

2010

Review of Financial Stability

Ist quarter, 2010

Central Bank of the Republic of Azerbaijan



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Introduction

In the 1st quarter of the current year banking system of Azerbaijan operated under the conditions of relative improvement of the foreign economic environment and continuation of the economic growth in the country.

The main indicators of the banking system, including deposit base and loan portfolio demonstrated the dynamics of positive growth. Trust of the population in the banking system was maintained.

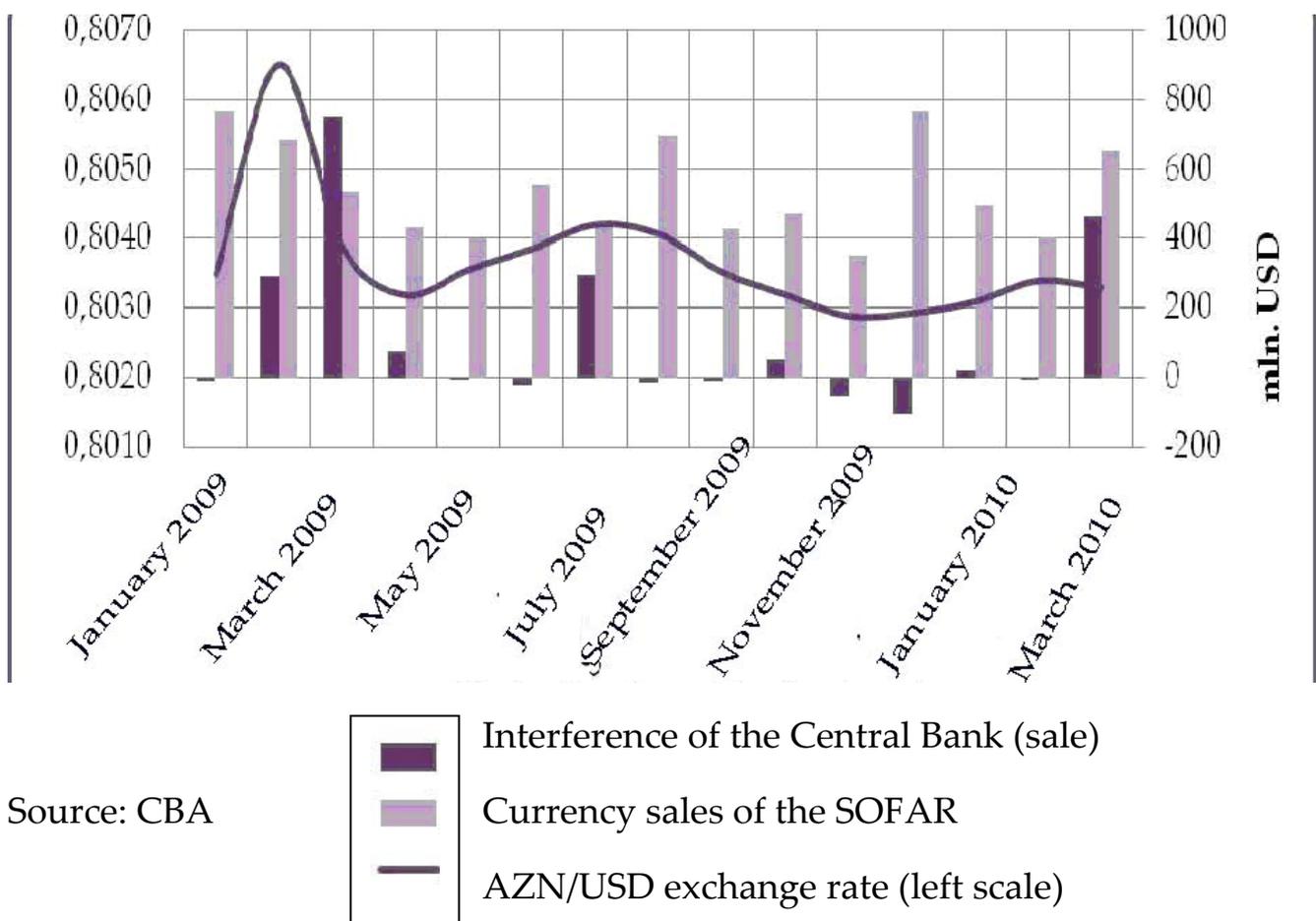
Banking system has sufficient liquidity resources and capital buffer.

Given the results of the global crisis in the next period, increasing of the sustainability of the banking system, measures aimed at the reduction of its sensitivity to the change of economic cycle and external environment became one of the priority tasks.

