



Caucasus

Outlook 2023

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Executive summary

2023 is likely to be a crunch year in the South Caucasus, with a high risk of a renewed outbreak of fighting between Azerbaijan and Armenia, and a slight chance of a peace deal that settles the status of the ethnic Armenian enclave of Nagorno-Karabakh within Azerbaijan.

Throughout 2022 Azerbaijan cranked up the pressure on Armenia to sign a final peace treaty following the 2020 war in which it retook most of Nagorno-Karabakh. Baku seeks complete control of the enclave (without granting it any significant autonomy), while also taking over what it calls the Zangezur corridor, linking Azerbaijan across Armenian territory with its exclave of Nakhchivan.

Baku is still occupying strategic heights on the Armenian border after its incursion in September 2022. Azerbaijani so-called environmental activists have also blocked the Lachin corridor, the only road linking Armenia and Nagorno-Karabakh, for the past month, causing severe hardship there over the winter.

Recognising Armenia's weakened position, Prime Minister Nicol Pashinyan has pursued improved relations with both Azerbaijan and its ally Turkey. Ankara this month ended its ban on air freight connections and has signalled that it would open the border once Yerevan reaches a peace deal with Baku.

Pashinyan had previously indicated that he was ready to do a deal that would settle Nagorno-Karabakh's status, despite strong domestic opposition and protests from Stepanakert. However, Baku's hardball tactics so far seemed to have been counter-productive, and Armenia has reacted to these provocations by halting the peace talks.

Russia, the traditional guarantor of Armenia's security, has been diverted by its disastrous invasion of Ukraine and has failed to intervene to manage these disputes.

This has created a vacuum that has been exploited by Baku and which has damaged Armenian-Russian relations. Russian peacekeepers have stood by while Azerbaijan has staged its series of provocations, leading Armenia to retaliate by cancelling military exercises by the Russian-led security pact CSTO on its territory. Yerevan has also refused to attend peace talks arranged by Moscow.

Moscow's absence has also opened up space for the EU and US to become more involved in the dispute and in the region as a whole. Both have led talks on the conflict, while the EU has reached a deal with Baku on expanded gas deliveries, and given Georgia hope of eventual accession.

As well as weakening Russia's geopolitical position in the region, President Vladimir Putin's invasion of Ukraine has also had significant economic repercussions. A wave of Russian migrants has fled to Armenia and Georgia. These migrants have brought spending power –

an estimated \$2bn has been transferred to Georgian banks – and talent, notably in IT.

Sanctions on Russia have also led some trade and financial flows to be rerouted via the South Caucasus countries, none of which have signed up to the Western embargoes, though they cannot be seen to violate them too openly.

At the same time, the fragile economies of the South Caucasus have been hit by the severe downturn of the Russian economy, on which they are still very dependent, as well as soaring energy prices and the Eurozone's slowing growth. According to the World Bank Global Economic Prospects, released this month, growth in the region in 2023 is projected to halve to 3.3%.

Hydrocarbon producer Azerbaijan has actually benefited from the high energy prices and it has also improved its geopolitical position because of Europe's search for non-Russian oil and gas supplies. Brussels signed a deal with Baku in July to double the gas imports it buys and European Commission President Ursula von der Leyen visited Baku in August in a trip notable for the lack of criticism of President Ilham Aliyev's dictatorship. Meanwhile, Aliyev has used his strengthened position to tighten his grip on the media and further restrict the position of political parties.

For Georgia, as for Armenia, Russia's invasion of Ukraine in February has sharpened its economic and geopolitical dilemmas. Paradoxically the invasion has made it even more dependent on Russia. Meanwhile, the wave of Russian migrants – an estimated 60,000 to 100,000 of whom still live in the country – has sparked calls from the political opposition for visas to be imposed.

Georgia's refusal to sign up to Western sanctions on Russia was undoubtedly a factor in its failure to be awarded EU candidate status in June, though its key failing was democratic backsliding.

The country's worsening international image was epitomised by the government's tone-deaf response to the outcry over former president Mikheil Saakashvili's deteriorating health in jail. If the opposition leader were to die in jail there would be huge international damage and potentially grave internal disruption.

Brussels has handed Tbilisi a wishlist of 12 political reforms that must be undertaken before the country can become a full candidate. The biggest challenge will be "de-oligarchisation", restricting the influence of the country's top business figures, notably Bidzina Ivanishvili, godfather to Georgia's ruling Georgian Dream Party.

A bill to supposedly achieve this has drawn sharp criticism, after lawmakers from the ruling party insisted that it will not apply to Ivanishvili. In November, the government capitulated to demands from both the opposition and Western leaders to send the draft bill to the Venice Commission for a legal opinion. How the government responds to the Council of Europe advisory body will show how serious it really is about achieving EU accession.

1.0 Political Outlook

1.1 Politics – Georgia

Georgia missed a major opportunity this year after the European Council declined to grant it candidate status during its June summit, while Ukraine and Moldova were allowed to move ahead in their dream of joining the bloc. The reason: EU officials' concerns about "democratic backsliding" in Georgia. Instead, Brussels handed authorities in Tbilisi a wishlist of 12 recommendations, or certain political reforms that must be undertaken before the country can become a candidate. Recommendations include improvements to the judicial system, media freedom, and anti-corruption reforms.

Georgian Prime Minister Irakli Garibashvili tried to put a brave face on Georgia's failure to secure EU candidate status from Brussels, saying that the country would work towards being given the status. However, intense domestic polarisation has gotten in the way of implementing the 12 recommendations, with both the opposition and ruling Georgian Dream party accusing the other of trying to derail the country's path to EU membership.

The biggest challenge facing the country's political establishment is what the EU has dubbed "de-oligarchisation." This is a not-so-subtle reference to Bidzina Ivanishvili, Georgia's wealthiest citizen and former prime minister, who made his fortune in Russia after the collapse of the Soviet Union. He claims to have retired from politics, having stepped down as chairman of Georgian Dream in 2021. However, his associates are still in power, and many regard Ivanishvili as the informal arbiter of major political decision-making in the country to this day.

Parliamentarians from Georgian Dream drew up a de-oligarchisation draft bill back in October, which has since passed through several readings in the country's legislature. But the bill has drawn sharp criticism after lawmakers from the ruling party insisted that it will not apply to Ivanishvili. MPs from Georgian Dream maintain that they are simply implementing EU recommendations. The opposition views the bill as an instrument for potential political repression. In either case, in November, the Georgian Dream-led government capitulated to demands from both the opposition and western leaders to send the draft bill to the Venice Commission for a legal opinion.

Meanwhile, Russia's invasion of Ukraine has done little to change the already cool relations between Tbilisi and Moscow. Although Georgia

has attempted over the past decade to reset relations with Russia following the 2008 Russo-Georgian War, these efforts have not led to significant advances on some of the most critical issues, namely Russia's continued occupation of Abkhazia and South Ossetia.

At the same time, the war and western sanctions against Russia now make clear that Georgia's economic dependence on its neighbour to the north brings serious risks. Between January and September 2022, Georgia received \$2.2bn in income from Russia through remittances, exports, tourism, and cash transfers from Russian citizens fleeing war. Russia is Georgia's second largest trade partner, making the latter highly dependent on the former, especially for the import of wheat and oil products.

That in large part explains why the Georgian government abstained from joining Western countries in imposing direct sanctions on Russia, much to the chagrin of Ukraine. But deep trade relations with Russia leave Georgia vulnerable to economic shocks emanating from its northern neighbour, whose economy, affected by protracted conflict and sanctions, is likely to experience a pronounced slump next year. Oddly enough, Georgia's economic dependence on Russia has only grown since the war's start in February.

A major consequence of the war that Georgia is grappling with is the influx of Russian citizens entering the country. An initial wave of Russians flowing into Georgia came after the invasion of Ukraine on February 24, whereas a second and much more massive influx was sparked by Vladimir Putin's mobilisation announcement on September 21. According to Georgian authorities, around 100,000 Russian citizens have entered and remained in the country since the war's start, or almost 3% of Georgia's total population of 3.7mn people.

The opposition within Georgia has called on the government to establish a visa regime for Russian citizens, who currently enjoy visa-free travel to the South Caucasian country. Polling data shows that the majority of Georgian citizens support such a move. However, the Georgian Dream-led government has insisted that a visa regime with Russia is not necessary.

In general, the domestic opposition's criticisms against the ruling party have heated up considerably against the backdrop of war. Opposition activists and MPs have vehemently accused Georgian Dream of pursuing a pro-Kremlin course due to its seeming ambivalence towards Russia. Tbilisi has maintained its policy of "strategic patience" with Moscow despite the war in Ukraine. However, Prime Minister Irakli Garibashvili was the only leader from among Russia's immediate neighbours to publicly condemn the invasion of Ukraine. Moreover, though Tbilisi has not imposed direct bilateral sanctions against Russia, Georgian financial institutions fully comply with international sanctions, as the US State Department noted in a report published in the summer.

