



AZƏRBAYCAN RESPUBLİKASININ
MƏRKƏZİ BANKI

Financial Stability Report

Half 1 2024

FINANCIAL STABILITY DEPARTMENT

Central Bank of the Republic of Azerbaijan

FINANCIAL STABILITY REPORT*

*** The Report is based upon data as of June 2024.**

ACRONYMS

AEs – advanced economies

NBCI – non-bank credit institution

ADB – Asian Development Bank

NC – national currency

CBA – Central Bank of the Republic
of 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

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 Half 1 2024, the global economic environment was characterized by a slowdown in commodity price slides, monetary policy easing expectations and positive dynamics in the stock market. During this period, the Azerbaijani financial system operated on the backdrop of recovering economic activity and the alignment of the banking system with monetary and prudential frameworks.

The Central Bank's macro and micro prudential policy enhanced financial resilience of the banking sector.

The banking sector's balance sheet expanded, with no considerable change in the level of credit risks across the banking sector with the macroprudential policy implemented amid ongoing high lending activity and effective risk management by banks.

The sector's currency position is within the prudential requirements. Over the period de-dollarization of the sector stabilized.

Liquidity in the sector stayed within a comfortable range, aligned with the new monetary framework and the application of prudential instruments. All banks exceeded the liquidity coverage ratio (LCR) established in aggregate and for foreign currency.

Profitability continued increasing amid banking sector expansion. In H1 2024 there was no bank operating at a loss. The capital adequacy ratio, a key sustainability indicator, is capable to absorb potential losses exceeding prudential requirements.

The insurance sector experienced growth. Positive dynamics in collection boosted penetration and depth indicators across the insurance sector. Insurance companies are realizing their potential as institutional investors.

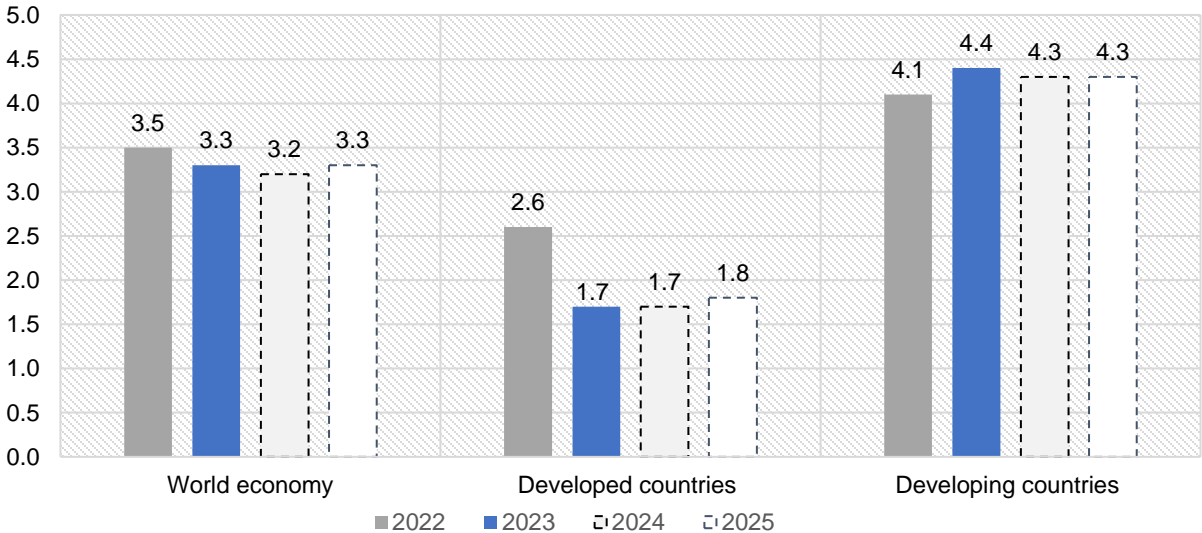
Securities turnover increased year-over-year, driven by repo/reverse-repo operations amid the implementation of the new monetary framework. The penetration and depth growth potential remains high in the capital market.

Global macroeconomic environment

In H1 2024, the global macroeconomic environment was characterized by monetary policy easing expectations and positive dynamics in the stock market. Financial market expectations have been positive amid the decline in global inflation and the anticipated monetary policy easing since October 2023. Investors' expectations that the monetary policy would ease with the decrease in interest rates, improved financial indicators of leading financial companies of the world and higher-than-expected corporate sector profitability fueled the rise in stock market prices and index values. Additionally, the credit spread between corporate and government securities narrowed, reflecting improved market conditions and reduced uncertainties in the corporate sector.

Global economic expectations and trends translated to forecasts of international organizations. While the IMF in WEO July 2024 kept global economic growth forecast as of end-2024 unchanged (3.2%), it revised global economic growth forecast for 2025 up by 0.1 pp to 3.3%. According to the July report, GDP is forecasted to grow by 1.7% and 1.8% in 2024 and 2025 respectively in AEs, the same as in the April forecast.

Chart 1. Global GDP growth forecasts, %

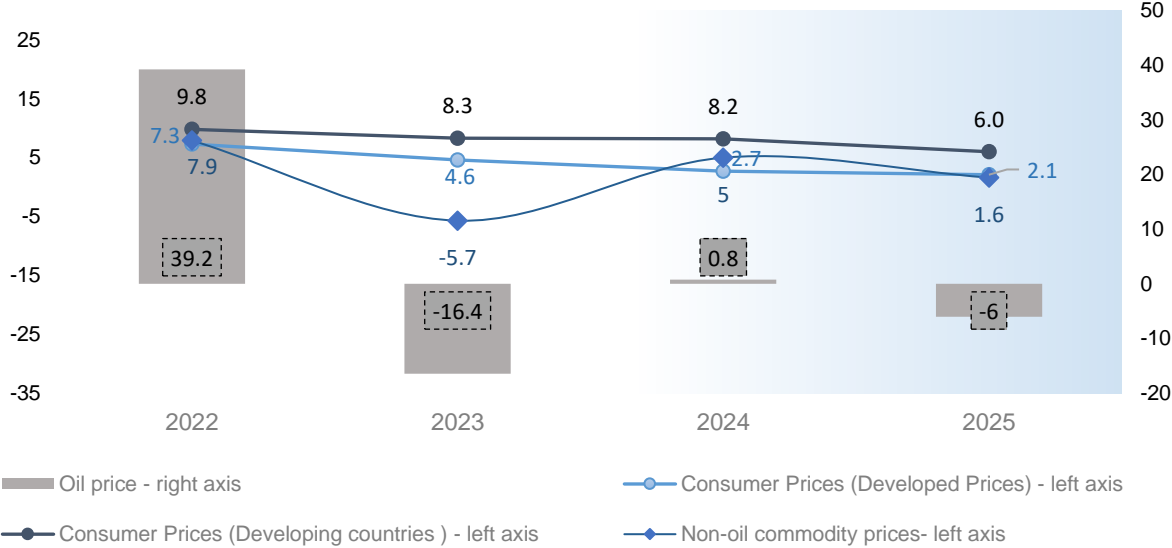


Source: IMF, World Economic Outlook (WEO), 2024 July updated

According to the report, economic growth is expected to be stable and positive in upcoming two years in EMEs. The July release revised IMF's forecast up by 1 pp to 4.3% for the end of 2024 and 2025 compared with the April forecast for EMEs.

