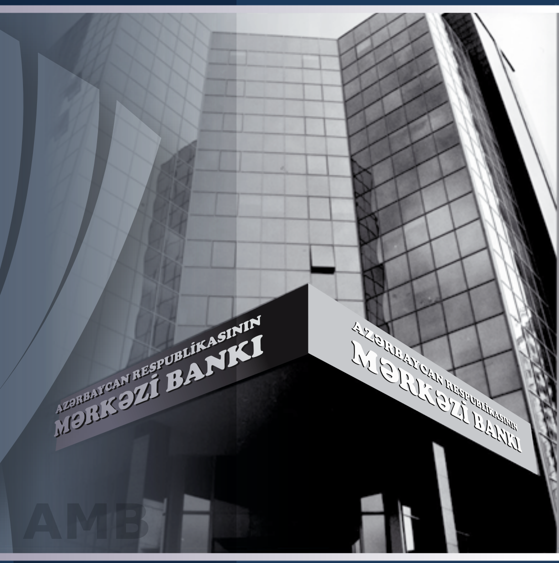

THE CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

2014 ANNUAL REPORT

THE CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

2014

ANNUAL REPORT

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FOREWORD

In 2014 the economy of Azerbaijan continued to develop as a pattern of stability and sustainability, despite to the complex trends in the global economy. The economic potential as a result of realized deep economic reforms was able to react adequately to all challenges and risks from the external environment. Non-oil sector was the main driver of economic growth as a result of diversification policy of the Government. Azerbaijan successfully retained its position as a one of the top 10 countries in the world according to macroeconomic stability indicators based on Global Competitiveness Report, World Economic Forum.

In pursuit of its goals and targets, the Central Bank provided necessary support during the year to conserving macroeconomic and financial stability, as well as to further boosting the economic growth. The Central Bank succeeded in ensuring that the inflation rate, a key macroeconomic sustainability indicator, is maintained in low digits, in parallel to securing the banking sector's financial stability in the reported year. Furthermore, a number of other successful endeavors were taken by the Central Bank to build on the existing financial intermediation function, modernize the payment systems and achieve a range of other equally significant goals.

The year of 2014 saw price stability and single-digit inflation rate continued. Income per capita surpassed the inflation rate in the reported year. The Central Bank set out to promote the capabilities of the monetary policy that were enabled by the low inflation rate environment. The Bank moved forward with developing the institutional framework of the monetary policy in the reported year with a view to enhancing its overall effectiveness.

The exchange rate policy in 2014 followed the path of preserving the current position of the balance of payments and the non-oil sector's competitive edge.

The banking system of Azerbaijan had a solid footing, progressing against its development targets. As part of this effort, capitalization enhanced the banks' risk resistance, while the key sustainability ratios improved well beyond the required minimum, and asset quality ratios remained positive. The banking system enjoyed increasingly stronger public confidence, entailing greater financial depth. The sector was actively involved in supporting economic growth and diversification processes; business loans remained the key assets of banks. Regional expansion of the banking system and broader outreach of NBCIs ensured better access to financial resources and services.

Expanding mortgage lending made better housing more accessible to households. Implementation of best industry practices had positive outcomes; an 'electronic mortgage' project was launched.

The Central Bank set out to make sure that the payment systems operate in a sound and safe fashion, as a key priority. The national payment infrastructure expanded and grew, and electronic banking followed in a rapid ascent. The National Payment System processed electronic payments to the order of more than twice as much as the GDP. Broadening non-cash transactions and electronic payment services was the key consideration in this respect.

The national economy's demand for cash was met in full and properly structured in 2014. The 'Clean Money in Circulation' policy advanced towards its stated aim of improving the quality of the national bank notes in circulation and refining the culture of bank note handling. The Central Bank made sure that cash management practices are in tune with the industry standards, optimizing the treasury infrastructure and improving cash safeguards while minimizing risks.

The Central Bank's management of its foreign exchange reserves was effective in the reported year. As uncertainty and low returns continued to reign over the global financial markets, the Central Bank set out to preserve the absolute value of reserves and improve the management effectiveness as a key priority. With this in mind, the Bank worked to diversify the currency and geographic structure of the reserves to a greater measure.

The Central Bank also moved on with building its own strategic planning of institutional capacity in the reported year. A comprehensive review of the previous years' performance helped identify mid-term strategic development priorities; the strategic program and project monitoring components of institutional performance were streamlined, along with the effectiveness assessment of risk management and internal controls.

Elman Rustamov
Chairman of the
Central Bank of Azerbaijan

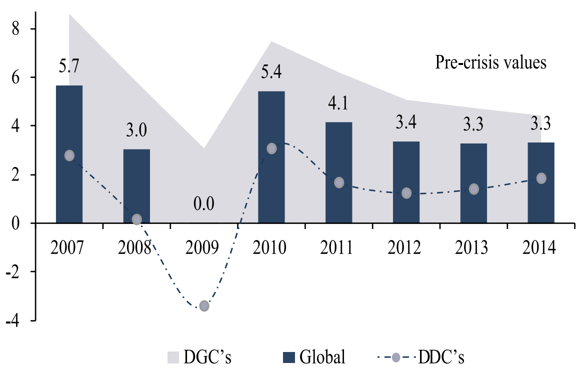
I. GLOBAL ECONOMIC PROCESSES IN 2014

The global economic growth was varied across regions with lower than expected rates in 2014, failing, yet again, to reach its pre-crisis values. The world economy faced a whole new set of challenges like dramatic volatility of commodity markets, geo-political escalation and directional shifts of capital flows, on top of the pre-existing deep-rooted problems of soaring unemployment and damaged financial stability.

The International Monetary Fund estimates that the **global economic growth rate** in 2014 remained the same as the previous year, at a mere 3.3%, quite lower than expectations.

Economic growth rate in developed countries (DDCs), having increased by 0.5% over the previous year's level, amounted to 1.8%, while developing countries (DGCs), on the contrary, had a growth rate reduced by 0.3% points below the last year's rate, thus totaling 4.4%.

Chart 1. Global economic growth rate, with constant prices , annual, %



Source: IMF

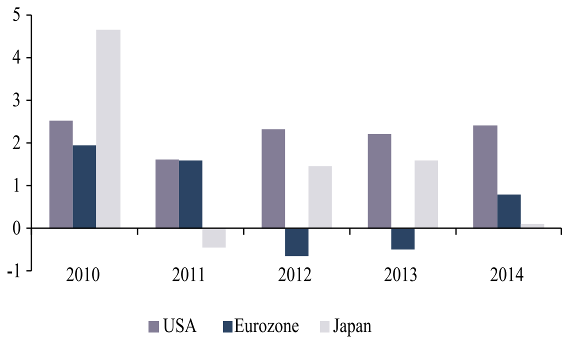
Obviously, the world economic growth rate failed to re-claim its pre-crisis values, largely due to underperformance of the euro zone, Japan, as well as the likes of China, Latin America, and Russia in terms of growth rates. While the economic growth rate of China, which is estimated to contribute approximately 15% to the world economy, over the last three decades has been a steady 10%, it dropped to 7 – 7.5% of late. In the DDC group, Great Britain (2.6%), USA (2.4%) and Canada (2.4%) performed relatively better.

The **USA** had higher than expected economic activity in the reported year. The inflation being low while employment is on the rise characterizes positive dynamics of the US economy. With energy prices dropping and monetary tightening measures postponed, private demand was given the much needed boost. İn the meantime, private demand has had increasingly larger input in growth as a result of rising dynamics of investments and household consumption. Net exports saw a set-back in their input in economic growth as the US Dollar appreciated. The US Federal Reserve System kept the interest rate unchanged during the year, at the level of 0.25%, while cutting the monthly liquidity support limit down to USD15 billion.

Japan's growth rate is estimated at 0.1%. This is a clear indication of the economy's failing struggle to break away from the negative impact of the crisis. Q3 and Q4 of 2014 saw technical recession emerge. The underperforming aggregate demand remains the main problem the Japanese economy is facing. Expansive fiscal and monetary policy efforts to revitalize household demand under the 'Abenomics' failed to fully deliver on the targets.

The **euro zone's** lower-than-expected growth rate is estimated at 0.8%. Poor investment performance and deflationary expectations, coupled with the continued debt crisis in some peripheral countries, have all adversely affected economic growth. In contrast, stronger public demand, on the one hand, and monetary mitigation on the other, contributed to rising aggregate demand. The European Central Bank reduced the interest rate twice during the year, down to 0.05%. Poor investment performance is flagging major structural and institutional problems, as well as high risk environment in the region.

Chart 2. Economic growth rate in leading countries, %

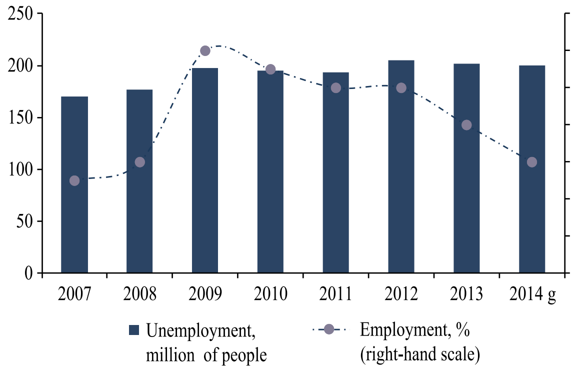


Source: IMF

The low growth rate in the **DGCs** stems largely from the poor performance of China, Russia and some other input exporters. The increasingly limited foreign demand and underperforming domestic private investment had a negative impact on China's economic growth. This, in turn, caused the region's input exporters to perform poorly as well. The negative effects of the Central Bank of China's efforts to limit the credit expansion with an aim to enhance financial stability were partly offset by positive effects of growing public investment projects, and new tax benefits for small and medium businesses. Declining energy prices were yet another factor supporting aggregate demand.

While **global unemployment** did drop to its pre-crisis value of 5.6%, it still remains one of the world economy's most urgent issues. A vast majority of the world countries experienced growth rates significantly below desirable levels, which had an adverse effect on job creation. The Global Employment Index, which indicates employment growth, increased by a mere 1.5% during the year, some 0.5% point below the pre-crisis values. In DDCs, some Eurozone countries in particular, unemployment is on the rise. In contrast, USA and Germany have managed to reduce unemployment quite considerably since the global recession first hit. Although DGCs did show some weak employment growth rates, unemployment still remained at the 2013 level.

Chart 3. Global unemployment rates

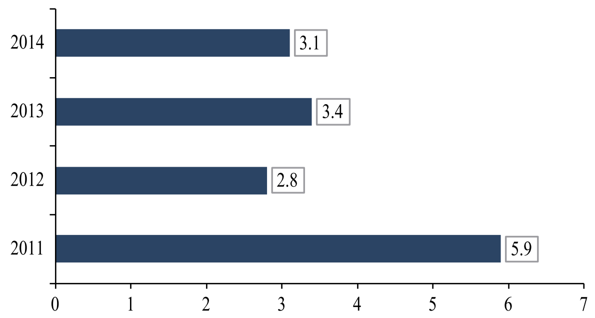


Source: International Labor Organization

The International Labor Organization (ILO) reports the world unemployed to have exceeded 200 million, with 73 million of them being young generation. The USA's unemployment rate was 5.6%, the euro zone's 11.4% and Japan's 3.4%. The euro zone's highest unemployment rate countries were Greece (26%), Spain (24%) and Croatia (16%), while the lowest rates were registered in Austria (4.9%), Germany (4.8%) and Luxembourg (5.9%). **Global youth unemployment** remained high during the year. The ILO predicts that if the global growth rates continue to perform poorly, global unemployment may reach 212 million people by 2019. 280 million new jobs need to be created over the next 5 years in order to restore global unemployment rates to their pre-crisis values.

Although six years have passed since the onset of the recent global economic crisis, **global trade** still tends to grow slowly. In the reported year global trade's growth rate decreased by 0.3% against the previous year, to 3.1 %. Imports grew by 3% in DDCs, and by 3.6% in DGCs. Trade shares of resource rich countries are severely declining. As governments attempt to employ protectionist policies to reverse economic growth decline, it has negatively affected global trade. UN estimates that G20 countries have taken some 1244 protectionist measures since 2008, with only 93 counted in 2014.

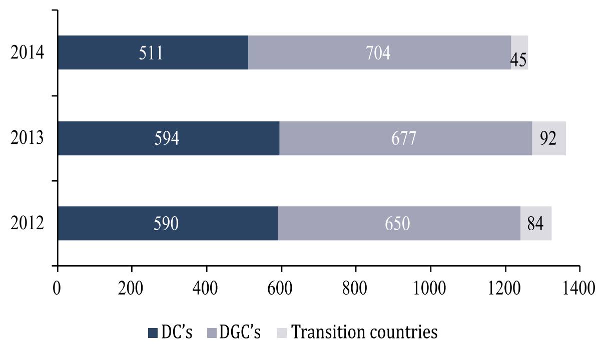
Chart 4. Global trade growth rate, %



Source: WTO

The weakening global growth also affected international foreign investment flows. In 2014, FDI flows declined by approximately 8%. DGCs accounted for 56% of the global FDI revenues in the reported year. Of the top 5 countries in terms of FDI receipts, 4 are in the DGC group. China's FDI intake was USD128 billion last year, the world's highest rate.

Chart 5. Global FDİ flow, USD billion

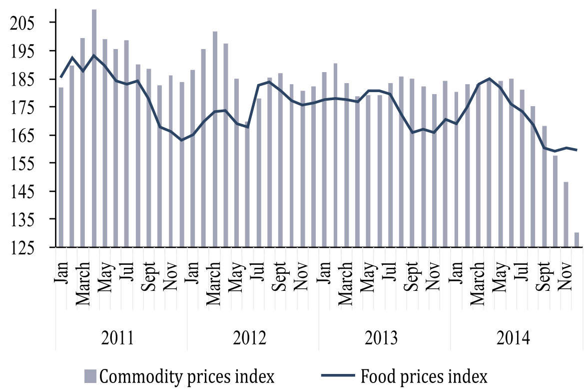


Sources: UNCTAD

The US Federal Reserve System's presumed gradual abandon of the quantitative easing policy played a key role in shifting the geography of capital flows. Consequently, capital flows re-directed more towards DDCs in late 2014. The geographic shifts of FDI flow, coupled with global economic fluctuations, are affecting DGCs asset prices and threatening financial stability in a variety of ways. Growing political and military escalation in some countries tend to impose greater uncertainty on portfolio investment flows along with FDI flow.

World commodity prices displayed declining trends in 2014. During the reported period, the **Commodity Prices Index** went down by 29%, while the food prices index dropped by 6.4%. The price decline is driven by both demand and supply factors. Energy, metal and mineral, agricultural produce indices started to decrease faster in the latter half of the year.

Chart 6. Commodity and food prices index, 2005 = 100



Source: IMF

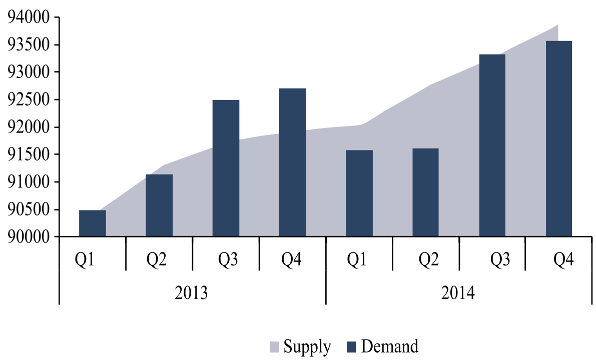
By the end of the reported year, the **Brent** oil price dropped by 43% year-to-date. The average annual price was USD99, which is 9.2% below the 2013 price levels (USD109).

Chart 7. Brent oil price, USD per barrel

Source: IMF

The global oil price drop was driven by a range of influences, such as increasing military and

Chart 8. Oil demand and supply at world markets, thousands of barrels / day

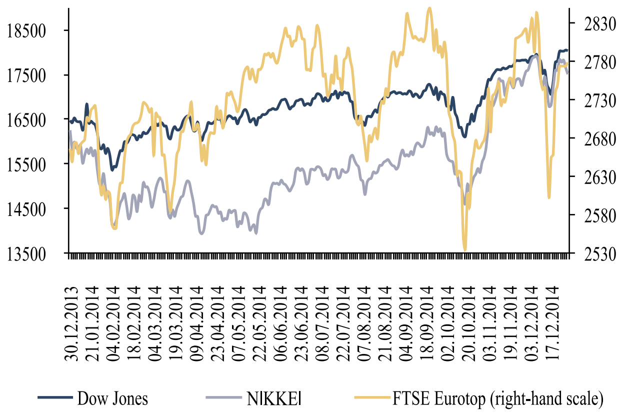


Source: Bloomberg, Reuters, Bank of America political tensions in main oil exporters, as well as reduction of global demand, increased shale oil production in the US, OPEC's unwavering high level production targets and US Dollar's appreciation.

The World Bank estimates that a 30% drop of oil prices has a 0.5% increasing effect on global economic growth. The oil price is below the fiscal break-even limit but above the production cost for oil exporting countries. Most oil exporters had reduced current balance surplus.

Global economic processes had their effect on **financial indices** as well. During the year, the Dow Jones index increased by 9.5%, FTSE Eurotop by 4.2% and NİKKEİ by 7.7%.

Chart 9. Development path of global financial indices

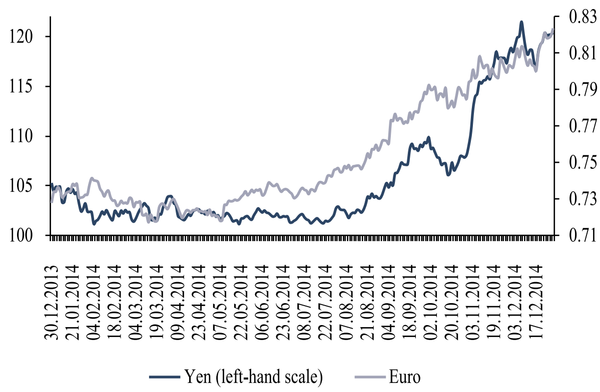


Source: Bloomberg

Global stock exchanges were in high gear in Q2 and Q3 of the reported year, but this trend reversed in the last quarter of the year: the last quarter's stock exchange performance declined by 9% from the preceding quarter, while dropping a staggering 24% against the previous year's level.

The US Dollar appreciated against other main currencies during 2014. The US Dollar appreciated by 13.2% against Euro, by 14.3% against the Japanese Yen, by 81% against the Russian Ruble and by 7.8% against the Turkish Lira year-to-date.

Chart 10. US Dollar exchange rate



Source: Bloomberg

The IMF revised global growth projections down for 2015 and 2016 in its recent report to reflect ongoing processes.

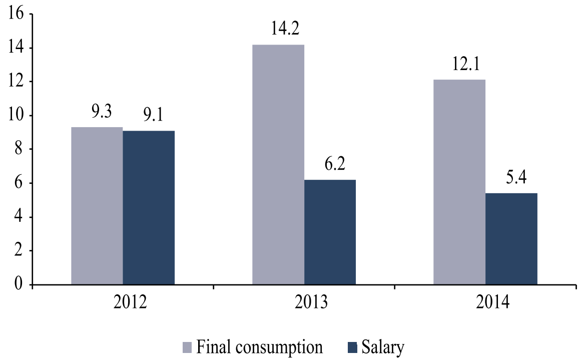
II. ECONOMY OF AZERBAIJAN IN 2014

2.1. Aggregate demand

Rising consumption expenditures along with high investment performance levels during the reported year influenced the GDP's demand components.

Final consumption expenditures represented the main demand factor of economic growth in 2014. In the reported year, nominal income per capita amounted to AZN 4180.5, 3.5% higher than the previous year level. Approximately 68.8% of household income was spent on consumption of goods and services. Final consumption expenses rose by 12.1% in nominal terms to AZN27.1 billion or 45.9% of GDP. 20% of household income was directed on savings and capital formation.

Chart 11. Average monthly salary and changes in household final consumption, %



Source: SSC

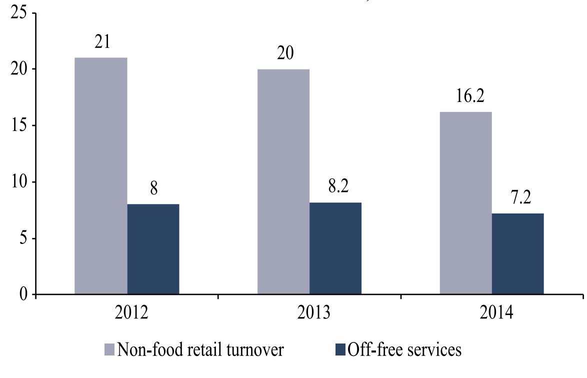
Salaries rose in most sectors of the economy in 2014, which also helped maintain a high share of final consumption in GDP. In 2014, the growth rate of average monthly salary increased by 5.4%, reaching AZN442.1.

The Central Bank's next 'Financial conducts, intentions and inflationary expectations of households' survey, conducted in December 2014, that covered 4250 households (families) suggested that the country's Consumer Confidence Index (23.8) to be in a positive range. The index is formulated through the respondents' positive expectations of their future financial conditions and economic activities, saving posbilities, and rise of employment.

High consumer expenses enabled **retail turnover** to expand. Total goods and services sold on the consumer market rose by 9.5% in 2014. Retail turnover went up by 10% to AZN22 billion. Therein, the private sector had a growth rate of 10%, with private businesses contributing 67% to the sector's real growth through retail.

Food products rose by 3.9% and non-food products by 16.2% as elements of retail turnover in 2014. Paid services increased by 7.2%, with 8.5% increase on non-public properties. The private sector accounted for 77.8% of paid services.

Chart 12. Non-food retail turnover and change in off-free services, %

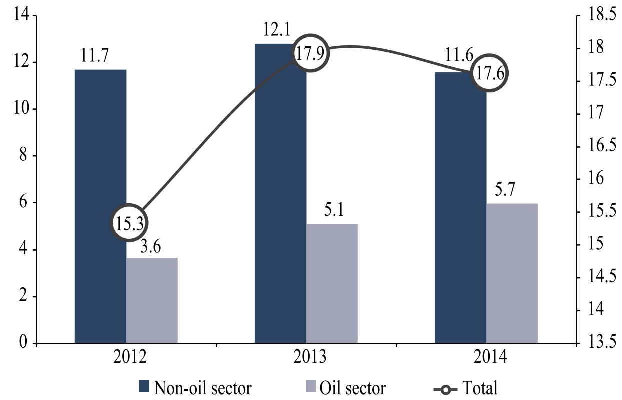


Source: SSC

Public expenditures remained a substantive contributor to domestic demand in 2014. Government's consumption expenditures were formed primarily from public spending on goods and services during the reported year. 40.5% of the government's budget spending was directed at fostering economic development, 11.8% at social security and insurance, 8% at education, and 3.7% at health care.

A total of AZN17.6 billion worth of **investments** were made to the economy in 2014, which equals 30% of GDP. Non-oil sector investments made up 66% of total investments, at AZN11.6 billion. Another AZN1.3 billion was spent on non-oil sector development.

Chart 13. Investments, AZN billion



Source: SSC

Domestic investments accounted for 72.3%, while foreign investments accounted for the remaining 27.7% .

Construction and trade were the non-oil sector's particularly best peformers in terms of growth.

Own funds of enterprises and institutions accounted for 54.8%, bank loans for 3.1%, budget funds for 36.6%, off-budget funds for 1.8% and personal savings for 3.2% of total investments.

The Central Bank's real sector monitoring exercise also indicates the country's rising investment performance. 58.3% of the enterprises monitored during the year were involved in investment activity.

