

Republic of Azerbaijan: 2010 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Azerbaijan

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2010 Article IV consultation with the Republic of Azerbaijan, the following documents have been released and are included in this package:

- The staff report for the 2010 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 3, 2010, with the officials of the Republic of Azerbaijan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 19, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its May 3, 2010, discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for the Republic of Azerbaijan.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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SUMMARY AND STAFF APPRAISAL

The Azerbaijani economy has withstood the impact of the global financial crisis relatively well, but has not been immune to it.

- In 2009, overall GDP grew at 9.3 percent, but non-oil GDP growth slowed from 16 to 3 percent, fiscal and export revenues fell by more than 30 percent, and credit and liquidity conditions tightened substantially.
- Due to the authorities' appropriate policy response, the exchange rate remained stable, inflation dropped dramatically, official poverty rates continued to fall, and financial stability was maintained.
- In 2010, overall GDP growth will slow down to 2.7 percent, driven by nearly flat oil GDP growth, but non-oil GDP growth is expected to recover to 4.2 percent. Inflation could increase slightly to 4 percent, with the exchange rate expected to remain stable.

IMF staff made the following policy recommendations:

- **On fiscal policy**, additional oil fund resources should not be used to increase spending in 2010, even if oil prices turn out to be higher than budgeted, given the scope to improve public expenditure efficiency and the need to ensure medium-term fiscal sustainability in light of the short-lived oil boom.
- **On the financial sector**, rising nonperforming loans need to be addressed, but liquidity support should be withdrawn as financial sector health improves, so as to limit fiscal risks and prevent a pickup in inflation. If additional support were to become necessary, the implied quasi-fiscal costs should be made transparent by requiring that any such support originates directly from the budget.
- **On the exchange rate**, the U.S. dollar peg will remain appropriate in the short term, while more flexibility will become beneficial in the medium term.
- **On structural reforms**, economic diversification should be accelerated through further improvements in the business climate, in particular, through further tax and customs modernization and structural financial sector reforms.

The Azerbaijani authorities broadly agreed with the policy recommendations.



INTERNATIONAL MONETARY FUND

REPUBLIC OF AZERBAIJAN

STAFF REPORT FOR THE 2010 ARTICLE IV CONSULTATION

Approved by Ratna Sahay (MCD)
and David Marston (SPR)

April 19, 2010

Prepared by an IMF mission team of the Middle East and Central Asia Department (MCD), which visited Baku during February 18–March 3, 2010. The staff team comprised Ms. Oomes (head), Mr. Gvenetadze, Ms. Mineshima, and Mr. Westelius, and was assisted by Ms. Gadirli and Mr. Mahmud (IMF Baku office). Ms. Ratna Sahay, Deputy Director of MCD, joined the mission for the policy discussions.

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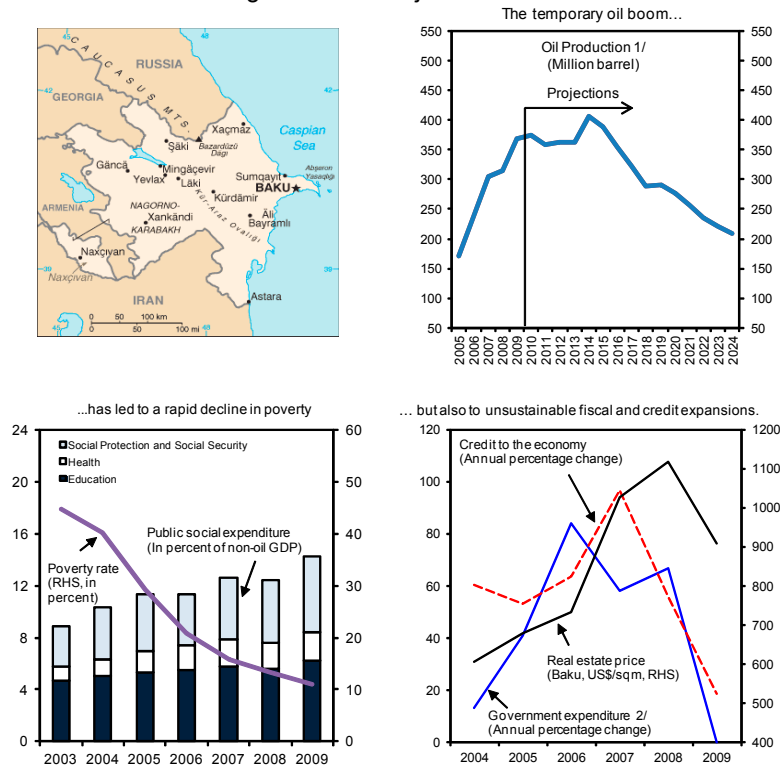
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I. BACKGROUND

- Major expansions in oil and gas production and large increases in public expenditure generated spectacular growth rates, averaging 20 percent during 2003–08, combined with a rapid decline in official poverty rates, from 45 percent in 2003 to 11 percent in 2009.¹ However, the oil boom also led to high inflation, unprecedented credit growth, and unsustainably high non-oil fiscal deficits.
- While the oil boom has created extraordinary opportunities for economic and social development, it is highly temporary in nature. Oil production is expected to peak in 2014, and oil reserves are expected to be exhausted in 20–25 years unless new discoveries are made.
- The de jure exchange rate regime has been a peg to a euro-dollar basket since March 2008, but the de facto regime has been stabilized against the U.S. dollar since June 2008 (see Informational Annex I).
- The last Article IV consultation was concluded on May 23, 2008. The staff report was published and can be found at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22135.0>. The next Article IV consultation is expected to take place on the standard 12-month consultation cycle.

Figure 1. Azerbaijan: Overview



Sources: Azerbaijani authorities; and Fund staff estimates.

1/ Includes oil production of the Azerbaijan International Operating Company (AIOC) only.

2/ Excludes foreign financed projects.

¹ Given its high per capita income (consistently above the International Development Association (IDA) operational cutoff for a number of years), the favorable medium-term outlook, and its relative resilience to external shocks, Azerbaijan is—from April 2010—no longer eligible for concessional IMF loans under the Poverty Reduction and Growth Trust (PRGT).

II. IMPACT OF THE CRISIS

1. The Azerbaijani economy has thus far withstood the impact of the world economic and financial crisis relatively well.

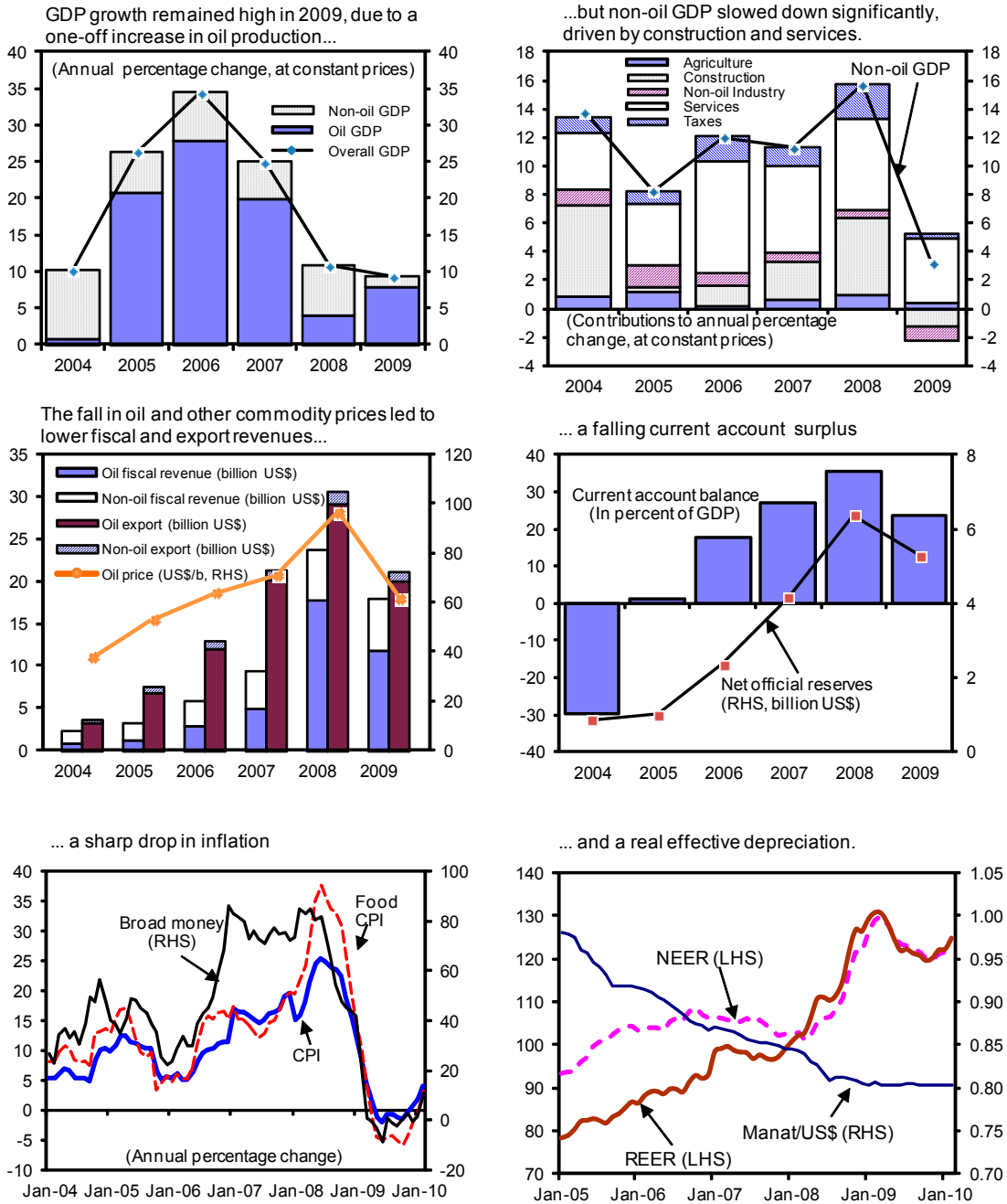
- The economy grew at an impressive 9.3 percent during 2009, driven by a pickup in oil production growth,² as well as continued growth in services and agriculture.
- Inflation fell dramatically, from more than 20 percent in 2008 to 1.5 percent in 2009, driven by falling international commodity prices, and lower domestic and external demand.
- Despite mounting depreciation expectations in early 2009, the Central Bank of Azerbaijan (CBA) successfully intervened to keep the exchange rate pegged against the U.S. dollar, which helped to reduce inflation, prevented further dollarization, and avoided a negative impact on households' and banks' balance sheets. While the CBA's gross international reserves fell by 16 percent as a result of its interventions, they remained comfortable at US\$5.4 billion (4.8 months of imports of goods and services) at end-2009.
- The official unemployment rate remained stable, and the official poverty rate declined further from 13 percent in 2008 to 11 percent in 2009, reflecting lower inflation and higher social spending.

2. Nevertheless, Azerbaijan has not been immune to the impact of the global crisis.

- The large drop in oil prices caused fiscal oil revenues to fall by 35 percent during 2009. Non-oil revenues remained roughly at their 2008 level, but were 17 percent lower than budgeted.
- The large drops in international commodity prices also caused total exports to fall by over 30 percent during 2009. Non-oil exports fell by about 22 percent, but there was no clear evidence of a loss in market share. Combined with falling remittances, the fall in exports reduced the current account surplus from 35 percent in 2008 to 24 percent of GDP in 2009.
- A number of state-owned enterprises (SOEs) and banks faced difficulties rolling over short-term foreign liabilities, which triggered a liquidity shortage in the banking system, and contributed to a sharp decline in credit growth.
- Non-oil GDP growth slowed down from 15.7 percent in 2008 to 3 percent in 2009, with falling output in construction and non-oil manufacturing sectors, further depressing demand for credit and further causing loan portfolios of banks to deteriorate.
- IMF staff expects non-oil GDP growth to recover to 4.2 percent in 2010, but overall GDP growth to slow down to 2.7 percent. Given that existing oil fields have already reached their maximum production capacity, oil GDP is projected to grow by only 1.3 percent. Inflation is expected to increase to 4 percent, reflecting the recovery of the non-oil sector and the rise in international commodity prices. Growth and inflation will be lower if businesses remain pessimistic or external demand recovers only modestly.

² Oil GDP growth increased from 7 percent in 2008 to 15 percent in 2009, largely due to a one-off resumption in oil production at the Azeri-Chirag-Gunashli (ACG) oilfield in the Caspian Sea, following a temporary shutdown in late 2008 in response to a natural gas leakage, combined with a pickup in oil production from a new platform at Deepwater Gunashli.

Figure 2. Azerbaijan: Impact of the Crisis



Sources: Azerbaijani authorities; and Fund staff estimates.

III. FISCAL POLICY: RETURNING TO A SUSTAINABLE PATH

3. In 2009, the government responded to the crisis with a number of fiscal policy measures that allowed the non-oil deficit to remain broadly unchanged.

- Despite the large drop in oil prices, the budgeted transfer of resources from the State Oil Fund of Azerbaijan (SOFAZ) was fully implemented, which limited the overall revenue impact.
- To support SOEs that faced difficulties with repaying foreign debt obligations resulting from the drop in commodity prices, the government provided a capital injection and a government-guaranteed loan to the state oil company (SOCAR), and another such loan to the state-owned aluminum company, in total amounting to US\$1.4 billion (3.2 percent of GDP).
- To support economic activity, profit and income tax rates were cut in 2009, effective 2010, and access to the simplified tax regime was increased by raising the VAT threshold.³
- The government adjusted for the fall in revenues by cutting non-priority spending and by financing only ongoing capital investment projects in 2009 (Figure 3). As a result, the non-oil fiscal deficit remained broadly unchanged, while the government was still able to increase social spending by 1.8 percentage points of non-oil GDP, mostly for education and social protection.

