

bne:Invest in Azerbaijan

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AZPROMO business forums strengthen ties with European partners

On the occasion of diplomatic visits from Slovenia and the Czech Republic to Baku, the Azerbaijan Export and Investment Promotion Foundation (AZPROMO) organised two bilateral investment forums aimed at strengthening ties with its European partners.

On March 2, a delegation led by the president of the Slovenian national council, Mitja Bervar,

arrived in Baku, and was welcomed by the deputy minister of economic development of Azerbaijan, Niyazi Safarov. The two dignitaries discussed bilateral relations, and the expansion of trade and economic cooperation, before the Slovenian delegation was received by the head of state and by Minister of Foreign Affairs Elmar Mammadyarov. During the bilateral business forum held later at the AZPROMO headquarters,



the foundation's president, Rufat Mammadov, introduced the guests to Azerbaijan's business climate and investment opportunities, and encouraged the Slovenian representatives of tourism, industry and other sectors to engage with their Azerbaijani counterparts. According to the Azerbaijani state customs committee, trade between Slovenia and Azerbaijan stood at a modest \$8.65mn in 2014, consisting mainly of Slovenian exports to Azerbaijan.

The following day, a Czech delegation headed by Minister of Industry and Trade Jan Mládek conducted a series of meetings in Baku with Minister of Finance Samir Sharifov, President Ilham Aliyev, the management of SOCAR, as well as with Azerbaijani representatives responsible for energy, transport and industry. Trade and investment between the two countries is sizeable, as Azerbaijan accounts for a third of the oil imports to the Czech Republic, while the latter has invested over \$1.2bn in Azerbaijan to date, and is financing \$2bn-worth of infrastructure projects in the Caucasian country. Bilateral trade increased by 23% in 2014, up to \$1.6bn. Mládek was reassured by his discussions with Sharifov that, despite the recent depreciation of the manat, the outlook for the currency is stable.

According to Mládek's statement available on the Czech Ministry of Industry and Trade

website, "Based on the meeting with the Minister of Finance, in addition to contacts with other representatives, I came to the conclusion that the situation was stabilised, that measures to decrease inflations were taken, and that all the investment projects would be implemented in their original scope. Absolutely crucial for me were assurances that loans that had been granted to finance Czech projects in Azerbaijan are not threatened. I see it as an important condition for further support of our companies on the local market through competitive financing."

While discussions revolved around the EU's Southern Gas Corridor, and increasing exports of oil and gas to Europe and the Czech republic in particular, the Czech delegation also participated in a bilateral business forum held at the AZPROMO headquarters, where the 32 Czech companies comprising the delegation discussed opportunities for investment and trade in agriculture, banking, logistics, telecommunications, infrastructure and engineering with their Azerbaijani counterparts. Attended by over 150 businesspeople from both countries, the event was deemed as a promising step forward that would pave the way for cooperation in energy, road construction and agriculture, and for exports of rail cars and railway equipment from the Czech Republic to Azerbaijan. •



Top story



Croatia, Montenegro to tap into TAP

Croatia and Montenegro have announced plans to connect to the Trans Adriatic Pipeline (TAP) – a key EU-backed pipeline that will carry Azerbaijani gas to Europe.

Speaking from the Budva resort in Montenegro on the sidelines of the two-day Adriatic Oil & Gas Summit that started March 10, the Croatian and Montenegrin ministers of economy, Ivan Vrdoljak and Vladimir Kavaric, revealed plans to construct a \$754mn gas route along the Adriatic sea, which would be linked to TAP, and which could also distribute to Bosnia-Herzegovina in the future.

"All the countries in the region want to get a link to TAP. This is also an opportunity for Montenegro to profit from gas from our future findings," Kavaric said, referring to his country's oil and gas

exploration efforts in the Adriatic Sea, for which three consortiums – including OMV, Marathon Oil Netherlands and Eni International – on March 12 filed bids for oil exploration and drilling rights.

Meanwhile, Croatia's upstream and downstream projects are pointing to its leadership in regional energy policy. The country is currently importing a third of its gas demand, estimated at 3bn cubic metres a year (cm/y), from Russia, and is hoping that the new pipeline will alleviate its dependence on Moscow.

As part of its upstream efforts, the Croatian government awarded exploration licenses this January to consortiums formed by Marathon Oil and OMV, Eni and Medoilgas, as well as to domestic player INA Industrija Nafta. In parallel, the country



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is working on a gas pipeline that would connect the natural gas terminal on the island of Krk in northern Croatia to Hungary – a scheme that will include Slovenia and Serbia when completed.

According to Vrdoljak, Croatia has an important say in the regional energy strategy, and should express its leadership through inclusiveness. "The priority projects are not only the LNG gas terminal [on Krk island] but also the pipelines, while Croatia becomes a country that should help this region get a new gas supply route," he said.

As the only alternative scheme to Russian gas for the Balkans after the EU aborted the costly Nabucco pipeline project in 2013, TAP has turned into a lifeline for the region, of which Greece, Albania and Bulgaria will be the main beneficiaries, but which is also being courted by their northern neighbours Croatia, Serbia, Kosovo, Bosnia and Montenegro. The 867km route will supply 10bn cm/y of gas to Europe in a first stage from the developing Shah Deniz II field off Azerbaijan's shores of the Caspian Sea. It will connect to the Trans Anatolian Pipeline (TANAP) near the border between Turkey and Greece at Kipoi, and cross Greece, Albania and the Adriatic Sea, before resurfacing in southern Italy.

