

Quarterly Economic Outlook

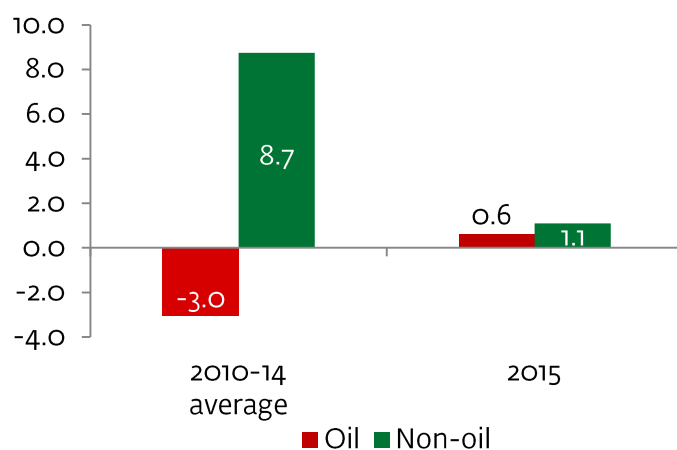
Year of 2015

Quarterly Economic Outlook

In 2015, complex global and regional economic processes also affected the Azerbaijani economy, which is closely integrated to the world economy. Sharp decline in oil prices brought about a considerable fall in foreign currency income and the surplus of balance of payments. In this regard, challenges to boost sustainability of the national economy have become more pronounced and in line with these challenges, budgetary-tax and monetary-exchange rate maneuvers have been used. Taking into consideration the further deepening of the long-term external economic shocks, the Central Bank has decided to switch to the "floating exchange rate regime" in order to equilibrate the balance of payments, to maintain foreign exchange reserves at a critical level and maintain competitiveness of the national economy.

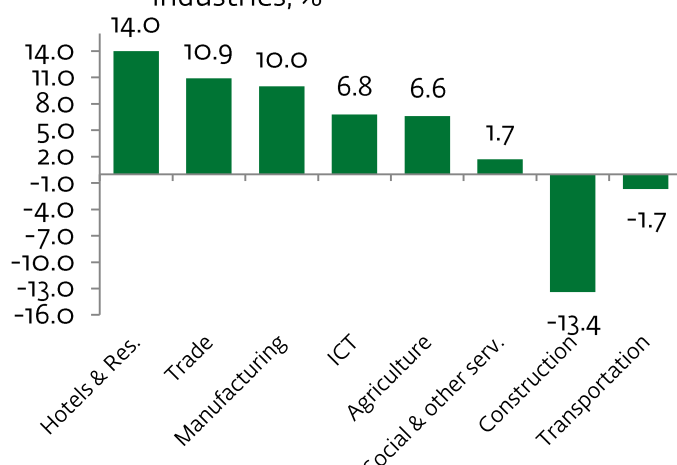
Economic performance. In 2015, Gross Domestic Product (GDP) increased by 1.1 percent YoY, and reached AZN 54.4 bln. Value added in non-oil sector expanded by 1.1 percent, whereas, growth in oil-gas sector was 0.6 percent. In oil-gas sector, the extraction of crude oil declined by 0.7 percent, whereas, 5.5 percent growth was recorded in gas extraction. The share of non-oil sector in total GDP comprised 63.5 percent in 2015, 7.5 percentage points up from 2014. The highest real growth was recorded in hotels & restaurants (14.0 percent) sector, whereas construction industry declined by 13.4 percent in real terms. Among non-oil manufacturing sectors, food processing increased by 2.9 percent, manufacturing of wood and wood products 67.3 percent, leather and leather products 3.0 percent, printing activities 86.7 percent, chemical products 43.2 percent, construction materials 6.3 percent, fabricated metallic products 54.1 percent, production of electric appliances 1.8

Figure 1. Economic growth, %



Source: State Statistics Committee

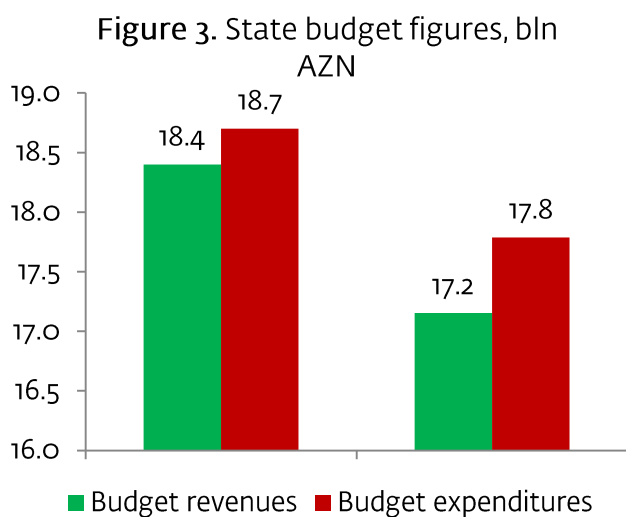
Figure 2. Growth rate of non-oil industries, %