The continued detention of former president Mikheil Saakashvili, who suddenly returned to Georgia following an eight-year exile in October

2021, remains just as divisive an issue as it was a year ago. In early December, Saakashvili's legal team, along with medical experts, claimed that the ex-president had been poisoned while in detention.

Likewise, a 2,980-page medical report on his health stated that Saakashvili showed symptoms which make his condition "incompatible with imprisonment." The ex-president's defence lawyers have petitioned the Tbilisi City Court to release him or to postpone sentencing due to his poor health. Georgian officials have so far declined requests for Saakashvili to be transported abroad for medical treatment.

Going into 2023, Georgia is entering one of the most turbulent periods of its recent development, and at this pivotal moment, the country seems to be losing its strategic compass and the foundation of its foreign policy. The Russian invasion of Ukraine triggered a chain of events that confirmed Georgia's place as an important crossroads between Russia and the West externally, and between authoritarianism and democratic development internally. How the country's political establishment will confront these internal challenges will grow clearer in the year ahead.

1.2 Politics – Armenia

Armenia enters 2023 with a big political challenge ahead – signing a peace treaty with Azerbaijan, which could potentially recognise Nagorno-Karabakh as part of Azerbaijan. As Russian influence in South Caucasus declines, the country is looking to Western allies to restrain threats of a possible war that Azerbaijan is eager to start in case Armenia refuses to sign the "peace deal".

The domestic political struggle continues in the country as the opposition wants to see the government removed; however, Prime Minister Nikol Pashinyan is still standing strong. In 2023 that could change as Armenia is looking to agree to painful concessions to avoid war in Armenia proper. The normalisation of relations with Turkey is underway, however slow and dependent on relations with Azerbaijan.

Armenia's relations with Russia continue to deteriorate. Russia and its Collective Security Treaty Organization (CSTO) have proven useless in terms of defending Armenia. The CSTO is unable and unwilling to help Armenia at the expense of Azerbaijan. In the light of what could be the biggest geopolitical shift in the modern history of the country, Armenia is looking towards the West, particularly the US. Local experts believe that Armenia won't leave the CSTO, but the future of the alliance is highly dependent on the situation in Nagorno-Karabakh and the war in Ukraine.

1.3 Politics – Azerbaijan

2022 was a year when the country's longtime dictator, President Ilham Aliyev, decided to further limit the democratic space. Azerbaijan introduced a new Law on Media, a sector which already was suffocating. The law contains a register for journalists and will apply to both domestic media outlets and those that transmit or publish to an Azerbaijani audience. Local media and human rights organisations have expressed concerns that the bill might allow the government to select who is legally recognized as a journalist, and that the register will include information about reporters and their professional connections.

Azerbaijan also introduced a new Law on Political Parties in 2022. Members of Azerbaijan's parliament have proposed a new rule that would make it harder to create new political parties and would severely limit those that already exist. The new proposed law, which was presented on September 7, would require new parties to have at least 200 founding members who have resided in Azerbaijan for the previous 20 years without interruption.

In defence and foreign policy, Aliyev had major wins in 2022, such as capturing several heights on sovereign Armenian territory, and striking a deal with European Commission President Ursula von der Leyen in July – who said “the EU is turning to *trustworthy* energy suppliers”. However, he also failed to achieve several goals since the country's victory over Armenia in 2020: Russian peacekeepers are still in place, as are the Armenian separatists in Karabakh.

The self-declared President of Nagorno-Karabakh Arayik Harutyunyan travelled to France and appeared on its public broadcaster. Ruben Vardanyan, an Armenian from Russia travelled to Karabakh to set up a government there. Aliyev's main promise – a Zangezur corridor, which is supposed to connect Azerbaijan to Nakhchivan and Turkey – is still not achieved. A peace treaty that was expected to be completed by the end of 2022 is not even in a draft phase. Moreover, Azerbaijan is now at odds with Iran, its southern neighbour, a dispute which was dormant for a long time.

Azerbaijan's main target for 2023 will be opening the Zangezur corridor and signing a peace treaty with Armenia, which would be accompanied by consolidation of rule inside the country.

2.0 Macroeconomic Outlook

2.1 Macroeconomy - Georgia

Georgia: key economic figures and forecasts							
	2016	2017	2018	2019	2020	2021	2022
Nominal GDP (EUR bn)	84.7	102.3	113.0	138.9	153.3	193.2	228.9
Real GDP (% y/y)	2.9%	4.8%	4.8%	5.0%	-6.8%	10.5%	10.2%
Industrial output (% y/y)							
Unemployment rate (avg, %)	21.7	21.6	19.2	17.6	18.5	20.6	21.1
Nominal industrial wages (% y/y)							
Producer prices (avg, % y/y)	99.9%	111.0%	106.1%	107.2%	108.6%	116.7%	
Consumer prices (avg, % y/y)	2.1%	6.0%	2.6%	4.9%	5.2%	9.6%	11.9%
Consumer prices (eop, % y/y)	1.8%	6.7%	1.5%	7.0%	2.4%	13.9%	9.2%
General budget balance (% of GDP)	-2.8%	-2.7%	-2.3%	-2.1%	-9.3%	-6.1%	-3.1%
Public debt (% of GDP)	40.3%	39.4%	38.9%	40.4%	60.2%	49.7%	39.6%
Current account balance (% of GDP)	-12.5%	-8.0%	-6.8%	-5.8%	-12.5%	-10.4%	-7.1%
Official FX reserves (EUR bn)							
Gross foreign debt (% of GDP)							
EUR/LC (avg)	2.3667	2.5086	2.5345	2.8192	3.1097	3.2209	3.1712
USD/LC (avg)	2.6172	2.8322	2.9913	3.1553	3.5519	3.8140	2.9685
Source: Geostat, Galt & Taggart							

2.1.1 GDP growth

Georgia's economy boasted one of the highest growth rates in the world in 2022 as many countries buckled up for recession, and the lari was one of the few emerging markets currencies to gain value against a

strong US dollar. The country's real GDP grew by 10% in the first 10 months of the year compared to 10.5% in the same period for 2021.

Recovery in the tourism sector continued, with inflows from foreign tourists surpassing pre-pandemic levels in 2019 already by October and a total of \$2.9bn in revenues. Double-digit growth was recorded in many other sectors too, including energy, transport, and manufacturing.

The inflow of Russian businesses and IT professionals who found refuge in Georgia boosted money transfers and further supported the services and hospitality sectors. At the same time, Georgia's trade deficit widened by 29% y/y by October, while imports and exports also increased, benefiting from the geographical diversification of trade.

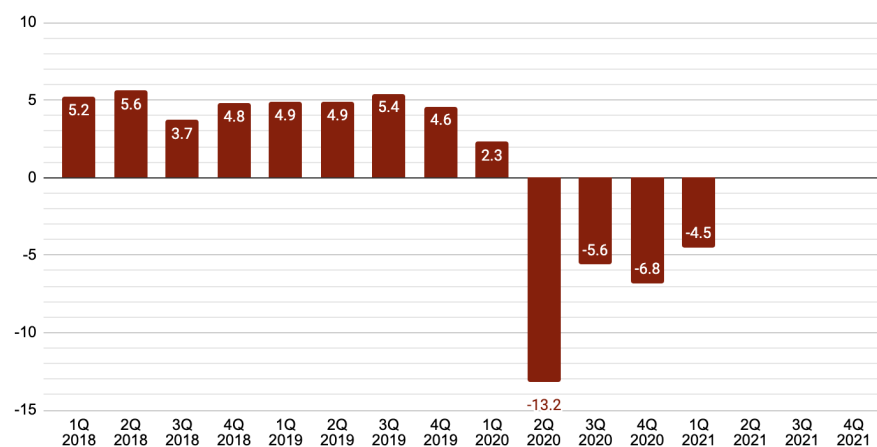
However, rising current account inflows helped to cover the trade deficit and supported the appreciation of the Georgian lari since a low point in March, leading to an increase of foreign reserves.

Amid high geopolitical uncertainty, the Georgian authorities secured a \$280mn precautionary Stand-By Agreement with the IMF in June, which is aimed at creating a more predictable business environment. Georgia's economy is likely to grow by around 9% for 2022 as negative spillovers from the war in Ukraine have not yet materialised.

For 2023, EBRD predicts moderate GDP growth of 5%. This would be a significant slowdown compared to the past two years of strong economic recovery following COVID restrictions in 2020. Risks to the Georgian economy remain high due to extreme uncertainty and a significant probability of external adverse shocks.

Georgia GDP growth y/y

source: Georgia state statistics agency



2.1.2 External environment

For the first 10 months of 2022, Georgia's trade deficit was up by 32.7% y/y and totalled \$6.1bn, as exports increased by 34.0% y/y to \$4.5bn, and imports were up by 33.3% y/y to \$10.7bn.

Despite the widening trade deficit, Georgia's current account improved in 2022, decreasing by 49% y/y in 2Q and standing at \$22.3bn in November. This has been thanks to tourism and large net money inflows, mostly from Russia. The World Bank predicts that the unanticipated windfall from the war is nonetheless expected to subside into the next year.

