

# bne:Invest in Azerbaijan

## Contents:

Top story	3
PASHA Bank	6
Interview	7
Feature	9
Sector	12
Economics & finance	14
Chart	18
News in brief	19

**Sign up for bne:Invest in Azerbaijan**

October 2015

 [Follow us on twitter.com/biznewseurope](https://twitter.com/biznewseurope)

[www.bne.eu](http://www.bne.eu)

AZPROMO is the main partner of the bne:Invest in Azerbaijan newsletter. [www.azpromo.az](http://www.azpromo.az)



## Russia and Azerbaijan boost commercial ties through series of bilateral events

The Azerbaijan Export and Investment Promotion Foundation (AZPROMO), in collaboration with the Ministry of Economy and Industry, organised an Azerbaijan-Russia business meeting at its headquarters in Baku on October 2. Together with the 6th edition of the Russia-Azerbaijan Interregional Business Forum, which took place in Yekaterinburg on September 30, the event was a

significant boost for bilateral ties between the two countries.

The gathering brought together 50 Russian and Azerbaijani representatives of companies active in industry, agriculture, logistics, construction and pharmaceuticals, in an effort to diversify bilateral investment away from oil and gas.



Azerbaijan Export & Investment  
Promotion Foundation



AZERBAIJAN INVESTMENT COMPANY

Energy accounts for over 90% of Russia's \$1.8bn aggregate investment in Azerbaijan, according to Rufat Mammadov, president of AZPROMO. "Another \$200mn represent investments in non-oil sectors, and we are currently working intensively to diversify our economic relations, which is a priority for both sides," Mammadov told the audience present at the meeting.

The meeting coincided with the visit to Baku of a delegation led by Georgy Poltavchenko, governor of St Petersburg, who met with the Azerbaijani President Ilham Aliyev and other officials to discuss enhancing business ties between his region and the Caucasian country.

## Building bridges

St Petersburg is one of the Russian regions with the strongest flow of investment and trade with Azerbaijan. Those ties were recently reinforced when one of the largest agri-businesses in Azerbaijan, Azersun Holding, announced it has created a joint venture in St Petersburg to supply Azerbaijani food products to Russia.

The economic sanctions on Russia are opening up opportunities that Azerbaijani companies are eager to tap. At the summit in Yekaterinburg, for instance, officials and businesspeople from Azerbaijan and 75 of Russia's regions discussed

ways to forge new partnerships. And while AZPROMO and its Russian counterpart signed an agreement to foster trade and investment, private companies from regions like Dagestan, Tatarstan, Stavropol Krai, Astrakhan, Sverdlovsk Oblast, Chelyabinsk Oblast, Russia and St Petersburg sought tangible ways to grow their trade with Azerbaijani companies, which stood at a commendable \$4bn in 2014.

The volume of bilateral trade increased by 50% in the first half of 2015, despite a 20% year-on-year drop in turnover caused by the devaluation of the Russian ruble, making Azerbaijan one of Russia's foremost trading partners in the Caucasus and Central Asia.

"Bilateral agreements in trade, technological and cultural cooperation were signed with a number of Russian regions at the intergovernmental level," Alexander Tsybulsky, Russia's deputy minister of economic development told the media on September 30. "We plan to sign similar documents with the Leningrad Oblast, Tambov Oblast, Ulyanovsk Oblast and the Republic of Bashkortostan."

According to Mammadov, some 600 companies with Russian capital have invested in Azerbaijan to date. ●

## Top story



### WEF survey finds Azerbaijan most competitive economy in CIS

The World Economic Forum (WEF)'s "Global Competitiveness Report for 2015-2016", published in late September, found that Azerbaijan is the most competitive country in the Commonwealth of Independent States (CIS). Ranked 40 out of 140 countries, with a score of 4.5 out of a possible 7.0, Azerbaijan placed two positions above Kazakhstan, its closest contender in the region, and scored higher than larger economies like Italy (43), Turkey (51) and India (55).

The WEF justified its ranking by the fact that Azerbaijan has weathered the regional economic slowdown better than neighbouring countries, and has a strong macroeconomic environment, characterised by low inflation and favourable public finances. However, Azerbaijan fell by two positions

from last year and WEF notes that, "the recent decline in the price of oil and gas, which is not captured in this year's edition because of a time lag in the data, may have an impact on the public budget," which may affect Azerbaijan's stellar rating for macroeconomic environment (6.4 out of 7, ranked 10 in the world).

The Azerbaijani economy, in which oil and gas account for 37% of GDP, over 70% of budget revenues and more than 95% of exports, is indeed highly exposed to declines in the price of hydrocarbons. An ICBC Standard Bank report on frontier markets in the CEE/CIS region that came out in October found that a 40% drop in oil prices, from \$100 per barrel to \$60, would translate into a 15.4% decline in Azerbaijan's GDP; the Azeri light crude currently



trades at less than \$60/b. Meanwhile, a 30% drop in natural gas prices, from \$380 per 1,000 cubic metres (cm) to \$266/000 cm, would translate into a 12% decline in GDP; and natural gas currently trades at \$220- \$230/000 cm.

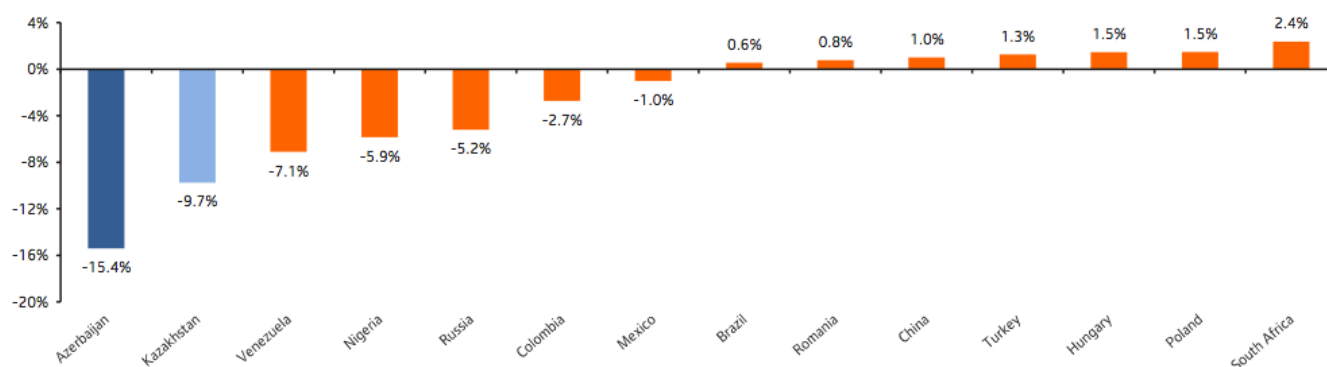
Baku has sought to counteract the drop in oil revenues, which plummeted from \$13bn in January-August 2014 to \$6.3bn in the same period this year, through higher public spending on public projects for the European Games in June and on large-scale infrastructure and industrial projects. However, the state budget, which normally runs at a surplus thanks to oil and gas revenues, is expected to fall into a \$3.5bn deficit this year, and \$1.6bn next year, so Baku will have to start looking elsewhere to maintain its strong macroeconomic fundamentals.

Other than the macroeconomic environment, Azerbaijan also ranks in the WEF survey relatively well in labour market efficiency (4.6 out of 7, 30th in the world), but lags in terms of health and primary education (102 in the world, with a score of 5.2), financial market development (114, 3.3), and higher education and training (89, 3.9).