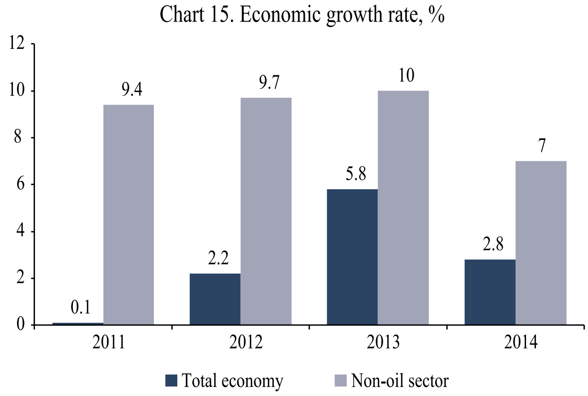
2.2. Aggregate supply

Aggregate supply continued to grow in 2014, with the non-oil sector being the primary source of economic growth.

In 2014, the real growth rate of the GDP was 2.8%, with the nominal GDP reaching AZN59 billion. The production sector accounted for 2/3 and the services sector for 1/3 of the value added, generated during the year.

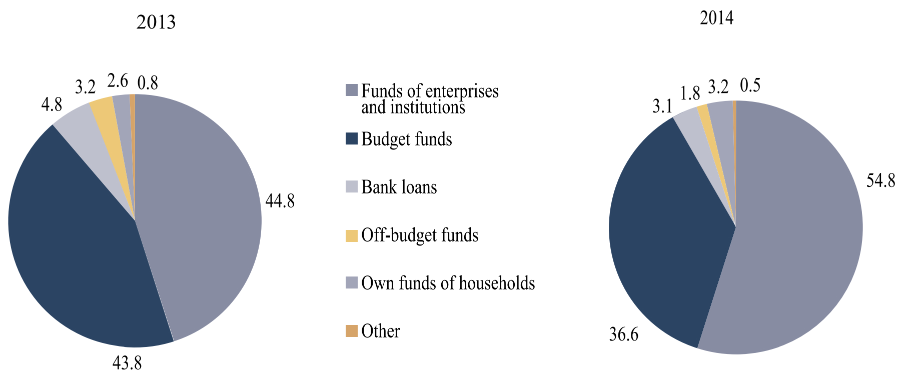
GDP growth was driven by the non-oil sector's active performance. Thus, the non-oil sector's real growth rate made 7% in the reported year. The sector's GDP share increased by 4.4% point over the previous year, reaching 61%.

Chart 15. Economic growth rate, %



Source: SSC

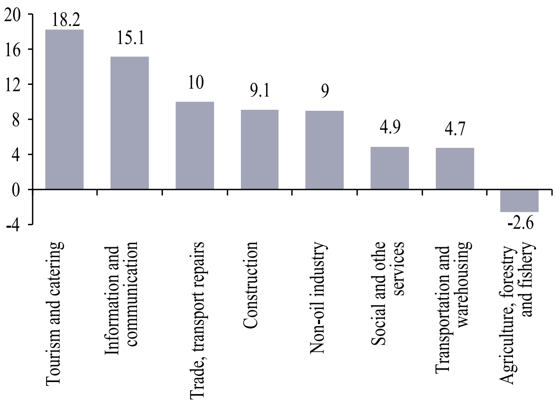
Chart 14. Structure of investments



Source: SSC

Most industries of the non-oil sector demonstrated growth during the year. In 2014, the non-oil sector posted highest growth rates in tourism and catering, information and communication, as well as trade, and transport repairs.

Chart 16. Economic growth rate by industry, %



Source: SSC

Activities carried out as part of the "Industrial Year" initiative were accompanied with some positive trends in the non-oil industry. Overall, the non-oil industry registered a growth rate of 9% in 2014, with the highest growth rates attributed to the clothing, automobile and trailer production, chemical, pharmaceutical and construction material production sectors.

The Central Bank's surveys and estimations confirm the high level of the country's economic activity. Thus, the Business Activity Index[1] remained in the positive range for both the non-oil processing industry and trade sector in 2014. It should be noted that the survey covers up to 400 enterprises with some 70 thousand employees in total.

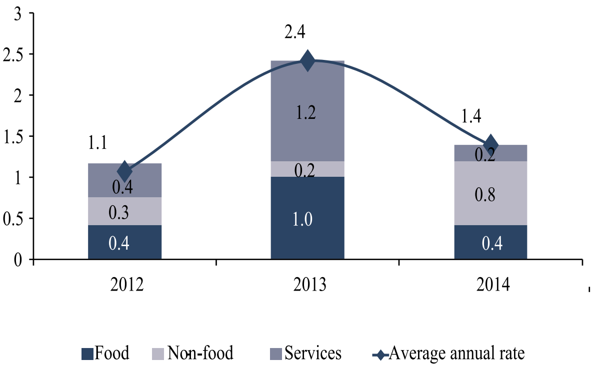
2.3. Inflation

Price stability was preserved in 2014, with inflation kept low at bay within the projected ranges.

The average annual inflation rate made 1.4% in the reported year, which is 1% point below the previous year's level. Average annual inflation rate on non-food products and services made 3.2% and 0.3% respectively, while food prices went up by 1%.

Price rise on food products formed 0.4% point of the average annual inflation rate, non-food products accounted for 0.8% points and services for 0.2% points.

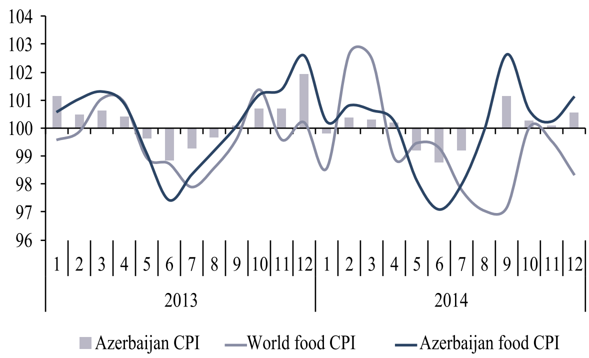
Chart 17. Average annual inflation rate, %



Source: CBA estimates based on SSC data

World food prices had a downward effect on the domestic inflation rate during the reported year.

Chart 18. Azerbaijan and world food CPI, monthly, %



Source: SSC and FAO

The average annual **core inflation rate**, which is inflation adjusted from swings in prices for commodities regulated by the government and seasonal factors, increased by 1.6%.

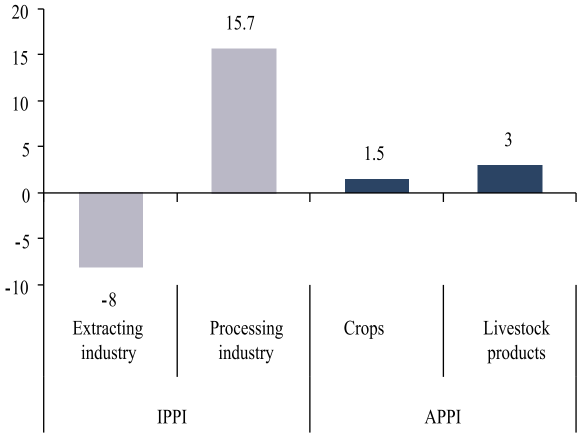
Trade partner countries observed an average annual inflation rate of 5.4% in 2014, which is 4% points higher than the one in Azerbaijan. In general, over 3 years in row Azerbaijan has had an inflation rate lower than that of foreign trade partner countries.

The average annual **industrial producer price**

[1] Business Activity in Industry Index = (production – stock + projected production)/3
Business Activity in Trade Index = (actual sales – stock + projected sales)/3

index went down by 5.1% in 2014, primarily owing to 8% price decline in extracting industries. Producer prices for the manufacturing went up by 15.7% during the year.

Chart 19. Change path of producer prices, annual average, %



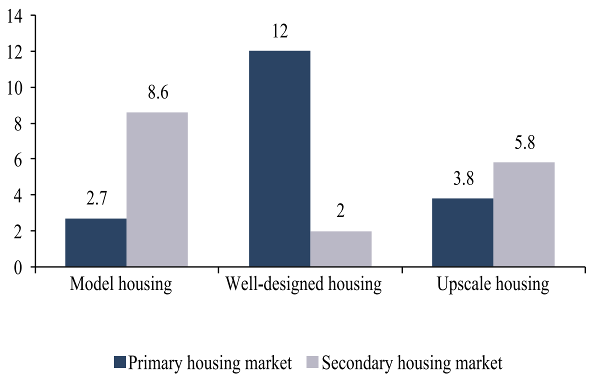
Source: SSC

The agricultural producers price index (APPI) changed by an average annual measure of 2.3% during the year, owing primarily to 3% and 1.5% price changes in livestock and crop products respectively. The slight change of agricultural prices in 2014 had a positive effect on preserving the overall price stability.

In 2014, transportation and postal charges went down by 1.3%, and communication prices declined by 8.4%. Furthermore, cargo transportation rates decreased by 2.3%, while passenger transportation prices went up by 2.6%.

According to the SSC, housing market prices went up by 10.1% in 2014. Secondary and primary housing markets had 10.1% and 9.1% price increases respectively. The highest price increase on the secondary housing market was registered for model / low comfort housing (14.6%), while the primary market price growth was mostly driven by well-designed residences (12%).

Chart 20. Housing market price index, as opposed to the previous year, %



Source: SSC

The CBA estimates that the notaries' deposit account receipts from property sales increased by 25.4%, which evidences how active the real estate market was during the year.

2.4. Employment

The country's employment indicators continued to improve in 2014 as well, stemming from the non-oil sector's high economic output.

According to SSC, in 2014 the economically active population counted 4840.7 thousand persons, 95.1% of which was engaged in various segments of the economy and the social sector.

In 2014, 1480.2 thousand hired workers were engaged in the non-oil sector.

A total of 127.3 thousand **new jobs** were created during the reported year, of which nearly 82.6% is full-time employment. Individuals accounted for 76.3% of full-time jobs, while existing and new or restored businesses and entities accounted for 10.4% and 12.6% respectively. Regional employment had a share of 69.8% of the total new jobs. New jobs were created mostly in processing, construction, retail and transport, as well as in public sector entities and institutions.

2.5. Balance of payments[2]

The balance of payments had a surplus in 2014.

The oil and gas sector played a key role in securing a positive balance of foreign economic operations during the year. The oil and gas sector's total revenues were formed primarily from oil and natural gas exports, and foreign investments in the sector.

[2] From 2013 the balance of payments is prepared in a format that complies with the International Monetary Fund's New (6th edition) Manual. Changes introduced in the New Manual cover the structural components of the balance of payments. Thus, Capital and Financial account transactions in the structure of the balance are recommended to be recorded as 'net financial assets' and 'net financial liabilities' instead of credit / debit format as it used to be. Furthermore, the new Manual also introduces a number of other changes as well. For the balance of payment development methodology visit http://cbar.az/assets/1186/final_metod.pdf.

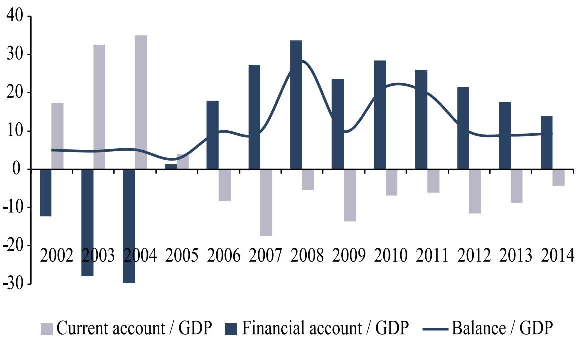
Table 1. Key indicators of the balance of payments, USD million

	2013	2014
Current operations and capital account	**13066.5**	**10423.6**
Foreign trade balance	21382.4	18927.6
Services balance	-4189.0	-6089.6
Primary income balance	-4120.6	-2581.7
-Investment income repatriation	-4190.3	-2599.4
Secondary income balance	6.6	174.2
Capital account	-12.9	-6.9
Financial account	**-6488.8**	**-3419.1**
Net financial assets	11771.4	
- Direct investments abroad	1490.0	2208.8
- portfolio investments	322.8	429.5
- other investments	9958.6	9053.9
Net financial liabilities	5282.6	8273.1
- Direct investments attracted to Azerbaijan	6290.2	8049.2
- attracted investment repatriation	-3661.0	-3635.7
- oil bonus	2.3	17.0
- portfolio investments		1750.9
- other investments	1609.8	2091.7
Net errors and omissions	**-2736.7**	**-2810.3**
Total surplus of the balance of payments (change in the reserve assets of the country)	**3841.0**	**4194.2**

Source: CBA

The sector's payments reflect income and investment repatriation, and imports of equipment and services. The oil and gas had a surplus of USD20.1 billion in 2014.

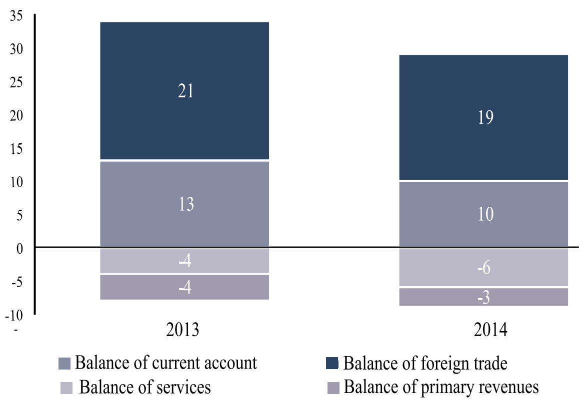
Chart 21. Balance of payments parameters as a percentage of GDP



Source: CBA

In 2014 the **current account's** surplus amounted to USD10.4 billion (14% of GDP), including USD18 billion of current accounts surplus on the oil-and-gas sector. Surplus of the oil-and-gas sector fully covered USD 7.6 billion deficit on the non-oil sector.

Chart 22. Balance of current account, USD billion



Source: CBA

Foreign trade turnover totaled USD37.6 billion, with the balance of foreign trade closing with a positive USD18.9 billion. Total exports were 3 times as much as total imports during the year.

Over the year Azerbaijan maintained trade relations with up to 154 countries across the world. CIS countries are reported to have had a 8.3% share in external trade, while other foreign countries accounted for the remaining

91.7%. Azerbaijan further intensified trade deals with Italy, Turkey, UK, Germany, the USA, Russia, Indonesia, Israel, France and Japan (these countries accounted for 66.9% of total trade).

The non-oil and gas sector's exports exceeded USD1.6 billion. 2014 performance outputs report commodity exports at 27.5% and service exports at 72.5% of the non-oil and gas industry's total exports.

During the reporting year **export** amounted to USD28.3 billion. The share of oil-and-gas products in the export made up 94.2%.

Oil products exported to foreign countries accounted for USD 25.3 billion, of which USD 1.8 billion was oil processing products and USD 23.5 billion – crude oil.

The share of vehicles, equipment and goods imported through investments comprised 12.1% and equaled USD 1127.9 million. 98.8% of this amount was the share of imports financed from investments used under oil and gas contracts. Besides, USD 4034.5 million worth of machines, equipment, chemical, ferrous and non-ferrous metal products were imported to the country for production purposes.

One of the major items in economic relations of Azerbaijan with other countries in 2014 was mutually provided services, the volume of which

Table 2. Structure of exports, USD million

	2013		2014	
	Amount	Share, %	Amount	Share, %
Export - total	31702.9	100.0	28259.6	100.0
including:				
1. Fuel-raw materials	30430.4	96.0	27073.0	95.8
- oil and gas products	30003.3	94.7	26627.3	94.2
- other raw materials	427.1	1.3	445.7	1.6
2.Machinery and equipment	292.6	0.9	269.6	1.0
3. Consumer goods	954.6	3.0	885.0	3.1
4. Other goods	25.3	0.1	32.0	0.1

Source: CBA

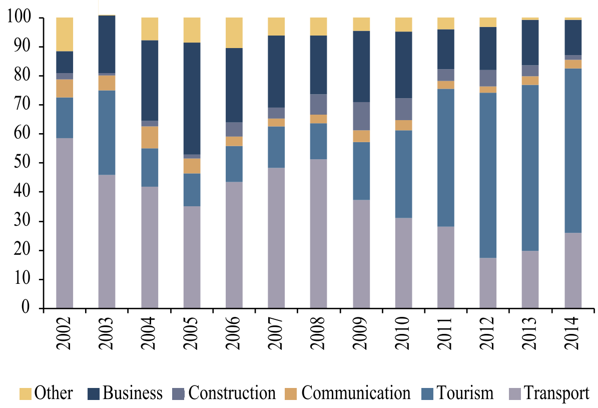
Table 3. Structure of imports, USD million

	2013		2014	
	Amount	Share, %	Amount	Share, %
Import – total	10320.6	100.0	9332.0	100.0
including:				
1. Consumer goods	4463.3	43.3	4168.7	44.7
- food products	1314.1	12.8	1220.1	13.1
- others	3149.2	30.5	2948.6	31.6
2. Investment oriented goods	1055.4	10.2	1127.9	12.1
- international oil and gas consortiums	865.3	8.4	1114.4	12.0
- others	190.1	1.8	13.5	0.1
3. Other goods	4801.9	46.5	4035.4	43.2

Source: CBA

was USD 14.7 billion. Out of this amount USD 10.4billion was rendered by non-residents for Azerbaijani residents, and USD 4.3billion – services provided by Azerbaijani residents for residents of foreign countries.

Chart 23. Structure of the non-oil sector's exports of services, %



Source: CBA

Transportation services accounted for 14.3% of the mutual services turnover. 46.9% of the USD 2097.5 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 to non-residents amounted to USD 1113.6 million.

The share of tourism revenues in total exports of services has been increasing. Over the reported period the value of tourism services provided for non-residents was estimated to be USD 2431.5 billion, 28.3% of which relates to business visits of non-residents to Azerbaijan. In its turn, y.o.y. increase in the value of tourism provided by foreign countries for Azerbaijani residents was 4.6% and made USD 3 billion. 67.4% of this amount falls to the share of private expenditures of Azerbaijani citizens (funds for shuttle import excluding).

Non-oil sector's imports of services amounted to USD6.3 billion having increased by 10% in 2014. Overall, mutual services had a share of 28% of the total imports and exports turnover of goods and services involving foreign countries.

In the reported period the total turnover of **primary income** receipts and payments reached USD5.9 billion. Of this, 71.8% (USD4.3 billion) represented payments from Azerbaijan, while the core of that amount (USD3.1 billion) represents income repatriation of foreign investors in oil-and-gas consortiums (mainly as crude oil), salaries paid to non-residents (USD286.5 million) and interest payments on external debts (USD547.5 million).

Total value of **secondary income** operations with foreign countries is estimated to equal USD 3.4 billion, 52.5% of which was receipts by Azerbaijan.

95% of total receipts on secondary income is comprised of remittances of individuals from foreign countries, 2.8% – value of humanitarian import goods, and 2.2% – other receipts. In total, surplus of secondary income operations made up positive USD 174.2 million.

During the year, net financial assets equaled USD 11.7 billion, which is primarily comprised of direct investments abroad (USD 2208.8 million), portfolio investments (USD 429.5 million) and other investments (USD 9053.9 million).

Total amount of **foreign direct investments** was USD 8 bln. The share of the oil-and-gas sector in the structure of these investments was 83.6%. Attracted investments were channeled to the domestic economy to finance large-scale oil-and-gas projects, primarily the BP Exploration (Shahdeniz) Ltd. project and works provided by the AIOC in Azeri- Chiragh-Guneshli.

According to estimates, total FDIs to the non-oil sector equaled to USD 1318.5 million. Direct investments from Azerbaijan to foreign economies totaled USD2.2 billion in 2014.

Net financial assets on **credits and loans** increased by USD189.2 million, while net financial liabilities went up by USD1543.5 million. Net financial liabilities rose against direct government and government guaranteed loans (USD 423.5 million.), banks (USD 449.4 million), other entities and companies (USD 670.6 million.).

Net financial assets on deposits and cash currency increased by USD4.8 million, while

Table 4. Net financial assets and liabilities, USD million

	Assets	Liabilities
Direct investments	2208.8	4413.5
- oil and gas sector	1481.0	3133.0
- other sectors	727.8	1280.5
Portfolio investments	429.5	1750.9
Other investments	9053.9	2091.7
- Trade credits and advances	4085.7	138.2
- Credits and loans	189.2	1543.5
- Deposits and cash	4779.0	410.0
Oil bonus	-	17.0
TOTAL	11692.2	8273.1

Source: CBA

net financial liabilities went up by USD410.0 million.

The surplus in the balance of payments was the principal factor contributing to the **reserves** increased by USD4194 million in the reported year. As of the end of 2014, the foreign exchange reserves to GDP ratio was 68.4%, sufficient to cover over 30 months of imports.

III. MONETARY AND EXCHANGE RATE POLICY, MONETARY CONDITION

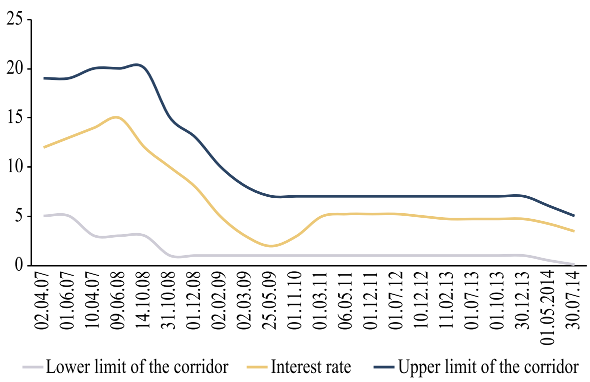
3.1. Monetary policy

As in previous years, in 2014 the Central Bank's monetary policy aimed at securing macroeconomic stability in the country.

While implementing the monetary policy, due consideration was given to the country's economic environment, the condition of financial markets and the monetary policy's transmission capacity.

Given the optimal level of inflation, the Central Bank changed the interest rate corridor twice during the year in order to provide the necessary support to economic growth. Consequently the **interest rate** was reduced on a phased-in basis from 4.75% to 3.5%, while the ceiling of the corridor was reduced from 7% to 5%, and the floor from 1% to 0.1%. Simultaneously the reserve requirements for the banks' foreign and domestic liabilities were decreased from 3% to 2% in August 2014.

Chart 24. Parameters of the interest rate corridor, %

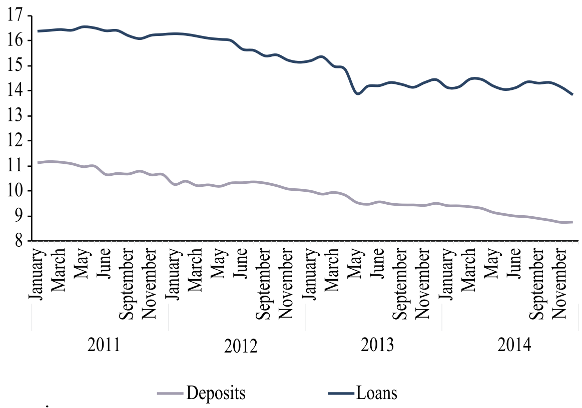


Source: CBA

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 the interest rate on loans went down by 0.6 percentage points as a whole, including 1.5% points on corporate loans.

Interest rates on deposits went down by 0.7% point.

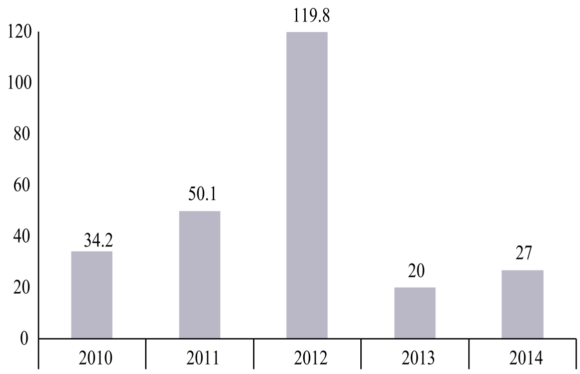
Chart 25. Nominal interest rates in Manat (CBA)



Source: CBA

Open market operations and reserve requirements were used as a part of the overall effort to **regulate** growth rates of money supply and the **liquidity level** of the banking system.

