INTERNATIONAL MONETARY FUND

IMF Country Report No. 25/98

REPUBLIC OF AZERBAIJAN

2025 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF AZERBAIJAN

April 2025

In the context of the 2025 Article IV Consultation, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 21, 2025 consideration of the staff report that concluded the Article IV consultation with the Republic of Azerbaijan.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 21, 2025, following discussions that ended on February 5, 2025, 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 March 6, 2025.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Azerbaijan.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR 25/118

IMF Executive Board Concludes 2025 Article IV Consultation with the Republic of Azerbaijan

FOR IMMEDIATE RELEASE

Washington, DC: On March 21, 2025, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Azerbaijan and endorsed the staff appraisal, as well as the 2024 Financial System Stability Assessment.

Following a slowdown in 2023, growth accelerated, and inflation picked up. Real GDP increased by 4.1 percent in 2024, up from 1.4 percent in 2023, supported by strong growth in construction, communication, transportation, and hospitality sectors. After declining by 2 percent in 2023, hydrocarbon GDP stabilized in 2024, as moderate gas production expansion compensated for the decline in oil output. Inflation picked up in the second half of 2024, partly reflecting adjustment in administered prices, reaching 4.9 percent at the end of the year, still within the CBA target of 4 ±2 percent. The 2024 Financial Sector Assessment Program (FSAP) found the financial sector to be broadly resilient against severe shocks.

The decline in oil and gas prices reduced the 2024 external surplus, but fiscal consolidation resumed. After recording a surplus of 11.5 percent of GDP in 2023, the current account balance is projected to weaken in 2024. During the first three quarters of 2024, the current account surplus has been about 50 percent lower than in the same period last year. The combined CBA and SOFAZ reserves reached about US$ 71 billion by end-2024, covering 41 months of next year’s imports. After remaining broadly unchanged in 2023, the nonoil primary deficit declined in 2024 to 20.5 percent on nonoil GDP, from 22.1 percent of nonoil GDP in 2023, reflecting strong nonoil tax revenues.

Looking ahead, growth is projected to moderate and inflation to remain within the CBA target. Growth is projected to slow down to 3.5 percent in 2025, reflecting a slowdown in investment and flat hydrocarbon production. In the medium term, growth is projected to be 2 ½ percent, in line with potential growth. Assuming broadly stable international food and energy prices, inflation is projected to remain within the CBA target of 4 ±2 percent. External position is projected to weaken in the medium term as hydrocarbon production declines, but FX reserves will remain strong.

Risks to the outlook remain broadly balanced but external uncertainty is high. Reduced hydrocarbon prices as a result of higher supply or lower demand could adversely affect growth, external position, and fiscal revenues. Conversely, intensification of conflicts could push hydrocarbon prices higher, providing a temporary boost to external and fiscal position. Deepening geoeconomic fragmentation, as well as trade and investment shocks, could affect

[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.

prospects for development of the nonhydrocarbon sector and economic diversification, and slower global growth could weigh on Azerbaijan's prospects. On the other side, trade and investment diversion to the region could also provide new opportunities. On the domestic side, pressures to increase budgetary spending could increase inflation, delay fiscal consolidation, and weaken the fiscal position and fiscal rule credibility. The presence of inefficient SOEs could undermine the development of the private sector, which is key to diversifying the economy and boosting growth.

Executive Board Assessment[2]

In concluding the AIV consultation with Azerbaijan, Executive Directors endorsed the staff's appraisal as follows:

Executive Directors agreed with the thrust of the staff appraisal. They noted that Azerbaijan's growth has remained resilient, supported by robust non-oil sector activity, and inflation is contained. Directors concurred that risks to the outlook are broadly balanced but are subject to significant uncertainty. They called for continued prudent policies and reforms to support diversification and sustainable growth over the medium term.

Directors welcomed the authorities' adherence to the fiscal targets under the fiscal rule. Cautioning that the expansionary 2025 budget would be procyclical, they broadly called on the authorities to continue with the fiscal adjustment in 2025, including by saving any revenue overperformance or expenditure shortfall to help contain inflationary pressures and reinforce fiscal sustainability. While recognizing Azerbaijan's investment needs, Directors urged the authorities to pursue fiscal consolidation over the medium term to ensure intergenerational equity, underpinned by revenue and expenditure measures and reforms to strengthen the fiscal rule framework. They noted the benefits of a potential TADAT and PIMA to support these efforts.

Directors viewed the central bank's current monetary policy stance as appropriate, with inflation within the central bank target band and the recent increase appearing transitory. They emphasized the need to closely monitor inflation risks and to be prepared to act swiftly if needed. Directors welcomed the enhanced monetary policy transmission and called for continued efforts to improve the monetary policy framework to prepare for a possible transition to a hybrid inflation targeting regime.

Directors welcomed the 2024 FSAP's assessment that Azerbaijan's financial system is broadly resilient, and the banking sector is well-capitalized. They commended the authorities for the significant progress in reinvigorating the regulatory reform agenda, and bolstering banks' capital and liquidity buffers to reinforce financial stability. Directors encouraged continued progress in strengthening prudential oversight and the financial safety net and expanding the systemic risk analysis and stress testing frameworks to address remaining vulnerabilities. In this regard, they underscored the importance of fully implementing consolidated supervision, developing early warning indicators and triggers for supervisory actions, reinforcing the resilience of domestic systemically important banks, and strengthening the emergency liquidity assistance framework.

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[2] 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.

Directors emphasized the need for private sector development to support economic diversification. They called for continued reforms to strengthen corporate governance in state-owned enterprises, and to create a level playing field for the private sector. Directors also called on the authorities to continue efforts to improve governance, combat corruption, and further strengthen the AML/CFT framework. They encouraged the authorities to intensify efforts to increase private sector access to finance and contribute to the global climate agenda.

Azerbaijan: Selected Economic and Financial Indicators, 2022–30

	2022	2023	Est. 2024	Projections 2025	2026	2027	2028	2029	2030
	(Annual percentage change, unless otherwise specified)								
National income									
GDP at constant prices	4.7	1.4	4.1	3.5	2.5	2.4	2.4	2.5	2.5
Of which: Oil sector 1/	-2.4	-2.0	0.3	0.2	-0.5	-0.5	-0.5	-0.5	-0.5
Non-oil sector	9.1	4.5	6.2	4.5	3.7	3.5	3.5	3.5	3.5
Consumer price index (period average)	13.9	8.8	2.2	5.7	4.5	4.0	4.0	4.0	4.0
Consumer price index (end of period)	14.4	2.1	4.9	5.2	4.0	4.0	4.0	4.0	4.0
Money and credit									
Domestic credit, net	29.9	14.7	5.0	9.1	6.9	7.0	6.8	6.9	6.9
Of which: Credit to private sector	17.4	14.7	15.9	10.0	8.0	8.0	8.0	8.0	8.0
Manat base money	-2.8	19.4	0.4	9.0	9.0	9.0	9.0	9.0	9.0
Manat broad money	23.8	19.6	9.0	10.6	7.9	8.4	8.3	8.4	8.4
Total broad money	23.6	5.3	11.9	9.2	6.5	7.0	7.0	7.0	7.0
External sector									
Exports f.o.b.	94.6	-30.8	-8.8	10.8	-10.0	-9.9	-8.0	0.3	0.3
Of which: Oil sector	105.1	-34.0	-10.1	10.8	-12.0	-12.5	-10.7	-0.9	-0.9
Imports f.o.b.	29.7	21.4	2.7	12.0	0.9	3.0	5.1	6.5	6.6
Of which: Oil sector	56.3	12.2	-6.9	1.4	1.5	1.7	2.1	0.0	0.0
Real effective exchange rate	11.8	8.1	-1.1	...	...	...	...	...	...
	(In percent of GDP, unless otherwise specified)								
Gross investment	12.1	18.3	17.8	18.3	16.2	14.6	13.7	13.7	13.7
Consolidated government	8.0	12.2	11.3	11.7	10.0	8.8	8.1	8.1	8.1
Private sector	4.1	6.1	6.5	6.7	6.2	5.8	5.6	5.6	5.6
Of which: Oil sector	-6.3	-0.3	1.1	1.3	1.5	1.6	1.7	1.6	1.6
Gross national savings	42.1	29.8	25.7	26.1	20.4	15.1	11.3	10.4	9.6
Consolidated general government finances 2/									
Total revenue and grants	32.1	40.6	37.1	34.4	32.8	31.0	29.8	29.5	29.2
Total expenditure	26.2	32.7	33.8	35.6	34.5	33.4	32.5	31.7	31.0
Current expenditure	18.2	20.5	22.5	23.9	24.4	24.6	24.4	24.4	24.0
Net acquisition of non-financial assets	8.0	12.2	11.3	11.7	10.0	8.8	8.1	7.3	7.0
Overall fiscal balance	6.0	7.9	3.2	-1.3	-1.7	-2.4	-2.8	-2.1	-1.8
Non-oil primary balance, in percent of non-oil GDP	-22.4	-22.1	-20.5	-22.1	-18.6	-16.3	-14.5	-12.7	-11.3
General government debt 3/	17.3	21.8	20.9	21.0	22.2	22.7	23.1	23.8	23.8
General government and government-guaranteed debt	26.9	28.9	27.6	27.6	28.6	28.9	29.1	29.6	29.4
External sector									
Current account (- deficit)	29.8	11.5	7.8	7.8	4.1	0.5	-2.4	-3.3	-4.2
Foreign direct investment (net)	-6.5	-2.9	-0.7	-0.4	-0.2	0.0	0.2	0.4	0.5
Memorandum items:									
Gross official international reserves (in millions of U.S. dollars)	8,996	11,281	10,960	10,760	10,560	10,360	10,160	9,960	9,760
in months of next year's non-oil imports f.o.b.	5.4	7.7	6.6	6.4	6.1	5.7	5.3	4.9	4.6
Nominal GDP (in millions of manat)	133,973	123,128	126,337	134,078	139,182	145,847	153,556	162,135	171,522
Nominal non-oil GDP (in millions of manat)	69,764	78,990	85,712	94,674	102,595	110,434	118,825	127,903	137,675
Nominal GDP (in millions of U.S. dollars)	78,807	72,429	74,316	78,870	81,872	85,792	90,327	95,373	100,895
Oil Fund Assets (in millions of U.S. dollars)	49,034	56,070	60,031	60,911	61,797	61,864	61,594	62,222	62,949
Assumed oil price, WEO plus $2-$3 premium (in U.S. dollars per barrel)	98.4	82.6	81.2	78.6	73.5	71.6	70.6	72.0	73.4
Assumed natural gas price, WEO plus a premium (in U.S. dollars per thousands of cubic meters)	1340.0	460.1	389.0	517.4	424.7	342.2	290.2	290.2	290.2
Exchange rate (manat/dollar, end of period)	1.7	1.7	1.7	...	...	...	...	...	...

Sources: National authorities; and IMF staff estimates and projections.
1/ Includes the production and processing of oil and gas.
2/ Consolidates State Budget, State Oil Fund of Azerbaijan (SOFAZ), Nakhchevan Autonomous Region (NAK) and State Social Protection Fund.
3/ Starting in 2021, includes guarantees issued to Aqrakredit for its acquisition of distressed assets from the IBA.

INTERNATIONAL MONETARY FUND

REPUBLIC OF AZERBAIJAN

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION

March 6, 2025

KEY ISSUES

Context. Growth accelerated in 2024, while inflation remained within the target band. Azerbaijan's main challenges are to maintain the fiscal adjustment momentum to build fiscal buffers for intergenerational equity and resilience against shocks and to accelerate private sector-led diversification, considering dwindling hydrocarbon reserves and the global energy transition.

Policy Recommendations.

- **Remain focused on fiscal consolidation.** The authorities have been meeting their fiscal rule that anchors the fiscal consolidation since its reintroduction in 2022. However, further consolidation is needed for intergenerational equity and long-term fiscal sustainability, based on boosting nonoil revenues and spending discipline. The fiscal rule needs strengthening, including greater clarity on the escape clause and correction mechanism. Repeated changes to the operational targets should be avoided as they would weaken fiscal rule credibility.

- **Keep monetary policy on hold but keep an eye on inflation.** Staff supports the CBA's decision to remain on hold. However, the CBA should remain vigilant, given the pickup in economic activity, strong credit growth, and external risks from international food prices. Strengthening the monetary transmission mechanism to lay the ground for the possible transition to hybrid inflation targeting should continue.

- **Continue strengthening banking supervision and regulation.** The recent FSAP pointed to a resilient banking sector, but some vulnerabilities remain, owing to Azerbaijan's heavy dependence on the hydrocarbon sector and still high dollarization. The authorities should continue aligning banking sector capital and liquidity requirements with Basel III, complete the transition to a risk-based and consolidated supervision framework, and strengthen financial safety nets.

- **Develop a conducive environment for the private sector to drive diversification.** The government has outlined export diversification plans that leverages Azerbaijan's geographic advantages. Reforms to enhance the role of the private sector should continue, including improving the performance of major SOEs and increasing the participation of the private sector, implementing the anti-corruption strategy, and deepening capital markets.

Approved By
Zeine Zeidane (MCD) and Koshy Mathai (SPR)

Discussions with the authorities were held in Baku, during January 22–February 5, 2025. The staff team comprised of Anna Bordon (head), Hoda Assem, Jiri Jonas, Francois Painchaud, and Gustavo Ramirez (all MCD), Zsuzsa Munkacsi (FAD), Julian Chow (MCM), with support from Carlos Segura (MCD). Patryk Łoszewski and Rashad Hasanov (OED) joined the mission. Branden Laumann provided excellent production assistance. The mission met with Central Bank of Azerbaijan Chairman Kazimov, Deputy Finance Minister Bayramov, Minister of Economy Jabbarov, Minister of Labor and Social Protection Babayev and other senior officials and representatives of private sector, academia, and the diplomatic community.

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ANNEXES

CONTEXT

1. **Following a moderation in growth in 2023, economic activity accelerated in 2024, while inflation remained subdued.** Growth slowed down in 2023, following technical problems in oil extraction and the expected moderation in non-hydrocarbon growth from post-pandemic peaks. With the normalization in oil production and an increase in investment, economic activity picked up in 2024. Inflation, which peaked in October 2022, has remained below the CBA's upper bound target since September 2023.

2. **The external environment presents risks and opportunities for Azerbaijan**. The country continues to face the challenge of accelerating private sector-led diversification while saving for the future generation, amidst a highly uncertain environment. While election results last year signaled the continuation of the status quo, the global shift to renewable energy combined with Azerbaijan's limited hydrocarbon reserves bring greater urgency to finding new sources of growth. Existing oil and gas reserves are expected to deplete in about 25 years (oil) and 40 years (gas) at the current rate of extraction. Meanwhile, sanctions on neighboring countries, along with a possible peace agreement with Armenia, provide openings for greater trade integration and investment in the

Azerbaijan: Implementation of IMF Recommendations

2023 Article IV Recommendation		Policy Action
Fiscal Policy		
Continue annual reduction of the non-oil primary deficit by at least 1.5 percent of non-oil GDP in the medium term.		The non-oil primary balance has improved by 1.5 percent of non-oil GDP in 2024.
Maintain spending prudence, including continued moderation in wage growth, rationalization of subsidies and gradual increase in domestic energy prices.		Budget spending growth in 2024 remained moderate at around 6 percent. In 2024, the authorities raised some administered prices, including for fuels and public transportation.
Continue effort to improve tax administration, broaden the tax base, and explore new sources of budgetary revenues.		Progress has been achieved under the ADB TA to improve tax administration. The authorities are undertaking a review of tax expenditures to assess their efficiency, budgetary costs, and scope for reduction.
Consider further improvements in the design of fiscal rule, including reassessing the triggers to changes in fiscal targets, clarifying the operation of correction mechanism, and continue effort to modernize the budgetary framework.		The authorities are preparing a change in the budget legislative system, including the fiscal rule.
Monetary and Exchange Rate Policy		
CBA should exercise caution before continuing to cut interest rates further.		With inflation continuing to fall, the CBA eased interest rates several times in 2023 and 2024.
Continue efforts to modernize monetary policy, including by strengthening the CBA's analytical and forecasting capacity and communication.		The CBA continued its effort to modernize monetary policy framework and improve monetary policy transmission, resulting in improved short-term interest rate control.
Financial Sector Policy		
Accelerate the implementation of plans to transition to risk-based and consolidated supervision.		As part of the 2024-2026 Financial Sector Development Strategy, the CBA has been implementing the Basel III prudential standards, developed a new Risk-based supervision model, and is working on implementing a consolidation supervision framework.
The authorities should continue conducting comprehensive assessment of credit quality, including conducting stress tests and thematic inspections, and accelerate NPL resolution.		As part of the 2024-2026 Financial Sector Development Strategy, the CBA is currently working on implementing risk-based and consolidated regulation which will address this recommendation.
Structural Policy		
When establishing free trade zones to support the economy's diversification, tax and other incentives to investors should be targeted and time bound.		The authorities are reviewing the existing tax exemptions and preferential tax rates, to assess their efficiency in meeting the stated goals.
More effort is needed in areas of governance, including upgrading, and enforcing the anti-corruption legal and institutional framework, improving asset disclosure and increasing beneficial ownership transparency.		Effort to strengthen governance continues. Azerbaijan has significantly strengthened its AML/CFT framework, but effective implementation remains a challenge, including the transparency of beneficial ownership of legal entities.

region. The situation requires strengthening policy frameworks and institutions for greater resilience and higher potential growth.

3. **Policy implementation was broadly in line with past Fund advice**. The authorities are focused on prudent fiscal policy, centered on moderate spending growth, and saving part of the oil revenues. In 2023, a portion of budgeted spending was saved, although the consolidation paused. The consolidation resumed in 2024. The CBA reduced interest rates only after the decline in inflation has been well established, and since May 2024 kept them unchanged. The CBA has also been making further progress in improving monetary policy transparency and transmission. The recently completed FSAP stability module concluded that the authorities are taking steps to address remaining weaknesses in banking regulation and supervision.

RECENT DEVELOPMENTS

4. **Following the slowdown in 2023, growth picked up in 2024.** Real GDP increased by 4.1 percent in 2024, up from 1.4 percent in 2023, driven by a 6.2 percent increase in non-hydrocarbon GDP, particularly in the construction, communications, transportation, and hospitality sectors. Hydrocarbon GDP shrank by 2.0 percent in 2023 but eked out a small increase of 0.3 percent in 2024, with stable crude oil production and moderate expansion in gas output. The estimated output gap turned positive in 2024.

5. **Inflation picked up in the second half of 2024 but remains within the central bank's target band.** After peaking in 2022, inflation eased over 2023, reaching 2.1 percent in December 2023. Inflation continued to ease to around zero in April 2024, before picking up in the second half of 2024, reaching 4.9 percent in December 2024, still within the CBA target of 4±2 percent. The recent increase in inflation is driven in part by a one-off adjustment in energy and other administered prices (transportation and utilities). Still, core inflation also increased from 2.3 percent in December 2023 to 4.4 percent (y-o-y) in December.

6. **The moderation in oil and gas prices reduced the external surplus.** The current account balance recorded a surplus of 11.5 percent of GDP in 2023 (from 29.8 percent in 2022). While the current account remained positive in the first three quarters of 2024, it is about 50 percent lower compared to the same period in 2023. The combined CBA and SOFAZ reserves nonetheless reached 41 months of next year's imports and about US$71 billion by end-2024. Strong foreign currency (FX) buffers continue to support the de facto peg, although demand for FX in official auctions increased in 2024. Following continued real exchange rate appreciation particularly in 2023, the external position is now assessed to be weaker than the level consistent with medium-term fundamentals and desirable policies (Annex I).

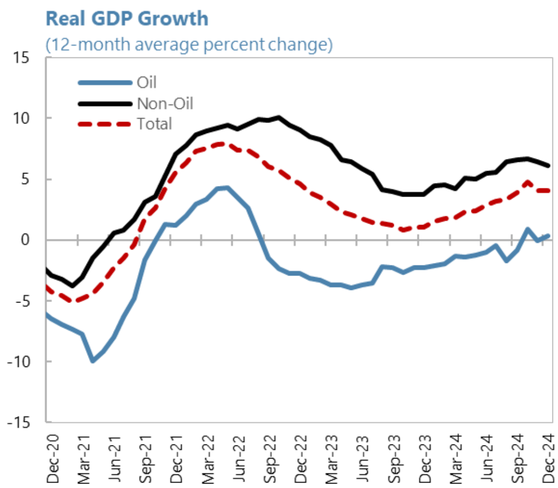
7. **Following a pause in 2023, fiscal consolidation resumed in 2024.** In 2023, the nonoil primary deficit (NOPD) remained broadly unchanged compared to 2022 at around 22½ percent of nonoil GDP. The NOPD was nonetheless about 2 percent of nonoil GDP lower than projected, reflecting stronger nonoil sector tax revenues and the slight under-execution of budget spending. For 2024, preliminary data point to an NOPD reduction of about 2 percent of nonoil GDP compared

to 2023, supported again by robust nonoil revenue growth and slight under-execution of budget spending, while lower oil revenues led to a decline in the overall budget surplus.

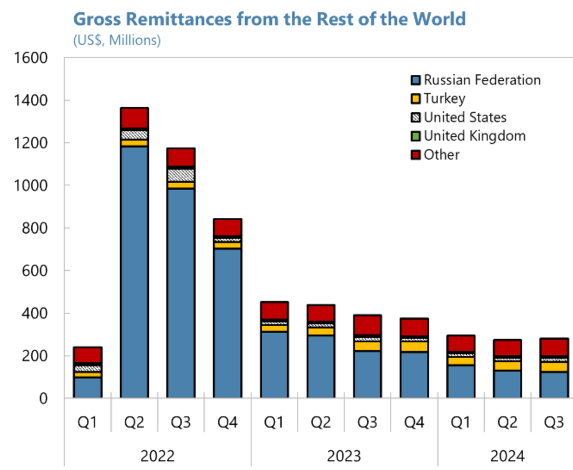
8. Credit growth accelerated in 2023 and 2024. Growth in total credit accelerated further to 22 percent (y/y) in 2024, from 19 percent (y/y) in 2023, precipitated by a sharp increase in nonbank lending. In particular, credit growth has been driven by loans to households and to legal entities, mainly industry and manufacturing whose share in total loans increased from 5 to 8 percent during 2024. In response to macroprudential measures, growth of household borrowing moderated in 2023 and 2024 but remains brisk.

Figure 1. Azerbaijan: Recent Developments

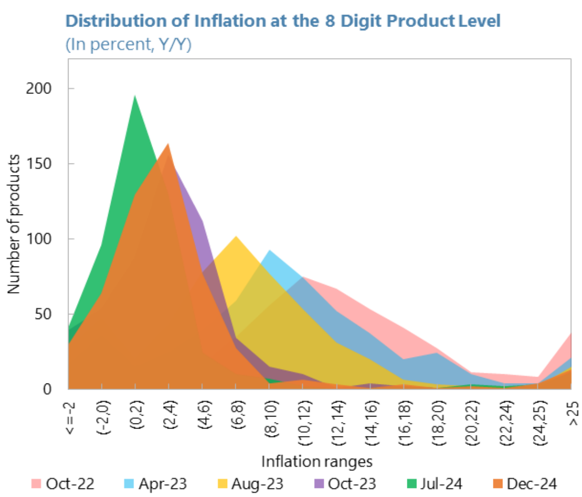
Non-oil sector growth picked up in 2024, while oil production stabilized…



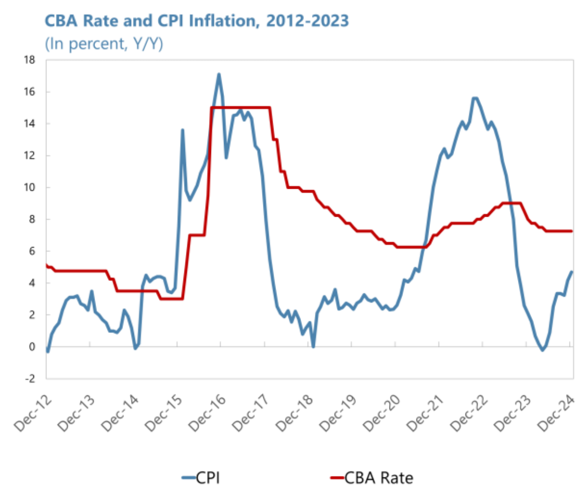
…and remittance inflows normalized from the 2022 peak.



Inflation retracted from the 2022 peak…



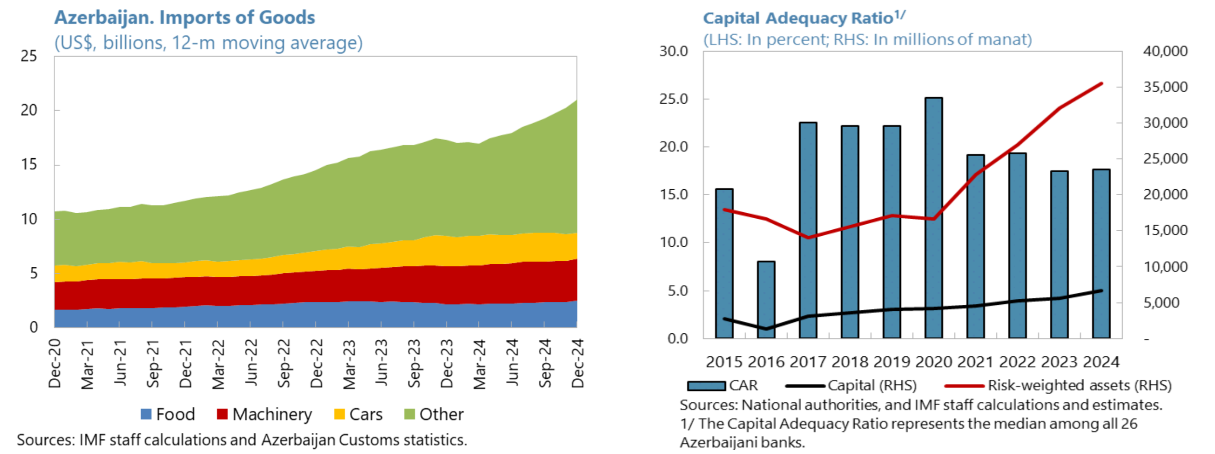
…with the CBA keeping policy rate positive in real terms.



Imports reflect the economic pick-up.

The capital adequacy ratio remains high, despite tighter regulations.

Figure 1. Azerbaijan: Recent Developments (Concluded)



9. The banking sector continues to be resilient, but some vulnerabilities remain. Financial soundness indicators have strengthened and are in line with regional peers. The capital adequacy ratio stood at 17.6 percent as of end-2024, while the systemwide total and foreign currency liquidity coverage ratios have exceeded the minimum requirements. Asset quality has been improving, and the nonperforming loan (NPL) ratio has fallen to 2.4 percent as of December 2024, from 3.8 percent at end-2022, as loans expanded despite some tightening of prudential regulations on consumer loans while the NPL amount has remained broadly constant. Profitability remains strong, underpinned by wide interest margins. The main vulnerabilities in the banking sector include high reliance on potentially volatile wholesale corporate deposits, high—albeit declining—deposit dollarization, and credit concentration.