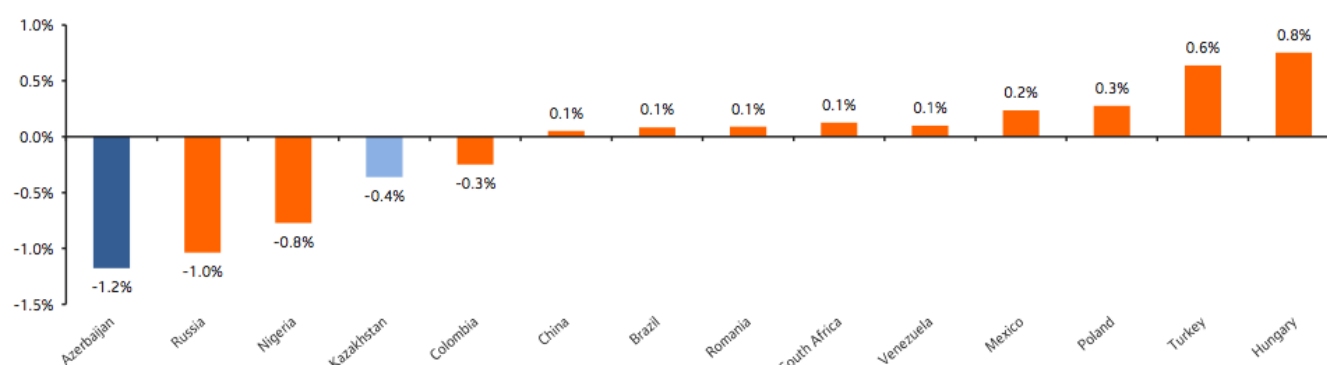
## Challenges to competitiveness

"Azerbaijan faces two main challenges to further development. First, corruption is still the most problematic factor for doing business; and second, its financial sector is still underdeveloped. This is particularly problematic for a country that needs private investments to diversify its economy. At a time when commodity prices are projected to remain relatively low, diversification and the implementation of market-based policies will

### Impact on Trade Account of \$40 drop in oil price (from 100 to 60) - as % of GDP



### Impact of 30% lower natural gas price (from \$380/bcm to \$266/bcm) - as % of GDP



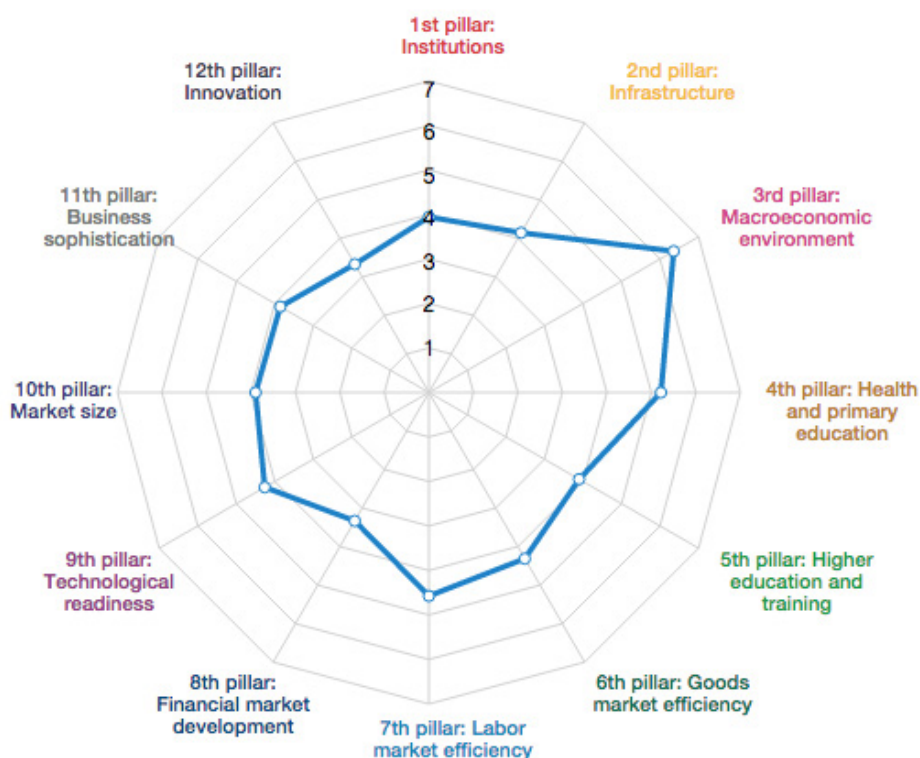
be particularly important to achieve long-term growth," the report reads.

Aware of the importance of the two challenges listed by the WEF, the Azerbaijani government says it is already working on addressing the shortcomings listed above. Thus, its banking sector is slowly enhancing its inclusiveness, reaching out to rural areas and increasingly delivering services that banks in developed countries provide - cardless withdrawals, contactless payments, pension and salary disbursements, amongst others. Supporting small and medium-sized enterprises (SME), which are the engine for growth in developed economies, is also a priority for Baku, and several banks - PASHA Bank, Accessbank, have made SME financing and consulting a priority for their growth strategy.

Capital market development, however, still lags far behind, and Baku is working with international financial institutions (IFIs) like the World Bank, which earmarked \$12mn in financing for the Baku Stock Exchange (BSE), to modernise BSE's trading platforms.

Baku is also timidly starting to tackle corruption, which remains widespread. In 2012, the government put forth the National Anti-Corruption Plan 2012-2015 (NACP) in order to reduce graft and conflicts of interest among public officials through anti-corruption training, improved income declaration regulations and gradual wage increase. Furthermore, Azerbaijan has employed technology in public services in order to contain bureaucracy and the opportunity for petty bribes. In 2014, it launched an automated one-stop-shops called Asan, where citizens can perform a number of government payments, or obtain passports and other documents.

For all its shortcomings, investors seem to agree that Azerbaijan, and particularly its energy sector, is one of the most attractive and competitive destinations for foreign direct investment (FDI) in the CIS. FDI stocks reached \$18bn, or 24.5% of GDP, in 2014, and are continuing to grow. In the first half of 2015, the country attracted an additional \$1.7bn in FDI, proving that the country might be a little more resistant to oil shocks than international observers would have us believe.



# PASHA Bank



## Fitch upgrades PASHA Bank's rating to 'BB-' with stable outlook

Rating agency Fitch raised PASHA Bank's long-term issuer rating from 'B+' to 'BB-' with a stable outlook on September 21, citing the improved track record of sovereign support for the banking sector in Azerbaijan, as well as PASHA Bank's (together with Kapital Bank) "systemic importance" to the Azerbaijani banking sector given their combined market shares. The two banks belong to PASHA Group, which is another factor that played a role in the rating upgrade, and will continue to positively influence the bank's risk evaluation.

The third largest Azerbaijani bank by assets, which stood at AZN1.5bn (\$1.4bn) in May, corresponding to 5.25% of the total banking assets in the country, PASHA Bank is focused on corporate banking and works primarily with companies active in sectors other than energy, a strategy that is in line with Baku's efforts to promote economic diversification in Azerbaijan. A member of PASHA Group, which operates businesses involved in insurance, construction, construction materials and tourism, PASHA Bank accounted for 8.1% of deposits and 3.2% of lending in the Azerbaijani banking sector between January

and June. In 2013 and 2014, the bank opened subsidiaries in Georgia and Turkey respectively, in an effort to create an interconnected banking system that will facilitate trade flows between Azerbaijan and its two leading commercial partners.