In H1 2024, global commodity price slides slowed down amid ongoing geopolitical tensions, global shipping challenges and geoeconomic fragmentation. According to the July report by the World Bank, in June 2024 the overall commodity price index increased by 4.6%, non-energy prices by 5.4% and energy prices by 4.2% compared with the end of 2023. The IMF in WEO July 2024 issued a more positive forecast for oil prices compared with the April forecast and forecasted that non-oil commodity prices will hike the years to come. While the April 2024 release forecasted that average annual oil prices will decrease by 2.5% and 6.3% in 2024 and 2025, the July release forecasted that average annual oil price will increase by 0.8% as of end-2024 and decrease by 6% in 2025. The July release forecasted that, non-oil commodity prices would increase by 5% and 1.6% in 2024 and 2025 respectively, and consumption prices will decrease both in AEs and EMEs in upcoming two years. According to forecasts, commodity prices will continue to depend on climate changes along with geopolitical and geoeconomic uncertainties.

Chart 2. Commodity price change, %



Source: IMF, World Economic Outlook (WEO), 2024 July updated

In 2023 a rapid recovery of the global supply chain was the key driver behind both core and headline inflation reaching their pre-2020 average. In 2023 energy price shocks and lower labor market overloading also drove global inflation down too. Note that, consumer prices are more sensitive to geopolitical shocks. Continued attacks in the Red Sea from November 2023 could lead to a sharp decline in cargo traffic through the Suez Canal and, consequently, an increase in inflation amid a weakening supply chain.

Table 1. Weight of fiscal balance and state debt in GDP, in percentage

	Fiscal balance				Government debt			
	2022	2023	Forecast		2022	2023	Forecast	
	2022	2023	2024	2025	2022	2023	2024	2025
AEs	-3.1	-5.6	-4.4	-4.2	111.2	111.0	111.2	112.4
US	-4.1	-8.8	-6.5	-7.1	120.0	122.1	123.3	126.6
Euro area	-3.7	-3.5	-2.9	-2.6	90.8	88.6	88.7	88.3
Japan	-4.4	-5.8	-6.5	-3.2	257.2	252.4	254.6	252.6
EMEs	-4.9	-5.4	-5.5	-5.3	64.0	68.0	69.4	71.3
Asia	-7.2	-6.7	-6.9	-7.0	74.2	79.0	82.4	85.4
Europe	-2.4	-4.3	-4.0	-3.1	31.9	33.9	36.2	37.7
Latin America	-3.3	-5.1	-4.7	-3.4	68.3	74.1	68.5	68.4
Middle East and North Africa	3.8	0.6	-1.5	-1.1	43.5	43.1	42.3	41.4

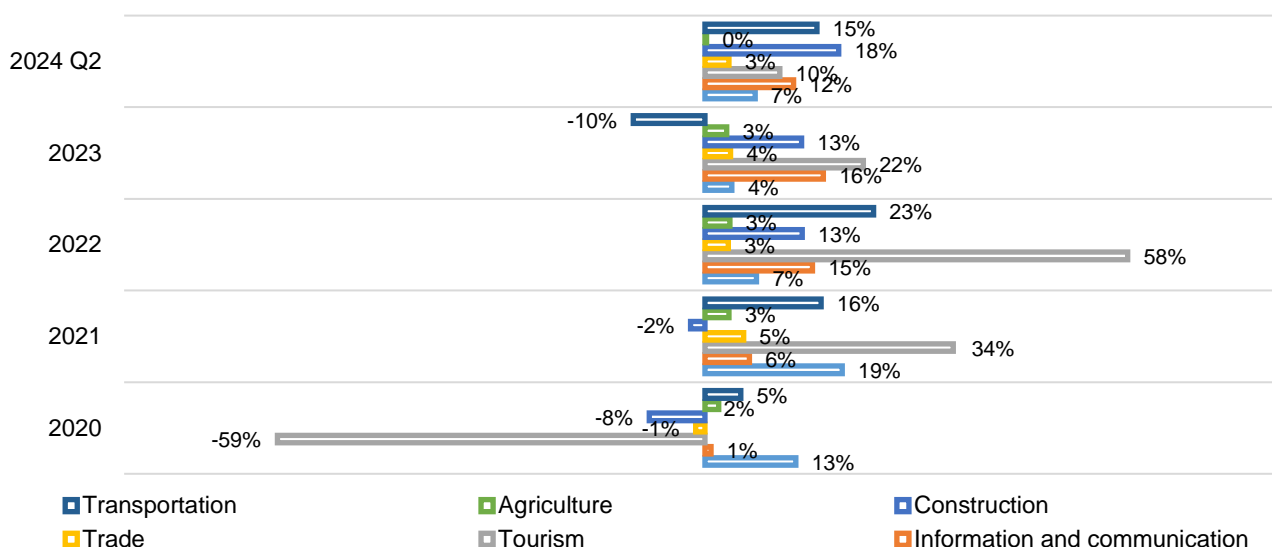
While expectations of a soft landing in the global economy have increased, persistent inflation risks may still pose a threat to market stability. Optimism related to soft landing of the global economy is rising amid the information that actual economic growth in various regions of the world will surpass the expectations. Investors expect monetary policy to be eased in the coming quarters, based on expectations that restrictive conditions created by previous interest rate hikes in most economies will bring inflation back to central banks' targets. In some countries, the recent volatility in inflation indicates that the disinflation process is not yet complete and that certain challenges may still arise.

Whereas global financial stability risks decline in the short run, vulnerabilities remain. According to the analyses of international financial institutions (IFIs), global economic growth outlook improved amid the decline in short term financial stability risks. According to the IMF's growth at risk (GAR) framework, global economic risks for the year to come decreased compared with the previous periods. Moreover, although short-term threats have diminished, the global economy, which has not yet fully recovered in the final stage of disinflation, may face new financial vulnerabilities. To manage these risks and ensure financial system stability in the future, it is necessary to continuously monitor and analyze the macroeconomic environment at both global and local levels.

