



CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

REPORT ON ACCOMPLISHMENT OF MAIN GOALS AND FUNCTIONS IN 2023



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Introduction

In 2023, the Central Bank of the Republic of Azerbaijan fulfilled its mandated functions and pursued policies aimed at safeguarding macroeconomic and financial stability.

Throughout the year, the Central Bank implemented its monetary policy in alignment with the 'Statement of the Central Bank of the Republic of Azerbaijan on the Main Directions of Monetary Policy for 2023'. The operational environment was characterized by global economic uncertainties, exacerbated by rising geopolitical tensions. Favorable conditions in the global energy market and increased non-oil exports positively impacted the balance of payments, FX market equilibrium, and economic activity. However, inflation dynamics in trade partner countries also influenced inflationary developments in Azerbaijan.

In response to risks in both domestic and international inflation environments, the Central Bank focused on managing inflation through the monetary condition. Monetary policy decisions were guided by actual and forecasted inflation rates, inflation expectations, FX market dynamics, and adjustments were made to interest rate corridor parameters as necessary. Efforts continued to enhance the monetary policy operational framework in view of strategic challenges.

In 2023, the Central Bank's financial stability policy prioritized maintaining confidence in the financial-banking system, minimizing risks, enhancing management capabilities, and bolstering resilience against financial sector shocks. Initiatives continued to broaden the real sector access to financial resources. Increased business lending and activity in the securities market expanded financing opportunities for economic growth and deepened financial markets. The expansion of cashless payments further strengthened the resource base of the financial sector.

1. Accomplishment of goals

The main goal of the Central Bank is to maintain price stability within the authorities established by the legislation and safeguard financial stability within the authorities established by the laws regulating financial markets without compromising the main goal.

1.1. Maintaining price stability within the authorities of the Central Bank established by the law

In 2023, the inflation rate moderated due to reduced global inflationary pressures and the implementation of anti-inflationary initiatives.

Inflation in Azerbaijan began to decrease after the first quarter. According to official statistics, in December 2023, twelve-month inflation stood at 2.1%, in the lower bound of the target band (4±2%). Annual core inflation calculated by excluding changes in regulated prices and prices for seasonally volatile agricultural products decreased to 2.3% in December 2023. Inflation decreased across all components. As of the end of the reporting year annual food inflation decreased to 0.8%. Prices for non-food products y.o.y. increased by 2.7%, annual service inflation was 3.7%.

Analyses suggest that annual inflation decreased due to a combination of external and internal factors, including anti-inflationary policies and the base effect. The relative decline in average weighted inflation in trade partners, the drop in global commodity prices, and return of international freight costs to pre-pandemic levels had a downward effect on inflation. The FX market equilibrium on the backdrop

of the balance of payments surplus, the appreciation of the nominal effective exchange rate of the manat, the government's anti-inflationary measures and monetary policy decisions moderated inflationary pressures. Additionally, adjustments of interest rate corridor parameters to the macroeconomic stance, prudent use of monetary policy tools, and changes to macroprudential requirements contained aggregate demand overexpansion.

The FX market equilibrium was critical in mitigating imported inflation. Despite high exchange rate fluctuations in certain trade partners, the national currency remained stable.

1.2. Safeguarding financial stability within the authorities established by the laws regulating financial markets without compromising the main goal

Actions taken and the policies pursued throughout the year enhanced financial system resilience to external shocks and strengthened financial stability.

The Central Bank's prudential policy was oriented towards strengthening the financial resilience of the banking sector. Banking sector capitalization measures, removal of two insolvent banks from the sector, higher prudential requirements on the risks forming sensitivity zones, intense dialogue with the sector and initiatives aimed at improving corporate governance positively influenced financial stability.

The banking sector's lending portfolio posted growth across all segments. Adjustments to the regulatory framework and effective risk management by credit institutions amid this growth paved the way to reducing sector's credit risks. As of end 2023 the banking system's capital adequacy ratio stood at 17.5%, 1.7 times higher than the regulatory requirement. At the same time, the instant liquidity ratio of the sector (52.2%) was 1.7 times higher than the minimum requirement. Banking sector profitability also followed a positive trend – net profit of the banking sector y.o.y. increased by 18% (AZN162M) to AZN1.1B. De-dollarization also continued over the reporting period.

Insurance sector's financial indicators improved, and its depth and penetration levels increased. As of end-2023 insurance premiums y.o.y. increased by 26% to AZN1223M, and insurance payments increased by 36% to AZN587M. Sector's profitability increased, and capital requirements still surpass prudential requirements.

Securities turnover in the capital market expanded amid the growth of Repo/reverse Repo operations. Financial indicators improved, and the capital position was in a comfort zone in the environment of high profitability and an expanding balance sheet of the sector.

2. Discharge of functions

To attain the main goals the Central Bank took necessary measures to establish and pursue the monetary policy, organize cash circulation, regularly set and announce the exchange rate of manat against foreign currencies, implement currency regulation and control, compile a BoP report and participate in the development of the forecast of BoP, maintain and manage international gold – foreign exchange reserves at its disposal, ensure stability and sustainability of financial markets, develop consolidated foreign debt statistics and international investment balance under the legislation and discharge other functions.

2.1. Setting and implementing the monetary and exchange rate policy

In 2023, the Central Bank's monetary policy aimed to revert inflation to the target band. Monetary policy tools were applied in response to the banking system's liquidity position and the balance of risks. Reforms continued to increase ability to affect inflation.

