmenistan is most unlikely to dispose of the currency peg, but could devalue by another 20-25% to stay in line with the oil price. Azerbaijan avoided taking any additional currency decision after the first-quarter devaluation because of the possible impact on the November parliamentary elections. Now it has no choice and either a move similar to Kazakhstan or a 20-25% shift in the peg is required.

Georgia's economy is more impacted by what happens in Azerbaijan than other regional economies. Hence the lari, which is free floating, has moved in line with the manat. That close relationship should continue, so that when the manat further devalues, expect a similar move in the lari. ●

*Chris Weafer is a founding partner of Macro Advisory, which helps investors cut through the noise & focus on underlying trends, real political risks, & opportunities in Russia/CIS. Follow him on @ChrisWeafer*



## Azerbaijan's industrial production up 2.2% y/y in Jan-Oct

Industrial production in Azerbaijan increased by 2.2% y/y to AZN22mn (€19.5bn) in the January-October period, according to the State Statistical Committee of Azerbaijan (Azstat).

Despite lower oil exports and revenues this year, Azerbaijan has seen a strong rebound in manufacturing, as well as gas drilling. The mining sector, which includes hydrocarbon exploration in Azstat reports, accounted for 62.9% of industrial production in January-October, followed by manufacturing (29.2%), power generation (7%), and water supply (0.9%).

Food production increased by 3.8% y/y; of shoes by 52.5%; of wood products by 46.7%; of printing products by 78%; and of chemical products by 87%.

## Azerbaijani regulators cancel licences for Eurobank and Azerbaijan Credit Bank

Azerbaijan's Central Bank cancelled the licences of two banks - Eurobank and Azerbaijan Credit Bank - between July and September.

After the cancellations, the Azerbaijani banking sector consists of 43 banks, two of which are state-owned. The number of banks with foreign capital decreased to 22, from 23 previously, because of Eurobank's exit.

Azerbaijan's banking sector has been hit by a

wave of external pressures this year, including the drop in oil prices, a 33% depreciation of the national currency, and depressed economic growth. The country's largest bank, International Bank of Azerbaijan (IBA), which is owned in part by the Azerbaijani government, was involved in a corruption scandal over bad loans in May, which led to the sacking and jailing of several business executives, including IBA's former chairman Jahangir Hajiyev.

The high dollarisation level of the banking sector has led to the restructuring of 100,000 foreign currency-denominated loans, worth \$600mn. Loan restructuring will continue, according to analysts.

## Azerbaijan's forex reserves drop by nearly 3% in October

The Central Bank of Azerbaijan (CBA) has reported that its currency reserves dropped by \$209.6mn to \$6.8bn in October.

In February, the regulator resorted to scrapping a four-year peg to the dollar in order to salvage its declining reserves, as maintaining the Azerbaijani currency, the manat, at its previous levels was unsustainable. This resulted in a steep depreciation of 25% on February 21, and an overall depreciation of 33% between February and November.

Since February, the manat has been relatively stable and maintained its value against an undisclosed basket of currencies that, experts estimate, include the dollar (78%), the euro (20%) and other currencies (2%).

Meanwhile, the CBA's reserves continued to drop, from a high of \$15.2bn in August 2014 to \$6.8bn in

November. Since January, the regulator has lost more than half of its reserves, or \$6.9bn.

The CBA's quickly declining reserves point to the fact that sustaining the manat at its current exchange rate is costing Azerbaijan large amounts of foreign reserves. Officials like CBA Governor Elman Rustamov and Finance Minister Samir Sharifov have said that the CBA is mulling letting the currency float freely, which will most likely lead to another sharp devaluation of the national currency.

Such statements are contributing to the declining trust in the manat, an increase in demand for dollars and a drop in lending activity.

## Azerbaijan's food producer prices up 0.3% m/m in October

Producer prices of food products increased by 0.3% m/m and those of non-food products by 0.1% m/m in Azerbaijan in October, according to the country's State Statistical Committee (Azstat). Producer prices of services remained unchanged compared to September.

Products that saw their prices increase in October range from food staples such as rice, vegetables, flour, sugar and meat to clothing, household appliances, car parts and stationery. Meanwhile, producer prices of construction materials, medication and furniture decreased in October.

The highest increase in producer prices in October was reported by agricultural operators. Overall, plant-based farmers reported a 1.7% m/m increase in producer prices, while animal husbandry operators a slightly higher 1.9% m/m increase.

Producer prices of crops like tomatoes, cucumbers, aubergines and beans increased, while prices of nuts, apples, grapes, and pomegranates decreased.

