THE CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

2012

ANNUAL REPORT

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FOREWORD

In 2012, the economy of Azerbaijan consistently displayed a high level of sustainability and a firm stance unwavered by the onset of complex global economic adversities, as the non-oil sector became a key factor that drove economic growth further up, and the national foreign exchange reserves were steadfast on a upwards path. The non-oil sector's high growth rate was largely attributable to export expansions and investment rollouts, coupled with the government's active spending designated to boost economic development. Continued enhancement of household welfare pushed the poverty rate further down, closing at 6%. Macroeconomic stability played an essential role in securing all of these accomplishments.

Within the scope of its mandate, in 2012 the Central Bank pursued a policy of maintaining a low, single-digit inflation rate, while ensuring a stable exchange rate for the manat, conducive to a sustainable growth pace of the banking and financial industry.

Seeking to realize an adequate monetary and exchange rate policy, the Central Bank worked to achieve its priority monetary policy target of stable prices and a single-digit **inflation rate**. The exchange rate policy balanced the demand and supply on the currency market during the year, whereby it secured a strong footing for a stable rated manat. The low inflation rate, leaning on the stable manat, made a positive contribution to the non-oil industry's international competitiveness with an improving effect on the financial industry's overall performance.

Efforts were continued in 2012 to preserve public confidence in banks, minimize systemic risks and build on governance and management capacities, as well as to achieve a stronger financial stature. By advancing further the risk-based prudential supervision framework aligned with the Basel III standards for bank supervision enabled a **supervisory environment** with an aim to preserving financial stability. A number of critical **consolidation and capitalization** decisions were made for the industry.

The measures above helped the banking system maintain its **financial stability**, and drive the capital adequacy ratio, a major function of the sector's overall sustainability, to a point considerably higher than the required regulatory level. Banks kept their liquidity levels high and asset quality ratios in positive ranges during the year.

The banking system carried on with its regional coverage efforts through a network expansion with a view to improving access to finance in 2012. The regional market penetration included support to non-bank credit institutions, making them more active players on the lending market, so as to provide consumers with better access to alternative sources of funding.

As the nation's mortgage lending program was continued in the reported year, it helped households get fairer housing deals, triggering their economic activity. The practice of drawing on a pool of market resources with a view to enhancing the scope of mortgage lending was carried over from the previous years.

Interbank settlement systems, initiated and directed by the Central Bank, remained stable and reliable components of the National Payment System. The country continued to migrate towards increased non-cash circulation, seeking to catch up with developed economies in the use of payment cards, well in line with its overall goal of targeting broader business and household audiences for a wider spread of electronic payment services.

The national economy's **cash demand** was met in full and on time in 2012. Projects were continued to help harmonize cash management with best practices and standards. As part of the ongoing Regional Central Banking endeavour, a set of functionalities was identified that would back the operations of Regional Centers, with a management structure aligned with uniform standards.

In a low yield rate environment that originated from a magnitude of uncertainties reigning across the globe, the Central Bank defined the security of funds as a key priority of its **foreign exchange reserves** management. Yet, the scale of investment opportunities was magnified by employing specialized instruments and geographic diversification in order to improve management efficiency.

In addition, the Central Bank carried on with elaborate programs and projects designed to improve and modernize all of the functionalities supporting its operations, and build on institutional capacities, as per its 2011-2014 strategic plan. Said programs and projects helped develop the Bank's internal capacities in addition to ensuring that more effective approaches are employed to achieve goals and functions mandated by the law.

Thus, the Central Bank was successful in 2012 as far as achieving the goals and conducting the functions mandated by the law are concerned. The inflation rate remained in a single-digit range, the manat exchange rate stayed stable, money supply climbed up in consistency with the economic growth rate. The banking system preserved its function of a reliable financial intermediary, along with financial sustainability, and overall, the industry kept its advancement pace firm and progressed further up on its development path. Payment systems developed, their coverage expanded, the economy's demand for cash satisfied, foreign exchange reserves managed effectively.

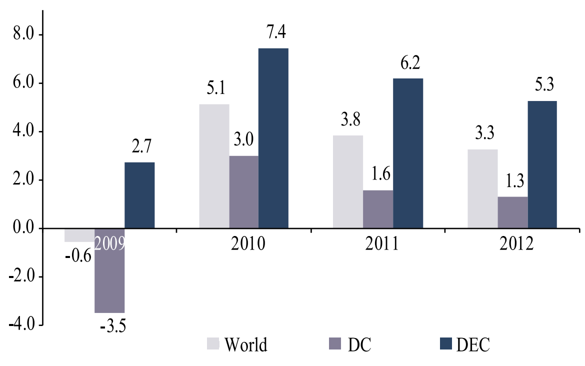
Elman Rustamov
Chairman of the
Central Bank of Azerbaijan

I. GLOBAL ECONOMIC PROCESSES IN 2012

While global economy did continue to develop in 2012, certain vulnerabilities and exposures in the global financial system and fiscal instability risks still existed. Emerging economies showed steady growth rates as opposed to the diminishing economic activity in developed countries.

The year 2012 was characterized with faster-paced **re-balancing** processes. Countries using a savings economic model experienced a decline in the aggregate surplus of the external sector, dropping down to as little as 1.7% of the worldwide GDP (against 3.1% in 2006). A gradual transformation of the savings model into a consumption model played a key role in the East Asian region. The surplus of China's **current account balance** (CAB) spiralled down from 10% to 2.6% of the GDP over the last 5 years.

Chart 1. Global economic growth, %

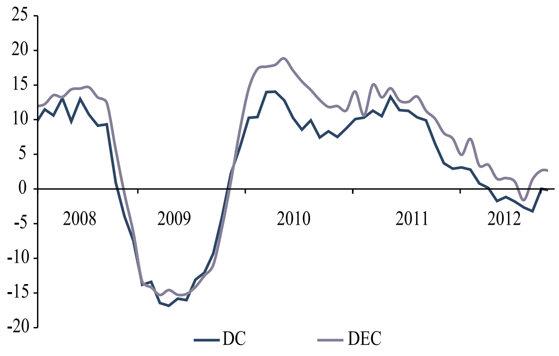


Source: IMF

Although the **world trade** eased out of the negative quarters later in the year in terms of growth rate, it was still lower than in the previous periods.

Eurozone's continued recession had an adverse effect on the region's imports. A number of countries, including Germany, India, Brazil, France, Japan started to substitute external demand channels of economic growth for domestic demand. On the other hand, the tendency to protect domestic markets grew stronger. Thus, the number of the WTO's disputed issues reached its highest in the past ten years in 2012.

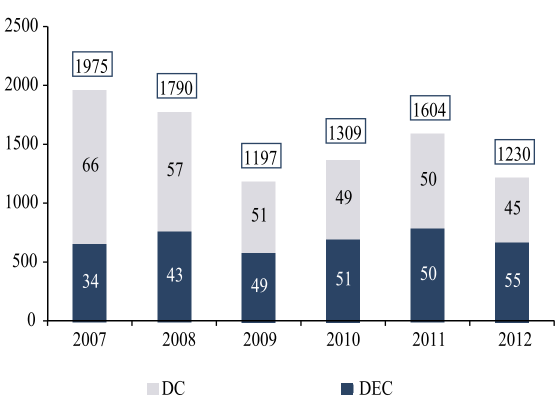
Chart 2. Global exports, against previous years, %



Source: WTO

Macroeconomic vulnerabilities and uncertainties resulted in an 18% decline of **direct foreign investment** (DFI) flows compared to previous years. The structure of DFI flows also changed considerably. A substantive decline of investments in USA and Eurozone reduced the share of developed countries (DC's) in total investments. The gap between developed and developing countries was at its highest (Chart 3). On the other hand, the restructuring of pre-crisis investments with an efficiency downgrade was still underway, while new investments shifted more in the direction of start-up business and "green economy" facilitation.

Chart 3. World in direct foreign investments, in USD billion



Source: UNCTAD

In 2012, the number of the **unemployed** went up by 4 million people, thus reaching 198 million (International Labor Organization). This rise was driven primarily by the insufficient economic growth rate and inadequate laborforce qualification levels failing to meet business requirements. In addition, a number of countries initiated greater tax benefits for return on equity, which descouraged investors from increasing their staff numbers. Many developed countries witnessed labor productivity and real salaries drifting further apart, resulting in unequal distribution of benefits. Presently about 800 million people of the world's total employed of 3 billion, earn as little as one dollar a day.

The downward trends of global economic growth had a strong squeezing effect on the **inflationary pressures**. The consumer price index decreased to 2% in DC's, and to 6.1% in developing countries (DEC's).

Even though the US real estate market was somewhat stable, a magnitude of social issues remained unaddressed. For example, employment rates and income per capita were not reinstated to their pre-crisis level. While there was some economic revitalization in early 2012, the year-end was marked with a slowdown, winding up with a negative economic growth rate in the fourth quarter. The Federal Reserves System declared that it would continue its stimulating efforts until the unemployment rate declines to 6.5% and the inflation rate rises to 2.5%. Despite that decision, the economic growth rate is expected to dwindle some more in 2013.

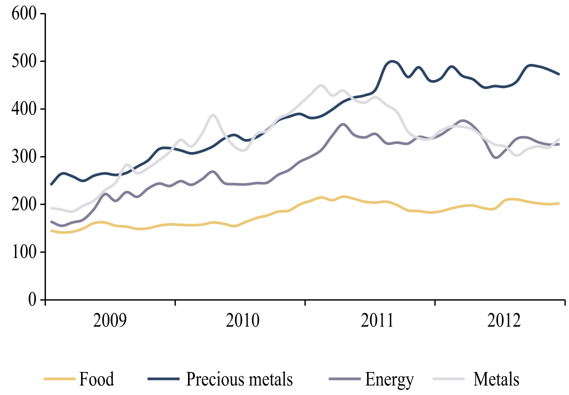
The Japanese economy was in a recession in the second half of the year. Although it is expected to make its way out of the dire circumstances in 2013, there is nevertheless strong anticipation of a weak economy up until 2014. The government is preparing to launch stimulating measures at the rate of 2% of the GDP.

In **Eurozone**, the malignancy of the debt crisis, worsened even more by the weakening external demand and rising oil prices dragged the region into a recession.

DEC's showed a somewhat slower economic growth rate, stooping down to 5.1%. China (7.8%) and India (4.9%) were at the decade's lowest in terms of economic growth. A set of stimulating efforts managed to secure economic activity in these countries to a certain extent as external demand diminished.

Lower than expected economic activity had a relatively stabilizing effect on commodity market prices. Food prices rose by 0.7%, precious metal prices went up by 1.7% on average in 2012.

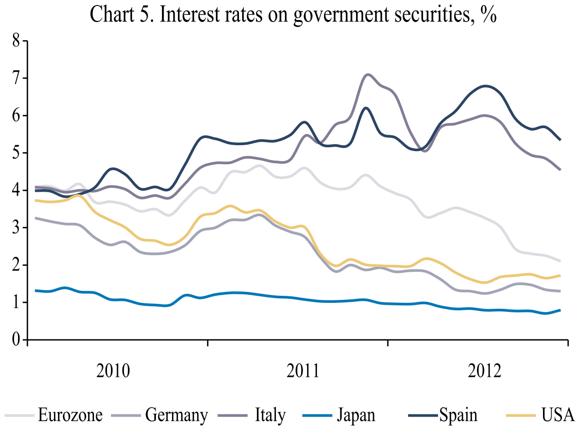
Chart 4. Commodity Price Index, 2009M1=100



Source: WB

The tumultous processes taking place in the Middle East, coupled with the growing energy consumption of some emerging economies and Europe's shift-away from nuclear power have effectively contributed to oil prices staying as high as they were (2012: USD 105). The excessively high oil prices are counted among the chief factors that prevent the global economy from revitalizing.

Chart 5. Interest rates on government securities, %



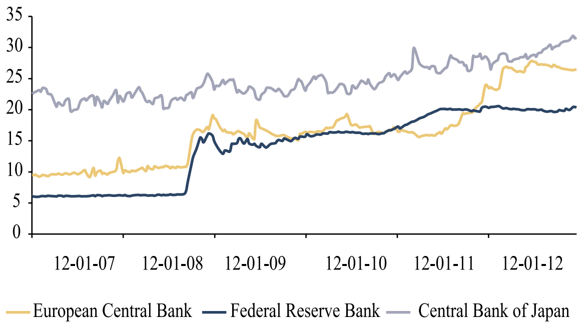
Source: IMF

Following the European Central Bank's purchase-oriented intervention to the securities market, stock markets stabilized and a number of countries had interest rate cuts on their government securities (Greece, Italy, Spain, Portugal, etc.).

Uncertain the global economic growth triggered a more cautious investor behavior, with the demand for gold remaining high in 2012.

Low inflationary pressures enabled some countries to conduct a mitigated monetary policy in support of the economy. 67 countries revised their interest rates in 2012, of which 25 are DC's, with a total of 55 countries reducing the interest rates. Some countries, on the contrary, felt they needed complementary measures because of the low interest rates, and a number of central banks managed to enhance their balance sheets considerably by conducting a series of purchase-oriented securities market interventions.

Chart 6. Ratio of the Central Bank's assets to GDP (2008 GDP)



Source: IMF, central banks

Most countries formulated their monetary policies conducive to meeting short-term economic needs, facing, as a result, an urgent need to take additional measures to ensure a sustainable economic growth rate in the long run.

DC's hit the highest post-World War II sovereign debt levels (110% of GDP). Governments carried on with fiscal consolidation of public revenues and expenditures. OECD countries shifted the tax burden from centralized production to consumption. Expenditures were restructured through public sector salary cuts (Austria, France, Greece, Czech Republic, Estonia, Slovakia, etc.), pension reforms (Hungary, Romania, etc.) and statutory restrictions on public sector employment (Belgium, Greece, Romania, etc.).

IMF's projections expect the year 2013 to witness a somewhat slow economic activity, while 2014 will be characterized with a more vigorous performance. A low global demand may result in food price declines.

Table 1. IMF's projections, %

	2012	2013(p)	2014(p)
	Economic growth rate, as compared to previous year		
World	3.2	3.5 ↓	4.1 ↓
DC	1.3	1.4 ↓	2.2 ↓
USA	2.3	2.0 ↓	3.0 ↑
Eurozone	-0.4	-0.2 ↓	1.0 ↓
DEC	5.1	5.5 ↓	5.9 ↓
China	7.8	8.2 ↓	8.5 ↓
CIS	3.6	3.8 ↓	4.1 ↓
	Exports, as compared to previous year		
DC	2.1	2.8 ↓	4.5 ↓
DEC	3.6	5.5 ↓	6.9 ↓
	CPI, as compared to previous year		
DC	2.0	1.6 ↓	1.8 ↓
DEC	6.1	6.1 ↑	5.5 ↑

Source: IMF

As the US real estate market evened out, with consumer confidence and low-cost domestic energy-consuming production on the rise, economic growth expectations for 2013 and 2014 got stronger. China's decision to inject USD157 billion in infrastructural developments also helped alleviate the probability of a huge economic setback in the country.

Manpower Group's survey of 65 thousand businesses from 42 countries averaged negative hiring outlooks for the first quarter of 2013. For instance, businesses in 29 countries (Greece, Italy, Spain, Slovakia, the Netherlands, etc.) expected to downsize their staff, with only 13 countries (Taiwan, India, Brazil, Mexico, etc.) anticipating the same or even higher laborforce headcounts. Furthermore, the International Labor Organization forecasts an increase of global unemployment in 2013 and 2014, to a point considerably higher than the 2009 rate.

UNCTAD reports indicate that DFI's are on a "lazy" track in the short run, expecting the 2011 level to be restored only in 2014. Pre-crisis levels are expected to come back in the long run only.

Attempts of some DC's to stimulate the economy by printing more money are bound to have an adverse effect on currency markets and cause greater exchange rate volatility.

Overall, different countries worked their way forward with tremendous stimulating efforts to support the economy. And it is hard to make substantiated judgements as to what the possible outcomes would be because there has simply been no similar experience in the past.

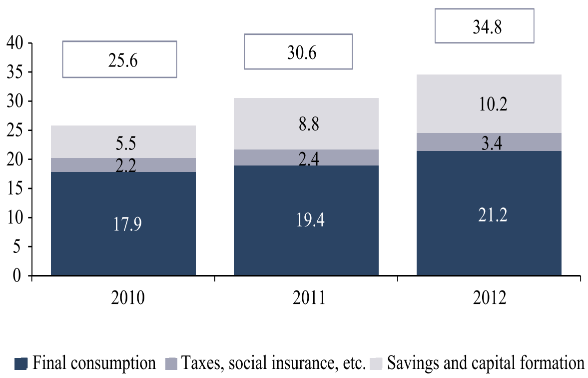
II. ECONOMIC GROWTH IN AZERBAIJAN AND ITS SOURCES

2.1. Aggregate demand

All components of aggregate demand had a positive effect on economic growth in 2012. Increased household income and investments in the economy stemming from growing domestic investments contributed to the vitalization of the GDP's demand components. Increased public expenditures played a special role in enhancing the aggregate demand.

Final consumption expenses represented the chief factor of the economic growth in 2012. In the reported year, nominal cash income per capita amounted to AZN3784.3, which is 12.2% higher than the previous year's level. Approximately 61% of household income was spent on consumption of goods and services. Final consumption expenses rose by 9.3% in nominal terms to AZN21.2 billion or 39.3% of the GDP. Household income spent on savings and capital formation amounted to AZN10.2 million, exceeding the 2011 level by 16%.

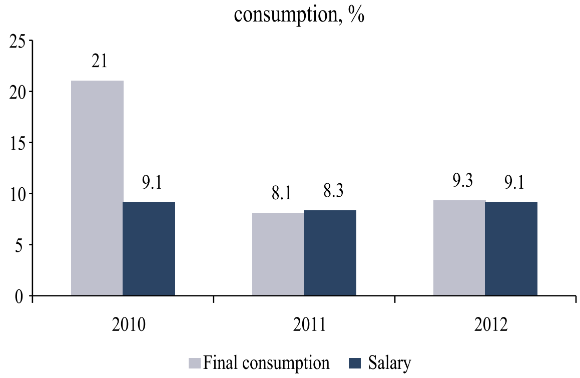
Chart 7. Household income, AZN billion



Source: State Statistics Committee (SSC)

Salaries rose in most sectors of economy in 2012, which also helped maintain a high share of final consumption in GDP. Average monthly salary went up by 20.2% in oil sector, by 8.0% in non-oil sector, 9.8% in public sector and 6.9% in private sector againstr the previous year's levels. Overall, the growth rate of average monthly salary surpassed the inflation rate by 7.6%, reaching AZN396.

Chart 8. Average monthly salary and changes in household final consumption, %

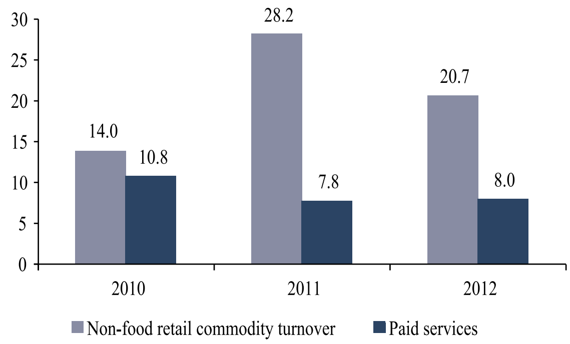


Source: SSC

Loans to households also had a stimulating effect on demand in 2012. Loans from commercial banks and non-bank credit institutions to households increased by 30.2%, totaling AZN4.3 billion in the reported year.

The continuing growth of demand contributed to the increase of retail turnover and paid services.

Chart 9. Change path of non-food retail commodity turnover and paid services, %



Source: SSC

Retail turnover increased by 9.6% during the year, where in non-food retail went up by 21%. Paid services increased by 8%.

In 2012, retail turnover amounted to AZN17.6 billion, of which 62% retains to trade enterprises and 38% to markets and fairs. Overall, trade enterprises accounted for 7.5% of the retail turnover's 9.6% increase during the year.

Table 2. Investments by economic sectors

Sector	2012, AZN million	Compared to previous year, %	As percentage of total
TOTAL	**15 338.5**	**118.0**	**100.0**
Where:			
Industry	5 615.4	103.0	36.6
Agriculture	583.5	131.4	3.8
Construction	456.3	198.9	3.0
Trade	540.8	173.0	3.5
Transportation and warehousing	2 591.7	101.4	16.9
Information and communication	325.3	103.1	2.1
Finance and insurance	76.9	195.4	0.5
Real estate	1408.2	146.8	9.2
Education	787.6	2.6 d.	5.1

Source: SSC

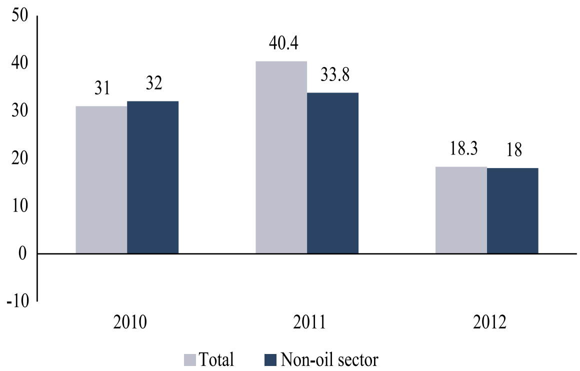
Government's consumption expenditures were formed primarily from public spending on goods and services during the reported year. Social expenditures funded from the state budget totaled AZN4.7 billion (27.4% of total expenditures), which is 7.9% higher than the 2011 level.

A total of AZN15.3 billion worth of investments were made in the economy in 2012 (28.3% of GDP), which exceeds the previous year's level by 18.3%. Domestic sources financed nearly a 4/5 of investments in fixed capital.

Investments in the non-oil sector exceeded the previous year's level by 18%, amounting to 76.2% of the total investments in fixed capital.

In general, investments in agriculture, construction, finance and insurance, trade and education had a specifically high growth rate among non-oil sectors. Investments in **tradable**[1] and **non-tradable**[2] sectors increased by 6% and 23% correspondingly.

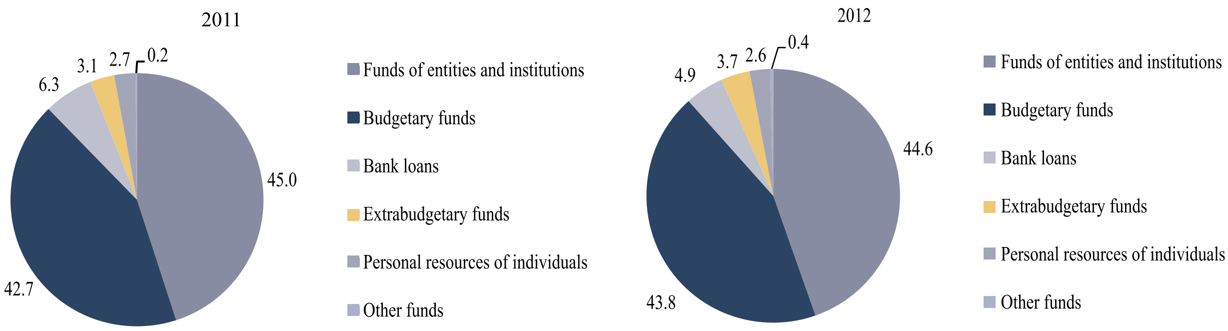
Chart 10. Change path of investments in the economy, %



Source: SSC

Own funds of enterprises and institutions accounted for 44.6%, bank loans for 4.9%, budgetary funds for 43.8%, extrabudgetary funds for 3.7% and personal savings for 2.6% of total investments in fixed capital.

Chart 11. Investments by sources, %



Source: SSC

[1] Tradable sector includes agriculture and industry.
[2] Non-tradable sector includes construction, transport, catering, hospitality services, etc.

Surveys of processing enterprises carried out by the Central Bank also point to a high level of investment activity. The surveys showed that investments increased in 1 in every 3 enterprises in 2012 (against 1 in every 5 in 2011).

2.2. Aggregate supply

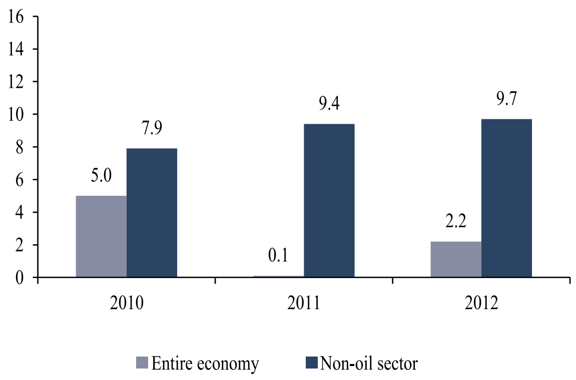
Aggregate supply increased in 2012, with the GDP growth stemming primarily from the non-oil sector's active contribution. Optimistic expectations of economic activity throughout the year helped boosting the overall output production.

The real growth rate of the GDP was 2.2% in 2012, with the nominal GDP reaching AZN54 billion. The oil and gas sector had a 5% decrease, while the non-oil sector demonstrated a 9.7% increase during the reported year. Production sectors accounted for 2/3 and services sectors for 1/3 of the added value generated. Tradable sectors accounted for 55% of GDP in 2012.

Crude oil production decreased by 5.3%, natural gas production increased by 5.4% compared to the previous year. 1563 kg of gold and 626 kg of silver were extracted during the year. **Oil refinery** products increased by 8.8% to 4.8 million tons, accounted for mostly by diesel fuel (21.1%), automobile gasoline (8.7%) and black oil fuel (18.2%). 26.2% of oil products was exported, with 73.8% directed to domestic markets.

GDP growth in 2012 was driven entirely by the non-oil sector activity.

Chart 12. Economic growth rate in January-December, %



Source: SSC

In 2012, the non-oil sector registered highest growth rates in hospitality, construction, communication and processing industries.

Excluding decline in the oil and gas industry, the non-oil tradable sector's input in the total economic growth rate was a positive 0.8%. Thus, the non-oil industry rose by 11.7% during the reported year. Industrial growth was driven chiefly by food, metallurgy, machinery and chemical industries. The high growth rate of agriculture was fostered by both plant cultivation and livestock production.

All industries of the **non-tradable sector** demonstrated growth during the year. Added value generated by non-tradable sectors increased by 10.1%, thus contributing approximately 3.5% to the overall economic growth.

Chart 13. Non-oil sector growth by industries, %

Source: SSC

Construction and communications industries registered the highest growth rates in services. The high growth rates resulted in continued double-digit growth rates of service exports. Tourism and related travel services account for over a half of the total service exports, with transport contributing 18% and construction 5%.

2.3. Economic activity expectations

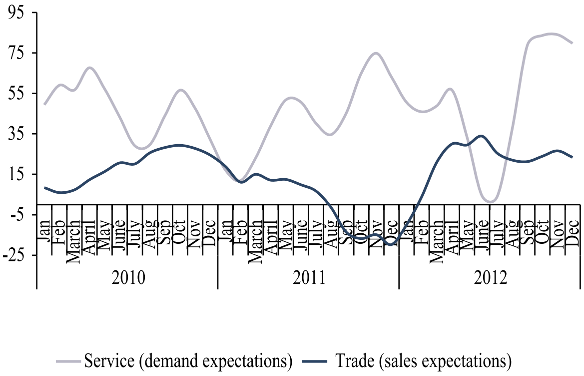
The government, Central Bank, as well as international institutions anticipate the country's economic growth to continue in the near term.

The World Bank's latest published economic overview estimates Azerbaijan's economic growth to be sustained in 2013, putting it at 4.2%. Overall, the WB, IMF, European Bank for Reconstruction and Development and UN have projected the country's economic growth rate at an average of 3.5% in 2013.

The Central Bank's Real Sector Monitoring exercise (RSM) also supports the optimistic expectations of economic activity. The RSM findings suggested that the demand for services and retail sales expectation index was on an upward path in 2012. Positive expectations were especially true of the food, construction material production and textile sub-sections of industry, as well as furniture and electric appliances sales segments of the trade sector. Positive expectations also had a reducing effect on the excessive unsold industrial stock.

In general, the CBA's RSM survey indicates an increasing number of businesses, which enhanced their scope of production and turnover during the year, as well as the sustainability of this increase.

Chart 14. Expectations



Source: CBA
Note: A 3 month sliding average method was employed to adjust dramatic seasonal changes in the monitoring exercise's findings.

The Central Bank's assessments indicate a shift of the **output gap (OG)**[3] from -0.5% of 2011 towards the positive zone in 2012 at about +1.1%.

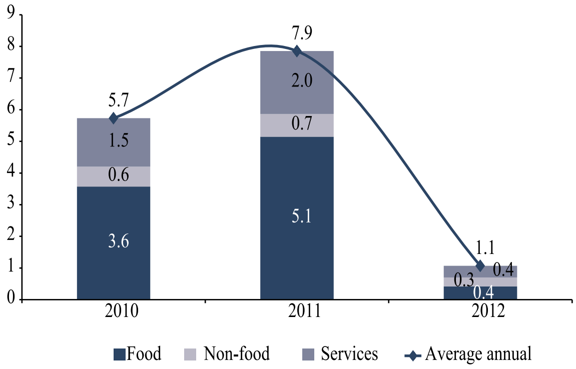
2.4. Inflation

Macroeconomic stability was secured in 2012, with the inflation rate kept in the single-digit range.

The average annual inflation rate made 1.1% in 2012, which is the lowest for the last three years.

Price increase on food products formed 0.4% percentage points of the average annual inflation rate, non-food products accounted for 0.3 percentage points and services for 0.4 percentage points in 2012.

Chart 15. Average annual CPI, %

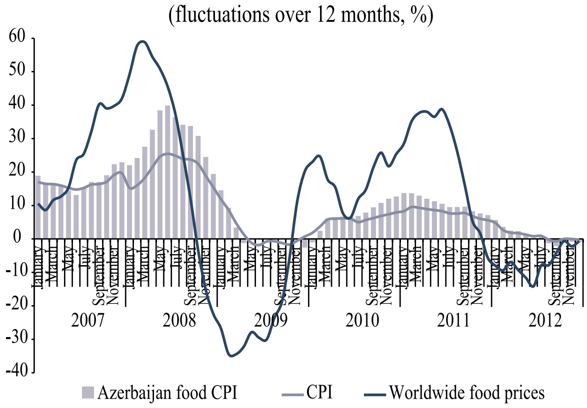


Source: CBA's estimates based on SSC data

Average annual inflation rate on non-food products and services made 1% and 1.2% respectively.

In December 2012 the overall price level declined by 0.3% against the same period of the previous year. This is primarily due to the fact that while food prices went up by 7.1% over the 12 months of 2011, they decreased by a measure of 1% in 2012.

Chart 16. Food CPI for Azerbaijan and the world (fluctuations over 12 months, %)



Source: CBA's estimates based on SSC and FAO data

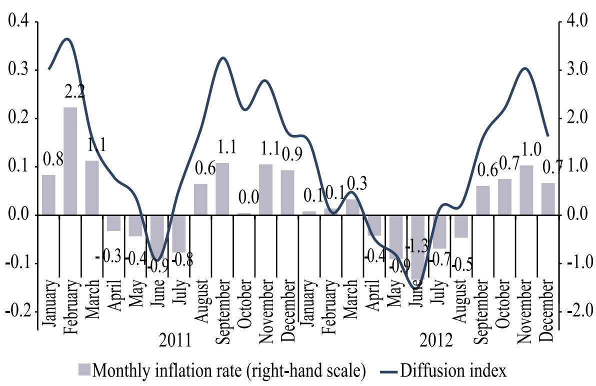
[3] Output gap is calculated as the difference between the potential and actual levels of GDP.

The average annual **baseline inflation rate, which is** adjusted to price fluctuations of government-regulated goods and seasonally volatile products made 1.6%, with the year-to-date rate at 0.3%.

Transport, postal and telecommunication rates went up by 0.1% in 2012. Load transportation charges for pipeline and maritime transport declined by 0.5% and 0.3%, while railway transportation prices went up by 21.3% during the reported year. Passenger transportation tariffs for railway transport declined by 3.1%, for airways by 14.8% and for maritime transport by 1%.

The diffusion index[4], which reflects the scope of volatility of price fluctuations, indicates that products with declining prices constitute a majority in the consumer basket and the scope of price reduction has expanded.