Its trajectory can facilitate gas supplies to Southeast Europe, while the ability to double its capacity means that some Western European markets could also receive supplies in the future through Italy. The first gas deliveries through TAP are expected to take place in 2019.

After E.ON and Total sold on their shares in the pipeline in 2014, its shareholding now comprises BP (20%), SOCAR (20%), Statoil (20%), Fluxys (19%), Enagas (16%) and Axpo (5%). In 2014, TAP awarded various bids for onshore pipeline construction in Albania and Greece, and access roads and bridges in Albania, and has announced a new series of bids in early 2015 for the 105km portion of subsea pipelines in the Adriatic Sea and onshore works in Italy.

The interest in the pipeline is indicative of the need for stable and affordable gas supplies in the Balkans, and of Azerbaijan's importance as the only feasible alternative to Russian gas in the region. Meanwhile, the infrastructure and exploration projects announced over the past year could pave the way for further supplies from Central Asia to Europe, and better connect the gas distribution networks in Southeast Europe. ●



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PASHA Bank

PASHA Bank promotes investment opportunities in Azerbaijani financial sector

Since the beginning of the year, PASHA Bank has supported several events aimed at increasing awareness about the developments and investment opportunities in the Azerbaijani banking and financial sectors.

The first such event, a seminar on the "Financial market in Azerbaijan: outlook for 2015", was held in London on January 27. The event attracted over 60 asset managers, investment bankers, financial journalists and other industry experts. Speaking at the seminar, Charles Hendry, British trade envoy to Azerbaijan, Matthew Bryza, former US ambassador, and Taleh Kazimov, PASHA Bank's Chief investment officer and CEO-elect, shed light on the prospects for the Azerbaijani capital markets and banking sector this year, and explained why the country stands out in the Caucasus region as an investment hub.

According to Taleh Kazimov, PASHA Bank believes that, "both Azerbaijan and the international investment community can benefit from closer cooperation. In recent years, Azerbaijan has made tremendous progress in modernising its economy, improving its business environment and diversifying away from the energy sector. This seminar is yet another step in building a better understanding among the international financial

community about our economy, drawing interest in investing in Azerbaijan and building partnerships for the future."

Shortly after the seminar in London, PASHA Bank sponsored the Azerbaijan Banking & Finance Forum, an event organised by Adam Smith Conferences in Baku on February 4-5. The forum attracted over 300 representatives from Azerbaijani public and private companies, as well as of the International Finance Corporation, the World Bank, the Asian Development Bank, and the European Investment Bank. Focusing on the finance sector, retail banking, small business financing and monetary stability, the panel also noted that the diversification into sectors like tourism, telecommunications, financial services, real estate and agriculture would ensure the country's sustained economic development.

In early March, PASHA Bank continued its awareness drive through the organisation of the third Caspian Energy Forum. Hosted in Baku, the event gathered over 300 attendees, representing the local government, banks and insurance companies and foreign organisations, to discuss the development of the oil and gas service sector, the prospects for the non-energy sectors in Azerbaijan, the importance of the financial sector in strengthening trade relations, and the legislative framework for business in Azerbaijan. According to Taleh Kazimov, PASHA Bank is striving to strengthen trade relations between Georgia, Turkey and Azerbaijan, particularly as they concern sectors other than energy. •



Interview



Asian Development Bank ups game in Caucasus, Central Asia

If you hear the name Asian Development Bank (ADB), the first thing you are likely to think of is China. But after a decade of transformation the Middle Kingdom is doing well on its own, so the development bank has spread its wings across Eurasia.

The ADB has 64 members from both the developing and developed worlds that provide the funds to encourage development. "The focus was initially on Asia and the Pacific Rim when we opened our doors in 1994, but we have expanded since," says Betty Wilkinson, Director of the Public Management, Financial Sector and Trade Division for Central and West Asia at the ADB.

China remains the most important country in the patch, but the ADB limits its lending there to \$1.5bn from a total of about \$11bn a year of lending – and even then these investments are very targeted at things like renewable energy. "It's amazing how fast and aggressively China dealt with the issue of poverty. We have a saying at the ADB:

if you have a good idea and the Chinese like it, then you better put your running shoes on as you are going to be running to keep up," says Wilkinson.

The ADB does two types of lending: ordinary capital instruments, which are offered to countries that are already well on the road to recovery, and assisted instruments for poorer countries that are still struggling. "The Chinese take loans for things like renewable energy projects, but the other [poorer] countries borrow to build things infrastructure. We do a lot of transport, especially roads, and energy projects," says Wilkinson.

The bank has a wide brief and also supports some urban development, water and sanitation, financial sector and education projects.

The ADB has been working for a long time in Central Asia with a lot of Kazakh projects under its belt, but more recently it has become more active in the other countries in Central Asia and the Caucasus, traditionally the stomping ground of Western development banks like the World Bank and European Bank for Reconstruction and Development (EBRD). To highlight its increased interest, the ADB will hold its annual general meeting this year in Azerbaijani capital of Baku in May, a few weeks after the EBRD's annual shindig in the next-door Georgian capital of Tbilisi.

"We overlap with the other development banks, but according to our estimates the infrastructure spending needs through to 2020 runs into the trillions of dollars so there is plenty of work to go round," says Wilkinson, who gave a talk on online innovations that banks can use during the "Azerbaijan Banking and Finance Forum" that was organised by Adam Smith Conferences in Baku in February. •



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Feature



COMMENT: **How Azerbaijan can avoid Russia's mistake**

In 2009 Russia took the easy path and waited for oil prices to recover rather than implement a comprehensive package of reforms to boost economic growth. That has directly led to the damaging results now visible. Today Azerbaijan faces a similar choice. Will the government in Baku take heed? Does it even have the option of waiting until oil prices recover or gas export volumes to the EU double?