In 2023, Central Bank's monetary policy decisions were taken considering developments in global and national economies. The interest rate corridor parameters were discussed 8 times over the reporting year. At the first three discussions the refinancing rate was increased from 8.25% to 9%, the ceiling of the interest rate corridor from 9.25% to 10% and the floor from 6.25% to 7.5%. The reason for increasing interest rates was to contain overexpansion of aggregate demand. The following period considering the decline in actual and forecasted inflation the CBA took a break in monetary policy tightening and decided to leave the interest rate corridor parameters unchanged at the next three meetings. The CBA started to decrease policy rates at the recent 2 meetings – the refinancing rate was decreased from 9% to 8%, the ceiling of the interest rate corridor from 10% to 9%, and the floor from 7.5% to 6.5%. The Bank began to ease the monetary policy also to reduce appreciation pressures on the exchange rate of the manat within current exchange rate regime.

Actions were taken to improve the monetary policy operational framework. Open market operations and standing facilities were actively used to attain monetary policy targets. Banks were more interested in one-day deposit operations. The quota applied on standing liquidity absorbing facility was increased at the end of February and removed on August 15. Regular auctions continued to place 28-day (1 month), 84-day (3 months), 168-day (6 months) and 252-day (9 months) notes for sterilization purposes as open market operations. Certain adjustments were made to the conditions of the placement of CBA notes to optimize a competitive environment at note auctions, enhance investor confidence and the effectiveness of liquidity absorbing operations. The Central Bank held total 125 various duration note auctions.

As part of the efforts on the formation of the alternative monetary policy anchor the Management Board of the CBA decided to approve the 'Regulations on calculation and publication of the benchmark rate (AZIR - Azerbaijan Interbank Rate) index at the unsecured interbank money market'. At the same time, the Baku Stock Exchange approved the changes to the 'Regulations on calculation and publication of indexes on transactions concluded in the Repo market', which allows representative interest rate (AINA – AZN INdex Average) indexes to spread at a higher frequency in the secured market. Currently, the CBA and the Baku Stock Exchange regularly publish the AZIR and two types of AINA indexes.

To regulate money supply more effectively, contain the concentration of liquidity across banks and facilitate de-dollarization trends the level and differentiation of reserve requirements were revised in several steps over the year. To avoid pressures over the liquidity management in the banking sector the differentiation rate of reserve requirements was increased gradually.

Monetary reforms positively affected more effective management of liquidity by banks, interbank market activity and the formation of the yield curve. In 2023, banks concluded AZN31.1B worth of 2467 transactions in the platform launched for unsecured operations in the Bloomberg system. AZN4.6B worth of 1246 transactions were concluded at the interbank Repo market.

The Central Bank started to publish the yield curve estimated on government bonds on its website weekly. Yield curves estimated throughout 2023 had an ordinary graphical form.

Interest rates in both unsecured and secured money markets responded to changes in the interest rate corridor. From the end of 2023, interbank interest rates started to enter the interest rate corridor for the first time. The average interest rate on 1-3-day operations (1D AZIR) in the interbank unsecured money market was 7.4% and average interest rates on 6-8-day operations (1W AINAIB) in the interbank Repo market was 7.8% in December 2023. Analyses suggest that interbank interest rates and interest rates of manat denominated deposits of legal entities of certain bank groups move in the same direction as indicative of the improvement of transmission of monetary policy decisions through the interest rate channel.

Central Bank's sterilization operations both supported interbank money market activity and regulation of average interest rates and contained overexpansion of money supply. In 2023 both monetary base in the manat and broad money supply in the manat (M2) increased by 19.6%. Money supply growth mainly stemmed from purchase-oriented interventions of the Central Bank to meet the needs of the fiscal sector. Central Bank's foreign exchange reserves increased by 29.1% to \$11.6B.

In 2023, the Central Bank continued to improve the analysis and forecasting process to strengthen the analytical support for monetary policy decision-making. Analytical initiatives were based on the 'Methodological Guidelines on Forecasting and Policy Analysis System', which came into force with the decision of the Management Board on 21 December 2022. Econometric models used for short and medium-term forecasting were improved. In addition to official statistical indicators, the Central Bank used results of its real sector monitoring and price data regularly received from retail chains in the analysis of inflation processes.

Over the reporting year, the Central Bank's monetary policy became more transparent. Monetary policy-related press releases were published with analytical comments and regular press conferences were held. Monetary policy reviews were made public quarterly. The Central Bank began to publish its own forecasts related to the core macroeconomic indicators (12-month inflation, current account balance, real growth of total and non-oil GDP). Activities of the Bank were regularly highlighted through its official website and social networks. Several educational and analytical materials were released to a wide audience in both written and video formats. Regular meetings continued with financial market participants and independent economic experts. Recognizing the special role of mass media in monetary policy communication, educational events for media representatives also continued.

2.2. Organization of cash circulation, issue of currency to and withdrawal from circulation

The Central Bank covered demand of the economy for cash in full, adequately and in time, and created necessary reserves of currency in 2023.

The Central Bank withdrew AZN8.07B (568.3 million units) worth currency from and issued AZN5.47B (495.5 million units) currency into circulation. Cash in circulation increased by 17.7% (AZN2.6B) (73 million units) to AZN17.31B (947 million units) as of the end-year.

To cover the demand of the economy, the Central Bank created necessary reserves – AZN547.35M (97.87 million units) banknotes and AZN3.6M (18.7 million units) worth coins had been

manufactured and brought to the country. Currently, national currency reserves amount to AZN12.62M (582.8 million units).

To ensure high quality of currency in circulation AZN1.78B (103 million units) worth unfit currency was replaced with new ones in 2023.

In 2023, based on the amendments made to the Law of the Republic of Azerbaijan 'on the Central Bank of the Republic of Azerbaijan', the Central Bank established requirements for the reproduction (imitation) of national currency in accordance with the international experience. The 'Regulation on currency reproduction' developed in accordance with the Law took effect on 3 November 2023. The Bank focused on the organization of anti-counterfeiting and coordination with law enforcement bodies, 521 counterfeit banknotes were discovered in the national currency (AZN42.8 thousand), signs of counterfeiting were discovered in 391 banknotes in foreign currency (AZN57.3 thousand), they were withdrawn from circulation and delivered to law enforcement bodies to take actions.