Financial markets

1.1. Foreign exchange market

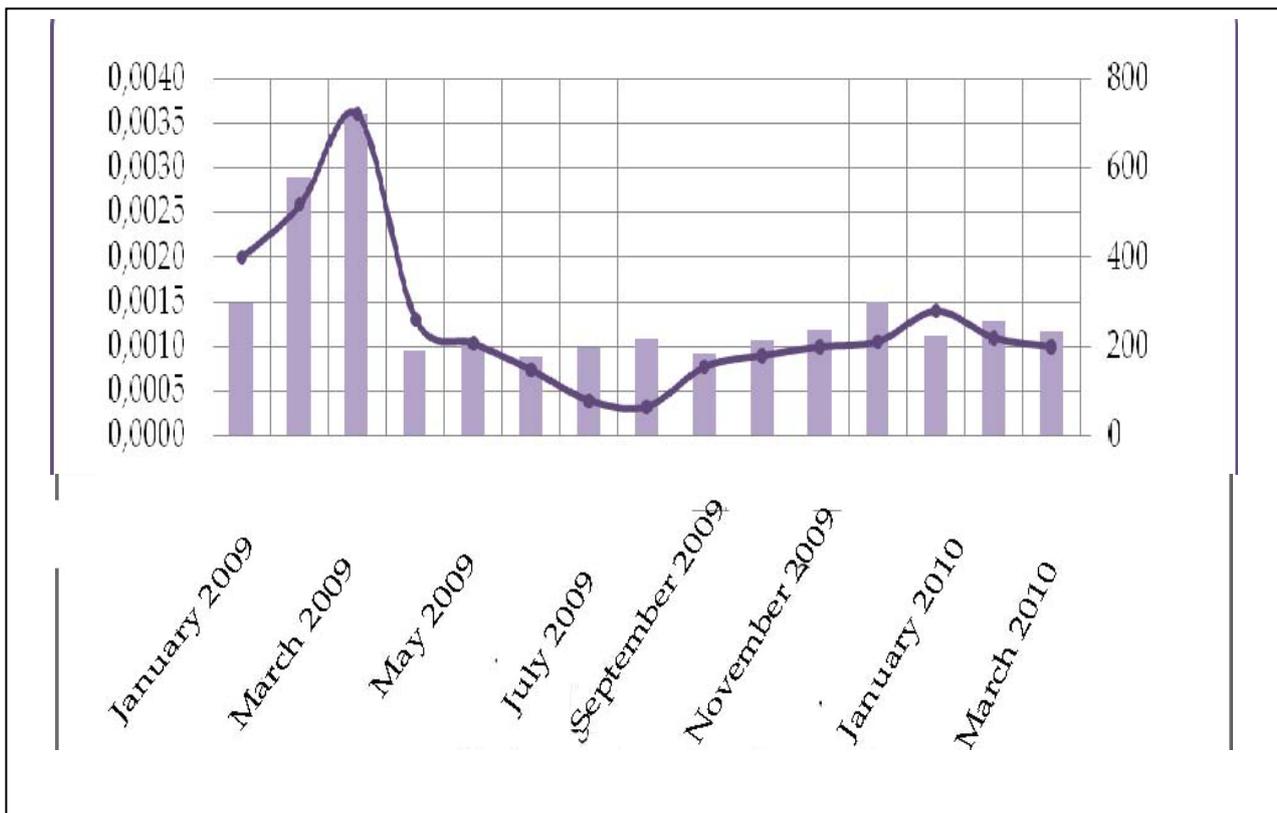
Anti-crisis policy carried out last year by the central bank had stabilizing influence on the exchange market. Gradual elimination of the crisis and increase of the trust in manat as a stable currency reduced pressure on the exchange market. As a result, the interference of the Central Bank was USD 476.5 mln, that is 2.2 times less than in the analogic period of the previous year. As an adequate regulation of the supply and demand in the exchange market official exchange rate of manat against USD within the reporting period fell totally for 0,03%/ (Schedule 1.1).

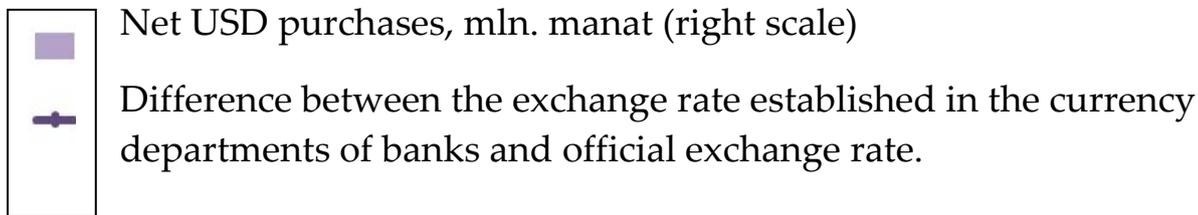


Source: CBA

Trust in manat continues to grow:

- volume of cash USD taken by natural and legal persons from banks has fallen from 1601,1 mln. manats to 720,2 mln. manats;
- difference between the free and official exchange rates has reduced for 3.6 times (Schedule 1.2);
- special weight of the foreign currency in the currency structure of the total credits has experienced 3,6% decrease in comparison with the last year and has fallen to 40,6% in the I quarter of the current year.
- special weight of the foreign currency in the total deposits has reduced for 1% and made 60,6%.





In general, in comparison with the I quarter of 2009 in the respective period of 2010 general volume of the domestic money market decreased 21,1% (or 1431 mln. manats) and fell to 5349 mln. manats.

Volume of interbank money market reduced 15,1% and the volume of interbank exchange operations 24,3%.

1.2. Stock market

1.2.1. State equity market

Attractiveness of SSTL market for investors has been maintained. Thus, in the course of the quarter 10 issues of SSTL were placed by means of auctions. Total volume of orders submitted by investors to auctions constituted 65,5% of the announced emission volume of placed issues. But as a result of the market strategy of the issuer 60% of the orders were provided. Therefore, total volume of the placed SSTL was 37,2 mln or 39,2% of the issue.

As in the previous year, for the regulation of the money market the Central Bank continued the issuance of 4 week notes in 2010. In the I quarter of 2009, despite the fact that total placed volume of notes was 135 mln., in the I quarter of 2010 the amount decreased 66% and fell to 45 mln. manats. Volume of notes in circulation reduced by 10 and constituted 20 mln. manats.

1.2.2. Corporate equity market

In the I quarter of the current year there was observed a certain activity in the corporate loan market. Thus, unlike the respective period of the last year, in the I quarter of 2010, loans in the amount of 19 mln. manats were placed in the loan market. However, the activity in the share market abated, volume of shares placed during the quarter constituted 23 mln. manats at par that constitutes 30% of the respective indicator of the last year.