Chart 26. Short-term notes in circulation, AZN million



Source: CBA

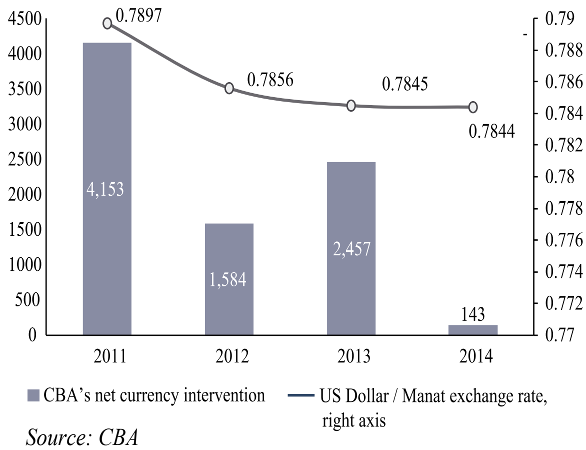
Year-end notes in circulation totaled AZN 27 million; average yield at the last auction was 0.91%, dropping from 1.07% at the beginning of the year.

3.2. Exchange rate policy and international competitiveness

A stable exchange rate of the Manat was secured in 2014. The exchange rate policy was implemented taking into account maintenance of competitiveness of the non-oil sector and the status of the balance of payments.

Amid surplus in the balance of payments supply prevailed over demand in the FX market. The Central Bank responded with USD142.8 million worth of net **foreign exchange sterilization**. The lower than usual amount of purchases is due to the fact that demand for foreign exchange increased drastically owing to psychological effects of devaluation, in the partner countries in December.

Chart 27. CBA's currency sterilization (USD million) and Manat's official exchange rate against US Dollar



Source: CBA

During the year the Manat's exchange rate against the US Dollar remained fairly undisturbed, having appreciated by a mere 0.02%.

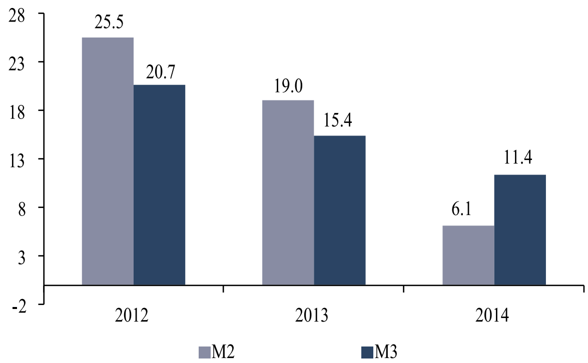
The difference between inflation in trade partner countries and in Azerbaijan had a downward effect on the **real effective exchange** rate (REER). Consequently, the Manat's REER on the non-oil sector appreciated by a measure of 16.9% in 2014.

3.3. Money supply

In 2014, the money supply continued to grow in consistency with the economy's demand, while its structure continued to improve.

The **broad money supply in Manat** increased by 6,1% during the reported year. The upward tendency of the money multiplier, which expresses the banking system's ability to generate money (7% growth year-to-date), is attributable to expanding volumes of non-cash money.

Chart 28. Changes of broad money, %



Source: CBA

Table 5. Bilateral nominal and real exchange rate indices of Manat in 2014, %

	Relative to December 2013 *	
	Nominal bilateral exchange rate index	Real bilateral exchange rate index
USA	100.02	99.1
Eurozone	111.1	111.1
United Kingdom	104.7	103.4
Turkey	111	102.5
Russia	170.6	152.9
Ukraine	189.7	151.7
Georgia	109.4	107.1
Iran	107.8	92.7
Kazakhstan	118.2	109.7
Japan	115.3	113.1
Israel	112.2	112.2
China	101.9	100.1
Belarus	116	99.6
S. Korea	104.4	103.3
Switzerland	109.1	92.6

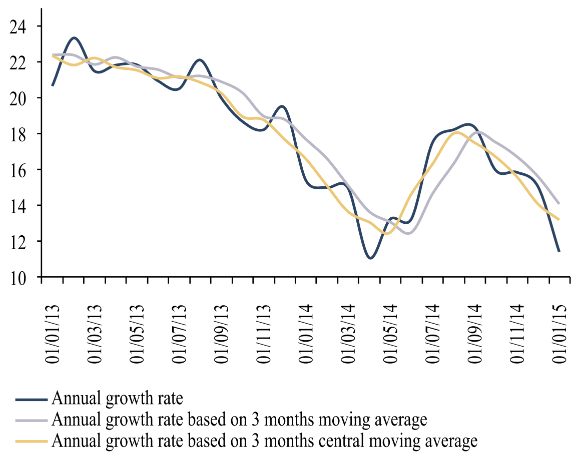
**Over 100 is appreciation, below 100 is depreciation.*

Source: CBA

The monetary base in Manat decreased by 0.9%.

During the reported year broad money (M3) increased by 11.4% totaling AZN21566.4 million as of 01.01.2015.

Chart 29. Development path of M3 money aggregate



Source: CBA

As of the end-2014, foreign exchange-denominated deposits amounted to 36.2% of total deposits and savings, while FX deposits made 19.2% of M3 broad money. Manat deposits and savings increased by 21.9% during the year.

Non-cash money aggregate increased by 21.9% during 2014; consequently the share of non-cash money aggregate in broad money in Manat went up by 5.4 % points, which represents the ever increasing use of the non-cash payment infrastructure.

3.4. Institutional framework of monetary management

In 2014, the Central Bank conducted a range of studies within the scope of its mandate and functions, while working to improve and build up the existing forecasting and modeling capacities. Developing statistics and improving public communications were also a subject of strong focus.

The Bank carried on with its efforts to improve the theoretical and methodological basis of the **econometric** framework of empirical economic and financial studies in the reported year. Currently the Central Bank employs over 16 short-term and long-term forecasting models, based on both the classical and Bayesian econometric approaches. The new models have enabled the Central Bank to improve macroeconomic forecasting precision, while also conducting alternative scenario analyses.

A variety of econometric methods were employed in order to study business cycles and sources of economic fluctuations during the year. The study findings helped formulate indicators that precede and fall behind the cycle. These indicators are expected to be used in taking various proactive steps with respect to the economic framework. This study entitled **'Cyclic barometer measurement'** assessed the current status and change prospects of output gap, as well as the locus of the economy in relation to the cycle. An added benefit of the assessment was the Central Bank's ability to come up with some significant results by anticipating the development path of inflation and employment.

As part of a broader endeavour to support economic diversification and export-oriented economy in the long-term, the domestic and foreign demand as well as exchange rate elasticity of imports and exports was studied. The findings play

Table 6. Money aggregates, AZN million

	01.01.12	01.01.13	01.01.14	01.01.15
M0 (Cash)	7158.4	9256.6	10458.7	10152.5
M1 (Cash, demand savings and deposits)	8796.3	11107.9	12736.9	12830.4
M2 (Cash, demand and term savings and deposits, in AZN)	10997.4	13806.4	16434.8	17435.8
M3 (Cash, demand and term individual and corporate deposits, AZN and hard currency)	13903.4	16775.3	19359.8	21566.4

Source: CBA

a significant role in **evaluating the transmission** of global shocks and exchange rate fluctuations.

The link was assessed that connects the banking sector's financial intermediation and economic growth, in a **study designed to research the financial system's development**. To this end, (i) the banking sector's depth, (ii) stability, (iii) effectiveness and access to financial services (inclusiveness) indicators that characterize the banking sector's development were analyzed individually; indices were calculated for each of these components, with an assessment of these indices' effect on economic growth.

In addition, the effect of non-cash payments on economic growth was studied. A card penetration ratio was estimated to help identify the future prospects and development path of non-cash payments in the country. Thereafter the ratio's link with the household consumption levels was evaluated. This sort of study helps to obtain some practical results that allow for measuring the impact of non-cash payments on financial depth and ultimately on economic growth.

Implementation of the Central Bank's "Electronic Statistical Analytical Reporting System – 2" project was continued as scheduled. The project is expected to be completed by September 2015. The scope and coverage of the real sector, foreign sector, monetary sector, banking and financial system and national account system's analytical statistics have expanded. The micro-coverage of the banking and financial statistics reporting and statistical bulletins continued to expand. Furthermore, the coverage of enterprises and institutions included in the Central Bank's real sector monitoring continued to expand in 2014 as well. The number of enterprises surveyed reached 400; they employ 70 thousand people, which allowed for measuring the economic activity index on a regular basis. In parallel, 4250 households were surveyed, as a basis for regular evaluation of the consumer confidence index.

Public communication remained a key area of focus for improvement in the reported period as it represents a significant element of the monetary and financial stability policy. The quarterly Monetary Policy Review and semi-annual Financial Stability Review, as well as numerous press-releases on policy measures and decisions were the main communication tools. The Central Bank also communicated complete and accurate information on the monetary policy and banking to the public using its regularly updated web-site with a yearly visitor count of 1 million people, and through a broad variety of events such as press-conferences, interviews, and journalist inquiries. Research findings and outcomes of economic model assessments are widely advertised through the *Central Bank and Economy* magazine and the *Research Newsletter.*

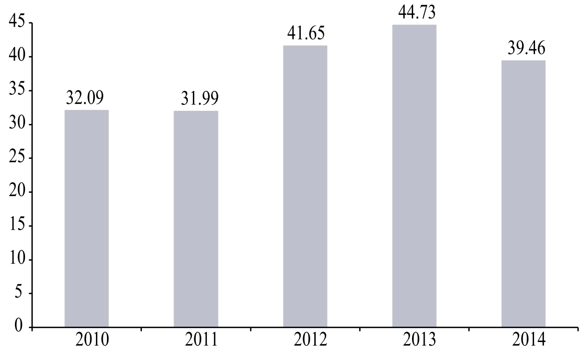
IV. FINANCIAL MARKETS

4.1. Foreign exchange market

The Central Bank's activities in foreign exchange market 2014 aimed at balancing demand and supply on the FX market within the scope of the 'intervention corridor' in order to preserve the Manat's stability at the foreign exchange market.

YoY decrease in FX market transactions was about 12% or USD5.3 billion against the previous year (USD44.7 billion last year), totaling to USD39.5 billion.

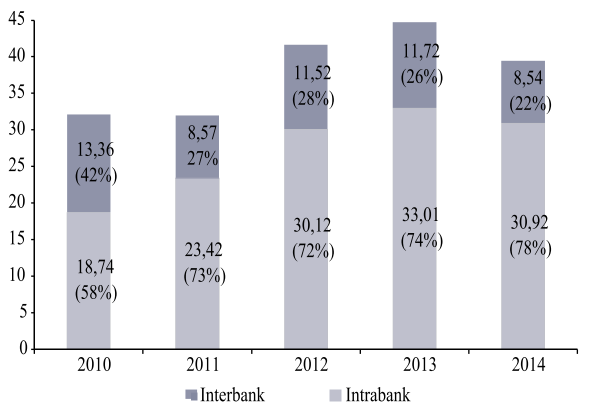
Chart 30. Domestic foreign exchange market transactions, USD billion



Source : CBA

Interbank currency transactions accounted for 22% (USD 8.54 billion), and intra-bank currency transactions for 78% (USD30.92 billion) of the total domestic FX market transactions as of the year-end.

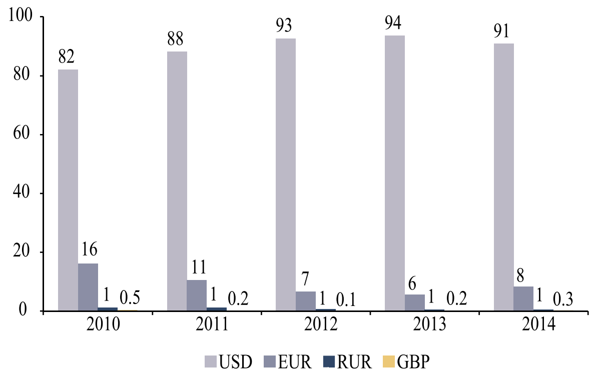
Chart 31. Structure of the domestic foreign exchange market, USD billion



Source : CBA

Approximately 75% of the interbank currency transactions were executed via the Bloomberg trading platform, with the number of commercial bank members of the Bloomberg system increasing to 23 in the reported year.

Chart 32. Currency structure of the domestic foreign exchange market



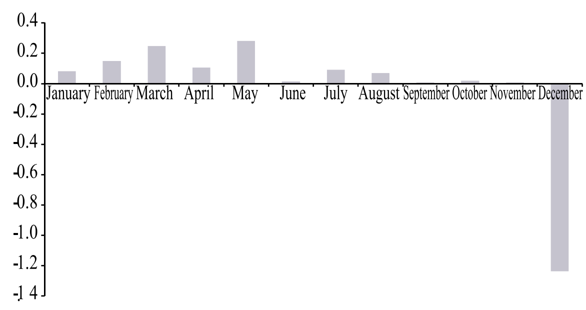
Source: CBA

As in previous years, US dollar transactions dominated in the FX market during the reported year (91%).

The Central Bank carried on with its policy of USD/Manat bilateral exchange rate targeting. Thereby, the US Dollar interventions under the "intervention corridor" set for the purpose of preserving a stable Manat were carried out via the Bloomberg trading platform.

The Central Bank pursued different intervention paths at the interbank FX market during the year. As supply was well above demand for US Dollar for

Chart 33. Central Bank's FX market intervention, USD billion

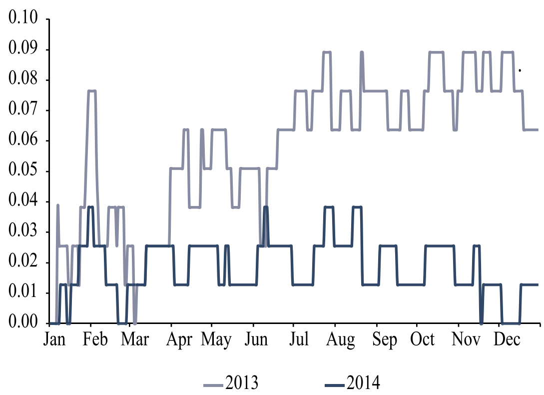


Source: CBA

the first 11 months of the year, the Central Bank's FX market interventions were purchase-oriented. In contrast, when demand for US Dollar increased dramatically owing to the negative experiences in the neighbouring countries, the Central Bank re-oriented its interventions to sale.

The corrective measures served to maintain the Manat's exchange rate stable, with the Manat appreciating by 0.01 gepiks, i.e., 0.01% against the US Dollar.

Chart 34. Change path of USD/AZN exchange rate



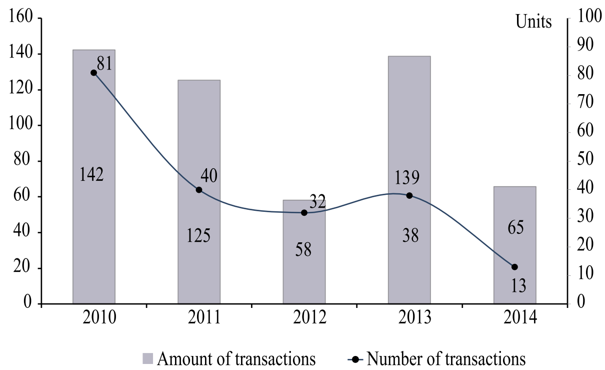
Source: CBA

4.2. Money market

Interbank market

During the reported year AZN66 million worth 13 transactions were recorded at the organized interbank money market. The transactions were recorded for 14-360 day maturity instruments.

Chart 35. Organized interbank money market, AZN million

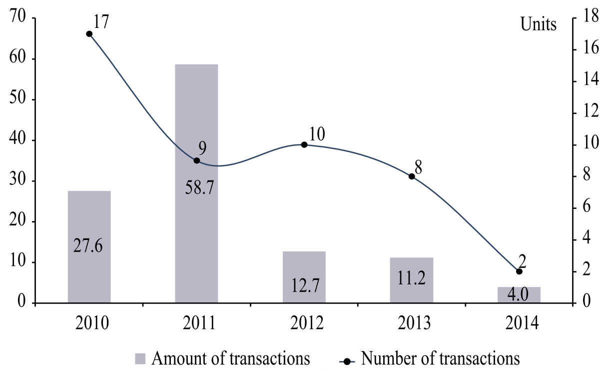


Source: CBA

Approximately 80% of the organized interbank money market transactions were executed via the Bloomberg trading platform. Thus, Bloomberg-based interbank money market deals executed totaled AZN51.8 million (6 transactions). The transactions were closed on money market instruments with maturity of 6 up to 12months.

The secured money market segment executed 1 transaction for AZN2 million, while the interbank repo market executed 2 transactions for AZN4 million.

Chart 36. Interbank repo market, AZN million



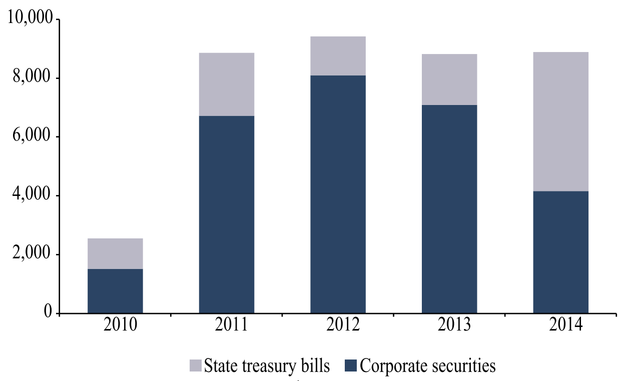
Source: BSE

Securities market

The securities market transactions remained virtually unchanged from 2013, at AZN8.9 billion.

As corporate securities transactions nearly tripled (to AZN4.7 billion in the reported year), the overall percentage of corporate securities transactions soared from 20% to 53%. In contrast, state treasury bill[3] transactions almost halved (to AZN4.2 billion in the reported year), the percentage of state treasury bill transactions dropped from 80% to 47%.

Chart 37. Securities market transactions, AZN million



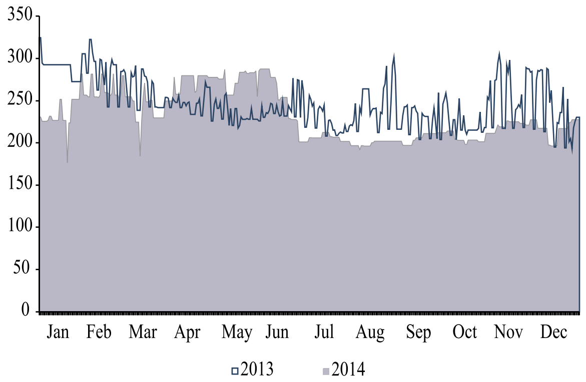
Source: BSE

28% of the corporate securities transactions (AZN1.3 billion) involved the Mortgage Fund-issued bonds.

[3] State treasury bills include the Central Bank's short-term notes and government bonds.

Total year-end outstanding state treasury bills remained practically the same as last year (AZN230.4 million), closing at some AZN227.3 million.

Chart 38. Outstanding state treasury bills, AZN million



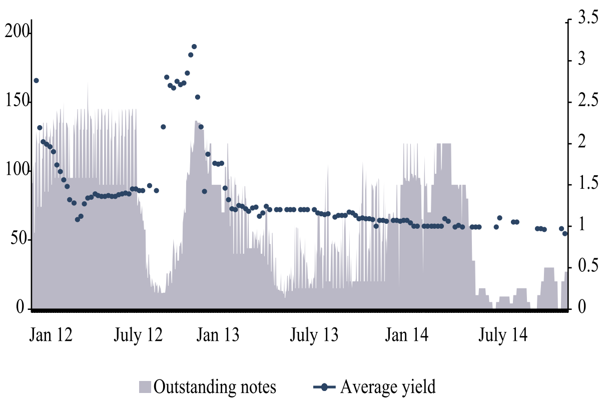
Source: BSE

The share of notes in the state treasury bills dropped from 30% to 12% over the previous year, while government bonds went up from 70% to 88%.

During the reported year the Central Bank issued AZN1560 million worth of short-term notes, of which AZN266 million were offered through auctions, 59% of which (AZN158.2 million) was sold. The average yield on notes at the recent auction was 0.91% (1.06% at the end of the previous year).

Notes outstanding (in circulation) decreased by AZN42 million or 61% against the previous year, totaling to AZN27 million at the year-end.

Chart 39. Outstanding notes, AZN million

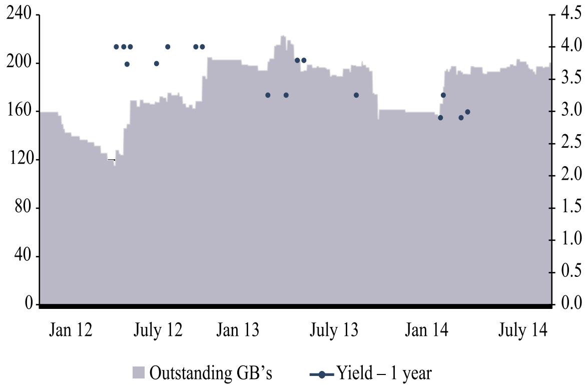


Source: CBA

Transactions involving the Central Bank's standing facility instruments[4] amounted to AZN3 317.6 million during the period, all of which were represented by repo transactions. The year-end interest rate on standing facility instruments equaled 0.1% for overnight repo transactions and 5%[5] for overnight reverse-repo transactions.

The year-end outstanding government bonds (GBs) increased by AZN39 million or 24% against the year-start rate equaling AZN200 million. Average yield on one year maturity GBs resolved at 3.25%.

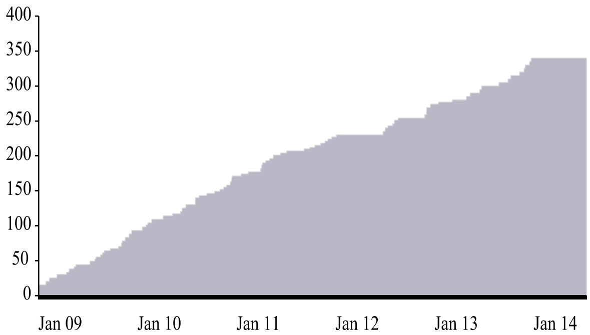
Chart 40. Outstanding government bonds, AZN million



Source: BSE

In the reported year, the Azerbaijan Mortgage Fund registered the data sheet for the 8th issue of 10 year maturity unsecured bonds for a total of AZN40 million. All bonds sold out through 8 auctions. Outstanding bonds at the year-end totaled to AZN340 million.

Chart 41. Outstanding mortgage securities, AZN million



Source: AMF

Secondary market transactions for mortgage backed securities totaled to AZN1035.8 million (182 transactions).

[4] Overnight repo and overnight counter-repo transactions initiated by commercial banks
[5] From 30.07.2014

V. FOREIGN EXCHANGE RESERVES MANAGEMENT

Given global financial market uncertainties in 2014, the Central Bank's investment policy with respect to the reserves primarily focused on preserving its assets as a top priority during the reported year.

In 2014, the Central Bank's foreign exchange reserves were managed in a low yield and high volatility environment resulting from the euro zone's expected economic stimulation and USA's anticipated abandon of soft monetary policy.

The year's top priority for reserves management was to minimize the reserves' geo-economic and regional dependency, while maintaining their absolute value, as well as to further expand the **currency and geographic diversification** of foreign exchange reserves in order to increase the asset management revenues. To this end, external managers were appointed through an open bidding process as part of the Bank's Asian investment roll-out plans, and subsequently a deal was negotiated with the People's Bank of China for investing funds in China's interbank bond market.

The Central Bank still followed the strategy of prioritizing security and liquidity in managing its foreign exchange reserves in the reported year. This strategy involves splitting the reserves into investment tranches that served as operating and collection instruments designed to support current operations.