OUTLOOK AND RISKS

10. Growth is projected to moderate in 2025, and inflation will remain within the CBA's target band. Growth is projected to decelerate to 3.5 percent in 2025, as the impact of investment diminishes and hydrocarbon production remains subdued, and the output gap closes by 2026. The economy is projected to expand by 2½ percent in the medium term. The external position is expected to weaken in the medium term, with declining trade balances from lower hydrocarbon production and prices and subdued non-hydrocarbon exports, but FX reserves will remain strong. Inflation is projected to remain in the CBA target band of 4±2 in the medium term, assuming broadly stable international food and energy prices and resumption of fiscal consolidation.

11. Risks to the outlook remain broadly balanced, but external uncertainty is high (Annex III). Higher supply or lower demand of oil and gas, including from the green transition, could reduce hydrocarbon prices, significantly affecting growth, the external position, and fiscal revenues. Other risks have a more uncertain impact. The intensification of conflicts could improve Azerbaijan's terms of trade, if hydrocarbon prices increase, and worsen it, if food prices increase. Deeper fragmentation, as well as trade policy and investment shocks, could undermine efforts to develop the nonhydrocarbon sector, but if trade and investment are diverted to the region, could also provide opportunities. Domestic risks continue to arise from pro-cyclical fiscal policies, fiscal risks from SOEs, and extreme climate events that would affect agricultural production, food security, and inflation.

12. The authorities expressed a more optimistic growth outlook while broadly agreeing with staff's view on the risks to the outlook. The authorities anticipate non-oil growth of 5 percent and overall GDP growth of about 3.5 percent in the medium term, exceeding staff's forecasts. The authorities believe growth will be supported by significant reconstruction and infrastructure investments and economic diversification efforts. They highlighted Azerbaijan's potential as a transit country for clean energy between Central Asia and Europe via interconnected electricity grids, while planning to stabilize oil output. The authorities' inflation forecasts align with staff's projections, and they recognized the need to maintain current account surpluses for intergenerational equity. The authorities acknowledged risks related to geopolitical tensions, inflationary pressures, and tariffs, necessitating further infrastructure investments to enhance competitiveness and market access. However, authorities consider fiscal risks from state-owned enterprises to be manageable due to recent reforms and improved performance.

POLICY DISCUSSIONS

Policy discussions focused on: (i) fiscal policy in the near and medium term, including the fiscal rule and measures to maintain fiscal sustainability and intergenerational equity; (ii) monetary policy under projected moderate inflation and further steps to improve the effectiveness of monetary policy; (iii) banking sector soundness and risks, and prudential, regulatory, and supervisory measures; and (iv) measures to promote private sector-led diversification.

A. Fiscal Policy: Staying Focused on Fiscal Consolidation

13. Staff baseline projections show an increase of the NOPD in 2025, reflecting the approved budget, before declining in the medium term. Compared to the preliminary 2024 outcomes, the 2025 budget envisages a weakening of the overall fiscal balance by about 4 ½ percent of GDP, from a surplus to a small deficit, while the NOPD is projected to increase by about 1.5 percent of non-oil GDP. Beyond 2025, staff's projections reflect the authorities' current medium-term spending plan, do not reflect the possible modification of the pace of fiscal adjustment (see ¶17), and are subject to considerable risks. It assumes continued moderate growth in current spending and a decline in capital spending as the current reconstruction spending winds down. On the revenue side, it assumes the expiration of the private nonoil sector PIT exemption by end-2025 and no further tax revenue losses due to new tax holidays and exemptions. In the baseline scenario, the overall risk of sovereign stress is assessed to be low (Annex IV).

14. Continued fiscal consolidation is needed for cyclical reasons in 2025 and to ensure that future generations benefit from hydrocarbon wealth. From the cyclical perspective, given robust economic growth and the projected positive output gap, fiscal easing is not appropriate in 2025. Instead, starting in 2025, an annual fiscal adjustment of about 1 ½ to 2 percentage point of non-oil GDP should be maintained for about 10 years until the NOPD approaches the estimated level that ensures real annuity across generations—currently estimated at 6 ½ percent of non-oil GDP (Annex V). Adhering to this consolidation plan, which is broadly consistent with earlier Presidential Decrees on the fiscal rule, would represent an important step towards intergenerational equity. Further revisions and backloading of the fiscal adjustment would weaken the fiscal rule credibility and complicate efforts to preserve assets for future generations.

15. Achieving substantial fiscal consolidation would require a comprehensive strategy. The authorities need to implement a range of measures, including broadening the tax base (the authorities estimate annual revenue loss from tax expenditures in excess of AZN 2 billion, or about 1.5 percent of GDP), continuing to strengthen tax administration and tax compliance, and reviewing the current tax system to identify new sources of revenues. Undertaking the TADAT would help identify potential weaknesses in tax administration and assist in the effort to improve revenue collection. On the expenditure side, the authorities should pursue the moderation of wage bill growth and rationalization of subsidies. In this context, staff welcomes the recent increase in fuel and public transport tariffs and administered prices. Gradual unwinding of public investment spending while focusing on improving investment efficiency should also contribute to fiscal consolidation. In this context, the authorities could consider undertaking a PIMA.

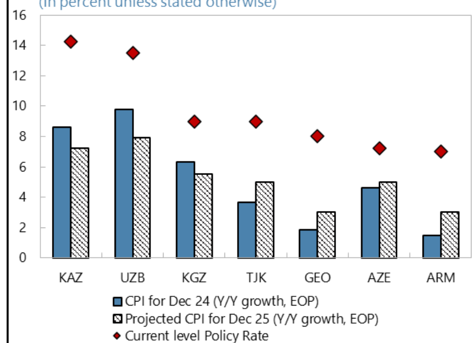
16. Sustained fiscal adjustment should be supported by a strengthened fiscal rule. While the authorities have so far been meeting the fiscal rule targets, largely due to significant overperformance in 2022, the medium-term deficit reduction target has been shifted (Annex V). Avoiding similar changes in the future and sticking to the targeted deficit reduction path are essential to boost the credibility of the fiscal rule. In addition, in the context of planned changes to the budget legislation system, the authorities could consider specifying a clearer and more limited escape clause to minimize changes to the fiscal rule targets and putting in place an automatic correction mechanism. Efforts to more closely link the annual budget to the fiscal rule and to take stock of fiscal risks should also continue.

17. The authorities confirmed their commitment to fiscal consolidation but are considering a slower pace to accommodate priority spending. The authorities plan to continue containing growth in current spending, but they pointed to significant reconstruction and infrastructure investment needs. Accommodating these would require an increase in the NOPD in 2025, followed by a slowdown in the reduction of the NOPD to less than 1.5 percent annually. To support the fiscal consolidation, the authorities envisaged further progress in tax administration, and broadening of the tax base by reducing ineffective tax exemptions and holidays. To further improve tax administration, the authorities have requested a training program to familiarize staff on the TADAT. The authorities are also planning to amend the fiscal rule to allow for greater flexibility in the near term by focusing less on annual targets and incorporating a correction mechanism. The authorities noted that the fiscal rule already contains an escape clause but did not exclude further improvements in the context of planned changes to the budget legislation.

B. Monetary and Exchange Rate Policy: Staying Vigilant and Committed to Enhancing the Framework

18. As inflation fell rapidly in 2023 and the first half of 2024, the CBA responded by gradually cutting policy rates. Even as inflation began to decline from its peak of 15.6 percent in October 2022, the CBA initially continued to increase its refinancing rate in the first half of 2023, from 8 percent to 9 percent. However, the continued sharp decline in inflation to around 2 percent by end-2023 and to zero by April 2024 prompted the CBA to reduce the policy rate to 7.25 percent by May 2024. The sharp disinflation was driven by lower imported inflation (slowing food inflation), together with continued nominal effective exchange rate appreciation. Since mid-2024, inflation began to increase again, reaching 4.9 percent by end-2024, and the CBA kept monetary policy on hold, assessing its policy stance as broadly neutral and expecting inflation to remain within its 4 ±2 percent target range in 2025 and 2026.

Caucasus and Central Asia: Monetary Policy Rates and CPI
(In percent unless stated otherwise)



Sources: Haver analytics, and IMF staff estimates and projections.
Note: CPI projections for 2025 are as of March 3rd, 2025.

19. With inflation projected to stabilize within the CBA target range, staff recommends keeping monetary policy on hold while remaining vigilant, forward-looking, and responsive to incoming data. To some extent, the recent increase in inflation reflects the adjustment in administered prices. Considering current and projected inflation, the CBA's refinancing rate remains broadly neutral in real terms.[1] However, both domestic (demand pressures from budget expenditure growth and strong credit growth) and external risks (geopolitical tensions, disruptions of global supply chains) of inflation remain, and the CBA needs to remain vigilant, monitor these risks closely, and be prepared to respond should these risks materialize.

20. The CBA should continue to further strengthen monetary policy transmission. The new liquidity management instruments introduced in 2022 have helped to improve the transmission of the policy rate to the interbank rate. Activity in the unsecured interbank market has increased, and the average interest rate on one-day unsecured transactions (1D AZIR) has been within the CBA interest rate corridor since November 2023. The CBA also strengthened monetary policy communication, including by publishing their forecasts. The authorities should build on these achievements and continue to further enhance monetary transmission, including the simplification of interbank transaction processes in secured markets, as well as steps to elevate monetary policy communication. These steps should further improve the efficacy of monetary policy, increase confidence in the domestic currency, and lay the ground for a possible transition to a hybrid

[1] Chapter 2 of the MCD Regional Economic Outlook estimated a long-run neutral real rate of 2 ¼ percent. Uncertainty around these estimates is large.

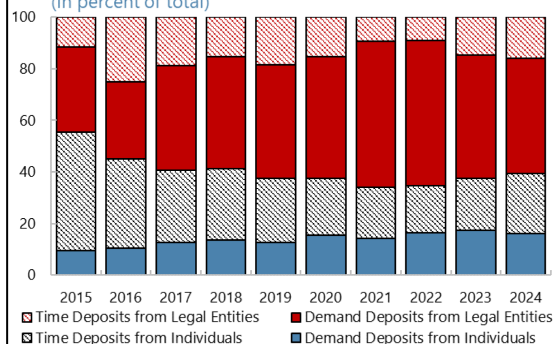
inflation targeting regime in the medium term. Closer coordination between the government's debt management operation and the CBA's liquidity management operations is also required (Annex VI).

21. The authorities agree with staff's recommendation that in the period ahead, caution is required before proceeding with further monetary policy easing. They consider the present monetary policy stance as broadly neutral and appropriate. The CBA views the recent pickup in inflation as largely transitory and expect inflation to stabilize within the target band, while recognizing elevated external and domestic uncertainties to the inflation outlook. The CBA noted that significant progress has been made in improving monetary policy operational framework and strengthening the transmission from the CBA policy rates to long-term interest rates. Regarding the possible transition to a hybrid inflation targeting regime, the authorities noted that they will continue working on creating pre-conditions for implementation in line with the Socio-economic Development Strategy of the Republic of Azerbaijan in 2022–26.

C. Financial Sector Policy: Addressing Vulnerabilities

22. The banking sector financial soundness indicators continue to be strong, but some vulnerabilities remain. As the recently completed FSAP concluded, the banking sector remains resilient, and bank solvency stress tests point to adequate capitalization under baseline and adverse scenarios, although some banks with thin capital buffers could breach the regulatory minimum in the adverse scenario. Also, reflecting the large role of the hydrocarbon sector in Azerbaijan's economy, potentially volatile wholesale corporate deposits may pose a liquidity risk. Financial dollarization—while declining—remains elevated and could also be a source of vulnerability (Annex VII). Moreover, strong growth of unsecured consumer lending could be a source of cyclical risk.

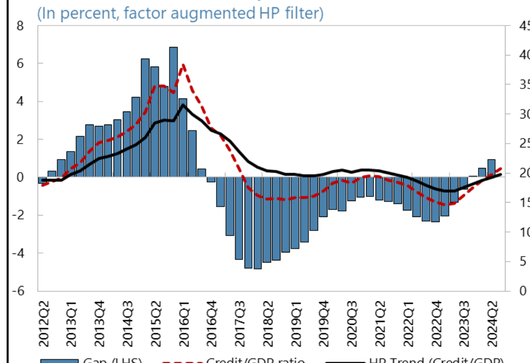
Deposits by Type and Counterparty
(In percent of total)



Sources: Central Bank of the Republic of Azerbaijan, and IMF staff calculations.

23. Staff welcomes the authorities' continued efforts to strengthen prudential oversight and the financial safety net. The CBA has made important progress in establishing new financial sector regulations and macroprudential policies to enhance prudential oversight, corporate governance, and risk management standards to underpin a more resilient banking sector that is better positioned to support economic growth. In response to recent strong credit growth and rising positive credit-to-GDP gap, the CBA implemented a requirement for an additional counter-cyclical capital buffer of 0.5 percent of banks' total regulatory capital starting March 1, 2025. Additionally, measures have been taken to mitigate

Credit-to-GDP: Ratio and Gap
(In percent, factor augmented HP filter)



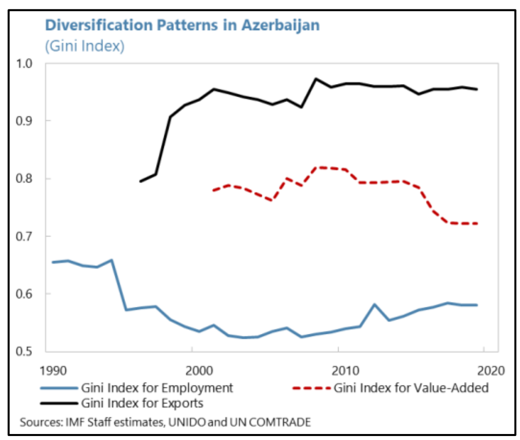
Sources: Central Bank of Azerbaijan, Haver Analytics, and IMF staff calculations.

liquidity risks, including higher reserves requirements for banks with high deposit concentration. Staff would like to emphasize the importance of further progress in the following macro-critical areas: (1) reinforcing the resilience of domestic systemically-important banks (D-SIBs) by introducing differentiated higher loss absorbency buffer requirements; (2) expediting legal and prudential steps to ensure full adoption of a consolidated supervision framework; (3) bolstering financial safety nets by finalizing resolution plans for D-SIBs and other banks whose failure would have systemic consequences; and (4) strengthening the emergency liquidity assistance (ELA) framework.

24. The authorities consider the banking sector as fundamentally healthy, posing little risks to financial stability. Both favorable macroeconomic conditions and active macro and micro prudential policies have contributed to enhanced financial resilience of the banking sector. Still, the CBA is taking steps to further beef up the banking sector capital strength and liquidity position and expect the transition to Basel III capital requirements to be implemented in line with the Financial Sector Development Strategy 2024–26, including the implementation of capital conversation buffer and D-SIB differentiated high loss absorbency requirements. The CBA noted that the banking sector is already well capitalized, and all banks exceed regulatory capital standards. Thus, the transition to Basel III should not adversely affect bank lending. The CBA recently approved and published the Macroprudential Policy Framework and are discussing steps to further reduce deposit dollarization; progress is being made with technical (testing of most suitable risk-based supervision models), legal, and prudential steps to ensure the adoption of a risk-based and consolidated banking supervision.

D. Structural Reforms: Enabling Private Sector-Led Growth

25. Diversification remains Azerbaijan's most urgent challenge, given limited hydrocarbon reserves and the ongoing energy transition. The economy has diversified in terms of output in recent years, but exports remain highly concentrated, even more so than other resource-rich economies. The authorities have been positioning Azerbaijan as a logistics, transport, and green energy hub that would connect Central Asia with Europe. Azerbaijan 2030 recognized the role of the private sector to drive investment, growth and employment, and the government simplified business procedures and licensing and has started taking steps to develop financial markets. Further growth is however constrained by major state presence in the non-oil sectors, governance issues, and limited access to skilled labor and capital. Staff urges the government to continue to create the conditions to attract private investment, minimize risks to public finances, and pursue several key reforms:



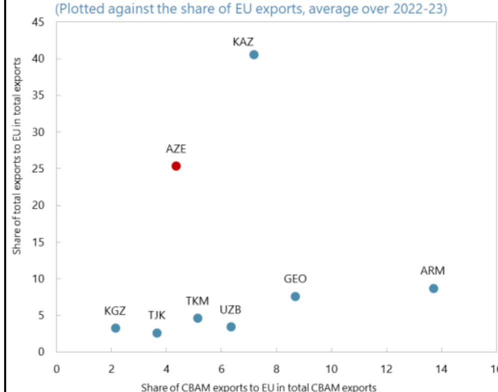
- **Reducing the footprint of the state and improving SOE performance.** The government established the Azerbaijan Investment Holding (AIH) in 2020 and the Azerbaijan Transport and Communications Holding (AZCON) in 2024 to improve the performance of several strategic state-owned enterprises (SOEs). Since 2020, the AIH has introduced several reforms on their portfolio companies, including establishing supervisory boards and committees, enhancing financial reporting and independent audit, and setting up KPIs and developing a monitoring dashboard. Following the OECD review of the AIH and SOEs, the authorities developed an action plan to implement the recommendations. Staff looks forward to progress on several key areas, such as developing an ownership policy, leveling the market playing field where SOEs compete, introducing independent board members, and improving transparency and disclosure practices. Applying good governance standards to all large SOEs and implementing the privatization roadmap should also be prioritized.

- **Sustaining gains in transparency, countering corruption, and AML/CFT.** Azerbaijan has made progress in enhancing fiscal transparency, ranking 23rd out of 125 countries in the 2023 Open Budget Survey, and implementing its anti-corruption policy and action plan. The authorities should continue efforts to close the gaps identified by the OECD, including by finalizing the draft law on conflict of interest, applying more transparent and competitive public procurement practices, operationalizing the asset disclosure system for public officials, and strengthening the enforcement of corruption offences. On AML/CFT. the authorities should also prioritize addressing MONEYVAL recommendations, building on recent initiatives to increase resources and build capacity on countering ML/FT, set up a centralized beneficial ownership registry, and enhance the sanctioning regime.

- **Promoting private sector access to finance.** Despite recent improvements, Azerbaijan's financial and capital markets remain underdeveloped, and access to finance remains an obstacle to faster private sector-led growth. The authorities have made progress towards achieving a stable banking sector, a necessary but insufficient condition for financial deepening. However, improving corporate governance, strengthening accounting and auditing standards in the private sector, and modernizing the legal framework on capital markets are some reforms required to support capital market development. Given their large number, improved access of SMEs to financing is also particularly important for future growth and diversification. The authorities' Financial Sector Development Strategy 2024–26 appropriately seeks to address these constraints.

26. Climate policies will prepare Azerbaijan for the global energy transition and contribute to reducing emissions and enhancing adaptation. As host of COP29, Azerbaijan played a significant role in advancing the global climate agenda. In addition, the government finalized its National Adaptation Plan and is expected to submit more ambitious mitigation targets this year, while efforts to meet its current NDC target of 35 percent reduction by 2030 compared to 1990 levels continue. The authorities have laid out electrification plans and initiatives to upgrade the transmission grid and enhance energy efficiency in buildings and transportation. Although the Carbon Border Adjustment Mechanism is not expected to have a significant impact on current trade with the EU

CCA: Share of Exports to EU in CBAM-Applicable Sectors
(Plotted against the share of EU exports, average over 2022-23)



Source: IMF Staff estimates based on GLORIA dataset.

in the near term, diversification to the metals and chemicals sectors could be affected, and the oil and gas sectors could be covered in the medium term. Staff welcomes efforts by the authorities to expand the share of renewables in installed capacity to 30 percent by 2030 and the state oil and company's net zero and methane reduction targets. Staff reiterates the need to withdraw direct and indirect fossil fuel subsidies to induce more efficient use and to free up resources for green technology investments as well as the more vulnerable.

27. The authorities broadly agreed with staff regarding structural reform priorities. They emphasized the importance of continuing economic diversification efforts and promotion of private sector development. The authorities highlighted that majority of employment is now in the private sector, and noted progress in boosting non-oil exports. They reiterated their commitment to SOE reforms, highlighting milestones such as increased profitability, improved corporate governance, and successful privatization efforts. The recently adopted PPP law should increase pressure on SOEs to increase efficiency and profits, and not rely on budgetary support. On the climate reform agenda, the authorities acknowledged the economic benefits of reducing domestic fossil fuel demand and have embarked on electrification, energy efficiency initiatives, and renewable energy projects. However, they also emphasized that energy transition needs to be based on sound feasibility studies. The authorities reported progress on governance, anti-corruption, and AML/CFT, addressing gaps identified by the OECD assessment and aligning the AML/CFT Law with FATF standards and Moneyval recommendations.

STAFF APPRAISAL

28. Azerbaijan's economy has remained resilient, and the outlook is favorable, amidst a highly uncertain external environment. Growth accelerated in 2024 with robust economic activity across several non-oil sectors helping to more than offset stable oil production. Inflation was contained and the external position remained strong, although the current account is estimated to have declined with lower oil and gas prices. The external position in 2024 is assessed to be weaker than implied by fundamentals and desirable policies. Growth is projected to moderate somewhat in 2025 and the medium term, and inflation to remain within the central bank's target band. Risks are broadly balanced, with external shocks potentially presenting risks and opportunities. The authorities should continue to pursue policies and reforms that will allow Azerbaijan to manage downside risks should they materialize and benefit from opportunities.

29. The authorities should stay focused on fiscal consolidation and maintain the momentum. The authorities have been meeting their non-oil primary balance target since the fiscal rule was reintroduced in 2022. In 2025, the authorities should press on with the adjustment, instead of the planned expansionary policy, and save any revenue overperformance or expenditure shortfall. This will help ease any inflationary pressures and bring the non-oil primary balance closer to the level that would ensure intergenerational equity. Given the still sizable fiscal adjustment required to achieve this objective, the authorities should avoid softening the fiscal consolidation effort. They should identify and start implementing a range of revenue and expenditure measures to support continued consolidation, including gradually reducing tax expenditures, continuing to strengthen tax administration, moderating current spending growth, and improving investment efficiency. Strengthening the fiscal rule framework, by specifying clear and limited escape clauses and automatic correction mechanisms, would also help sustain the fiscal adjustment.

30. The central bank's monetary policy stance is appropriate, along with commendable efforts to enhance monetary policy operations. With inflation within the central bank target and recent increases driven by one-off factors, the central bank kept policy rates on hold. The central bank should continue to monitor inflation risks, considering continued strong growth in credit and the non-oil sector, the projected expansionary fiscal policy reflected in the 2025 budget, and potential global supply chain disruptions. Meanwhile, the authorities have successfully strengthened the transmission of the policy rate to interbank market rates and to some deposit rates. Creating the conditions for a more active interbank market and elevating monetary policy communications will further strengthen the interest rate instrument which, under a future hybrid inflation targeting regime, is critical for achieving inflation goals.

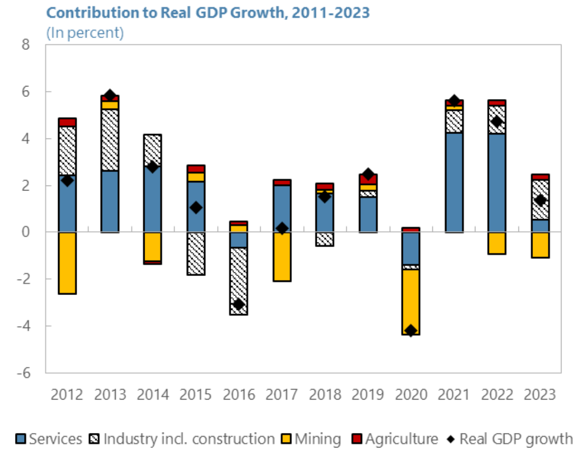
31. The central bank should continue to address remaining vulnerabilities in the banking sector. The overall banking sector is resilient, as reflected by strong financial sector indicators, thanks to the central bank's efforts to strengthen prudential oversight, corporate governance, and risk management standards. However, pockets of vulnerabilities remain, particularly from weaknesses at the individual banks level, high reliance on potentially volatile wholesale corporate deposits, high deposit dollarization, and credit concentration. The central bank should complete the transition to a risk-based and consolidated supervision framework, beef up financial safety nets, and reinforce the resilience of D-SIBs.

32. Structural reforms should focus on increasing the role of the private sector in driving diversification. Reforms to increase the profitability of and strengthen corporate governance in SOEs, as well as to level the market playing field where SOEs compete should continue, to pave the way for greater private sector participation in the future and to reduce risks to the state budget. Building on the anti-corruption strategy and action plan, the authorities should implement the asset disclosure requirements for public officials, finalize draft laws on conflict of interest, enhance transparency and competition in public procurement, and strengthen the enforcement of corruption offences. The government should also intensify efforts to increase private sector access to finance. Finally, Azerbaijan should continue to contribute to the climate agenda, including by continuing to gradually reduce energy subsidies and increase energy efficiency standards.

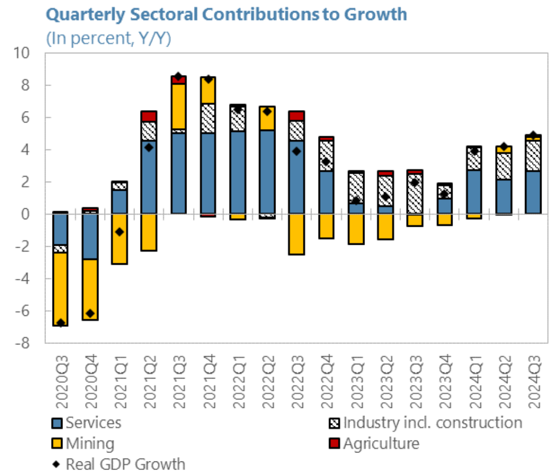
33. It is recommended that the next Article IV consultation takes place on the standard 12-month cycle.

Figure 2. Azerbaijan: Real Sector Indicators

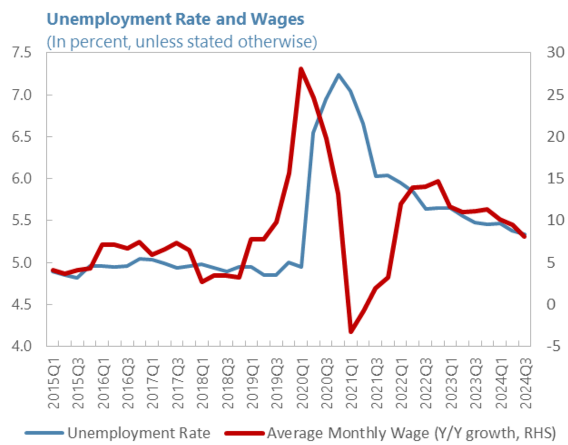
Growth slowed down in 2023, after two consecutive years of strong expansion,...



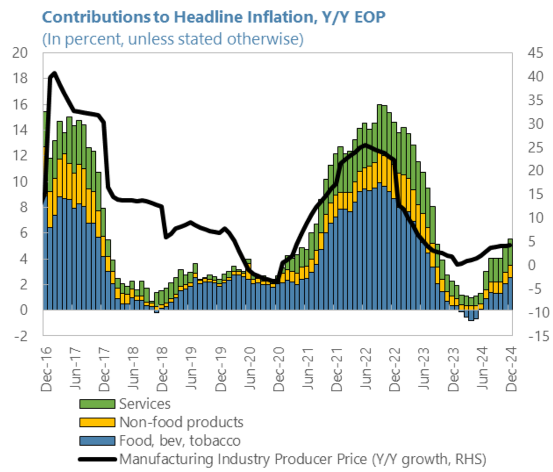
... and recovered in 2024.