Source: State Statistics Committee

percent, furniture 10.1 percent, repair of machinery and equipment 2.7 times, production of metallurgy products 5.1 percent, and production of computer, optic and electronic appliances 2.1 times, however, textile decreased by 55.2 percent, rubber and plastic products 21.4 percent, wearing apparel 44.2 percent, and wine production 11.2 percent in the reporting period.

State budget and investments. In 2015, budget revenues fell by 6.8 percent compared to the previous year and totaled AZN 17.2 bln. A decrease in budget revenues is mainly due to a 13.0 percent fall in the transfers from the State Oil Fund of Azerbaijan (SOFAZ) to the state budget.



Source: Ministry of Finance

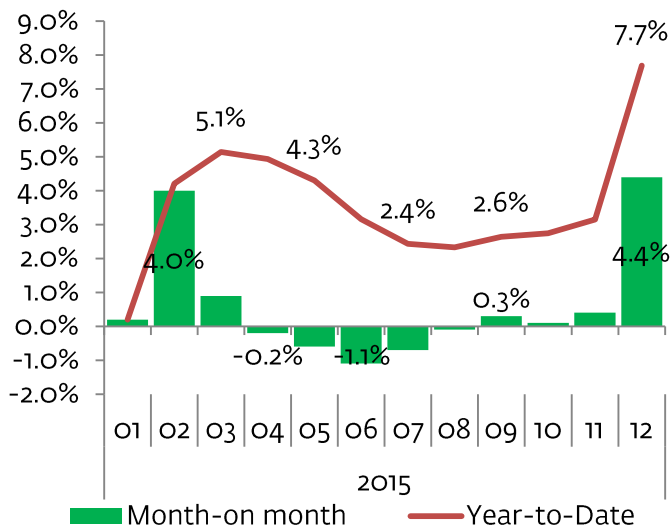
Budget expenditures dropped by 4.9 percent and amounted to AZN 17.8 bln. As a result, there was a budgetary deficit of around AZN 634 mln. In 2015, some 28.1 percent of budget expenditures were allocated to financing investment expenditures. Investment spending has

been one of the main sources of finance for construction in the country. According to the official statistics, total investment in the economy amounted to AZN 16.0 bln (11.1 percent decrease YoY) with 20.0 percent financed by budgetary and non-budgetary funds, 67.0 percent by own means of firms, and the rest by other sources. As a consequence of the on-going fiscal consolidation, the share of government contribution to overall investment funding continued to fall (down 18 p.p. compared to the year back). Some 45 percent of investments were allocated to the oil sector and 55 percent to the non-oil sector. Domestic investment maintained a leading position in overall investment at 56 percent, with foreign investment constituting the remaining 44 percent. Some 7.7 percent of total investments was allocated to non-oil manufacturing sector, while 13.7 percent went to construction (including 6.5 percent to housing construction), 13.7 percent to transportation, 4.0 percent to state administration and defense, 2.2 percent to ICT, 2.7 percent to health and education, and 2.9 percent to tourism. The government's foreign debt stands at USD 6.9 bln (19.8 percent of GDP) in date of 01 January of 2016. World Bank, Asian Development Bank, European Bank for Reconstruction and Development, Islamic Development Bank, Japan International Cooperation Agency and other international organizations have provided financial means to Azerbaijan government

in order to support implementation of economic reforms, recovering and reconstruction of infrastructure, including rebuilding of roads, improvement of water provision system in regions etc.