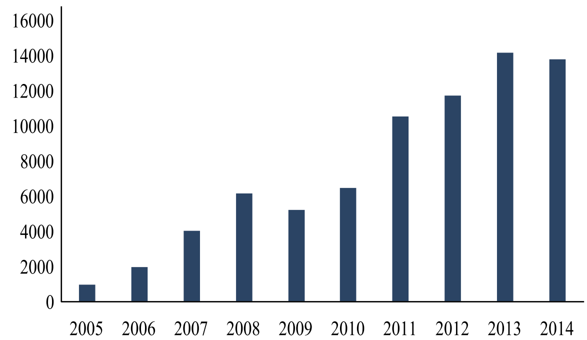
The operating tranche maintained with an objective of sustaining the existing exchange rate regime framework amounted to USD4 billion. 100% of these reserves was maintained in the US dollar, the dominant currency of foreign trade and the country's foreign liabilities. Management of the investment tranche had the principal objective of preserving the absolute value of the reserves. To achieve this target, the tranche was maintained in currencies composing a modified SDR basket, excluding the Japanese yen (49% in USD, 38% in euro and 13% in GBP).

Furthermore, the Central Bank continued the practice of engaging external asset managers for its FX reserves in 2014 as well.

In the reported year the Central Bank commissioned the Wall Street Suite portfolio management system that covers all areas of management in order to improve the overall effectiveness and security of foreign exchange reserves management.

The foreign exchange reserves of the Central Bank decreased by 2.78% to USD13 758.3 million, owing to exchange rate fluctuations. Management return on strategic financial assets amounted to 0.29%.

Chart 42. Central Bank's reserves, USD billion



VI. BANKING SYSTEM AND FINANCIAL STABILITY

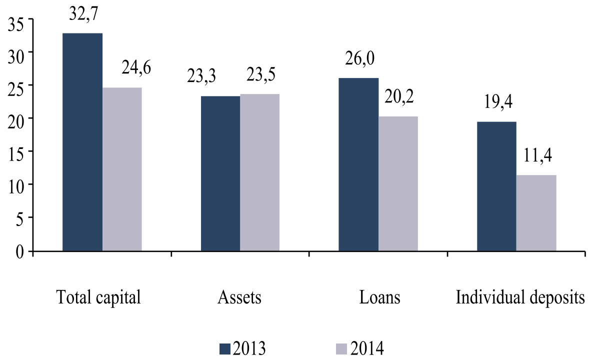
6.1. Change path and institutional development of the banking system

The Azerbaijani banking system managed to retain its positive growth pace, stability and sustainability in terms of main performance indicators despite global economic complexities in 2014.

The financial stability policy pursued by the Central Bank of Azerbaijan throughout the year was designed to maintain the banking system's financial sustainability while expanding its financial intermediation. The policy succeeded in executing the capitalization 'roadmap' for banks, improving the banking sector's competitiveness and financial depth.

The banking system continued to perform positively well in terms of **financial intermediation**. Bank assets rose to 76%, loans to economy to 56.1% and bank equity to 12.9% of the non-oil GDP in 2014.

Chart 43. Growth of the banking system's core performance indicators, %



Source: CBA

Getting the banking sector's growth rate to fall in pace with economic growth, and stabilizing credit expansion was the Central Bank's top priority in 2014. In this view, the Central Bank's measures taken with this in mind sought to prevent the banking services market from overheating, and to minimize risks. The long-term development of assets is indicative of the banking sector's evolvution from its rapid development phase into a more moderate growth mode.

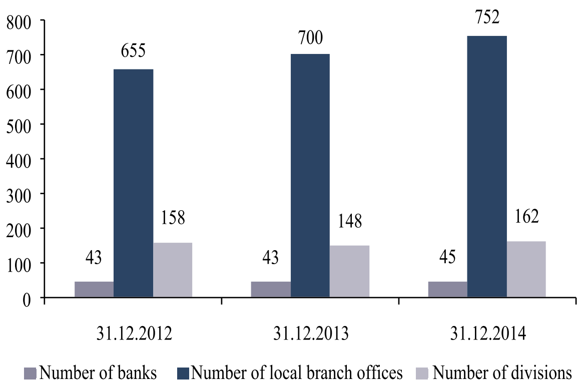
In 2014, consumers started using more banking services of multiple kinds. This, in turn, had a stimulating effect on the range of deposits, loans and products, while also enhancing the customer base.

The Central Bank worked on to solidify the system designed to protect the best interests of banking services users, which is expected to ultimately yield broader usage of banking services and stronger public confidence in banks, private and corporate customers alike. The Bank worked hand in hand with foreign central banks, domestic banking institutions, international organizations and government agencies, engaging in a succession of events and activities, with an aim to raise financial literacy of the general public.

In 2014, the banking system remained **attractive to foreign investors.** Banks with foreign equity investments went up to 23, with foreign investments in the banking sector rising up to AZN566.8 million, having increased by an impressive AZN105.2 million (23%).

Despite increasingly complicated macroeconomic processes, banks succeeded in retaining their respective credit ratings assigned by the world's lead credit rating agencies.

Chart 44. Statistics of financial institutions

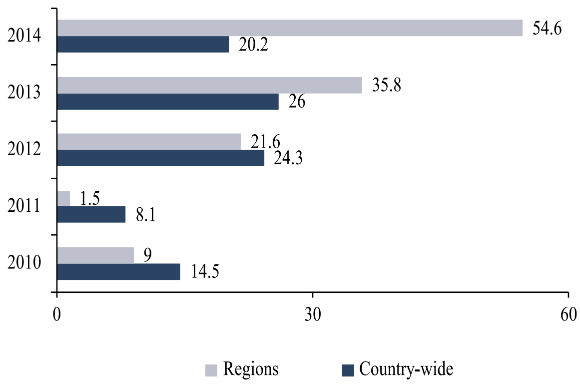


Source: CBA

Banks continued to **expand their branch network and other structural divisions** in order to address the economy's needs for financial services and improve customer access to financial services in the reported year. They launched 50 new branches in 2014; thereby the number of bank branches reached 752. With the launch of 14 new bank divisions the number of bank divisions reached 148.

37 of new branch offices were established in different regions. As at 01.01.2015, there are 389 regionally operating bank branch offices.

Chart 45. Annual growth rate of loans, %

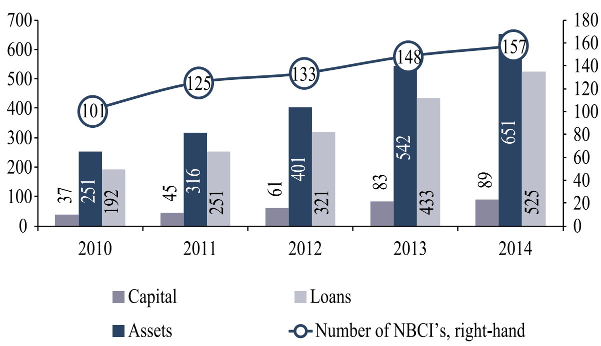


Source: CBA

Credit institutions continued to roll-out their regional lending in 2014, raising their regional loan portfolios by 54.6% during the year.

The number of other financial institutions that provide limited banking services also increased in parallel to the banking system development. NBCIs, including credit unions, and other kinds of financial institutions rose to 157 in number (from 154 at year start), while their branch offices increased up to 212 (from 191 at year start).

Chart 46. Performance summary of non-bank credit institutions



Source: CBA

Total assets of NBCIs increased by 20%, while their lending increased by 21% during the year.

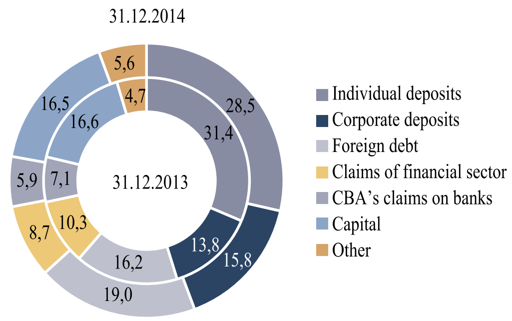
The expanded geographic coverage of the banking infrastructure enhanced access of economic agents, especially individuals **to banking services**. Presently, 7.9 banks and NBCIs and their divisions provide financial services to every 100000 m2 and 17.5 to every 100.000 adults.

6.2. Liabilities of the banking system

In 2014, the resource base of the banking system increased due to funds attracted from both domestic and foreign markets.

In 2014, total bank liabilities, raised from both domestic and foreign sources, reached AZN21023 million, having increased by 23.7% (AZN4026 million). In the reported year, funds (deposits) raised 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 (including deposits of financial institutions) increased by 23.9% to AZN15453.4 million during the reported year, thus constituting 73.5% of total liabilities.

Chart 47. Structure of the banks' resource base, %



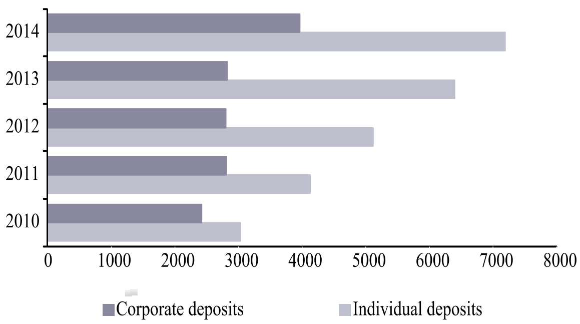
Source: CBA

Individual deposits increased by 12% to AZN 7188.4 million in 2014, thereby representing 29% of total bank liabilities.

Corporate deposits increased by 41% or AZN1148 million in 2014; thereby reaching AZN3966.9 million as at January 1, 2015 (the 2013 growth rate was mere 0.6%). Corporate term deposits rose by 66%, demand deposits by 33%. Consequently corporate deposits went up to a 16% share of the resource base (14% in 2013).

In 2014, funds attracted from financial institutions (loans, deposits and other resources from banks and other financial institutions) totaled AZN8.4 billion (33.3% of total bank assets) as of January 1, 2015. Funding raised from other financial institutions in 2014 went up by 23%, thus becoming a substantive funding source for the banking industry.

Chart 48. Deposits of non-financial sector, AZN million

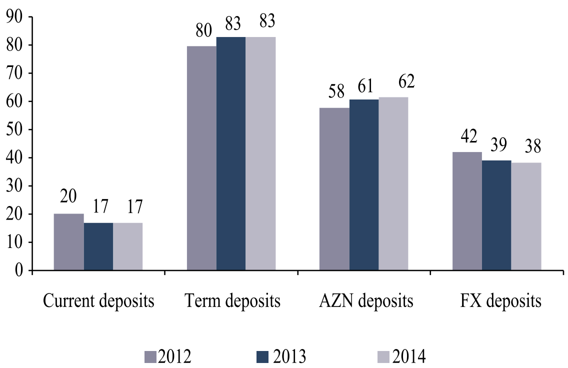


Source: CBA

No substantive changes occurred in the depositor structure, as resident individual depositors represented 90% and non-resident depositors accounted for 10% of total individual deposits.

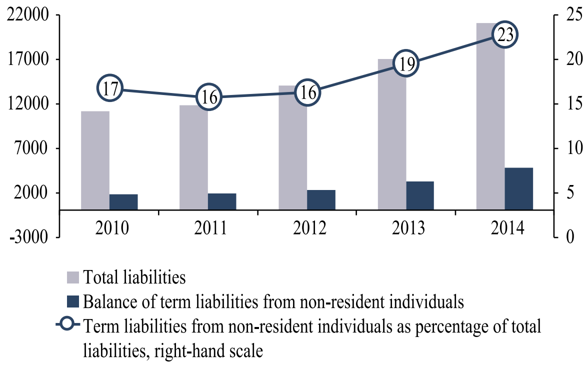
Funds raised from non-resident banks and international financial institutions totaled to AZN4781 million. External borrowings represented 19% of total bank assets.

Chart 49. Structure of deposits, %



Source: CBA

Chart 50. Development path of foreign debt, AZN million



Source: CBA

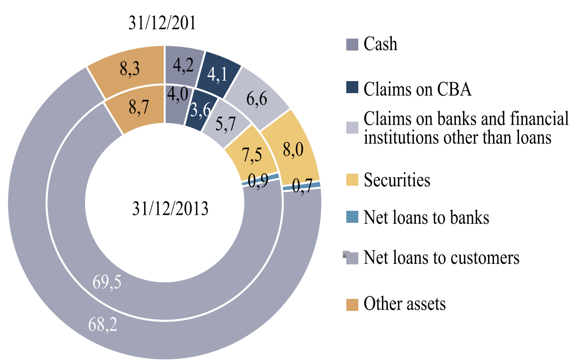
6.3. Structure of the banking system's assets

Bank assets shifted into a stable growth pace, with positive changes in the structure of bank assets in tow.

In 2014 the total bank assets increased by AZN4797 million or 23.5% totaling to AZN25182 million. Bank loans increased by AZN2999 million or 21%, reaching AZN17174 million (the net loan portfolio had a growth rate of 26% in 2013). By the year-end the percentage of loans in the total assets declined by 1.3%, to 68.2%. This is largely attributable to the measures taken by the Central Bank for the regulation of the sector's lending activity (especially in the consumer lending segment). Overall the share of loans in total assets has steadily increased over the past 8 years to the current 70% average.

With the loan portfolio's growth now moderately paced, the share of liquid assets and investments in total assets went up by 3%, closing 2014 at 28%.

Chart 51. Structure of assets, %



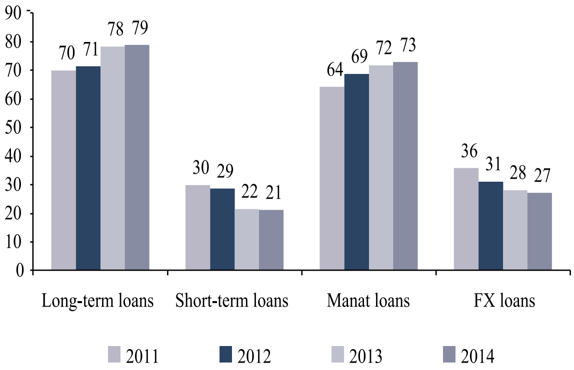
Source: CBA

Growth of the **loan portfolio** is largely attributable to savings of individuals and corporate sector deposits.

Long-term loans increased by 21% to AZN14611.3 million by the year-end. Long-term loans amounted to 79% of the total loan portfolio by the end of 2014 (78% as at 01.01.2014).

National currency-denominated loans had a growth rate (22%) which exceeded the growth pace of foreign exchange-denominated loans (16%) in 2014. Manat loans amounted to 73% of the total loan portfolio at the year-end.

Chart 52. Structure of loans, %



Source: CBA

The banking sector continued to support the economic growth. In fact, lending to various economic sectors was a priority for the banks in 2014. Loans to the communication and transportation sector increased by 45%, to industrial and production sector by 34%, to agriculture and processing by 16%, to construction and real estate by 8% during the year.

Loans to households increased by 24%, totaling AZN7731.8 million by the year-end, which represents 42% of the loan portfolio.

Mortgage loans had a growth rate of 36.8% in 2014; overall, mortgage lending amounted to AZN1219.1 million as at January 1, 2015 (the mortgage loan portfolio totaled AZN890 million as of 01.01.2014). Such loans represented 6.6% of the total bank loan portfolio as at 01.01.2015.

Investments in securities totaled to AZN2013 million as at January 1, 2015, which exceeds the previous year level by 31% or AZN476 million. Securities represented 8.9% of average assets. While corporate securities made up 80% (AZN1237 million) of the securities portfolio in 2013, this indicator reached 83% (AZN1671 million) by the end of 2014. Investments in government securities reached AZN341.

6.4. Capital of the banking sector

Banks progressed further with strengthening their capital base, and maintained the overall capital adequacy of the banking system at an acceptable level.

The year of 2014 saw successful implementation of the capitalization 'roadmap', with the banks that account for 99.7% of the sector's total assets raising sufficient funds to meet the new capital requirements.

Table 7. Loans by sectors

	31.12.2013		31.12.2014		Change	
	AZN million	percentage %	AZN million	percentage %	AZN million	percentage %
Trade and services	2219.9	14,4	2680.7	14	460.8	21
Households	6214.7	40,3	7731.8	42	1517.1	24
Agriculture and processing	733.3	4,8	847.3	5	114.0	16
Construction and real estate	2362.6	15,3	2555.1	14	192.4	8
Industry and production	1516.4	9,8	2027.8	11	511.4	34
Transport and communication	506.0	3,3	736.0	4	230.0	45
Other	1870.0	12,1	1963.8	11	93.8	5

Source: CBA

Total bank capital increased by 25% or AZN842.6 million to AZN4269.1 million in 2014. Tier I capital represented 82.3% of the total capital, having increased by 29% during the year. In general, paid-in capital drove the increase (89%) in total bank capital: paid-in capital increased by AZN753 million or 29%. Overall the capital's growth rate outpaced that of the risk-weighted assets.

Table 8. Structure and development path of the banking sector's total capital, AZN million

	31.12.2013	31.12.2014
Tier I capital	**2716.9**	**3515.1**
Change year-to-date, %	*33*	*29*
Paid-in capital	2587.7	3341
Share premium	21.8	21.8
Net retained earnings	229	376
Deductions from Tier I capital	-58.8	-92
Tier II capital	**872.9**	**1018.9**
Profits from the current year	287.3	386.1
General reserves	234.3	247.9
Other capital funds	351.2	384.8
Deductions from total capital	-104.4	- 172.5
Total capital after deductions	**3426.5**	**4269.1**
Change year-to-date, %	*33*	*25*

Source: CBA

The banking system's total **capital adequacy** ratio increased by 1% to 19.2%, while Tier I capital adequacy ratio went up by 1.3% to 15.4%. Hence, the actual capital adequacy ratios are above the minimum requirements set by the Central Banks and the minimum level according to the best international practices, and industry standards.

6.5. Financial performance of the banking sector

Overall, the banking system's financial performance in 2014 was satisfactory.

Profits earned by banks in 2014 (before taxes) totaled AZN458 million, while net profits after taxes increased by 38% against the previous year totaling to AZN370.54 million.

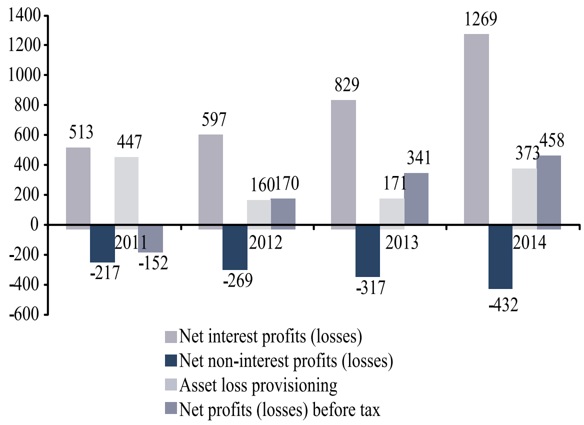
During the year **interest income** totaled to AZN 2255.73 million, having increased by 36.9% (with interest income on loans to customers increasing by 38% to AZN 2106 million) vs the previous year. Total income of banks amounted to AZN2732.1 million, which exceeds the 2013 level by AZN 642.7 million or 30.8%. The total interest income's share in the total income increased to82.6% in 2014.

Interest expenses totaled to AZN986 million by the year-end having increased by 20% against the previous year. The ratio of interest expenses to average assets made 4.36%.

Net interest profit of banks totaled to AZN1269.29 million in 2014, which exceeds the 2013 level by AZN440.07 million or 53%.

Non-interest expenses of banks increased by 19.7% against the previous year, totaling to AZN909 million. Total non-interest expenses remained smooth (4.02%) as a percentage of average assets, primarily due to rise of salary, remuneration and other operating costs.

Chart 53. Structure of profits, AZN million



Source: CBA

Return on assets of the banking sector (calculated as a ratio of net profits after taxes to average assets, ROA) made 1.7% in 2014, while return on equity (calculated as a ratio of net profits after taxes to average equity, ROE) amounted to 11.6%.

VII. MORTGAGE LENDING

The bulk of the Azerbaijan Mortgage Fund's (AMF) activities in 2014 involved supporting the mortgage lending system's sustainable development.

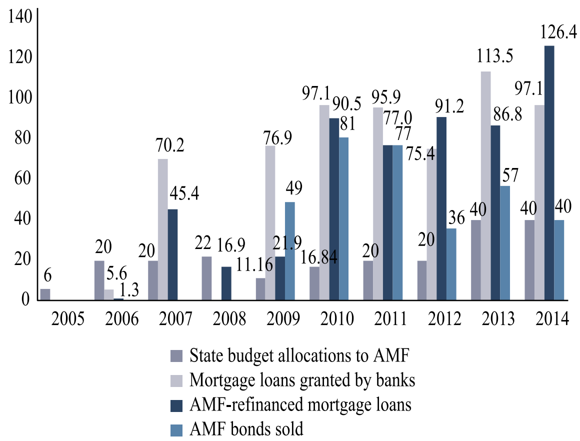
The AMF continued to raise free resources domestically in 2014, and consequently the banks channeled AZN97.07 million worth of mortgage loans (including AZN42.2 million of discounted loans) to 2204 households families.

The AMF's **refinancing transactions** totaled AZN126.38 million in the reported year, which exceeds the previous year's level by 46%. Mortgage loans channeled through authorized credit institutions totaled AZN632.87 million (including AZN156.81 million worth of discounted mortgage loans). The AMF refinanced 88% of these loans. Overall, the number of families with improved housing reached 15834.

The AMF sold AZN40 million worth of bonds in 2014 in order to sustain mortgage lending, form a proper secondary mortgage market and direct the resources available to mortgage lending. Consequently the AMF raised up to AZN340 million from the free market in 2009-2014. In parallel, the AMF's intake from the public budget totaled AZN216 million.

In May 2014 the Fitch Ratings Agency re-assessed the AMF's BBB- credit rating assigned for its long-term liabilities in local and foreign currencies, and retained the AMF's credit rating equal to that of the country's. As the AMF has maintained its investment quality international credit rating, it would allow it to further increase its borrowing capacity, to access international capital markets and to offer debt securities at these markets with some favorable interest rates going forward.

Chart 54. Development path of mortgage loan funding, AZN million



Source: AMF

An 'Electronic Mortgage' system was put in operation to allow for automating the AMF's business processes. In parallel, a new automated payment system was introduced that operates off the Government Payment Portal, designed to take in mortgage loan-related payments in order to improve the overall quality of services offered to consumers. Indeed, this system allow for dramatically improving the quality of services offered and ensuring a high level of transparency of borrower payments by digitizing mortgage loan payments and effectively managing the existing credit and operating risks.

The Central Bank of Azerbaijan prepared and introduced a **new development strategy** that calls for a considerable expansion of mortgage lending and creation of new mechanisms of supplying consumers with housing as a means of making an impact on the current status of the general public's housing conditions and meeting the high demand for residences. The strategy also deals with improving access to mortgage loans with better terms.

VIII. CENTRALIZED CREDIT REGISTRY

The Centralized Credit Registry (CCR) continued to collect detailed credit information on individuals and legal entities with outstanding credit liabilities due to the banking system in parallel to enabling users to make online inquiries in 2014.

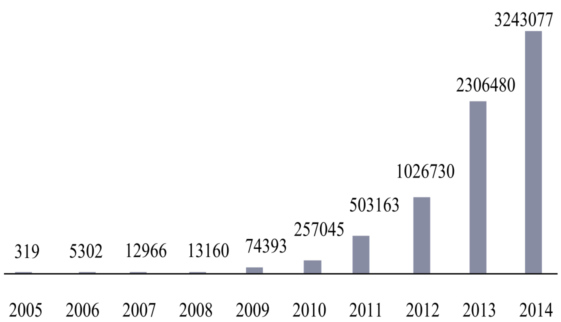
The CCR **coverage** continued to expand in 2014 as well, as 12 newly licensed non-bank credit institutions (NBCIs) joined the registry. As of the end of the reported year, the registry's network counted 43 banks, 45 NBCIs, up to 700 branches and over 1500 user points covering the entire country.

The CCR started working on an interface to link the Registry with the Central Bank's Electronic Statistics and Analytical Reporting System (ESAS) that will serve the purpose of ensuring proper use of credit data in order to assist the Central Bank in discharging its supervisory duties and securing financial stability.

The CCR completed the process of setting up a **Web Service** platform that allows for a faster flow of data between the Registry and its users. The platform is scheduled for commissioning in 2015.

