

**2010**

# **Financial Stability Review**

**2010**

**Central Bank of the Republic of  
Azerbaijan**



## Table of Contents

Introduction .....	4
1. Financial markets .....	6
1.1 Foreign exchange market .....	6
1.2 Stock exchange .....	8
1.2.1 State securities market .....	8
1.2.2. Corporate securities market .....	11
2 Banking sector and risks .....	14
2.1 Dynamics of key indicators of the banking sector .....	14
2.2 Financial sustainability of the banking sector .....	18
2.3 Financial results of the banking sector performance .....	20
2.4 Loan portfolio .....	22
<b>2.5 Financial resources and liquidity risk .....</b>	<b>28</b>
<b>3 Payment systems .....</b>	<b>32</b>

## List of charts

Chart 1.1.1. Key indicators of the foreign exchange market (2010) .....	7
Chart 1.1.2. Purchase of net foreign currency in 2010, in mln manats .....	8
Chart 1.2.1. State securities market (2010).....	9
Chart 1.2.2. Interbank REPO market (2010) .....	11
Chart 1.2.3. Corporate bonds and shares market, in mln.manats (2010).....	12
Chart 1.2.4. Share market, in mln manats (2010).....	13
Chart 2.1.1. Key indicators of the banking sector, in mln.manats.....	14
Chart 2.1.2. Quarterly growth rate of key bank indicators in 2010, percent .....	15
Chart 2.1.3. Share of loans in total assets, % .....	15
Chart 2.1.4. Structure of loan portfolio by subjects.....	16
Chart 2.1.5. The number of structural network of banks.....	17
Chart 2.3.1. Profit structure, in mln.manats.....	20
Chart 2.4.1. Foreign currency structure of the loan portfolio .....	233
Chart 2.4.2. Purpose structure of loans to individuals,percent .....	25
Chart 2.4.3. Maturity structure of loans to individuals, in mln.manats .....	26
Chart 2.4.4. Loan provisioning .....	26
Chart 2.5.1. Maturity structure of deposits of individuals, percent .....	288
Chart 2.5.2. Share of deposits in manats in total deposits,percent .....	29
Chart 2.5.3. Dynamics of external debt .....	3030
Chart 2.5.4. The structure of liquid assets, percent.....	311
Chart 3.1. Dynamics of payment transactions in the National Payment Systems.	322
Chart 3.2. Dynamics of payments on RTGS (Large-value payment system) .....	333
Chart 3.3. Dynamics of payments on BCSS (Retail Payment System).....	344

## List of tables

Table 2.2.1. Structure and dynamics of total capital of the banking sector, in mln. manats .....	19
Table 2.4.1. Sectoral structure and dynamics of loan portfolio.....	24
Table 3.1. ATMs and POS-terminals.....	35

## **Introduction**

Financial stability policy pursued by the Central Bank is aimed at increase in financial sustainability of the banking sector. The policy implemented has preserved financial stability, supported positive trend and economic activity of socio-economical dynamics of the country, and provided stability of the national currency.

Volume of net cash currency purchased by natural and legal persons from banks decreased by 3,5 percent and made AZN 4137.1 mln against 2009, including volume of net USD purchase amounting to AZN 3959.9 mln.

The year of 2010 witnessed growth in the Azerbaijani corporate securities market (corporate shares and bonds). The growth occurred both in the volume of placed bonds and in transactions in the secondary market.

The Azerbaijani banking sector preserved growth dynamics. Key banking indicators continued their positive dynamics. Financial intermediation of the banking sector deepened further.

In order to provide demand of the economy for financial services and increase access to financial services, the banks kept expanding their branch network and other structural units. In 2010 the banks opened 32 new branches, thus the banking sector hosts 644 branches, 15 new bank departments opened and the number of bank departments increased to 120.

Expansion of geographical network of the banking infrastructure triggered access of economic agents, particularly the population to the banking services. Every 1.000 sq.m of the country territory is served by 11,3 (10,9 at the beginning of the year) and 100.000 mature population by 16,1 (15,8 at the beginning of the year) bank and non-banking structural units.

Capital adequacy indicators of the banks exceed the minimum limit set by the Central Bank. The share of Tier I Capital in total capital equals to 80 percent. Regulatory system stepped to another phase. Thus, the requirements of capitalization and the capital structure are tightened (leverage ratio applied). The quality of capital improved. Share of retained earnings in the structure of the capital shifted from 7,9 percent up 8,9 percent.

Profit earned by banks in 2010 (before tax) made AZN 140,1 mln. Net profit after tax constituted AZN 120,3 mln.

Lending behavior of the banks being conservative aimed at maximum provision of demand of the economy (legal and natural persons) for lending resources. Whereas primary goal of financial stability for 2009 was associated with exchange rate stability and liquidity support, in 2010 it primarily targeted risk management, improvement of capitalization and supervisory–regulatory framework.

In 2010 resource base of the banks mainly sourced from deposits attracted from legal and natural persons. Liquidity level of banks assets was sufficient to timely meet commitments before lenders and borrowers.

The previous year once more proved sustainability of the banking sector to external shocks and its capability to timely and fully meet domestic and external liabilities. Simulation analysis of vulnerability of the banks to the most exceptional however possible shocks indicates that the banks possess sufficient capital buffer to absorb potential losses.

## **Financial markets**

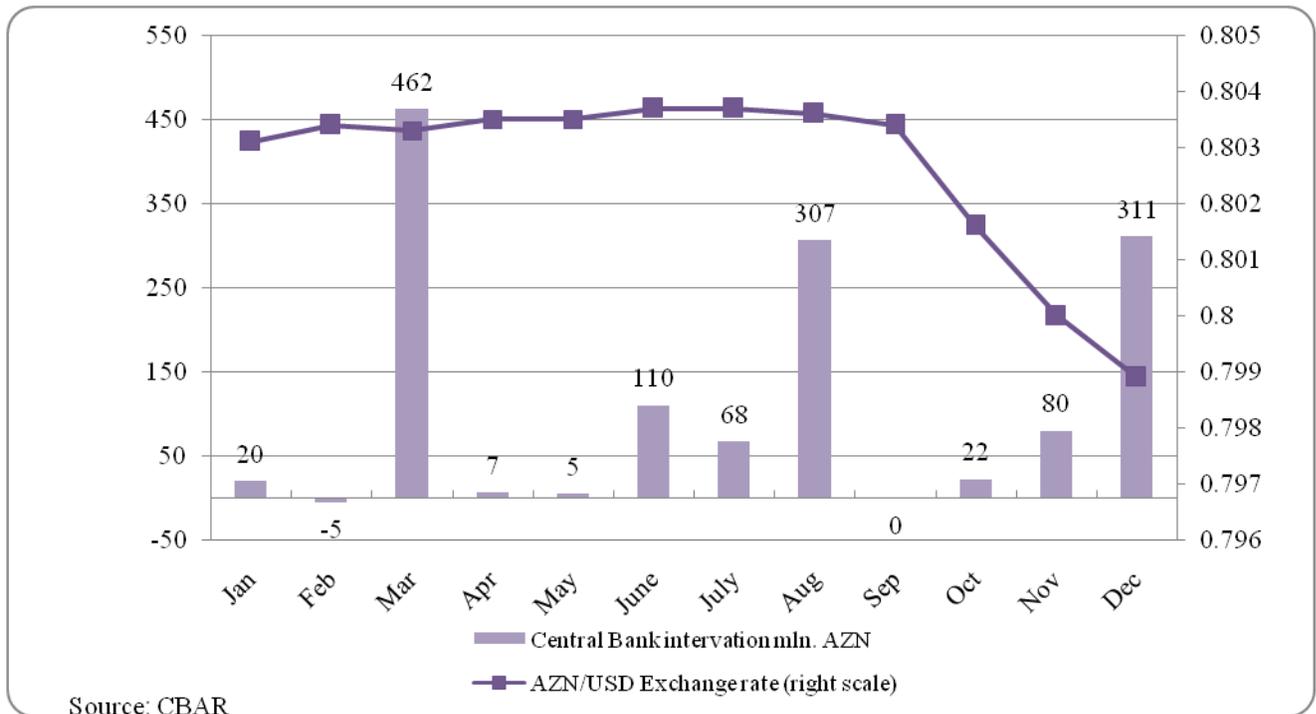
### **1.1 Foreign exchange market**

In 2010 the Central Bank pursued its exchange rate policy in the environment of expansion of supply channels in foreign exchange markets.

Total volume of domestic foreign exchange market slightly increased against 2009 (1.1 percent) and made AZN 25716.2 mln. Volume of transactions in unorganized foreign exchange market (OpIFEM and IBT) increased by 5.3 percent (or AZN 1269.7 mln) and made AZN 25158.3 mln against the previous year and took 97.8 percent of domestic foreign exchange market. Volume of transactions conducted in IBT constituted 59,7 percent of unorganised foreign exchange market. Volume of organised interbank foreign exchange market (BEST) decreased by 63.9 percent (or AZN 991.7 mln) and became AZN 558.1 mln and took 2.2 percent of total volume of domestic foreign exchange market.

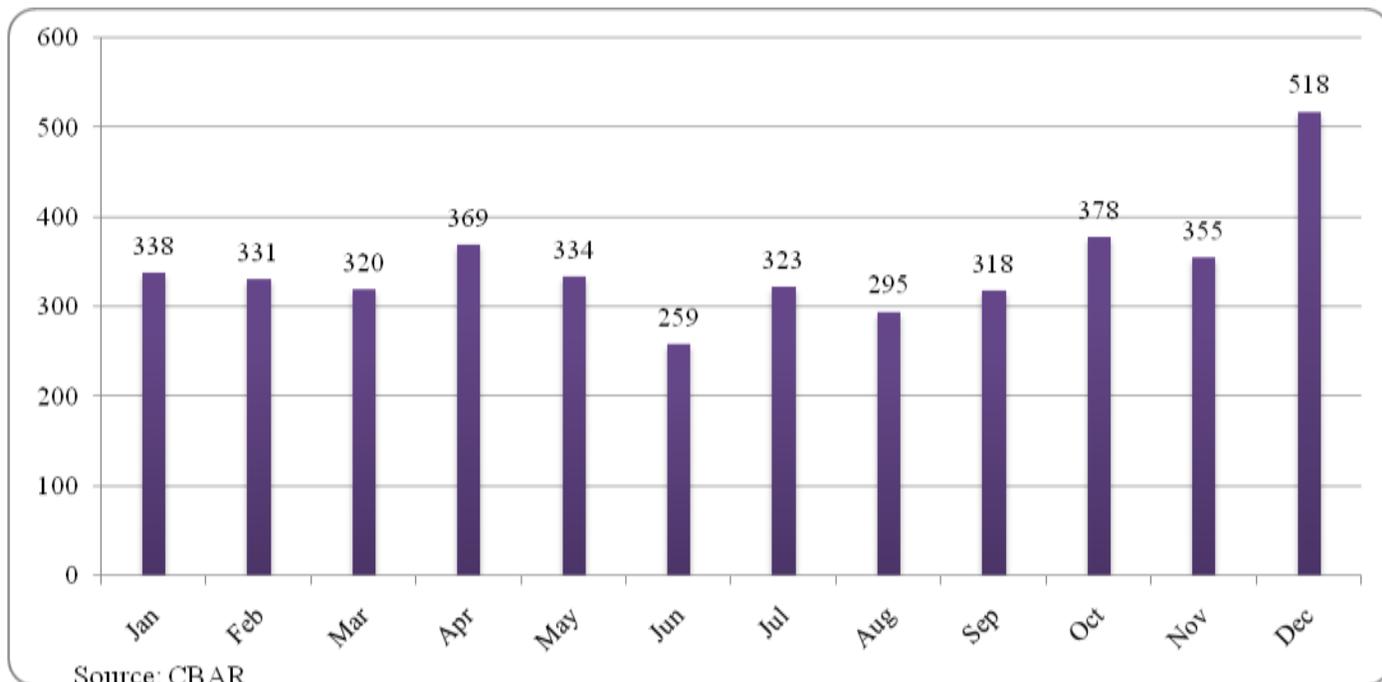
In 2010 the volume of net purchases of the Central Bank made USD 1385.3 mln. Foreign currency intervention peaked in March and December (Chart 1.1.1).