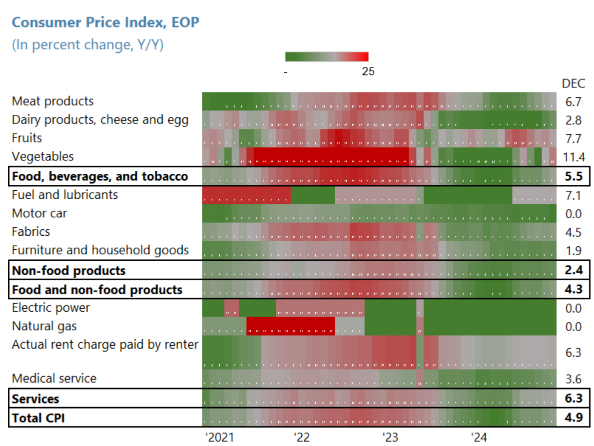
The labor market is normalizing.



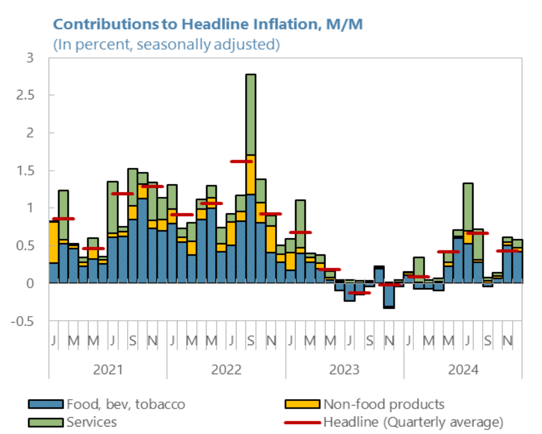
Inflationary pressures have remained low...



...across the consumer basket...



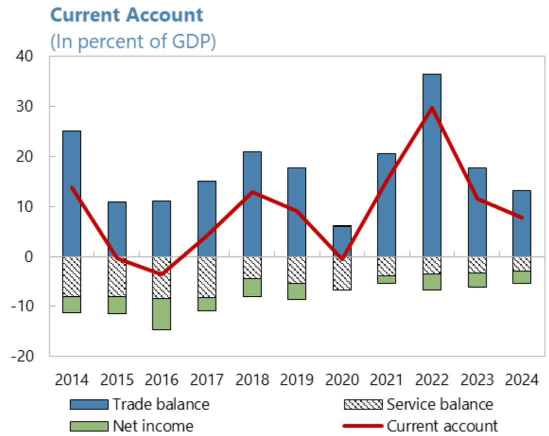
... despite regulated price adjustments during the summer.



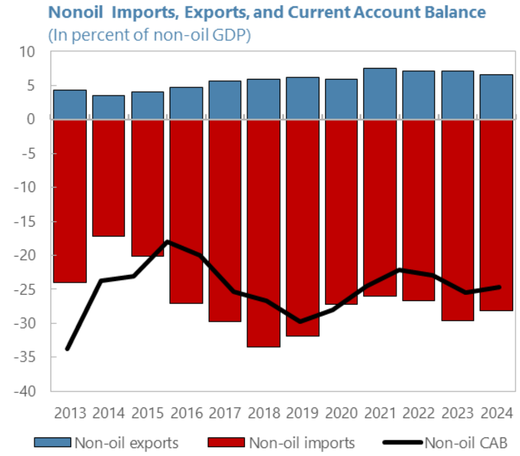
Sources: National authorities, Haver, and IMF staff calculations.

Figure 3. Azerbaijan: External Sector

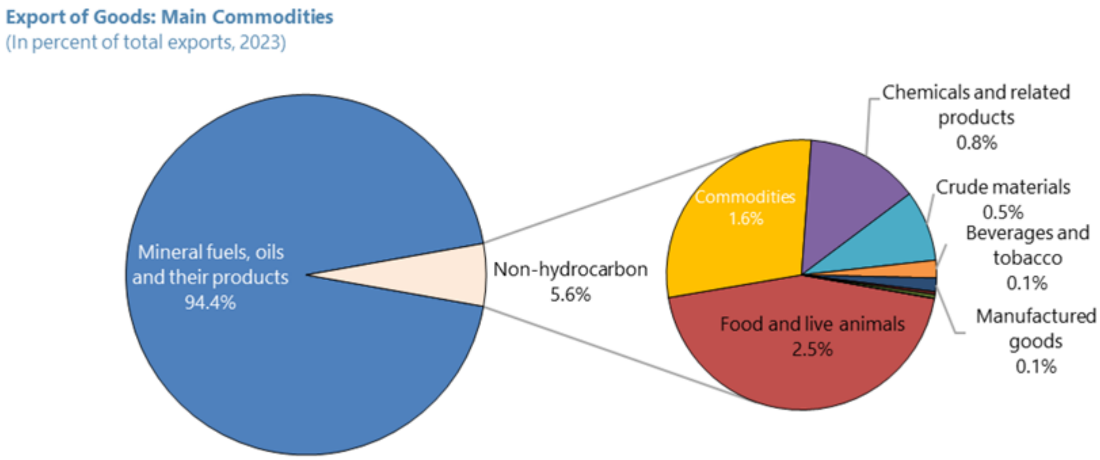
The external position remained favorable, despite lower oil and gas prices after the 2022 pick-up…



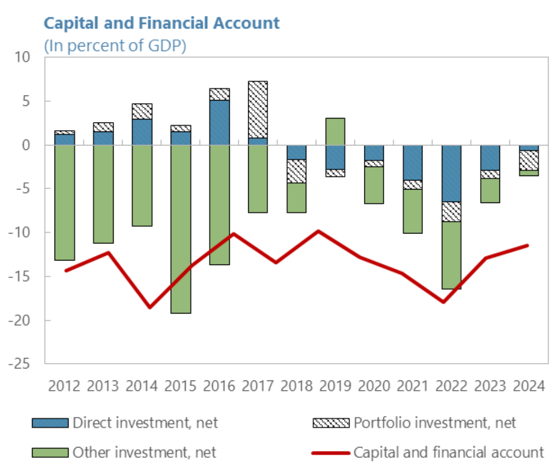
… and an increase in nonoil imports.



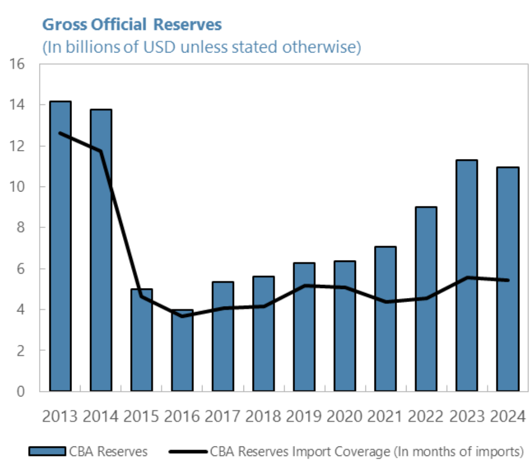
Exports remain highly concentrated in hydrocarbon products.



Despite net outflows of FDI and other investments…



…reserves continue to accumulate.

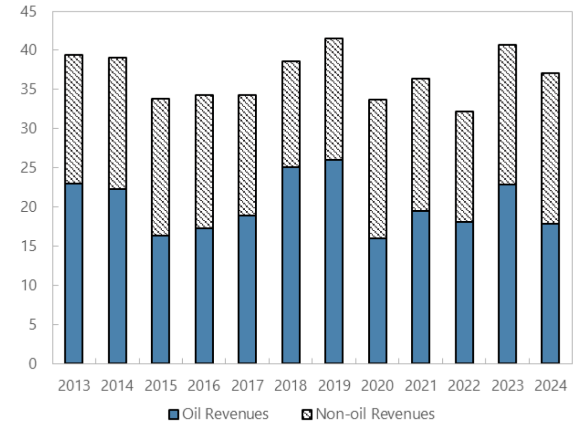


Sources: WITS, Haver, and IMF staff calculations.

Figure 4. Azerbaijan: Fiscal Sector

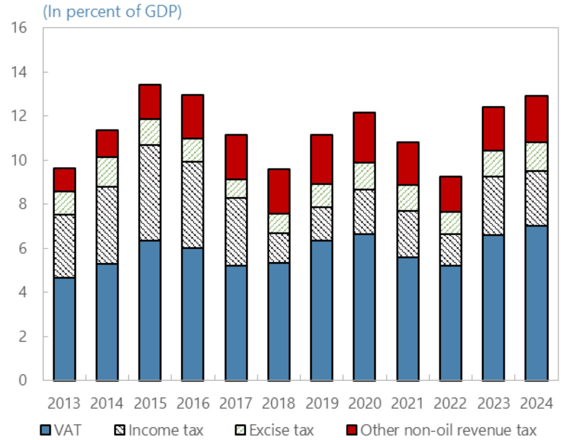
Oil revenues are an important part of total government revenues …

Consolidated Government Revenues
(In percent of GDP)



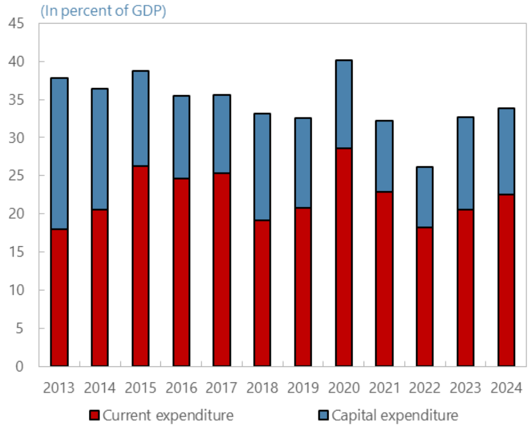
… with tax revenues relatively low, particularly direct tax revenues.

Tax Revenues
(In percent of GDP)



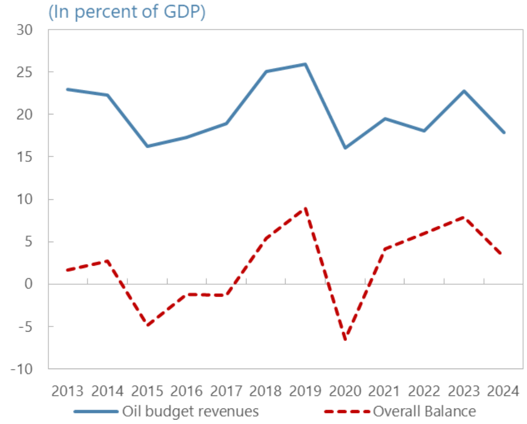
Total expenditures increased moderately in 2024, driven by higher current expenditures.

Total Expenditures
(In percent of GDP)



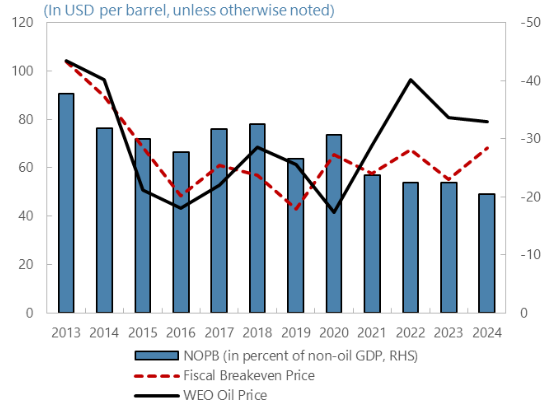
The overall budget balance moves in line with oil budget revenues.

Overall Balance and Oil Budget Revenues
(In percent of GDP)



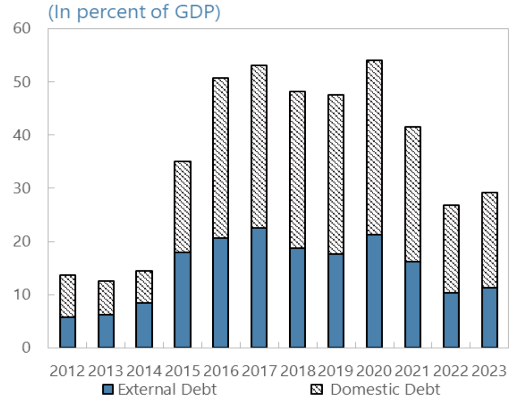
The nonoil primary deficit remains high and the breakeven oil price remains below the WEO oil price.

Oil Price, Fiscal Breakeven Oil Price, Nonoil Primary Balance
(In USD per barrel, unless otherwise noted)



After peaking in 2020, public and publicly guaranteed debt as percent of GDP has declined markedly.

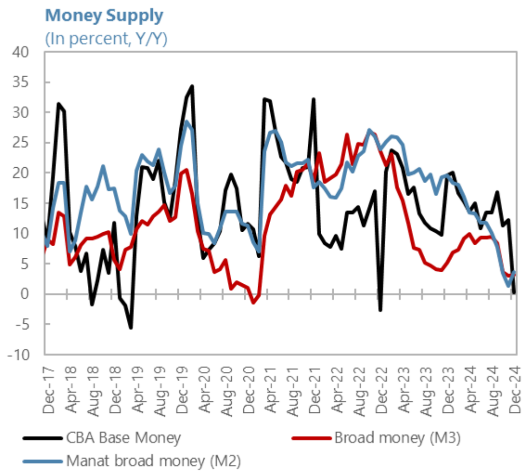
Total Public Debt
(In percent of GDP)



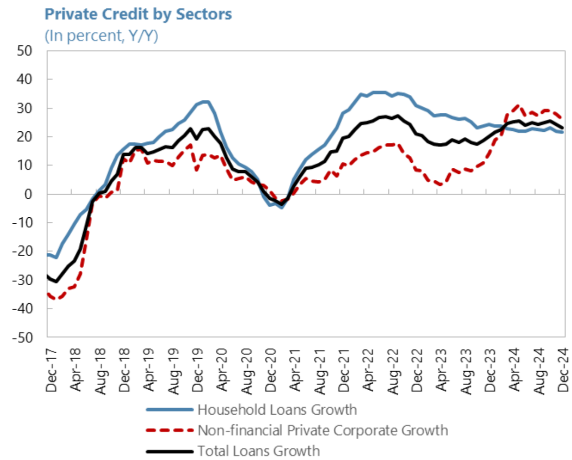
Sources: National authorities, Haver, IMF World Economic Outlook, and IMF staff calculations.

Figure 5. Azerbaijan: Monetary and Exchange Rate Developments

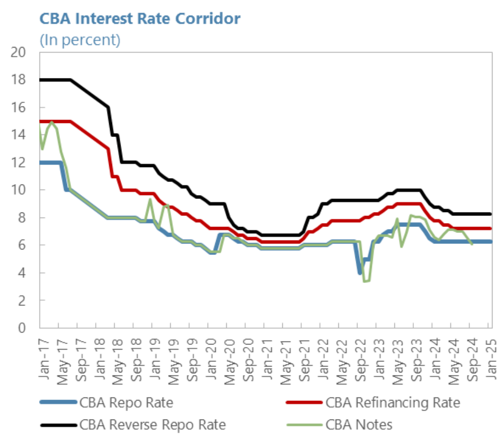
Money growth has broadly slowed down since 2023…



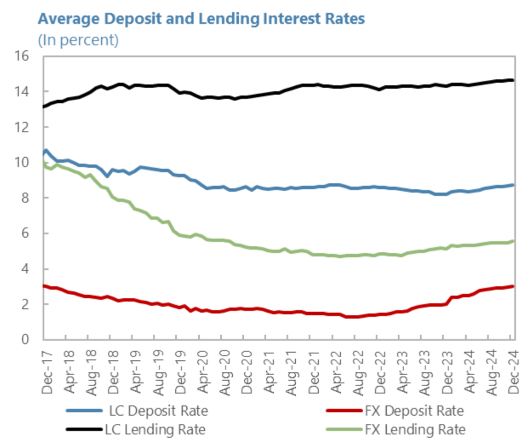
… while credit to non-financial corporates accelerated in 2024 and the growth of credit to households moderated..



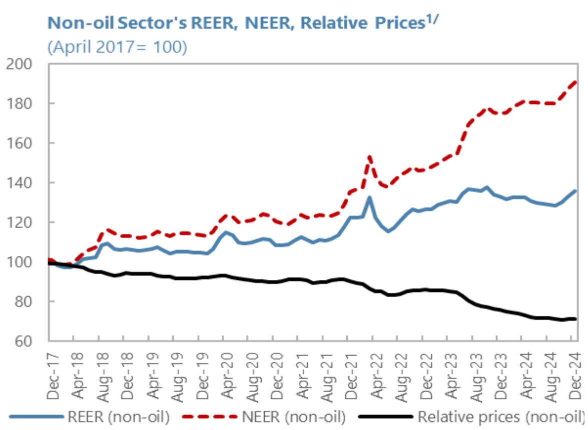
The CBA has recently paused easing monetary policy …



…but bank LC lending and deposit rates remain broadly stable while FX rates have risen.



The real effective ER has been appreciating since 2020.



Sources: Haver analytics and IMF Staff estimates.
1/ The non-oil NEER and non-oil REER are calculated using exchange rates weighted by non-oil trade shares. Unlike standard indices, they specifically reflect exchange rate competitiveness for non-oil sectors.

Since Q2 2021, FX demand has been mostly below supply.

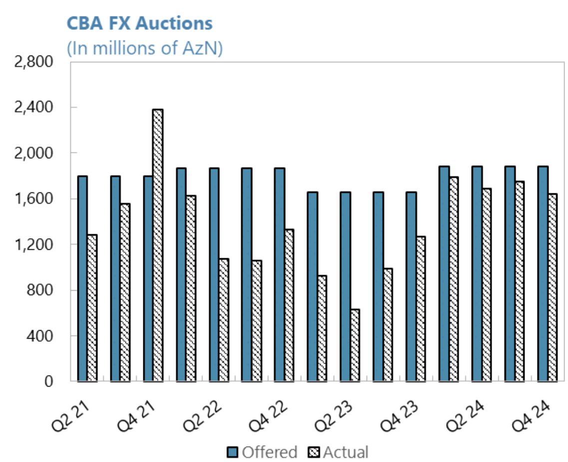
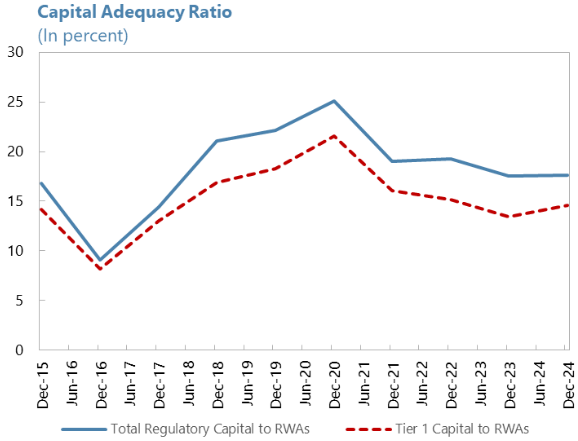
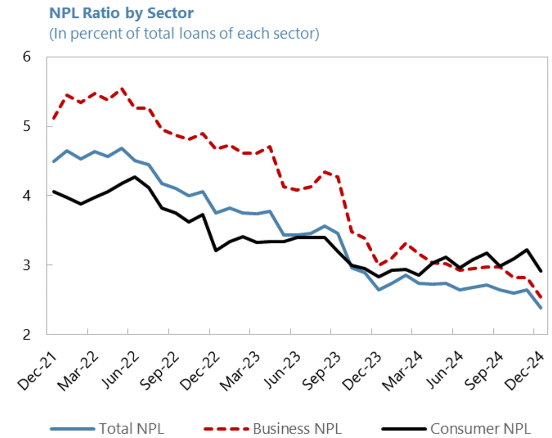


Figure 6. Azerbaijan: Banking Sector

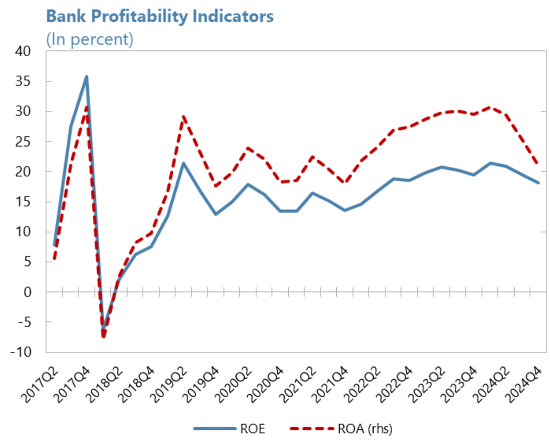
Banks' capital position remains strong, as the decline from the 2020 peak reflects the unwinding of regulatory easing.



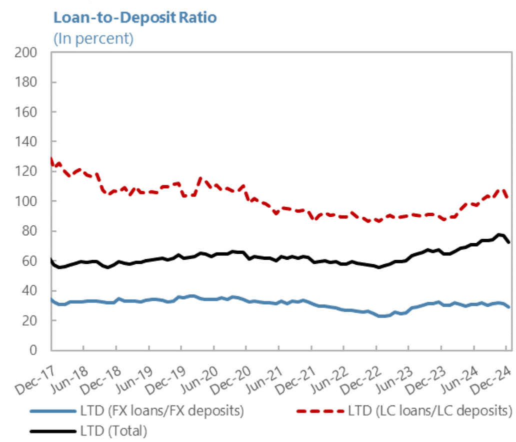
The nonperforming loans ratio has been declining.



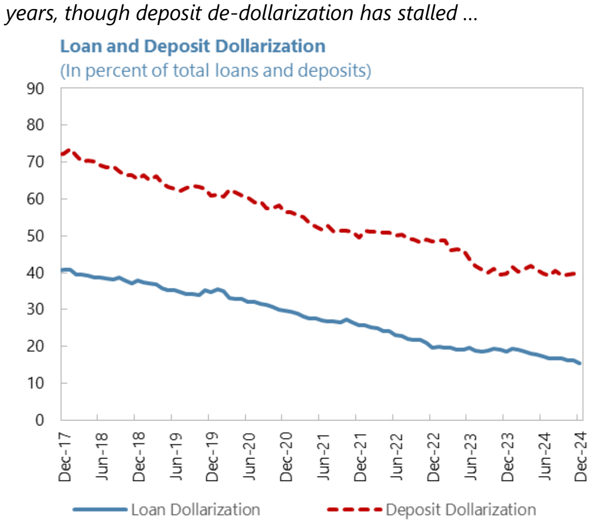
Bank profitability remains solid.



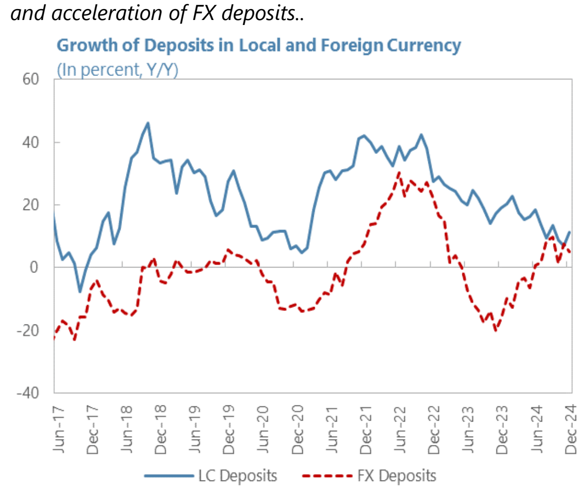
Manat deposits are the main source of manat loans funding, but FX deposits exceed FX loans.



Loan and deposit dollarization have been declining in recent years, though deposit de-dollarization has stalled …



…reflecting the recent slowdown in manat deposits growth and acceleration of FX deposits..



Sources: National authorities, Haver, and IMF staff estimates.

Table 1. Azerbaijan: Selected Economic and Financial Indicators, 2022–30

			Est.	Projections					
	2022	2023	2024	2025	2026	2027	2028	2029	2030
	(Annual percentage change, unless otherwise specified)								
National Income									
GDP at constant prices	4.7	1.4	4.1	3.5	2.5	2.4	2.4	2.5	2.5
Of which: Oil sector 1/	-2.4	-2.0	0.3	0.2	-0.5	-0.5	-0.5	-0.5	-0.5
Non-oil sector	9.1	4.5	6.2	4.5	3.7	3.5	3.5	3.5	3.5
Consumer price index (period average)	13.9	8.8	2.2	5.7	4.5	4.0	4.0	4.0	4.0
Consumer price index (end of period)	14.4	2.1	4.9	5.2	4.0	4.0	4.0	4.0	4.0
Money and Credit									
Domestic credit, net	29.9	14.7	5.0	9.1	6.9	7.0	6.8	6.9	6.9
Of which : Credit to private sector	17.4	14.7	15.9	10.0	8.0	8.0	8.0	8.0	8.0
Manat base money	-2.8	19.4	0.4	9.0	9.0	9.0	9.0	9.0	9.0
Manat broad money	23.8	19.6	9.0	10.6	7.9	8.4	8.3	8.4	8.4
Total broad money	23.6	5.3	11.9	9.2	6.5	7.0	7.0	7.0	7.0
External Sector									
Exports f.o.b.	94.6	-30.8	-8.8	10.8	-10.0	-9.9	-8.0	0.3	0.3
Of which: Oil sector	105.1	-34.0	-10.1	10.8	-12.0	-12.5	-10.7	-0.9	-0.9
Imports f.o.b.	29.7	21.4	2.7	12.0	0.9	3.0	5.1	6.5	6.6
Of which: Oil sector	56.3	12.2	-6.9	1.4	1.5	1.7	2.1	0.0	0.0
Real effective exchange rate	11.8	8.1	-1.1	...	...	...	...	...	...
Gross Investment	12.1	18.3	17.8	18.3	16.2	14.6	13.7	13.7	13.7
Consolidated government	8.0	12.2	11.3	11.7	10.0	8.8	8.1	8.1	8.1
Private sector	4.1	6.1	6.5	6.7	6.2	5.8	5.6	5.6	5.6
Of which: Oil sector	-6.3	-0.3	1.1	1.3	1.5	1.6	1.7	1.6	1.6
Gross National Savings	42.1	29.8	25.7	26.1	20.4	15.1	11.3	10.4	9.6
Consolidated General Government Finances 2/									
Total revenue and grants	32.1	40.6	37.1	34.4	32.8	31.0	29.8	29.5	29.2
Total expenditure	26.2	32.7	33.8	35.6	34.5	33.4	32.5	31.7	31.0
Current expenditure	18.2	20.5	22.5	23.9	24.4	24.6	24.4	24.4	24.0
Net acquisition of non-financial assets	8.0	12.2	11.3	11.7	10.0	8.8	8.1	7.3	7.0
Overall fiscal balance	6.0	7.9	3.2	-1.3	-1.7	-2.4	-2.8	-2.1	-1.8
Non-oil primary balance, in percent of non-oil GDP	-22.4	-22.1	-20.5	-22.1	-18.6	-16.3	-14.5	-12.7	-11.3
General government debt 3/	17.3	21.8	20.9	21.0	22.2	22.7	23.1	23.8	23.8
General government and government-guaranteed debt	26.9	28.9	27.6	27.6	28.6	28.9	29.1	29.6	29.4
External Sector									
Current account (- deficit)	29.8	11.5	7.8	7.8	4.1	0.5	-2.4	-3.3	-4.2
Foreign direct investment (net)	-6.5	-2.9	-0.7	-0.4	-0.2	0.0	0.2	0.4	0.5
Memorandum Items:									
Gross official international reserves (in millions of U.S. dollars)	8,996	11,281	10,960	10,760	10,560	10,360	10,160	9,960	9,760
in months of next year's non-oil imports f.o.b.	5.4	7.7	6.6	6.4	6.1	5.7	5.3	4.9	4.6
Nominal GDP (in millions of manat)	133,973	123,128	126,337	134,078	139,182	145,847	153,556	162,135	171,522
Nominal non-oil GDP (in millions of manat)	69,764	78,990	85,712	94,674	102,595	110,434	118,825	127,903	137,675
Nominal GDP (in millions of U.S. dollars)	78,807	72,429	74,316	78,870	81,872	85,792	90,327	95,373	100,895
Oil Fund Assets (in millions of U.S. dollars)	49,034	56,070	60,031	60,911	61,797	61,864	61,594	62,222	62,949
Assumed oil price, WEO plus $2-$3 premium (in U.S. dollars per barrel)	98.4	82.6	81.2	78.6	73.5	71.6	70.6	72.0	73.4
Assumed natural gas price, WEO plus a premium (in U.S. dollars per thousands of cubic meters)	1340.0	460.1	389.0	517.4	424.7	342.2	290.2	290.2	290.2
Exchange rate (manat/dollar, end of period)	1.7	1.7	1.7	...	...	...	...	...	...