4. IMF staff welcomed the conservative 2010 budget and the authorities' renewed commitment to fiscal sustainability, and made the following recommendations:

- Even if oil prices turn out to be higher than budgeted, additional oil fund resources should not be used to increase government spending given (i) the available room to improve the quality and efficiency of spending, and (ii) the need to significantly reduce the non-oil deficit to secure medium-term fiscal sustainability.⁴ Estimates of a positive non-oil output gap, while subject to the usual caveats (e.g., WP/06/68), also support a contractionary fiscal stance in 2009 and 2010.
- To gradually reduce expenditure, the government should (i) improve expenditure efficiency by increasing budget transparency and tightening procurement procedures, particularly for public investment; (ii) lower the current expenditure burden through pension and civil service reform, and better-targeted public services and social safety nets; and (iii) reduce the financial support to SOEs by improving their financial discipline and by better monitoring their quasi-fiscal activities.
- To increase non-oil revenues, the government should further reduce exemptions, simplify the tax system, and strengthen risk management approaches, along with other measures (Section VI).

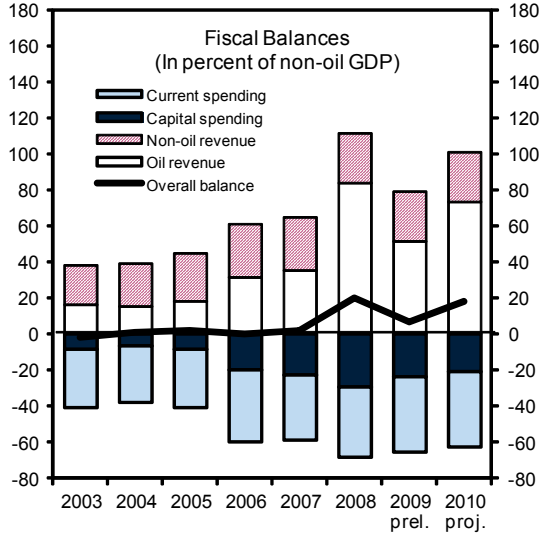
Given the caveats involved in output gap estimation, the authorities were not convinced that the output gap was still positive, but they agreed on the medium-term fiscal consolidation path, as well as on the expenditure and revenue reforms, which they stressed would take many years.

³ Effective January 1, 2010, the profit tax rate was reduced from 22 to 20 percent, and the maximum personal income tax rate was reduced from 35 to 30 percent for labor income, and from 35 to 20 percent for the self-employed. At the same time, the VAT threshold was increased from 23,500 manat per quarter to 150,000 manat per year. The Tax Ministry estimates that these measures imply about a 100 mln manat reduction in tax revenues, but that this will be offset by an increase in compliance.

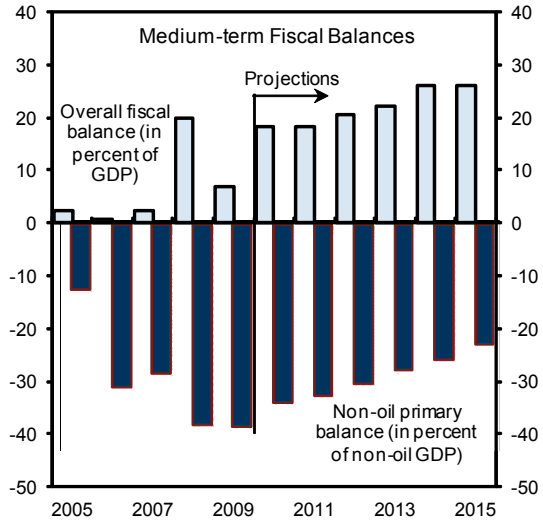
⁴ The estimated sustainable non-oil deficit (Figure 3) is derived from a permanent income model for oil revenue, which aims at a sustainable level of constant real spending. A similar definition is used in the government's Long Term Oil Revenue Management Strategy (LTORMS), which was developed in 2004 with IMF assistance, and is supported by the World Bank.

Figure 3. Azerbaijan: Fiscal Indicators

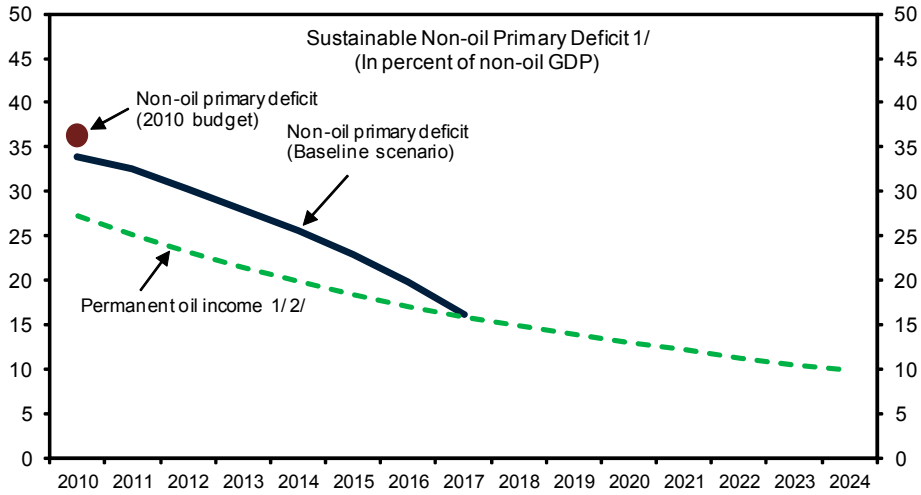
In response to a large drop in oil revenue, the government cut nonpriority capital expenditure, but the overall fiscal surplus declined in 2009...



...while the non-oil primary fiscal deficit remained broadly unchanged.



However, the government needs to significantly reduce the non-oil deficit to secure fiscal sustainability.



1/ Permanent oil income is calculated as the real return on public sector net assets (oil fund + NPV of oil revenue - public sector debt). The discount factor and real investment return are assumed to be 3.5 percent and 3 percent, respectively. The results are sensitive to these assumptions.

2/ Oil price projections are based on the IMF's *World Economic Outlook*, and are assumed to be

Sources: Azerbaijani authorities; and Fund staff estimates.

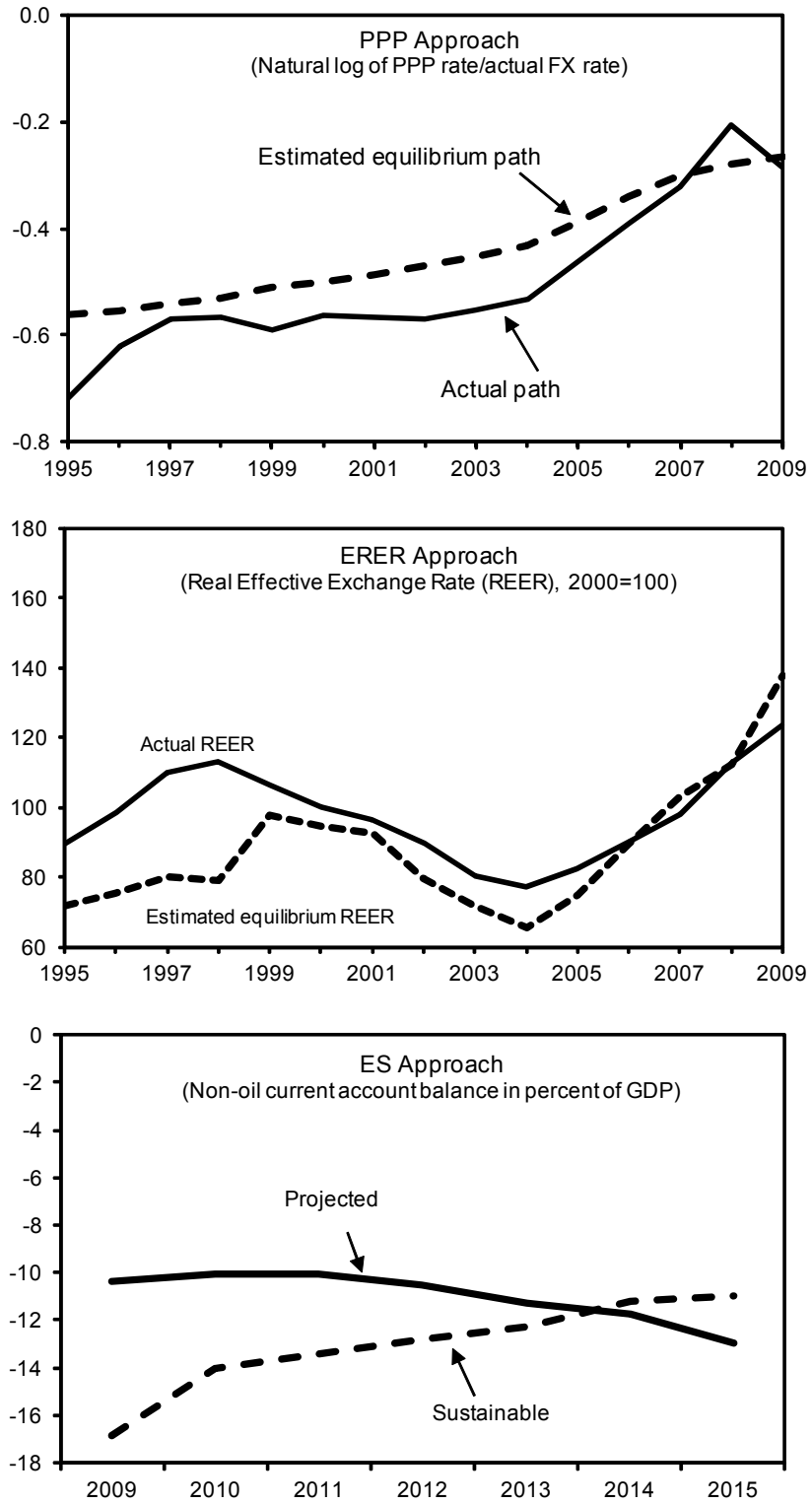
IV. EXCHANGE RATE POLICY: MAINTAINING STABILITY

- 5. Following the transition in March 2008 to a euro-dollar basket peg, the CBA first increased and then reduced the weight on the euro, implying a de facto peg against the dollar.**
- Mounting expectations of exchange rate depreciation in early 2009, fueled by the large depreciations in other countries in the region, caused large deposit outflows and an increase in dollarization, creating additional liquidity pressures for banks.⁵
 - Despite the strong depreciation pressures, the CBA successfully defended the de facto peg against the dollar by making foreign exchange sales of more than US\$1 billion (16 percent of reserves) in February and March 2009. As a result, dollarization was reduced, deposits returned, and a negative impact on households' and banks' balance sheets was avoided.
- 6. IMF staff advised that exchange rate stability will remain appropriate in the short term, while more flexibility will become beneficial in the medium term:**
- Due to the dramatic drop in inflation, the real exchange rate remained close to equilibrium in 2009, or even became somewhat undervalued. Staff estimates based on the Purchasing Power Parity (PPP) approach, External Sustainability (ES) approach, and Equilibrium Real Exchange Rate (ERER) approach all suggest slight undervaluation in 2009, by 4, 6, and 10 percent, respectively (Figure 4).
 - In the short term, there are clear benefits from continuing to peg to the U.S. dollar, given that a significant share of trade is U.S.-dollar denominated, the volatility of capital flows is relatively low, there is a need to stabilize expectations given the recent history of high inflation and high dollarization, and no strong real appreciation or depreciation pressures are expected.
 - In the medium term, however, the benefits from more flexibility will increase as the economy becomes more diversified and more integrated with international capital markets. Based on the ES approach—which defines the sustainable non-oil current account deficit as a constant annuity on Azerbaijan's net foreign assets, including the present value of oil and gas wealth—the non-oil current account deficit is expected to start exceeding the sustainable level after 2014. This underlines the importance of developing a strategy to promote non-oil exports (Section VI).
 - There are several conditions for moving to further exchange rate flexibility, some of which may only be fully met after more flexibility is, in fact, introduced. A first condition is to strengthen monetary policy, including through increased central bank independence, more flexible and responsive policymaking and policy coordination, and the development of a new credible nominal anchor to replace the peg. A second condition is to improve exchange rate risk management by market participants, including through tighter prudential regulation and supervision. Third, to avoid excessive volatility during the transition, a deep and liquid foreign exchange market needs to be developed, with a reduced market role for the public sector and a coherent intervention strategy.

The authorities fully agreed with the exchange rate assessment, and looked forward to further discussions on the timing, modalities, and conditions for increasing flexibility.

⁵ Total deposits fell by 30 percent during the first quarter of 2009, while the deposit dollarization ratio for private banks increased from 34 to 52 percent between September 2008 and June 2009, after which it fell back to 44 percent by end-2009.

Figure 4. Azerbaijan: Equilibrium Exchange Rate Estimates



Sources: WEO, IFS, and IMF staff estimates.

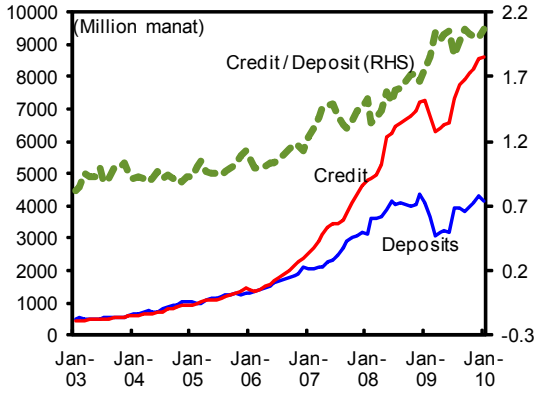
V. MONETARY AND FINANCIAL SECTOR POLICIES: ENSURING FINANCIAL STABILITY

- 7. During 2009, the CBA successfully maintained financial stability by keeping the exchange rate stable and providing liquidity support to the banking system.**
- To address the tightening of liquidity and credit conditions, the CBA reduced the reserve requirement on deposits from 12 to 0.5 percent, and cut the refinancing rate from 15 to 2 percent between September 2008 and December 2009 (Figure 5). In addition, the CBA allowed the Azerbaijan Mortgage Fund (AMF) to resume its lending activity from July 2009, financed through budget transfers and by the issuance of long-term AMF bonds.
 - Overall, the CBA provided about US\$1.1 billion (2.6 percent of GDP) in liquidity support to banks, and another US\$1.1 billion in government-guaranteed credit to the state-owned International Bank of Azerbaijan (IBA) for onlending to the state oil and aluminum companies, which required an amendment of the central bank law. In addition, banks and insurance companies were exempted from tax on profits used for recapitalization from 2009 onwards.
 - To further boost confidence in the banking system, the deposit insurance coverage was increased significantly in June 2009, including by raising the deposit limit from 6,000 to 30,000 manat (7.8 times GDP per capita).
- 8. IMF staff advice focused on the need to remain vigilant, while working on an exit strategy:**
- While nonperforming loans remain low, they have been rising and are likely to be underestimated. The authorities should, therefore, continue to closely monitor the banking system and strengthen banking supervision by periodically assessing balance sheets, dealing with nonperforming loans on a timely basis, and improving risk management and corporate governance.
 - As financial sector health improves and credit growth resumes, liquidity support should be gradually withdrawn so as to limit fiscal risks and prevent a pickup in inflation. If additional support were to become necessary, this should originate directly from the government budget rather than from the CBA, so as to make transparent the implied quasi-fiscal costs and limit any conflict of interest with the CBA's supervisory responsibilities.
 - Despite the significant reduction in the refinancing rate and the fall in inflation, average deposit and lending rates remain high, keeping credit and liquidity conditions tight. To bring down interest rates, the authorities should (i) make monetary policy transmission more effective, including by deepening the secondary market for government securities; (ii) facilitate the recovery of collateral by banks; and (iii) increase competition in the banking system, including by privatizing IBA within the next few years, as its market dominance (nearly 50 percent of total banking system assets) and extensive lending to SOEs distorts competition and crowds out private credit.