Azerbaijan's budget and economy are highly dependent on oil and gas exports to the European Union, Turkey and CIS states. Energy exports account for almost 95% of total exports, approximately 45% of GDP and 70% of budget revenues. Hydrocarbon revenues have helped sustain real GDP growth over the past five years and have improved the nation's balance sheet. However, progress with reforms has been very slow, if at all. The country ranks badly in such surveys as Transparency International's Corruption Perception Index and the World Bank's Ease of Doing Business survey. FDI was a modest US\$2.4bn last year and

while investment spending reached US\$27bn, almost half was in the oil and gas sectors.

The government in Baku keeps talking about the need to advance reforms so as to attract a higher and sustainable volume of investment into other parts of the economy and has even adopted a programme aimed at boosting investment into designated sectors by 2020. Inevitably, last year's oil price collapse, which will lead to a lower pace of growth in the economy this year, has invigorated the debate over reforms and the need for faster change

The problem is that Azerbaijan is within three years of substantially boosting gas export volumes to the EU, and along with it, gas revenues into the budget. The danger, therefore, is that the government simply decides to take the easy path and wait until either the oil price recovers or the gas export volumes double.

Double whammy

The country's over-reliance on oil and gas revenues led to a slower pace of growth in 2014. GDP expanded by 3% compared to 5.8% the previous year. Forecasts for this year are lower still and concern about the double-whammy hit from lower oil and the collapse in Russia's ruble forced the government to devalue the manat on February 21. A devaluation had been expected, but the scale of the hit, at 33% against the US dollar, was a surprise. It is a reflection of just how strong are the economic headwinds buffeting the country as a result of the oil price fall and the recession in Russia. The budget deficit will rise to approximately 5% of GDP from just above breakeven last year; while the current account is expected to shrink considerably, to 3% or 4% of GDP, as a result of lower oil and gas export revenues.



Although the oil price collapse should ordinarily be something of a wake up call, the government knows that by 2018 it will have the potential to double gas export volumes to the EU as a result of Phase 2 of the Shah-Deniz gas project and the TANAP-TAP pipelines coming online. Thus, it may take the view that it just needs to ride out this interim period of lower revenue and wait for the extra gas volumes. Hence the surprisingly large devaluation of the manat, which will reduce imports, protect budget revenues from the lower oil price and allow for a slower drawdown on national savings. October 2018 is also the date for the next presidential election and President Aliyev, who won a third consecutive five-year term in 2013, is known to want a fourth term. Stability, rather than taking reform risks, may seem like a sensible strategy to his advisors.

That said, according to the Azerbaijan 2020 development program, the key areas for future growth, as well as investment opportunities, should be in tourism, construction, telecoms, banking & financial services, real estate and agriculture related sectors. Having hosted the Eurovision Song Contest in 2012, Azerbaijan's next major event will be to host the first European Games in June this year. By engaging in such high profile events, the government hopes to attract further foreign investment to the non-energy sectors.

The country is also in a relatively good position to use its low debt position, which is around 8% of GDP, and its national savings to help create a more diversified economy, should it wish to. The success of the past two decades in the country's hydrocarbon sector has enabled Azerbaijan to accumulate substantial reserves valued at more than \$50bn, which are held at both the Central Bank and the national energy fund SOFAZ. With a strong reserve base, FX stability and a steady growth profile, Azerbaijan is actually in a relatively good position to weather any regional economic distress in the wake

of a Russian recession. That of course is both a positive and a negative depending on how you view the pressure to get more serious about reforms.

Shaking assumptions

Apart from where the oil price trades and the contagion from Russia's ruble collapse, two additional factors could shake the assumption that the country can simply wait until Shah-Deniz II comes to the rescue. One is the fact that rating agency S&P has perched Azerbaijan's sovereign credit rating just above investment grade. A poor response to the slowing economy could pull that rating to sub-investment grade and reduce the pool of available investors. The government finalised its 2015 budget late last year but this remains optimistic unless the oil price rallies strongly in the second half of this year. The assumption is for total tax revenue of US\$22.8bn and spending of US\$24.8bn. The resulting deficit, of US\$2bn, would equal 2.8% of planned GDP. However, most independent observers assume a worse outcome, i.e. a 5% budget deficit because of an assumed lower oil price. The country is expected to come to the external markets for new debt and use some of the near \$40bn of savings in its sovereign wealth fund to cover the deficit. The former would be a lot more difficult if S&P were to cut to junk status, albeit the latter will now be less expensive after the big devaluation.

Currently Azerbaijan has only one sovereign Eurobond listing. That is the \$1.25bn bond with a maturity in March 2024 and a coupon yield of 7.36%. It is rated BBB- by S&P and, in mid-February, it was yielding 4.9%. The next most liquid issue is from the state oil company, SOCAR. It has a \$1bn bond, maturing in 2023, rated BBB- by S&P and with a coupon yield of 6.62%. It was yielding 6.1% in mid February. There are also some smaller issues from AzRail, International Bank of Azerbaijan and from SOCAR. The



International Bank of Azerbaijan is reported to be planning a \$200mn-300mn Islamic Bond (sukuk) in the coming months, a task which would also be more difficult with a lower credit rating.