Sources: National authorities; and IMF staff estimates and projections.

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

2/ Consolidates State Budget, State Oil Fund of Azerbaijan (SOFAZ), Nakhchevan Autonomous Region (NAK) and State Social Protection Fund.

3/ Starting in 2021, includes guarantees issued to Aqrakredit for its acquisition of distressed assets from the IBA.

Table 2a. Azerbaijan: Balance of Payments, 2022–30

(In millions of U.S. dollars, unless otherwise specified)

			Est.	Projections					
	2022	2023	2024	2025	2026	2027	2028	2029	2030
Exports, f.o.b.	42,207	29,202	26,646	29,519	26,559	23,920	22,000	22,068	22,124
Oil and gas sector	39,267	25,935	23,318	25,827	22,740	19,888	17,762	17,608	17,446
Other	2,940	3,267	3,329	3,692	3,819	4,032	4,238	4,460	4,677
Imports, f.o.b.	-13,509	-16,397	-16,839	-18,860	-19,024	-19,592	-20,593	-21,941	-23,392
Oil and gas sector	-2,539	-2,849	-2,652	-2,689	-2,730	-2,777	-2,834	-2,834	-2,834
Others	-10,970	-13,548	-14,187	-16,171	-16,295	-16,815	-17,759	-19,107	-20,557
Trade Balance	28,697	12,806	9,807	10,659	7,535	4,327	1,406	127	-1,268
Services, net	-2,698	-2,335	-2,107	-2,280	-2,135	-2,066	-2,082	-2,003	-1,929
Oil and gas sector	-1,983	-2,062	-1,816	-1,588	-1,418	-1,406	-1,393	-1,379	-1,283
Others	-715	-273	-292	-692	-717	-660	-689	-624	-646
Factor income, net	-5,487	-3,199	-2,674	-3,042	-2,824	-2,673	-2,448	-2,252	-2,052
Oil and gas	-6,078	-3,933	-3,485	-3,711	-3,561	-3,411	-3,261	-3,111	-2,961
Others	591	734	811	669	737	738	813	858	908
Transfers, net	2,965	1,058	798	809	819	829	912	963	1,019
Current Account Balance	23,478	8,329	5,823	6,147	3,395	417	-2,211	-3,166	-4,231
Non-oil Current Account Balance	-5,189	-8,762	-9,542	-11,693	-11,637	-11,877	-12,484	-13,449	-14,599
Capital account, net	--	-10	-10	-10	-10	-10	-10	-10	-10
Direct investment, net	-5,099	-2,093	-486	-323	-156	14	192	377	539
Oil and gas	-6,127	-2,804	-1,788	-1,672	-1,557	-1,442	-1,327	-1,213	-1,099
Others	1,028	710	1,301	1,350	1,401	1,456	1,519	1,590	1,638
Portfolio investment, net	-1,793	-683	-1,719	-494	-494	-494	-494	-494	-494
Other investment, net	-6,045	-1,979	-426	-5,098	-2,507	-518	1,594	3,264	4,264
Oil and gas	-5,052	-1,845	-192	-192	-192	-192	-192	-192	-192
Others	-994	-134	-234	-4,906	-2,315	-326	1,786	3,456	4,456
Oil bonus	452	471	458	458	458	458	458	458	458
Financial derviatives	0	0	0	0	0	0	0	0	0
Financial Account, Net	-12,485	-4,284	-2,173	-5,457	-2,700	-540	1,750	3,604	4,766
Capital and Financial Account Balance	-12,485	-4,294	-2,183	-5,467	-2,709	-549	1,740	3,594	4,757
Errors & Omissions	-1617.8	1320.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	9,375	5,356	3,640	680	685	-132	-471	429	526
Financing	-9,375	-5,356	-3,640	-680	-685	132	471	-429	-526
Change in net foreign assets of CBA (increase -)	-1,921	-2,285	322	200	200	200	200	200	200
Change in Oil Fund assets (increase -)	-4,009	-7,036	-3,962	-880	-885	-68	271	-629	-726
Change in other government FX assets (increase -)	-3446	3965	0	0	0	0	0	0	0
Memorandum Items:									
Current account balance (in percent of GDP)	29.8	11.5	7.8	7.8	4.1	0.5	-2.4	-3.3	-4.2
Gross official international reserves	8,996	11,281	10,960	10,760	10,560	10,360	10,160	9,960	9,760
in months of next year's non-oil imports f.o.b.	5.4	7.7	6.6	6.4	6.1	5.7	5.3	4.9	4.6
Oil Fund assets	49,034	56,070	60,031	60,911	61,797	61,864	61,594	62,222	62,949
Total external debt (in percent of GDP)	9.7	9.8	8.2	7.9	7.8	7.5	7.2	7.0	6.6
Oil price (US$ per barrel)	98.4	82.6	81.2	78.6	73.5	71.6	70.6	72.0	73.4
Exchange rate (average, AZN/$)	1.7	1.7	1.7	...	...	...	...	...	...
Nominal GDP (in millions of U.S. dollars)	78,807	72,429	74,316	78,870	81,872	85,792	90,327	95,373	100,895

Sources: National authorities; and IMF staff estimates and projections.

Table 2b. Azerbaijan: Balance of Payments, 2022–30
(In percent of GDP, unless otherwise specified)

			Est.	Projections					
	2022	2023	2024	2025	2026	2027	2028	2029	2030
Exports, f.o.b.	53.6	40.3	35.9	37.4	32.4	27.9	24.4	23.1	21.9
Oil and gas sector	49.8	35.8	31.4	32.7	27.8	23.2	19.7	18.5	17.3
Other	3.7	4.5	4.5	4.7	4.7	4.7	4.7	4.7	4.6
Imports, f.o.b.	-17.1	-22.6	-22.7	-23.9	-23.2	-22.8	-22.8	-23.0	-23.2
Oil and gas sector	-3.2	-3.9	-3.6	-3.4	-3.3	-3.2	-3.1	-3.0	-2.8
Others	-13.9	-18.7	-19.1	-20.5	-19.9	-19.6	-19.7	-20.0	-20.4
Trade Balance	36.4	17.7	13.2	13.5	9.2	5.0	1.6	0.1	-1.3
Services, net	-3.4	-3.2	-2.8	-2.9	-2.6	-2.4	-2.3	-2.1	-1.9
Oil and gas sector	-2.5	-2.8	-2.4	-2.0	-1.7	-1.6	-1.5	-1.4	-1.3
Others	-0.9	-0.4	-0.4	-0.9	-0.9	-0.8	-0.8	-0.7	-0.6
Factor income, net	-7.0	-4.4	-3.6	-3.9	-3.4	-3.1	-2.7	-2.4	-2.0
Oil and gas	-7.7	-5.4	-4.7	-4.7	-4.3	-4.0	-3.6	-3.3	-2.9
Others	0.7	1.0	1.1	0.8	0.9	0.9	0.9	0.9	0.9
Transfers, net	3.8	1.5	1.1	1.0	1.0	1.0	1.0	1.0	1.0
Current Account Balance	29.8	11.5	7.8	7.8	4.1	0.5	-2.4	-3.3	-4.2
Non-oil Current Account Balance	-6.6	-12.1	-12.8	-14.8	-14.2	-13.8	-13.8	-14.1	-14.5
Capital Account, Net	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment, net	-6.5	-2.9	-0.7	-0.4	-0.2	--	0.2	0.4	0.5
Oil and gas	-7.8	-3.9	-2.4	-2.1	-1.9	-1.7	-1.5	-1.3	-1.1
Others	1.3	1.0	1.8	1.7	1.7	1.7	1.7	1.7	1.6
Portfolio investment, net	-2.3	-0.9	-2.3	-0.6	-0.6	-0.6	-0.5	-0.5	-0.5
Other investment	-7.7	-2.7	-0.6	-6.5	-3.1	-0.6	1.8	3.4	4.2
Oil and gas	-6.4	-2.5	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Others	-1.3	-0.2	-0.3	-6.2	-2.8	-0.4	2.0	3.6	4.4
Oil bonus	0.6	0.7	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Financial derviatives	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account, Net	-15.8	-5.9	-2.9	-6.9	-3.3	-0.6	1.9	3.8	4.7
Capital and Financial Account Balance	-15.8	-5.9	-2.9	-6.9	-3.3	-0.6	1.9	3.8	4.7
Errors & Omissions	-2.1	1.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	11.9	7.4	4.9	0.9	0.8	-0.2	-0.5	0.4	0.5
Financing	-11.9	-7.4	-4.9	-0.9	-0.8	0.2	0.5	-0.4	-0.5
Change in net foreign assets of CBA (increase -)	-2.4	-3.2	0.4	0.3	0.2	0.2	0.2	0.2	0.2
Change in Oil Fund assets (increase -)	-5.1	-9.7	-5.3	-1.1	-1.1	-0.1	0.3	-0.7	-0.7
Change in other government FX assets (increase -)	-4.4	5.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum Items:									
Current account balance	29.8	11.5	7.8	7.8	4.1	0.5	-2.4	-3.3	-4.2
Gross official international reserves	11.4	15.6	14.7	13.6	12.9	12.1	11.2	10.4	9.7
in months of next year's non-oil imports f.o.b.	5.4	7.7	6.6	6.4	6.1	5.7	5.3	4.9	4.6
Oil Fund assets	62.2	77.4	80.8	77.2	75.5	72.1	68.2	65.2	62.4
Oil price (US$ per barrel)	98.4	82.6	81.2	78.6	73.5	71.6	70.6	72.0	73.4
Exchange rate (average, AZN/$)	1.7	1.7	1.7	...	...	...	...	...	...
Nominal GDP (in Millions of US$)	78,807	72,429	74,316	78,870	81,872	85,792	90,327	95,373	100,895

Sources: National authorities; and IMF staff estimates and projections.

Table 3a. Azerbaijan: Statement of Consolidated Government Operations, 2022–30 1/

(In millions of manat)

	2022	2023	Est. 2024	Projections 2025	2026	2027	2028	2029	2030
Revenue									
Total revenue	43,059	50,049	46,843	46,064	45,590	45,154	45,694	47,843	50,162
Tax revenue	24,745	27,676	28,028	29,167	30,329	31,398	33,054	35,224	37,565
Income taxes	9,362	9,684	8,626	7,710	8,241	8,128	8,316	8,739	9,193
Individual income tax	1,462	1,657	1,839	2,032	3,001	3,231	3,476	3,742	4,028
Enterprise profits tax	7,900	8,027	6,787	5,679	5,240	4,897	4,839	4,997	5,165
Value added tax (VAT)	6,963	8,128	8,894	9,987	10,209	10,763	11,477	12,351	13,292
Excise taxes	1,359	1,452	1,656	1,840	1,954	2,088	2,240	2,411	2,595
Taxes on international trade	2,020	2,202	2,425	2,772	2,762	2,884	3,062	3,295	3,546
Other taxes	677	792	867	958	1,038	1,117	1,202	1,294	1,393
Social security contributions	4,365	5,418	5,559	5,900	6,124	6,418	6,757	7,134	7,547
Nontax revenue	18,293	22,353	18,794	16,876	15,241	13,735	12,618	12,595	12,573
Of which : Oil Fund revenues	16,858	21,662	18,039	16,060	14,371	12,812	11,638	11,554	11,465
Grants	20	20	20	20	20	20	20	20	20
Expenditure									
Total Expenditure	35,070	40,296	42,758	47,742	47,998	48,657	49,940	51,317	53,238
Current Expense	24,403	25,294	28,477	32,061	34,017	35,847	37,428	39,519	41,220
Compensation of employees	7,465	8,130	8,673	9,580	10,181	10,559	10,961	11,399	11,870
Use of goods and services	6,730	7,473	8,447	9,331	9,611	9,845	10,094	10,365	10,657
Social benefits	8,109	7,295	8,750	10,196	11,021	12,048	12,773	13,874	14,563
Of which : Social protection fund	1,920	1,937	2,138	2,362	2,559	2,755	2,964	3,191	3,435
Subsidies	1,401	1,462	1,604	1,738	1,727	1,758	1,806	1,890	1,979
Grants	20	20	20	20	20	20	20	20	20
Interest	632	868	921	1,133	1,391	1,550	1,708	1,906	2,066
Other expense	45	47	61	63	65	66	66	66	66
Net Acquisition of Nonfinancial Assets	10,667	15,002	14,281	15,681	13,981	12,810	12,512	11,798	12,018
Overall Balance	7,989	9,752	4,085	-1,678	-2,408	-3,503	-4,246	-3,475	-3,076
Overall balance excluding one off items	7,989	9,752	4,085	-1,678	-2,408	-3,503	-4,246	-3,475	-3,076
Non-oil primary balance 2/	-15,637	-17,460	-17,573	-20,877	-19,102	-18,020	-17,251	-16,221	-15,597
Net Financial Transactions	7,989	9,752	4,085	-1,678	-2,408	-3,504	-4,248	-3,478	-3,080
Net Acquisition of Financial Assets	7,935	11,168	6,112	1,229	1,205	-225	-849	623	544
Oil Fund	8,300	11,738	5,143	1,496	1,505	115	-460	1,069	1,060
Privatization and other sale of assets	-115	-116	-139	-167	-200	-241	-289	-346	-416
Banking System 3/	-250	-490	-100	-100	-100	-100	-100	-100	-100
Others	0	36	1,209	0	0	0	0	0	0
Net Incurrence of Liabilities	489	1,416	2,027	2,907	3,613	3,279	3,399	4,100	3,624
Domestic debt issuance	200	200	400	500	200	180	204	232	263
Of which: Domestic banking sector	1,870	1,020	830	400	200	120	0	0	0
External Loans	253	300	500	878	1,000	1,000	1,000	1,000	1,000
Other	36	916	1,127	1,529	2,413	2,099	2,195	2,869	2,361
Memorandum Items:									
Oil revenue	24,258	28,081	22,579	20,331	18,085	16,066	14,710	14,649	14,582
Non-oil revenue	18,800	21,968	24,263	25,733	27,504	29,087	30,981	33,191	35,576
Non-oil tax revenue 4/	12,981	15,839	17,929	18,997	20,490	21,726	23,225	24,995	26,900
Non-oil GDP (in million of manats)	69,764	78,990	85,712	94,674	102,595	110,434	118,825	127,903	137,675

Sources: National authorities; and IMF staff estimates and projections.

1/ Consolidated government includes oil fund SOFAZ, State Social Protection Fund, Unemployment Insurance Fund, State Agency for Mandatory Health Insurance, and Nakhchivan Autonomous Republic budget. These entities have been added to budgetary central government.

2/ Defined as non-oil revenue minus total expenditure (excl. interest payments) and statistical discrepancies. Does not include possible slowdown in fiscal adjustment.

3/ Comprises government deposits in CBA and commercial banks.

4/ Tax revenue excluding AIOC and SOCAR profit tax.

Table 3b. Azerbaijan: Statement of Consolidated Government Operations, 2022–30 1/

(In percent of non-oil GDP)

	2022	2023	Est. 2024	Projections 2025	2026	2027	2028	2029	2030
Revenue									
Total revenue	61.7	64.4	54.7	48.7	44.4	40.9	38.5	37.4	36.4
Tax revenue	35.5	35.6	32.7	30.8	29.6	28.4	27.8	27.5	27.3
Income taxes	13.4	12.5	10.1	8.1	8.0	7.4	7.0	6.8	6.7
Individual income tax	2.1	2.1	2.1	2.1	2.9	2.9	2.9	2.9	2.9
Enterprise profits tax	11.3	10.3	7.9	6.0	5.1	4.4	4.1	3.9	3.8
Value added tax (VAT)	10.0	10.5	10.4	10.5	10.0	9.7	9.7	9.7	9.7
Excise taxes	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Taxes on international trade	2.9	2.8	2.8	2.9	2.7	2.6	2.6	2.6	2.6
Other taxes	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Social security contributions	6.3	7.0	6.5	6.2	6.0	5.8	5.7	5.6	5.5
Nontax revenue	26.2	28.8	21.9	17.8	14.9	12.4	10.6	9.8	9.1
Of which : Oil Fund revenues	24.2	27.9	21.0	17.0	14.0	11.6	9.8	9.0	8.3
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure									
Total Expenditure	50.3	51.9	49.9	50.4	46.8	44.1	42.0	40.1	38.7
Current Expense	35.0	32.6	33.2	33.9	33.2	32.5	31.5	30.9	29.9
Compensation of employees	10.7	10.5	10.1	10.1	9.9	9.6	9.2	8.9	8.6
Use of goods and services	9.6	9.6	9.9	9.9	9.4	8.9	8.5	8.1	7.7
Social benefits	11.6	9.4	10.2	10.8	10.7	10.9	10.7	10.8	10.6
Of which : Social protection fund	2.8	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Subsidies	2.0	1.9	1.9	1.8	1.7	1.6	1.5	1.5	1.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest	0.9	1.1	1.1	1.2	1.4	1.4	1.4	1.5	1.5
Other expense	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Net Acquisition of Nonfinancial Assets	15.3	19.3	16.7	16.6	13.6	11.6	10.5	9.2	8.7
Overall Balance	11.5	12.6	4.8	-1.8	-2.3	-3.2	-3.6	-2.7	-2.2
Overall balance excluding one off items	11.5	12.6	4.8	-1.8	-2.3	-3.2	-3.6	-2.7	-2.2
Non-oil primary balance 2/	-22.4	-22.1	-20.5	-22.1	-18.6	-16.3	-14.5	-12.7	-11.3
Net Financial Transactions	11.5	12.6	4.8	-1.8	-2.3	-3.2	-3.6	-2.7	-2.2
Net Acquisition of Financial Assets	11.4	14.4	7.1	1.3	1.2	-0.2	-0.7	0.5	0.4
Oil Fund	11.9	15.1	6.0	1.6	1.5	0.1	-0.4	0.8	0.8
Privatizations and other sale of assets	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3
Banking System 3/	-0.4	-0.6	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Others	0.0	0.0	1.4	0.0	0.0	0.0	0.0	0.0	0.0
Net Incurrence of Liabilities	0.7	1.8	2.4	3.1	3.5	3.0	2.9	3.2	2.6
Debt securities	0.3	0.3	0.5	0.5	0.2	0.2	0.2	0.2	0.2
Of which: Domestic banking sector	2.7	1.3	1.0	0.4	0.2	0.1	0.0	0.0	0.0
External Loans	0.4	0.4	0.6	0.9	1.0	0.9	0.8	0.8	0.7
Other	0.1	1.2	1.3	1.6	2.4	1.9	1.8	2.2	1.7
Memorandum Items:									
Oil revenue	34.8	36.2	26.3	21.5	17.6	14.5	12.4	11.5	10.6
Non-oil revenue	26.9	28.3	28.3	27.2	26.8	26.3	26.1	26.0	25.8
Non-oil tax revenue 4/	18.6	20.4	20.9	20.1	20.0	19.7	19.5	19.5	19.5
Non-oil GDP (in billion of manats)	69.8	77.7	85.7	94.7	102.6	110.4	118.8	127.9	137.7

Sources: National authorities; and IMF staff estimates and projections.

1/ Consolidated government includes oil fund SOFAZ, State Social Protection Fund, Unemployment Insurance Fund, State Agency for Mandatory Health Insurance, and Nakhchivan Autonomous Republic budget. These entities have been added to budgetary central government.

2/ Defined as non-oil revenue minus total expenditure (excl. interest payments) and statistical discrepancies. Does not include possible slowdown in fiscal adjustment.

3/ Comprises government deposits in CBA and commercial banks.

4/ Tax revenue excluding AIOC and SOCAR profit tax.

Table 4. Azerbaijan: Summary Accounts of the Central Bank, 2022–30

(In millions of manat, unless otherwise specified)

			Est.	Projections					
	2022	2023	2024	2025	2026	2027	2028	2029	2030
Net Foreign Assets	18,835	22,720	22,174	21,834	21,494	21,154	20,814	20,474	20,134
Net international reserves of the CBA	18,604	22,548	23,830	21,838	21,498	21,158	20,818	20,478	20,138
Gross international reserves	19,804	23,757	25,003	23,011	22,671	22,331	21,991	21,651	21,311
Foreign liabilities	-1,199	-1,209	-1,173	-1,173	-1,173	-1,173	-1,173	-1,173	-1,173
Other items, net	-1	-4	-4	-4	-4	-4	-4	-4	-4
Net Domestic Assets	2,049	1,119	1,540	7,136	9,362	11,871	14,519	17,345	20,347
Domestic credit	3,215	3,130	3,477	9,102	11,357	13,896	16,575	19,431	22,465
Net claims on consolidated central government	-3,114	-2,523	-798	-798	-798	-698	-598	-497	-395
Of which : claims on central government	317	445	389	389	389	389	389	389	389
manat deposits of central government	-3,626	-3,039	-4,565	-4,565	-4,565	-4,465	-4,365	-4,264	-4,162
Net claims on banks 1/	7,440	6,557	9,430	9,900	12,155	14,594	17,173	19,928	22,860
Credit to the economy	0	0	0	0	0	0	0	0	0
Net claims on other financial corporations 1/									
Other items, net	-1,167	-2,011	-1,937	-1,966	-1,995	-2,025	-2,056	-2,086	-2,118
Reserve Money	20,884	23,839	23,714	28,970	30,856	33,024	35,333	37,819	40,481
Manat reserve money	17,444	20,830	20,913	22,795	24,847	27,083	29,520	32,177	35,073
Currency outside CBA	14,714	17,318	17,449	16,773	18,282	19,928	21,721	23,676	25,807
Bank reserves and other deposits	2,730	3,512	3,464	6,022	6,564	7,155	7,799	8,501	9,266
Reserves in foreign currency	3,440	3,009	2,801	6,175	6,009	5,942	5,813	5,642	5,408

Sources: National authorities; and IMF staff estimates and projections.

1/ Includes CBA holdings of Aqrarcredit's bonds as a part of the SPV, and IBA deposits.

Table 5. Azerbaijan: Monetary Survey, 2022–30

(In millions of manat, unless otherwise specified)

			Est.	Projections					
	2022	2023	2024	2025	2026	2027	2028	2029	2030
Net Foreign Assets	25,031	25,217	26,610	24,701	24,445	24,190	23,936	23,683	23,431
Net international reserves of the CBA	18,604	22,548	23,830	21,838	21,498	21,158	20,818	20,478	20,138
Net foreign assets of commercial banks	7,041	3,684	3,993	4,093	4,193	4,293	4,393	4,493	4,593
Other	-614	-1,015	-1,214	-1,231	-1,247	-1,262	-1,276	-1,289	-1,301
Net Domestic Assets	9,730	12,563	14,647	21,480	25,619	30,294	35,234	40,510	46,119
Domestic credit, net	18,510	23,178	22,831	26,054	28,750	31,658	34,654	37,875	41,338
Net claims on consolidated central government	-1,971	-319	-4,413	-3,913	-3,613	-3,293	-3,092	-2,890	-2,687
Credit to the economy	20,473	23,490	27,234	29,958	32,354	34,943	37,738	40,757	44,018
Of which: private sector	20,473	23,490	27,234	29,958	32,354	34,943	37,738	40,757	44,018
Credit to other financial public sector	8	7	9	9	9	8	8	8	7
Other items, net	-8,779	-10,614	-8,184	-4,573	-3,131	-1,364	580	2,635	4,781
Broad Money	42,825	45,073	50,419	55,043	58,626	62,746	67,133	71,856	76,913
Manat broad money	29,550	35,327	38,508	42,590	45,948	49,805	53,958	58,473	63,358
Cash outside banks	13,297	15,873	15,417	14,740	15,518	16,317	17,134	17,966	18,808
Manat deposits	16,252	19,453	23,091	27,850	30,430	33,488	36,824	40,507	44,550
Foreign currency deposits	13,275	9,747	11,911	12,453	12,678	12,941	13,174	13,383	13,556
	(Annual percentage change)								
Net foreign assets	24.1	0.7	5.5	-7.2	-1.0	-1.0	-1.1	-1.1	-1.1
Net domestic assets	37.7	29.1	16.6	46.7	19.3	18.2	16.3	15.0	13.8
Credit to the economy	17.4	14.7	15.9	10.0	8.0	8.0	8.0	8.0	8.0
Of which: private sector	17.4	14.7	15.9	10.0	8.0	8.0	8.0	8.0	8.0
Broad money (M3)	23.6	5.3	11.9	9.2	6.5	7.0	7.0	7.0	7.0
Manat broad money (M2)	23.8	19.6	9.0	10.6	7.9	8.4	8.3	8.4	8.4
Reserve money	5.7	14.2	-0.5	22.2	6.5	7.0	7.0	7.0	7.0
Manat reserve money	-2.8	19.4	0.4	9.0	9.0	9.0	9.0	9.0	9.0
Memorandum Items:									
Gross official international reserves (US$ millions)	8,996	11,281	10,960	10,760	10,560	10,360	10,160	9,960	9,760
Velocity of total broad money (M3)	1.7	1.8	1.7	1.7	1.8	1.8	1.8	1.8	1.8
Credit to private sector in percent of non-oil GDP	29.3	29.7	31.8	31.6	31.5	31.6	31.8	31.9	32.0
Share of foreign currency credits in total credit portfolio	24.9	22.4	20.2	18.2	16.4	14.7	13.3	11.9	10.7
Current to broad money ratio	31.1	35.2	30.6	26.8	26.5	26.0	25.5	25.0	24.5
Share of foreign currency deposits in total deposits	45.0	33.4	34.0	30.9	29.4	27.9	26.3	24.8	23.3
Foreign currency deposits to broad money ratio	31.0	21.6	23.6	22.6	21.6	20.6	19.6	18.6	17.6

Sources: National authorities; and IMF staff estimates and projections.