PASHA Bank's lending activity has outstripped sector growth this year; driven primarily by construction loans and retail lending, its loan portfolio grew by 65% on year, compared with a 23% increase in lending activity in the sector as a whole. However, the increased lending on the back of a 34% depreciation of the national currency this year has resulted in a higher rate of non-performing loans (NPLs), which grew from 4% in January-June 2014 to 13.6% this year; restructured loans accounted for a further 7.5% of its loan portfolio. Most banks in Azerbaijan have been faced with an increase in NPLs this year, and have had to restructure loans denominated in foreign currencies.

Fitch also reaffirmed PASHA Bank's visibility rating (VR) as 'b+', reflecting the bank's "solid capitalisation and comfortable liquidity, and manageable (although somewhat deteriorated) asset quality metrics". At 20.4%, the bank's capital adequacy ratio at the end of the first half of the year was "sufficient" to increase its loan impairment reserves to around 21.3% of gross loans without breaching the 12% minimum requirement. "This would have been sufficient to cover the NPLs and restructured loans. PASHA Bank's margin of safety on a consolidated basis is even more significant, as the AZN128mn (\$122.8mn) of equity injected into its Georgian and recently launched Turkish subsidiary is deducted from regulatory capital. Thus, at the end of the first half-year, the bank's Fitch core capital ratio was around a high 29% (end-2014: 36.2%)," the rating agency concluded. ●

# Interview



## PASHA Bank finds consulting as important as financing in volatile times

As of this summer, PASHA Bank has a new CEO in the person of the young, but accomplished financier Taleh Kazimov, who sat down with bne IntelliNews to discuss how he will inject dynamism into the bank's development by offering holistic solutions to clients that encompass financing to consulting.

Having been with PASHA Bank since its inception in 2007, Kazimov is in no rush to make drastic changes to its strategy, preferring instead to keep a close eye on the market and adapt to changes as they come along. "In case of necessity, we can reconsider our growth programme in order to adapt to new market trends", he says, adding that, "we see no need for changes in the strategic vision for now."

That strategic vision, which has informed PASHA Bank's growth in recent years, has been to contribute to the development of the non-oil economy in Azerbaijan, to support the growth of small and medium-sized enterprises (SMEs),

regional development and creating financial links between Azerbaijan and its closest commercial partners Georgia and Turkey – directions that largely echo Baku's growth strategy as well.

One of the directions that PASHA Bank will pursue more proactively with Kazimov at its helm is the SME segment. At the moment, SMEs only account for 10% of Azerbaijan's GDP, which is low by Central Asian standards, where the average contribution of SMEs to the economy is closer to 30-40%. But PASHA Bank wants to change that. "SMEs have always been a priority for us. In late 2013, the bank opened the first out of four currently operating service centres dedicated exclusively to SMEs. Just like with our corporate clients, we offer our SME clients tailor-made services; we have no interest in growing this type of lending aggressively, though, through minimum analysis and maximum security. Unlike other banks, we provide both financial and consulting services to our clients," he explains.

SME business owners need professional advice to channel their companies' growth in the right direction, and PASHA Bank offers such services for free. "Any bank is capable of providing a loan, but not every bank is capable of ensuring that clients will fully benefit from these funds," Kazimov adds.

### To the regions and beyond

In an effort to promote regional development in Azerbaijan, PASHA Bank has opened offices in the towns of Ganja and Zagatala, as well as a business centre in Zagatala focused on supporting entrepreneurs working in agriculture. Looking ahead, PASHA Bank is eyeing a further expansion of its regional network to Sumgayit and Guba. "We see a big potential for development in the regions of the country, the demand for expertise and business



Azerbaijan Export & Investment  
Promotion Foundation



AZERBAIJAN INVESTMENT COMPANY



consultations we provide,” Kazimov explains.

In order to support the development of agribusinesses in Azerbaijan and Georgia, PASHA Bank has partnered up with non-banking credit organisations like FINCA, whose inaugural bond issue on the Baku Stock Exchange and Georgian Stock Exchange it underwrote. PASHA Bank also organises events aimed at bringing financiers together with agribusiness entrepreneurs to the same table; its February workshop on the development of microfinance in agriculture is a case in point.

In 2013 and 2014, PASHA Bank opened subsidiaries in Turkey and Georgia respectively, a choice of locations that was no accident according to Kazimov. “These countries are among the major trading partners of Azerbaijan. By establishing a banking network within the economic triangle Azerbaijan-Turkey-Georgia, we

aspire to contribute to much higher trade flows between the countries as well. We are more than confident in the successful future of the region, ready to become one of the engines of its economic development, and plan to lend support both to the Azerbaijani entrepreneurs in these countries and local business,” Kazimov states.

Looking ahead, Kazimov believes that PASHA Bank's ability to guide its clients will set it apart from competition. “Considering the rising macroeconomic challenges in the region, the financing provided by credit organisations becomes a minor product, while proper business consulting takes centre stage. Entrepreneurs need competent and weighty advice on how to improve business models, manage cash flows and other topics, and PASHA Bank is making efforts to ensure that the funds allocated to businesses contribute to their development,” Kazimov concludes. ●



## Supporting Non-oil Sector Development in Azerbaijan



**European Bank**  
for Reconstruction and Development



**Keppel**

**Holcim**

— [www.aic.az](http://www.aic.az) —

T: +994 12 488 8010

F: +994 12 488 8012

[info@aic.az](mailto:info@aic.az)





# Feature



## Azerbaijan to overhaul pension system with World Bank, EU support

Azerbaijan is seeking to revamp its pension system with the help of the EU and the World Bank.

A remnant of the Soviet era, the pension system is overseen by the State Social Protection Fund (SSPF). It consists of a mandatory set pension stipend for those who have worked for 12 years or more, and a flexible social insurance allowance that constitutes 25% of a retiree's average monthly income.

Baku has been working to reform its pension system together with international assistance from bodies such as the United Nations Development Programme (UNDP) since 2002, with some positive steps to date, but significant amounts of work are left to do. Most notably, the SSPF has improved its IT infrastructure and

successfully introduced a streamlined pension disbursement system. Thus starting in July, every retiree receives a pension card, which he or she can use to withdraw their pension from Kapital Bank ATMs, thus avoiding bureaucracy and facilitating payments.

Yet as it stands, Azerbaijan's pension system needs reform if it is to survive over the longer term. "Studies show that although Azerbaijan's pension and insurance system stands out through its financial sustainability, we could face serious financial problems if we don't deepen the insurance principles in the future," Elman Mehdiyev, the head of SSPF, told reporters on September 28. He added that Azerbaijan's pension and insurance system has a lot of expenditures that are not related to the compulsory state social insurance at all.

The main problem is that Baku is using social security payments from current employees to pay for the pensions of those who have already retired and who made contributions under the Soviet benefit system. "We shouldn't forget that the citizens who pay premiums for compulsory social insurance, will come for their pensions at some point... However, alongside with the transfers from the state budget, we use these funds for the pension coverage of the population, for example, paying pensions granted to some welfare beneficiaries before 1992," Mehdiyev said.