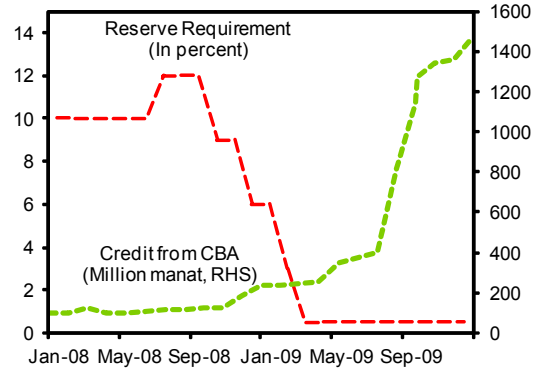
The authorities agreed on the exit strategy, but preferred not to finance any needed further support directly from the budget, as this would require a supplementary budget and could prevent a swift policy response. While the CBA was of the view that interest rates are largely market-determined, the authorities agreed on the proposed monetary and financial sector reforms, including on the need to privatize IBA in the next few years.

Figure 5. Azerbaijan: Financial Sector Developments

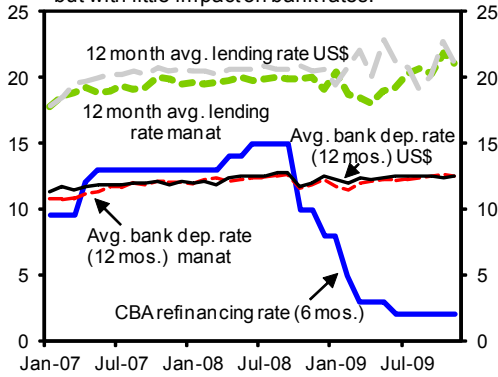
The credit-to-deposit ratio rose significantly as banks increased their reliance on foreign borrowings.



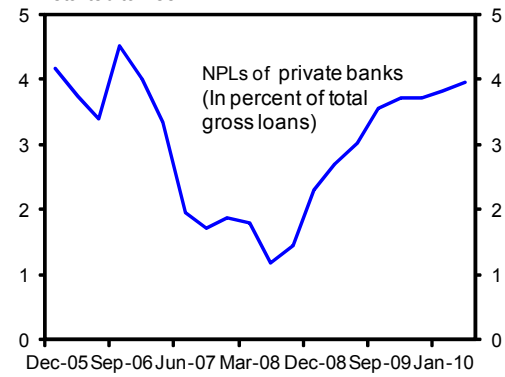
As liquidity and credit conditions tightened, the CBA provided liquidity support...



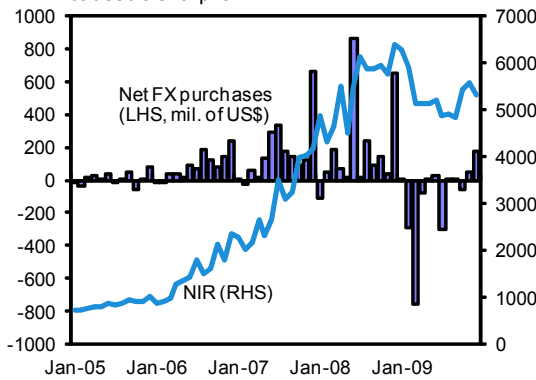
...and reduced its policy rate, but with little impact on bank rates.



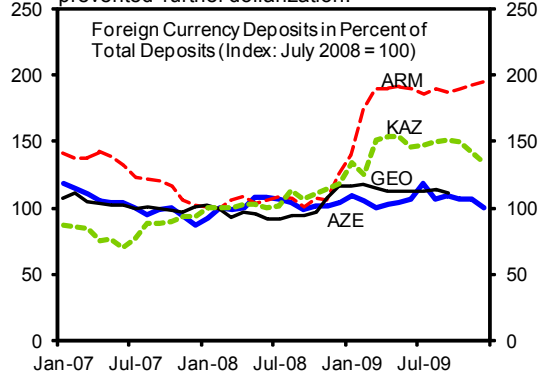
Nonperforming loans (NPLs) started to rise...



...and increased depreciation expectations caused a sharp fall in NIR



....but the commitment to the peg prevented further dollarization.



Sources: Azerbaijani authorities; and Fund staff estimates.

VI. AZERBAIJAN'S MAIN MEDIUM-TERM CHALLENGE: DEVELOPING THE NON-OIL ECONOMY

9. **The unexpected fall in oil revenues and the sharp slowdown in the non-oil economy in 2009 have once again illustrated the crucial importance of accelerating reforms to diversify the economy and improve the medium-term outlook for Azerbaijan.**
- Starting from 2010, oil production will no longer be the main source of growth (with the exception of 2014, when the Chirag oil field becomes operational), while non-oil growth will likely no longer be boosted by oil-fueled demand for nontradables. Non-oil exports, which currently account for only 5 percent of total exports, will therefore need to take over as the driver of the economy in the medium term.
 - Azerbaijan's *Doing Business* ranking improved significantly in 2009, from 97 to 33 out of 183 countries, driven by the establishment of a "one-stop shop," a more flexible labor code, and improvements in contract enforcement. However, the country continued to score poorly in the areas of paying taxes, trading across borders, and dealing with licenses. Moreover, Transparency International's 2009 Corruption Perception Index remained high at 143 out of 180 countries, while important anti-monopoly and investment legislation were recently withdrawn from Parliament.
10. **IMF staff recommended that, rather than aiming to stimulate specific export sectors, the most effective way to develop non-oil exports is through further improving the business environment, including through tax, customs, and financial sector reforms:**
- Further progress with tax and customs reforms is crucial for improving the business environment. Regarding tax reforms, the recently introduced tax cuts and the sophisticated electronic tax filing system have already reduced some of the tax burden on businesses,⁶ but further progress with risk management approaches and reducing exemptions is needed to create a level playing field for all businesses. Regarding customs reforms, the authorities' continued commitment to join the World Trade Organization (WTO) is welcome, as this requires further improvements in customs legislation and administration, regulations for customs valuation, and customs tariff policy.
 - Further progress with structural financial sector reforms is needed to (i) improve access to credit for the non-oil sector, including through increasing the availability of borrower information to creditors, and accelerating the ability of creditors to access collateral in the event of default; (ii) gradually eliminate directed credit and interest rate subsidies to SOEs; (iii) foster banking sector consolidation through prudential and other means to increase capitalization, efficiency, and confidence; (iv) increase competition in the banking sector by privatizing IBA and encouraging the entry of strategic investors; and (v) address the remaining deficiencies in the area of anti-money laundering and combating terrorist financing (AML/CFT).⁷

The authorities broadly agreed with the recommendations, and are committed to developing a non-oil export strategy that focuses on improving the business environment.

⁶ According to the authorities, 99 percent of registered VAT payers and 87 percent of all tax payers filed their tax returns electronically during 2009, and by end-2010, 30 tax terminals will have been built to assist taxpayers with e-filing.

⁷ These include bringing the AML/CFT legislation in line with international standards, making the Financial Intelligence Unit fully operational, boosting domestic coordination, and ensuring that the AML/CFT provisions are implemented more effectively.

BOX 1: MEDIUM-TERM OUTLOOK FOR DEBT SUSTAINABILITY

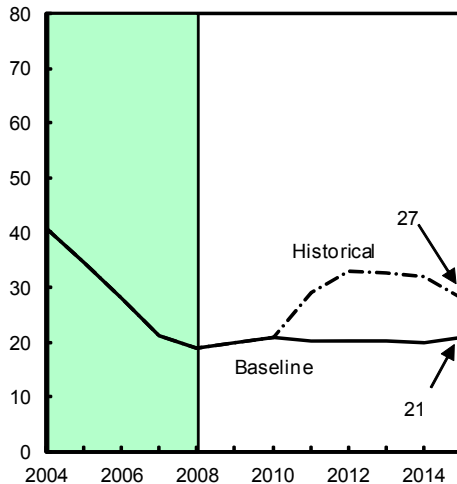
External debt in percent of GDP has declined substantially since oil production took off in 2005, and is expected to remain low in the medium term.

- Since 2005, the Azerbaijani government has been able to use its rapidly growing oil revenues to finance a large part of domestic investment projects, which reduced external debt from 40 percent of GDP in 2004 to 20 percent in 2009.
- The government's intention to issue US\$500 million in Eurobonds in 2010 would set a useful benchmark for companies looking to raise funds in international capital markets, while keeping external debt broadly stable at about 20 percent of GDP in the medium term. Even if key variables return to their 2000-09 historical levels, external debt would remain below 30 percent.

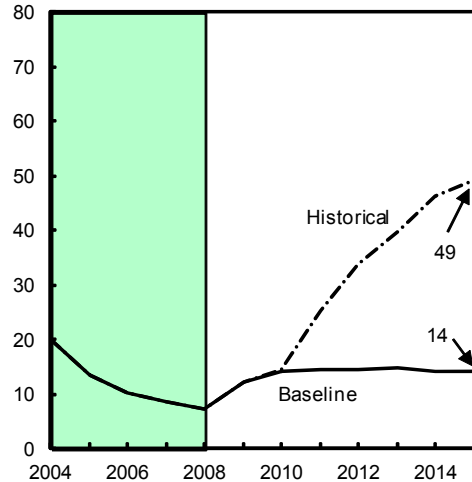
Public and publicly guaranteed debt will remain low as well, but may increase moderately in the medium term.

- The government-guaranteed loans extended to the state oil and aluminum companies in 2009 caused public-sector domestic debt to increase by about 2.7 percent of GDP.
- The government's plan to increase the issuance of both T-bills and longer-term government securities is a welcome measure to further develop securities markets. While public and publicly guaranteed debt would increase moderately over the medium term, it is expected to remain low at around 14 percent of GDP. However, public debt could go up to 50 percent if fiscal parameters were to return to their historical 2000–09 levels.

External Debt-Sustainability Analysis
(In percent of GDP; baseline and historical scenarios)¹



Public Debt-Sustainability Analysis
(In percent of GDP; baseline and historical scenarios)¹



Sources: International Monetary Fund, country desk data, and staff estimates.

^{1/} The historical scenario assumes that key variables (for the external DSA: real GDP growth, nominal interest rate, dollar GDP deflator growth, non-interest current account and non-debt inflows in percent of GDP; for the public DSA: primary fiscal deficit, real GDP growth, nominal and real interest rates, GDP deflator growth, and revenue to GDP ratio) are at their 2000-09 historical averages during 2010-15.