Georgia received \$2.9bn from international tourism in January-October of 2022, surpassing pre-pandemic levels. Georgia's National Tourism Administration said in November that revenues from international tourism had increased by 183.2% y/y in the first 10 months of 2022. The agency also noted that figures showed a 100.2% recovery from the same period in 2019. For the month of October alone, tourism revenues reached \$337mn, marking a 126.4% recovery from the same month in 2019 and an increase of 137.1% y/y.

In October, the volume of money transfers to Georgia from abroad reached \$502mn, an increase of 142.9% compared to the same period last year, reports the National Bank of Georgia. Of the total money transfers from abroad in October, 98.0% came from Georgia's 23 largest partner countries, with the volume of transfers from these countries each exceeding \$1mn for October 2022.

The volume of money inflows from Russia continued to top all other countries, reaching nearly \$300mn for just October, whereas overall transfers from Russia in the first 10 months of 2022 amounted to \$1.4bn. After Russia, the second largest source of money transfers into Georgia is Italy, which for the same period in 2022 contributed \$353mn to overall transfers. According to the brokerage house Galt & Taggart, the total volume of remittance flows to Georgia in 2022 is expected to reach \$4bn.

Foreign direct investment in Georgia in 1Q22 amounted to \$568.2mn, which is \$435.7mn more than in the same period last year, Geostat reported, citing preliminary data. Thus, the figure increased by 4.3 times. By 2Q22, the UK was Georgia's largest foreign direct investor at 18.4% (\$151.8mn over the first two quarters of 2022). In 2Q22 FDI amounted to \$351.8mn, up 9.1% from the adjusted data of 2Q21.

Persistent inflation, coupled with the tightening of global financial conditions, could impact the Georgian lari in the next year, potentially affecting macro-financial stability due to the high levels of dollarisation. The Russian economy could also suffer a more pronounced slump in 2023, affected by protracted conflict and sanctions, which would negatively affect tourism and remittances in Georgia.

Domestic political uncertainty could increase volatility and affect business confidence, as well as the pace of planned reforms. However, money inflows could last longer than initially expected, and Georgia could benefit from some trade diversion as transport corridors are reconfigured.

Due to trade openness and reliance on income from tourism, Georgia is vulnerable to external and global shocks. High dollarisation and dependency on external savings increase the risks associated with currency depreciation. Still, Georgia's swift post-pandemic rebound and the recovery from the initial impact of the Ukraine war and associated sanctions have demonstrated the growing resilience of the economy.

2.1.3 Inflation and monetary policy

Georgia lucked out fighting inflation in 2022. The huge influx of Russian migrants that first arrived after Russia invaded Ukraine in February and a second more recent wave escaping the mobilisation actually pushed Georgia's inflation down. The appreciation of the lari mitigated some of the pressure from imported prices of food and energy.

After peaking at 13.3% in 2Q, inflation gradually began to ease, resulting in a moderation of inflation from a peak of 12.5% in June. By November, Georgia's consumer price index increased by 0.5% m/m compared to the previous month, while the annual inflation rate fell modestly to 10.4% compared to 10.6% in October.

The National Bank of Georgia steadily hiked rates steadily since the start of the year to the current 11%, but against the deflationary backdrop, the regulator has left interest rates more or less flat. The National Bank of Georgia has been able to keep its refinancing rate at 11% since March, after a 300 basis points increase in the preceding 12 months.

Higher food and energy prices (as well as utility costs) accounted for most of Georgia's inflation in 2022. According to high-frequency surveys from May 2022, about three-quarters of the respondents from low-income households reported having reduced food consumption in response to rising prices.

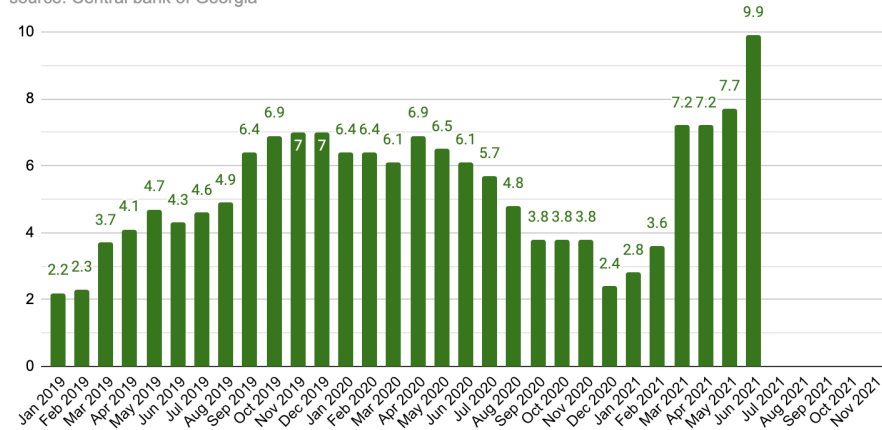
The World Bank predicts Georgia's inflation to decline in 2023 and beyond, as international oil prices and supply-side bottlenecks ease.

The long-term fixed-price contracts for gas supply and a shared border with Russia are expected to help offset any commodity price spikes.

Monetary policy is expected to remain tight until inflationary pressures subside. Inflation is likely to have regressive impacts, disproportionately affecting lower-income households and those reliant on incomes from social assistance. These may have longer-term welfare impacts through losses in human capital and other assets.

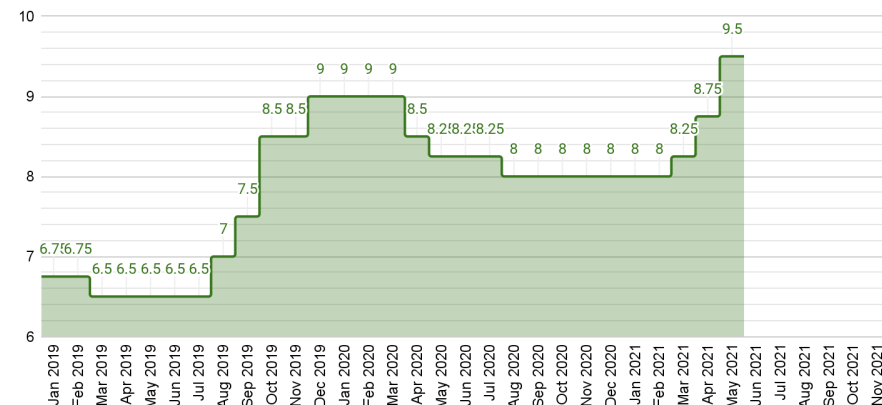
Georgia inflation y/y

source: Central bank of Georgia



Georgia monetary policy rate

source: Central bank of Georgia



2.1.4 Industrial production

Industrial production in Georgia rose 17.6% y/y in 3Q22, easing from 23.10% growth in the previous period. Production increased at a slower pace for both electricity, gas, steam & air-conditioning supply (17.4% vs 48.0%) and manufacturing (17.8% vs 20.9%). Meanwhile, output continued to grow for both mining & quarrying (17.0% vs 9.7%) and water supply sewerage, waste management and remediation activities (14.4% vs 6.6%).

Manufacturing production in Georgia decreased 1.58% in June over the same month in the previous year.

2.2 Macroeconomy – Armenia

Armenia: key economic figures and forecasts							
	2016	2017	2018	2019	2020	2021	2022
Nominal GDP (EUR bn)	9.065	9.954	10.764	11.705	11.058	13.01	19.88
Real GDP (% y/y)	0.2	7.5	5.2	7.6	-7.6	5.7	14
Industrial output (% y/y)		16.6	5.6	7.9	0.0	0.36	9.9
Unemployment rate (avg, %)	17.6	17.7	19.0	18.8	20.2	21.21	13.6
Nominal industrial wages (% y/y)							
Producer prices (avg, % y/y)						2.1	2.9
Consumer prices (avg, % y/y)		3.7	-0.1	-1.1	3.0	3.94	8.8
Consumer prices (eop, % y/y)							
General budget balance (% of GDP)	-5.5	-4.8	-1.6	-0.8	-5.1	-4.59	-3.1
Public debt (% of GDP)	51.4	58.4	51.0	50.0	64.0	60.25	60.2
Current account balance (% of GDP)	-1.0	-1.5	-6.9	-7.2	-3.1	-3.7	-3.8
Official FX reserves (EUR bn)							
Gross foreign debt (% of GDP)	94.4	91.3	87.6	90.3	102.3	99.9	63.50
EUR/LC (avg)	531.9	545.1	570.6	537.9	558.4	597.3	417.9
USD/LC (avg)	480.5	482.7	483.0	480.4	489.0	504.4	394.4
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH, Armstat, Armenia Statistical Yearbook 2021 Others hyperlinked in category							

2.2.1 GDP growth

Armenian GDP growth in 2022 will amount to 14%, according to the latest forecast of the Ministry of Economy.

The World Bank (WB) forecasts a slowdown in Armenia's GDP growth in 2023 to 4.3% (from its estimated 7% growth in 2022), and the International Monetary Fund (IMF) – to 4-5% (from an estimated 11% growth in 2022).