The SSPF currently runs at a deficit, which is expected to reach AZN1.8bn (€1.5bn) next year, and which the state covers out of oil and gas revenues. However, an increasingly cash-strapped Baku, which has been faced with a 50% drop in oil prices and a 33% drop in natural gas prices this



Azerbaijan Export & Investment  
Promotion Foundation



AZERBAIJAN INVESTMENT COMPANY

year, will have an increasingly hard time footing the bill for the pension system, and is looking for solutions to make the system pay for itself.

## Demographics

Azerbaijan is a predominantly young country, with 40% of the population 24 and under and less than 9% is above 60, but is nevertheless affected by high levels of underemployment – roughly 1.7mn of the 4.6mn labour market is engaged in agriculture, which generally involves subsistence farming. Besides, the fertility rate is below the replacement level and is set to keep falling, meaning that the burden on social services will increase over the coming decades.

That the basic pension in Azerbaijan is roughly AZN60 (\$57) goes to show that the country's pension system is not only expensive for the government to administer, but also barely provides enough income for the elderly. The overall average pension payment was AZN180 (\$172) in 2014, according to the State Statistics Committee (Azstat), which includes the basic pension payment and a social contribution representing 25% of average income.

## In comes the World Bank

The World Bank is no stranger to Azerbaijan. Having maintained a presence in the country since 1992, the multilateral lender has invested over \$3bn in 55 projects to date, covering areas ranging from infrastructure to agriculture to social protection. And as of September, it has been assisting Baku in overhauling the pension system. So far, World Bank experts have put forth 10 different options on which Baku could model its pension system. In all cases, the new pension system would scrap the twelve-year minimum work experience required to qualify for a state pension.

In addition, it will "enable Baku to double the capital accumulated in the individual account of employees, stimulate the doubling of the pension capital and as a result to ensure the pension system pegged to the insurance part of pension, as this option is considered optimal for sustainable and higher pension insurance," says Mehdiyev. "Another important measure is to divide the obligations of the state and the pension insurance system due to the formation of additional sources of funding."

"The system should ensure proper distribution of income of the elderly population, or rather create a system to avoid bringing the elderly to the poverty level after the loss of their capacity to work," the World Bank's country director for Azerbaijan, Larisa Leshchenko, told the media. She added that although Azerbaijan has increased the level of social contributions in recent years, they are still not enough to ensure the sustainability of the pension system.

The country will also seek to gradually increase the retirement age from 60 for women and 62 for men at the moment to 67 by 2029, to reflect the increase in life expectancy.

The World Bank programme is still in its early stages, in which the two parts are considering different models for the future pension system, and no financial commitment has been made to date.

## A private alternative?

In parallel to its work with the World Bank, the SSPF is working with the Ministry of Welfare of Latvia and the German Association for Social Security Policy and Research to introduce a private pension system in the country.

Not only would private pensions support the

government's overloaded pension system and enable retirees to receive higher pensions, but it will also promote the development of capital markets in Azerbaijan, according to Latvian welfare expert Agrita Groza.

Funded by the EU's European Neighbourhood Policy (ENP) scheme, the consulting project is

about to come to the end of its 18-month period. However, results cannot be expected too quickly. "Even if the Azerbaijani government decides to introduce a non-state pension system, it will take quite a long time and a huge amount of work to implement it," Groza told Trend news agency. "For example in Latvia, it took 12 years to develop a modern pension system." •

## It's October, so pomegranates are in

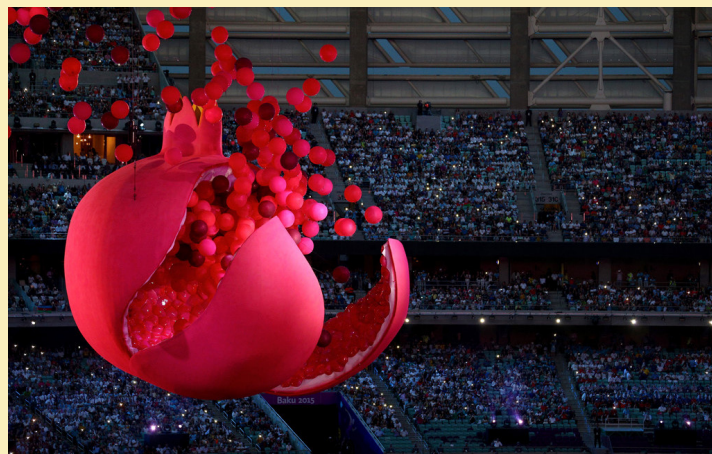
Nothing encapsulates the essence of Azerbaijan better than the pomegranate – a fruit widely cultivated that has been celebrated since time immemorial in the Caucasus and Persia. Persians went so far so as to claim that Eve offered Adam a pomegranate instead of an apple in the Garden of Eden.

A token of abundance, love and good luck, the pomegranate is now in season and can be found in every bazaar and supermarket in Azerbaijan – both as fresh fruit and in product form of compote, jelly, juice and sauce. There are reportedly as many as 100 species of pomegranate cultivated in Azerbaijan, and the country produces a staggering 30,000 tonnes of the fruit a year.

Azerbaijanis consume the pomegranates with everything; the omnipresent pomegranate jelly is a treat that they have with tea or for breakfast; nar sharab, or pomegranate sauce, is normally used with fish or kebabs, but can be added to virtually any food; and fresh pomegranate juice is served at every fair, market, park and shopping mall. In restaurants, every other dish is decorated or garnished with pomegranate seeds, and

are a key ingredient in salads and desserts. Rich in antioxidants and with a host of health benefits, pomegranate is also said to enhance memory and prevent a number of cancers and cardiovascular diseases.

The fruit that the national poet Nizami believed burst open out of love is so close to the Azerbaijanis' hearts that since 2006 the Ministry of Culture and Tourism has been organising a Pomegranate festival every October in the northern Goychay region. The event attracts up to 7,000 visitors every year, who get to taste a variety of pomegranate delicacies, watch popular dances, and pomegranate-related competitions and tutorials.





# Sector



## BakuBuild brings construction innovation to Azerbaijan as sector struggles to recover

Baku is set to open its doors to “Caspian Construction Week” starting on October 21, a four-day event that attracts professionals from the construction, interior design, construction materials and real estate sectors to the Azerbaijani capital. The centrepiece of the event will be the BakuBuild expo, in its 21st year, which will showcase products and services from over 500 companies and of seven countries that have booked national stands – Germany, Spain, Italy, Iran, the United Arab Emirates (UAE) and, for the first time, India and the Czech Republic.

An important investor in Azerbaijan's construction sector through major developers like Tefken Construction, Turkey has also reserved a large area at the expo. Despite the economic slowdown in the Caucasus this year, the number of exhibitors has remained at last year's level, and

increased by 30% compared with 2013.

Some companies, like local start-up Art Vitrage Studio, will use the event to introduce themselves and their services to the Azerbaijani market. The construction machinery sector will be represented by Turkish equipment manufacturers and will constitute another highlight at BakuBuild.

The range of products on show will also be more varied according to organiser Iteca Caspian, and will comprise building materials, ceramics, finishing stone, marble, paint and coatings, windows and doors, interiors, roofing and flooring materials, furniture, street lighting, landscaping, park development, metal and bronze works, among others. Furthermore, the expo will feature innovative solutions new to the global construction market, like lifts without machine rooms, modular polypropylene coatings, a new generation of cement and coatings, and high quality mixers for bathrooms.

