CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

Financial Stability Report

2024

FINANCIAL STABILITY DEPARTMENT

Central Bank of the Republic of Azerbaijan

FINANCIAL STABILITY REPORT*

*** Data referenced in this report pertains to the period ending December 2024.**

ACRONYMS

AEs – advanced economies

NBCI – non-bank credit institution

ADB – Asian Development Bank

NC – national currency

CBA – Central Bank of the Republic Azerbaijan

OCP – open currency position

CA – capital adequacy

OVDL – overdue loans

CAR – capital adequacy ratio

pp – percentage point

DTI – debt-to-income ratio

ROA – return on assets

EMEs – emerging market economies

ROE – return on equity

FX – foreign Exchange

RWA – Risk weighted assets

GDP – gross domestic product

SCC – State Customs Committee

GS – government securities

SOFAZ – State Oil Fund of the RA

HP – Hodrick-Prescott filter

SSC – State Statistics Committee of

IMF – International Monetary Fund

WB – World Bank

LE – legal entity

yoy – year over year

MCGF – Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan

MSME – Micro, small, and medium enterprises

MLSPP – Ministry of Labor and Social Protection of the Population

NPL – non-performing loans

NGS – non-government securities

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Executive summary

In 2024, the Central Bank's core financial stability priorities included maintaining confidence in the financial-banking system, minimizing systemic risks, and enhancing the financial sector's governance capacity and resilience to external shocks.

The macroprudential, regulatory, and supervisory measures implemented throughout the year contributed to the stable functioning of all segments of the financial sector and bolstered overall financial system stability.

During the year, the CBA approved and published the macroprudential policy framework for the banking sector and the 'Risk-based supervision policy' concept documents.

The banking sector's financial intermediation function further deepened in parallel with active lending. The expansion of the balance sheet on the backdrop of higher confidence in the banking sector, the new monetary policy operational framework, and the macroprudential policy framework, was supported by term deposits, recognized a more sustainable funding source. Meanwhile, credit risk declined, supported by improvements in the regulatory framework and effective risk management practices by credit institutions amid a growing lending portfolio.

Banking sector liquidity remained in the comfort zone. The liquidity position has been aligned to the new monetary framework and the prudential tools application framework. All banks exceeded the liquidity coverage ratio (LCR) set in aggregate and in foreign currency. The instant liquidity ratio stands at 52% (22 pp above the minimum threshold). Liquid assets accounted for 27% of the sector's total assets, and increased reserve requirements created a solid buffer against potential liquidity shocks.

The banking sector's foreign currency position remained within prudential limits, and the de-dollarization trend continued. In 2024, the dollarization of the lending portfolio declined by 2.7 pp to 16.1%, while the dollarization of the deposit portfolio decreased by 0.9 pp to 37.5%.

Profitability in the banking sector maintained a positive trajectory, with net profits exceeding AZN1B. As of end-2024, the capital adequacy ratio stood at 17.6% (1.8 times the minimum regulatory requirement). ROA was 2.1%, and ROE reached 18.1%

To enhance resilience and support uninterrupted lending, a decision was made to introduce a 0.5% countercyclical capital buffer on banks' total regulatory and Tier I capital, effective from March 1, 2025. This decision was influenced by high lending growth, strong profitability, and robust capital adequacy indicators in the banking sector.

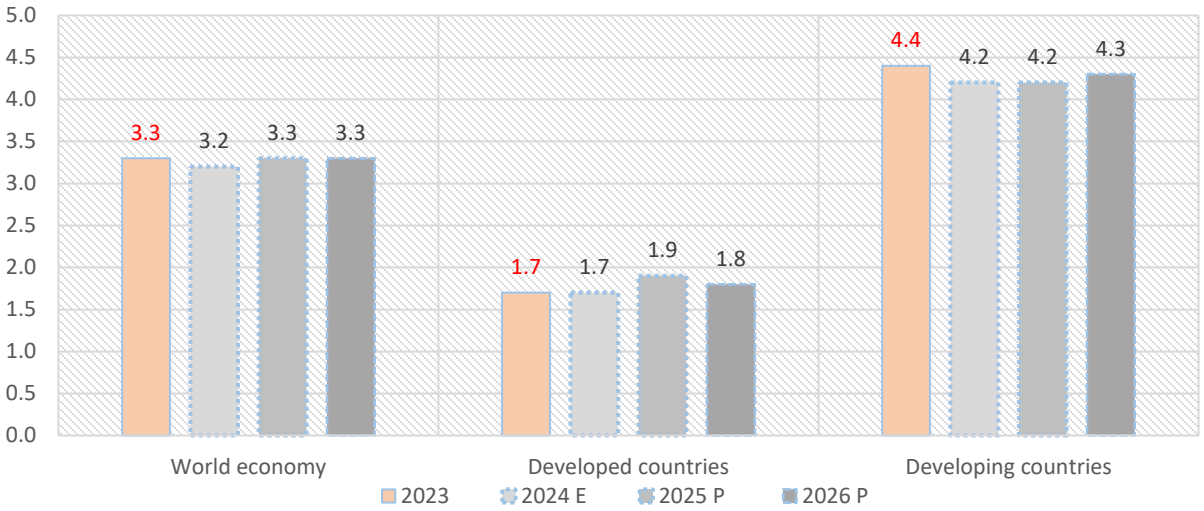
The insurance market continued to deepen, evolving into one of the key institutional investors within the financial sector. During the reporting year financial indicators of the insurance sector improved, aided by higher inclusiveness and depth. In 2024, insurance premiums yoy increased by 11% to AZN1.4B, while insurance payments increased by 26% to AZN737M. The sector remained profitable, with total regulatory capital exceeding the minimum required capital by more than 1.9 times.

Although investment companies currently hold a relatively small share of the financial system, the sector demonstrates significant growth potential. Securities circulation in the capital market saw a substantial year-over-year increase. Efforts continued to modernize the capital market infrastructure and enhance the regulatory environment.

Global macroeconomic environment

In 2024, the global economy maintained its growth rate despite a complex environment marked by geopolitical tensions and economic policy uncertainty. According to the IMF, global economic growth stood at 3.2% in 2024. Economic growth in AEs remained unchanged year-over-year (1.7%). Although the economy in EMEs grew by 4.2% in 2024, year-over-year it was 0.2 pp lower. In general, global economic growth in 2024 remained below the average pre-pandemic levels. The U.S. economy performed better-than-expected and the euro area and certain EMEs posted weak economic results due to structural issues and shifts in the trade policy.

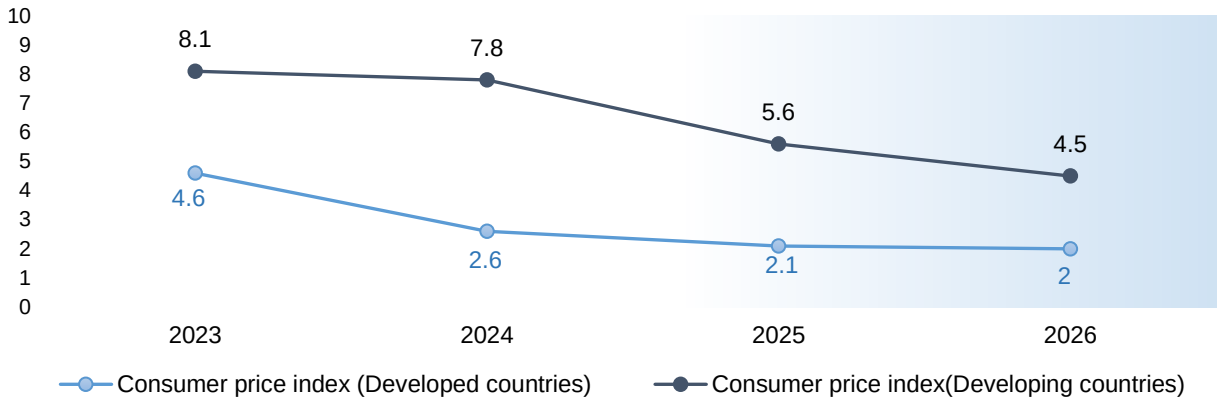
Chart 1. Global GDP growth forecasts, in %



Source: IMF, WEO, January 2025 (updated)

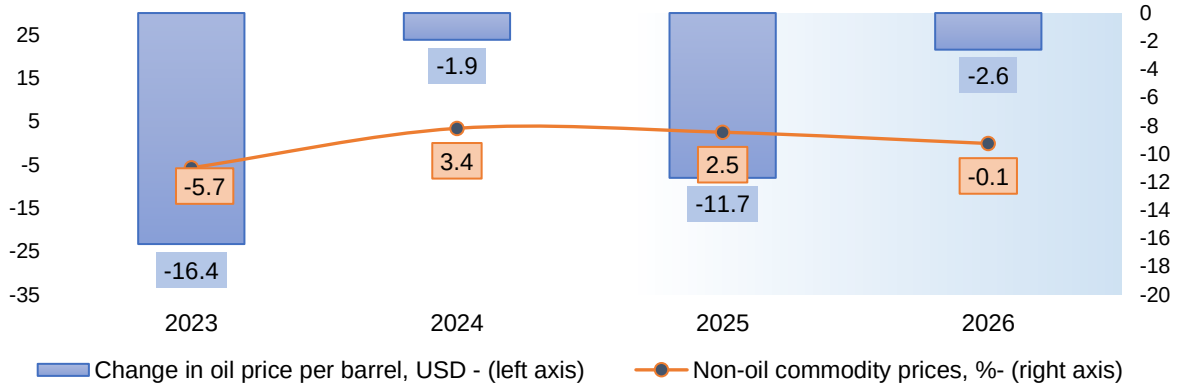
Despite rising service prices in most countries, inflation gradually decreased in 2024. The easing of raw material and food price increases, as well as the decline in natural gas prices, had a dampening effect on inflation. The current level of inflation has approached the targets set by major central banks. However, in certain emerging economies—particularly in Europe and Latin America—inflation remains high due to local factors. At the same time, the intensification of protectionist trade policies and deglobalization trends continue to be key factors negatively affecting prices going forward. The expected decline in energy prices is anticipated to support the reduction of inflation toward central bank targets. In China, however, deflation expectations persist due to problems with domestic demand. Taking these factors into account, most central banks lowered their policy interest rates last year, though they acted cautiously.

Chart 2. Consumer price index, %



Source: IMF, WEO, January 2025 (updated)

Chart 3. Commodity price change

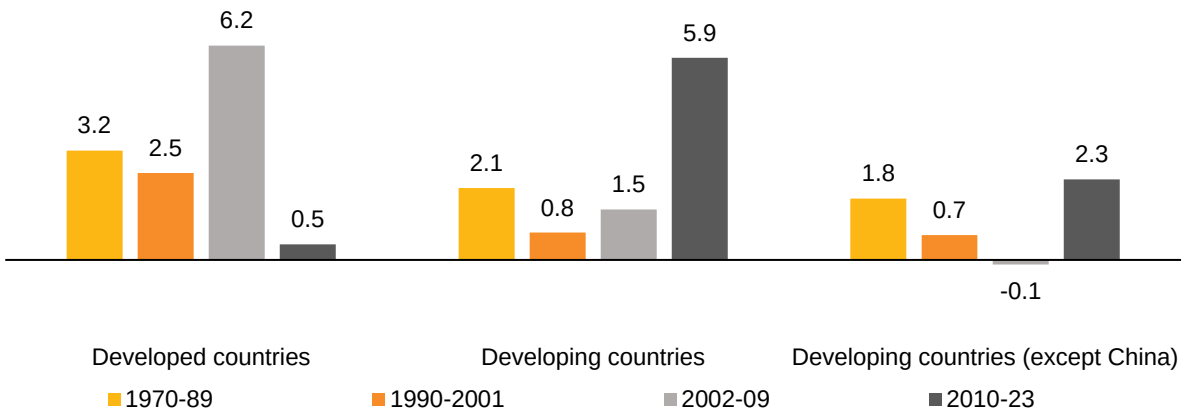


Source: IMF, WEO, January 2025 (updated)

Protectionist trade policies implemented by some major countries pose risks and challenges for the global economy. Uncertainties surrounding global trade—manifesting in the form of new waves of tariffs and trade barriers—are negatively impacting global economic growth. According to the IMF, the intensification of such protectionist policies among major economic powers will reduce the volume of global trade and harm investment. Based on World Bank estimates, new trade tariffs proposed by the U.S., along with potential retaliatory measures from partner countries, could reduce global economic growth by 0.3 pp.

Although AEs are the main drivers of inconsistencies in global economic policy measures, negative consequences are felt more strongly in EMEs. In many EMEs, particularly in low-income countries, weak fiscal positions and elevated levels of debt underline the need for coordinated global policy actions to prevent severe debt crises. The large wave of borrowing begun in EMEs in 2010 is the most extensive and fastest among the debt accumulation episodes observed over the past 60 years. Climate change is considered a major long-term challenge for global development, driving significant demand for investment to support adaptation to climate risks, especially in low-income countries.

Chart 4. Dynamics of the change of the share of debt in GDP, percentage point



Source: World Bank, Global Economic Prospects (January 2025)

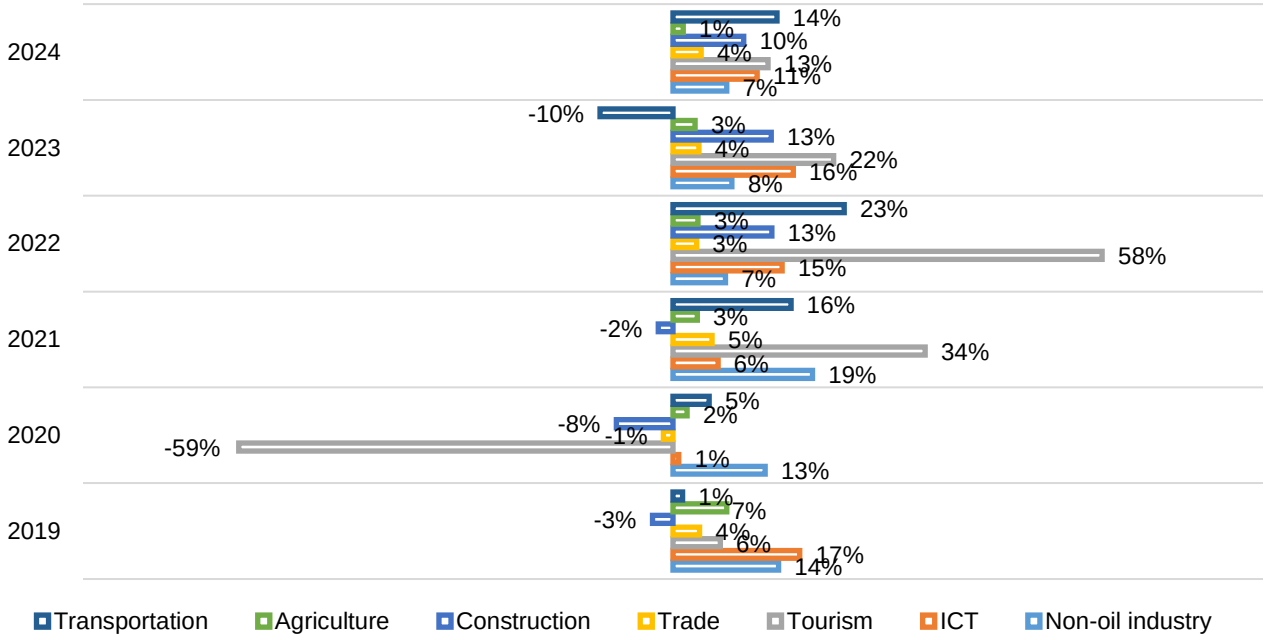
Despite regional disparities, global financial and credit conditions have remained broadly supportive. In AEs, particularly in the U.S., expectations of business-friendly economic policies have driven up equity prices. However, the strengthening of the U.S. dollar, amid expectations of new tariffs and high interest rates, has kept financial conditions tight in EMEs. In 2024, most countries faced constraints in fiscal policy due to high public debt. The IMF has raised alarms about the importance of gradual fiscal consolidation to safeguard financial stability. Otherwise, rising debt servicing costs, high interest rates, and low investment levels could undermine long-term growth prospects for EMEs.

Macroeconomic environment for financial institutions in Azerbaijan

In 2024, despite the uncertainties caused by global geopolitical and geoeconomic risks, as well as relatively weak recovery of global economic activity, economic growth in the country continued. In 2024 GDP grew by 4.1% in real terms to nominal AZN126B. Economic growth was driven by the non-oil-gas sector. Over the reporting year, the non-oil-gas sector accounted for 68% of GDP – the non-oil-gas sector grew by 6.2%. Oil-gas value added increased by 0.3%. Per capita GDP made AZN12.4 thousand.

In 2024 all areas of the non-oil-gas sector posted growth compared with the end of 2023. The highest growth was in transportation (14%).

Chart 5. Economic growth rate of non-oil-gas areas



Source: SSC

Nominal income and salaries of the population continued to increase. Labor force numbered 5312.1 thousand persons as of end-2024, out of which 5029.8 thousand persons were employed population. The number of hired labor was 1778.5 thousand persons, of which 49.6% was employed in the public sector (883 thousand persons), and 50.4% (896 thousand persons) in the private sector. The oil-gas sector employed 31.8 thousand and the non-oil-gas sector employed 1746.7 thousand persons. The average monthly nominal salary of hired labor yoy increased by 8.1% to AZN1009.2. Income of the population yoy increased by 6.4% to AZN83.1B in nominal terms.

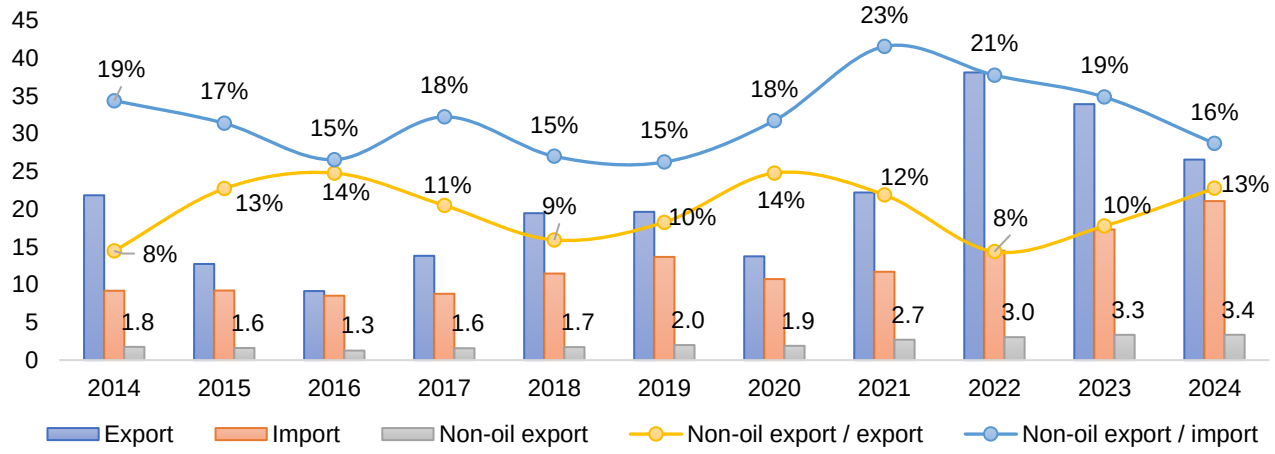
Annual inflation was within the target range over the year (4±2%). According to the SSC, annual inflation stood at 4.9% in December 2024. Annual food inflation stood at 5.5%, non-food product prices hiked by 2.4%, and annual service inflation was 6.3%. Annual core inflation excluding regulated prices and price changes of seasonal agricultural products stood at 4.4% in December.

Changes in inflation were driven by both domestic and external factors. Lower inflation in trade partners, the appreciation of the nominal effective exchange rate and the anti-inflationary policy implemented in the country had a downward effect on inflation. The current monetary policy aims to keep inflation within the target range and stabilize inflation expectation. Under the current policy, inflation is forecasted to be within the target (4±2%) in 2025 and 2026.

In 2024, one of the core priorities of the CBA was to maintain price stability. The interest rate corridor parameters were discussed 8 times in 2024. At the first three meetings dedicated to the monetary policy the refinancing rate was decided to be shifted to 7.25% from 8%, the ceiling of the interest rate corridor to 8.25% from 9%, and the floor to 6.25% from 6.5%. At 5 consecutive meetings the interest rate corridor parameters were left unchanged. The CBA made interest rate decisions public under the pre-announced schedule through press releases with appropriate analytical commentary. Monetary policy tools continued to be applied in a new configuration. The CBA reduced the volume of its liquidity absorbing operations, considering the downward effect of the non-monetary policy on banking system liquidity. During the reporting year, the exchange rate of the manat varied against the currencies of trade partner countries. The dynamics of bilateral exchange rates impacted multilateral exchange rates. In 2024, the non-oil trade weighted NEER of the manat appreciated by 9%, and the REER appreciated by 2.2%. Inflation in Azerbaijan was lower than the weighted average inflation in trade partners and had a downward effect on the REER.

The international conjuncture was favorable for Azerbaijan in terms of the balance of payments. In 2024, current account surplus amounted to $4.7B (6.3% of GDP). Foreign trade turnover made $47.6B. The value of exported products amounted to $26.6B and import $21.1B, resulting in $5.5B worth of trade surplus (7.4% of GDP). Export of non-oil-gas products accounted for 12.6% of total export, yoy up by 2.8 pp. Azerbaijan traded with 180 countries of the world. EU countries accounted for 41% and other countries for 59% of foreign trade. The private sector accounted for 56% of foreign trade turnover.

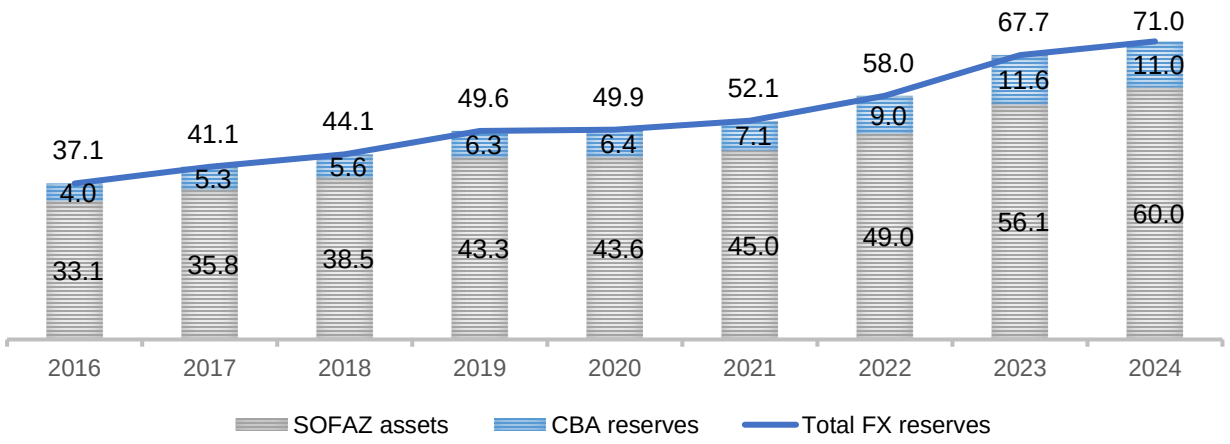
Chart 6. Import and export dynamics, billion USD dollars



Source: SCC

Strategic foreign exchange reserves continued to grow. Over the period foreign exchange reserves of the CBA decreased by 5.6% to $11B, while reserves of the SOFAZ increased by 7% to $60B. In general, foreign exchange reserves of the country increased by 4.8% to $71B.

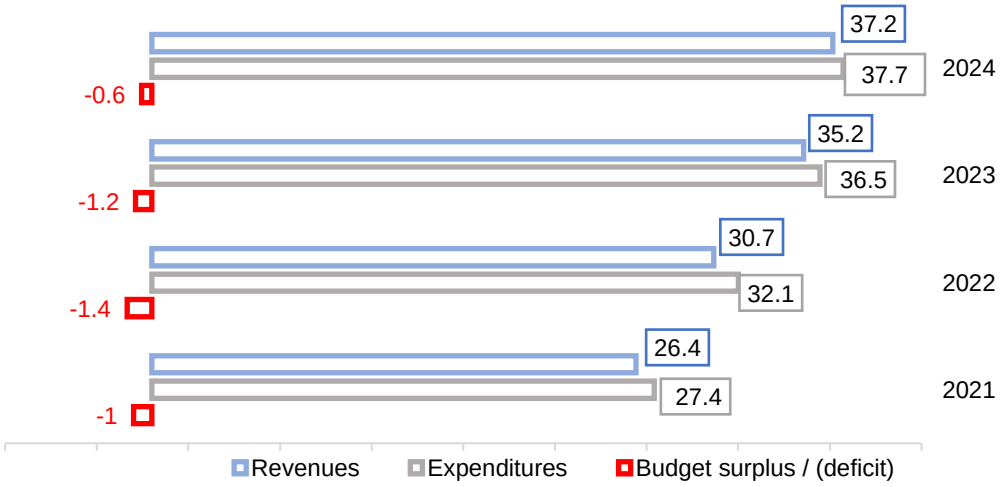
Chart 7. Dynamics of foreign exchange reserves of CBA and SOFAZ, billion US dollars



Source: CBA, SOFAZ

Fiscal expenses were crucial in supporting economic activity. Budget expenditures were directed toward supporting economic growth and implementing measures to improve the well-being of the population, particularly the recovery of the liberated territories. In 2024, state budget revenues amounted to AZN37.2B, and expenditures to AZN37.7B. Budget deficit amounted to AZN0.6B (0.4% of GDP). Excluding the transfer from the SOFAZ, state budget revenues amounted to AZN24.4B, exceeding the forecast by 3.3%.

Chart 8. State budget revenues and expenditures, billion manats



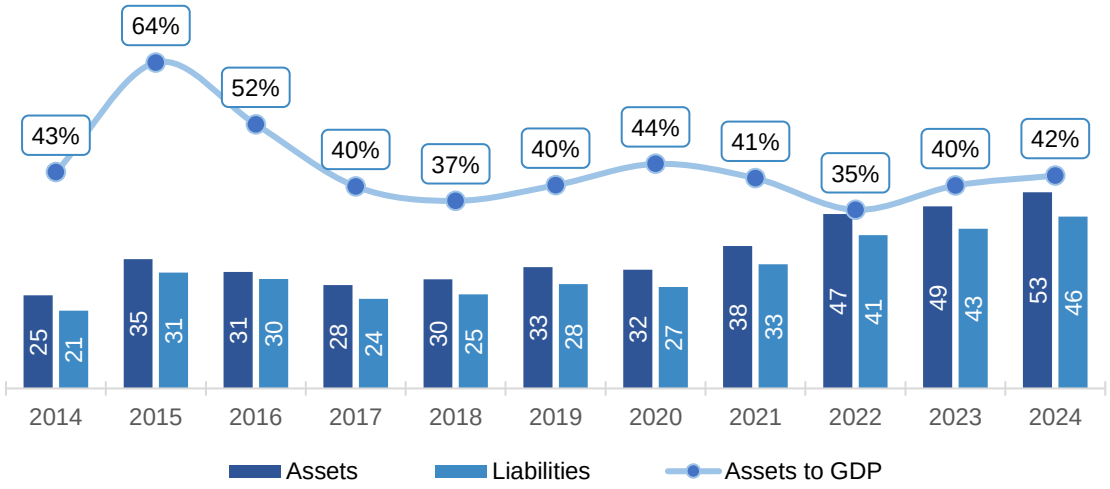
Source: CBA, SSC and MoF

Overview of the banking system

- ***Dynamics of banking sector assets and liabilities***

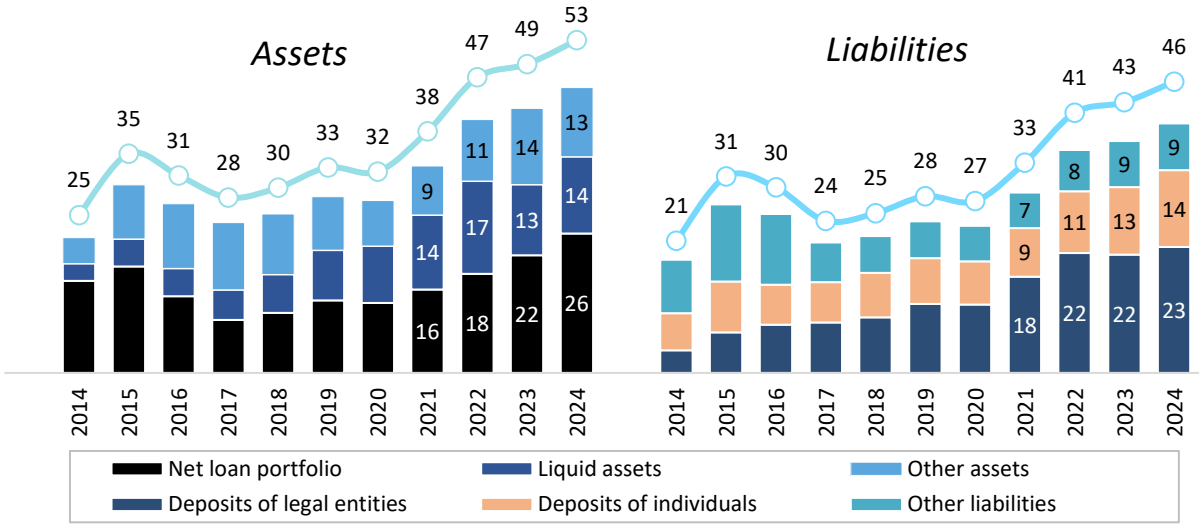
The balance sheet of the banking sector continues to expand, driven by sustained economic activity and the growth of term deposits. In 2024, banking sector assets increased by 8% (AZN4.03B) to AZN53B. Liabilities increased by 8% (AZN3.41B) to AZN46.4B. Consequently, the assets-to-GDP ratio (a key indicator of banking sector depth) increased by 2 pp to 42%. As of end-2024, the net lending portfolio accounted for 49%, liquid assets for 27% and other assets for 24% of total assets of the banking sector. The liability breakdown is as follows: deposits of legal entities 50%, savings of individuals 31%, amounts due to financial institutions 13% and other liabilities 6%. Amid higher confidence in the banking sector, along with the new monetary policy operational framework and macroprudential policy measures, the expansion of balance sheets is supported by term deposits—a more sustainable source of financing. Throughout the year, term deposits of legal entities increased by 29% (AZN1.3B) and term savings of individuals increased by 25% (AZN1.7B), 95% of the growth in the total deposit portfolio.