**Chart 1.1.1. Key indicators of foreign exchange market (in 2010)**



Volume of net cash foreign currency purchased by legal and natural persons from banks decreased by 3.5 percent against 2009 and made AZN 4137.1 mln (Chart 1.2.1), including 3959.9 mln volume of net USD purchase. Difference between market and official exchange rates ranged between 0.06-0.17 percent.

**Chart 1.1.2. Net foreign currency purchase in 2010, mln. manat**

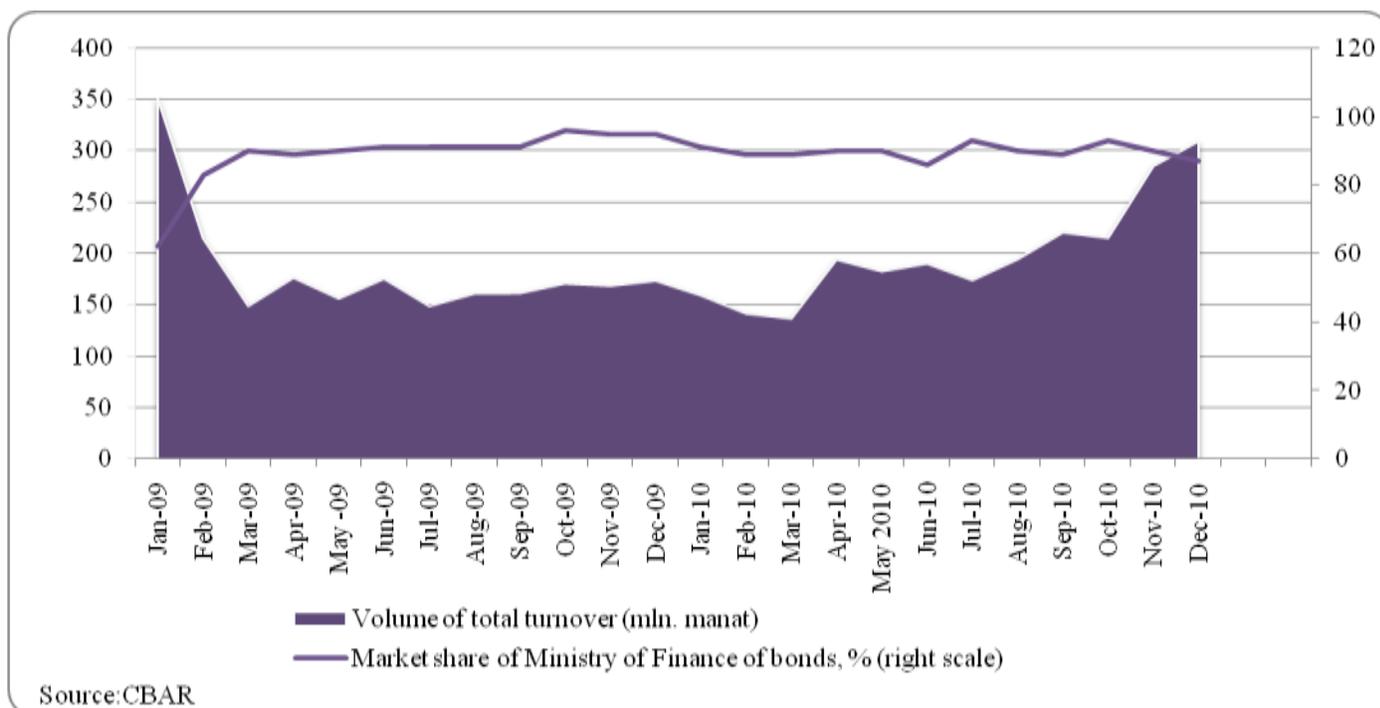


## **1.2 Stock exchange**

### **1.2.1 State securities market**

The year of 2010 witnessed revival in state securities market as in other sectors (Chart 1.2.1).

**Chart 1.2.1. State securities market (in 2010)**



In 2010 placement of State short- and medium-term bills continued. Volume of placed bills in 2010 decreased by 53 percent (or AZN 373.7 mln) against 2009 and made AZN 328.43 mln. Bills were more actively placed in November and made AZN 84.78 mln. During the period volume of State short-term bills in circulation increased by 38.9 percent (or AZN 104.8 mln) and constituted AZN 269.7 mln. Average return rate on short- and medium-term bills within the year was 2.73 percent.

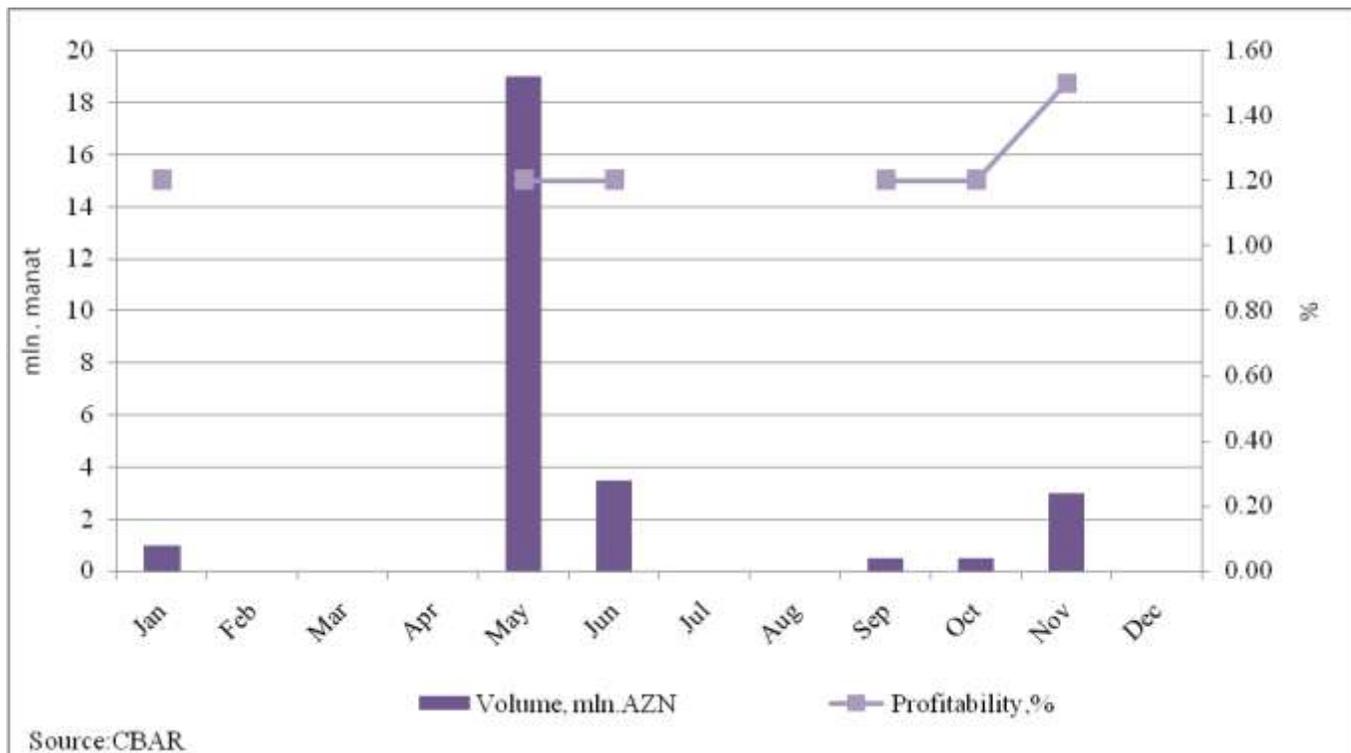
Volume of notes placed by the Central Bank during the year amounted to AZN 223.8 mln. To compare, the volume of placements in 2009 made AZN 287.8 mln. Weighted average return on notes slightly increased against the previous year (0.84 basis points) and stood at 1.84 percent level. The volume of notes in circulation having increased by AZN 31 mln against 2009, made AZN 40 mln as of the yearend of 2010. As of the yearend of 2010, share of state short-term bills in the

market decreased to 87 percent (95 percent in 2009), and the share of notes increased to 13 percent (5 percent 2009).

According to analyses, in 2010 investors primarily preferred investments to short-term instruments in 2010. As in 2009, all state short-term bills were owned by residents. 100 percent of the CBA notes in circulation and 90 percent of state short-term bills were owned by local banks. The remainder of the bills is owned by insurance companies, the Azerbaijan State Mortgage Fund, and the Azerbaijan Deposits Insurance Fund.

As compared with 2009, the volume of transactions in the repo market decreased by 58 percent and became AZN 27.6 mln. The number of transactions moved from 42 to 17. The biggest volume in repo operations in 2010 was in May (AZN 19 mln) (Chart 1.2.2). Interest rate on one day interbank repo operations decreased by 0.8 percent against 2009 and made 1.5 percent as of the end of the reporting period.