Table 6. Azerbaijan: Banking Sector Financial Soundness Indicators, 2019–24

(In percent, unless otherwise specified)

	2019	2020	2021	2022	2023	2024
Capital Adequacy						
Regulatory Capital to Risk-Weighted Assets	22.2	25.1	19.2	19.3	17.5	17.6
Tiet I Capital to Total Regulatory Capital	83.0	86.0	84.0	79.0	77.0	77.2
Risk-Weighted Assets to Total Assets	55.0	52.0	62.0	57.0	65.0	66.8
Asset Quality						
Nonperforming Loans (NPLs) to Total Loans	8.3	6.2	4.5	3.8	2.6	2.4
Nonperforming Loans (billions of manat)	1.2	0.9	0.7	0.7	0.6	0.7
Share of Restructured Loans	12.4	14.5	8.8	5.8	3.6	4.0
Loan-loss provisioning to nonperforming loans ratio	117.1	55.0	57.5	58.1	63.5	73.5
Liquidity						
Instant Liquidity Ratio	59.0	61.0	62.0	60.0	52.0	51.9
Liquid Assets to Total Assets 1/	29.0	33.0	36.0	37.0	27.0	27.0
Liquidity Coverage ratio 2/	…	…	…	…	134.0	150.1
FX Liquidity Coverage Ratio 2/	…	…	…	…	118.0	178.0
Profitability						
Bank Return on Assets	1.6	1.8	1.8	2.7	3.0	2.1
Bank Return on Equity	24.9	12.7	13.6	18.5	20.3	18.1
Foreign Currency Position and Dollarization						
Deposit Dollarization	57.2	53.2	47.6	47.1	38.4	37.5
Loan Dollarization	35.3	30.2	26.2	20.1	18.8	16.1
Net Open FX Position	-36.9	-25.3	-11.3	2.7	1.4	-5.3

Sources: Central Bank of Azerbaijan and IMF staff caulculations.
1/ Liquid assets include cash and cash equivalents, claims on the CBA, Nostro accounts, and deposits with financial institutions.
2/ CBA introduced in 2023.

Annex I. External Sector Assessment

Overall Assessment*: Staff assesses the external position in 2024 to be weaker than implied by fundamentals and desirable policies. Oil and gas prices have moderated from the high 2022 levels while hydrocarbon production contracted in 2023 and slightly increased in 2024, leading to oil export revenues declining and the external position weakening in strength for two consecutive years. Moreover, the real effective exchange rate appreciated in 2023 and 2024, and non-oil imports grew faster than non-oil exports. A larger and more sustained current account (CA) surplus is however needed to preserve intergenerational equity. With the global supply of oil and gas expected to remain high, global energy prices are projected to stay below 2022 levels. If external conditions persist and without a more competitive non-oil sector, the CA balance will likely continue to be weaker than the level needed for future generations. This overall assessment is subject to a high degree of uncertainty related to the future path of oil and gas prices.*

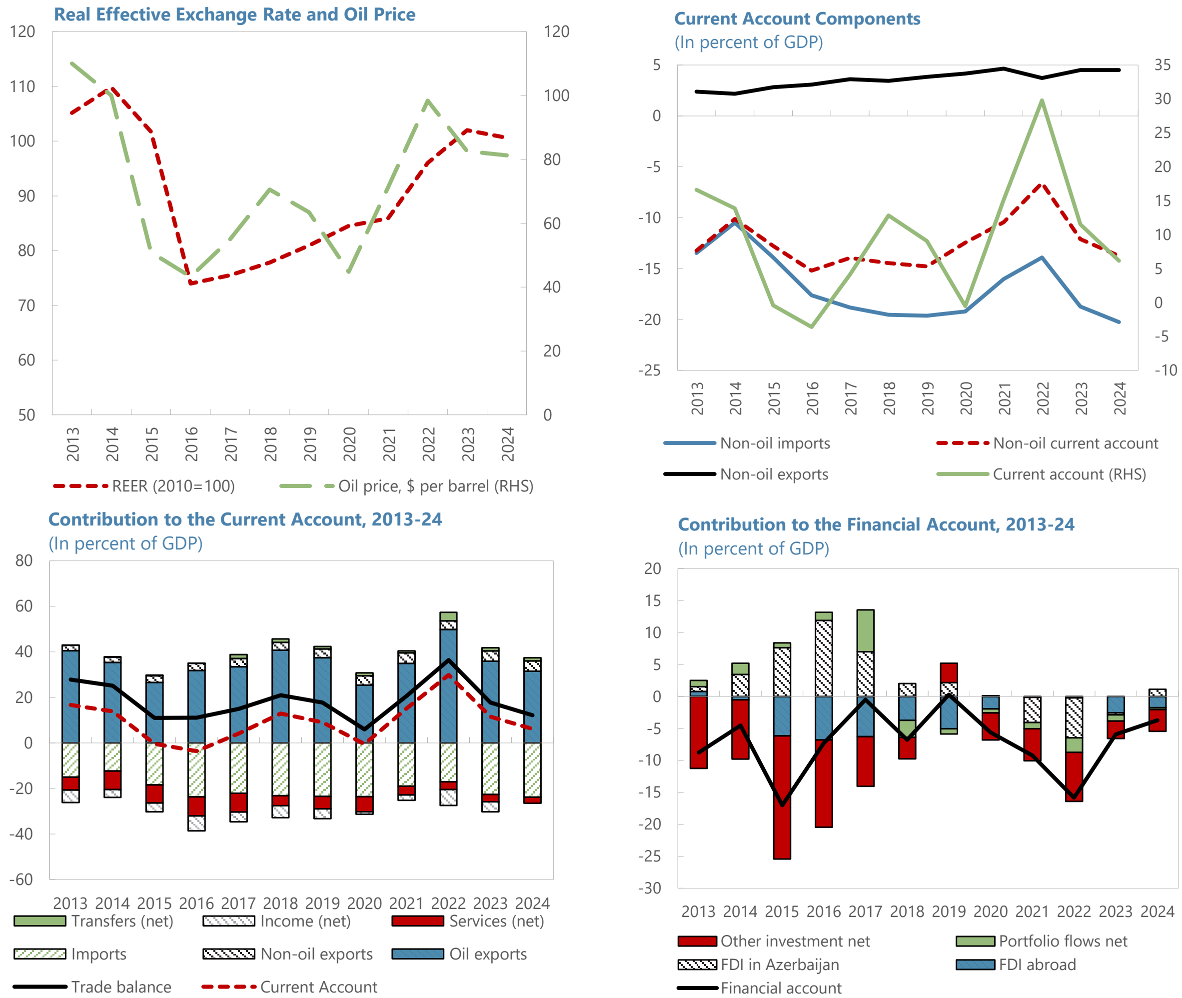
Potential Policy Responses*: Given the projected decline of hydrocarbon production and revenues, fiscal consolidation should be sustained to preserve some level of intergenerational equity and help increase the saving-investment balance. The central bank should also be prepared to use its tools to keep inflation within the target band, while continuing to strengthen the monetary policy framework and gradually transition to hybrid inflation targeting. More importantly, these policies should go in tandem with reforms to attract private investment and develop a competitive and export-oriented non-oil sector.*

Current Account

Background. The CA surplus for 2024 is estimated at 7.8 percent of GDP, well below the 11.5 percent in 2023 and the 29.8 percent in 2022, but a surplus large enough to increase external buffers. Despite Brent oil prices remaining above $80 per barrel and oil and gas production stable in 2024, the dollar value of oil exports declined by 10 percent. Nonoil imports are estimated to remain high at about 19 percent of GDP in 2024, despite growing only by about 5 percent following two years of double-digit growth. Nonoil exports remain low at 4.5 percent of GDP and the nonoil CA deficit increased from 12 percent of GDP in 2023 to 13 percent of GDP in 2024. The CA surplus is projected to remain at 7.8 percent of GDP in 2025 on the back of higher projected gas exports and only a slight decline in prices. Beyond 2025, the CA balance is projected to gradually decline in tandem with the projected reduction of oil prices and expected decline in oil export volumes. Rising demand for gas in Europe could generate additional business opportunities, but this will require significant capital investments.

Assessment. Overall, staff assesses the external position to be weaker than the level consistent with medium term fundamentals and desirable policies. This assessment is based on the EBA-lite commodity module's consumption model, which in turn is based on the permanent income hypothesis (PIH). Specifically, staff assesses the CA gap to be negative, around -2.9 percent of GDP, based on the constant real annuity estimated by the EBA-Lite commodity approach. The results are highly sensitive to the assumed oil price.

Figure I.1. Azerbaijan: Real Effective Exchange Rates and Contributions to Current Account



Sources: National authorities, IMF World Economic Outlook, and IMF staff calculations.

- The EBA-Lite commodity approach[1] is preferable for assessing the CA position in Azerbaijan because it is based on PIH and reflects the fundamental goal of achieving intergenerational equity in a country with nonrenewable resources. Assuming the annuity is constant in real terms, the CA norm is estimated at 10 percent of GDP in 2024, implying a CA gap of -2.9 percent of GDP.[2] The gap is expected to remain negative over the medium term at -5.7 percent of GDP, implying that Azerbaijan's declining CA balance could remain below the level needed to preserve intergenerational equity and further efforts to build additional buffers will be required.

- The current account model, which estimates an equilibrium level of the CA consistent with the gamut of structural and policy factors in the IMF's multilaterally consistent External Balance Assessment-Lite framework, suggests that the CA was substantially stronger than implied by fundamentals and desirable policies in 2024. The CA norm is estimated at 2.5 percent of GDP, implying a favorable gap of 4.6 percent of GDP, after adjusting for the remaining cyclical effects and other exogenous factors.

Table I.1. Azerbaijan: Model Estimates for 2024

(In percent of GDP)

	CA model 1/	REER model 1/	Consumption model
		(in percent of GDP)	
CA-Actual	**7.8**		**7.8**
Cyclical contributions (from model) (-)	0.1		0.1
Natural disasters and conflicts (-)	0.6		0.6
Adjusted CA	**7.1**		**7.1**
CA Norm (from model) 2/	**2.5**		**10.0**
Adjustments to the norm (+)	0.0		0.0
Adjusted CA Norm	**2.5**		**10.0**
CA Gap	**4.6**	**-3.7**	**-2.9**
o/w Relative policy gap	4.4		
Elasticity	-0.3		
REER Gap (in percent)	**-15.0**	**12.1**	**9.6**

1/ Based on the EBA-lite 3.0 methodology

2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. The manat continued to appreciate in real terms in 2023 and 2024. It has been de facto pegged to the dollar at a rate of 1.7 since April 2017. The real effective exchange rate (REER) was 35 percent stronger than 2017 and 2.3 percent stronger than 2023, at the end of 2024.

Assessment. The current account and REER models suggest a REER gap in a wide range of -15 to 12.9 percent. The EBA-lite commodity model—the preferred approach—points to a negative REER gap, in line with the negative CA gap implied by a constant real annuity.

Capital and Financial Accounts: Flows and Policy Measures

Background. Azerbaijan has been a net supplier of capital. The capital and financial accounts recorded net cumulative outflows in 2023 and in the first three quarters of 2024, reflecting the CA surplus.

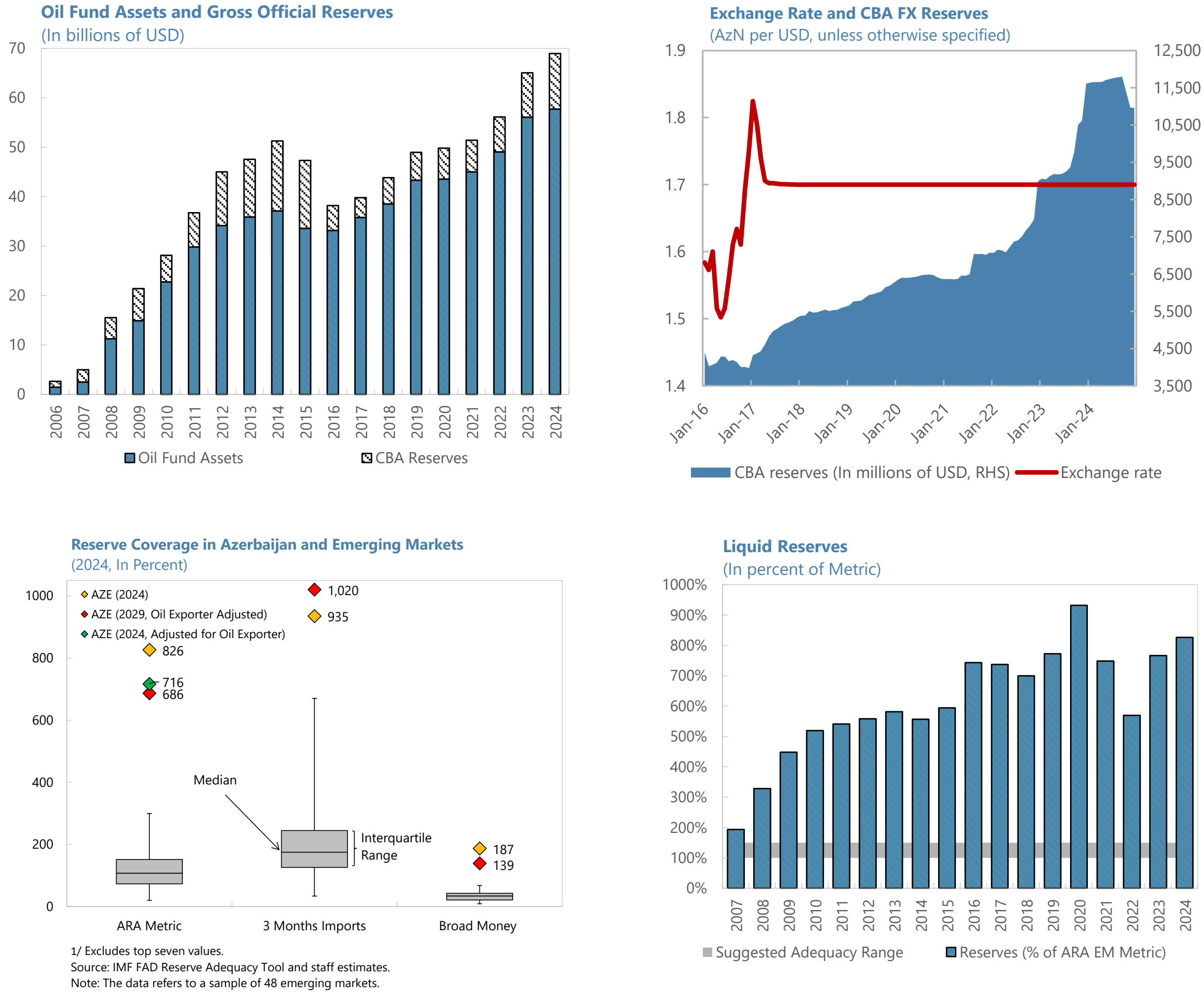
Assessment. Azerbaijan's capital and financial accounts are generally open but domestic financial markets are underdeveloped compared to those in regional and global peers. Capital inflows are dominated by FDI, mostly related to the oil sector, and portfolio inflows, while outflows include oil fund portfolio investments, trade credits, bank outflows, and outward FDI, mainly by the national oil company.

FX Intervention and Reserves Level

Background. With the CA surplus, the CBA's gross international reserves increased, reaching $11 billion (15 percent of GDP, 6.6 months of next year's imports) by end-2024. The CBA's reserves are complemented by the liquid part of foreign assets held by the State Oil Fund (SOFAZ). This liquid part, mostly fixed income instruments, equities, and gold, represents about 75 percent of the $60 billion in assets (81 percent of GDP) at end 2024. Together, CBA and SOFAZ liquid assets are equivalent to 45 months of next year's imports. In 2024 SOFAZ FX sales have more than doubled compared to 2023, with weekly auctions now close to the government programmed amounts, unlike in 2023.

Assessment. The external reserve coverage remains more than adequate. Azerbaijan scores much better than most EMs on all criteria of the IMF's Assessing Reserve Adequacy (ARA) metric, which combines information on exports, broad money, short-term debt, and other investment liabilities (yellow diamonds lower left chart). This is the case even after adjusting the ARA metric for the country's heavy reliance on oil exports (green diamond in same chart). Reserve coverage scores are projected to remain strong into 2029, given expected CA surpluses, rising reserves, and limited increases in external debt (red diamonds).

Figure I.2. Azerbaijan: Exchange Rates and Reserve Adequacy



Sources: National authorities, Haver, IMF FAD Reserve Adequacy Tool, and IMF staff calculations.
Note: The data for EM refer to a sample of 47 emerging markets.

1/ Bems, R., and I. de Carvalho Filho, 2009, "Exchange Rate Assessments: Methodologies for Oil-Exporting Countries," IMF Working Paper 09/281.

2/ The estimated norm is sensitive to the choice of model parameters, such as the GDP growth rate, interest rate, and population growth rate, as well as the underlying oil prices.

Annex II. Data Issues Annex

Figure II.1. Azerbaijan: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

B

Questionnaire Results 2/

Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	B	B	B	A	B	B

Detailed Questionnaire Results

Data Quality Characteristics	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency
Coverage	C	B	B	B	A	
Granularity 3/	C		B	B	A	
			B		A	
Consistency			B	B		B
Frequency and Timeliness	B	A	B	B	A	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance* , January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund are adequate for surveillance.
B	The data provided to the Fund have some shortcomings but are broadly adequate for surveillance.
C	The data provided to the Fund have some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund have serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. *Data provision to the Fund has some shortcomings but are generally adequate for surveillance. It does not hamper the identification of macroeconomic and financial risks and there is little risk of inaccurate assessment of these risks and inappropriate policy recommendations. The main shortcomings are: i) national accounts statistics are not reported on a quarterly basis in constant prices from the expenditure side ; ii) Azerbaijan does not report International Investment Position (IIP) data; and iii) government finance statistics is not fully consistent with GFSM 2014.*

Changes since the last Article IV consultation. *No material changes since the last Article IV consultation.*

Corrective actions and capacity development priorities. *The authorities are closing the data gaps. The IMF has provided TA on quarterly national accounts and imports and exports price deflators. Authorities have shared preliminary data on GDP from the expenditure side on annual basis but continue to work on quarterly data. On IIP statistics, the CBA continues to work on compiling the statstics but have not finalised it. The IMF has recently provided TA on GFS compilation and reporting.*

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. *Staff does not use any data and/or estimates in the staff report in lieu of official statistics.*

Other data gaps.

Table II.1. Azerbaijan: Data Standards Initiatives

Azerbaijan participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since February 2019.

Table II.2. Azerbaijan: Table of Common Indicators Required for Surveillance

As of February 14, 2025

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Azerbaijan[8]	Expected Timeliness[6,7]	Azerbaijan[8]
Exchange Rates	1/2025	2/14/2025	D	D	D	30	...	40
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/2024	2/2025	M	M	M	...	1M	...
Reserve/Base Money	12/2024	2/2025	M	M	M	30	2M	40
Broad Money	12/2024	2/2025	M	M	M	30	1Q	40
Central Bank Balance Sheet	12/2024	2/2025	M	M	M	30	2M	40
Consolidated Balance Sheet of the Banking System	12/2024	2/2025	M	M	M	30	1Q	40
Interest Rates[2]	12/2024	2/2025	M	M	M	30	...	40
Consumer Price Index	1/2025	2/2025	M	M	M	30	2M	15
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	12/2024	2/2025	M	M	A	...	3Q	...
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	12/2024	2/2025	M	M	Q	365	1Q	180
Stocks of Central Government and Central Government-Guaranteed Debt[5]	9/2024	12/2024	Q	Q	Q	365	2Q	180
External Current Account Balance	9/2024	12/2024	Q	Q	Q	90	1Q	80
Exports and Imports of Goods and Services	9/2024	12/2024	M	M	M	30	12W	45
GDP/GNP	1/2025	2/2025	M	M	Q	90	1Q	90
Gross External Debt	12/2023	12/2024	Q	Q	Q	...	2Q	...
International Investment Position	N/A	N/A	N/A	N/A	A	...	3Q	...

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

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

[3] Foreign, domestic bank, and domestic nonbank financing.

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

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex III. Risk Assessment Matrix[1]

Risk	Description	Likelihood	Possible Impact
External Risks and Spillovers			
Trade policy and investment shocks. Higher trade barriers or sanctions reduce external trade, disrupt FDI and supply chains, and trigger further U.S. dollar appreciation, tighter financial conditions, and higher inflation.	**High**	**Medium.** Prospects for economic diversification could be affected. Trade barriers or sanctions could slow the development of the non-oil sector. Slower global growth could also weigh on Azerbaijan, though some trade and investment diversions could be beneficial.	Accelerate structural reforms and promote private sector development. Enhance integration with the world economy, including by accelerating Azerbaijan's WTO accession process.
Deepening geoeconomic fragmentation. Persistent conflicts, inward-oriented policies, protectionism, weaker international cooperation, labor mobility curbs, and fracturing technological and payments systems lead to higher input costs, hinder green transition, and lower trade and potential growth.	**High**	**Medium.** Prospects for economic diversification could be affected, potentially shrinking the market for non-oil exports. Moreover, slower global growth could weigh on Azerbaijan, though reconfiguration could however provide opportunities, as exports and trade routes would be diverted towards Azerbaijan (e.g., higher demand for gas from the EU, development of a China-EU trade route through the region).	Accelerate structural reforms and promote private sector development. Enhance integration with the world economy, including by accelerating Azerbaijan's WTO accession process.
Commodity price volatility. Supply and demand volatility (due to conflicts, trade restrictions, OPEC+ decisions, AE energy policies, or green transition) increases commodity price volatility, external and fiscal pressures, social discontent, and economic instability.	**Medium**	**High**. Rising food prices could lead to higher inflation. Budgetary spending will also increase to protect the vulnerable. However, given the large dependence on hydrocarbon production and exports, volatility of oil and gas prices would have a more significant impact on the balance of payments, budget, and economic activity. It could also adversely affect bank's asset quality, profitability, and financial intermediation.	Follow a prudent fiscal policy to avoid adding to inflationary pressures. Use fiscal space for emergency spending. Enhance banks' resilience by raising capital buffers in line with Basel III requirements. In the longer term, pursue structural reforms to reduce the economy's dependence on hydrocarbons.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Risk	Description	Likelihood	Possible Impact
Climate change. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability.	**Medium**	**Medium.** Severe drought could affect agricultural output and increase food prices.	Use fiscal space to temporarily support the most vulnerable. Build resilient infrastructure and accelerate efforts to promote a more sustainable and green economy.
Domestic Risks			
Loss of spending discipline, leading to a procyclical fiscal policy. Higher oil and gas prices boost budget revenues, leading to increased spending pressures.	**Medium**	**Medium.** Pressure to increase spending, instead of saving the oil windfall revenues, could lead to a procyclical fiscal policy, increase inflation, and delay fiscal consolidation, weakening the long-term fiscal position and fiscal rule credibility.	Gradually but steadily reduce the nonoil primary deficit by maintaining spending discipline, saving most of the oil windfall revenues, and increasing nonoil budget revenues.
Weak SOE performance. Failure to improve the financial performance of weak SOEs will result in losses, with negative impact on economic growth and on the effort to diversify the economy. It could also renew the accumulation of contingent liabilities to the budget.	**Low**	**Low.** The number of SOEs remains high, although large SOEs have recently turned a profit and government guarantees have been limited and have not increased in recent years. Inefficient SOEs nonetheless would hamper efforts to promote the private sector, diversify the economy, and increase potential growth. Weak SOE's performance could also adversely affect banks.	Continue reforms to improve corporate governance and the efficiency of SOEs. Divest SOEs that are not strategically important and could operate on a commercial basis.

Annex IV. Summary of Sovereign Risk and Debt Sustainability Assessment

Table IV.1. Azerbaijan: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Low	The overall risk of sovereign stress is low, reflecting a low level of vulnerability in the near and medium term, and moderate level of vulnerability in the long term.
Near term 1/			
Medium term	Moderate	Low	Medium-term risks are assessed as low as overall deficit and borrowing needs are projected to remain moderate, with projected high though moderately declining oil price and increasing production of natural gas mitigating the impact of declining oil production and oil revenues.
Fanchart	Moderate	Moderate	
GFN	Low		
Stress test	...	...	
Long term	...	Moderate	Long-term risks are assessed as moderate. The decline in hydrocarbon revenues is projected to increase the deficit and public debt gradually and moderately, while increased reliance on domestic rather than external borrowing results in shorter debt maturity and higher amortization. However, already high public sector financial assets are projected to increase further, while domestic securitites marketd development should allow maturity extension.
Sustainability assessment 2/			Not required for surveillance-only countries.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Azerbaijan is at a low overall risk of sovereign stress. While Azerbaijan's public debt is projected to increase gradually in the baseline, it remains relatively low as a percent of GDP and relative to sovereign fund assets. However, with hydrocarbon production and government hydrocarbon revenues projected to gradually decline in the medium- and long term, in the absence of fiscal adjustment, fiscal balance is projected to gradually weaken, and borrowing requirements and public debt to gradually increase. Still, medium-term liquidity risks as analyzed by the GFN Financeability Module are low. Mechanical signal shows moderate fanchart risk, reflecting past elevated volatility of debt drivers. With an improved macro framework, less procyclical fiscal policy and large asset buffers, staff also assesses this risk as moderate. Over the longer run, Azerbaijan should implement reforms to diversify its economy, reduce reliance on the hydrocarbon revenues and boost nonoil revenues. The authorities acknowledge the need to undertake this adjustment and are planning measures to diversify

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Figure IV.1. Azerbaijan: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/

CG	GG	NFPS	CPS	Other
	chosen coverage			

1a. If central government, are non-central government entities insignificant? n.a.

2. Subsectors included in the chosen coverage in (1) above:

		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	Not applicable
CPS / NFPS / GG: expected	5	Local governments	No	Not significant
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	Yes	

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
chosen coverage	chosen coverage	chosen coverage	Missing from recommended coverage	Missing from recommended coverage

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
	chosen	chosen		

5. Debt consolidation across sectors: Consolidated | Non-consolidated (chosen)

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-Government Debt Holdings

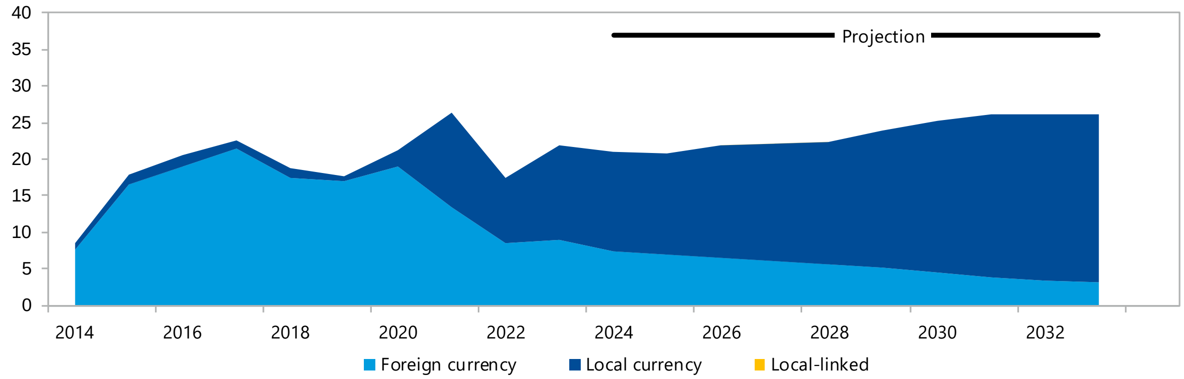
		Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Debt coverage includes the general government. Debt guaranteed by the government is not included, except for, starting in 2021, the guarantees issued to Aqrakredit for its acquisition of distressed assets from the state-owned bank IBA. Azerbaijan is a unitary state. Other than the Nakhichevan Autonomous Republic (added to the budgetary CG), there are no independent states and no debt issued by local governments.