To accept for expertise and exchange unfit currency held by the population, the Central Bank continued the operation of cash offices established in Baku and regions. In 2023, AZN4M (80,000 units) worth of currency notes were accepted and exchanged from the public. In addition, on 10 May 2023, the Central Bank, in honor of the 100th anniversary of the birth of the National Leader of the Azerbaijani people, Heydar Aliyev, for the first time in the country's history, issued to circulation bullion coins made of high-purity Azerbaijani gold in weights of 1 troy ounce (31.1 grams), 1/2 troy ounce (15.55 grams), 1/4 troy ounce (7.78 grams), and 1/10 troy ounce (3.11 grams).

At the same time, the Central Bank issued commemorative coins made of high-purity Azerbaijani gold, weighing 1 kg, 10 troy ounces (311 grams), 5 troy ounces (155.5 grams), and 1 troy ounce (31.1 grams) to immortalize the 100th anniversary of the birth of the Great Leader Heydar Aliyev. These commemorative coins are intended for special state events. Note that, a total of 2,530 commemorative and bullion coins were sold over the period. In 2023, commemorative coins were sold through the 'Azersouvenir' LLC under the Affairs Department of the President of Azerbaijan Republic, while bullion coins were sold through designated agent banks.

At the same time, the Central Bank selected operator banks and outsourced certain business processes to make the organization of cash circulation more effective and efficient.

2.3. Regular establishment and announcement of the official exchange rate of manat against foreign currencies

Huge balance of payments surplus had a positive effect on the FX market equilibrium and supported the exchange rate stability, the key price stability anchor.

The Bank held a total of 96 currency auctions in 2023 to sell foreign currency provided by the SOFAZ. At 92% of currency auctions supply prevailed over demand, average demand amounted to \$40.4M vs \$70M worth supply. The Central Bank made \$2.1B worth purchase-oriented interventions in the FX market. Despite high exchange rate volatility in some trade partners, the manat remained stable.

The official AZN/USD exchange rate based on the average exchange rate on interbank transactions over the period (both auction and over-the counter on the Bloomberg platform) and was AZN1.7 on a daily average. Commercial banks' average buy/sell rate was 1.6945 /1.7020.

The exchange rate of the manat fluctuated differently against currencies of other trade partner countries. The dynamics of bilateral exchange rates influenced that of effective exchange rates. 19.3% appreciation of the non-oil NEER of the manat neutralized part of imported inflation.

2.4. Storage and management of international gold-foreign exchange reserves at disposal of the Central Bank

In 2023, Central Bank's FX reserves were managed under conditions of high interest rates in foreign financial markets, amidst ongoing tight monetary policies by leading central banks as part of efforts to combat global inflationary pressures. The successful moderation of inflation towards target levels by these tight monetary policies in AEs, without causing a crisis, led to a reduction in global economic downturn expectations by the end of the year and a decrease in the high volatility in foreign financial markets. As a result, unlike in previous years, most segments of foreign financial markets exhibited high profitability during the reporting year.

The Central Bank adopted a new strategy and regulations to improve the framework for managing its FX reserves. In accordance with the new strategy and regulations, the operational investment program for managing the Central Bank's FX reserves for 2023 was approved.

According to the operational investment program of 2023, the Central Bank's FX reserves were managed by dividing them into an operational tranche to support monetary policy and an investment tranche to enhance profitability. The Central Bank's FX reserves were invested in government and quasi-government debt liabilities with investment-grade credit ratings from foreign countries, based on benchmarks set according to the objectives of each tranche and sub-portfolios. Although most of the FX reserves were managed within the internal management framework, cooperation with external managers continued during the reporting period. As of end-2023, 88% of official FX reserves were in U.S. dollars, 4% in euros, 2% in British pounds, and 6% in SDR (Special Drawing Rights of the International Monetary Fund).

Due to the favorable environment for fixed-income securities in foreign financial markets and the portfolio strategies implemented to increase relative returns, total income from managing the Central Bank's FX assets reached a record amount of \$466.5M, with an investment portfolio return of 4.73%. Overall, yield on the investment portfolio was higher than the weighted average return of the benchmarks applied to sub-portfolios.

The Central Bank's official FX reserves increased by \$2,617.3M or 29.1% during the reporting period due to currency purchases from the domestic market, income from management, and exchange rate differences, reaching \$11.6B as of end-2023.

2.5. Compilation of monetary, financial markets and payment system statistics, the balance of payments, international investment position, and summary foreign debt statistics, ensuring the summarization and dissemination of data, as well as participating in forecasting of the balance of payments in accordance with international standards and methodologies

In 2023, the statistics on monetary, financial markets, and payment systems was still compiled based on relevant international standards.

Monetary statistical data, including the Central Bank's analytical balance, monetary indicators, money aggregates, and other related metrics, were compiled in accordance with international

standards and presented to relevant public authorities, international organizations, and the public via the Central Bank's official website. As part of the data dissemination schedule, monthly updates on aggregate indicators of banks and other financial institutions were provided for the section of the IMF's website dedicated to Azerbaijan.

Current monetary statistic data were further improved in accordance with relevant classifications and international methodological recommendations. The publicly disclosed statistical bulletin was improved and the scope of the data was expanded. The bulletin now also includes information on several indicators related to the insurance sector. After the Law of the Republic of Azerbaijan 'on Payment services and payment systems' took effect, the Central Bank continues efforts to expand the coverage of payment system statistics provided by payment institutions, non-bank credit institutions and payment system operators. New indicators regarding internet banking, mobile banking, payment transactions conducted through the interbank card center, payment card transactions conducted abroad, and statistics on the payment service network by economic regions were included in the Central Bank's monthly statistical bulletins and presented to the broad public.