2. Banking system and risks

2.1. Dynamics of the banking system

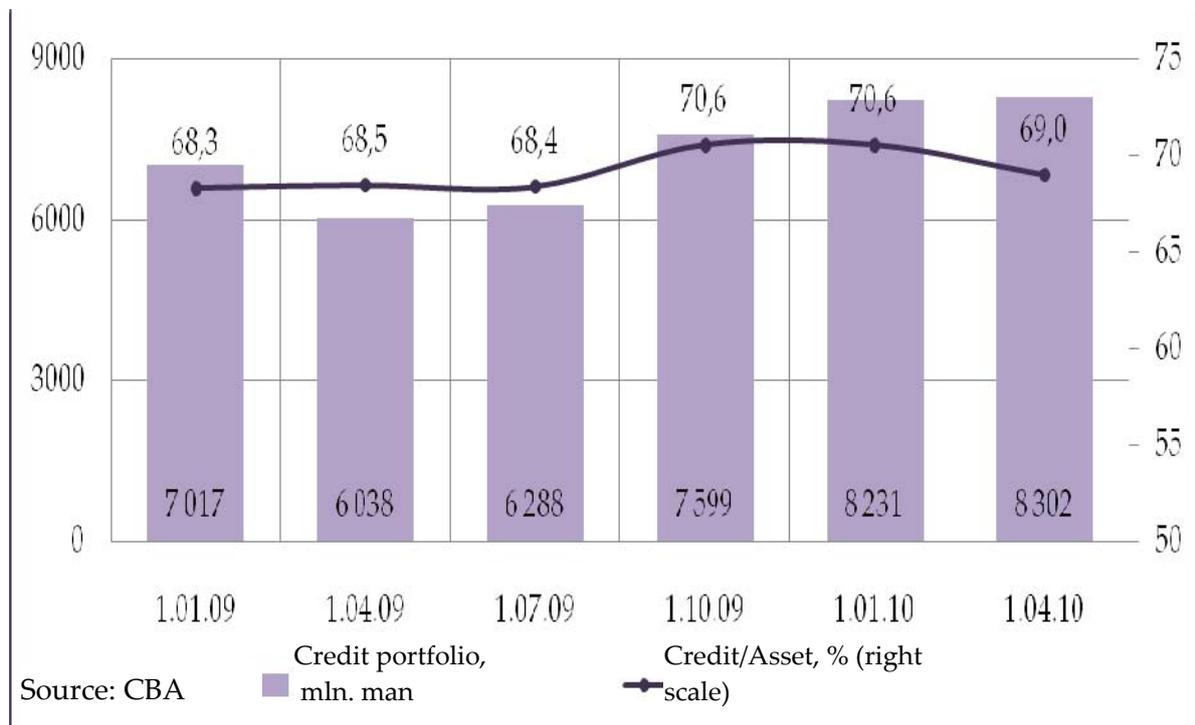
Maintenance of macroeconomic stability and carrying out of a monetary policy forms ground for the maintenance of the growth dynamics of the banking system. As in the previous periods, policy of the Central Bank was aimed at the maintenance of the stability of the banking system and implementation of preventive measures against negative trends.

In the I quarter of 2010 assets of the banking system increased 365 mln. _manats or 3,1% and constituted 12 bln. mantas at the of the quarter. Main indicators of the banking system displayed growth dynamics both on yearly and quarterly basis. (Schedule 2.1).



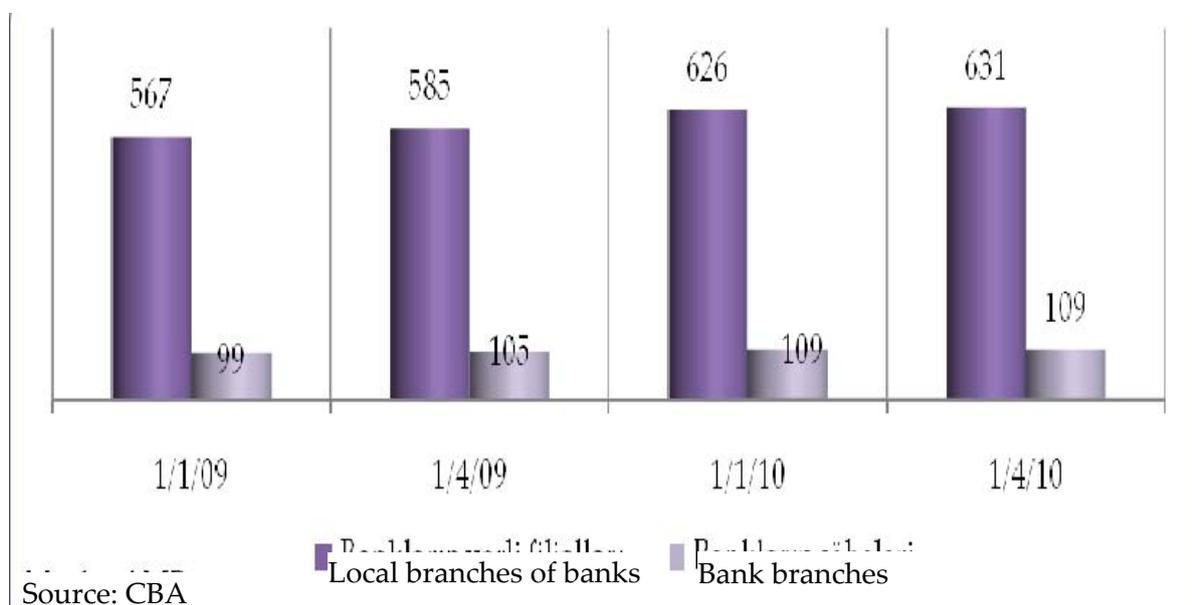
In comparison with the last year bank credits increased for 2,3 bln manats or 37,5% and constituted 8302 mln. manats. From the beginning of the year the

growth constituted 71 mln. manats or 1%. As a result, special weight of credits in the assets of the banking system decreased insignificantly and constituted 69% (Schedule 2.2).



Despite the fact of insignificant decrease in credits issued to legal persons during the quarter (0,8%), annual growth constituted 52,6%. As a result, the volume of this kind of credits reached 5,7 bln manats. Volume of credits issued to domestic economy increased 3,1% (6,5%in comparison with the last year) and constituted 2,2 bln. manats.

Institutional development of the banking system continued. At the end of March, bank “BTB” OJSC was issued a license for the implementation of banking activity. As a result, number of the operating banks reached 47. During the quarter 6 branches of banks were opened and as the result the number of bank branches reached 631. From April 1 the number of bank branches has increased from 105 to 109 (Schedule 2.3).



Along with the expansion of the bank network activity scope of the other agencies has also expanded. Thus, for the improvement of access of the population, especially of region residents, “AZERPOCHT” Limited Liability Company national operator of postal communication was issued a license for the implementation of a restricted number of bank transactions.

2.2. Financial stability of the banking system

2.2.1. Capitalization of the banking system

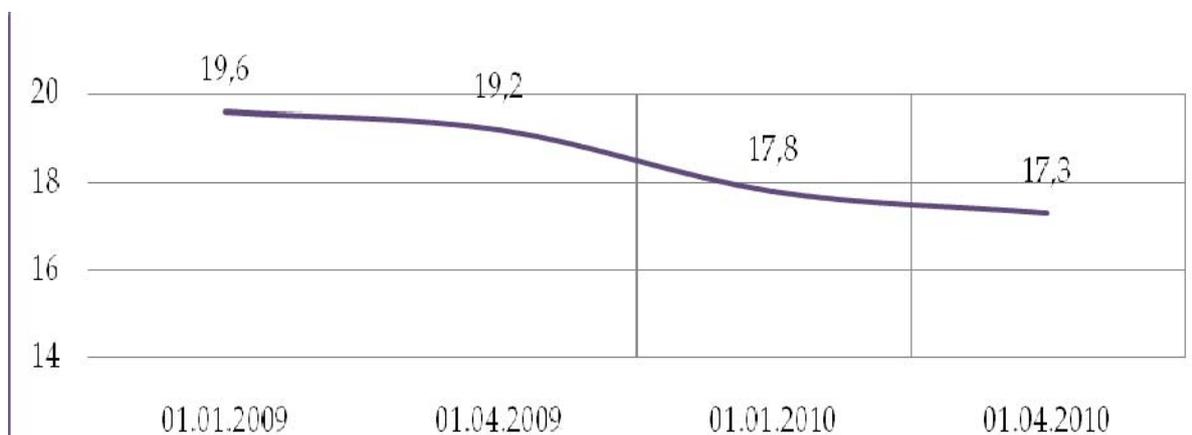
As in the previous years, indicators of the capital adequacy of the banking system was at the admissible level.