Chart 9. Dynamics of assets and liabilities of the banking system, in billion AZN



Source: CBA

Chart 10. Dynamics of the structure of banking systems assets and liabilities, in billion AZN



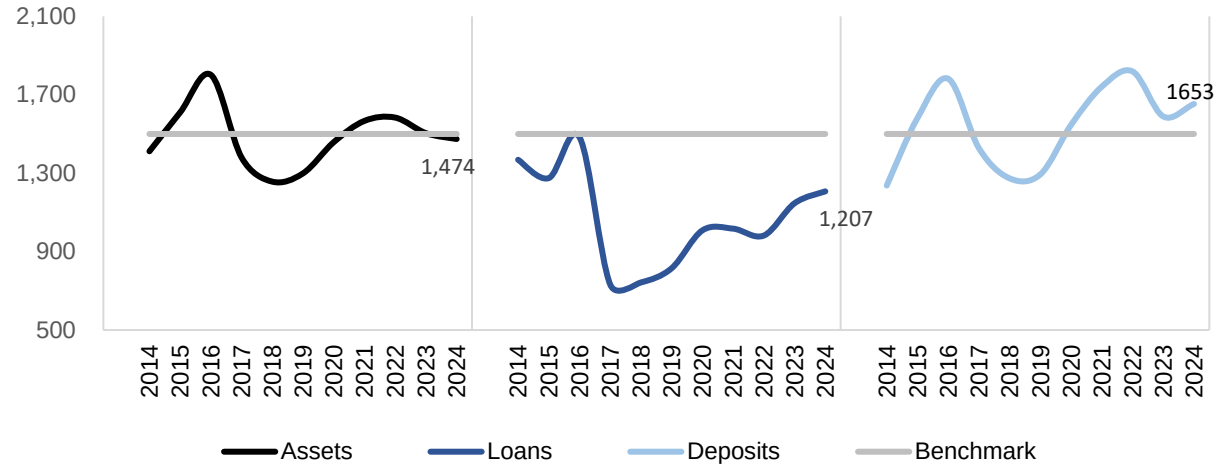
Source: CBA

- ***Concentration in the banking sector***

Although asset concentration has slightly decreased compared to the end of the previous year, concentration in deposit and lending portfolios has increased. According to the HHI[1] widely used in international practice, as of the end of the year concentration in the banking sector yoy increased by 61 points to 1207. Concentration in the deposit portfolio yoy increased by 64 points to 1653. The HHI index for assets decreased by 30 points to 1,474. Accordingly, the lending portfolio of the banking system is at a low level of concentration, while the deposit portfolio is at a medium level. Based on total assets, the banking sector stands at the threshold between low and medium concentration.

[1] *The HHI index stands for to assess the level of competitiveness and concentration in markets in international practice. According to the experience of the U.S. Department of Justice, markets are divided into three categories based on this index: low-concentration markets (HHI < 1500), medium-concentration markets (1500 < HHI < 2500), and high-concentration markets (HHI > 2500). The value of the HHI ranges from 0 to 10,000.*

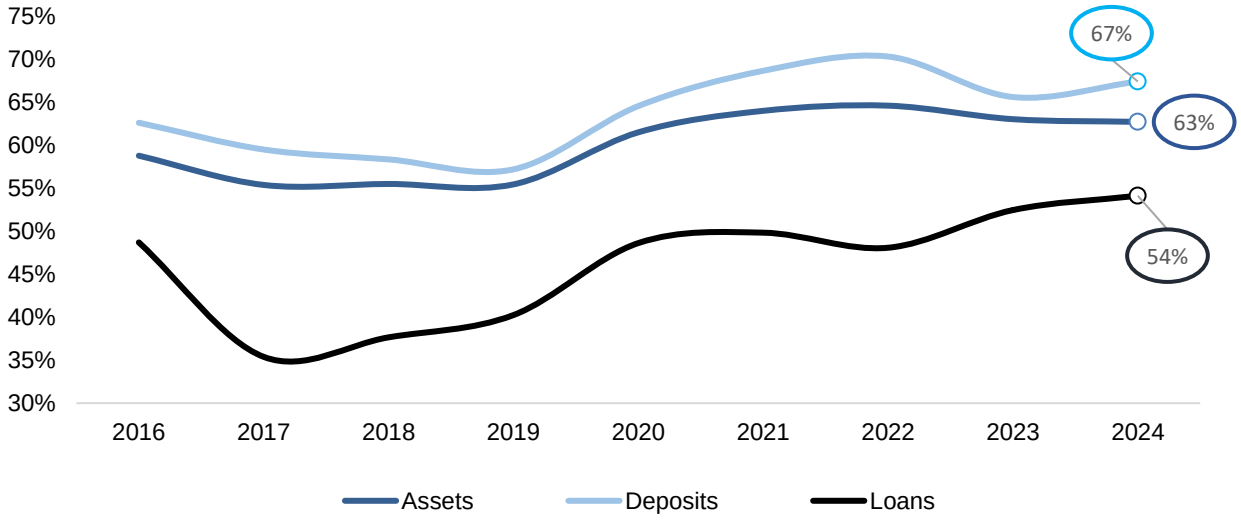
Chart 11. Dynamics of the HHI index across the banking sector



Source: CBA

The dynamics of the market share of the three largest banks show that concentration increased in 2024 in both the lending and deposit portfolios. The market share of the lending portfolio of three largest banks yoy increased by 1.7 pp to 54.1%, while that of the deposit portfolio increased by 1.8 pp to 67.4%. There was no considerable change in the market share of three largest banks on assets. The CBA always attaches significant importance to the concentration in the banking sector.

Chart 12. Dynamics of the market share of three largest banks

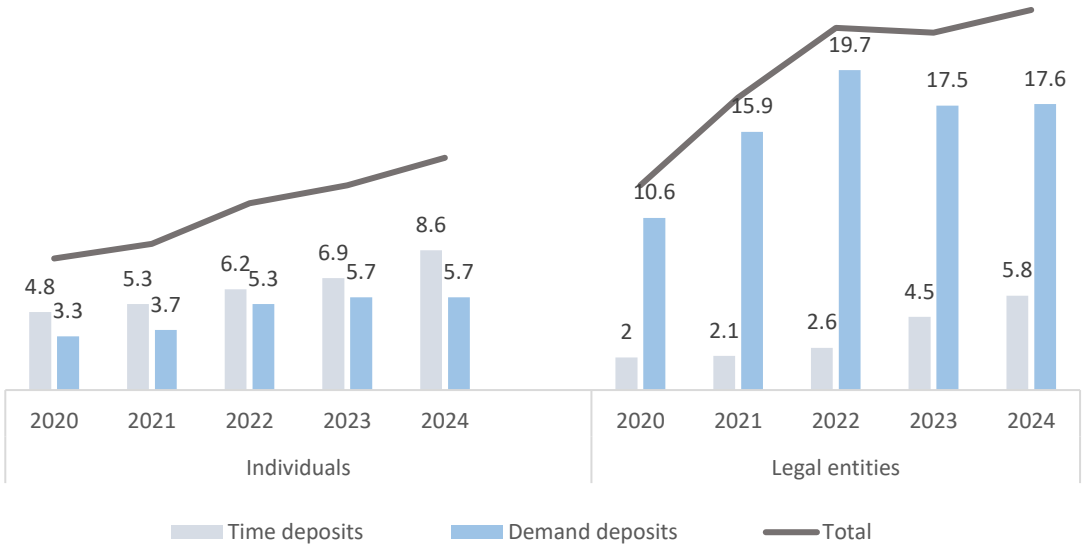


Source: CBA

- ***Resources attracted across the banking sector***

Deposits of legal entities and savings of individuals, the main financing source of the sector, increased. In 2024, deposits of legal entities increased by 7% (AZN1.43B) to AZN23.4B, and savings of individuals increased by 14% (AZN1.72B) to AZN14.3B. As of end-2024, the share of deposits of legal entities in total liabilities decreased by 0.5 pp to 50.4%, and the share of savings of individuals in total liabilities increased by 1.65 pp to 30.8%. Note that, the deposit growth both on individuals and legal entities was driven by term deposits.

Chart 13. Dynamics of deposit portfolio growth of individuals and legal entities, in billion AZN



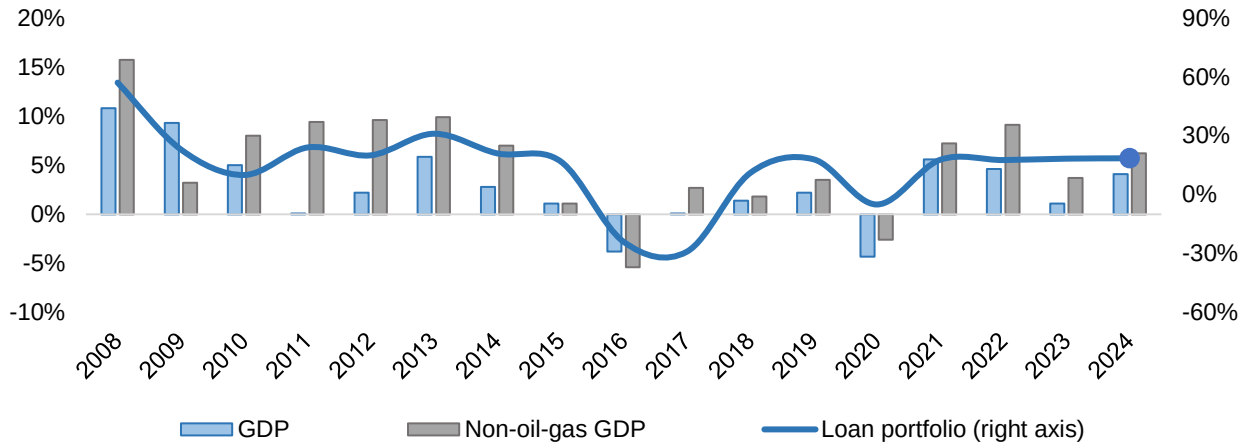
Source: CBA

The rise in term deposits enhances the banking sector's opportunities for long-term asset generation. In 2024, demand deposits of legal entities increased by 1% (AZN0.2B) to AZN17.58B, while term deposits increased by 29% (AZN1.32B) to AZN5.8B. Additionally, term deposits of individuals increased by 25% (AZN1.72B) to AZN8.6B, and their demand deposits remained nearly unchanged. Amid higher confidence in the banking sector, new monetary and macroprudential policy frameworks implemented, including further digitalization, the unique number of individuals in the term deposits portfolio yoy increased by 41.2% to 150.5 thousand persons. The entry of a large number of new depositors into the banking system is not only an indicator of increased financial inclusion in the sector, but also supports the resilience of banks through the growth of stable funding sources.

- ***Banking sector's lending activity***

Bank lending continues to be active both in consumer and business portfolios. In 2024, the growth rate of the credit portfolio (18.5%) exceeded the growth rate of nominal non-oil GDP by up to 1.7 times. The lending portfolio of 19 banks increased year-over-year, and in 15 of these banks, the growth outpaced the increase in nominal non-oil GDP. In 12 banks, the growth exceeded 15%. To enhance the resilience of the banking sector and ensure the continuity of lending activity, a decision was made to introduce an additional counter-cyclical capital buffer of 0.5% on total regulatory capital and Tier 1 capital of banks, effective from March 1, 2025 (Box 1).

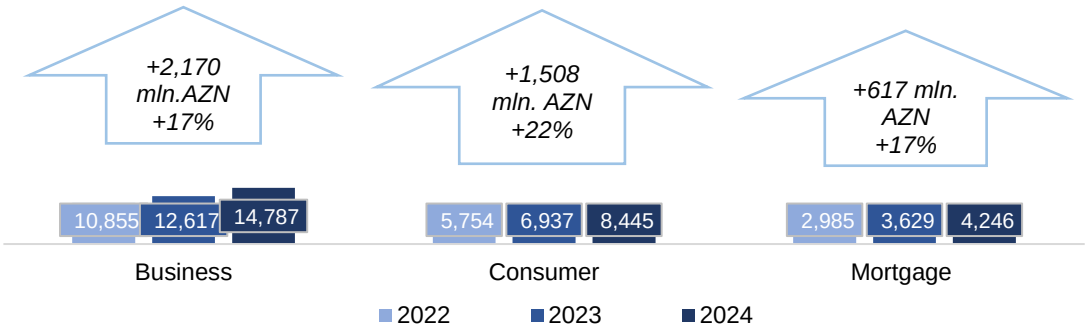
Chart 14. Loan portfolio and GDP annual growth rate



Source: CBA

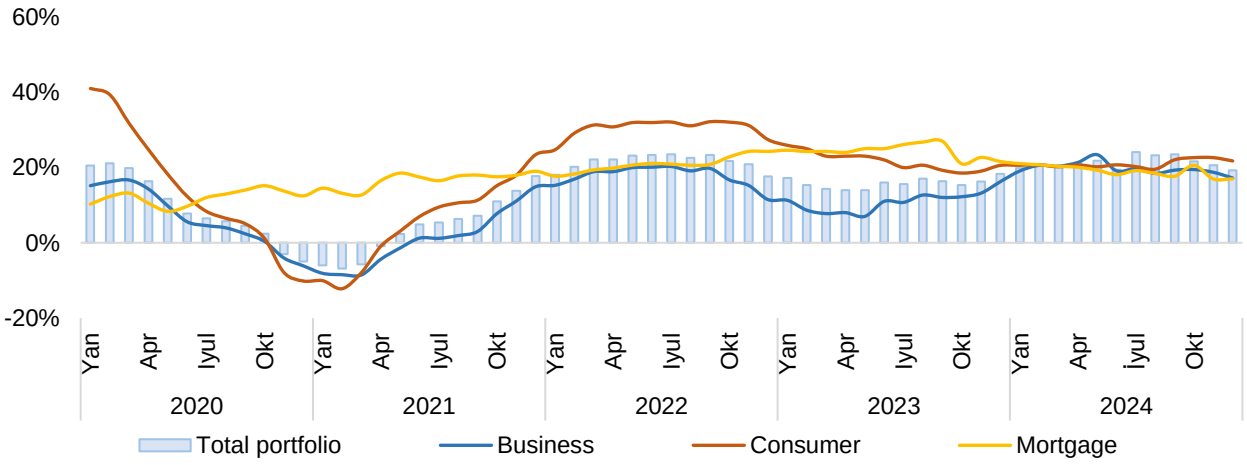
Business, consumer and mortgage lending portfolios are growing. Although the dynamics of consumer lending has been prone to decreasing since 2022 due to the tightening of the regulatory framework for consumer lending, the annual growth rate of the portfolio has averaged 23% over the past three years (compared to 32% prior to the regulatory changes). Compared to the end of the previous year, business loans increased by 17%, consumer loans by 22%, and mortgage loans by 17%**.**

Chart 15. Annual growth of the loan portfolio, in million AZN



Source: CBA

Chart 16. Dynamics of annual growth of the loan portfolio, in %



Source: CBA

Business loans increased by AZN2.2B to AZN14.8B compared to the end of 2023. As of end-2024 the mortgage portfolio increased by AZN0.6B to AZN4.25B. The growth of the mortgage lending portfolio was driven by the loans issued from state funds (44%, or AZN272M), and loans issued from banks' own funds (56%, or AZN344M). Over the period, the consumer lending portfolio increased by AZN1.51B to AZN8.44B.

Box 1. Activation of countercyclical capital buffer (CCyB)

The Counter-Cyclical Capital Buffer is a macroprudential policy tool implemented to safeguard financial stability and mitigate the impact of economic fluctuations on the banking sector. Introduced within the Basel III framework, this mechanism requires banks to hold an additional capital buffer during periods of rapid credit growth and allows the reduction or release of this buffer during periods of economic slowdown. This helps manage sharp shifts in credit cycles.

The main goal of the CCyB is to prevent the accumulation of risks during credit booms and ensure that banks can continue to provide stable financial intermediation during times of economic hardship. The buffer level is determined by regulatory authorities based on the state of credit growth and potential systemic risks. Regulators require banks to build up more capital reserves during periods of economic expansion, while during slowdowns, these requirements are relaxed to support sustainable lending by banks.

This regulatory approach strengthens the resilience of banks to cyclical economic shocks, reinforces the capital base during credit expansion phases, and helps safeguard financial stability during periods of slowed or declining economic growth. In this way, the counter-cyclical effect of macroprudential policy is enhanced, risky behaviors in the banking sector are curbed, and contributions are made to the protection of financial stability.

The main indicator used to trigger the activation of the counter-cyclical capital buffer is the gap between the long-term trend and the current ratio of the total lending portfolio to GDP (credit gap[2]). When the credit gap exceeds 2%, regulatory authorities consider activating the buffer.

As part of its systemic risk analysis, the CBA continuously monitors the credit gap indicator. Based on conducted assessments, the credit gap was 2.9% as of November 2024, which has made the activation of the counter-cyclical buffer relevant. The decision-making framework for applying the CCyB consists of a four-stage analysis and evaluation process, which includes the following:

1. **Calculation of the credit gap**: the credit gap indicator was calculated both in accordance with the rules and using alternative methods that consider various

[2] deviation of the credit-to-GDP ratio from its long-term trend

structural factors. Based on the regulations, the credit gap was calculated at 2.9%, while the gap calculated using alternative methods [3] was around 2.8%. In both methodologies, the fact that the credit gap exceeds 2% has made the activation of the buffer relevant.

2. **Assessment of financial cycle indicators:** Considering the activation of the buffer triggered by the credit gap exceeding 2%, additional sensitivity indicators related to the financial cycle were also assessed. Factors such as the improvement in banks' capital positions, profitability, leverage, the high dynamics of ROE, and trends in household borrowing and housing prices have supported the implementation of the buffer.

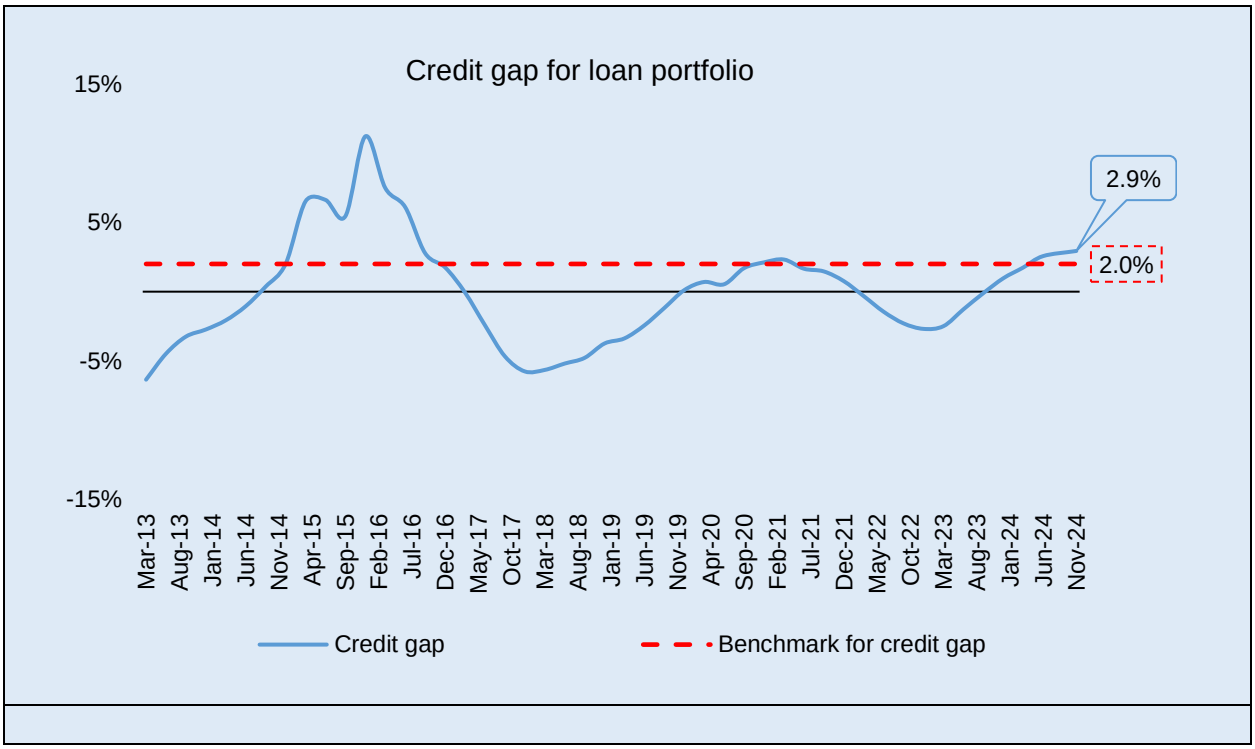
3. **Analysis of lending growth dynamics in the banking system:** At this stage, the lending growth dynamics across the banking system was analyzed, with evaluations carried out on bank groups, sectors, and the overall credit portfolio that significantly contributed to the credit gap. Based on data as of November 2024, lending portfolios increased in 19 out of 21 active banks, with 18 banks recording growth exceeding the nominal non-oil GDP growth rate (7.1%). In 12 banks, growth exceeded 15%

4. **Quantitative impact analysis of buffer implementation:** In analyzing the quantitative impact, the effect on individual banks' lending capacity and dividend-paying ability was assessed. According to the evaluation, the application of a 0.5% buffer is projected to result in AZN18.7B of potentially usable RWAs based on forecast indicators. This demonstrates that even after the new decision, the banking sector retains significant potential for credit portfolio expansion.

Against the background of the four-stage assessment the Management Board of the Central Bank of the Republic of Azerbaijan, in accordance with the relevant regulations,[4] decided to o set an additional counter-cyclical capital buffer of 0.5% on banks' total regulatory capital and Tier 1 capital on 6 January 2025, effective from 1 March 2025.

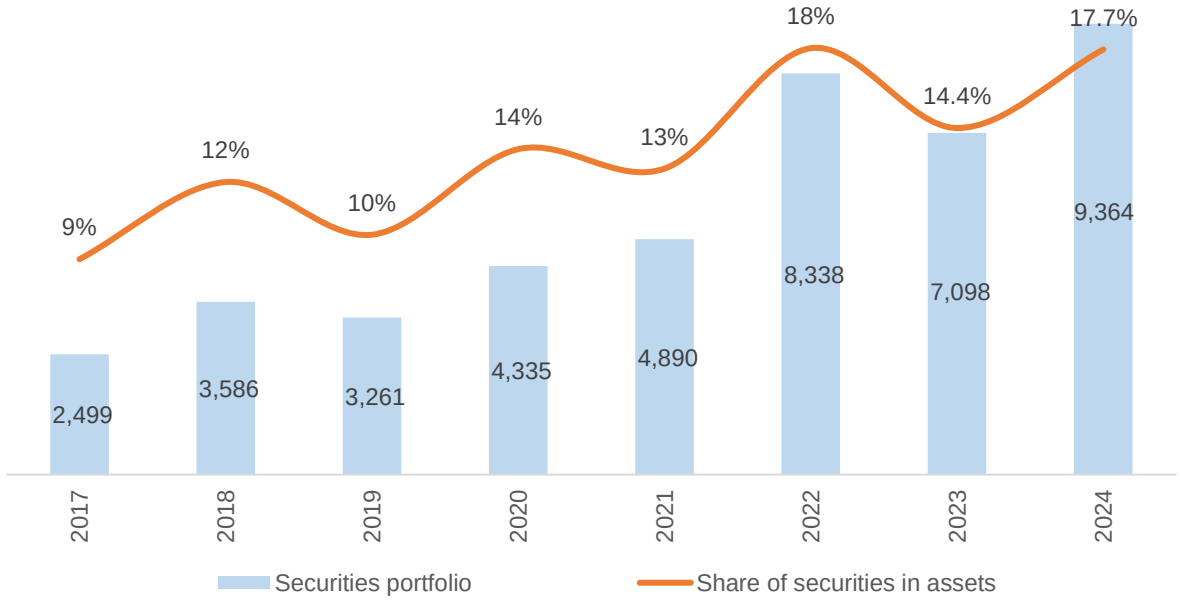
[3] *The credit gap indicator calculated with the alternative method was determined as the difference between the average ratio of the total lending portfolio issued to customers by both active banks and banks under liquidation during the relevant period to GDP, and the ratio of lending to the non-oil sector to non-oil GDP, and the long-term trend average of these ratios for the same period.*

[4] *Regulation on calculation of bank capital and its adequacy*



Investments in highly liquid government securities increased amid changes to the regulatory framework and high interest rates. Compared with the end-2023, the securities portfolio increased by 32% (AZN2.3B). The share of the securities portfolio in total assets yoy increased from 14.4% to 17.7%. The rise in investments in U.S. treasury bills was AZN1.37B, 60% of total rise on securities. To help banks manage foreign exchange liquidity risks the CBA introduced a LCR promoting them to maintain their foreign currency funds in highly liquid assets. Additionally, amid high interest rates investments in securities of the Ministry of Finance yoy increased by 31% (AZN1.1B) in 2024. According to the yield curve published by the CBA at the end of 2024, all maturity segments of the yield curve increased compared to the end of 2023.

Chart 17. Dynamics of the securities portfolio, in million AZN



Source: CBA

Box 2. Banking sector macroprudential policy framework

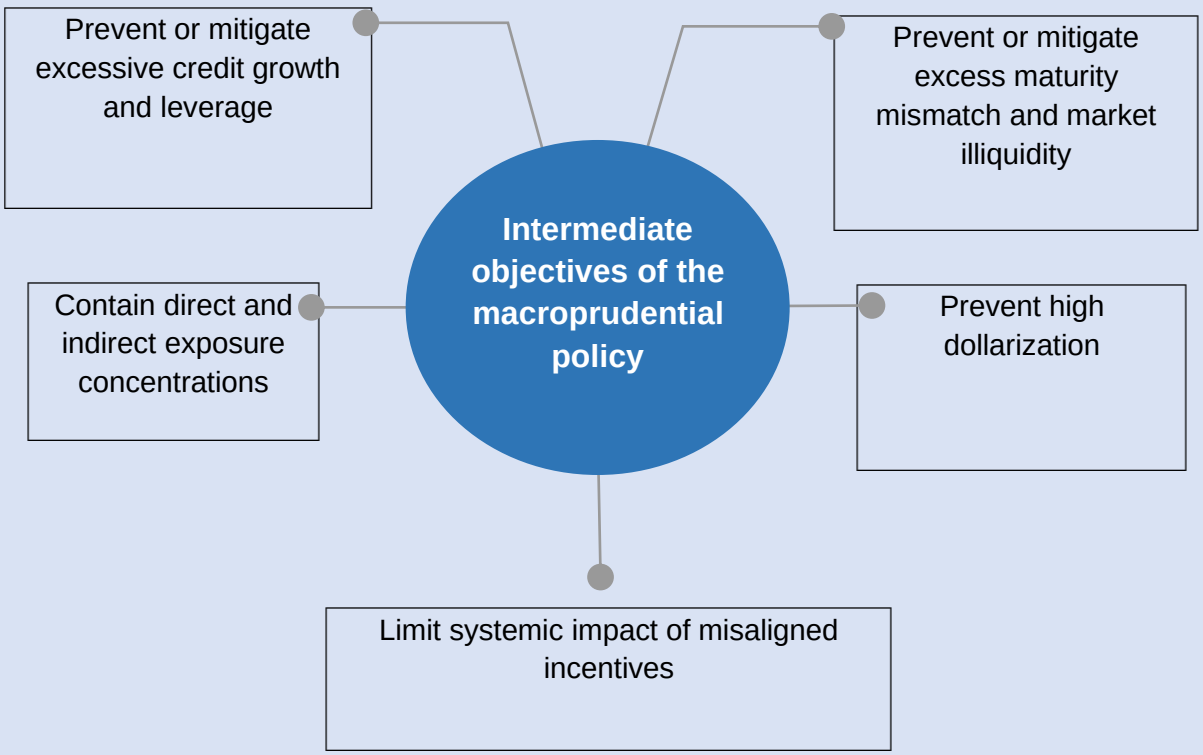
With the amendment made to the Law of the Republic of Azerbaijan 'on the Central Bank of the Republic of Azerbaijan' in 2022, the CBA is mandated to safeguard financial stability within the authorities specified in the laws regulating financial markets. Hence, the CBA discharges the functions of maintaining the stability and resilience of financial markets, regulating, and supervising financial markets, and exercising macroprudential regulation and supervision.

The '**Banking sector macroprudential policy framework**' document was approved in December 2024. This framework document reflects the **ultimate and intermediate objectives, application directions**, and process **of the macroprudential policy** implemented by the CBA, its institutional design, communication, policy approach regarding the non-bank sector, as well as the interaction of macroprudential policy with other policies. The paper also presents the types of macroprudential tools used by the CBA to promote financial stability and those that may be used in the future, in the context of the improvement of the regulatory framework.