Over 9 months of 2023, the balance of payments continued to be compiled based on relevant international standards (BPM6). Cross-checks and clarifications conducted through the International Transactions Reporting System (ITRS) enabled further improvement of the reporting and accounting system for the balance of payments. During the reporting year, several cross-checks with banks' financial statements were implemented to enhance the accuracy and processing of statistical indicators within the ITRS framework. Additionally, starting from April 2023, the process of compiling the report was initiated based on the 'Guidelines for the preparation and submission of statistical reports on external debt and international investments', approved by Decision No. 18/1 of the Management Board of the Central Bank. This included cross-checking and clarifying operations.

Obtaining detailed information from several public institutions and entities (mainly the Ministry of Finance and SOCAR) enabled the clarification of data related to foreign investments (direct, portfolio, and others) and corresponding interest payments. Additionally, through data sharing with the State Tax Service under the Ministry of Economy, quarterly indicators for royalties and license services covering the years of 2018-2021 were also clarified and included in the relevant section of the balance of payments, and subsequently submitted to the International Monetary Fund.

Considering the latest macroeconomic trends, the Central Bank conducted regular consultations with relevant authorities regarding the forecasting of the balance of payments in 2023 and sent necessary inquiries to several large state enterprises. To support the preparation of medium-term socio-economic development forecasts, extensive information on the balance of payments and an official opinion on the final forecasts were delivered to the Ministry of Economy.

In the first nine months of 2023, the collection and consolidation of data on aggregate external debt statistics and the balance of international investments continued. The external debt statistics and international investment balance were compiled by the Central Bank based on data from the Ministry of Finance, commercial banks, the State Statistical Committee, the National Depository Center, and oil and gas enterprises and organizations. Along with indicators on state and state-guaranteed loans, government and corporate securities, payables and receivables, the statistics also took into account

information provided by banks. These aggregate statistics on external debt and international investments were submitted to relevant public authorities and international organizations.

To enhance the collection, consolidation, and analytical capabilities of aggregate external debt statistics and international investment balance data, the process of gathering statistical information was carried out starting from the first quarter of 2023 in accordance with the 'Guidelines for the preparation and submission of statistical reports on external debt and international investments,' approved by Decision No. 18/1 of the Management Board of the Central Bank.

At the same time, to enhance analytical capabilities of aggregate external debt statistics and the balance of international investments, aggregate reports that include a breakdown by government and non-government sectors were prepared in accordance with international standards and methodologies. As part of these initiatives, the automation process for processing foreign debt data, presented in a new format by the Ministry of Finance, completed, and separate statistics for state and state-guaranteed external debt by currency was established.

2.6. Maintaining stability and sustainability of financial markets, regulation, and supervision of financial markets, including macroprudential regulation and supervision

The banking sector

Amid the uncertainties stemmed from complex geopolitical processes, the banking sector continued its stable performance. Throughout 2023, the capital and liquidity indicators of the banking sector significantly exceeded regulatory norms, and profitability indicators improved. The credit portfolio growth contributed to economic activity as part of macroeconomic and financial stability goals.

In 2023, the financial stability of the banking sector was closely monitored within the supervisory framework. Credit risks, trends in the FX market, and dollarization were regularly tracked, payment channels that gained relevance due to the impact of geopolitical processes were monitored, and the current financial condition of banks was assessed. Over the reporting period, comprehensive inspections were conducted in 6 banks, a thematic inspection was conducted in 1 bank.

In 2023 banking licenses issued by the Central Bank to two banks were revoked. By the decision of the Management Board of the Central Bank of 16 May 2023 the license of Gunay Bank OJSC was revoked from 17 May 2023 in accordance with relevant articles of the Law of the Republic of Azerbaijan 'on Banks' due to the fact that the amount of total regulatory capital fell below the minimum amount set for banks, the capital adequacy ratio of total regulatory capital was below 3 percent, and the bank failed to maintain its current activities reliably and prudentially. Assets of Gunay Bank OJSC accounted for 0.6% of total banking system assets, 1% of the lending portfolio and 0.5% of total liabilities of the sector. By the decision of the Management Board of the Central Bank of 18 October 2023 the license of Mugan Bank OJSC was revoked from 19 October 2023 in accordance with relevant articles of the Law of the Republic of Azerbaijan 'on Banks' due to the fact that the amount of total regulatory capital fell below the minimum amount set for banks, the capital adequacy ratio of total regulatory capital was below 3 percent, the bank failed to maintain its current activities reliably and prudentially and the bank's internal management and control procedures were not adequate. Assets of Mugan Bank OJSC accounted for 1.4% of total banking system assets, 2% of the lending portfolio and 1.3% of total

liabilities of the sector. The revocation of the licenses of these banks did not threaten banking sector's financial resilience and stability.

As of 31 December 2023, there were 23 active banks, including two state-owned banks in the country. Among the banks in operation, 9 banks have foreign capital participation in their capital structure. Banks provide their services through 475 branches, 96 divisions (including currency exchange outlets), 3040 ATMs, as well as 23569 employees. Over the reporting period total regulatory capital of the banking sector increased by 8% (AZN417M) to AZN5.6B. Banking sector's capital adequacy (17.5%) exceeded the minimum regulatory requirement by about 1.7 times (12% for systemically important banks, 10% for other banks). In 2023 net profit of the banking sector y.o.y increased by 18% (AZN162M) to AZN1.1B.

Bank lending was high in 2023. Banks' lending portfolio increased by 18.3% (AZN3.6B) to AZN23.2B. Consumer portfolio increased by 20.6%, mortgage portfolio by 21.6%, and business portfolio by 16.2%. As of 31 December 2023 business loans accounted for 54.4% of total lending portfolio. Note that, in 2022 banks' lending portfolio increased by 17.6% (AZN2.9B), and by 17.7% (AZN2.5B) in 2021.