### Recent developments in Azerbaijan's construction market

The event is timely, for Azerbaijan's construction market, which has grown tremendously in the last decade on the back of high public spending, needs to develop through more private investment and partnerships. According to the country's central bank, construction companies continue to run at a deficit, which is largely covered by public financing and investments. Although sector output increased from AZN300mn (\$384mn at the pre-devaluation exchange rate) in 2000 to AZN8.6bn (\$11bn) in 2014, companies' spending, which amounted to AZN800mn (\$764mn) in January to August 2015, exceeds their sales by a factor of 2.5. In 2014, spending in the construction sector exceeded income by a factor of 4.3.



And state money is starting to dry up due to decreased revenues from oil and gas; between January and August, oil exports amounted to \$6.3bn, less than half the revenues in January-August 2014. The drop will translate into a budget deficit as high as \$3.8bn this year and \$1.6bn in 2016. After a spending bonanza ahead of the first European Games in June, Baku is starting to roll back spending. In 2016, it budgeted for \$15.4bn in public spending, down from \$24.8bn (AZN19.4bn, at the old exchange rate of \$1=AZN0.78) this year.

While most large projects are funded by the state or international lenders, private companies have built more than four-fifths of the construction projects in Azerbaijan to date. The most ambitious construction project in recent years is, without a doubt, Avesta Concern's Khazar Islands project – a planned residential complex of 41 artificial islands in the Caspian Sea that will include 150 schools, 51 hospitals, a 1,051-metre high tower called the Azerbaijan Tower, and other facilities. The company has already made headway in the construction works, but may have to curb its ambitions, as it is starting to have trouble finding the \$100bn in financing required to complete the project.

A brainchild of the administration of President Ilham Aliyev, and designed by Atkins and Foster and Partners, Baku White City was inaugurated in May to great popular acclaim, for the seaside project was the face of a decade-long urban regeneration effort, and added glitz and the glamour of 5-star hotels to an area that used to be an industrial wasteland. Parks, green areas and a seaside promenade complete the project, a part of which is still under construction.

In addition to Azerbaijan Tower, another edifice to grace Baku's skyline in the coming years will

be Baku Tower, a 50-storey office building in the capital's central Nizami district. Works are underway and, in early October, Hill International reported that developer Azvil Tikinti had appointed it as the project manager for the construction, in a \$3.7mn agreement.

## **Renting becomes more popular**

Away from the luxury towers in downtown Baku, residents are struggling with real estate prices that are stubbornly high. Once a very lucrative sector that attracted more than 200 companies, or half of the construction firms in the country, residential real estate has borne the brunt of the slide in oil prices, the devaluation of the manat and the almost-stalled mortgage lending.

Prices in dollars have dropped by 30% since the beginning of the year, but locals still find them prohibitive, for the drop in manat terms has been a meagre 5%. In August alone, the volume of real estate purchase and sale transactions recorded by notary public offices decreased by up to 20%.

Experts say that properties that are on the outskirts of Baku have been particularly affected, with prices there decreasing the most, and that owners have taken their properties off the market and put them up for rental. That in turn has resulted in a 6% increase in rental prices, a trend that was also boosted by the influx of students coming into Baku from the regions between August and October.

However, things are set to improve by the end of the year, according to the executive director of Property Market Participants association, Elnur Asadov, for mortgage lending it to pick up. "Mortgage lending is projected to reach AZN250mn (\$238mn) by the end of the year, and will contribute to the revival of the real estate market," he said. ●



# Economics & finance

## Iran's opening seen a bigger opportunity than threat to Azerbaijan

The impending lifting of sanctions on Iran will open up enough opportunities for Azerbaijan to partially offset the competition from Iran's oil and gas exports, according to a September 28 report released by rating agency Moody's Investors Service.

The lifting of sanctions on Iran is expected to add between 600,000 and 1mn barrels of oil to global supply by March 2016, putting further downward pressure on oil prices and being credit negative for all oil-exporting countries in the region, including Azerbaijan. However, Moody's believes that increased trade, infrastructure projects and investment in non-oil sectors will boost Baku's economic diversification agenda and contribute to growth.

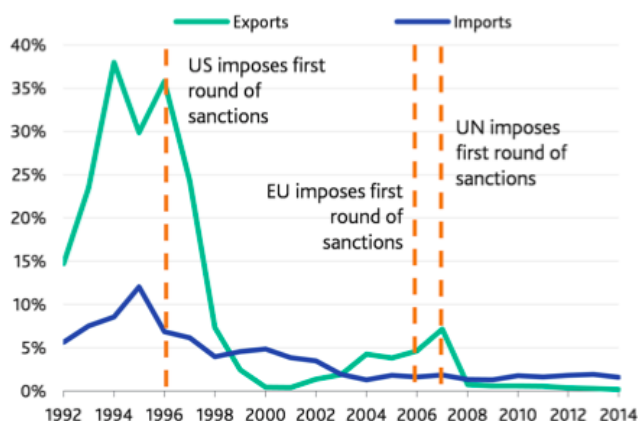
Having a large and competitive economy like Iran's open up to global trade is bound to enhance

trade with Azerbaijan; case in point, Iranian Minister of Communications and Information Technology Mahmoud Vaezi expects bilateral trade with Azerbaijan to reach \$1.5bn in 2016, up from \$500mn in 2014.

Iran is the world's 18th largest economy measured by nominal GDP at purchasing power parity, and is the third largest economy in the Middle East and the Commonwealth of Independent States, after Russia and Saudi Arabia. While its competitiveness has been stifled by the sanctions that were first imposed by the US back in 1996 and have been broadened since, Iran's large population of 78mn remains highly skilled, and the country is among the top 50 most innovative in the world according to Bloomberg, scoring particularly well in patents (22nd in the world) and tertiary efficiency (18th).

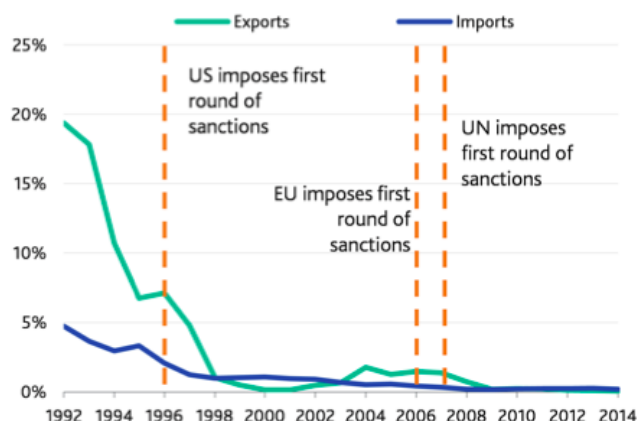
Azerbaijan was among the first countries to seek new foreign trade and investment opportunities with Iran when the decision to lift sanctions

**Foreign goods trade between Azerbaijan and Iran took hit...**  
Goods exports/imports to/from Iran, % of total goods exports/imports



Sources: Haver, IMF, AZSTAT, Moody's Investors Service

**...following the adoption of international sanctions on Iran**  
Goods exports/imports to/from Iran, % of Azerbaijan's nominal GDP



Sources: Haver, IMF, AZSTAT, Moody's Investors Service



Azerbaijan Export & Investment  
Promotion Foundation

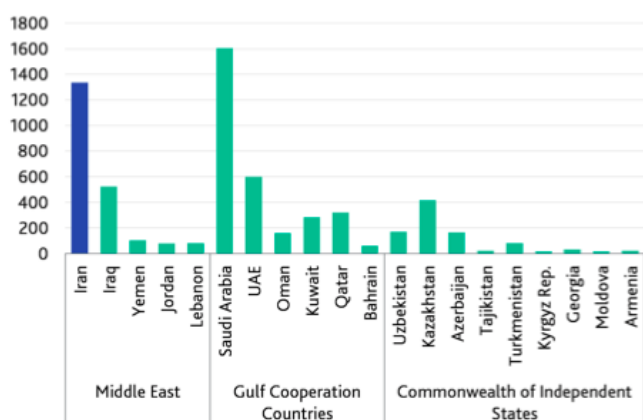


AZERBAIJAN INVESTMENT COMPANY



## Iran has the second largest economy ...

Nominal GDP (PPP), billions of current international dollar



Sources: Haver, IMF, Moody's Investors Service

earlier this year was made, Moody's notes. Since August, the two neighbours have been working on a number of joint projects in hydropower, railway connections, oil and gas swaps, and engineering.

