

# Caucasus Business Forecast Report Q3 2014

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## Abstracts

### Core Views

Azerbaijan's progress on deepening ties with the EU is set to falter following a new Council of Europe report criticising the government's lack of improvement in ending alleged human rights violations and ensuring basic freedoms. However, this will not destabilise the government, nor deter foreign investors, given the country's huge hydrocarbons potential.

Georgia's signing of an Association Agreement with the EU is set to occur by June at the latest, with Brussels keen to have the agreement in place as soon as possible to dissuade any Russian interference. However, the move is likely to provoke Russian sanctions against Georgia, and reports of the issuance of Russian passports to citizens in breakaway provinces will only heighten security risks. The appointment of Hovik Abrahamyan as prime minister of Armenia is unlikely to result in any significant alteration to the country's policy direction. Armenia remains on course to join a Russian-led customs union, ensuring some degree of military security but also cementing the country within Moscow's sphere of influence.

### Major Forecast Changes

We have revised down our forecast for real GDP growth in Armenia in 2015, from 3.4% to 2.8%, on the back of declining global demand for industrial metals hurting not only net exports but also fixed investment levels. Given the reliance of the Armenian economy on the production of copper and molybdenum, our Commodities team's downbeat outlook for global industrial metal prices will continue to weigh on Armenia's growth potential.

## Contents

Core Views  
Major Forecast Changes  
Key Risks To Outlook

### **CHAPTER 1.1: POLITICAL OUTLOOK - ARMENIA**

Domestic Politics

Still On The Russian Path Following PM Switch

The appointment of Hovik Abrahamyan as prime minister of Armenia is unlikely to result in any significant alteration in the country's policy direction.

Table: Armenia - Political Overview

Long-Term Political Outlook

Mitigation Of Regional Tensions Key To Stability

Armenia will continue to have difficult relations with neighbours Turkey and Azerbaijan through the medium term as a result of sensitive historical grievances and strong domestic pressure groups on both sides.

### **CHAPTER 1.2: ECONOMIC OUTLOOK - ARMENIA**

Economic Activity

Few Drivers Of Growth Ahead

Armenia will remain vulnerable to the deteriorating outlook for the Russian economy in 2014 and 2015 as the former becomes more closely integrated with the latter. Russia is already Armenia's largest export market, and with Armenia set to join the Eurasian customs union in Q314, this reliance will become even more ingrained as opportunities for Western investment diminish.

Table: Armenia - Economic Activity

### **CHAPTER 1.3: 10-YEAR FORECAST - ARMENIA**

The Armenian Economy To 2023

Convergence To Continue

Our relatively pessimistic medium-term view on the Armenian economy continues through our long-term forecast to 2023. We believe the lack of economic and political reforms enacted by the government and the pivot

away from the EU will hinder long-term economic activity, and as such we forecast real GDP growth to average 3.8% between 2018 and 2023.

Table: Armenia - Long-Term Macroeconomic Forecasts

## **CHAPTER 2.1: POLITICAL OUTLOOK - AZERBAIJAN**

### Domestic Politics

#### Renewed Human Rights Concerns Threaten European Ambitions

Azerbaijan's progress towards deepening ties with the EU is set to falter following a new Council of Europe report criticising the government's lack of improvement in ending alleged human rights violations and ensuring basic freedoms.

Table: Azerbaijan - Political Overview

### Long-Term Political Outlook

#### Everything Hinges On Nagorno-Karabakh

Attempts to win back the Nagorno-Karabakh enclave will remain the defining issue of Azerbaijani foreign and domestic policy through the medium term. A quick resolution is not likely, and heightened tensions with Armenia have the potential to result in small-scale armed clashes, with escalation not ruled out.

## **CHAPTER 2.2: ECONOMIC OUTLOOK - AZERBAIJAN**

### Economic Activity

#### Hydrocarbons Continue To Bolster Growth Outlook

Azerbaijan will remain reliant on the production and export of hydrocarbons to support real GDP growth over the course of our 10-year forecast period. The country's non-oil sector will continue to grow as the state pumps hydrocarbon revenues into social expenditure but will remain a secondary priority for the government and investors.

Table: Azerbaijan - Economic Activity

## **CHAPTER 2.3: 10-YEAR FORECAST - AZERBAIJAN**

### The Azeri Economy To 2023

#### Trend Growth Bolstered

Over our 10-year forecast period to 2023, we believe Azerbaijan's economy will remain on a positive trajectory. Undoubtedly, energy

exports will continue to be the key driver underpinning growth. In addition, we expect rising incomes and consumption to help keep growth buoyed during our forecast horizon.

Table: Azerbaijan - Long-Term Macroeconomic Forecasts

## **CHAPTER 2.4: BUSINESS ENVIRONMENT - AZERBAIJAN**

Business Environment Outlook

Institutions

Table: BMI Legal Framework Rating

Table: Labour Force Quality

Table: Emerging Europe - Annual FDI Inflows

Table: Trade And Investment Ratings

Infrastructure

Market Orientation

Operational Risk

## **CHAPTER 3.1: POLITICAL OUTLOOK - GEORGIA**

Domestic Politics

EU Integration Generates Security Threats

Georgia's signing of an Association Agreement with the EU is set to occur by June at the latest, with Brussels keen to have the agreement in place as soon as possible to dissuade any Russian interference in the country.

Table: Georgia - Political Overview

Long-Term Political Outlook

Pro-Western Path To Continue

We expect tensions between Georgia and Russia to continue to subside marginally over the next 10 years as the Georgian Dream coalition government attempts to improve Russo-Georgian relations. We highlight, however, that the potential for social unrest in border areas will remain pronounced, especially in the aftermath of the Ukraine crisis and Georgia's shift towards the EU and NATO.

## **CHAPTER 3.2: ECONOMIC OUTLOOK - GEORGIA**

Economic Activity

Economy Vulnerable To Russian Retaliation

Georgian real GDP growth will be threatened in 2014 if Russia decides to place trade restrictions on Georgian exports in retaliation for the country's deepening ties with the EU.

Table: Georgia - Economic Activity

### **CHAPTER 3.3: 10-YEAR FORECAST - GEORGIA**

The Georgian Economy To 2023

Foreign Investment Will Support Growth

Over our 10-year forecast period, we project Georgian growth to remain relatively robust, averaging 5.1% over 2018-2023. Georgia will continue to rely heavily on foreign direct investment as a key driver of growth over the long run, which will be enhanced by continued economic and structural reforms.

Table: Georgia - Long-Term Macroeconomic Forecasts

### **CHAPTER 4: BMI GLOBAL ASSUMPTIONS**

Global Outlook

Growth Increasingly Polarised

Table: Global Assumptions

Table: Developed States , Real GDP Growth , %

Table: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH FORECASTS, %

Table: Emerging Markets , Real GDP Growth , %

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