Chart 17. Diffusion index

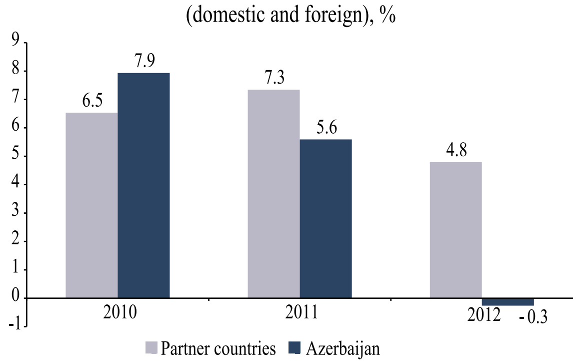


Source: CBA's estimates based on SSC data

Trade partner countries registered an inflation rate of 4.8% in 2012, which is 5 percentage points higher than Azerbaijan's inflation rate. In general, among trade partner countries of Azerbaijan developed countries had an inflation rate of 1.6%, developing countries 6.6% and oil exporting countries 8.8%.

The average annual **industrial producer price index** went up by 4.5%, while non-oil industrial product prices rose by 0.1% in 2012. Producer prices for extracting industries went up by the annual average of 4.9%, for machinery and equipment by

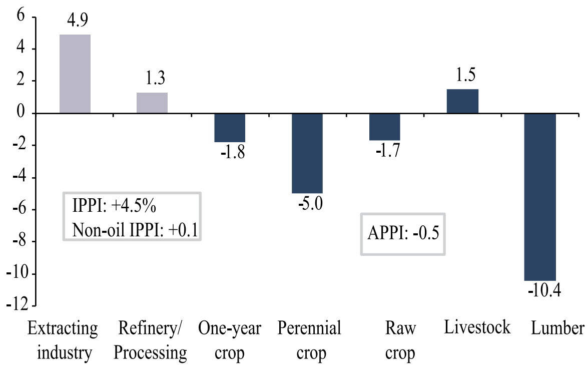
Chart 18. Consumer price index (domestic and foreign), %



Source: SSC

5.5%, for metal industry by 7.1% and for chemical industry by 1.1%. Price declines were most significant in food production (-3%), tobacco (-8%), rubber and plastic production (-10.3%).

Chart 19. APPI and IPPI, %



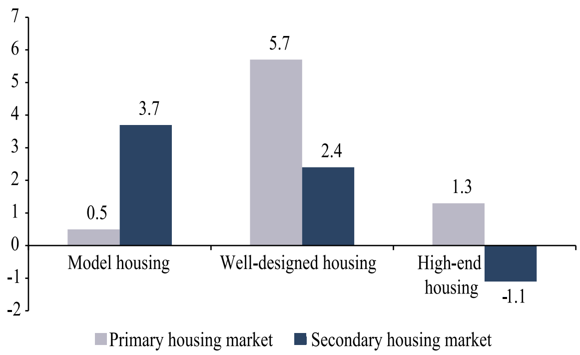
Source: CBA

Price declines that swept through different economic sectors during the year had a rather considerable impact on various agircultural industries as well. Overall, the agricultural producer price index (APPI) decreased by 0.5% on average in 2012.

SSC reports a 2.7% price increase on the secondary **housing market**, and a 3.2% increase on the primary market in 2012. While the secondary housing market had a 1.1% price cut on high-end residences, all other housing categories registered a price increase. According to an appraisal consultancy 'MBA LTD', residential and commercial space rentals went up by 19.7% and 8.2% respectively.

[4] Diffusion index is the ratio of the difference between the number of the consumer basket's growing products and decreasing products to the total number of products.

Chart 20. Housing market price index, %



Source: SSC

The country is expected to retain the price stability. The CBA's regular Real Sector Monitoring exercise points to no significant rises in price expectations.

A number of international institutions predict Azerbaijan will keep a single-digit inflation rate in 2013. For instance, the Asian Development Bank and International Monetary Fund estimate Azerbaijan's average annual inflation rate in 2013 at 6%, which is 1.7% lower than the overall expectations for CIS.

2.5. Employment

The country's high growth rate in 2012 had a positive effect on employment rates as well.

Per SSC's reports, the headcount for economically active individuals totaled 4688.4 thousand people in 2012, of which nearly 95% are employed in various economic and social sectors. The year-end headcount of people on payroll made 1440.5 thousand people for the non-oil sector, and 37.2 thousand people for the oil sector.

A total of 120.4 thousand new jobs were created during the reported year, of which nearly 80% is full-time employment. Individuals accounted for 69.2% of full-time jobs, while existing and new or restored businesses and entities accounted for 21.3% and 9.5% respectively. Rural employment had a share of 67.9% of the total new jobs. New jobs were created mostly in retail and transport, processing and construction industries, as well as in public sector entities and institutions.

The CBA's real sector monitoring covering roughly 300 entities provides evidence of increased employment. Of the entities monitored, construction and industrial sector businesses had the most significant staff increases.

2.6. Balance of payments[5]

As in the previous years, the country's favorable foreign position was preserved and a positive balance of payments maintained in 2012.

In 2012 the oil and gas sector's foreign economic transactions arrived at a positive balance while the non-oil industry concluded the year with a negative balance. Total revenues of the oil and gas sector were attributed to primarily by oil and natural gas exports and a stream of foreign investments funneled into the industry. The industry's expenditures represent profit and investment repatriation, imports of equipment and

Table 3. Key indicators of the balance of payments, USD million

	2011	2012
I. Balance of the current account	17146.1	14916.3
Foreign trade balance	24328.4	22216.6
Balance of services	-2995.8	-2923.8
Balance of revenues	-4859.8	-4326.5
-Repatriation of investment revenues	-5148.8	-4518.9
Balance of current transfers	673.3	-50.0
II. Balance of the capital and finance account	-4789.9	-9960.7
Direct investments	912.6	810.4
- To Azerbaijan	4443.9	5289.4
- To foreign countries	-554.0	-1194.2
- Repatriation of investments	-2977.3	-3284.8
Loans and other investments	-5722.5	-10773.1
Petroleum bonus	20.0	2.0
III. Overall balance of payments (change in the country's strategic reserves)	12356.2	4955.6

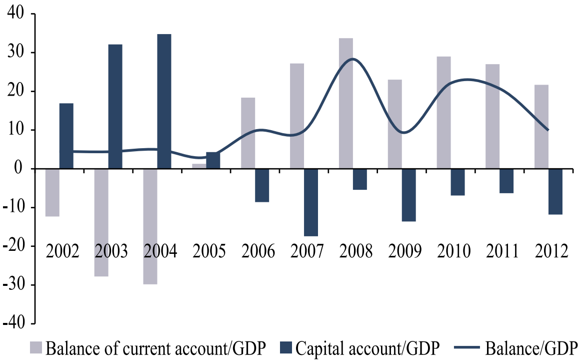
Source: CBA

[5] Details on the balance of payment methodology is available at http://cbar.az/assets/1186/final_metod.pdf

services. The total positive balance of the oil and gas industry amounted to USD23.2 billion in 2012.

The capital and finance account's deficit is fully covered by the surplus generated by the current account, and the overall balance currently has a surplus of 1/8 of GDP. In general, the country's balance of payments turnover has increased tenfold over the past ten years, consequently exceeding 50% of GDP.

Chart 21. Balance of payments` components, %



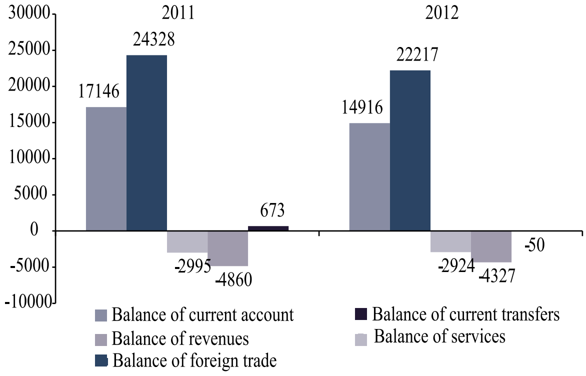
Source: CBA

In 2012 the **current account** generated a surplus of USD14.9 billion, with USD23.4 billion surplus in the current account for the oil and gas sector. That surplus fully covered the USD8.5 billion deficit of the non-oil sector's current account.

The foreign trade turnover amounted to USD43.1 billion and arrived at a positive USD22.2 billion.

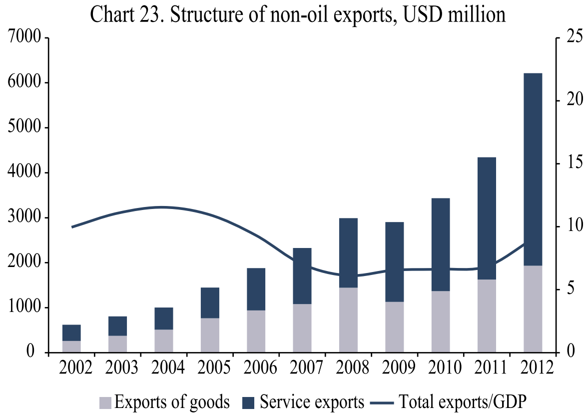
In 2012 Azerbaijan maintained trading relations with 157 countries across the globe. CIS countries are reported to have had a share of 9.7% in foreign trade while other foreign countries accounted for the remaining 90.3%. Azerbaijan further intensified its trading affairs with Italy, USA, United Kingdom, Turkey, Russia, France, India, Germany, Indonesia and Israel (These countries accounted for 67.4% of the total trade).

Chart 22. Balance of current account, USD million



Source: CBA

Chart 23. Structure of non-oil exports, USD million



Source: CBA

Table 4. Key foreign trade partners in 2012, USD million

	Commodity turnover	Exports	Imports	Balance
Italy	5807	5548	259	+5289
USA	4188	3480	708	+2772
United Kingdom	3881	3392	489	+2903
Turkey	3291	1771	1520	+251
Russian Federation	2528	1056	1472	-416
France	1962	1778	184	+1594
India	1960	1892	68	+1824
Germany	1874	981	893	+88
Indonesia	1795	1757	38	+1719
Israel	1725	1667	58	+1609
Others	14040	9312	4728	+4584
Total	43051	32634	10417	+22217
Including:				
CIS countries	4193	1615	2578	-963
Other countries	38858	31019	7839	+23180

Source: CBA

The non-oil and gas sector carried further on the growth path. 2012 performance outputs report commodity exports at 31% and service exports at 69% of the non-oil and gas industry's total exports.

The country's non-oil and gas exports in 2012 increased by 19.1% against the previous year, totaling USD1933.5 million. It should be noted that non-oil exports have had technology improvements lately: the share of middle and high technology products neared 30%.

Table 5. Structure of exports

	2011		2012	
	Amount, USD million	As percentage of total	Amount, USD million	As percentage of total
Total exports	34494.9	100.0	32634.0	100.0
of which:				
1. Fuel and raw materials	33435.6	96.9	31260.5	95.8
- oil and gas products	32871.0	95.3	30700.5	94.1
- other raw materials	564.6	1.6	560.0	1.7
2. Machinery and equipment	177.7	0.5	380.0	1.2
3. Consumer goods	841.1	2.5	968.2	2.9
4. Other goods	40.5	0.1	25.3	0.1

Source: CBA

In the reported year **exports of goods** totaled USD32.6 billion. Non-oil and gas products accounted for 94.1% of the total exports of goods.

USD29.4 billion worth of oil products were exported to foreign countries, of which exported petroleum processing products accounted for USD1.7 billion and crude oil exports for USD27.7 billion.

USD26.1 billion is the value of oil produced by the Azerbaijan International Operating Company (AIOC), out of the total oil exports. USD1.7 billion worth of crude oil exports were made by other entities, of which USD134.9 million pertained to the condensate produced from the Shakhdeniz field and USD1.6 billion is the share of the SOCAR.

Total exports were 3 times as much as total imports during the year.

In the reported year **imports of goods** amounted to USD10.4 billion. Imports of consumer goods totaled USD4375.9 million, where food products accounted for USD1303.6 million.

Imports of machinery and equipment and goods financed by foreign investments accounted for 9.2% of the total imports thus amounting to USD961.8 million. Out of this amount, imports of goods financed by investments used under the international oil and gas contracts totaled to 82.1%. Furthermore, industrial

Table 6. Structure of imports

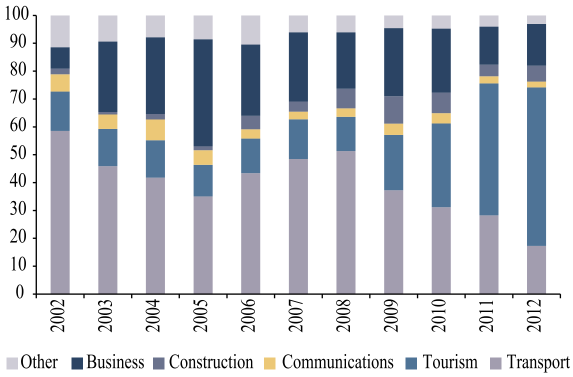
	2011		2012	
	Amount, USD million	As percentage of total	Amount, USD million	As percentage of total
Total imports	10166.5	100.0	10417.5	100.0
of which:				
1. Consumer goods	3884.1	38.2	4375.9	42.0
- food products	1267.7	12.5	1303.6	12.5
- other	2616.4	25.7	3072.3	29.5
2. Investment quality goods	1008.4	9.9	961.8	9.2
- international oil and gas consortiums	877.5	8.6	789.4	7.6
- other	130.9	1.3	172.4	1.6
3. Other goods	5274.0	51.9	5079.8	48.8

Source: CBA

machines and equipment, chemical, ferrous and non-ferrous metal products for a total worth of USD5079.8 million were imported to the country

Mutual **services** held a special place in Azerbaijan's economic relations with foreign countries in 2012, amounting to USD11.5 billion. Of this, services provided by non-residents to Azerbaijani residents totaled to USD7.2 billion, and services provided by Azerbaijani residents to foreign residents amounted to USD4.3 billion.

Chart 24. Structure of non-oil service exports, %



Source: CBA

Transportation services accounted for 14.9% of the total services turnover. 56.7% of the USD1708.7 million worth of transport services related to the use of foreign transportation systems by Azerbaijani residents.

The total value of transportation services provided by Azerbaijani residents amounted to USD740.3 million.

Revenues from tourism have been rapidly increasing their share of total exports of services. Travel-related services provided to foreign country residents in the reported year were USD2.4 billion. Of this, 39.5% pertained to business trips of foreign residents to Azerbaijan.

In their turn, the total value of travel-related services provided by foreign countries to Azerbaijani residents amounted to USD2.5 billion, having gone up by 1.5 times. Of this, 63.1% represented the spending of Azerbaijani residents while traveling to foreign countries (excluding shuttle imports).

Non-oil sector's imports of services amounted to USD5107.3 million having increased by 23.9% in 2012.

Overall, mutual services had a share of 21.1% of the total imports and exports turnover of goods and services involving foreign countries.

In the reported period the **total turnover of revenues and payments** reached USD6.5 billion. Of this, 83.2% (USD5.4 billion) represented payments leaving Azerbaijan, while the core of that amount (USD4.2 billion) represents the repatriation of income of the international petroleum and gas consortiums' foreign investors (mainly as crude oil and gas), remuneration to non-residents (USD180.4 million) and interest on foreign loans (USD331.7 million).

Transactions with foreign countries relating to

Table 7. Structure of foreign investments drawn

	2011		2012	
	Amount, USD million	As percentage of total	Amount, USD million	As percentage of total
Direct investments	4443.9	54.8	5289.4	49.9
- oil and gas sector	3465.6	42.7	4290.0	40.5
- other sectors	978.3	12.1	999.4	9.4
Loans and other investments	3651.0	45.0	5303.5	50.1
- sovereign-guaranteed loans	1255.1	15.5	1245.5	11.8
- loans w/o government guarantees	2053.1	25.3	2267.1	21.4
- oil and gas sector	706.0	8.7	486.0	4.6
- banks	828.9	10.2	1556.7	14.7
- other	518.2	6.4	224.4	2.1
- other investments	342.8	4.2	1790.9	16.9
Petroleum bonus	20.0	0.2	2.0	-
TOTAL	8114.9	100.0	10594.9	100.0

Source: CBA

current transfers totaled to USD4.0 billion in value. Of this, 49.4% represent the country's revenues.

94.8% of these revenues represent bank notes transferred from foreign countries to individuals, 1.7% humanitarian goods imported to the country and 3.5% other revenues

Overall, the negative balance of current transfers totaled to USD50.0 million.

Foreign capital drawn to the country during the year totaled to USD10.6 billion. This indicator was driven primarily by foreign loans and direct investments drawn to the country. The non-oil sector has also increased its share of the incoming **capital flows**, reaching 48.2% in 2012.

Total investments drawn from foreign countries in the form of **direct investments** amounted to UD5.3 billion. The oil and gas industry accounted for 81.1% of the total investments. The national economy used these investments to finance large-scale oil and gas projects, mainly BP Exploration (Shakhdeniz) Ltd. project and operations carried out at the Azeri-Chirag-Guneshly field of the Azerbaijan International Operating Company.

Direct investments to the non-oil sector totaled USD999.4 million. This amount represented 18.9% of the total direct investments accessed by the country.

Azerbaijani investors have demonstrated increasing interest to foreign financial markets. A total of USD1194.2 million of direct investments were made from Azerbaijan to foreign economies in 2012.

Investments categorized as **loans and other investments** accounted for 50.1% (USD5303.5 million) of the total foreign investments. This amount was mostly formed from loans obtained directly by the government and those backed with sovereign guarantees, by the oil and gas sector and banks. 35.5% (USD1245.1 million) of that amount represented loans obtained directly by the government and those backed with sovereign guarantees (loans from international financial and other institutions); 64.5% (USD2267.1 million) million represents loans without sovereign guarantees, of which USD1556.7 million were acquired by banks, and USD710.4 million by other entities and firms.

USD2710.3 million was repaid on loans obtained in the previous periods. Of this amount, the banking system accounted for 48.4% (USD1312.5 million), loans obtained directly or backed by the governments for 12.2% (USD330.5 million), the oil and gas sector for 28.5% (USD772.3 million), and other entities and firms for 10.9% (USD295.0 million).

The country's **financial assets (reserves)** increased by USD4956.0 million in the reported year.

The surplus in the balance of payments was the principal factor contributing to the country's huge strategic currency reserves. At the end of 2012, the ratio of financial assets to GDP was 67%, exceeding the foreign debt by 4 times and sufficient to cover 4 years of imports.

III. MONETARY AND EXCHANGE RATE POLICY, MONETARY CONDITIONS

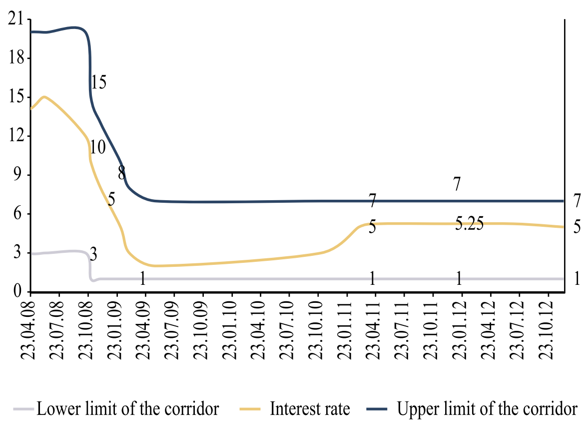
3.1. Monetary policy

In 2012, the Central Bank supported macroeconomic and financial stability as well as economic growth by realizing its goas as stated. As mandated, the Central Bank's 2012 monetary policy followed the principal objective of maintaining a single-digit inflation rate, keeping the manat's exchange rate stable, strengthening the sustainability of the banking and financial sector, and achieved its objectives.

In 2012, monetary policy instruments were employed in consideration of economic dynamics, inflationary expectations and specific features of the monetary policy's **transmission** to aggregate demand and prices.

Seeking to ehnance its support to the non-oil sector's ecoomic growth by enabling further reduction of interest rates in an optimal inflationary environment, the Management Board of the Central Bank resolved to decrease the interest rate from 5.25% to 5% as of December 10, 2012, whilst keeping the other parameters of the interest rate corridor intact.

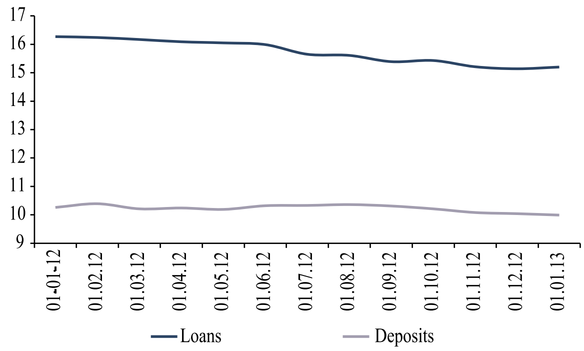
Chart 25. Parameters of interest rate corridor, %



Source: CBA

Central Bank's monetary policy decisions were a key factor that had a modifying effect on the banking sector's interest rates. During the year interest rate on loans went down by 1.1% as a whole, including 1.2% for interest rates on corporate loans and 0.8% for interest rates on individual loans.

Chart 26. Nominal interest rate in Manat

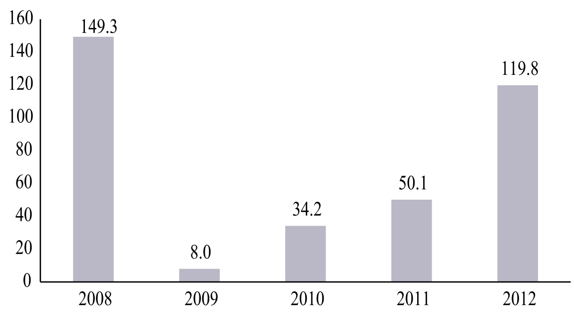


Source: CBA

Open market transactions and reserve requirements were used as part of the overall effort to regulate the growth rates of money supply and **liquidity levels** of the banking system. The implementing mechanism of reserve requirements was modified significantly, a new set of regulations were developed to enable banks to manage their liquidity more effectively.

AZN1675.6 million worth of notes were issued in 2012 as part of a sterilization exercise. Of this amount, AZN1058.8 million worth of notes were sold through auctions.

Chart 27. Amount of notes issued by CBA, period-end, AZN million



Source: CBA

Average yield rate on notes made 1.87% at the last auction, having gone down from 2.84% at year-start. Outstanding notes amounted to AZN119.8 million as of 01.01.2013.

3.2. Exchange rate policy and international competitiveness

The 2012 exchange rate policy was designed to ensure a stable exchange rate of the manat. Parameters of the exchange rate policy were identified taking account of the balance of payments status, and the overarching goals of securing financial sustainability of the banking sector and competitiveness of the non-oil sector.

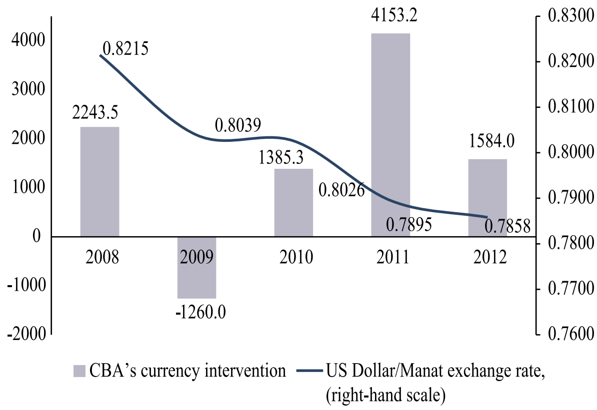
Central Bank continued to conduct its exchange rate policy on the USD/AZN two-way exchange rate basis within the exchage rate corridor in 2012.

As a result of the large-scale surplus in the balance of payments, supply in the foreign exchange (FX) market exceed the demand. However, the Central Bank implemented USD1584 million worth of FX sterilization measures during the year in order to prevent the exchange rate from appreciating significantly and thereby to mitigate the negative effects on the non-oil sector's competitiveness.

As a result, the manat's appreciation against the US Dollar was as little as 0.19%. A stable national currency had a positive effect on the country's macroeconomic and financial stability.

The change of manat's nominal bilateral exchange rate impacted the real exchange rates as well. The manat appreciated both in nominal and real terms against the Ukrainian, Georgian and Japanese currencies. The manat depreciated in real terms against the currencies of other trade partners, and appreciated in nominal terms against the currencies of USA, Euro zone countries, Iran, Kazakhstan, Israel and Belarus.

Chart 28. CBA's currency intervention during the year, USD million



Source: CBA

The non-oil sector's nominal effective exchange rate (total trade turnover-weighted) in the reported year depreciated by 0.5%. The difference between the inflation rates in partner countries and Azerbaijan had a reducing effect of 4.9% on the real effective exchange rate.

Consequently, the non-oil sector's real effective exchange rate of the manat depreciated by 5.4% during the reported year.

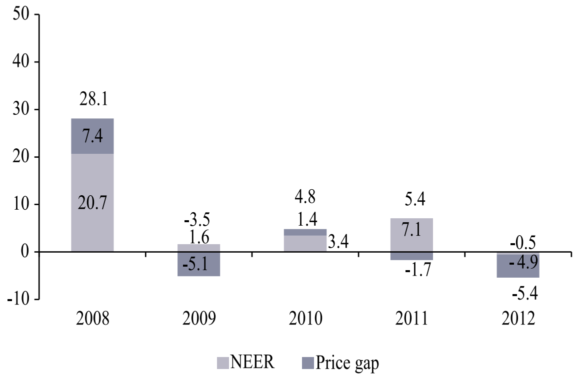
Table 8. Bilateral nominal and real exchange rate indices of Manat in 2012, %

	As opposed to December 2011	
	Nominal bilateral exchange rate index*	Real bilateral exchange rate index
USA	100.2	98.4
Eurozone	100.7	98.2
Great Britain	96.9	94
Turkey	95.9	90.1
Russia	97.9	91.6
Ukraine	101.4	101.4
Georgia	100.2	101.4
Iran	112.3	84.9
Kazakhstan	101.9	95.8
Japan	107.8	108.3
Israel	100.3	98.6
China	98.3	96.8
Belarus	101.3	83
South Korea	93.9	92.7

** Average monthly change of the manat's exchange rate against the partner country's currency..*

Source: CBA

Chart 29. Structure of the REER, %



Source: CBA

Thus, the Central Bank managed to maintain the manat's two-way exchange rate stable in 2012. The real multilateral exchange rate of manat depreciated, which had a positive effect on the non-oil sector's competitiveness.

3.3. Money supply

In 2012, the monetary aggregate continued to grow in consistency with the economy's demand, while its structure continued to improve.

The manat broad money increased by 25.5% in 2012. As a result, monetization of the economy (M2/GDP) increased by 3.6 percentage points.

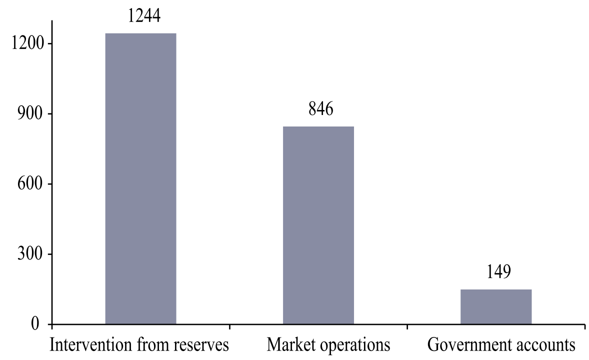
Chart 30. Changes of broad money, %

Source: CBA

The monetary base increased by 27.1% during the reported year. Growth of the monetary base is mostly explained by the Central Bank's currency sterilization and open market transactions. Reducing balances of government accounts also had an increasing effect on the monetary base.

As of 01.01.2013 broad money (M3) increased by 20.7% to AZN16775 million.

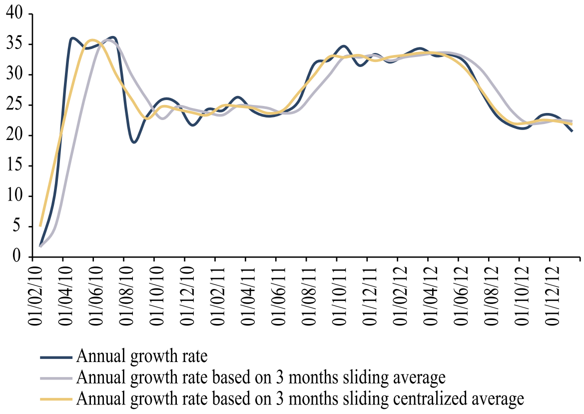
Chart 31. Change factors of monetary base



Source: CBA

The broad money expanded due to the growth of both cash in circulation and non-cash money aggregate.

Chart 32. Change path of M3 money aggregate, %

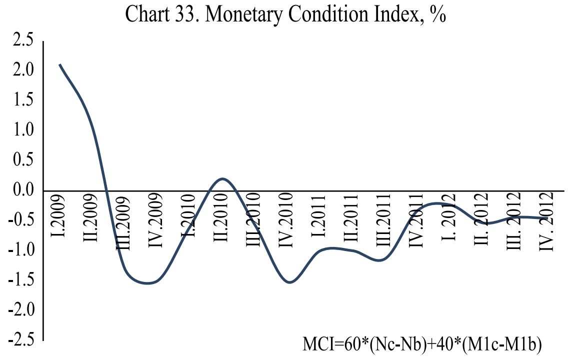


Source: CBA

Non-cash money aggregate increased by 11.5% during the reported year.

As confidence in the national currency grew stronger, the dollarization level (foreign currency-denominated individual and corporate deposits as percentage of M3) went down by 3.2% in 2012.

Chart 33. Monetary Condition Index, %



Source: CBA

Table 9. Money aggregates, AZN million

	01.01.10	01.01.11	01.01.12	01.01.13
M0 (Cash)	4147.8	5455.8	7158.2	9256.6
M1 (Cash, individual and corporate demand deposits)	5239.8	6718.9	8824.8	11107.9
M2 (Cash, demand and term individual and corporate deposits, AZN)	6169.2	8297.5	10997.2	13806.4
M3 (Cash, demand and term individual and corporate deposits, AZN and hard currency)	8469.2	10527.5	13903.2	16775.3

Source: CBA

With the nominal effective exchange rate of manat relatively depreciated and money supply increased, the Monetary Condition Index[6] (MCI) remained generally moderate.

3.4. Research and diagnostic framework of the monetary policy

In 2012, the Central Bank carried on with its efforts aimed at conceiving and structuring an institutional framework for the monetary policy.

Table 10. Models studied by the Central Bank

	Name of Model and Study	Purpose
1.	Evaluation of resource effect in Azerbaijan	Examining consumer behavior of households, with empirical assessment of resource effect on consumer behavior.
2.	Evaluation of the monetary transmission effect	Allows for econometric evaluation of monetary transmission. Central Bank evaluated empirically the growing effect on interest rates across the banking sector.
3.	Evaluation of the currency substitution	Provided empirical evidence of the de-dollarization process getting stronger, public confidence in the national currency enhancing using a small-scale general balance model.
4.	Assessment of the output gap	An ex-post assessment of output gap carried out an econometric model built based on different filters for quarterly projection/ forecasting purposes.
5.	Evaluation of optimal capital adequacy for the banking sector	Evaluated the banking sector's capital adequacy and identified an optimal level using empirical methods.
6.	Assessment of the national economy's J-curve	Assessed the J-curve at overall economy, non-oil industry and sector levels, provided empirical evidence of the J-curve effect.
7.	Development of the Dynamic-Scholastic General Equilibrium (DSGE) model	A DSGE model was built based on economic agent optimization problems and reflecting cross-industry connections in order to conduct various policy analyses and evaluate policy scenarios, as well as provide short- and mid-
8.	Evaluation of factors affecting interest rates	The study conducted an empirical evaluation of factors affecting interest rates, and analyzed the interest rate spread.
9.	Assessment of the real estate market's price bubble	Conducted an empirical evaluation of the real estate market's price bubble, identified a balanced level for real estate prices.

Source: CBA

[6] MCI is a ratio that characterizes the average change of the money aggregate and the nominal effective exchange rate based on their shares.

Under its 2011-2014 strategic plan, the Central Bank took a number of actions designed to build macroeconomic diagnostic and research capacities.

Identification of systemic risks inherent in the banking sector were a focal point in the CBA's efforts of building on capacities for **financial stability assessments**. Stress-tests and financial stability indicators were used on a regular basis to assess the banking sector's sustainability and sensitivity. A study was carried out centering on structural optimization modelling for bank capital (Tier 1 and 2 capital), resulting in policy recommendations and proposals. Parallel to the drafting of a payment systems law, possible effects were thoroughly examined that the development of payment systems may have on economic growth.

As part of the **econometric model improvement** initiative, studies were carried out focusing on inflation, economic growth and macroeconomic balance. Symmetry and asymmetry of the monetary policy decisions' pass-through into the economy were assessed, and preliminary findings were presented internationally.

As part of the **financial awareness initiative** technical assistance was secured from the World Bank, International Development Fund for Savings Banks of Germany, PricewaterhouseCoopers. Electronic handouts were prepared and 25 events were arranged for the financial awareness initiative. "Banks to schools, schools to banks", a joint effort with commercial banks, was organized and conducted for a week, during which bank employees and school teachers attended various training seminars. A series of Financial Awareness training courses was organized for loan officers of commercial banks.