**Chart 1.2.2. Interbank repo market (2010)**



### 1.2.2. Corporate securities market

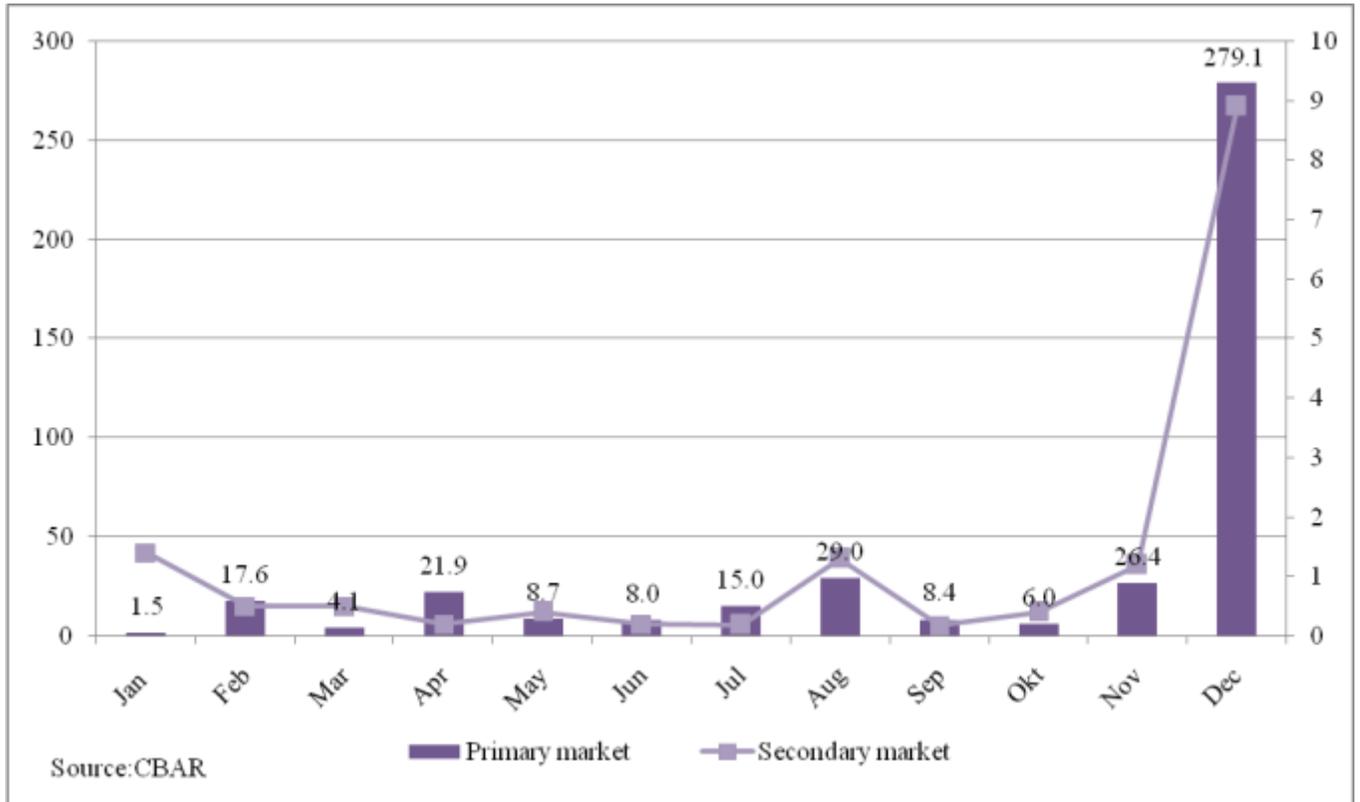
*There was growth in the Azerbaijan corporate securities market (corporate bonds and shares) in 2010.* The growth occurred both in the volume of placed bonds and in operations in the secondary market. Placement on corporate bonds increased by about 2 times against 2009 and constituted AZN 101.3 mln in 2010. Growth in the secondary market of corporate bonds was more rapid. Thus, if in 2009 the secondary market operations made AZN 61.8 mln, this indicator increased 2.6 times as much and reached AZN 164.7 mln in 2010. (Chart 1.2.3). In 2010 revival in placement and secondary market operations in the corporate securities market primarily benefited from placement of bonds of financial institutions and the Mortgage Fund.

**Chart 1.2.3. Corporate securities market, mln.manat (2010)**



Total amount on placement of shares in 2010 increased by 2.2 times as much against 2009 and reached AZN 425.8 mln. (Chart 1.2.4). Sharp growth was witnessed in December (AZN 279.1 mln). Unlike corporate bonds, the volume of transactions in the secondary market on shares significantly decreased. Thus, the latter indicator decreased by 2.7 times in 2010 and shifted from AZN 41.92 mln (in 2009) to AZN 15.6 mln.

**Chart 1.2.4. Share market, mln. manat (2010)**



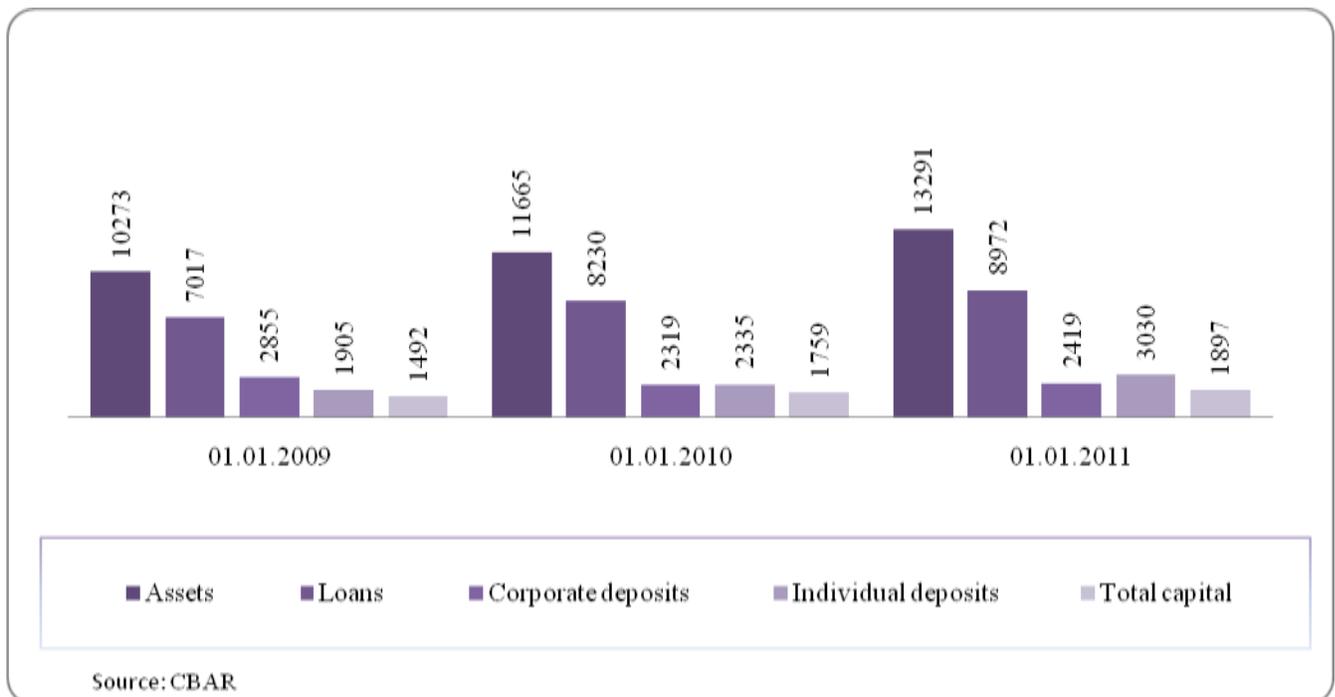
## 2. Banking sector and risks

### 2.1 Dynamics of key indicators of the banking sector

*In 2010 the banking sector preserved its sustainability, continued to develop and key parameters of the banking activity kept growing.*

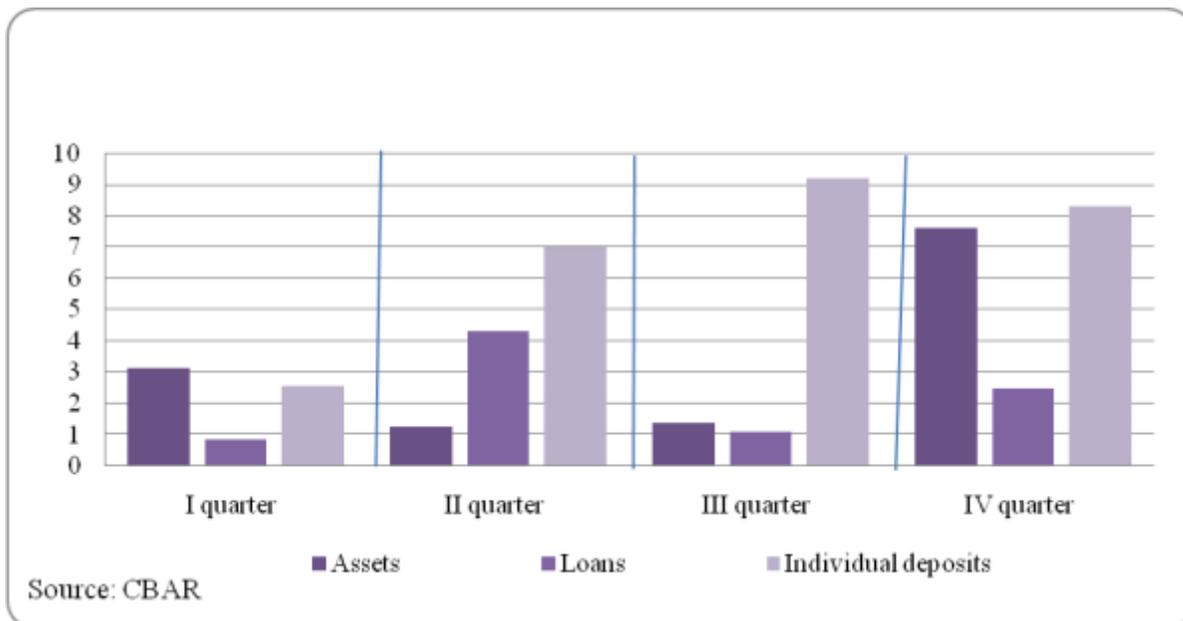
In 2010 assets of the banking sector increased by AZN 1626 mln or 13,9 percent and made AZN 13.3 bln as of 1 January 2011 (Chart 2.1.1).

**Chart 2.1.1. Key indicators of the banking sector, mln.manat**

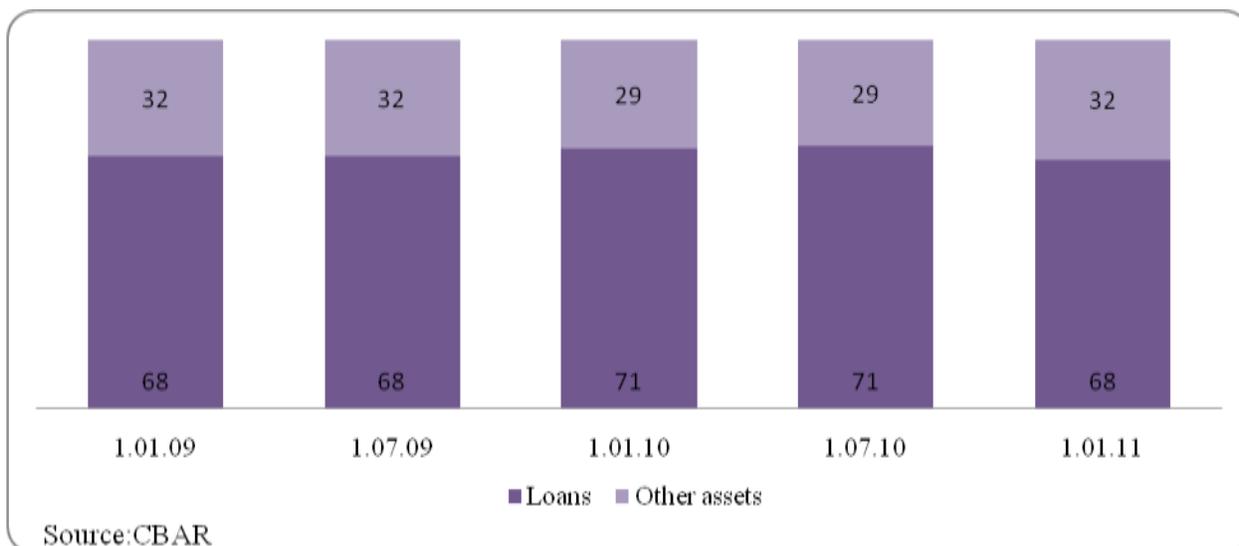


Most part of the assets growth occurred in the fourth quarter which is due to growth in deposit base. Maximum lending growth was observed in the second quarter of the year (Chart 2.1.2).