According to the framework document, the goal of macroprudential policy is to enhance the resilience of the financial system, safeguard financial stability by eliminating the accumulation of systemic risks, and thereby support long-term sustainable economic growth. **Financial stability** is defined as the condition in which the financial system is capable to perform its core functions effectively while also being resilient to crises.

To achieve the primary objective of the macroprudential policy, intermediate objectives should be established. **The intermediate objectives provide an economic basis for selecting appropriate tools, making macroprudential policy more prompt, transparent, and accountable.** Accordingly, five intermediate objectives of macroprudential policy have been established, and current as well as potential future macroprudential tools have been grouped under these objectives.

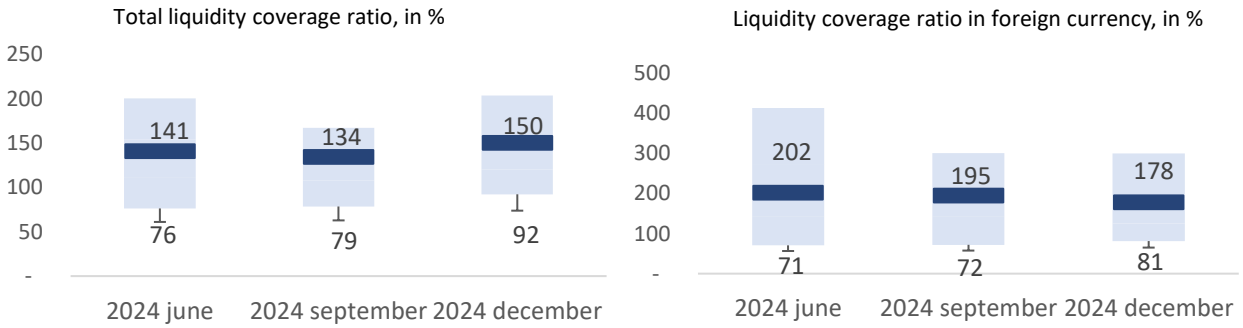
Table 1. Intermediate objectives of the macroprudential policy



Liquidity risk of the banking system

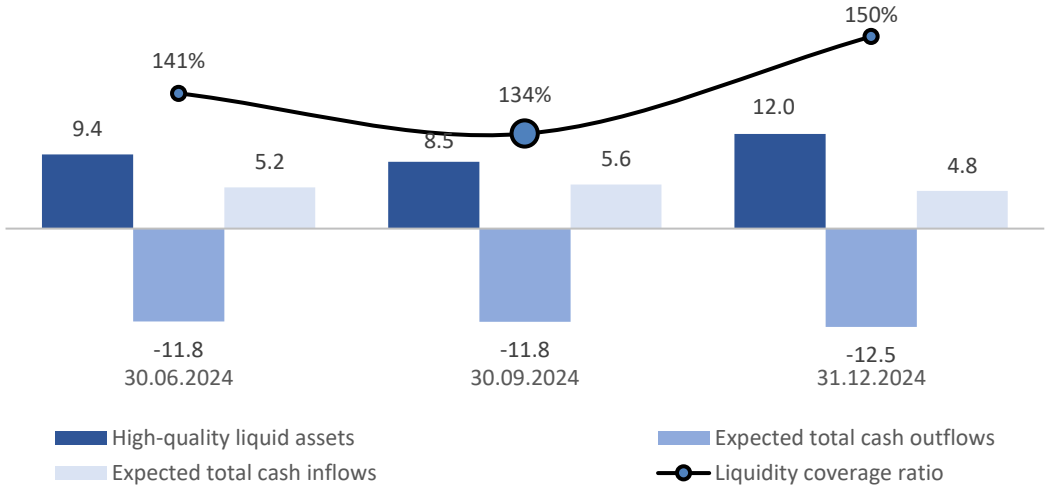
The sector's liquidity position has adjusted to the new monetary framework and the framework for the application of prudential tools. The LCR stood at 150% and 178% in aggregate and in a foreign currency, respectively. As of end 2024, total expected cash inflows on the banking sector amounted to AZN4.8B; and total expected cash outflows amounted to AZN12.5B and total net cash outflows amounted to AZN7.7B. AZN12B worth of highly liquid assets of the banking sector outpace total net cash outflows. The LCR both maintain an adequate level of high-quality liquid assets and makes banks more resilient against short-term liquidity shocks.

Chart 18. LCR in aggregate and in foreign currency, %



Source: CBA

Chart 19. High-quality liquid assets and total expected net outflows, in billion AZN

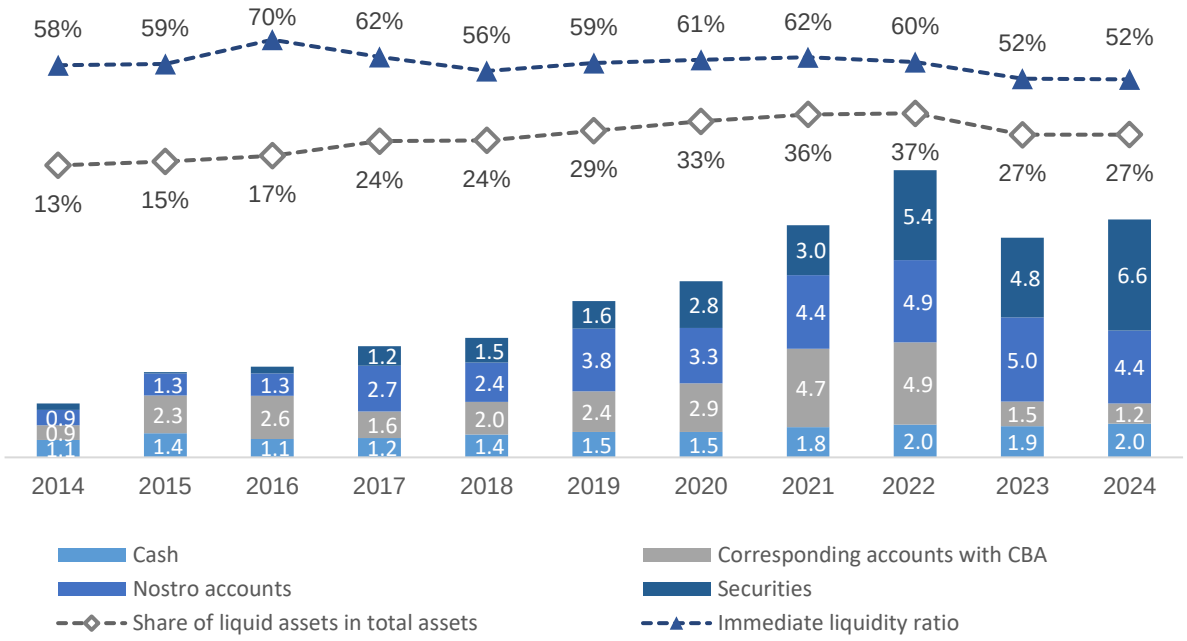


Source: CBA

According to the LCR requirements, banks should increase their liquidity coverage ratios stepwise in 2025. Starting from 1 June 2025, systemically important banks should maintain an LCR ratio of 100%, while other banks should maintain a ratio of 90%. Other banks should increase the LCR to 100% starting from 1 December 2025, and all banks should have their LCR equal to 100% as of the end of 2025. The sector's instant liquidity ratio made 52%, 22 pp up compared to the minimum requirement. Liquid assets stand at 27%, allowing the sector to have an adequate buffer against potential liquidity shocks.

Liquid assets of the sector increased. Over the past year liquid assets increased by 8% (AZN1.1B) to AZN14.2B.

Chart 20. Dynamics of the structure of liquid assets of the banking sector, in billion AZN

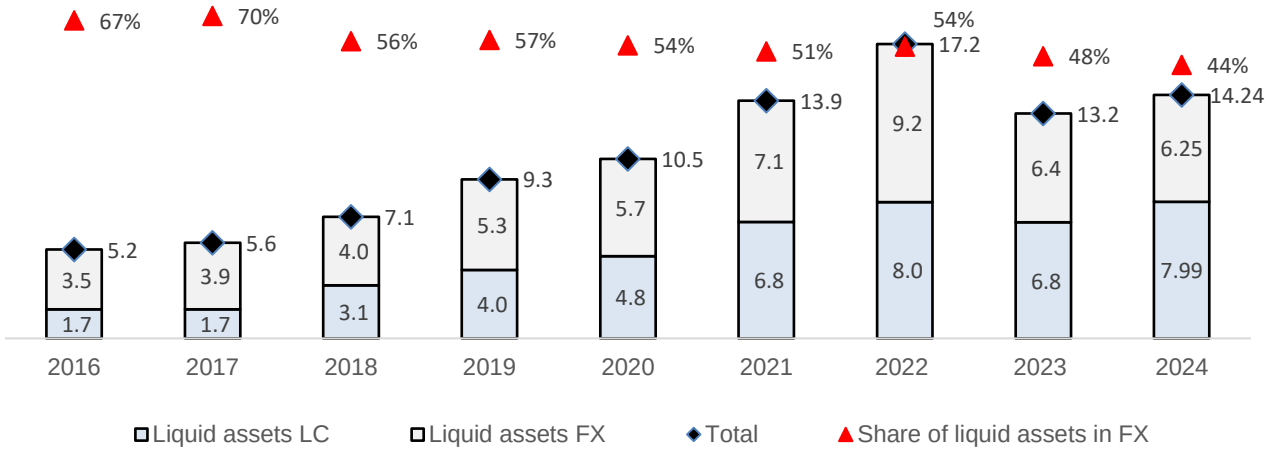


Source: CBA

Securities accounted for 46.6%, nostro accounts and overnights for 30.7%, cash for 14.1%, and correspondent accounts with the CBA (less reserves) for 8.6% of total liquid assets.

The share of liquid assets increased in the currency structure of liquid assets. As of end-2024, the share of liquid assets in the national currency stood at 56% (52% in 2023).

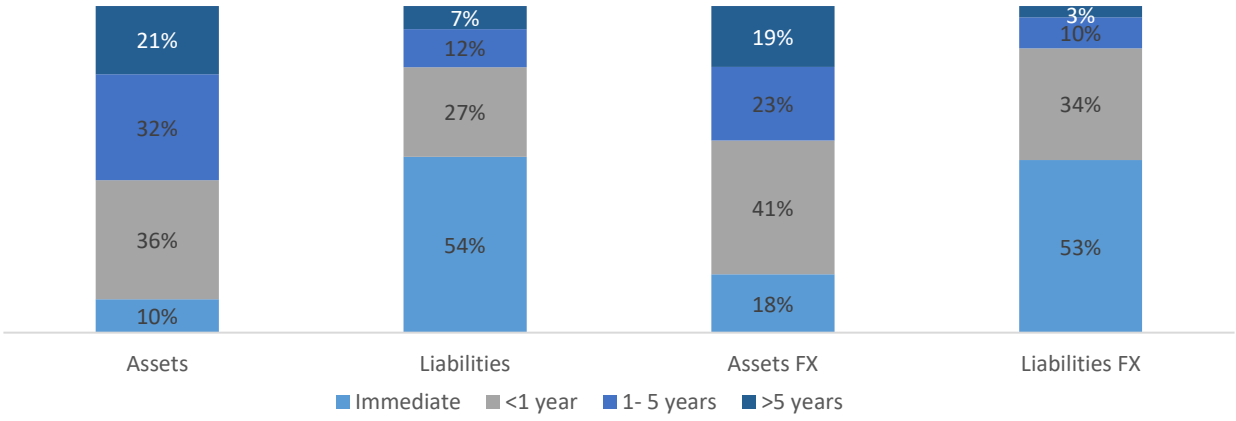
Chart 21. Dynamics of the currency structure of liquid assets of the banking sector, in billion AZN



Source: CBA

The share of assets with up to one year maturity in total assets stood at 46%, and the same indicator for liabilities stood at 81%. 62% of liabilities have a maturity of less than 90 days, which contains long-term financing. Although the high share of current liabilities in the balance sheet of the banking sector contributes to maturity mismatches, the sector's substantial liquidity buffer mitigates the impact of this mismatch on liquidity risk.

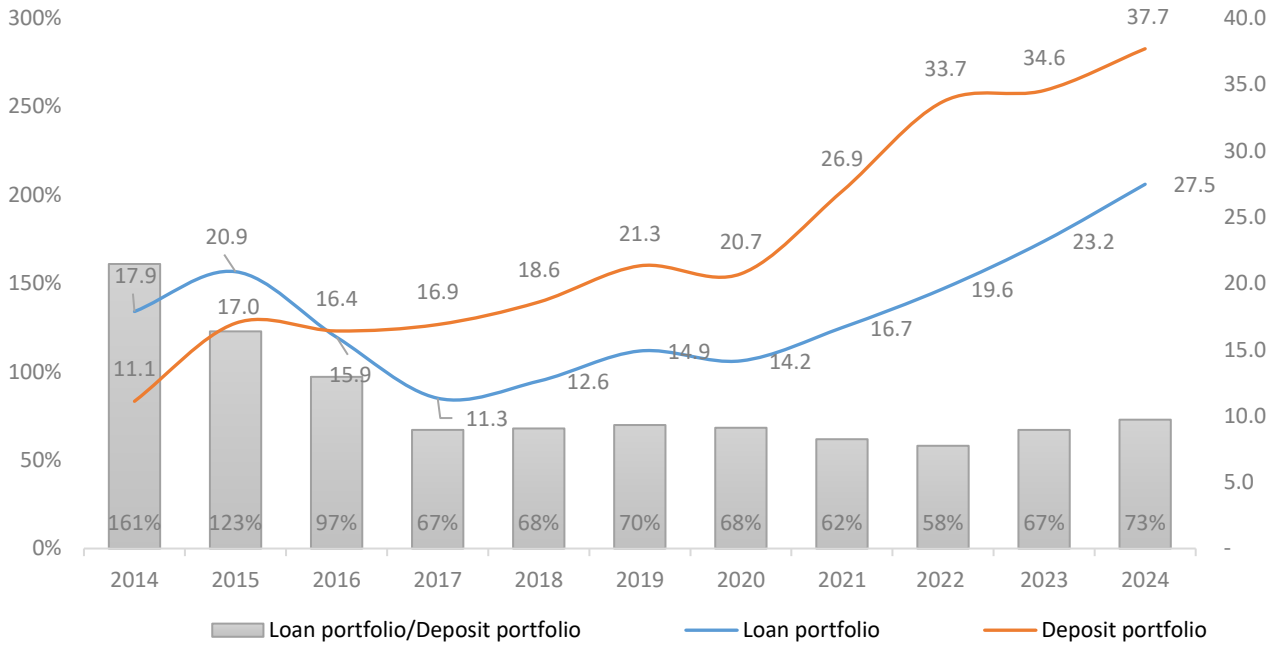
Chart 22. Maturity structure of banking sector assets and liabilities



Source: CBA

The loans-to-deposits ratio is growing. The balance sheet of the banking sector expanded due to the rise in the term deposits base and supported high lending growth. As of end 2024, the growth rate of the deposit portfolio outpaced the growth rate of the lending portfolio year-over-year. Consequently, the loan-to-deposit ratio increased by 6 pp to 73% last year.

Chart 23. Dynamics of the loan-to-deposit ratio, in billion AZN

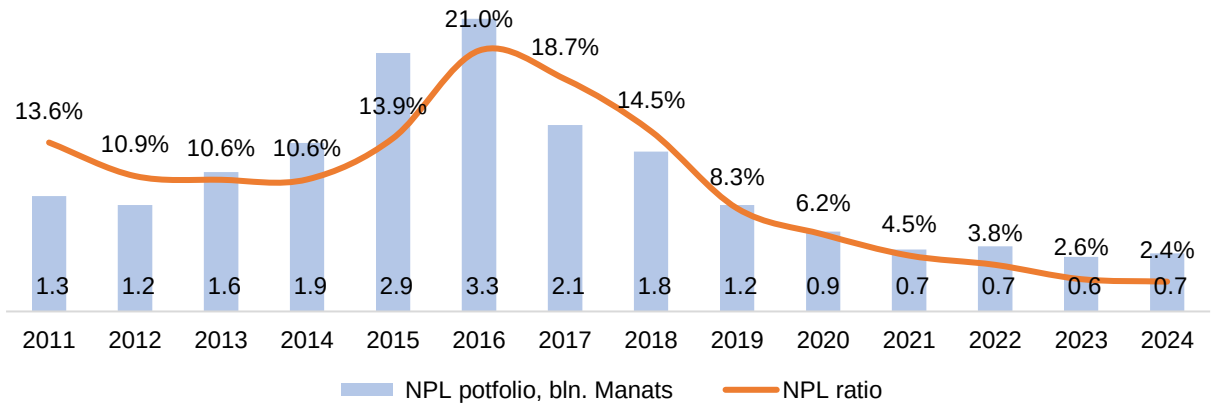


Source: CBA

Credit risk of the banking system

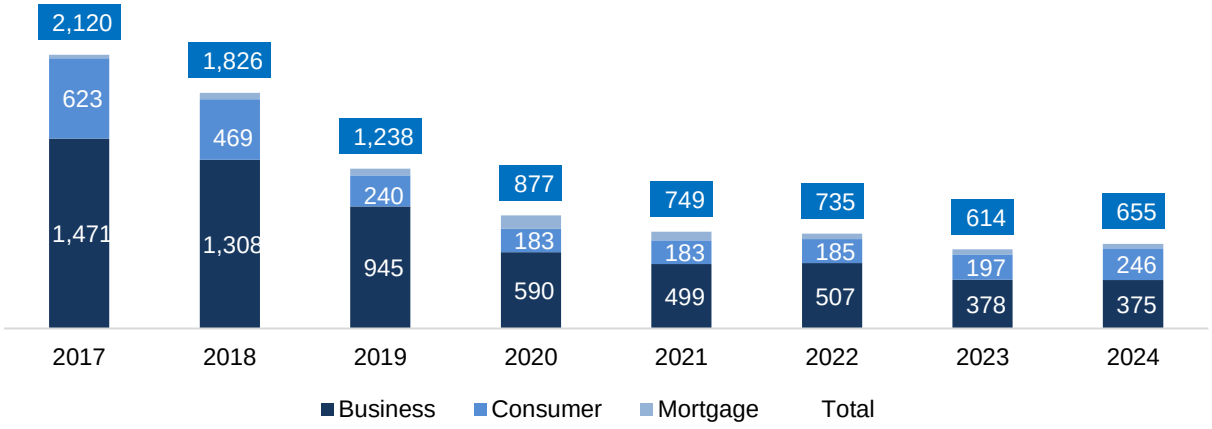
There has been no significant change in credit risks in 2024. The size of non-performing loans (NPLs) increased by 6.7% (AZN41M) in absolute terms to AZN655M. Amid high lending dynamics the share of NPLs in the total portfolio decreased by 0.2 pp to 2.4%.

Chart 24. Dynamics of the NPL portfolio on the banking sector, in billion AZN



Source: CBA

Chart 25. Sectorial dynamics of the NPL portfolio, in billion AZN

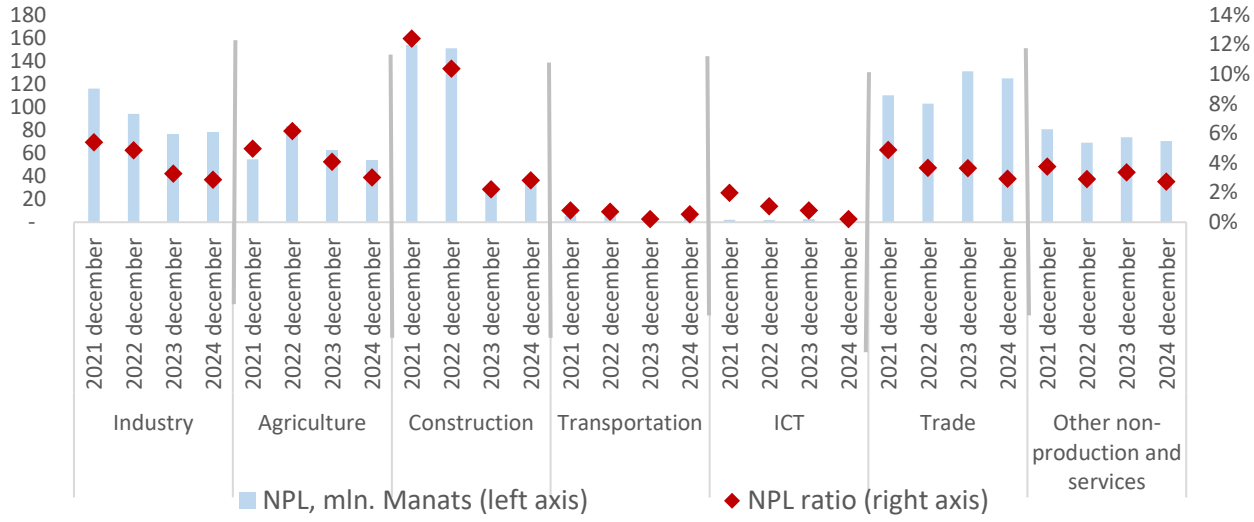


Source: CBA

In 2024, total write-offs across the banking sector amounted to AZN216M, driven by the consumer portfolio**.** Over the period write-offs on the consumer portfolio accounted for 64% (AZN137M) of total write-offs.

In 2024, there has been no notable change in credit risks on the business loans portfolio. Compared to the end of the previous year the size of NPLs in the business portfolio decreased by 0.8% to AZN375M. Furthermore, the NPL ratio decreased by 0.5pp to 2.5% due to the rise in the size of newly issued business loans. Credit risks remain stable in the dynamics of the NPL portfolio across business sectors.

Chart 26. Dynamics of the NPL portfolio on business loans across sectors of the economy, in million AZN

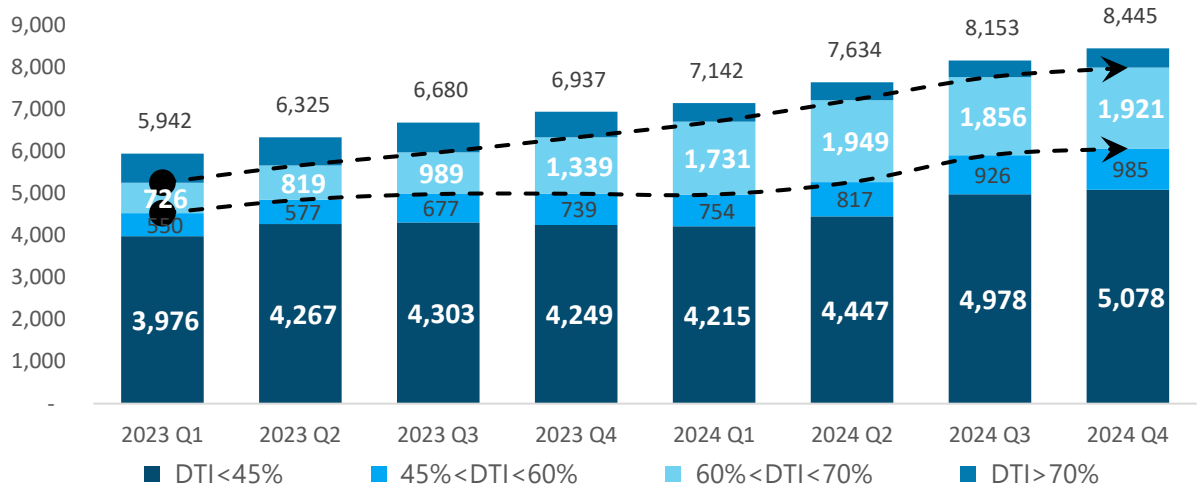


Source: CBA

Credit risks on the consumer portfolio are kept on focus. In 2024, the size of the NPL portfolio on consumer loans increased by 25% in nominal terms (AZN50M) to AZN246M. Nevertheless, due to the high growth rate of consumer loans compared to the end of last year, the NPL ratio increased by just 0.08 pp to 2.92%. Note that 54% of consumer loans were issued to individuals employed in the public sector with stable incomes.

Consumer portfolio growth is driven by the DTI<45%. In 2024, 55% (AZN830M) of the consumer portfolio growth was due to BGN<45%. The CBA's prudential policy on consumer lending aims to promote healthy and responsible borrowing among the population and safeguard the sector against potential risks. Based on the amendments to the regulatory framework, an imperative cap of 70% has been set for the upper limit of the DTI ratio. To reduce risks associated with consumer loans that have a high DTI ratio (DTI > 45%), provisioning requirements and risk weights based on the DTI ratio have been tightened.

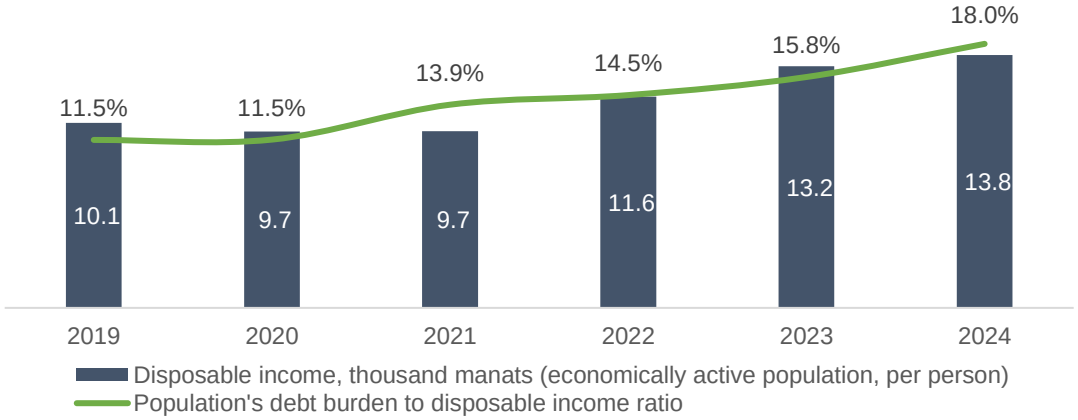
Chart 27. Dynamics of the breakdown of the consumer portfolio on DTI, in million AZN



Source: CBA

Dynamics of the debt burden of the population[5] is kept on focus. Although disposable income of the population has shown growth, the share of debt burden in disposable income is rising. The share of debt burden of the population in disposable income increased by 2.2 pp to 18% compared to the end of last year. Findings of the Credit Conditions and Funding Sources survey also suggest that 15% of banks reported a moderate increase in household borrowing. The CBA attaches great importance to the dynamics of borrowing of the population and shapes a related regulatory policy.

Chart 28. Dynamics of debt burden of the population to disposable income

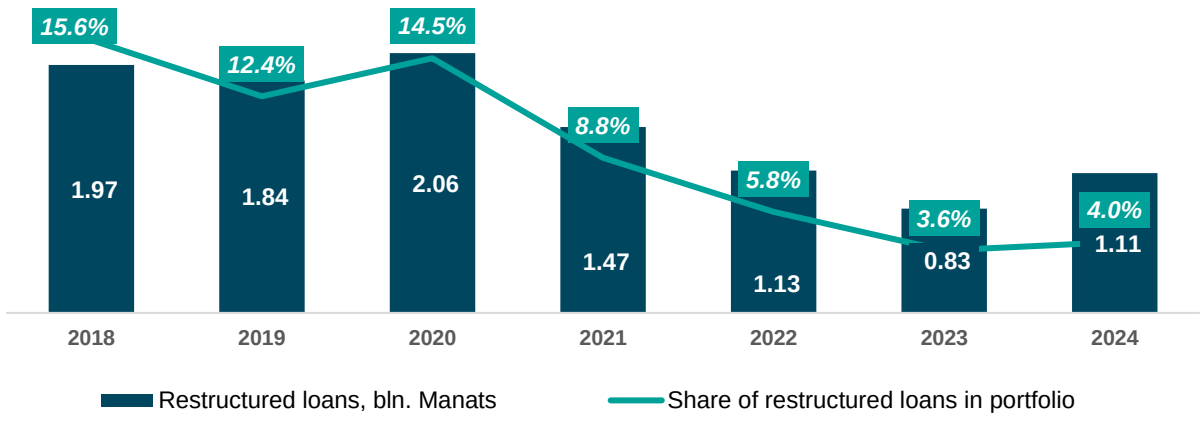


Source: CBA

[5] Debt burden of the population = the total outstanding amount of consumer and mortgage loans owed by individuals to credit institutions (banks and NBCIs)

The NPL ratio on the mortgage lending is on the lows of recent years. In 2024, the nominal size of NPL on the mortgage portfolio decreased by 14% (AZN5.4M) to AZN34M. The share of NPLs in the portfolio decreased by 0.3 pp to 0.8%.

Chart 29. Dynamics of the restructured portfolio, in billion AZN



Source: CBA

Although the restructured loan portfolio has increased, it is not systemic in nature. In 2024, the restructured loan portfolio increased by 34% (AZN282M) to AZN1.1B, driven by a limited number of borrowers on the business loans portfolio (AZN273M).

Box 3. Behavioral model-based measures for lending regulation

The rapid development of digital transformation and information technologies has led to the emergence of new trends in the financial system. The expansion of technological capabilities has enabled traditional banking services to be delivered through alternative channels at lower cost and with greater speed. As a result of process automation in banks, the strengthening of customer-centric approaches, and more precise risk measurement, the volume of data collected has increased. In addition, the ongoing advancement of artificial intelligence and machine learning has further enhanced the accuracy of forecasting by leveraging customer data.

Driven by these technological innovations and the availability of extensive customer data, the use of behavioral models in lending has become increasingly relevant for banks. While the application of behavioral models facilitates financial inclusion and optimizes business processes, it also requires that banks using these models have adequate resources, ensure continuous validation of the models, and comply with regulatory requirements.

