

# ECONOMIC BULLETIN

*May 2010*

## *Fitch upgrades Azerbaijan to Investment Grade*

Fitch Ratings has upgraded Azerbaijan's Long-term foreign and local currency Issuer Default Ratings (IDRs) to 'BBB-' from 'BB+'. The Outlooks on both ratings are Stable. Fitch has also upgraded Azerbaijan's Country Ceiling to 'BBB-' from 'BB+' and upgraded its Short-term foreign currency IDR to 'F3' from 'B'.

"Fitch's upgrade of Azerbaijan's sovereign rating to investment grade reflects the rapid increase and prudent management of oil revenues that are being used to build a strong public and external net creditor position," says Andres Klaar, Associate Director in Fitch Sovereigns Group. "The strong sovereign balance sheet provides a powerful buffer against potential shocks emanating from the country's structural weaknesses."

The prudent use of the oil windfall has brought about an accumulation of assets in the State Oil Fund of Azerbaijan Republic (SOFAZ), the sovereign wealth fund, to USD16.2bn as of end-March 2010 (38% of 2009 GDP). Despite volatile international oil prices and the global financial crisis, Azerbaijan ran a general government budget surplus of 6.3% of GDP in 2009, as the authorities' cut budget expenditures rather than increasing transfers from SOFAZ, delivering an increase in SOFAZ assets of USD3.7bn. The current account surplus was 20.7% of GDP in 2009, while inflation fell to 1.5% in 2009 from 20.8% in 2008.

As an oil exporting country, virtually every external finance indicator in Azerbaijan is superior to the peer group median. Its sovereign net foreign assets reached 37% of GDP at end-2009, similar to Kazakhstan's 41% and Russia's 33%. However, the moderate private sector indebtedness in Azerbaijan is strength relative to its two CIS peers, as illustrated by Azerbaijan's strong net external creditor position of 36% relative to Russia's 26% and Kazakhstan's net external debt position at 27%. The Central Bank of the Republic of Azerbaijan (CBRA) has successfully maintained the manat's exchange rate against the USD during the global financial crisis.

Fitch believes the fiscal rule that limits the annual expenditure of oil revenues to a level consistent with the "permanent income" from the oil endowment is appropriate. The agency also draws comfort from the transparency of the SOFAZ, underlined by Azerbaijan being the first country to be fully compliant with the international Extractive Industries Transparency Initiative. Fitch forecasts assets in SOFAZ to increase to around USD22bn at end-2010 (45% of GDP).

## *Nabucco project perspectives*

The Republic of Azerbaijan is interested in rapid implementation of gas pipeline construction project Nabucco, Minister of Industry and Energy Natiq Aliyev told Trend's correspondent in Tbilisi. "The volume in which Azerbaijan will be involved in gas supplies to Europe via this route depends on the needs and scale," Aliyev added.

Azerbaijan expressed interest in the project at the state level. However, Minister stressed that Azerbaijan has not taken any commercial commitments to "Nabucco". "We are interested in this project. The closer organizers will be to its realization, the more actively we begin to discuss the conditions of our participation in it," the minister said.

The launch of the construction of the gas pipeline has been scheduled for 2011, with the first supplies commencing in 2014. Maximal capacity of pipeline will hit 31 billion cubic meters per year. About 30% of the total project cost will be invested by Nabucco Gas Pipeline International shareholders in the form of equity participation, the remaining 70 % will be financed by loans extended by international financial institutions and banks.

## *Gas export to Russia*

According to the State Oil Company of Azerbaijan (SOCAR) the explosion at the Russian sector of the gas pipeline Mazdok-Kazimagomed did not affect volumes of export of Azerbaijani gas to Russia. The Russian side continues to receive gas based on the previous volumes.

Azerbaijan exported 261.7 million cubic meters of gas to Russia in January-April. In April this figure amounted to 89.6 million cubic meters. The Kazimagomed-Mozdok pipeline transports the Azerbaijani gas to Russia. The pipeline's capacity is about five billion cubic meters per year. Till 2007, Azerbaijan imported about 4.5 billion cubic meters of gas via this pipeline. However, as of 2007 Azerbaijan stopped to import the Russian gas. As of 1st January of 2010 Azerbaijan's gas supplies are transported via this pipeline to Russia.