**Chart 2.1.2. Quarterly growth rate of key banking indicators in 2010, %**



**Chart 2.1.2. Share of loans in total assets, %**

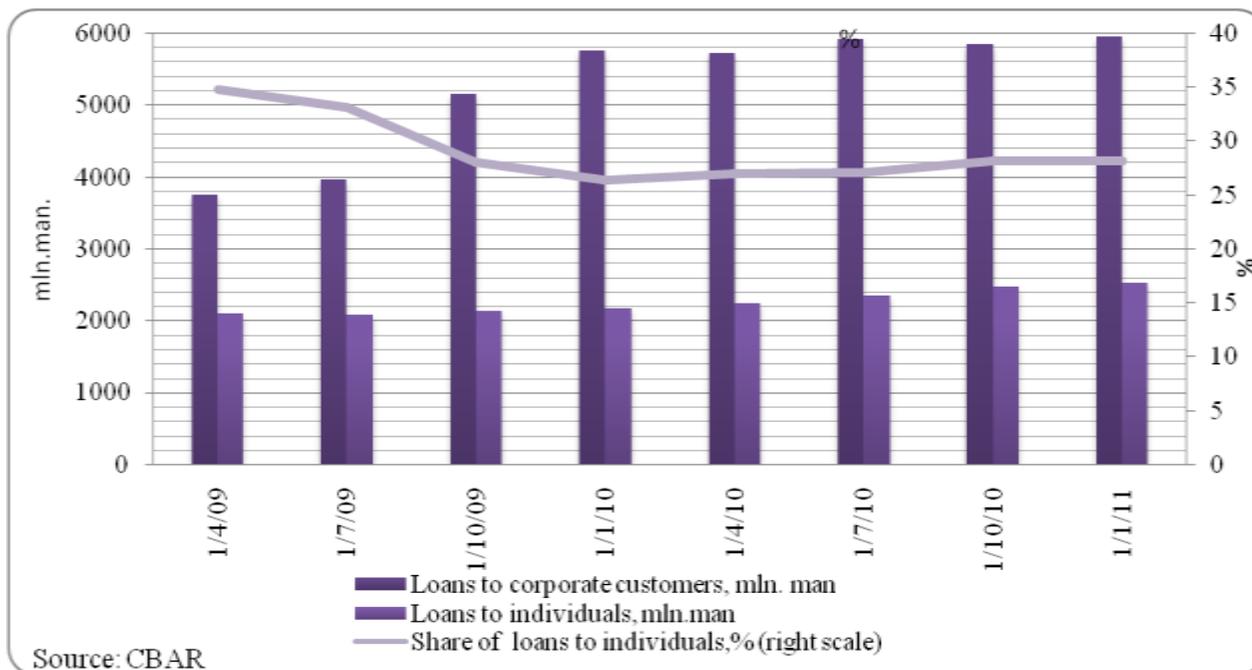


Assets growth is mainly due to loan portfolio growth (46 percent). In 2010 the share of loans in total assets was 68-71 percent (Chart 2.1.3). If to compare with 2009, the bank loans increased by AZN 741,3 mln or 9 percent and

constituted AZN 8971,8 mln as of 1 January 2011. The loan portfolio mainly grew through increase in deposits, interbank operations and funds attracted from other financial institutions.

In 2010 volume of loans to legal persons increased by 3,3 percent and made AZN 5,96 bln. Volume of loans to households has increased by 16,6 percent since the beginning of the year and constitutes AZN2,53 bln. At the same time, the share of loans to individuals in total loans of banks made 27-28 percent (Chart 2.1.4).

**Chart 2.1.4. The structure of loan portfolio by subjects**



The banking sector continued its institutional development and rehabilitation along with resumption and expansion of its financial intermediation. One new bank was licensed and licenses of two banks were revoked during the year. Consequently, the number of banks is currently 45.

**Chart 2.1.5. The number of structural network of the banks**



In order to maintain demand of the economy for financial services, and increase access to financial services, branch network and other structural units kept expanding. In 2010 32 new branches of banks were launched, currently the number of bank branches is 644, with 15 new bank divisions having been opened the number of bank divisions became 120 (Chart 2.1.5).

Every 1.000 sq.m. of the country territory is served by 11,3 (10,9 at the beginning of the year), 100.000 mature population is served by 16,1 (15,8 at the beginning of the year) bank and non-banking structural units.

Expansion of the banks network was accompanied by expansion of scope of activities of other institutions providing financial services. Thus, in order to expand access of rural population to financial services, the CBA licensed “AZERPOCHT” Limited Liability Company, the national operator of postal communication to conduct limited number of banking operations.

## 2.2 Financial sustainability of the banking sector

Volume of total capital of the banking sector increased by 7,9 percent and made AZN 1,9 bln. The capital growth was primarily witnessed in Quarter III.

Capital was sustained at the expense of the share capital. Thus, authorised capital increased by 18,8 percent (AZN 214,8 mln) compared to the beginning of the year (Table 2.2.1).

At the same time, participation of foreign investors in the banking sector capital increased. In 2010 investments of shareholders of the kind to banks authorised capital increased by 19,8 percent (AZN 40,5 mln) and constituted AZN 245 mln as of 01.01.2011 (17,8 percent of banking sector's total paid-in capital).

**Table 2.2.1. Structure and dynamics of the total capital of the banking sector, mln. manat**

	1/1/2009	1/1/2010	1/1/2011
<b>Tier I Capital</b>	<b>1091.8</b>	<b>1 285.5</b>	<b>1520.5</b>
<i>Changes against the beginning of the year, in %</i>	<i>44.6</i>	<i>17.7</i>	<i>18.3</i>
<b>Paid-in capital</b>	949.7	1144.6	1359.4
<b>Share premium</b>	32.3	20.7	20.7
<b>Retained net earnings</b>	125.2	138.8	169.2
<b>Tier II Capital</b>	<b>449.0</b>	<b>531.0</b>	<b>440.1</b>
<b>Profit of the current year</b>	192.1	269.6	165.8
<b>Aggregate reserves</b>	93.9	122.8	139.8
<b>Other funds of capital</b>	169.7	138.6	134.4

<b>Deductions from total capital</b>	48.6	57.0	63.4
<b>Total capital after deductions</b>	<b>1491.7</b>	<b>1 758.9</b>	<b>1897.1</b>
<i>Changes against the beginning of the year, in %</i>	47.7	17.9	7.9
<b>Source: CBA</b>			

*The quality of the capital improved.* Share of Tier I Capital in total capital was 80 percent, however, in previous years this indicator was 73 percent. The share of retained earnings in the structure of capital shifted from 7,9 percent to 8,9 percent.

The actual level of the systemic capital adequacy indicator displays sufficient capital reserve buffer in banks. Total capital adequacy of the banking sector preserved high level (16,9 percent) and fairly exceeded the norm set up by the Central Bank (12 percent). At the same time, adequacy of Tier I Capital increased against the beginning of the year from 13 percent and reached 13,5 percent, which twice as much (6 percent) exceeds the norm.

*Hardening of requirements on capitalisation level and the structure of capital.* The Central Bank applied new leverage ratio<sup>1</sup> at the end of 2010 in order to neutralize imbalances in growth rates of assets and capital, secure stability of the banking sector, prevent asset bubbles, provide sound growth of bank assets. The banks are obliged to maintain the leverage ratio below 8 percent.

---

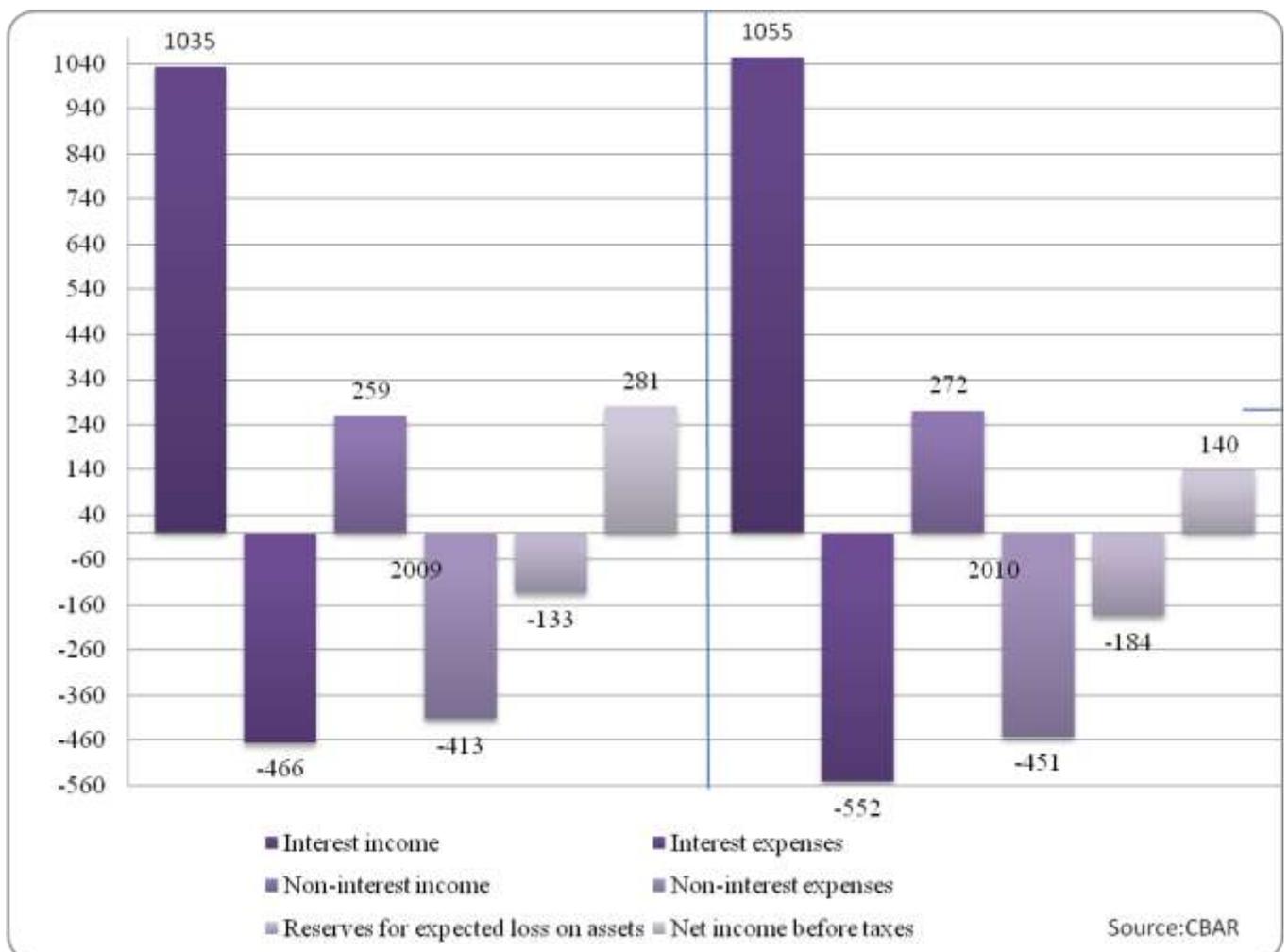
<sup>1</sup> Leverage ratio – is calculated as a ratio of Tier I Capital of banks to balance assets and off-balance sheet liabilities (guarantees, warranties, and outstanding portion of liabilities on credit lines).