Employment and inflation. The number of economically active population has reached to 4.9 mln, on which 4.7 mln were engaged in employment, as of 01 January 2016. The number of waged employees is 1.5 mln, where 58.7 percent of them work in government sectors. The number of enterprises and organizations increased by 6.1 percent during 2015, reaching to 100325 (of which 84.2 percent is commercial firms),

Figure 4. Headline CPI



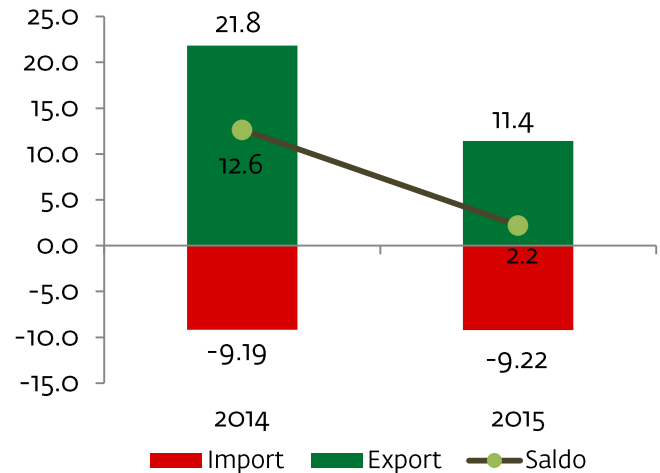
Source: State Statistics Committee

as for 01 January 2016. The number of individual entrepreneurs has totaled 577

thousand, at the end of 2015. Notably, some 33.7 percent of individual entrepreneurs registered in Baku, 19.8 percent in Aran, 12.9 percent in Ganja-Gazakh and 7.4 percent in Lankaran economic regions. High level of employment has been reflected in the growth of total household income as well, which increased by 5.7 percent and amounted to AZN 41.7 bln in 2015. Per capita household income rose by 4.5 percent which exceeds average annual inflation rate of 4.0 percent. Some 72.1 percent of income was spent on consumer goods, 9.1 percent on taxes, credit and social security payments, 2.9 percent on interest expenses on loans, and the remaining 15.9 percent was saved. The average monthly wage, a main welfare indicator, grew by 4.5 percent and reached to AZN 462. The average wage in the oil sector was AZN 2105.5, while it was AZN 422.1 in the non-oil sector, also AZN 357.3 in the public sector, and AZN 608.2 in the private sector. On the back of the growth in household income consumer prices increased 7.7 percent since the beginning of the year. At the end of 2015, the price change was 9.4 percent in food products, 11.0 percent in non-food products and 2.3 percent in services, respectively.

Foreign trade and exchange rate. The price of Azerbaijan's main export product, crude oil, was USD 53.8 a barrel on average in the reporting period, which is almost 1.9 times lower than that in 2014. In 2015, overall exports decreased by 47.6 percent sliding to USD 11.4 bln, due to mostly falling of oil exports. Due to fall in oil prices, export of crude oil declined by 52 percent, totaling to USD 8.9 bln in 2015. At the same time, non-oil export contracted by 8.5%, including 0.7 percent decline in the export of aluminum products, 4.1 percent decline in sugar, 28.4 percent decline plastics and plastic products, 37.6 percent decline in tea, 19.4 percent decline in vegetable oils, 19 percent decline in alcoholic and non-alcoholic drinks, 20.5 percent decline in ferrous metals, and 49.4 percent decline in export of leather. In 2015, export of chemical products and export of fruit and vegetables increased by 5.1 percent and 7.2 percent, respectively. Overall export of non-oil products shared a 14.1 percent of total export. Import increased by 0.4 percent and totaled USD 9.2 bln. in 2015. The growth of import originated from 56.2 percent increase in import of ferrous metals (17.2 percent of total import), and 44.6 percent growth in import of vehicles and spare parts (13.2 percent of total import). Despite the value of vehicles import increased significantly, its volume in numbers (number of cars, trucks etc.) has decreased by more than 2 times. It was related with the import ban of vehicles that do not meet "Euro-4"