Efforts were continued to update banking and financial statistical guidelines, reporting format development and design, and to align monetary and financial statistics to IMF standards under the methodology assistance and support program for the banking and financial system, ensuring conformance to the best practices in **statistics**. Capacities were built and implemented for receipt, automated processing and electronic dissemination to internal and external users of all statistical reports and information from the banking and financial system under the electronic statistics database and analytical reporting system (ESAS) development project. Electronic transmission of the database acquired from economic agents to ESAS system was launched. The Bank also continued to harmonize its balance of payments preparation procedures with the IMF's new methodology (6th edition) as part of the process implementing electronic processing and development of the balance of payments with an aim to improving external sector statistics, with the technical assistance and support from a SECO expert.

The real sector monitoring exercise expanded its coverage of entities and institutions monitored. 98 non-oil processing industry entities, 38 service businesses and 25 construction companies were added to the monitoring scope in 2012. In parallel, preparations were made for household surveys.

IV. FINANCIAL MARKETS

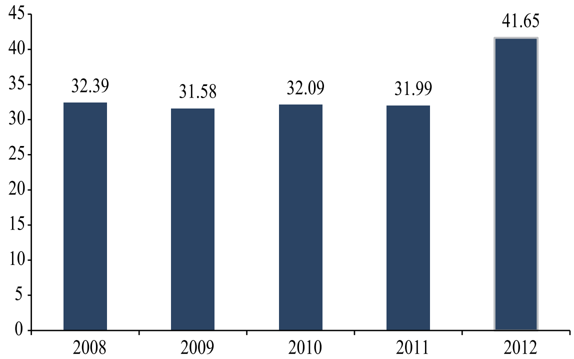
4.1. Foreign exchange (FX) market

As the domestic FX market displayed a considerable excess of supply over demand in 2012, the Central Bank's operations under the "intervention corridor" were aimed at sterilizing the excess currency supply in order to preserve the stability of manat.

Central Bank's interventions were executed using the Bloomberg-based uniform electronic trading platform. 74% of interbank FX market transactions involving the USD/AZN currency pair was registered in the Bloomberg system in the reported year.

FX market transactions increased by approximately 31% or USD10 billion against the previous year, totaling to USD42 billion.

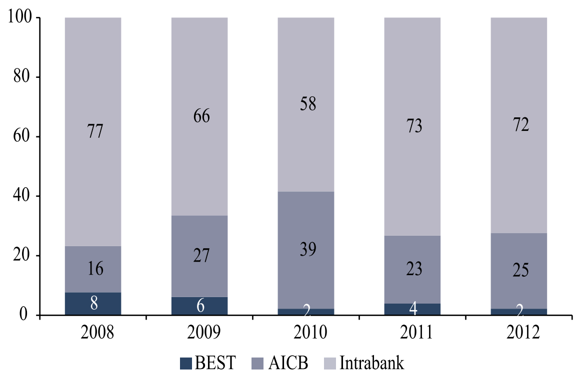
Chart 34. Total domestic FX market transactions, USD billion



Source: CBA

Interbank transactions accounted for 27% of the total FX market transactions. However AICB's share

Chart 35. Domestic FX market by segments, %

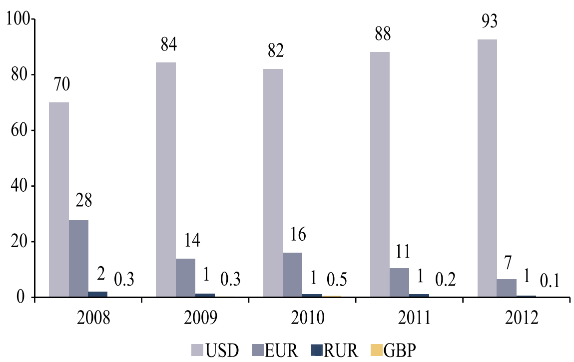


Source: CBA

of transactions at the interbank FX market increased, while that of BICB declined.

The share of USD transactions at the domestic FX market increased during the reported year (93%).

Chart 36. Domestic FX market by currency, %

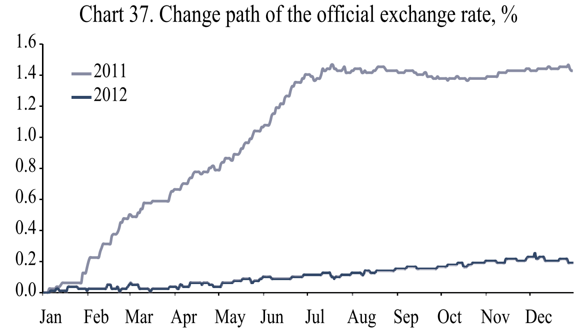


Source: CBA

Central Bank conducted USD1.6 billion worth of **FX sterilization efforts** in order to prevent the exchange rate from appreciating excessively.

Central Bank carried on with its policy of USD/AZN bilateral exchange rate targeting. **The official nominal exchange rate** of manat against US Dollar changed by as little as 0.15 copecks, i.e., 0.19%.

Chart 37. Change path of the official exchange rate, %

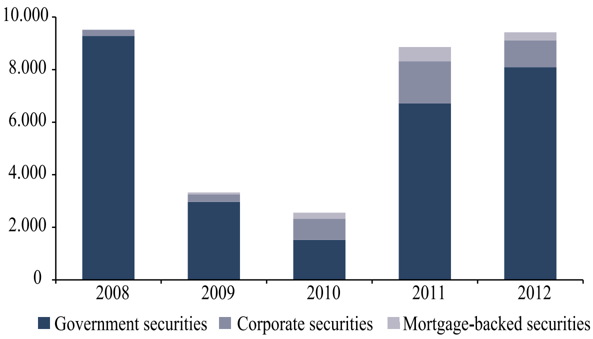


Source: CBA

4.2. Money market

The securities market increased by 6% against the previous year, totaling AZN9.4 billion. The government securities[7] market accounted for 86% (of which 98% pertained to short-term notes), and the corporate securities market for 14% of the overall securities market (of which 23% pertained to the Mortgage Fund's bonds).

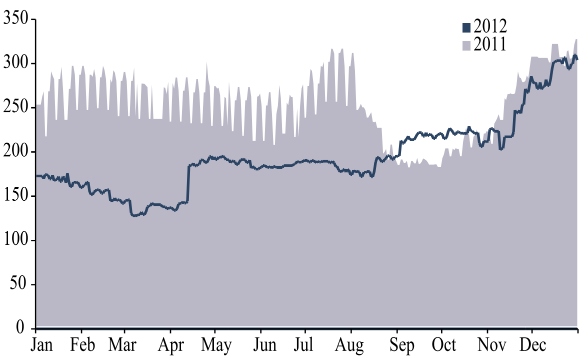
Chart 38. Organized securities market, AZN million



Source: CBA

By the year-end outstanding government securities increased by AZN74 million or 29.5% from the previous year's level (AZN250.7 million), up to AZN324.6 million.

Chart 39. Government securities in circulation, AZN million



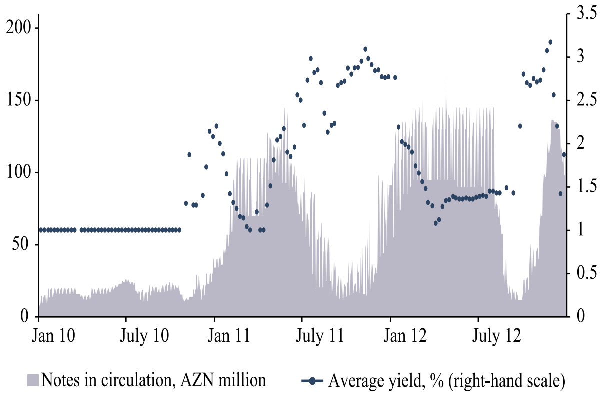
Source: BSE

At the year-end the share of notes amounted to 37%, while the share of GSTS's (T-bills) amounted to 63% within the total outstanding government securities.

During the reported year AZN1840 million worth of the **Central Bank's short-term notes** were issued, of which AZN923 million were offered through auctions, a half of which (AZN850.8 million) was sold. The average yield of notes at the last auction was 1.87%. This indicator had made 2.84% at the beginning of the year.

Notes in circulation increased by AZN28.77 million (including repo transactions) or 31.54% against the previous year thus totaling to AZN120.00 million at the year-end.

Chart 40. Notes in circulation

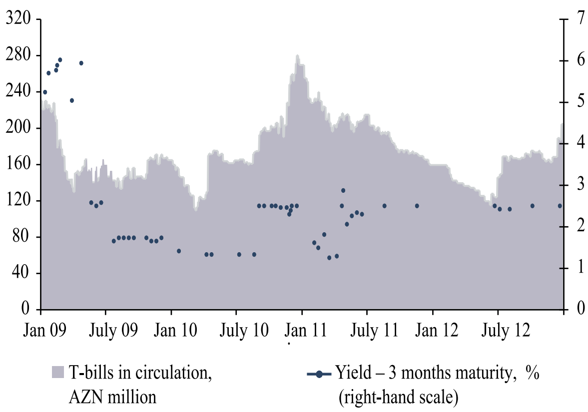


Source: CBA

Transactions involving framework instruments amounted to AZN6 849.4 million during the period, all of which were represented by repo transactions. The year-end interest rate on framework instruments equaled 1% for overnight repo transactions and 7% for overnight counter-repo transactions.

The year-end outstanding **government bonds (GB's)** decreased by AZN45.2 million or 28.3% against the year-start rate equaling AZN204.6 million. Average yield on one year maturity GB's resolved at 4%.

Chart 41. T-bills in circulation



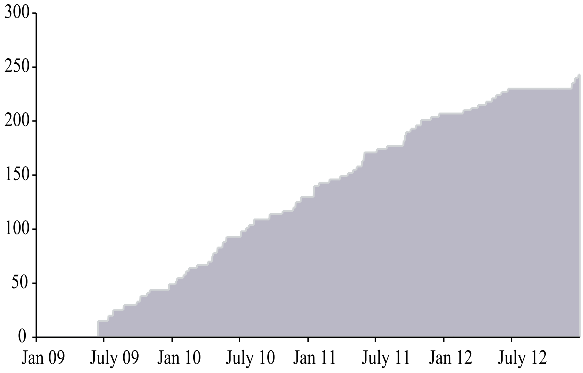
Source: BSE

In 2012, the Azerbaijan Mortgage Fund registered the data sheet for the 5th issue of 10 year maturity unsecured bonds for a total of AZN30 million and the date sheet for the 6th issue of 10 year maturity unsecured bonds for a total of AZN40 million. 1 auction was held to sell AZN3 million worth of bonds under the 4th issue's data sheet, 9 auctions to sell

[7] This includes short-term notes issued by the Central Bank and bonds issued by the Ministry of Finance.

AZN30 million worth of bonds under the 5th issue's data sheet, and 1 auction to sell AZN3 million worth of bonds under the 6th issue's data sheet. Outstanding bonds at the year-end totaled to AZN243 million.

Chart 42. Outstanding mortgage-backed securities, AZN million



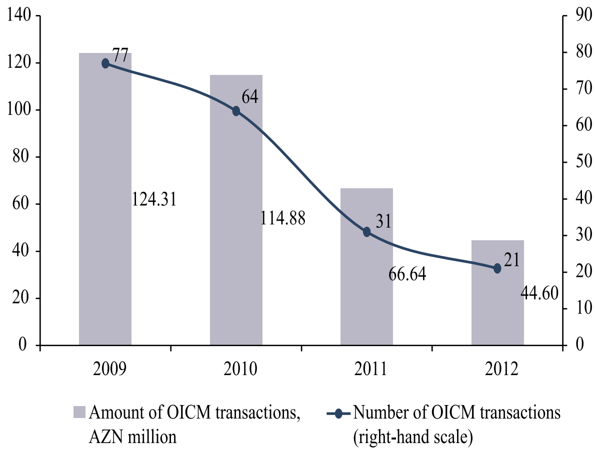
Source: AMF

Secondary market transactions for mortgage backed securities totaled to AZN268.9 million (72 transactions).

4.3. Interbank market

In 2012 the **Organized Interbank Credit Market (OICM)** carried out AZN44.6 million worth of 21 transactions.

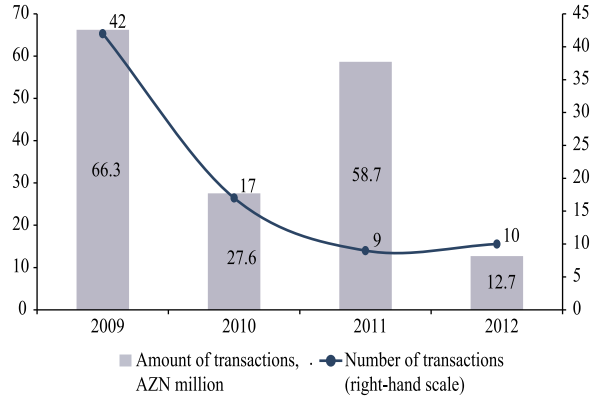
Chart 43. Organized Interbank Credit Market



Source: CBA

The Secured Money Market, a segment of the Organized Interbank Credit Market established with the Central Bank's support in 2010 with an aim to revitalize the money markets, amounted to AZN10.5 million (9 transactions).

Chart 44. Interbank repo market



Source: CBA

V. FOREIGN EXCHANGE RESERVES MANAGEMENT

As in the previous years, in 2012 the Central Bank managed its foreign exchange reserves based on strategic pillars of safety, liquidity and profitability and operating investments.

The Central Bank found itself facing an urgent need to expand the scope of investment opportunities by using the investment framework's credit rating requirements, instruments and geographic diversification in order to build on the overall management effectiveness in the shaky global financial market environment, with an overarching goal of increasing its foreign exchange reserves.

The Central Bank had to manage its foreign exchange reserves maneuvering safely out of the turmoil of a deepening debt crisis in Eurozone and the reign of low yield rates ensuing from the poor economic performance of industrially developed countries in 2012. Given the global financial market uncertainties, the Central Bank's investment policy with respect to the reserves primarily sought **to preserve its assets** as a top priority during the reported year.

In the reported year, the reserves were sub-divided into investment tranches, which represent an instrument of operation and recovery underpinning the current activities. **Currency diversification and retention of the high creditworthiness of assets** remained the principal component of the management strategy.

The operating tranche was re-quantified in consideration of providing proper support to the current exchange rate policy and preserving the country's financial stability, as well as precluding adverse impacts of currency crises. The currency set-up of the tranche is consistently maintained taking account of the currencies that constitute the very core of the country's foreign trade balance and liabilities. Thus, 95% of the tranche were held in the US Dollar, the dominating currency of foreign trade and the country's foreign liabilities, and 5% in Euro, while the investment tranche was divided between the US Dollar, Euro and British Pound.

With the principal objective of reserve management being diversification of the foreign exchange reserves, reduction of sensitivity to global shocks and preservation of the absolute value of reserves, the investment tranche was maintained in USD0.66, Euro 0.423 and GBP 0.111 that constitute the SDR (modified SDR) basket, excluding the Japanese Yen, as defined by the International Monetary Fund.[8]

During the year the **Central Bank carried on with its efforts to build and foster domestic capacities for foreign exchange reserves management**. In this view, the Bank scrutinized the possibilities of introducing state-of-the-art management methods at all levels of the investment process, and developed an asset strategic distribution methodology and mathematical models to support the inclusion of new investment quality assets to the portfolio. The Central Bank maintained its focus on the continuing upgrade of the IT infrastructure and efficient supply of data as they are instrumental in foreign exchange reserves management.

The Bank's domestic capacity building efforts continued to benefit from the technical assistance under the "Reserve Management and Advisory Program" developed specifically for central banks by the World Bank's Treasury.

Furthermore, in 2012 the Central Bank continued its **partnership with international financial institutions specialized** in asset management.

In 2012, the Central Bank's currency reserves totaled to USD11 694.8 million, having increased by **USD1 213.3** million or **11.58%**, through the domestic FX market interventions and **revenues generated from asset management**. Assets under management amounted to USD11 643.4 million, of which 3% is managed by external managers. The interest yield/rate of return on management of currency assets amounted to 0.31%.

[8] This structure incorporates the IMF's amendments of December 30, 2010.

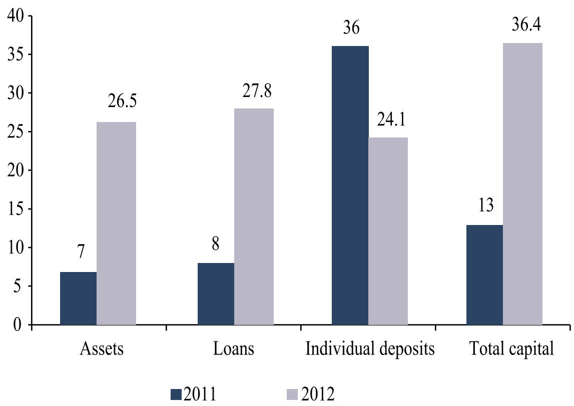
VI. BANKING SYSTEM AND FINANCIAL STABILITY

6.1. Change path and institutional development of the banking system

The banking sector managed to maintain its development pace in 2012, while further deepening its financial intermediation function, and increasing the total assets by 26.5% and the total loan portfolio by 27.8%.

The ratio of bank assets to the non-oil GDP amounted to 67.4% in 2012, ratio of equity to the non-oil GDP to 9.8%, loans to economic sectors to 47.4%, while deposits of individuals to 19.5%.

Chart 45. Growth rates of main banking indicators, %



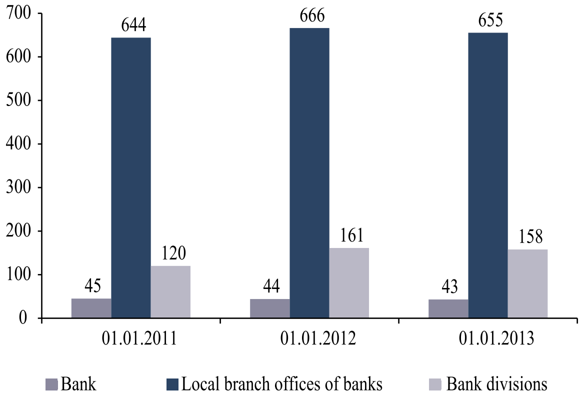
Source: CBA

Large banks (top 5 banks in terms of assets) had a share of total bank assets of 59.3%. According to Herfindale-Hiershman index[9] the banking system has a middle level of concentration.

Institutional and infrastructural efforts continued as part of the banking system's development had an increasing effect on the **banks' attractiveness for foreign investors** in 2012. The number of banks with foreign capital was 22, while total foreign equity investments in banks reached AZN330.3 million through an AZN34.7 million (11.7%) gain.

Local banks managed to maintain their international ratings intact while the world's leading rating agencies downgraded a number of banks in developed countries.

Chart 46. Structural network of banks, units

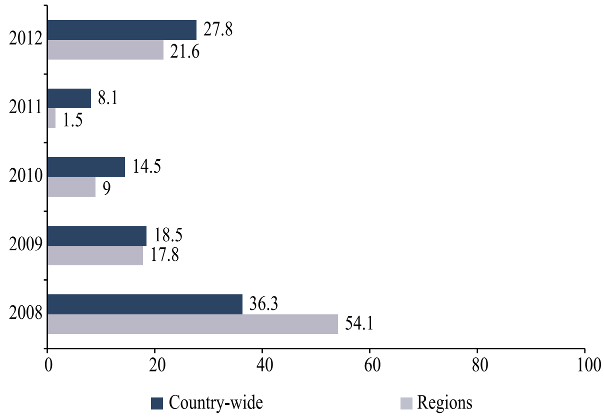


Source: CBA

Banks continued **to expand their branch office network and other structural divisions** in order to address the economy's needs for financial services and improve customer access to financial services. 27 new branch offices were opened for business in 2012; thus, the number of bank branch offices totaled to 655. 14 new bank divisions were opened; the number of bank divisions thus reached 158.

9 of the new branch offices were established in different regions. As at 01.01.2013, 330 bank branch offices (49.6% of the total) operate in regions.

Chart 47. Annual growth rate of loans, %



Source: CBA

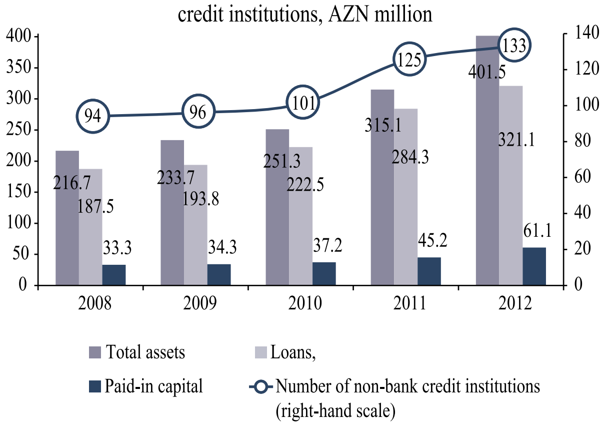
[8] The Herfindale-Hierschman Index is equal to the total squares of banks' shares in the banking system

Credit institutions continued their regional lending expansion in 2012, raising their regional loan portfolio by 21.6% during the year.

The number of other financial institutions that provide limited banking services also increased in parallel to the banking system's development. These are **non-bank credit** institutions, including credit unions, non-bank credit institutions and other kinds of financial institutions rose to 133 in number (125 at the beginning of the year), while their branch offices increased up to 102 (86 at the beginning of the year). The Central Bank granted licenses to 1 new non-bank credit institution, and 13 new credit unions during the reported year.

In parallel to the increasing number of non-bank credit institutions their transactions also gained on in terms of volume. Thus, the total assets of such institutions increased by 27.3%, while their lending increased by 27.7% during the year.

Chart 48. Basic performance indicators of non-bank credit institutions, AZN million



Source: CBA

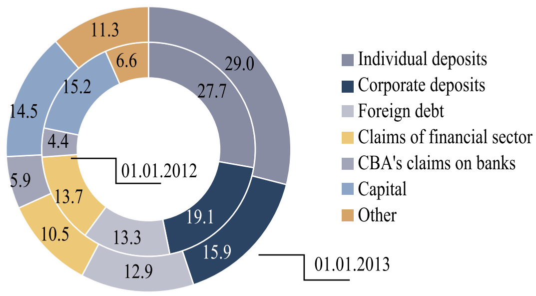
The expanded geographic coverage of the banking infrastructure enhanced the access of economic agents, especially **individuals to banking services**. Presently, 7.6 banks and non-bank credit institutions and their divisions provide financial services to every 1000 m2 and 10 to every 100.000 individuals of age.

6.2. Liabilities of the banking system

The banking system continued to forge a stronger resource base principally by raising funding from more domestic sources in 2012.

In 2012, the total bank liabilities reached AZN15088.1 million having increased by 27.6% (AZN3 259.8 million). In the reported year, funds (deposits) drawn from legal entities (financial and non-financial institutions) and individuals traditionally had a large share in the set up of the banks' resource base. Individual and corporate deposits increased by 13.3% to AZN10 699.2 million during the reported year, thus constituting 71% of the total liabilities and 61% of the total assets. This growth was largely attributable to individual deposits.

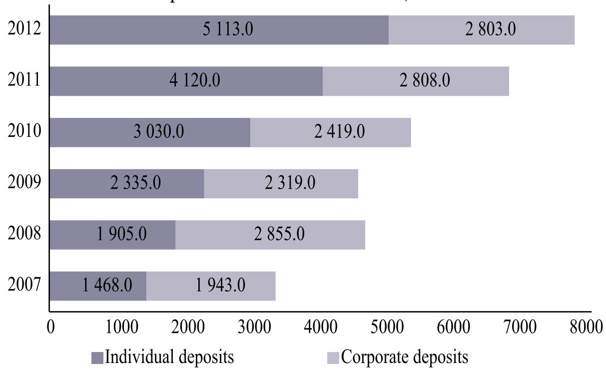
Chart 49. Structure of banks' resource base, %



Source: CBA

In 2012, household deposits increased by 24.1% to AZN5113.4 million, thus amounting to 34% of the total bank liabilities. Corporate deposits (non-financial institutions) totaled to AZN2803 million as at January 1, 2013. Corporates demonstrated a clear preference to term deposits, as term deposits outpaced demand deposits in growth during the year. Corporate term deposits accounted for 60% of the total corporate deposits.

Chart 50. Deposits of non-financial sector, AZN million



Source: CBA

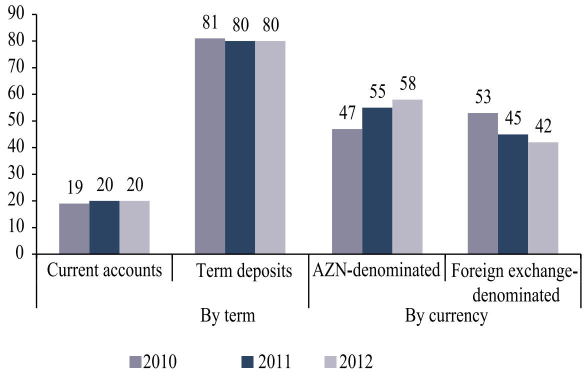
The deposit base displayed positive changes in terms of quality in addition to the quantifiable growth. **Term deposits** increased as a percentage of the total individual deposits: while individual current accounts rose by AZN199 million, term deposits went up by AZN794.5 million.

The dollarization level declined during the year as the Manat's exchange rate remained stable. Thus, national currency-denominated individual deposits increased by 30%, rising up to 58% of the total deposits (55% as at 01.01.2012).

No substantive changes occurred in the depositor structure, as resident individual depositors represented 88.5% and non-resident depositors accounted for 11.5% of the total individual deposits.

Funds obtained from the Central Bank amounted to 6.9% of the banking sector's year-end total liabilities.

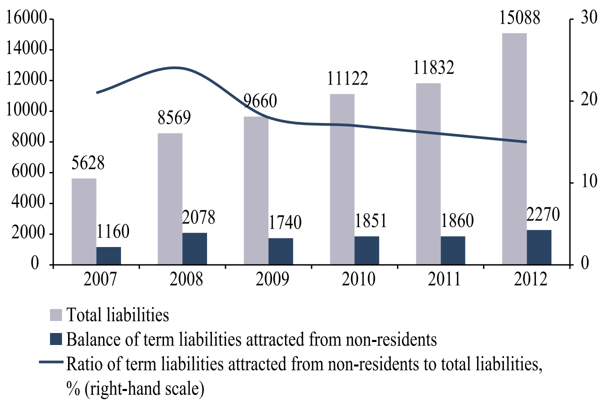
Chart 51. Structure of deposits, %



Source: CBA

In 2012, funds attracted from financial institutions (loans, deposits and other resources from other banks and other financial institutions) totaled to AZN4.1 billion (27.2% of the total bank liabilities) as of January 1, 2013.

Chart 52. Change path of external borrowings, AZN million



Source: CBA

Funds attracted from non-resident banks and international financial institutions totaled to AZN2269.5 million through a 22% increase. External borrowings remained positive, representing 15% of the total bank liabilities (against 16% as of January 1, 2012).

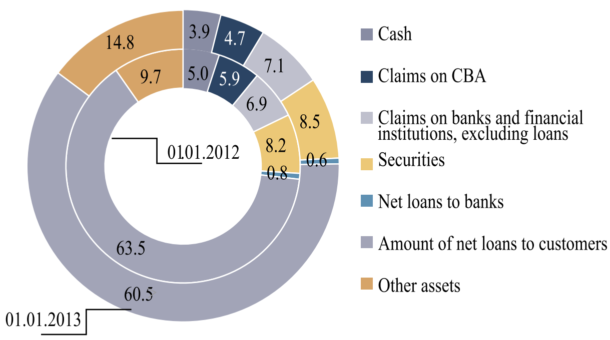
As banks reduced their dependency on external funding, substituting them increasingly with domestic deposits, they managed to enhance their ability to withstand external shocks and secure a more stable funding source to feed their lending activities.

6.3. Structure of the banking system's assets

During the reported year banks continued the provision of financial support to economic activity, and scored some positive structural shifts in assets.

In 2012 the total bank assets increased by AZN3696.6 million or 26.5% totaling to AZN17643.4 million. Bank loans increased by AZN2 700.6 million or 27.8%, reaching AZN12 399.4 million as at January 1, 2013. Loans represented 73% of the total assets.

Chart 53. Structure of assets, %



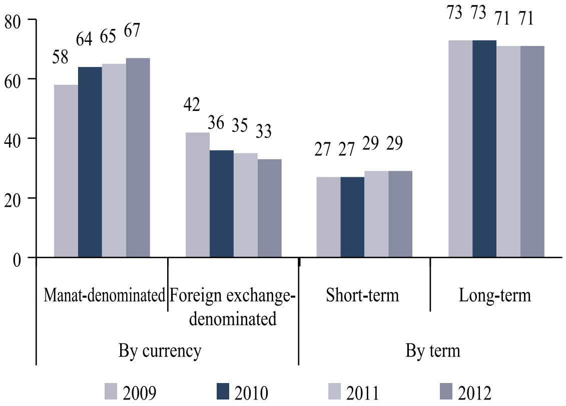
Source: CBA

The growth of the **loan portfolio** is largely attributable to individual deposits and the corporate sector's deposits.

Long-term loans increased by 28.1% to AZN 8751.5 million by the year-end. Long-term loans amounted to 76% of the total loan portfolio by the end of 2012.

The **currency structure of loans** also showed positive shifts during the year. The stable exchange rate enabled the national currency-denominated loans to have a growth rate (+32.3%) that exceeded the growth pace of foreign exchange-denominated loans (+19.7%) in 2012. Manat loans increased by 2.3% thus amounting to 67% of the total loan portfolio at the year-end.

Chart 54. Structure of loans, %



Source: CBA

Construction and real estate sectors (45.1%), energy and natural resources (71%%), transport and communications (96.7%), industry and production (122.6%), agriculture and processing industries (17.1%) showed the highest growth rates in terms of lending. Plastic card loans increased by 30% consequently to the introduction and facilitation of cutting-edge banking technologies and instruments.

Loans to households increased by 30.1%, totaling to AZN4014.3 million by the year-end, which represented 32.4% of the total loan portfolio. Consumer loans (for all lenders) increased by 33.7%, thus representing 77% of the total loans to households.

Mortgage loans had a growth rate of 22.2% in 2012; overall, mortgage lending amounted to AZN703.7 million as at January 1, 2013 (the mortgage loan portfolio totaled to AZN401.4 million as of 01.01.2012). Such loans represented 5.7% of the total (bank) loan portfolio as at 01.01.2013.

Investments in securities totaled to AZN1503.6 million as at January 1, 2013, which exceeds the previous year's level by 32% or AZN364.3 million. Securities represented 8.0% of the average assets. While corporate securities made up 70.8% (AZN959.7 million) of the securities portfolio in 2011, this indicator reached 71.1% (AZN1234 million) in 2012. Investments in government securities increased by 22%, totaling AZN481 million by the year-end.

6.4. Capital of the banking sector

Banks progressed further down the path of strengthening their equity base, and retained the overall capital adequacy of the banking system at an acceptable level.

The total bank capital increased by 36.4% or AZN686.9 million to AZN2573 million in 2012. Tier I capital increased represented 79.3% of the total capital, having increased by 32.5% during the year. In general, paid-in capital drove the increase (81.6%) in the total bank capital. Thus, paid-in capital increased by AZN540.8 million or 34.7%.

Table 11. Loans by sectors

	01.01.2012		01.01.2013		Change	
	AZN million	As percentage of total	AZN million	As percentage of total	AZN million	As percentage of total
Trade and services	2843.5	29.3	2648.2	21.4	-195.3	-6.9
Households	3085.2	31.8	4014.3	32.4	929.1	30.1
Agriculture and processing	457.2	4.7	535.4	4.3	78.2	17.1
Construction and real estate	875.3	9	1270.3	10.2	395	45.1
Industry and production	582.9	6	1297.6	10.5	714.7	122.6
Transport and communications	409.7	4.2	805.9	6.5	396.2	96.7
Other	1445.1	15	1827.7	14.7	382.6	26.5

Source: CBA

Table 12. Structure and development path of the banking sector's total capital, AZN million

	01.01.2012	01.01.2013
Tier I capital	**1 538.9**	**2039.6**
Change year-to-date, %	*-0.7*	*32.5*
Paid-in capital	1558.9	2099.7
Surplus	20.7	20.7
Net retained earnings	-40.7	-80.8
Deductions from Tier I capital	-36.5	-59.7
Tier II capital	**466.8**	**689**
Profits from the current year	163.5	195.6
General reserves	159.4	190.9
Other capital funds	143.9	302.6
Deductions from total capital	-83	-95.9
Total capital after deductions	**1886.2**	**2573.1**
Change year-to-date, %	*-0.6*	*36.4*

Source: CBA

The banking system maintained a high level of total **capital adequacy** (16.8%), substantively higher than the Central Bank's minimum requirement (12%) and the internationally accepted minimum (8%). The Tier I capital adequacy was also two times as much as the required minimum (12.9%).