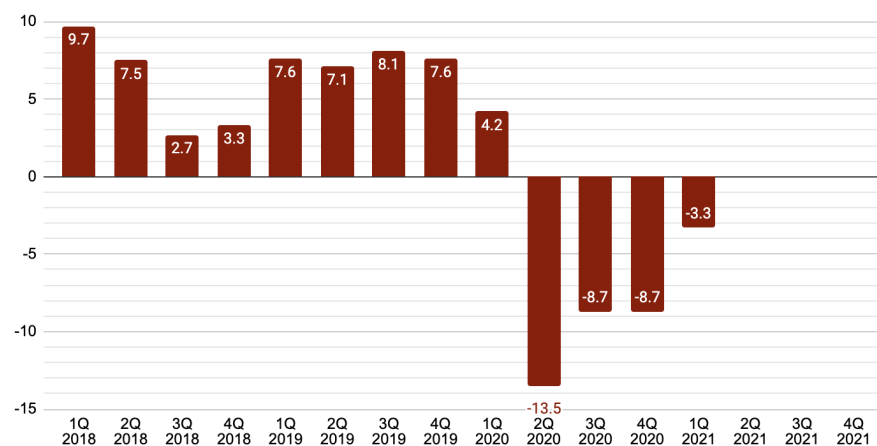
In terms of inflation, both the WB and the IMF forecast a decline to 6.7% and 6% respectively (from an estimated 8.5% for 2022). The rising cost of living due to the energy crisis and the war in Ukraine is blamed for the slowdown.

The 2023 forecast of the central bank regarding GDP growth is the same as the World Bank's – 4.5% – but the 2022 forecast is very different – 12.9% versus 7%. In terms of inflation, the expectations of the Central Bank of Armenia for 2023 are closer to the WB forecast: a decrease in official y/y inflation to 7% (from estimated 8.6% for 2022), and a decrease in core y/y inflation to 6.7% (from estimated 8.7% for 2022). However, in its forecast update scheduled for November, the central bank is likely to adjust its expectations for GDP growth for 2022 as well as for inflation for 2022 and 2023, taking into account new factors that have not been taken into account in the September forecast.

According to the National Statistical Committee, Armenia's economic activity in the first 10 months of this year registered a growth of 14.5% y/y. According to the Armenian government, 2022 economic growth could be one of the highest growth rates recorded in the last 15-20 years, being in the range of 13-14% real GDP growth.

Armenia GDP growth y/y

source: Armenia state statistics agency



2.2.2 External environment

Armenia's foreign trade in the first 10 months of 2022 surged by 66.4% from the first 10 months of 2021 to about \$10.9bn, the National Statistical Committee (NSC) announced.

It said the trade with the CIS countries amounted to \$4.1bn, an increase of 80.4% y/y. The largest foreign trade partners were Russia with \$3.8bn, a 86.4% y/y increase, Belarus with \$146.7mn, a 2.3 times increase, and Ukraine with \$75mn, a 41.2% decrease.

The trade turnover with the EU countries amounted to about \$1.8bn, a 39.2% growth. Germany with \$393 mn, a 73% rise, Italy \$267 mn, a 11.3% rise, and the Netherlands with \$220mn, a 23.3% increase, were the most prominent trade partners of Armenia in the European Union.

Armenia's exports in the first 10 months of 2022 rose by 71.2% against January-October 2021, to about \$4.2 bn.

Exports to the CIS countries totalled \$1.8mn, having increased 2.5 times. The top three largest importers of Armenian products were Russia (\$1.7 bn, 2.5 times growth), Belarus (\$54.5mn, 2.8 times growth), and Kazakhstan (\$13.4mn, 46.2% growth).

Armenian exports to the EU countries rose by 21.1% to \$667mn. The first three countries in terms of imports of Armenian goods were Bulgaria (\$198 mn, up 5.9%), the Netherlands (\$180 mn, up 21.3%), and Germany (\$89mn, up 38.1%).

Imports to Armenia in January-October 2022 amounted to about \$6.8bn, an increase of 63.5% y/y.

Imports from the CIS countries amounted to about \$2.45bn, having risen by 45.2%. The top three leading exporters to Armenia were Russia with \$2.3bn, with an increase of 48.2%, Belarus \$99mn, a two-fold increase, and Ukraine with \$90mn, down by 27.2%.

Imports from the EU countries rose by 64.7% to about \$1.4bn. The first three countries in terms of exports to Armenia were Germany with \$338mn, up by 95.9%, Italy \$189mn, up by 14.6%, and the Netherlands \$100 mn, up by 46%.

2.2.3 Inflation and monetary policy

Armenia's [Central Bank](#) envisages the country to end 2022 with an inflation rate of 10%.

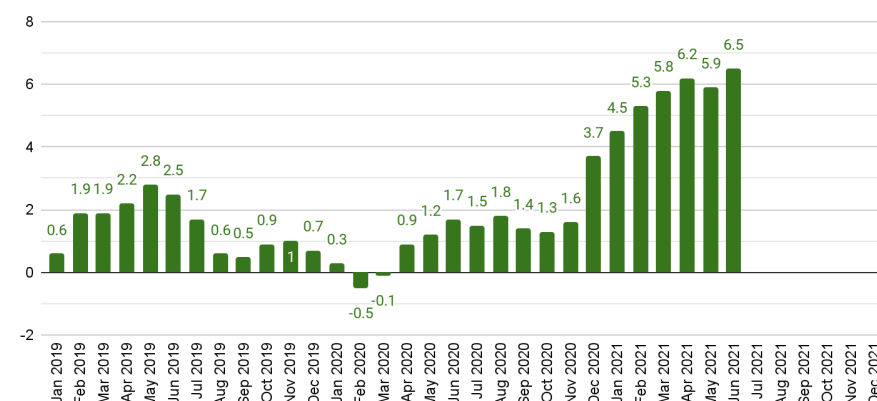
According to the [Statistical Committee](#), in January-September, inflation of 8.6% was recorded in the consumer market of Armenia (against inflation of 6.7% a year ago), which was facilitated by a rise in prices for food products by 13%, non-food products by 6.8% and an increase in tariffs for services by 4.5%. The average monthly price increase in the consumer market amounted to 0.6% in January-September 2022. In September 2022, against September 2021, consumer prices

increased by 9.9% due to an increase in the price of food products by 13.1% and non-food products by 8.1%, with an increase in tariffs for services by 7.5%.

Armenia [increased](#) its interest rates by 0.5 percentage points, from 10% to an annual rate of 10.5% in November.

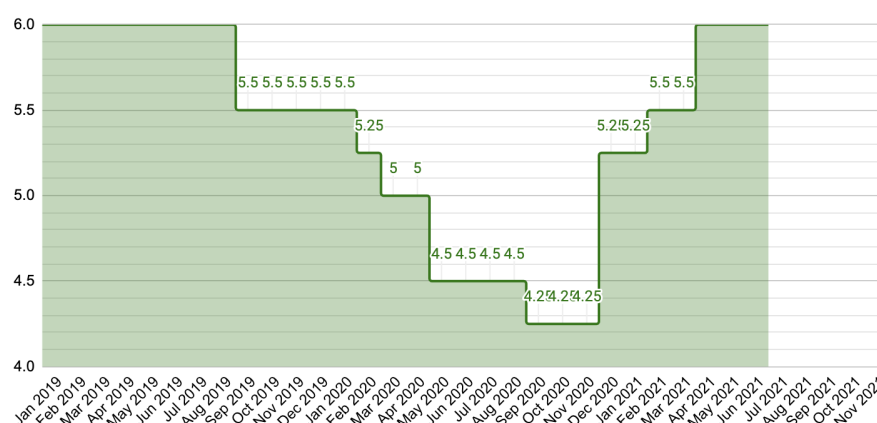
Armenia inflation y/y

source: central bank of armenia



Armenia monetary policy rate

source: Central bank of Armenia



2.2.4 Industrial production

Armenia's industrial output in the first 10 months of 2022 amounted to over AMD2.1 trillion in current prices, an increase of 9.9% y/y, according to the [National Statistical Committee](#) (NSC).

The mining sector accounted for about AMD438bn, a 5.1% y/y decrease, while the output of the processing industry grew by 18.1% to over AMD1.4tn. Electricity, natural gas, steam and purified air supplies amounted to about AMD267.2bn (2.6% growth), while water supply, sewerage, waste management and recycling to about AMD23bn, (7.4% growth).

The processing industry accounted for 65.8% of the total output. The mining sector's share was 20.6%, that of electricity, natural gas, steam and purified air 12.5% and that of water supply, sewerage, waste management and recycling 1.1%.

2.3 Macroeconomy – Azerbaijan

2.3.1 GDP growth

After the coronavirus (COVID-19) pandemic severely damaged the economy and led it to decline by 4.3% in 2021, Azerbaijan's economic development quickly resumed. The rate of immunisation remained consistent, and while 46% of the populace have had all three injections, 15% have received booster shots.