## 2.3 Financial results of the banking sector performance

*Financial standing of the banks remained stable, optimization of the structure of gains and losses continued.*

Profit earned by banks in 2010 (before tax) constituted AZN 140,1 mln. (Chart 2.3.1). Net profit after tax amounted to AZN 120,3 mln.

**Chart 2.3.1. Profit structure, mln.manat**



Decline in interest rates on loans and rise in the volume of overall earning assets resulted in 2 percent increase in banks interest bearing assets and equalled to

AZN 1055,3 mln (including interests on loans to customers being respectively 1,8 percent and AZN 945,1 mln).

Aggregate income from other interest bearing operations (interbank exposures, securities and financial lease) increased by 3,7 percent and the ratio of other interest income to average assets made 0.9 percent.

In parallel, banks are increasing alternative sources of income and non-interest income. Non-interest income of banks rose by 5 percent and constitutes AZN 271,6 mln. Amidst revival of economic activity growth of non-interest income is put down to increase in commissioning fee for maintenance of customer accounts and their servicing. The commissioning earned during the year rose by 19 percent and amounted to AZN 174,7 mln. At the same time, volume of net gains from foreign exchange operations during the year decreased by 3 percent as compared with the relevant period of the previous year and amounted to AZN 83,8 mln. The ratio of gains from foreign exchange operations to average assets of the banking sector shifted from 0,9 percent to 0,7 percent. Contraction of net gains from foreign exchange operations of banks is due to regulation of open currency position by banks. Thus, total income of banks amounted to AZN 1326,9 mln. which exceeds that of 2009 by AZN 33,5 mln. or 2,6 percent.

Interest expenses rose by 18.4 percent againsts the previous year and made AZN 551,6 mln which is primarily due to increase in the volume of deposits of individuals. 90 percent of the growth in total interest expenses falls into the share of interest on term deposits. Despite absolute increase in interest expenses their ratio to average assets contracted from 4,6 percent to 4,5 percent against the previous year.

Interest income prevails in the structure of bank gains (79,5 percent), whereas interest payments prevail in expenses (55 percent).

Non-interest expenses of banks increased by 9.2 percent against the previous year and constituted AZN 451,3 mln. Increase in expenses of the kind is due to institutional expansion of banks, including launch of new structural units (branches and divisions). Thus, the number of banks employees increased by 11 percent and was over 15.000 persons.

Despite absolute increase in the volume of non-interest expenses against the previous year, their ratio to average assets of the banking sector moved from 4,1 percent to 3,7 percent. Relative decline in non-interest expenses come from optimization of banks' operational expenses (not related to interest expense).

Total expenses of banks (both interest and non-interest) increased by AZN 124 mln or 14,1 percent and reached AZN 1002,9 mln.

Potential risks are at the maximum considered in lending policy of the banks. This trend revealed itself in growth dynamics of loan loss provisioning. Thus, in 2010 these allowances increased by 38.5 percent compared to the previous year and constituted AZN 184 mln.

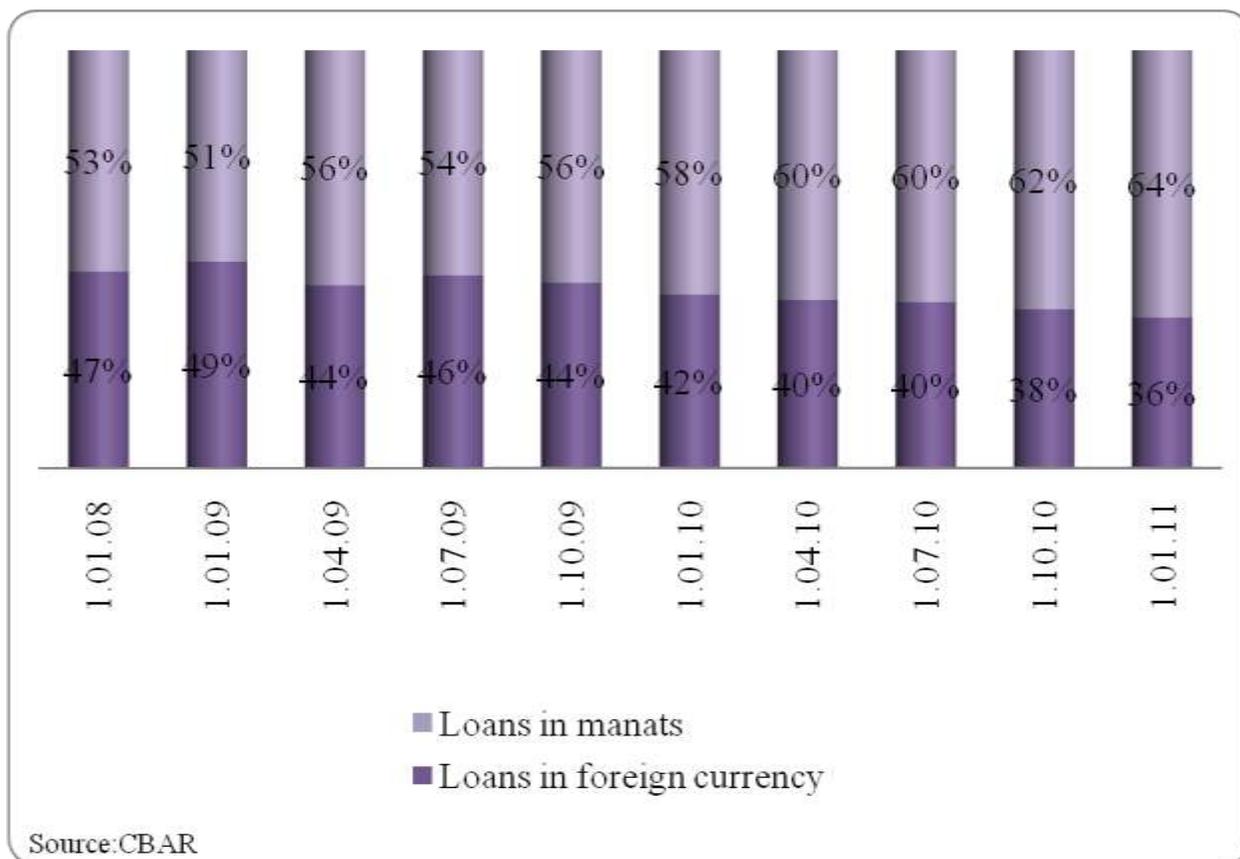
Net profit on average assets (ROA) was 1 percent in 2010, and net profit to average capital (ROE) was 7,4 percent.

## **2.4 Loan portfolio**

In 2010 volume of the loans to non-financial sector increased by AZN 741,3 mln or 9 percent against the previous year and reached AZN 8971,8 mln.

With the exchange rate stability being preserved in domestic foreign exchange market, loans in the national currency rose by 19.9 percent in 2010 which stipulated their becoming a primary source for total loan portfolio growth. As a result, the share of loans in the national currency shifted from 58,5 percent to 64,3 percent (Chart 2.4.1). The share of currency structure of the banking sector liabilities is observed to consistently contract which creates favorable condition for contraction of overall dollarization of banks' loan portfolio and decrease in risks arising from exchange rate volatility (direct and indirect).

**Chart 2.4.1. Currency structure of the loan portfolio**



Growth rate of long-term loans (9,3 percent) nearly kept pace with growth rate of total loans (9 percent) and equalled to AZN 6,55 bln as of 1 January 2011. In 2010 share of long-term loans in the structure of loan portfolio fluctuated between 73-74 percent.

There were changes in sectoral structure of loans along with changes in currency structure of loans. The highest growth rate on loans was witnessed in loans issued to non-oil industry and production (+27,1 percent), trade and services (+20 percent), agriculture and processing (+11,9 percent) and construction and property (+14,6 percent) (Table 2.4.1).

**Table 2.4.1. Sectoral structure and dynamics of the loan portfolio of banks**

	1/1/2009		1/1/2010		1/1/2011		Increase, decrease (-), in 2010	
	in mln. AZN.	share, in %	in mln. AZN.	share, in %	in mln. AZN.	share, in %	in mln. AZN.	share, in %
<b>Trade and services</b>	1910.4	27.2	1833.5	22.3	2201.0	24.5	367.5	20.0
<b>Households</b>	2175.8	31.0	2171.6	26.4	2531.3	28.2	359.7	16.6
<i>including, loans on operations with plastic cards</i>	93.9	1.3	119.4	1.5	135.9	1.5	16.5	13.8
<b>Energy, chemistry and natural resources</b>	855.7	12.2	1522.0	18.5	984.0	11.0	-538.0	35.3
<b>Agriculture and processing</b>	255.4	3.6	389.3	4.7	435.4	4.9	46.2	11.9
<b>Construction and property</b>	461.3	6.6	576.4	7.0	660.6	7.4	84.2	14.6
<b>Industry and production</b>	427.3	6.1	536.7	6.5	682.3	7.6	145.6	27.1
<b>Transport and communication</b>	669.1	9.5	520.4	6.3	454.4	5.1	-66.0	12.7

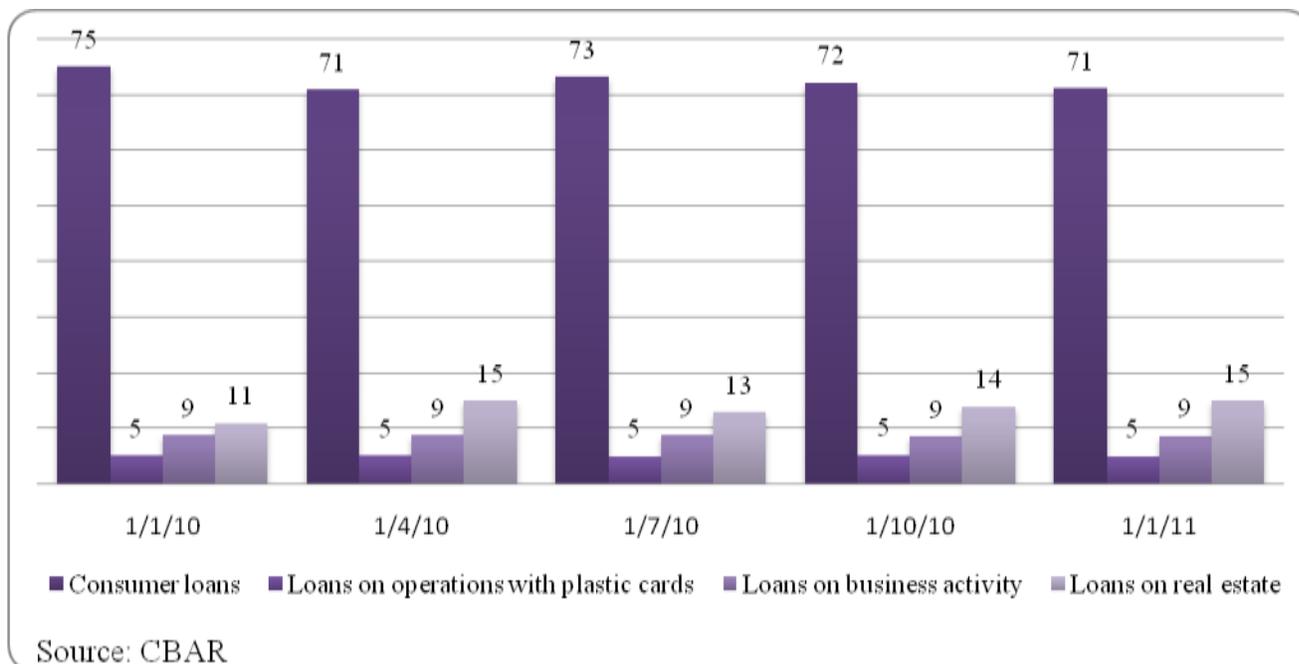
Source:CBA

Crediting of the population is the key of banking services. Economic growth, decrease in uncertainty on customer risks resulted in banks' reviving retail lending from Quarter II.

