

# 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.

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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.

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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.

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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.

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

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Table: Azerbaijan - Political Overview

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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**

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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

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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.

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Table: Georgia - Economic Activity

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