The oil and gas-rich economy of Azerbaijan expanded by 5.2% in the first 10 months of 2022, driven by high energy prices. Azerbaijan's GDP grew by 5.7% y/y in the second quarter of 2022, down from a 6.8% increase in the previous three months. Slower growth was recorded primarily in the hotel and restaurant industry (63.2% versus 120.8% in Q1) and financial intermediation (9.8% vs 23.7%). Meanwhile, production in other communal, social, and personal service activities fell considerably (-29.6% vs 35%); real estate, renting, and commercial operations fell (-18.4% vs 0.5%); and manufacturing fell (-10.1% vs 20.8%).

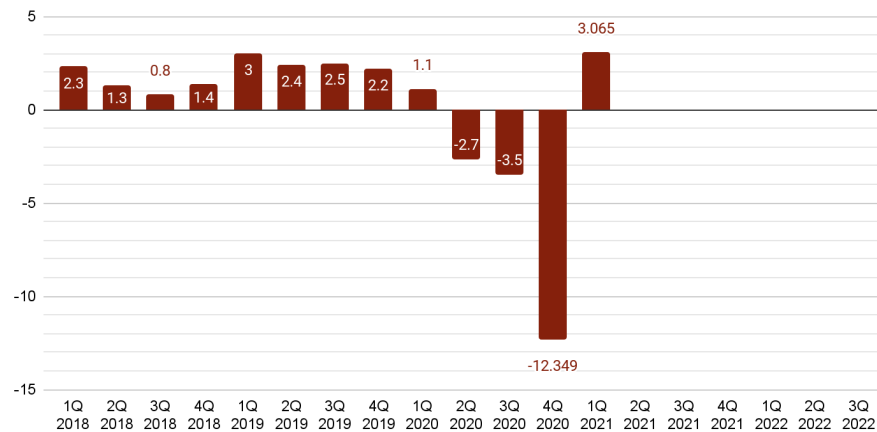
By the end of 2022, Azerbaijan's GDP is anticipated to reach AZN130bn (\$76.4bn), according to Economy Minister Mikayil Jabbarov. Azerbaijan's GDP is expected to grow by 4.2% in 2022 and 2.8% in 2023 according to the Asian Development Bank.

“Energy prices and demand for Azerbaijani gas are expected to remain high in the short term, which will support overall economic performance. We expect strong GDP growth of 4.5% in 2022, but some moderation to 2.5% in 2023,” the EBRD said in its Transition Report 2022-23. The IMF forecast is 2.5% as well.

Currently, Azerbaijani government has a 10-year development strategy called “Azerbaijan 2030: National Priorities for Socio-Economic Development”. Azerbaijan wants to build infrastructure, guarantee social inclusion, increase human capital, transition to "green growth," and establish a competitive and sustainable economy. The medium-term goal of the government is to lower the level of foreign debt, and high-tech and innovative external borrowing is being considered.

Azerbaijan GDP growth y/y

source: Azerbaijan state statistics agency



2.3.2 External environment

Being a major hydrocarbon exporting country, Azerbaijan posted a significant current account surplus equal to 22.4% of GDP in the first quarter of the year, because of the high oil prices. The country had a current account surplus of \$6378.10mn – a record high number – in 2Q22. According to the Asian Development Bank, it will benefit from higher oil and gas exports and reach 21.2% in 2023. Meanwhile the EBRD forecasted an even higher surplus of 31.7%, while the IMF forecast 31.4%. According to the EBRD, the current account surplus will be driven by high demand for alternative gas supplies on the European market and facilitated by the Trans Adriatic Pipeline, which was completed in 2020.

2.3.2 Inflation and monetary policy

Inflation increased to 12.9% y/y in January-June 2022, up from 4.3% in the same period in 2021. Rising global food and energy costs as well as supply interruptions accelerated inflation in Azerbaijan later to 14.2% in August 2022. Food costs increased the greatest, while service prices increased by nearly double digits as well.

Food prices increased by 18.4%, other commodities by 6.7%, and services by 10.3%. Food price inflation was prompted by high global food price inflation, while increasing fuel and utility costs in 2021 fuelled service inflation. A steady exchange rate prevented inflation from increasing.

Because of the increase in inflation, the government increased the monthly minimum wage by 20% to 300 manats. Furthermore, the central bank boosted its policy rate by 50 basis points in two increments to 7.75% in March, which it kept until July when inflationary pressures eased.

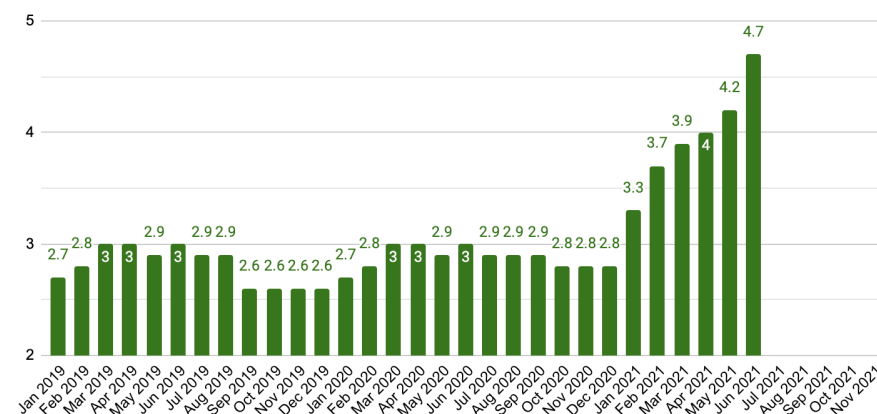
In the meantime, the government provided assistance to vulnerable groups through a package of budgetary measures that included increases in the minimum wage, pension and social allowances, subsidies to flour producers, and VAT exemptions for wheat, wheat flour, and bread. Despite these efforts, tax collections have been growing far faster than expenditures since the beginning of the year, resulting in a sizable budget surplus.

The Asian Development Bank expects 7% inflation in 2023, while the EBRD's forecast is as high as 12.2%. The IMF holds a middle ground of 10.8% in its World Economic Outlook.

The increased possibility of a global recession may lead to increased volatility in financial and commodities markets. Simultaneously, the Central Bank of Azerbaijan emphasised that domestic macroeconomic policy will be directed towards minimising these risks (including through the introduction of a fiscal rule). This will also be aided by continuous improvements to the monetary policy operational structure.

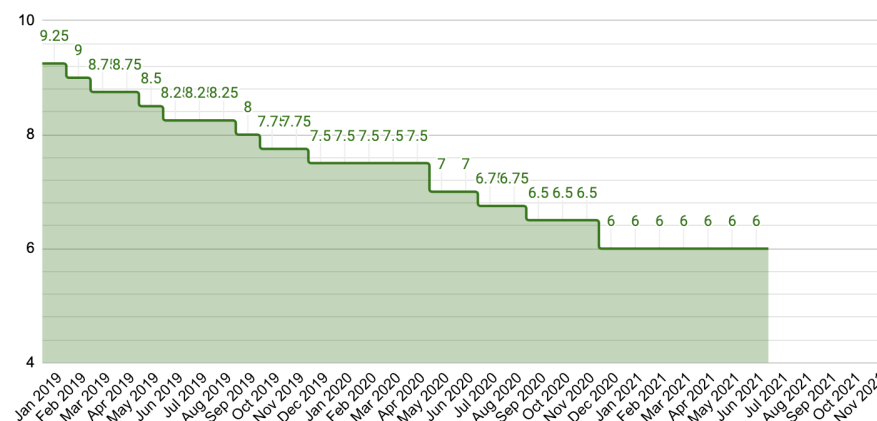
Azerbaijan inflation y/y

source: Central bank of Azerbaijan



Azerbaijan monetary policy rate

source: Central bank of Azerbaijan



2.3.4 Industrial production

The nominal volume of industrial production in Azerbaijan in January-November was AZN80bn (~\$47bn), a decline compared to the first 10 months of 2021 of 1.1% according to the State Statistics Committee. The volume of industrial production in the non-oil and gas sector increased by 5%, while in the oil and gas sector it decreased by 2.2%.

3.0 Real economy outlook

3.1 Real economy – Georgia

3.1.1 Retail

Retail sales in Georgia increased 22.6% y/y in the second quarter of 2022, down from a 31% increase in the previous quarter, according to Geostat. The second quarter of 2020 was by far the largest decline in retail trade recorded at -14.5%, brought on by the pandemic.

In 2017, retail trade turnover reached GEL9,929.8mn, up from GEL8,101.9mn in 2016. Retail sales, which has been growing at a strong double-digit pace for several years, grew by only 8-9% in 2015-16 as wage growth slowed and unemployment rose.

Retail sales y/y in Georgia averaged 14.5% from March 2010 to June 2021.

3.1.2 Banks

Georgian commercial banks' financial reports indicate that 14 banks in the country together earned a net profit of GEL836mn (\$285mn) in the first half of 2022. According to the Banking Association of Georgia, 95% of these profits were attributed to the country's two largest banks, TBC and Bank of Georgia. In 1H22, the banks received interest income of GEL2.7bn (\$919mn), most of which stemmed directly from loans made to citizens and businesses.