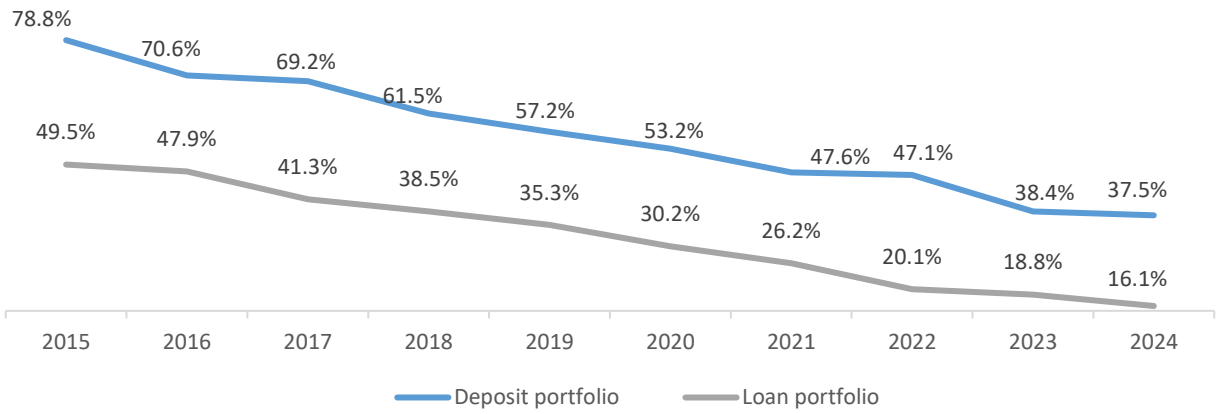
Accordingly, in December 2024 changes were made to the **'Regulation on credit risk management in banks', the 'Regulation on prudential ratios and requirements related to credit risks, including large credit risk exposures', the 'Regulation on creation of specific provisions for asset classification and loan loss provisioning'** ***and the 'Regulation on calculation of bank capital and its adequacy' regarding*** **behavioral model-based measures for lending regulation**. As a result of amendments to the existing regulations, new concepts specific to behavioral models have been introduced. The amendments establish requirements concerning the comprehensiveness of the risk management system, the model development and validation processes, as well as the obligation to inform the CBA about the models in use. Furthermore, the definition of borrower income has been revised, and considering potential risks associated with model-based lending, new limits and additional provisioning requirements have been introduced.

Market risk of the banking system

The banking sector's foreign currency position is within the prudential requirements. As of end-2024, the banking system's short open currency position amounted to AZN329M, the banking system's open currency position to total regulatory capital ratio was 5.3%, which is within prudential requirements. According to the 'Regulations on setting open currency position in banks', the maximum threshold on the ratio of the open currency position on freely convertible currency to bank's total regulatory capital is [-20%, +20%] (for one currency [-10%, +10%]).

De-dollarization of the sector continues. In 2024, dollarization of the banking sector's lending portfolio decreased by 2.7 pp to 16.1% (historical lows). De-dollarization of the deposit portfolio continued as well. Dollarization of the deposit portfolio decreased by 0.9 pp to 37.5% compared to the end of 2023.

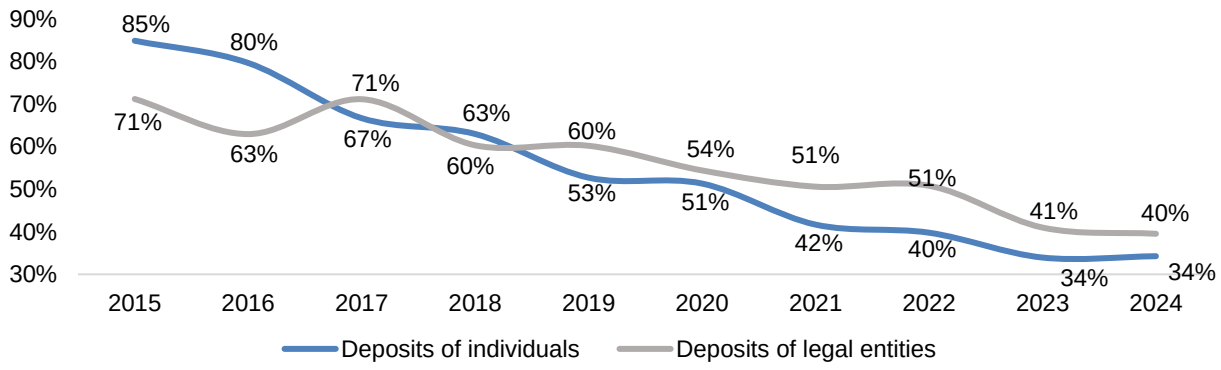
Chart 30. Dynamics of dollarization of the deposit and loan portfolios



Source: CBA

De-dollarization of the deposit portfolio continued. Dollarization of term deposits of LEs decreased by 6.7 pp to 52.5%. The share of foreign currency denominated demand deposits of LEs in total deposits decreased by 1 pp to 35.3%. Dollarization of term deposits of individuals increased by 0.8 pp to 35.1%, and that of demand deposits decreased by 0.5 pp to 33.0% compared with the end of 2023.

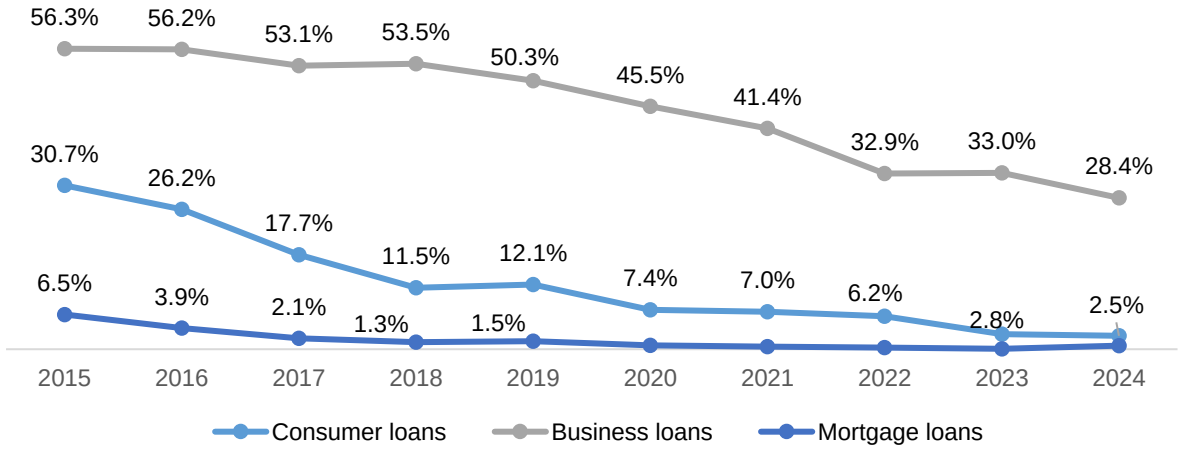
Chart 31. Dynamics of dollarization of the deposit portfolio



Source: CBA

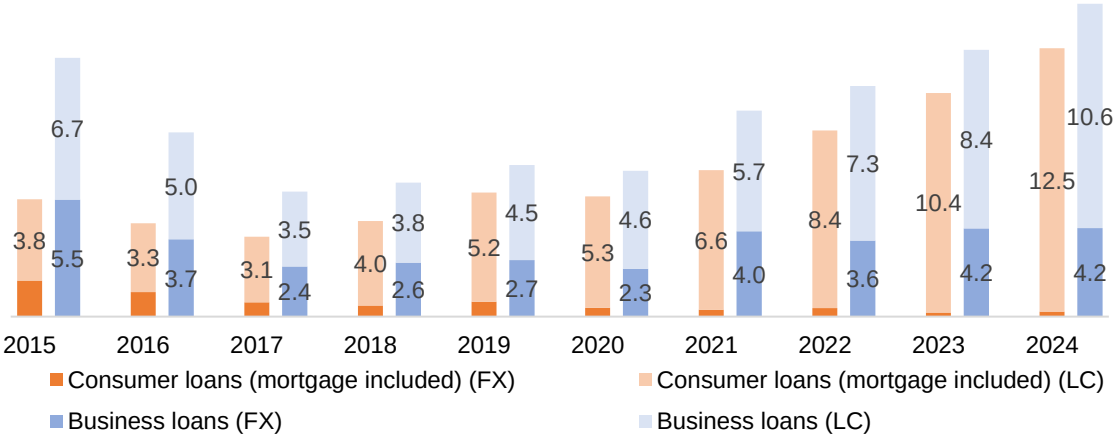
In 2024, de-dollarization of the lending portfolio was driven by business loans. Amid the exchange rate stability of the manat and the expansion of manat lending, the share of national currency denominated loans in the lending portfolio continued to grow. Dollarization of the lending portfolio decreased by 2.7 pp to 16%, due to business loans. Over the reporting year dollarization of business loans decreased by 4.6 pp to 28.4%. As, according to CBA's regulations, mortgage loans are required to be issued in the national currency only, the mortgage lending is nearly in the national currency. Dollarization of consumer loans decreased by 0.3 pp to 2.5%. As of 31.12.2024, dollarization of consumer loans stood at 0.3%, except for consumer loans secured with foreign currency denominated deposits.

Chart 32. Share of foreign currency in the loan portfolio, in %



Source: CBA

Chart 33. Currency structure and dynamics of the lending portfolio, in billion AZN



Source: CBA

Banks interest rate sensitivity does not threaten their resilience. The interest rate risk was analyzed with the duration method[6]. Since most assets and liabilities are recognized at a balance value in the sector, calculations were made over the balance value and discounted at the refinancing rate of the CBA. The main source of the

Chart 34. Maturity breakdown and average weighted duration of assets and liabilities

	Assets		Liabilities		Nominal gap (Assets – liabilities)
Immediate	11.7	22%	25	53.8%	-13.3
0-1 year	18.9	35.6%	12.7	27.5%	6.2
1-3 years	12.6	23.8%	4.4	9.6%	8.2
3-5 years	4.5	8.5%	1.0	2.1%	3.5
>5 years	5.3	10.1%	3.3	7.1%	2
Total	53	100%	46.4	100%	6.6
Average weighted duration	1.29		0.67		

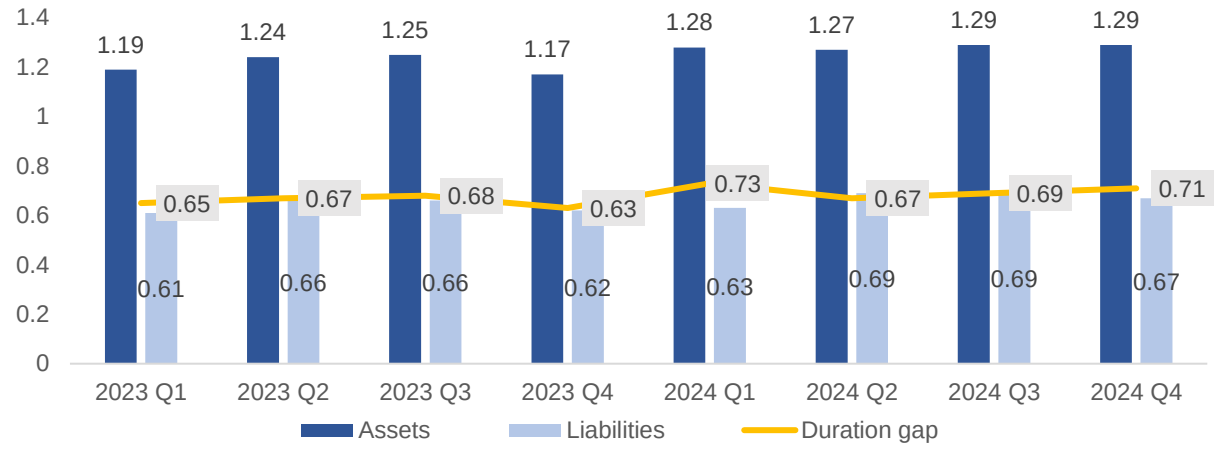
Source: CBA

duration mismatch between assets and liabilities is that the average weighted duration on the loans issued is three times more than that of deposits attracted.

[6] *The duration analysis is used for measuring the weighted average term of assets and liabilities according to Macaulay duration concept. To remind, the duration gap analysis measures the sensitivity of banks to market interest rates with the following formula:* $\partial(asset) - [\partial(\text{liability}) * \text{liability}/\text{asset}]$. *During the analysis, assets and liabilities are discounted by the discount rate of the CBA.*

As a result of a positive duration gap, an increase in interest rates has a reducing effect on banks' capital. Based on simulations conducted, a 1 pp increase in the interest rate leads to a 1 pp decrease in the capital adequacy ratio, which does not pose a threat to the financial stability of the banking system.

Chart 35. Average weighted duration and duration gap of assets and liabilities



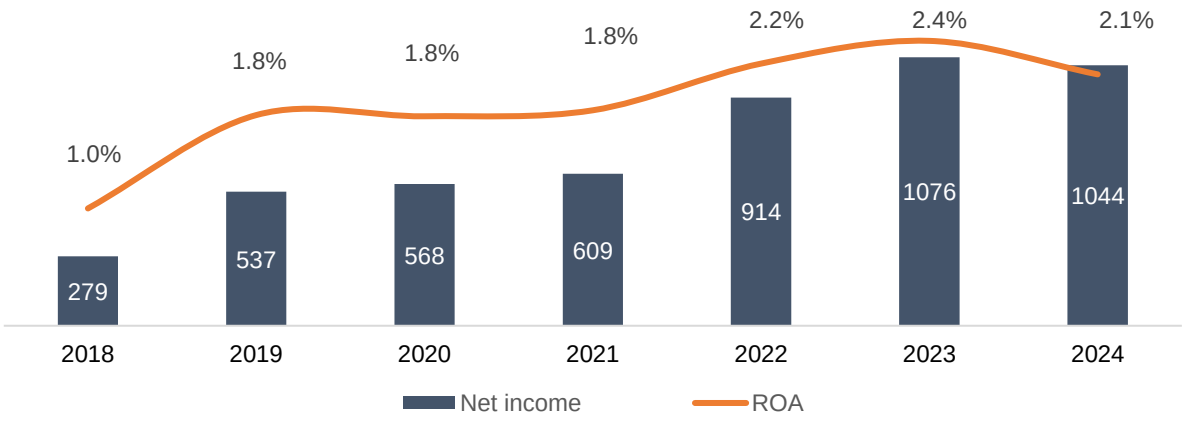
Source: CBA

Average weighted duration gap of the sector increased year-over-year. In 2024, average weighted duration on assets increased year-over-year, attributable to the rise in the share of assets with 3-5-year maturity, driven by securities and loans to customers. The rise in average weighted duration on liabilities is attributable to the rise in the share of liabilities with 1-3-year maturity, driven by customer deposits and securities issued by banks. Consequently, the average weighted duration gap yoy increased from 0.63 to 0.71.

Banking system profitability

While the banking system's profitability decreased slightly due to rising interest and non-interest expenses, the sector's overall profitability remains high. In 2024, net profit of the banking system yoy decreased by 3% (AZN-32M) to AZN1044M. Amid the drop in sector's profitability, ROA decreased by 0.3 pp to 18.1%, driven by rising interest and non-interest expenses.

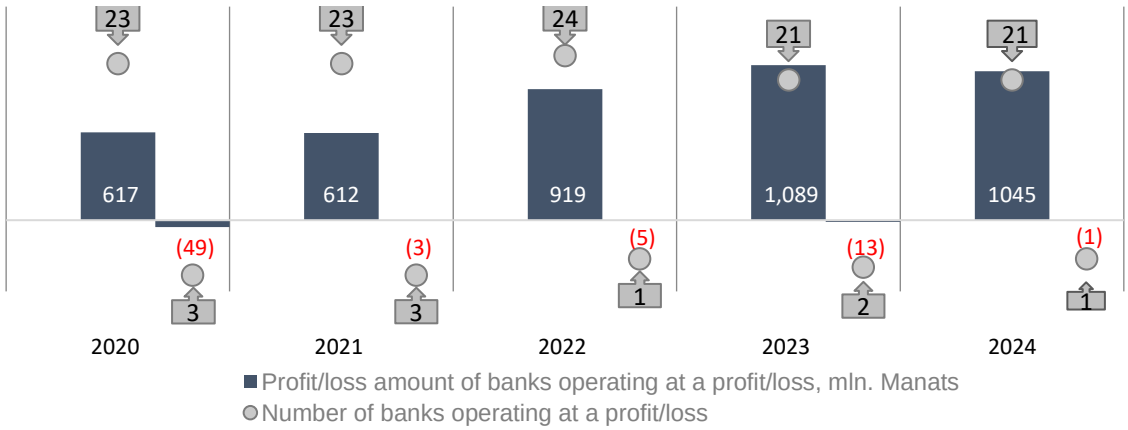
Chart 36. Net profit and ROA of the banking sector



Source: CBA

In 2024, all banks operated profitably except for one. The profit of the 21 banks that operated profitably amounted to AZN1,045M, while the loss of the one unprofitable bank was AZN1M.

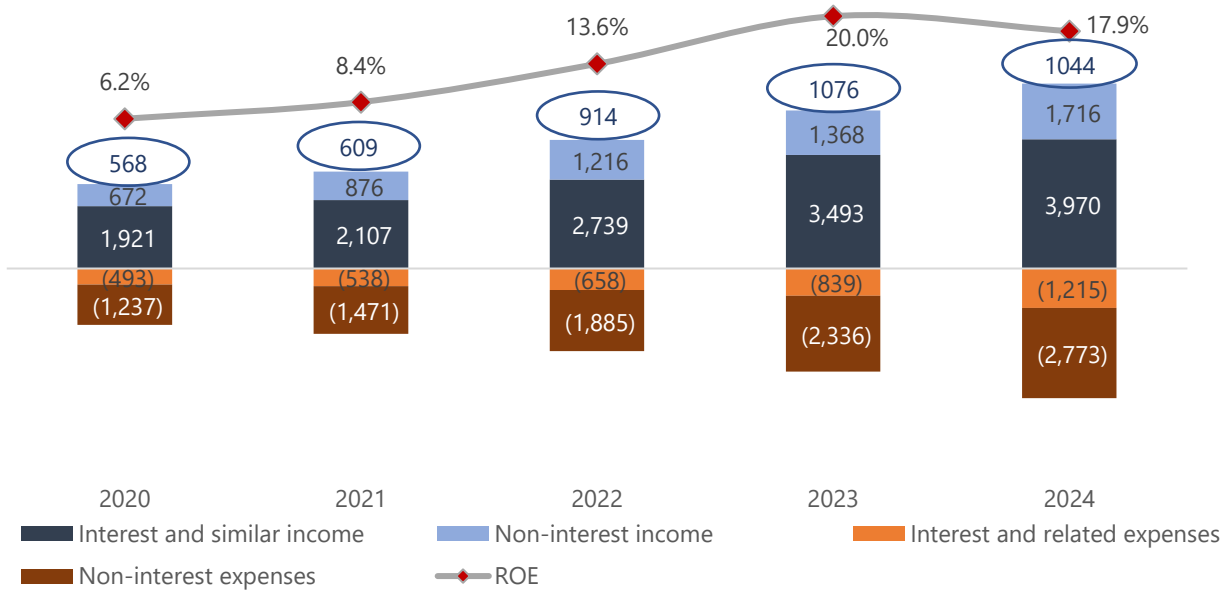
Chart 37. Indicators of banks operating at profit/loss



Source: CBA

The sector's profitability decreased due to rising interest and non-interest expenses. Interest and non-interest income yoy increased by 14% and 25% respectively, and interest and non-interest expenses increased by 45% and 19% respectively. Interest and non-interest expenses increased due to recent slight rise in deposit rates by banks, as well as growing operating expenses. However, the banking system's profitability remains high.

Chart 38. ROE of the banking sector and its key components, in million AZN

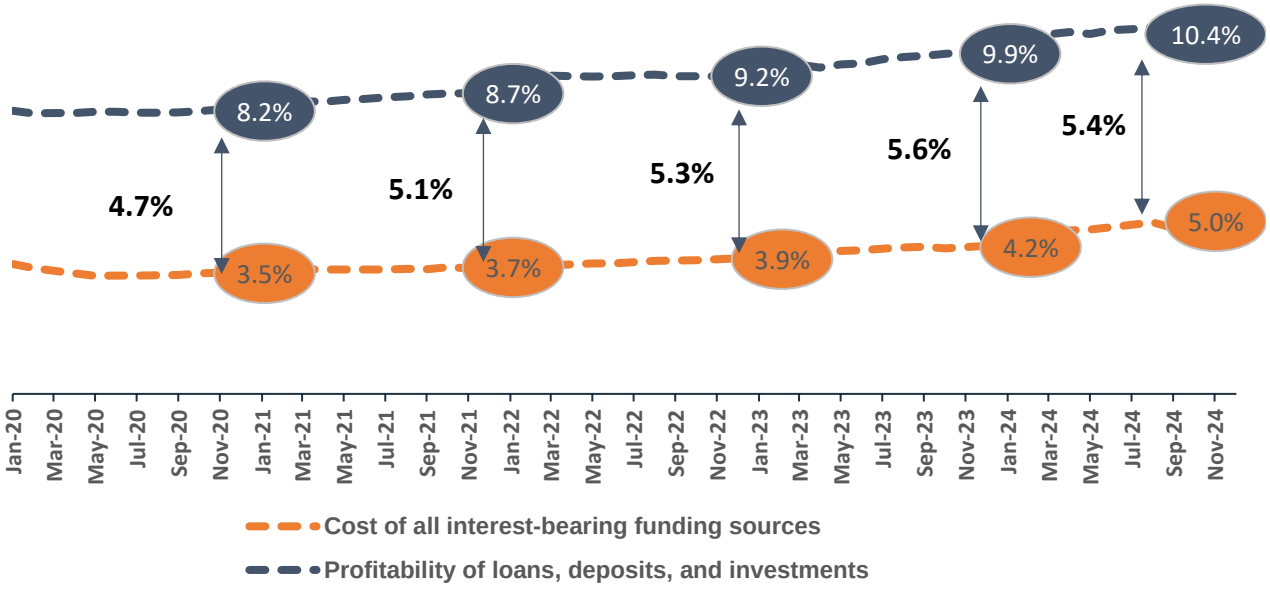


Source: CBA

Funding expenses in the sector are rising. Interest expenses increased year-over-year on both individual and legal entity deposits, as well as on other interest-bearing liabilities such as repos/reverse repos, interbank deposits, and loans.

Net interest rate spread slightly shrank amid rising interest expenses. Cost of all interest-bearing funding sources yoy increased by 0.7 pp to 5%, and ROA increased by 0.5 pp to 10.5%. Consequently, interest spread shrank by 0.2 pp year-over-year.

Chart 39. Funding cost and profitability of the banking sector, in %

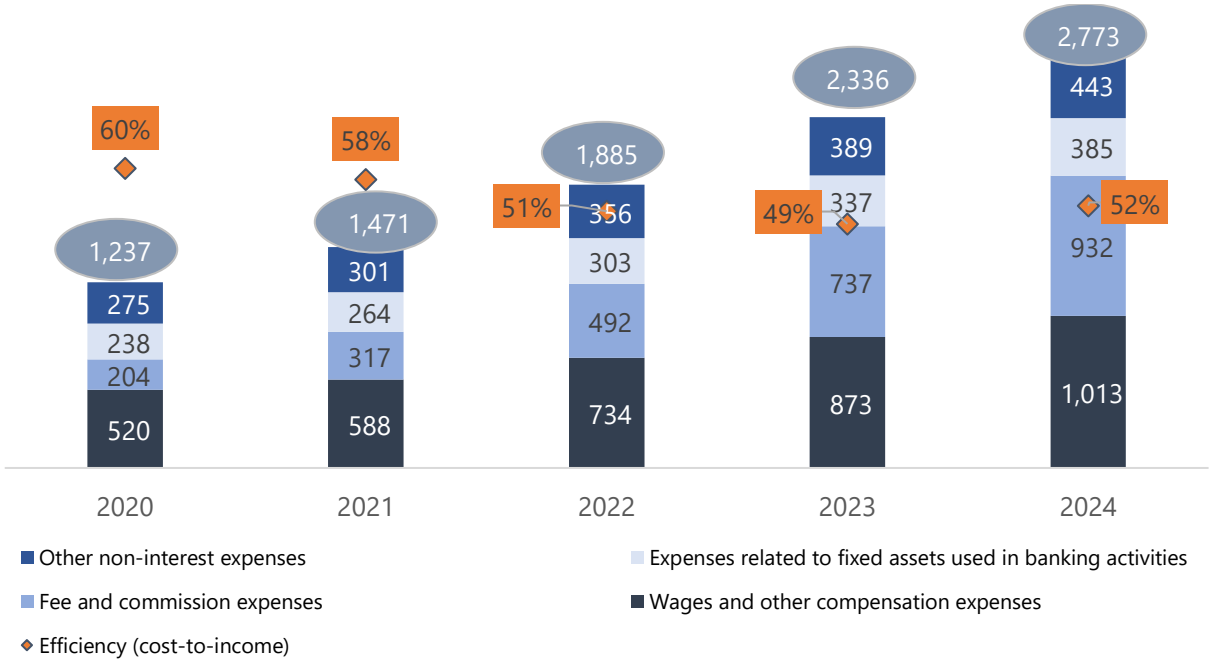


Source: CBA

The efficiency indicator of the banking sector declined against the backdrop of an increase in non-interest expenses. Compared to the end of 2023, banks' non-interest expenses increased by 18.7% (AZN437M) to AZN2.8B, driven by salary and other compensation expenses (AZN140M) and fee/commission expenses (AZN195M). Due to the growth rate of non-interest expenses outpacing the growth rate of net interest and non-interest income, the sector's efficiency indicator[7] declined by 3.7 pp to 52.4%.

[7] Efficiency indicator = (non-interest expenses – commission expenses)/ (Net interest income + non-interest income – Commission income)

Chart 40. Efficiency indicators of the banking sector, in million AZN

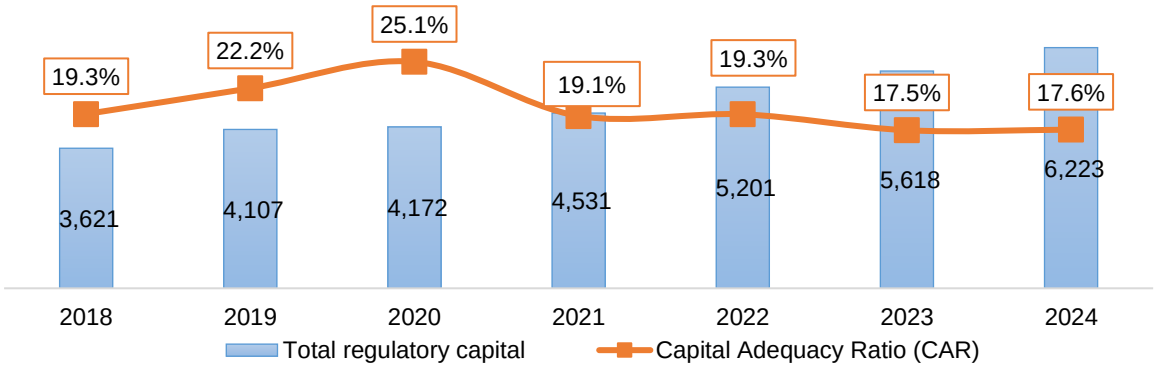


Source: CBA

Capital position of the banking sector

The sector's capital position is capable to absorb potential losses surpassing prudential requirements. In 2024, total regulatory capital of the banking sector increased by 10.8% (AZN605M) to AZN6.2B. The capital adequacy ratio (CAR) increased by 0.1 pp to 17.6%, up to 1.8 times higher than the minimum prudential requirement. The increase in the CAR was driven by the growth in total regulatory capital outpacing the increase in RWAs amid strong lending dynamics.

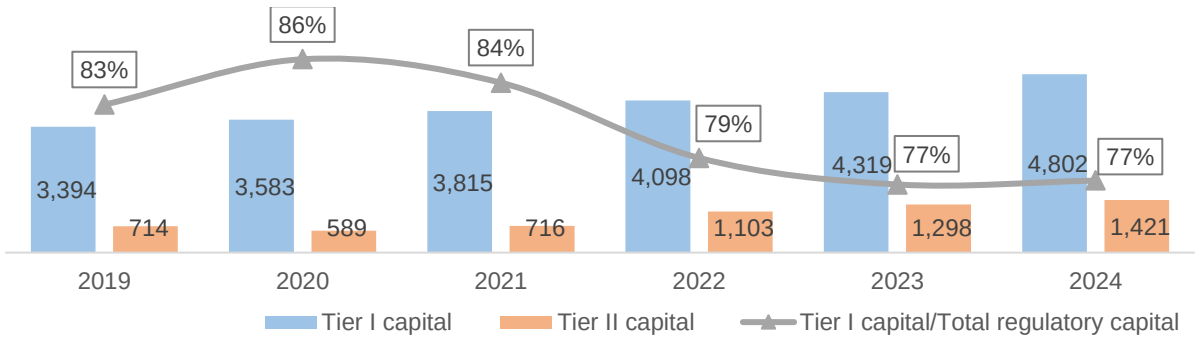
Chart 41. Dynamics of capital adequacy, in million AZN



Source: CBA

Total regulatory capital increase stemmed from Tier I capital. Tier I capital increased by 11.2% (AZN482M) to AZN4.8B, Tier II capital increased by 9.4% (AZN122M) to AZN1.4B. Capital increase was attributable to profit generation by banks. High-quality Tier I capital increased due to the migration of retained earnings for 2023 to net profit, Tier II – due to profit of the current year. Capital injections of over AZN153M were made in the form of increases to banks' shareholder capital. Additionally, the sector paid out AZN0.6B in dividends.