6.5. Financial performance of the banking sector

Overall, the banking system's financial performance was satisfactory in 2012.

Profits earned by banks in 2012, before taxes, totaled AZN169.9 million, while net profits after taxes doubled against the previous year totaling to AZN130 million.

77% of banks completed the year of 2012 with profits of AZN195.5 million, while 23% of banks with losses of AZN65.5 million. Banks that completed the year with losses accounted for 9.3% of the total bank assets.

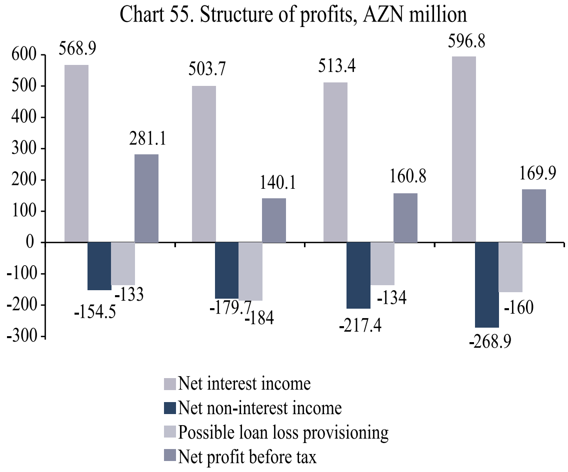
During the year **interest income** totaled to AZN1257.8 million having increased by 14.4% (with interest income on loans to customers increasing by 13.6% to AZN1 149.1 million) against the previous year. Total income of banks amounted to AZN1625.1 million, which exceeds the 2011 level by AZN204.3 million or 14.4%. Total interest income represented 77.4% of the total income in 2012.

Interest expenses totaled to AZN661 mil by the year-end having increased by 12.7% against the previous year. Despite the growth of the interest expenses in absolute terms, the ratio of such expenses to average assets decreased from 4.5% of 2011 to 4.3%.

Net interest profit of banks totaled to AZN596.8 million in 2012, which exceeds the 2011 level by AZN8.3 million or 16.2%.

Non-interest expenses of banks increased by 18.1% against the previous year, totaling to AZN635.9 million. Total non-interest expenses remained flat at 4.1% as a percentage of average assets, primarily due to the growth of salary, remuneration and other operating costs.

Chart 55. Structure of profits, AZN million



Source: CBA

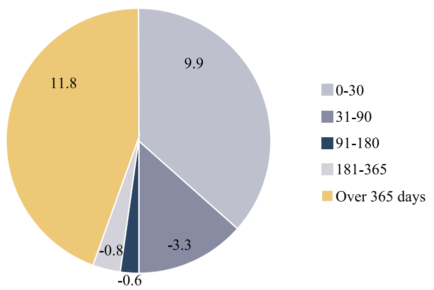
Return on assets of the banking sector (calculated as a ratio of net profits before taxes to average assets, ROA) made 0.8% in 2012, while return on equity (calculated as a ratio of net profits before taxes to average equity, ROE) amounted to 7.1%.

6.6. Risks of the banking sector

The banking system retained its financial stability, and kept risks at a manageable level in 2012. Analysis of asset and liability maturity mismatch indicates that the banking system's liquidity is at an acceptable level.

In the reported year, the banking system maintained a **level of liquidity** sufficient to honor its obligations to creditors and borrowers on time. Improvements in the term and currency structure of the banking system's deposit base made a positive contribution to the strengthening of the liquidity position.

Chart 56. Maturity mismatch of assets and liabilities (as percentage of assets, %), 01.01.2013



Source: CBA

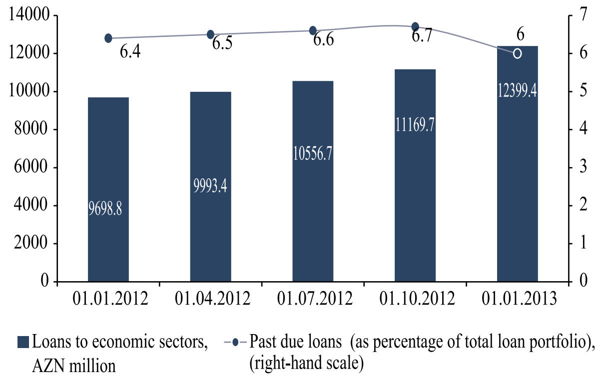
The high level of liquidity has enabled the banks to improve access to financial resources for borrowers, which, in its turn, fosters the banking system's financial depth.

As lending activities re-intensified during the reported year, highly marketable assets increased their percentage of total assets in excess of the regulatory minimum of 10%. The instant liquidity ratio was 66.8%, which exceeds the Central Bank's minimum requirement of 30%.

The maturity mismatch between assets and liabilities remained manageable, enabling the banking system to benefit from reduced liquidity risks.

Past due loans amounted to 6%, sub-standard loans for 11% of the total loan portfolio at the year-end.

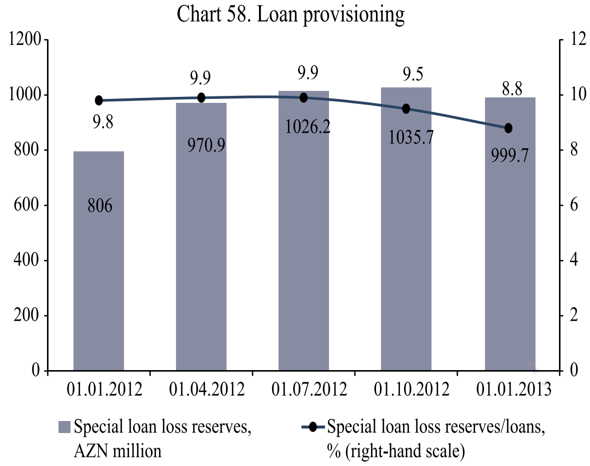
Chart 57. Characteristics of loans to economic sectors and past due loans



Source: CBA

The **loan loss reserves** amounted to 8.8% of the loan portfolio as of January 1, 2013 9.7% as of 01.01.2011).

Chart 58. Loan provisioning



Source: CBA

6.7. Bank supervision

The supervisory function's regulatory and oversight efforts in 2012 aimed at optimizing the balance of growth and sustainability. The supervisors were charged with the priority tasks of minimizing the systemic risks, tackling the banking sector's issues as they arise on an ongoing basis and securing its stable performance, as well as supporting the sector and maintaining public and investor confidence.

A number of significant decisions were made to facilitate the sector's development concept under the bank superivision umbrella. As a response to the sector's challenges, more supervisory tools were employed to a greater degree and depth, with the overall effectiveness of bank supervision improved.

As banks modified their business strategies and quicker sale channels were formed, new risks arose that needed to be addressed and contained. In this view, the supervisory function directed its efforts at monitoring intensively various risks inherent in the banking system alongside its financial strength and soundness using a **diversified quick reporting system**. In parallel, regular stress-tests were used as an effective tool for pro-active management of financial sustainability of the test outputs. Diagnostic tools were tailored to meet today's requirements; problem areas of the banking sector were identified.

Systemic risks were kept at bay during the year, and the sector's major trends and risk accumulation, as well as retail banking and consumer lending were reviewed and analyzed on a regular basis. A potential for positive growth and prospects of acceptable risks were identified and appropriate strategic recommendations were presented to banks.

The group approach to bank supervision was introduced in order to ensure targeted risk management and support an integrated and optimized distribution of supervisory processes. The framework of intensive macro- and micro-prudential supervision continued operating to handle the the systemic bank-specific risks.

With a view to enhancing the effectiveness of financial intermediation and financial strength, the **minimum total capital requirement** was raised to AZN50 million as of January 1, 2014. Banks that account for 89% of the total bank assets have already increased their capital to that level.

New supervisory tools were introduced with respect to **non-bank credit institutions (NBCI)**. The new regulations updated NBCI reporting to CBA; the new reporting system has had a trial run, and switched to risk-based case-by-case supervision.

The new **counter-cyclical management framework** of bank supervision was actively developed, building on its early warning capacities. A leverage ratio was introduced in order to improve the quality of bank capital and stimulate bank assets to grow in a stable fashion. Consideration was given to implementing a "sectoral capital buffer" that plays a particularly key role in ensuring the banking system's stability, alongside the new liquidity requirements suggested by Basel III standards in order to improve the liquidity management practices of banks.

A new policy framework was developed for the risk-based supervision framework in consistency with the best international practices that identify the architecture, key business processes and a hierarchy of responsibilities and authorities within the bank supervision system. The new policy framework's concept was grounded in a risk and systemic model. This model allows for carrying out structural assessments of risks and risk management functions of banks, as well as for effectively integrating the internal processes of the bank supervision function.

The *Regulation for Implementation of Corporate Governance Standards in Banks* and the *Risk Management Regulation for Banks* were revised in order to support the development of an effective and transparent **management and reporting system**, by introducing more stringent requirements to internal controls and risk management systems.

Preparations were continued in 2012 for the **Financial Sector Assessment Program**. An action plan was developed and executed that covered the functional areas (bank supervision, monetary policy and research, payment systems) to be accomplished by the central bank under the program. Also, draft amendments to the banking laws and regulations were developed.

The **consumers' rights protection initiative** focused primarily on increasing public awareness of banking services in 2012. Most inquiries received during the year centered on settlement of disputes arising from loan agreements, or revisions to repayment terms, as well as requests to grant mortgage loans and other loans. In addition, individuals filed in petitions requesting reimbursement of savings deposited in the USSR period and early 1990-ies, as well as plastic card and ATM-related issues to be handled. Responses were made to all inquiries and requests in accordance with the existing laws and necessary measures were taken to address the issues submitted.

The Government of Azerbaijan and the Swiss State Secretariat for Economic Issues (SECO) launched their joint effort, the "Project for Protection of Financial Services Consumers' Rights and Increasing Financial Awareness of the Public". The project developed a *Program for Protection of Banking Services Consumers' Rights*, which was approved by the competent government agency.

VII. MORTGAGE LENDING

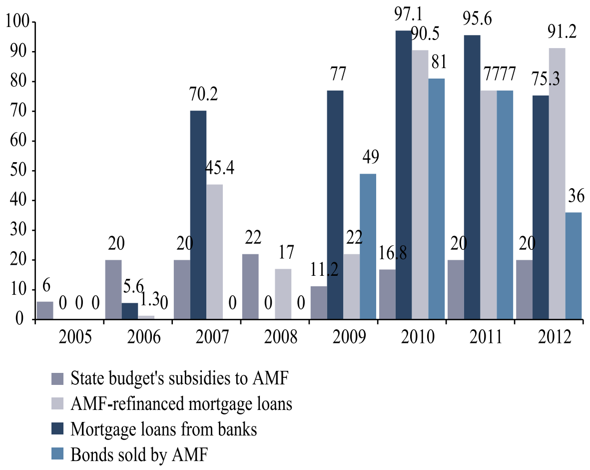
Continuing mortgage lending played a key role in improving consumers' housing conditions and supporting economic activity in 2012.

A total of AZN75.3 million of mortgage loans was channeled through authorized credit institutions to approximately 2000 individuals in 2012. Thereby, the Azerbaijan Mortgage Fund (AMF) counted AZN421 million worth of 1100 mortgage loans it had financed by the end of 2012. The Fund's refinanced loan portfolio totaled to AZN300 million.

The AMF continued to offer secured bonds, generating AZN36 million rom domestic market during the year.

The government's social policy of **discounted mortgage loans** (at 4% per annum interest rate) to special categories such as young families (members of Martyr and National Heroes' families, internally displaced persons, public servants, candidates of sciences or doctors of sciences, decorated/honorary accomplished masters of sports) and military servants. Discounted mortgage loans amounted to AZN29.4 million in the previous year, while the total discounted mortgage loan portfolio for the period of 2007-2012 amounted to AZN71.4 million

Chart 59. Financial resources by mortgage loans, AZN million



Source: CBA

(2177 loans). The state budget's subsidies made over the 2005-2012 period for mortgage loan refinancing totaled to AZN136 million.

Overall, the AMF, which had become an active player at the financial market, managed to raise AZN243 million worth of free market funds in 2009-2012.

The "BBB-" credit rating assigned to the Azerbaijan Mortgage Fund by Fitch Ratings was maintained at the same level as the country rating of Azerbaijan Republic. The AMF's success in retaining its investment grade international credit rating will enable the Fund to further improve its creditworthiness, gain access to international funds markets and offer its debt securities through such markets at favorable rates.

In addition, a mechanism was developed in 2012 for transferring claims on borrowers with deteriorating financial position.

The Fund completed the **Electronic Mortgage system** project, designed to automate mortgage lending, in 2012. This system will allow keeping track of mortgage loan requirements in real time, establishing a priority line for application review, automating lending and refinancing processes and properly managing operating risks.

Furthermore, a set of proposed actions was developed in conjunction with stakeholder agencies and submitted to the government for enhancing access to mortgage loans to young people and young families under the State Program "**Azerbaijan Youth in 2011-2015**". It proposes developing a state program that would cover a range of mortgage-related issues such as enhancing the scope and coverage of eligible young people and young families for inclusion in the discounted mortgage program, increasing the maximum amount of normal mortgage loans, developing a collateral mechanism for mortgage loans, and ensuring an integrated approach is used to foster the development of the residential construction sector and mortgage lending system, and many other issues at hand.

VIII. CENTRALIZED CREDIT REGISTRY

The Centralized Credit Registry continued to collect detailed credit information on individuals and legal entities with outstanding credit liabilities to banks in parallel to enabling users to make online inquiries in 2012.

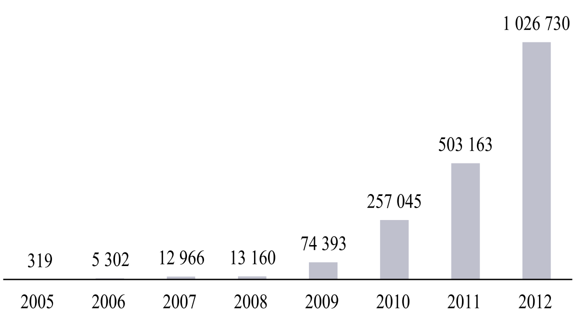
Non-bank credit institutions (NBCI's) continued to join the Centralized Credit Registry (CCR) in 2012. 9 more **NBCI's joined the register** in the reported year. 27 NBCI's and Agrar Kredit JSC completed their accession to the register by the year-end.

Branch office networks of banks and NBCI's also carried on with their CCR accession. 21 banks completed their branch office network accession to the CCR system; 423 branch offices were allowed direct access to the CCR's database. The number of system users neared 1000, rising continually as more requests from credit institutions are received regularly to this effect.

Under their revised by-laws **regional offices** of the Central Bank are authorized to respond to CCR queries and applications. Regional offices will start offering relevant services from 2013.

As part of the effort to **ease the use of CCR** for system users, a Technical Summary of Data Structure for uploading users, and a User's Manual to Borrower Queries for query makers were developed and disseminated to users; electronic copies of the documents were also made available in the system.

Chart 60. Number of queries



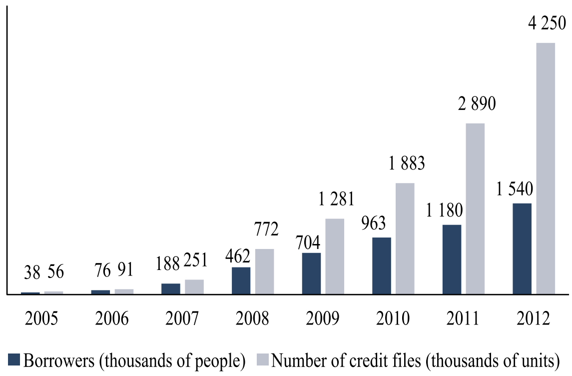
Source: CBA

A "Distant CCR Borrower Self-Query" form was developed and posted on the Central Bank's web-site, which will make it easier for users from different regions of the country to make CCR queries.

At the year-end, the CCR counted 1 540 096 borrowers, 4 249 977 credit files and 545 629 guarantors. 43 banks and 21 NBCI's used the registry during the year.

The CCR processed 1 026 730 inquiries during the reported period, which is 2.04 times more than the previous year's level (503 163 in 2011). 2 043 individuals made inquiries during the reported period (1 494 in 2011).

Chart 61. Development path of the CCR's data flows



Source: CBA

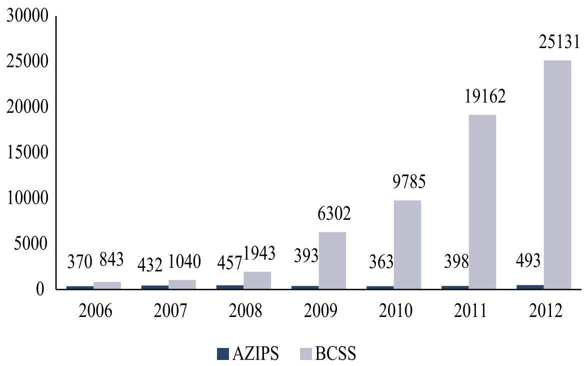
IX. PAYMENT SYSTEMS

9.1. Ensuring stable and reliable operation of payment systems

Alongside other priority tasks for 2012, the Central Bank focused on ensuring sound and reliable operation of the payment systems, upgrading the electronic payment services by enhancing their infrastructural capacities in accordance with best international practices and promoting effective use of such capacities.

Azerbaijan Interbank Settlement System (AZIPS) processed AZN107 billion (3 times as much as GDP) worth of 493 thousand payment documents, which exceeds the previous year's level by 7.8% (AZN7706 million) and 23.9% (95 thousand documents) accordingly. The system's average daily document load counted 2406 payment documents, with each one at AZN217 thousand.

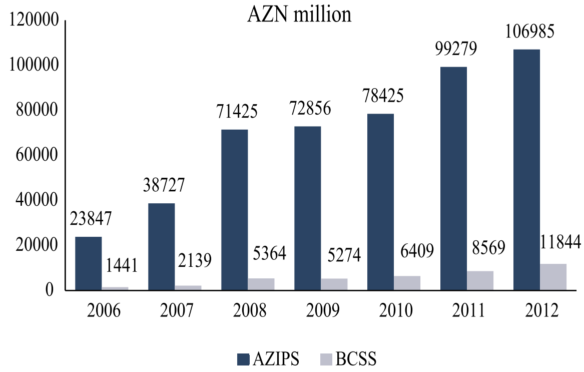
Chart 62. Number of payment documents in AZIPS and BCSS systems, thousands of pcs.



Source: CBA

The National Payment System's other major component, the Bulk Clearing and Settlement System (BCSS), processed a total of 25131 thousand payment documents for a total worth of AZN11.8 billion, which exceeds the previous year's level by 31.2% (5969 thousand documents) and 38.2% (AZN3275 million) correspondingly. On a daily basis the system processed on average 104.3 thousand documents, where each document amounted to AZN471 on average.

Chart 63. Total payments in AZIPS and BCSS systems, AZN million



Source: CBA

AZIPS had a 1.9% and BCSS a 98.1% share of the total number of payment documents in 2012, while AZIPS accounted for 90% of the total payments, with BCSS closing at 10%.

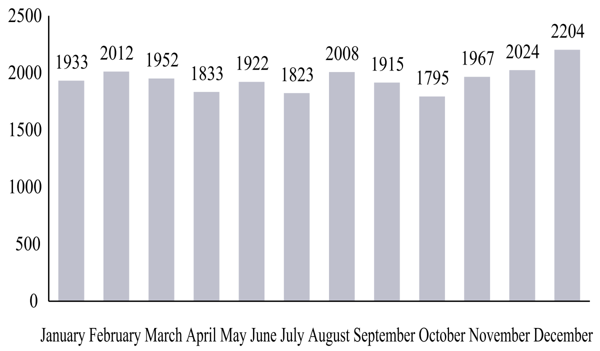
9.2. Development of the National Payment System

The functionalities and scope of use of the electronic payment systems were greatly enhanced as a result of the measures taken in the reported year.

Works were done to establish the Government Payment Portal using the technical and functional capacities of the CISMP.

Ministries of Taxes and Finance, the Chief Traffic Police Administration of the Ministry of Internal Affairs, as well as the State Social Protection Fund were integrated to the Government Payment Portal at the inception phase of the project. Consequently, Azerpost's offices and nearly 1200 payment offices of 41 banks have been equipped to offer cash payments, as well as web and ATM-based options for paying utility bills, taxes, traffic tickets and social security charges.

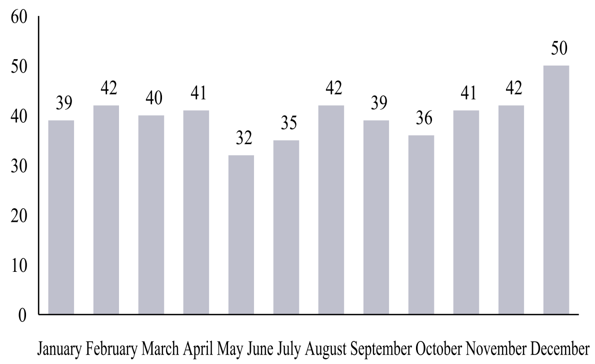
Chart 64. Total payments in CISMP, AZN million



Source: CBA

The system processed 23.4 million transactions for a total worth of AZN481.2 million in 2012. Transactions processed by the system increased by 46.6% (AZN153 mil) and the number of transactions by 18.8% (3.7 million) against the previous year's level.

Chart 65. Number of payments in CISMP, thousands of units



Source: CBA

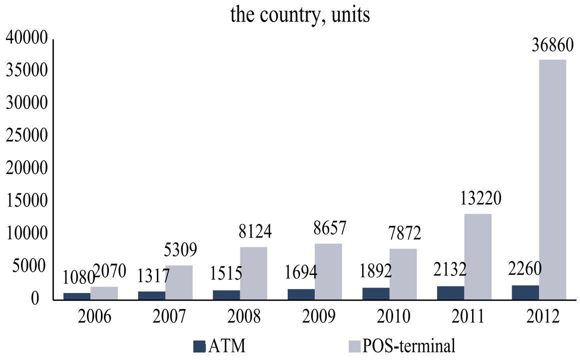
The project of implementing an **international bank account number (IBAN)** was successfully completed, which was designed to improve electronic customer identification, enhance automation of payment processing and eliminate the seggregated nature of the bank account structure. All banks switched to, and started actively operating the IBAN scheme as of 07.01.2013.

Azerpost LLC increased the number of post offices that provide financial services in 2012. Thus, the number of branch offices and post offices licensed by the Central Bank to provide financial services reached 63 and 945 respectively in 2012. Azerpost LLC joined MasterCard and issued 7284 MasterCard-branded cards. In parallel, 317 local cards were also issued.

The card infrastructure, especially its POS-terminal network component epxanded considerably in 2012. The number of POS-terminals across the country increased by 2.8 times (23640 units) to 36860 units (3231 units in rural areas). The number of POS-terminal transactions increased by 2.5 times (2.8 million) to 4.7 million transactions, while in monetary terms they increased by 53.7% (AZN208.4 million) to AZN597 million.

The number of ATM's increased by 6.9% (145 units) to 2260 units across the country. The number of ATM transactions increased by 4.8% (2240 thousand) to 48.8 million transactions, while in monetary terms they increased by 19.4% (AZN1241 million) to AZN7629 million.

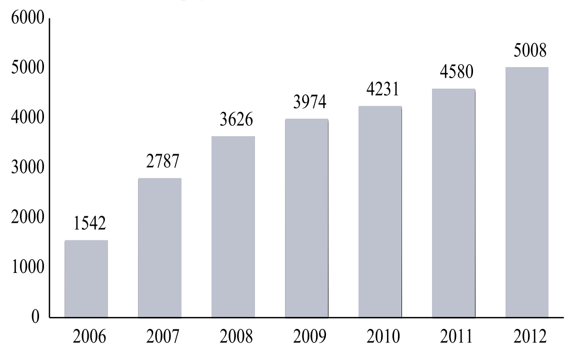
Chart 66. Number of ATM's and POS-terminals installed across the country, units



Source: CBA

During the year, the number of banks issuing payment cards reached 39, the number of cardholders – 4.42 million people, the number of cards – 5 million pieces, of which 4.6 million are debit and 407.9 thousand are credit cards.

Chart 67. Number of payment cards in circulation, thousands of units



Source: CBA

Visa cards accounted for 66.3%, MasterCards for 29.9% and other cards for 3.8% of the payment cards in circulation.

As part of the E-Government initiative, a **National Payment Board** was established, representing relevant government agencies and leading commercial banks, that has been charged with the task of coordinating the efforts of integrating the information systems of government agencies in the National Payment System's infrastructure as well as enhancing the extent to which electronic payment services are used.

A special focus was placed on **enhancing the security measures for card payments and fraud prevention**. To this end, a Working Group for Card Fraud Risk Control was established that consists of specialists from the Central Bank, Azerbaijan Bank Association, leading banks, card processing centers and law enforcement agencies, to develop necessary recommendations. An Action Plan was prepared that covers 3 years of the Board's operations. In parallel, the Central Bank developed Recommended Actions for Payment Card Fraud Prevention, aligned with the best international practices.

In order to stimulate payers to use payment cards for their tax, duty and other state budget payments, a lower fee limit was set for budget payments, which was coordinated and implemented in conjunction with Visa Inc and MasterCard Worldwide and their principal member banks.

A preliminary draft of the Law on **Payment Systems and Services** was developed, which is designed to expand the scope of use of innovative tools at the country's market, conceive and establish a proper supervisory framework for new service providers and fill in the existig legislative gaps.

The draft **Regulation for Issue and Uses of Payment Cards** was enacted into effect, which is a legal instrument designed for regulating the issue and use of payment cards, and provides legal guidance for managing card-related risks.

The Cabinet of Ministers approved the Regulation for Installation, Use and Application of POS-Terminals in Azerbaijan Republic and Identification Criteria for POS-Terminal Hosting Entities developed jointly by the Central Bank, Ministries of Tax and Economic Development to address the issues arising during registration and operation of POS-terminals.

The Central Bank developed and submitted to the government for review and approval the "**2013-2017 State Program for Expansion of the Scope of State-of-the-art Electronic Payment Services in Azerbaijan Republic**" to raise the non-cash turnover to a level compatible with that of developed countries, and to support and promote the use of non-cash payment tools, spread over the next 5 years.

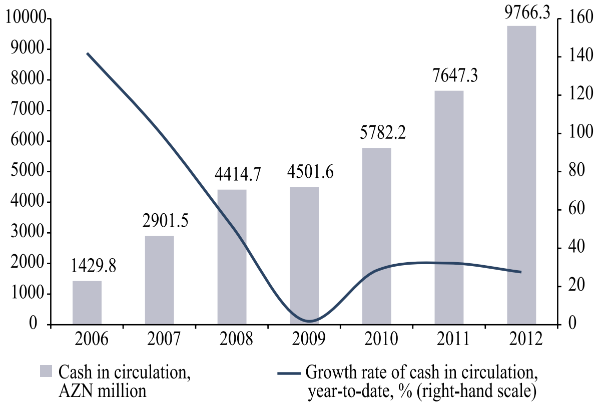
X. CASH CIRCULATION

10.1. Addressing the economy's cash requirements

In the reported year the Central Bank addressed the national economy's cash demand in full and on time, while forming up strategic reserves of bank notes and coins.

At January 1, 2013, the cash in circulation increased (including cash outside the banking system and in bank vaults) by 27.7% (AZN2.1 billion) to AZN9.8 billion, while in terms of units it increased by 17.2% (62.2 million units) year-to-date during 2012 thus reaching 422.9 million units.

Chart 68. Change of cash in circulation in 2006-2012 (year-end)



Source: CBA

Cash in circulation broke down as follows in 2012: 99.6% - bank notes, 0.4% metal coins in terms of amounts, and 50.5% - bank notes and 49.5% - metal coins in terms of number of units. Bank notes in circulation increased by 27.7% or AZN2.1 billion year-to-date thus reaching AZN9731.7 million, and by 16.5% or 30.3 mil units in terms of number of units to 213.6 million units. Coins rose by 18.6% or AZN5.4 million to AZN34.6 million, and by 18% or 31.9 million units to 209.4 million units.

The most used bank note in circulation during 2012 was the 100 Manat denomination, in terms of amount and units (74.3% or AZN7234.1 million, and 33.9% or 72.3 million in terms of units), while among coins the most used denomination was 50 copecks in terms of amount (AZN14 million), with the 20 copeck (65.9 million).

The average nominal weight of bank notes and coins in circulation increased against the previous year. The average nominal weight per bank note made AZN45.6, while for coins in made 16.6 copecks, which indicates that the 50 and 100 denominations of bank notes and 20 and 50 copecks of coins were the most used denominations in circulation.

In the reported year the Central Bank introduced AZN8.9 billion worth of 314.2 million units of money, while withdrawing AZN11.0 billion worth of 376.4 million units of money from circulation during the year. In general, the Central Bank's yearly issue of money totaled to AZN2.1 billion or 62.2 million units (including coins), against the

Table 12. Cash in circulation by bank notes

Denomination	Amount, AZN million	Million of units
1	49.0	49.0
5	108.8	21.8
10	147.0	14.7
20	397.1	19.9
50	1795.7	35.9
100	7234.1	72.3
Total:	9731.7	213.6

Source: CBA

last year's AZN1.9 billion (50.1 million units).

The Central Bank discovered only 610 units of counterfeit money (AZN10 798) in 2012. Compared to the relevant international experience, if only 1 counterfeit bank note is identified by the Central Bank for every 10-20 thousand bank notes in circulation, it means that there is only 1 counterfeit bank note for every 350 thousand bank notes circulating in Azerbaijan.

The process of withdrawing the old design bank notes (AZM) from circulation continued in 2012 as well. Overall, 6.1 thousand units or AZN72.3 million AZM (equivalent of AZN14.5 thousand) worth of old design notes were destroyed during the year. In general, 99% of AZM's in terms of amount were revoked and destroyed by the end of 2012.

The Central Bank carried on with the **Clean Money in Circulation Policy**, managing to maintain a high level of quality of money issued in circulation.

The Central Bank's Head Office and Regional Centers continued to replace bank notes received from the public. The Head Office and Regional Centers' overall bank note replacement transactions amounted to AZN2.3 million, of which 47.8% (AZN1.1 million) pertains to the Head Office, and 52.2% (AZN1.2 million) to Regional Centers.

To intensify the circulation of coins in 2012, the **Mobile Cash-Desk** set up at the Head Office and the Ganja Regional Center continued its operations. During the reported year, the Mobile Cash-Desks injected coins for a total worth of AZN1.8 million (10.5 million units), which made 21.5% of the total amount of coin money withdrawn year-to-date.

Two commercial banks continued the initiative of **Service to the Public** days, with the Central Bank's policy guidance and support, designed to address efficiently the ever increasing flow of cash-related inquiries and requests from the general public, as well as to conduct expert assessments and replace bank notes.

The Central Bank also continued to follow its earlier adopted policy of **issuing anniversary and memorial coins**. In 2012, silver coins were issued in commemoration of the Central Bank's 20th anniversary.

10.2. Cash management

The Central Bank took necessary measures to ensure that cash management meets best international practices, treasury infrastructures are optimized and upgraded to fully comply with international standards, cash-related business processes are entirely safeguarded and risks are minimized.

The Central Bank advanced further in implementing various projects under its **Program for Introduction of Best International Practices of Cash Management**.

Furthermore, the Central Bank carried on with the setting-up of a fully automated **Cash Center** that meets the internationally accepted standards. Proposals were assessed from international companies that possess the most extensive experience in establishing such systems.

In addition, the Central Bank continued to implement the project of creating a fully integrated **Cash Management Information System** (CMIS), and launched a range of processes supporting the implementation of the system.

The Central Bank continued implementing the project of **Creation of a New Logistics Model for Cash Management** with an aim to optimizing and upgrading the treasury infrastructures, and developing Regional Central Banking. Office buildings were constructed and commissioned for regional centers as part of the overall process of harmonizing such centers with contemporary requirements and best international practices and standards.

The management structure of Regional Centers was unified and streamlined to compliance with uniform standards in order to support the development of Regional Central Banking.

The Bank continued implementing the project of **Creating business processes based on international standards for expert assessment of bank notes**. The project initiated the establishment of a National Expert Assessment Center equipped with the state-of-the-art high technology systems.

The **Bank Note Development Capacity Building** project was launched; procedures were initiated to develop a Policy for formulating a design and safeguard philosophy for next generation bank notes, and issuing memorial and investment coins.