TBC Bank reported a continued, “robust” financial performance in its third quarter, with net profit for 3Q22 totaling GEL321mn (\$119.6mn). This made for 55% annual growth, driven by both interest and non-interest income streams. The FTSE 250 company said that as a result, its return on equity for the quarter stood at 31.1%, while its return on assets amounted to 4.8%. For the first nine months of 2022, its net profits came to GEL780m (\$290.5mn) – up by 28% y/y – with a return on equity of 26.6% and on assets of 4.1%.

“I am confident that the strength of our Georgian banking franchise, coupled with our international operations, will ensure strong growth and profitability in years to come,” said TBC Bank CEO Vakhtang Butskhrikidze.

3.1.3 Industry

Georgia's manufacturing sector remains highly concentrated and severely underdeveloped. In 3Q22 manufacturing accounted for just 9.5% of total business turnover, a modest 111.9% increase compared to the same period in 2021. The total production value in the manufacturing sector for the third quarter of 2022 stood at GEL4.29bn (\$1.63bn).

3.1.4 Energy & power

Hydropower accounts for more than 80% of Georgia's generating capacity and 75-90% of power generation, based on average hydrologic conditions.

Russia is Georgia's number one import partner in terms of oil and refined oil products. Meanwhile, in 2021 about half of gasoline and diesel imports were sourced from the EU. While in 2021 15% of Georgia's petrol came from Russia, in the first half of 2022 this figure hit 39%. Likewise, 24% of diesel was Russia-sourced in 2021, and this year it increased to 34%. Georgia's energy dependence on Russia brings obvious risks as Moscow is known to wield energy as a political weapon.

Georgia received \$64.78mn from exporting electricity between January-July, recording a 337% y/y increase, the State Electricity System reported. The figures show that 93% of the exports were for Turkey, with 631mn kWh of electricity exported to the country.

In 2022 Georgia received a €40mn EBRD loan and a €13mn grant from the EU that will be used to reduce energy consumption, mostly in schools, contributing to overall energy security and protection of the environment.

Germany's national development bank KfW also provided additional financing to Georgia's energy sector. "Lower utility bills, a cleaner environment and greater energy security benefits us all," said Catarina Bjorlin Hansen, EBRD Regional Director for the Caucasus. "Together with the European Union and KfW, we are directing our efforts to make schools in Georgia greener and to provide comfortable learning environments for students."

Chevron's Tengizchevroil (TCO), operator of the giant Tengiz oilfield in Kazakhstan, began shipping oil via Georgia's Batumi port on the Black Sea in 2022. The development came after a sharp fall in exports from the Caspian Pipeline Consortium (CPC) pipeline that runs to the Caspian Sea, as Russia halted certain mooring point operations over claimed storm damage.

3.1.5 Construction

The 2021 market size of Georgia's construction materials and home improvement sector was estimated at \$3.4bn. Following a pandemic-driven downturn, the sector rebounded quickly in 2021, boosted by a reopening of the economy and pent-up demand, as well as increased consumer preferences for comfortable housing. Continued strong economic growth and rent market demand spike further supported the sector in 2022 despite a high interest rate environment and high prices.

The brokerage house Galt & Taggart expects the construction materials and home improvement sector to continue robust growth in the coming years, aided by a solid public infrastructure pipeline, strong fundamentals in residential construction, as well as a boost from migration and revived hospitality investments.

Public infrastructure investments are planned at 7.0% of GDP over 2023-26, down from 8.0% in previous 5 years, but this is still considered solid by global and regional standards. The slowdown is largely the result of the completion of the East-West Highway project, but future large-scale projects (roads, critical municipal infrastructure) are likely to reinvigorate growth in the sector.

3.1.6 Major Sectors

Georgian Railways registered the highest rail cargo volume in the past seven years. The railway transported 6.8mn tonnes of cargo during the first half of 2022, which is a 13.3% increase y/y.

Traditional export markets for Georgian wine were thrown off balance in 2022 due to the war in Ukraine. Usually, Russia and Ukraine top the list of importers of Georgian wine, but exports to the latter country essentially evaporated in 2Q of this year. So far, shipments to Russia continue without major disruptions. Yet in August the chairman of Georgia's National Wine Agency, Levan Mekhuzla, said that over the next five years Russia's share in wine exports – currently hovering around 60% – is planned to decrease to about 40%.

Despite the shock to Georgia's wine industry earlier this year, most producers managed to weather the storm by redirecting their product to other markets. The cumulative drop in total wine exports in 2022 was considered negligible compared to previous years. In the past, Georgian wine has shown resilience to external shocks: during the pandemic, exports to strategic markets, such as Poland, China, and the US, actually grew by 20% compared to 2019. In 2022, total export revenues to these markets reached an all-time high of \$49mn.

Analysts at TBC Bank predict a steady rise of Georgian wine exports in 2023 and around 9% growth in the following years. Taken together, this year's wobbly and war-torn markets strengthened ongoing trends of market diversification among Georgian winemakers, something on which the industry spends approximately GEL10-20mn (\$3.5-4mn) each year.

Georgia's world-famous Borjomi Mineral Water Company was partially nationalised following a three-week strike by workers in May. The government acquired part of the company's shares in a free transfer deal. As a result, Russian oligarch Mikhail Fridman, who was the target of international sanctions imposed against Russia, lost his controlling stake in the company.

3.2 Real economy – Armenia

3.2.1 Retail

According to the National Statistical Committee, Armenia's retail trade rose 15.5% in the first 10 months of 2022 from 2021 to over AMD3.4tn.

High growth rates were reported by wholesale and retail trade, repair of automobiles and motorcycles (20%), construction (19.9%), manufacturing (18%), administration and related activities (16.2%) and accommodation and catering (12.8%). Wholesale trade grew by 24.3% to about AMD2tn.

Stores accounted for 79.1% of the retail trade or about AMD1.1tn showing 3.6% y/y growth. Consumer goods markets accounted for 4% of the total or about AMD52.bn, having fallen by almost 14%.

Farmer markets accounted for only 1.1% of the total or a little over AMD13.6bn. Their share dropped by 9.5% from the first ten months of 2021.

Kiosk trade dropped by 9.7% to 1.4% of the total or AMD18.6bn. Other trade outlets grew by 2.9% to about AMD187bn or 14.4% of the total.

3.2.2 Banks

Together the 17 Armenia-based commercial banks earned AMD188bn (\$479mn) in profits in the first nine months of 2022, up by AMD121.5bn or 183.3% y/y, according to the Union of Banks of Armenia (UBA).

According to UBA, the profit in the third quarter of this year alone amounted to about AMD76.6bn.

The banks also earned AMD430.3mn as interest income is up 9.5% y/y and about AMD312mn as non-interest income is up 267% y/y.

The ratio of total capital to risk-weighted assets at the end of September was 26.52% with the minimum required standard at 9%.

The ratio of highly liquid assets to total assets was 37.82%, while the standard is 15%, and the ratio of highly liquid assets to liabilities on demand was 139.17%, while the minimum standard is 60%.

Return on equity (ROE) at the end of September of this year was 20.53%, and return on assets (ROA) was 3.49%. In January-September, the ROA grew by 13.01% and the ROE by 2.2%.

According to the Union of Banks of Armenia, as of late September 2022, the total capital of all 17 banks stood at AMD1.2tn with 30% y/y growth, assets at AMD7.7tn (9.4% growth), total liabilities at AMD6.5tn (6.2% growth), lending stood at AMD4.1tn with 2.4% growth, and the deposits were at AMD4.5tn with 11.4% growth.

3.2.3 Industry

Armenia's industrial output in the first 10 months of 2022 amounted to over AMD2.1tn in current prices, an increase of 9.9% y/y, according to the [National Statistical Committee](#) (NSC).

The mining sector accounted for about AMD438bn, a 5.1% y/y decrease, while the output of the processing industry grew by 18.1% to over AMD1.4tn. Electricity, natural gas, steam and purified air supplies amounted to about AMD267.2bn (2.6% growth), while water supply, sewerage, waste management and recycling to about AMD23bn, (7.4% growth).

The processing industry accounted for 65.8% of the total output. The mining sector's share was 20.6%, that of electricity, natural gas, steam and purified air 12.5%, and that of water supply, sewerage, waste management and recycling 1.1%.

3.2.4 Energy & power

In the first 10 months of 2022 production of Electricity, natural gas, steam and purified air supplies amounted to about AMD267.2bn (2.6% growth).

Armenia signed a memorandum of understanding on economic cooperation in the energy field with Iran. During an Armenian delegation visit to Tehran on November 1, Majid Chegeni, the deputy minister of oil for gas affairs and National Iranian Gas Company (NIGC) CEO said: "Now we export one million cubic metres of gas to Armenia on a daily basis, which will be doubled based on the new memorandum."

The two countries thus extend the "gas for electricity" deal until 2030.

Armenia has been importing gas from Iran since mid-2009. Armenia is carrying out a barter deal with Iran, "gas in exchange for electricity," at the rate of 1 cubic metre of blue fuel from Iran in exchange for 3 kWh of electricity from Armenia. Gas supplies are carried out through the Iran-Armenia gas pipeline, and electricity from Armenia is supplied to Iran through two power lines.