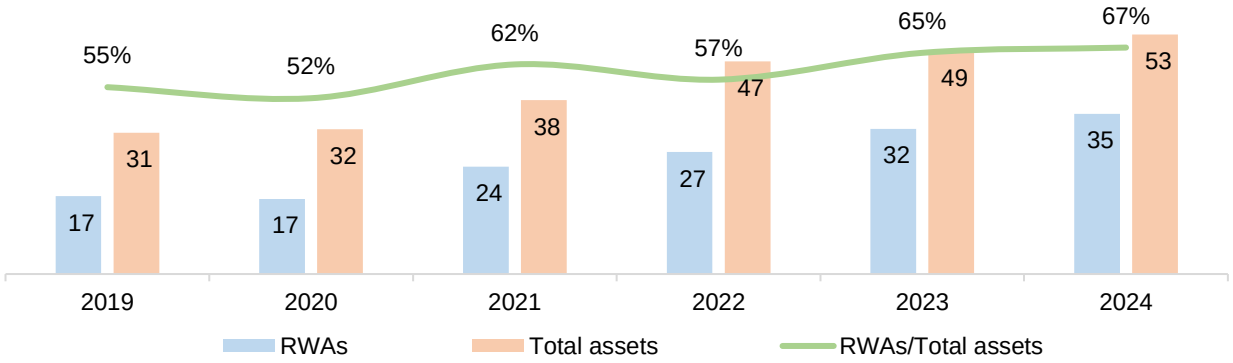
Chart 42. Dynamics of capital adequacy, in million AZN



Source: CBA

RWAs increased amid high lending dynamics. Amid a 7.8% (AZN3.8B) increase in total assets, RWAs rose by 10.3% (AZN3.3B). As a result, the RWAs to total assets ratio increased by 2 pp to 67%, driven by active lending operations in the banking sector. Of the total risk-weighted assets, 93.3% are related to credit risk, 5.9% to operational risk, and 0.8% to market risk.

Chart 43. Dynamics of assets and RWAs, in billion AZN



Source: CBA

Box 4. Impact of operational resilience risks on financial stability in the banking sector

Although the growing digitalization and increasing interconnections between segments of the financial system have elevated the importance of operational resilience, **macroprudential regulation in this area remains a relatively new and developing field in international practice. While several developed countries have adopted different approaches, the process of shaping common frameworks is still ongoing. (Table 2)**

In recent times, the widespread use of digital technologies in the operations of banks in our country has highlighted **the relevance of operational resilience risks for financial system stability**. To mitigate the potential systemic impact of these risks, it is essential to first establish an operational risk management framework **at an individual bank level**, ensure the collection of operational risk data, and implement reporting mechanisms to the supervisory authority.

Operational risks can primarily spread through **three main transmission channels** in the financial system, amplifying the impact of an incident and posing a threat to system stability:

1. **Operational contagion –** an operational incident originating in one segment of the financial system may **cause disruptions in the operations** of other segments, the financial system, or even the broader economy.
2. **Financial contagion – financial losses** resulting from an operational failure at one financial institution may lead to its inability to meet liabilities, which may impact other financial institutions, triggering a domino effect.
3. **Loss of confidence –** may lead to a **loss of confidence** in a specific financial institution or the overall financial system.

Table 2. International approaches to the prudential regulation of operational resilience

Issuing authority	Document name	Coverage of the document
FED (2020)	Sound Practices to Strengthen Operational Resilience	The document outlines existing practices aimed at enhancing operational resilience and includes the FED's guidance for large banks in this area.
Basel Committee (2021)	Principles for Operational Resilience	The Basel Committee's principles on operational resilience cover areas such as governance, operational risk management, business continuity planning and testing, identification and mapping of critical operations and their delivery processes, management of third-party dependencies, incident management, and the resilience of ICT, including cybersecurity.
EU (2025)	Digital Operational Resilience Act (DORA)	The DORA Regulation sets requirements for financial institutions and third parties to ensure resilience against risks that may arise from ICT-related operational incidents.
Bank of England (2024)	Preliminary Research Paper on a Macroprudential Approach to Resilience Against Operational Risks	The document establishes a framework for the assessment of operational resilience. The framework addresses issues such as systemic risks to operational resilience, cyber stress tests, and the evaluation of dependencies on critical third parties. Additionally, it includes the concept of impact tolerance in the assessment of systemic operational resilience, which defines the expectations regarding how quickly financial institutions can resume critical functions following an operational incident.

*Table 3. Selected main banking system indicators *, in million AZN*

	2023 QIV	2024 QI	2024 QII	2024 QIII	2024 QIV
Balance sheet items					
Total assets	49,178	48,910	50,328	50,841	53,001
Liquid assets	13,154	12,673	12,509	11,922	14,243
Lending portfolio	23,183	24,103	25,430	26,706	27,478
Business loans	12,617	13,202	13,875	14,408	14,787
Consumer loans	6,937	7,142	7,634	8,153	8,445
Mortgage loans	3,629	3,759	3,921	4,145	4,246
Total liabilities	43,115	42,612	44,086	44,550	46,383
Current liabilities	23,687	24,769	24,806	24,234	24,866
Deposits of individuals	12,582	12,869	13,880	13,849	14,299
term deposits	6,882	7,227	7,751	8,243	8,601
demand deposits	5,700	5,642	6,130	5,606	5,698
Deposits of legal entities	21,968	21,944	21,305	22,210	23,397
term deposits	4,500	4,860	5,052	5,401	5,817
demand deposits	17,468	17,085	16,253	16,809	17,580
Equity	6,063	6,297	6,242	6,291	6,618
Capital position					
Tier I capital	4,319	5,342	4,950	4,755	4,802
Total regulatory capital	5,618	5,817	5,792	5,927	6,223
RWAs	32,085	31,954	33,126	34,532	35,401
Tier I capital adequacy	13.50%	16.72%	14.94%	13.77%	13.57%
Total regulatory capital adequacy	17.50%	18.20%	17.49%	17.16%	17.58%

	2023 Q IV	2024 Q I	2024 Q II	2024 Q III	2024 Q IV
Profitability					
Net profit	1,076	311	614	830	1,044
ROA	2.40%	2.54%	2.49%	2.24%	2.10%
ROE	20.30%	21.86%	21.37%	19.39%	18.12%
Liquidity risk profile					
Liquid assets	13,154	12,673	12,509	11,922	14,243
Liquid assets in total assets	26.70%	25.91%	24.85%	23.45%	26.87%
Instant liquidity ratio	52.20%	49.97%	49.62%	46.24%	51.94%
Liquidity coverage ratio, total	134.47%	134.52%	140.98%	133.86%	150.06%
National currency	106.24%	99.61%	103.62%	95.58%	126.30%
Foreign currency	118.05%	168.48%	201.73%	191.75%	177.99%
Credit risk profile					
Non-performing loans	614	660	673	707	655
Business loans	378	417	406	428	375
Consumer loans	197	204	226	244	246
Mortgage loans	39	39	40	36	34
NPL ratio	2.60%	2.74%	2.65%	2.65%	2.38%
Business loans	3.00%	3.16%	2.93%	2.97%	2.53%
Consumer loans	2.80%	2.85%	2.97%	2.99%	2.92%
Mortgage loans	1.10%	1.00%	1.00%	0.86%	0.80%
Market risk profile					
Assets dollarization	33.70%	33.30%	32.40%	32.00%	30.60%
Liabilities dollarization	37.30%	38.00%	36.00%	35.60%	35.80%

* *Prudential reporting methodology based.*

Assessment of banking system resilience

The resilience of the banking system to external shocks was assessed through stress testing. A top-down stress test was conducted to evaluate banks' capital resilience under various adverse macro-financial scenarios and identify appropriate mitigation and policy measures. A pessimistic scenario was developed using the extreme but plausible approach, taking into account a baseline scenario to determine the impact of macroeconomic factors on banks' resilience under stress conditions. Macroeconomic indicators projected under these scenarios were integrated into econometric satellite models, and dependent variables (NPL ratios, interest rates, etc.) were forecasted for upcoming years. In the next stages, simulations based on these projected dependent variables were conducted for credit risk, interest rate risk, exchange rate risk, and securities revaluation risk. As a result, the financial position of banks for the following years was assessed on a dynamic basis.

The assumptions under the baseline and pessimistic scenarios were as follows:

Baseline scenario:

The baseline scenario is based on a stable global environment, sustained economic growth, and controlled inflation. Within this framework, it is expected that the growth rate of GDP will demonstrate a positive trend in the coming years, supported by stable Brent crude oil prices.

In the baseline scenario, the non-oil sector is anticipated to be the main driver of economic growth, with a faster pace of development. At the same time, annual inflation is projected to gradually decline to a manageable level, and both the nominal and real effective exchange rates of the national currency are expected to appreciate—supporting the strengthening of the manat's purchasing power.

Against the backdrop of price stability, a trend toward monetary policy easing is anticipated, along with growing expectations of a reduction in the policy rate. Fiscal policy, on the other hand, is expected to remain stable, with government budget expenditures held at consistent levels. This approach will not only ensure the continued development of the economy but also contribute to safeguarding macroeconomic stability.

Pessimistic scenario:

This scenario anticipates severe macroeconomic pressures such as prolonged oil price shocks, a global economic downturn, and a deep financial crisis. It is developed in line with potential global economic risks and is not considered an official forecast.

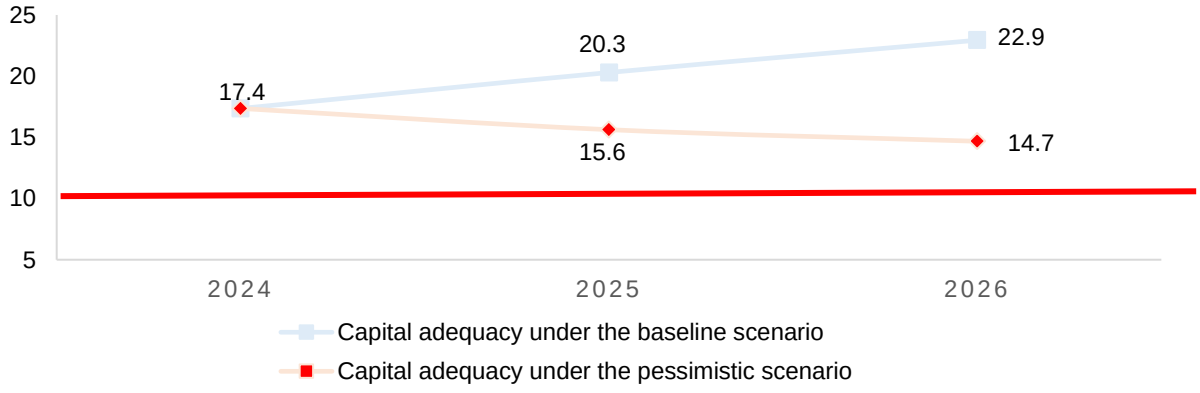
Under the severest scenario, a sharp decline in Brent crude oil prices is assumed, which could pose significant risks to the Azerbaijani economy. Under such conditions, GDP growth weakens considerably, followed by economic contraction in upcoming years.

In this scenario, the non-oil sector experiences modest growth initially, followed by a decline. A sharp rise in inflation creates serious pressure on price stability. The nominal and real effective exchange rates of the national currency drop significantly, leading to a depreciation of the manat. On the fiscal side, consolidation measures are implemented, and budget expenditures, especially capital expenditures, are reduced.

Overall, this scenario is characterized by reduced economic activity, rising prices, and increased pressure on the foreign exchange market, making it more difficult to maintain economic stability.

According to stress-test results, banking sector's current capital buffer is capable to absorb losses. Under the baseline scenario the CAR stands at 20.3% in 2025 and stable growth in the following year is expected to result in the CAR reaching

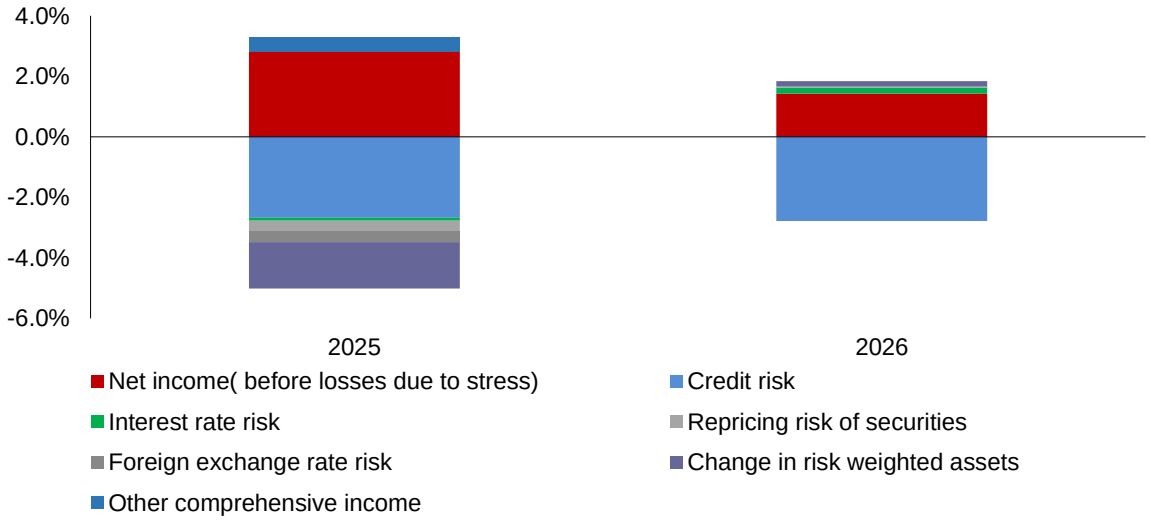
Chart 44. Stress-test resulted CAR of the banking system, in %



Source: CBA

22.9%[8] in 2026. While under the pessimistic scenario, the CAR of the banking sector decreases by 1.7 pp and 0.9 pp to 15.6% and 14.7% in 2025 and 2026, respectively. Overall, although the banking sector experiences a certain degree of capital erosion according to the stress test, the sector's capital adequacy exceeds the minimum regulatory requirements.

Chart 45. Channels of impact of the CAR under the pessimistic scenario, in %



Source: CBA

According to stress-test findings, the main channels affecting banks' capital adequacy were credit risk and rising RWAs. In 2024, the credit risk channel had a 2.7 pp, and RWAs a 1.5 pp downward effect on capital adequacy.

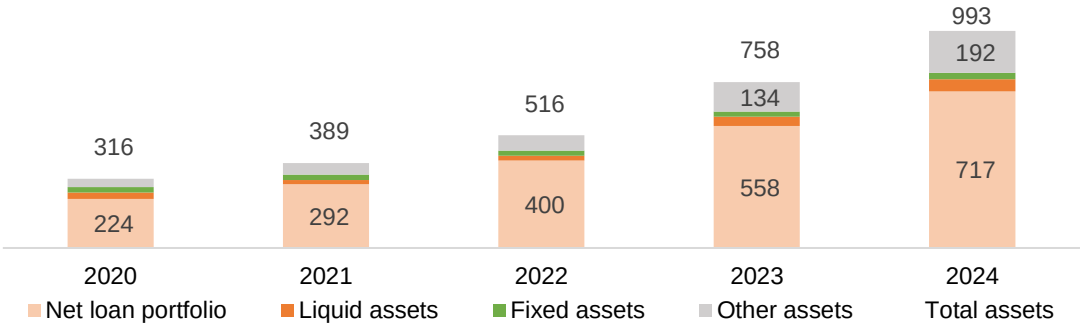
[8] Under the baseline and pessimistic scenarios banks were assumed not to pay dividends

Non-bank credit institutions

As of end-2024, the number of non-bank credit institutions totaled 93, including 57 NBCIs and 36 credit unions (CUs).

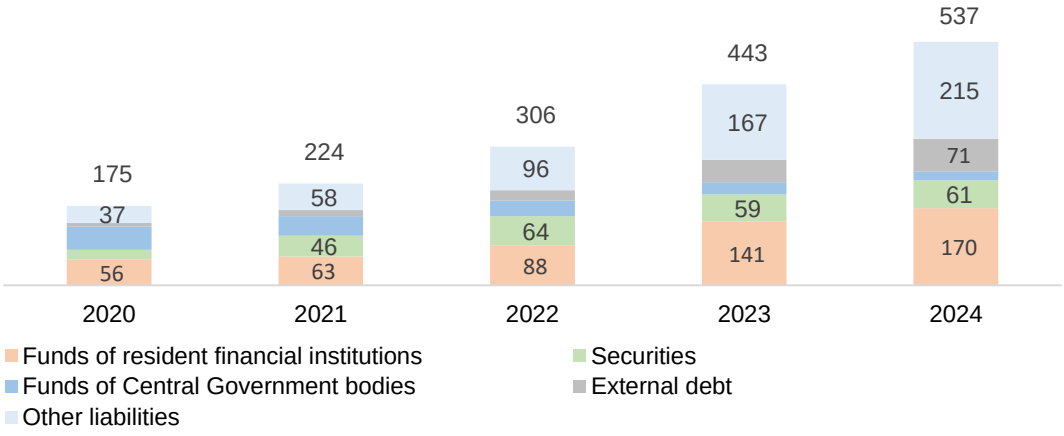
High growth of NBCIs' assets over recent two years further increased their role in financial intermediation. The market share of NBCIs was 1.6% in terms of their assets[9]. In 2024, licenses of 4 NBCIs were revoked, and 3 NBCIs were licensed. 15 of the currently active NBCIs operate with foreign capital, of which 12 have foreign capital shares exceeding 50%. During six months the number of persons employed with NBCIs increased by 257 persons to 3 546 persons and the number of branches increased by 8 to 304.

Chart 46. Dynamics of NBCIs' assets, in million AZN



Source: CBA

Chart 47. Dynamics of NBCIs' liabilities, in million AZN



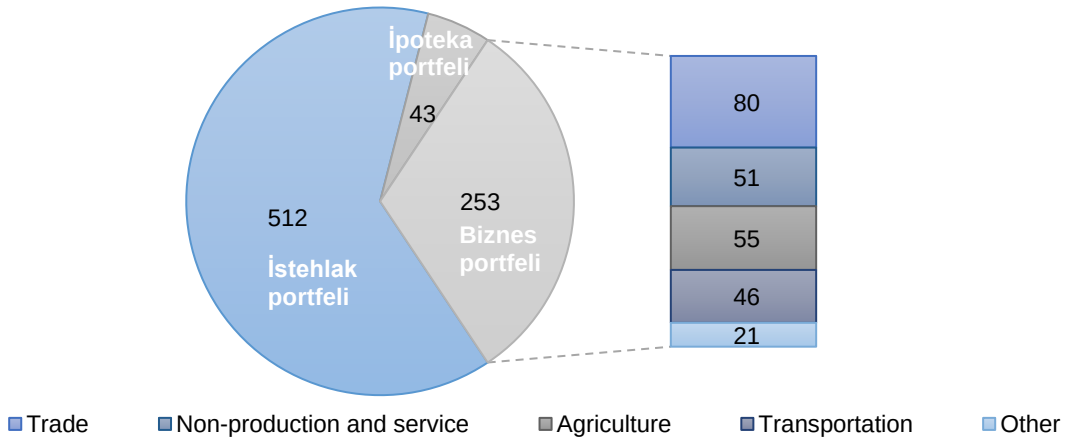
Source: CBA

[9] *Analysis of NBCIs were analyzed without taking into account 'Aqrarkredit' CJSC NBFC.*

In 2024, balance sheets of the NBCI sector expanded amid directing attracted funds to the net lending portfolio. Total assets of NBCIs increased by 31% (AZN235 M) to AZN993M, driven by the net lending portfolio. The net lending portfolio increased by 28% (AZN159M), due to consumer loans.

Amid the rising assets of NBCIs, the size of funds attracted from banks and other financial institutions increased as well. Total liabilities of NBCIs increased by 21% (AZN94M) to AZN537M, due to loans from resident and non-resident banks and other financial institutions (AZN50M). The share of other liabilities was also high in the increase of NBCIs' liabilities. Other liabilities yoy increased by 29% (AZN48M), the main part of which was made up of the loans provided by the founders to the NBCIs.

Chart 48. Lending portfolio structure of NBCIs, in million AZN



Source: CBA

Consumer loans continue to hold the largest share in NBCIs' portfolios. The lending portfolio increased by 35% (AZN208M) to AZN808M. Consumer loans yoy increased by 41% (AZN150M), mortgage loans by 247% (AZN31M), and business loans by 12% (AZN27M). As of end-2024, consumer loans accounted for 63.4% (AZN512M), business loans for 31.3% (AZN253M), and mortgage loans for 5.3% (AZN43M) of the total lending portfolio of NBCIs. Business loans were broken down as follows: trade 32% (AZN80M), agriculture 22% (AZN55M), other non-production and services 20% (AZN51M), transportation 18% (AZN46M), and other areas 8% (AZN21M).

Box 5. Enhancing prudential regulation of NBCIs and establishing framework for daily (short-term) loans

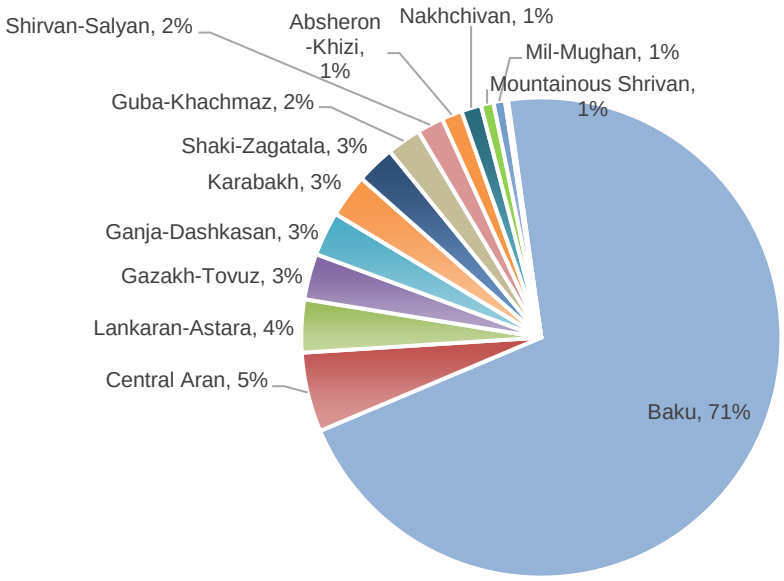
As an essential element of financial inclusion, NBCIs provide broader access to financial resources for the population and SMEs. To stimulate this activity and strengthen regulation in the sector, the Management Board of the Central Bank of the Republic of Azerbaijan with its decisions of 15.11.2024 approved the 'Regulation on prudent management of non-bank credit institutions' and the 'Regulation on credit risk management in non-bank credit institutions'.

The regulations introduce new requirements aimed at ensuring the financial stability of NBCIs. The minimum authorized capital requirement for newly established NBCIs has been increased to AZN1M, a capital requirement of AZN1M and a liabilities-to-capital ratio requirement has also been set for both existing and new NBCIs, the provisioning requirements have been revised. The regulations also introduce qualitative requirements: the establishment of a credit risk management system, credit risk policy, procedures for credit risk assessment and administration, risk monitoring, and the methodology for calculating the effective annual interest rate under credit agreements in NBCIs.

Additionally, for the first time, the regulations define the concept of 'daily (short-term) loans' and establish maximum thresholds for their amount, term, and daily interest rate, along with stricter prudential standards. Daily loans may only be issued in the national currency and up to a maximum amount of AZN 500. The daily interest rate on such loans is capped at 0.3%, and the maximum loan term is limited to 45 days. The regulations also specify that neither movable nor immovable property may be used as collateral for these loans. Furthermore, daily loans may not be restructured. In terms of classification, a daily loan is considered a 'watch loan' upon issuance, and as a 'loss asset' if overdue by just one day. Borrowers may obtain new daily loans only three business days after fully repaying previous ones. Overall, this regulatory framework is designed to reduce risks, prevent over-indebtedness among borrowers, and strengthen lending market sustainability.

While the quality of consumer loans portfolio deteriorated year-over-year, the quality of business loans improved. In 2024, the sector's NPL portfolio increased by 51.7% to AZN112.7M. The NPL ratio increased by 1.6 pp to 13.9%. The NPL ratio increased by 4 pp to 15.8% on consumer loans and decreased by 1.4 pp to 12.5% on business loans.

Chart 49. Distribution of the lending portfolio by economic regions, in %

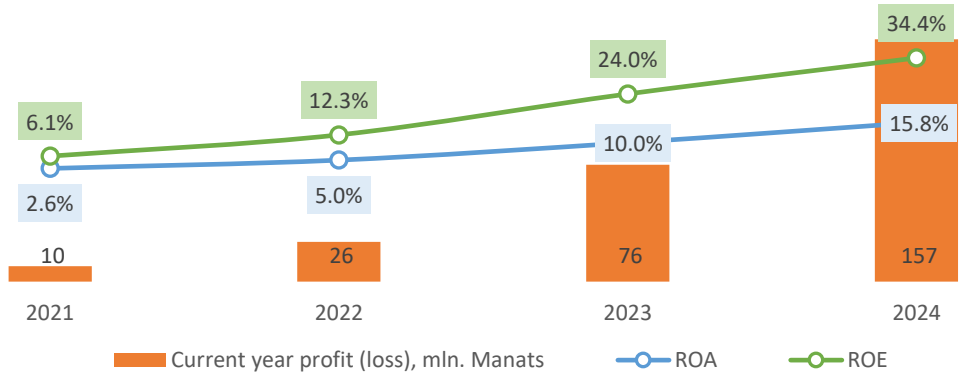


Source: CBA

In terms of regional lending activity, NBCIs are more actively involved compared to banks. In 2024, 29% of NBCIs' loan portfolios consisted of loans issued across economic regions (23% for banks).

Profitability of NBCIs increased. NBCIs earned high profitability in 2024 (net profit – AZN157M), approximately twice the profit of 2023. Sector's ROA and ROE stood at 15.8% and 34.4% respectively.

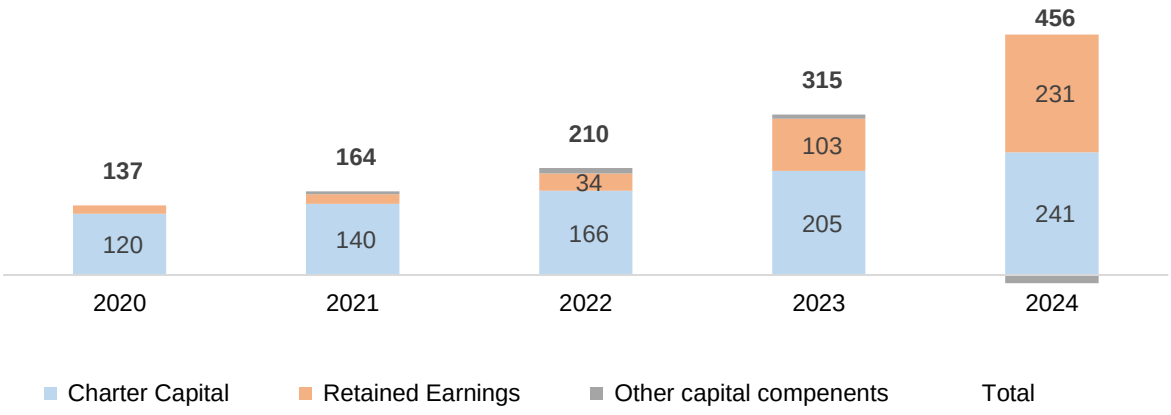
Chart 50. Profitability indicators of NBCIs



Source: CBA

Against the backdrop of rising profitability, the sector's capital position continues to be positive. Over the year capital of NBCIs increased by 45% (AZN141M) to AZN456M, driven by both capital injection, and profit generation of the NBCI sector. Retained earnings doubled to AZN231M, and authorized capital increased by 18% (AZN37M) to AZN241M.

Chart 51. Dynamics of capital components across the NBCI sector, in million AZN



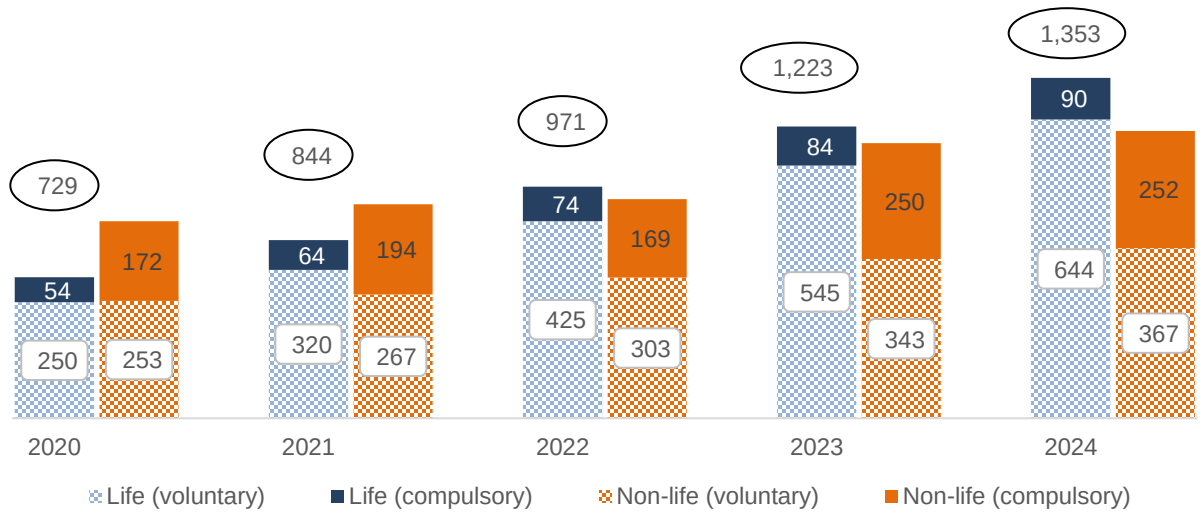
Source: CBA

Insurance sector

As of end-2024, the Azerbaijani insurance market hosted 16 insurance and one reinsurance companies. Of insurance companies 5 were life and 11 nonlife companies. 23 insurance brokers and 481 insurance agents also contributed to activities of the insurance sector.