The other risk is the continuing state of war with Armenia over Nagorno-Karabakh. That conflict always appears to be close to a much more serious escalation and the number of fatal cross border skirmishes has been increasing since last summer. More clashes, and more threatening rhetoric, are expected ahead of this year's parliamentary elections, scheduled for November. Any return to full scale fighting would leave Russia, the US and the EU in a difficult position

and might slow investment flows and hurt political relations.

One additional area of concern for investors is the divide between the rich and poor. Although poverty has more than halved over the past 15 years, from 30% in 2001 to 8% in 2014, the significant disconnect in the living standards enjoyed by the country's elite and ordinary citizens remains a key complaint. One way to address those concerns of course is to focus on economic reforms and create a more diversified economy — one that benefits all citizens. Whatever path is chosen, it would not diminish the EU's appetite for the country's gas exports. •



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Sector



Azerbaijan continues drive to develop IT with hi-tech cluster at Mingachevir

Developments in recent months add to the Azerbaijani administration's drive to develop technology and IT, and to position the country as a leader in these sectors in the Caucasus region.

Currently, the country is a net importer of hardware and software solutions, with multinationals like HP, Microsoft, Siemens, Huawei and Alcatel-Lucent working on large-scale e-government and fiber optic projects. However, local IT companies are becoming increasingly competitive, and participating in government tenders alongside multinationals. Meanwhile, exports of IT services and hardware are growing, albeit from a modest base of approximately \$52mn last year.

The flagship project that is expected to drive innovation in Azerbaijan is the High Tech Park (HTP), which is currently under construction on a

50-hectare plot on Pirallahi Island, off the coast of the Absheron Peninsula. While work on the project is already underway and should be completed in the next two years, the Azerbaijani administration announced in February that a branch of the park will be established in Mingachevir, the country's fourth largest city.

Issued on February 27, the presidential decree establishing the Mingachevir HTP mentions that the purpose of the project is to "carry out research and development in order to prepare, develop or improve product innovation and high-tech applications for industry, services, and other sectors." The project was allocated 1.3ha of land and will be overseen by the Ministry of Communications and High Technologies (MCHT). The Azerbaijani government reportedly intends to build high-tech complexes in other towns, starting with neighbouring Ganja, Azerbaijan's second largest city. The parks offer incentives for investors and companies looking to set up shop, such as VAT waivers for the import of technology and equipment, subsidised office space, and profit tax waiving for up to seven years.

Mingachevir is already home to an electronics and computer equipment assembly plant. The Kur plant was founded in 2005 as a joint venture between an MCHT association, the Radio and Television Production Association, and local IT company Sinam. To date, the plant has been assembling devices like KURTEL phones, DVB-T, ADSL 2/2, modems and thermal photo printers. However, multinationals like Intel and Acer have expressed interest in using the infrastructure at the plant to produce processors, chips and assemble computers.



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In December, Intel announced that it would start producing Classmate PCs, processors and chips at Kur, emulating the example of its partners Dell and HP, which already have an established presence on the software market in Azerbaijan. In a December interview, Alexei Sleptsov, Intel's representative in Azerbaijan, noted that, "The advantage of this establishment will be an increase in the skill level of engineers and programmers. This is very important, since it is Azerbaijani programmers who know best what Azerbaijani users need."

Meanwhile, John Davis, Intel's Vice President for the World Ahead programme, mentioned that Azerbaijan would be joining Intel's other assembly centres, which are located in Argentina, Portugal, and several countries of Africa. "It is possible that this type of plant will also start functioning in Azerbaijan," he concluded. The main beneficiary of the deal will be Taiwan's Acer, which would be using the Intel processors and chips for its computers, and which is currently negotiating the deal with the Azerbaijani government.

In addition to the HTP and large assembly and production plants like Kur, the government

continues to foster a grassroots culture of innovation by supporting entrepreneurs through financing schemes and business incubators. In 2014, its first full year of activity, the State Fund for IT Development allocated approximately AZN 4.6mn for IT projects developed by startups. Meanwhile, the business incubator at the HTP in Pirallahi received its first residents last year.

While still in its early days, there are strong indications that the Azerbaijani administration is increasingly looking at knowledge-based sectors like IT as potentially significant contributors to economic diversification away from oil and gas. The fact that Azerbaijan is the most populous and wealthiest country in the Caucasus, and that it speaks a Turkic language, easily translatable to Turkish, makes the country an attractive investment destination for foreign IT companies. Meanwhile, the relatively high cost of labour compared with traditional technology manufacturing hubs in East and Southeast Asia, and the availability of skilled labour are challenges that the administration needs to address to facilitate the development of knowledge-based industries. ●



Economics & finance

Worries rise as Azerbaijan devalues manat

On February 21 the Central Bank of Azerbaijan (CBA) devaluated the manat, the national currency, by 33.5% against the US dollar and 30% against the euro. The bank explained the move as a way to keep business competitive after the devaluation of the currencies of Azerbaijan's major trading partners.

The announcement followed the bank's switch to a dual-currency basket earlier that month when the CBA abandoned the manat's dollar peg in favour of a dollar-euro basket. This move was taken as a way to manage an exchange rate that's been increasingly affected by the falling oil price and Western sanctions against Russia, Azerbaijan's biggest trading partner.

The bank rate for the manat has now been set at AZN1.05, down from a rate of AZN0.7860 against the dollar. "The decision was taken in order to create additional incentive for the diversification of the national economy, strengthen its international competitiveness and export potential, and to ensure the strategic stability of the balance of payments and international solvency of the country," said the CBA.