## Azerbaijan establishes new mortgage fund

The Azerbaijani president, Ilham Aliyev, has issued a decree to set up a mortgage fund with a capital of \$712mn, according to APA news agency.

The setup of the Azerbaijan Mortgage Fund (AMF) is timely as the real estate sector has posted a 30% drop in turnover this year so far on the back of stalled mortgage lending in the country.

The AMF will disburse its initial capital through 17,603 loans. The Cabinet of Ministers will discuss the mandate of the new fund in the coming month, while the Central Bank of Azerbaijan (CBA) was asked to align its own mortgage fund with the new one.

## Fitch places Azerbaijan Railways Company on rating watch negative

Ratings agency Fitch placed Azerbaijan Railways Company's (ADY) long-term Issuer Default Rating (IDR) of BBB - on negative watch on November 4. The railway company, which is rated on a par with the country's sovereign rating, might suffer a loss in state support "at a time of expected drop in earnings", according to Fitch.

"We expect authorities to adjust capital spending to lower oil prices....We may notch ADY's rating down from the sovereign rating if we think





the support and links are weakening," a Fitch statement said.

"ADY continues to be highly dependent on export/import and transit shipments, with a high share of oil and oil products, with only marginal revenue coming from local freight shipments...Following a decline in freight transportation volumes, during the first half of 2015, we do not expect it to improve considerably in 2015-2018, on the back of slowing economies across the region, as well as increasing competitive pressure from pipelines for crude oil transportation," the statement continued.

Fitch predicts a 10% decline in freight transport in 2015, flat volumes in 2016, and low-single digit increases starting in 2017. The opening of the Baku-Tbilisi-Kars railway connecting Georgia, Azerbaijan and Turkey, which is expected in 2016, will likely boost freight transport volumes.

## IBA disburses first instalment of €520mn loan to Socar

Azerbaijan's national oil company, Socar, has received an AZN200mn (€173mn) loan from the country's largest bank, International Bank of Azerbaijan (IBA), to finance rigging works at the ageing Guneshli field and for the reconstruction of the Heydar Aliyev oil refinery.

The loan represents the first instalment of an AZN600mn (€520mn) loan, according to Socar Vice-President Suleyman Gasimov, but the official did not mention when the rest would be disbursed. The interest rate on the loan is 4%. Socar has already received another AZN690mn (€597mn) loan from IBA for the same project.

## Sofaz revenues €1.9bn short in 2015

Azerbaijan's sovereign wealth fund Sofaz is expecting an AZN2.2bn (€1.9bn) deficit in income in 2015, according to trend.az.

"Taking into account the oil price at \$50 a barrel, Sofaz' total income, including the proceeds from the oil and gas sale are predicted at AZN7.4bn until the end of 2015, which is 28% less than Sofaz had forecast," the fund's statement to trend.az reads.

In addition to the drop in income, Sofaz has had to foot the bill for this year's budget deficit, which was \$734mn in the first half-year, but is anticipated to reach \$3.8bn by the end of the year. Next year, Baku will tap into other sources of funding for its anticipated \$1.6bn budget deficit, such as privatisations, foreign and domestic borrowing, foreign grants and the Azerbaijani treasury.

Sofaz' assets stood at \$35bn in June.

# Chart

## Middle of the road

As the World Bank explains, for policymakers, knowing where their economy stands in the aggregate ranking in the “Doing Business” survey is useful. Also useful is to know how it ranks relative to comparator economies and relative to the regional average.

As can be seen from the chart below, Azerbaijan’s score (unchanged from last year) of 67.8 shows it stands slightly behind the Europe and Central Asia average of 69.8, but far higher than the lowest ranked country in the region, Tajikistan at 54.2. ●