XI. HUMAN RESOURCES MANAGEMENT

In 2012, the Central Bank implemented a range of necessary measures to form a human capital with extensive professional knowledge, competencies and corporate values, and align the related management system with best international standards and practices.

The Bank focused on investing in training and education processes, introducing new forms of training, formulating step-by-step recruitment procedures and electronic testing, and finally, automating Human Resources Management (HRM) processes.

The **competence-based project of Establishing a Human Resources Management System (HRMS) to Motivate High Output Individual Performance and Development** was one of the Central Bank's top priority tasks under the 2011-2014 strategic plan. The project developed draft documents and project plans for its "Competence-Based Recruitment", "Workplace Analysis", "Job Categorization and Remuneration" and "Training Arrangements" sub-project components.

A number of amendments and revisions were made to the automated recruitment testing system and "Job Requirements/Qualifications" catalogue to ensure a more efficient candidate selection process as part of the **adequate staffing capacity building** endeavour of the Bank. Vacancies were regularly advertised through the Azerbaijani Association of US Alumni (AAA) and IRES AZ LLC's recruitment agency's official web-site in order to attract young, well-educated economics professionals.

In parallel, the Central Bank was afforded an opportunity to publicize the Central Bank's operations and HRM system at the "Graduate 2012" graduate fair organized by the Ministry of Education at the Azerbaijan State University of Economics. Consequently, the Central Bank's recruitment procedures improved and enhanced substantially against the previous year's level both in terms of quantity and quality. The number of job applicants increased by 37% to 1712 people, of which 49 were actually hired.

A more skill-oriented and effective training process was identified as a top priority, with a special focus placed on upgrading appropriate skill sets and qualifications in staff members.

Foreign language proficiency is a high training priority for the Bank's personnel. Staff members passed a series of tests delivered by the British Council to identify their proficiency levels in English.

The Internship Program continued to generate

Table 13. Central Bank's 2012 HRM

Overall for Central Bank												
				Education statistics (training/person)								
				In-house training			Outsourced training				External training
New hires	Dismissls	Promotions	Of which, based on seniority	Specialization	Management	Additional skills	Experience exchange	Semi nar	Certification course	Other	
49	41	33	5	11/164	0	3/66	8/12	91/98	8/8 & 18/9	9/7	14/187

Source: CBA

positive effects in 2012 as well by helping identify and educate young and promising bankers-to-be. Nearly 500 applications were filed with the Central Bank for internship at both national and foreign universities. Consequently, 75 interns were invited to 18 of the Central Bank's departments. Interns made roughly more than 6% of the Central Bank's overall hiring in 2012.

The Central Bank's **Human Resources Portal** was supplemented with a new module (creating a personalized profile for each staff member).

A performance evaluation carried out as part of the **employee motivation and performance appraisal** process resulted in 26 career advancements, 22 promotions and award of non-financial incentives to 22 staff members (letters of gratitude/recognition). Provision of life insurance policies to the Bank's personnel played a key role in enhancing employee motivation and social security.

The HRD completed another joint endeavor with Deloitte&Touche LLC for **HRM Process Automation.**

XII. COMMUNICATIONS OF THE CENTRAL BANK

The strategic objectives of the Central Bank's communication policy were devised on the over-reaching premise of enhancing public confidence in the Bank by improving the transparency of its operations, ensuring that the general public perceives the Bank's vision and mission statement as they are intended and providing an input to economic awareness of the general public.

The Bank's communication efforts in 2012 involved implementation of the **Program for Creation of a Contemporary Communication System**, as one of the key objectives under the Strategic Plan. The Bank worked to execute the action plans under the Program's "Development of an External Communication System", "Development of an Internal Communication System" and "Formulation of a Corporate Social Responsibility (CSR) Policy" projects.

In 2012, the Central Bank's web-site counted 960.1 thousand visitors, which exceeds the last year's level by 4.7%.

A total of 42 press-releases were prepared and posted on the Bank's web-site respecting the Central Bank's operations, the Governor's meetings, monthly statistics, importnat decisions made by the Central Bank and other issues. Press-releases were publicized via the press in accordance with best international practices. Dissemination of press-releases, which has improved in terms of quality and delivery methods, covered news, analyses, opinions, interviews, reports, statements and other communications involving the Central Bank, scoring a total of 383 information releases to general audiences.

The Bank's Translation Unit translated and posted on the Bank's web-site 106 publications (the Governor's interviews, articles, statistical summaries, regulations, etc.), as part of the overall endeavor to upgrade the web-site's English version.

A special page was designed and launched as an element of the Central Bank's official web-site to commemorate the Bank's 20th anniversary; the page contains press-releases and an image and video gallery covering the anniversarial events.

The Central Bank established effective working contacts with foreign mass media as well, taking them up yet another notch of professional and business relationships. The mass media outlets the Bank has built relationships with include Reuters, Bloomberg, Central Banking, RBK-Russia news agencies, Euromoney, Le Nouvel Economiste, Деньги и Кредит, Вопросы экономики, Forbes, BusinessNewEurope, Valeurs Actuelles, Financial Journal, The Banker magazines and The Guardian, USA Today newspapers. The Bank continued to closely monitor the mass media; senior executives of the Bank were interviewd by The Business Year and Interfax news agencies.

An "Open Doors Day" event was organized for journalists in recognition of the National Press Day. At this even hosting representatives of more than 15 print and other media providers, the Central Bank's department directors gave the journalists presentations of what their departments were doing.

Interviews of the Central Bank's officials for television channels, newspapers and news agencies represented an effective channel for communicating all the events organized by the Bank.

The Central Bank also worked to develop **an internal communication** system that served the purpose of providing the Bank's employees with better access to any information they may need, as well as giving them a better and profound knowledge of their own and others' roles within the organization, along with creating a platform for staff members to effectively share their views and opinions, all in line with the principal objective of enhancing the professionalism and qualifications of the staff.

A survey was conducted that included all of the Central Bank's employees, as an endeavour to examine the Bank's both internal and external perceptions. The anonymous survey sought to identify a range of internal factors that may have an impact on how the Bank is perceived both internally and externally. Following quality and quantity checks, survey findings were used as an aid in designing new development targets.

The “E-mails from the Governor” tradition was continued in an effort to reinforce the Governor’s in-house communications. A functional framework

Celebrating the 20th Anniversary of establishment of the Central Bank of Azerbaijan Republic

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for the Single Corporate Intranet was developed and thereafter moved to the next phase of producing this communication channel.

Corporate events represent a key element of effective internal communications. The CBA held its anniversarial celebration event at the Hilton Baku on February 11, 2012.

A documentary film entitled “Central Bank of Azerbaijan in 20 years” that gives an historical overview of the Central Bank’s operations was demonstrated at the event in parallel to airing on several television channels.

On December 28, 2012, an “Info Day” event was organized at the Central Bank, which involved all of its personnel. The event’s chief objective was to present the personnel’s inputs to the Bank’s corporate values, as well as academic and athletic achievements of staff members; prizes and gifts were presented.

Under the Bank’s internal communications development program, the Azerbaijan Bowling Sports Federation assisted the Central Bank in organizing a bowling contest for the Bank’s employees.

The Bank carried on with its efforts of instilling a **Corporate Social Culture** (CSC) by expanding the personnel’s level of engagement in a variety of social projects and promoting the culture of voluntary involvement in order to foster the sense of ownership and commitment to the Bank’s functional values. A CSC concept paper was prepared following a thorough investigation of the relevant experiences of leading central banks and reputable institutions.

The Central Bank organized a “Donate blood, save a life!” blood donation event. The blood collected and blood-based medications were handed over to relevant institutions for treatment of hemophilia and talassemia patients, as well as any other patients in need of blood transfusion.

All business units of the Central Bank joined in the Bank’s launch of a recycled paper and paper materials project in the reported year. Essentially an environmental protection endeavour, this CSC project is also expected to have a positive input to increasing public awareness and help nurture commitment to effective use of wastes.

XIII. INTERNAL AUDIT

As the Central Bank's unit responsible for evaluating the effectiveness of risk management and internal control systems and supporting improvements in management processes, the Internal Audit function carried on with its advisory and assurance work in 2012.

The 2011-2014 Strategic Plan contains a strategic goal of establishing a corporate governance system that would assist the Central Bank in improving its business efficiency, wherein exists a sub-project of fully aligning the **Internal Controls and Risk Management System** with best international standards and practices. As part of implementation of this sub-project, evaluation criteria were developed in 2012 for **elements of the supervisory environment.**

The internal audit function addressed **high risk areas** of business using the Central Bank's operational chart. To improve its own operating efficiency, the internal audit function leaned more towards using a rather proactive approach to controls.

The 2012 audits also supplied advisory services to the audited business units in addition to assurance services. Internal auditors worked closely with Deloitte&Touche to execute the Central Bank's **Information Technologies (IT) and Security Assessment**. The audit team adhered to the Internal Auditors Institute's, Information Systems Audit and Control Association (ISACA) and COBIT 4.1 and ISO 27002 standards.

The Central Bank worked out an **IT Development Strategy**. The project's next phase includes an intelligence/maturity assessment of IT processes under the latest Cobit 5.0 upgrade of international standards.

Considerable improvements were made to the audit function's **follow-up control activities** using the "what needs to be done" and "what has been done" questions as a comparative basis; furthermore, the underpinning guidelines and policies were modified to consistency with the current standards and best practices.

The Central Bank worked closely with external auditors to ensure that external and internal audit functions are properly coordinated and responsibility overlaps and job duplications are avoided.

The Bank's internal auditors carried on with their partnership relations with the Internal Auditors Institute and Information Systems Audit and Control Association (ISACA), as well as the Central Bank of Germany, to get the necessary assistance and insights in training design and delivery.

XIV. INFORMATION TECHNOLOGIES OF THE CENTRAL BANK

As the country's information and communication technologies, alongside electronic services, developed rapidly, with the backing of an increasingly automated process environment, the Central Bank found itself facing new IT development challenges. To address such challenges effectively, the Bank directed its efforts primarily at automating the operating, accounting and management systems, as well as ensuring reliable and sustainable operation of the information systems currently in use, with due consideration to upgrade needs and trends.

In addition to realizing its strategic IT objectives, the Central Bank worked to ensure that the Temenos General Ledger, Automated Bank Statistical Report, Centralized Credit Registry, internal communications, local networks, Archive/Records, Fina, a prudential reporting system for credit institutions, as well as the Central Bank's web-site are in full compliance with COBIT standards.

In general, the year 2012 was characterized with the Central Bank's successful completion of IT projects; information systems were set up that represent an important component of the nation-wide Electronic Azerbaijan platform, and a number of business processes were automated thereby minimizing the human involvement factor.

A new IBAN (International Bank Account Number) structure was introduced in the **Temenos General Ledger System** (GLS) that serves the purpose of improving customer identification in the electronic payment universe and de-seggregating the existing bank account structures. Consequently, all payment-related entries and communications exchanged by banks are now handled based on electronic payment documents generated in the newly implemented IBAN structure.

All balance sheet accounts inside the Temenos GLS have been switched to a new chart of accounts; the entire banking system moved to the new chart of accounts in 2013.

An online distant workplace was established in order to handle the daily payment transactions of the Financial Monitoring Service, Azerbaijan Mortgage Fund, State Oil Fund of Azerbaijan Republic, National Depository Center, Baku Stock Exchange, Baku Interbank Currency Exchange and Deposit Insurance Fund through their Central Bank accounts.

The Central Bank's Regional Offices were connected to the central software platform at the Central Bank's Head Office, which enables them to operate inside the system in order to allow for managing the regional operating and accounting processes in a centralized fashion. This technological capacity has helped to reduce dramatically operating and technical risks, while enhancing the management efficiency and enabling environment for developing a single hardware platform.

Special attention was given to the **Human Resources Management System**, one of the Central Bank's projects for management process automation and improvement of performance effectiveness and efficiency, as well as interactive evaluation procedures. The cutting-edge HR process management solution, Oracle E-Business Suite was used as a platform for building an electronic functionality operated as a means for complete automation of electronic employment, uploading of job applications to the system, HR planning and evaluation, motivation and education processes through integration with the Bank's web-site. The Human Resources Management System that will optimize human capital management was commissioned in 2013.

An **Electronic Statistical Database and Analytical Reporting System** (ESAS), a cutting-edge technology-based functionality, was established at the Central Bank for the purpose of developing a modern and standardized single-source statistical data platform for collecting, processing and disseminating financial sector statistics, with a special data upload portal. The ESAS has substantially improved the Central Bank's statistical and prudential report collection process and assisted in automating the control system in consideration of timeliness and quality criteria of data.

Commercial banks, non-bank credit institutions, Processing Centers and other entities were trained on a step-by-step basis and presented detailed explanations on the information system's operating procedures to ensure their untroubled connection to, and operation of the ESAS and portal.

An **Electronic Paperwork/Clerical System"** (EPS) has been established that will assist the Central Bank in exchanging electronic documents with other government agencies and institutions, receiving, registering, replying to and ensuring adequate follow-up on consumer inquiries, and switching the Central Bank's document flows from paper to electronic media. The EPS is integrated with the Central Bank's Electronic Signature Certification System; special electronic signature tools have been submitted to executive officers for signing electronic documents.

Another top priority IT and automation project was the creation of a fully automated contemporary treasury infrastructure and a new cash management system meeting modern requirements. To this effect, a **Cash Management Information System** project was launched, and business processes were identified that will be automated as part of this information system.

Yet another innovative project implemented by the Central Bank is the establishment of a **Cost Accounting System.** This information system will allow for identifying the financial costs of every business process and every functionality of the Bank. As a continuation of this work, Oracle Hyperion, a cutting-edge cost accounting solution, was procured and put in operation.

XV. INTERNATIONAL RELATIONS OF THE CENTRAL BANK

The Central Bank continued to work successfully on building and developing its foreign relations and international collaboration in 2012.

Strategic dialogue and partnership relations with international financial institutions and development agencies were reinforced, measures were taken to build new contacts, ongoing projects were continued and new projects were introduced during the reported year. A number of international events were held with the Central Bank's organizational input; the Bank's senior management's meetings and joint seminars with foreign central banks were duly organized and conducted.

In 2012, the Central Bank housed a number of significant international events. Thus, the **Second High Level Economic Policy Forum** was organized and held in Baku with the World Bank's assistance. The forum that covered the country's long-term social and economic development strategy invited the world's most reputable brain centers, Nobel prize laureates, as well as experts of worldwide renown to take part in intellectual discussions of international significance.

Furthermore, the Bank hosted the **27th convention of the Central Asian, Black Sea Region and Balkan States Central Bank Governors' Club** in Baku in 2012. The convention discussed the Eurozone's debt problem and its impact on non-EU Asian countries, along with the global financial stability and the member states' related experiences. Holding the convention in Baku afforded an opportunity to discuss collaborative relations and share experiences with the central banks of the member states.

A joint seminar was arranged that served as an inception meeting for the project of **Protection of Financial Services Consumers' Rights and Increasing Public Financial Awareness** in conjunction with the **World Bank** (WB). The principal objective of the project in relation to protecting bank services consumers' rights is to (i) improve the legal framework and regulatory mechanisms; (ii) develop and implement various methods and standards to enhance the quality of bank services; (iii) implement information/awareness methods and tools covering large groups of population.

IMF experts visited the CBA to discuss Paragraph IV of the Articles of Agreement with the **International Monetary Fund** (IMF). Meetings held covered a range of issues such as macroeconomic stability and the banking system's sustainability. The Central Bank invited the IMF's technical assistance for monetary policy and statistics, and worked closely with the Fund's experts to evaluate the prospects of the next **Financial Sector Assessment Program**.

Cooperation with foreign central banks represented a principal area of interest for the CBA in terms of international relations. CBA representatives went on study tours to the National Banks of Bulgaria, Austria, Czech Republic, Turkey, Poland and Switzerland, the Bundesbank, Federal Reserves Bank of Boston, the Monetary Agency of Saudi Arabia. In parallel, as part of its advisory services on various areas, the CBA arranged study tours for representatives of the national banks of Switzerland, Lithuania, Turkey and the Bundesbank to the Central Bank. The Bank worked with the Bundesbank to organize "Real Sector Monitoring", "Financial Stability" and "Creation of an Effective Communication System for the Central Bank" seminars in Baku.

Cooperation with international development agencies was also successfully continued during the reported year. Technical assistance projects provided with the assistance of the US Agency for International Development (USAID) were coordinated, including institutional capacity building for the Financial Monitoring Service, development of an automated cash management system, enhancement of the risk-based bank supervision, improvement of the institutional framework of strategic management and enhancement of the CBA's financial management capacities. The Swiss Secretariat for Economic Affairs (SECO), under its cooperation program, provided advisory support for improvement of the monetary policy. Presentation and Negotiation Skills, Basel II and International Accounting Reporting Standards seminars were organized in conjunction with the **Agency for Transfer of Financial Technology** (ATTF). With the support from the **Turkish International Cooperation Agency** (TIKA), the CBA's monetary policy, communication, human resources and cash management staff attended training courses delivered at the Central Bank of Turkey.

In 2012, **the Central Bank also continued to share its successful experiences with partner foreign central banks**. Study tours were arranged for representatives of partner central banks to the CBA for experience sharing on the CBA's role in stimulating the banking sector to facilitate and develop the retail payment network, CBA's regulatory activities with respect to the money transfer system employed by non-bank credit institutions, and retail money transfer expertise.

XVI. THE CENTRAL BANK`S 2012 FINANCIAL STATEMENTS

Independent Auditor's Report

To the Management Board of the Central Bank of the Republic of Azerbaijan:

We have audited the accompanying financial statements of the Central Bank of the Republic of Azerbaijan (the "Bank") which comprise the statement of financial position as of 31 December 2012 and the statements of comprehensive income, changes in equity and cash flows for the year then ended and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers Audit Azerbaijan LLC

19 April 2013
Baku, Azerbaijan

Statement of Financial Position

In thousands of Azerbaijani Manats	Note	31/12/2012	31/12/2011
ASSETS			
Cash and cash equivalents	7	5,816,626	6,682,504
Special Drawing Rights holdings with the International Monetary Fund	8	185,975	185,029
Trading securities	9	3,422,816	1,506,339
Loans to local banks	10	3,382,847	2,080,159
Investment securities	11	157,871	361,483
Promissory note from the Government	22	225,732	221,095
Premises and equipment	12	57,809	40,977
Intangible assets	12	14,512	9,617
Other financial assets	13	3,464	3,965
Other assets	14	40,868	46,433
TOTAL ASSETS		**13,308,520**	**11,137,601**
LIABILITIES			
Money issued in circulation	15	9,777,522	7,658,486
Amounts due to credit institutions	16	869,310	867,697
Amounts due to government organizations	17	2,348,298	2,503,224
Amounts due to other organisations	18	14,305	4,678
Debt securities in issue	19	119,930	50,185
Amounts due to international financial institutions	20	4,239	3,769
Liabilities on transactions with the International Monetary Fund	8	198,275	208,173
Other financial liabilities	21	6,203	2,150
Other liabilities		20	23
TOTAL LIABILITIES		**13,338,102**	**11,298,385**
EQUITY			
Charter capital	22	10,000	10,000
Capital reserves	22	209,517	209,517
Accumulated deficit		(249,099)	(380,301)
TOTAL EQUITY		**(29,582)**	**(160,784)**
TOTAL LIABILITIES AND EQUITY		**13,308,520**	**11,137,601**

The notes set out on pages 58 to 106 form an integral part of these financial statements.

Statement of Comprehensive Income

In thousands of Azerbaijani Manats	Note	2012	2011
Interest income	23	111,414	111,752
Interest expense	23	(2,381)	(2,118)
Net interest income		**109,033**	**109,634**
Impairment charge for interest-bearing assets	10	(15,288)	(5,963)
Net interest income after provision for loan impairment		**93,745**	**103,671**
Fee and commission income	24	3,908	7,884
Fee and commission expense	24	(760)	(724)
Gains less losses/(losses less gains) from trading securities		6,641	(9,948)
(Losses less gains)/gains less losses from financial derivatives	30	(7,229)	3,023
Losses less gains from trading in foreign currencies		(625)	(3,287)
Gains less losses/(losses less gains) from foreign exchange translation		77,751	(136,789)
Other operating income	25	3,531	1,649
Administrative and other operating expenses	26	(45,760)	(50,129)
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR		**131,202**	**(84,650)**

Statement of Changes in Equity

In thousands of Azerbaijani Manats	Charter capital	Capital reserves	Accumulated losses	Total equity
Balance at 1 January 2011	**10,000**	**209,517**	**(295,651)**	**(76,134)**
Total comprehensive loss for the year	-	-	(84,650)	(84,650)
Balance at 31 December 2011	**10,000**	**209,517**	**(380,301)**	**(160,784)**
Total comprehensive income for the year	-	-	131,202	131,202
Balance at 31 December 2012	**10,000**	**209,517**	**(249,099)**	**(29,582)**

The notes set out on pages 58 to 106 form an integral part of these financial statements.

Statement of Cash Flows

In thousands of Azerbaijani Manats	Note	2012	2011
Cash flows from operating activities			
Interest received		90,457	109,773
Interest paid		(2,722)	(2,000)
Fees and commissions received	24	3,908	7,884
Fees and commissions paid	24	(760)	(725)
Net losses from trading in trading securities		838	(12,227)
Net losses from financial derivatives		(4,882)	(84)
Net losses from trading in foreign currencies		(625)	(3,287)
Other operating income received	25	3,531	1,649
Staff costs paid	26	(14,261)	(13,718)
Administrative and other operating expenses paid	26	(23,911)	(30,323)
Cash flows from operating activities before changes in operating assets and liabilities		**51,573**	**56,942**
Net increase in trading securities		(1,873,566)	(766,465)
Net (increase)/decrease in SDR holdings with the International Monetary Fund		(661)	1,511
Net increase in loans to local banks		(1,301,597)	(172,136)
Net (increase)/decrease in other financial assets		1,284	210
Net decrease in other assets		5,566	32
Net increase in money issued in circulation		2,119,036	1,865,267
Net increase in amounts due to credit institutions		990	137,676
Net (decrease)/increase due to government organizations		(150,305)	1,258,668
Net increase in amounts due to other organisations		9,627	2,282
Net increase/(decrease) in other financial liabilities		2,336	(2,796)
Net increase/(decrease) in other liabilities		2,927	(63)
Net (used in)/cash from operating activities		**(1,132,790)**	**2,381,128**
Cash flows from investing activities			
Acquisition of investment securities		(3,033)	(3,712,444)
Proceeds from sales/redemption of investment securities		206,222	4,387,090
Acquisition of premises and equipment		(22,868)	(11,787)
Acquisition of intangible assets		(6,449)	(2,335)
Net cash generated from investing activities		**173,872**	**660,524**
Cash flows from financing activities			
Proceeds from debt securities issued		1,080,356	647,528
Repayment of debt securities issued		(1,010,657)	(631,575)
Proceeds from/(repayment of) borrowings from international financial institutions		479	(291)
Repayment of borrowings from International Monetary Fund		(9,815)	(15,153)
Net cash from financing activities		**60,363**	**509**
Effect of exchange rate changes on cash and cash equivalents		**32,677**	**(123,112)**
Net (decrease)/increase in cash and cash equivalents		**(865,878)**	**2,919,049**
Cash and cash equivalents at the beginning of the year	7	6,682,504	3,763,455
Cash and cash equivalents at the end of the year	7	**5,816,626**	**6,682,504**

The notes set out on pages 58 to 106 form an integral part of these financial statements.

Notes to the Financial Statements – 31 December 2012

1. Introduction

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2012 for the Central Bank of the Republic of Azerbaijan (the "Bank").

Principal activity. The Central Bank of the Republic of Azerbaijan (the "Bank") is the central bank of the Republic of Azerbaijan, and is wholly-owned by the Republic of Azerbaijan. It acts in accordance with the "Law on the Central Bank of the Republic of Azerbaijan" effective from 10 December 2004 (the "Law").

Article 4 of the Law sets out the goals of the Bank, which are as follows:

- The primary goal of the Bank is to ensure, within its power, the stability of prices;
- Ensure the development and strengthening of the banking and payment systems; and
- Profit making is not a primary goal of the Bank.

Article 5 of the Law sets out the functions of the Bank as follows:

- Determine and implement monetary policy;
- Organize cash circulation; in accordance with paragraph 2 of article 19 of the Constitution and the Law: issue, put into circulation, and withdraw banknotes from circulation;
- Determine and declare the official exchange rate of Azerbaijani Manat;
- Implement foreign currency regulation and control;
- Maintain and manage the gold and foreign currency reserves at its disposal;
- Manage the drawing up of the reporting balance of payments and participate in the drawing-up of the projected balance of payments of the country;
- In accordance with normative acts issued in accordance with the Laws of the Azerbaijan Republic "On Banks", "On Post" and "On Central Bank of the Azerbaijan Republic", licenses and regulates banking activities and supervises banking activities subject to procedures established by legislation.
- Determine, coordinate and regulate activities of payment systems;
- Implement other functions as stipulated by the legislation.

In accordance with Article 14.1 of the Law, the Bank cannot be declared bankrupt. Any deficit in capital is to be covered by the Government of Azerbaijan Republic. Refer to Note 22.

Pursuant to the legislation of the Republic of Azerbaijan and the international treaties acceded to by the Republic of Azerbaijan, the Bank represents the Republic of Azerbaijan in relations with the central banks of foreign states, as well as international financial and credit institutions in matters relating to the Bank's responsibilities.

The Bank may conclude agreements on cooperation with the central banks of foreign countries concerning various areas of its activities. It may also conclude clearing and settlement agreements and other agreements with foreign public and private clearing agencies, on its own behalf and on behalf of the Republic of Azerbaijan, if appropriately empowered.

The Bank may participate in the capital and activity of international organizations for the purpose of cooperation in monetary, foreign currency and banking areas.

At 31 December 2012, the Management Board (the "Board") of the Bank was composed of the following members:

Name	**Position**
Mr. Elman Rustamov	Governor
Mr. Alim Quliyev	First Deputy Governor
Mr. Aftandil Babayev	Deputy Governor
Mr. Vadim Khubanov	Deputy Governor
Mr. Khagani Abdullayev	Deputy Governor

Registered address and place of operations. The Bank's main office is located on the following address: 32 R. Behbudov Street, Baku, AZ1014, Azerbaijan. At 31 December 2012, the Bank had five regional branches in the Republic of Azerbaijan (31 December 2011: five). As of 31 December 2012, the Bank had 623 employees (31 December 2011: 617).
Presentation currency. These financial statements are presented in Azerbaijani Manats ("AZN"), the national currency of the Republic of Azerbaijan, unless otherwise stated.

2. Operating Environment of the Bank

A well-developed business and regulatory infrastructure is being established in Azerbaijan as a country with a newly emerged market economy. A number of developments are being implemented that positively affect the overall investment climate of the country.

Over the last few years the Azerbaijani government and the Bank implemented significant reforms necessary to create banking, judicial, taxation and regulatory systems. Those measures also included the adoption of a new body of legislation and amendments to the existing legislation. These steps will contribute to mitigation of the risks incurred by entities doing business in Azerbaijan.

The reforms aimed at the overall improvement of the business environment are expected to continue. However, the Azerbaijani economy is quite sustainable to market downturns and economic slowdowns in its partner countries. In spite of the fact the global economy is gradually recovering from the recession, persistence of significant risks remain in the global financial market and in capital markets instability. Growth and development of the Azerbaijan economy continued and sustainable macroeconomic stability was maintained at a time of such a situation in the global economy. The liquidity needs of the economy were fulfilled and stability of the exchange rate of the national currency was maintained through measures of the Azerbaijani Government.

In addition to these, monetary policy and banking operations carried out in Azerbaijan can be subject to certain risks. Currently, all the necessary measures are implemented to support the Bank's role in maintaining macroeconomic and financial stability. However, especially sharp changes of operating environment (including global environment) could affect the Bank's results and financial position in a manner not currently determinable.

3. Summary of Significant Accounting Policies

Basis of preparation. These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") under the historical cost convention, as modified by the initial recognition of financial instruments based on fair value, and by the revaluation of available-for-sale financial assets, and financial instruments categorised as at fair value through profit or loss. The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated (refer to Note 5).

Financial instruments - key measurement terms. Depending on their classification financial instruments are carried at fair value or amortised cost as described below.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair value is the current bid price for financial assets and current asking price for financial liabilities which are quoted in an active market. For assets and liabilities with offsetting market risks, the Bank may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange or other institution and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques such as discounted cash flows models or models based on recent arm's length transactions or consideration of financial data of the investees are used to fair value certain financial instruments for which external market pricing information is not available. Valuation techniques may require assumptions not supported by observable market data. Disclosures are made in these financial statements if changing any such assumptions to a reasonably possible alternative would result in significantly different profit, income, total assets or total liabilities.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial instrument. An incremental cost is one that would not have been incurred if the transaction had not taken place. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisors, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

Amortised cost is the amount at which the financial instrument was recognised at initial recognition less any principal repayments, plus accrued interest, and for financial assets less any write-down for incurred impairment losses. Accrued interest includes amortisation of transaction costs deferred at initial recognition and of any premium or discount to maturity amount using the effective interest method. Accrued interest income and accrued interest expense, including both accrued coupon and amortised discount or premium (including fees deferred at origination, if any), are not presented separately and are included in the carrying values of related items in the statement of financial position.

The effective interest method is a method of allocating interest income or interest expense over the relevant period so as to achieve a constant periodic rate of interest (effective interest rate) on the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts (excluding future credit losses) through the expected life of the financial instrument or a shorter period, if appropriate, to the net carrying amount of the financial instrument. The effective interest rate discounts cash flows of variable interest instruments to the next interest repricing date except for the premium or discount which reflects the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates. Such premiums or discounts are amortised over the whole expected life of the instrument. The present value calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Initial recognition of financial instruments. Trading securities and derivatives are initially recorded at fair value. All other financial instruments are initially recorded at fair value plus transaction costs. Fair value at initial recognition is best evidenced by the transaction price. A gain or loss on initial recognition is only recorded if there is a difference between fair value and transaction price which can be evidenced by other observable current market transactions in the same instrument or by a valuation technique whose inputs include only data from observable markets.

All purchases and sales of financial assets that require delivery within the time frame established by regulation or market convention ("regular way" purchases and sales) are recorded at trade date, which is the date that the Bank commits to deliver a financial asset. All other purchases are recognised when the Bank becomes a party to the contractual provisions of the instrument.

Derecognition of financial assets. The Bank derecognises financial assets when (a) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (b) the Bank has transferred the rights to the cash flows from the financial assets or entered into a qualifying pass-through arrangement while (i) also transferring substantially all the risks and rewards of ownership of the assets or (ii) neither transferring nor retaining substantially all risks and rewards of ownership but not retaining control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose restrictions on the sale.

Where the Bank has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Bank's continuing involvement is the amount of the transferred asset that the Bank may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Bank's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Cash and cash equivalents. Cash and cash equivalents are short-term items which are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Cash and cash equivalents consist of cash on hand in foreign currency and unrestricted balances on correspondent accounts including overnight deposits and deposits with a maturity of three months from origination. Cash and cash equivalents are carried at amortised cost.

Trading securities. Trading securities are financial assets which are either acquired for generating a profit from short-term fluctuations in price or trader's margin, or are securities included in a portfolio in which a pattern of short-term trading exists. The Bank classifies securities into trading securities if it has an intention to sell them within a short period after purchase, i.e. within one month. The Bank may choose to reclassify a non-derivative trading financial asset out of the fair value through profit or loss category if the asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of fair value through profit or loss category only in rare circumstances arising from a single event that is unusual and highly unlikely to reoccur in the near term. Financial assets that would meet the definition of loans and receivables may be reclassified if the Bank has the intention and ability to hold these financial assets for the foreseeable future or until maturity.

Trading securities are carried at fair value. Interest earned on trading securities calculated using the effective interest method is presented in profit or loss for the year as interest income. All other elements of the changes in the fair value and gains or losses on derecognition are recorded in profit or loss for the year as gains less losses from trading securities in the period in which they arise.

Loans and receivables. Loans and receivables including promissory note from the government are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available-for-sale. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the current year profit when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Impairment of financial assets carried at amortised cost. Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of the financial asset and which have an impact on the amount or timing of the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. If the Bank determines that no objective evidence exists that impairment was incurred for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realizability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue by more than ninety days and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- the borrower's credit rating is downgraded;
- there is an infringement of the original terms of the contract; or
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and the experience of management in respect of the extent to which amounts will become overdue as a result of past loss events and the success of recovery of overdue amounts. Past experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect past periods and to remove the effects of past conditions that do not exist currently.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Where possible, the Bank seeks to restructure financial assets held at amortised cost rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new terms. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. If the terms of an impaired financial asset held at amortised cost are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms.