"The correction of the exchange rate will help neutralize the negative impact on the competitiveness of the national economy from the recent reduction of rates of national currencies of major trade partners of Azerbaijan," it said.

Ripple effect

According to government officials, Azerbaijan's

state budget for 2015 was based on an oil price averaging \$90 per barrel, while GDP growth was set at an optimistic figure of 4.4%. With Brent crude now trading around at \$60, the devaluation was seen as necessary, says Ziyah Samedzadeh, chairman of the Parliamentary Committee for Economic Policy.

His views echoed those of President Ilham Aliyev, who said the sharp depreciation of currencies in neighbouring countries coupled with the declining oil price had begun to take their toll on the country's revenues. In a televised statement, Aliyev said the CBA was having to sell up to \$500mn a day to sustain the manat's rate following the switch to the dual-currency basket; the CBA had spent more than \$2bn from its foreign reserves holdings. "If such a situation had continued, the currency reserves would have been reduced significantly," said Aliyev.

Of all the former Soviet states, Azerbaijan has been less affected by the crisis in Russia. But with over 60% of country's GDP depending on oil and gas revenue and hydrocarbons making up to 90% of country's exports, it was only a matter of time before sustaining manat artificially "at all costs" had to be ceased. Azerbaijan's manat had been stable at just over 0.78 per dollar since mid-2011 until the recent slump in global oil prices.

People factor

For ordinary Azerbaijanis the announcement came as a shock, hitting savings and leaving many disillusioned. "I did not see this coming and couldn't have imagined they would depreciate the manat by so much," a top official at Azerbaijan's



state oil company SOCAR told bne IntelliNews. “I lost over 30% of my savings in a matter of days. And as my money is tied up in manats, suddenly everything abroad became so expensive.”

The concerns of the majority of Azerbaijan's population revolve more around the rising costs of everyday essentials such as bread and medicine. Some of the first retailers to react to the devaluation were local pharmacies, with some of them bold enough to hike medicine prices by 40%. But the government insisted that such incidents of “unnecessary” increase in prices would be monitored and nipped in the bud. According to the Azerbaijani ministry of economy, measures have now been taken to lower pharmaceutical prices back to pre-devaluation levels. Hours after the devaluation news broke out, the government announced it would take measures against those who use the situation to increase costs for consumers.

Following the devaluation announcement on Saturday morning, a large number of local supermarkets around the country closed for the entire weekend so they could re-price products. That, coupled with Azerbaijani banks' stopping the sale of dollars for manats, fuelled further panic among locals, who took to their Facebook pages to vent their frustration with the government. Many simply posted: “my government betrayed me today”.

But Ziyad Samedzadeh, chairman of the Parliamentary Committee for Economic Policy, said the manat's devaluation wasn't an anti-crisis measure, but an “aspect of an efficient management”. Minister for Labour and Social Protection Salim Muslimov said the depreciation of the national currency would not affect the financing of social benefits. “Manat rate decline

means increase in fiscal revenues, curbing the problems with benefits' financing,” said Muslimov.

What spooked citizens was not so much the devaluation itself but its magnitude. “Devolution of the manat should not have come as a surprise,” Murad Gassanli, a London-based analyst and expert on South Caucasus, told bne IntelliNews. “There were a number of indications since at least December last year that the Azerbaijani government was growing increasingly concerned with falling oil prices and was finding it difficult to maintain the value of the national currency. In the face of rapidly changing global and regional economic reality, Baku had no option but to respond to the challenges. These include not only falling energy prices but also economic crises in neighbouring countries, especially in Russia.”

“The problem with the manat devaluation is the way the process was handled by the central bank. Instead of a stable and managed process, there was a single shock-effect decision amounting to an overnight 35% devaluation of the currency. This in turn created much uncertainty, which persists, and led to speculative moves on the markets,” he said.

“It is now essential for the central bank to maintain a tough financial regulatory regime; to prevent inflation, rein in speculators seeking to take advantage of market instability; and maintain fiscal discipline,” he said. “The real challenge long term to the Azerbaijani economy is the unsustainable levels of public spending, especially on major ‘prestige’ projects and defence expenditure.”



Russian contagion increases risks for neighbours, says Fitch

The sharp slowdown in the Russian economy is a significant shock for other former Soviet countries, but the impact on these countries' credit profiles varies considerably, according to Fitch Ratings.

"Armenia and Ukraine have the most direct exposure among Fitch-rated sovereigns, while the steep fall in oil prices has magnified the fallout in Kazakhstan and Azerbaijan," the ratings agency said in a March report entitled, "Russia slowdown hits CIS sovereigns".

Former Soviet countries with excessive dependence on trade, remittances and investment from Russia are directly impacted by the Russian economic crisis. Although direct Russian exposure is lower in Kazakhstan and Azerbaijan in terms of share of GDP, the ruble's depreciation on their fixed currencies is a major indirect channel of contagion - particularly in a context of lower oil prices, Fitch said. "Azerbaijan has responded by devaluing the manat and shifting from a dollar peg to a euro/dollar basket," the agency said. Azerbaijan's central bank devalued the energy-rich country's currency, the manat, by 33.5% to the dollar and by 30% to the euro on February 21. The new exchange rates were set at AZN1.05 to the dollar and AZN1.195 to the euro.