Macroeconomic environment in Azerbaijan

Despite ongoing global geopolitical and geoeconomic vulnerabilities, in H1 2024 the Azerbaijani economy followed growth behavior. Over the period, foreign trade surplus and the non-oil-gas sector made a crucial contribution to economic growth amid rising aggregate demand. GDP increased by 4.3% in real terms to nominal AZN59.5B. Economic growth is still driven by the non-oil-gas sector. Whereas value added in the oil-and-gas sector increased by 0.6%, the non-oil-gas sector grew by 6.9%. Consequently, over the period the share of the non-oil sector in GDP increased to 65.2% from 60%. Per capita GDP was AZN5.8 thousand.

Chart 3. Economic growth rate of non-oil-gas areas



Source: SSC

All areas of the non-oil sector posted growth year-over-year in H1 2024. The highest growth was in construction (18%) due to construction and rebuilding efforts in liberated areas.

The number of labor force and nominal income of the population increased. As of end-2024 labor force numbered 5280.6 thousand persons, out of which 4996.5 thousand persons were employed population. The number of hired labor was 1794.4 thousand persons, of which 51% was employed in the public sector (893 thousand persons), and 49% (856 thousand persons) in the private sector. In January-June 2024 the average monthly nominal salary of hired labor y.o.y. increased by 8.8% to AZN1002,8. Income of the population y.o.y. increased by 5.3% to AZN39,9B in nominal terms.

In H1 2024 annual inflation continued decreasing. According to the SSC, in June 2024 annual inflation (June 2024 vs June 2023) made 1.1%, 1 pp down compared to

annual inflation in December 2023. Average annual inflation of the current year (January-June 2024 vs January-June 2023) was 0.7%, down by 8.1 pp compared to the average annual inflation as of end-2023.

Despite fluctuating inflation in partner countries, the appreciation of the nominal effective exchange rate of the manat contributed to the drop in inflation.

According to the World Bank report of June 2024, the commodity price index grew on an annual basis along with the non-energy price index. Despite price volatility in global commodity and energy markets, 3% appreciation of the NEER of the manat contributed to the drop in inflation during six months of 2024. Furthermore, adjustments made to the prices and tariffs of the products and services regulated by the government had an upward effect on inflation forecast. In the first half of 2024, the rise in regulated prices is expected to have a 1.5 pp direct and indirect effect on the inflation forecast, with 1 pp likely to materialize in 2024.

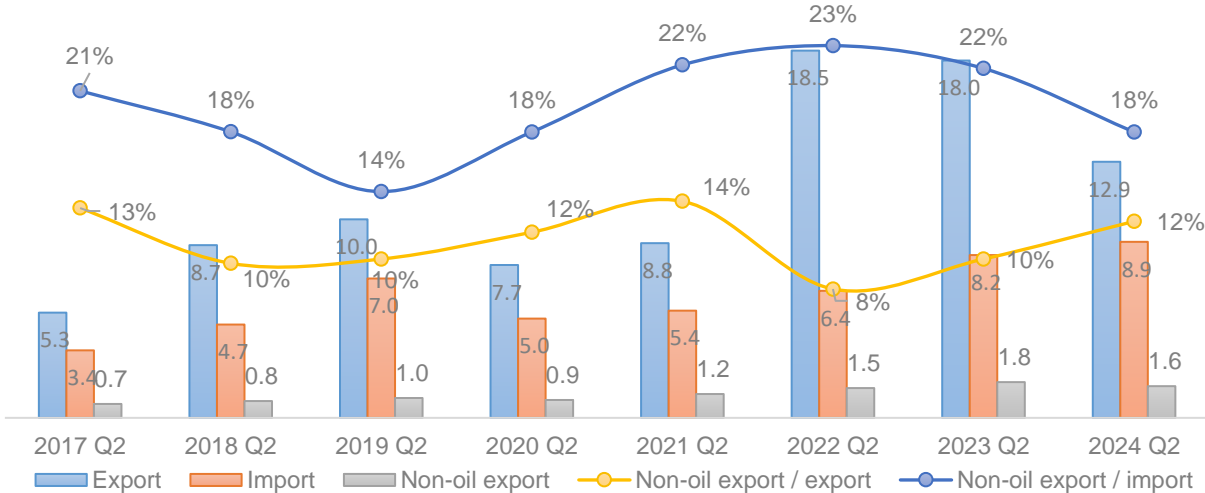
In H1 2024 the Central Bank pursued the monetary policy to regulate inflationary developments amid the improved transmission of monetary policy decisions.

Interest rate corridor parameters related decisions were made in consideration of the dynamics of inflationary factors, the effect of non-monetary factors and aggregate demand. 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%, while the interest rate corridor parameters were left unchanged at the last meeting. These decisions weighed on aggregate demand and inflationary factors through the monetary policy.

In August the average interest on one-day unsecured transactions (1D AZIR) was 7.28%, close to the refinancing rate within the interest rate corridor. In general, the difference between the 1D AZIR and the refinancing rate was in lows of recent months. Transactions made within one day in the unsecured market in August were in highs of recent months in terms of the size. The Central Bank decreased the amount of liquidity absorbing transactions taking into account the effect of the changes in balances of government accounts on banking system liquidity. The volume of notes issued by the Central Bank decreased by 45.6% during 8 months of the current year.

In H1 2024 foreign trade balance was in surplus. The SCC reported that, export had decreased y.o.y. by 28% (\$5.1B) to \$12.9B, while import increased by 8.1% (\$0.7B) to \$8.9B, resulting in \$4B worth surplus.

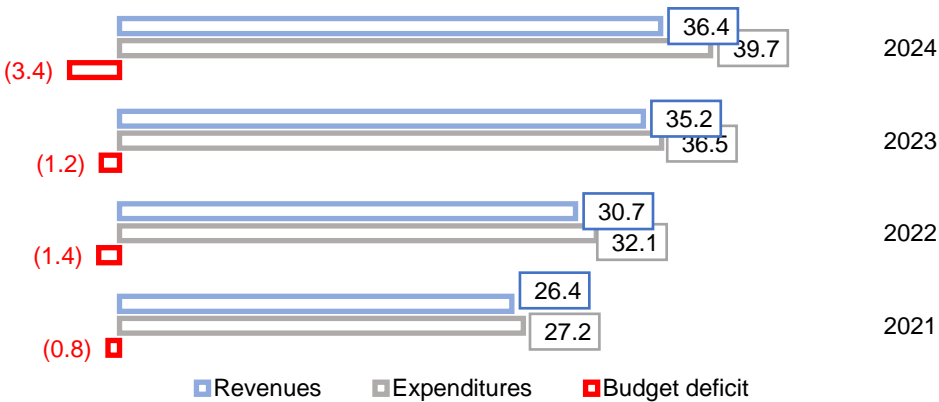
Chart 4. Import and export dynamics, billion USD dollars



Source: SCC

Fiscal spending remains essential for sustaining economic activity. As in the previous year, in H1 2024 the budget was revised to introduce additional financial safeguards to improve the population’s welfare, continue efforts to support economic growth, and implement the actions outlined in State Program I regarding Great Return, as well as reinforce the defense capabilities and national security following the full restoration of the territorial integrity and sovereignty of the country. Government revenues and expenditures were approved at AZN36.4B and AZN39.7B respectively, and budget deficit was approved at AZN3.4B as of end-2024.