"Iran was an important export market destination for Azerbaijan during the pre-sanctions period. Before the first round of sanctions was imposed in 1996, Azerbaijan's exports of goods to Iran accounted for a very large share of Azerbaijan's total exports of goods. In 1994, the share of Azerbaijani goods exports to Iran in Azerbaijan's total goods exports reached a high of more than 35%. In the aftermath of the sanctions on Iran, however, Azerbaijan's goods exports to Iran plummeted and they currently account for a meagre 0.1% of Azerbaijan's nominal GDP only," the report reads.

The increase in trade with Iran would serve well one of Baku's top development strategies, which is that of diversification away from oil and gas. A thriving industrial hub, where industry accounts for over 40% of GDP, Iran could be a source of know-how and commerce in areas such as IT services, pharmaceuticals, agro-industrial processing, construction materials, chemicals and petrochemicals, and mining.

Assuming Azerbaijan' exports of goods go back to pre-sanction levels and partly takes place in non-oil sectors, Azerbaijan could somewhat reduce its overreliance on hydrocarbons, thus helping Baku reach its target of a 7% annual growth rate of the non-oil economy.

In the times of oil bonanza, when the barrel of oil traded at over \$140, Azerbaijan was able to tap into its generous state reserves to foster growth in the non-oil economy. As recently as this year, Baku registered 7.3% growth in the non-oil economy between January and August, on the back of increased public spending on infrastructure projects like Baku White City and stadiums, swimming centres, residential compounds, and public transportation schemes in preparation for the European Games in June. The economy remains over reliant on hydrocarbons, which account for 37% of GDP, 70% of budget revenues and over 90% of exports.

## Eurasian currencies continue to face devaluation pressures

Despite significant devaluations already in 2015, Central Asian and Caucasus currencies are continuing to face depreciation pressures because of sluggish economic growth and worsening foreign trade, the IMF predicts in its autumn World Economic Outlook, presented during the IMF/WB Annual Meetings in Lima, Peru, on October 6.

The IMF said in the outlook that weakening commodity prices had triggered "sizeable" currency depreciations since last spring, especially in August. Central Asian and Caucasus currencies have fallen by 40-50% in value this year, most notably the Azerbaijani manat by nearly 35% and the Kazakh tenge by over 45%.

"Countries with weakening growth prospects and worsening terms of trade are facing [further] currency depreciation pressures," the outlook suggests. At the same time, "exchange-rate depreciation has generally been a useful buffer for countries experiencing growth slowdowns – and has already been substantial – but could cause adverse balance-sheet effects where there is foreign-currency borrowing," Maurice Obstfeld, IMF chief economist, warned as he presented the report at a news conference in Lima.

Kazakhstan issued 10-year Eurobonds worth \$1.5bn and 30-year bonds worth \$1bn last October, while Azerbaijan sold its first international bond sale of \$1.25bn in March 2014.

The outlook predicts net energy exporters in Central Asia and Caucasus – Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan – will post a combined current account deficit of 2.7% of GDP in 2015 and 3.2% in 2016 against a combined surplus of 3.3%. While Azerbaijan and Uzbekistan are expected to maintain their balance sheets in the black, Kazakhstan's current account is expected to post deficits of 3% of GDP in 2015 and 4.1% in 2016 against a surplus of 2.1% in 2014.

According to the outlook, economic growth in the Caucasus and Central Asia will be held back by lower commodity prices and spillovers from Russia (through trade, foreign direct investment, and especially remittances), which will interact with existing structural vulnerabilities.

In the Caucasus, Azerbaijan is the only country that is forecast to grow faster this year compared to last, as well as to slow down in 2016. The IMF predicts it will grow by 4.0% in 2015 (after 2.8% in 2014) and then by 2.5% in 2016. For Armenia it predicts 2.5% and 2.2%, and for Georgia a big drop to 2.0% in 2015 and a slight recovery to 3.0% in 2016.

## EU reaffirms support for Azerbaijan's WTO accession

The European Union reaffirmed its commitment to help Azerbaijan accede to the World Trade Organisation (WTO) on October 9. "The EU recognises the work completed by Azerbaijan in recent years towards WTO conformity and is looking forward to Azerbaijan's completion of the remaining reforms envisaged under the WTO accession procedures," the statement read.

The reforms concern tariff adjustment for agricultural and industrial products, but more importantly custom and competition rules. Azerbaijan's custom system is notoriously corrupt, and competition stifled by state monopolies and interventions from the government and individuals and businesses close to it.

Azerbaijan started consultations on WTO accession in 2004, but progress has been slow. Baku is filing to join as a developing country, which would grant it the right to higher subsidies, justifying the financial burden posed by its almost one million internally displaced persons (IDPs) on state revenues. The IDPs, who lost their homes during the war over Nagorno-Karabakh in the early 1990s, still receive housing and heavy subsidies and pensions from the Azerbaijani government.

## Azerbaijan govt forecasts \$3.8bn budget deficit in 2015

The Azerbaijani government modified the state budget for 2015, by decreasing the forecast for revenues by 12.1% to AZN17bn (\$16.2bn), according to Finance Minister Samir Shrifov. The change will bring the 2015 budget deficit to AZN4bn (\$3.8bn).



Azerbaijan has had to adjust its budget for 2015 before, as it had originally planned for a baseline Azeri light price of \$90/ barrel, and later changed it to \$50/barrel.

In January-June, the country incurred a \$734mn budget deficit instead of an anticipated \$738.1mn surplus. The difference was covered by the sovereign wealth fund SOFAZ, the assets of which dropped by \$1.4bn to \$35bn in August.

Covering the budget deficit for the second half of 2015 could mean SOFAZ's assets decrease by another \$3bn by the end of the year. In 2016, the Azerbaijani government will tap into other sources of funding to cover the anticipated \$1.6bn deficit, such as privatisations, foreign and domestic borrowing, foreign grants and the Azerbaijani treasury.

## Azerbaijan central bank reserves drop 54% y/y in September

The Central Bank of Azerbaijan (CBA) reported a \$271.2mn decline in its foreign currency reserves

in September. The reserves declined by 3.7% m/m and by 54% y/y to \$7bn in September.

The Azerbaijani regulator has spent billions in reserves since last September to bolster the national currency, the manat, to no avail. In February, the CBA was forced to drop a four-year peg to the dollar and let the currency float against a basket of foreign currencies that included the euro and the dollar, which resulted in a 34% depreciation of the manat against the dollar. Observers are expecting a second depreciation to take place shortly.

