



ECONOMIC NEWS BULLETIN

EMBASSY OF THE REPUBLIC OF AZERBAIJAN

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MACROECONOMY

Fitch upgrades Azerbaijani banks' ratings

Fitch Ratings has upgraded Azerbaijan-based Unibank Commercial Bank (UB) and Demirbank's (Demir) Long-term Issuer Default Ratings (IDRs) to 'B' from 'B-'. At the same time, Fitch has affirmed Technikabank (TB) and AGBank's (AGB) Long-term IDRs at 'B-'. The Outlooks on all four banks are Stable. A full list of rating actions is at the end of this commentary.

The upgrades of UB and Demir reflects Fitch's acknowledgement of their relatively sound credit profiles in the post-crisis environment, as reflected by either better asset quality metrics (in the case of Demir) or greater loss absorption capacity (UB) compared to peers. Although both banks' profitability has been notably reduced relative to pre-crisis levels, they have continued to generate profits on a cash basis, while accumulated problem loans have been properly recognised and prudently reserved.

In Fitch's view, UB and Demir also have somewhat sounder corporate governance than peers, translating into greater transparency, lower related party lending and lesser accounting risks. Cooperation with

international financial institutions (which hold minority stakes in both banks) has also been beneficial in terms of capital and liquidity replenishment, in particular for Unibank.

The ratings of TB and AGB continue to reflect their weaker credit metrics, in particular significant unreserved non-performing loans (NPLs) and potential for further NPL recognition from restructured loans, combined with only moderate capacity to absorb additional credit losses. The quality of their capital and reported profits is also undermined by the high proportion of accrued interest income not received in cash (particularly in the case of AGB).

However, Fitch notes that asset quality pressures have abated somewhat at both banks and the currently supportive operating environment is allowing them to gradually absorb accumulated problems through business growth. Strong deposit inflows are also supporting sector liquidity, and allowing the banks to manage refinancing needs.

Upward potential for the ratings of all four banks is currently constrained by their limited franchises and generally high balance sheet concentrations, resulting in weak financial flexibility. Additional challenges arise from the generally high risk profiles of local

borrowers and the cyclical oil-dependent economy, which is potentially vulnerable to external shocks.

Downward pressure on the ratings could emerge in the case of deterioration in the operating environment, which would be particularly sensitive for banks that demonstrated high growth rates in 2011 (above 20% in the case of UB, AGB and TB). Increased competition in the retail segment, which is the focus of business development for all four banks, may also be detrimental to the banks' credit profiles through margin compression and potential loosening of underwriting standards.

Downward pressure on TB's profile additionally arises from its high exposure to the construction sector (which exceeded the bank's equity at end-2011), the poor liquidity of its corporate loan book (which is dominated by project-finance loans with significant grace periods) and some corporate governance concerns due to low transparency in respect to ultimate shareholder control of the bank. Unlike its peers, TB has not received fresh equity during the past four years, and the shareholders' capacity for capital replenishment cannot be assessed.

The rating actions are as follows:

AGB

Long-term IDR: affirmed at 'B-'; Outlook Stable
Short-term IDR: affirmed at 'B'
Viability Rating: affirmed at 'b-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

Demir

Long-term IDR: upgraded to 'B' from 'B-'; Outlook Stable
Short-term IDR: affirmed at 'B'
Viability Rating: upgraded to 'b' from 'b-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

UB

Long-term IDR: upgraded to 'B' from 'B-'; Outlook Stable
Short-term IDR: affirmed at 'B'
Viability Rating: upgraded to 'b' from 'b-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

TB

Long-term IDR: affirmed at 'B-'; Outlook Stable
Short-term IDR: affirmed at 'B'
Viability Rating: affirmed at 'b-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

Moody's international rating agency stressed the existence of strong potential for Azerbaijan's medium-term economic growth.

"However, given the country's large oil and gas reserves, Azerbaijan's medium-term economic growth potential is strong although a lack of economic diversification could hinder growth in the long term if not addressed," the agency said.

Financial robustness is ranked high, with government debt ratios expected to remain low in the medium term.

"Azerbaijan runs a large current account surplus, which is estimated at 27.2 percent in 2011, slightly below its 2010 level of 29 percent as a result of a temporary disruption in oil production," the message said. "The government's State Budget usually targets a modest deficit in the government's financial balance (1.5 percent of GDP in the 2012 State Budget) as part of an active policy to develop the country's domestic capital market.

The consolidated budget however, (which includes the State Oil Fund's - SOFAZ's - revenues) usually registers sizeable surpluses which for 2011 is estimated at 9.8 percent.