The insurance sector is realizing its growth potential. Insurance premiums collected in 2024 yoy increased by 10.6% (AZN130M) to AZN135, derived from life (54%) and non-life insurance classes (46%). Life insurance premiums increased by 16.7% to AZN734M, and non-life insurance premiums increased by 4.4% to AZN619M. The growth of both life and non-life insurance stemmed from voluntary insurance. Voluntary insurance classes increased by 13.9% (AZN123M) to AZN1011M, compulsory insurance classes increased by 2.4% (AZN8M) to AZN342M. Endowment life insurance contributed to the growth in voluntary insurance classes (76%, or AZN94M). Although premiums collected in the sector increased, the growth was driven by a limited number of companies.

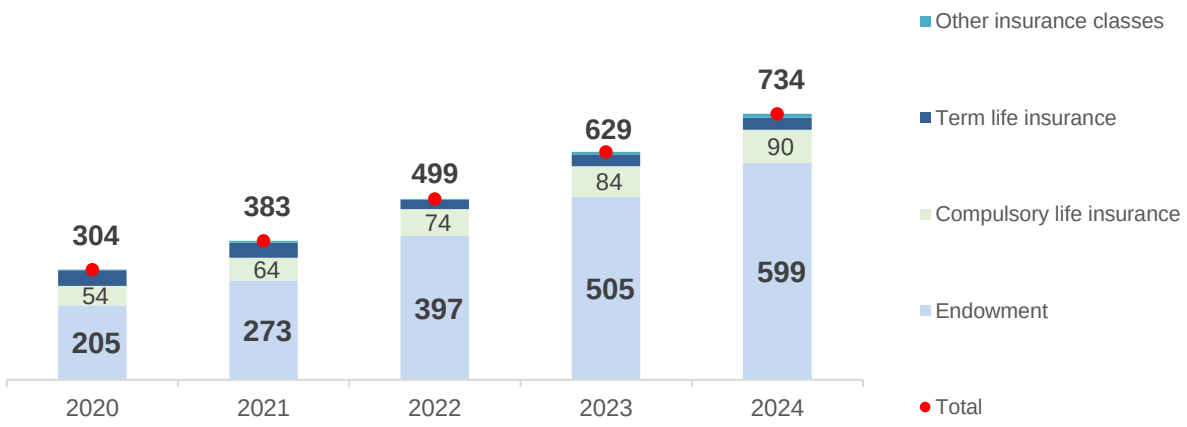
Chart 52.Dynamics of insurance premiums, in million AZN



Source: CBA

The main driver of life insurance growth was endowment life insurance. Insurance premiums collected on endowment life insurance yoy increased by 19% (AZN94M) to AZN599M. Insurance premiums collected on the insurance class in question accounted for 82% of total insurance premiums. Over recent five years the share of that insurance class in life insurance premiums shifted to 82% from 68%.

Chart 53. Dynamics of insurance premiums on life insurance classes, in million AZN

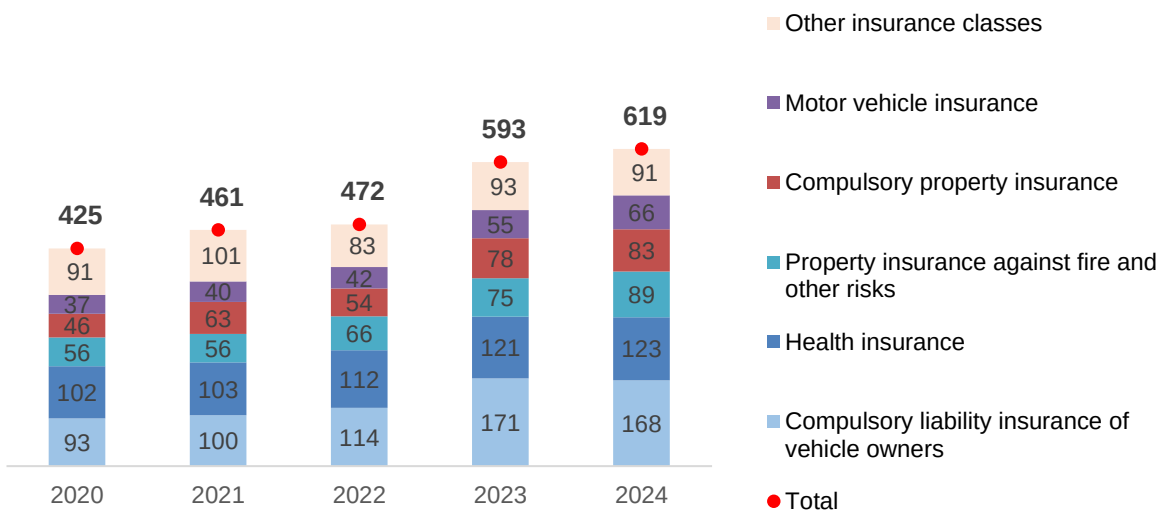


Source: CBA

Life insurance premiums are not expected to decline in the medium term despite changes in tax incentives. At the end of 2024, amendments to the Tax Code introduced restrictions on tax and social insurance benefits in the endowment life insurance with respect to the public sector. These restrictions apply to agreements concluded after 1 January 2025. As a result of this change, a decrease in endowment life insurance premiums is not anticipated in the medium-term outlook.

The main drivers of premiums on the non-life insurance were medical insurance and compulsory civil liability insurance for motor vehicle owners. Insurance premiums collected on compulsory civil liability insurance for motor vehicle owners accounted for 27% and medical insurance for 20% of non-life insurance premiums. Collections on non-life insurance grew due to the insurance of vehicles and the insurance of property against fire and other risks. Premiums collected on the insurance of vehicles yoy increased by 20% to (AZN11M) to AZN66M, the insurance of property against fire and other risks by 19% to (AZN14M) AZN89M. Over recent five years the share of medical insurance in non-life insurance collections decreased from 24% to 20%, meanwhile, the share of the compulsory motor third-party liability insurance class increased from 22% to 27%.

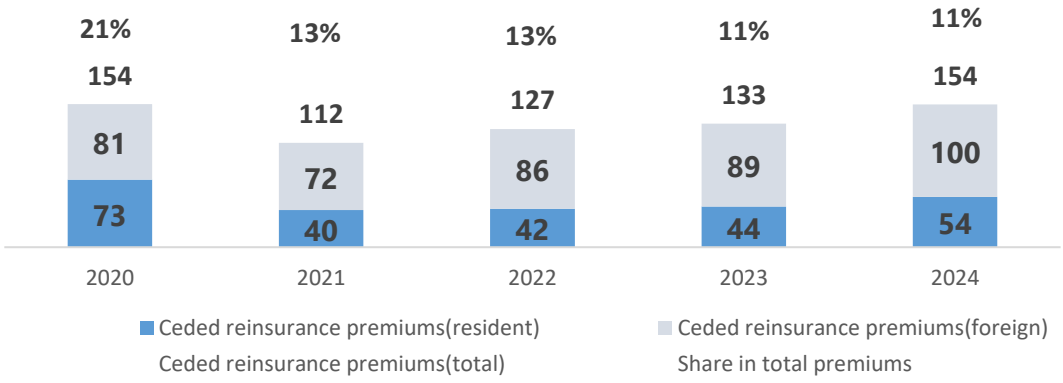
Chart 54. Dynamics of insurance premiums on non-life insurance classes, in million AZN



Source: CBA

The share of ceded reinsurance premiums in total insurance premiums remains low. In 2024, ceded reinsurance premiums increased by 16% (AZN21M) year-over-year to AZN154M. The share of ceded reinsurance premiums in total insurance premiums was 11%. Of the total ceded reinsurance premiums, 3% (AZN5M) came from life, while 97% (AZN 149M) from non-life insurance classes. Ceded reinsurance premiums in the life insurance segment accounted for 1% of total life insurance premiums, whereas in the non-life segment, they made up 24% of total non-life insurance premiums.

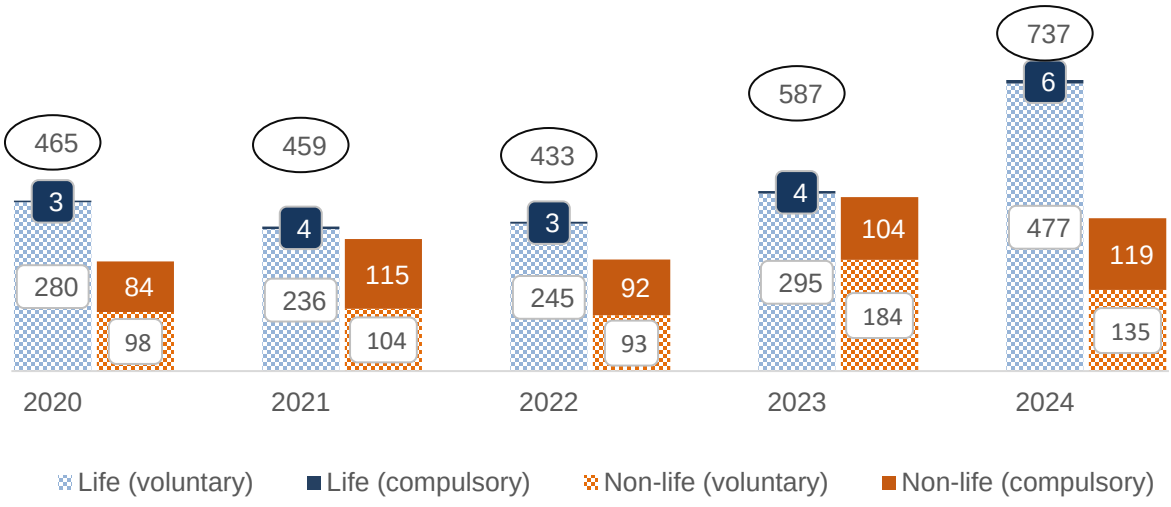
Chart 55. Dynamics of reinsurance premiums calculated to domestic and foreign reinsurers, in million AZ



Source: CBA

In 2024, the size of insurance premiums increased year-over-year. Insurance payments collected throughout the year yoy increased by 26% (AZN150M) to AZN737M. 66% of insurance premiums came from life insurance and 34% from non-life insurance classes. Life insurance payments increased by 62% to AZN483M, while payments decreased by 12% to AZN254M on non-life insurance.

Chart 56. Dynamics of insurance premiums, in million AZN

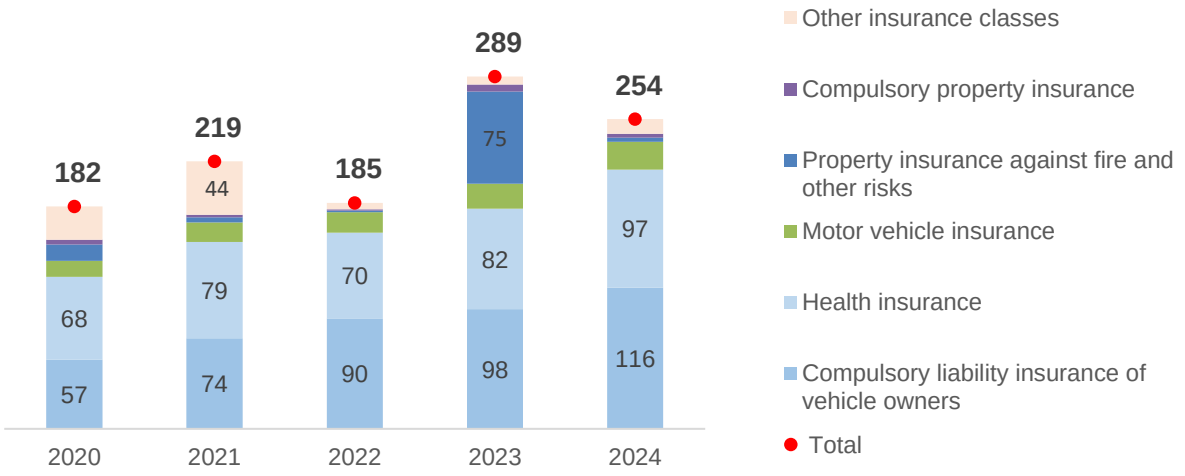


Source: CBA

Growth of insurance premiums on life insurance was driven by endowment life insurance. Payments on endowment life insurance yoy increased by 62% to AZN474M. Insurance payments made on this insurance class accounted for 98% of insurance payments made on life insurance.

The main drivers of insurance payments on non-life insurance were compulsory civil liability insurance for motor vehicle owners and medical insurance. Insurance payments on compulsory insurance classes accounted for over 46% and on medical insurance for 38% of non-life insurance payments. While insurance payments on non-life insurance decreased, insurance payments on medical insurance yoy increased by 17% to AZN97M, and those on compulsory civil liability insurance for motor vehicle owners yoy increased by 18% to AZN116M. The drop in insurance payments is attributable to the insurance of property against fire and other risks. As about AZN70M worth of payment was made in 2023 for two largest cases (these events were reinsured at 100%), insurance payments for 2023 increased from AZN1M to AZN75M vs 2022 and dropped again to AZN3M in 2024.

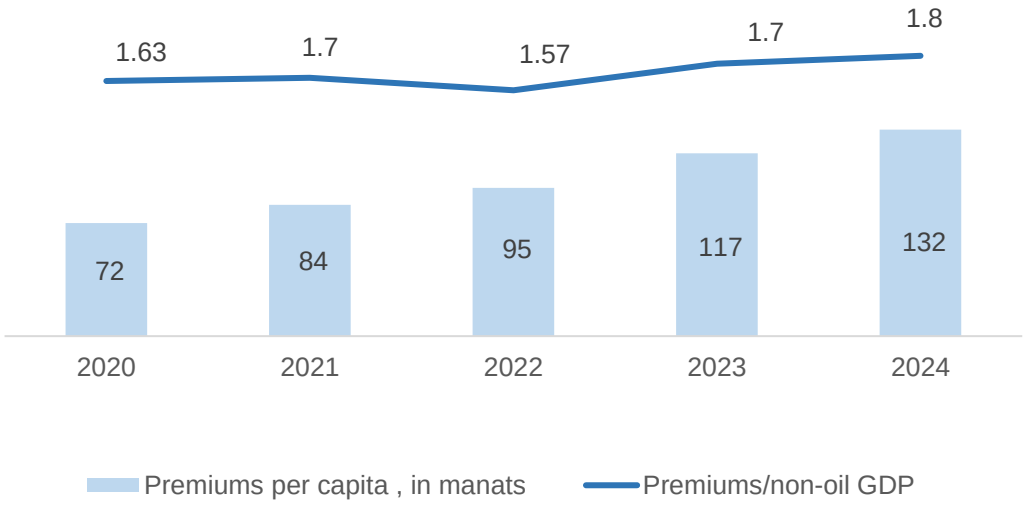
Chart 57. Dynamics of insurance payments on non-life insurance classes, in million AZN



Source: CBA

Positive dynamics in premiums elevated insurance sector's penetration and depth indicators. Per capita insurance payments yoy increased by 13% to AZN132M. The aggregate insurance payments to non-oil-gas GDP increased from 1.7% to 1.8%.

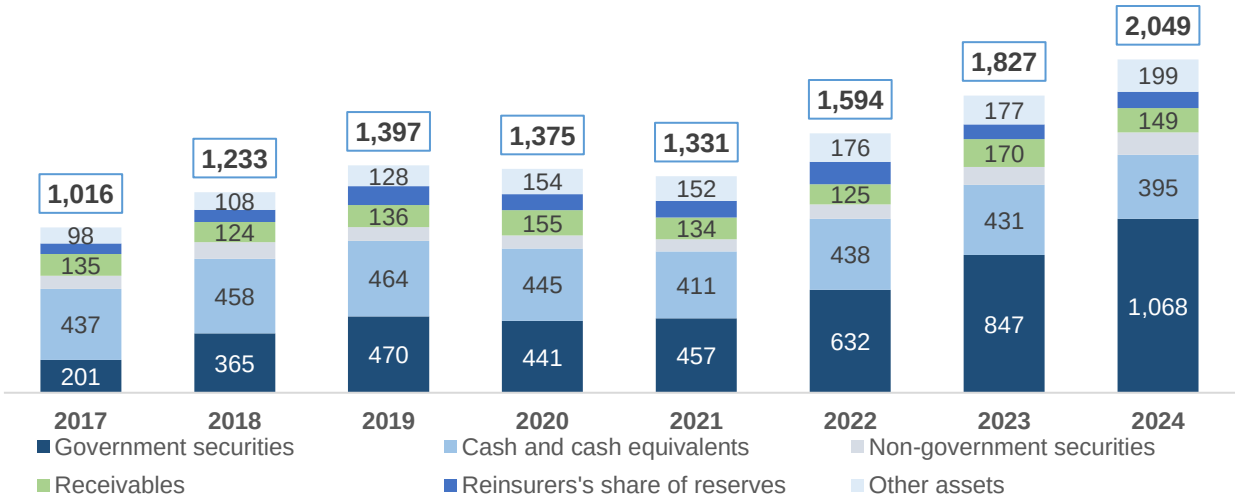
Chart 58. Dynamics of insurance sector penetration



Source: CBA

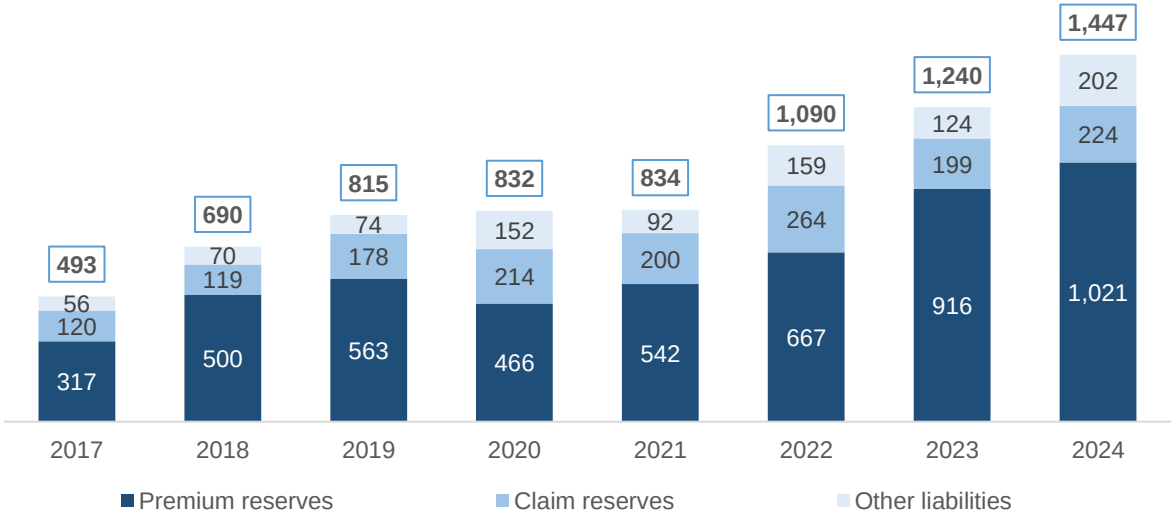
Sector's assets are following a positive dynamic amid market expansion. In 2024, insurance sector assets increased by 12% (AZN222M) and exceeded AZN2B. Assets breakdown is as follows: government securities (52%, or AZN1068M), bank funds (19%, AZN395M), non-government securities (7%, AZN138M), receivables (7%, AZN149M) and other assets (15%). Liabilities increased by 17% (AZN207M) to AZN1.45B. Liability breakdown is as follows: insurance premium reserves (70%), insurance event reserves (16%) and other liabilities (14%). Insurance premium reserves yoy increased by 11% (AZN105M) to AZN1021M.

Chart 59. Dynamics of insurance sector assets, in million AZN



Source: CBA

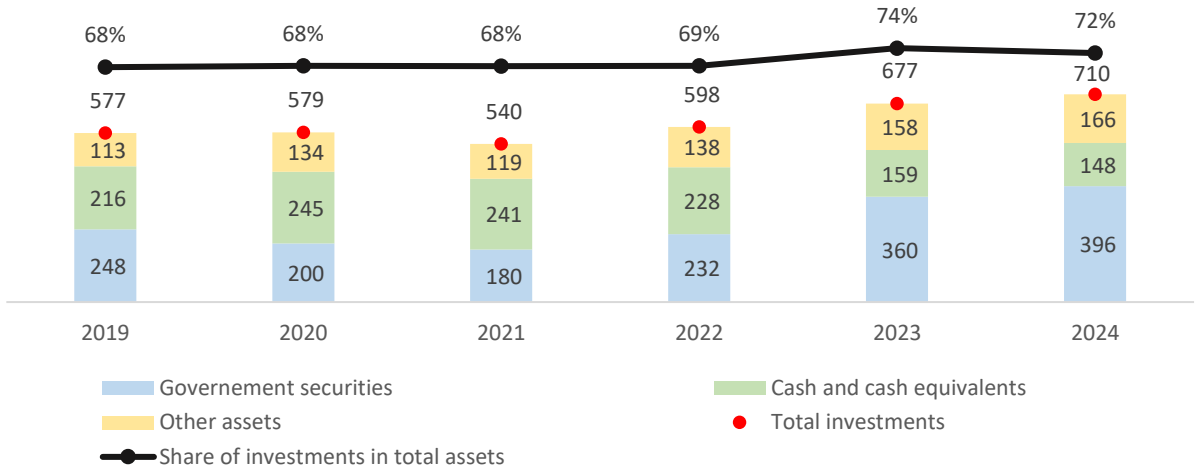
Chart 60. Dynamics of insurance sector liabilities, in million AZN



Source: CBA

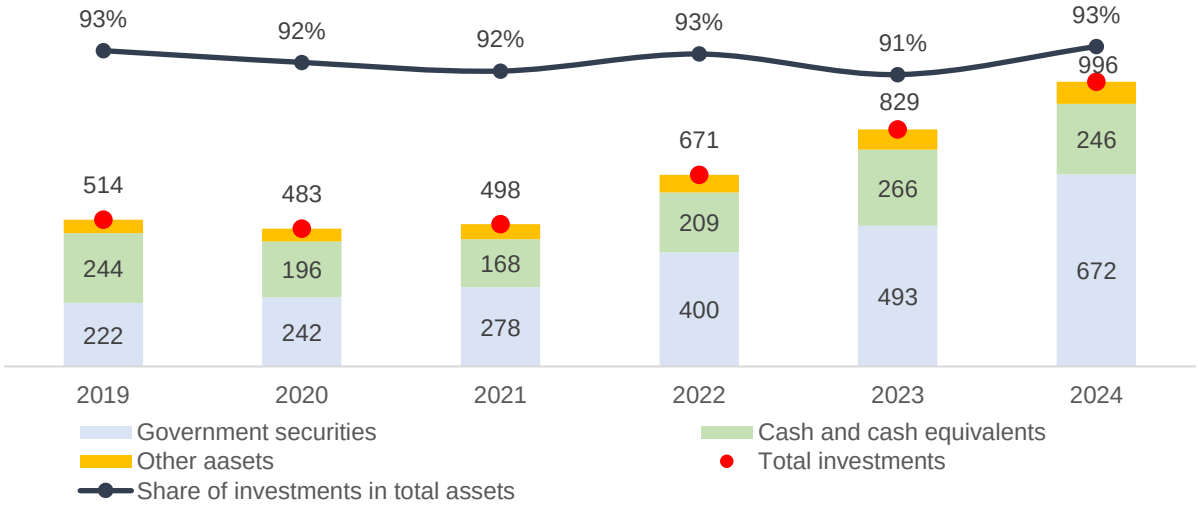
Although insurance companies' investment options are limited, they are realizing their potential as institutional investors. Insurance company investments yoy increased by 13% (AZN199M) to AZN1705M, driven by government securities (AZN216M). In general, the investment portfolio accounted for 93% of life insurance company assets and for 72% of non-life insurance company assets. Investment assets of insurance companies comprise of government securities and bank funds. As of end-2024, the insurance sector earned AZN114M worth of income from investment activities (8% of total income).

Chart 61. Dynamics of investment activities of non-life insurance companies, in million AZN



Source: CBA

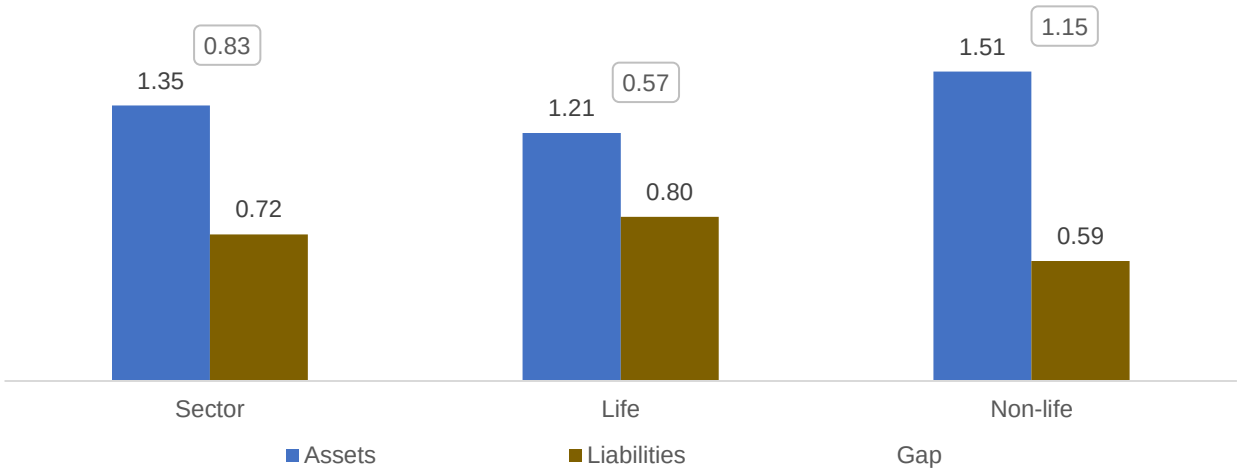
Chart 62. Dynamics of investment activities of life insurance companies, in million AZN



Source: CBA

Insurance companies' sensitivity to interest rates does not pose a threat to their stability. Insurers' interest rate sensitivity was assessed with the duration method. Since assets and liabilities of insurance companies are reflected at book value, calculations were based on book value and discounted using the CBA's refinancing rate. Due to the positive duration gap, an increase in interest rates has a reducing effect on the total capital to required capital ratio. Based on the simulations conducted, a 1 pp increase in interest rates leads to a 1.6 pp decrease in the total capital to required capital ratio in the insurance sector, which does not pose a threat to the sector's financial stability.

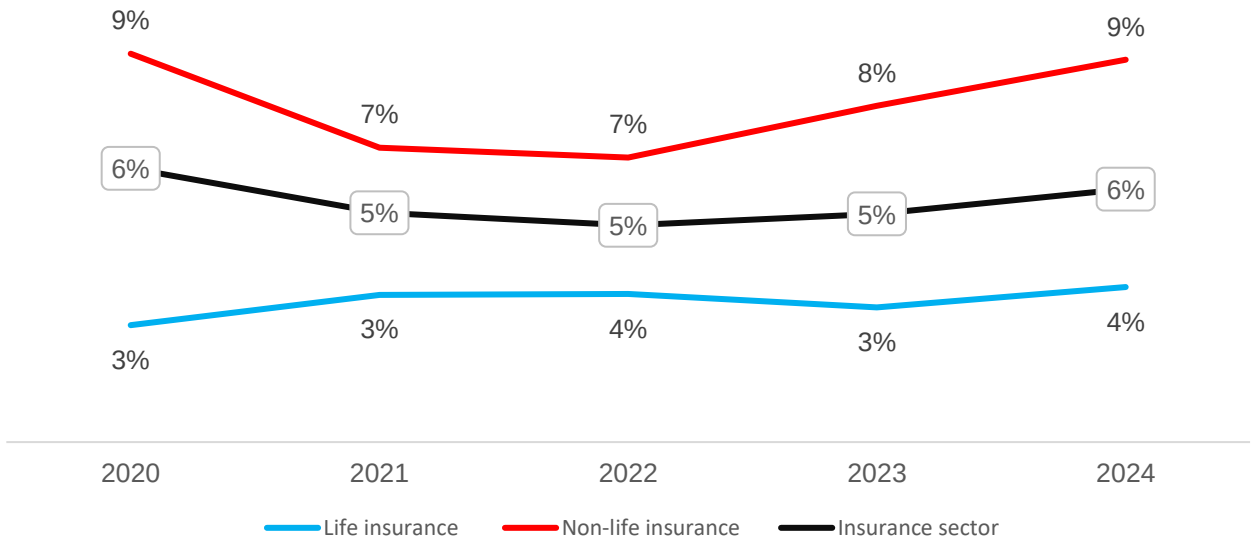
Chart 63. Average maturity or duration of insurance sector assets and liabilities (in years)



Source: CBA

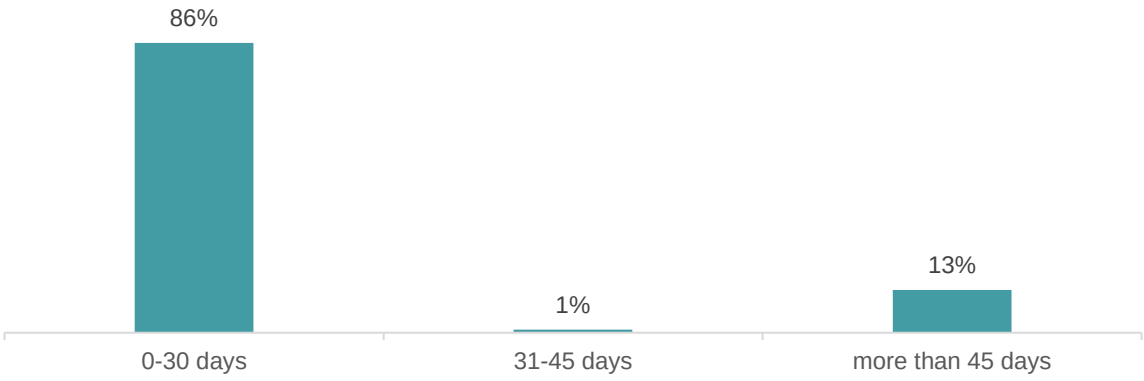
Insurance payables of insurance companies do not pose a threat to their stability. Insurers' insurance premium payables yoy increased by 23% (AZN21M) to AZN112M, insurance premium payables on life insurance increased by 35% (AZN10M) to AZN39M, and those on non-life insurance increased by 17% (AZN11M) to AZN73M. The share of insurance sector's insurance premium payables stood at 6%. Insurance premiums up to 30-day delinquency accounted for 86%, those delinquent for 31-45 days accounted for 1%, and those delinquent for over 45 days accounted for 13% of total insurance premium payables. According to the regulation on investment operations of insurers, insurance premiums that are overdue by more than 45 days are not included in the calculation of total capital. Therefore, these payables do not pose a threat to the financial stability of insurers.