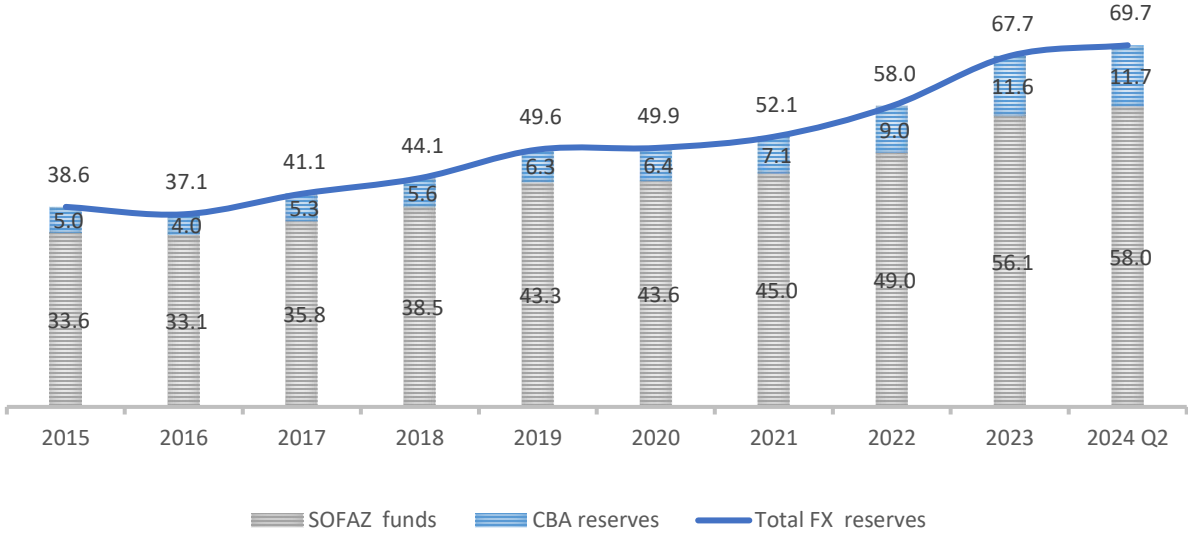
Chart 5. State budget revenues and expenditures, billion manats



Source: CBA, SSC

Long-term growth of foreign exchange reserves continued. Foreign exchange reserves increased both at the expense of funds of the SOFAZ and foreign exchange reserves of the CBA. Foreign exchange reserves have been increasing since 2016. In H 1 2024 foreign exchange reserves of the Central Bank increased by 1.1% (\$125M) to \$11.7B, those of the SOFAZ increased by 3.4% (\$1.9B) to \$58B. In general, foreign exchange reserves of the country increased by 3.1% (\$2.05B) to \$69.7B, historical highs of recent years.