Impairment losses are always recognized through allowance accounts to write down the asset's carrying amount to the present value of expected cash flows (which exclude future credit losses that have not been incurred) discounted at the original effective interest rate of the asset. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account through profit or loss for the year.

Uncollectible assets are written off against the related impairment loss provision after all the necessary procedures to recover the asset have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are credited to impairment loss account in profit or loss for the year.

Investment securities available for sale. This classification includes investment securities which the Bank intends to hold for an indefinite period of time and which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Investment securities available for sale are carried at fair value. Interest income on available-for-sale debt securities is calculated using the effective interest method and recognised in profit or loss for the year. All other elements of changes in the fair value are recognised in other comprehensive income until the investment is derecognised or impaired, at which time the cumulative gain or loss is reclassified from other comprehensive income to profit or loss for the year.

Impairment losses are recognised in profit or loss for the year when incurred as a result of one or more events ("loss events") that occurred after the initial recognition of investment securities available for sale. A significant or prolonged decline in the fair value of an equity security below its cost is an indicator that it is impaired. The cumulative impairment loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that asset previously recognised in profit or loss – is reclassified from other comprehensive income to profit or loss for the year. Impairment losses on equity instruments are not reversed and any subsequent gains are recognised in other comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through profit or loss for the year.

Sale and repurchase and reverse repurchase agreements. Sale and repurchase agreements ("repo agreements") which effectively provide a lender's return to the counterparty are treated as secured financing transactions. Securities sold under such sale and repurchase agreements are not derecognised. The securities are not reclassified in the statement of financial position unless the transferee has the right by contract or custom to sell or repledge the securities, in which case they are reclassified as repurchase receivables. The corresponding liability is presented within amounts due to credit institutions or other organizations.

Securities purchased under agreements to resell ("reverse repo agreements") which effectively provide a lender's return to the Bank are recorded as loans to local banks. The difference between the sale and repurchase price is treated as interest income and accrued over the life of reverse repo agreements using the effective interest method.

Investment securities held to maturity. This classification includes quoted non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank has both the intention and ability to hold to maturity. Management determines the classification of investment securities held to maturity at their initial recognition and reassesses the appropriateness of that classification at the end of each reporting period. Investment securities held to maturity are carried at amortised cost.

Premises and equipment. Premises and equipment are stated at cost less accumulated depreciation and provision for impairment, where required.

Costs of minor repairs and maintenance are expensed when incurred. Costs of replacing major parts or components of premises and equipment items are capitalised when the recognition criteria is met and the replaced part is retired.

At the end of each reporting period management assesses whether there is any indication of impairment of premises and equipment. If any such indication exists, management estimates the recoverable amount, which is determined as the higher of an asset's fair value less costs to sell and its value in use. The carrying amount is reduced to the recoverable amount and the impairment loss is recognised in profit or loss for the year. An impairment loss recognized for an asset in prior years is reversed if there has been a change in the estimates used to determine the asset's value in use or fair value less costs to sell.

Gains and losses on disposals determined by comparing proceeds with carrying amount are recognised in profit or loss for the year (within other operating income or expenses).

Depreciation. Depreciation of an asset begins when it is available for use. Land and construction in progress are not depreciated. Depreciation on other items of premises and equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives using the following rates:

	%
Buildings	3
Furniture and fixtures	20-25
Computers and office equipment	25
Motor vehicles	15

The residual value of an asset is the estimated amount that the Bank would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Intangible assets. The Bank's intangible assets have definite useful life and primarily include capitalised computer software and licenses.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring them to use. Development costs that are directly associated with identifiable and unique software controlled by the Bank are recorded as intangible assets if an inflow of incremental economic benefits exceeding costs is probable. Capitalised costs include staff costs of the software development team and an appropriate portion of relevant overheads. All other costs associated with computer software, e.g. its maintenance, are expensed when incurred. Capitalised computer software is amortised on a straight line basis over its expected useful lives.

Operating leases. Where the Bank is a lessee in a lease which does not transfer substantially all the risks and rewards incidental to ownership from the lessor to the Bank, the total lease payments are charged to profit or loss for the year (rental expense) on a straight-line basis over the period of the lease.

Leases embedded in other agreements are separated if (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset.

Borrowings. Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to Government, amounts due to credit institutions, amounts due to other organisations, debt securities issued, funds borrowed from international financial institutions and liabilities to International

Monetary Fund. These are initially recognised at fair value less directly attributable transaction costs. After initial recognition, borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in current year profit when the borrowings are derecognised as well as through the amortisation process.

Derecognition of financial liabilities. A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the current year profit.

Money issued in circulation. Money issued in circulation represents banknotes and coins issued by the Bank in accordance with the Law and its function as a central bank. Banknotes and coins in circulation are recorded in the statement of financial position at their nominal value net of cash in the Bank's cash offices.

The costs of the production of notes and coins are expensed upon delivery by the suppliers to the Bank.

When notes and coins are returned to the Bank by the commercial banks they are removed from notes in circulation and depending on their condition or legal tender status, are either held under the reserve funds of the Bank off-balance sheet or destroyed.

Amounts due to credit institutions. Amounts due to credit institutions are recorded when money or other assets are advanced to the Bank by counterparty banks. The non-derivative liability is carried at amortised cost. If the Bank purchases its own debt, the liability is removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains or losses arising from early retirement of debt.

Amounts due to government organisations and other organisations. Amounts due to government organisations and other organisations are non-derivative liabilities and are carried at amortised cost.

Debt securities in issue. Debt securities in issue include promissory notes issued by the Bank. Debt securities are stated at amortised cost. If the Bank purchases its own debt securities in issue, they are removed from the statement of financial position and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from early retirement of debt.

Derivative financial instruments. In the normal course of business, the Bank enters into derivative financial instruments such as forwards. Such financial instruments are held for trading and are recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in current year profit as gains less losses from trading securities or gains less losses from foreign currencies dealing, depending on the nature of the instrument.

Provisions for liabilities and charges. Provisions for liabilities and charges are non-financial liabilities of uncertain timing or amount. They are accrued when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Charter capital and capital reserves. The Bank's capital is comprised of its authorized paid-in capital and capital reserves. Refer to Note 22.

Income and expense recognition. Interest income and expense are recorded for all debt instruments on an accrual basis using the effective interest method. This method defers, as part of interest income or expense, all fees paid or received between the parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fees integral to the effective interest rate include origination fees received or paid by the entity relating to the creation or acquisition of a financial asset or issuance of a financial liability, for example fees for evaluating creditworthiness, evaluating and recording guarantees or collateral, negotiating the terms of the instrument and for processing transaction documents. Commitment fees received by the Bank to originate loans at market interest rates are integral to the effective interest rate if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after origination. The Bank does not designate loan commitments as financial liabilities at fair value through profit or loss.

When loans and other debt instruments become doubtful of collection, they are written down to the present value of expected cash inflows and interest income is thereafter recorded for the unwinding of the present value discount based on the asset's effective interest rate which was used to measure the impairment loss.

All other fees, commissions and other income and expense items are generally recorded on an accrual basis by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided. Loan syndication fees are recognised as income when the syndication has been completed and the Bank retains no part of the loan package for itself or retains a part at the same effective interest rate as for the other participants.

Commissions and fees arising from negotiating, or participating in the negotiation of a transaction for a third party, such as the acquisition of loans, shares or other securities or the purchase or sale of businesses, and which are earned on execution of the underlying transaction, are recorded on its completion. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-proportion basis. Asset management fees related to investment funds are recorded rateably over the period the service is provided. The same principle is applied for wealth management, financial planning and custody services that are continually provided over an extended period of time.

Taxation. The Bank is exempt from all taxes, except for taxes on employees' remuneration as a tax agent and social taxes, in accordance with the laws of the Republic of Azerbaijan.

Retirement and other benefit obligations. The Bank does not have any pension arrangements separate from the state pension system of Azerbaijan. In addition, the Bank has no post-retirement benefits or other significant compensation benefits requiring accrual. In accordance with the requirements of the Azerbaijan legislation, the Bank withholds amounts of pension contributions from employee salaries and pays them to the state pension fund. Upon retirement all retirement benefit payments are made by the state pension fund.

Membership in the IMF and other international financial institutions. Based on the provision of Article 9 of the Law of the Republic of Azerbaijan on the Central Bank of the Republic of Azerbaijan, the Bank acts as an intermediary of the Government of the Republic of Azerbaijan in transactions related to the membership of Azerbaijan in international financial organizations (e.g. IMF, World Bank), including payment of membership fees to such organizations.

The International Monetary Fund ("IMF") is an international organization established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. In accordance with the presidential decree issued in 1992, the Bank acts as a depository agent in relationships of Azerbaijan with the IMF and the role of fiscal agent is performed by the Ministry of Finance of the Republic of Azerbaijan.

Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription, or quota, is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. A member's quota delineates basic aspects of its financial and organizational relationship with the IMF.

Membership fees payable to IMF are denominated in Special Drawing Rights (SDR) and are revalued in AZN at the rate of exchange set by the IMF at year-end. Membership quota and securities issued by the Ministry of Finance of the Republic of Azerbaijan in respect of IMF quota are not presented in the statement of financial position as they do not represent the assets and liabilities of the Bank, but are disclosed in Note 8 to the financial statements.

General and special allocations received from the IMF to boost the liquidity of member countries are taken up by the Bank as an asset under SDR holdings with the IMF and on the other hand, as a liability to the Government of the Republic of Azerbaijan.

Contingencies. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognised in the statement of financial position but is disclosed when an inflow of economic benefits is probable.

Foreign currency translation. The functional and presentation currency of the Bank is the national currency of the Republic of Azerbaijan, Azerbaijani Manats ("AZN").

The financial statements are presented in Azerbaijani Manats, which is the Bank's functional and presentation currency. Transactions in foreign currencies are initially recorded in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the end of the reporting period. Gains and losses resulting from the translation of foreign currency transactions are recognised in current year profit or loss for the year (as foreign exchange translation gains less losses). Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the official exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the official rate on the date of the transaction are included in gains less losses from trading in foreign currencies.

The Bank used the following official exchange rates at 31 December 2012, 31 December 2011 and 31 December 2010 in the preparation of these financial statements:

	2012	**2011**	**2010**
1 US Dollar	AZN 0.7850	AZN 0.7865	AZN 0.7979
1 Euro	AZN 1.0377	AZN 1.0178	AZN 1.0560
1 Pound sterling	AZN 1.2694	AZN 1.2123	AZN 1.2377
1 Special Drawing Right	AZN 1.2058	AZN 1.2037	AZN 1.2234

Fiduciary assets. Assets held by the Bank in its own name, but on the account of third parties, are not reported in the statement of financial position. Commissions received from fiduciary activities are shown in fee and commission income.

Offsetting. Financial assets and liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts, and there is an intention to either settle on a net basis, or to realise the asset and settle the liability simultaneously.

Staff costs and related contributions. Wages, salaries, contributions to the Republic of Azerbaijan state pension and social insurance funds, paid annual leave and sick leave, bonuses, and non-monetary benefits are accrued in the year in which the associated services are rendered by the employees of the Bank. The Bank has no legal or constructive obligation to make pension or similar benefit payments beyond the payments to the State Social Security Fund under statutory defined contribution scheme.

Amendments of the financial statements after issue. The Management Board of the Bank has the power to amend the financial statements after issue.

4. Critical Accounting Estimates, and Judgements in Applying Accounting Policies

The Bank makes estimates and assumptions that affect the amounts recognised in the financial statements and the carrying amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Management also makes certain judgements, apart from those involving estimations, in the process of applying the accounting policies. Judgements that have the most significant effect on the amounts recognised in the financial statements and estimates that can cause a significant adjustment to the carrying amount of assets and liabilities within the next financial year include:

Impairment losses on financial assets carried at amortised cost. The Bank regularly reviews its financial assets carried at amortised cost to assess impairment. In determining whether an impairment loss should be recorded in profit or loss for the year, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of assets before the decrease can be identified with an individual asset in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience. A 10% increase or decrease in actual loss experience compared to the loss estimates used would result in an increase or decrease in loan impairment losses of AZN 5,767 thousand (2011: AZN 5,322 thousand), respectively. Impairment losses for individually significant loans are based on estimates of discounted future cash flows of the individual loans, taking into account repayments and realisation of any assets held as collateral against the loans. A 10% increase or decrease in the actual loss experience compared to the estimated future discounted cash flows from individually significant loans, which could arise from differences in amounts and timing of the cash flows, would result in an increase or decrease in loan impairment losses of AZN 2,977 thousand (2011: AZN 3,810 thousand), respectively.

Loans to local banks at refinancing rate. The Bank issues short and long-term loans to local banks at interest rates equal to the Bank's refinancing rate prevailing at the time of issuance and which may be lower than rates at which the local banks could ordinarily source the funds from commercial banks. Management has considered whether losses should arise on initial recognition of such instruments. As the transactions are with unrelated parties, management's judgment is that these lending activities are at the market rates and no initial recognition losses should arise. In making this judgment management also considered that these instruments are specific in nature due to their amount and terms attached and therefore, represent a separate market segment. The total carrying value of loans to local banks is disclosed in Note 10.

Entities not subject to consolidation. As of 31 December 2012, the Bank had two entities acting under the Bank: the Azerbaijan Mortgage Fund ("AMF") and the Financial Monitoring Service ("FMS"). These entities are not consolidated in these financial statements due to the fact that the Bank does not have actual control over these entities. While the Bank acts as supervisor of these entities as mandated by law, it has no title over their assets and liabilities, has no share ownership and rights over their economic benefits arising from their activities. The management believes that, had these two entities been consolidated to the financial statements of the Bank, total assets of the Bank at 31 December 2012 would not be different by more than 3% of current total assets (31 December 2011: 3%).

5. Adoption of New or Revised Standards and Interpretations

The following new standards and interpretations became effective for the Bank from 1 January 2012:

"Disclosures—Transfers of Financial Assets" – Amendments to IFRS 7 (issued in October 2010 and effective for annual periods beginning on or after 1 July 2011). The amendment requires additional disclosures in respect of risk exposures arising from transferred financial assets. The amendment includes a requirement to disclose by class of asset the nature, carrying amount and a description of the risks and rewards of financial assets that have been transferred to another party, yet remain on the entity's balance sheet. Disclosures are also required to enable a user to understand the amount of any associated liabilities, and the relationship between the financial assets and associated liabilities. Where financial assets have been derecognised, but the entity is still exposed to certain risks and rewards associated with the transferred asset, additional disclosure is required to enable the effects of those risks to be understood. The standard requires these new disclosures to be presented in a separate note.

6. New Accounting Pronouncements

Certain new standards and interpretations have been issued that are mandatory for the annual periods beginning on or after 1 January 2013 or later, and which the Bank has not early adopted.

IFRS 9 "Financial Instruments Part 1: Classification and Measurement". IFRS 9, issued in November 2010, replaces those parts of IAS 39 relating to the classification and measurement of financial assets. IFRS 9 was further amended in October 2010 to address the classification and measurement of financial liabilities and in December 2011 to (i) change its effective date to annual periods beginning on or after 1 January 2015 and (ii) add transition disclosures. Key features of the standard are as follows:

- Financial assets are required to be classified into two measurement categories: those to be measured subsequently at fair value, and those to be measured subsequently at amortised cost. The decision is to be made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

- An instrument is subsequently measured at amortised cost only if it is a debt instrument and both (i) the objective of the entity's business model is to hold the asset to collect the contractual cash flows, and (ii) the asset's contractual cash flows represent payments of principal and interest only (that is, it has only "basic loan features"). All other debt instruments are to be measured at fair value through profit or loss.

- All equity instruments are to be measured subsequently at fair value. Equity instruments that are held for trading will be measured at fair value through profit or loss. For all other equity investments, an irrevocable election can be made at initial recognition, to recognise unrealised and realised fair value gains and losses through other comprehensive income rather than profit or loss. There is to be no recycling of fair value gains and losses to profit or loss. This election may be made on an instrument-by-instrument basis. Dividends are to be presented in profit or loss, as long as they represent a return on investment.

- Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

While adoption of IFRS 9 is mandatory from 1 January 2015, earlier adoption is permitted. The Bank is considering the implications of the standard, the impact on the Bank and the timing of its adoption by the Bank.

IFRS 10, Consolidated Financial Statements (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces all of the guidance on control and consolidation in IAS 27 "Consolidated and separate financial statements" and SIC-12 "Consolidation - special purpose entities". IFRS 10 changes the definition of control so that the same criteria are applied to all entities to determine control. This definition is supported by extensive application guidance.
The Bank is currently assessing the impact of the amended standard on its financial statements.

IFRS 11, Joint Arrangements, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), replaces IAS 31 "Interests in Joint Ventures" and SIC-13 "Jointly Controlled Entities—Non-Monetary Contributions by Ventures". Changes in the definitions have reduced the number of types of joint arrangements to two: joint operations and joint ventures. The existing policy choice of proportionate consolidation for jointly controlled entities has been eliminated. Equity accounting is mandatory for participants in joint ventures. The new standard does not have any impact on these financial statements.

IFRS 12, Disclosure of Interest in Other Entities, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), applies to entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. It replaces the disclosure requirements currently found in IAS 28 "Investments in associates". IFRS 12 requires entities to disclose information that helps financial statement readers to evaluate the nature, risks and financial effects associated with the entity's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities. To meet these objectives, the new standard requires disclosures in a number of areas, including significant judgements and assumptions made in determining whether an entity controls, jointly controls, or significantly influences its interests in other entities, extended disclosures on share of non-controlling interests in group activities and cash flows, summarised financial information of subsidiaries with material non-controlling interests, and detailed disclosures of interests in unconsolidated structured entities.

IFRS 13, Fair value measurement, (issued in May 2011 and effective for annual periods beginning on or after 1 January 2013), aims to improve consistency and reduce complexity by providing a revised definition of fair value, and a single source of fair value measurement and disclosure requirements for use across IFRSs. The Bank is currently assessing the impact of the standard on its financial statements.

IAS 27, Separate Financial Statements, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013), was changed and its objective is now to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The guidance on control and consolidated financial statements was replaced by IFRS 10, Consolidated Financial Statements.

IAS 28, Investments in Associates and Joint Ventures, (revised in May 2011 and effective for annual periods beginning on or after 1 January 2013). The amendment of IAS 28 resulted from the Board's project on joint ventures. When discussing that project, the Board decided to incorporate the accounting for joint ventures using the equity method into IAS 28 because this method is applicable to both joint ventures and associates. With this exception, other guidance remained unchanged.

Amendments to IAS 1, Presentation of Financial Statements (issued June 2011, effective for annual periods beginning on or after 1 July 2012), changes the disclosure of items presented in other comprehensive income. The amendments require entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be reclassified to profit or loss in the future. The suggested title used by IAS 1 has changed to 'statement of profit or loss and other comprehensive income'. The Bank expects the amended standard to change presentation of its financial statements, but have no impact on measurement of transactions and balances.

Amended IAS 19, Employee Benefits (issued in June 2011, effective for periods beginning on or after 1 January 2013), makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits. The standard requires recognition of all changes in the net defined benefit liability (asset) when they occur, as follows: (i) service cost and net interest in profit or loss; and (ii) remeasurements in other comprehensive income. ***Disclosures—Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013)***. The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments.

"Offsetting Financial Assets and Financial Liabilities" - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014). The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement. The Bank is considering the implications of the amendment, the impact on the Bank and the timing of its adoption by the Bank.

Improvements to International Financial Reporting Standards (issued in May 2012 and effective for annual periods beginning 1 January 2013). The improvements consist of changes to five standards. IFRS 1 was amended to (i) clarify that an entity that resumes preparing its IFRS financial statements may either repeatedly apply IFRS 1 or apply all IFRSs retrospectively as if it had never stopped applying them, and (ii) to add an exemption from applying IAS 23 "Borrowing costs", retrospectively by first-time adopters. IAS 1 was amended to clarify that explanatory notes are not required to support the third balance sheet presented at the beginning of the preceding period when it is provided because it was materially impacted by a retrospective restatement, changes in accounting policies or reclassifications for presentation purposes, while explanatory notes will be required when an entity voluntarily decides to provide additional comparative statements. IAS 16 was amended to clarify that servicing equipment that is used for more than one period is classified as property, plant and equipment rather than inventory. IAS 32 was amended to clarify that certain tax consequences of distributions to owners should be accounted for in the income statement as was always required by IAS 12. IAS 34 was amended to bring its requirements in line with IFRS

8. IAS 34 will require disclosure of a measure of total assets and liabilities for an operating segment only if such information is regularly provided to chief operating decision maker and there has been a material change in those measures since the last annual financial statements.

Transition Guidance Amendments to IFRS 10, IFRS 11 and IFRS 12 (issued in June 2012 and effective for annual periods beginning 1 January 2013). The amendments clarify the transition guidance in IFRS 10 "Consolidated Financial Statements". Entities adopting IFRS 10 should assess control at the first day of the annual period in which IFRS 10 is adopted, and if the consolidation conclusion under IFRS 10 differs from IAS 27 and SIC 12, the immediately preceding comparative period (that is, year 2012 for a calendar year-end entity that adopts IFRS 10 in 2013) is restated, unless impracticable. The amendments also provide additional transition relief in IFRS 10, IFRS 11 "Joint Arrangements" and IFRS 12 "Disclosure of Interests in Other Entities", by limiting the requirement to provide adjusted comparative information only for the immediately preceding comparative period. Further, the amendments will remove the requirement to present comparative information for disclosures related to unconsolidated structured entities for periods before IFRS 12 is first applied.

Amendments to IFRS 1 "First-time adoption of International Financial Reporting Standards - Government Loans" (issued in March 2012 and effective for annual periods beginning 1 January 2013). The amendments, dealing with loans received from governments at a below market rate of interest, give first-time adopters of IFRSs relief from full retrospective application of IFRSs when accounting for these loans on transition. This will give first-time adopters the same relief as existing preparers.

Other revised standards and interpretations: IFRIC 20 "Stripping Costs in the Production Phase of a Surface Mine", considers when and how to account for the benefits arising from the stripping activity in mining industry. The interpretation will not have an impact on the Bank's financial statements.

Unless otherwise described above, the new standards and interpretations are not expected to affect significantly the Bank's financial statements.

7. Cash and Cash Equivalents

In thousands of Azerbaijani Manats	**31/12/2012**	**31/12/2011**
Cash on hand	99,238	100,928
Placements with non-resident credit institutions	5,717,388	6,581,576
Total cash and cash equivalents	**5,816,626**	**6,682,504**

At 31 December 2012 cash and cash equivalents included AZN 5,121,098 thousand placed with two internationally recognised Organization for Economic Co-operation and Development ("OECD") banks (31 December 2011: AZN 6,063,233 thousand placed with two internationally recognised OECD banks).

The credit quality of current accounts with non-resident credit institutions may be summarised, based on the lowest of the ratings assigned by Standard and Poor's, Fitch Ratings and Moody's, as follows at 31 December 2012 and 2011:

In thousands of Azerbaijani Manats	**Current accounts with non-resident credit institutions (31/12/12)**	**Current accounts with non-resident credit institutions (31/12/11)**
Neither past due nor impaired		
- AAA rated	2,889,634	2,291,593
- AA- to AA+ rated	2,770,011	4,289,976
- A- to A+ rated	57,743	7
Total cash and cash equivalents, excluding cash on hand	**5,717,388**	**6,581,576**

Interest rate, currency and geographical analyses of cash and cash equivalents are disclosed in Note27.

8. Balances with the International Monetary Fund

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Assets		
Special Drawing Rights (SDR) holdings	185,975	185,029
Liabilities		
IMF current accounts	656	659
Borrowings from the IMF:		
Poverty Reduction and Growth Facility (PRGF)	12,415	22,598
SDR allocation:		
General allocation	143,853	143,630
Special allocation	41,351	41,286
Total SDR allocation	**185,204**	**184,916**
Total liabilities on transactions with the International Monetary Fund	**198,275**	**208,173**
Off-balance sheet balances:		
IMF Quota	195,367	205,674
Securities held in custody in respect of the IMF quota	(195,367)	(205,674)

SDR holdings. SDR holdings represent the current account with the IMF used for borrowings and settlements with the IMF. Interest accrued in respect of SDR holdings is calculated using the rate set by the IMF weekly on the basis of short-term market rates in major money markets. Average rate earned during 2012 was 0.11% per annum (2011: 0.40%).

IMF current accounts. The Bank maintains two separate accounts with IMF for special purposes: IMF No. 1 and IMF No. 2. IMF No. 1 account is used for paying commissions for the transactions with IMF, whereas IMF account No. 2 is used for covering expenses of the IMF representatives during their visit to member countries.

Borrowings. Borrowing from the IMF is a loan to the Government of the Republic of Azerbaijan with original maturity of ten years and bears interest 0.5% (31 December 2011: 0.5%) per annum. The borrowing is denominated in SDR and matures in 2015. The Government of the Republic of Azerbaijan has a legal obligation for the repayment of funds borrowed from the IMF that are maintained with the Bank in its depository role and the borrowing is treated by the Bank as a liability to the Government.

SDR allocation. SDR allocation is an unconditional distribution of SDR amounts to members by decision of the IMF. A general SDR allocation became effective 28 August 2009. The allocation is designed to provide liquidity to the global economic system by supplementing the IMF member countries' foreign exchange reserves. The general SDR allocation was made to IMF members in proportion to their existing IMF quotas. Separately, on 10 August 2009, the Fourth Amendment to the IMF Articles of Agreement providing for a special one-time allocation of SDRs entered into force to boost global liquidity. According to the amendment, the special allocation was made to IMF members, which includes Azerbaijan, on 9 September 2009. Members and prescribed holders may use their SDR holdings to conduct transactions with the IMF. The Bank treats the allocation as foreign exchange liability to the Government of the Republic of Azerbaijan.

IMF Quota and Securities held in custody in respect of IMF Quota. The IMF Quota, in the amount of SDR 160.9 million which has remained fixed since 25 January 1999, represents the membership subscription of the Republic of Azerbaijan with the IMF. Securities were issued by the Government of the Republic of Azerbaijan as a guarantee for this amount and are held by the Bank for the benefit of the IMF.

9. Trading Securities

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
US Treasury notes	2,309,681	260,950
Agency notes	510,980	729,686
Notes issued by international financial institutions	259,672	189,223
Regional authority notes	117,745	161,200
Government bonds	113,575	51,907
UK Treasury notes	102,946	102,568
Corporate bonds	8,217	10,805
Total trading securities	**3,422,816**	**1,506,339**

	31/12/2012		31/12/2011	
	Coupon rate	Maturity	Coupon rate	Maturity
US Treasury notes	0.13% - 2.63%	2013 - 2019	0% - 3.50%	2012 - 2018
Agency notes	0% - 5.50%	2013 – 2017	0% - 5.25%	2012 - 2014
Notes issued by international financial institutions	0.37% - 6.00%	2013 - 2018	0.51% - 4.50%	2013 - 2015
Regional authority notes	0%	2013	0% - 0.94%	2012
Government bonds	0% - 6.75%	2013 - 2021	0.50% - 6.75%	2012 - 2021
UK Treasury notes	2.75% - 3.75%	2015 - 2021	0% - 6.59%	2012 - 2021
Corporate bonds	1.25% - 5.25%	2014 – 2022	0.78% - 4.10%	2012 - 2016

The Bank uses reputable asset managers for the management of certain of its trading securities per set investment guidelines which include the requirement that the issuers of such securities are all domiciled in OECD countries.

Agency notes are represented by US Dollar and Euro denominated notes issued by international financial agencies of Europe and USA, and were managed by the Bank and Bank's external managers.

US Treasury notes are US dollar denominated notes issued by the US Government and traded internationally, with semi-annual coupon payments, and were managed by the Bank and Bank's external managers.

Government bonds are represented by US Dollar and Euro denominated notes issued by foreign governments, and were managed by the Bank and Bank's external managers.

Notes issued by international financial institutions are represented by US Dollar, Euro and British Pound Sterling of International Bank for Reconstruction and Development and other international financial institutions, and managed by the Bank and Bank's external managers.

Regional authority notes are US Dollar denominated notes issued by Canadian regional authority and were managed by the Bank's external managers.

UK Treasury notes are British Pound Sterling denominated notes issued by the UK Government and traded internationally, with semi-annual coupon payments, and were held and managed by the Bank and Bank's external managers.

Corporate bonds are represented by US Dollar, Euro and British Pound Sterling denominated bonds of financial corporations, and were managed by the Bank's external managers.

Trading securities are carried at fair value which reflects any credit risk related write-downs. As trading securities are carried at their fair values based on observable market data using bid prices primarily from Bloomberg, the Bank does not analyse or monitor impairment indicators.

An analysis by credit quality of debt trading securities, based on the lowest of the ratings assigned by Standard and Poor's, Fitch Ratings and Moody's, is as follows at 31 December 2012:

In thousands of Azerbaijani Manats	**US Treasury notes**	**Agency notes**	**Notes issued by interna-tional financial institutions**	**Regional authority notes**	**Govern-ment bonds**	**UK Treasury notes**	**Corporate bonds**	**Total**
Neither past due nor impaired (at fair value)								
- AAA	-	223,660	258,737	117,745	96,252	102,946	5,289	804,629
- AA+	2,309,681	284,217	935	-	12,190	-	-	2,607,023
- AA-	-	2,377	-	-	1,441	-	1,076	4,894
- A+	-	250	-	-	3,692	-	208	4,150
- A	-	476	-	-	-	-	1,373	1,849
- A+	-	-	-	-	-	-	271	271
Total debt trading	**2,309,681**	**510,980**	**259,672**	**117,745**	**113,575**	**102,946**	**8,217**	**3,422,816**

An analysis by credit quality of debt trading securities, based on the lowest of the ratings assigned by Standard and Poor's, Fitch Ratings and Moody's, is as follows at 31 December 2011:

In thousands of Azerbaijani Manats	US Treasury notes	Agency notes	Notes issued by international financial institutions	Regional authority notes	Govern-ment bonds	UK Treasury notes	Corporate bonds	Total
Neither past due nor impaired (at fair value)								
- AAA	-	719,594	189,223	157,258	49,259	102,568	5,300	1,223,202
- AA+	260,950	9,114	-	-	-	-	4,078	274,142
- AA	-	978	-	-	-	-	-	978
- AA-	-	-	-	3,942	2,544	-	-	6,486
- A+	-	-	-	-	104	-	-	104
- BB+	-	-	-	-	-	-	1,427	1,427
Total debt trading securities	**260,950**	**729,686**	**189,223**	**161,200**	**51,907**	**102,568**	**10,805**	**1,506,339**

Interest rate, currency, geographical and maturity analyses of trading securities are disclosed in Note 27.

10. Loans to Local Banks

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Loans under government guarantee	2,479,728	1,530,817
Refinancing loans	678,833	578,918
Subordinated loans	257,908	-
Lender of last resort loans	24,052	23,646
Less: Provision for impairment	(57,674)	(53,222)
Total loans to local banks	**3,382,847**	**2,080,159**

Movements in the provision for impairment of loans to local banks are as follows:

In thousands of Azerbaijani Manats	Refinancing loans	Lender of last resort loans	Subordinated loans	Total
Provision for impairment at 1 January 2011	**26,859**	**20,400**	**-**	**47,259**
Provision for impairment during the year	2,717	3,246	-	5,963
Provision for impairment at 31 December 2011	**29,576**	**23,646**	**-**	**53,222**
Provision for impairment during the year	9,724	406	5,158	15,288
Amounts written off during the year as uncollectible	(10,836)	-	-	(10,836)
Provision for impairment at 31 December 2012	**28,464**	**24,052**	**5,158**	**57,674**

Interest income accrued on loans, for which individual impairment allowances have been recognised, as at 31 December 2012 comprised AZN 6,169 thousand (31 December 2011: AZN 5,601 thousand). In accordance with the Bank's internal regulations, loans may only be written off with the approval of the Management Board.

At 31 December 2012 the Bank had balances with nine counterparty banks (31 December 2011: seven banks) with aggregated loan amounts above AZN 50,000 thousand. The total aggregate amount of these loans was AZN 3,198,827 thousand (31 December 2011: AZN 1,818,315 thousand) or 93% of the total amount of loans to local banks (31 December 2011: 86%). Included in these loans were AZN 2,479,728 thousand (31 December 2011: AZN 1,530,817 thousand) issued to a state controlled and several commercial banks which were further on-lent to state entities for financing of large scale infrastructural projects implemented by the Government of Azerbaijan. These loans were collateralised by the guarantee letters received from Ministry of Finance of the Republic of Azerbaijan.

At 31 December 2012 the Bank had a concentration in its loans represented by AZN 1,132,705 thousand due from the largest single borrower or 33% of gross loan portfolio (31 December 2011: AZN 964,387 thousand due from the largest single borrower or 45% of gross loan portfolio).