Fitch believes there is a high possibility Kazakhstan could also devalue "as the tenge's real effective exchange rate has appreciated to levels last seen before the February 2014 adjustment". Kazakhstan devalued the tenge by 19% in February 2014 and expectations of another devaluation were high, resulting in tenge run: the share of foreign-currency denominated retail

deposits widened from 44% to 67.5% in 2014 and to 67.7% in January 2015, according to National Bank of Kazakhstan figures.

"Devaluation poses risks for both sovereigns, but they have strong buffers," Fitch said. Kazakhstan has over \$100bn in international reserves, while Azerbaijan has \$9.3bn.

"Georgia is less exposed to Russia via remittances and trade ties, although we are still likely to slightly revise down our GDP growth projections for 2015-2016," the ratings agency said. "Both Armenia and Georgia have allowed their currencies to float, providing a shock absorber and preserving foreign-exchange reserves."

EBRD revises down Azerbaijan's GDP growth outlook for 2015 to 1.5%

The European Bank for Reconstruction and Development (EBRD) revised down its GDP growth outlook for 2015 to 1.5% from the 3.0% it was previously predicting. However the development bank went on to say that despite the economic shocks buffeting the country, its reserve funds were adequate to cushion the blow.

"Huge stocks of foreign exchange reserves at the Central Bank and the State Oil Fund of Azerbaijan will mitigate the impact of potential external shocks, however the growth of non-oil sector alone is unlikely to lead to the overall growth rate stability," EBRD said in a note.

All of the countries in Eurasia have seen their economy slow as a result of the regional economic problems however Azerbaijan retains one of the highest growth rates in Eastern Europe



and the crocuses. The exception is Georgia, which has already disengaged self from the Russian economy. It is looking forward to growth of 4.2% and is one of Azerbaijan's closest trade and investment partners.

Other development banks and international financial institutions have retained their higher forecasts for growth this year, but are likely to follow the EBRD following the devaluation of the manat in February. The Asian Development Bank predicts Azerbaijan's GDP growth at 3.5%, the International Monetary Fund-at 4.3% and the World Bank-at 4.1% in 2015.

Azerbaijan foreign external debt only 8.6% of GDP

Azerbaijan has one of the lowest level of foreign debt exposure of any country in Eurasia, a mere 8.6% of GDP.

The intensely conservative government has relies heavily on its oil revenues to finance most of its investment over the last years and shied away from tapping international capital markets.

However, that started to change more recently with the first sovereign Eurobond issue last year. Corporate are also looking at borrowing abroad in order to accelerate their growth.

The debt profile is also extremely healthy with 7.3% of external borrowings having maturities are up to 10 years, another 60.2% are between 10 and 20 years, and the remaining 32.5% has a maturity of over 20 years.

Nearly two-thirds of the debt is in US dollars (64.8%) with another 21.4% in euros and another

10% made in the form of special drawing rights from the IMF.

Azerbaijan invests \$1bn in Russia over a decade

Azerbaijan invested \$1bn in the Russian economy between 2004 and 2013. Russia's investment in Azerbaijan totalled \$1.8bn in the same decade.

At a meeting with Russian Deputy Prime Minister Arkady Dvorkovich in Baku on February 10, Azerbaijani Economy and Industry Minister Shakhin Mustafayev said that there were 600 companies with Russian capital operating in Azerbaijan at the moment. Still, "there is potential to expand cooperation in such spheres as agriculture, machine-building, pharmaceuticals and others", Mustafayev said.

Azerbaijan has a network of industrial parks offering favourable conditions, which, the Azerbaijani minister noted, could be attractive to Russian companies seeking to expand to the Caucasus country, he added.

In the run-up to the Russia-led Customs Union's transformation into the Eurasian Economic Union in 2015, Moscow sought Azerbaijan's membership of the free-trade bloc. However, Baku openly rejected any talk of Azerbaijan joining any trade bloc. Last June, Mustafayev said Azerbaijan preferred developing economic relations on a bilateral basis.

Azerbaijan's imports from Russia fell from \$1.5bn in 2013 to \$1.3bn in 2014, while exports to Russia decreased from \$1.1bn to \$640mn. The economic slowdown in Russia as a result of the Western sanctions imposed on Moscow for its continuing support to rebels in eastern Ukraine is hurting



Russia's trading partners in the CIS. When in response to the sanctions Russia refused to buy foodstuffs from Western countries, Azerbaijan and other former Soviet countries saw a chance to fill the gap, but their hopes have been dashed by the falling purchasing power of Russian citizens, with the ruble losing nearly 50% since 2014.

There is strong opposition in some quarters in Azerbaijani society to closer relations with Moscow because of its unwavering support to Azerbaijan's arch-rival Armenia. The two countries fought a bloody war in the 1990s over the Armenia enclave of Nagorno-Karabakh that Yerevan still occupies. Armenia is Moscow's staunch ally in the Caucasus and is a member of the Moscow-led military and political bloc Collective Security Treaty Organisation, and the free-trade bloc Eurasian Economic Union.

term economic development of the country and much of his money goes into infrastructure and educational projects.

Amongst the biggest expenditures this year are: financing a project on reconstruction of the Samur-Absheron irrigation system; financing construction of the Baku-Tbilisi-Kars railway line; financing the State Program on Education of Azerbaijani youth abroad in 2007-2015; and financing Azerbaijan's share in the Southern Gas Corridor project.

The planned investment for this year do not represent much of a change from previous years. Of the liquid assets in the fund, half are invested into US Treasury bills, another 35% into Euros and 5% into British pounds. The remaining 10% can go into other currencies, such as the Russian ruble all the Chinese Yuan.