A second CCR outlet was commissioned at the 'ASAN service' center (the State Agency for Public Service and Social Innovations under the President of the Republic of Azerbaijan) in the reported year with an aim to improving the CCR's treatment of **customer queries**. High quality service combined with a range of cutting-edge technologies introduced enables individuals to make prompting credit reports an immediate on-the-spot transaction.

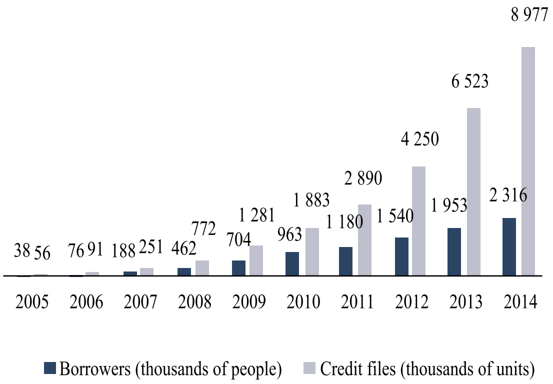
Chart 55. Number of inquiries



Source: CBA

41 banks and 45 NBCIs used the registry during 2014.The CCR counted 2 316 540 **borrowers**, 8 977 859 credit files and 1 078 807 guarantors at the year-end.

Chart 56. Development path of CCR data



Source: CBA

The CCR processed 3 243 077 inquiries during the reported period, which is 1.4 times more than the previous year's level (2 306 480 in 2013). 77 558 individuals made inquiries during the reported period (5 355 in 2013).

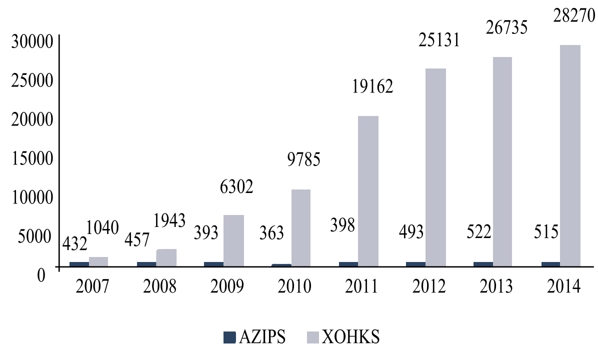
IX. PAYMENT SYSTEMS

9.1. Ensuring stable and reliable operation of payment systems

Alongside other priority tasks in 2014, the Central Bank focused on ensuring uninterrupted and reliable operation of payment systems, upgrading electronic payment services by enhancing, and promoting effective use of their infrastructural capacity.

The Real Time Interbank Settlement System (AZIPS) processed AZN104.3 billion worth of 515 thousand payment documents in 2014. The system's average daily document load counted 2128 payment documents, with each one at an average of AZN202.5 thousand.

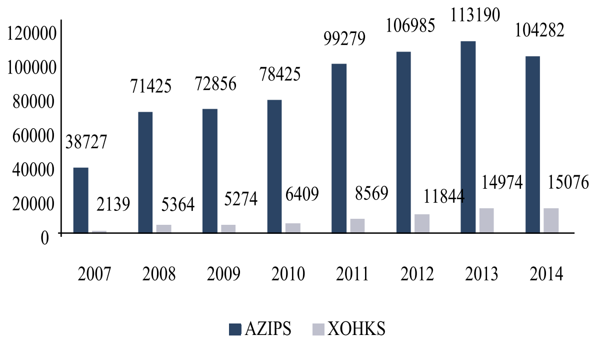
Chart 57. Number of payment documents processed by AZIPS and XOHKS (thousands of units)



Source: CBA

The National Payment System's other major component, **the Retail Payment System** (XOHKS), processed a total of 28270 thousand payment documents for a total worth of AZN15 billion, which exceeds the previous year level by 0.7% (102 thousand documents) and 5.7% (AZN1535 million) correspondingly. On a daily basis the system processed on average 116.8 thousand documents, where each document amounted to AZN533.3 on average.

Chart 58. Amount of payment documents processed by AZIPS and XOHKS, AZN million



Source: CBA

AZIPS had a 2% and XOHKS a 98% share of the total number of payment documents in 2014, while AZIPS accounted for 87% of the total payments, with XOHKS closing at 13%.

The 'National Payment System Upgrade' project was launched that was designed to enable AZIPS to operate off of a Local Telecommunication Network in parallel to SWIFT, expand XOHKS functionality and build infrastructure capacities of the new back-up center for both systems. The project is scheduled to be completed in the first half of 2015.

9.2. Development and regulation 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 across the country in the reported year.

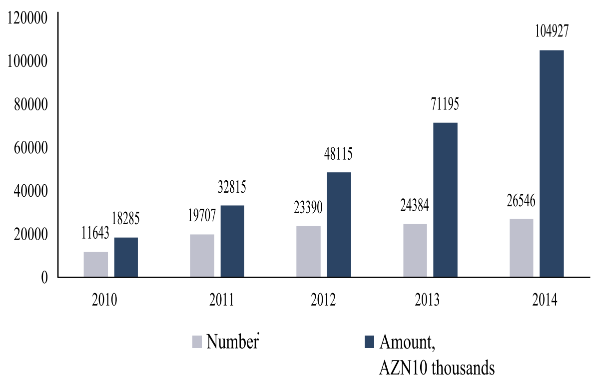
The Government Payment Portal (GPP) that uses the technical and functional capacities of the Centralized Information System for Mass Payments continued to expand its coverage.

This expansion included 9 government

agencies (the Ministry of Taxes, the Ministry of Finance, the Ministry of Economy and Industry, the Ministry of Internal Affairs, the Ministry of Emergency Situations, the State Customs Committee, the State Social Protection Fund, the State Migration Service and the Azerbaijan Mortgage Fund), 5 utility companies (the Azerenerji JSC, Bakielektrikshebeke JSC, Azersu JSC, SOCAR's Azerigaz, Azeristiliktechizat JSC) and 6 communication operators (BTRIB, Aztelekom, Azercell Telekom LLC, Bakcell LLC, Azerfon LLC), allowing them to take and process payments throughout the country via the GPP infrastructure.

Presently about 1500 payment points of 43 banks and the Azerpost LLC combined connected to the GPP's established infrastructure handle cash and card payments using the system's web-based functionalities for the above listed institutions.

Chart 59. Number and amount of payments via GPP, thousands of units



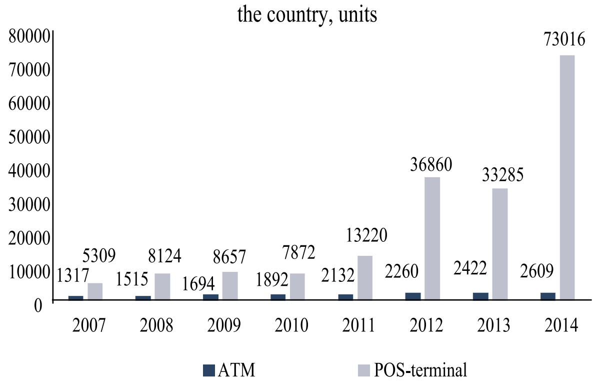
Source: CBA

The system processed 26.5 million transactions for total worth of AZN1049 million in 2014. Transactions processed by the system increased by 47.3% (AZN337million) and the number of transactions by 8.6% (2.1 million) against the previous year level.

The National Payment System's infrastructure was further expanded in 2014, with an emphasis on improving access to financial services for individuals and enterprises in rural areas. The number of postal offices acting as Central Bank-authorized financial service providers rose to 63, while postal departments within the said offices went up to 999 as of 01.01.2015. Joining MasterCard, the Azerpost LLC issued 10885 MasterCard-branded payment cards.

The payment card infrastructure also expanded in 2014. Consequently, the number of POS-terminals across the country increased by 2.2 times (39731 units) to 73016 units, while the number of **POS-terminals** in rural areas increased by 5.3 times (18616) to 22963 units over the year.

Chart 60. Number of ATM's and POS-terminals across the country, units

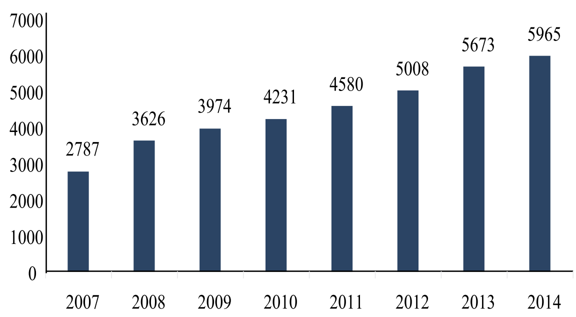


Source: CBA

The number of **ATM's** increased by 7.7% (187 units) to 2609 units across the country.

During the year, the number of banks issuing **payment cards** reached 41, the number of card holders 5.4 million people, the number of cards went

Chart 61. Number of payment cards in circulation, thousands of units



Source: CBA

up to approximately 6 million pieces, of which 4.7 million are debit and 1.3 million are credit cards.

Overall, transactions involving **payment cards** issued by domestic banks totaled AZN11.1 billion worth of 73.2 million, of which non-cash payments make 7.2% and 25.2% respectively in 2014. Transactions involving locally issued payments cards increased by 16% in terms of amount and

16.3% in terms of number as opposed to the previous year.

The interlinked and well-coordinated infrastructure of all card processing agencies helped improve data security. A **National Network for Card Payments** was launched in order to enable environment that would promote the use of local payment cards in social projects; the network is currently in the design stage.

The Regulations on issue and use of payment cards was amended and revised with a view to supporting the introduction of cutting-edge payment card technologies, innovative products and services as well as reinforcing the risk management system.

The Regulations on licensing and oversight of processing entities was harmonized with the Law of the Republic of Azerbaijan “On business audits and protection of enterpreneurs’ rights”, and was further amended in the part where it deals with the reliability and security of processing introducing more stringent minimum requirements.

One of the priority areas identified for 2014 was the continued execution of stimulating efforts aimed at expanding the use of cutting-edge banking technologies and the scope of non-cash payments by introducing various nominations to incentivize banks. Consequently winners of the “Leading non-cash payment bank” and “Electronic banking leader” nominations were announced. In parallel, an article contest titled “Rapid development trends of non-cash payments: reality and prospects” was carried out among journalists, with prizes offered to the winners.

The Draft law **on Payment Services**, expected to help improve access to payment services, stimulate competition at the payment services market and protect the best interests and rights of payment services users was developed. Comments and suggestions were invited on the draft law from various stakeholders.

A self-assessment of AZIPS was carried out in accordance with the Principles for Financial Market Infrastructures developed by the Bank for International Settlements and the Committee of the International Organization of Securities Commissions in 2012. The Central Bank aligned its Payment Systems Oversight Concept of the Central Bank of Azerbaijan with the new principles.

The oversight concept identifies the principles of overseeing payment systems, defines overseen entities and payment system evaluation processes in order to ensure safe and sound operation of payment systems.

The Bank developed Recommendations on ensuring business continuity of AZIPS members in emergencies to advise payment system members of the steps and actions they should take in emergencies.

X. CASH CIRCULATION

10.1. Addressing the economy's demand for cash

In the reported year the Central Bank addressed the national economy's cash demand in full and on time, in a well-devised and structured manner, meanwhile forming up strategic reserves of banknotes and coins.

As at January 1, 2015, **cash in circulation** decreased (including cash outside the banking system and in bank vaults) by 1.7% to AZN10.8 billion as opposed to the beginning of 2014.

In the reported year the Central Bank withdrew AZN6.4 billion worth of (343.1 million units) of monetary units into circulation, while issuing AZN6.2 billion worth of 365.7 million monetary units from circulation during the year. In general, the Central Bank's reserve injection amounted to AZN187.5 (including gepiks). For comparison, the Bank issued AZN1.3 billion in 2013.

Chart 62. Development path of cash in circulation in 2006-2014 (year-end)

Source: CBA

Cash in circulation broke down as follows in 2014: 99.6% - banknotes (10 788.9), 0.4% metal coins (AZN45.5 million) in terms of amount, and 47% - banknotes (241 million units) and 53% - metal coins (272 million units) in terms of quantity.

The most used bank note in circulation was the 100 Manat denomination, in terms of amount and units (67.4% or AZN7306.7 million), while among coins the most used denomination was 50 gepiks in terms of amount (AZN19.2 million), with the 20 gepiks (83.3 million units) prevailing in terms of number of units.

Low denomination coins (1, 3 and 5 gepiks) increased by 16.4% to AZN2.5 million during the period. The increased demand for low denomination coins is presumed to have stemmed from the inflation rate maintained at an acceptable level while low denomination coins have been increasingly gaining on scope in retail and pricing.

The process of withdrawing old design bank

Table 9. Structure of cash in circulation as of 01.01.2015

Denomination	Amount, AZN million	Units, million
1 AZN	56.0	56.0
5 AZN	105.7	21,1
10 AZN	133.1	13,3
20 AZN	458.2	23,0
50 AZN	2,729.3	54,6
100 AZN	7,306.7	73,1
Total bank notes:	10 789.0	241.0
Metal coins:	45.5	272.0
Total:	10 834.5	513.0

Source: CBA

notes (AZM) from circulation continued in 2014 as well. Overall, 5.1 thousand units or AZM40.8 million (equivalent of AZN8.2 thousand) worth of old design notes were destroyed during the year. In general, 99% of AZM in terms of amount was withdrawn and destroyed by the end of 2014.

The Central Bank carried on with the **Clean Money in Circulation Policy** in 2014, managing to maintain high quality money in circulation.

The Central Bank's Head Office and Regional Centers continued to replace bank notes received from the public via Exchange Cashiers. The Central Bank-based cash offices' overall bank note replacement transactions amounted to 5.7 million units (AZN3.3 million).

To intensify the circulation of coins in 2014, the **Mobile Cash-Office** set up at the Central Bank continued to operate. Over year, the Mobile Cash-Offices injected coins for a total worth of AZN1 million (5.2 million units).

The Central Bank discovered only 491 units of counterfeit money (AZN7901) in 2014. Compared to the relevant international experience, the level of money counterfeiting in Azerbaijan was 20 times lower.

10.2. Cash management

The Central Bank took necessary measures to ensure that cash management meets best 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 carried on with the setting-up of a fully automated, robot-operated **Cash Center** that meets the internationally accepted standards under the **Introduction of Up-to-date Cash Management Practices Program**, approving the Cash Center's Design Concept. In parallel, technical requirements and specifications were developed, bidding procedures carried out, potential suppliers identified, and all legal and other terms negotiated with the head contractor.

Software was developed, core servers and hardware installed as part of the establishment of the **Cash Management Information System** (CMS) that will fully automate cash management transactions and data flows, and the Central Bank accepted the system. Hardware and systems were acquired and installed at the Central Bank's head office, preliminary tests carried out, and credit institutions were connected to the CMS.

The **Bank Note Development Capacity Building** project was completed; a policy was developed for issuing the first ever investment coins in Azerbaijan, along with the first version of the Catalogue of anniversarial and commemorative coins issued, and the design concept of 20 types of coins to be issued across 5 thematic subjects.

The Creation of a New Logistics Model for Cash Management project was completed, resulting in aligning Regional Centers' operation with the best international standards and practices. A new state-of-the-art treasury infrastructure was established, with the Ganja Regional Center's new office building completed. Management structures and security systems of Regional Centers were harmonized with uniform standards as part of the Regional Central Banking development initiative. The Central Bank's cash collection and transportation staff was optimized, undergoing specific training to help align the cash collection and transportation function with the best international practices and standards.

The Creating business processes based on international standards for expert assessment of bank notes project was completed. Expert assessment was institutionalized and properly staffed. High tech systems were procured and installed for international standard-compliant expert assessment of bank notes and securities. Measures were taken to improve the coordination and automated data sharing between relevant government agencies in order to organize effective control of bank note counterfeiting.

XI. HUMAN RESOURCES MANAGEMENT

In 2014 the Central Bank continued to work on further improving the quality of human capital and aligning the human resources management system to best practices.

Top priorities in terms of human resources management included upgrades of recruitment, appraisal, motivation systems, in-house training, a management development program.

Upgrade of the automated recruitment testing system was completed with an aim to ensure a more goal-driven selection of candidates as part of the overall effort of **staffing** the Bank with appropriately qualified personnel. Vacancies were regularly advertised via the Central Bank's official web-site to recruit potential specialists. To this end, the Bank continued collaboration with the Azerbaijani USA and UK alumni (AAA, UKA) associations, and the Azerbaijan Students and Alumni International Forum (ASAIF). Furthermore, the Central Bank's operations and the Bank's HRMS system were widely promoted at the graduate fairs organized by the Ministry of Education. Overall, the number of job applicants under the Central Bank's recruitment endeavor made 2076 people, with 56 individuals recruited as a result.

More target-oriented and effective organization of education was set as a priority for the reported year, with a special focus on upgrading appropriate competences, management and leadership skills of the staff. Overall, up to 358 employees participated in the education process. 130 bank employees attended a variety of training courses, such as external (domestic and foreign) seminars, experience sharing, certification courses, conferences and forums. 47 in-house seminars were organized on specialization and additional skills for 228 employees.

In 2014, each employee had 17.02 hours of training on average, both in-house and external.

A new Action Portfolio was developed jointly with the ADA University. It had 22 Central Bank employees undergo the Management Development Program, 5 more trained as trainers, and 15 employees attended the Business Ethics and Protocol seminar.

1070 candidates applied for the Internship Program in 2014, which serves the purpose of educating young staff for the financial sector as well as expanding the Central Bank's own staff capacity. The number of applicants has increased by 93% since its inception in

Table 10. Central Bank's 2014 HRMS education statistics

Education statistics (training/person)							
In-house		Outsourced					External training
Specialization	Additional skills	Experience exchange	Seminar	Certification (course and exam)	Management	Other (forum, conference, membership fee) haqqı)	
14/113	33/207	15/11	130/99	14 (4+10) /4+9	1/22	1+3+3/1+3+3	7/340

Source: CBA

2010. The screening process resulted in 71 individuals admitted to the program.

A big HR project **Automation of HRM processes** was completed, leading to a successful automated staff appraisal for the first time with respect to the staff's performance in 2013 in the first half of the previous year. The Bank promoted 17 distinguished employees, rewarded 76 employees financially and awarded 9 staff members with non-financial incentives (letters of gratitude).

XII. COMMUNICATION OF THE CENTRAL BANK

Ensuring that the general public receives full information on the Central Bank's core activities, and policies, and providing a meaningful input to economic awareness were the primary strategic objectives that defined the communication endeavors in the reported year, which served the purpose of enhancing transparency of execution of the Bank's mission, and fostering public confidence in the Bank.

The Bank's communication efforts in 2014 were largely aimed at successfully completing the **Creation of a Modern Communication System Program**. The Bank successfully executed the Development of an External Communication System, Development of an Internal Communication System and Formulation of a Corporate Social Responsibility (CSR) Policy projects under the Program, followed by application of the resultant new strategic communication products.

The **official web-page**, the Central Bank's single most important external communication channel, was constantly upgraded during the year. The web-site's mobile device application helped increase the number of visitors. Presently the web-site counts **up to 2 million** visitors annually. As a result, at the end of 2014 the Central Bank's official web-page was announced the 'Electronic Government' nomination winner in the 'National Net' contest initiated by the Azerbaijan Internet Forum.

The Central Bank equipped its web-page with a special **survey platform** to conduct regular **external image research** as an important means of the external communication system. The platform hit the ground running by launching broad-coverage sociological surveys in target groups.

A total of 60 press-releases were prepared and posted on the Bank's web-site related to Central Bank operations, Governor's meetings, monthly statistics, important decisions made by the Central Bank and other issues. Press-releases were publicized via the press in accordance with best practices. Dissemination of press-releases, 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 over 1200 information releases to general audience via the mass media.

In the reported year, 50 journalist queries were replied to, 3 conferences and 9 interviews organized for local and foreign press representatives on a variety of topics.

Another **Open Door** event was organized at the Central Bank for journalists to commemorate the 139th anniversary of the Azerbaijani national press. As a primary stakeholder of the Bank, mass media representatives were informed on the Central Bank's core business areas, indicating a special role that the mass media plays in ensuring that the general public is properly informed and perceives more effective implementation of the Bank's mission and monetary and banking policies.

The **Central Bank's internal communication** system was further upgraded in 2014.

The Single Intranet Portal, fully equipped with a range of useful modules, and bringing all existing internal portals together, was put in operation as the most viable and significant internal communication solution; this internal communication channel operated on a continuous, and uninterrupted basis. The Bank continued its "E-mails from the Governor" tradition on notable dates, as yet another important means of internal communications; employees could also benefit from a summary of both local and foreign press posted daily on the single intranet portal.

As a part of voluntary **CSR** projects, another blood donation initiative was carried out with the involvement of the Central Blood Bank's mobile working unit. In the reported year, all of the Central Bank's units collected and submitted up to 4 tons of recyclable paper and paper products under the 'Recycle Paper, Save Trees motto, which effectively means that at least 60 trees were prevented from being cut down for industrial purposes.

Thus, new communication products were successfully introduced in the reported year, while the Bank also worked to further expand and improve its public relations and better educate the general public on the Central Bank's operations and policies, and continued to develop internal communications, all of which consequently aided the Central Bank to a measurable extent in successfully realizing its mission.

XIII. INTERNAL AUDIT

As the Central Bank unit responsible for evaluating the effectiveness of risk management and internal control systems (ICS) and supporting improvements in management processes, the Internal Audit function carried on with its advisory and assurance work in 2014.

The Internal Audit function targeted high risk areas of the Central Bank using an operational map. To enhance the effectiveness of its work, the internal audit service applied analytical methods to a broader extent, and shifted its focus towards employing more preventive controls. Audits of core business operations in the reported year identified significant risks and recommended preventive measures to manage such risks.

Post-audit follow-up activities were also upgraded as the principal indicator of the audit function's value added element. The Bank strengthened follow-up on recommendations provided to audited units as a result of audits.

The Bank continued to align the internal audit function to international auditing standards. In the reported year, internal and external assessments of the Internal Audit function were carried out as a part of the overall effort to align internal audit with standards and ensure its sustainable development. Furthermore, audits were conducted using a methodology upgraded in consistency with the latest audit trends.

Automated audit tools (CAAT) were introduced that are broadly used in international practices and applied by the Big Four audit firms, in order to improve the internal audit processes. An ACL (audit command language) software application was used that allows for real time ongoing audit monitoring of high risk operations.

IT risk assessment and analysis as part of the 2014 audits were grounded in the Internal Auditors Institute, Information Systems Audit and Control Association (ISACA), as well as COBIT 4.1 and ISO 27002 standards. Advisory services were continued in order to assist in improving IT risk management and control processes.

The Central Bank's internal audit service was successfully evaluated based on the **Internal Control System's COSO standards**. The evaluation covered 3 major components of the internal control system: i) supervisory environment; ii) supervisory activities; iii) information and communication elements. The findings were reported back to the relevant business units to take appropriate action.

The Central Bank continued to work closely with the Internal Auditors Institute and ISACA, both professional audit institutions, to further refine its internal resources.

XIV. INFORMATION TECHNOLOGIES OF THE CENTRAL BANK

The Central Bank's IT endeavors in 2014 were largely focused on digitizing the 'customer-bank' relations, as well as the unautomated operating, accounting and management processes and ensuring safe, sound and sustainable operation of the information systems currently in use, as a way of adequately responding to any external challenges while also enhancing the effectiveness and efficiency of the internal supporting services.

The electronic government reforms implemented in the reported year coupled with the rapidly paced innovative information and communication technology advancements world over have put the Central Bank face to face with a whole new range of IT challenges. In parallel to its strategic IT objectives and goals, the Central Bank worked to ensure that the Temenos General Ledger, the Electronic Statistics Database and Analytical Reporting, the Centralized Credit Registry, the Electronic Signature Certification, the Electronic Paperwork/Clerical System, Human Resources Management, prudential reporting system for credit institutions, Archive/Records, internal communications, local and global networks, web-page and other internal supporting service systems operate in a sound and safe manner, without interruption.