There was continued activity in inquiries to the Azerbaijan Credit Bureau (Bureau). From the time the Bureau began operations until December 31, 2023, the total number of inquiries reached 172.1 million (including 139.6 million bulk inquiries), while the number of scoring inquiries reached 5.3 million. In 2023 alone, the total number of inquiries received by the Bureau was 53.5 million (including 41 million bulk inquiries), and the number of scoring inquiries was 0.7 million.

Liquid assets amounted to AZN13.2B (27%) of total assets. The instant liquidity ratio was 52%, over 1.7 times more than the minimum regulatory requirement (min. 30%). Total liabilities of the sector increased by 4.1% (AZN1.7B) to AZN43.1B. Deposits accounted for 80% of total liabilities: AZN12.6B deposits of the population (excluding individuals engaged in entrepreneurship). In 2023 deposits of the population increased by 9.6% (up by 20.2% in national currency, down by 6.5% in foreign currency).

De-dollarization of deposits and the lending portfolio continued – dollarization decreased by 5.8 pp to 34% in deposits of the population, by 9.8 pp to 41% on deposits of individuals (excluding financial sector deposits), and by 1.2 pp to 18.8% on the lending portfolio.

The banking sector's term loans increased by 81% to AZN501.7M. However, the share of foreign debt in liabilities of the banking sector remains low. As of 31 December 2023 foreign debt accounted for just 2% of total liabilities of banks.

In 2023 the Central Bank took appropriate measures to improve the banking sector regulatory framework. To align the existing regulatory framework with advanced international standards, the regulatory framework for liquidity risk management was updated. According to the newly adopted regulation, the Bank launched a *liquidity coverage ratio* (LCR ratio) for both aggregate and foreign currency, which is based on historical data related to customer behavior and prepared in accordance with the approach of the Basel Committee for banking supervision. The purpose of the ratio is to ensure the bank's ability to continue its uninterrupted operations, including full and timely execution of obligations, by maintaining liquidity resilience in the short-term horizon of 30 days under stressed conditions.

To enhance corporate governance in banks, related progressive international practices were reviewed to revise the 'Corporate governance standards in banks' accordingly. The new standards address optimizing the boundaries between banks' oversight and management functions, enhancing powers of supervisory boards, setting requirements for the composition of supervisory boards (including the appointment of an independent board member and defining criteria for the independent member), improving functions related to risk management, internal control, internal audit, and compliance, engaging independent external experts, applying a risk-based approach in the remuneration system, and other related issues.

To stimulate banks' *lending to the real sector*, and enhance the role of banks in financing agriculture, the Central Bank revised some regulations to establish differentiated prudential requirements for agricultural loans (AG loans). The changes to the regulations encompass the classification of AG loans, the application of loan loss provisioning, restructuring, risk weights, and additional underwriting requirements, taking into account the characteristics of AG loans and sector inherent risks.

Additionally, as part of enhancing the existing regulatory framework, the Bank specified requirements for restructured loans, and project financing loans. Special classification requirements were established for the loans of borrowers who temporarily lost their source of income (employment), creating opportunities for restructuring. Additionally, project financing loans were considered fully secured loans and exempted from the concentration limit for unsecured loans. Furthermore, according to the latest changes in the Central Bank's relevant regulations aimed at *promoting the use of environmentally friendly vehicles*, loans for the purchase of electric and hybrid vehicles that meet the relevant criteria for the production year are exempt from the additional provisioning requirement related to the borrower's high debt-to-income ratio.

The insurance sector

In 2023, there were 17 insurers, 1 reinsurer, 1 mutual insurer ('Aqrar Sığorta Müştərək Sığorta Şirkəti' OJSC), 24 insurance brokers and 481 insurance agents in the insurance sector. In accordance with scheduled comprehensive inspections the Central Bank conducted next comprehensive inspection in four insurers and one insurance agent, and revoked insurance licenses of 'Günay Sığorta' OJSC and 'Naxçıvansığorta' OJSC based on their voluntary requests. In the process of liquidation, the Bank regularly implements supervisory measures to protect the rights of the insured and creditors.

Insurance premiums y.o.y. increased by 26% to AZN1223M, and insurance payments increased by 36% to AZN587M. Insurance premiums of both life and non-life insurance companies grew by 26%.

Draft amendments to the insurance legislation, which envision the improvement of insurers' activities, the implementation of risk-based supervision of the insurance sector, the enhancement of control over its financial resilience, and other related directions in accordance with international legislation and insurance principles, was adopted at an extraordinary session of the Milli Majlis of the Republic of Azerbaijan on July 6, 2023. Additionally, during the reporting period, the project related to the transition to risk-based regulation and supervision continued to be implemented, and the Management Board with its relevant decisions approved the 'Regulation on investment operations of insurers', and the 'Regulation on the content, form, and submission of the actuarial report', the

'Regulation on setting limits and requirements for reinsurance of risks with foreign insurers, as well as requirements for insurers' and reinsurers' reinsurance policies and reinsurance of catastrophic risks'.

The digitalization of insurance services was one of the priority directions of the Central Bank's activities, and measures continued to facilitate the signing of compulsory insurance agreements as an electronic document. To expand consumers' access to certificates in an electronic document form and accelerate the transition to digitalization, new requirements for the content and form of existing insurance certificates for certain types of compulsory insurance (compulsory property insurance, compulsory third party liability insurance associated with the use of the property, and compulsory personal accident insurance of passengers) were prepared and approved by the decision of the Central Bank's Management Board dated 12 April 2023.

In line with the communication strategy based on the Memorandum signed between the Central Bank, the Compulsory Insurance Bureau, and the Azerbaijan Insurers Association, extensive promotion and awareness-raising activities were carried out to educate the public about insurance. As part of efforts to enhance citizens' insurance literacy, educational trainings were conducted for university students and company representatives, along with public awareness campaigns in mass media. Additionally, competitions were held among students of higher and secondary specialized education institutions in connection with the 100th anniversary of the National Leader Heydar Aliyev. The first insurance festival in the Republic of Azerbaijan was held from August 26 to September 10, 2023, covering several regions. Certificates were awarded to individuals who achieved successful results in the distance courses presented on the Central Bank's virtual education platform (edu.e-cbar.az).