Azerbaijan sovereign wealth fund SOFAZ portfolio hits \$26.6bn

The investment portfolio of Azerbaijan sovereign wealth fund SOFAZ will total AZN28bn (\$26.6bn) in 2015.

"In 2015, SOFAZ will implement an investment policy, which allows obtaining the maximum yield at a low risk of loss of main capital," the fund said in a statement.

The fund was set up to receive cash from oil exports. It is mainly used to support the long-

FDI into Azerbaijan increases in 2014 despite a global decrease

Azerbaijan and Kazakhstan were among the few countries that actually saw an increase in foreign direct investment (FDI) in 2014 as the rest of the world saw investors pull their heads into their shells in the face of global economic turmoil.

Total investments into Azerbaijan reached \$27bn in 2014, including \$16bn of the domestic investment and \$11bn of foreign direct investment. The stands in stark contrast to the FDI going into the Russian economy, which fell by 70% in 2014 to around \$19bn. Ukraine also saw direct investment fall by \$200mn.



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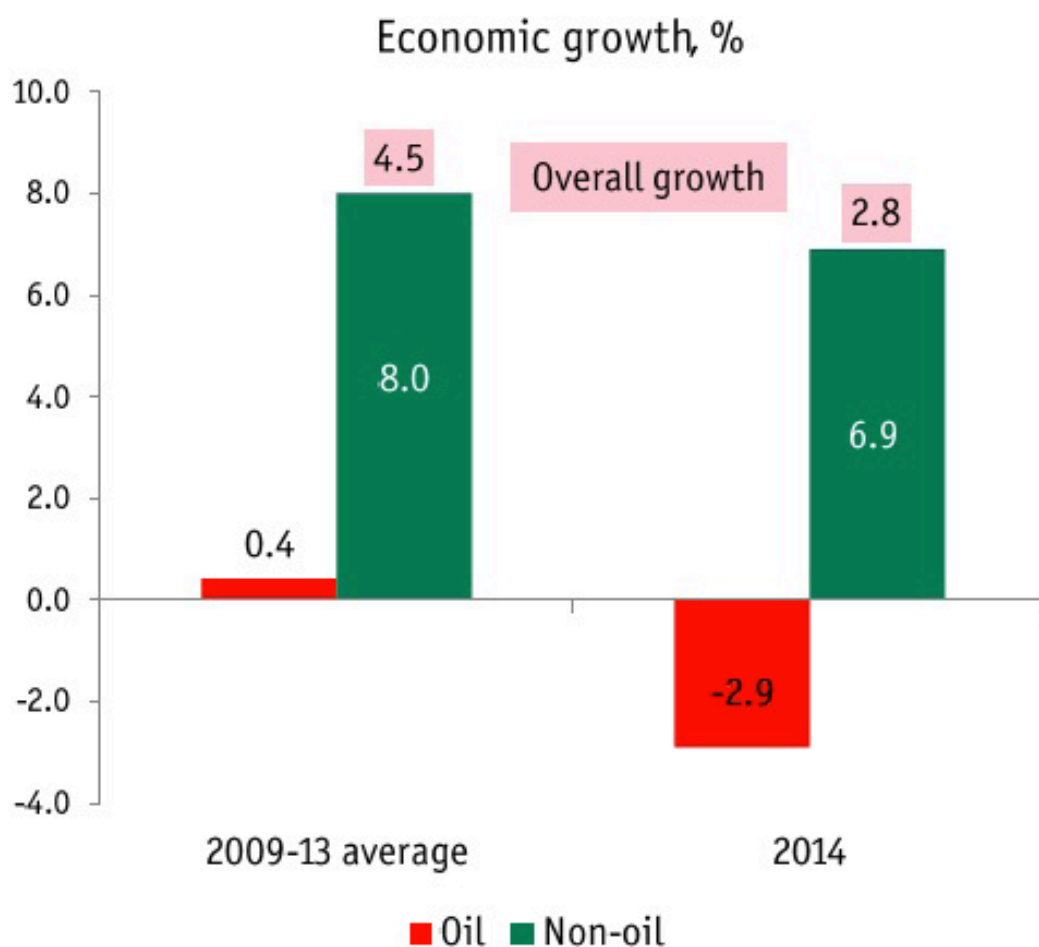
Chart

Growth of Azerbaijan's non-oil sector outstrips oil production

Despite all the talk of the diversification amongst the countries of the former Soviet Union, Azerbaijan is one of the few that is actually delivering on the promise.

Best known as an energy producer, oil's contribution to Azerbaijan's economic growth is actually contracting, falling by 2.9% in 2014, against the growth of the non-oil sector, which was up by 6.9% in the same year.

Of all the non-oil sectors food and beverages is growing fastest and already accounts for just over half of non-oil manufacturing (54%). That is followed by the production of construction materials (9%), metallurgy (8%), machinery and equipment (7%), chemicals (7%), electronic equipment (5%) with other miscellaneous manufacturing accounting for the final 10%. •



News in brief

Azerbaijan enters a new round of WTO accessing talks

As part of its ongoing bid to join the World Trade Organisation (WTO), Azerbaijan entered the next round of bilateral negotiations with the international trade organisation in March.

The talks were held in Geneva on March 3-7 and were led by Azerbaijani Deputy Foreign Minister Mahmud Mammadgulyev, who discussed rules covering Azerbaijan's export of goods and services, domestic support for agriculture and the general trade policy of the country.

Currently, Azerbaijan is in the process of negotiations with the US, Japan, Brazil, Ecuador, Sri Lanka, European Union, Norway, India, South Korea, Taiwan Province of China, Canada, Switzerland, and Honduras on joining the WTO.