Overall, the year of 2014 was characterized with the automation of a number of important business processes. It saw the set-up of a foreign exchange asset management system for the securities market, development of an effective cash management infrastructure, and accreditation of an electronic signature infrastructure, an important element of the electronic government platform.

Activities designed to broaden the scope of non-cash settlements, while also enhancing the coverage of non-cash payments called for faster implementation and expansion of state-of-the-art information and communication technologies, and eliminating paper medium in the customer-bank relations as a top priority.

In order to further expand the scope of distance banking services, the Central Bank's Electronic Signature Certification System was accredited by the Ministry of Communication and High Technologies on October 14, 2014, which the **Bank Certification Services Center**. The Center is expected to provide corporate and individual bank customers with electronic signature carriers going forward.

The project of establishing a **Portfolio Management System**, one of the most important of the Central Bank's practical initiatives, was completed in the reported year assisting the information system to successfully integrate to local and international financial systems. The newly established automated information system allowed for interactive monitoring of any changes in the securities markets, identification of financial risks arising in foreign exchange management, as well as for real time intake of financial performance indicators identified by external managers. Furthermore, the information system gained access to both in-house and international information resources; it was also interfaced with the Temenos General Ledger and SWIFT, Bloomberg, Reuters, Bank of New York Mellon.

The Cash Management Information System (CMS) was put in operation that serves the purpose of ensuring secure and effective cash management and circulation, as well as automating business processes of issuing and withdrawing bank notes to and from circulation in consistency with best international practices. As the continuation of these efforts the Central Bank's treasury infrastructure was equipped with all necessary hardware and software, and the CMS was integrated in the Temenos General Ledger System.

In parallel to the above listed projects, the Bank also continued to work on further expanding and upgrading the banking statistics warehouse and aggregating performance indicators for all economic sectors in a single platform. Consequently the **Electronic Statistics and Analytical Reporting System** was further upgraded, along with integrating it in the information systems of the country's economic agencies and international financial institutions.

A number of upgrades were introduced in the **Human Resources Management System**, which operates for the purpose of automating the Central Bank's HR management processes, while enhancing this area's effectiveness and efficiency as well as ensuring interactive evaluation process management. The performance appraisal principles of the said automated information system were redefined in consistency with new requirements, adding a functionality of giving early warning and notices to stakeholders when realizing business processes via the system.

The **Single / Uniform Intranet Portal and Electronic Archive System** are rightfully counted among the Central Bank's IT infrastructure modernization successes as they were implemented solely with the Bank's own resources. These information systems introduced in the reported year were developed in the state-of-the-art programming languages and used to automate any of the Bank's areas left outside the automation scope. The Central Bank identified the relevant business processes qualifying for automation of internal supporting services, and digitized them via the Single / Uniform Intranet Portal. Furthermore the morally outdated information system employed for archiving the Bank's hard copy documents was replaced with a new Electronic Archive System. The new information system's design incorporated broad reporting and monitoring functionalities, along with the capabilities for quick uploading and viewing of multiple pages.

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 2014 as well. International cooperation activities mainly involved expanding the Central Bank's bilateral relations map, attracting technical assistance and project management, and effectively supporting the CBA's technical assistance donor activities.

In the reported year, strategic dialogue and partner relations with international financial institutions and development agencies were reinforced, and the bilateral relations map expanded. During the year existing projects continued, while new projects were launched. During the year the Central Bank's management had high level meetings and joint seminars with foreign central banks.

The Central Bank hosted a number of significant international events in 2014. Consequently the Baku offices of the World Bank and International Monetary Fund held the **next scheduled** constituency meeting in the reported year, of which Azerbaijan is also a member. The primary objective of holding the meeting in Baku was to enhance Azerbaijan's cooperation with the constituency group'w member countries, while also reinforcing Azerbaijan's own position within the WB and IMF's Constituency Group. The meeting was preceded by the seminar titled 'Economic Diversification and Macroeconomic Policy Issues in Resource Rich Countries'. The Constituency Group's meeting also discussed preparations for the WB and IMF's next annual conference, global economic processes, protection of the member countries' mutual interests, and a range of other points on the agenda.

Furthermore, Baku organized the 1st **International Research Conference** on 'Macroeconomic Policies and Financial Stability Issues in Developing Countries' in 2014. The conference's main objective was to provide a platform for researchers and politicians to share their views and discuss institutional reforms, macroeconomic and financial policy frameworks, as well as challenges encountered by emerging economic systems including post-crisis financial stability issues.

The Bank continued to collaborate successfully with the World Bank (WB) on consumer finance protection and raising general public's financial awareness, and formulating a supervisory framework for operating risks. In addition, as part of the Financial Sector Modernization Project's Azerpost component management arrangements, a number of measures were taken in support of the Azerpost LLC, including an audit, staff training and new image development.

The International Monetary Fund (IMF) experts visited the CBA to discuss Paragraph IV of the Articles of Agreement with IMF. The meetings covered a range of issues, such as maintenance of macroeconomic stability and the banking system's sustainability. As part of the IMF collaboration, the Bank gained technical assistance for improvement of the external sector's statistics and reached an agreement for conducting the next Financial Sector Assessment Program.

Cooperation with foreign central banks represented a principal area of interest for the Central Bank in terms of international relations. CBA representatives went on study tours to the National Banks of India, Brazil, Malaysia, South African Republic, Italy, Switzerland, Bundesbank, Georgia and Hungary. In parallel, as part of its advisory services on various areas, the CBA arranged study tours for representatives of the Treasury and Finance Department experts from the Australian state of Victoria. The Bank worked with the Bundesbank to organize a joint seminar on 'Payment Systems Framework in EU' in Baku.

Cooperation with international development agencies also successfully continued during the reported year. In the reported year the Central Bank cooperated with the Swiss State Secretariat for Economic Affairs (SECO), the TAIEX Program, a technical assistance instrument of the European Commission, Luxembourg Financial Technology Transfer Agency (ATTF), the Asian Development Bank.

In 2014, **the Central Bank also continued to share its successful experiences with partner foreign banks**. Study tours were arranged for representatives of partner foreign central banks to the Central Bank of Azerbaijan to share IT experience.

XVI. THE CENTRAL BANK`S 2014 FINANCIAL STATEMENTS

Independent Auditors' 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 at 31 December 2014, and the statements of profit or loss and other 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.

Auditors' 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 about 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 financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

KPMG Azerbaijan Limited

Baku, the Republic of Azerbaijan

29 March 2015

Statement of Financial Position

In thousands of Azerbaijani Manats	Notes	31.12.2014	31.12.2013
ASSETS			
Cash and cash equivalents	4	5,144,849	8,382,174
Special Drawing Rights with the IMF	5	174,540	186,911
Trading securities	6	2,939,638	1,930,345
Derivative financial instruments	7	1,422	367
Investment securities	8	3,600,246	1,101,406
Loans to banks	9	3,450,152	3,359,861
Promissory notes from government	19	234,979	230,356
Property, equipment and intangible assets	10	98,081	72,094
Other assets	11	82,791	63,404
Total assets		**15,726,698**	**15,326,918**
LIABILITIES			
Money issued in circulation	12	10,845,946	11,033,336
Amounts due to government organizations	13	3,666,911	3,053,973
Amounts due to credit institutions	14	1,014,153	751,104
Amounts due to other organizations	15	6,859	10,580
Derivative financial instruments	7	353	1,254
Debt securities in issue	16	27,007	19,994
Liabilities on transactions with the IMF	5	176,643	191,533
Amounts due to international financial institutions	17	2,898	3,010
Other liabilities	18	43,671	11,143
Total liabilities		**15,784,441**	**15,075,927**
EQUITY			
Share capital	19	10,000	10,000
Capital reserves		209,517	209,517
(Accumulated losses)/retained earnings		(277,260)	31,474
Total equity		**(57,743)**	**250,991**
Total liabilities and equity		**15,726,698**	**15,326,918**

The financial statements were approved by Management on 29 March 2015 and were signed on its behalf.

The notes set out on pages 51 to 94 form an integral part of these financial statements

Statement of Profit or Loss and Other Comprehensive Income

In thousands of Azerbaijani Manats	Notes	2014	2013
Interest income	20	190,986	165,211
Interest expense	20	(631)	(897)
Net interest income		**190,355**	**164,314**
Fee and commission income	21	10,274	8,574
Fee and commission expense	22	(1,430)	(727)
Net fee and commission income		**8,844**	**7,847**
Net losses from trading securities		(5,733)	(10,041)
Net gains/(losses)from derivative financial instruments		5,465	(6,107)
Net (losses)/gains from foreign exchange translation		(454,713)	138,949
Net gains from trading in currencies		3,823	7,065
Other operating income		6,652	13,109
Operating (loss)/income		**(245,307)**	**315,136**
Impairment (losses)/recovery		(8,463)	22,143
Administrative and other operating expenses	23	(54,964)	(56,706)
Total comprehensive (loss)/income for the year		**(308,734)**	**280,573**

Statement of Changes in Equity

In thousands of Azerbaijani Manats	Share capital	Capital reserves	(Accumulated losses)/ Retained earnings	Total equity
Balance as at 1 January 2013	**10,000**	**209,517**	**(249,099)**	**(29,582)**
Total comprehensive income for the year	-	-	280,573	280,573
Balance as at 31 December 2013	**10,000**	**209,517**	**31,474**	**250,991**
Total comprehensive loss for the year	-	-	(308,734)	(308,734)
Balance as at 31 December 2014	**10,000**	**209,517**	**(277,260)**	**(57,743)**

The notes set out on pages 51 to 94 form an integral part of these financial statements.

Statement of Cash Flows

In thousands of Azerbaijani Manats	Notes	31/12/2014	31.12.2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest receipts		60,254	144,350
Interest payments		(634)	(809)
Fee and commission receipts		10,274	8,574
Fee and commission payments		(1,430)	(727)
Net payments from trading securities		(5,345)	(11,152)
Net receipts/(payments) from derivative financial instruments		3,509	(5,441)
Net receipts from trading in foreign currencies		3,823	7,065
Other operating income receipts		6,652	13,109
Administrative and other operating expenses payments		(44,032)	(48,327)
Cash flows from operating activities before changes in operating assets and liabilities		**33,071**	**106,642**
(Increase)/decrease in operating assets			
Trading securities		(1,263,019)	1,522,270
Special Drawing Rights with the IMF		720	-
Loans to banks		(47,774)	54,633
Other assets		(20,267)	(19,148)
Increase/(decrease) in operating liabilities			
Money issued in circulation		(187,390)	1,255,814
Amounts due to government organizations		620,624	703,784
Amounts due to credit institutions		265,554	(118,206)
Amounts due to other organizations		(3,721)	(4,403)
Other liabilities		43,125	3,708
Cash flows (used in)/from operations		**(559,077)**	**3,505,094**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of investment securities		(2,553,381)	(1,344,107)
Sale and repayment of investment securities		18,198	403,891
Purchases of property, equipment and intangible assets		(36,919)	(8,152)
Cash flows used in investing activities		**(2,572,102)**	**(948,368)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from debt securities in issue		27,007	344,603
Repayment of debt securities in issue		(19,993)	(444,636)
Repayment of borrowings from IMF		(3,139)	(7,692)
Repayment of amounts due to international financial institutions		(110)	(1,229)
Cash flows from/(used in) financing activities		**3,765**	**(108,954)**
Net (decrease)/increase in cash and cash equivalents		**(3,127,414)**	**2,447,772**
Effect of changes in exchange rates on cash and cash equivalents		(109,911)	117,776
Cash and cash equivalents as at the beginning of the year		8,382,174	5,816,626
Cash and cash equivalents as at the end of the year	4	**5,144,849**	**8,382,174**

The notes set out on pages 51 to 94 form an integral part of these financial statements.

Notes to the financial statements for the year ended 31 December 2014

1. Background

These financial statements have been prepared in accordance with International Financial Reporting Standards for the year ended 31 December 2014for the Central Bank of the Republic of Azerbaijan.

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 Republic of Azerbaijan "On Banks", "On Post" and "On Central Bank of the Republic of Azerbaijan", 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 25.

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 2014, the Management Board (the "Board") of the Bank was composed of the following members:

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

The Bank's main office is located on the following address: 32 Rashid Behbudov Street, Baku, AZ1014, Azerbaijan. The Bank had six regional branches in the Republic of Azerbaijan (2013: six). As of 31 December 2014, the Bank had 607 employees (2013: 613).

Functional and presentation currency

The functional currency of the Bank is Azerbaijani Manats ("AZN") as, being the national currency of the Republic of Azerbaijan. These financial statements are presented in AZN, rounded to nearest thousand, unless otherwise stated.

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 Government of the Republic of Azerbaijan 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 the Republic of 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 its capital markets instability. Growth and development of the Republic of 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 through measures of the Azerbaijani Government.

In addition to these, monetary policy and banking operations carried out in the Republic of Azerbaijan can be subject to certain risks due to the issues arising in world economy. 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.

2. Basis of preparation

Basis of measurement

These financial statements are prepared on the historical cost basis except that financial instruments at fair value through profit or loss, available-for-sale financial assets and investment property are stated at fair value.

Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results could differ from those estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies is described in the following notes:

- loan impairment estimates – Note 9;
- estimates of fair values of financial assets and liabilities – Note 29.

Changes in standards

The following amendments to the standard with a date of initial application of 1 January 2014 were accepted

- *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32 Financial Instruments: Presentation)

Offsetting Financial Assets and Financial Liabilities

Amendments to IAS 32 Financial Instruments: Disclosure and Presentation - Offsetting Financial Assets and Financial Liabilities do not introduce new rules for offsetting financial assets and liabilities; rather they clarify the offsetting criteria to address inconsistencies in their application. The Amendments specify that an entity currently has a legally enforceable right to set-off if that right is not contingent on a future event; and enforceable both in the normal course of business and in the event of default, insolvency or bankruptcy of the entity and all counterparties.

These amendments didn't have an impact on these financial statements.

3. Significant accounting policies

The accounting policies set out below are applied consistently to all periods presented in these financial statements.

Foreign 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 recognized 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.

As of 31 December 2014, exchange rates for translation of foreign currency balances were as follows:1 US Dollar = AZN 0.7844, 1 Euro = AZN 0.9522, 1 Pound sterling = AZN 1.2173and 1 Special Drawing Right = AZN 1.1364(31 December 2013: 1 US Dollar = AZN 0.7845, 1 Euro = AZN 1.078, 1 Pound sterling = AZN 1.2927 and1 Special Drawing Right = AZN 1.2122).

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.

Financial instruments

Classification

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.

Available for sale financial assets

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. Available for sale financial assets are carried at fair value.

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 amortized cost.

Loans and receivables

Loans and receivables 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.

Derivative financial instruments and financial instruments designated as at fair value through profit or loss upon initial recognition are not reclassified out of at fair value through profit or loss category.

Financial assets that would have met the definition of loans and receivables may be reclassified out of the fair value through profit or loss or available-for-sale category if the Bank has an intention and ability to hold them for the foreseeable future or until maturity.

Other financial instruments not included in the category of loans and receivables may be reclassified out of at fair value through profit or loss category only in the case that is unusual and highly unlikely to recur in the near term.

Recognition

Financial assets and liabilities are recognized in the statement of financial position when the Bank becomes a party to the contractual provisions of the instrument.

Measurement

A financial asset or liability is initially measured at its fair value plus, in the case of a financial asset or liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or liability.

Subsequent to initial recognition, financial assets, including derivatives that are assets, are measured at their fair values.

Loans and receivables and held-to-maturity investments which are measured at amortized cost are measured using the effective interest method.

All financial liabilities, other than those designated at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset carried at fair value does not qualify for derecognition, are measured at amortized cost.

Amortized cost

Amortized costs the amount at which the financial instrument was recognized 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 amortization 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 amortized 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.

Fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk. When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

When there is no quoted price in an active market, the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in these circumstances.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price, i.e., the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognized in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Gains and losses on subsequent measurement

A gain or loss arising from a change in the fair value of a financial asset or liability is recognized as follows:

- a gain or loss on a financial instrument classified as at fair value through profit or loss is recognized in profit or loss;
- a gain or loss on an available-for-sale financial asset is recognized as other comprehensive income in equity (except for impairment losses and foreign exchange gains and losses on debt financial instruments available-for-sale) until the asset is derecognized, at which time the cumulative gain or loss previously recognised in equity is recognized in profit or loss. Interest in relation to an available-for-sale financial asset is recognized in profit or loss using the effective interest method.

For financial assets and liabilities carried at amortized cost, a gain or loss is recognized in profit or loss when the financial asset or liability is derecognized or impaired, and through the amortization process.

Derecognition

The Bank derecognizes financial assets when (a) the assets are redeemed or the contractual rights to cash flows from the assets expired or (b) the Bank transfers 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 the risks and rewards of ownership and not retaining control of the financial asset. 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.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised.

In transactions where the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset, it derecognises the asset if control over the asset is lost.

In transfers where control over the asset is retained, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred assets.

If the Bank purchases its own debt, it 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.

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 organisations.

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.

If assets purchased under an agreement to resell are sold to third parties, the obligation to return securities is recorded as a trading liability and measured at fair value.

Derivative financial instruments

Derivative financial instruments include swaps, futures, forwards and spot transactions in interest rates, foreign exchanges.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognized immediately in profit or loss.

Property and equipment

Items of property and equipment are stated at historical cost less accumulated depreciation and impairment losses.

Depreciation

Depreciation is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Depreciation of an asset begins when it is available for use. Land is not depreciated. Estimated useful life is determined using the following annual depreciation rates:

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

Intangible assets

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

Acquired intangible assets are stated at cost less accumulated amortisation and impairment losses.

Amortisation is charged to profit or loss on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives range from 1 to 10 years.

Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in normal course of business, or for the use in production or supply of goods or services or for administrative purposes. Investment property is measured at fair value with any change recognized in profit or loss.

When the use of a property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting.

Impairment

The Bank assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the Bank determines the amount of any impairment loss.

A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a loss event) and that event (or events) has had an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that financial assets are impaired can include default or delinquency by a borrower, breach of loan covenants or conditions, restructuring of financial asset or group of financial assets that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, deterioration in the value of collateral, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers in the Bank, or economic conditions that correlate with defaults in the group.

In addition, for an investment in equity securities available-for-sale a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

Financial assets carried at amortized cost

Financial assets carried at amortized cost consist principally of loans and other receivables (loans and receivables). The Bank reviews its loans and receivables to assess impairment on a regular basis.

The Bank first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for loans and receivables that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan or receivable, whether significant or not, it includes the loan or receivable in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Loans and receivables that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on a loan or receivable has been incurred, the amount of the loss is measured as the difference between the carrying amount of the loan or receivable and the present value of estimated future cash flows including amounts recoverable from guarantees and collateral discounted at the loan or receivable's original effective interest rate. Contractual cash flows and historical loss experience adjusted on the basis of relevant observable data that reflect current economic conditions provide the basis for estimating expected cash flows.

In some cases the observable data required to estimate the amount of an impairment loss on a loan or receivable may be limited or no longer fully relevant to current circumstances. This may be the case when a borrower is in financial difficulties and there is little available historical data relating to similar borrowers. In such cases, the Bank uses its experience and judgment to estimate the amount of any impairment loss.

All impairment losses in respect of loans and receivables are recognized in profit or loss and are only reversed if a subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. The Bank writes off a loan balance (and any related allowances for loan losses) when management determines that the loans are uncollectible and when all necessary steps to collect the loan are completed.

Financial assets carried at cost

Financial assets carried at cost include unquoted equity instruments included in available-for-sale financial assets that are not carried at fair value because their fair value cannot be reliably measured. If there is objective evidence that such investments are impaired, the impairment loss is calculated as the difference between the carrying amount of the investment and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

All impairment losses in respect of these investments are recognized in profit or loss and cannot be reversed.

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognised by transferring the cumulative loss that is recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized in other comprehensive income.

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 government organizations and other organizations

Amounts due to government organizations and other organizations are non-derivative liabilities and are carried at amortized cost.

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 amortized 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.

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.

Charter capital and capital reserves

The Bank's capital is comprised of its authorized paid-in capital and capital reserves.

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.

Membership with the International Monetary Fund 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 the Republic of Azerbaijan in international financial organisations (e.g. IMF, World Bank), including payment of membership fees to such organisations.

The International Monetary Fund ("IMF") is an international organisation 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 the balance of payments adjustments. In accordance with the presidential decree issued in 1992, the Bank acts as a depository agent in relations of the Republic 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 (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 organisational 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 5 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.

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.

Loan origination fees, loan servicing fees and other fees that are considered to be integral to the overall profitability of a loan, together with the related transaction costs, are deferred and amortized to interest income over the estimated life of the financial instrument using the effective interest method.

Other fees, commissions and other income and expense items are recognised in profit or loss when the corresponding service is provided.

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease.

New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective as at 31 December 2014, and are not applied in preparing these financial statements. Of these pronouncements, potentially the following will have an impact on the financial position and performance. The Bank plans to adopt these pronouncements when they become effective.

- IFRS 9 Financial Instruments is to be issued in phases and is intended ultimately to replace International Financial Reporting Standard IAS 39 Financial Instruments: Recognition and Measurement. The first phase of IFRS 9 was issued in November 2009 and relates to the classification and measurement of financial assets. The second phase regarding the classification and measurement of financial liabilities was published in October 2010. The third phase of IFRS 9 was issued in November 2013 and relates to general hedge accounting. The standard was finalized and published in July 2014. The final phase relates to a new expected credit loss model for calculating impairment. The Bank recognizes that the new standard introduces many changes to accounting for financial instruments and is likely to have a significant impact on the financial statements. The Bank has not analyzed the impact of these changes yet. The Bank does not intend to adopt this standard early. The standard will be effective for annual periods beginning on or after 1 January 2018 and will be applied retrospectively with some exemptions.

- Various Improvements to IFRS are dealt with on a standard-by-standard basis. All amendments, which result in accounting changes for presentation, recognition or measurement purposes, will come into effect not earlier than 1 January 2015. The Bank has not yet analyzed the likely impact of the improvements on its financial position or performance.

4. Cash and cash equivalents

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
Cash on hand	**655,106**	**106,345**
Nostro accounts with non-resident banks		
- rated AAA	121,684	3,025,076
- rated AA- to AA+	3,543,942	5,248,781
- rated A- to A+	7,432	1,972
- rated BBB	87,927	-
Total nostro accounts with non-resident banks	**3,760,985**	**8,275,829**
Cash equivalents		
Term deposits with other banks		
- rated A- to A+	728,758	-
Total term deposits with other banks	**728,758**	-
Total cash and cash equivalents	**5,144,849**	**8,382,174**

No cash and cash equivalents are past due or impaired.

As at 31 December 2014and 2013, ratings of nostro accounts and deposits with non-resident banks are disclosed based on the lowest of ratings assigned by Fitch Ratings, Standard and Poor's and Moody's agencies.

5. Balances with the International Monetary Fund

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
ASSETS		
Special Drawing Rights (SDR) holdings	174,540	186,911
Total assets with IMF	**174,540**	**186,911**

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
LIABILITIES		
Current accounts	656	655
Borrowings from the IMF:		
Poverty Reduction and Growth Facility	1,463	4,713
SDR allocation:		
General allocation	135,546	144,587
Special allocation	38,978	41,578
Total SDR allocations	**174,524**	**186,165**
Total liabilities with IMF	**176,643**	**191,533**

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 rates set by the IMF on weekly basis in accordance with short-term market rates in major money markets.

Current accounts

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

Borrowings

Borrowing from IMF is a 10 year loan issued to the Government of the Republic of Azerbaijan with an annual interest rate of 0.5% maturing in 2015. The Government of the Republic of Azerbaijan has a legal obligation for the repayment of these funds that are maintained by the Bank on behalf of the Government of the Republic of Azerbaijan acting as a depository and the borrowing is treated by the Bank as a liability to the Government of the Republic of Azerbaijan.

SDR allocation

SDR allocation is an unconditional distribution of SDRs to member countries by the IMF. A general SDR allocation became effective since 28 August 2009. The allocation is designed to provide liquidity to the global economic system by supplementing the IMF member countries' foreign exchange reserves. General SDR allocation is determined proportionate to existing IMF quotas for each member country.