Growth in the volume of loans to individuals sourced from mortgage (AZN +151 mln) and consumer (AZN +175 mln) loans. As of 1 January 2011 share of loans issued for consumer purposes in loans to households made 71 percent,

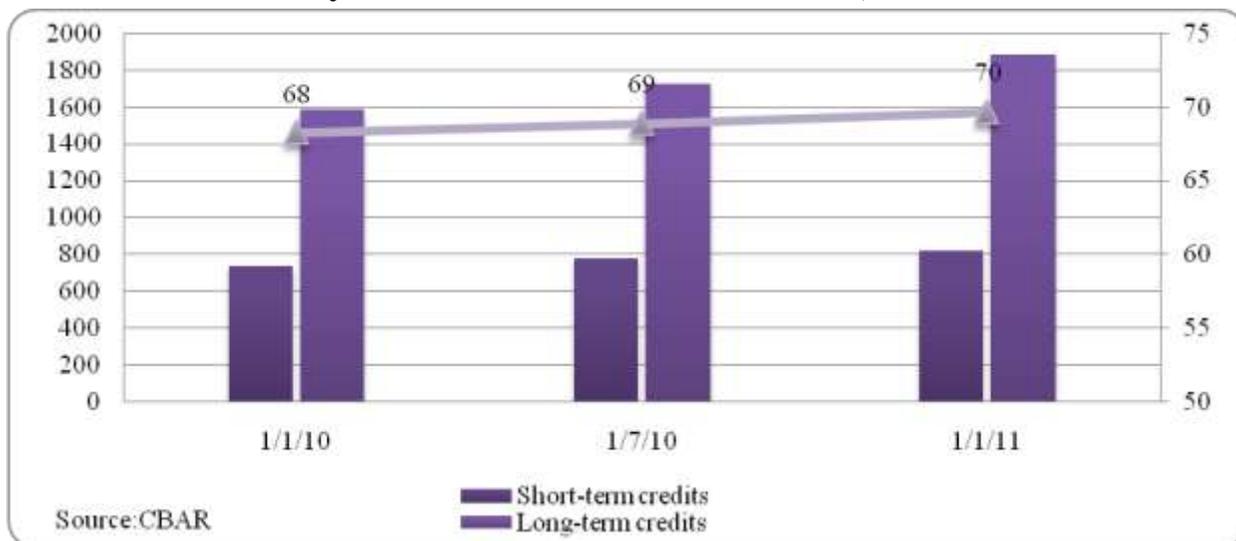
whereas mortgage loans took 15 percent. The share of consumer loans in loans to households declined, and the share of real estate loans rose. No change was observed on loans for entrepreneurship and outstanding balance on credit cards (Chart 2.4.2).

**Chart 2.4.1. Purpose structure of loans to individuals, %**



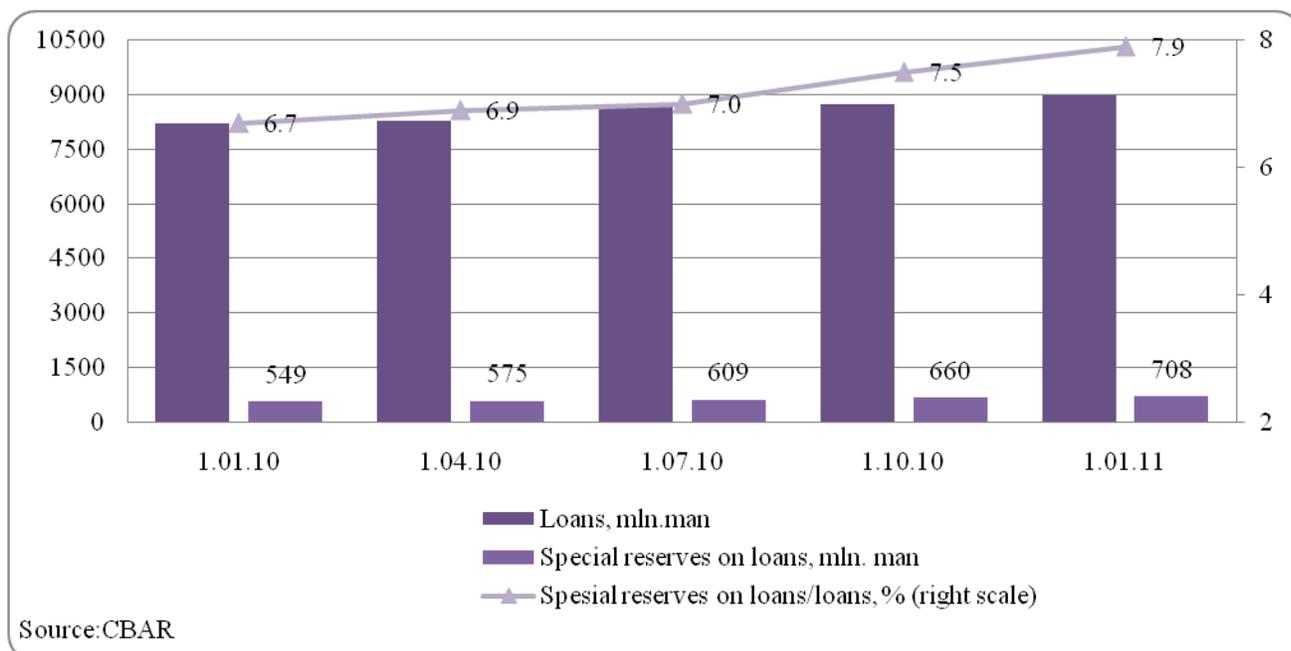
During the year long-term loans to individuals increased by 18,4 percent and as of 1 January 2011 made AZN 1,9 bln ( 01.01.10 - AZN 1,6 bln). Growth of the volume of mortgage loans stipulated growth of the share of long-term loans to individuals. As of 1 January 2011 the share of long-term loans to individuals in the loan portfolio shifted from 68,3 percent to 69,7 percent against the beginning of the year (Chart 2.4.3).

**Chart 2.4.3. Maturity structure of loans to individuals, mln.manat**



The quality of the loan portfolio preserved acceptable level. Thus, non-standard loans took 8 percent of the portfolio (6 percent as of 01.01.2010). The share of non-performing loans in the portfolio was 4,7 percent (3,5 percent at the beginning of the year). As of 1 January 2011 loan loss reserves take 7.9 percent of the loan portfolio (6,7 percent as of 01.01.2010) (Chart 2.4.4).

**Chart 2.4.4. Loan loss provisioning**



## **2.5 Financial resources and liquidity risk**

As in previous periods, financial resources primarily benefited from deposits and savings of natural and legal persons. If to compare with the beginning of the year total deposit base (financial institutions excluding) rose by AZN 794,6 mln (+17,1 percent) and amounted to AZN 5,45 bln. During the year, the share of deposits and savings in the structure of total average liabilities constituted 46,6 percent, and the share in total resources base was 38,6 percent.

If to compare with the beginning of the year deposits of legal persons increased by AZN 99,7 mln and became AZN 2,4 bln. There was observed seasonal volatility in dynamics of deposits of legal persons and they took monthly average 20,6 percent of total bank liabilities.

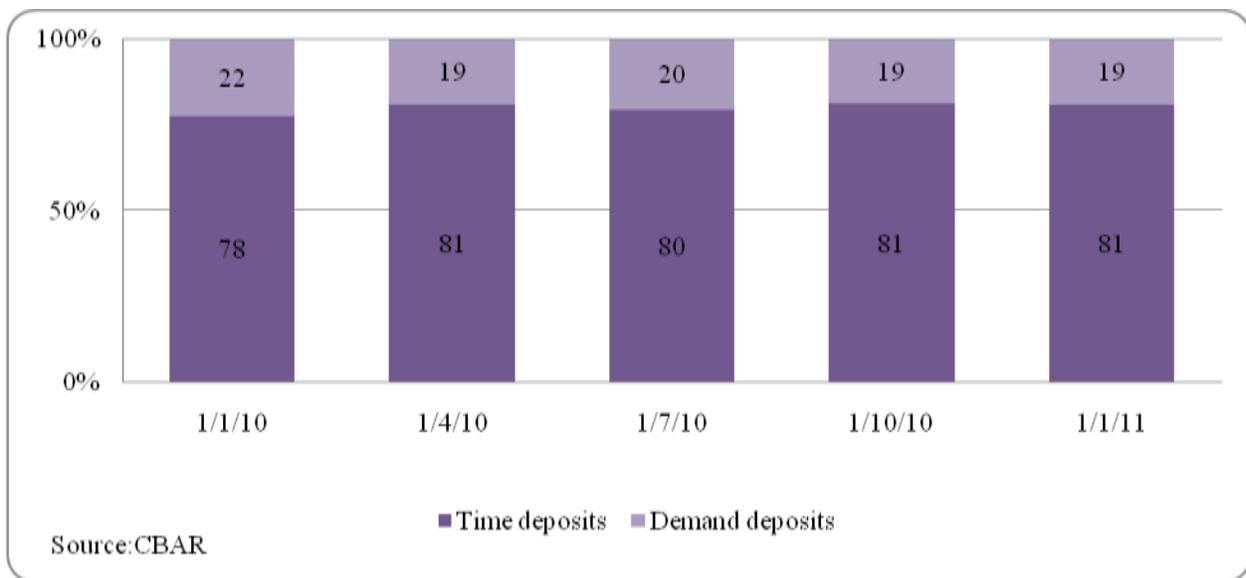
Policy of promotion of decrease in interest rates on deposits continued. The Trustee Board of the Azerbaijan Deposits Insurance Fund reduced the highest level of insured deposits from 15 percent to 12 percent from 1 June 2010 in agreement with the Central Bank. This decision having a downward effect on interest rates of deposits enabled downward trend in interest rates on loans.

During the year deposits of the population increased by 29,8 percent and made AZN 3,030 bln. The share of deposits of the population in attracted resources is observed to grow which reflects the policy of diversification of banks' financing resources. Thus, banks prefer internal resources in improving financial resilience, and subsiding liquidity risk. As of 1 January 2011 the share of deposits of the population in bank liabilities was 27,2 percent (24.2 percent as of January 2010). Average monthly growth in deposits of the population was 2,2 percent. However, huge deposit growth occurred in the second half of the year. Deposit growth amidst

reduction in interest rate ceiling on insured deposits once more proves high confidence in the banking sector.

There were positive changes in the quality of deposit base along with its absolute growth. Thus, term deposits prevailed over demand deposits. While demand deposits of the population increased by 10,4 percent, term deposits grew by 35,3 percent (Chart 2.5.1).