Efforts to expand the human resource potential of the insurance market continued, and training is currently being conducted based on the Actuary Development Program, which consists of theoretical and practical components.

Capital markets

During the reporting year, intensive measures were taken to increase the efficiency of regulation and supervision of the securities market, align the legal framework of the capital market with international standards, improve the operational infrastructure, and support supply and demand in the market. Four inspections were conducted during the reporting period.

The amendments to the Law of the Republic of Azerbaijan 'on the Securities Market' that took effect on 31 July 2023 are intended to simplify the requirements for the issuance of securities by international organizations to which the Republic of Azerbaijan is a member, enable the National Depository Center to perform the functions of a depository for investment funds and provide limited financial services, allow banks to provide investment services as determined by the Central Bank in a specified volume and manner, and exempt issuers of bonds placed through public offering from the requirement to approve the report on the results of the issuance. The 'Regulation on the issue, public offering, and circulation of investment securities of international organizations, Azerbaijan is a member of' developed in accordance with the amendments to the Law took effect on 31 October 2023.

To increase the access of issuers and investors to the capital market, the Central Bank continued efforts to create an incentivizing tax regime in the capital market, establishing economic and fiscal

incentives. From 1 February 2023, for a period of 5 years, dividends, discounts, and interest income from shares and bonds that are publicly offered and traded on a regulated market were exempted from taxes. At the same time, the calculation of interest tax on bonds was aligned to international practices.

To establish a legal framework for green bonds, draft amendments to the Civil Code prepared by the Central Bank were discussed with the relevant public authorities. Additionally, work began, in cooperation with the World Bank, on developing relevant regulations covering the scope of projects financed through the issuance of green bonds, criteria for those projects, the use of raised funds, and other related issues.

In 2023, the Central Bank, in association with the Mortgage and Credit Guarantee Fund (MCGF), launched a bond guarantee mechanism, under which the Fund is expected to provide guarantees for obligations of bond issuers.

A project for creating a mechanism for investor insurance in the capital market was developed and presented to the Economic Council in July of the reporting year. The aim of the project is to provide insurance payments to customers of investment companies that have become insolvent, enhance the protection of investors' rights in the capital market through this method, and promote investor participation in the capital market. Currently, based on the Economic Council's protocol instructions, work is underway to establish a legal framework of the project in cooperation with the Deposit Insurance Fund, with the involvement of foreign technical expertise.

To improve the capital market infrastructure and enhance the access of foreign investors to the local capital market, a nominal custodian account for Turkey's central depository was opened at the National Depository Center. In H1 2023, a project was initiated with the support of the Asian Development Bank to determine the directions for improving the operational infrastructure of the National Depository Center.

To launch a modern information system in the capital market, both the Baku Stock Exchange and the National Depository Center completed work on trading and depository systems, which were launched on 31 March 2023. The system facilitates the organization of trading and post-trading environments in line with modern technical standards, optimizes processes, and enhances efficiency.

During the reporting period, efforts to promote private sector financing initiatives in the capital market and listing on the stock exchange continued. The Baku Stock Exchange continued to reward investment companies providing underwriting services. Intensive awareness-raising activities were organized with the participation of international financial institutions, the Baku Stock Exchange, the Small and Medium Business Development Agency (KOBIA), the Confederation of Entrepreneurs of Azerbaijan, the Entrepreneurship Development Fund, and investment companies, aimed at increasing the knowledge of potential issuers and investors about the market and enhancing professionalism in capital markets in general.

Total trade turnover in the securities market amounted to AZN28.1B. The corporate securities market y.o.y. grew by 4%, the government securities market by 1%, and repo transactions by 3.4 times. The amount of transactions conducted at the Baku Stock Exchange was AZN27.3B, the size of trade in primary market segment of the corporate securities market increased by 22%. The amount of transactions conducted in the government securities market made AZN8405M. The Ministry of Finance held 51 auctions on the placement of government bonds, AZN3734M worth government bonds were

placed with the Baku Stock Exchange. Total amount of repo transactions was AZN17384M, 80% of transactions were conducted with government bonds, while 18% were conducted with CBA notes. Repo transactions with government bonds jumped by four times, those with CBA notes by two times and those with corporate securities by three times. The Central Bank state registered AZN10638.7M worth stocks and bonds, a total of 34 emission prospectuses and 4 information memorandums, with a total amount of AZN548.2M for corporate securities' public offerings, were approved.

2.7. Ensuring stable, secure, and effective operation and supporting the development of payment systems

One of the priority directions of the Central Bank was to ensure stable, safe, and effective operation of payment systems. The Bank focused on cyber resilience on the backdrop of global digitalization.

Total value of payments made through the core components of the National Payment System – the Real Time Gross Settlement System (AZIPS), the Low Value Payment Clearing and Settlement System (LVPCSS) and the Instant Payments System (IPS) y.o.y increased by 2.2 times to AZN766.4B (6.2 times of GDP), and the number of payments increased 51.4% to 147.7 million units.

Payments are collected for over 1100 services across the institutions integrated to the Government Payments Portal (GPP). Total value of transactions conducted over the GPP amounted to AZN6.9B, cashless transactions account for 68.7% of these transactions. Total value of transactions y.o.y. increased by 37.4%, and the value of cashless transactions increased by 42.7%. The value of transactions processed in the national currency over the Interbank Card Center was AZN18.9B, in foreign currency it was USD51.2M and EUR22.7M.