Information about collateral at 31 December 2012 is as follows:

In thousands of Azerbaijani Manats	Loans under government guarantee	Refinancing loans	Subordinated loans	Total
Unsecured loans	-	132,285	252,750	385,035
Loans collateralised by:				
- residential real estate	-	52,166	-	52,166
- other real estate	-	430,844	-	430,844
- tradable securities	-	35,074	-	35,074
- guarantee letters from government	2,479,728	-	-	2,479,728
Total loans to local banks	**2,479,728**	**650,369**	**252,750**	**3,382,847**

Information about collateral at 31 December 2011 is as follows:

In thousands of Azerbaijani Manats	Loans under government guarantee	Refinancing loans	Subordinated loans	Total
Unsecured loans	-	87,839	-	87,839
Loans collateralised by:				
- residential real estate	-	32,303	-	32,303
- other real estate	-	428,368	-	428,368
- tradable securities	-	832	-	832
- guarantee letters from government	1,530,817	-	-	1,530,817
Total loans to local banks	**1,530,817**	**549,342**	**-**	**2,080,159**

The disclosure above represents the lower of the carrying value of the loan or collateral taken; the remaining part is disclosed within the unsecured exposures. The carrying value of loans was allocated based on liquidity of the assets taken as collateral.

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters. The main types of collateral obtained are residential property and other types of which include land, plants, office buildings and shops. Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for loan impairment.

An analysis by credit quality of loans to local banks outstanding at 31 December 2012 is as follows:

In thousands of Azerbaijani Manats	Loans under government guarantee	Refinancing loans	Subordinated loans	Lender of last resort loans	Total
Neither past due nor impaired					
- Top 20 Azerbaijani banks	1,946,437	475,814	257,908	-	2,680,159
- Other banks	533,291	190,314	-	-	723,605
Total neither past due nor impaired	**2,479,728**	**666,128**	**257,908**	**-**	**3,403,764**
Balances individually determined to be impaired (gross)					
- 91 to 180 days overdue	-	-	-	-	-
- 181 to 360 days overdue	-	4,410	-	-	4,410
- over 360 days overdue	-	8,295	-	24,052	32,347
Total individually impaired (gross)	**-**	**12,705**	**-**	**24,052**	**36,757**
Less provision for impairment	**-**	**(28,464)**	**(5,158)**	**(24,052)**	**(57,674)**
Total loans to local banks	**2,479,728**	**650,369**	**252,750**	**-**	**3,382,847**

An analysis by credit quality of loans to local banks outstanding at 31 December 2011 is as follows:

In thousands of Azerbaijani Manats	Loans under government guarantee	Refinancing loans	Lender of last resort loans	Total
Neither past due nor impaired				
- Top 20 Azerbaijani banks	1,082,195	426,454	-	1,508,649
- Other banks	448,622	133,535	-	582,157
Total neither past due nor impaired	**1,530,817**	**559,989**	**-**	**2,090,806**
Balances individually determined to be impaired (gross)				
- 91 to 180 days overdue	-	1,218	-	1,218
- 181 to 360 days overdue	-	6,136	-	6,136
- over 360 days overdue	-	11,575	23,646	35,221
Total individually impaired (gross)	**-**	**18,929**	**23,646**	**42,575**
Less provision for impairment	**-**	**(29,576)**	**(23,646)**	**(53,222)**
Total loans to local banks	**1,530,817**	**549,342**	**-**	**2,080,159**

The Bank applied the portfolio provisioning methodology prescribed by IAS 39, Financial Instruments: Recognition and Measurement, and created portfolio provisions for impairment losses that were incurred but have not been specifically identified with any individual loan by the end of the reporting period. The Bank's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The impairment provisions may exceed the total gross amount of individually impaired loans as a result of this policy and the portfolio impairment methodology.

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any. As a result, the Bank presents above an ageing analysis of loans that are individually determined to be impaired.

The financial effect of collateral is presented by disclosing collateral values separately for (i) those assets where collateral and other credit enhancements are equal to or exceed carrying value of the asset ("over-collateralised assets") and (ii) those assets where collateral and other credit enhancements are less than the carrying value of the asset ("under-collateralised assets"). The effect of collateral at 31 December 2012:

In thousands of Azerbaijani Manats	**Over-collateralised assets**		**Under-collateralised assets**	
	Carrying value of the assets	Fair value of collateral	Carrying value of the assets	Fair value of collateral
Loans under government guarantee	2,479,728	2,479,728	-	-
Refinancing loans	518,084	1,522,411	132,285	-
Subordinated loans	-	-	252,750	-

The effect of collateral at 31 December 2011:

In thousands of Azerbaijani Manats	**Over-collateralised assets**		**Under-collateralised assets**	
	Carrying value of the assets	Fair value of collateral	Carrying value of the assets	Fair value of collateral
Loans under government guarantee	1,530,817	1,530,817	-	-
Refinancing loans	461,148	1,125,701	88,194	-
Subordinated loans	-	-	-	-

Refer to Note 31 for the estimated fair value of each class of loans to local banks. Interest rate, currency, geographical and maturity analyses of loans to local banks are disclosed in Note 27. Information on related party balances is disclosed in Note 33.

11. Investment Securities

In thousands of Azerbaijani Manats	**31/12/2012**	**31/12/2011**
Loans and advances:		
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	122,166	128,253
Held-to-maturity investments:	**-**	**197,521**
US Treasury bills	-	197,521
Investments available-for-sale:		
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	40,000	40,004
Less: Provision for impairment	(4,295)	(4,295)
Total investment securities	157,871	361,483

A comparison of nominal and carrying values of investment securities is as follows:

In thousands of Azerbaijani Manats	31/12/2012 Carrying value	31/12/2012 Nominal value	31/12/2011 Carrying value	31/12/2011 Nominal value
Loans and advances:				
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	122,166	117,680	128,253	123,760
Held-to-maturity investments:	**-**	**-**	**197,521**	**196,625**
US Treasury bills	-	-	197,521	196,625
Investments available for sale:				
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	40,000	40,000	40,004	40,004
Investment securities (gross)	**162,166**	**157,680**	**365,778**	**360,389**
Less: Provision for impairment	(4,295)	-	(4,295)	-
Investment securities (net)	**157,871**	**157,680**	**361,483**	**360,389**

Nominal interest rates and maturities of these securities are as follows:

	31/12/2012 Coupon rate	31/12/2012 Maturity	31/12/2011 Coupon rate	31/12/2011 Maturity
Loans and advances:				
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	0.15% - 0.30%	2021 - 2023	0.15% - 0.30%	2021 - 2023
Investments held to maturity:				
US Treasury bills	-	-	0.38% - 1.38%	2012
Investments available for sale:				
Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	2.00%	2015	2.00%	2015

At 31 December 2012, investment securities were represented by the following fixed income and discount securities:

Bonds issued by the Ministry of Finance of the Republic of Azerbaijan are AZN denominated:

- Securities issued with annual effective interest rate of 0.30% (31 December 2011: 0.30%) maturing in 2021 (31 December 2011: 2021). These securities were issued for repayment of debts on centralized loans of Rural Investment Joint Stock Company during 2001;
- Securities issued with annual effective interest rate of 0.15% (31 December 2011: 0.15%) maturing in 2023 (31 December 2011: 2023). These securities were issued to finance loans previously provided to cover the budget deficits during 1992 – 1996; and
- Securities issued with annual effective interest rate of 2.00% maturing in 2015. These securities were purchased during the year ended 31 December 2010. These securities were issued by the Ministry of Finance to finance infrastructural projects.

US Treasury bills are US Dollar denominated bills issued by the US Government and traded internationally. These treasury bills were managed by the Bank and by the external managers.

An analysis by credit quality of investment securities classified at 31 December 2012 is as follows:

In thousands of Azerbaijani Manats	Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	US Treasury bills	Total
Neither past due nor impaired			
- AA+ rated	-	-	-
- BBB- rated	157,871	-	157,871
Total neither past due nor impaired	**157,871**	**-**	**157,871**
- over 360 days overdue	4,295	-	4,295
Less provision for impairment	**(4,295)**	**-**	**(4,295)**
Total debt securities	**157,871**	**-**	**157,871**

The credit quality information provided in the above table is based on the lowest of the ratings assigned by Standard and Poor's, Fitch Ratings and Moody's.

An analysis by credit quality of investment securities classified at 31 December 2011 is as follows:

In thousands of Azerbaijani Manats	Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	US Treasury bills	Total
Neither past due nor impaired			
- AA+ rated	-	197,521	197,521
- BBB- rated	163,962	-	163,962
Total neither past due nor impaired	**163,962**	**197,521**	**361,483**
- over 360 days overdue	4,295	-	4,295
Less provision for impairment	**(4,295)**	**-**	**(4,295)**
Total debt securities	**163,962**	**197,521**	**361,483**

Refer to Note 31 for the disclosure of the fair value of each class of investment securities. Interest rate, currency, geographical and maturity analyses of investment securities are disclosed in Note 27.

Information on related party investment securities is disclosed in Note 33.

12. Premises, Equipment and Intangible Assets

In thousands of Azerbaijani Manats	Note	Land	Buildings	Furniture and fixtures	Computers and communication equipment	Motor vehicles	Assets under construction	Total
Carrying amount at 1 January 2011	-	5,513	14,922	5,123	2,066	513	5,810	33,947
Additions		10,213	252	384	766	191	-	11,806
Disposals at cost		-	(33)	(148)	(155)	(55)	-	(391)
Accumulated depreciation of disposals		-	15	146	153	55	-	369
Depreciation charge	26	-	(693)	(3,061)	(731)	(269)	-	(4,754)
Carrying amount at 31 December 2011		**15,726**	**14,463**	**2,444**	**2,099**	**435**	**5,810**	**40,977**
Cost at 31 December 2011		15,726	24,387	31,044	7,069	1,926	5,810	85,962
Accumulated depreciation		-	(9,924)	(28,600)	(4,970)	(1,491)	-	(44,985)
Carrying amount at 31 December 2011		15,726	14,463	2,444	2,099	435	5,810	40,977
Additions		-	9	336	3,968	107	18,644	23,064
Disposals at cost		-	(200)	(114)	(232)	-	-	(546)
Accumulated depreciation of disposals		-	5	114	232	-	-	351
Transfers		14,274	9,476	704	-	(24,454)	-	40,977
Depreciation charge	26	-	(1,115)	(3,648)	(1,082)	(192)	-	(6,037)
Carrying amount at 31 December 2012		**15,726**	**27,436**	**8,608**	**5,689**	**350**	**-**	**57,809**
Cost at 31 December 2012		15,726	38,470	40,742	11,509	2,033	-	108,480
Accumulated depreciation		-	(11,034)	(32,134)	(5,820)	(1,683)	-	(50,671)
Carrying amount at 31 December 2012		**15,726**	**27,436**	**8,608**	**5,689**	**350**	**-**	**57,809**

The movements in intangible assets which comprised acquired computer software and licenses were as follows:

	Note	2012	2011
Cost:			
1 January		**17,312**	**14,977**
Additions		6,446	2,335
31 December		**23,758**	**17,312**
Accumulated amortization:			
1 January		**(7,695)**	**(6,349)**
Amortisation charge	26	(1,551)	(1,346)
31 December		**(9,246)**	**(7,695)**
Carrying amount:			
1 January		**9,617**	**8,628**
31 December		**14,512**	**9,617**

13. Other Financial Assets

In thousands of Azerbaijani Manats	Note	31/12/2012	31/12/2011
Receivables for investments disposed		1,886	-
Loans to employees		1,355	1,621
Advances received for foreign currency dealing operations		79	154
Foreign exchange forward contracts	30	75	2,133
Other financial assets		84	77
Less: Provision for impairment		(15)	(20)
Total other financial assets		**3,464**	**3,965**

An analysis by credit quality of other financial assets outstanding at 31 December 2012 is as follows:

In thousands of Azerbaijani Manats	Receivables for investments disposed	Loans to employees	Advances received for foreign currency dealing operations	Foreign exchange forward contracts	Other financial assets	Total
Neither past due nor impaired						
- Collected or settled after the end of the reporting period	1,886	-	79	75	84	2,124
- Loans guaranteed by salaries	-	1,355	-	-	-	1,355
Total neither past due nor impaired	**1,886**	**1,355**	**79**	**75**	**84**	**3,479**
Less provision for impairment	**-**	**(15)**	**-**	**-**	**-**	**(15)**
Total other financial assets	**1,886**	**1,340**	**79**	**75**	**84**	**3,464**

An analysis by credit quality of other financial assets outstanding at 31 December 2011 is as follows:

In thousands of Azerbaijani Manats	Receivables for investments disposed	Loans to employees	Advances received for foreign currency dealing operations	Foreign exchange forward contracts	Other financial assets	Total
Neither past due nor impaired						
- Collected or settled after the end of the reporting period	-	-	154	2,133	77	2,364
- Loans guaranteed by salaries	-	1,621	-	-	-	1,621
Total neither past due nor impaired	**-**	**1,621**	**154**	**2,133**	**77**	**3,985**
Less provision for impairment	**-**	**(20)**	**-**	**-**	**-**	**(20)**
Total other financial assets	**-**	**1,601**	**154**	**2,133**	**77**	**3,965**

Refer to Note 31 for the disclosure of the fair value of each class of other financial assets. Currency, geographical and maturity analyses of other financial assets are disclosed in Note 27. Information on related party balances is disclosed in Note 33.

14. Other Assets

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Prepayments to suppliers	40,868	46,433
Total other assets	**40,868**	**46,433**
Current	2,774	6,359
Non-current	38,094	40,074

At 31 December 2012, the balance of prepayments to suppliers included total of AZN 38,094 thousand (31 December 2011: AZN 40,074 thousand) paid for the construction of the Bank's new office building, regional branches and buildings intended to be used for other purposes, also AZN 2,025 thousand (31 December 2011: AZN 4,976 thousand) paid for the production of banknotes and coins.

Information on related party balances is disclosed in Note 33.

15. Money Issued in Circulation

Money issued in circulation represents the amount of national currency of the Republic of Azerbaijan issued by the Bank. This comprises the Azerbaijani Manat issued into circulation from 1 January 2006, and old Azerbaijani Manat ("AZM") issued into circulation since the introduction of the national currency in 1992. The Azerbaijani Manat was denominated on 1 January 2006 and, starting from that date, AZM 5,000 is equal to 1 AZN.

During the year ended 31 December 2012 the Bank accepted new banknotes amounting to AZN 395,698 thousand from the printing company (2011: AZN 225,380 thousand).

In thousands of Azerbaijani Manats	2012	2011
1 January	**7,658,486**	**5,793,219**
Banknotes issued into circulation	2,113,605	1,860,614
Old banknotes withdrawn from circulation	(22)	(53)
Commemorative coins issued in circulation	5	205
New coins issued into circulation	5,448	4,501
31 December	**9,777,522**	**7,658,486**

16. Amounts Due to Credit Institutions

Amounts due to credit institutions comprise the following:

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Current accounts	740,539	725,701
Obligatory reserves	128,064	100,726
Blocked accounts	707	336
Repurchase transactions	-	40,934
Amounts due to credit institutions	**869,310**	**867,697**

Included in current accounts and obligatory reserves is a balance of AZN 381,400 thousand (31 December 2011: AZN 472,042 thousand) with five largest local banks (31 December 2011: with five largest local banks).

Obligatory reserves represent legal reserves required of credit institutions to be maintained with the Bank, and are calculated as 3% (31 December 2011: 3%) of the banks' eligible liabilities to customers. Current accounts and obligatory reserves are non interest-bearing.

Refer to Note 31 for the disclosure of the fair value of each class of amounts due to credit institutions. Interest rate, currency, geographical and maturity analysis of amounts due to credit institutions are disclosed in Note 27. Information on related party balances is disclosed in Note 33.

17. Amounts Due to Government Organizations

Amounts due to government organizations consist of the following:

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Amounts due to the Central Treasury of the Republic of Azerbaijan	2,179,547	2,360,519
Amounts due to the State Oil Fund of the Republic of Azerbaijan	156,670	133,919
Other demand deposits	12,081	8,786
Amounts due to government organizations	**2,348,298**	**2,503,224**

Amounts due to the State Oil Fund of the Republic of Azerbaijan were placed with the Federal Reserve Bank of New York with interest rate based on the Federal Reserve rate.

Interest rate, currency, geographical and maturity analysis of amounts due to government organisations are disclosed in Note 27.

18. Amounts Due to Other Organisations

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Public organisations	14,168	4,473
Other financial institutions	136	186
Other	1	19
Amounts due to other organisations	**14,305**	**4,678**

Refer to Note 31 for the disclosure of the fair value of each class of amounts due to other organisations. Interest rate, currency, geographical and maturity analysis of amounts due to other organisations are disclosed in Note 27. Information on related party balances disclosed in Note 33.

19. Debt Securities in Issue

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Short-term notes	119,930	50,185
Total debt securities in issue	**119,930**	**50,185**

Information about short-term notes is as follows:

	Interest rate p.a.	Maturity	Nominal value	Carrying value	Market price, % of nominal value
31 December 2012	1.20% - 2.74%	January 3 -January 23, 2013	120,000	119,930	99.88% - 99.97%
31 December 2011	2.79% - 2.99%	January 7 - January 28, 2012	50,335	50,185	99.77% - 99.79%

Refer to Note 31 for the disclosure of the fair value of each class of debt securities in issue. Interest rate, currency, geographical and maturity analysis of debt securities in issue are disclosed in Note 27.

20. Amounts Due to International Financial Institutions

In thousands of Azerbaijani Manats	31/12/2012	31/12/2011
Borrowings from International Development Association (IDA)	3,214	3,591
Amounts due to other international financial institutions	1,025	178
Total amounts due to international financial institutions	**4,239**	**3,769**

Borrowings from IDA are loans with original maturity of 19 years and bear interest of 1.0% (2011: 1.0%) per annum. The IDA loans are received from the Ministry of Finance of Azerbaijan through a secondary agreement. The repayment of the first loan commenced in 2005, the second loan in 2007 on a semi-annual basis for the amount of USD 85 thousand and USD 149 thousand per period, respectively. The repayment of the third loan has not started yet. The loans are denominated in US Dollars. First and second loans will be fully repaid by 2021.

Refer to Note 31 for disclosure of the fair value of each class of amounts due to international financial institutions. Interest rate, currency, geographical and maturity analysis of amounts due to international financial institutions are disclosed in Note 27.

21. Other Financial Liabilities

In thousands of Azerbaijani Manats	Note	31/12/2012	31/12/2011
Amounts in the course of settlement		3,737	581
Amounts payable for investments securities purchased		1,672	588
Foreign exchange forward contracts	30	657	345
Advances received for the purchase of foreign currency		137	636
Total other financial liabilities		**6,203**	**2,150**

Refer to Note 31 for disclosure of the fair value of each class of other financial liabilities.

22. Equity

The authorized and fully paid capital of the Bank is AZN 10,000 thousand. During the year ended 31 December 2009, the Ministry of Finance of the Republic of Azerbaijan contributed additional capital to the Bank by issuing non-interest bearing promissory notes with the nominal amount of AZN 255,400 thousand with maturity in 2019. The purpose of this contribution was to cover the capital deficit of the Bank in the amount of AZN 255,399 thousand which occurred further to losses amounting to AZN 402,155 thousand arising in 2008 from the revaluation of foreign currency position of the Bank due to the appreciation of Azerbaijani Manat against foreign currencies. The notes were initially recognised at the fair value of AZN 209,517 thousand with the corresponding increase in capital reserves.

In accordance with Article 14 of the Law on the Central Bank of Azerbaijan (the “Law”), the Bank cannot be declared bankrupt and any deficit in capital is to be covered by the State. At 31 December 2012, the Bank had a capital deficit of AZN 29,582 thousand (31 December 2011: AZN 160,784 thousand). The Management Board expects that during the year ending 31 December 2013 the Ministry of Finance of Azerbaijan will make a capital contribution in accordance with the Article 14 of the Law. The management considered whether any receivable from the State should be recognised in these financial statements for the expected capital contribution as at 31 December 2012 and 31 December 2011 and concluded that due to the absence of the determined form and time frame of the capital contribution, criteria for the recognition of an asset with respect to the expected capital contribution were not met. Refer to Note 28.

23. Interest Income and Expense

In thousands of Azerbaijani Manats	2012	2011
Interest income		
Loans to local banks	80,296	63,870
Trading securities	14,802	20,866
Placements with non-resident credit institutions	8,618	17,026
Promissory note from the government		4,624
Investment securities held-to-maturity	1,462	3,254
Investments securities available for sale	1,310	1,231
Other	290	881
Total interest income	**111,414**	**111,752**
Interest expense		
Debt securities issued	1,740	1,161
Liabilities on transactions with the International Monetary Fund	606	918
Amounts due to international financial institutions	33	37
Amounts due to government organisations	2	2
Total interest expense	**2,381**	**2,118**
Net interest income	**109,033**	**109,634**

Interest income includes AZN 1,413 thousand (2011: AZN 977 thousand) interest income recognised on impaired loans to local banks.

24. Fee and Commission Income and Expense

In thousands of Azerbaijani Manats	2012	2011
Fee and commission income		
Fee and commission income not relating to financial instruments at fair value through profit or loss:		
- Settlements operations	3,856	3,195
- Cash operations	33	57
- Currency conversion operations	15	4,628
- Cash collections and transportation	4	4
Total fee and commission income	**3,908**	**7,884**
Fee and commission expense		
Fee and commission expense not relating to financial instruments at fair value through profit or loss		
- Securities operations	672	657
- Settlements operations	72	47
- Currency conversion operations	16	20
Total fee and commission expense	**760**	**724**
Net fee and commission income	**3,148**	**7,160**

Securities operations is primarily comprised of fees incurred in relation to external asset managers' services in managing certain of the Bank's investment portfolios under the Asset Management Agreements entered into by the Bank with three external asset managers.

The Bank involved external asset managers to manage a certain volume of the Bank's foreign currency denominated assets and appointed them as its agents and delegated them to manage the investment and reinvestment of certain monies and assets which are deposited by the Bank. The Bank entered into a Custodian Agreement with a leading foreign bank specialized in this area to serve as the Custodian of the investment portfolios. The funds and assets are held at the third party Custodian, which monitors portfolios and is provided by the Bank the authority to release or deliver securities of the portfolio, register securities, and conduct transactions based on the asset manager's requests on buy/sell decisions. The Custodian provides the Bank a monthly report of all monies received in respect of the portfolio or paid out of the portfolio. Investment emphasis is on high-quality instruments with a high degree of marketability and liquidity. A minimum credit quality of A- by Standard & Poor's (or A3 by Moody's) is a benchmark for these investments. The assets placed with external managers can be recalled by the Bank upon 30 days' written notice in advance.

The external asset managers, acting as agents, have complete discretion but within Asset Management Agreements, for the account of the Bank to buy, sell or otherwise deal in investment securities and other assets, make deposits, subscribe to issues and offers for sale, and accept placements, underwritings and sub-underwritings, of any investments, advise on or execute transactions in unregulated collective investment schemes, effect transactions in markets identified in investment guidelines, negotiate and execute counterparty and account opening documentation, take day to day investment decisions and otherwise act as the external managers judge appropriate in relation to the management of the funds.

25. Other Operating Income

In thousands of Azerbaijani Manats	2012	2011
Income from central credit register system	2,095	922
Income from sales of commemorative coins	1,065	534
Other	371	193
Total other operating income	**3,531**	**1,649**

26. Administrative and Other Operating Expenses

In thousands of Azerbaijani Manats	Note	2012	2011
Staff costs		14,261	13,718
Bank notes and coins production and transportation expenses		12,600	10,172
Depreciation of premises and equipment	12	6,037	4,754
Software maintenance fees		1,894	992
Regional construction and social expenses		1,832	11,352
Amortisation of software and other intangible assets	12	1,551	1,346
Security		1,320	1,147
Expenses related to financing of Financial Monitoring Service		1,319	3,350
Repairs and maintenance of property and equipment		1,124	739
Legal and consultancy		812	140
Communications		633	534
Office supplies		434	370
Heating and lighting		335	254
Representation expenses		299	138
Insurance		227	229
Business travel and related		197	180
Printing		153	98
Occupancy and rent		138	141
Utilities		56	40
Other		538	435
Total administrative and other operating expenses		**45,760**	**50,129**

Included in staff costs are statutory pension contributions of AZN 2,468 thousand (2011: AZN 2,348 thousand).

27. Financial Risk Management

The activities of the Bank are exposed to various risks. Risk management therefore is a critical component of its banking activities. Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and daily monitoring, subject to risk limits and other controls. At certain times, the Bank may be overly exposed to certain risks and/or take disadvantageous positions in fulfilling its responsibilities, which are typical for central banks and consequently incur unexpected financial losses, e.g. losses from translation of foreign currency balances.

Each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk. It is also subject to operating risks.

The independent risk control process does not include business risks such as changes in the environment, technology and industry. They are monitored through the Bank's strategic planning process.

The Management Board is ultimately responsible for identifying and controlling risks; however, there are separate business units responsible for managing and monitoring the various risks:

Management Board. The Management Board is responsible for the overall risk management approach, risk tolerance levels and for approving the main principles of risk management.

Investment Committee. The Investment Committee is responsible for defining the acceptable limits for management of the Bank's foreign currency assets in accordance with the "Regulations for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan".

Risk Management Unit. The Risk Management Unit of the Market Operations Department regularly controls the limits set for management of foreign currency assets in accordance with the "Regulations for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan", "Main Directions for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan", and "Operational Investment Strategy for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan".

Internal Audit. Risk management processes throughout the Bank are audited annually by the Internal Audit that examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal Audit discusses the results of all assessments with management, and reports its findings and recommendations to the Chairman of the Bank.

Risk measurement and reporting systems. Depending on the structure of operations, the risk management in the Bank is conducted by centralized and non-centralized methods. Financial risk management is conducted centrally whereas operational risk management is not centralized.

Operations are allocated among members of the Management Board based on control principle. Each Board member must control the operations under his sector of responsibility.

Risk management is conducted directly by various departments. There are also special committees and commissions within the Bank for conducting operations and control such as the Investment Committee, Credit Committee, and Regular Commission on determination of official exchange rates of the Bank, and others.

The risk related to the Bank's foreign currency assets is a significant risk. Segregation of duties, procedures and reporting for risk management are regulated by the "Guidelines on Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan". Acceptable limits on managed risks are stipulated in the "Guidelines on Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan", "Main Directions of Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan", "Operational Investment Strategy for Management of Foreign Currency Assets of the Central Bank of the Republic of Azerbaijan" and "Investment Rules for Management of Assets by Foreign Managers". These limits are defined by the Investment Committee and approved by the Management Board. Ongoing control over risks is exercised by Risk Management Division of the Market Operations Department and Financial Market Operations Division of the Payment Systems and Settlements Department.

Operational risks management is conducted by the Management Board and the Internal Audit Department. The Management Board approves operational procedures and guidelines for limitation of operational risk. The Internal Audit Department regularly monitors and reports to the Management Board on the implementation of operational procedures.

Excessive risk concentration. Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risks, the Bank's policies and procedures include specific guidelines to focus on maintaining a diversified portfolio.

Credit risk. The Bank is exposed to credit risk, which is the risk that one party will incur a loss because the other party failed to comply with its financial obligations. Exposure to credit risk arises as a result of the Bank's lending and other transactions with counterparties giving rise to financial assets. Credit risk is managed and controlled through proper selection of investment assets, credit quality of investment assets and setting limits on the amount of investment per investment asset.

The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Limits on the level of credit risk by product and industry sector are approved regularly by management. Such risks are monitored on a revolving basis and subject to an annual or more frequent review.

In accordance with the investment guidelines of the Bank, only investment instruments with short-term ratings of not less than A-2 (Standard & Poor's), F-2 (Fitch) or P-2 (Moody's) and long-term ratings of not less than A- (Standard & Poor's, Fitch) or A3 (Moody's) may be used for management of the Bank's assets. At the same time, the maximum amount invested in one commercial bank, except the government and other central banks, is defined as the equivalent of US Dollar 200 million. Subject to the terms of the investment instrument, minimal credit rating is defined as A- (Standard & Poor's, Fitch) for investment instruments with a term of up to one month, A (Standard & Poor's, Fitch) for deposits with a term from one to twelve months, and A+ (Standard & Poor's, Fitch) for deposits with a term over twelve months. When different credit ratings are designated by the various agencies, the rating meeting the minimum required level for this asset is used.

The Bank classifies loans based on a credit rating system. This provides early identification of possible changes in the creditworthiness of counterparties. Credit rating allows the Bank to assess the potential loss as a result of the risks to which the Bank is exposed and take corrective action.

Bank accounts
The Bank may open correspondent accounts in central banks of countries with a country rating of not less than A+ (Standard&Poor's, Fitch) or A1 (Moody's), International Settlements Bank and commercial banks with rating of not less than A+ (Standard&Poor's, Fitch) or A1 (Moody's).

Custodian services
Central banks with a country rating of not less than A+ (Standard&Poor's, Fitch) or A1 (Moody's), International Settlements Bank and commercial banks with a rating of not less than A+ (Standard&Poor's, Fitch) or A1 (Moody's) may act as foreign custodian for securities of the Bank.

Financial market counterparties
Only financial institutions with credit rating of not less than A- (Standard & Poor`s, Fitch) and A3 (Moody`s) may be financial market counterparties of the Bank.

Derivative financial instruments
Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the statement of financial position.

The Bank's maximum exposure to credit risk is reflected in the carrying amounts of financial assets in the statement of financial position. The impact of possible netting of assets and liabilities to reduce potential credit exposure is not significant. The credit risk is mitigated by collateral and other credit enhancements as disclosed in Notes 7, 8, 9, 10 and 11.

In order to monitor credit risk exposures, regular reports are produced by the officers of Market Operations Department based on a structured analysis focusing on the customer's business and financial performance. Any significant exposures against customers with deteriorating creditworthiness are reported to and reviewed by the Management Board.

The Bank's Market Operations Department reviews ageing analysis of outstanding loans and follows up on past due balances. Management therefore considers it appropriate to provide ageing and other information about credit risk as disclosed in Notes 7, 9, 10 and 11.

Loans to local banks portfolio is classified as follows:

- Refinancing loans
- Lender of last resort loans
- Loans under government guarantee
- Subordinated loans

The Bank classifies its investment held to maturity portfolio as follows:

High grade - government securities having no changes in the terms and conditions, and no overdue in principal and interest.

Sub-standard grade – government securities having changes in the terms and conditions of loan agreements and no overdue in principal and interest.

It is the Bank's policy to maintain accurate and consistent risk ratings across the credit portfolio. The attributed risk ratings are assessed and updated regularly.

Market risk. The Bank takes on exposure to market risks. Market risks arise from open positions in (a) currency and (b) interest rate, all of which are exposed to general and specific market movements. Management sets limits on the value of risk that may be accepted, which is monitored on a daily basis. However, the use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

Currency risk. Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Subject to the currency structure of assets, the value of assets of the Bank is exposed to risk of changes in exchange rates of main foreign currencies.

The foreign currency assets of the Bank are primarily maintained in US Dollars, Euro and Pound Sterling. Currency composition of assets was defined by the "Main Directions for Management of Currency Assets of the Central Bank of the Republic of Azerbaijan" approved by the resolution of the Management Board dated 10 July 2012. This document is taken as a basis by the Market Operations department of the Bank, who is the major body responsible for management of the currency risk. Also the department acts in accordance with its own charter approved by the Management Board.

Currency risk is managed through diversification of foreign currency portfolio and determination of the following parameters:

- foreign currencies subject to management;
- maximum share of the managed currency in the total assets denominated in foreign currencies (minimum volume for the base currency).

The table below summarises the Bank's exposure to foreign currency exchange rate risk on its monetary assets and liabilities at 31 December 2012:

	AZN	USD	EUR	GBP	SDR	Other	Total
Financial assets							
Cash and cash equivalents	202	2,919,893	2,357,837	538,587	-	107	5,816,626
SDR holdings with the IMF	-	-	-	-	185,975	-	185,975
Trading securities	-	3,011,734	178,631	232,451	-	-	3,422,816
Loans to local banks	3,005,993	376,854	-	-	-	-	3,382,847
Investment securities	157,871	-	-	-	-	-	157,871
Promissory note from the Government	225,732	-	-	-	-	-	225,732
Other financial assets	1,503	1,886	-	-	-	-	3,389
Total financial assets	**3,391,301**	**6,310,367**	**2,536,468**	**771,038**	**185,975**	**107**	**13,195,256**

	AZN	USD	EUR	GBP	SDR	Other	Total
Financial liabilities:							
Money issued in circulation	9,777,522	-	-	-	-	-	9,777,522
Amounts due to credit institutions	723,989	120,959	24,358	4	-	-	869,310
Amounts due to government organizations	2,245,795	58,520	29,021	14,855	-	107	2,348,298
Amounts due to other organisations	14,301	3	1	-	-	-	14,305
Debt securities issued	119,930	-	-	-	-	-	119,930
Amounts due to international financial institutions	1,000	3,239	-	-	-	-	4,239
Liabilities on transactions with the International Monetary Fund	656	-	-	-	197,619	-	198,275
Other financial liabilities	1,101	1,804	2,557	-	-	84	5,546
Total financial liabilities	**12,884,294**	**184,525**	**55,937**	**14,859**	**197,619**	**191**	**13,337,425**
Derivatives	**-**	**59,296**	**(39,509)**	**(8,461)**	**-**	**(11,908)**	**(582)**
Net balance sheet position	**(9,492,993)**	**6,185,138**	**2,441,022**	**747,718**	**(11,644)**	**(11,992)**	**(142,751)**

Derivatives presented above are monetary financial assets or monetary financial liabilities, but are presented separately in order to show the Bank's gross exposure.