Despite the fact of decrease in the volume of the aggregate capital of the banking system of Azerbaijan, yearly volume increased 13% (200,4 mln. manats) and reached 1758 mln. manats. Funds of the shareholders served as a main source of the capital stability. Thus, authorized capital of banks increased 4,6% (54 mln. manats) in comparison with the beginning of the year and constituted 68,2% of the aggregate capital (Table 2.1).

Table 2.1. Structure and dynamics of the aggregate capital of the banking system

<i>mln.man.</i>	1/4/2009	1/1/2010	1/4/2010
I degree capital	1271,3	1 285,5	1500,7
Authorized capital	997,0	1144,6	1198,2
Funds additional to the share issue	32,3	20,7	20,7
Retained net profit	257,1	138,8	302,8
II degree capital	334,3	530,9	316,9
Profits of the current year	87,1	269,6	57,4
General reserves	100,7	122,8	125,6
Other funds of the capital	146,5	138,6	133,9
Charges from the aggregate capital	47,4	57,0	59,0
Aggregate capital after the charges	1557,6	1 758,9	1758,0
Source: CBA			

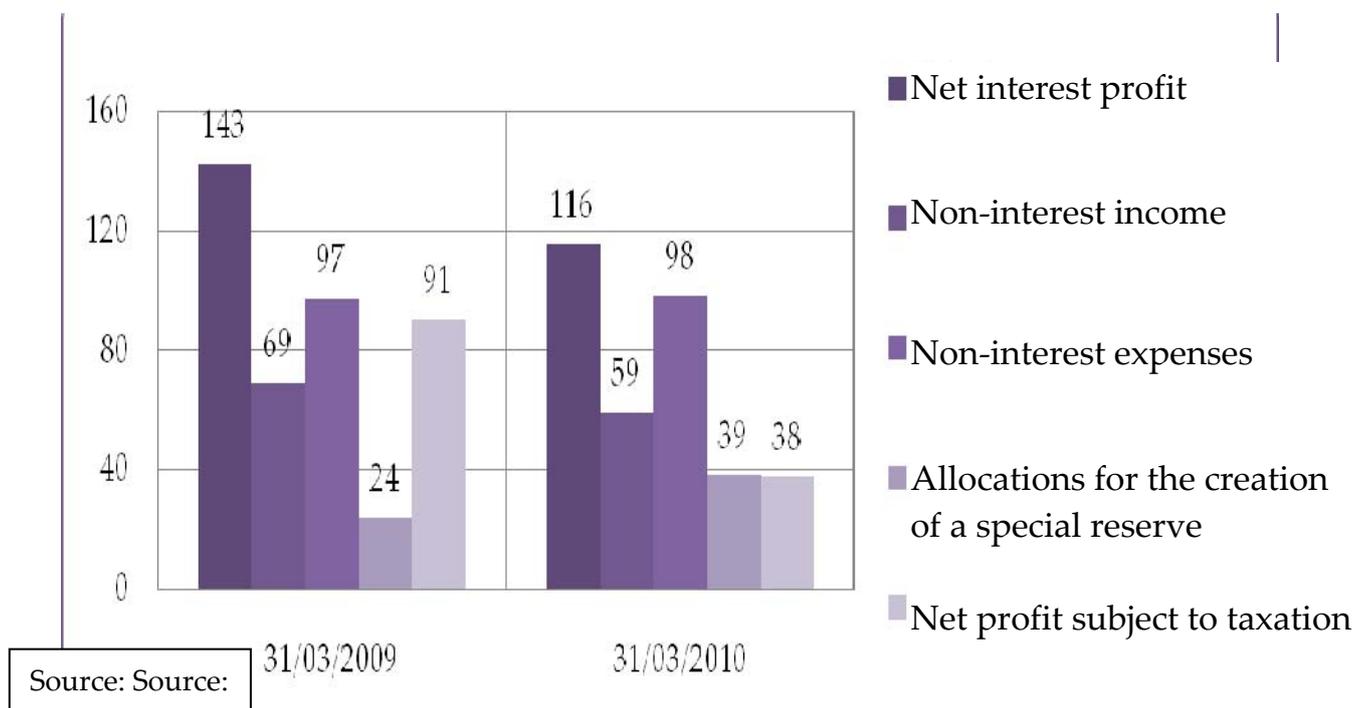
Aggregate capital adequacy of the banking system remained at a high level (17,3%) and considerably exceeded (12%) the minimum norm established by the Central Bank. At the same time, the adequacy of I degree capital constituted 14,8% and exceeded the norm more than 2 times. Thus, actual level of capital adequacy according to the system shows availability of a significant capital buffer at banks (Schedule 2.4).



Source: CBA

2.2.2. Financial results of the activity of the banking system

In the I quarter of 2010, profit realized by banks (before-tax) was 38,2 mln. manats that is 52 mln. manat less than in comparison with the respective period of the last year. Consequently, after-tax net profit decreased 52% and constituted 38 mln. manats. (Schedule 2.5).



As a result of credit interests fall trend in the banking system interest profits of banks decreased 4% in comparison with the respective period of the last year and constituted 248,6 mln. manats by the end of the quarter. Non-

interests incomes decreased 14% and constituted 59,5 mln. manats.

Interest expenses increased 13,7% in comparison with the I quarter of the last year and constituted 132,5 mln. manats at the end of the quarter. Increase of interest expenses, change in the structure of resources is connected with the increase of share of higher-value internal resources (especially, deposits of natural persons). It should be also noted that despite the increase in the interests expenses, their ratio to average assets fell from 4,8% to 4,5%.