Doing Business 2016

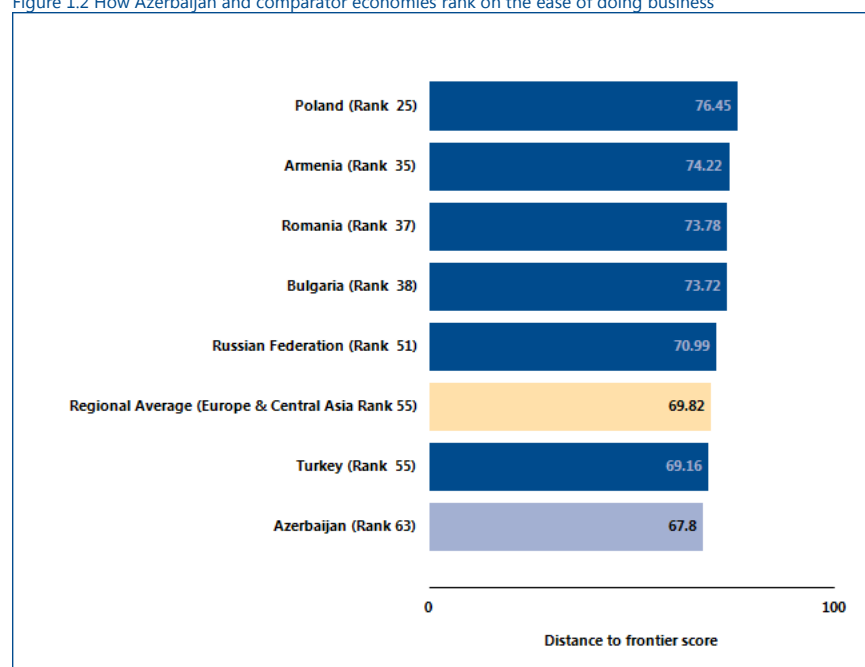
Azerbaijan

### THE BUSINESS ENVIRONMENT

For policy makers, knowing where their economy stands in the aggregate ranking on the ease of doing business is useful. Also useful is to know how it ranks relative to comparator economies and relative to the

regional average (figure 1.2). The economy’s rankings (figure 1.3) and distance to frontier scores (figure 1.4) on the topics included in the ease of doing business ranking provide another perspective.

Figure 1.2 How Azerbaijan and comparator economies rank on the ease of doing business



Note: The rankings are benchmarked to June 2015 and based on the average of each economy’s distance to frontier (DTF) scores for the 10 topics included in this year’s aggregate ranking. The distance to frontier score benchmarks economies with respect to regulatory practice, showing the absolute distance to the best performance in each *Doing Business* indicator. An economy’s distance to frontier score is indicated on a scale from 0 to 100, where 0 represents the worst performance and 100 the frontier. For the economies for which the data cover 2 cities, scores are a population-weighted average for the 2 cities.

Source: *Doing Business* database.

Sources: AZSTAT, Moody's Investors Service

## News in brief

### Central Bank of Azerbaijan reserves drop by nearly 3% in October

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### Azerbaijani president dismisses long-serving IT minister

President Ilham Aliyev fired long-serving Minister of Communications and High Technologies Ali Abbasov by a presidential decree issued on November 11. No reasons were given for Abbasov's dismissal, who had been doing the job since February 2004.

The manner in which Abbasov was dismissed is reminiscent of former National Security Minister Eldar Mahmudov's dismissal on October 17. Mahmudov was sacked without explanation, together with more than 13 high-ranking security officials at the ministry.

### Iran, Azerbaijan to build bridge at road checkpoint

Iran and Azerbaijan will build a bridge at the Aslanduz-Horadiz border checkpoint in order to shorten travel times for freight trucks and other vehicles, according to Iranian lawmaker Arsalan Fathipour.

"We are interested in developing relations with Azerbaijan, especially trade," Fathipour told Iranian news agency IRIB on November 10.

A team of engineers has been analysing different options for bridge locations in the last two weeks



and settled on Aslanduz-Horadiz. Apart from Aslanduz-Horadiz, there are five other border crossings along the Azerbaijani-Iranian border.

Azerbaijan and Iran have mulled several joint initiatives in recent months, including a railway connection to integrate their railway networks, hydropower plants and energy projects, in preparation for when sanctions on Iran are lifted and the two countries are able to increase trade and investment.

## Azerbaijan to produce computer equipment under national brand

Azerbaijan will begin manufacturing computer equipment at the Kur plant, which is part of the Mingachevir High Tech Park (MHTP), according to the Ministry of Communications and High Technologies. The ministry did not reveal when the new production line would be launched.

Taiwanese company Acer, one of the companies operating at the MHTP, began manufacturing its branded computer equipment at the Kur plant in October.

MHTP is part of Azerbaijan's strategy to develop high-tech industries and works in cooperation with the Baku High Tech Park. The latter is a 50-hectare development on the Pirallahi island, off the shores of the Caspian Sea, and will host the largest tech hub in Azerbaijan.

In addition to the Kur plant, the more modest MHTP is building a production facility on a 1.3 hectare plot, for an initial investment of AZN2mn (€1.8mn).