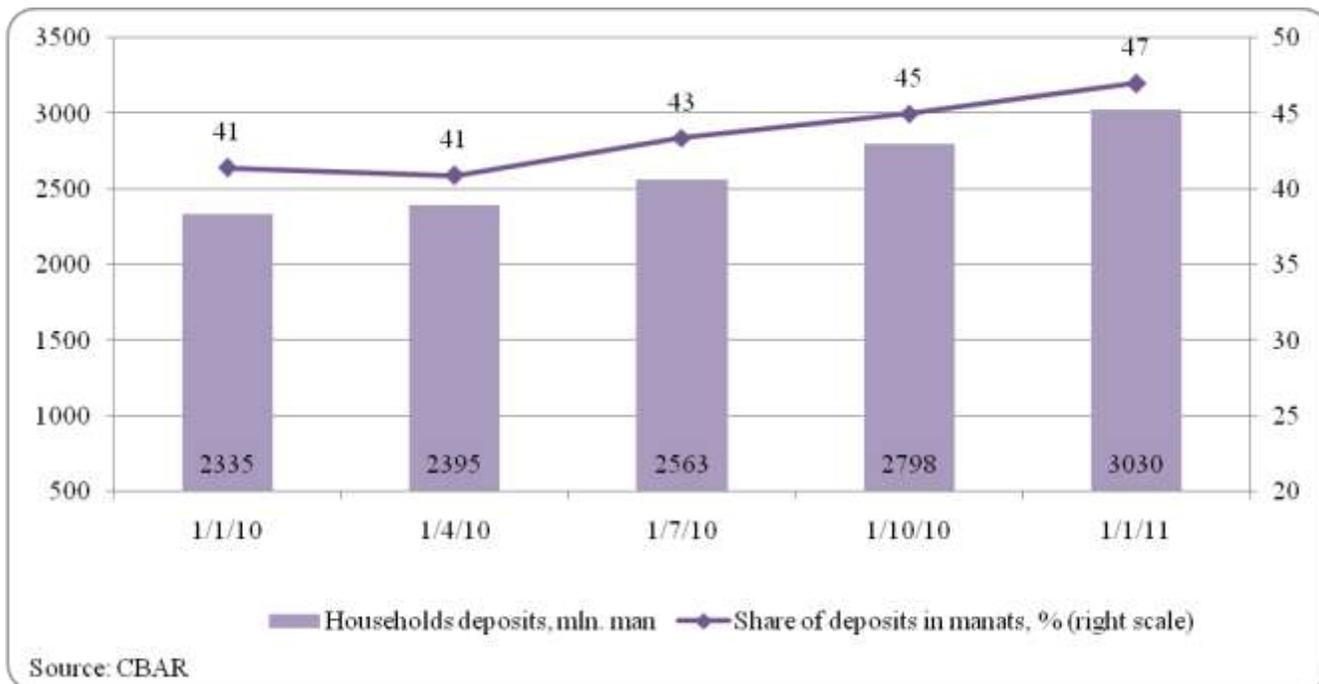
**Chart 2.5.1. Maturity structure of deposits of individuals, %**



Overall stability of the deposit base improved, its duration increased as well. Thus, 34,6 percent of total deposits is the deposits with over one year maturity (32,3 percent as of 01.01.2010).

At the same time, deposits of individuals in the national currency increased by 46 percent during the year and its share in total deposits was 46,5 percent (41,4 percent as of 01.01.2010) (Chart 2.5.2).

**Chart 2.5.2. Share of deposits in manat in total deposits**

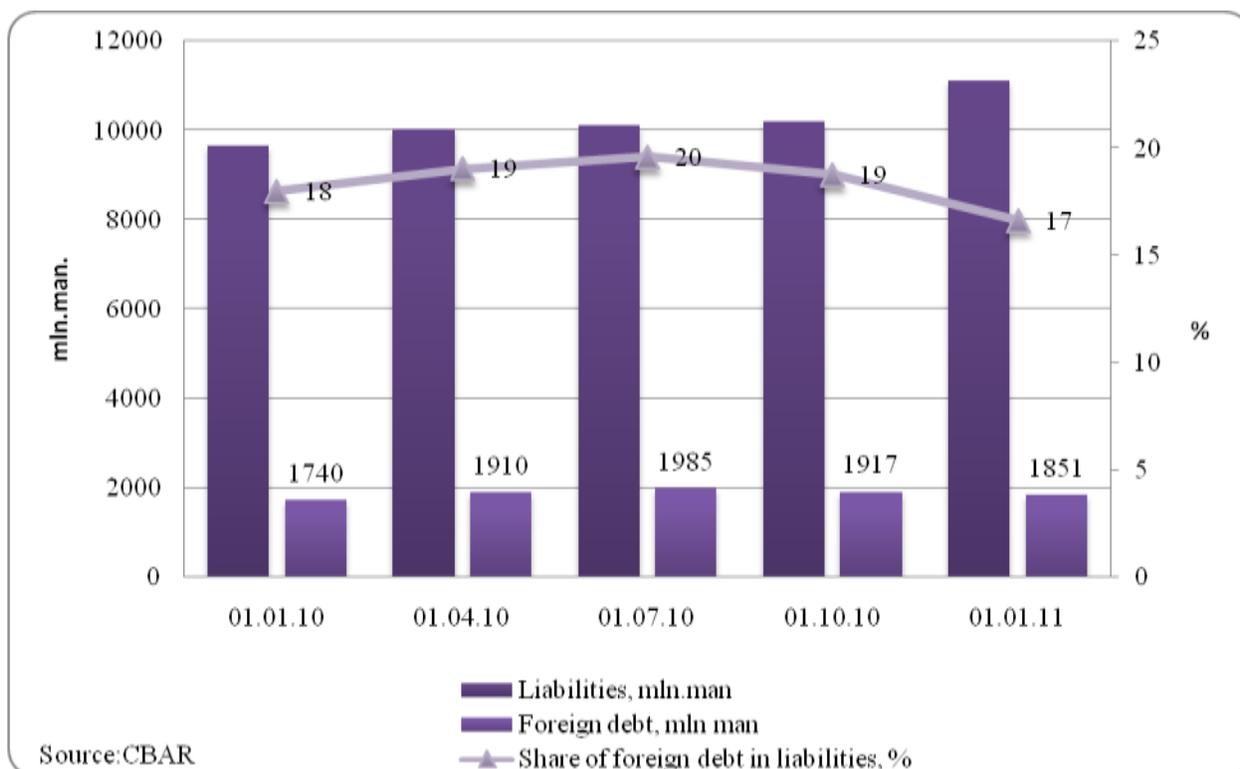


The exposure of the Central Bank to the banking sector remained almost the same during the year and equalled to AZN 1,54 bln as of the yearend. The share of resources of the kind in bank liabilities shifted from 15,2 percent to 13,9 percent during the year.

Interbank liabilities were observed to grow. Volume of interbank liabilities increased by AZN 417,4 mln. (24,5 percent) during the year and as of 01.01.2011 reached AZN 2,1 bln. Ratio of the resources of the type to average assets came to 15-16 percent.

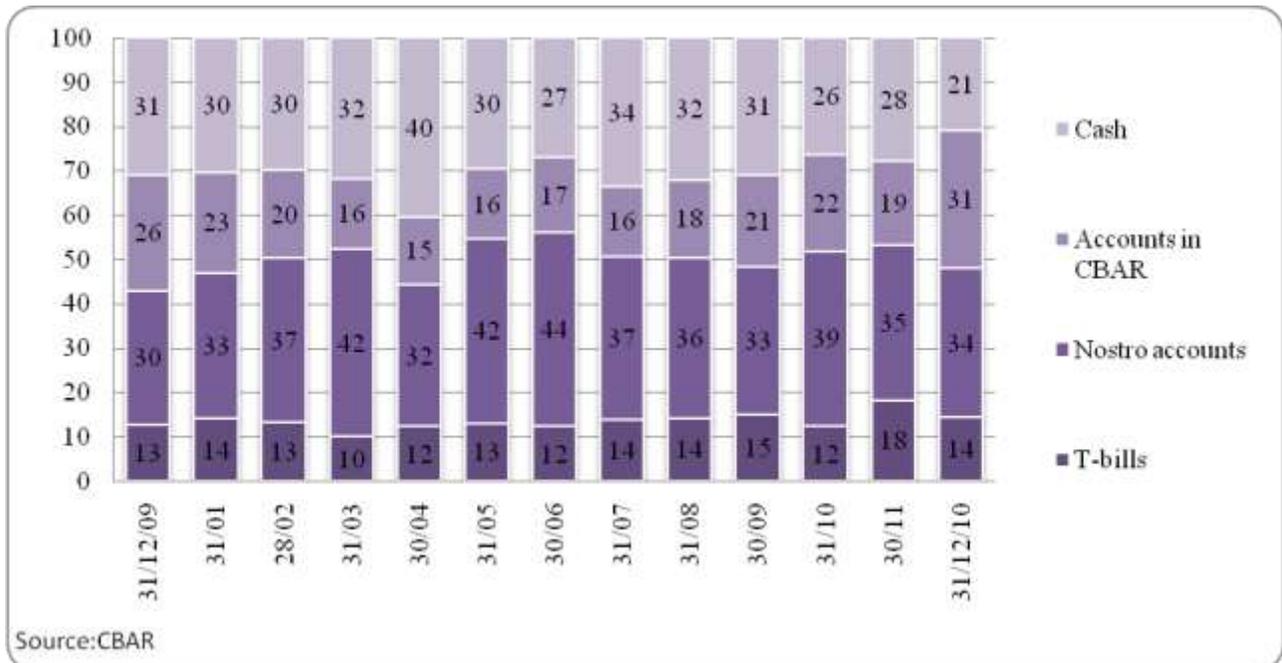
Funds attracted from non-residents increased by AZN 111,4 mln (+6,4 percent) within the year. Volume of external borrowings of the banking sector constituted AZN 1,85 bln, and its share in total liabilities was 16,6 percent (Chart 2.5.3).

**Chart 2.5.1. Dynamics of foreign borrowing**



Despite revival in lending activity liquidity level of banks remained high. The ratio of liquid assets to total assets proves adequate management of the liquidity risk in the banking sector. Growth rate of term deposits (+14 percent) prevailed over growth rate of loans (+9 percent). In 2010, liquid assets took about one fifth of total assets. In 2010 there were no significant changes in the structure of liquid assets, the changes at the yearend were associated with seasonal factors. Thus, as of 01.01.2011 the share of funds in correspondent accounts was up to 65 percent (average annual 56 percent), the share of cash funds went down to 21 percent (average annual 30 percent), the share of securities remained stable at 14 percent level (Chart 2.5.4).