Table 1. Azerbaijan: Selected Economic and Financial Indicators, 2005–10

	2005	2006	2007	2008	2009 Prel.	2010 Proj.
(Annual percentage change, unless otherwise specified)						
National income						
GDP at constant prices	26.4	34.5	25.0	10.8	9.3	2.7
<i>Of which:</i> Oil sector 1/	65.4	62.0	37.3	6.9	14.8	1.3
Non-oil sector 2/	8.2	12.1	11.3	15.7	3.0	4.2
GDP at current prices	46.8	49.7	51.3	34.0	-9.0	20.3
Implicit GDP deflator	16.1	11.3	21.0	20.9	-16.8	17.2
Consumer price index (end of period)	5.5	11.4	19.5	15.4	0.9	4.0
Consumer price index (period average)	9.7	8.4	16.6	20.8	1.5	4.7
Consolidated central government finance						
Total revenue	36.9	67.5	52.6	142.6	-26.0	39.7
<i>Of which:</i> Non-oil revenue	34.9	34.5	43.2	30.4	1.7	12.5
Total expenditure	28.7	80.9	43.3	60.8	1.7	3.7
<i>Of which:</i> Current expenditure	22.8	50.9	33.5	48.3	12.2	9.6
Investment expenditure	59.9	203.4	63.1	81.6	-12.7	-6.8
Money and credit						
Net foreign assets	7.5	89.3	46.9	40.5	-17.4	12.4
Net domestic assets	47.9	82.7	106.4	47.4	15.1	16.7
Domestic credit	50.2	74.4	95.5	36.8	21.5	11.6
<i>Of which:</i> Credit to the economy	53.0	63.6	96.5	55.6	18.4	10.0
Manat base money	7.5	132.6	101.4	48.5	1.7	23.6
Manat broad money	15.8	168.3	107.3	38.2	1.5	18.0
Total broad money	22.1	86.4	72.4	44.0	-0.3	15.0
Foreign currency deposits ratio to broad money	56.9	37.9	25.4	28.4	27.2	25.3
Velocity of total broad money (M3) 3/	5.2	4.8	3.8	3.0	3.1	2.8
External sector (in US\$)						
Exports f.o.b.	104.4	70.1	63.4	43.8	-31.0	32.1
<i>Of which:</i> Oil sector	113.0	75.4	67.2	44.3	-31.5	32.5
Imports f.o.b.	21.4	21.1	14.7	25.3	-14.0	25.0
<i>Of which:</i> Oil sector	18.7	-9.1	-26.2	-17.6	-34.2	28.3
Export volumes	47.8	40.5	47.2	7.5	5.4	9.0
Import volumes	15.4	7.4	2.6	16.1	-0.7	17.1
Terms of trade	17.0	11.6	4.3	24.0	-24.4	13.5
Real effective exchange rate	6.8	9.2	9.0	14.3	10.8	...
(In percent of GDP, unless otherwise specified)						
Gross investment	41.5	29.9	21.5	19.8	18.9	17.9
Consolidated government	4.1	8.6	9.7	13.2	12.7	9.8
Private sector	37.4	21.2	11.8	6.6	6.3	8.1
<i>Of which:</i> Oil sector	17.6	7.8	3.6	2.9	2.0	3.0
Gross national savings	42.8	47.5	48.8	55.3	42.5	43.2
Consolidated government	7.0	8.8	12.4	34.0	19.5	28.1
Private sector 4/	35.8	38.7	36.4	21.3	23.0	15.1
Consolidated central government finance						
Overall fiscal balance	2.6	-0.2	2.6	20.8	6.8	18.3
Non-oil primary balance, in percent of non-oil GDP	-12.6	-31.1	-28.3	-38.2	-38.5	-34.0
External sector						
Current account (- deficit)	1.3	17.6	27.3	35.5	23.6	25.3
Foreign direct investment (net)	3.5	-6.1	-15.4	-1.2	0.3	1.0
Public and publicly guaranteed external debt outstanding	12.5	9.4	7.7	6.5	7.9	10.2
Memorandum items:						
Gross official international reserves (in millions of U.S. dollars)	1,178	2,500	4,273	6,467	5,364	6,652
Nominal GDP (in millions of manat)	12,523	18,746	28,361	38,006	34,579	41,596
Nominal non-oil GDP (in millions of manat) 2/	7,002	8,655	12,446	17,431	18,322	20,003
Nominal GNP per capita (in U.S. dollars)	1,347	2,107	3,182	4,621	4,415	5,295
Oil Fund Assets (in millions of U.S. dollars) 5/	1,394	1,915	3,106	11,380	15,045	26,408
Population (mid-year, in millions)	8.6	8.7	8.8	8.9	9.0	9.0
Exchange rate (manat/dollar, end of period)	0.919	0.871	0.845	0.801	0.803	...

Sources: Azerbaijani authorities; and Fund staff estimates and projections.

1/ Includes the production and processing of oil and gas.

2/ Includes the transportation of oil and gas (except transportation through the western route), as well as the export tax paid by the state oil company.

3/ Defined as gross domestic demand (excluding oil sector-related imports) divided by average broad money.

4/ Historical data includes statistical discrepancy.

5/ Includes the central government foreign exchange deposits managed by the Oil Fund.

Table 2. Azerbaijan: Balance of Payments, 2005–10
(In millions of U.S. dollars, unless otherwise specified)

	2005	2006	2007	2008	2009 Prel.	2010 Proj.
Exports, f.o.b.	7,649	13,015	21,269	30,586	21,097	27,874
Oil and oil products	6,883	12,075	20,190	29,143	19,970	26,465
Other	766	939	1,079	1,443	1,127	1,409
Imports, f.o.b.	-4,350	-5,269	-6,045	-7,575	-6,514	-8,144
Oil sector	-1,927	-1,752	-1,292	-1,064	-700	-898
Others	-2,423	-3,517	-4,753	-6,511	-5,814	-7,246
Trade balance	3,299	7,745	15,224	23,012	14,583	19,730
Services, net	-1,970	-1,923	-2,131	-2,343	-1,613	-3,464
Credit	683	940	1,248	1,547	1,776	1,717
Debit	-2,653	-2,863	-3,379	-3,889	-3,389	-5,180
Oil sector	-1,658	-1,602	-1,851	-1,970	-1,205	-3,410
Income	-1,646	-2,681	-5,079	-5,266	-3,519	-3,923
Investment income, net	-1,666	-2,684	-5,024	-5,200	-3,421	-3,817
Of which : profit of oil consortium	-1,422	-2,375	-4,815	-5,040	-2,937	-3,810
Compensation of employees, net	21	3	-55	-66	-98	-105
Transfers, net	484	566	1,005	1,050	722	776
Private	369	504	911	999	686	711
Public	115	62	94	51	35	65
Current account balance	167	3,708	9,019	16,454	10,173	13,120
Capital account, net	41	-4	-3	11	9	6
Direct investment, net	459	-1,289	-5,035	-541	147	505
Abroad, net	-1,221	-705	-286	-556	-326	-512
Oil sector	-1,217	-689	-281	-465	-156	-342
In reporting economy, net	1,680	-584	-4,749	15	473	1,017
Oil sector, net	1,459	-963	-5,182	-581	-274	120
Credit	4,246	4,101	3,919	3,343	2,147	3,868
Debit	-2,787	-5,064	-9,102	-3,924	-2,422	-3,748
Others, net	221	379	433	596	747	897
Portfolio investment, net	31	-12	-26	-347	-139	441
Other investment	64	-393	-660	-2,658	-6,036	-1,406
Assets, net	-890	-1,006	-1,534	-3,585	-5,654	-3,265
Liabilities, net	954	613	875	927	-383	1,860
General government	38	80	139	166	109	1,195
Government guaranteed	74	1	230	342	176	170
Others, net	842	531	505	418	-667	496
Oil sector	768	275	-455	-86	-938	150
Others	74	256	961	505	271	346
Financial account, net	554	-1,695	-5,720	-3,547	-6,028	-460
Capital and financial account balance	595	-1,698	-5,723	-3,536	-6,019	-454
Errors and omissions	-126	-256	-361	-846	-1,463	--
Overall balance	636	1,753	2,935	12,072	2,691	12,666
Financing	-636	-1,753	-2,935	-12,072	-2,691	-12,666
Change in net foreign assets of CBA (increase -)	-161	-1,342	-1,781	-2,460	1,089	-1,303
Net credit from the Fund	-29	-37	-37	-22	-14	-15
Disbursements/purchases	20	--	--	--	--	--
Repayments/repurchases	-48	-37	-37	-22	-14	-15
Change in gross official international reserves (increase -)	-132	-1,305	-1,745	-2,438	1,104	-1,288
Change in Oil Fund assets (increase -) 1/	-476	-411	-1,154	-9,612	-3,665	-11,363
Memorandum items:						
Current account balance (in percent of GDP)	1.3	17.6	27.3	35.5	23.6	25.3
Gross official international reserves	1,178	2,500	4,273	6,467	5,364	6,652
Oil Fund assets 1/	1,394	1,915	3,106	11,380	15,045	26,408
Public and publicly guaranteed external debt stock (in percent of GDP)	12.5	9.4	7.7	6.5	7.9	10.2
Private sector debt (in percent of GDP)	22.2	18.7	13.6	12.6	12.0	11.0
WEO oil price (US\$ per barrel)	53.3	64.3	71.1	97.0	61.8	80.0
Exchange rate (average, AZN/\$)	0.945	0.892	0.857	0.819	0.802	...

Sources: Azerbaijani authorities; and Fund staff estimates and projections.

1/ Includes the central government foreign exchange deposits managed by the Oil Fund.

Table 3. Azerbaijan: Consolidated Central Government Operations, 2005-10
(In millions of manat)

	2005	2006	2007	2008	2009		2010	
					Budget	Prel.	Budget	Staff Proj. 5/
Total revenue and grants	3,143	5,253	8,007	19,426	16,444	14,368	11,941	20,073
Total revenue	3,132	5,248	8,007	19,426	16,444	14,368	11,941	20,073
Tax revenue	1,902	3,341	5,635	7,176	7,657	5,591	5,544	6,663
Income taxes	673	1,768	3,046	3,490	3,114	1,911	1,776	2,529
Individual income tax	317	407	589	627	900	582	680	680
Enterprise profits tax	355	1,361	2,458	2,862	2,214	1,329	1,096	1,849
Social security contributions	198	294	551	599	821	582	696	696
Value added tax (VAT)	600	738	1,179	1,911	2,295	2,013	1,876	2,113
Domestic	346	386	644	1,136	1,395	1,180	1,078	1,239
Imports	254	351	535	775	900	832	798	874
Excise taxes	141	187	403	487	485	485	552	552
Taxes on international trade	205	239	288	450	658	421	378	507
Other taxes	85	115	167	240	284	179	267	267
Nontax revenue 1/	938	1,499	2,209	12,250	8,787	8,777	6,397	13,409
Of which: Oil Fund revenues 2/	596	984	1,871	11,865	8,361	8,274	5,963	12,807
Tax credits for SOCAR energy subsidies	292	408	163	0	0	0	0	0
Total grants (current)	11	5	0	0	0	0	0	0
Total expenditure	2,839	5,134	7,356	11,829	14,210	12,027	12,466*	12,466
Current expenditure	2,281	3,442	4,595	6,816	8,177	7,649	8,386	8,386
Primary current expenditure	1,973	3,021	4,402	6,783	8,040	7,613	8,235	8,235
Wages and salaries	580	745	1,086	1,567	2,045	1,825	1,951	1,951
Goods and services	716	1,285	1,770	3,034	3,132	3,105	3,336	3,336
Transfers	640	884	1,297	1,883	2,552	2,287	2,484	2,484
Of which: social protection fund	495	566	1,038	1,423	1,776	1,706	1,757	1,757
Subsidies	28	41	161	191	302	289	281	281
Oil Fund (operating expenditures)	2	1	4	7	10	10	10	10
Other	7	66	83	102	0	97	173	173
SOCAR energy-related subsidies	292	408	163	0	0	0	0	0
Interest	16	13	30	33	136	36	151	151
Investment expenditure and net lending	558	1,692	2,761	5,014	6,033	4,378	4,080	4,081
Domestically-financed	438	1,427	2,613	4,914	5,272	4,093	3,031	3,032
Foreign-financed	120	265	148	100	761	285	1,049	1,049
Statistical discrepancy	-17	155	-100	-312	21	-26	25	0
Consolidated government balance, cash basis	321	-36	751	7,909	2,213	2,367	-550	7,606
Excluding foreign project loans	441	229	899	8,009	2,974	2,652	499	8,655
Non-oil primary balance 3/	-884	-2,690	-3,525	-6,659	-8,215	-7,058	-7,271	-6,794
Financing	-321	36	-751	-7,909	-2,213	-2,367	550	-7,606
Domestic (net)	-436	-223	-876	-7,934	-2,883	-2,589	-413	-8,972
Banking system	-40	106	12	-838	130	114	200	50
Of which: Treasury bills	16	6	26	8	150	19	200	150
Oil Fund	-339	-353	-959	-7,185	-3,041	-3,018	-668	-9,127
Nonbank sector	12	42	65	66	-52	282	0	50
Privatizations and other sale of assets	20	0	6	23	80	33	55	55
External (net)	115	259	125	25	671	222	963	1,366
Loans	135	274	154	130	761	287	1,049	1,049
Eurobond		0	0	0	0	0	0	402
Memorandum items:								
Oil revenue	1,221	2,667	4,305	14,600	10,564	9,461	6,871	14,552
Non-oil revenue 4/	1,922	2,585	3,701	4,826	5,880	4,907	5,070	5,521

Sources: Azerbaijani authorities; and Fund staff estimates and projections. 5023.10841 18202.2169 13151.7882 11778.6487 8554.53187 18116.9124

1/ Includes contingent revenues accrued on the "deposit account" of budgetary organizations.

2/ Includes profit oil, acreage fees, and income earned on Oil Fund assets. Oil bonuses also enter in the Oil Fund, but these are treated as a financing item.

3/ Defined as non-oil revenue minus total expenditure (excluding interest payments) and statistical discrepancies.

4/ Excludes AIOC profit tax, profit oil, SOCAR profit tax, SOCAR export tax, SOCAR contingency payments, and tax credits for SOCAR subsidies grants, but includes VAT and excise taxes on oil and gas, tax withholding on the Azerbaijan International Oil Company's subcontractors, and SOCAR tax credits for energy subsidies.

5/ Staff projections using the WEO commodity price assumptions.