Relevant work was conducted under the Actions Plan of the 'Digital Payments Strategy of the Central Bank of the Republic of Azerbaijan for 2021-2023' elaborated to develop cashless payments. The Central Bank's 'Financial Sector Development Strategy' for the next strategic period covering the years 2024-2026, outlines the strategic directions, actions to be taken, and key performance indicators related to the payments section. The strategy aims to modernize the National Payment System, create a favorable market environment for participants, and establish an effective oversight framework to increase access to payment services through the implementation of innovative solutions, enhance transparency and competitiveness in the payments market, and ensure the efficiency and security of payment services.

As of end-2023 the number of payment cards in circulation was 16.9 million units, ATMs 3.1 thousand units and POS-terminals 86.4 thousand units. The value of domestic payment card transactions doubled to AZN49B. The number of e-commerce transactions y.o.y. increased by 2.2 times, while their value increased by 2.1 times. The weight of domestic card payments y.o.y. increased by 12.4 pp to historical highs (55.6%). The value of Internet banking transactions y.o.y. increased by 12%, while the value of mobile banking transactions doubled.

The Law of the Republic of Azerbaijan 'on Payment services and payment systems' developed to improve the legal framework for payment services and enhance legal protection of payment service users took effect on 9 November 2023. Draft regulations were developed in accordance with the requirements of the Law, discussed with market participants and improved.

The promotion of digital payments, awareness-raising, and advocacy for cashless payments were also kept in focus and numerous promo and educational events were organized in association with international card institutions and relevant authorities. Based on the '2023 Financial Literacy Actions Plan in Digital Payments,' prepared in cooperation between the Central Bank and the Azerbaijan Banks Association, educational video, and audio clips about frauds during the use of payment cards were produced. These clips were continuously broadcast on social media accounts of the Central Bank and banks, as well as on TV and radio channels.

2.8. Taking actions to protect the rights of consumers and investors and promoting financial literacy initiatives in financial markets

The Central Bank took necessary actions to prevent violation of the rights of consumers and investors and ensure restoration of violated rights based on received appeals in 2023.

A total of 77509 appeals were received from consumers and investors in writing, via the hotline and WhatsApp. 67.5% out of 11984 written appeals were related to the banking sector (8100 appeals), 23.5% (2826 appeals) to the insurance sector, 3% (360 appeals) to the capital market and 6% (698 appeals) to other matters. 61713 calls to the hotline 966 were promptly responded, meetings were held with 1613 citizens, 2199 appeals received through the WhatsApp were handled.

Mobile receptions for citizens were conducted in the regional reserve centers and several cities. To enhance the access of investors and other capital market participants to the National Depository Center, a '966-0' hotline was launched, and efforts were made to raise awareness about it. An agreement was signed with 'Aztelekom' LLC to cover the costs of calls made to the '966' hotline from landline phone networks in the regions (excluding the Nakhchivan Autonomous Republic (NAR)). Efforts were also undertaken to increase awareness about the '2244' hotline created for financial service consumers in the NAR. A 'Reception Room' for citizens and a Consumer Finance Protection Section were established at the Central Bank's NAR Office.

To measure the satisfaction level of citizens regarding written responses to appeals by the Central Bank and evaluate the performance of the relevant structural unit, a survey option was included in the response letters for assessment purposes. Additionally, to enhance transparency, it was decided to disclose the complaint index regarding bank customers' use of banking services monthly on the Central Bank's official website. For written appeals received on paper where the citizen's mobile number is provided, an SMS notification began to be sent to the applicant regarding the registration and response to the application. Several updates were made to the Bank's official website and were made available for the use of investors and issuers.

A memorandum was signed between the Mediation Council and the Azerbaijan Banks Association (ABA) and the Azerbaijan Micro-finance Association (AMFA) with the support of the Central Bank. The Central Bank, together with relevant institutions, held a scientific conference on the topics 'Successful Ways of Resolving Banking Disputes' and 'Successful Ways of Resolving Insurance Disputes.' An accessibility menu was created on official websites of banks.

Efforts to raise financial literacy continued, with 116 training sessions conducted for various target groups. A total of 1,428 participants attended these traditional and online training sessions.

Additionally, virtual, and in-person competitions were organized. 30 students from different regions attended the 'Financial Health' summer school.

In celebration of International Savings Day and Financial Literacy Month, a competition was held in cooperation with the Mastercard international, which included a virtual course on 'Banking and Digital Payments' for school students, as well as three virtual courses on the Virtual Education Platform for teachers from secondary schools. The competition saw the participation of 153 students and 6 teachers from 16 cities and regions of the country.

In the insurance sector, two major projects titled 'Training Professional Staff' and 'Increasing Insurance Literacy, Awareness, Promotion, and Irresistible Measures' continued, along with actuarial courses organized within the framework of cooperation between the Central Bank, the Turkish Insurance Institute Foundation, and the Azerbaijan Insurers Association.

The content of the financial literacy portal (bizimpullar.az) was enriched, and the portal received 26,562 visitors with 146,529 views throughout the year. New courses were added to the Central Bank's Virtual Education Platform (edu.e-cbar.az), and the 'Taxes and Taxation' distance course was updated and made available. For those who completed their education on the platform, 1,732 final exams were organized, and 1,182 relevant certificates were prepared and presented. The Virtual Education Platform received 44,749 visitors with 1,671,635 views throughout the year.

The registry in the financial products and services information search system (infobank.az) was updated according to relevant categories, and the system received 13,785 visitors with 38,438 views during the year. Materials related to financial literacy were regularly shared on social media.

2.9. Currency regulation and control

The Central Bank performs the currency regulation and control function in accordance with the Law of the Republic of Azerbaijan on 'Currency Regulation' and adopts related regulations. The currency regime applied in the country contributes to the stability of the foreign exchange market within the framework of complex measures aimed at ensuring financial stability.