Minister of Territorial Administration and Infrastructures of Armenia Gnel Sanosyan on November 28 signed a memorandum with Eugene Zhukov, Director General of Central and West Asia Regional Department at the Asian Development Bank (ADB), for developing wind energy.

A memorandum "On technical assistance to assess the viability of projects for the production of electricity using wind energy" was signed. The minister emphasised that Armenia has a great solar energy potential, but it is also necessary to use the potential of wind.

Eugene Zhukov, for his part, noted that the bank has set a goal to increase investments in the energy sector to \$100bn by 2030, and Armenia is an important part of this plan.

Armenia's economically justified wind energy potential is estimated at 450 MW of total installed capacity and with the generation of 1.26bn kWh of electricity. The main promising areas are the Zod Pass, the Bazum Mountains, the Pushkin and Jajur passes, the Aparan and Meghri regions.

3.2.5 Construction

According to the National Statistical Committee, Armenia's construction sector grew by 14.4% y/y in the first 10 months of 2022 to about AMD360.8bn.

3.3 Real economy – Azerbaijan

3.3.1 Retail

From January to October 2022, Azerbaijan's retail trade network sold AZN40.4bn (€22.5bn) worth of food, beverages, and tobacco items, as well as AZN17.7bn worth of non-food commodities to customers. In contrast to the same time last year, retail trade turnover climbed by 2.9%, food, drinks, and tobacco items by 2.2%, and non-food products by 3.6%.

3.3.2 Banks

The Azerbaijani banking system is exhibiting indications of revival after a lengthy period of decline, with commodities prices encouraging loan demand and asset quality improving. Azerbaijan's banking industry had a net profit of AZN769.9mn (\$452.88mn) during January to October 2022.

Within the first 10 months of 2022, banks' operating income was AZN3.1bn AZN (\$1.87bn), or 30.8% more y/y, operating expenses were AZN2bn AZN (\$1.19bn), or 27.3% more y/y, allocations to special reserves were AZN209.8mn (\$123.41mn), or 28.2% more y/y, unexpected expenses amounted to AZN0.5mn (nearly \$0.3mn), and income tax payments amounted to AZN178mn (\$104.71mn), or 62.3% more y/y.

S&P assumes a moderate deterioration of NPLs to about 4%-5% in 2022, compared with 3.5% officially reported at mid-2022. Annual lending growth should continue in 2022, at about 15%.

On the reform side, the introduction of the country's first agent banking model has increased financial inclusion, according to the EBRD. In March 2022, the Central Bank of Azerbaijan authorised third-party sales of banking products and services in order to improve access to financial services for the public in regions with limited bank branch coverage. Access Bank's services will be distributed first through the national postal service, Azerpost, with more banks anticipated to follow.

Customers may now get micro and agri-loans, as well as consumer loans and debit cards.

For the usage of QR code payments, the central bank created methodological recommendations in November 2021. The recommendations would guarantee that QR payments given by banks

and non-bank payment organisations are standardised, and that contactless payments are more widely accepted, resulting in cheaper payment options. The central bank reviewed and approved the regulation in April 2022, which increases access to remote banking and allows bank accounts to be created remotely using digital identity.

Finally, Azerbaijani banks largely enabled the Google Pay system for their customers.

S&P believes that credit costs will remain elevated in 2022 and beyond, reflecting lower real disposable income of households and small and midsize enterprises (SMEs) because of higher inflation.

Fitch Ratings revised the outlook on Azerbaijan to positive and affirmed it at "BB+", while Moody's Investors Service upgraded the LT- local currency credit rating of Azerbaijan to "Ba1" from "Ba2". S&P, like Fitch, affirmed "BB+", adding the forecast about credit losses in 2022-2023, which will remain within 0.5%-1.0% of average loan books, still well below their historical cyclical level.

3.3.3 Industry

Azerbaijan has a workforce of 4.8mn out of its 10.1mn population. Its economy is based on gas and oil, steel, iron, chemical and petrochemical products, and textiles. According to the State Statistics Committee, 76.1% of production fell on the mining industry, 20.1% processing, 3.2% production and distribution of electricity, gas and steam, 0.6% water supply, waste treatment and processing.

In the structure of the processing industry, growth was recorded in the production of other vehicles (+340%), cars, trailers, semi-trailers (+73.9%), leather, leather goods and footwear (+64.3%), machinery and equipment (+46.9%), clothing (+39%), electrical equipment (+37.1%), furniture (+33.4%), printing products (+23.2%), woodworking products and wood products (+ 19.6%), paper and cardboard (+17.4%), construction materials (+14.5%), finished metal products (+13%), food products (+8%), pharmaceutical products (+7.7%), rubber and plastic products (+6%), chemical products (+2.7%), metallurgical products (+2.1%).

A decline took place in the production of computers, electronic and optical products (-1.2%), beverages (-4.7%), tobacco products (-4.9%), petroleum products (-5.3%), installations and repair of machinery and equipment (-23.3%), textile industry (-28.8%).

In the field of production and distribution of electricity, gas and steam, the growth in production in January-November 2022 amounted to 3.2%, in the field of water supply, waste treatment and processing was 4.7%.

3.3.4 Energy & power

Azerbaijan is one of the countries with a strong renewable energy potential. Thus, the potential of commercially viable and technically practicable renewable energy sources is projected to be 27,000 MW, comprising 3,000 MW of wind energy, 23,000 MW of solar energy, 380 MW of biofuel potential, and 520 MW of mountain rivers.

Azerbaijan's overall power generating capacity is 7,542.2 MW, with renewable energy power plants, including big HPPs, accounting for 1,304.5 MW, or 17.3% of total capacity. Hydropower capacity is 1,154.8 MW (30 stations, 20 of which are SHPP), wind power capacity is 66.1 MW (7 stations, 2 of which are hybrid), bioenergy capacity is 37.7 MW (2 stations, 1 of which is hybrid), and solar energy capacity is 45.9 MW (12 stations, 2 of which is hybrid). One HPP (Gobustan) is equipped with wind-2.7 MW, solar-3 MW, and bioenergy-0.7 MW. Four SPPs with a combined capacity of 33 MW have been commissioned in the Nakhchivan Autonomous Republic. Renewable energy capacity, excluding big hydropower facilities, was 194 MW in 2021, accounting for 2.5% of total electricity generating capacity.

The foundations for the 240 MW Khizi-Absheron Wind Power Plant and the 230 MW Garadagh Solar Power Plant were placed on 13 January 2022 and 15 March 2022, respectively. The Ministry of Energy has set the primary goal of increasing the percentage of installed renewable energy capacity in the country's total energy balance to 30% by 2030. It is planned to build a total of 1500 MW of additional generation capacity at the cost of renewables, including 440 MW in 2023, 460 MW in 2023-2025, and 600 MW in 2026-2030.

Azerbaijan is aggressively developing plans for "green energy zones" in Karabakh. President Ilham Aliyev named the Karabakh and East Zangezur economic areas a green energy zone. The plan is to harness the region's renewable energy potential, which will power the "smart towns and villages" that Azerbaijan is constructing in its freed areas. All of the above indicate that Azerbaijan intends to build the backbone of its energy supply system. This will boost the country's power export potential in the future, as Azerbaijan plans to send electricity to Europe via the "Green Energy Corridor."

As for oil and energy sector, according to the State Customs Committee, Azerbaijan exported over 22,682,798 tonnes of crude oil and oil products worth \$17.180bn from January to October 2022, compared to 23,800,444 tonnes (\$11.220bn) during the same period in 2021. As a result, Azerbaijan's earnings from crude oil and oil product exports climbed by 53.1% y/y. Crude oil and oil products accounted for 49.49% of Azerbaijan's total exports during the reporting year, down from 66.59% the previous year.

This downward trend in oil production is related to increase in gas transport and production after the European Commission deal signed in

July 2022. According to the deal, Azerbaijan agreed to boost Southern Gas Corridor exports to 20 bcm per year by 2027, the maximum capacity of the pipeline network.

Azerbaijan generated 38.4 bcm of natural gas during January to October 2022, according to operational statistics. Azeri-Chirag-Gunashli generated 11.1 bcm of gas, Shah Deniz produced 20.7 bcm, while SOCAR produced 6.6 bcm. Gas production increased by 7.3 %, or 2.6 bcm y/y.

3.3.5 Construction

In January-October of 2022, construction materials worth AZN617.7 mn were produced in Azerbaijan. According to the information provided by the State Statistics Committee, this is 26.4% more y/y.

The volume of cement production in the country decreased by 0.2% to 2.8mn tonnes, the volume of asphalt production decreased by 56.1% to 145,900 tonnes, the volume of brick production increased by 20.5% to 421,000 cubic metres, the volume of gypsum production increased by 230% to 18,300 tonnes, the volume of lime production decreased by 29.1% to 27,500 tonnes, the volume of cement, artificial stone or concrete blocks and bricks production decreased by 37.5% to 47,600 tonnes, the production of prefabricated concrete structures increased by 1.4% to 37,200 cubic metres, the volume of production of processed marble, travertine, alabaster and products derived from them decreased by 32.7% to 21,605.8 tonnes, and the volume of ready-made concrete mix production increased by 5.1% to 605,800 tonnes.