Chart 6. Foreign exchange reserves of the CBA and the SOFAZ, billion USD dollars



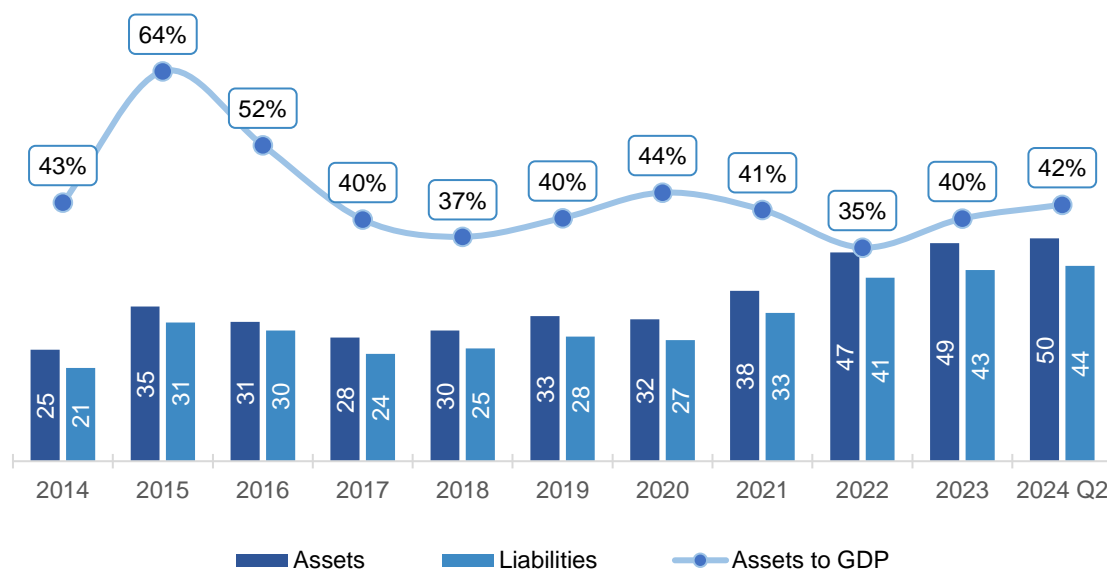
Source: CBA, SOFAZ

Overview of the banking system

- Dynamics of banking sector assets and liabilities

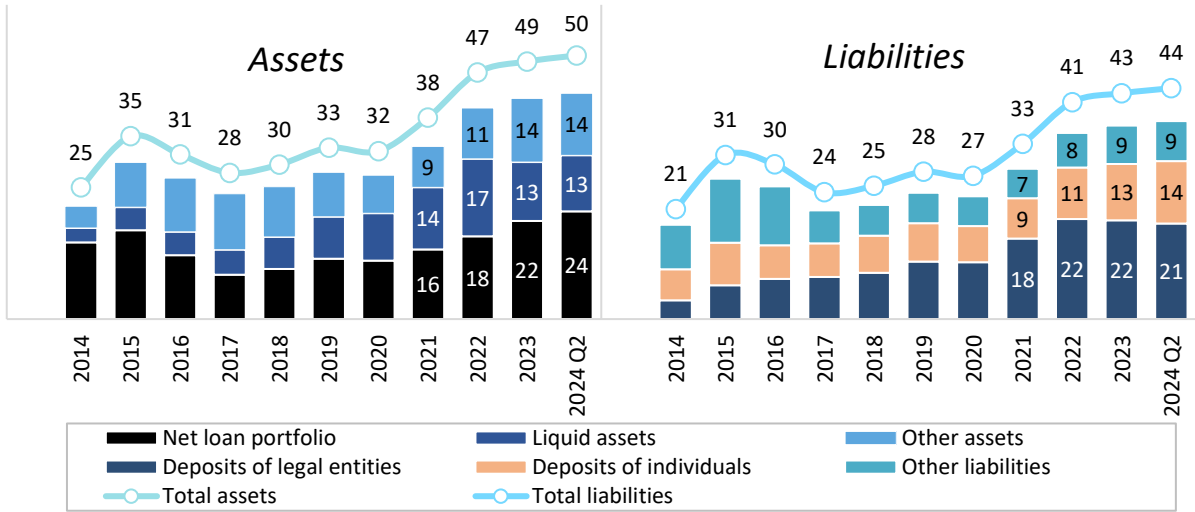
Growth of deposits of the individuals amid confidence of the population in the banking system was essential in expanding banking sector assets. During six months banking sector assets increased by 2.4% (AZN1.15B) to AZN50.3B. Liabilities increased by 2.3% (AZN971M) to AZN44B. According to the information regarding the end of the first half of 2024, the net lending portfolio accounted for 48%, liquid assets for 27% and other assets for 25% of total banking sector assets. Whereas the share of deposits of individuals increased in the financing of the banking sector, liabilities were driven by deposits of legal entities. Deposits of legal entities accounted for 48%, deposits of individuals for 31% and other liabilities for 20% of total liabilities. The assets of the banking sector expanded due to increased economic transparency, ongoing economic growth, deepening of the interbank market, and a rise in individual deposits, which is a key indicator of public confidence in the banking sector.

Chart 7. Banking system assets and liabilities, billion manats



Source: CBA

Chart 8. The structure of banking system assets and liabilities, billion manats



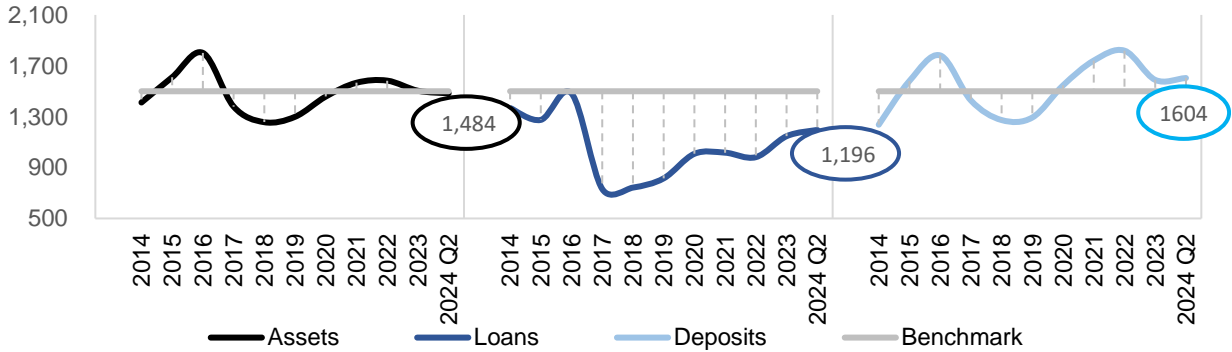
Source: CBA

Concentration in the banking sector

While there has been no significant year-over-year change in the concentration of assets and deposits, the concentration of the lending portfolio has increased.

According to the HHI¹ widely used in international practice, the concentration of the lending portfolio increased by 49 units to 1196 in H 1 2024 compared to the end of the previous year. While there has been no significant change in the HHI on assets and deposits, this indicator equals to 1484 and 1604 respectively, attributable to high concentration.

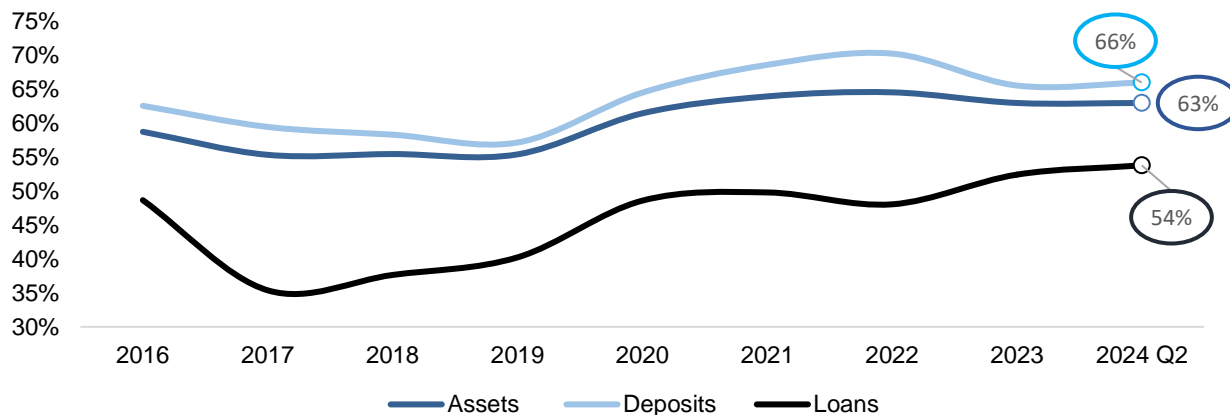
Chart 9. Banking sector’s HHI index



Source: CBA

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 10. Market share of top three largest banks



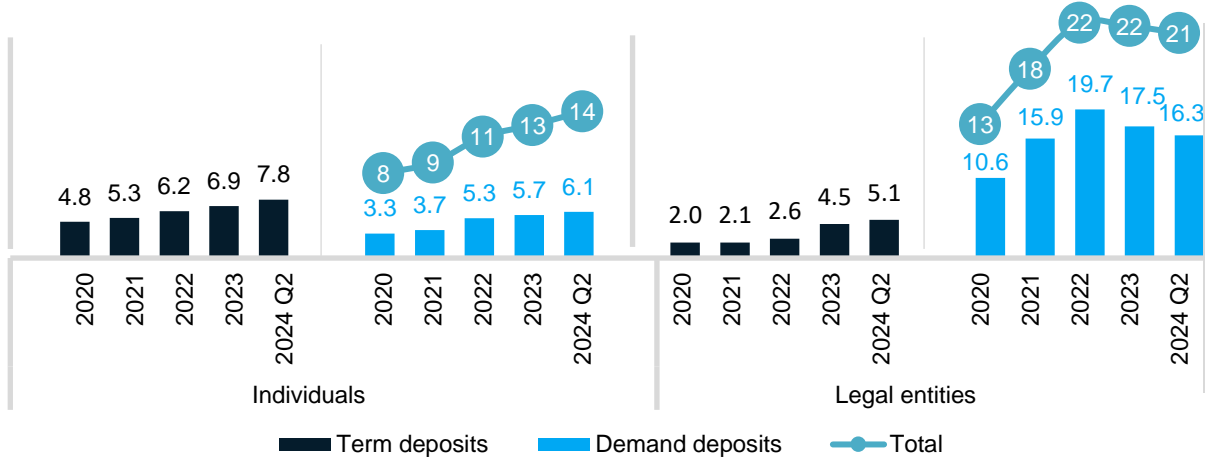
Source: CBA

The dynamics of the market share of the three largest banks shows the increased concentration in the lending portfolio in 2024. The market share of the lending portfolio of top three banks y.o.y. increased by 1.4 pp to 53.8%. There has been no significant change in the market share of top three banks across assets and deposit portfolios. The CBA always focuses on the concentration in the banking sector.