CBA's reserves reached their peak - \$15.2bn - in September 2014, and have been steadily declining since. In July reserves increased slightly by 1% m/m to \$8.52bn, raising hopes that the manat had stabilised, but that did not last; in August, reserves started dropping again.

Meanwhile, the country's monetary base increased by 11% m/m to \$7bn in September, after declining from \$11.5bn since January.



# Chart

## Short cut

The 50% drop in oil prices since last summer is beginning to take its toll on the Azerbaijani economy. With an expected \$3.8bn budget deficit this year and \$1.6bn in 2016, the government is increasingly strapped for cash, and needs to find other ways to sustain its economic diversification efforts. Iran's opening is therefore timely, and Baku is rushing to set up transport infrastructure to send its exports to its southern neighbour as sanctions are lifted.

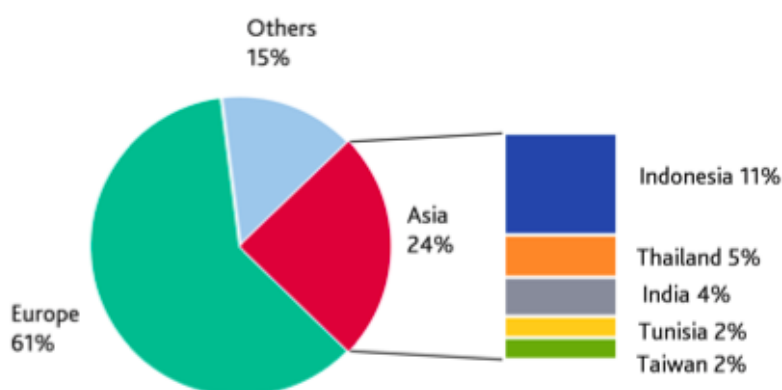
In August, the two countries discussed the construction of a 7km railway link between the towns of Astara in Azerbaijan and Astara in Iran, a \$400mn project that would effectively integrate their railway networks and which could be ready as early as 2016. In early October, bilateral discussions focused on a different route for freight

transport that would connect Iran's Persian Gulf ports to Baku. The second route would entail ferrying trains from the Iranian Caspian Sea port of Amirabad to Baku, from where they would be sent further north to Azerbaijan, Georgia or Russia by rail.

Azerbaijan would also benefit from a road running from over the border and down through Iran to the Persian Gulf, Moody's posits, as it "would significantly shorten the shipping distance and the number of transiting countries of the 25% of Azerbaijan's oil exports that go to Asia."

Currently, Azerbaijan's main oil export route goes through the Black Sea, the Mediterranean Sea and the Red Sea, Moody's says. ●

**Azerbaijan could benefit from shipping its Asia-bound oil via Iran**  
% of Azerbaijan crude petroleum exports, 2014



Sources: AZSTAT, Moody's Investors Service

# News in brief

## Azerbaijani banks restructure over 100,000 loans in 2015

Azerbaijani banks have restructured over 100,000 loans worth AZN600mn (\$573.5mn) since the beginning of the year, according to Elman Rustamov, chairman of the central bank, speaking during a plenary session at the parliament.

He added that the banks have reduced interest rates, and even forewent charging interest rates in many cases for the entire duration of the restructured loans. Azerbaijan banks have given out AZN7.5bn (\$7.1bn) in loans this year, AZN5bn (\$4.8bn) of which went to businesses.

Since a 33.7% devaluation of the Azerbaijani currency, the manat, against the dollar took place in February, banks have resorted to restructuring loans denominated in foreign currencies in order to contain the rate of non-performing loans (NPLs), which stands at 6.5%.

## Opec sees Azerbaijan's oil production dropping to 820,000 b/d in 2016

Azerbaijan's average daily oil production will decline by 10,000 barrels per day (b/d) to 860,000 b/d in 2015, according to the Organisation of Petroleum Exporting Countries (OPEC)'s Monthly Oil Market Report (MOMR) released on October 12.

Furthermore, Azerbaijan's oil production is expected to drop by a further 40,000 b/d to 820,000 b/d in 2016. "Lower prices are likely to accelerate

declines in Azeri production in 2016 compared to 2015," the report reads.

Oil production dropped by 20,000 b/d to 840,000 b/d in August as the country's largest oil producing field, the Azeri, Chirag, and Guneshli (ACG), entered decline. Planned maintenance works are planned at the ACG, starting on October 20-22, and said to last 20 days, and are expected to further weigh on fourth-quarter production.

## Azerbaijan's Silk Way West Airlines becomes IATA certified

Silk Way West Airlines, a new airline in Azerbaijan belonging to the conglomerate Silk Way Group, received a membership certificate from the International Air Transport Association (IATA) on October 12. Silk Way West has already passed the first audit and will become fully compliant with IATA standards by January 2017, according to CEO Kamran Gasimov.

Azerbaijan's largest airline, flag carrier Azerbaijan Airlines (AZAL), which flies to over 57 destinations worldwide, has been IATA certified since 2005. AZAL operates both passenger and freight flights.

In recent years, smaller airlines, such as freight carrier Silk Way Airlines, have emerged. Both Silk Way and Silk Way West Airlines belong to Silk Way Group, a business conglomerate comprising of 23 companies that run activities including airport maintenance at the Heydar Aliyev International Airport, ground handling, cargo services, insurance, travel agencies, catering, banking services, and the Sheraton Baku hotel.



Azerbaijan Export & Investment  
Promotion Foundation



AZERBAIJAN INVESTMENT COMPANY

## Azerbaijan gas production drops 7.7% to 19bn cm in Jan-Aug

Azerbaijan's production of natural gas dropped by 7.7% y/y to 19bn cubic meters (cm) in January-August, according to national oil company Socar.

Socar itself produced 7.22bn cm of these from the Azeri, Chirag and Guneshli (ACG) offshore field, while BP and its partners exploited the remaining 11.8bn cm from other offshore fields, like Shah Deniz.

Natural gas prices in Europe have dropped in the last year from a high of \$380 per thousand cubic metres (cm) to between \$220 and \$230 at the moment. Azerbaijan is expecting to increase its gas exports by at least 16bn cm by the end of the decade, which will be recovered from the Shah Deniz II offshore field and pumped through a network of pipelines named the Southern Gas Corridor (SGC) to Turkey and Europe.

Meanwhile, the state oil company is seeking to enhance its oil production, which declined by 1.4% y/y to 5.5mn tonnes in January- August. Thus, Socar announced that it dug a new well with a daily flow of 10 metric tonnes of oil at the "Oil Rocks" field on October 9.

Socar's oil production is just a fraction of the total oil production in Azerbaijan, which stood at 42.4mn metric tonnes in 2014. Socar mainly produces oil for domestic consumption, while BP is in charge of exporting oil. The value of Azerbaijan's oil exports more than halved y/y in January-August, to \$6.3bn, on the back of a 50% drop in oil prices in the last year.

## Azerbaijan, Iran mull new freight transport scheme

Iran and Azerbaijan are working on a freight transport scheme that would connect Iran's Persian Gulf ports to Azerbaijan's railway system, according to Abbas Nazari, head of the international transport department of the Iranian State Railway.

"Currently, Iran operates a railway from the Persian Gulf to the port of Amirabad on the Caspian Sea. From there, trains will be put across on the ferry to the port of Baku, and then they will be sent to Russia and Georgia again by railway," he said.