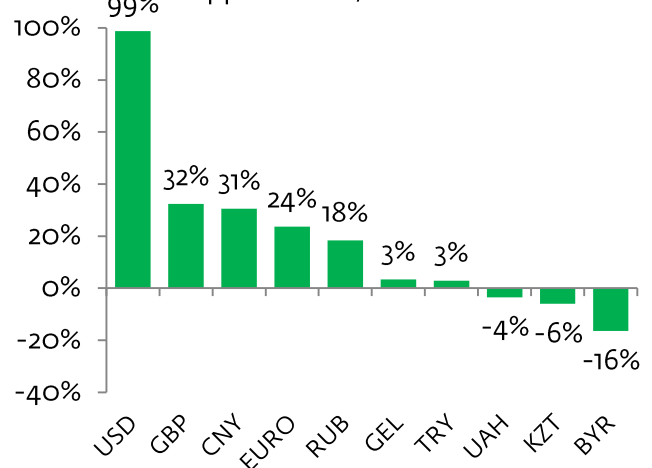
Figure 5. Foreign trade, bn USD



Source: State Customs Committee

environmental standards as well as with more than 40% decrease in auto loans. In general, although foreign trade transactions of the country contracted foreign trade balance was in surplus totaling to around USD 2.2 bln in 2015 (y/y 5.7 times down). During the reporting period, national currencies of several trade partners have appreciated against manat, which is considered as one of the main conditions for the competitive advantage of Azerbaijan in foreign trade. One of the

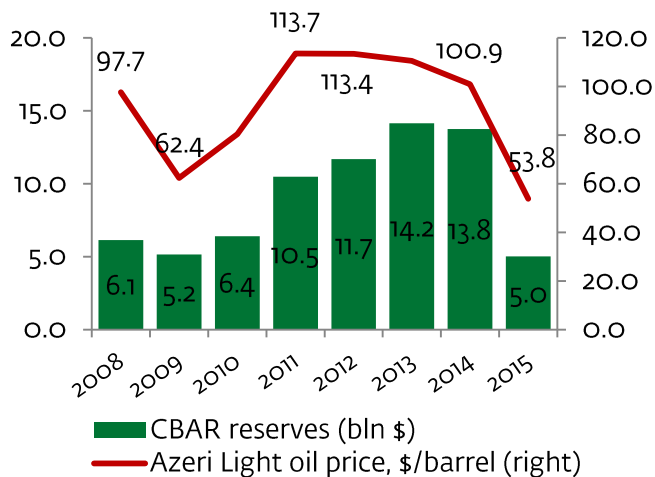
Figure 6. Manat exchange rate, "+" FX appreciation, YTD



Source: Central Bank

main economic phenomena occurred in 2015 was the Central Bank's monetary policies related to manat's exchange rate adjustments. Thus, first the Board of the CBAR decided to discontinue targeting

Figure 7. CBAR foreign reserves and Azeri Light oil price

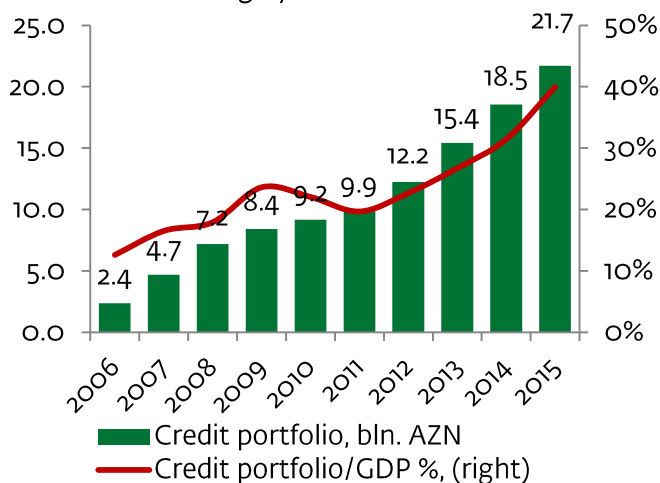


Source: Central Bank

USD/AZN exchange rate and moved to targeting the currency basket comprising both USD and EUR with immediate effect from 16th of February. In addition, The Management Board of the CBAR decided to set USD/AZN exchange rate at 1.05 as of 21 February 2015. This decision was taken in an attempt to launch additional incentives to diversify the national economy, further boost its international competitiveness and export potential, and ensure strategic sustainability of the balance of payments and the country's international creditability. Moreover, starting from the end of July 2015, oil price continued declining that increased the pressure on FX market of the country. Taking into consideration the further deepening of the long-term external economic shocks, the Board of the

CBAR has decided to switch to the "floating exchange rate regime" on 21 December 2015, in order to equilibrate the balance of payments, to maintain foreign exchange reserves at a critical level and maintain competitiveness of the national economy. After that decision, dollar appreciated 47.6 percent against manat and USD/AZN exchange rate was set at 1.55. The floating exchange rate should reliably safeguard the economy against negative external shocks, strengthen the country's mid- and long term sustainability, accelerate diversification of the economy and exports, and further increase international competitiveness of domestic production.