By adjusting to a new activity environment, banks optimized administration costs. Thus, in comparison with the I quarter of the last year, however, there was not a decrease in the volume of non-interest expenses, their special weight in the average assets of the banking system fell from 4,0% to 3,4%.

In the I quarter of 2010 the volume of net income from the foreign currency transactions of banks decreased 31% in comparison with the respective period of the last year and constituted 20,6 mln. manat. At the same time, special weight of income from such transactions in general incomes decreased and constituted 6.7%.

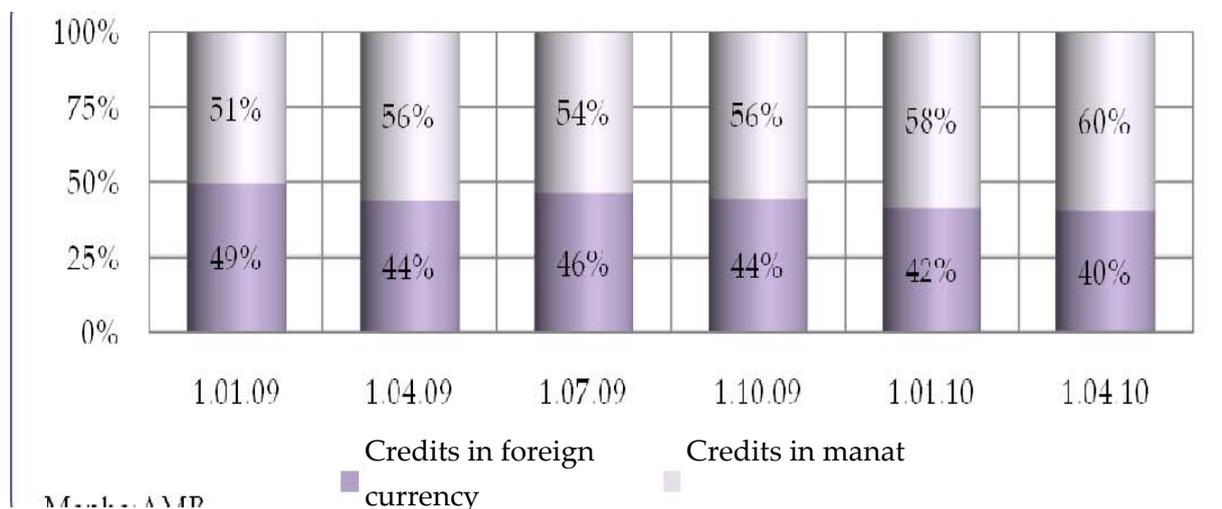
For the purpose of payment of possible loss in the assets, ratio of allocations for the creation of resources to average assets did not changed in comparison with the last year and remained at 1.3% level.

Profitability of bank assets in the 1 quarter of 2010 was 1,3% (3,3% - in the respective period of 2009), and profitability of the capital constituted 9,7% (23,7% in the respective period of 2009).

2.3. Credit portfolio

Under the conditions of first activity trends in the world economy and continuation of the re-assessment process of domestic and foreign risks by banks no significant changes took place in the dynamics of credit activity.

During the first quarter of 2010, credits increased 1% and constituted 8302 mln.manats. Maintenance of the exchange rate stability led to 3,1% increase of credits in national currency and made it the main source of the increase in total credit portfolio. As a result, potential dollarization in the credit structure was prevented, special weight of credits in national currency increased from 58,5% to 59,8% (Schedule 2.6).



Special weight of long-term credits in the structure of credit investments increased 1,2% and constituted 74% at the end of the quarter (6141,9 mln. manat). Along with currency and term structure of credits, a number of changes took place in the aerial structure. (Table 2.2).

In general, areal concentration of the portfolio has not increased. The highest growth in the credits (in comparison with the corresponding period of the previous year) was observed in the spheres of energetics, non-oil industry and production, trade and service.

Table 2.1. Structure of the credit portfolio by spheres

	01.04.2009		01.04.2010		growth	
	<i>mln. man.</i>	<i>share, %</i>	<i>mln. man.</i>	<i>share, %</i>	<i>mln. man.</i>	<i>%</i>
Trade and service	1268,2	21,0	1842,3	22,2	574,1	45,3
Domestic economies	2101,8	34,8	2238,5	27,0	136,7	6,5
- <i>Credits to operations carried out by means of plastic cars</i>	95,2	1,6	124,0	1,5	28,8	30,3
Energetics, chemistry and natural resources	335,0	5,5	1508,2	18,2	1173,2	350,2
Agriculture and processing	343,5	5,7	381,5	4,6	38,0	11,1
Construction and property	626,6	10,4	562,3	6,8	-64,3	10,3
Industry and production	466,1	7,7	596,9	7,2	130,8	28,0
Transport and communication	416,6	6,9	438,8	5,3	22,2	5,3

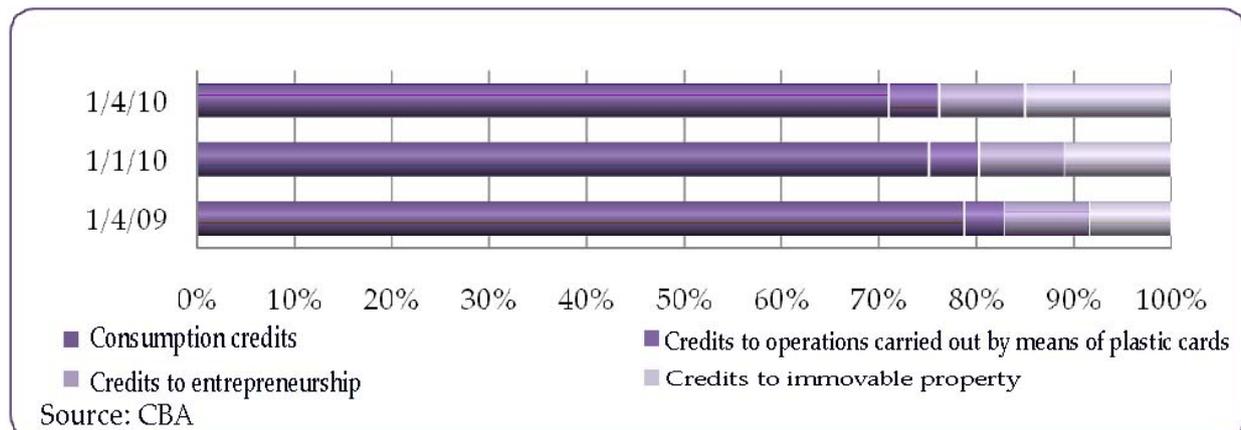
Source : CBA

Crediting of the population remains an important part of the banking services. Thus, reassessment of credit risks and diversification tends of the portfolio had influence of the credits allocated for natural persons. Special

weight of credits allocated for natural persons in the total of credits increased by 0,6% within a quarter and constituted 27%.