Table 4. Azerbaijan: Consolidated Central Government Operations, 2005-10
(In percent of non-oil GDP)

	2005	2006	2007	2008	2009		2010	
					Budget	Prel. 5/	Budget	Staff Proj. 5/
Total revenue and grants	44.9	60.7	64.3	111.4	89.7	78.4	59.7	100.3
Total revenue	44.7	60.6	64.3	111.4	89.7	78.4	59.7	100.3
Tax revenue	27.2	38.6	45.3	41.2	41.8	30.5	27.7	33.3
Income taxes	9.6	20.4	24.5	20.0	17.0	10.4	8.9	12.6
Individual income tax	4.5	4.7	4.7	3.6	4.9	3.2	3.4	3.4
Enterprise profits tax	5.1	15.7	19.7	16.4	12.1	7.3	5.5	9.2
Social security contributions	2.8	3.4	4.4	3.4	4.5	3.2	3.5	3.5
Value added tax (VAT)	8.6	8.5	9.5	11.0	12.5	11.0	9.4	10.6
Domestic	4.9	4.5	5.2	6.5	7.6	6.4	5.4	6.2
Imports	3.6	4.1	4.3	4.4	4.9	4.5	4.0	4.4
Excise taxes	2.0	2.2	3.2	2.8	2.6	2.6	2.8	2.8
Taxes on international trade	2.9	2.8	2.3	2.6	3.6	2.3	1.9	2.5
Other taxes	1.2	1.3	1.3	1.4	1.6	1.0	1.3	1.3
Nontax revenue 1/	13.4	17.3	17.7	70.3	48.0	47.9	32.0	67.0
Of which: Oil Fund revenues 2/	8.5	11.4	15.0	68.1	45.6	45.2	29.8	64.0
Tax credits for SOCAR energy subsidies	4.2	4.7	1.3	0.0	0.0	0.0	0.0	0.0
Total grants (current)	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure	40.5	59.3	59.1	67.9	77.6	65.6	62.3	62.3
Current expenditure	32.6	39.8	36.9	39.1	44.6	41.7	41.9	41.9
Primary current expenditure	28.2	34.9	35.4	38.9	43.9	41.6	41.2	41.2
Wages and salaries	8.3	8.6	8.7	9.0	11.2	10.0	9.8	9.8
Goods and services	10.2	14.8	14.2	17.4	17.1	16.9	16.7	16.7
Transfers	9.1	10.2	10.4	10.8	13.9	12.5	12.4	12.4
Of which: social protection fund	7.1	6.5	8.3	8.2	9.7	9.3	8.8	8.8
Subsidies	0.4	0.5	1.3	1.1	1.6	1.6	1.4	1.4
Oil Fund (operating expenditures)	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1
Other	0.1	0.8	0.7	0.6	0.0	0.5	0.9	0.9
SOCAR energy-related subsidies	4.2	4.7	1.3	0.0	0.0	0.0	0.0	0.0
Interest	0.2	0.2	0.2	0.2	0.7	0.2	0.8	0.8
Investment expenditure and net lending	8.0	19.6	22.2	28.8	32.9	23.9	20.4	20.4
Domestically-financed	6.3	16.5	21.0	28.2	28.8	22.3	15.2	15.2
Foreign-financed	1.7	3.1	1.2	0.6	4.2	1.6	5.2	5.2
Statistical discrepancy	-0.2	1.8	-0.8	-1.8	0.1	-0.1	0.1	0.0
Consolidated government balance, cash basis	4.6	-0.4	6.0	45.4	12.1	12.9	-2.8	38.0
Excluding foreign project loans	6.3	2.6	7.2	45.9	16.2	14.5	2.5	43.3
Non-oil primary balance 3/	-12.6	-31.1	-28.3	-38.2	-44.8	-38.5	-36.3	-34.0
Financing	-4.6	0.4	-6.0	-45.4	-12.1	-12.9	2.8	-38.0
Domestic (net)	-6.2	-2.6	-7.0	-45.5	-15.7	-14.1	-2.1	-44.9
Banking system	-0.6	1.2	0.1	-4.8	0.7	0.6	1.0	0.2
Of which: Treasury bills	0.2	0.1	0.2	0.0	0.8	0.1	1.0	0.7
Oil Fund	-4.8	-4.1	-7.7	-41.2	-16.6	-16.5	-3.3	-45.6
Nonbank sector	0.2	0.5	0.5	0.4	-0.3	1.5	0.0	0.2
Privatizations and other sale of assets	0.3	0.0	0.0	0.1	0.4	0.2	0.3	0.3
External (net)	1.6	3.0	1.0	0.1	3.7	1.2	4.8	6.8
Loans	1.9	3.2	1.2	0.7	4.2	1.6	5.2	5.2
Eurobond	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.0
Memorandum items:								
Oil revenue	17.4	30.8	34.6	83.8	57.7	51.6	34.3	72.7
Non-oil revenue 4/	27.5	29.9	29.7	27.7	32.1	26.8	25.3	27.6

Sources: Azerbaijani authorities; and Fund staff estimates and projections.

1/ Includes contingent revenues accrued on the "deposit account" of budgetary organizations.

2/ Includes profit oil, acreage fees, and income earned on Oil Fund assets. Oil bonuses also enter in the Oil Fund, but these are treated as a financing item.

3/ Defined as non-oil revenue minus total expenditure (excluding interest payments) and statistical discrepancies.

4/ Excludes AIOC profit tax, profit oil, SOCAR profit tax, SOCAR export tax, SOCAR contingency payments, and tax credits for SOCAR subsidies grants, but includes VAT and excise taxes on oil and gas, tax withholding on the Azerbaijan International Oil Company's subcontractors, and SOCAR tax credits for energy subsidies.

5/ Staff projections using the WEO commodity price assumptions.

Table 5. Azerbaijan: Summary Accounts of the Central Bank, 2005-10
(In millions of manat)

	2005	2006	2007	2008	2009	2010 Proj.
Net foreign assets	930	2,071	3,527	5,113	4,064	5,100
Net international reserves of the CBA	931	2,061	3,524	5,115	4,257	5,292
Gross international reserves	1,082	2,179	3,612	5,180	4,308	5,343
Foreign liabilities	-151	-118	-88	-65	-50	-50
Other items, net 1/	-1	9	3	-3	-194	-192
Net domestic assets	-44	-26	-87	-149	844	957
Domestic credit	-9	8	-60	-390	875	988
Net claims on consolidated central government	-52	25	93	-476	-591	-709
<i>Of which</i> : claims on central government	140	138	137	134	390	390
manat deposits of central government	-158	-74	-33	-522	-870	-970
Claims on banks	73	94	97	233	1,473	1,700
Credits to the economy	1	1	1	2	2	2
CBA notes	-31	-113	-251	-149	-8	-5
Other items, net	-35	-34	-27	241	-31	-31
Reserve money	886	2,045	3,441	4,964	4,908	6,057
Manat reserve money	688	1,600	3,221	4,781	4,861	6,007
Currency outside CBA	594	1,449	2,911	4,426	4,513	5,551
Bank reserves and other deposits	94	150	310	355	345	457
Reserves in foreign currency	198	445	220	183	47	49

Sources: Central Bank of Azerbaijan; and Fund staff estimates and projections.

1/ In 2009, Azerbaijan received general and special SDR allocations from the IMF in the amount of SDR 153.6 millions.

Table 6. Azerbaijan: Monetary Survey, 2005-10
(In millions of manat, unless otherwise specified)

	2005	2006	2007	2008	2009	2010 Proj.
Net foreign assets	1,033	1,954	2,872	4,036	3,336	3,749
Net international reserves of the CBA	931	2,061	3,524	5,115	4,257	5,292
Net foreign assets of commercial banks	109	-103	-468	-869	-659	-1,284
Other	-7	-3	-185	-210	-263	-259
Net domestic assets	802	1,466	3,026	4,458	5,133	5,990
Net claims on consolidated central government	-69	36	48	-804	-754	-704
Credit to the economy	1,445	2,364	4,644	7,225	8,556	9,412
Other items, net	-574	-935	-1,667	-1,962	-2,669	-2,718
Broad money	1,835	3,420	5,897	8,494	8,469	9,740
Manat broad money	791	2,123	4,402	6,081	6,169	7,279
Cash outside banks	547	1,311	2,714	4,146	4,175	4,592
Manat deposits	244	812	1,688	1,935	1,994	2,686
Foreign currency deposits	1,043	1,297	1,496	2,413	2,300	2,461
	(Annual percentage change)					
Net foreign assets	7.5	89.3	46.9	40.5	-17.4	12.4
Net domestic assets	47.9	82.7	106.4	47.4	15.1	16.7
Credit to the economy	53.0	63.6	96.5	55.6	18.4	10.0
Broad money (M3)	22.1	86.4	72.4	44.0	-0.3	15.0
Manat broad money (M2)	15.8	168.3	107.3	38.2	1.5	18.0
Reserve money	6.3	130.8	68.3	44.3	-1.1	23.4
Manat reserve money	7.5	132.6	101.4	48.5	1.7	23.6
Memorandum items:						
Gross official international reserves (US\$ millions)	1,178	2,500	4,273	6,467	5,364	6,652
Velocity of total broad money (M3) 1/	5.2	4.8	3.8	3.0	3.1	2.8
Broad money as a ratio to non-oil GDP	26.2	39.5	47.4	48.7	46.2	48.7
Currency as a ratio to broad money	29.8	38.3	46.0	48.8	49.3	47.2
Foreign currency deposits as a ratio to broad money	56.9	37.9	25.4	28.4	27.2	25.3

Sources: Central Bank of Azerbaijan; and Fund staff estimates and projections.

1/ Velocity is defined as gross domestic demand (excluding oil sector-related imports) divided by average broad money.

Table 7. Azerbaijan: Selected Economic and Financial Indicators, 2005–2015

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
					Prel.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
(Annual percentage change, unless otherwise specified)											
National income											
GDP at constant prices	26.4	34.5	25.0	10.8	9.3	2.7	0.6	3.0	2.7	7.8	0.7
<i>Of which:</i> Oil sector 1/	65.4	62.0	37.3	6.9	14.8	1.3	-3.3	1.1	0.3	11.0	-3.8
Non-oil sector 2/	8.2	12.1	11.3	15.7	3.0	4.2	4.7	4.9	5.0	5.0	5.0
GDP at current prices	46.8	49.7	51.3	34.0	-9.0	20.3	4.3	4.6	4.4	9.3	2.7
Implicit GDP deflator	16.1	11.3	21.0	20.9	-16.8	17.2	3.7	1.6	1.7	1.4	2.0
Consumer price index (end-period)	5.5	11.4	19.5	15.4	0.9	4.0	3.0	3.0	3.0	3.0	3.0
Consumer price index (period average)	9.7	8.4	16.6	20.8	1.5	4.7	3.5	3.0	3.0	3.0	3.0
Consolidated central government finance											
Total revenue	36.9	67.5	52.6	142.6	-26.0	39.7	5.8	9.5	7.4	15.0	2.8
<i>Of which:</i> Non-oil revenue	34.9	34.5	43.2	30.4	1.7	12.5	10.5	8.9	8.9	9.2	9.5
Total expenditure	28.7	80.9	43.3	60.8	1.7	3.7	6.8	4.4	4.4	4.4	3.4
<i>Of which:</i> Current expenditure	22.8	50.9	33.5	48.3	12.2	9.6	6.2	5.1	5.3	4.3	3.3
Investment expenditure	59.9	203.4	63.1	81.6	-12.7	-6.8	8.0	2.9	2.7	4.7	3.6
External sector (in U.S. dollars)											
Exports f.o.b.	104.4	70.1	63.4	43.8	-31.0	32.1	0.7	2.8	1.3	13.1	-2.8
<i>Of which:</i> Oil sector	113.0	75.4	67.2	44.3	-31.5	32.5	-0.2	2.0	0.4	12.9	-4.2
Non-oil sector	49.9	22.7	14.9	33.7	-21.9	25.0	18.2	15.5	14.5	14.4	13.2
Imports f.o.b.	21.4	21.1	14.7	25.3	-14.0	25.0	6.0	10.8	8.5	10.4	8.5
<i>Of which:</i> Oil sector	18.7	-9.1	-26.2	-17.6	-34.2	28.3	-0.1	22.1	-6.7	0.6	-2.8
Non-oil sector	23.8	45.2	35.1	37.0	-10.7	24.6	6.8	9.5	10.4	11.4	9.6
Export volumes	47.8	40.5	47.2	7.5	5.4	9.0	-6.2	-0.2	-0.5	10.8	-5.1
Import volumes	15.4	7.4	2.6	16.1	-0.7	17.1	3.4	9.7	7.8	9.6	7.9
Terms of trade	17.0	11.6	4.3	24.0	-24.4	13.5	4.7	2.0	1.1	1.3	1.9
Real effective exchange rate	6.8	9.2	9.0	14.3	10.8	...	...	...	...	...	...
(In percent of GDP, unless otherwise specified)											
Gross investment	41.5	29.9	21.5	19.8	18.9	17.9	19.5	20.8	22.0	22.7	24.8
Consolidated government	4.1	8.6	9.7	13.2	12.7	9.8	10.2	10.0	9.8	9.4	9.5
Private sector	37.4	21.2	11.8	6.6	6.3	8.1	9.4	10.8	12.2	13.3	15.3
<i>Of which:</i> Oil sector	17.6	7.8	3.6	2.9	2.0	3.0	3.2	3.2	3.0	2.8	2.7
Gross national savings	42.8	47.5	48.8	55.3	42.5	43.2	43.8	44.3	45.9	48.6	48.5
Consolidated government	7.0	8.8	12.4	34.0	19.5	28.1	28.4	30.6	31.9	35.6	35.5
Private sector 3/	35.8	38.7	36.4	21.3	23.0	15.1	15.3	13.7	14.0	13.0	13.0
Consolidated central government finance											
Total revenue and grants	25.1	28.0	28.2	51.1	41.6	48.3	48.9	51.2	52.7	55.4	55.5
Oil revenue	9.8	14.2	15.2	38.4	27.4	35.0	34.9	36.6	37.4	40.1	39.2
Non-oil revenue	15.3	13.8	13.1	12.7	14.2	13.3	14.1	14.6	15.3	15.2	16.3
Total expenditure	22.7	27.4	25.9	31.1	34.8	30.0	30.7	30.6	30.6	29.2	29.4
Current expenditure	18.2	18.4	16.2	17.9	22.1	20.2	20.5	20.6	20.8	19.8	19.9
Investment expenditure	4.5	9.0	9.7	13.2	12.7	9.8	10.2	10.0	9.8	9.4	9.5
Overall fiscal balance	2.6	-0.2	2.6	20.8	6.8	18.3	18.3	20.6	22.1	26.2	26.0
Non-oil primary balance, in percent of non-oil GDP 4/	-12.6	-31.1	-28.3	-38.2	-38.5	-34.0	-32.6	-30.2	-27.9	-25.7	-22.9
External sector											
Current account balance	1.3	17.6	27.3	35.5	23.6	25.3	24.2	23.5	23.9	25.9	23.7
Foreign direct investment (net)	3.5	-6.1	-15.4	-1.2	0.3	1.0	2.1	2.8	3.1	3.6	4.6
Public and publicly guaranteed external debt outstanding	12.5	9.4	7.7	6.5	7.9	10.2	10.6	10.8	10.9	10.5	10.7
Memorandum items:											
Gross official international reserves (in millions of U.S. doll)	1,178	2,500	4,273	6,467	5,364	6,652	7,840	8,828	9,816	10,904	11,192
Gross official reserves (in months of next year's imports c.i.f)	1.7	3.2	4.5	7.8	4.8	5.6	5.8	6.2	6.3	6.5	6.2
Nominal GDP (in millions of manat)	12,523	18,746	28,361	38,006	34,579	41,596	43,390	45,400	47,415	51,828	53,217
Nominal non-oil GDP (in millions of manat) 2/	7,002	8,655	12,446	17,431	18,322	20,003	21,737	23,519	25,473	27,500	29,817
Nominal GDP per capita (in U.S. dollars)	1,538	2,415	3,759	5,213	4,807	5,729	5,929	6,154	6,376	6,914	7,043
Oil Fund Assets (in millions of U.S. dollars) 5/	1,394	1,915	3,106	11,380	15,045	26,408	36,836	48,963	62,517	79,920	97,662
Population (mid-year, in millions)	8.6	8.7	8.8	8.9	9.0	9.0	9.1	9.2	9.3	9.3	9.4

Sources: Azerbaijani authorities; and Fund staff estimates and projections.