Figure 8. Credit portfolio of the banking system



Source: Central Bank

Generally in 2015, the CBAR took part in local FX market actively and sold USD 8.7 bln in order to manage exchange rate deviations.

Financial system and financial markets. In 2015, insurance premiums increased by 3.2 percent compared a year back, amounting to AZN 443 mln. Overall,

insurance claims equated to AZN 180 mln, boosting the sector's financial resources. Growth in credit portfolio of the banking system was 17.1 percent, being the main contributor to the overall growth in the total assets of the banking system. The total credit portfolio amounted to AZN 21.7 bln, of which 16 percent extended to Azerbaijan's regions, and 76 percent was long-term loans. Some 41 percent of the portfolio was made up of household loans, while 59 percent was allocated to business sector. The Central Bank's portfolio of notes issued in the primary and secondary market, and Ministry of Finance's securities as well as repo transactions amounted to AZN 144.5 mln in 2015. The turnover of securities and bonds in the corporate sector reached AZN 4.2 bln. The entire turnover in the stock market, including the derivatives totaled to AZN 10.5 bln – equal to 19 percent of GDP.

Changes to regulatory environment. The government has begun to form proposals to diversify economy as well as to implement measures in order to improve business climate and development of entrepreneurship, according to the decrees and orders signed by the President in 2015. In addition, with a decree on declaring 2015 as the “Year of Agriculture”, the government established agro-parks and big agricultural enterprises in different regions in order to be able to ensure food security and increase export-oriented output in this industry. In accordance with the State Program as part of a policy of

industrialization, modern industrial parks have been established in the country. On the regulation of medicines market, an improved methodology has been developed based on the experience of advanced countries, and the prices of nearly 3540 medicines have been adjusted. This reform will strengthen state control over the medicines market, create additional opportunities for the prevention of tax evasion, and contribute to the development of the insurance system. Significant decisions were taken within the framework of banking system restructuring. Remediation actions on preparation for privatization of state owned shares of the "International Bank of Azerbaijan" was defined by the decree of the President of the Republic of Azerbaijan dated July 15, 2015. As part of the implementation of the decree, bank's bad assets were transferred to the “Aqrarkredit” CJSC Non-Bank Credit Institution (“Aqrarkredit” CSC). At the same time, 2 unhealthy banks were removed from the banking sector (the share of those banks' assets in total banking sector assets was 0.3 percent).

Outlook and economic growth expectations for 2016. According to the projections from a number of international organizations, the economic growth in the country is expected to continue in 2016. Based on the latest publication of the World Bank, “Global Economic Prospects”, economic growth of country is forecasted on average 0.8 percent for 2016. World

Bank states that recovery would be helped by structural reforms, diversification of economy, improvement resource allocation, strengthen of corporate governance, and the continuation of investment in non-oil sector. According to the World Economic Forum's "Global Competitiveness Report 2015-2016", Azerbaijan is the 40th place in the competitiveness ranking of 140 countries (1st among CIS). In recent publication of "Fitch Ratings", an international credit rating agency, confirmed the international credit rating of Azerbaijan at the investment level of "BBB-" keeping its forecast as "stable". However, "Standard & Poor's" and "Moody's" rating agencies downgraded Azerbaijan's rating to "BB+" and "Ba1", respectively to non-investment level. For 2016, Moody's projection of real GDP is 0.7% and for 2017 the rating agency projects growth of around 1%. The reasons to cut the credit rating of Azerbaijan: 1. the

impact of the further fall in oil prices, likely sustained for several years, on Azerbaijan's economic strength, 2. the related and rising pressures on Azerbaijan's financial system and balance of payments position, 3. deteriorating fiscal position and debt metrics. According to the latest statement of CBAR, the strategic challenge of the economic policy is to "rebalance" the national economy, accelerate transition to an economic growth model based on private investments and exports ("supply economy") and ensure more sustainable and diversified economic growth on this basis. In line with this challenge, the Central Bank will take a set of actions jointly with the government to transit the national economy to a new level of macroeconomic sustainability, and thereby ensure macroeconomic and financial stability by synchronizing all directions of the economic policy more effectively.