At the end of the 1st quarter of 2010, special weights of credits allocated to entrepreneurship and consumption in the total credit portfolio allocated to domestic economy constituted 9% and 71%, respectively. 15% of the credit portfolio fell to the share of the credits for the immovable property. According to the outcomes of the quarter residual debt on the credit cards remained at 5% level of the retail credit portfolio and 1,5% level of the general total bank credits (Chart 2.7).

Chart 2.7. Purpose structure of the credits allocated for natural persons

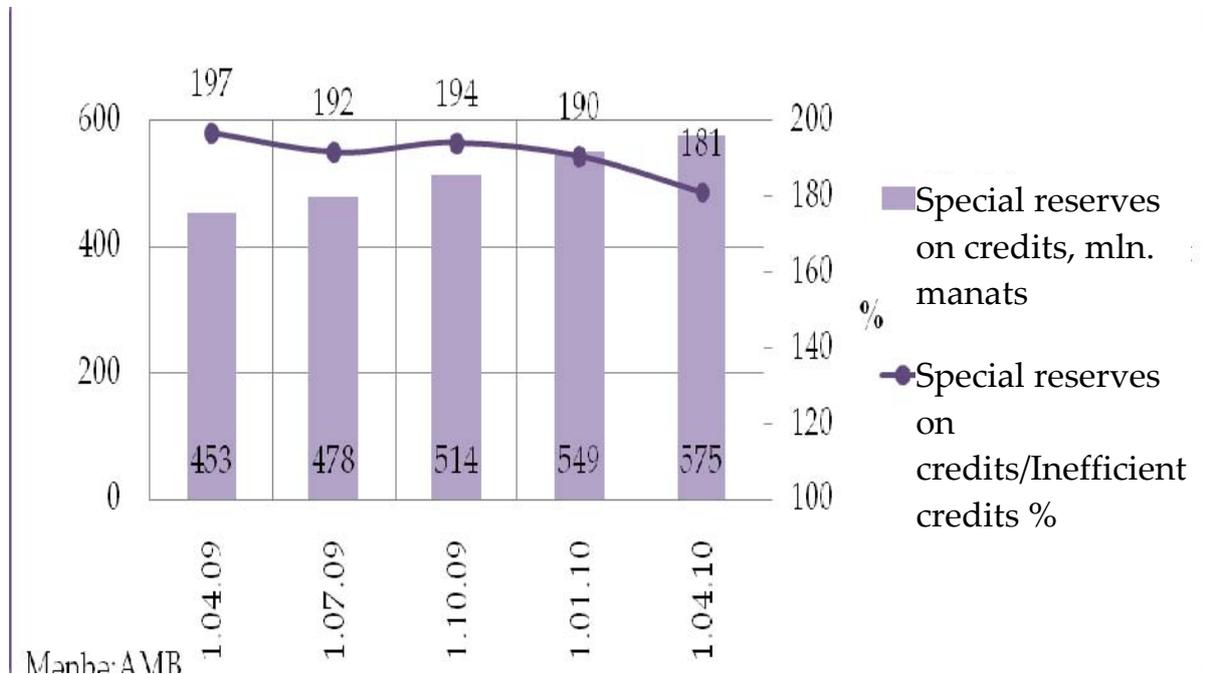


The volume of credit allocated to all kinds of debtors for construction or purchase of immovable property increased for 63 mln. manats or 7%. The quality of the credit portfolio remained at the admissible level. Therefore, at the beginning of the current year constituted 6% and at the end of the quarter 6,6% of the credit portfolio. The share of the inactive credits in the portfolio increased for 0.3% and constituted 3,8%.

Reserves created for credits by April 1, 2010 constituted 7% of the

portfolio, that is 0,3% higher than the level at the beginning of the year. It should be noted, that a large part of reserves created by banks was formed till 2008.

Reserves created by banks exceeded inefficient credits 2 times, and bad credits – 4,4 times (Schedule 2.8).



2.4. Financial resources and liquidity risk

Although, the share of foreign funding and interbank operations in the establishment of resource base increased in the I quarter of the current year, deposits remained in the role of main resource.

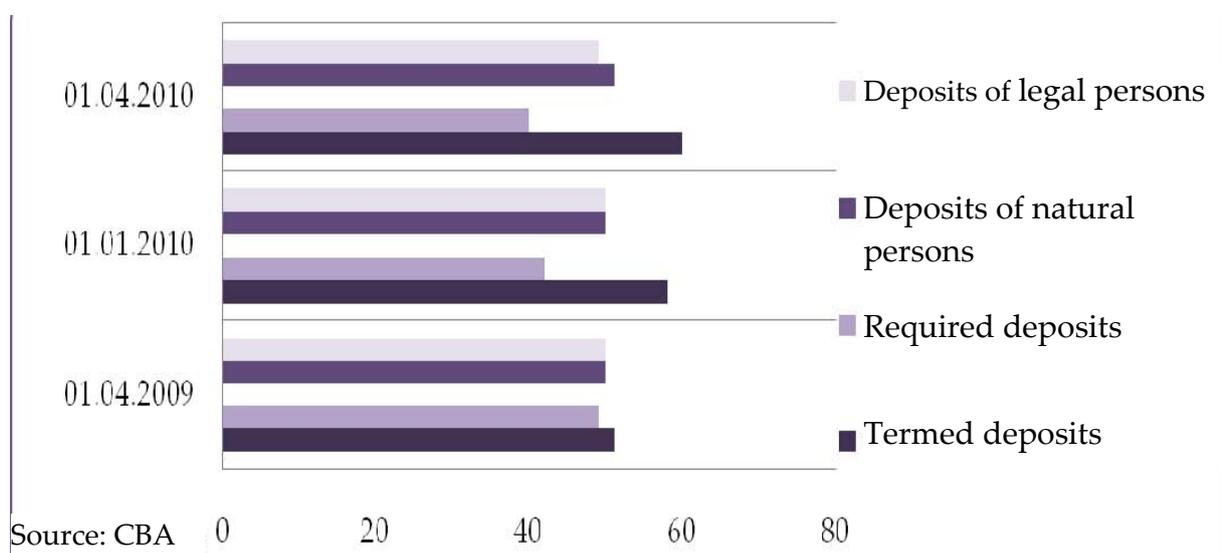
In comparison with the beginning of the year, general deposit base increased 29 mln manats and constituted 4683,4 mln. Share of deposits in the structure of total obligations was 47%.