1/ Includes the production and processing of oil and gas.

2/ Includes the transportation of oil and gas (except transportation through the western route), as well as the export tax paid by the state oil company.

3/ Historical data includes statistical discrepancy.

4/ Defined as non-oil revenue minus total expenditure (excluding interest payments) and statistical discrepancies.

5/ Includes the central government foreign exchange deposits managed by the Oil Fund.

Table 8. Azerbaijan: External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -4.4
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
Baseline: External debt	34.7	28.1	21.3	19.1	19.9	21.4	20.8	21.3	21.3	20.4	20.7	
Change in external debt	-6.1	-6.6	-6.7	-2.2	0.8	1.5	-0.6	0.5	0.1	-1.0	0.4	
Identified external debt-creating flows (4+8+9)	-18.8	-24.3	-22.3	-40.4	-22.5	-27.1	-26.6	-27.1	-27.7	-31.2	-28.5	
Current account deficit, excluding interest payments	-3.1	-19.0	-28.3	-36.2	-24.3	-26.1	-24.9	-24.3	-24.8	-26.7	-24.5	
Deficit in balance of goods and services	-10.0	-27.7	-39.6	-44.6	-30.1	-31.9	-29.5	-26.5	-24.9	-26.5	-22.6	
Exports	62.9	66.4	68.0	69.3	53.1	58.0	55.9	55.2	53.9	55.6	53.0	
Imports	52.9	38.7	28.5	24.7	23.0	26.1	26.4	28.8	29.0	29.1	30.5	
Net nondebt creating capital inflows (negative)	-3.5	6.1	15.2	1.2	-0.3	-1.0	-2.1	-2.9	-3.1	-3.6	-4.6	
Automatic debt dynamics 1/	-12.2	-11.5	-9.2	-5.4	2.1	0.0	0.4	0.1	0.3	-0.8	0.5	
Contribution from nominal interest rate	1.8	1.4	1.0	0.7	0.7	0.4	0.5	0.7	0.8	0.7	0.7	
Contribution from real GDP growth	-7.1	-7.5	-4.5	-1.6	-1.9	-0.5	-0.1	-0.6	-0.6	-1.5	-0.1	
Contribution from price and exchange rate changes 2/	-7.0	-5.3	-5.8	-4.5	3.4	...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 3/	12.7	17.7	15.5	38.2	23.3	28.6	26.0	27.6	27.8	30.3	28.9	
External debt-to-exports ratio (in percent)	55.2	42.3	31.3	27.5	37.5	36.9	37.2	38.5	39.6	36.6	39.1	
Gross external financing need (in billions of U.S. dollars) 4/	-0.1	-3.6	-8.9	-16.2	-9.9	-12.9	-12.8	-12.9	-13.7	-16.3	-15.3	
in percent of GDP	-0.4	-17.2	-27.0	-35.0	-23.0	-25.2	-23.8	-22.9	-23.3	-25.4	-23.2	
Scenario with key variables at their historical averages 5/						21.4	29.7	33.2	32.9	31.7	27.4	-11.4
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	26.4	34.5	25.0	10.8	9.3	2.7	0.6	3.0	2.7	7.8	0.7	
GDP deflator in U.S. dollars (change in percent)	20.7	18.0	25.9	26.5	-15.0	15.3	4.6	1.6	1.7	1.4	2.0	
Nominal external interest rate (in percent)	6.9	6.3	5.7	4.8	3.3	2.6	2.6	3.5	4.0	3.5	3.5	
Growth of exports (U.S. dollar terms, in percent)	96.7	67.5	61.4	42.7	-28.8	29.4	1.4	3.4	1.9	12.8	-2.0	
Growth of imports (U.S. dollar terms, in percent)	10.9	16.1	15.9	21.7	-13.6	34.5	6.3	14.1	5.3	9.8	7.4	
Current account balance, excluding interest payments	3.1	19.0	28.3	36.2	24.3	26.1	24.9	24.3	24.8	26.7	24.5	
Net nondebt creating capital inflows	3.5	-6.1	-15.2	-1.2	0.3	1.0	2.1	2.9	3.1	3.6	4.6	

1/ Derived as $[r - g - \rho(1+g) + \alpha\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth; α = nominal appreciation (increase in dollar value of domestic currency), and $\alpha\alpha$ = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \alpha\alpha(1+r)] / (1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\epsilon > 0$) and rising inflation ($\pi > 0$).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 9. Azerbaijan: Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	
1 Baseline: Public sector debt 1/	13.3	10.2	8.6	7.3	12.1	14.1	14.5	14.5	14.6	14.0	14.2	0.0
<i>Of which</i> : foreign-currency denominated	12.1	9.2	7.6	6.3	7.9	10.2	10.6	10.8	10.9	10.5	10.7	
2 Change in public sector debt	-6.8	-3.1	-1.6	-1.3	4.8	2.0	0.4	0.1	0.1	-0.6	0.2	
3 Identified debt-creating flows (4+7+12)	-9.9	-4.6	-5.5	-22.4	-3.3	-18.2	-17.4	-20.1	-21.9	-27.0	-26.3	
4 Primary deficit	-2.6	-0.7	-2.4	-20.1	-6.9	-18.7	-18.6	-20.9	-22.4	-26.5	-26.4	
5 Revenue and grants	25.1	28.0	28.2	51.1	41.6	48.3	48.9	51.2	52.7	55.4	55.5	
6 Primary (non-interest) expenditure	22.5	27.3	25.8	31.0	34.7	29.5	30.4	30.3	30.2	28.9	29.1	
7 Automatic debt dynamics 2/	-7.2	-3.9	-3.1	-2.3	1.1	-1.5	-0.4	-0.3	-0.3	-0.9	0.0	
8 Contribution from interest rate/growth differential 3/	-6.3	-4.4	-3.4	-2.1	0.8	-1.5	-0.4	-0.3	-0.3	-0.9	0.0	
9 <i>Of which</i> : contribution from real interest rate	-2.7	-1.3	-1.7	-1.4	1.6	-1.2	-0.3	0.1	0.1	0.2	0.1	
10 <i>Of which</i> : contribution from real GDP growth	-3.6	-3.1	-1.7	-0.7	-0.7	-0.3	-0.1	-0.4	-0.4	-1.0	-0.1	
11 Contribution from exchange rate depreciation 4/	-0.9	0.4	0.3	-0.2	0.3	...	...	...	...	...	...
12 Other identified debt-creating flows	-0.2	0.0	0.0	-0.1	2.5	2.0	1.5	1.2	0.8	0.4	0.1	
13 Privatization receipts (negative)	-0.2	0.0	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	2.6	2.1	1.7	1.2	0.8	0.5	0.1	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	3.1	1.5	3.9	21.1	8.1	20.2	17.8	20.1	22.0	26.4	26.5	
Public sector debt-to-revenue ratio 1/	53.1	36.5	30.4	14.2	29.1	29.3	29.6	28.4	27.8	25.3	25.7	
Gross financing need 6/	-1.9	0.6	-2.4	-20.4	-6.4	-17.9	-17.8	-20.0	-21.5	-25.6	-25.5	
in billions of U.S. dollars	-0.2	0.1	-0.4	-4.9	-1.4	-4.8	-5.0	-5.9	-6.6	-8.7	-8.8	
Scenario with key variables at their historical averages 7/						14.4	25.3	33.8	39.8	46.4	49.3	-9.8
Scenario with no policy change (constant primary balance) in 2010-2015						14.1	14.4	16.7	20.5	27.4	35.3	0.0
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	26.4	34.5	25.0	10.8	9.3	2.7	0.6	3.0	2.7	7.8	0.7	
Average nominal interest rate on public debt (in percent) 8/	0.9	0.8	1.5	1.3	1.3	4.2	2.3	2.5	2.6	2.8	2.6	
Average real interest rate (nominal rate minus change in GDP deflator, in p	-15.2	-10.5	-19.5	-19.6	18.1	-11.3	-2.2	0.9	1.0	1.4	0.6	
Nominal appreciation (increase in U.S. dollar value of local currency, in per	7.6	-5.1	-4.3	3.6	-3.9	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	16.1	11.3	21.0	20.9	-16.8	15.5	4.6	1.6	1.7	1.4	2.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	11.1	63.0	18.2	33.1	22.1	-11.3	2.5	2.7	2.6	2.9	1.5	
Primary deficit	-2.6	-0.7	-2.4	-20.1	-6.9	-18.7	-18.6	-20.9	-22.4	-26.5	-26.4	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha d(1+r)) / (1+g+\pi+g\pi)]$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and d = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha d(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.



INTERNATIONAL MONETARY FUND

REPUBLIC OF AZERBAIJAN

2010 ARTICLE IV CONSULTATION

INFORMATIONAL ANNEX

Prepared by the Middle East and Central Asia Department

April 19, 2010

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ANNEX I. AZERBAIJAN: RELATIONS WITH THE FUND

(As of March 31, 2010)

I. **Membership Status:** Joined: September 18, 1992; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	160.90	100.00
Fund Holdings of Currency	160.80	99.94
Reserve position in Fund	0.13	0.08

III. SDR Department:	SDR Million	Percent of Allocation
Holdings	153.60	100.02

IV. Outstanding Purchases and Loans:	SDR Million	Percent of Quota
ECF Arrangements	37.81	23.50

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
ECF ¹	Jul. 06, 2001	Jul. 04, 2005	67.58	54.71
ECF ¹	Dec. 20, 1996	Mar. 19, 2000	93.60	81.90
EFF	Dec. 20, 1996	Mar. 19, 2000	58.50	53.24

VI. **Projected Payments to Fund:**

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Principal	8.05	10.94	8.53	6.44	2.57
Charges/Interest	<u>0.02</u>	<u>0.01</u>	<u>0.05</u>	<u>0.03</u>	<u>0.02</u>
Total	8.06	10.95	8.58	6.46	2.59

VII. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Central Bank of Azerbaijan (CBA) was subject to an assessment with respect to the PRGF arrangement that was approved on July 06, 2001, and expired on July 5, 2004. The assessment was completed on March 11, 2002, and it was concluded that the external audit and financial reporting were adequate. The assessment proposed a set of measures to strengthen internal control, data reporting to the Fund, and the legal framework. The majority of the recommendations were implemented, except for the recommendation to establish an Audit Committee. The external audit of 2009 CBA financial statements is scheduled to be completed by end-April 2010, and the audit report is expected to be published immediately afterwards.

¹ Following the Low Income Countries (LIC) reforms, effective January 7, 2010, the PRGF arrangements were renamed the Extended Credit Facility (ECF) Arrangements.

VIII. **Exchange Rate Arrangements**

The currency of Azerbaijan is the manat, which became sole legal tender on January 1, 1994. The *de jure* exchange rate regime has been a peg to a euro-dollar basket since March 2008, but the *de facto* regime has been stabilized against the U.S. dollar since June 2008.

Azerbaijan accepted the obligations of Article VIII, Sections 2, 3, and 4 effective November 30, 2004, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions, except for restrictions maintained for security reasons that have been notified to the Fund.

IX. **Article IV Consultation**

The 2008 Article IV consultation with Azerbaijan was concluded on May 23, 2008.

X. **ROSCs**

A fiscal transparency ROSC module was prepared by FAD (SM/00/278, 12/12/01) and updated in April 2003 (SM/03/159, 04/30/03). A fiscal ROSC update mission took place in April 2005. A data dissemination ROSC module was completed by STA in March 2003 (IMF Country Report No. 03/86). The authorities published the fiscal ROSC, and it is available on the IMF web site. Several financial systems ROSC were conducted in the context of the FSAP (2003–04) but were not published. A CPI data ROSC completed in July 2008 (IMF Country Report No. 08/273).

XI. **Resident Representative**

In October 2009, Mr. Koba Gvenetadze ended his term as IMF Resident Representative in Azerbaijan. Since November 2009, the IMF no longer has a Resident Representative in Azerbaijan, but the IMF Office in Baku, located in the building of the Ministry of Finance of Azerbaijan, continues to operate, headed by Ms. Aghgun Gadirli (Office Manager).

XII. **Resident Advisers**

An adviser on the establishment of the Treasury in the Ministry of Finance, Mr. Nurcan Aktürk, was stationed in Baku from December 1994 to September 1996. He was succeeded by Mr. B.K. Chaturvedi, whose assignment was extended twice, first through August 2000, and then through May 2001. Mr. B.K. Chaturvedi was replaced by Mr. A. Khan, whose assignment started in May 2001 and ended in August 2002. A technical long-term adviser for tax administration, Mr. Mark Zariski, was stationed in Baku from April 1995 to April 1996. He was succeeded by Mr. Peter Barrand, who was stationed in Baku from January 2001 to December 2002. Mr. Isaac Svartsman was resident advisor in the CBA for bank supervision and restructuring from September 1998 to April 2001. Ms. Nataliya Ivanik was stationed in Baku as a STA regional external sector statistics advisor from November 2006 to November 2008.