The medium-term contract on purchase-sale of Azerbaijani gas to Russia (with the possibility of extension) was signed between SOCAR and Gazprom in Baku last year covering years of 2010-2014. Under the contract, the Azerbaijani side will annually supply gas amounting to no less than 500 million cubic meters to Russia. The contract did not specify any particular peak of commercial gas volume. SOCAR will notify the opposite side of the amount which the company can deliver for the next six months.

Earlier, Gazprom and SOCAR have agreed that in 2009 Russia will acquire 1 billion cubic meters of the Azerbaijani gas instead of 500 million and in 2011 the volume of supply will be doubled and reach about 2 billion cubic meters.

### **Azerbaijan's non-oil export increased**

In the first quarter Azerbaijan's non-oil export increased 2.3 times compared to the same period of 2009, Azerbaijani Economic Development Ministry Administration Chief Samir Veliyev said at a workshop on "Direction of Azerbaijan's Export Development".

"This is an indicator of the fact that the goods exported by Azerbaijan comply with EU requirements, including their labeling, packaging and other parameters," Veliyev said. According to him, measures aimed at improving the quality of products exported from Azerbaijan, and export promotion, will continue.

Veliyev said that decree "On additional measures in the sphere of development of the rules regulating import and export operations of Azerbaijan" signed by the President May 14, 2010 will contribute to full compliance of export and import procedures with the requirements of economic development and increase state support for entrepreneurship, to expand socio-economic development of regions and the growth of export, and increase of production of non-oil products.

### **Launch of "Azercosmos"**

The recent Presidential decree to launch Azercosmos JSC under the Communications and IT Ministry will facilitate Azerbaijan's entrance to the international space market," Minister of Communications and IT Ali Abbasov said.

He said that launch of the company has two objectives. The first is to lay the groundwork for formation and use of outer space for peaceful purposes. The second goal is the use of outer space for commercial purposes.

Under the presidential order, the Azerbaijani Cabinet of Ministers has to approve the charter and structure of public companies within two months.

The Ministry of Communications and IT deals with establishment of a board to examine scientific and technological achievements and excellence in the field of space activities, participation in the adoption of appropriate measures to implement the state policy in this area and will prepare proposals concerning the development of the industry

### **EBRD director to get familiarized with Azerbaijan's priorities for future cooperation**

A delegation of the European Bank for Reconstruction and Development (EBRD), which will include representatives of the Board of Directors expected to pay visit to Baku soon.

The main purpose of the visit of the delegation of the Board of Directors of the Bank to Azerbaijan is to get familiarized with the process of transition to a market economy, and the role that EBRD play in this process.

Within the future strategy of the bank's cooperation with Azerbaijan, the Bank's director will get acquainted with the latest priorities of the Azerbaijani Government on the expected goals of the EBRD, said in the report.

During the visit, it is expected to conduct meetings with partners of the bank, the organizations, state agencies with which the Bank is cooperating. EBRD Board of Directors conducts such missions in each member country included in the zone of operations of the bank every 3-4 years. A mission visited Azerbaijan in 2007 last time.

In 2009, the Bank invested 230 million euros in Azerbaijani economy, of which 120 million euros was directed to finance expansion of Garadagh cement plant. The Bank has financed 103 projects worth \$1.4 billion. Financial institutions cooperating with the EBRD, received 69 lines of credit and investments totaling \$223 million from the bank.

### **World Bank approves 3rd Azerbaijan highway project**

The World Bank's Board of Executive Directors has approved the 3rd Highway Project on Azerbaijan, which amounts to a total of \$356.15 million.

The WB approved \$241.6 million for the project, of which \$171.6 million will be provided by the International Bank for Reconstruction & Development and \$70 million by the International Development Association.

The rest of the funds will be covered by the Azerbaijani government. The project envisages the expansion of the Baku-Shamakhi highway.