- **Resources attracted across the banking sector**

While deposits of legal entities, the key funding source of the sector, decreased, those of individuals increased. In H1 2024 deposits of legal entities decreased by 3% (AZN663M) to AZN21.3B, while deposits of individuals increased by 10.3% (AZN1.3B) to AZN13.9B. As a result, as of the end of the first half of the year, the share of deposits of legal entities in total liabilities decreased by 2.7 pp to 48.3%, while the share of deposits of individuals in total liabilities increased by 2.3 pp to 31.5%. Note that, a major part of the growth of deposits of individuals (67%) was driven by the growth in term deposits. The main reason for the drop in deposits of legal entities was business operations of large oil and gas companies.

Chart 11. Deposit portfolio of individuals and legal entities, billion manats



Source: CBA

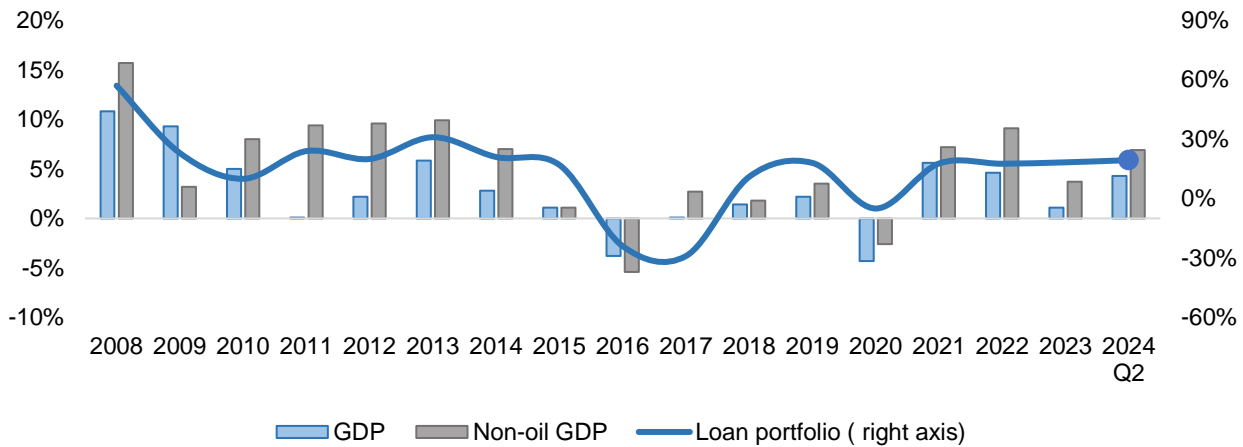
A rise in term deposits elevates banking sector’s potential for long-term asset generation. Demand deposits of legal entities decreased by 7% (AZN1.2B) to AZN16.3B, while term deposits increased by 12.3% (AZN552M) to AZN5.1B. Note that, amid volatility in demand deposits of legal entities, term deposits of both individuals and legal entities have been growing steadily in recent years.

There has been no significant change in dollarization of deposits. The level of dollarization of the total deposit portfolio stood at 38.7%, deposits of individuals 34.4% and deposits of legal entities 41.5% compared with the end of the previous year.

- **Bank lending**

Bank lending was highly active. Against the backdrop of rising GDP (annual +4.3%) and non-oil GDP (annual +6.9%) the banking system’s lending portfolio increased by 19.4% (AZN4.1B) to AZN25.4B in H1 2024.

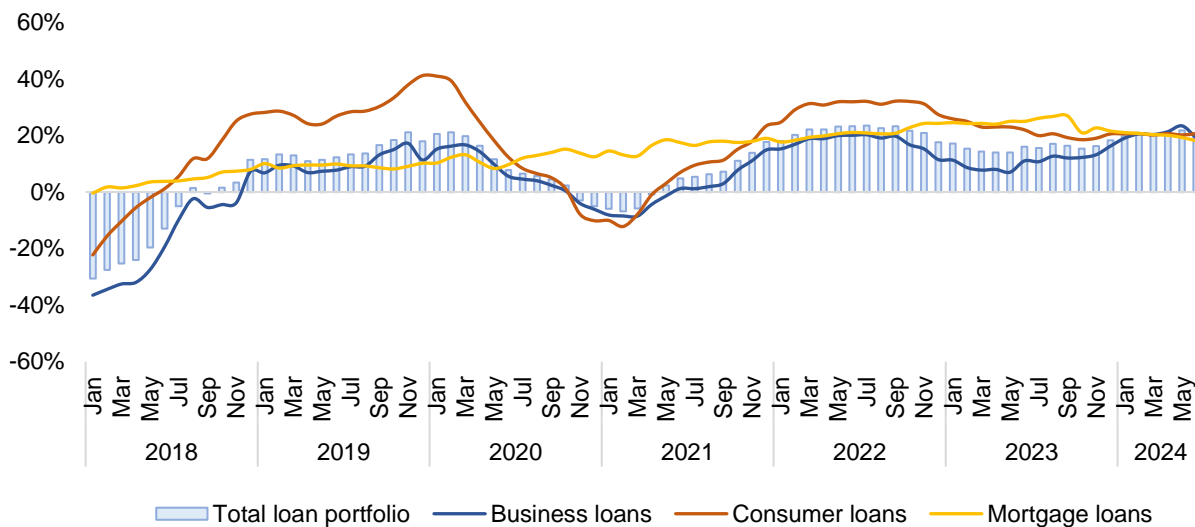
Chart 12. Loan portfolio and GDP annual growth rate



Source: CBA

Lending grew across all segments. While the growth dynamics of the portfolio has been declining since 2022 due to the regulatory tightening on consumer lending, over recent one year the portfolio’s growth rate remained stable around 20% (prior to regulatory adjustments the annual growth rate on the consumer lending was 32%, currently 21%). Business loans y.o.y. increased by 19%, consumer loans by 20.7% and mortgage loans by 18.1%.