Additionally, on 10 August 2009, the Fourth Amendment to the IMF Articles of Agreement providing for a special one-time SDR allocation came into force to boost global liquidity. According to the Amendment, the special allocation was made to IMF members, including the Republic of 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 (AZN 182,847 thousand and AZN 195,043 thousandas at 31 December 2014 and 2013 respectively) has remained unchanged since 25 January 1999 and represents the membership subscription of the Republic of Azerbaijan with the IMF. Securities were issued by the Government of the Republic of Azerbaijan to guarantee these amounts. These securities are held by the Bank for which IMF is acting as the beneficiary.

6. Trading securities

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Agency notes	1,468,548	800,505
Notes issued by international financial institutions	587,584	442,528
UK Treasury notes	356,080	219,784
Municipal bonds	259,413	85,476
US Treasury notes	156,199	142,299
Government bonds	75,739	214,571
Corporate bonds	36,075	25,182
Total trading securities	**2,939,638**	**1,930,345**

No trading securities are past due or impaired.

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.

All trading securities are rated above A- rating per Fitch ratings. Refer to note 24 for credit risk disclosure.

7. Derivative financial instruments

The fair value of derivative financial instruments as at 31 December 2014 and 2013 are as follows:

			31/12/2014			31/12/2013
In thousands of Azerbaijani Manats	Notional amount		Fair value	Notional amount		Fair value
		Assets	Liabilities		Assets	Liabilities
Foreign exchange contracts	128,613	1,380	(156)	197,836	129	(1,174)
Future contracts	33,506	42	(197)	30,240	238	(80)
Total derivative financial instruments	**162,119**	**1,422**	**(353)**	**228,076**	**367**	**(1,254)**

Foreign currency contracts

The table below summarises, by major currencies, the contractual amounts of forward exchange contracts outstanding, with details of the weighted average contractual exchange rates and remaining periods to maturity. Foreign currency amounts presented below are translated at rates ruling at the reporting date.

In thousands of Azerbaijani Manats	Notional amount		Weighted average contractual exchange rates	
	31/12/2014	31/12/2013	31/12/2014	31/12/2013
Buy USD sell EUR				
Less than 3 months	22,415	41,082	0.8138	0.7275
Sell USD buy EUR				
Less than 3 months	62,581	107,603	1.2346	1.3643
Buy USD sell GBP				
Less than 3 months	7,002	7,472	0.6421	0.6050
Sell USD buy GBP				
Less than 3 months	16,833	17,664	1.5623	1.6407
Buy USD sell CAD				
Less than 3 months	2,246	2,735	1.1625	1.0635
Sell USD buy CAD				
Less than 3 months	8,051	8,364	0.8688	0.9399
Buy USD sell other currencies				
Less than 3 months	2,611	3,659	-	-
Sell USD buy other currencies				
Less than 3 months	6,874	9,257	-	-

8. Investment securities

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
- Held-to-maturity investments		
US Treasury notes	1,334,654	803,058
UK Treasury notes	195,029	
Government bonds	865,469	-
Notes issued by international financial institutions	850,276	-
Agency Notes	55,066	-
Total held to maturity investments	**3,300,494**	**803,058**

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
- Available-for-sale investments		
Securities issued by Kapital Bank OJSC	148,169	133,026
Ministry of Finance of the Republic of Azerbaijan	40,000	40,000
Azerbaijan Mortgage Fund	19,678	20,434
Total available-for-sale investments	**207,847**	**193,460**
- Loans and advances		
Ministry of Finance of the Republic of Azerbaijan	96,200	109,183
Impairment allowance	(4,295)	(4,295)
Total loans and advances less impairment allowance	**91,905**	**104,888**
Total investment securities	**3,600,246**	**1,101,406**

9. Loans to banks

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Loans under government guarantee	2,214,675	2,113,452
Refinancing loans	903,851	907,508
Subordinated loans	351,133	350,350
Lender of last resort loans	24,488	24,082
Gross loans to banks	**3,494,147**	**3,395,392**
Impairment allowance	(43,995)	(35,531)
Total loans to banks less impairment allowance	**3,450,152**	**3,359,861**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2014 are as follows:

In thousands of Azerbaijani Manats	Refinancing loans	Lender of last resort loan	Total
Balance at the beginning of the year	15,144	20,387	35,531
Net charge	7,220	1,244	8,464
Balance at the end of the year	**22,364**	**21,631**	**43,995**

Movements in the loan impairment allowance by classes of loans to customers for the year ended 31 December 2013 are as follows:

In thousands of Azerbaijani Manats	Refinancing loans	Subordinated loans	Lender of last resort loan	Total
Balance at the beginning of the year	28,464	5,158	24,052	57,674
Net recovery	(13,320)	(5,158)	(3,665)	(22,143)
Balance at the end of the year	**15,144**	**-**	**20,387**	**35,531**

Credit quality

The following table provides information on the credit quality of loans to banks as at 31 December 2014:

In thousands of Azerbaijani Manats	Gross loans	Impairment allowance	Net loans
Loans under government guarantee			
Loans without individual signs of impairment	2,214,675	-	2,214,675
Total loans under government guarantee	**2,214,675**	**-**	**2,214,675**
Refinancing loans			
Loans without individual signs of impairment	880,126	(16,898)	863,228
Overdue or impaired loans:			
- overdue less than 30 days	3,177	(329)	2,848
- overdue 30-90 days	45	(7)	38
- overdue more than 360 days	20,503	(5,130)	15,373
Total overdue or impaired loans	23,725	(5,466)	18,259
Total refinancing loans	**903,851**	**(22,364)**	**881,487**
Subordinated loans			
Loans without individual signs of impairment	351,133	-	351,133
Total subordinated loans	**351,133**	**-**	**351,133**
Lender of last resort loans			
Overdue or impaired loans:			
- overdue more than 360 days	24,488	(21,631)	2,857
Total overdue or impaired loans	24,488	(21,631)	2,857
Total lender of last resort loans	**24,488**	**(21,631)**	**2,857**
Total loans to banks	**3,494,147**	**(43,995)**	**3,450,152**

The following table provides information on the credit quality of loans to banks as at 31 December 2013:

In thousands of Azerbaijani Manats	Gross loans	Impairment allowance	Net loans
Loans under government guarantee			
Loans without individual signs of impairment	2,113,452	-	2,113,452
Total loans under government guarantee	**2,113,452**	**-**	**2,113,452**
Refinancing loans			
Loans without individual signs of impairment	883,786	(11,106)	872,680
Overdue or impaired loans:			
- overdue 180-360 days	11,784	(1,749)	10,035
- overdue more than 360 days	11,938	(2,289)	9,649
Total overdue or impaired loans	23,722	(4,038)	19,684
Total refinancing loans	**907,508**	**(15,144)**	**892,364**
Subordinated loans			
Loans without individual signs of impairment	350,350	-	350,350
Total subordinated loans	**350,350**	**-**	**350,350**

In thousands of Azerbaijani Manats	Gross loans	Impairment allowance	Net loans
Lender of last resort loans			
Overdue or impaired loans:			
- overdue more than 360 days	24,082	(20,387)	3,695
Total overdue or impaired loans	24,082	(20,387)	3,695
Total lender of last resort loans	**24,082**	**(20,387)**	**3,695**
Total loans to banks	**3,395,392**	**(35,531)**	**3,359,861**

As at 31 December 2014 included in the loan portfolio are renegotiated loans to banks in the amount of AZN 416,933 thousand (2013: AZN 27,410 thousand). The main reason for renegotiation is due to stabilization of short-term liquidity and protection of financial stability. Renegotiated loans are included in the category of assets without individual signs of impairment in the tables above, unless the borrower fails to comply with the renegotiated terms.

Key assumptions and judgments for estimating the loan impairment

The Bank estimates loan impairment based on an analysis of the future cash flows for loans with individual signs of impairment and based on its past loss experience for portfolios of loans for which no individual signs of impairment has been identified.

In determining the impairment allowance, management makes the following key assumptions:

- a discount of between 20% and 40% to the originally appraised value if the property pledged is sold;
- 12 to 36 months for the foreclosure of collateral.

Analysis of collateral and other credit enhancements

Loans to banks are subject to individual credit appraisal. The general creditworthiness of a bank tends to be the most relevant indicator of credit quality of the loan extended to it. However, collateral provides additional security and collateral requirement is stipulated in the legislation.

In thousands of Azerbaijani Manats	31/12/2014		31/12/2013	
	Loans to banks, carrying amount	Fair value of collateral assessed as of loan date	Loans to banks, carrying amount	Fair value of collateral assessed as of loan date
Loans without individual signs of impairment				
Guarantee letters from government	2,214,675	2,214,675	2,113,452	2,113,452
Commercial real estate	769,697	769,697	796,262	796,262
Residential real estate	10,260	10,260	62,409	62,409
Traded securities	-	-	14,009	14,009
Loans without collateral	434,404	-	350,350	-
Total loans without individual signs of impairment	**3,429,036**	**2,994,632**	**3,336,482**	**2,986,132**
Overdue or impaired loans				
Residential real estate	19,586	19,586	-	-
Commercial real estate	1,530	1,530	23,379	23,379
Total overdue or impaired loans	**21,116**	**21,116**	**23,379**	**23,379**
Total loans to banks	**3,450,152**	**3,015,748**	**3,359,861**	**3,009,511**

10. Property, equipment and intangible assets

The following table provides information on the movement of property, equipment and intangible assets for the year ended at 31 December 2014:

In thousands of Azerbaijani Manats	Land	Buildings	Furniture and fixtures	Computers and communication equipment	Motor vehicles	Intangible assets	Total
Cost							
Balance at 1 January 2014	15,726	38,480	42,397	12,575	2,033	27,869	139,080
Additions	-	4,373	9,617	1,833	267	20,829	36,919
Transfers	-	-	(23)	23	-	-	-
Disposals	-	(348)	(649)	(249)	(111)	-	(1,357)
Balance at 31 December 2014	**15,726**	**42,505**	**51,342**	**14,182**	**2,189**	**48,698**	**174,642**
Depreciation and amortisation							
Balance at 1 January 2014	-	(12,192)	(35,101)	(6,498)	(1,764)	(11,431)	(66,986)
Depreciation and amortisation for the year	-	(1,217)	(4,090)	(2,381)	(94)	(2,939)	(10,721)
Transfers	-	-	15	(15)	-	-	-
Disposals	-	137	649	249	111	-	1,146
Balance at 31 December 2014	**-**	**(13,272)**	**(38,527)**	**(8,645)**	**(1,747)**	**(14,370)**	**(76,561)**
Carrying amount							
At 31 December 2014	**15,726**	**29,233**	**12,815**	**5,537**	**442**	**34,328**	**98,081**

The following table provides information on the movement of property, equipment and intangible assets for the year ended at 31 December 2013:

In thousands of Azerbaijani Manats	Land	Buildings	Furniture and fixtures	Computers and communication equipment	Motor vehicles	Intangible assets	Total
Cost							
Balance at 1 January 2013	15,726	38,470	40,742	11,509	2,033	23,758	132,238
Additions	-	10	1,744	2,256	46	4,111	8,167
Disposals	-	-	(89)	(1,190)	(46)	-	(1,325)
Balance at 31 December 2013	**15,726**	**38,480**	**42,397**	**12,575**	**2,033**	**27,869**	**139,080**
Depreciation and amortisation							
Balance at 1 January 2013	-	(11,034)	(32,134)	(5,820)	(1,683)	(9,246)	(59,917)
Depreciation and amortisation for the year	-	(1,158)	(3,056)	(1,868)	(109)	(2,185)	(8,376)
Disposals	-	-	89	1,190	28	-	1,307
Balance at 31 December 2013	**-**	**(12,192)**	**(35,101)**	**(6,498)**	**(1,764)**	**(11,431)**	**(66,986)**
Carrying amount							
At 31 December 2013	**15,726**	**26,288**	**7,296**	**6,077**	**269**	**16,438**	**72,094**

11. Other assets

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
Receivables from the sale of foreign currencies	31,435	-
Receivables from trade securities disposed	9,632	7,850
Loans to employees	1,062	1,197
Amounts in the course of settlement	85	89
Other financial assets	59	44
Impairment allowance	(12)	(14)
Total other financial assets	**42,261**	**9,166**
Prepayments to suppliers	36,042	49,743
Investment property	4,400	-
Repossessed assets	-	4,400
Other non-financial assets	88	95
Total other non-financial assets	**40,530**	**54,238**
Total other assets	**82,791**	**63,404**

Movements in the impairment allowance for the years ended 31 December 2014 and 2013 are as follows:

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
Balance at the beginning of the year	14	15
Net recovery	(2)	(1)
Balance at the end of the year	**12**	**14**

12. 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 AZN issued into circulation for 1 January 2006, and old Azerbaijani Manats ("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, AZM5,000 is equal to AZN 1.

During the year ended 31 December 2014 the Bank accepted new banknotes amounting to AZN 10,002,500 thousand from minting company (2013: AZN 16,107 thousand).

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
Balance at the beginning of the year	11,033,336	9,777,522
Net amount of banknotes and coins(withdrawn from)/issued into circulation	(187,390)	1,255,814
Balance at the end of the year	**10,845,946**	**11,033,336**

13. Amounts due to government organizations

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Amounts due to the Central Treasury of the Republic of Azerbaijan	3,341,746	2,876,424
Amounts due to State Oil Fund of the Republic of Azerbaijan	319,951	169,699
Other demand deposits	5,214	7,850
Total amounts due to government organisation	**3,666,911**	**3,053,973**

Interest rate, currency and maturity analysis of amounts due to government organisations are disclosed in note 24.

14. Amounts due to credit institutions

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Current accounts	785,095	592,210
Mandatory reserves	228,056	157,000
Blocked accounts	1,002	1,894
Total amounts due to credit institutions	**1,014,153**	**751,104**

15. Amounts due to other organizations

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Public organisations	5,781	10,441
Other financial institutions	1,078	139
Total amounts due to other organisations	**6,859**	**10,580**

16. Debt securities in issue

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Short-term notes	27,007	19,994
Total debt securities in issue	**27,007**	**19,994**

As at 31 December 2014, the Bank has 27,007 short-term notes in issue.

17. Amounts due to international financial institutions

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Borrowings from International Development Association (IDA)	2,469	2,843
Amounts due to other international financial institutions	429	167
Total amounts due to international financial institutions	**2,898**	**3,010**

18. Other liabilities

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
Advances received for the sale of foreign currencies	31,479	241
Amounts payable for investment securities purchased	10,341	10,174
Amounts in the course of settlement	1,338	643
Total other financial liabilities	**43,158**	**11,058**
Deferred income	433	20
Other	80	65
Total other non-financial liabilities	**513**	**85**
Total other liabilities	**43,671**	**11,143**

19. Share capital

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 Republic (the “Law”), the Bank cannot be declared bankrupt and any deficit in capital is to be covered by the State. At 31 December 2014, the Bank had a capital deficit of AZN 57,743 thousand (at 31 December 2013 was surplus of AZN 250,991 thousand). The Management Board is going to assess the capital position during the year ending 31 December 2015 and in case of continuous capital deficit, the Bank expects that the Ministry of Finance of Azerbaijan Republic will make a capital contribution in accordance with the Article 14 of the Law.

20. Interest income and expenses

In thousands of Azerbaijani Manats	2014	2013
Interest income		
Loans to banks	133,417	125,419
Investment securities:		
Held-to-maturity investments	20,936	8,896
Available-for-sale investments	9,069	2,265
Trading securities	18,805	16,482
Promissory notes from government	4,624	4,624
Placements with non-resident banks	3,925	7,298
SDR holdings with the IMF	142	149
Other assets	68	78
Total interest income	**190,986**	**165,211**

In thousands of Azerbaijani Manats	2014	2013
Interest expense		
Debt securities in issue	463	720
Liabilities on transactions with the IMF	142	147
Amounts due to international financial institutions	26	29
Amounts due to government organizations	-	1
Total interest expense	**631**	**897**
Net interest income	**190,355**	**164,314**

Included within various line items under interest income for the year ended 31 December 2014 is a total of AZN 7,918 thousand (2013: AZN 2,081 thousand) accrued on impaired financial assets.

21. Fee and commission income

In thousands of Azerbaijani Manats	2014	2013
Cash withdrawal	6,772	3,701
Settlement	3,496	4,867
Other	6	6
Total fee and commission income	**10,274**	**8,574**

22. Fee and commission expense

In thousands of Azerbaijani Manats	2014	2013
Securities operations (management, custodian and brokerage)	823	660
Cash withdrawal	537	-
Settlement	70	67
Total fee and commission expenses	**1,430**	**727**

23. Administrative and other operating expenses

In thousands of Azerbaijani Manats	2014	2013
Staff costs	14,826	14,768
Regional construction and social	9,775	11,975
Banknotes and coin production	9,762	13,348
Depreciation of premises and equipment	7,782	6,191
Amortization of software and other intangible assets	2,939	2,185
Repair and maintenance	2,125	968
Software maintenance	1,958	1,803
Financing of Financial Monitoring Service	1,543	1,528
Security	1,358	1,268
Communication	447	403
Office supplies	349	388

In thousands of Azerbaijani Manats	**2014**	**2013**
Heating and lighting	345	310
Occupancy and rent	259	194
Representation	242	93
Insurance	213	198
Business travel	143	173
Printing	114	190
Legal and consultancy	82	71
Utilities	41	43
Other	661	609
Total administrative and other operating expenses	**54,964**	**56,706**

21. Risk management

The activities of the Bank are exposed to various risks. Bank's risks are classified in the following four categories based on the "Framework Document on operational risk management of the Central Bank of Azerbaijan Republic" approved by the Management Board on 5 February 2014:

- *Strategic (policy) risks* – are the risks related with the monetary policy, financial stability, bank control and other strategic issues arising out of mandate. Strategic (policy) Risk Managementis implemented by Bank's Management Board, Monetary Policy and Financial Stability Committee, as well as relevant units (Monetary Policy, Credit Organisations Activity Control, Prudential Policy and Methodology, Market operations, Strategic Management and other departments);

- *Financial risks* – is targeted at the identification, management of credit, market and liquidity risks on the management of Bank's currency reserves, Financial risk management Policy, establishment of relevant risk limits and controls, and regular monitoring of implementation of risk levels and limits. Risk management policy and procedures are regularly reviewed considering the changes in the market condition, offered products and services and innovations in the advanced practice;

- *Operational risks* – are the risks arising out of the intentional or careless behaviour of employees of Bank's units and Bank's project team, non-adequacy of the internal processes, deficiency in the technical equipment, as well as software and technical platforms of the information system, and external events;

- *Reputational risks* – are the risks arising out of the personal life, behaviour and communication of Bank's high-ranking officials (Members of the Management Board and General Directors), as well as discrepancy between the Bank's goals and activities and the public opinion. Bank's reputational risks are managed by the Management Board, General Directors and Communication Department. Reputational losses in the result of inefficient management of strategic (policy), financial, operational risks are not considered as reputational risks. Those losses are considered as one of the risk impact categories within the strategic (policy), financial, operational risks management.

Financial risk management policies and procedures

Risk management 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.

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

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.

Investment Committee. The Investment Committee is responsible for the preparation of "Key directions of Foreign Currency Assets management of the Central Bank of Azerbaijan Republic" in accordance with "Rules of Foreign Currency Assets management of the Central Bank of Azerbaijan Republic", and adoption of "Operational Investment Strategy on Foreign Currency Assets management of the Central Bank of Azerbaijan Republic", as well as control over foreign currency assets management.

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.

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.

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.

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.

The maximum exposure to credit risk from financial assets at the reporting date is as follows:

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
ASSETS		
Cash and cash equivalents	4,489,743	8,275,829
Special Drawing Rights with the IMF	174,540	186,911
Trading securities	2,939,638	1,930,345
Derivative financial instruments	1,422	367
Investment securities	3,600,246	1,101,406
Loans to banks	3,450,152	3,359,861
Promissory notes from government	234,979	230,356
Other financial assets	42,261	9,166
Total maximum exposure	**14,932,981**	**15,094,241**

Collateral generally is not held against claims under derivative financial instruments, investments in securities, and loans to banks, except when securities are held as part of reverse repurchase and securities borrowing activities.

For the analysis of collateral held against loans to banks and concentration of credit risk in respect of loans to banks refer to note 9.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises currency risk, interest rate risk and other price risks. Market risk arises from open positions in interest rate and equity financial instruments, which are exposed to general and specific market movements and changes in the level of volatility of market prices and foreign currency rates.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Bank is exposed 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 also reduce or create losses in the event that unexpected movements occur.

Interest rate gap analysis

Interest rate risk is managed principally through monitoring interest rate gaps. A summary of the interest gap position for major financial instruments as at 31 December 2014 is as follows:

In thousands of Azerbaijani Manats	Less than 3 months	3-6 months	6-12 months	More than 1 year	Non-interest bearing	Carrying amount
31 December 2014						
ASSETS						
Cash and cash equivalents	3,825,518	538,044	-	-	781,287	5,144,849
Special Drawing Rights with the IMF	174,540	-	-	-	-	174,540
Trading securities	2,939,638	-	-	-	-	2,939,638
Derivative financial instruments	-	-	-	-	1,422	1,422
Investment securities	-	40,116	136,932	3,423,198	-	3,600,246
Loans to banks	63,276	116,747	334,208	2,935,921	-	3,450,152
Promissory notes from government	-	-	-	234,979	-	234,979
Other financial assets	41,201	11	54	995	-	42,261
	7,044,173	**694,918**	**471,194**	**6,595,093**	**782,709**	**15,588,087**
LIABILITIES						
Money issued in circulation	-	-	-	-	10,845,946	10,845,946
Amounts due to government organisations	-	-	-	-	3,666,911	3,666,911
Amounts due to credit institutions	-	-	-	-	1,014,153	1,014,153
Amounts due to other organisations	-	-	-	-	6,859	6,859
Derivative financial instruments	-	-	-	-	353	353
Debt securities in issue	27,007	-	-	-	-	27,007
Liabilities on transactions with the IMF	1,463	-	-	-	175,180	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	2,898
Other financial liabilities	43,158	-	-	-	-	43,158
	74,526	**-**	**-**	**-**	**15,709,402**	**15,783,928**
	6,969,647	**694,918**	**471,194**	**6,595,093**	**(14,926,693)**	**(195,841)**

A summary of the interest gap position for major financial instruments as at 31 December 2013 is as follows:

In thousands of Azerbaijani Manats	Less than 3 months	3-6 months	6-12 months	More than 1 year	Non-interest bearing	Carrying amount
31 December 2013						
ASSETS						
Cash and cash equivalents	8,275,829	-	-	-	106,345	8,382,174
Special Drawing Rights with the IMF	186,911	-	-	-	-	186,911
Trading securities	1,930,345	-	-	-	-	1,930,345
Derivative financial instruments	-	-	-	-	367	367
Investment securities	-	-	-	1,101,406	-	1,101,406
Loans to banks	92,654	276,147	110,901	2,880,159	-	3,359,861
Promissory notes from government	-	-	-	230,356	-	230,356
Other financial assets	9,166	-	-	-	-	9,166
	10,494,905	**276,147**	**110,901**	**4,211,921**	**106,712**	**15,200,586**
LIABILITIES						
Money issued in circulation	-	-	-	-	11,033,336	11,033,336
Amounts due to government organizations	3,053,973	-	-	-	-	3,053,973
Amounts due to credit institutions	751,104	-	-	-	-	751,104
Amounts due to other organizations	10,580	-	-	-	-	10,580
Derivative financial instruments	-	-	-	-	1,254	1,254
Debt securities in issue	19,994	-	-	-	-	19,994
Liabilities on transactions with the IMF	1,564	1,564	-	-	188,405	191,533
Amounts due to international financial institutions	196	196	1,616	1,002	-	3,010
Other financial liabilities	11,058	-	-	-	-	11,058
	3,848,469	**1,760**	**1,616**	**1,002**	**11,222,995**	**15,075,842**
	6,646,436	**274,387**	**109,285**	**4,210,919**	**(11,116,283)**	**124,744**

Interest rate sensitivity analysis

The management of interest rate risk based on interest rate gap analysis is supplemented by monitoring the sensitivity of financial assets and liabilities. An analysis of sensitivity of net profit or loss and equity to changes in interest rates (repricing risk) based on a simplified scenario of a 100 basis point (bp) symmetrical fall or rise in all yield curves and positions of interest-bearing assets and liabilities existing as at 31 December 2014 and 2013 is as follows:

In thousands of Azerbaijani Manats	31/12/2014	31/12/2013
100 bp parallel fall	(90,273)	(76,273)
100 bp parallel rise	90,273	76,273

An analysis of sensitivity of net profit or loss and equity as a result of changes in the fair value of trading securities and financial assets available-for-sale due to changes in the interest rates based on positions existing as at 31 December 2014 and 2013 and a simplified scenario of a 100 bp symmetrical fall or rise in all yield curves is as follows:

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
100 bp parallel fall	(28,646)	(20,218)
100 bp parallel rise	28,646	20,218

The table below displays average effective interest rates for interest bearing assets and liabilities as at 31 December 2014 and 2013. These interest rates are an approximation of the yields to maturity of these assets and liabilities.