Currency regulation efforts primarily aimed at increasing the effectiveness of currency control, strengthening the fight against illegal currency operations, as well as eliminating unnecessary difficulties created by the current currency regime for the population and supporting foreign trade activities of business entities. Specifically, to ensure transparent and secure conduct of currency exchange operations, prevent the shadow economy, and effectively control currency exchange operations, the Central Bank, based on amendments made to the Law of the Republic of Azerbaijan on 'Currency Regulation' on July 6, 2023, approved the 'Regulation on currency exchange operations by currency exchange license holders and on supervision of currency exchange operations' on 11 December 2023. The regulation specifies capital requirements for currency exchange outlets, the cap of their currency exchange operations, and improvements in collateral regulation. The amendments to the law generally created a legal basis for the institutionalization of currency exchange outlets (designated as a specialized activity) and for increasing the transparency of their capital (requirements for qualifying holding owners and beneficial owners were established).

To improve currency regulation within the framework of the said objectives, several changes were made to the 'Regulations on currency operations of residents of the Republic of Azerbaijan in foreign

currency, as well as non-residents in national and foreign currencies,' which were approved by the Central Bank's Decision No. 45/1 dated 28 November 2016, on 26 July 2023. According to the changes, daily limits on amounts transferred abroad by individuals for personal purposes are abolished, and a monthly limit of up to 20,000 (twenty thousand) US dollars or its equivalent are established regardless of the transfer method (whether through an account or otherwise), the documentation process for transfers related to imported goods is simplified, the possibility of advance payments of up to 180 days to the seller based on a bank guarantee or letter of credit by intermediaries in trade mediation transactions is introduced, and a special regime for advance payments related to air, sea, rail, and space objects is provided, taking into account problems arising from the current regulations. Additionally, the Regulations specify a cash withdrawal limit for resident individuals with payment cards issued in the Republic of Azerbaijan, with a limit of up to 10,000 (ten thousand) US dollars or its equivalent per calendar month.

Additionally, to enhance the effectiveness of currency control, the 'Statute on a single information system on currency operations' was approved by the Central Bank's Management Board Decision No. 62/1 dated December 20, 2023, in accordance with the Law of the Republic of Azerbaijan on 'Currency Regulation.' The Statute establishes the legal, organizational, and technological foundations for the formation, operation, and use of a single information system for monitoring currency transactions conducted by residents and non-residents, as well as the types of information to be provided to the information system. Taking into account the need to adapt to the requirements of the information system, the Central Bank's decision specifies that information on currency exchange operations should be submitted to the system starting 1 March 2024, and information on foreign currency transfers outside the Republic of Azerbaijan should be submitted starting 1 July 2024.

2.10. Oversight of deposit insurance scheme

The Central Bank continued its activities on the oversight of the deposit insurance scheme. The main objectives included planning and organizing resolution measures related to supervised entities, as well as implementing oversight measures for the activities of liquidators (liquidation commissions, asset managers) of supervised entities undergoing liquidation.

Additionally, a project was developed for calculating and collecting insurance premiums paid by participating banks to the Deposit Insurance Fund on a risk-based framework with respect to participating banks, which is currently under discussion.

In 2023, depositors of 'Gunay Bank' OJSC and 'Mugan Bank' OJSC, which had been declared bankrupt, received 97% and 92% of their protected deposits, respectively. As of 31 December 2023, compensation totaling AZN34.2M was paid to 2,176 depositors of 'Gunay Bank' OJSC undergoing liquidation, and AZN187.5M was paid to 6,405 depositors of 'Mugan Bank' OJSC undergoing liquidation.

3. Financial results of Central Bank's activities

According to the International Financial Reporting Standards, as of 31 December 2023, the Central Bank's revenues amounted to AZN748.3M. Of which, AZN572.1M came from interest, revaluation, and conversion gains on currency assets, AZN34.4M from interest on securities obtained in the domestic market, AZN2.1M from interest on centralized credit resources, and AZN24.1M from

services provided to clients. Additionally, revenues included AZN47.9M from the initial recognition of financial liabilities (deposits attracted from the International Bank of Azerbaijan OJSC (IBA)) at fair value, AZN14.2M from amortization of financial assets (loans provided to the Deposit Insurance Fund), AZN3.0M from changes in the fair value of those assets, and AZN0.6M from revenues related to derivative financial instruments in the domestic market. Furthermore, AZN1.1M was derived from the sale of commemorative and bullion coins, among other sources. The accounting income from the revaluation of the currency position was AZN48.8M.

The Central Bank's total expenses amounted to AZN399.0M, of which AZN226.2M were operational expenses. The operational expenses primarily consisted of costs arising from the Central Bank's sterilization operations, including AZN109.3M in interest expenses on deposits attracted from banks, AZN96.6M on CBA notes, and AZN0.3M on Repo transactions with banks. Additionally, operational expenses included AZN2.1M in commission costs for transactions in foreign financial markets, AZN2.5M in interest expenses related to the SOFAZ and the Deposit Insurance Fund, AZN0.6M in net interest expenses to the IMF, AZN1.2M in costs associated with bringing in foreign cash, and AZN13.6M in costs for the production and transportation of banknotes and coins (including commemorative coins).

After deducting operational expenses, remaining expenses included AZN24.8M in reserves created for depreciated financial assets, AZN0.8M in costs related to the depreciation of securities, AZN5.0M in accounting losses from derivative financial instruments managed by an external manager, AZN94.4M in administrative and other traditional expenses, including AZN43.5M in employee salaries and contributions to the State Social Protection Fund, AZN30.5M in depreciation of fixed assets and intangible assets, AZN2.3M in accounting losses related to the liquidation of intangible assets, and AZN18.1M in other traditional expenses (such as software and server support, maintenance and security of administrative buildings, and travelling expenses).

Amortization costs of financial liabilities on deposits attracted from the IBA amounted to AZN47.8M.

Consequently, as of 31 December 2023 Central Bank's financial activities resulted in a profit of AZN349.3M.

As of the reporting period, the Central Bank's total equity amounted to AZN1,547.9M, including accumulated accounting income of AZN53.0M from fair value through other comprehensive income as of 31.12.2023.