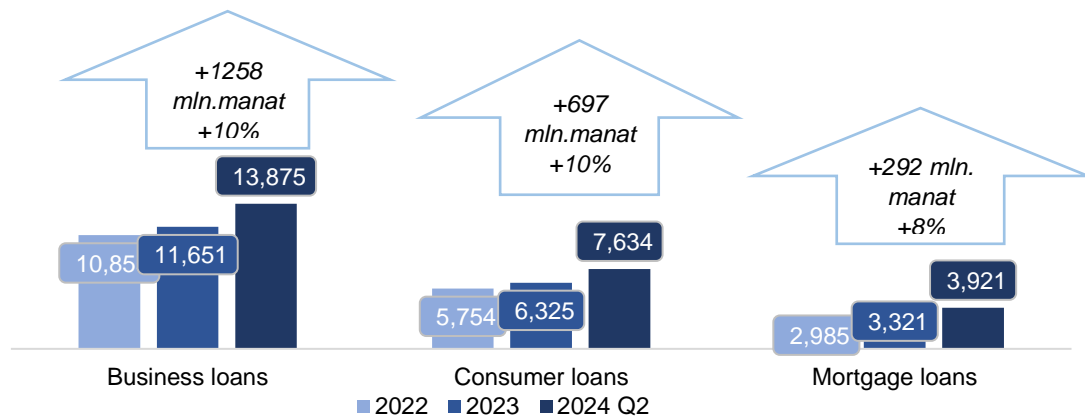
Chart 13. Annual dynamics of loan portfolio, %



Source: CBA

Compared to the early year, business loans increased by AZN1,258M to AZN13.9B. In H1 2024 the mortgage portfolio increased by AZN292M to AZN3.9B. The growth of the mortgage lending portfolio was driven by those issued from government funds (59%, or AZN174M) and from banks' own funds (41%, AZN118M). Over the period consumer loans increased by AZN697M to AZN7.6B.

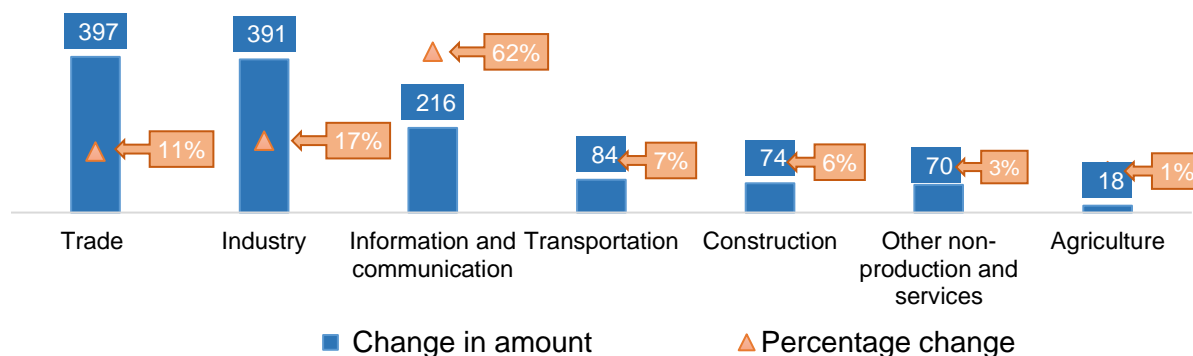
Chart 14. Loan portfolio dynamics, billion manats



Source: CBA

In H1 2024 the business portfolio grew across all areas. Business loans account for 54.5% of the total lending portfolio. Banks' business portfolio increased by 10% to AZN13.9B compared to the end of the previous year. The main drivers of the business portfolio's growth were trade, industry, information and communication, compared to the end of 2023 these sectors grew by 11% (AZN397M), 17% (AZN391M) and 62% (AZN216M) respectively. Growth on these three sectors accounted for 80% of the total business portfolio growth.

Chart 15. Business portfolio across economic sectors, million manats



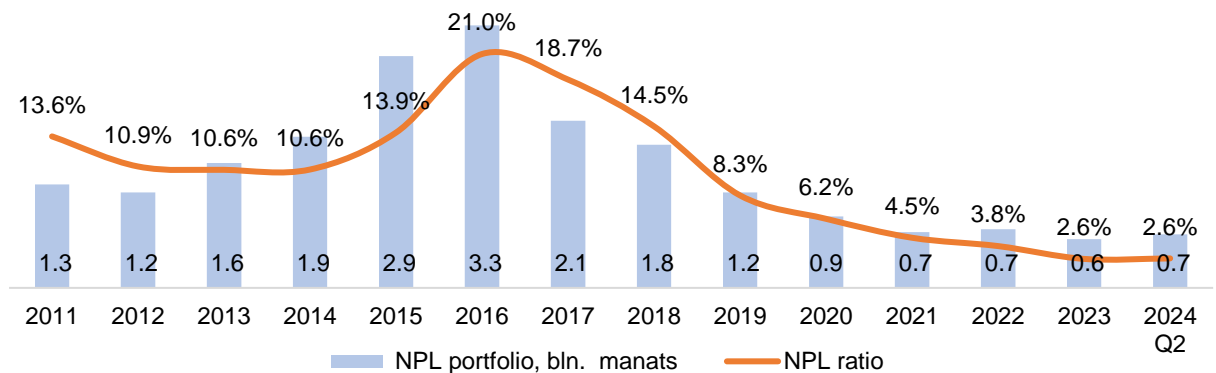
Source: CBA

Credit risk of the banking system

In H1 2024 there has been no significant change on credit risks. NPLs increased by 9.5% (AZN58M) in absolute terms to AZN0.7B. The share of NPLs in the total portfolio remained unchanged (2.6%).

Total AZN88M worth of funds were written off across the banking sector. Funds were written off on the consumer portfolio in the limited number of banks (74%, or AZN65M). If to skip write-offs, the relevant ratio of the sector made 3%.