	31/12/2014 Average effective interest rate, %				**31/12/2013 Average effective interest rate, %**			
	AZN	**USD**	**EUR**	**Other currencies**	**AZN**	**USD**	**EUR**	**Other currencies**
Interest bearing assets								
Cash and cash equivalents	-	0.01	0.15	0.49	-	0.25	0.50	-
Special Drawing Rights with the IMF	-	-	-	0.05	-	-	-	0.13
Trading securities	-	0.34	0.31	0.58	-	1.19	-	-
Investment securities	3.33	1.36	1.70	1.43	2.96	1.40	-	-
Loans to banks	4.20	2.50	-	-	4.30	2.40	-	-
Promissory notes from government	2.00	-	-	-	2.00	-	-	-
Other financial assets	5.88	-	-	-	11.00	-	-	-
Interest bearing liabilities								
Debt securities in issue	0.14	-	-	-	1.15	-	-	-
Liabilities on transactions with the IMF	-	-	-	0.50	-	-	-	0.50
Amounts due to international financial institutions	-	-	-	-	-	1.00	-	-

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 9 December 2013. 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 following table shows the foreign currency exposure structure of financial assets and liabilities as at 31 December 2014:

In thousands of Azerbaijani Manats	**USD**	**EUR**	**Other currencies**	**Total**
ASSETS				
Cash and cash equivalents	4,091,631	859,332	193,886	5,144,849
Special Drawing Rights with the IMF	-	-	174,540	174,540
Trading securities	1,602,835	743,525	593,278	2,939,638
Derivative financial instruments	1,422	-	-	1,422
Investment securities	1,601,618	1,479,533	219,343	3,300,494
Loans to banks	507,174	-	-	507,174
Other financial assets	9,632	22,017	9,477	41,126
Total assets	**7,814,312**	**3,104,407**	**1,190,524**	**12,109,243**
LIABILITIES				
Amounts due to government organizations	377,521	63,444	64	441,029
Amounts due to credit institutions	260,612	60,822	3,660	325,094
Amounts due to other organizations	223	2	-	225
Derivative financial instruments	353	-	-	353
Liabilities on transactions with the IMF	-	-	176,643	176,643
Amounts due to international financial institutions	2,898	-	-	2,898
Other financial liabilities	41,199	621	-	41,820
Total liabilities	**682,806**	**124,889**	**180,367**	**988,062**
Net recognized position	**7,131,506**	**2,979,518**	**1,010,157**	**11,121,181**
The effect of derivatives	(60,065)	40,166	19,899	-
Net position	**7,071,441**	**3,019,684**	**1,030,056**	**11,121,181**

The following table shows the currency structure of financial assets and liabilities as at 31 December 2013:

In thousands of Azerbaijani Manats	**USD**	**EUR**	**Other currencies**	**Total**
ASSETS				
Cash and cash equivalents	5,011,071	3,031,412	339,691	8,382,174
Special Drawing Rights with the IMF	-	-	186,911	186,911
Trading securities	1,199,057	156,309	574,979	1,930,345
Derivative financial instruments	367	-	-	367
Investment securities	803,058	-	-	803,058
Loans to banks	513,351	-	-	513,351
Other financial assets	7,850	-	-	7,850
Total assets	**7,534,754**	**3,187,721**	**1,101,581**	**11,824,056**
LIABILITIES				
Amounts due to government organisations	2,608	23,004	20,557	46,169
Amounts due to credit institutions	130,219	20,897	2	151,118
Derivative financial instruments	1,254	-	-	1,254
Liabilities on transactions with the IMF	-	-	190,878	190,878
Amounts due to international financial institutions	3,010	-	-	3,010
Other financial liabilities	10,382	1	-	10,383
Total liabilities	**147,473**	**43,902**	**211,437**	**402,812**
Net recognised position	**7,387,281**	**3,143,819**	**890,144**	**11,421,244**
The effect of derivatives	(87,940)	66,521	21,419	-
Net position	**7,299,341**	**3,210,340**	**911,563**	**11,421,244**

A weakening of the AZN, as indicated below, against the following currencies at 31 December 2014 and 2013 would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis is based on foreign currency exchange rate variances that the Bank considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
30% appreciation of USD against AZN	2,121,432	2,189,802
30% appreciation of EUR against AZN	905,905	963,102

A strengthening of the AZN against the above currencies at 31 December 2014 and 2013 would have had the equal but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market. Other price risk arises when the Bank takes a long or short position in a financial instrument.

An analysis of sensitivity of net profit or loss and equity to changes in securities prices based on positions existing as at 31 December 2014 and 2013 and a simplified scenario of a 10% change in all securities prices is as follows:

In thousands of Azerbaijani Manats	**31/12/2014**	**31/12/2013**
10% increase in securities prices	293,964	193,041
10% decrease in securities prices	(293,964)	(193,041)

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 an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2014:

In thousands of Azerbaijani Manats	**Demand and less than 1 month**	**From 1 to 3 months**	**From 3 to 12 months**	**From 1 to 5 years**	**More than 5 years**	**No maturity**	**Overdue**	**Total**
ASSETS								
Cash and cash equivalents	4,416,365	190,440	538,044	-	-	-	-	5,144,849
Special Drawing Rights with the IMF	-	-	-	-	-	174,540	-	174,540
Trading securities	2,939,638	-	-	-	-	-	-	2,939,638
Derivative financial instruments	1,422	-	-	-	-	-	-	1,422
Investment securities	-	-	177,048	3,235,244	187,954	-	-	3,600,246
Loans to banks	-	35,803	450,955	812,603	2,123,318	-	27,473	3,450,152
Promissory notes from government	-	-	-	234,979	-	-	-	234,979
Property, equipment and intangible assets	-	-	-	-	-	98,081	-	98,081
Other assets	41,199	2	65	23	972	40,530	-	82,791
Total assets	**7,398,624**	**226,245**	**1,166,112**	**4,282,849**	**2,312,244**	**313,151**	**27,473**	**15,726,698**
LIABILITIES								
Money issued in circulation	-	-	-	-	-	10,845,946	-	10,845,946
Amounts due to government organizations	3,666,911	-	-	-	-	-	-	3,666,911
Amounts due to credit institutions	1,014,153	-	-	-	-	-	-	1,014,153
Amounts due to other organizations	6,859	-	-	-	-	-	-	6,859
Derivative financial instruments	353	-	-	-	-	-	-	353
Debt securities in issue	27,007	-	-	-	-	-	-	27,007
Liabilities on transactions with the IMF	1,463	-	-	-	-	175,180	-	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	-	-	2,898
Other liabilities	43,158	-	-	-	-	513	-	43,671
Total liabilities	**4,762,802**	**-**	**-**	**-**	**-**	**11,021,639**	**-**	**15,784,441**
Net position	**2,635,822**	**226,245**	**1,166,112**	**4,282,849**	**2,312,244**	**(10,708,488)**	**27,473**	**(57,743)**

The table below shows an analysis, by expected maturities, of the amounts recognised in the statement of financial position as at 31 December 2013:

In thousands of Azerbaijani Manats	Demand and less than 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	More than 5 years	No maturity	Overdue	Total
ASSETS								
Cash and cash equivalents	8,381,973	201	-	-	-	-	-	8,382,174
Special Drawing Rights with the IMF	-	-	-	-	-	186,911	-	186,911
Trading securities	1,930,345	-	-	-	-	-	-	1,930,345
Derivative financial instruments	367	-	-	-	-	-	-	367
Investment securities	36	116	128	452,835	648,291	-	-	1,101,406
Loans to banks	247	166,627	313,075	506,875	2,349,883	-	23,154	3,359,861
Promissory notes from government	-	-	-	-	230,356	-	-	230,356
Property, equipment and intangible assets	-	-	-	-	-	72,094	-	72,094
Other assets	9,166	-	-	-	-	54,238	-	63,404
Total assets	**10,322,134**	**166,944**	**313,203**	**959,710**	**3,228,530**	**313,243**	**23,154**	**15,326,918**
LIABILITIES								
Money issued in circulation	-	-	-	-	-	11,033,336	-	11,033,336
Amounts due to government organisations	3,053,973	-	-	-	-	-	-	3,053,973
Amounts due to credit institutions	751,104	-	-	-	-	-	-	751,104
Amounts due to other organizations	10,580	-	-	-	-	-	-	10,580
Derivative financial instruments	1,254	-	-	-	-	-	-	1,254
Debt securities in issue	19,994	-	-	-	-	-	-	19,994
Liabilities on transactions with the IMF	1,564	1,564	-	-	-	188,405	-	191,533
Amounts due to international financial institutions	196	196	1,616	1,002	-	-	-	3,010
Other liabilities	11,058	-	-	-	-	85	-	11,143
Total liabilities	**3,849,723**	**1,760**	**1,616**	**1,002**	**-**	**11,221,826**	**-**	**15,075,927**
Net position	**6,472,411**	**165,184**	**311,587**	**958,708**	**3,228,530**	**(10,908,583)**	**23,154**	**250,991**

25. 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 disclosed in the statement of financial position.

No external capital requirements exist for the Bank as the central bank, except for the size of the statutory capital and minimum amount of 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 19, at 31 December 2014 the authorised and fully paid capital of the Bank was AZN 10,000 thousand (31 December 2013: 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 AZN is accounted for in the statement of profit or loss and other 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 realised 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 2013 were not at the level required by the Law, there were no transfers made to the State Budget during the year 2014. At 31 December 2014, 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.

26. Operating leases

The Bank leases a number of premises and equipment under operating leases. The leases typically run for an initial period of one year, with an option to renew the lease after that date. Lease payments are usually increased annually to reflect market rentals. None of the leases includes contingent rentals.

27. Contingencies

Litigations

In the ordinary course of business, the Bank is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial condition or the results of future operations.

28. 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.

Bodies under the state's control represent the Azerbaijan Mortgage Fund ("AMF"), the Financial Monitoring Service ("FMS") and International Bank of Azerbaijan. 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.

Transactions with the members of the Management

Total remuneration included in personnel expenses for the years ended 31 December 2014 and 2013 is as follows:

In thousands of Azerbaijani Manats	**2014**	**2013**
Short term employee benefits (salary)	**846**	**843**

Transactions with government-related entities

The Bank is a state owned entity, and in the ordinary course of business operates with various state owned companies. Significant transactions with government owned companies include loans to banks, investment securities, promissory notes from government, placements by government and credit institutions and interest income.

The outstanding balances and the related average effective interest rates as at 31 December 2014 and related profit or loss amounts of transactions for the year ended 31 December 2014 with other related parties are as follows:

	31.12.2014						
	Government of Azerbaijan		**Management Board**		**Government controlled entities**		**Total**
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
Statement of financial position							
ASSETS							
Investment securities	131,905	0.75	-	-	19,678	3.04	151,583
Loans to banks							
Principal balance	-	-	-	-	1,362,202	1.90	1,362,202
Impairment allowance	-		-		-		-
Promissory notes from government	234,979	2.00	-	-	-	-	234,979
Other assets	41	-	57	4.60	72	-	170

	31.12.2014						
	Government of Azerbaijan		Management Board		Government controlled entities		Total
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
LIABILITIES							
Amounts due to government organizations	3,343,325	-	-	-	323,586	-	3,666,911
Amounts due to credit institutions	-	-	-	-	126,315	-	126,315
Amounts due to other organizations	1,562	-	-	-	5,202	-	6,764
Liabilities on transactions with the IMF	176,643	-	-	-	-	-	176,643
Amounts due to international financial institutions	2,898	-	-	-	-	-	2,898
Other liabilities	-	-	-	-	82	-	82
Profit (loss)							
Interest income	800	-	16	-	52,659	-	53,475
Interest expense	(25)	-	-	-	(130)	-	(155)
Fee and commission income	549	-	-	-	6,078	-	6,627
Other general and administrative expenses	-	-	-	-	(1,543)	-	(1,543)

The outstanding balances and the related average effective interest rates as at 31 December 2013 and related profit or loss amounts of transactions for the year ended 31 December 2013 with other related parties are as follows:

	31.12.2013						
	Government of Azerbaijan		Management Board		Government controlled entities		Total
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
Statement of financial position							
ASSETS							
Investment securities	144,888	0.86	-	-	20,434	3.25	165,322
Loans to banks							
Principal balance	-	-	-	-	1,301,057	4.15	1,301,057
Promissory notes from government	230,356	-	-	-	-	-	230,356
Other assets	47	-	69	4.60	43	-	159

	31.12.2013						
	Government of Azerbaijan		Management Board		Government controlled entities		Total
	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats	Effective interest rate, %	In thousands of Azerbaijani Manats
LIABILITIES							
Amounts due to government organizations	3,051,005	-	-	-	2,968	-	3,053,973
Amounts due to credit institutions	-	-	-	-	41,898	-	41,898
Amounts due to other organizations	10,432	-	-	-	42	-	10,474
Liabilities on transactions with the IMF	191,533	-	-	-	-	-	191,533
Amounts due to international financial institutions	3,010	-	-	-	-	-	3,010
Profit (loss)							
Interest income	7,050		3		46,384		53,437
Interest expense	(29)		-		-		(29)
Fee and commission income	1,632		-		1,987		3,619
Impairment recovery	-		-		7,605		7,605
Other general and administrative expenses	-		-		(1,528)		(1,528)

29. Financial assets and liabilities: fair values and accounting classifications

Accounting classifications and fair values

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2014:

In thousands of Azerbaijani Manats	Trading securities	Designated at fair value	Held-to-maturity	Loans and receivables	Available-for-sale	Other amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	-	-	-	5,144,849	-	-	5,144,849	5,144,849
Special Drawing Rights with the IMF	-	-	-	174,540	-	-	174,540	174,540
Trading securities	2,939,638	-	-	-	-	-	2,939,638	2,939,638
Derivative financial instruments	-	1,422	-	-	-	-	1,422	1,422
Investment securities	-	-	3,300,494	91,905	207,847	-	3,600,246	3,599,746
Loans to banks	-	-	-	3,450,152	-	-	3,450,152	3,454,152
Promissory notes from government	-	-	-	234,979	-	-	234,979	234,979
Other financial assets	-	-	-	42,261	-	-	42,261	42,261
	2,939,638	**1,422**	**3,300,494**	**9,138,686**	**207,847**	**-**	**15,588,087**	**15,591,587**
Money issued in circulation	-	-	-	-	-	10,845,946	10,845,946	10,845,946
Amounts due to government organizations	-	-	-	-	-	3,666,911	3,666,911	3,666,911
Amounts due to credit institutions	-	-	-	-	-	1,014,153	1,014,153	1,014,153
Amounts due to other organizations	-	-	-	-	-	6,859	6,859	6,859
Derivative financial instruments	-	353	-	-	-	-	353	353
Debt securities in issue	-	-	-	-	-	27,007	27,007	27,007
Liabilities on transactions with the IMF	-	-	-	-	-	176,643	176,643	176,643
Amounts due to international financial institutions	-	-	-	-	-	2,898	2,898	2,898
Other financial liabilities	-	-	-	-	-	43,158	43,158	43,158
	-	**353**	**-**	**-**	**-**	**15,783,575**	**15,783,928**	**15,783,928**

The table below sets out the carrying amounts and fair values of financial assets and financial liabilities as at 31 December 2013:

In thousands of Azerbaijani Manats	**Trading securities**	**Designated at fair value**	**Held-to-maturity**	**Loans and receivables**	**Available-for-sale**	**Other amortised cost**	**Total carrying amount**	**Fair value**
Cash and cash equivalents	-	-	-	8,382,174	-	-	8,382,174	8,382,174
Special Drawing Rights with the IMF	-	-	-	186,911	-	-	186,911	186,911
Trading securities	1,930,345	-	-	-	-	-	1,930,345	1,930,345
Derivative financial instruments	-	367	-	-	-	-	367	367
Investment securities	-	-	803,058	104,888	193,460	-	1,101,406	1,105,701
Loans to banks	-	-	-	3,359,861	-	-	3,359,861	3,326,461
Promissory notes from government	-	-	-	230,356	-	-	230,356	230,356
Other financial assets	-	-	-	9,166	-	-	9,166	9,166
	1,930,345	**367**	**803,058**	**12,273,356**	**193,460**	**-**	**15,200,586**	**15,171,481**
Money issued in circulation	-	-	-	-	-	11,033,336	11,033,336	11,033,336
Amounts due to government organizations	-	-	-	-	-	3,053,973	3,053,973	3,053,973
Amounts due to credit institutions	-	-	-	-	-	751,104	751,104	751,104
Amounts due to other organizations	-	-	-	-	-	10,580	10,580	10,580
Derivative financial instruments	-	1,254	-	-	-	-	1,254	1,254
Debt securities in issue	-	-	-	-	-	19,994	19,994	19,994
Liabilities on transactions with the IMF	-	-	-	-	-	191,533	191,533	191,533
Amounts due to international financial institutions	-	-	-	-	-	3,010	3,010	3,010
Other financial liabilities	-	-	-	-	-	11,058	11,058	11,058
	-	**1,254**	**-**	**-**	**-**	**15,074,588**	**15,075,842**	**15,075,842**

The estimates of fair value are intended to approximate the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. However given the uncertainties and the use of subjective judgment, the fair value should not be interpreted as being realizable in an immediate sale of the assets or transfer of liabilities.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments the Bank determines fair values using other valuation techniques.

The objective of valuation techniques is to arrive at a fair value determination that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable prices exist, Black-Scholes and polynomial option pricing models and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other premia used in estimating discount rates, bond and equity prices, foreign currency exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date that would have been determined by market participants acting at arm’s length.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

For more complex instruments, the Bank uses proprietary valuation models. Some or all of the significant inputs into these models may not be observable in the market, and are derived from market prices or rates or are estimated based on assumptions. Example of instruments involving significant unobservable inputs include certain loans and securities for which there is no active market, certain over the counter structured derivatives, and retained interests in securitizations.

Fair value hierarchy

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted market price (unadjusted) in an active market for an identical instrument;

- Level 2: inputs other than quotes prices included within Level 1 that are observable either directly (i.e, as prices) or indirectly (i.e, derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data;

- Level 3: inputs that are unobservable. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument’s valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Where third-party information, such as broker quotes or pricing services are used to measure fair value, Product Control assesses and documents the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS. This includes:

- verifying that the broker or pricing service is approved by the Bank for use in pricing the relevant type of financial instrument;
- understanding how the fair value has been arrived at the extent to which it represents actual market transactions;
- when prices for similar instruments are used to measure fair value, how these prices have been adjusted to reflect the characteristics of the instrument subject to measurement;
- where a number of quotes for the same financial instrument have been obtained, how fair value has been determined using those quotes.

The table below analyses financial instruments measured at fair value at 31 December 2014, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognised in the statement of financial position:

In thousands of Azerbaijani Manats	**Level 1**	**Level 2**	**Total**
Financial assets			
Trading securities	2,939,638	-	2,939,638
Derivative financial instruments	-	1,422	1,422
Available-for-sale financial assets			
- Debt and other fixed income instruments	207,847	-	207,847
	3,147,485	**1,422**	**3,148,907**
Financial liabilities			
Derivative financial instruments	-	(353)	(353)
	-	**(353)**	**(353)**

The table below analyses financial instruments measured at fair value at 31 December 2013, by the level in the fair value hierarchy into which the fair value measurement is categorised. The amounts are based on the values recognized in the statement of financial position:

In thousands of Azerbaijani Manats	**Level 1**	**Level 2**	**Total**
Financial assets			
Trading securities	1,930,345	-	1,930,345
Derivative financial instruments	-	367	367
Available-for-sale financial assets			
- Debt and other fixed income instruments	193,460	-	193,460
	2,123,805	**367**	**2,124,172**
Financial liabilities			
Derivative financial instruments	-	(1,254)	(1,254)
	-	**(1,254)**	**(1,254)**

The table below analyses financial instruments not measured at fair value at 31 December 2014, by the second level in the fair value hierarchy:

In thousands of Azerbaijani Manats	Level 1	Level 2	Total fair value	Total carrying amount
ASSETS				
Cash and cash equivalents	-	5,144,849	5,144,849	5,144,849
SDRs with the IMF	-	174,540	174,540	174,540
Loans to banks	-	3,454,152	3,454,152	3,450,152
Investment securities				
- Held to maturity investments	3,300,494	-	3,300,494	3,300,494
- Loans and advances	-	91,405	91,405	91,905
Promissory notes from government	-	234,979	234,979	234,979
Other financial assets	-	42,261	42,261	42,261
LIABILITIES				
Money issued in circulation	10,845,946	-	10,845,946	10,845,946
Amounts due to government organizations	-	3,666,911	3,666,911	3,666,911
Amounts due to credit institutions	-	1,014,153	1,014,153	1,014,153
Amounts due to other organizations	-	6,859	6,859	6,859
Debt securities in issue	27,007	-	27,007	27,007
Liabilities on transactions with the IMF	-	176,643	176,643	176,643
Amounts due to international financial institutions	-	2,898	2,898	2,898
Other financial liabilities	-	43,158	43,158	43,158

The table below analyses financial instruments not measured at fair value at 31 December 2013, by the second level in the fair value hierarchy:

In thousands of Azerbaijani Manats	Level 1	Level 2	Total fair value	Total carrying amount
ASSETS				
Cash and cash equivalents	-	8,382,174	8,382,174	8,382,174
SDRs with the IMF	-	186,911	186,911	186,911
Loans to banks	-	3,326,461	3,326,461	3,359,861
Investment securities				
- Held to maturity investments	803,058	-	803,058	803,058
- Loans and advances	-	109,183	109,183	104,888
Promissory notes from government	-	230,356	230,356	230,356
Other financial assets	-	9,166	9,166	9,166

In thousands of Azerbaijani Manats	Level 1	Level 2	Total fair value	Total carrying amount
LIABILITIES				
Money issued in circulation	11,033,336	-	11,033,336	11,033,336
Amounts due to government organizations	-	3,053,973	3,053,973	3,053,973
Amounts due to credit institutions	-	751,104	751,104	751,104
Amounts due to other organizations	-	10,580	10,580	10,580
Debt securities in issue	19,994	-	19,994	19,994
Liabilities on transactions with the IMF	-	191,533	191,533	191,533
Amounts due to international financial institutions	-	3,010	3,010	3,010
Other financial liabilities	-	11,058	11,058	11,058

30. Subsequent events

On 21 February 2015, the Central Bank of the Republic of Azerbaijan ("the CBAR") announced that the currency will now trade at AZN 1.05 per USD.

As the devaluation occurred after the reporting date, these separate financial statements have not been adjusted for the rate change.

Management is still in the process of evaluating the effects of the devaluation on the Bank but does not expect the operational impact to be significant. See note 24 for details of the Bank's exposure to foreign currency risk at the reporting date.

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