Currently, the Azerbaijani government is implementing large-scale rehabilitation projects in Karabakh. These works stimulate the increase in the production volume of construction materials. However, prices for materials are rising as well.

3.3.6 Major Sectors

In January-October of this year, agricultural products worth AZN9.7 bn were produced in Azerbaijan, which is 3.2% more y/y. The value of agricultural products produced in the country increased by 3.2% to AZN5.3bn, and the value of livestock products increased by 3.1% to AZN4.42bn.

By November 1 of 2022, 2.8mn tonnes or 6.2% less than the same period last year were harvested from the fields of grain and grain legumes (without corn) in the country.. In addition, 232,700 tonnes of crops were collected from 30,400 hectares of corn fields. From the beginning of harvesting, 1mn tonnes of potatoes or 2.4% more than the same period last year, 1.7mn tonnes (1.4% more) of vegetables, 468,700 tonnes (1.9% more) of melons products, 1mn tonnes (3.5%

more) of fruits and berries, 204,700 tonnes (1.7% more) of grapes, 954.2 tonnes (15.5% less) of green tea leaves, 153,600 tonnes (5.2% less) of sugar beet, 199,100 tonnes (8.3% more) of cotton, 28,500 tonnes (10.9% more) of sunflower and 3,700 tonnes (35.2% less) tobacco was collected.

By the end of October, 3117 units of greenhouses with a total area of 1600 hectares were operating in Azerbaijan. Compared to the same period last year, the production of tomatoes, which are the main crops grown in greenhouses, increased by 14% to 318,200 tonnes, and the production of cucumbers increased by 37.9% to 25,000 tonnes.

Appropriate work is being done on farms for the harvest of 2023. Plows were raised on 941,800 hectares of land for the autumn crops of the current year. For the next year's harvest, 344,900 hectares of autumn fields for grain were sown. Of this, 190,700 hectares are wheat, 154,100 hectares are barley and 100 hectares are rye.

The production of live weight meat, including poultry, increased by 2.9% to 470,800 tonnes, milk production increased by 1.6% to 1.8mn tonnes, egg production increased by 6.7% to 1.6bn units, wool production decreased by 2.2% to 15,600 tonnes.

4.0 Budget and debt outlook

4.1 Budget and debt – Georgia

Towards the end of 2022, Georgian authorities planned to reduce government debt to around 40% over the medium-term, while also increasing the share of domestic debt to around 30%, which would reduce FX vulnerabilities and support capital market development. Authorities are also pursuing further tax administration improvements and a reduction in tax expenditures.

Georgia's government projects a 2.8% deficit in the 2023 draft budget. The budget for next year is based on 5% real GDP growth and 5% deflator assumptions. The government revised its 2022 growth forecast from 8.5% to 10%. Consolidated budget tax revenues are set to increase by 8.9% y/y to 23.7% of GDP in 2023, slightly below nominal GDP growth. Current expenditures are set at 21.9% of GDP in 2023, including planned increase in wages by 10% y/y. Notably, capital expenditures will remain high at 8.1% of GDP in 2023 (8.0% of GDP in 2021 and 8.8% in E2022). The fiscal deficit is projected at 2.8% of GDP in 2023, down from an expected 3.1% in 2022, with government debt projected at 38.3% of GDP for 2023 (reduced further from 39.6% of GDP expected in 2022), below pre-pandemic levels.

4.2 Budget and debt – Armenia

Armenia's state budget for 2022 has undergone several changes in recent months, the most recent of which [occurred](#) on December 9. The [current budget](#) anticipates AMD2.2tn (\$4.4bn) of public spending in 2022, an [increase](#) of more than 18.2% from 2021. Anticipated revenues are AMD1.946tn (a 28.9% increase y/y), while the deficit is predicted at AMD242.2bn (a 29.1% decrease from 2021). The largest single sector of spending will be social programmes (AMD580bn, up 15.1% y/y), followed by road construction and other capital projects (AMD345.4bn, a 49% increase y/y) and defence (AMD345.5bn, up 10.8% y/y). According to the central bank, the state budget deficit will rise to 3.1% of GDP in 2023 due to an increase in capital expenses.

Armenia's public debt is expected to reach AMD4.741tn in 2022, or 60.2% of GDP, comprised of 69% foreign debt and 31% domestic. AMD214bn (9.8% of budget expenditure, 2.7% of GDP) is earmarked for debt repayment in the 2022 state budget.

4.3 Budget and debt – Azerbaijan

Both revenues and expenses of 2023's state budget are predicted to be in record amounts - AZN30.7bn and AZN33.3bn, respectively. The priorities of the state budget will be related to social protection, education, restoration of territories freed from occupation, strengthening of the country's national security and defence potential, and further improvement of material and technical support of the armed forces. Half of the growth is accounted for by the non-oil and gas sector, and half by the oil and gas sector. AZN1.807bn of revenues provided through tax and customs authorities have already been planned. At the same time, the 10-month performance indicators of this year's budget revenues suggest that the budget revenues of 2023 will be more than planned. He noted that the volume of transfers from the State Oil Fund to the state budget is planned to be reduced by AZN235mn in 2023 and to be reduced by the same amount on average in the next three years.

The government considers it acceptable to increase defence, security, judicial, law enforcement and prosecutor's expenses by AZN500mn and exceed AZN8bn. It is planned to increase the expenses allocated to education by AZN536mn, and the expenses allocated to healthcare by AZN197.6mn. Increasing the cost of labour payment up to AZN420mn is considered acceptable from the point of view of ensuring the gradual increase of the ratio of the wage fund to the GDP. Azerbaijan will also cut the subsidies of 57 regions from the state budget in 2023.

According to the government plan for 2023, the real growth rate of GDP in 2023 will be 2.7%, and the real growth rate of the non-oil-gas GDP will be 4.5%, the growth will be provided mainly at the expense of the non-oil sector, it is predicted that the share of the non-oil/gas sector in GDP will reach 70%, the average monthly salary will reach AZN898, the average annual inflation will be 6.9%, the tax payment balance, the current account and the foreign trade balance will be in surplus. The price of 1 barrel of oil was taken equal to \$50 in the calculation of income and expenses of the state and general budget.

In 2023, the limit on foreign debts is set at the level of AZN 750mn (+25% y/y) while the domestic debt limit is expected to be AZN1.3bn (+18.2% y/y). In addition, the upper bound of the limit on state guarantees in 2023 was proposed at the level of AZN1bn against AZN800mn in 2022 (an increase of 25%).

According to the project, the government of Azerbaijan plans to allocate AZN775mn to payments related to foreign debt service (a decrease of 52%), including AZN456.1mn for interest payments. Payments related to the service of the domestic debt are expected at the level of AZN230mn (decrease of 0.9%).

As of July 1, 2022, Azerbaijan's public debt was AZN14.9bn or 13% of GDP. Its foreign debt was \$7.17bn or 10.6% of GDP, domestic debt was AZN2.7bn or 2.4% of GDP. In the first half of the year, foreign debt decreased by 11.9%, domestic debt decreased by 9.1%.

5.0 Markets outlook

5.1 Markets – Georgia

23 companies were admitted on the Georgian Stock Exchange (GSE) as of May 2022, and Georgia market capitalisation accounted for \$825mn in October 2022, compared to \$807.7mn in the previous month, according to the Georgian Stock Exchange.

5.2 Markets – Armenia

In November 2022 the overall market and trade values of securities on the Armenia Securities Exchange (AMX) was significantly higher compared with November 2021.

On the primary auction platform of AMX, the allocation volume of government bonds has reached AMD15.4bn.

The trade value of the government bonds in November made AMD8.4bn. A total of 64 trades were concluded with treasury government bonds.

Corporate bonds show the same dynamic growth in market value and trade value of securities compared to the indices of the same period last year. The market value of this month reached AMD406.9 billion. Trade value in October 2022 reached more than AMD22.7bn, with 244 trades concluded. The number of corporate bonds traded at AMX reached 100.

The number of repo agreements has increased to AMD589mn.

The same increase in dynamics is recorded in equity data. Trade value reached more than AMD262mn, market capitalisation surged by 56%, reaching a total sum of AMD263.5bn, with 528 trades concluded.

5.3 Markets – Azerbaijan

The total value of transactions on all financial instruments at the Baku Stock Exchange CJSC (BSE) in January-November 2022 was AZN12.3bn (\$7.2bn) which is 12.5% less than in the same period last year.

Over the past year, the number of transactions concluded decreased by 17.1% and amounted to 8,977. State securities accounted for AZN6.68bn or 54% of the turnover of the BSE. This is 2.4% less y/y.

During the reporting period, the value of transactions in the corporate securities market increased by almost 95.7% and amounted to AZN1.2bn, the value of repo transactions decreased by about 33.5% and amounted to AZN4.41bn.