Appendix 1. Macroeconomic and financial indicators

	2011	2012	2013	2014	2015
I. Social economic indicators and Inflation					
Gross Domestic Product, mln AZN	52082	54744	57708	58978	54352
Share of non-oil GDP, %	43%	48%	57%	61%	69%
Economic growth, %	0.1	2.2	5.8	2.8	1.1
Oil sector, %	-9.8	-5.0	1.0	-2.9	0.6
Non-oil sector, %	9.4	9.6	10.0	7.0	1.1
Per capita GDP, nominal AZN	7003	7491	7913	7986	5704
Inflation _ annual average	7.9	1.1	2.4	1.4	4.0
Average wage, AZN	357	396	419	442	462
Unemployment, %	5.4	5.2	5.0	5.0	-
Poverty, %	7.6	6.0	5.3	5.0	-
II. Investment and State Budget					
Total Investment, mln AZN	12799	15407	17872	17616	15957
Domestic investment	10199	12148	13705	12735	8937
Foreign investment	2600	3259	4167	4881	7020
Investment to non-oil economy, mln AZN	9729	11553	13047	11652	8796
Budget revenues, mln AZN	15701	17282	19495	18401	17153
Ratio to GDP, %	30%	32%	34%	31%	32%
Budget expenditures, mln AZN	15398	17417	19144	18699	17787
Ratio to GDP, %	30%	32%	33%	32%	33%
III. External Sector and Monetary Indicators					
Goods export, mln \$	24328	22217	23975	21829	11424
of which, non-oil goods export	1624	1934	1821	1754	1606
Goods import, mln \$	10166	10417	10710	9188	9221
Azeri Light oil price (on average), \$/barrel	113.7	113.4	110.6	100.9	53.8
Strategic reserves, bn \$	40.6	46.1	50.2	51.1	38.6
AZN / \$ (period average)	0.7897	0.7856	0.7845	0.7844	1.0261
Foreign state debt, mln \$	4817	5708	6059	6381	6894
Monetary base, mln AZN	8275	10515	11642	11542	6902
M2, mln AZN	10997	13806	16435	17436	8613
Assets of banks, mln AZN	13947	16530	20385	25183	34906
Ratio to GDP, %	27%	30%	35%	43%	64%
Credit portfolio, mln AZN	9850	12244	15423	18543	21718
of which, households	3315	4317	6215	7732	8384
Deposits, mln AZN	9447	10699	12476	15453	23463
of which, households	4120	5113	6396	7188	9474
Deposits/Loans, %	96%	87%	81%	83%	108%
Net profit before taxes, mln AZN	-152	170	341	459	-
ROA, %	-1.2	0.9	1.5	1.7	-
ROE, %	-8.9	7.1	11.7	11.6	-
Capital adequacy, %	14.7	16.9	18.1	19.2	17.8

Source: State Statistics Committee, Ministry of Finance, Central Bank

Appendix 2. Industrial production

	Production in 2015	YoY growth, %
Crude oil, thousand ton	41605.9	99.3
Natural gas, mln m ³	19720.5	105.5
Iron ore, thousand ton	127.6	139.6
Gold, kg	2229.3	119.1
Silver, kg	137.9	57.6
Meat, thousand ton	254.1	100.8
Sausages, ton	2105.9	114.2
Milk, thousand ton	857.4	102.2
Cream and sour cream, ton	4698.4	101.0
Cheese and curd, thousand ton	48.5	100.8
Butter, thousand ton	23.7	102.6
Vegetable oils, thousand ton	67.5	103.2
Sugar and granulated sugar, thousand ton	330.3	80.6
Wine, thousand dkl	821.4	88.8
Beer, thousand dkl	4276.3	83.3
Soft drinks, thousand dkl	24518.3	89.6
Cigarettes, mln units	1979.4	98.3
Cotton fiber, ton	6332.9	47.4
Leather, thousand m ²	841.9	69.9
Leather shoes, thousand pairs	67.0	95.4
Propylene, thousand ton	45.5	96.6
Polyethylene, thousand ton	103.5	102.4
Plastic pipes, ton	12404.4	68.0
Cement, thousand ton	2938.1	102.4
Construction gypsum, thousand ton	129.4	114.5
Concrete structures, thousand m ³	22.2	65.9
Asphalt, thousand ton	474.7	117.9
Building bricks, thousand m ³	264.3	89.7
Cast iron, ton	1132.7	79.2
Steel foundry, thousand ton	302.2	93.2
Power transformers, units	756	4.6t.
Refrigerators, units	2794	76.2
TVs, units	788	13.0
Tractors, units	955	75.5
Trucks, units	385	135.6
Cars, units	728	39.1

Source: State Statistics Committee

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