The table below summarises the Bank's exposure to foreign currency exchange rate risk on its monetary assets and liabilities at 31 December 2011:

	AZN	USD	EUR	GBP	SDR	Other	Total
Financial assets							
Cash and cash equivalents	269	4,380,872	1,858,281	442,981	-	101	6,682,504
SDR holdings with the IMF	-	-	-	-	185,029	-	185,029
Trading securities	-	1,176,207	230,746	99,386	-	-	1,506,339
Loans to local banks	2,080,159	-	-	-	-	-	2,080,159
Investment securities	163,962	197,521	-	-	-	-	361,483
Promissory note from the Government	221,095	-	-	-	-	-	221,095
Other financial assets	1,832	-	-	-	-	-	1,832
Total financial assets	**2,467,317**	**5,754,600**	**2,089,027**	**542,367**	**185,029**	**101**	**11,038,441**

	AZN	USD	EUR	GBP	SDR	Other	Total
Financial liabilities:							
Money issued in circulation	7,658,486	-	-	-	-	-	7,658,486
Amounts due to credit institutions	653,642	183,155	26,413	4,487	-	-	867,697
Amounts due to government organizations	2,389,071	109,034	347	4,671	-	101	2,503,224
Amounts due to other organisations	4,674	3	1	-	-	-	4,678
Debt securities issued	50,185	-	-	-	-	-	50,185
Amounts due to international financial institutions	153	3,616	-	-	-	-	3,769
Liabilities on transactions with the International Monetary Fund	659	-	-	-	207,514	-	208,173
Other financial liabilities	504	25	1,199	-	-	77	1,805
Total financial liabilities	**10,757,374**	**295,833**	**27,960**	**9,158**	**207,514**	**178**	**11,298,017**
Derivatives	**-**	**62,168**	**(45,470)**	**(7,019)**	**-**	**(7,891)**	**1,788**
Net balance sheet position	**(8,290,057)**	**5,520,935**	**2,015,597**	**526,190**	**(22,485)**	**(7,968)**	**(257,788)**

Amounts disclosed in respect of derivatives represent the fair value, at the end of the reporting period, of the respective currency that the Bank agreed to buy (positive amount) or sell (negative amount) before netting of positions and payments with the counterparty. The amounts by currency are presented gross as stated in Note 30. The net total represents the fair value of the currency derivatives. The above analysis includes only monetary assets and liabilities.

The following tables present sensitivities of profit or loss to reasonably possible changes in exchange rates applied at the end of the reporting period relative to the functional currency of the Bank, with all other variables held constant:

In thousands of Azerbaijani Manats			2012		
	USD	**EUR**	**GBP**	**SDR**	**Other**
Increase in currency rate of 1%	61,851	24,410	7,477	(116)	(120)
Increase in currency rate of 5%	309,255	122,051	37,386	(582)	(600)
Increase in currency rate of 10%	618,514	244,102	74,772	(1,164)	(1,199)
Decrease in currency rate of 1%	(61,851)	(24,410)	(7,477)	116	120
Decrease in currency rate of 5%	(309,255)	(122,051)	(37,386)	582	600
Decrease in currency rate of 10%	(618,514)	(244,102)	(74,772)	1,164	1,199

In thousands of Azerbaijani Manats			2011		
	USD	**EUR**	**GBP**	**SDR**	**Other**
Increase in currency rate of 1%	55,209	20,156	5,262	(225)	(80)
Increase in currency rate of 5%	276,047	100,780	26,310	(1,124)	(398)
Increase in currency rate of 10%	552,094	201,560	52,619	(2,249)	(797)
Decrease in currency rate of 1%	(55,209)	(20,156)	(5,262)	225	80
Decrease in currency rate of 5%	(276,047)	(100,780)	(26,310)	1,124	398
Decrease in currency rate of 10%	(552,094)	(201,560)	(52,619)	2,249	797

The exposure was calculated only for monetary balances denominated in currencies other than the functional currency of the Bank.

Interest rate risk. The Bank takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The main objective when managing the interest rate risk is to maintain stable return on investments while not exceeding the risk levels that can be undertaken per investment policies. Management monitors on a daily basis and sets limits on the level of mismatch of interest rate repricing that may be undertaken.

The table below summarises the Bank's exposure to interest rate risks. The table presents the aggregated amounts of the Bank's financial assets and liabilities at carrying amounts, categorised by the earlier of contractual interest repricing or maturity dates.

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	More than 1 year	Non-interest bearing	Total
31 December 2012						
Total financial assets	6,286,715	3,621,259	75,485	3,112,396	99,476	13,195,331
Total financial liabilities	2,471,428	3,323	3,647	194,016	10,665,668	13,338,082
Net interest sensitivity gap at 31 December 2012	**3,815,287**	**3,617,936**	**71,838**	**2,918,380**	**(10,566,192)**	**(142,751)**
31 December 2011						
Total financial assets	5,931,133	2,331,662	283,819	2,389,567	104,393	11,040,574
Total financial liabilities	52,119	4,522	5,138	200,348	11,036,235	11,298,362
Net interest sensitivity gap at 31 December 2011	**5,879,014**	**2,327,140**	**278,681**	**2,189,219**	**(10,931,842)**	**(257,788)**

All of the Bank's debt instruments reprice within 5 years (2011: all reprice within 5 years).

The Bank monitors interest rates for its financial instruments. The table below summarises interest rates at the respective reporting date based on reports reviewed by key management personnel. For securities, the interest rates represent yields to maturity based on market quotations at the reporting date:

In % p.a.			31/12/2012			
	AZN	**USD**	**EUR**	**GBP**	**SDR**	**Other**
Assets						
Cash and cash equivalents	-	0.20	0.08	-	-	-
SDR holdings with the IMF	-	-	-	-	0.11	-
Trading securities	-	1.22	1.78	1.46	-	-
Loans to local banks	4.26	2.56	-	-	-	-
Investment securities	0.95	-	-	-	-	
Promissory note from the Government	2.00	-	-	-	-	-
Other financial assets:						-
- Loans to employees	11.00	-	-	-	-	-
Liabilities						
Debt securities issued	1.97	-	-	-	-	-
Amounts due to international financial institutions	-	1.00	-	-	-	-
Liabilities on transactions with the International Monetary Fund	-	-	-	-	0.50	-

The sign "-" in the table above means that the Bank does not have the respective assets or liabilities in the corresponding currency.

In % p.a.	AZN	USD	31/12/2011 EUR	GBP	SDR	Other
Assets						
Cash and cash equivalents	-	0.21	0.19	-	-	-
SDR holdings with the IMF	-	-	-	-	0.40	-
Trading securities	-	1.12	2.96	-	-	4.16
Loans to local banks	3.90	-	-	-	-	-
Investment securities	0.95	0.17	-	-	-	-
Promissory note from the Government	2.00	-	-	-	-	-
Other financial assets:						
- Loans to employees	11.00	-	-	-	-	-
Liabilities						
Debt securities issued	2.89	-	-	-	-	-
Amounts due to international financial institutions	-	1.00	-	-	-	-
Liabilities on transactions with the International Monetary Fund	-	-	-	-	0.50	-

Geographical risk concentrations. The geographical concentration of the Bank's financial assets and liabilities at 31 December 2012 is set out below:

In thousands of Azerbaijani Manats	Azerbaijan	OECD	Total
Financial assets			
Cash and cash equivalents	99,238	5,717,388	5,816,626
SDR holdings with the IMF	-	185,975	185,975
Trading securities	-	3,422,816	3,422,816
Loans to local banks	3,382,847	-	3,382,847
Investment securities	157,871	-	157,871
Promissory note from the Government	225,732	-	225,732
Other financial assets	1,503	1,961	3,464
Total financial assets	**3,867,191**	**9,328,140**	**13,195,331**
Financial liabilities			
Money issued in circulation	9,777,522	-	9,777,522
Amounts due to credit institutions	869,310	-	869,310
Amounts due to government organizations	2,348,298	-	2,348,298
Amounts due to other organisations	14,305	-	14,305
Debt securities issued	119,930	-	119,930
Amounts due to international financial institutions	-	4,239	4,239
Liabilities on transactions with the International Monetary Fund	-	198,275	198,275
Other financial liabilities	1,184	5,019	6,203
Total financial liabilities	**13,130,549**	**207,533**	**13,338,082**
Net position in on-balance sheet financial instruments	**(9,263,358)**	**9,120,606**	**(142,751)**

Assets and liabilities have been based on the country in which the counterparty is located.

The geographical concentration of the Bank’s assets and liabilities at 31 December 2011 is set out below:

In thousands of Azerbaijani Manats	Azerbaijan	OECD	Total
Financial assets			
Cash and cash equivalents	100,928	6,581,576	6,682,504
SDR holdings with the IMF	-	185,029	185,029
Trading securities	-	1,506,339	1,506,339
Loans to local banks	2,080,159	-	2,080,159
Investment securities	163,962	197,521	361,483
Promissory note from the Government	221,095	-	221,095
Other financial assets	1,921	2,044	3,965
Total financial assets	**2,568,065**	**8,472,509**	**11,040,574**
Financial liabilities			
Money issued in circulation	7,658,486	-	7,658,486
Amounts due to credit institutions	867,697	-	867,697
Amounts due to government organizations	2,503,224	-	2,503,224
Amounts due to other organisations	4,678	-	4,678
Debt securities issued	50,185	-	50,185
Amounts due to international financial institutions	-	3,769	3,769
Liabilities on transactions with the International Monetary Fund	-	208,173	208,173
Other financial liabilities	581	1,569	2,150
Total financial liabilities	**11,084,851**	**213,511**	**11,298,362**
Net position in on-balance sheet financial instruments	**(8,516,786)**	**8,258,998**	**(257,788)**

Liquidity risk. Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stress circumstances. Management of the liquidity risk by the Bank is based on keeping the liquidity at required level for meeting the requirements of the Bank in any condition.

In order to achieve the Bank’s primary goals of maintaining currency stability and control over monetary policy, the Bank maintains operational foreign currency assets which are a group of liquid assets from its foreign currency assets to ensure timely intervention when deemed necessary. Such group of operational liquid foreign currency assets of the Bank is adequate for meeting the foreign currency demand for currency intervention, financing foreign trade equivalent of three-month import, and financing short-term foreign debt of the country. Liquidity risk management consists of identifying the liquid assets and determining the minimum liquidity limits of foreign currency assets over its investment period.

The table below shows liabilities at 31 December 2012 by their remaining contractual maturity. The amounts disclosed in the maturity table are the contractual undiscounted cash flows. Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in the statement of financial position is based on discounted cash flows. Financial derivatives are included at the contractual amounts to be paid or received, unless the Bank expects to close the derivative position before its maturity date in which case the derivatives are included based on the expected cash flows.

The table below shows maturity analysis of non-derivative financial assets at their carrying amounts and based on their contractual maturities except for assets that are readily saleable in case it would be necessary to meet cash outflows on financial liabilities. Such financial assets are included in the maturity analysis based on their expected date of disposal. Impaired loans are included at their carrying amounts net of impairment provisions and based on the expected timing of cash inflows. Derivatives are presented based on their contractual maturities.

When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. Foreign currency payments are translated using the spot exchange rate at the end of the reporting period.

The maturity analysis of financial instruments at 31 December 2012 is as follows:

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	2,926,992	2,889,634	-	-	-	5,816,626
SDR holdings with the IMF	-	21	-	-	185,954	185,975
Trading securities	3,422,816	-	-	-	-	3,422,816
Loans to local banks	32,994	731,554	75,460	1,059,026	1,483,813	3,382,847
Investment securities	-	-	-	40,000	117,871	157,871
Promissory note from the Government	-	-	-	-	225,732	225,732
Gross settled forwards:						
- inflows	-	28,915	4,552	-	-	33,467
- outflows	-	(28,865)	(4,527)	-	-	(33,392)
Other financial assets	3,389	-	-	-	-	3,389
Total	**6,386,191**	**3,621,259**	**75,485**	**1,099,026**	**2,013,370**	**13,195,331**
Liabilities						
Money in circulation	9,777,522	-	-	-	-	9,777,522
Amounts due to credit institutions	869,310	-	-	-	-	869,310
Amounts due to government organizations	2,348,298	-	-	-	-	2,348,298
Amounts due to other organisations	14,305	-	-	-	-	14,305
Debt securities in issue	120,000	-	-	-	-	120,000
Amounts due to international financial institutions	1,128	196	196	1,616	1,283	4,419
Liabilities on transactions with the International Monetary Fund	1,057	2,775	3,170	5,413	185,860	198,275
Gross settled forwards:						
- inflows	-	(49,521)	(30,680)	-	-	(80,201)
- outflows	-	49,885	30,973	-	-	80,858
Other financial liabilities	5,546	-	-	-	-	5,546
Total potential future payments for financial obligations	**13,137,166**	**3,335**	**3,659**	**7,029**	**187,143**	**13,338,332**
Liquidity gap arising from financial instruments	**(6,750,975)**	**3,617,924**	**71,826**	**1,091,997**	**1,826,227**	**(143,001)**

The maturity analysis of financial instruments at 31 December 2011 is as follows::

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 6 months	From 6 to 12 months	From 12 months to 5 years	Over 5 years	Total
Assets						
Cash and cash equivalents	4,390,908	2,291,596	-	-	-	6,682,504
SDR holdings with the IMF	-	57	-	-	184,972	185,029
Trading securities	1,506,339	-	-	-	-	1,506,339
Loans to local banks	133,231	41,006	86,384	900,929	918,609	2,080,159
Investment securities	-	-	197,521	40,004	123,958	361,483
Promissory note from the Government	-	-	-	-	221,095	221,095
Gross settled forwards:						
- inflows	79,767	-	-	-	-	79,767
- outflows	(77,634)	-	-	-	-	(77,634)
Other financial assets	1,832	-	-	-	-	1,832
Total	**6,034,443**	**2,332,659**	**283,905**	**940,933**	**1,448,634**	**11,040,574**
Liabilities						
Money in circulation	7,658,486	-	-	-	-	7,658,486
Amounts due to credit institutions	867,697	-	-	-	-	867,697
Amounts due to government organizations	2,503,224	-	-	-	-	2,503,224
Amounts due to other organisations	4,678	-	-	-	-	4,678
Debt securities in issue	50,335	-	-	-	-	50,335
Amounts due to international financial institutions	283	196	196	2,023	1,286	3,984
Liabilities on transactions with the International Monetary Fund	1,651	4,338	4,954	11,713	185,924	208,580
Gross settled forwards:						
- inflows	(8,786)	(17,123)	-	-	-	(25,909)
- outflows	8,987	17,268	-	-	-	26,255
Other financial liabilities	788	145	872	-	-	1,805
Total potential future payments for financial obligations	**11,087,343**	**4,824**	**6,022**	**13,736**	**187,210**	**11,299,135**
Liquidity gap arising from financial instruments	**(5,052,900)**	**2,327,835**	**277,883**	**927,197**	**1,261,424**	**(258,561)**

The Bank does not use the above maturity analysis based on undiscounted contractual maturities of liabilities to manage liquidity. Instead, the Bank monitors expected maturities and the resulting expected liquidity gap as follows:

The maturity analysis of financial instruments at 31 December 2012 and 31 December 2011 are as follows:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 6 months**	**From 6 to 12 months**	**From 12 months to 5 years**	**Over 5 years**	**Total**
31 December 2012						
Total financial assets	6,386,191	3,621,259	75,485	1,099,026	2,013,370	13,195,331
Total financial liabilities	13,137,096	3,323	3,647	6,885	187,131	13,338,082
Net liquidity gap based on expected maturities at 31 December 2012	(6,750,905)	3,617,936	71,838	1,092,141	1,826,239	(142,751)
31 December 2011						
Total financial assets	6,034,443	2,332,659	283,905	940,933	1,448,634	11,040,574
Total financial liabilities	11,087,193	4,811	6,010	13,556	186,792	11,298,362
Net liquidity gap based on expected maturities at 31 December 2011	**(5,052,750)**	**2,327,848**	**277,895**	**927,377**	**1,261,842**	**(257,788)**

The entire portfolio of trading securities is classified within demand and less than one month based on management's assessment of the portfolio's realisability.

Management believes that despite of the fact that the Bank's liabilities for money in circulation as well as for amounts due to credit institutions and government organisations are classified as being on demand, the nature of the liabilities and past experience of the Bank would indicate that their full settlement will not be claimed in the short-term and therefore provide a long-term and stable source of funding for the Bank.

28. Management of Capital

The capital of the Bank comprises the residual value of the Bank's assets after deduction of all its liabilities.

The Bank's objectives when managing capital are to maintain an appropriate level of capital to ensure economic independence of the Bank and ability to perform its functions. The Bank considers total capital under management to be equity shown in the statement of financial position as disclosed in these financial statements.

No external capital requirements exist for the Bank as the central bank, except for the size of the statutory capital and minimum amount capital reserves stipulated by the Law of the Republic of Azerbaijan "On the Central Bank of the Republic of Azerbaijan" (the "Law").

As disclosed in Note 22, at 31 December 2012 the authorized and fully paid capital of the Bank was AZN 10,000 thousand (31 December 2011: AZN 10,000 thousand).

According to Article 10.3 of the Law, capital reserves should make up 15% of the national currency in cash put into circulation by the Bank and are established by allocations from the profit for the year. The difference resulting from the revaluation of assets and liabilities that are held in gold and foreign currency because of changes in the rate of Azerbaijani Manat is accounted for in the statement of comprehensive income of the Bank, but shall not be taken into consideration in the calculation of the capital reserves. Upon establishment of capital reserves, the residual balance of realized profit of the Bank shall be transferred to the State Budget.

Due to the fact that the capital reserves of the Bank at 31 December 2011 were not at the level required by the Law, there were no transfers made to the State Budget during the year 2012. At 31 December 2012, the Bank did not have the capital reserves required by the Law and therefore, no liability was recognised for the transfers to the State Budget.

29. Contingencies and Commitments

Legal proceedings. From time to time and in the normal course of operations, claims against the Bank may be received. On the basis of its own estimates and both internal professional advice management is of the opinion that no material losses will be incurred in respect of claims and accordingly no provision has been made in these financial statements.

Operating lease commitments. As at 31 December 2012 and 2011, the Bank did not have material commitments under non-cancellable operating leases.

30. Derivative Financial Instruments

In thousands of Azerbaijani Manats	Note	31/12/2012		31/12/2011	
		Contracts with positive fair value	**Contracts with negative fair value**	**Contracts with positive fair value**	**Contracts with negative fair value**
Foreign exchange forwards: fair values, at the end of the reporting period, of	31				
- USD receivable on settlement (+)		27,413	59,046	62,390	21,545
- USD payable on settlement (-)		(6,004)	(21,160)	(17,233)	(4,534)
- Euros receivable on settlement (+)		15	18,286	11,032	4,364
- Euros payable on settlement (-)		(18,726)	(39,084)	(49,796)	(11,070)
- Pound Sterling receivable on settlement (+)		5,111	-	3,552	-
- Pound Sterling payable on settlement (-)		-	(13,571)	(7,163)	(3,408)
- Other currencies receivable on settlement (+)		927	2,871	2,793	-
- Other currencies payable on settlement (-)		(8,661)	(7,045)	(3,442)	(7,242)
Net fair value of foreign exchange forwards	13, 21	**75**	**(657)**	**2,133**	**(345)**

Foreign exchange derivative financial instruments entered into by the Bank are generally traded in an over-the-counter market with professional market counterparties on standardised contractual terms and conditions. Derivatives have potentially favourable (assets) or unfavourable (liabilities) conditions as a result of fluctuations in market interest rates, foreign exchange rates or other variables relative to their terms. The aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

31. Fair Value of Financial Instruments

(a) Fair values of financial instruments carried at amortised cost.

Fair values of financial instruments carried at amortised cost are as follows:

In thousands of Azerbaijani Manats	31/12/2012 Carrying amount	31/12/2012 Fair value	31/12/2011 Carrying amount	31/12/2011 Fair value
FINANCIAL ASSETS				
Cash and cash equivalents				
- Cash on hand	99,238	99,238	100,928	100,928
- Placements with non-resident credit institutions	5,717,388	5,717,388	6,581,576	6,581,576
SDR holdings with the IMF	185,975	185,975	185,029	185,029
Loans to local banks				
- Loans under government guarantee	2,479,728	2,479,728	1,530,817	1,530,817
- Refinancing loans	650,369	650,369	549,342	549,342
- Subordinated loans	252,750	252,750	-	-
- Lender of last resort loans	-	-	-	-
Investment securities				
- Bonds issued by the Ministry of Finance of the Republic of Azerbaijan	117,871	105,845	123,958	108,987
- US Treasury bills	-	-	197,521	197,521
Promissory note from the Government ***Other financial assets***	***225,732***	***225,732***	***221,095***	***221,095***
- Receivables for investments disposed	***1,886***	***1,886***	***-***	***-***
- Loans to employees	1,340	1,340	1,601	1,601
- Advances received for foreign currency dealing operations	79	79	154	154
- Other financial assets	84	84	77	77
TOTAL FINANCIAL ASSETS CARRIED AT AMORTISED COST	**9,732,440**	**9,720,414**	**9,492,098**	**9,477,127**

In thousands of Azerbaijani Manats	31/12/2012 Carrying amount	31/12/2012 Fair value	31/12/2011 Carrying amount	31/12/2011 Fair value
FINANCIAL LIABILITIES				
Money issued in circulation	9,777,522	9,777,522	7,658,486	7,658,486
Amounts due to credit institutions				
- Current accounts	740,539	740,539	725,701	725,701
- Obligatory reserves	128,064	128,064	100,726	100,726
- Blocked accounts	707	707	336	336
- Repurchase transactions	-	-	40,934	40,934
Amounts due to government organizations				
- Amounts due to the Central Treasury of the Republic of Azerbaijan	2,179,547	2,179,547	2,360,519	2,360,519
- Amounts due to the State Oil Fund of the Republic of Azerbaijan	156,670	156,670	133,919	133,919
- Other demand deposits	12,081	12,081	8,786	8,786
Amounts due to other organisations				
- Public organisations	14,168	14,168	4,473	4,473
- Other financial institutions	136	136	186	186
- Other	1	1	19	19
Debt securities issued				
- Short-term notes	119,930	119,930	50,185	50,185
Amounts due to international financial institutions				
- Borrowings from International Development Association (IDA)	3,214	3,214	3,591	3,591
- Amounts due to other international financial institutions	1,025	1,025	178	178
Liabilities on transactions with the International Monetary Fund				
- IMF current accounts	656	656	659	659
- Borrowings from the IMF	12,415	12,415	22,598	22,598
- SDR allocation	185,204	185,204	184,916	184,916
Other financial liabilities				
- Amounts in the course of settlement	3,737	3,737	581	581
- Amounts payable for investments securities purchased	1,672	1,672	588	588
- Advances received for the purchase of foreign currency	137	137	636	636
TOTAL FINANCIAL LIABILITIES CARRIED AT AMORTISED COST	**13,337,425**	**13,337,425**	**11,298,017**	**11,298,017**

(b) Analysis by fair value hierarchy of financial instruments carried at fair value.

For financial instruments carried at fair value, the levels in the fair value hierarchy into which the fair values are categorised are as follows:

In thousands of Azerbaijani Manats	31/12/2012 Quoted price in an active market	31/12/2012 Valuation technique with inputs observable in markets (Level 2)	31/12/2011 Quoted price in an active market	31/12/2011 Valuation technique with inputs observable in markets (Level 2)
FINANCIAL ASSETS				
Trading securities	3,422,816	-	1,506,339	-
Investment securities available for sale	40,000	-	40,004	-
Foreign exchange forward contracts	-	75	-	2,133
TOTAL FINANCIAL ASSETS CARRIED AT FAIR VALUE	**3,462,816**	**75**	**1,546,343**	**2,133**

Management applies judgement in categorising financial instruments using the fair value hierarchy. If a fair value measurement uses observable inputs that require significant adjustment, that measurement is a Level 3 measurement. Significance of a valuation input is assessed against the fair value measurement in its entirety.

In thousands of Azerbaijani Manats	31/12/2011 Valuation technique with inputs observable in markets (Level 2)	31/12/2010 Valuation technique with inputs observable in markets (Level 2)
FINANCIAL LIABILITIES		
- Foreign exchange forward contracts	657	345
TOTAL FINANCIAL LIABILITIES CARRIED AT FAIR VALUE	**657**	**345**

(c) The methods and assumptions applied in determining fair values.

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by an active quoted market price. Where quoted market prices are not available, the Bank used valuation techniques. The fair value of floating rate instruments that are not quoted in an active market was estimated to be equal to their carrying amount. The fair value of unquoted fixed interest rate instruments was estimated based on estimated future cash flows expected to be received discounted at current interest rates for new instruments with similar credit risk and remaining maturity. When determining fair values of foreign exchange forward contracts using a valuation technique, the management assumed that foreign exchange rate patterns would change as expected and at the dates of settlement of the contracts they would not be significantly different from rates used as input to valuation technique.

Discount rates used depend on currency, maturity of the instrument and credit risk of the counterparty and were as follows:

	31/12/2012	31/12/2011
Cash and cash equivalents		
- Placements with non-resident credit institutions	0% - 0.5% p.a.	0.09% - 0.24% p.a.
Trading securities		
- Agency notes	0%-5.50% p.a.	0% - 5.25% p.a.
- US Treasury notes	0.13%-2.63% p.a.	0.13% - 3.5% p.a.
- Government bonds	0.50%-6.75% p.a.	0.5% - 6.75% p.a.
- Notes issued by international financial institutions	0.37%-6.00% p.a.	0.51% - 4.50% p.a.
- Regional authority notes	0% p.a.	0% - 0.94% p.a.
- UK Treasury notes	0%-3.75% p.a.	0% - 6.59% p.a.
- Corporate bonds	1.25%-5.25% p.a.	0.78% - 4.10% p.a.
Loans to local banks		
- Loans under government guarantee	2.56% - 5.50% p.a.	3.00% - 5.50% p.a.
- Refinancing loans	2.00% - 6.00% p.a.	2.00% - 5.69% p.a.
- Subordinated loans	6.00% p.a.	-
- Lender of last resort loans	2.00% p.a.	2.00% p.a.
Special Drawing Rights holdings with the IMF	0.11% p.a.	0.40% p.a.
Investment securities		
- Bonds issued by the Ministry of Finance	0.15% - 2.00% p.a.	0.15% - 2.00% p.a.
- US Treasury bills	-	0.38% - 1.38% p.a.
Promissory note from the Government	2.00% p.a.	2.00% p.a.
Other financial assets		
- Loans to employees	11.00% p.a.	11.00% p.a.
Debt securities in issue	1.20%-2.74% p.a.	2.79% - 2.99% p.a.
Amounts due to International financial institutions		
- Borrowings from International Development Association (IDA)	1.00% p.a.	1.00% p.a.
- Amounts due to other international financial institutions	1.00% p.a.	1.00% p.a.
Liabilities on transactions with the International Monetary Fund	0.50% p.a.	0.50% p.a.

32. Presentation of Financial Instruments by Measurement Category

For the purposes of measurement, IAS 39, Financial Instruments: Recognition and Measurement, classifies financial assets into the following categories: (a) loans and receivables; (b) available-for-sale financial assets; (c) financial assets held to maturity and (d) financial assets at fair value through profit or loss ("FVTPL"). Financial assets at fair value through profit or loss have two subcategories: (i) assets designated as such upon initial recognition, and (ii) those classified as held for trading. The following table provides a reconciliation of financial assets with these measurement categories as of 31 December 2012:

In thousands of Azerbaijani Manats	Loans and receivables	Trading assets	Held to maturity	Total
ASSETS				
Cash and cash equivalents	5,816,626	-	-	5,816,626
Special Drawing Rights with the IMF	185,975	-	-	185,975
Trading securities	-	3,422,816	-	3,422,816
Loans to local banks	3,382,847	-	-	3,382,847
Investment securities	157,871	-	-	157,871
Promissory note from the Government	225,732	-	-	225,732
Other financial assets	3,389	75	-	3,464
TOTAL FINANCIAL ASSETS	**9,772,440**	**3,422,891**	**-**	**13,195,331**

The following table provides a reconciliation of financial assets with the measurement categories at 31 December 2011:

In thousands of Azerbaijani Manats	Loans and receivables	Trading assets	Held to maturity	Total
ASSETS				
Cash and cash equivalents	6,682,504	-	-	6,682,504
Special Drawing Rights with the IMF	185,029	-	-	185,029
Trading securities	-	1,506,339	-	1,506,339
Loans to local banks	2,080,159	-	-	2,080,159
Investment securities	163,962	-	197,521	361,483
Promissory note from the Government	221,095	-	-	221,095
Other financial assets	1,832	2,133	-	3,965
TOTAL FINANCIAL ASSETS	**9,334,581**	**1,508,472**	**197,521**	**11,040,574**

As of 31 December 2012 and 31 December 2011 all of the Bank's financial liabilities except for derivatives were carried at amortised cost. Derivatives belong to the fair value through profit or loss measurement category.

33. 33 Related Party Transactions

Parties are generally considered to be related if the parties are directly or indirectly under common control or one party has the ability to control the other party or can exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

"Other related parties" represent the Azerbaijan Mortgage Fund ("AMF") and the Financial Monitoring Service ("FMS"). The Bank acts as supervisor of these entities as mandated by law, but it has no title over their assets and liabilities, has no share ownership and rights over their economic benefits arising from their activities. Refer to Note 4.

At 31 December 2012 and 31 December 2011, the outstanding balances with related parties were as follows:

	31/12/2012			**31/12/2011**		
In thousands of Azerbaijani Manats	**Government of Azerbaijan and Government controlled entities**	**Key**	**Other related parties**	**Government of Azerbaijan and Government controlled entities**	**Key**	**Other related parties**
Loans and advances (contractual interest rate: 3 - 11% p.a.)	1,132,705	32	-	955,818	41	-
Impairment provisions for loans and advances	(7,605)	-	-	(1,645)	-	-
Investment securities (contractual interest rate: 0.15 – 2.00% p.a.)	162,166	-	-	168,257	-	-
Impairment provisions for investment securities	(4,295)	-	-	(4,295)	-	-
Promissory note from the Government	225,732	-	-	221,095	-	-
Other assets	-	-	326	-	-	827
Amounts due to credit institutions (non-interest bearing)	52,563	-	-	120,850	-	-
Amounts due to government organisations (non-interest bearing)	2,346,118	-	2,180	2,500,166	-	3,058
Liabilities on transactions with the International Monetary Fund (contractual interest rate: 0. 5% p.a.)	198,275	-	-	208,173	-	-
Amounts due to international financial institutions (contractual interest rate: 1.0% p.a.)	4,239	-	-	3,591	-	-

The income and expense items with related parties for 2012 and 2011 were as follows:

In thousands of Azerbaijani Manats	2012 Government of Azerbaijan and Government controlled entities	2012 Key	2012 Other related parties	2011 Government of Azerbaijan and Government controlled entities	2011 Key	2011 Other related parties
Interest income on loans and advances	34,854	2	-	32,533	2	-
Interest income on investment securities	1,051	-	515	1,117	-	431
Interest income on promissory note from the Government	4,636	-	-	4,624	-	-
Provision for loan impairment	5,960	-	-	40	-	-
Administrative and other operating expenses	-	819	1,319	-	801	3,350

Key management compensation is presented below:

In thousands of Azerbaijani Manats	2012		2011	
	Expense	Accrued liability	Expense	Accrued liability
Short-term benefits:				
- Salaries	819	-	801	-
Total	**819**	**-**	**801**	**-**

During the year ended 31 December 2012, AZN 9,815 thousand of the liabilities of the Government of Azerbaijan Republic on the transactions with the International Monetary Fund was settled (2011: AZN 15,153 thousand).

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