Talks have already been completed with Turkey, the Sultanate of Oman, the United Arab Emirates, Georgia, and Kyrgyzstan.

Azerbaijan to launch third high-tech park

As part of the state's efforts to diversify the economy away from oil and gas and build a modern technology-based market, the government has announced it will launch the construction of its third high-tech Park in the country's fourth largest city of Mingachevir.

The facility will fall under the administration of the

Communication and High Technologies Ministry. AZN2mn has been allocated from the president's reserve fund to complete the construction, which is due to later this year.

The city is already helping computer manufacturing in the country. Earlier the government launched a programme to produce and provide the population with subsidised computers as part of this effort to get the population online. The effort is centred in the city of Mingachevir, which is home to the KUR computer manufacturing plant.

The KUR plant was established in 2005 and is the only assembly-line production of computer equipment and electronics in the South Caucasus region. Part of the investment going to upgrading the plan in order that they can produce more sophisticated products.

Russia's Gazprom affirms that it will continue to buy Azerbaijani gas

Following comments by deputy chairman of the Russian gas giant Gazprom, Alexander Medvedev, that the company would reduce the volume of gas it buys from countries in Central Asia by 10bn cm a year, the company backtracked in February and affirmed that it will continue to stick to current purchase agreements with Azerbaijan.

"Gazprom, thanks to investments to the mining complex and the transport sector requires no purchase of gas from abroad, regardless the source. Gazprom has enough resources to meet



the needs of the market of any region of the Russian Federation, as well as to ensure supplies of gas to our customers both in Europe and in the future, in Asia," Medvedev said, reported Azernews.

Azerbaijan signed a supply agreement with Russia in 2009, however the contract allows Gazprom to increase, reduce or suspend gas supplies at any time.

Belgium to build a cheese plant in Azerbaijan

The Belgian firm Scherjon has announced plans to build a Gouda cheese plant in Azerbaijan.

The plant will be built on the basis of supplies from the local Imishli dairy cattle farm and the production is aimed at both the local and regional markets.

The facility will cover 500 hectares next to the farm, which has over 1000 head of cattle. This will be raised by bringing in more cows from Holland in order to improve the quality of the milk for the production.

Car imports to Azerbaijan down, production up in 2014

The number of cars being imported to Azerbaijan fell in 2014, however the number of cars being produced within the country increased, reported the state customs committee.

Part of the reason for the fall was the government introduced new European ecological standards requirements for imports, which precludes any cars other than those made since 2005 in Europe

from being imported into the country. This has led to a estimated 40% decline in imports in 2014, or a total of 63,368 vehicles in 2014 versus 104,385 imported in 2013.

Part of the rationale of the decision to impose what is in effect an administrative barrier was to promote domestic production of vehicles in the country. Azerbaijan manufactured 1061 cars in 2004 which is 4.4 times more than it made in the same period a year earlier, reported the state statistics committee.

Azerbaijan has the highest birthrate in Europe

With 18.3 live births per 1,000 people, Azerbaijan has the highest birth rate of any country on the European continent, according to the most recent statistics from the EU is just agency Eurostat.

Last year the country added 115,900 new citizens, bringing the total to 9.59mn as of the start of this year, according to Azerbaijan State statistics committee.

Azerbaijan's neighbour Turkey has the second fastest growing population on the Eurasian landmass with 16.8 births per 1,000 people. Ireland is in third place with 15 births per 1,000 people. Greece has the lowest birth rate with only 7 births per 1,000 people according to Eurostat.

Azerbaijan moves tax payments online

To improve the efficiency of government all taxpayers in Azerbaijan can now pay their taxes



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online, according to the republic's tax minister, Fazil Mammadov.

The initiative is part of the development of e-government in Azerbaijan. The tax ministry already provides the population of 59 types of electronic services designed to improve the efficiency and simplicity of making tax returns. This is part of a wider programme where the government offers 481 different e-services of which 320 are integrated into the electronic government portal.

"Filing of tax returns, fulfillment of tax obligations and all of the processes that connect users with the tax authority have been electronized. Approximately 90% of taxpayers impose tax returns in electronic form," Mammadov said at a recent forum, reports Azernews.

The latest addition to the system was the International Bank of Azerbaijan, which has started issuing electronic certificates through the government portal (e-gov.az).

Azerbaijan invests \$5.8mn into IT start-ups

The government of Azerbaijan is pushing the development of IT in the country hard and a state fund invested ANZ4.8mn (\$5.8mn) into startup

enterprises in 2014. Amongst the recipients of the fund's investment were 12 companies specialising in IT technologies.

Typically the state supplies money in the range of ANZ10,000 to AZN50,000 over three years for small projects and from AZN50,000 to AZN500,000 over five years for medium-sized projects with a final category in the range of AZN500,000 to AZN5mn over 10 years for the very largest projects.

The fund works under the auspices of the communication high-technology minister which was set up by presidential decree on March 15, 2012.

Azerbaijan to become an SCO observer

Azerbaijan has applied to become an observer at the Shanghai Cooperation Organisation (SCO).

Originally set up by China as an economic and security bloc to unite the interests of the Eurasian continent, the organisation has been growing in prominence in recent years and became a forum for investment and discussion with China, which has become increasingly active in Eurasia.

According to the SCO Secretary General Dimitriy Mezentsev, Armenia, Bangladesh, Maldives, Nepal, and Syria are also applying to become observers.