In the first 2 months of the quarter, there was observed volatility in the dynamics of the legal persons' deposits. Its volume decreased 1,3% during a quarter and constituted 2288,4 mln. manats. On the yearly basis, deposits

increased 28,5% and constituted 22,8% of general bank obligations.

In the reporting period, deposits of the population reached 2395 mln. manats with 2,6% increase, and constituted 23,9% in the share of bank obligations. In comparison with the last year, growth rate reached 35%.

Improvement of the term structure of deposits, displayed the growing confidence in the banking system. Thus, although a special weight of the termed deposits in the total deposits was 51% in the I quarter of 2009, in the reporting period it changed between 60-63% (Schedule 2.9).



Along with this, there was observed growth dynamics in the collections of the population. Thus, volume of termed deposits increased 7% during the quarter and reached 1941,6 mln. manats. The share of this kind of deposits in the total deposits changed 78-81% during a quarter.

Along with the term structure of the deposit basis, its duration also improved. Thus, deposits with more than 1 year term constituted 33,4% of total deposits (32,3% at the beginning of the year).

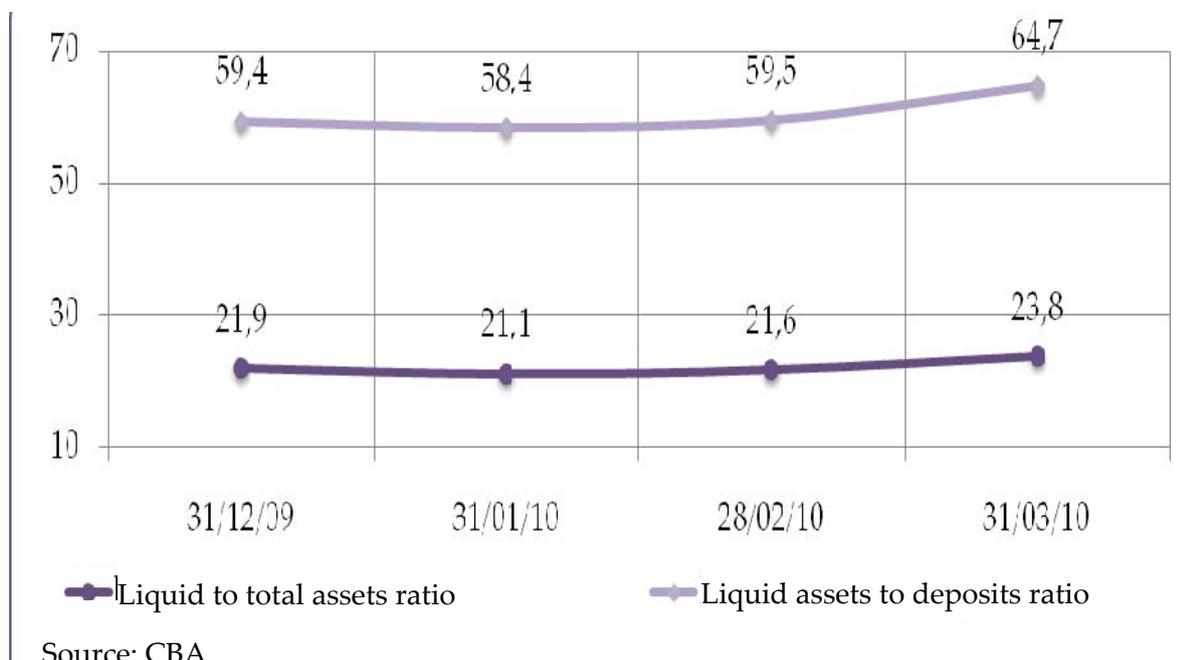
Volume of interbank obligations increased 322,5 mln. manats (18,9%)

during a quarter and constituted 2 bln. manats (1/5) by 01.04.2010.

During the I quarter of 2010 net growth of obligations drawn from non-residents was 170 mln. manats (or 9,8%). At the end of the quarter volume of funds drawn from non-resident financial agencies was 1,9 bln.manats and their share in total obligations constituted 19%.

Restoration of resources of the banking system reduced the need for the funds of the Central Bank. As a result, the share of resources drawn from the Central Bank decreased from 15,2% to 14,4% during the quarter.

Liquid to total assets ration confirms adequate management of the liquidity risk in the banking system. Thus, by the end of the quarter, share of liquid assets in the total assets was 24%, and its ratio to deposits changed between 59-64% during a quarter (Schedule 2.10). Liquid assets available in the banking system enables timely and complete payment of current obligations.



Term analysis of liquidity by assets and obligations (GAP analysis) displayed acceptable level of liquidity (Schedule 2.11).



Thus, during the reporting period, the Central Bank continued restrained and sound growth policy in the banking system. Monitoring and assessment of the rationality of measures aimed at the strengthening of the risk management systems in banks. Subject to the results, it is offered to correct and improve existing and planned measures of banks. In management of liquidity system, the Central Bank encouraged banks to be more conservative in their credit and deposit stance.