Chart 64. Dynamics of insurance premium payables in totl assets, in %



Source: CBA

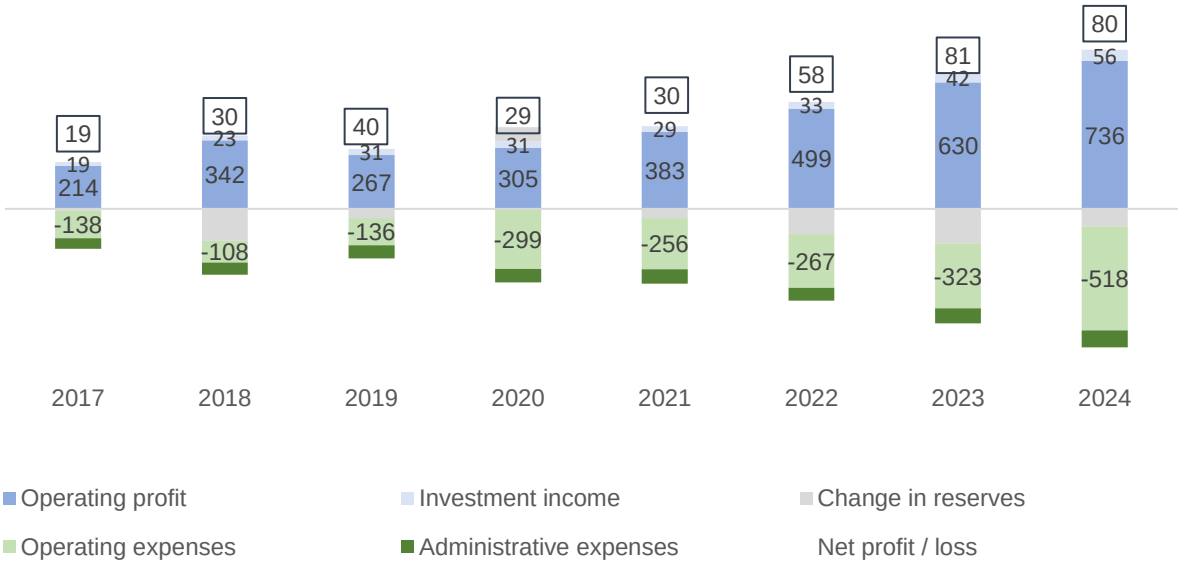
Chart 65. Breakdown of payables on delinquencies, in %



Source: CBA

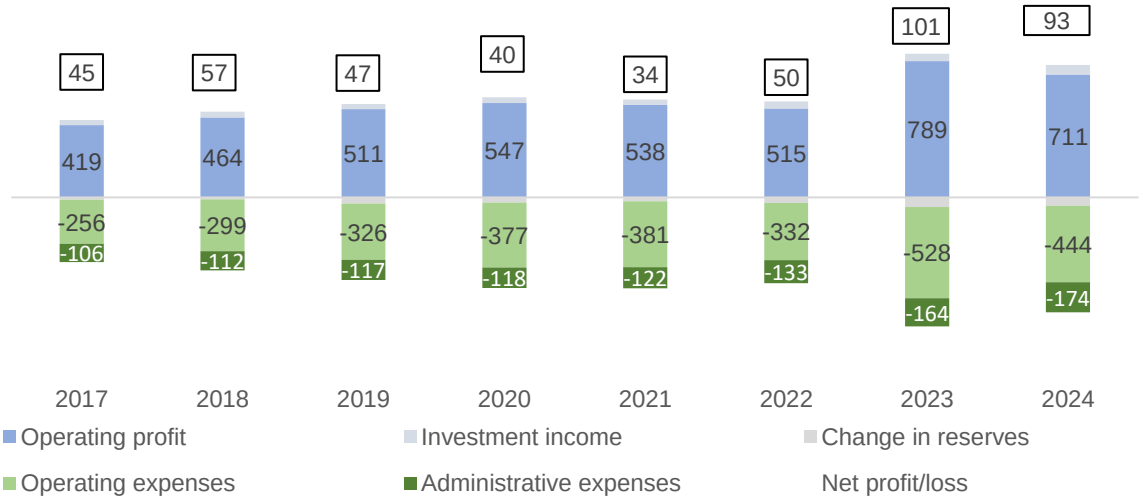
Although the insurance sector operated at profit, profitability of the sector declined year-over-year. As of end-2024 net profit of the insurance sector yoy decreased by 5% (AZN9M) to AZN173M. Amid refunded insurance premiums and operating expenses, profitability in life insurance companies decreased by AZN1M to AZN80M, while in non-life insurance companies it declined by AZN8M to AZN93M.

Chart 66. Dynamics of life insurance profitability, in million AZN



Source: CBA

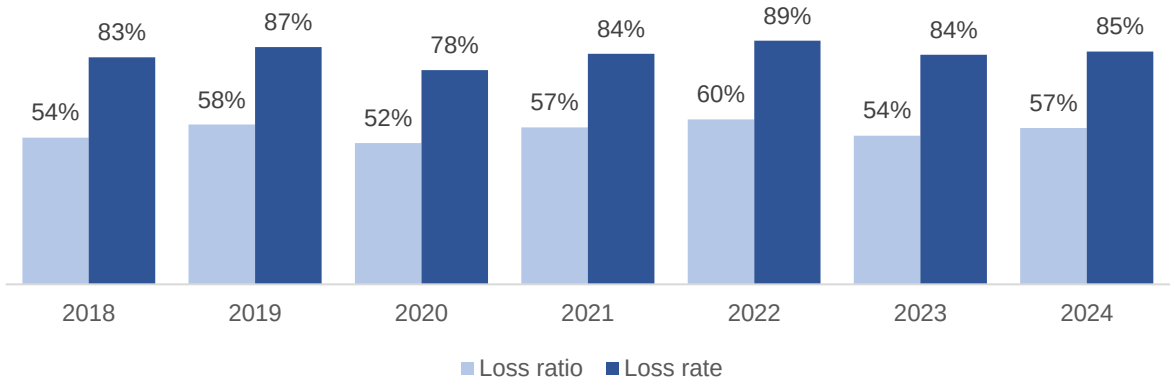
Chart 67. Dynamics of non-life insurance profitability, in million AZN



Source: CBA

Insurance sector's loss ratio increased by 1 pp. In 2024, insurance sector's loss ratio yoy increased by 1 pp to 85%. The increase in loss ratios in insurance classes with high market share weighed in on the overall rise in the sector's loss ratio.

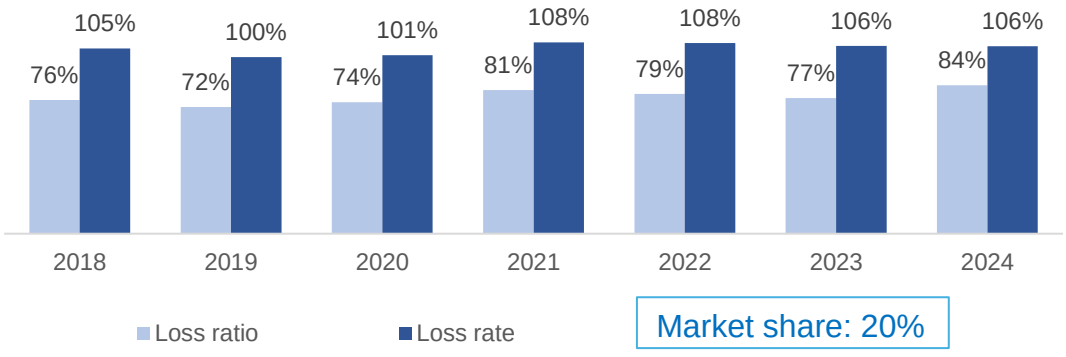
Chart 68. Dynamics of insurance sector's loss rate, in %



Source: CBA

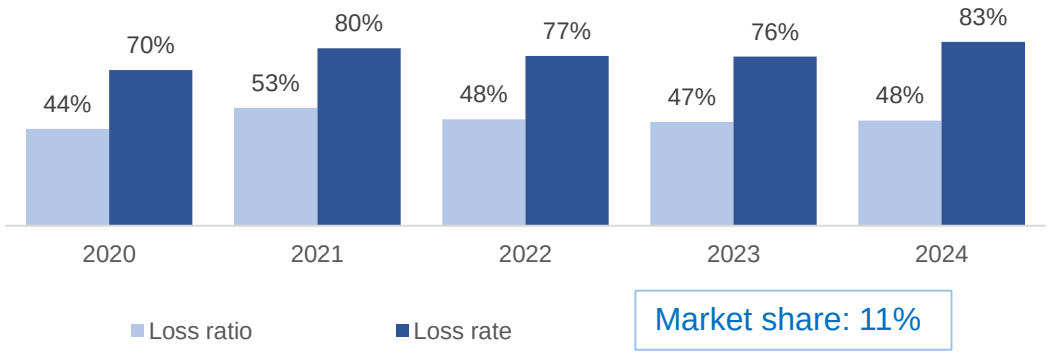
The loss ratio on high-market-share insurance classes is high. Compared to 2023, in 2024 while the loss ratio on compulsory civil liability insurance for motor vehicle owners increased by 1 pp, the loss rate remained unchanged (103%). The loss ratio on compulsory civil liability insurance for motor vehicle owners increased by 1 pp, and the loss rate increased by 7 pp. The increase in the loss rate was driven by 6 pp rise in the expense ratio. Although the loss ratio in the voluntary health insurance class increased by 7 pp, the overall combined ratio remained unchanged at 106%.

Chart 69. Dynamics of loss ratio on medical insurance, in %



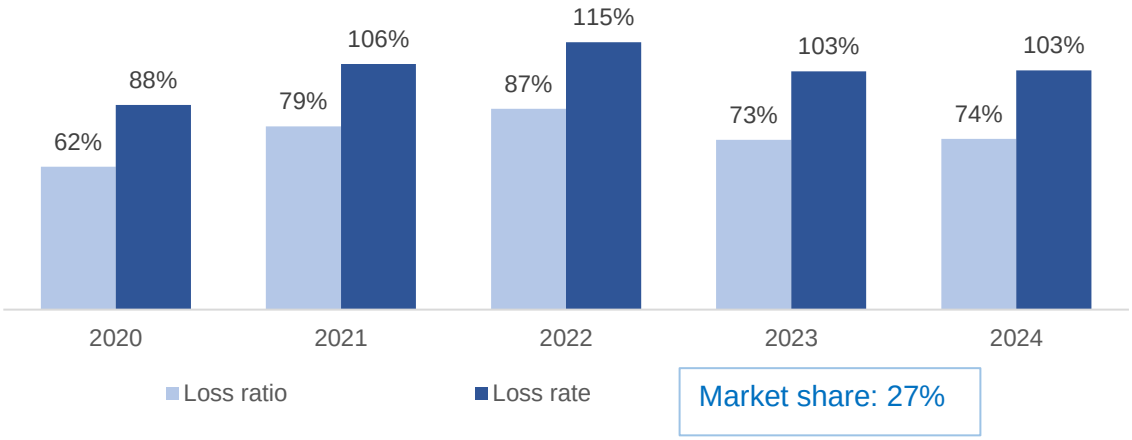
Source: CBA

Chart 70. Dynamics of loss rate on auto casco insurance, in %



Source: CBA

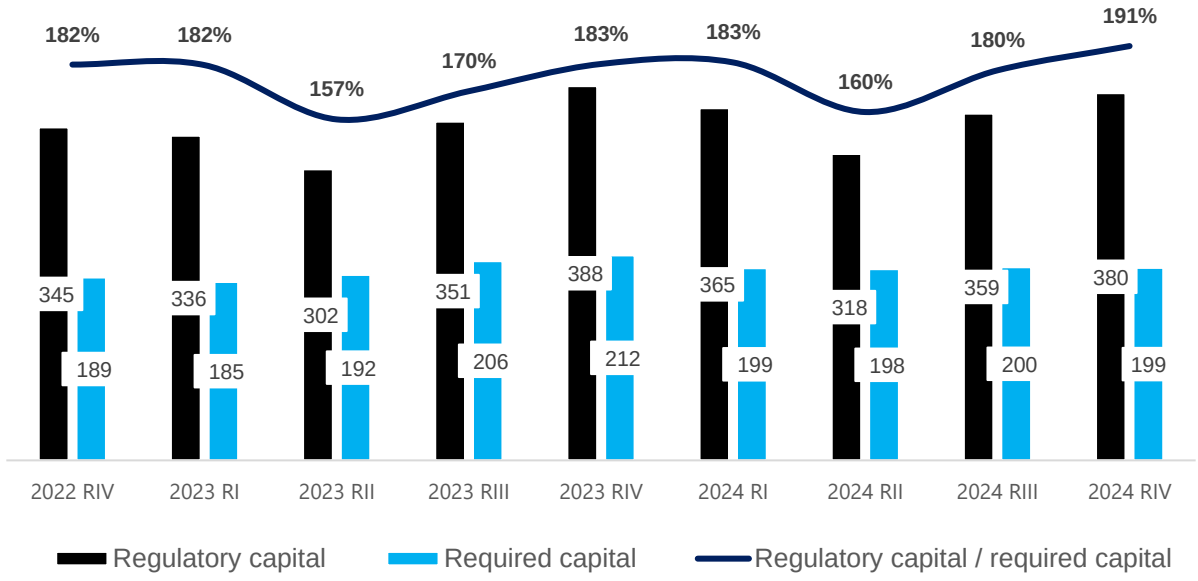
Chart 71. Dynamics of loss rate on auto compulsory insurance, in %



Source: CBA

Insurance sector's capital position exceeds prudential requirements and is in a comfort zone. As of end-2024, insurance sector's total regulatory capital yoy decreased by 2% (AZN8M) to AZN380M, required capital decreased by 6% (AZN13M) to AZN198M, and the capital buffer increased by 3% (AZN6M) to AZN181M.

Chart 72. Dynamics of total regulatory and required capital, in million AZN



Source: CBA

Box 6. Liquidity risk in the insurance sector

Liquidity risk is the risk that an insurance company may face difficulties in converting its investments and other assets into cash in a timely manner, and thus fail to meet its financial liabilities. Managing liquidity risk is a crucial tool to ensure sound operations of insurers, the protection of policyholders, and overall financial stability. Liquidity risk for insurers may arise from some factors:

1. A mismatch between the insurer's sources of liquidity and its liquidity needs.
2. A mismatch between the insurer's cash inflows and cash outflows.

In 2024, to measure insurers' liquidity, the Insurance Liquidity Ratio (ILR) was calculated based on the methodology of the International Association of Insurance Supervisors (IAIS). The ILR assesses whether insurer's high-quality liquid assets are sufficient to meet expected net cash outflows for insurance liabilities over a 3-month period.

**** ILR = (Highly liquid assets) / (Expected cash payments – Expected cash inflows)***

Where,

Highly liquid assets - assets adjusted by liquidity factors in accordance with the IAIS methodology.

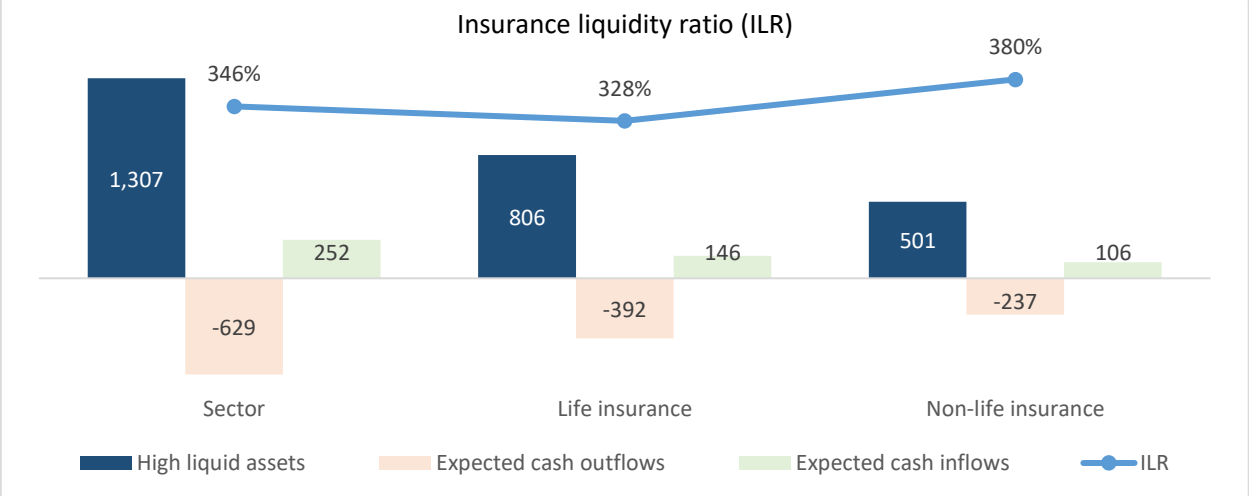
Expected cash inflows are net earned premiums over a 12-month period, adjusted by an inflow factor.

Expected cash payments are anticipated cash payments related to liabilities and other items, adjusted by outflow factors.

Highly liquid assets	
Liquidity ratio	**Assets**
100%	Cash funds and demand deposits
40%	Term deposits
15%	Funds held in investment funds
95%	Government securities of the Republic of Azerbaijan
60%-95%	Government securities of foreign countries with an investment-grade rating
90%	Government backed non-government securities
75%	Mortgage bonds issued by the Mortgage and Credit Guarantee Fund
95%	Non-government securities issued by multilateral development banks
40%-50%	Non-government securities with investment-grade rating
30%-40%	Investments in charter capital of legal entities

Expected cash inflows	
Inflow ratio	**Items**
20%	Net insurance premiums earned within 12 months

Expected cash outflows	
Outflow ratio	**Items**
10%-50%	Insurance premiums refunded on terminated agreements
10%-100%	Insurance payments on insurance events
25%	Insurance operating expenses
15%	Share of reinsurers in insurance events
15%-25%	Insurance payments on catastrophic insurance events
1.25%	Risk adjustment on net insurance events
1%	Insurance premiums calculated within12 months
75%	Short-term debt liabilities
75%	Repo liabilities
12.50%	Off-balance sheet liabilities



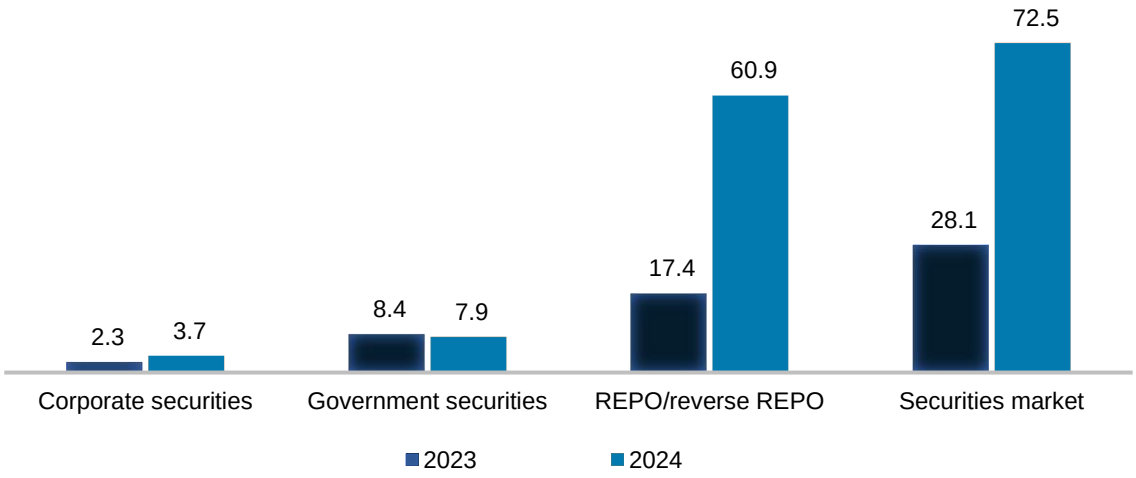
Source: CBA

As of end-2024, the liquidity position of insurers was calculated based on the ILR methodology. Highly liquid assets of the insurance sector amounted to AZN1307M, expected cash outflows AZN629M, expected cash inflows AZN252M, and the ILR of the sector stood at 346%. Accordingly, an adequate level of high-quality liquid assets increases insurers' resilience against short-term, (three-month) liquidity shocks.

Capital market

The securities turnover increased year-over-year, driven by repo/reverse repo operations. Trade turnover of the securities market yoy increased by 2.6 times (AZN44.4B) to AZN72.5B due to repo/reverse repo operations. The amount of repo/reverse repo operations yoy increased by 3.5 times (AZN43.5B) to AZN60.9B. The main factor behind the increase in repo and reverse repo operations was the more active use of the secondary market by banks to meet their daily liquidity needs, in the context of the implementation of the new operational framework of monetary policy. Corporate securities yoy increased by 62% (AZN1.4 B), while government securities decreased by 6% (AZN0.5B). The drop in government securities stemmed from CBA notes.

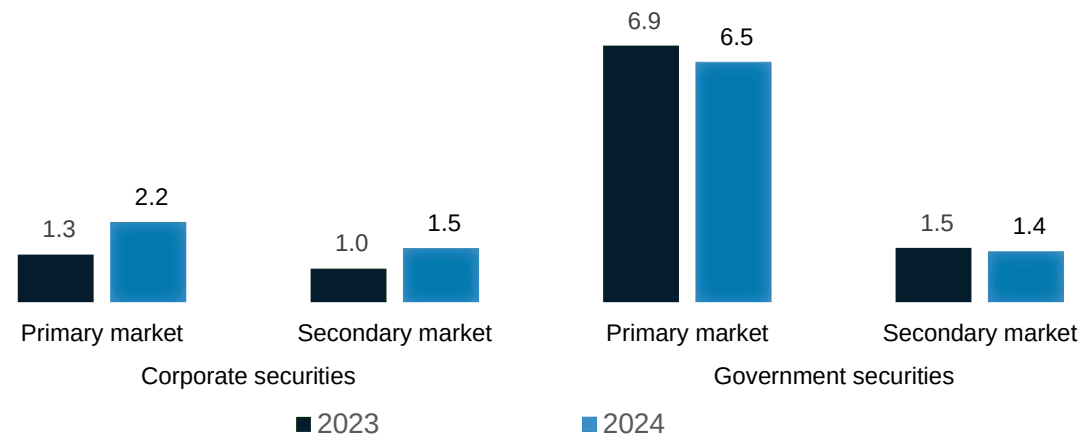
Chart 73. Capital market turnover, in billion AZN



Source: CBA

Trade turnover of corporate securities increased, while that of government securities decreased. The size of primary market turnover of corporate securities yoy increased by 65% (AZN0.9 B) to AZN2.2B, and secondary market turnover increased by 57% (AZN0.5B) to AZN1.5B. The turnover of government securities decreased year-over-year. Primary market turnover of government securities decreased by 6% (AZN0.4B), and secondary market turnover decreased by 7% (AZN0.1B) to AZN6.5B and AZN1.4B respectively.

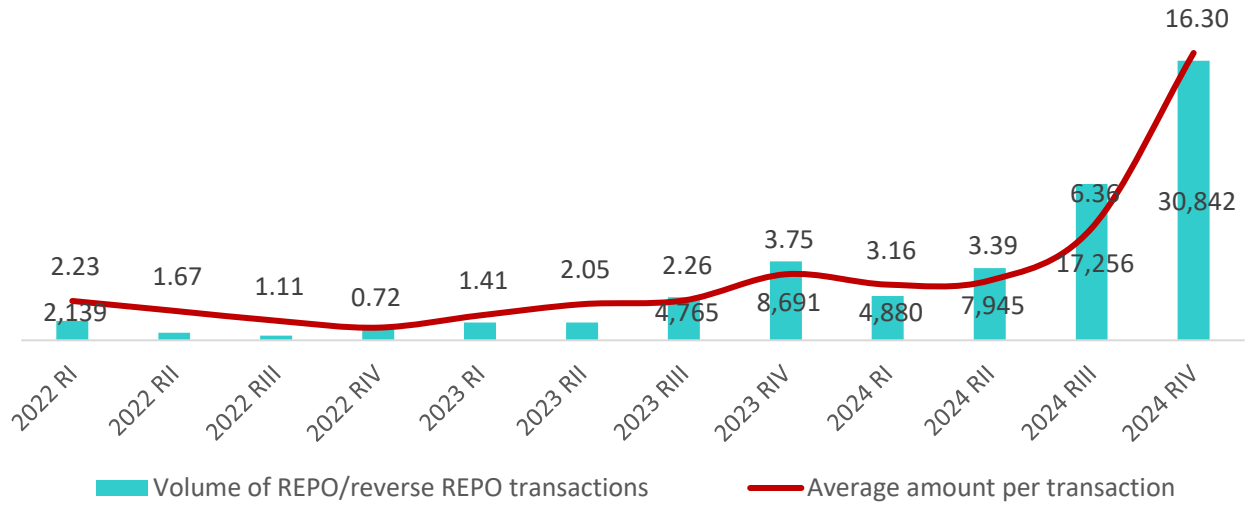
Chart 74. Size of primary and secondary market operations, in billion AZN



Source: CBA

Amid the new monetary policy operational framework introduced in 2023, banks have increasingly utilized the secondary market to meet their daily liquidity needs, which has stimulated activity in the repo/reverse repo market. Over the reporting period, the size of repo/reverse repo operations amounted to AZN60.9B, the majority of which (79% or AZN48.1 B) took place in the second half of the year. In general, since the second quarter of last year, both the size of quarterly operations and the average amount per transaction have been increasing noticeably.

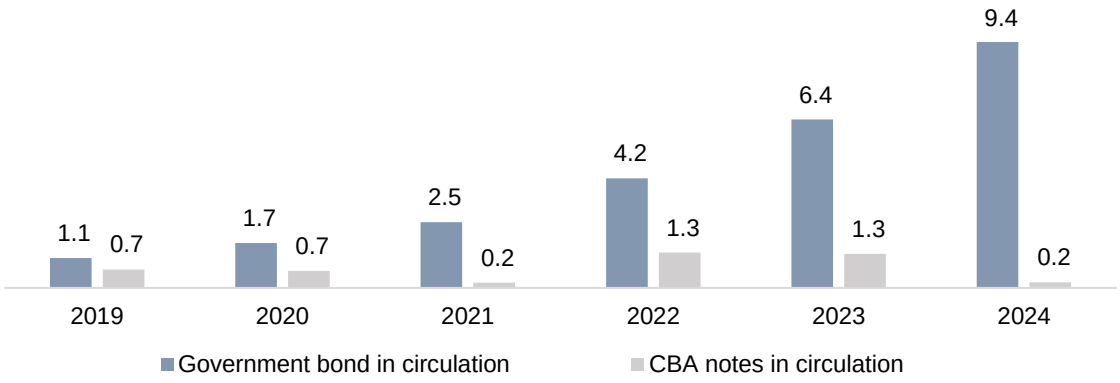
Chart 75. Dynamics of repo operations, in million AZN



Source: CBA

The amount of government securities in circulation increased. Compared to the end of last year the amount of government securities in circulation increased by 24% (AZN1.9B) to AZN9.6B, driven by government bonds. In 2024 the amount of government bonds in circulation increased by 46% (AZN3.0B) to AZN9.4B compared to the end of last year. The amount of government bonds increased at the expense of the issuance of long-term government securities.