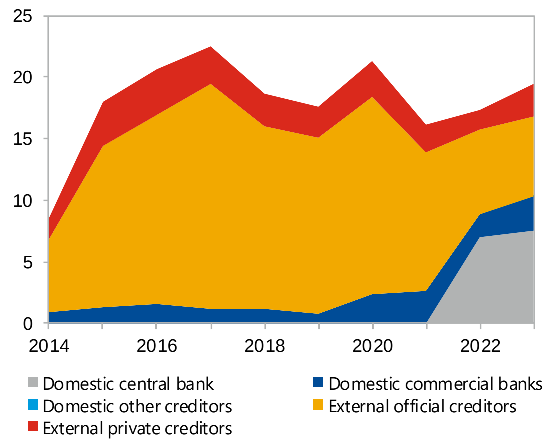
Figure IV.2. Azerbaijan: Public Debt Structure Indicators

Debt by Currency (In Percent of GDP)



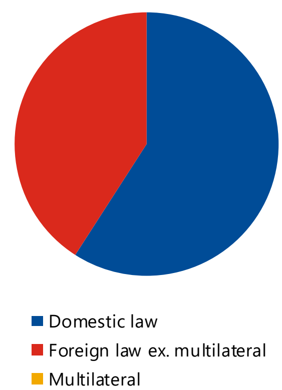
Note: The perimeter shown is general government.

Public Debt by Holder (In percent of GDP)



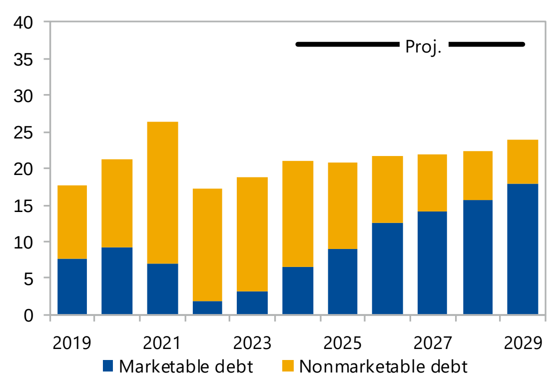
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (In percent)



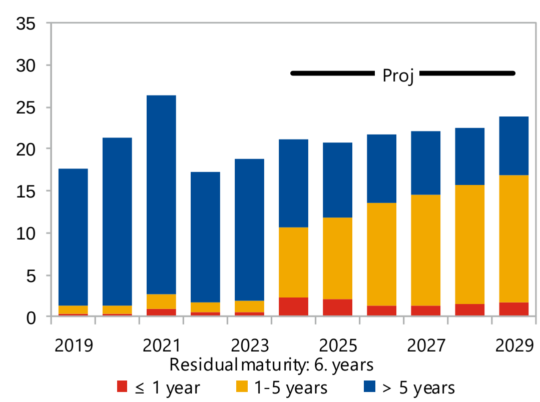
Note: The perimeter shown is general government.

Debt by Instruments (In percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (In percent of GDP)



Note: The perimeter shown is general government.

Commentary: The projected declining share of external debt reflects the authorities' plan to reduce the dependence on external borrowing. Increased central bank share in 2021 reflects the recognition of guarantee to Aqrarkredit, a government-controlled credit agency, on the bond it issued to acquire bad assets from the IBA during the 2015-16 crisis.

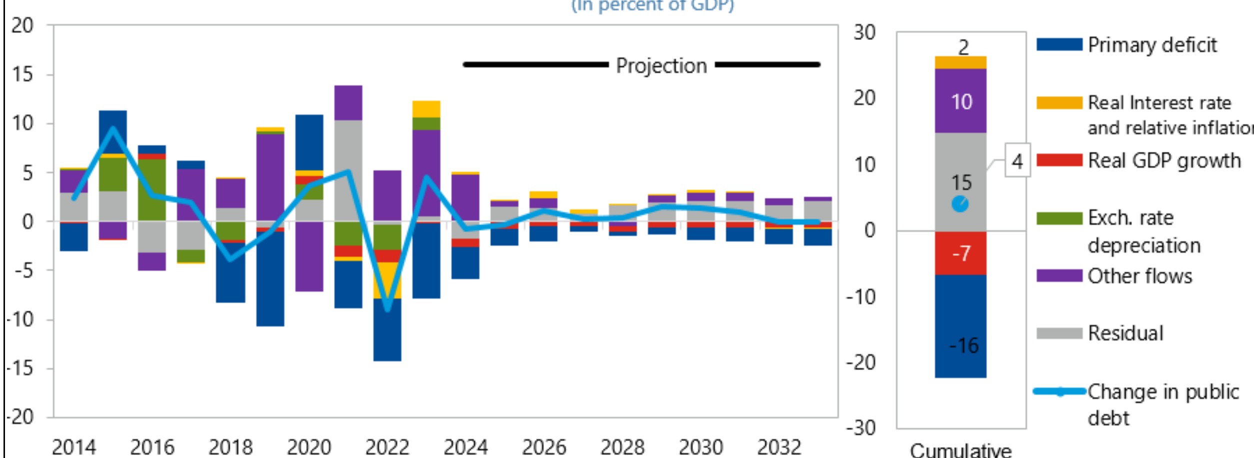
Table IV.2. Azerbaijan: Baseline Scenario

(In percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	21.8	21.1	20.7	21.8	22.0	22.4	23.9	25.3	26.2	26.2	26.2
Change in public debt	4.5	-0.7	-0.4	1.1	0.2	0.4	1.5	1.3	1.0	0.0	0.0
Contribution of identified flows	3.9	1.0	-1.9	-0.4	-0.6	-1.2	-0.5	-0.8	-1.1	-1.8	-2.0
Primary deficit	-7.7	-3.2	-1.8	-1.5	-0.5	-0.4	-0.8	-1.3	-1.5	-1.6	-1.7
Noninterest revenues	40.6	37.1	34.4	32.8	31.0	29.8	29.5	29.2	28.8	28.1	27.5
Noninterest expenditures	33.0	33.9	32.6	31.3	30.5	29.3	28.7	28.0	27.3	26.5	25.8
Automatic debt dynamics	2.8	-0.6	-0.6	0.1	-0.1	-0.3	-0.3	-0.4	-0.5	-0.8	-0.7
Real interest rate and relative inflation	1.8	0.2	0.1	0.6	0.4	0.3	0.2	0.2	0.1	-0.1	-0.1
Real interest rate	1.8	0.2	0.1	0.6	0.4	0.3	0.2	0.2	0.1	-0.1	-0.1
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-0.2	-0.9	-0.7	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6	-0.7
Real exchange rate	1.3	...	...	...	...	...	...	...	...	...	...
Other identified flows	8.7	4.8	0.5	1.0	0.0	-0.5	0.6	0.9	0.8	0.6	0.4
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions 1/	8.7	4.8	0.5	1.0	0.0	-0.5	0.6	0.9	0.8	0.6	0.4
Contribution of residual	0.6	-1.8	1.6	1.4	0.8	1.6	2.0	2.1	2.1	1.7	2.0
Gross financing needs	-6.3	0.7	1.6	2.8	4.0	4.3	4.5	4.7	4.8	4.9	4.5
of which: debt service	1.4	3.9	3.4	4.3	4.4	4.7	5.3	5.9	6.3	6.5	6.3
Local currency	1.0	1.9	2.6	3.3	3.3	3.5	4.1	4.5	4.8	5.1	5.2
Foreign currency	0.4	2.0	0.9	1.0	1.1	1.2	1.2	1.5	1.5	1.4	1.0
Memo:											
Real GDP growth (percent)	1.4	4.1	3.5	2.5	2.4	2.4	2.5	2.5	2.5	2.5	2.6
Inflation (GDP deflator; percent)	-9.3	0.4	1.7	-0.5	1.0	1.6	1.8	1.9	1.9	2.6	2.2
Nominal GDP growth (percent)	-8.1	2.6	6.1	3.8	4.8	5.3	5.6	5.8	5.9	6.3	6.2
Effective interest rate (percent)	0.0	1.6	2.1	2.5	2.9	2.8	2.8	2.8	2.5	2.2	1.9

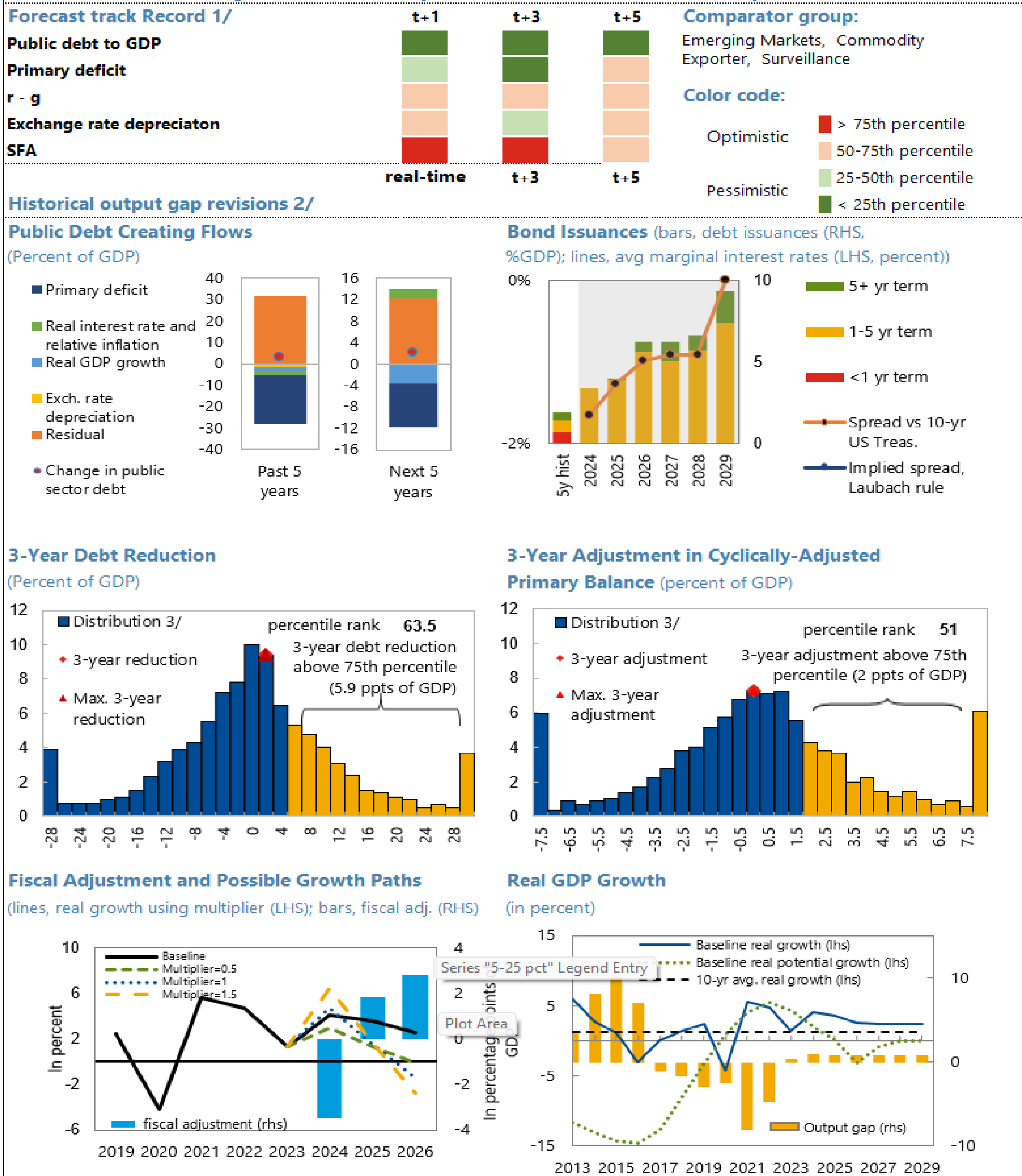
Contribution to Change in Public Debt

(In percent of GDP)



Staff commentary: Public debt is projected to increase gradually, reflecting mainly the moderate though declining primary deficit, and assumption that part of the oil revenues will be saved, boosting SOFAZ assets. 1/ Includes accumulation of SOFAZ assets.

Figure IV.3. Azerbaijan: Realism of Baseline Assumptions



Commentary: Following the recovery from COVID-19, and reflecting the declining oil production, growth is projected to moderate. Realism analysis does not point to major concerns: past forecast errors do not reveal any systematic biases and the projected fiscal adjustment and debt reduction are well within the norms.

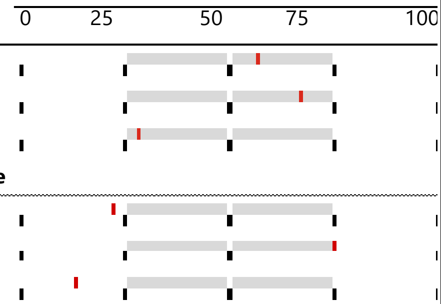
Source : IMF Staff.
1/ Projections made in the October and April WEO vintage.
2/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
3/ Starting point reflects the team's assessment of the initial overvaluation from EBA (or EBA-Lite).

Figure IV.4. Azerbaijan: Medium-Term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

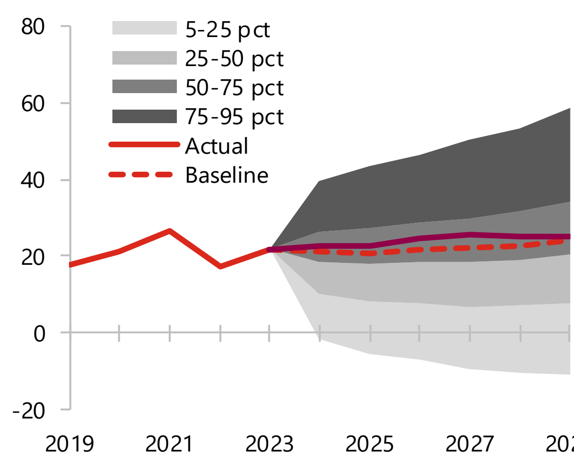
(In percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	69.6	1.0	...
	Probability of debt not stabilizing (pct)	84.0	0.7	...
	Terminal debt level x institutions index	12.6	0.3	...
	Debt fanchart index	**...**	**2.0**	**Moderate**
GFN finance-ability module	Average GFN in baseline	3.0	1.0	...
	Bank claims on government (pct bank assets)	8.1	2.6	...
	Chg. in claims on govt. in stress (pct bank asset	1.9	0.6	...
	GFN financeability index	**...**	**4.3**	**Low**

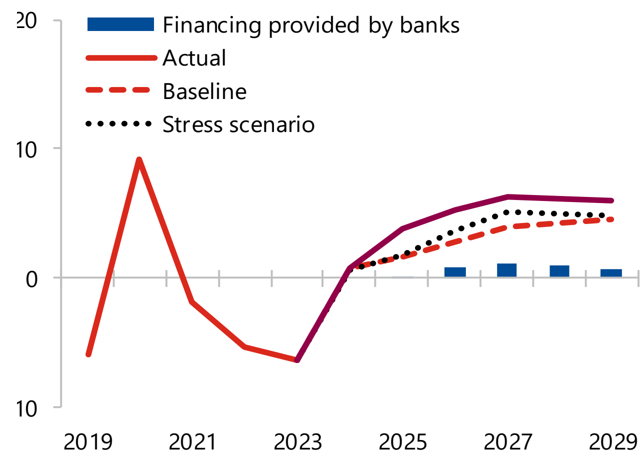


Legend: Interquartile range; Azerbaijan

Final Fanchart (In percent of GDP)



Gross Financing Needs (In percent of GDP)

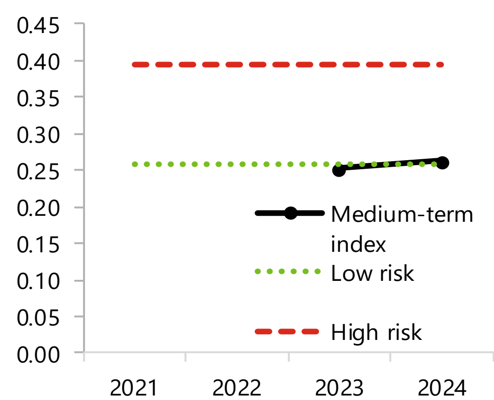


Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index

(In index number)



Medium-Term Risk Analysis

	Low risk threshold	High risk threhsold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.4
GFN finaceability index	7.6	17.9	0.5	0.1
Medium-term index (MTI)	0.3	0.4	...	0.3, Moderate

Prob. of missed crisis, 2024-2029 (if stress not predicted): 18.2 pct.

Prob. of false alarm, 2024-2029 (if stress predicted): 39.8 pct.

Commentary: Of the two medium-term tools, the Debt Fanchart Module is pointing to a moderate level of risk, reflecting mainly past elevated macroeconomic volatility, while the GFN Financeability Module suggests a low level of risk. The commodity price stress test shows a moderate worsening of debt and GFN path relative to the baseline, which already includes the projected oil production decline. The risk of sovereign debt distress is also mitigated by large SOFAZ assets which are about four times higher than public debt. About one half of SOFAZ assets are in liquid fixed income instruments.

Figure IV.5. Azerbaijan: Long-term Risk Analysis

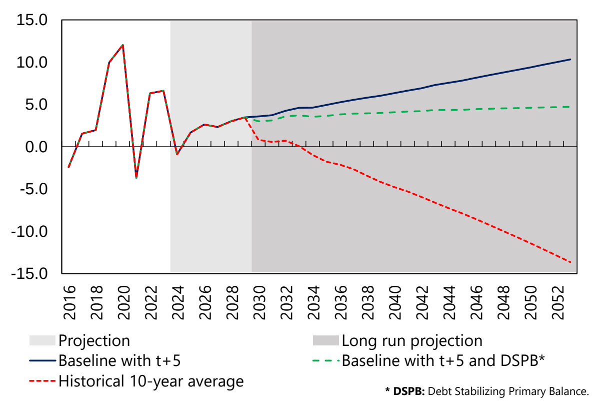
Large Amortization Trigger

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	

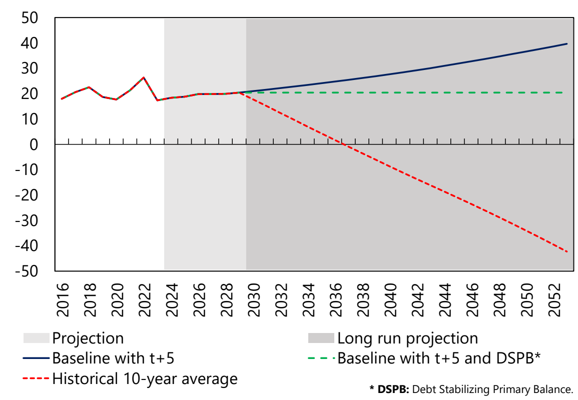
Overall Risk Indication	

Alternative Baseline Long-term Projections

GFN-to-GDP ratio



Total public debt-to-GDP ratio



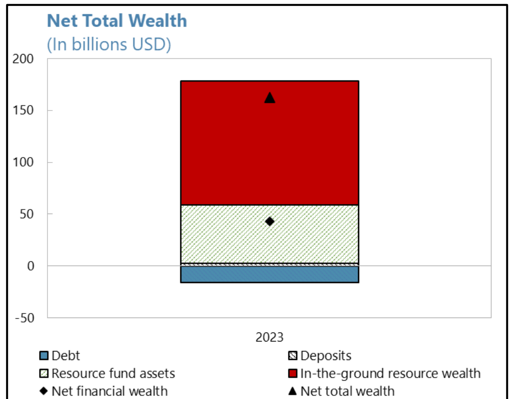
Commentary: Amortization payments are projected to increase as a result of the gradual increase in borrowing and a shift from external to domestic borrowing. The historical 10-year average scenario underscores how Azerbaijan has benefited in the past from high oil revenues. Over the long-run, debt amortization will be steadily increasing as hydrocarbon production and related revenues decline, necessitating more borrowing in the absence of adjustment. Moreover, in line with the new Debt Management Strategy, the authorities aim to reduce external borrowing and rely more on domestic debt issuance which tends to have shorter maturities. However, the authorities understand the fiscal implications of declining oil revenues and are committed to implement spending and revenue measures to ensure fiscal sustainability. Also, with the development of domestic securities market, gradual lengthening of domestic debt maturitites is likely. Therefore, the long-term fiscal risks stemming from the decline in hydrocarbon production and switch from external to domestic borrowing are expected to remain manageable.

Annex V. Fiscal Anchors and Rules in Azerbaijan[1]

Resource revenues are an opportunity: they can support fiscal stabilization and sustainability, economic development, and intergenerational equity. At the same time, each resource-rich country faces numerous challenges, such as the finite nature of resources, and uncertainty around resource prices and production costs. Using the IMF's stylized framework for designing fiscal strategies in resource-rich countries, we calculate fiscal anchors for Azerbaijan and find that significant consolidation is needed to reach even the least-conservative of them. Furthermore, although the re-introduction and revision of the fiscal rules in 2022 are welcome, continued efforts to increase credibility are essential to further strengthen the framework.

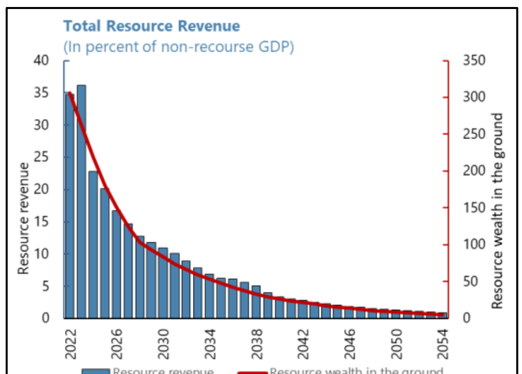
A. Background

1. Azerbaijan is rich in oil and gas. In 2024, 32.2 percent of its nominal GDP and 52.0 percent of its total consolidated government revenues came from resources. The two main resources are oil and gas, with oil accounting for about 2/3 of hydrocarbon revenues. Relatedly, the country's resource fund assets largely outweigh its debt resulting in a net financial wealth of 42.9 billion USD in 2023. Meanwhile, as of 2021, an estimated 7 billion barrels and 2.5 trillion cubic meters of oil and gas reserves, respectively, remain untapped.



Source: IMF staff calculations based on Basdevant and others (2021a, 2021b).

2. Nonetheless, total resource revenues are projected to gradually decline. Although there is uncertainty about the exact year and the relative share of oil and gas along the path, running out of natural resources will mean losing about half of the currently still available revenues. Namely, assuming no change in policies, the authorities will have to make larger transfers from SOFAZ, the state oil fund, to finance expenditures in the state budget. As such, re-designing and enhancing fiscal policies, both in the medium (fiscal anchor) and shorter terms (fiscal rules), is critical.



Source: IMF staff calculations based on Basdevant and others (2021a, 2021b).

B. Fiscal Anchors

3. For resource-rich countries, a fiscal anchor is typically a version of the permanent income hypothesis, translated into a target for the non-resource primary fiscal balance. A permanent income hypothesis (PIH)-based anchor serves as a long-term reference point, which can be complemented with short- or medium-term fiscal rules (see section C). In principle, a resource-rich

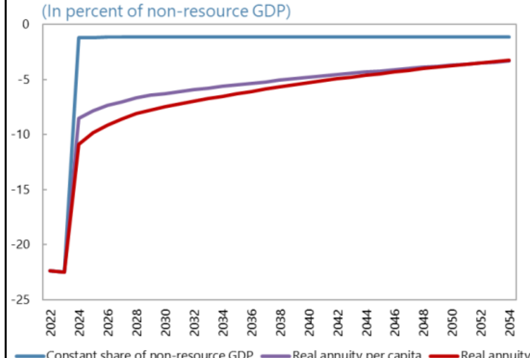
[1] Prepared by Zsuzsa Munkacsi (FAD).

country can run a non-resource primary fiscal deficit (to enhance development, e.g.),[2] financed by income generated from future resources. A key goal is to delink public expenditure from the volatility of resource revenues and prices. Under the PIH, a constant non-resource balance is maintained over an infinite period.

4. **Three PIH-based fiscal anchors can be considered to guide medium- to long-term fiscal policy (Basdevant, 2021a, 2021b).** Generally, future generations should also derive benefits from current resource wealth. The three fiscal anchors differ according to how the constant non-resource balance is defined. According to the *real annuity per capita approach*, to achieve an equal distribution of resource consumption across generations, the resource balance should be constant in real per capita terms. Under the second approach, the resource balance is *constant as a share of non-resource GDP*. Many countries define the anchor this way as it facilitates fiscal planning, being directly translatable into a budgetary framework. However, if economic growth exceeds population growth, it favors future generations compared to current ones. Under the third approach, the *real annuity approach* the resource balance is constant in real terms. This would however result in a declining real per capita consumption (with population growth).

5. **Our estimates are highly sensitive on macroeconomic projections and assumptions, and projections of resource revenues.** Staff macroeconomic projections are considered until 2028 and then extrapolated till the end of the projection horizon by assuming that the historical trend will continue. Assumptions about the long-term macroeconomy are also made as follows: the long-term real non-resource GDP growth is assumed to be 3.5 percent, population growth 0.8 percent, the GDP deflator growth 4 percent, and the real interest rate 4 percent. Staff assumes the extraction of 7 billion barrels of oil and 2.5 trillion cubic meters of gas for about 25 and 40 years, respectively. Changes to these assumptions would have a significant impact on the fiscal anchor. In general, higher resource revenues—say, owing to the discovery of more oil and gas reserves—and higher return to financial wealth would lead to less fiscal consolidation under all approaches. A higher deflator would lead to more fiscal consolidation, given the need to maintain the non-resource balance constant in real terms. Meanwhile, a higher non-resource GDP growth increases the need for fiscal consolidation under the second approach, because the non-resource balance would have to rise as much as nominal GDP to keep the ratio of non-resource primary balance to non-resource GDP constant. A higher population growth increases the need for fiscal consolidation under the real per capita GDP approach. The estimated fiscal anchors are therefore subject to significant uncertainty.

Fiscal Anchors If Attained Immediately
(In percent of non-resource GDP)



Source: IMF staff calculations based on Basdevant and others (2021a, 2021b).

6. **Under the assumptions above, the estimated fiscal anchors imply a significant fiscal consolidation.** Even though the different anchor methodologies point to different magnitudes, according to all of them, the non-resource primary deficit should be significantly lower. To achieve an

[2] In this annex, the term “non-resource” fiscal balance/deficit/GDP is used in place of the “non-oil” fiscal balance/deficit/GDP.

equal distribution of resource consumption across generations or a constant resource balance, the real annuity per capita approach and the real annuity approach point to a non-resource primary deficit of 5.5–6.5 percent of non-resource GDP in 2034 and 2035, respectively. This envisions a rather significant improvement, given that the non-resource primary balance stood at -20.5 percent of non-resource GDP in 2024. Without a consolidation, a considerable rise in public debt can be expected in Azerbaijan.

7. A multi-year fiscal adjustment is needed to achieve intergenerational equity. In line with previous IMF recommendations, this can be achieved by a combination of revenue and expenditure measures and reforms:

- **Revenue side.** Boosting non-resource revenues should be a priority. Possible measures include broadening the tax base by reducing tax holidays, tax exemptions and reduced tax rates for selected sectors and activities, reforming the personal income tax system (no new exemptions, progressive taxation) and modernizing the property tax system (market value assessments), and reducing tax expenditures from extensive exemptions.[3,4] Further information is available in Annex V of the 2021 AIV report.

- **Expenditure side.**

  - The ongoing consolidation has relied largely on spending restraint. However, there could still be some scope to further rationalize spending in the areas of public wage bill, and goods and services. Following a 40 percent increase in the public sector wages in 2019 and another significant hike in 2021, anchoring wage increases on labor productivity can help preserving the country's competitiveness. A reduction of ghost employees would be advisable, too (OECD, 2016). Furthermore, as advised previously, after adjusting and liberalizing some regulated fuel prices and water tariffs in January 2021, further rationalization of subsidies is warranted, while protecting the most vulnerable.