Azerbaijan: Technical Assistance, 2003–10

Fund. Dept.	Area of Assistance	Mission Dates
FAD	Budget systems law	Feb/March 2003
STA	Consumer Price Statistics	June 2003
STA	National Accounts	Jul/Aug. 2003
MFD	Regional Technical Assistance in Public Debt Management	Jul/Sep. 2003
MFD	Payment and Settlement Systems	September 2003
FAD	Revenue Administration	August 2003
FAD	Tax Policy	August 2003
MFD	Payment and Settlement Systems	January 2004
STA	Balance of Payments Statistics	May 2004
MFD	Payment and Settlement Systems	May 2004
MFD	Regional Public Debt management	April 2004
FAD	Customs Administration	September 2004
STA	National Accounts	Sep/Oct. 2004
FAD	Tax administration	December 2004
MFD	Public Debt Management	December 2004
STA	National Accounts	Mar/Apr. 2005
LEG	AML/CFT Legislation	June 2005
FAD	Taxation of SOCAR Operations	August 2005
STA	Balance of Payments and External Debt Statistics	Nov/Dec. 2005
STA	Consumer Price Statistics	February/March 2006
MFD	Monetary Operations	August 2006
FAD	Public Financial Management	September 2006
STA	Government Finance Statistics	Oct/Nov. 2006
MCM	Banking Supervision	April 2007
FAD	Tax Administration Diagnostic	February 2008
FAD	Tax Administration (expert visits)	July 2008/April 2009
MCM	Domestic Securities Market Development	September 2008
MCM	Public Debt Management	August 2009
LEG	AML/CFT Legislation	Aug/Sep. 2009
STA	External Sector Statistics	October 2009
LEG	AML/CFT Legislation	February 2010

ANNEX II. AZERBAIJAN: RELATIONS WITH THE WORLD BANK

(As of April 8, 2010)

1. The World Bank has been actively implementing a Country Partnership Strategy (CPS) that supports poverty reduction and improves economic management in Azerbaijan. The CPS for 2007–10 has been focusing on four key pillars: (i) improving public sector governance; (ii) fostering non-oil economy growth; (iii) strengthening social services; and (iv) improving environmental management. Over this period, the Bank has provided about \$1.5 billion in lending with a heavy emphasis on water supply, highways, railways, public sector institutions, and rural investments. On the analytical side, the Bank has completed a Country Economic Memorandum (“A New Silk Road: Export-Led Diversification”), a Programmatic Poverty Assessment, and a Corporate Governance ROSC. The Bank recently organized a High Level Forum, chaired by the Prime Minister and the Bank’s Managing Director, that brought together key government officials, international practitioners and academics, and Bank staff to review key challenges and policy options for improving competitiveness and export diversification of the non-oil sectors in the post-crisis environment.
2. The World Bank Group is currently preparing a new CPS for Azerbaijan for the period 2011–14. The strategic framework of the CPS will likely rest on three pillars: (i) promoting economic diversification and competitiveness; (ii) strengthening human capital for growth with equity; and (iii) supporting sustainable development. Bank staff expects to present the new CPS to the Board in the fall of 2010.
3. The strategy of the International Finance Corporation (IFC) focuses on supporting the non-oil sector to help economic diversification. To this end, the IFC aims to catalyze foreign direct investment in non-oil sector projects and to contribute to the modernization of the country’s financial sector, its agriculture, its manufacturing base, and basic infrastructure. The IFC’s strategy for the non-oil sector involves (i) promoting competition and improving corporate governance in the banking sector; (ii) establishing joint ventures in the nonbank financial sector; (iii) providing technical assistance to private local banks for institutional capacity building; and (iv) improving access to finance through credit lines to local private banks for on-lending to small and medium size enterprises.
4. Relations between the Bank and the Fund concerning Azerbaijan are very good in terms of coordinated policy advice and collaboration on macroeconomic monitoring. There is also broad agreement between the Bank and the Fund on the division of labor between the two institutions. The Bank’s investment operations and analytical activities will continue to focus on the areas of competitiveness and sustainability of economic outcomes, infrastructure provision, budgeting and public expenditure management, education, private sector development, and other sectoral issues, as well as some financial sector issues as outlined in the three pillars of the upcoming CPS. The Fund will continue to focus on macro-critical areas, and will share responsibilities with the Bank on banking and financial sector soundness, taking care to coordinate closely so as to minimize overlap and ensure harmonization of policy advice.

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ANNEX III. AZERBAIJAN: RELATIONS WITH THE EBRD

(As of December 31, 2009)

1. As of December 2009, the EBRD has signed 114 projects in Azerbaijan for a cumulative business volume of US\$1.6 billion (including regional projects). The current portfolio stock amounts to US\$979 million, and the ratio of private sector projects in the portfolio now stands at 62 percent.
2. The infrastructure sector (municipal infrastructure, transport, and power) dominates EBRD's portfolio, representing 34 percent. EBRD financed three power projects for a total of US\$281 million, making Azerenergy, Azerbaijan's state-owned power utility, EBRD's single largest client. EBRD also financed five transport projects and one municipal project for a total of US\$201 million. The natural resource sector represents about 25 percent of the portfolio. EBRD financed 16 natural resource projects for a total of US\$571 million, including several landmark transactions such as BTC, ACG, and Shah Deniz. The corporate sector represents about 22 percent of EBRD's portfolio. EBRD financed 15 projects for a total of US\$224.7 million, including two projects with Garadagh Cement, EBRD's second largest client in Azerbaijan. The financial sector represents 18.6 percent of EBRD's portfolio but covers 73 projects, more than any other sector.
3. In 2009, EBRD invested a total of US\$232 million in 9 projects. This included a EUR 120 million loan to Garadagh Cement—EBRD's largest loan in the non-oil sector of Azerbaijan to-date—that will implement a state-of-the-art dry process cement production technology, significantly reducing energy consumption and CO₂ emission. The other projects in 2009 were in the financial sector. EBRD also worked closely with Azerenergy to generate carbon credits under the Clean Development Mechanism (CDM) established by the Kyoto Protocol. In July 2009, Azerenergy signed an Emission Reduction Purchase Agreement (ERPA) to sell carbon credits generated by the rehabilitation of the Azdres Thermal Power Plant financed by EBRD. The project is expected to reduce CO₂ emissions by three million tons annually. This is a landmark deal that involved the development of a new CDM methodology for power plant rehabilitation projects. The methodology, which was developed with EBRD's assistance, can now be applied worldwide. EBRD is preparing a new country strategy for Azerbaijan for 2010–13. The strategy will be provided to the government for comments in early May, posted on EBRD's website for public consultation in late July, and is expected to be adopted by EBRD's board of directors in late September. The central theme of the strategy will be EBRD's support to the development of Azerbaijan's non-oil economy through investments in financial institutions, private enterprise, and infrastructure.
4. Azerbaijan is part of EBRD's Early Transition Countries (ETC) initiative. Launched in April 2004, this initiative aims to increase investments in EBRD's eight countries of operation in the early transition stage, while building on international efforts to address poverty in these countries. Through this initiative, the EBRD focuses its efforts on private sector business development and selected public sector interventions. It aims to stimulate market activity by using a streamlined approach to financing, focusing on smaller projects, mobilizing more investment, and encouraging ongoing economic reform. EBRD will accept higher risk in the projects it finances in the ETCs, while still respecting the principles of sound banking.

ANNEX IV. AZERBAIJAN: STATISTICAL ISSUES

1. Economic and financial statistics provided to the Fund are broadly adequate for surveillance purposes. Although the authorities have made significant progress in improving the quality and timeliness of their macroeconomic statistics, a number of weaknesses should be addressed, particularly in the areas of national accounts, price statistics, and external sector statistics. STA has provided extensive technical assistance and recommendations in these areas.
2. Azerbaijan has participated in the GDDS since mid-2001. In April 2002, a data ROSC mission reviewed Azerbaijan's data dissemination practices against GDDS guidelines and conducted an assessment of the quality of national accounts, consumer price index (CPI), producer price index (PPI), government finance, monetary, and balance of payments statistics. The data module of the ROSC is available on the IMF's external website. Azerbaijan nominated a national SDDS Coordinator in August 2005. An SDDS assessment mission in April 2007 provided technical assistance on the outstanding issues required for SDDS subscription. A data ROSC module to reassess the Consumer Price Index (CPI) completed in July 2008.

A. Real Sector

National accounts and price statistics

3. Under STA's national accounts project, significant technical assistance has been provided to the State Statistics Committee (SSC) and progress has been made in a number of areas. Methods for compiling gross national income have been improved and revised estimates disseminated; quarterly national account estimates at constant prices for 1998–2004 have been compiled; capital investment data have been revised; estimates of undeclared wages have been made; and a new methodology for calculating price indices for the construction and transportation sectors is well underway. The March–April 2005 mission identified the following problems: (i) the Oil Fund's transactions are not adequately reflected in the national accounts due to lack of information from the Oil Fund; (ii) the SSC does not have sufficient information to make reliable estimates of remittances from domestic residents working abroad; and (iii) there are no estimates of informal sector activity.
4. In January 2005, the CPI was revamped—the consumption basket was expanded to cover 585 items and expenditure weights updated to reflect recent consumption patterns. With respect to regional coverage, which is now expanded to 54 regions, the SSC used population-based weights in the aggregation of elementary price indices. However, this treatment raised methodological questions, because (i) international best practices suggest the use of expenditure-based weights in every stage of aggregation in CPI compilation, and (ii) population shares are not reliable proxies for regional expenditure shares. The recent reassessment of the CPI found that, although the SSC did use population weights for regional aggregation through 2006, it has weighted regional indexes by expenditure since 2007, using 2006 Household Budget Survey results on household expenditure, while 2009 data are based on 2008 expenditure weights.
5. Given that property prices are thought to be inflating rapidly in urban centers, it is important for the SSC to measure both the asset and rental prices of housing. Accordingly, the 2008 CPI reassessment mission suggested compiling a house price index, which would provide an estimate of inflation for the capital formation component of household final expenditure. The SSC has been considering proposing such an index for its statistical development program, as a new price indicator distinct from its consumption-based CPI.

B. Fiscal Sector

6. Recent treasury modernization efforts are expected to improve the compilation of fiscal data. With the assistance of a Fund peripatetic advisor, the Ministry of Finance developed the treasury chart of accounts (COA), an essential input to the new treasury system. The October 2006 STA government

finance statistics mission found the latest draft COA broadly consistent with the *Government Finance Statistics Manual, 2001*. The work on the COA is proceeding in parallel with the computerization of Treasury operations.

7. The 2002 data ROSC mission recommended expanding the coverage of government finance statistics by including all operations recorded by the treasury and publishing details on financing and debt outstanding. Starting in 2006, the state budget incorporates transfers to Nakhichevan as a separate expenditure item, but no further details are provided.

C. Monetary Sector

8. The Azerbaijan National Bank (CBA) compiles monetary statistics according to the methodology of the *Monetary and Financial Statistics Manual*. The CBA reports monetary data to STA within three weeks after the end of the reference month, via Standardized Report Forms (SRFs). Monetary and financial data have also been published in the *International Financial Statistics (IFS) Supplement* since December 2006.

D. External Sector

9. Azerbaijan's balance of payments (BOP) statistics are compiled and disseminated by the CBA and are broadly in accordance with the fifth edition of the *Balance of Payments Manual (BPM5)*. The CBA has also initiated compilation of International Investment Position (IIP) statistics. The IIP data for 2002–2008 have been published in *IFS*; however, the authorities have indicated that they have discontinued the official publication of IIP data effective 2009.

10. During November 2006–November 2008, a Regional Advisor in External Sector Statistics to Azerbaijan and Georgia was stationed in Baku to (i) facilitate activities carried out by different government agencies in the development of external sector statistics; (ii) assist with statistical capacity building; (iii) coordinate the technical assistance activities of STA with the MCD's work program; and (iv) assist the authorities in coordinating with other international institutions and bilateral agencies involved in technical assistance in statistics in Azerbaijan and Georgia. Moreover, Azerbaijan has benefited from a STA technical assistance mission in external sector statistics, which visited Baku in October 2009 to further assist the authorities with addressing a number of outstanding issues related to the compilation and dissemination of external sector statistics.

11. The 2009 mission found that appropriate statistical legislation to assign responsibilities for compilation and dissemination of external sector stocks statistics (IIP and gross external debt) has yet to be developed. A draft Presidential Decree *On Improvement of the Gross External Debt and International Investment Position Statistics of Azerbaijan* was developed in order to authorize the CBA to compile private and public debt data from relevant agencies, but still has not been approved. As a result, the CBA temporarily discontinued dissemination of IIP statistics and the development of the compilation system for the IIP and gross external debt statistics. The mission recommended the authorities to address these issues, as they would affect the timing of Azerbaijan's subscription to the SDDS. The mission also expressed concerns with regard to the pace of implementation of the strategic framework for the development of external sector statistics. However, the authorities note that recent changes in staffing have led to improvements in this area.

12. The 2009 mission also found that, in spite of the CBA's efforts, data sharing and data provision remain a challenge for the compilation of external sector statistics. Consequently, the mission recommended to set up a formal, high-level structure for data sharing and data provision. Moreover, given the outstanding issues related to data sharing and data provision by various respondents, and non-reporting by major market participants, the mission considered that the existing International Transactions Reporting System (ITRS) should be further developed, including by changing the ITRS design to introduce a closed ITRS, and by further improving ITRS verification procedures via the on-site inspection of reporting banks.

13. Statistics for public and publicly guaranteed external debt are reported quarterly on a due-for-payment basis with a lag of one to two months. A debt service schedule for public and publicly guaranteed external debt, separately identifying the principal and interest components, is also provided with a one quarter lag. However, systematic information on nonguaranteed external debt, including a sectoral breakdown, is lacking. On external debt, the 2005 BOP mission noted that it would be desirable to use balance sheet data from commercial banks pertaining to banking sector liabilities, which would permit presentation of information with a breakdown by maturities and instruments.

14. Monthly data on total official reserve assets and daily CBA net interventions in the foreign exchange market are provided within 15 days of the end of each month. Data on official reserves during the month are provided on request from Fund staff. Azerbaijan does not disseminate International Reserves and Foreign Currency Liquidity Template data, but the CBA and the government have stated that there have not been any forward or futures transactions that could give rise to contingent short-term net drains on foreign currency assets. STA has recently advised the authorities on the definition and coverage of gross official reserve assets. As the authorities indicated that several definitions of gross official reserve assets are used, STA stressed the importance of using only one definition, more specifically the definition that follows the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*. STA will continue to provide advice to the authorities for the correct compilation of Azerbaijan's gross official reserve assets.