"Every year, over 4,000 trucks run between Azerbaijan and Iran, and the opening of this corridor will turn Azerbaijan and Iran into important transit countries for Russia, Georgia, the Gulf States, and India," he added.

Since August, Azerbaijan and Iran have been working on a number of transport schemes to improve connectivity and prepare for increased trade flows when sanctions on Iran are lifted. A 7km railway connection between the towns of Astara in Iran and Astara in Azerbaijan is also in the works. Azerbaijan-Iran trade is expected to triple from \$500mn a year at the moment to \$1.5bn in 2016.

## Azerbaijan's Benkons starts building juice factory in Russia's Tatarstan

Azerbaijan's Benkons Group has started construction on a juice factory in Sokury village, Tatarstan, according to the Tatarstan Investment Development Agency (TIDA). The investment of more than RUB4bn (€57mn) will produce more



Azerbaijan Export & Investment  
Promotion Foundation



AZERBAIJAN INVESTMENT COMPANY



than 53.8mn litres of juice per year and create over 250 jobs.

TIDA and Benkons signed the agreement on the juice plant in Baku in December. Rustam Minnikhanov, the president of the Republic of Tatarstan, was in attendance at the October 7 ceremony dedicated to the beginning of construction works on the factory.

Benkons Group operates various trade and construction businesses in Azerbaijan, and is the leading exporter of Gilan Holding's products. The latter operates the largest agribusiness in Azerbaijan, producing juices, sauces, compotes, and jellies, among others.

## Azerbaijan halves vehicle imports in Jan-Aug

Azerbaijan's car imports halved y/y to 21,147 vehicles between January and August, according to data from the State Statistical Committee (Azstat). During the same period of 2014, the country had imported 43,276 vehicles.

The value of automotive imports decreased by 41.3% y/y to \$841mn in 2014, because Baku moved to enforce the Euro-4 emission standard in April 2014. This year, the drop in the value of car imports is expected to exceed 60% y/y. Most vehicles imported into Azerbaijan come from Europe through neighbouring Georgia, and are second hand or older cars that do not comply with Euro-4 standards.

The ban on imports of models non-compliant with Euro-4, together with the 34% depreciation of the Azerbaijani manat in February, have led to a depressed demand for used cars in Azerbaijan. And seeing how Azerbaijan is Georgia's leading

market for used cars, accounting for 55% of its neighbour's automotive sales, this also affected Georgia's car exports, which dropped by 66% to \$122mn in January-August.

Over 1.2mn vehicles are registered in Azerbaijan, a country with a population of 9.5mn and poor road infrastructure outside the capital city. By 2025, the number of vehicles is expected to exceed 3mn.

## Socar to sell 17% share in Greek gas distributor Desfa for €100mn

Azerbaijan's state oil company is seeking to sell a 17% share in the Greek gas distributor Desfa for €100mn, according to abc.az.

Socar won the tender for a 66% stake in the Greek utility for €400mn in December 2013, which was part of Athens' privatisation scheme, but has been unable to go through with the deal because the European Commission (EC) blocked the deal, as it violates EU competition laws. Through the purchase, Socar would become both the supplier and distributor of gas, which would hinder competition in the transmission market, according to the EC.

With a 49% stake, Socar would no longer hold a controlling stake in the gas distribution company, and the deal could presumably go through. So far, Belgium's Fluxys, which holds a 16% share in the Trans Adriatic Pipeline (TAP), has expressed its interest in acquiring 8% in Desfa, while Holland's Gasunie, Romania's Transgas and Italy's Snam will bid for the full 17% of shares on sale. The deal is not expected to be completed by the end of the year.



## Turkey, Azerbaijan to accelerate TANAP construction

Turkey and Azerbaijan will speed up the construction of the Trans-Anatolian Pipeline (TANAP), Turkish President Recep Tayyip Erdogan told media at the G20 energy ministers' meetings in Istanbul.

One of the key elements of the Southern Gas Corridor (SGC), which is to deliver 16bn cubic meters (bcm) of Azerbaijani gas to Turkey and Europe by 2018- 2019, TANAP will enhance both Azerbaijan's standing as a contributor to Europe's energy security and Turkey's as a transit point for gas from the Caucasus, and possibly Central Asia and Iran in the future.

"While Europe did nothing for the Nabucco project implementation, Azerbaijan started to successfully implement the TANAP project, in which Turkey also has its share," Erdogan told the media.

Construction on the \$10bn pipeline began earlier this year, and is to be completed by 2018. The Azerbaijani state energy company Socar is the majority shareholder (58%) in TANAP, followed by Turkey's Botas (30%) and BP (12%).

## Number of inbound tourists to Azerbaijan up 8.2% to 47,500 in Jun-Aug

The number of foreign tourists visiting Azerbaijan between June and August increased by 8.2% y/y to 47,500, according to data from the Ministry of Culture and Tourism. The majority of visits - 28,000 - occurred during the European Games, which were staged in Baku between June 12 and 28.

Azerbaijan's tourism industry has experienced a downturn this year as a result of the decrease in arrivals from the main source countries - Russia, Turkey, Iran and Georgia, which account for 95% of incoming visitors. As a result, tourism receipts dropped by 12.5% y/y to \$1.1bn in the first six months.

## Azerbaijani exports drop by 87.5% y/y in Jan-Aug

Azerbaijan's exports decreased by 87.5% y/y to \$8.18bn between January and August, according to a report by the State Customs Committee. The drop was prompted by the steep decline in the value of crude oil exports, which amounted to \$6.3bn, down from \$13.12bn in January-August 2014.

Oil prices more than halved in the last year, and affected the highly energy-dependent Azerbaijani economy, where hydrocarbons account for 40% of GDP, 95% of goods exports and more than 50% of budget revenues.

Other energy exports also dropped in the said period - oil products from \$867mn in January-August 2014 to \$534mn this year and natural gas from \$225mn to \$159mn. Virtually all of Azerbaijan's other exports saw significant decreases this year, with the exception of aluminium, which increased from \$53mn to \$58mn, and chemical products from \$45mn to \$70mn.

Meanwhile, exports of agricultural products also declined - tea from \$19mn to \$10mn; sugar from \$156mn to \$152mn; cooking oil from \$142mn to \$101mn; alcoholic and non-alcoholic drinks from \$21mn to \$16mn; and fruit and vegetables from \$147mn to \$143mn.

Conversely, imports increased from \$5.6bn in January-August 2014 to \$5.9bn, resulting in a narrowing of trade surplus from \$9.7bn in the first eight months of 2014 to \$2.28bn.

## **WB to finish prelim work on \$400mn Azerbaijan power project by yr-end**

The World Bank (WB) is seeking to complete preliminary work on the Azerbaijan power distribution modernisation project by the end of the year, its Baku office told local press on September 25.

The \$400mn project aims to improve electricity distribution and transmission in Azerbaijan, with a focus on the regions, which will receive 70% of the funds.

Projects such as this one are important because the regions of Azerbaijan remain underdeveloped, and infrastructure shortcomings are hampering economic development and job creation.

The WB will finance \$300mn out of \$400mn through the International Bank for Reconstruction and Development (IBRD). Earlier this year, the Azerbaijani government announced plans to raise loan financing in several tranches in order to rebuild entirely the grid in selected pilot regions.

According to a new country strategy released in July, the WB's cooperation with Azerbaijan between 2015-2020 will focus on public sector management and service delivery and economic competitiveness. The WB Group has funded over 55 projects in the country since 1992 to the tune of \$3bn.