Azerbaijan's exchange currency trading jumps

The Baku Interbank Stock Exchange (BBVB) has renewed statistics of its operations. BBVB reports that in March 2012 the 13 participating banks concluded 35 deals in 32 trading sessions in e-trading system (BEST). The total volume of trading in currency auctions for the reported month on USD/AZN totaled AZN 83.8 million or \$106.658 million.

The volume of trading in the currency section rose this March by 2.3 times or \$59.358 million against February 2012.

The average daily turnover in exchange e-trading system on USD/AZN in March reached approximately \$6.67 million, while the average amount of each transaction reached \$3.047 million.

Exchange rate of national currency on tool USD/AZN_TOD for the reported month dropped by 0.05% - from AZN 0.7853 to AZN 0.7857 to the US dollar. At that, weighted average rate of U.S. dollar to manat was AZN 0.7858 to the US dollar in March 2012 against AZN 0.7859 in February 2011.

For Jan-Mar 2012 the BBVB currency turnover totaled AZN 185.8 million or \$236.455 million.

The Ministry of Taxes provided with data on tax payments to the state budget

In January-February 2012, the Ministry of Taxes provided tax payments to the state budget amounting to 1.47 billion, the ministry said March 14.

According to information, payments on profit tax were 39.6 percent of total tax revenue, value added tax - 26.5 per cent, income tax - 11.4 per cent, excise tax - 6.7 percent, other taxes - 15, 8 percent.

Non-oil sector provided revenue to the state budget in the amount of 571.66 million manat, which exceeds the forecast for this period and the figure for the same period last year by 32.6 percent.

The total number of taxpayers as of March 1 amounted 431,628. In Jan-Feb the proportion of tax returns filed in electronic form, was 92.2 percent.

New business portal opened

Ministry of Economic Development of Azerbaijan on Thursday presented the portal www.icazeler.gov.az, which will reflect the information on permits issued by central and local executive authorities.

Business entities that want to engage in any business, entrepreneurs who want to expand their activities or work in new areas, can obtain from a single source information, depending on type of activities about the necessary documents of licensing character, the date of issue and validity of these permits, and information about state agencies issuing these permits, and legislation in the field of entrepreneurship. Thus, entrepreneurs will have the practical means to reduce risks in their business planning.

Deputy Minister Niyazi Safarov said the creation of such a portal is another measure of the state to support the private sector.

"The work of this portal will provide increased awareness of entrepreneurs about the permissions and transparency in this area," Safarov said.

The portal is designed for business entities, particularly small and medium businesses. It will reflect the information on permits issued by central and local executive bodies (name of kind of permit, the legal basis, a list of required documentation, the name and legal address of the authority which issued the permit).

Moreover, the portal will create a section of services that will house draft legislation related to entrepreneurship elaborated by central and local executive authorities.

Text of the draft will be stored on site within a month and will be available for comment from the public.

Also a convenient search engine will be created on the portal for all types of permits (name of type of permit, the legal basis, a list of required documentation, the name and legal address of the authority which issued the permit) necessary to do business. Creation of a special section on the portal services, along with improving awareness of entrepreneurs in this field, will ensure their direct involvement in the elaboration of legislative acts. On the other hand, this section will make it possible to carry out transparently the process of drafting legal acts regulating the sphere of business.

Creation of a portal is provided by the decree of the President of Azerbaijan "On some questions in connection with licensing and system of permits required for doing certain types of business".

Availability of information on the procedures for obtaining permits for certain types of entrepreneurial activity is important in terms of improving the business environment and increasing transparency.

FUEL AND ENERGY

SOCAR presents its oil production nanotechnologies

Research & production center Nanotechnologies of the State Oil Company of Azerbaijan (SOCAR) in collaboration with industrial association Azneft (part of SOCAR structure) and BP-Brightwater conducted a meeting on the results of research on use of nanotechnologies in the oil industry.

The SOCAR reports that nanosystems created by the Center enable to increase the level of production and quality of work. In the prospect these systems can be applied at the local and international markets, and negotiations were held on the occasion of their bringing up to the global level.

Azerbaijan invests \$90 million to alternative energy sector

Azerbaijan is one of the few countries with a national strategy for alternative energy

development, State Agency for Alternative and Renewable Energy Director Akim Badalov said at a meeting of the Parliamentary Assembly EURONEST on Energy Security in Baku on Monday.

Badalov said Azerbaijan is known worldwide as oil and gas country, but also has a large resource of alternative and renewable energy.

Azerbaijan allocated 70 million manat to the development of alternative energy up to the present day. A polygon in Gobustan was created as part of this activity. "There is a plan to fully provide Gobustan with alternative energy" Badalov said.

OJSC Azerenerji was the first in the region certified on ISO 14000:2004 standards.

Azerbaijan's energy operator OJSC Azerenerji has become the first in the Caucasus to be certified on ISO 14000:2004 standard. Azerenerji has reported that the decision on certificate issuance was made on 27 February.