  - On top of spending rationalization, improving the efficiency of public investment and prioritizing growth-enhancing projects are warranted. Azerbaijan's public investment management scores below average compared to other developing and emerging market economies (Medas and co-authors, 2017). Azerbaijan is a country with rich resources of renewable energy sources which should be better utilized, too.

C. Rule-Based Fiscal Framework

8. Medium-term fiscal anchors should be accompanied by short- or medium-term fiscal rules. A fiscal anchor is not expected to be binding in every annual budget but should be achieved over the medium term (Eyraud and co-authors, 2023). The annual budget should be constrained by operational rules instead. In resource-rich countries, the main purpose of the operational rules is to

[3] Experience suggests that significant efforts would be required to realize revenues from property taxes.

[4] Staff recognize that any personal income tax reforms would need to be delayed until after the seven-year sunset clauses of the 2019 reforms expire.

contain and stabilize spending: countries should not fully spend all their revenues in good times to be able to protect spending in bad times and make sure that the fiscal position remains sustainable.

9. The return to the revised fiscal rules in 2022 is welcome, but clarifying and meeting the operational rules going forward will be critical for credibility. In accordance with Article 11-1 of the Budget System Law, the reformed rules consider limits on the non-resource primary balance (NRPB) to non-resource GDP ratio and the public debt-to-GDP ratio. Targeting the non-resource balance and public debt is in line with international best practices and previous IMF recommendations. However, three Presidential Decrees specified targets for years on a rolling basis (text table), and the recent medium-term deficit target of 17.5 percent has shifted from 2026 to 2027, according to the October 2023 Decree, as investment needs emerged. The public debt to GDP ratio ceiling was set to 30 percent.

Azerbaijan: Non-resource Primary Deficit as a Share of Non-resource GDP

	2021	2022	2023	2024	2025	2026	2027
Pres. Decree Mar 2022 No. 1637		27.5			20.0		
Pres. Decree Dec 2022 No. 1950			25.0			17.5	
Pres. Decree Oct 2023 No. 2332				24.0			17.5
Actual	23.7	22.4	22.5	20.5			

10. Further steps are also needed to enhance transparency when observing the rules and avoid any potential slippages in an accountable way. In line with previous IMF recommendations, measures related to escape clauses and correction mechanism should be carried out as follows:

- **Escape clauses.** Cross-country experience shows that credible and effective escape clauses should specify (i) the nature of the triggers; (ii) the authority to activate and monitor the escape clauses; and (iii) the procedures for returning to rule compliance.
  - Triggers should be restricted to unexpected significant events—such as natural disasters, epidemics, or a state of emergency—outside the control of the government.
  - Quantitative triggers linked to economic conditions (e.g., growth during recession) should be used.
  - The provision could indicate which aspect of the rule (e.g., NRPB and/or debt ceiling) is suspended.
  - Pre-specifying how long the fiscal rule is suspended is desirable. A duration of 2 years is appropriate-it would allow for a swift response through supplementary budgets in the year the shock hits and a subsequent response in the next year budget.

  - A policy statement should describe concrete measures the government would take to return to the fiscal rule after exiting the escape clause, and reporting on the progress ex-post would be good practice.

- **Correction mechanism.** The correction mechanism should specify the duration and magnitude of adjustments needed to comply with the fiscal rule. Remedial action should take place within the next 2 years to return to the limits in the fiscal rule, and, to allow a gradual process, annual adjustment magnitude for current deviation could be a minimum between the actual deviation and a maximum of 2 percent of non-oil GDP in non-oil primary balance.

11. Moreover, the debt ceiling could be based on risk analysis, and all the rules should be reviewed periodically, ideally not more frequently than once every 4–5 years (to avoid a loss in credibility).

12. Although there is the Chamber of Accounts, mandating an independent institutional body (fiscal council) to monitor and report on the application of fiscal rules could further enhance credibility and transparency. Azerbaijan does not have an independent fiscal council,[5] and we suggest establishing one. The Chamber of Accounts is part of the government, while fiscal councils are non-partisan, technical bodies entrusted as a public finance watchdog. As a permanent agency with a statutory or executive mandate, they can strengthen credibility by assessing publicly and independently from partisan influence fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short- to medium-term macroeconomic stability, and other official objectives (IMF, 2013).

13. The fiscal framework could be further strengthened by improving fiscal reporting and macro-fiscal capacity. Currently, fiscal reporting that forms the basis of the non-oil primary balance is not fully consistent with Government Finance Statistics Manual (GFSM) 2014. External debt repayment is treated as an expenditure above the line. Moreover, fiscal reporting also does not include public law entities. With the help of ongoing IMF technical assistance, the Ministry should finalize the GFSM-consistent presentation of their fiscal reports and expand fiscal coverage and use the new reports as the basis for the annual and medium-term budgets and subsequently the fiscal rule. Finally, ongoing improvements in macro-fiscal capacity should continue. Building capacity would ensure both timely data and good-quality (macroeconomic, fiscal and resource price) forecasts for the calibration of fiscal rules (the upper limits for fiscal rule targets are calculated based on the export price of crude oil) or re-assessing the fiscal anchors.

[5] https://www.imf.org/en/Data/Fiscal/fiscal-council-dataset.

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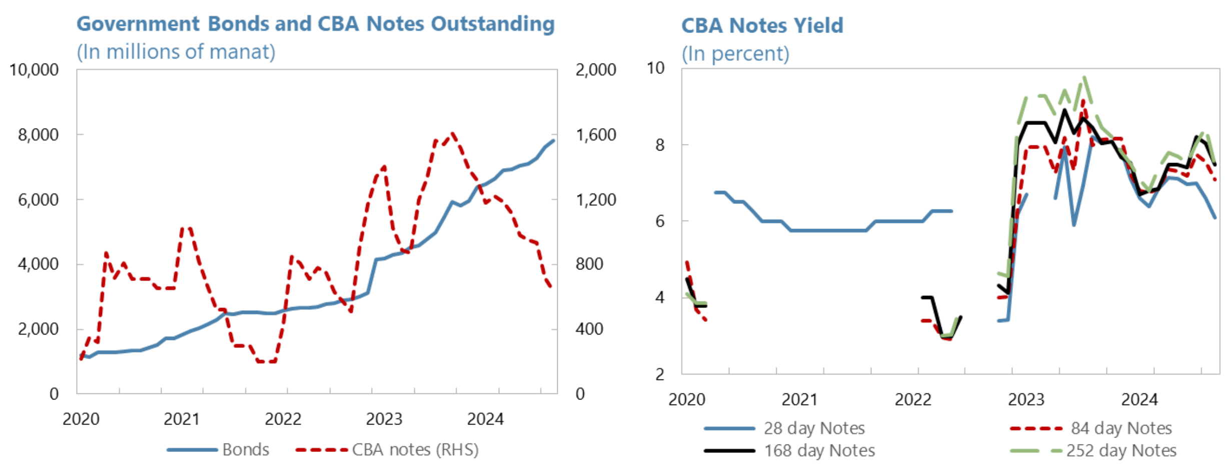
Annex VI. Liquidity Management: T-Bills or Central Bank Notes?[1]

A. Introduction

1. In recent period, the challenge of achieving both debt management and monetary policy objectives has emerged. The effort of the Central Bank of Azerbaijan (CBA) to mop up excessive liquidity, understandable from the monetary policy perspective, impacted debt management and government securities issuance as it resulted in (temporary) tightening of liquidity conditions and increasing yields on government securities. This brings out the question how best to achieve both liquidity management and debt management objectives.

2. In September 2022, the central bank expanded the maturities of its securities to manage liquidity more effectively. As part of the package of measures to improve the management of liquidity in the banking sector and strengthening the monetary policy transmission, the CBA extended the range of maturities of CBA notes issued to withdraw liquidity from the banking system by adding to the 28-day paper notes with longer maturities of 3,6, and 9 months (Figure VI.1). Between September 2022 and mid-2023, the outstanding amount of CBA notes tripled, from 500 million manat to over 1,600 million manat. At the same time, yields on CBA notes of all maturities broadly doubled, from around 4 percent to 8–9 percent. Even as the volume of outstanding CBA notes subsequently fell back to around 300 million by end-2024, yields remained elevated, in the range of 6–8 percent.

Figure VI.1. Azerbaijan: Government Bonds and CBA Notes



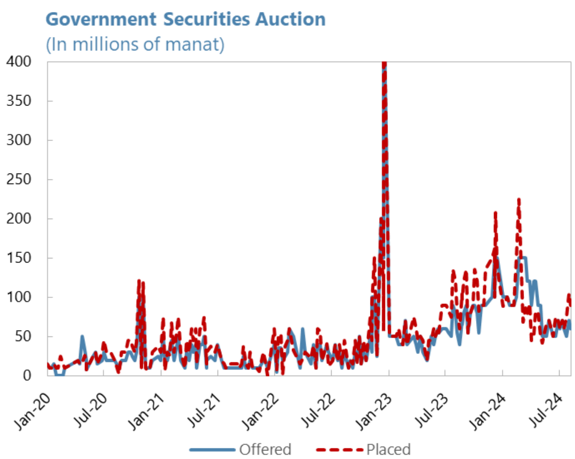
Sources: Central Bank of Azerbaijan and IMF Staff estimates.

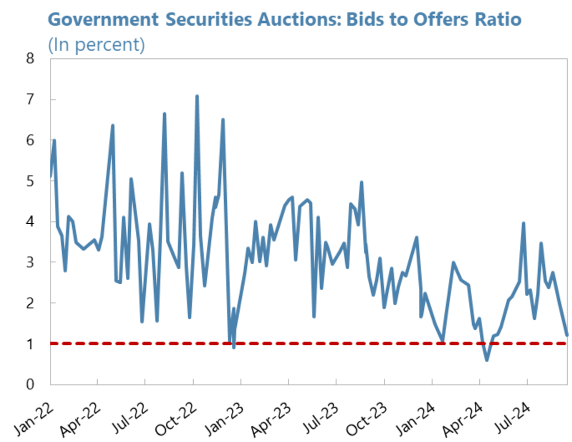
3. At the same time, the Ministry of Finance has been increasing the issuance of domestic debt, leading to increased competition between central bank and government securities. Partly as a result of the new debt management strategy to rely more on domestic rather than external debt to finance state budget deficits, the amount of outstanding domestic government securities increased from 4.2 bn manat in December 2022 to over 9 bn manat by December 2024 (Figure VI.1, left), and the share of domestic public debt in total public debt (excluding government guarantees) jumped during the same period from 27 percent to 53 percent. The increasing use of CBA notes to absorb excessive

[1] Prepared by Jiri Jonas (MCD).

liquidity in the banking sector at the same time that the government ramped up its domestic debt issuance has had implications for the government securities auctions. A combination of increased CBA notes issuance and the increase in reserve requirements on manat deposits led to tightened banking sector liquidity, resulting in a temporary problems with government securities' issuance. 2 As shown in Figure VI.2, on several occasions during 2023 and 2024, the ratio of bids to offers on the securities auction declined and even fell below 1 at some auctions (suggesting that there were less bids than the offered amount, regardless of the price). As a result, there was an increasing negative cumulative difference between actually placed amounts (accepted bids) of government securities and the offered amount (supply) during 2024. The Ministry of Finance even cancelled some auctions. While such step could be understandable from the point of view of minimizing the costs of borrowing, it would also make the issuance less predictable and would eventually undermine the development of well-functioning government securities and broader financial market—an important policy objective.

Figure VI.2. Azerbaijan: Government Securities Auctions





Sources: Central Bank of Azerbaijan and IMF Staff estimates.

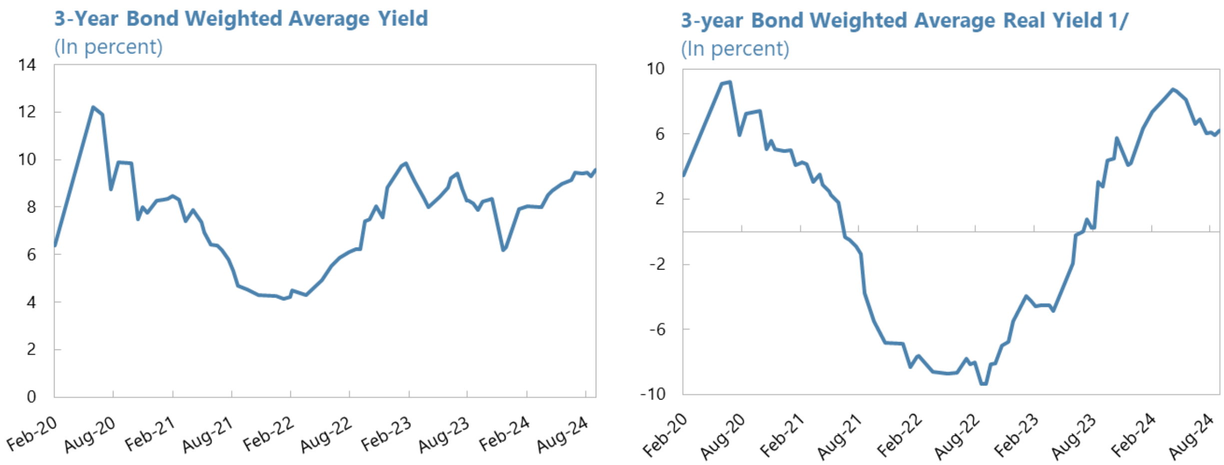
4. The pressure in the government securities' auctions could be seen in the changes of the bond yields. Figure VI.3 shows the weighted average of the 3-year bond (since mid-2023 the longest-issued maturity). From 6 percent by the end of 2023, the yield increased sharply to around 10 percent by mid-2024, around the previous peak in February 2023. The increase in yield is even more prominent when adjusted for inflation: during the spike in inflation in 2022–23, bond yields were deeply negative in real terms, but a combination of rapidly falling inflation and rising nominal yields in 2023–24 pushed the real yields sharply in the positive territory.

5. Effort could be made to reduce elevated bond yields and the cost of government borrowing in a market-friendly and sustainable way. The above-discussed developments highlight the importance of close coordination between monetary policy (liquidity management) and debt management (government securities issuance). This requires a close cooperation and coordination between the Ministry of Finance responsible for the issuance of government securities for budget financing, and the CBA responsible for the issuance of CBA notes for liquidity management (section

[2] The CBA increase required reserves on manat deposits in two steps in August and December 2023 from a single rate of 5 percent to a range of 5–25 percent.

C). In this context, the question also arises whether the CBA note is the preferable instrument for liquidity management, or whether CBA should use short-term government securities (T-bills) instead.

Figure VI.3. Azerbaijan: Government Bond Yields



Sources: Central Bank of Azerbaijan and IMF Staff estimates.

1/ Nominal yield less y/y CPI inflation.

B. CBA Notes vs. T-bills to Manage Banking Sector Liquidity

6. The use of central bank notes or government securities to effectively manage liquidity varies across countries. To manage banking sector liquidity, central banks could issue their own notes, or they can use government securities. In advanced economies, central banks typically use government securities to manage liquidity through open market operations. In these countries, the benefits of using government securities rather than central banks' paper are well established. However, under certain circumstances that are likely to prevail particularly in developing markets, issuing central bank securities can be a viable option (see IMF and the World Bank, 2001, for a more detailed discussion).

7. There are several points to consider when deciding which securities to use for open market operations:

- **Government securities:**
  - **Pros:** Government bond markets are generally larger and more liquid than markets for central bank papers, making it easier for central banks to buy and sell securities to influence liquidity without significantly affecting prices. Using government securities for primary market operations could also support financial market development and improve monetary policy transmission. Using government securities also allows a central bank to avoid potential conflicts with the government over the issuance of its own notes, thus providing more scope for autonomous monetary policy decisions. Finally, the costs of monetary policy tightening are explicitly and transparently allocated to the budget.

  - **Cons:** Using government securities for monetary policy operations requires a high degree of coordination between central banks and treasuries. In the absence of effective coordination, central banks' operational autonomy could be weakened.

- **Central bank securities:**

  - **Pros:** Provide flexible tool for liquidity management. Particularly in situations where precise control over short-term liquidity is needed, or where government securities markets are not well developed, central bank securities can be more effective. Provides central banks more operational independence – though under the condition of coordination with the issuance of government securities.

  - **Cons.** Using central bank securities could result in certain circumstances to the reduction of central bank profits or—in case of large issuance—even generate central bank losses, ultimately requiring central bank recapitalization. Issuance of central bank paper also required cooperation with the treasury to avoid creating segmented and illiquid markets.[3]

8. **The assessment of the pros and cons of the two options for central bank liquidity management does not yield a clear-cut answer.** While some authors (Nyawata, 2012) argue that treasury bills are the first best option for both debt management and monetary policy/liquidity management purposes, others (Quintyn), 1997) argue that there is no clear dominance of government securities or central bank notes and that both options could work well in practice. The importance of the pros and cons of the two options must be assessed in the context of specific circumstances and policy priorities of Azerbaijan.

C. Conclusions and Recommendations

9. **The current system of using CBA notes for monetary purposes has been working reasonably well, but the episode of temporary difficulties with government securities auction points to the importance of close cooperation between the CBA and the Government.** The CBA has been issuing its own notes to conduct OMOs and manage liquidity for some time, and the system works reasonably well, but when resulting in tighter liquidity conditions, it could impact the government securities market and increase the cost of government borrowing. While the reduction of yields on government securities is an important objective, it should not be pursued at the cost of compromising monetary policy objectives. Thus, close cooperation between the CBA and the government is necessary to minimize the problems and avoid any surprises. Improved reliability of the calendar of government securities issuance should allow the CBA to improve its own medium-term liquidity projections and better calibrate the issuance of its notes. Making the government securities auctions' system less cumbersome would reduce issuance fees and market distortions. And allowing the government securities' market pricing to operate and avoiding auction cancellations and haircuts

[3] However, depending on the fiscal conditions of the country, the risk of a reduction in central bank profits or even central bank losses potentially necessitating recapitalization is not entirely absent even when central bank uses government bonds for liquidity management.

would promote a formation of well-established yield curve and development of domestic financial market, thus creating conditions for sustainable reduction in the government borrowing costs.

10. Some modifications of the current system of CBA notes issuance for monetary policy purposes could be considered, to minimize the impact on debt management objectives. While replacing CBA notes with government securities could bring some benefits, there does not appear to be an immediate need of such transition. First, the government does not currently issue any treasury bills as it uses its balances in the Treasury account with the CBA to meet any short-term liquidity needs. Thus, the only government securities currently available are longer-term government bonds, which are not appropriate as instruments for liquidity management. Second, the concern that issuing its own debt would increase CBA interest expenses, weaken its profitability, and balance sheet, and potential compromise its independence and monetary policy conduct, does not (yet) seem relevant for Azerbaijan.[4] However, some minor adjustments of the current practice could be considered. Once excess structural liquidity declines sufficiently as a result of the recent CBA mopping operations, the authorities could consider shortening the maturity of the issued CBA notes. In the future, the CBA should focus solely on controlling the very short end of the yield curve (less than 12 months), and long-term issuances should have a market development purpose, especially as there is limited outstanding government issuances. At a minimum, the CBA could phase out the issuance of the 9M notes. Relatedly, with the possibility that the government will have to return at some point to the issuance of short-term securities for its cash management, increased attention will have to be paid to the coordination of CBA and government issuance.[5]

11. Looking further ahead, the relative benefits of using treasury bills for liquidity management are likely to increase. Therefore, it could be desirable to periodically assess whether the CBA should replace its notes with treasury bills for OMOs. The main argument in favor of switching over time to treasury bills is the need to promote the development of deep and liquid market for government securities as an important step towards financial sector development. In turn, a well-developed government securities market is an important pre-condition for further improving monetary policy transmission and thus the CBA's ability to pursue its price stability mandate. The experience of other countries supports this conclusion: a number of countries switched from using the central bank notes to treasury bills and most of the advanced economies are now using treasury bills for monetary policy purposes.

[4] According to the 2023 financial statement, even as its interest expenses almost doubled in 2023 relative to 2022, interest income increased even more, and the CBA recorded 350 million manat profits. See Central Bank of Azerbaijan (2023). 3de4195af5ea6820b9eeb1f40.pdf.

[5] This could require either issuing government securities and CBA notes with the same characteristics (which would add liquidity when both markets are expected to remain thin for an extended period of time), or clear differentiation of the two securities to reduce direct competition (which would usually mean an issuance of very short maturities, say 1M or less, by the CBA, and longer (3-9M) maturities by the ministry of finance. For more detail, see Quintyn (2012).

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Annex VII. Dollarization in Azerbaijan: Developments, Risks and Prospects[1]

A. Dollarization: Causes, Costs, and Challenges

1. The level of financial dollarization reflects country characteristics, economic fundamentals, and economic policies. The literature identifies a so-called "natural" or "benchmark" level of dollarization that reflects country characteristics, such as openness to trade and capital flows, remittances, and FDI.[2] But financial dollarization often exceeds the estimated "benchmark" level of dollarization. High financial dollarization – widespread use of foreign currency as a unit of account, medium of exchange, and store of value, – has usually reflected a history of high and volatile inflation and exchange rate volatility, caused by mismanaged economic policies, particularly monetary policies.

2. Azerbaijan's dollarization is closely linked to history of macroeconomic instability. As a result of large fiscal deficits and money printing in late 1994, monthly inflation reached a hyperinflation level of 50 percent, and the currency lost about 40 percent of its value, leading to significant dollarization of the economy. Even as inflation subsequently fell, deposit dollarization remained over 80 percent till about late 2005. Continued exchange rate stability and generally low inflation eventually brought dollarization down to below 40 percent by 2015, when another bout of macroeconomic instability following a sharp decline in oil prices led to inflation and currency devaluation, and another spike in dollarization.

3. Dollarization could carry significant costs and risks and pose major challenges for policymakers. High levels of dollarization and associated currency mismatches make economies more vulnerable to exchange rate volatility. A banking sector with mismatches between FX assets and liabilities could be exposed to currency mismatch risk from exchange rate movements. Banks could also face increased credit risk if they extend foreign currency credit to customers without either financial hedge or natural hedge in the form of FX income or assets as depreciation could weaken the balance sheet and debt servicing capacity of such borrowers. In addition, banks with foreign currency (FX) deposits are exposed to higher liquidity risks in case of central banks' lower capacity to provide emergency FX liquidity assistance. High dollarization also exposes the public sector balance sheet to exchange rate risks, making countries less tolerant to large exchange rate fluctuations because of its contractionary impact on aggregate output and leading to the "fear of floating" (Calvo and Reinhart, 2002). Finally, high dollarization implies loss of seignorage and weakens monetary policy's transmission and effectiveness, making it more difficult to achieve low inflation and macroeconomic stability.[3]

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[1] Prepared by Ece Ozge Emeksiz (MCM) and Jiri Jonas (MCD).

[2] See Della Valle G. et al., 2018.

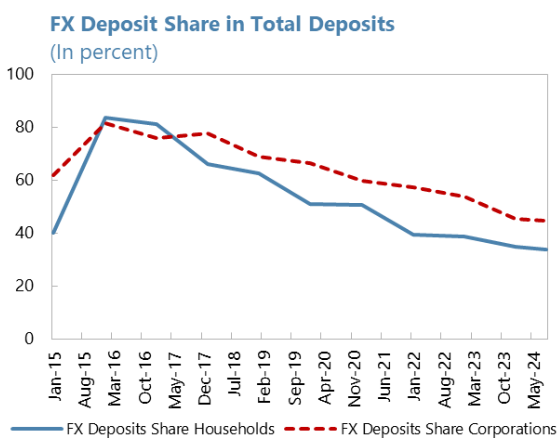
[3] Dollarization could also bring some benefits: in countries with history of macroeconomic instability, deposit dollarization could support financial intermediation and deepening.

B. De-dollarization Trends and Drivers in Azerbaijan

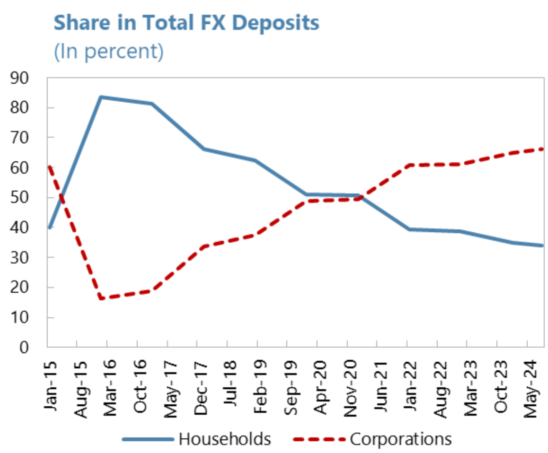
4. **Following the peak in 2016, deposit dollarization in Azerbaijan has been declining steadily.** In the aftermath of the 2015 banking crisis and currency devaluation, deposit dollarization peaked in early 2016 at around 80 percent from a low level of 40 percent. The crisis episode, preceded by a decline in oil prices and a procyclical fiscal policy, undermined confidence in the domestic currency, leading to a sudden sharp switch to FX deposits. After the spike, it began to decline gradually, driven by both households and corporations, returning to around pre-crisis levels by the end of 2023 (Figure 1). To the extent that households are more sensitive to the confidence in domestic currency stability, while corporations' FX holdings are more likely to reflect their business needs, the decline in household deposit dollarization suggests increased confidence in macroeconomic and currency stability. Both high oil prices and improved macroeconomic policy conduct have likely contributed to this outcome.

Figure VII.1. Azerbaijan: Trends in Deposit De-dollarization

The share of both household and legal entities' FX deposits in total deposits has been declining steadily after peaking in early 2016 …



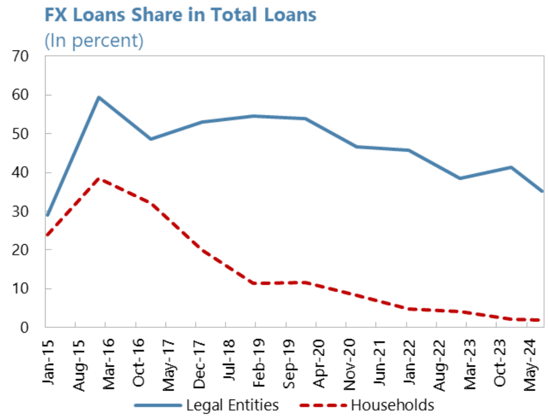
… but the share of legal entities' FX deposits in total FX deposits has been increasing while the share of households' FX deposits declining.



Sources: Central Bank of Azerbaijan, staff calculations.