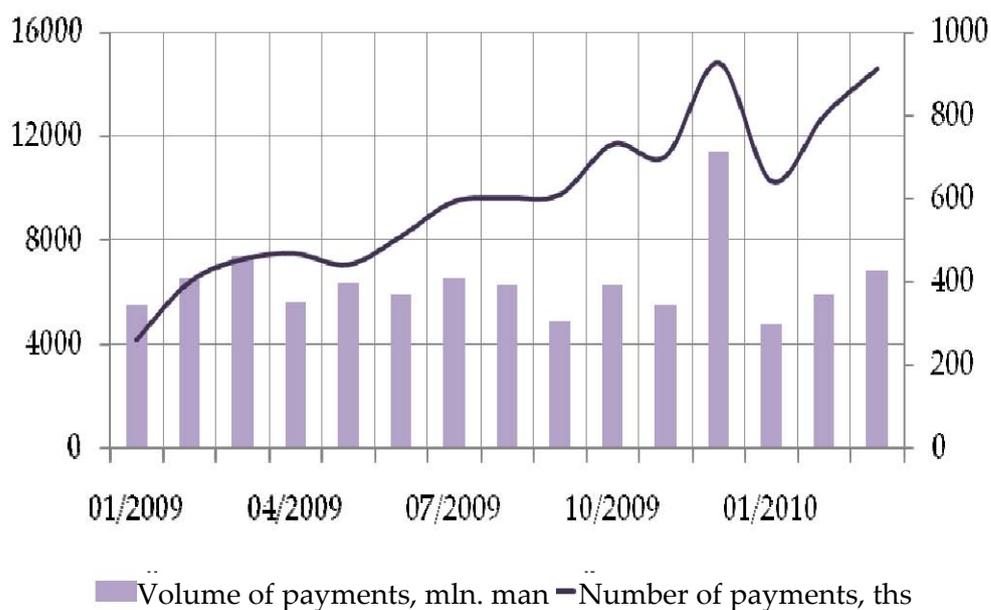
3. Payment systems

During the I quarter of the current year, 2,36 mln. transactions with 17,6 mlrd. manats volume, were carried out in the National Payment System. In comparison with the respective period of the last year, the number of operations increased 113% (1249 thousand operations), but their total volume decreased 10% (1,87 bln. manats).

Interbank National Settlement system – has a significant place in the AZIPS national payment system and its purpose in the financial sphere is to carry out large volume and priority payments. During the I quarter of 2010 93% of payments were carried out by means of this system. During the reporting period, 81 ths payment documents with 16,3 bln manats total volume were processed by AZIPS system that is 11% (1,8 bln manats) and 7% (6 ths documents) less in comparison with the respective period of the last year. The amount of each payment document was in average 201 ths manats.

Settlement Clearing System on Small Payments - SCSSP mainly carries out retail small payments. In the I quarter of the current year, 2278 ths payment documents with 1236 mln manats total volume were processed in the system.

Schedule 3.1. Dynamics of payment operations in the National Payment System



Source: CBA

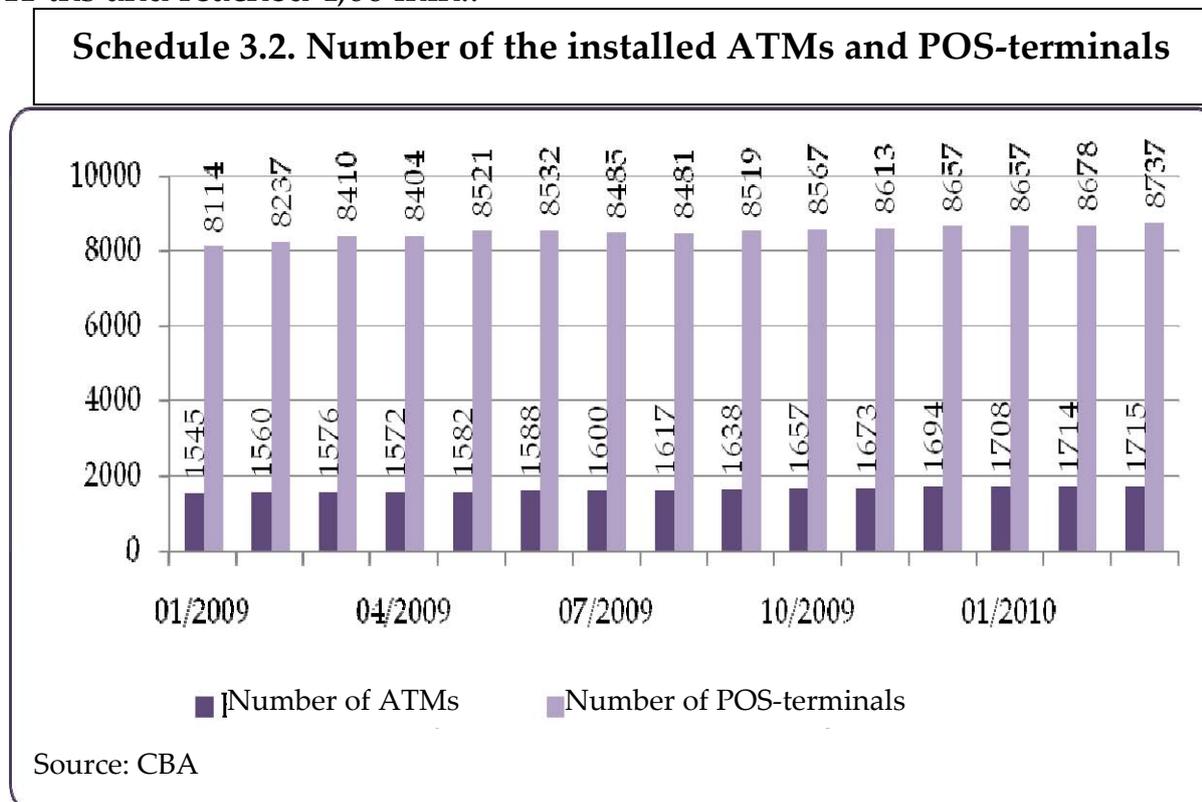
During the reporting period, number of ATM installed in bank branches, retail trade and service outlets of the country increased 9% (139) in comparison with the respective period of the last year and constituted 1715, of them 967 are located in Bank, and 748 in regions.

In the I quarter of the current year, 10,4 mln transactions with 1,2 bln manat total volume were carried out by means of ATMs. In this period, the number of POS-terminals increased 4% (327) and reached 8737. Number of operations carried out by means of POS-terminals was 179 ths, and their volume – 45 mln. manats.

Increase in the number of ATMs and POS terminals in general displays growth of the finance and bank infrastructure and expansion of the geography of payment system. This also shows increase of access to bank services and

deepening of financial mediation.

Growing expansion of the application of modern bank services, payment tools and payment methods confirms the dynamics of operations carried out by cards. Thus, in the I quarter of the current year, the number of cards increased for 41 ths and reached 4,06 mln..



In the I quarter of the current year there was observed more active use of the electronic payment systems. Thus, transfers by means of electronic network and devices constituted 17,96 mln. manats, internet banking - 303,3 ths manats, transfers through mobile phones 55,97 ths manats.

Expansion of operations carries out by means of cashless payment tools is an obvious indicator of the active use of the means of banking system, and strengthening of confidence of the population and corporative sector in the banking system.