"It affirms high management quality on generation, transmission and supply to the consumers in Azerenerji. The certification was made through Bureau Veritas company within second stage of Azerenerji's corporate development program", - the OJSC noted. The OJSC has become the only owner of this certificate in South Caucasus.

SOCAR defines place for refinery in Kyrgyzstan

The State Oil Company of Azerbaijan (SOCAR) intends building a new oil refinery in Kyrgyzstan with a likely location in the country's Chuy province, the Kyrgyz Energy Ministry said on Monday.

According to information, the Chuy province administration has offered four parcels of land for the construction of SOCAR's oil refinery with a capacity of two million tons.

It has emerged the energy ministry had previously worked out the question of the plant's supply of

electricity with the National Electric Network of Kyrgyzstan.

The Azerbaijani delegation led by the vice-president of SOCAR on processing David Mammadov was in Kyrgyzstan on March 2-4. It aimed at discussing in detail issues regarding the implementation of the project, as well as taxation and investments.

The delegation held talks in the Kyrgyz Energy Ministry with along with the participation of representatives of the Chuy province administration, National Electric Network of Kyrgyzstan, Kyrgyzneftegaz and had meetings with representatives of the country's oil traders association, the state agency for geology and mineral resources and the State Tax Service under the government.

During the meetings the Kyrgyz side provided information about the structure of the oil refining industry of the republic, a system of taxation and investment, the pricing policy, issues of export and import of petroleum products in the country, volume of oil and natural gas, gas and reserves of natural resources of the country.

Representatives of the Azerbaijani delegation brought the Kyrgyz side's attention to issues relating to the project for further development.

The agreement on the construction of the oil refinery was reached on Jan.19 at a meeting of Kyrgyz President Almazbek Atambayev and SOCAR President Rovnag Abdullayev. The oil refinery is scheduled to be commissioned in late 2013.

The minimum cost of the oil refinery, which SOCAR plans to build in Kyrgyzstan, hits \$100 million.

Azerbaijan to choose commercially attractive gas supply route

South-Eastern Europe chosen as a sales market of Azerbaijani gas will reduce the risk of dependence on one source of market, fellow at the Strategic Studies Center under the Azerbaijani President Gulmira Rzayeva told media on 2 April.

"Weak diversification of gas supplies, both in Italy and in South-Eastern Europe, makes both markets attractive for Azerbaijan in terms of high gas prices," she said. "But a large number of countries in South-Eastern Europe will reduce risks of dependence on one market."

She said that despite the presence of a large number of countries in South-Eastern Europe, the gas consumption is small. However, if the Azerbaijani gas is brought to Baumgartner (gas hub in Austria), this will ensure the sale of gas, both in the market of South-East Europe, other European countries.

"Taking into account the plans to increase gas production in Azerbaijan, the development of the fields and perspective structures, including "Absheron", "Babak", "Umid" and others, the gas within the Shah Deniz second stage to the amount of 10 billion cubic meters can be transported to Italy," she said. "After obtaining additional volumes of gas, they can be delivered to Central and South-Eastern Europe."

Currently, the Shah Deniz consortium is considering three possible export routes - Nabucco, the South East Europe Pipeline (SEEP) and TAP. The final decision will be made in 2013.

She stressed that "Nabucco" project takes into account more consumer interests, rather than gas exporters. The companies participating in "Shah Deniz" project may join SEEP project. This will allow them ensuring their own interests.

In any case, Azerbaijan's main criterion for choosing the route of gas supplies to Europe is the commercial attractiveness and maximal profitability of the sales, Rzayeva stressed. Azerbaijan is going to export 10 billion cubic meters to Europe within the Shah Deniz-2 project and considers several options to export gas to the European markets.

In February Shah Deniz consortium excluded ITGI from the list of those being considered to export Azerbaijani gas to the European countries, and made TAP (Trans Adriatic Pipeline) a priority route for export of Azerbaijani gas to Italy.

Gas reserves in the "Shah Deniz" field are estimated at 1.2 trillion cubic meters.

The contract to develop the offshore Shah Deniz field was signed on June 4, 1996. Participants to the agreement are: BP (operator) - 25.5 per cent, Statoil - 25.5 per cent, NICO - 10 per cent, Total - 10 per cent, LukAgip - 10 per cent, TPAO - nine per cent and SOCAR-10 per cent.

In particular, the concept of creating Trans-Anatolian gas pipeline, designed to ensure gas supply from the Turkish eastern border to the west one is under preparation. This will give an opportunity to choose among the projects envisaging gas supplies from the border with Turkey to Europe.