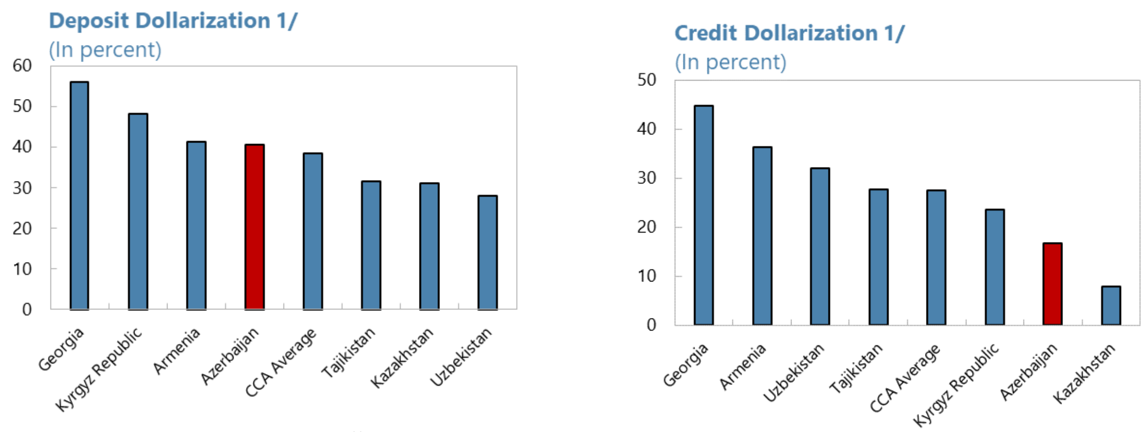
5. **Dollarization of loans to households and corporates has been displaying a more divergent trend.** Loan dollarization also increased in 2015. For legal entities, it doubled from 30 to 60 percent. For households, loan dollarization peaked at 40 percent in 2016 (Figure 2). During the period 2015–2020, outstanding FX loans to corporates represented about one half of total corporate loans before declining to about 40 percent by end-2023. In contrast, the share of FX loans to households in total household loans has been declining since 2016 to close to zero by end-2023, with regulatory restrictions contributing to this trend. Almost all outstanding loans to households are now in manat. Looking at new loans shows even more stark de- dollarization. Since 2020, the amount of newly extended manat loans has accelerated, but the amount of FX loans has been broadly unchanged, resulting in an increasing share of manat loans.

Figure VII.2. Azerbaijan: Dollarization of Loans



6. **The level of financial dollarization in Azerbaijan has been in line with or below that of other countries.** Deposit dollarization at around 40 percent by end-2023 is broadly in line with average dollarization in the Caucasus and Central Asia (Cakir et al. (2022)). Loan dollarization in Azerbaijan is however below the CCA average and Latin American median of close to 30 percent and 40 percent, respectively (M. Vargas and J. Sanchez, 2023).

Figure VII.3. Azerbaijan: Dollarization in CCA Countries



Sources: Country authorities; IMF staff calculations.

1/ Data as of January 2023, for Azerbaijan August 2024.

C. Benchmark Level of Dollarization

7. **The literature has identified several factors that drive dollarization in a country.** These factors can be positive and negative. For instance, dollarization can stem from growing trade and financial integration. Exporters earning revenue in foreign currency may prefer FX borrowing to hedge against exchange rate risks, while consumers might hold FX savings to protect against domestic price fluctuations of imported goods. On the other hand, financial dollarization can also

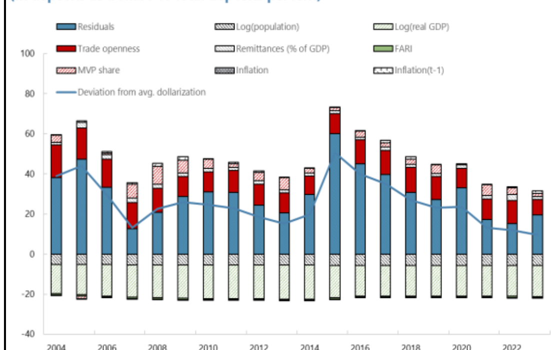
reflect less benign factors, such as macroeconomic instability and high inflation, which undermine confidence in the domestic currency and make foreign currency savings more attractive.

8. These factors can be used to determine a benchmark level of dollarization, and an indication of the potential for further de-dollarization. The benchmark level of dollarization is the level of dollarization that an economy is expected to experience given its structural characteristics, while accounting for its macroeconomic performance. This can be estimated by a cross-country panel regression of dollarization rates on variables that proxy for factors that drive dollarization. The difference between the actual dollarization level and the estimated benchmark level of dollarization provides an indication of the potential scope of de-dollarization policies.

9. A cross-country panel regression of deposit dollarization rates on structural and policy variables was conducted to estimate the benchmark level of dollarization. Following the approach of IMF (2021), the regression covered 102 countries and included both structural and policy variables. Structural variables represent factors that policymakers have limited control over in the short to medium term, such as the country's economic size (measured by population and real GDP per capita), trade openness (as a percentage of GDP), capital account openness (proxied by the IMF's Financial Account Restrictiveness Index (FARI)), and remittances (as a percentage of GDP). In contrast, policy variables under policymakers' control include current and lagged inflation, as well as the optimal mean-variance portfolio (MVP),[4] which considers the effects of real exchange rate depreciation and the variances and covariance of inflation on dollarization (Della Valle G., V. Kota, R. Veyrune, E. Cabezon, and S. Guo, 2018).

10. Results show that Azerbaijan's deposit dollarization remains above the benchmark level. In the text chart, the blue line shows the deviation of actual dollarization from the benchmark level suggested by the model. While the level of dollarization in Azerbaijan is above the benchmark, the difference is declining and is currently around 10 percentage points, consistent with results reported by R. Gondo and M. Singh (2024). The bars capture individual drivers of deviation of the actual dollarization from the benchmark. High trade openness, and to a less extent lagged inflation and the MVP, together with remittances inflows in some years, have been the main characteristics contributing to high dollarization. On the other side, the results

Contribution of Drivers of Dollarization
(fx deposits as a share of total deposits percent)



Source: IMF staff calculations.

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[4] The minimum variance portfolio has been shown in Ize and Levy Yeyati (2003) to explain levels of dollarization across countries. The optimal portfolio share of foreign currency is given by:

$$cMVP\ share\ = \frac{Var(\pi)+Cov(\pi,dep)}{Var(\pi)+Var(dep)+2Cov(\pi,dep)}.$$

A high volatility in inflation relative to the volatility in real exchange rate depreciation makes foreign currency more attractive as a store of value as it lowers the variance of the portfolio – even if uncovered interest parity holds.

show a relatively strong (negative) impact on dollarization of real growth, population, and the FARI, suggesting that increased growth and population together with further progress in financial openness should support further de-dollarization. However, the results indicate that the residual has been the dominant driver of dollarization in Azerbaijan, spiking during the 2015 devaluation and steadily declining since but remaining relatively high. The residual likely reflects lingering concerns about currency depreciation, driven by Azerbaijan's dependence on oil and gas exports and vulnerability to oil price shocks.

D. Policy Recommendations

11. De-dollarization has been supported by a combination of improved macroeconomic policies and macroprudential measures. Azerbaijan has achieved significant progress in reducing dollarization. Following the devaluation, Azerbaijan has strengthened its macroeconomic policy framework and implementation, supported recently by high oil prices. Less procyclical fiscal policy and the introduction of fiscal rule have removed a major source of macroeconomic instability, and timely monetary policy response to inflationary pressures succeeded in bringing inflation down quickly and maintaining confidence in manat. Macroprudential measures introduced in recent years have reduced incentives for financial intermediation in foreign currency and made the financial system more resistant to adverse shocks such as a decline in oil price. Banks are extending loans mainly to hedged borrowers, have significantly reduced their NOP, and their FX liquidity is high.

12. Looking ahead, further reduction in dollarization is likely to be more gradual and requires a combination of policy measures to improve confidence in the domestic currency:

- **Continued commitment to macroeconomic stability.** The evidence from a broader sample of countries suggests that achieving a significant de-dollarization takes time, because confidence in the local currency is not renewed overnight.[5] For further de-dollarization, it will be crucial to maintain high growth, low inflation, and confidence in the currency even during less favorable external circumstances, such as lower oil prices. In this respect, continued adherence to prudent fiscal policy and the fiscal rule targets, monetary policy focused on maintaining low inflation, and further modernization of the monetary policy framework will play a key role.

- **Development of the local capital market.** A more developed capital market, active public debt management including regular issuance of benchmark bonds and the development of the domestic investor base, should support demand for longer-term local currency instruments, help to reduce the dollarization of public debt, and create more confidence and investment opportunities in local currency.

- **Structural reforms to diversify the economy.** Gradual diversification of the economy away from hydrocarbon production will be a key factor determining the ultimate success of de-dollarization. As long as the hydrocarbon production and exports play a dominant role, the

[5] For example, Yeyati (2021) found that during the period from 2000 to 2018, 16 Latin American countries reduced on average dollarization of term deposits by about 20 percentage points.

currency value will remain vulnerable to swings in oil and natural gas prices. Sound macroeconomic policies could not fully isolate the economy from the impact of large price swings on external balance and inflation. Only a more diversified structure of production, exports, and budget revenues could reduce this structural source of vulnerability.

- **Macroprudential measures.** While the authorities have already adopted a number of macroprudential measures with the objective to reduce dollarization and/or banking sector's vulnerability due to dollarization, further measures could be considered. Specifically, the authorities could consider a widening of the required reserves (RR) wedge between local currency and FX deposits. Presently, the maximum wedge between the local currency and FX deposits is 2.5 percentage points and is only 1 percentage point for smaller deposits or zero for some deposits of legal entities. In several countries, including some in the CCA region, this wedge has been much higher (see Cakir et al., 2022). Increasing the wedge would reduce relative attractiveness of FX deposits and could help in further deposit de-dollarization, as well as a reduction in banks' net open position.

13. As dollarization is likely to remain elevated for some time, it is important to manage the related risks to financial stability. The CBA has in recent years introduced a number of macroprudential and regulatory measures to reduce the financial stability risk of dollarization. These include restrictions on FX loans to households, higher risk weights for FX loans to corporates, separate liquidity coverage ratios for FX, and limits on net open currency position. Going forward, further strengthening data collection and monitoring is desirable, to better understand and manage the potential risks and vulnerabilities of the financial system to exchange rate volatility. This requires, among others, addressing data gaps on: (i) FX income, hedging, and exchange rate risk exposure of non-financial corporate borrowers; (ii) FX assets, liabilities, and open currency exposures of nonbank financial institutions.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF AZERBAIJAN

STAFF REPORT FOR THE 2025 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

March 6, 2025

Prepared By: Middle East and Central Asia Department (In Consultation with Other Departments)

CONTENTS

RELATIONS WITH THE FUND

(As of January 31, 2025)

Membership Status: Joined: September 18, 1992; Article VIII

General Resources Account:	**SDR Million**	**Percent Quota**
Quota	391.70	100.00
IMF's Holdings of Currency (Holdings Rate)	333.90	85.24
Reserve Tranche Position	57.83	14.76

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	529.00	100.00
Holdings	451.71	85.39

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

Implementation of HIPC Initiative

Not applicable.

Implementation of Catastrophe Containment and Relief Initiative (CCR)

Not applicable

Exchange Rate Arrangements

The de jure exchange rate arrangement is free-floating, and the de facto exchange regime is classified as a stabilized arrangement. The currency of Azerbaijan is the manat, which became sole legal tender on January 1, 1994. Azerbaijan has accepted the obligations under Article VIII, Sections 2(a), 3, and 4 of the IMF Articles of Agreement, and maintains an exchange system that is free of multiple currency practices and 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 pursuant to Executive Board Decision No. 144-(52-51).

Article IV Consultation

Azerbaijan is on a 12-month Article IV consultation cycle. The previous Article IV consultation was concluded on January 11, 2024.

Resident Representative

Since November 2009, the IMF no longer has a Resident Representative in Azerbaijan, but the IMF Office in Baku headed by an office manager continued to operate, until its closure in June 2023.

RELATIONS WITH OTHER INTERNATIONAL INSTITUTIONS

(As of January 31, 2025)

Information about Azerbaijan's relations with the World Bank Group and other international financial institutions can be obtained from the following webpages.

World Bank Group:

• Country page: https://www.worldbank.org/en/country/azerbaijan

• Overview of Word Bank Group lending: https://financesapp.worldbank.org/countries/Azerbaijan /

• IBRD-IDA project operations: https://projects.worldbank.org/en/projects-operations/projects-summary?lang=en&countrycode_exact=AZ

Asian Development Bank:

• Country page: https://www.adb.org/countries/azerbaijan/main

• ADB projects and results: https://www.adb.org/countries/azerbaijan/results-adb-supported-operations

European Bank for Reconstruction and Development:

• Country page: https://www.ebrd.com/azerbaijan.html

• EBRD projects: https://www.ebrd.com/work-with-us/project-finance/project-summary-documents.html?1=1&filterCountry=Azerbaijan

Statement by Patrick Loszewski, Executive Director,
and Rashad Hasanov, Advisor for the Republic of Armenia
March 21, 2025

On behalf of our Azerbaijani authorities, we thank staff for the constructive discussions during the Article IV and FSAP missions, which have resulted in comprehensive and insightful reports. The authorities appreciate the staff's thorough assessment of the macroeconomic situation and welcome staff's policy recommendations, which provide valuable input for the authorities' policy agenda.

Recent macroeconomic developments

Azerbaijani economy has demonstrated remarkable resilience in the face of a highly uncertain external environment, supported by effective macroeconomic policies. Following moderate growth in 2023, economic activity gained momentum in 2024, with real GDP expanding by 4.1 percent. The output growth was primarily driven by the non-hydrocarbon sector, which grew by 6.2 percent. Robust non-hydrocarbon GDP growth was supported by double-digit growth in the transportation (14.1 percent), communication (11.4 percent), and hospitality (12.9 percent) sectors. The construction sector also posted a strong growth of 9.6 percent, fueled by increased public investments, most notably in large-scale reconstruction projects in the Karabakh and Eastern Zangezur economic regions. The hydrocarbon sector returned to growth in 2024, expanding by 0.3 percent, driven by stable crude oil production and moderate gains in gas output, despite lower oil and natural gas prices compared to 2023.

Inflation has significantly declined from its peak of 13.9 percent in February 2022, reaching 4.9 percent in December 2024, well within the Central Bank of Azerbaijan's (CBA) target range of 4 ±2 percent. Disinflation was driven by lower inflation in trade partners, appreciation of manat's nominal effective exchange rate, and policies aimed at maintaining price stability. Moreover, the unemployment rate edged down from 5.5 percent at the beginning of 2024 to 5.3 percent by year-end, reflecting steady labor market improvements and continued economic growth.

Despite moderation in oil and gas prices, the current account remained in surplus at 7.2 percent of GDP in the first three quarters of 2024, reflecting the economy's resilience. Meanwhile, the combined reserves of the CBA and the State Oil Fund of Azerbaijan (SOFAZ) reached USD71 billion (96 percent of GDP) by the end of 2024. These reserves provide a strong external buffer, covering 41 months of next year's imports and reinforcing economic stability.

Azerbaijan's fiscal position remains robust, with a consolidated budget surplus of 4 percent of GDP in 2024 and a modest state budget deficit of just 0.4 percent of GDP. The nonoil primary deficit (NOPD) continued to improve in 2024, narrowing by approximately 2 percent of nonoil GDP, supported by strong nonoil revenue growth and prudent fiscal management. Public debt remains low relative to GDP and sovereign fund assets. As of January 1, 2025, total public debt stood at 21.7 percent of GDP, well below the fiscal rule limit of 30 percent, and external debt stood at a modest 6.9 percent of GDP.

Financial soundness indicators continue to point to a resilient and well-capitalized banking sector which recorded a strong credit growth and improved asset quality in 2024. Total credit expanded by 22 percent in 2024, driven by increased lending of nonbank credit institutions and higher loans to households and businesses, particularly to industry and manufacturing sectors. The banking sector capital adequacy ratio stood at 17.6 percent at the end-2024, while liquidity coverage ratios remained above minimum requirements. Asset quality has improved, with the nonperforming loan ratio declining to 2.4 percent, from 3.8 percent in 2022. Profitability remains robust, supported by strong interest margins.

Outlook and risks

The authorities anticipate a favorable growth outlook, projecting real non-oil growth to reach 5 percent in the medium term, while overall GDP growth is expected to stabilize at around 3.5 percent. They expect that significant public and private investments, particularly in the Karabakh and Eastern Zangezur economic regions, along with the ongoing economic diversification efforts, will drive medium-term growth. The authorities are actively positioning Azerbaijan as a strategic logistics, transport, and green energy hub, serving as a key corridor between Central Asia and Europe. Azerbaijan plays a crucial role in the Middle Corridor and North-South Transport Corridor, driven by major infrastructure investments focusing on developing railways, ports, and road networks. The completion of the Baku-Tbilisi-Kars railway and the expansion of Baku International Sea Trade Port are increasing capacity for the transit route for trade between Asia and Europe. The authorities view large-scale solar and wind projects, and the country's emerging role as a green electricity and hydrogen exporter to Europe as a potential growth driver. Moreover, the Karabakh and Eastern Zangezur economic regions boast fertile farmland and water resources, creating opportunities for intensive agriculture. Their successful reintegration into the national economy will contribute to long-term sustainable growth. The authorities' near-term inflation projections of 5.1 percent in 2025 and 4.3 percent in 2026, remain well within the CBA's target range.

The authorities view risks to the outlook as broadly balanced, acknowledging potential external challenges such as sticky inflation in key non-oil trade partners, higher tariffs, and global fragmentation. They remain vigilant in monitoring these risks to ensure economic stability. Additionally, the authorities see fiscal risks from state-owned enterprises (SOEs) as minimal, given recent corporate governance reforms, a reduction in SOEs' debt to acceptable levels, and improvements in their performance and profitability.

Fiscal policy and public financial management (PFM)

The stronger-than-expected 2024 budget outcome reflects both higher-than-projected revenue collection and expenditure savings. The growth of nonoil tax revenue continued to outpace nonoil GDP growth, driven by improved tax administration, higher compliance, reduced tax evasion, a shrinking shadow economy, greater labor market transparency, and an improved investment climate. On the expenditure side, savings stemmed from unfilled vacancies in the public sector, lower than budgeted utility payments and purchases of goods and services, and stricter budget discipline among spending agencies.

To strengthen budget discipline and ensure fiscal and debt sustainability, the authorities introduced the fiscal rule in 2018, as part of broader PFM reforms, with implementation beginning in 2019. Although the fiscal rule was temporarily suspended over the 2020–2022 period due to the COVID-19 pandemic and oil price shocks, it was reinstated in 2022. At the same time the fiscal rule was amended and enhanced with the support of the Fund's TA. Since 2018, the authorities successfully reduced the NOPD by 11.5 percentage points, from 32.1 percent of non-oil GDP in 2018 to 20.6 percent in 2024. In 2024 the NOPD outperformed the target by 3.4 percentage points, driven by higher non-oil revenues, strong non-oil GDP growth, and expenditure savings. The authorities remain committed to a gradual reduction of the NOPD, ensuring a balanced approach that aligns fiscal sustainability goals with the investment needs and key national programs, including the Socio-Economic Development Strategy for 2022–2026 and the "Great Return" program, consistent with the overarching Azerbaijan's 2030 National Priorities. The "Great Return" program supports reconstruction, revitalization, and demining of the Karabakh and Eastern Zangezur economic regions, facilitating the long-awaited return of internally displaced persons to their homes. The authorities also plan to amend the fiscal rule to enhance its near- term flexibility by shifting its focus away from strict annual targets to medium-term target and incorporating a correction mechanism.

To support fiscal consolidation, the authorities plan to strengthen tax administration and broaden the tax base by reducing ineffective tax exemptions and tax holidays. Given Azerbaijan's relatively high effective tax burden compared to its peers, their focus remains on broadening tax base and improving revenue collection rather than increasing tax rates. While acknowledging the importance of incentives for development of industrial parks, the authorities are conducting a thorough review of tax expenditures to ensure that various tax incentives are indeed achieving their intended objectives. Tax incentives will be subject to strict time limits and will expire unless proven effective. Additionally, to further strengthen tax administration, the authorities have expressed openness to undertake a Tax Administration Diagnostic Assessment (TADAT).

Azerbaijan faces a low overall risk of sovereign stress, as public debt remains low as a share of GDP. In line with the Medium- and Long-Term Debt Management Strategy, the authorities are gradually shifting the debt composition by reducing external debt while increasing reliance on domestic borrowing, to reduce external vulnerabilities.

As part of the PFM reforms, the implementation of the medium-term expenditure framework and the transition to program-based budgeting have been successfully carried out since 2019, aimed at enhancing budget efficiency and effectiveness. Initially introduced in three pilot sectors, program budgeting is gradually being expanded to five additional sectors.

Monetary policy and financial sector developments

The authorities have pursued a cautious and data-driven approach to monetary policy in response to evolving inflation dynamics. As inflation declined sharply in 2023 and early 2024, driven by lower imported inflation and nominal exchange rate appreciation, the CBA gradually eased its policy stance, reducing the policy rate to 7.25 percent in May 2024. As inflation rebounded to 4.9 percent by the end of 2024—primarily due to short-term supply shocks, higher agricultural producer prices, and adjustments in regulated tariffs—the CBA maintained its policy rate in March 2025, considering recent price increases as largely transitory. The CBA projects that under the current neutral monetary policy stance, inflation will remain well within the target band in both 2025 and 2026. While the authorities acknowledge elevated uncertainties, they remain committed to responding swiftly to emerging risks. In line with staff recommendations, they emphasize a cautious approach to further monetary easing, ensuring that inflation expectations remain well-anchored.

The authorities have made significant progress in improving monetary policy transmission. Since the introduction of the new liquidity management instruments in 2022, the transmission from the key CBA policy rate to long-term interest rates has improved. Excess liquidity in the banking system has been reduced and activity on both secured and unsecured interbank market has increased, allowing the CBA to better control the interbank interest rates and keep them within the interest rates corridor. The changes in short-term interest rates now start affecting deposit and lending rates, as well as yields on securities. The CBA is currently working on putting in place the preconditions for the transition to the inflation targeting regime, in line with the Socio-Economic Development Strategy for 2022-26, and will reassess these preconditions at the end of the strategic period.

The banking sector remains resilient, with recent FSAP findings confirming adequate capitalization even under adverse scenarios. The CBA has made significant strides in strengthening financial sector regulation and macroprudential policies aimed at enhancing prudential oversight, corporate governance, and risk management frameworks. In response to strong credit growth and a widening credit-to-GDP gap, the CBA has introduced an additional 0.5 percent counter-cyclical capital buffer, effective from March 1, 2025, to ensure that banks remain well-capitalized through the economic cycles. To further mitigate liquidity risks, the CBA has also implemented higher reserve requirements for banks with high deposit concentration, reinforcing financial stability and resilience.

The CBA continues to enhance capital strength and liquidity management within the banking sector. Following the activation of the counter-cyclical capital buffer, the transition to Basel III capital requirements is set to be completed by end-2025, including the introduction of capital conservation buffers and higher loss absorbency requirements for domestic systemically important banks. The banking sector is well-capitalized, with all banks' capital at the end of 2024 exceeding regulatory capital minimum, ensuring a smooth transition to Basel III capital requirements without negatively impacting bank lending. Additionally, following the introduction of the Liquidity Coverage Ratio in 2023, preparations are underway for the adoption of the Net Stable Funding Ratio, and the authorities are currently assessing its impact on banks' maturity transformation. The CBA recently adopted a Macroprudential Policy Framework. In line with the 2024–2026 Financial Sector Development Strategy and the FSAP recommendations, the CBA is implementing measures to further reduce deposit dollarization. Progress is being made with technical, legal and prudential steps to ensure an adoption of a risk-based and consolidated banking supervision.

Structural reforms

While hydrocarbon production remains a key pillar of the economy, Azerbaijan has made notable progress in diversifying its economy. This progress is evident in the employment structure, as in 2024, for the first time in recent history, private sector employment surpassed public sector employment. Additionally, both the range of exported products and the number of export markets have increased, reflecting a broader and more diversified economic base.

The Azerbaijan 2030 National Priorities emphasize the private sector's crucial role in fostering investments, growth, and employment. To support private sector development, the government has simplified business procedures and licensing and initiated development of domestic financial market, with the objective to promote a more dynamic and investment-friendly economic environment.

The authorities remain committed to SOE reforms, emphasizing the recent implementation of milestone reforms that improved accountability, profitability and corporate governance of major SOEs under Azerbaijan Investment Holding (AIH). Regarding privatization, the authorities successfully completed the IPO of the country's largest state-owned bank last year and are preparing privatization roadmaps for other SOE. Following the OECD review of the corporate governance of AIH and its SOEs, the authorities developed an action plan to implement the OECD recommendations. Building on the AIH model, the government established AZCON, a dedicated holding company for SOEs operating in transportation and communications sectors, to leverage synergies and strengthen Azerbaijan's role as a logistics hub between Central Asia and Europe. Looking ahead, plans are underway to integrate additional large SOEs into either AIH or AZCON, with a view of improving their positioning for potential privatization.

The authorities have undertaken significant reforms in recent years to enhance budget transparency, strengthen accountability, and improve fiscal governance. These efforts have been positively recognized in the Open Budget Index 2023 report, published by the International Budget Partnership in May 2024. Azerbaijan achieved a score of 67 points, reflecting a 10-point improvement from the previous assessment and exceeding the global average of 45 points by 22 points. This progress propelled the country from 44th to 23rd place among 125 participating nations, marking a 21-position jump and placing Azerbaijan in the category of countries with adequate budget openness.

The authorities have also made significant progress in strengthening governance, anti-corruption, and AML/CFT frameworks. The recent OECD Report on Anti-Corruption Reforms in Azerbaijan highlights strong performance in anti-corruption policy implementation, strengthening judicial independence, and improvements in public procurement transparency and public service digitalization. The country's anti-corruption policy framework was highly rated, with a score of 83 (outstanding), reflecting a well-developed strategy. The report recognizes progress in strengthening judicial independence and points to notable improvements in legal regulations and judicial selection processes. The new public procurement law has improved transparency and competition, leading to a decline in single-source tender cases. Azerbaijan has also made notable advancements in e-governance and use of digital tools that have helped reduce corruption risks. To address key gaps identified in the OECD assessment, the authorities are preparing new legislation on conflict of interest and plan to implement an automated asset declaration system based on international best practices. Additionally, they have committed to addressing the deficiencies identified in the 2023 MONEYVAL assessment, with significant progress already made, including aligning the AML/CFT Law with FATF standards and updating corresponding regulatory frameworks.

Moreover, as host of COP29 and current COP President, Azerbaijan has been playing a key role in advancing the global climate agenda. The authorities remain committed to ambitious climate reforms. The government has finalized its National Adaptation Plan and is expected to submit more ambitious mitigation targets this year, while continuing with efforts to achieve its current NDC target of 35 percent reduction in emissions by 2030. While Azerbaijan's contribution to global emissions remains small, reducing domestic fossil fuel consumption would lower carbon intensity in non-oil exports and support non-oil sector growth. To achieve this, the authorities have launched electrification and energy efficiency programs in construction and transportation sectors, alongside renewable energy projects aimed at doubling the share of renewables in installed capacity by 2030. The newly established Energy Efficiency Fund will support energy efficiency measures in the country. Solar and wind power projects are primarily financed through private sector investments and public-private partnerships (PPPs) to minimize fiscal pressures, while also noting the need to monitor risks associated with PPPs as they gain traction. Azerbaijan is also emerging as a regional green energy hub, positioning itself as a key exporter of green electricity and green hydrogen to Europe. Large-scale wind and solar projects, developed in collaboration with international energy companies are advancing Azerbaijan's renewable energy transition. A landmark agreement with Georgia, Hungary and Romania will facilitate the export of green Azerbaijani energy via an undersea cable beneath the Black Sea, linking planned Caspian Sea wind farms to the European grid. As part of its sustainability efforts, Azerbaijan has declared the Karabakh and Eastern Zangezur economic regions a "Green Energy Zone", ensuring that all electricity in these regions would come exclusively from renewables. Additionally, the authorities have been gradually reducing fuel subsidies and supporting State Oil Company's efforts to decarbonize operations. The authorities are also conducting preliminary studies on carbon pricing mechanisms and emissions trading systems in select industries to further align with global climate policy trends.