**Chart 2.5.4. The structure of liquid assets, %**

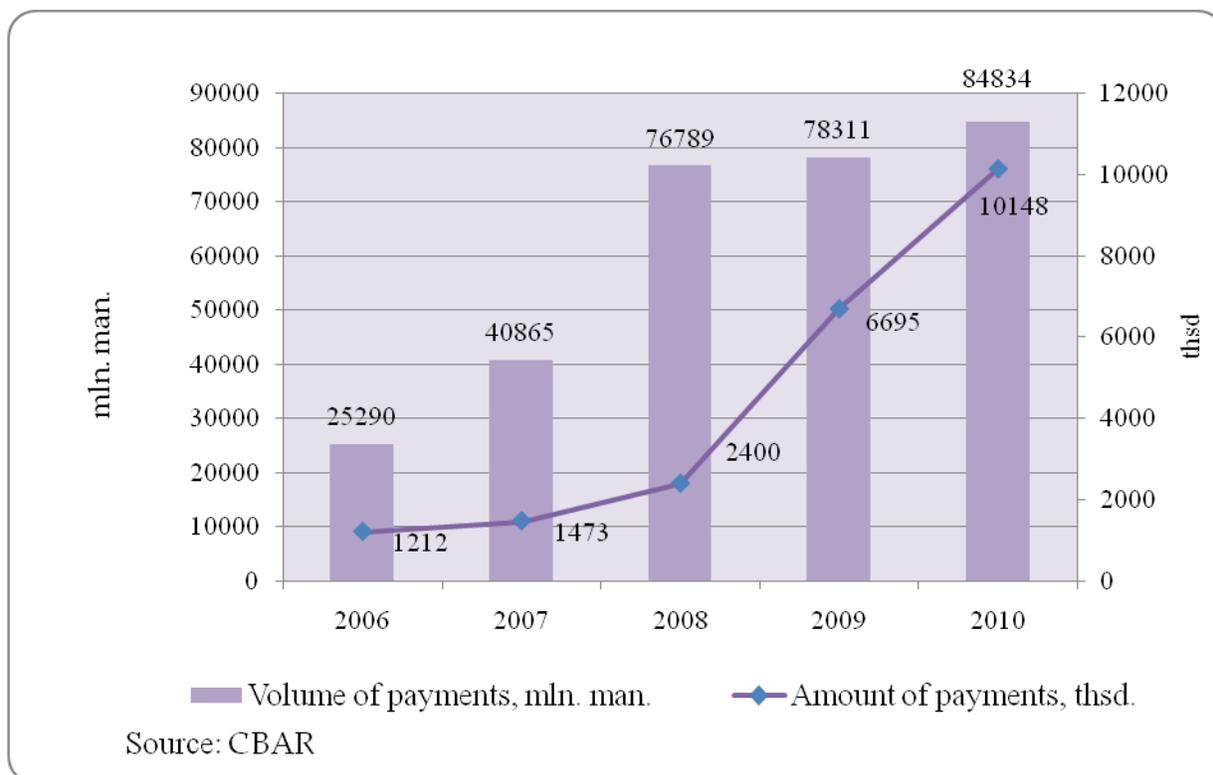


Maturity analysis of liquidity by assets and liabilities (GAP analysis) as well reflects acceptable level of liquidity (the ratio of GAP to asstes as of 01.01.11 was within -0,2 percent/ +7,6 percent).

### 3. Payment systems

In 2010 turnover of the National Payment Systems achieved its historical maximum. 10,15 mln pieces of transactions were conducted in the payment system in total amounting to AZN 84,83 bln.

**Chart 3.1. Dynamics of payment operations in the National Payment System**

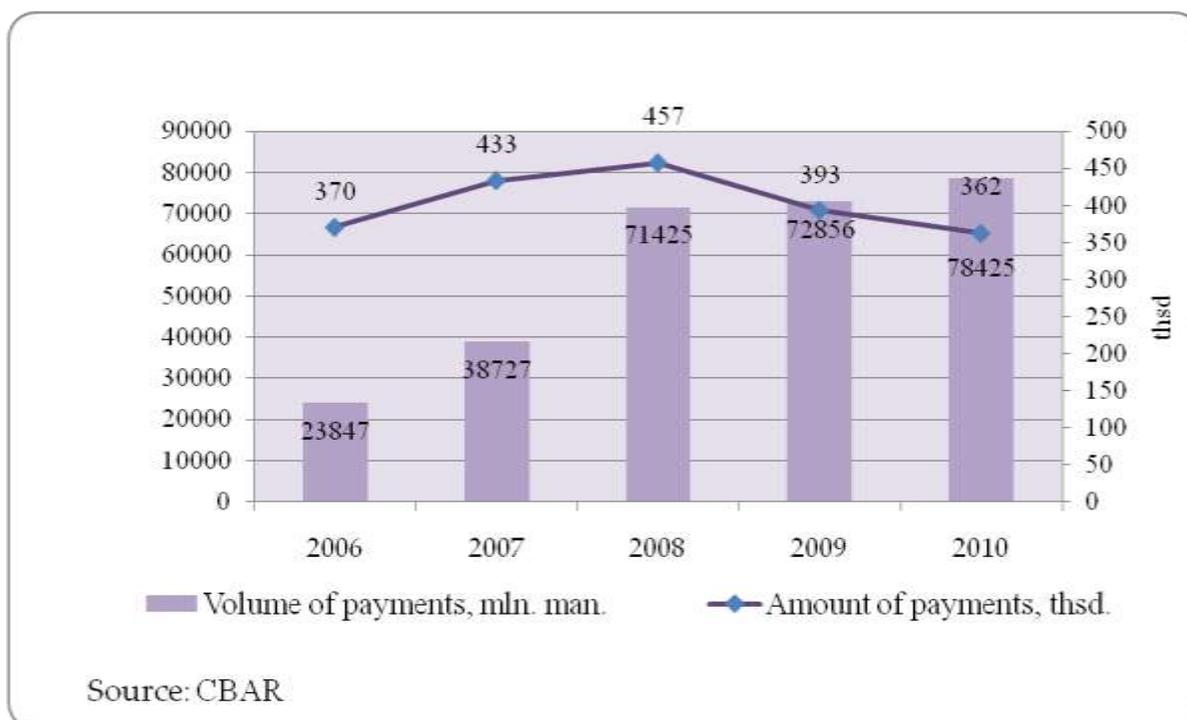


In comparison with 2009 the number of payment transactions increased by 52 percent (3,5 mln. pcs), total volume – by 8 percent (AZN 6,5 bln) (Chart 3.1.). Average daily 38,4 thousand pieces of payments amounting to AZN 321,3 mln. were conducted in 2010 (in the previous year on average respectively 25,4 thousand pieces and AZN 296,6 mln).

Interbank National Settlements System – AZIPS – takes a significant role in the national payment system and is assigned to provide large volume and priority

payments in the financial sector. 92 percent of non-cash payments in 2010 was provided through this system. 362 thousand pieces of payment orders were processed in the AZIPS system in total amounting to AZN 78,4 bln it exceeds the volume of 2009 by 7,6 percent (AZN 5,6 bln), whereas from the quantity standpoint it is less than 7,9 percent (AZN 31 thousand pieces). Average amount per payment order was AZN 216,6 thousand.

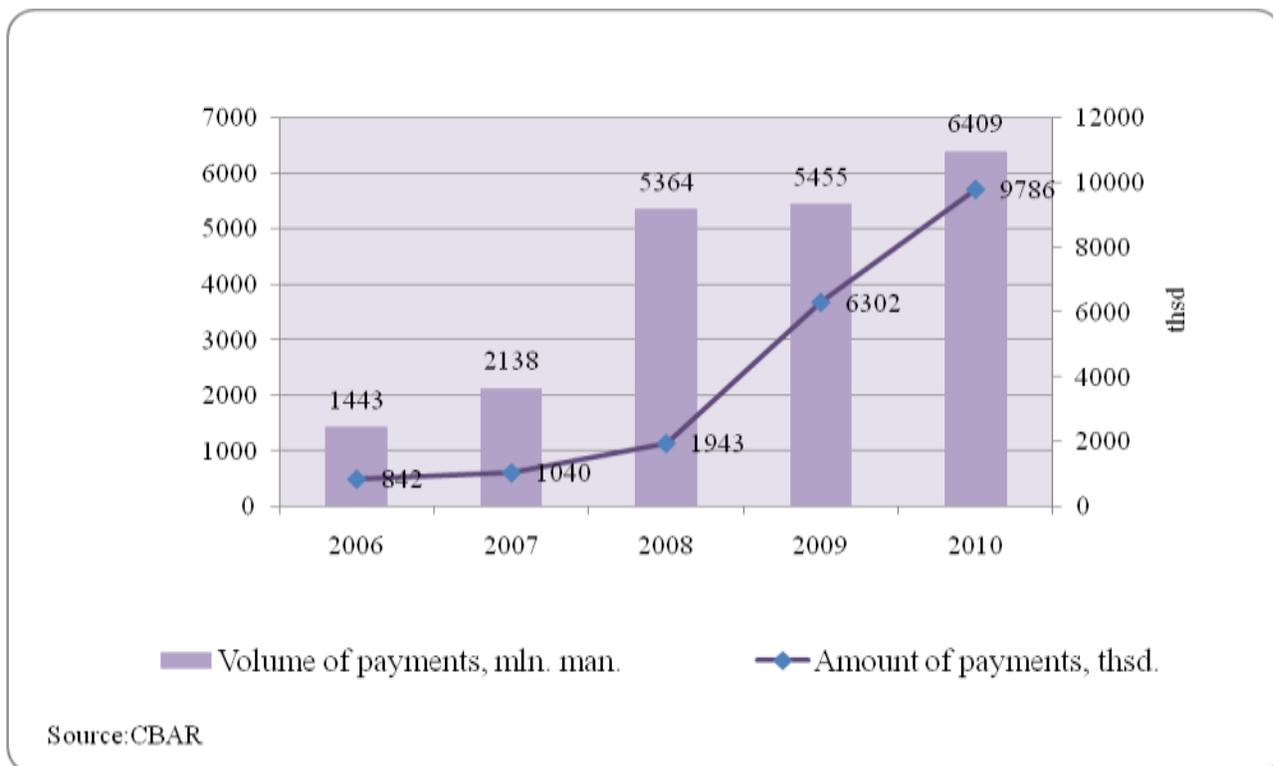
**Chart 3.2. Dynamics of payments by AZIPS**



In Retail Payment System (BCSS) vast majority of all non-cash payments - 96,4% from the number standpoint, and 7,6% from volume standpoint (amount – AZN 6,4 bln, 9,8 mln. pieces of orders) were processed as small volume non-cash settlements which displays assignment of the system to provide retail small payments. In comparison with 2009, in 2010 the volume of payments is 17,5

percent more, and the number exceeds by 55,3 percent. Average amount per payment document was AZN 655.

**Chart 3.3. Dynamics of payments by BCSS**



Economic growth and mitigation of effects of the financial crisis in 2010 positively affected development of payment systems. In total 44,7 mln pcs of transactions were conducted through ATMs and POS-terminals in 2010 amounting to AZN 5,7 bln.

The number of ATMs installed in bank branches, in retail trade and service entities throughout the country has increased by 12 percent (198 pieces) against the previous year and constituted 1892 pieces, of which 1053 are installed in the city of Baku and 839 pieces in regions. On average 310 ATMs serve every 1 million of mature population.

**Table 3.1. ATMs and POS terminals**

<b>il</b>	<b>The number of ATMs, pcs</b>			<b>The number of POS-terminals, pcs</b>		
	Total	including		Total	including	
		in Baku	in regions		in Baku	in regions
<b>2006</b>	1080	655	425	2070	1719	351
<b>2007</b>	1317	820	497	5309	4871	438
<b>2008</b>	1515	867	648	8124	7397	727
<b>2009</b>	1694	959	735	8657	7871	786
<b>2010</b>	1892	1053	839	7872	7069	803

In 2010 the number of bank cards increased by 257 thousand pieces and made 4,23 mln. pieces and on average 694 payment cards fall into the share of every thousand persons.

29,98 thousand transactions were conducted through Internet banking amounting to AZN 75,47 mln.