## BP, Azerbaijan ponder Shah Deniz 3 difficulties

BP is planning to develop the Shah Deniz offshore oil and gas field past the Shah Deniz 2 milestone development, in cooperation with the Azerbaijani government, according to BP Southern Corridor Vice-President Joe Murphy.

"We intend to implement Shah Deniz 3, but we need to do prior works to contain high formation pressure before that, which will require special equipment," he told an audience gathered at an energy conference in Baku.

An unnamed Socar representative reportedly added that "separate talks on Shah Deniz 3 may not be required, as the parties will advance within the previously agreed special programme, to work with formation pressure of 20 pound-force per square inch (psi). At the current fields in Azerbaijan's sector of the Caspian Sea, companies have not encountered pressure higher than 15 psi."

"The terms of implementation and cost of Shah Deniz 3 have yet to be clarified," he said.

Present at the same conference, Khoshbakht Yusifzadeh, the first vice-president of Azerbaijan's national oil company Socar, told the audience that Socar "is not discussing the possibility of new cooperation on (offshore) fields" with Iran at the moment, although the possibility to do so in the future exists. Iran's national oil company, Nioc, is involved in developing the gas condensate field Shah Deniz in Azerbaijan.

Yusifzadeh and Socar's president, Rovnag Abdullayev, will travel to Tehran in November to meet with their counterparts from Nioc, to discuss cooperating in nanotechnologies, research and development, and increasing the volume of gas swaps.





## Oil production at Azerbaijan's ACG field drops in July-October

Oil production at Azerbaijan's main field in the Caspian Sea, Azeri, Chirag, Guneshli (ACG), was 25mn tonnes between January and October, according to Khoshtakht Yusifzadeh, first vice president of national oil company Socar. During the same period, the field produced 10bn cubic metres of gas.

The volume corresponds to an average daily production of 603,000 barrels in January-October. For the first half of 2015, BP reported an average daily production of 641,000 barrels at the field. BP had scheduled maintenance works at an oil platform in October, but decided to postpone the works.

## BP signs five-year contract with British Wood Group for Caspian Sea drilling

BP has signed a five-year contract with British Wood Group, a subcontractor with which it had worked previously in the Gulf of Mexico and North Sea, to build subsea infrastructure for its drilling operations in the Caspian Sea.

The agreement is for the provision of operation systems, software, underwater project management and engineering support on October 29. BP is the largest taxpayer in Azerbaijan, and has been extracting oil and gas from the Caspian Sea since the signing of a production sharing agreement (PSA) with Baku in 1994. The company is a lead shareholder in some of the most important developments in the Azerbaijani energy sector at the moment, such as the Shah Deniz 2 gas project, aimed at exporting Azerbaijani gas to Turkey and Europe.



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## Wizzair to relaunch Baku-Budapest flights in March 2016

Low-cost airline Wizzair will recommence its flights between Baku and Budapest in March 2016, according to Azerbaijani state news agency Azertag. The airline operated the same route between 2013 and 2014, but suspended flights because they were unprofitable.

However, renewed negotiations between Wizzair and Baku will see the reopening of flights in spring 2016, with a frequency of once a week in low season and twice a week during the summer. Bringing Wizzair back to Baku was reportedly Azerbaijani President Ilham Aliyev's goal.

Azerbaijan has been making strides in improving its air connectivity in the past year, with flag carrier Azerbaijan Airlines (Azal) launching a low-cost service to four destinations - Antalya, Istanbul, Moscow and Dubai, in August. In October, the airline announced that it would increase the number of low-cost seats.

Baku sees the country's poor air connectivity with Europe as a disadvantage, particularly since it is looking to increase tourism from European countries. Azal runs a number of direct flights between Baku and major European cities like London, but the cost of airfare is prohibitive. Most people flying from Baku to Europe choose to do so via Istanbul's Ataturk International Airport.

## Baku-Tbilisi-Kars railway to be commissioned by Q2 2016

The Baku-Tbilisi-Kars (BTK) railway connecting Azerbaijan, Georgia and Turkey will be commissioned no later than the second quarter of 2016, according to Cenap Asci, Turkish minister of customs and trade.

“The last tunnels are under construction at present in Turkey under the BTK project,” Asci told Anadolu news agency.

The project was supposed to be completed this year, but construction works on the Turkish segment have been delayed due to the increased instability in the southeast part of the country.

The \$610mn project is funded by Azerbaijan's sovereign wealth fund Sofaz, and is the biggest land transport project in the Caucasus. Upon completion, it will transport both freight and passengers, but the freight component will be significantly larger.