Azerbaijan: Table of Common Indicators Required for Surveillance
(As of April 16, 2010)

	Date of latest observation	Date received	Frequency of data ⁶	Frequency of reporting ⁶	Frequency of publication ⁶	Memo Items:	
						Data Quality – Methodological soundness ⁷	Data Quality Accuracy and reliability ⁸
Exchange Rates	4/12/10	4/12/10	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	4/9/10	4/12/10	D	W	M		
Reserve/Base Money	4/9/10	4/12/10	D	W	M	O, O, O, O	O, O, O, O, LO
Broad Money	2/28/10	3/12/10	M	M	M		
Central Bank Balance Sheet	4/9/10	4/12/10	D	W	M		
Consolidated Balance Sheet of the Banking System	2/28/10	3/12/10	M	M	M		
Interest Rates ²	Dec 2009	3/26/10	M	M	M		
Consumer Price Index	Mar 2010	4/15/10	M	M	M	O, O, O, O	O, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Feb 2010	3/19/10	M	M	M	LO, LNO, LNO, LO	LO, LO, O, O, LO
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	Feb 2010	3/19/10	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Dec 2010	2/10/10	Q	Q	Q		
External Current Account Balance	Q4 2009	3/19/10	Q	Q	Q	LO, LO, LO, LO	O, LO, LO, O, LO
Exports and Imports of Goods and Services	Q4 2009	3/19/10	Q	Q	Q		
GDP/GNP	Mar 2010	4/15/010	M	M	A	O, LO, O, LO	LO, LNO, O, O, O

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic nonbank financing.

⁴The general government consists of the central government (budgetary funds, extrabudgetary funds, and social security funds) and state and local governments.

⁵Including currency and maturity composition.

⁶Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

⁷Reflects the assessment provided in the data ROSC published on March 20, 2003 and based on the findings of the mission that took place during April 8–23, 2002 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁸Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.



INTERNATIONAL MONETARY FUND

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FOR IMMEDIATE RELEASE
May 13, 2010

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2010 Article IV Consultation with Republic of Azerbaijan

On May 3, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article VI consultation with the Republic of Azerbaijan.¹

Background

The Azerbaijani economy has withstood the impact of the global financial crisis relatively well, but has not been immune to it. Overall gross domestic product (GDP) grew at an impressive 9.3 percent during 2009, but non-oil GDP growth slowed from 16 percent in 2008 to 3 percent in 2009. The large drop in international oil and other commodity prices caused fiscal and export revenues to fall by more than 30 percent. In addition, a number of state-owned enterprises (SOEs) and banks faced difficulties rolling over short-term foreign liabilities, which triggered a liquidity shortage in the banking system, and contributed to a sharp decline in credit growth. As international commodity prices fell, average annual inflation dropped dramatically from more than 20 percent in 2008 to 1.5 percent in 2009.

The government responded to the crisis with effective fiscal policy measures. First, it limited the budgetary impact of the large drop in oil prices by allowing the oil fund to still transfer the budgeted amount of resources to the state budget. Second, it provided a large capital injection and government-guaranteed loans to help the state oil and aluminum companies stay current

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

on their foreign debt obligations. Third, the government adjusted for the fall in revenues by cutting non-priority spending and by financing only ongoing capital investment projects. As a result, the government managed to keep the non-oil fiscal deficit broadly stable and was still able to increase social spending. The 2010 budget targets a narrowing of the non-oil deficit, while allowing for cuts in profit and income taxes.

The Central Bank of Azerbaijan (CBA) successfully maintained financial stability by keeping the exchange rate stable and injecting liquidity into the banking system. Despite mounting depreciation expectations in early 2009, the CBA successfully intervened to keep the exchange rate pegged against the U.S. dollar, which reduced inflation, prevented further dollarization, and avoided a negative impact on households' and banks' balance sheets. To address the tightening of liquidity and credit conditions, the CBA reduced the reserve requirement on deposits from 12 to 0.5 percent and cut the refinancing rate from 15 percent to 2 percent between September 2008 and December 2009. Furthermore, the CBA provided about US\$1.1 billion (2.6 percent of GDP) in liquidity support to banks that were faced with temporary liquidity difficulties. Finally, the deposit insurance limit was increased by five times, which helped to restore confidence in the banking system.

Non-oil GDP is expected to recover to 4.2 percent in 2010, but downside risks remain. Oil GDP is projected to grow by only 1.3 percent, implying overall GDP growth of only 2.7 percent. Along with the recovery of the non-oil sector and the rise in international commodity prices, inflation in 2010 is expected to increase slightly to 4 percent. Growth will be lower if businesses remain pessimistic or external demand recovers only modestly.

Given that oil production will likely no longer be the main source of growth from now on, the medium-term outlook for the Azerbaijani economy depends strongly on whether non-oil exports, which currently account for only 5 percent of total exports, will be able to take over as the driver of the economy. Realizing this, the authorities are committed to developing a non-oil export strategy that focuses on further improving the business environment.

Executive Board Assessment

Directors commended the authorities' prudent policy responses to the impact of the global crisis, which helped maintain macroeconomic and financial stability and robust GDP growth. Going forward, the key challenges are to preserve the hard-won stability and diversify the sources of economic growth.

Directors commended the authorities' adjustment measures in the face of falling fiscal revenues in 2009 and their renewed commitment to fiscal sustainability. They supported the intention not to increase spending in 2010 even if oil prices turn out to be higher than budgeted, given the room to improve expenditure efficiency and the need to significantly reduce the non-oil deficit to secure medium-term fiscal sustainability. Directors commended the authorities on making Azerbaijan the first country to be fully compliant with the principles and criteria of the Extractive Industries Transparency Initiative. They looked forward to greater transparency on the expenditure side and reforms to lower the current expenditure burden and the financial support to state-owned enterprises, cut tax exemptions, and simplify the tax system.

Directors agreed that the authorities' decision to maintain a stable exchange rate had served the country well during the crisis, by reducing inflation, preventing further dollarization, and avoiding a negative impact on households' and banks' balance sheets. They saw continued benefits from maintaining exchange rate stability, noting that the real exchange rate remained close to equilibrium in 2009. Directors broadly concurred that the benefits from more flexibility could be expected to increase in the medium term, as the economy becomes more diversified and more integrated with international capital markets. They saw merit in close cooperation between the staff and the authorities in this area.

Directors commended the authorities' skilful monetary and financial sector responses during the crisis, including the sharp reductions in reserve requirements and the policy rate, as well as substantial liquidity support to the banking system. Given rising nonperforming loans, albeit from a low level, Directors stressed the need for continued close monitoring of the banking system and strengthened banking supervision. As financial sector health improves and credit growth resumes, the authorities should gradually exit from crisis-related liquidity support so as to limit fiscal risks and prevent a pickup in inflation. Directors encouraged the authorities to press ahead with further reforms to improve monetary policy transmission and access to credit by the non-oil sector, foster banking sector consolidation, and privatize the International Bank of Azerbaijan. They welcomed the strengthening of the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, and looked forward to further progress.

Directors welcomed the authorities' commitment to developing a non-oil export strategy that focuses on enhancing competitiveness and improving the business environment through further progress with tax, customs, and financial sector reforms. They welcomed the authorities' continued commitment to join the World Trade Organization.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2010 Article IV Consultation with the Republic of Azerbaijan is also available.

Azerbaijan: Selected Economic Indicators, 2005–10

	2005	2006	2007	2008	2009 Prel.	2010 Proj.
	(Annual percentage change)					
Real economy						
GDP at constant prices	26.4	34.5	25.0	10.8	9.3	2.7
Oil sector 1/	65.4	62.0	37.3	6.9	14.8	1.3
Non-oil sector 2/	8.2	12.1	11.3	15.7	3.0	4.2
CPI (end-of-period)	5.5	11.4	19.5	15.4	0.9	4.0
	(In percent of GDP, unless otherwise specified)					
Consolidated government						
Total revenue and grants 3/	25.1	28.0	28.2	51.1	41.6	48.1
Total expenditure 3/	22.7	27.4	25.9	31.1	34.8	29.9
Fiscal balance 4/	2.6	-0.2	2.6	20.8	6.8	18.2
Non-oil primary fiscal balance (in percent of non-oil GDP)	-12.6	-31.1	-28.3	-38.2	-38.5	-33.8
	(Annual percentage change)					
Money and credit						
Manat reserve money	7.5	132.6	101.4	48.5	1.7	23.6
Manat broad money	15.8	168.3	107.3	38.2	1.5	18.0
Banking sector credit to the economy	53.0	63.6	96.5	55.6	18.4	10.0
Velocity of total broad money (M3) 5/	5.2	4.8	3.8	3.0	3.1	2.8
	(In percent of GDP, unless otherwise specified)					
Balance of payments						
Current account balance (-, deficit)	1.3	17.6	27.3	35.5	23.6	25.2
External public debt	12.5	9.4	7.7	6.5	7.9	10.1
Gross official international reserves						
In millions of US\$, end of period	1,178	2,500	4,273	6,467	5,364	6,653
In months of imports, c.i.f.	1.7	3.2	4.5	7.8	4.8	5.6
Exchange rate						
End-of-period (Manat/US\$)	0.92	0.87	0.85	0.80	0.80	...
Real effective exchange rate (percentage change, "-"=depreciation)	6.8	9.2	9.0	14.3	10.8	...

Sources: Azerbaijani authorities; and IMF staff estimates.

1/ Includes the production and processing of oil and gas.

2/ Includes the transportation of oil and gas (except transportation through the western route), as well as the export tax paid by the state oil company.

3/ Includes tax credits allocated to the state oil company.

4/ Includes statistical discrepancy.

5/ Defined as gross domestic demand (excluding hydrocarbon imports) divided by average broad money.

**Statement by Katarzyna Zajdel-Kurowska, Alternate Executive Director for Republic
of Azerbaijan and Ibrahim Chowdhury, Advisor to Executive Director
May 3, 2010**

On behalf of our Azerbaijani authorities, we thank the staff for the comprehensive and insightful staff report, and for very constructive discussions. Both provide valuable input into the authorities' policy formulation and implementation. The authorities broadly agree with the staff's appraisal, especially with respect to the need for fiscal and financial sector reforms. In the post-crisis context, they are even more aware now that sustained economic growth requires effective management of resource revenues and non-oil sector diversification. Against this background, the authorities remain committed to developing a non-oil export strategy that focuses on further improving the business environment.

Since the last Article IV consultation, economic developments in Azerbaijan have been marked by the global crisis. As highlighted in the staff report, non-oil real GDP growth declined from 15.7 percent in 2008 to 3.0 percent in 2009, but overall real GDP growth in 2009 still reached an impressive 9.3 percent. The impact of the crisis was mostly felt through lower oil revenues due to weaker crude oil prices and lower external demand. In addition, commercial banks cut back their loans to the private sector, as increased risk aversion lowered access to foreign financing and refinancing became more challenging. On the other hand, with falling international commodity prices, average annual inflation dropped drastically from more than 20 percent in 2008 to 1.5 percent in 2009.

Looking beyond 2009, Azerbaijan is expected to benefit from the effects of higher oil prices and increased external demand. These factors will support economic growth in 2010. In the first quarter of 2010, non-oil GDP grew at 4.4 percent year-on-year, in line with staff projections.

The authorities responded successfully to the difficult challenge of managing an abrupt shift from overheating to a sharp slowdown in the wake of the global crisis. A combination of revenue and expenditure measures helped support economic activity. On the revenue side, a number of tax measures were introduced, including a reduction in the profit and income tax rate effective from January 2010. Notably, despite the large drop in oil prices, the impact on overall revenue was limited as the budgeted transfers from the State Oil Fund of Azerbaijan (SOFAZ) were fully carried out, allowing the oil fund to fulfill a countercyclical function. On the expenditure side, lower non-priority spending helped to limit the fiscal deficit. The authorities agree that, going forward, additional oil fund resources should not be used to increase spending in 2010, even if oil prices turn out to be higher than budgeted. They also reiterate their commitment to improve public expenditure efficiency and to ensure medium-term fiscal sustainability.

Owing to its limited linkages to global financial markets, the Azerbaijani banking system avoided many of the negative repercussions of the global crisis. Nonetheless, the banking

system has not been immune. Nonperforming loans have been rising, although from a low level, and the banking system experienced a liquidity shortage. The Central Bank of Azerbaijan (CBA) reduced the reserve requirements for commercial banks' domestic and foreign currency deposits to 0.5 percent and increased the deposit insurance coverage to ensure sufficient liquidity and strengthen confidence in the banking sector. As mentioned in the staff report, the CBA provided liquidity support and government-guaranteed credit to the banking sector, in part for onlending to the state oil and aluminum companies that experienced temporary financing problems as a result of the drop in international commodity prices. The authorities are aware that liquidity support should be withdrawn as financial sector health improves, so as to limit fiscal risks and prevent a pickup in inflation. In addition, the CBA will continue to further improve its monetary policy framework and instruments, so as to make monetary policy transmission more effective.

The authorities are determined to continue to closely monitor the banking system, strengthen banking supervision and improve risk management and corporate governance in the banking sector. In its outlook for 2010, the CBA is confident that it will continue to ensure the stability of the banking system. To this end, the CBA is developing a medium-term strategy for banking sector consolidation and optimization. The authorities are hopeful that the restructuring of the banking sector will increase competition, reduce interest rates in line with the fall inflation in 2009, and reduce the spread between lending and deposit rates.

The authorities fully concur with staffs' assessment on the need to eventually increase exchange rate flexibility in the medium term as the Azerbaijan economy becomes more diversified and more integrated with international capital markets. They acknowledge the benefits of developing a new credible anchor to replace the peg, improving exchange rate risk management, and fostering a deep and liquid foreign exchange market.

The authorities have remained focused on implementing their macroeconomic and structural reform agenda. Significant progress has been made in achieving more transparency and accountability in large state enterprises. In 2003, the government established a committee to implement its obligations under the Extractive Industries Transparency Initiative (EITI), and Azerbaijan has since published annual and semi-annual EITI reports. In December 2009, Azerbaijan released its 11th EITI report. Taking into account that Azerbaijan has instituted a regular process of disclosing, reconciling and publishing company payments and government receipts, it became in 2009 the first ever country to complete the EITI's quality assurance process, which verifies compliance with EITI principles and criteria. The most notable, yet simple achievement of the initiative is that the public reporting of revenues from the oil and gas industry, which did not occur in Azerbaijan before the EITI, has now become routine.