Azeri Light crude sells for \$128.50

Oil prices have again jumped up in the world markets on 27 March, with a barrel of Azeri Light crude trading for \$128.50. On the New York Mercantile Exchange NYMEX cost of the US Light crude oil rose 16 cent to stand at \$107.03. A barrel of British Brent crude oil surged 52 cent to trade.

INTERNATIONAL COOPERATION

Baku hosts energy conference

An international conference "Main regional prospects: transit energy routes between the Caspian and Europe" has started on 2 April in Baku. The event was organized by the Center for Strategic Studies under President of Azerbaijan, Finland's Foreign Ministry and Aleksanteri Institute of University of Helsinki.

The event brought together scientists and specialists from Great Britain, Romania, Finland, Italy, Holland and Poland, representatives of the international organizations and diplomatic corps. Geopolitical significance, opportunities, security and commercial risks of the southern energy corridor will be in focus of the conference.

Russia seeks to enhance economic cooperation with Azerbaijan

The current level of mutual investment does not meet the existing potential financial and economic opportunities of Azerbaijan and Russia, Russian trade representative in Azerbaijan Yuri Shchedrin said.

"However, work in this direction is underway, and it can be considered as a "messenger" of projects for large cooperation," Shchedrin said in an interview published on Wednesday. Shchedrin noted that on 29 March Azerbaijan change from the country, attracting investment, into the country, which invests itself in other countries.

"Large investments made in Georgia, Turkey and Europe has an impact on the international image of Azerbaijan as a partner," the trade representative said.

The agreement on laying a new railway, passing in transit through the territory of Russia, Azerbaijan and Iran, and connecting the Indian Ocean and Europe is still actual at the present time.

The Azerbaijani businessmen are also actively involved in major projects carried out in preparation for the Winter Olympic Games, which will be held in two years in Sochi, Shchedrin said.

"Azerbaijani investors interested in growing and processing of grain, fruits and vegetables, in getting into the field of tourism, wood processing," the trade representative said. For example, tea-packing factory was built and commissioned, the construction of fruit and vegetable cannery is nearing completion through the means of "Azersun Holding" at Belorechensk district of Krasnodar region. "Matanat-A" company will begin to build a plant for the production of dry contaminants in Otradnoe district of Krasnodar region in the near future.

The meeting between Advanced Communication Technologies Company and Baku Telephone Network production association is held in April. Work on registering the subsidiary with 100 percent Russian capital is being implemented at

the moment. Russian organization Third Rome and concern "Avesta" are interested in the cooperation with Azerbaijan.

At present, 71 subject of the Russian Federation has foreign economic relations with hundreds of business entities of Azerbaijan.

Azerbaijan and Turkey mark 20th jubilee of economic cooperation

An event dedicated to the 20th anniversary of the Azerbaijani-Turkish economic cooperation will be arranged in Mardan Palace Hotel in Antalya, Turkey on 31 March.

According to the Azerbaijan Export and Investment Promotion Foundation (AZPROMO), the event organized by the Azerbaijan Women Entrepreneurs Public Union will be attended by officials of both countries, presidents of companies, businessmen and public figures.

Azerbaijan-China business meeting has been held.

Azerbaijan-China business meeting organized by Azerbaijan Export and Investment Promotion Foundation (AZPROMO) and supported by Azerbaijan's Economic Development Ministry has been held here.

The event has brought together Azerbaijani and Chinese businessmen engaged in construction and infrastructure spheres.

AZPROMO's vice-president Gulshan Rzayeva made a presentation on business and investment environment in Azerbaijan, and spoke of cooperation prospects between the businessmen of the two countries.

Vice chairman of China International Contractors Association Chi Changhai briefed the attendees on the activity of companies represented in the delegation.

Azerbaijan to ratify loan agreement with Serbia

Azerbaijan has evolved from a borrowing to a lender country, Chairman of the Committee on Economic Policy Ziyad Samadzade said on 15 March at a meeting of the Azerbaijani parliament.

At a meeting of the parliamentary committee the loan agreement between Azerbaijan and Serbia signed on Feb. 1 was discussed. Loan worth 300 million euros was issued for 15 years with a three-year grace period and an annual rate of four percent for construction of road in Serbia.

"Active process of Azerbaijan investing abroad continues. Azerbaijan is implementing investment projects in Turkey, Russia, Moldova and other countries," Samadzade said.

MP Vahid Ahmedov said monetary reserves of Azerbaijan today allow to implement similar projects.

"Due to cheapening of euro and dollar value of the assets of the State Oil Fund of Azerbaijan is gradually decreasing, so that Azerbaijan should make more use of such projects," said Ahmedov.

Department head in the Ministry of Economic Development Sahil Babayev said this agreement provides for rather stringent conditions for the Serbian side and protects the interests of Azerbaijan.