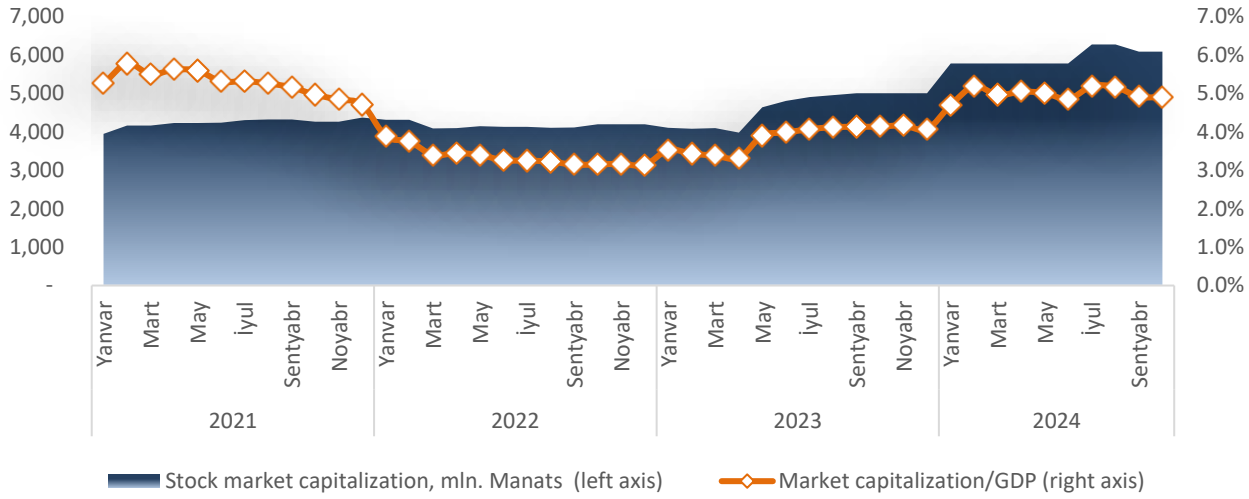
Chart 76. Dynamics of government securities in circulation, in billion AZN



Source: CBA

Capitalization of the stock market continues its positive trend. The capitalization of the stock market yoy increased by 22% to AZN6.0B.

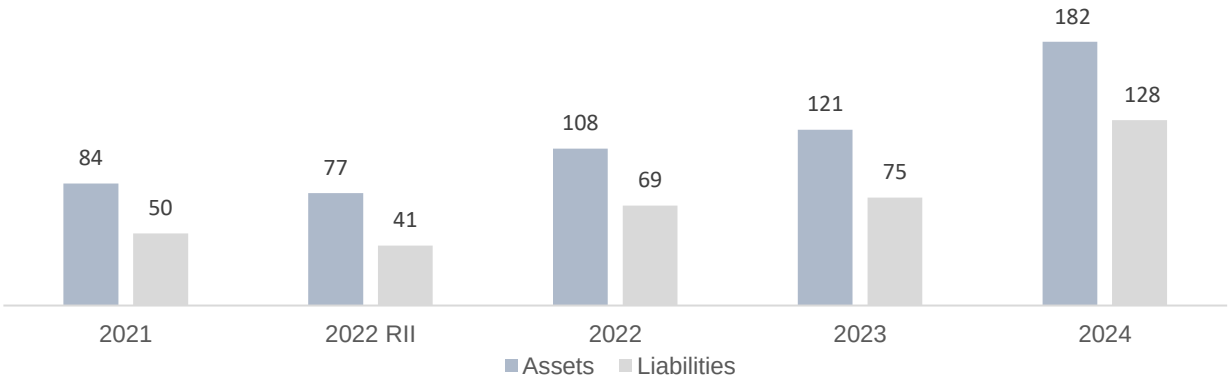
Chart 77. Dynamics of stock market capitalization (in million AZN) and penetration



Source: CBA, BSE

Over the reporting year balance sheets of investment companies expanded. Assets of investment companies yoy increased by 50% (AZN61M) to AZN182M, and liabilities increased by 71% (AZN53M) to AZN128M, attributable to the rise in the amount of repo/reverse-repo operations.

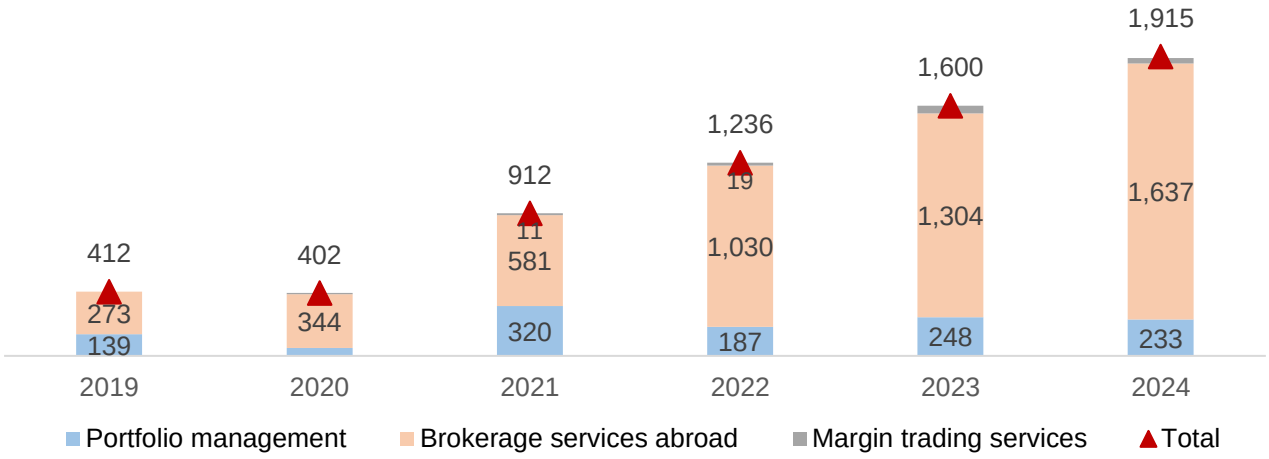
Chart 78. Dynamics of balance sheets of investment companies, in million AZN



Source: CBA

Over the period client assets of investment companies expanded. Client assets of investment companies yoy increased by 20% (AZN315M) to AZN1,915M, owing to brokerage services in a foreign market. Client assets on brokerage services in the foreign market increased by 26% (AZN333M).

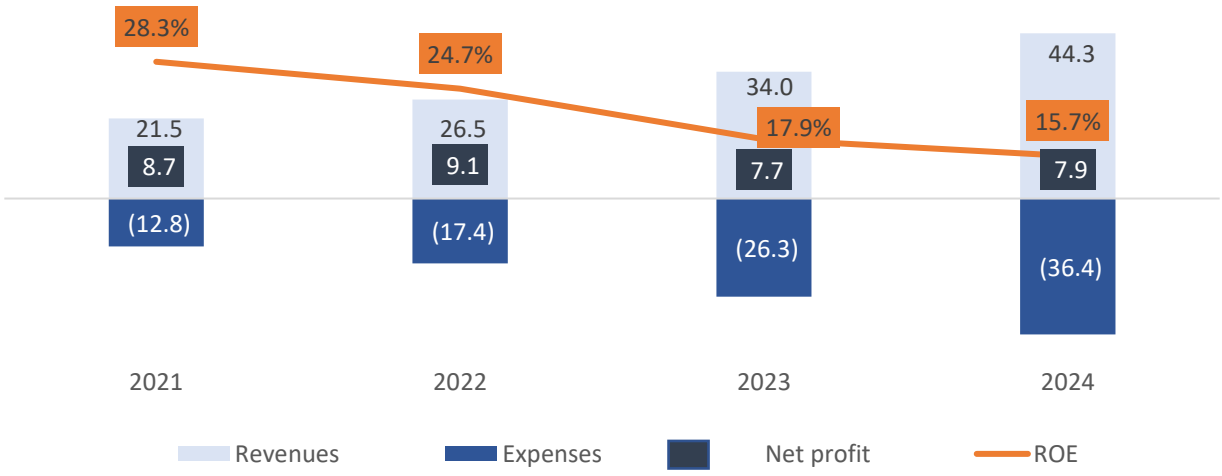
Chart 79. Dynamics of client assets of investment companies, in million AZN



Source: CBA

Net profit of investment companies increased. In 2024, net profit of investment companies yoy increased by 2.7% (AZN0.2M) to AZN7.9M. Although net profit of investment companies grew, amid the rising capital ROE decreased by 2.2 pp to 15.7%.

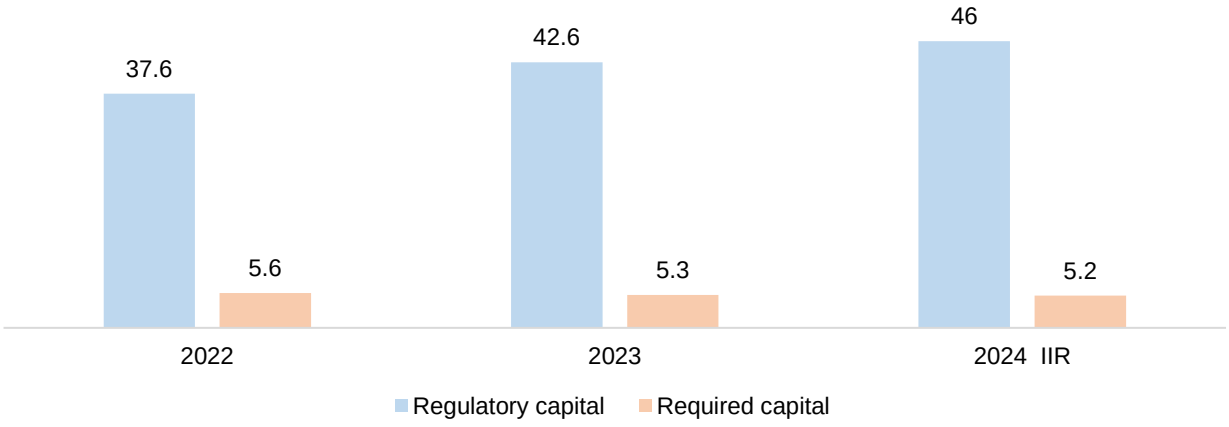
Chart 80. Dynamics of profitability of investment companies, in million AZN



Source: CBA

The capital position of investment companies is in a comfort zone. As of end-2024, total regulatory capital of the sector amounted to AZN52.7M, and required capital amounted to AZN7.2M, this ensures that investment companies have a sufficient capital buffer.

Chart 81. Dynamics of total regulatory capital and capital requirement, in billion AZN



Source: CBA

In 2024, the CBA took several regulatory, supervisory, and development-oriented actions in the capital market. The CBA continued actions to enhance the efficiency of regulation and supervision in the securities market, align the legal framework of the capital market with international standards, improve the operational infrastructure, and support demand and supply in the market. In the reporting year, trading and post-trading systems were integrated into digital platforms to digitize the operational infrastructure of the capital market. Consequently, for the first time, the subscription process for the public offering of shares of a local commercial bank was maintained through a mobile application. As a continuation of the process, secondary market operations for those shares were also executed via the mobile application. Additionally, the 'Corporate governance standards for investment companies' were approved to improve risk management and reporting systems.

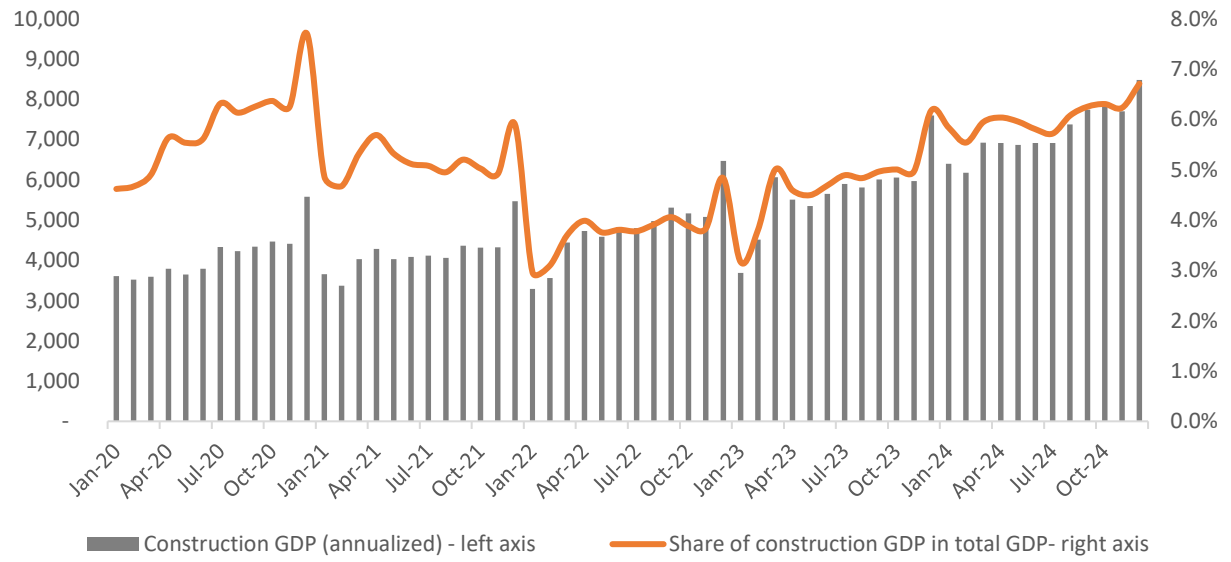
Real estate market

From a financial stability perspective, tracking real estate trends and construction sector performance is essential. As a major contributor to GDP and a catalyst for economic activity, the construction sector holds strategic significance.

In general, GDP from construction is posting a stable growth. Although the share of the construction sector in GDP has shown some fluctuations in recent years, since the second half of 2023, both the nominal volume of GDP generated by the sector and its overall share in the economy have been steadily increasing, largely driven by the revival of investment flows, the implementation of major infrastructure projects, particularly in liberated territories, and the strengthening of demand factors in the real estate market.

The stable growth rate of the construction sector has had a positive impact on strengthening the overall investment climate in the economy and maintaining employment levels. As such, the recent increase in the construction sector's share of GDP has played a significant role in supporting overall economic activity. In 2024, the number of salaried employees working in construction enterprises increased by 3.7% year-over-year to 117,000 individuals.

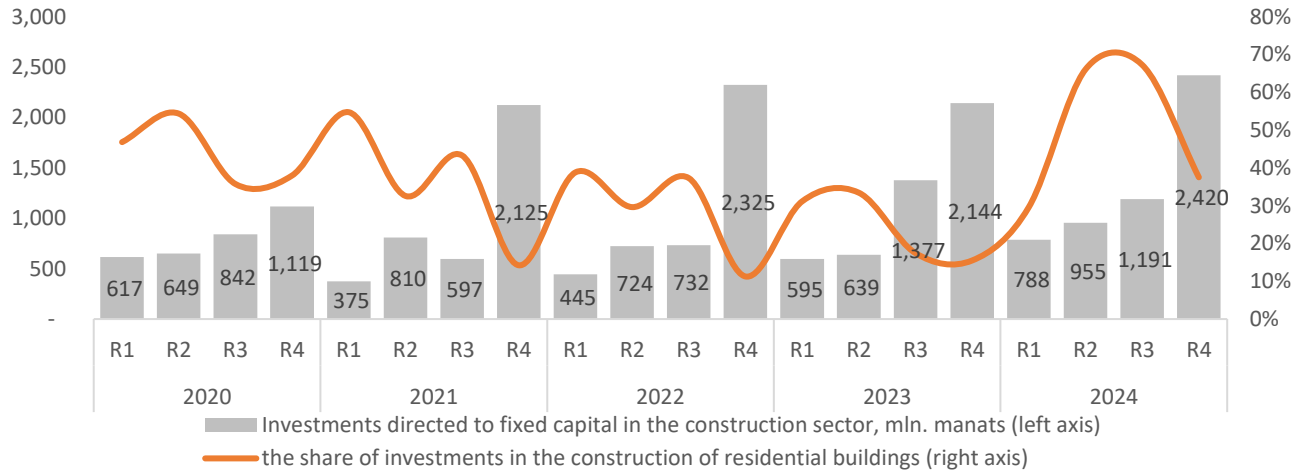
Chart 82. Dynamics of GDP from construction, in million AZN



Source: State Statistics Committee

Although investments directed toward the construction sector have fluctuated over certain periods, the funds allocated to residential housing construction and their share in investments in fixed assets have been increasing. In recent times, this trend has further strengthened, contributing to heightened market activity. The rise in investments in residential construction has been driven both by growing demand and the implementation of new projects by the public and private sectors.

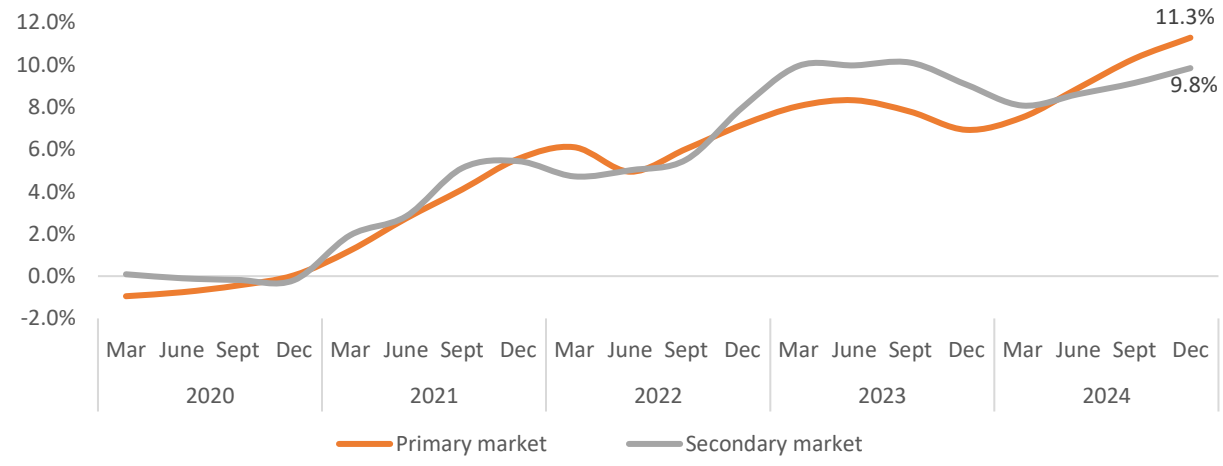
Chart 83. Investments in fixed assets in the construction sector and the dynamics of the share of investments in residential building construction within those investments



Source: State Statistics Committee

Housing prices are increasing both in primary and secondary markets. In 2020, due to the pandemic, relative price stability was observed in the real estate market; however, in the following years, they were prone to rising. In general, compared to the end of 2020, housing prices jumped by 32.4%.

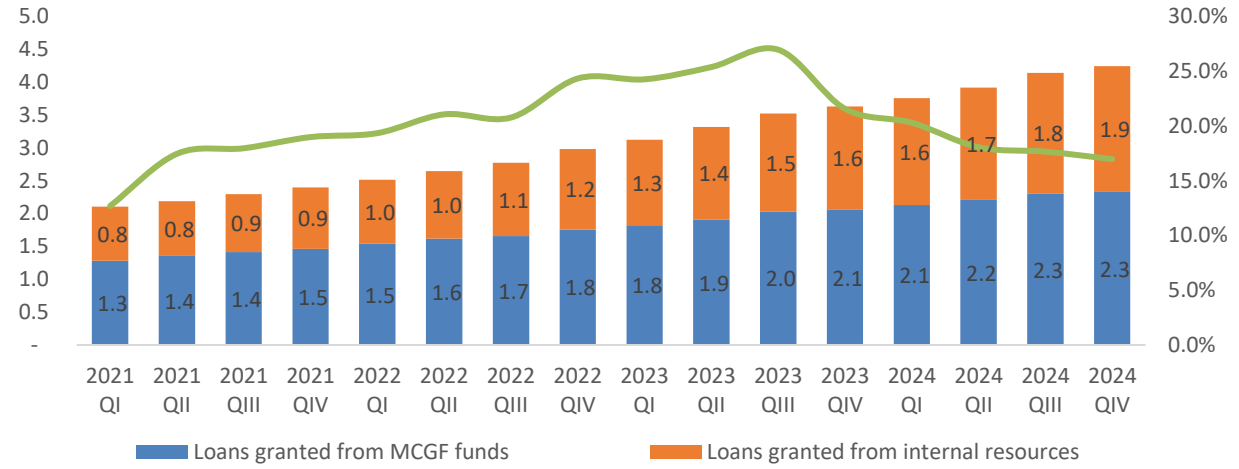
Chart 84. Dynamics of annual growth rate of primary and secondary market houding prices, in %



Source: State Statistics Committee

In recent years mortgage lending has been growing. Since 2020, the volume of mortgage loans has increased, however the growth rate stabilized in 2023, attributable to the loans issued through the Mortgage and Credit Guarantee Fund (MCGF), which in turn, contributed to stabilization of the price growth in the secondary housing market.

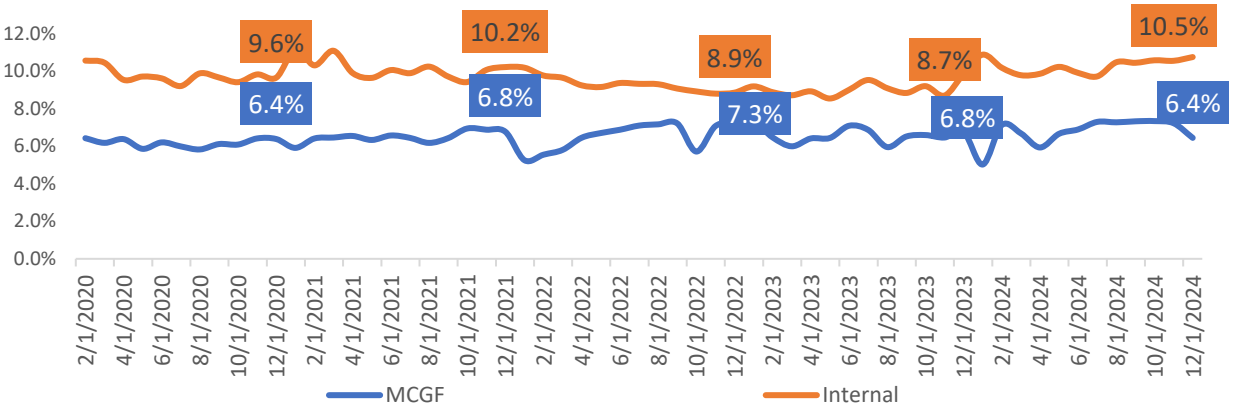
Qrafik 85. Dynamics of mortgage portfolio, in billion AZN



Source: CBA

Internal mortgage interest rates of banks are increasing. Although there have been no considerable changes in interest rates on mortgage loans issued through the MCGF, interest rates on mortgage loans issued through banks' internal resources are increasing. The increase in the share of mortgage loans issued through banks' internal resources in the total mortgage portfolio has led to a rise in the average interest rates on mortgage loans.

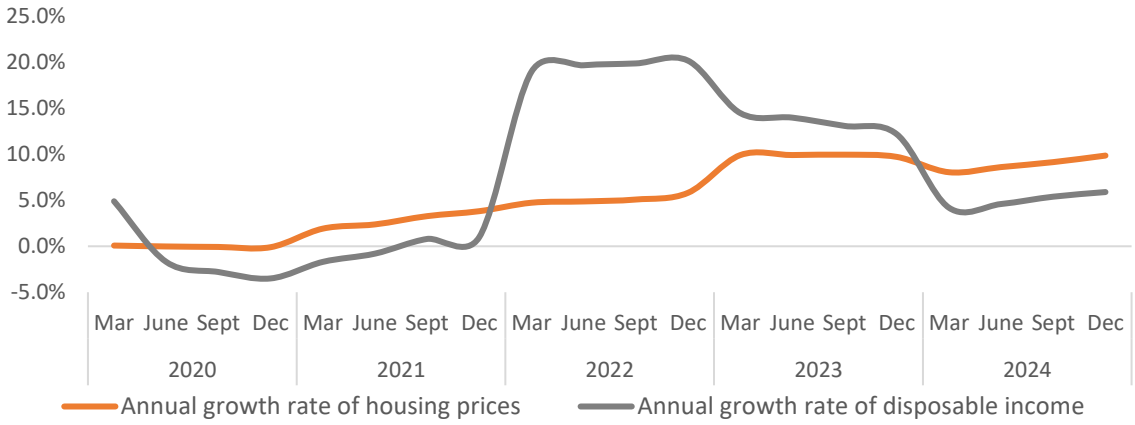
Chart 86. Dynamics of the average interest rate on newly issued mortgage loans, in %



Source: CBA

In 2024, the growth rate of housing prices surpassed the growth rate of disposable income. According to the SSC, housing prices were up by 9.9% year-over-year, while the growth rate of disposable income stood at 5.9%. Overall, housing prices have increased by 32%, and disposable income by 39% since 2020.

Chart 87. Dynamics of the growth rate of housing prices and disposable income of the population, in %



Source: State Statistics Committee

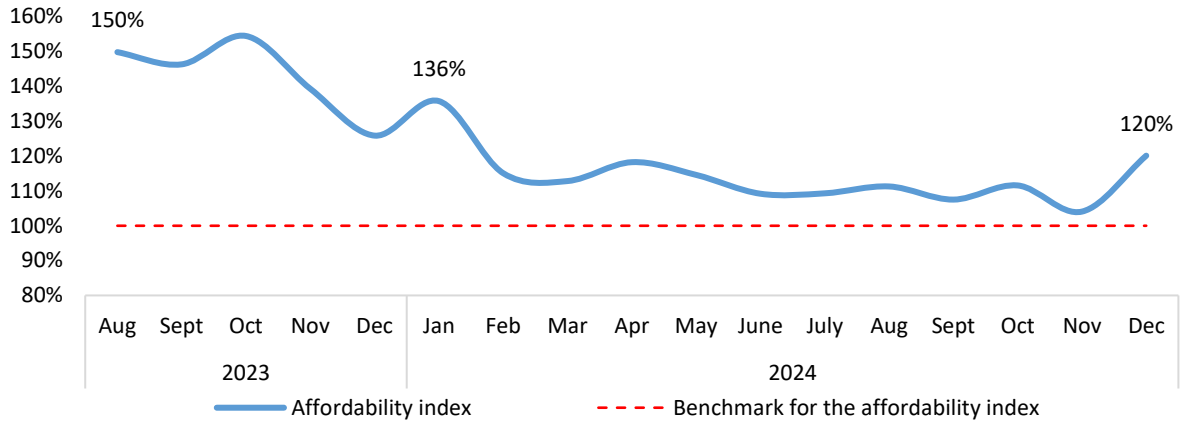
Despite the rising prices offered at the housing market[10], population's disposable income allows sustainable mortgage lending. The affordability index[11] widely used in international practice, is calculated as the ratio of per capita disposable income to the average monthly payment on newly issued mortgage loans within a month. A value above 100% indicates that the population's disposable income is sufficient to cover mortgage payments, while a value below 100% shows that the monthly mortgage payment exceeds the available income. In 2024, the increase in housing prices, as well as the rise in average interest rates on newly issued domestic mortgage loans, decreased the

[10] The offered prices in the housing market have been obtained from open sources, including websites specialized in real estate transactions.

[11] Affordability index= (monthly disposable income* 70%) / *Average monthly payment on newly issued mortgage loans within a month.*

* The main reason for taking 70% of the disposable monthly income is the requirement for loans issued through the MCGF.

Chart 88. Dynamics of affordability index, in %

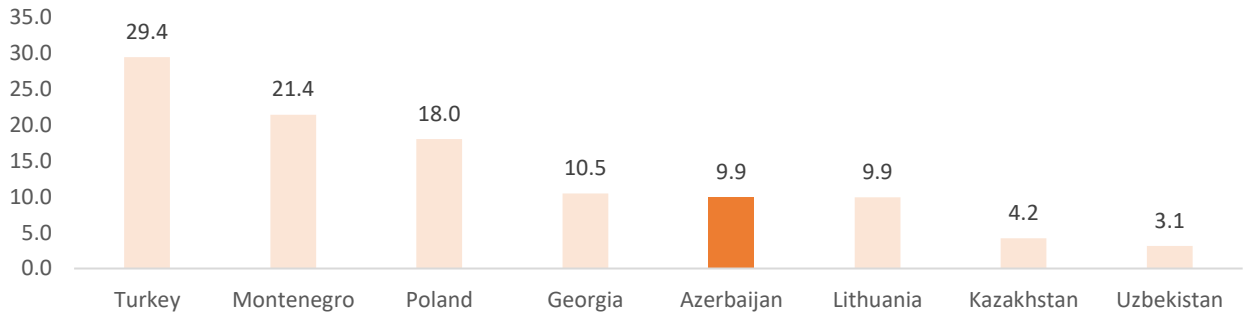


Source: CBA, State Statistics Committee, Real estate trading related open sources

affordability index. However, the positive dynamics of the population's disposable income resulted in the affordability index being higher than the benchmark indicator index.

Although housing prices increased in Azerbaijan year-over-year, this growth rate was lower compared to some benchmark countries. According to the State Statistical Committee, housing prices increased by 9.9% year-over-year. While this growth rate is higher than in some benchmark countries (Kazakhstan and Uzbekistan), it is lower than in Turkey, Georgia, and other countries. Based on data from available open sources for the housing market, the median monthly rental price in Baku is AZN927, which results in a capitalization period of[12] 19.5 years for real estate. The ratio of average house prices to the average nominal monthly salary (for Baku) is 189 months, or 15.7 years [13].

Chart 89. Dynamics of annual growth of housing prices across countries recent one year, in %



Source: Statistical Offices by Countries

[12] Capitalization Period = Median Housing Price / Median Annual Rent

[13] The calculations were based on property sale and rental listings published on open sources related to real estate transactions. Specifically, more than 75% of the property sale listings used in the calculations for the end of 2024 were new constructions. Additionally, 82% of the rental property listings used in the calculations were for new buildings. Listings for rental apartments in the city center and nearby areas accounted for 75% of the total rental property listings.

Charts and tables