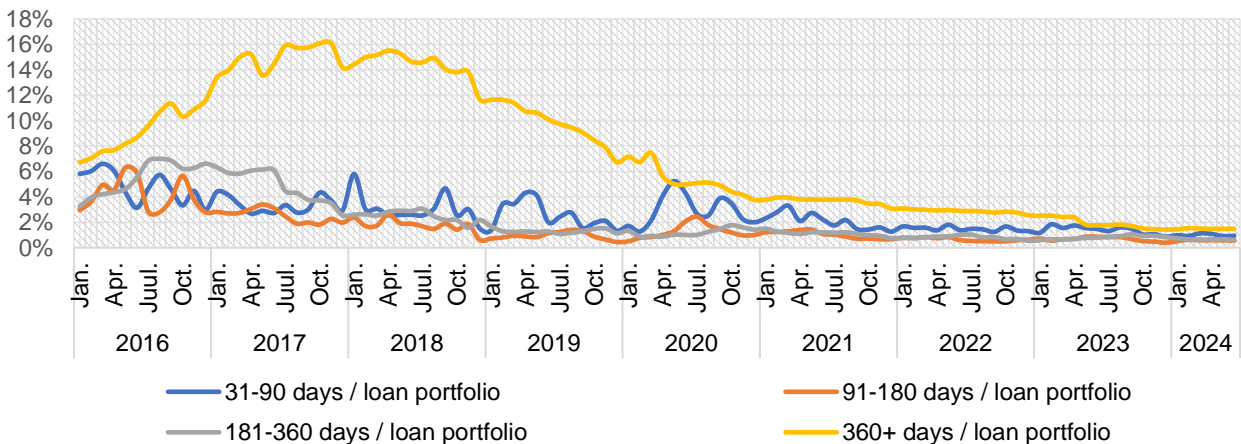
Chart 16. NPL portfolio on banking sector



Source: CBA

The share of loans delinquent for over a year in the structure of delinquency breakdown of the NPL portfolio keeps falling. Against the backdrop of banking sector remediation, the share of NPLs delinquent for over one year in the total portfolio decreased by 11.3 pp to 1.4% from 12.7%. The share of loans with over one-year delinquency in the total portfolio is positively impacted by banks writing off loss loans from their balance sheets.

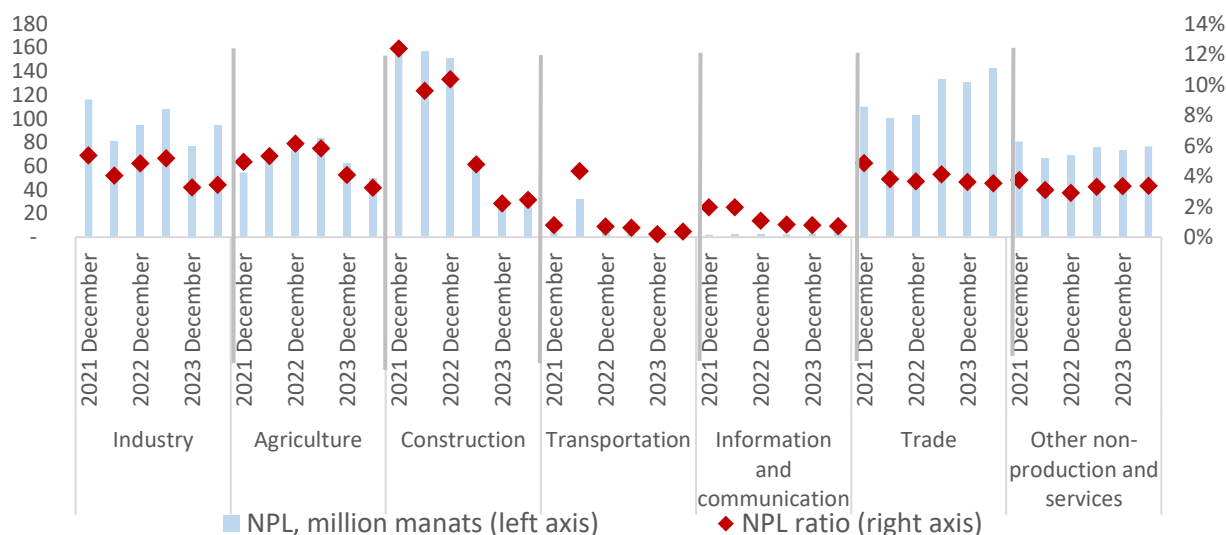
Chart 17. Delinquency breakdown of loan portfolio



Source: CBA

In H1 2024 credit risks in the business portfolio did not change significantly. NPLs in the business portfolio increased by 7% to AZN406M compared to the end of the previous year. However, since the growth rate of newly issued business loans exceed that of NPLs, the NPL ratio decreased by 0.1 pp to 2.9%. Looking at the dynamics across business sectors within the NPL portfolio, credit risks remain stable.

Chart 18. NPL portfolio on business loans across industrial areas, in million manats



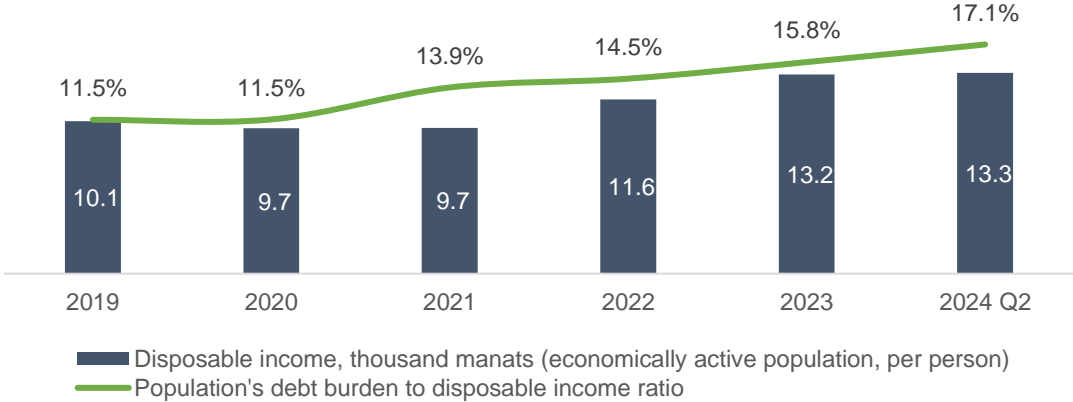
Source: CBA

Credit risks are kept on focus on the consumer portfolio. In H1 2024, NPLs on consumer loans increased by 15% (AZN30M) to AZN226M in nominal terms. However, since the growth rate of consumer loans was higher compared to the end of the previous year, the NPL ratio increased by merely 0.2 pp to 3%. Note that 52% of consumer loans were issued to individuals with fixed income employed with the public sector.

The consumer portfolio is driven by DTI>45%. In H1 2024 53% (AZN260M) of consumer loan growth was driven by DTI>45%, the most part of which is on the 60%<DTI<70% range. The CBA's prudential policy on consumer lending aims to promote the population's healthy and responsible borrowing, including protecting the sector from potential threats. According to the changes made to the regulatory framework, a mandatory cap of 70% has been placed on the DTI ratio. To mitigate risks on consumer loans with a high DTI (DTI > 45%), DTI-based provisioning requirements and risk weights have been tightened.

The dynamics of the population's debt burden remain a key focus. Although disposable income has shown growth, the share of debt burden in disposable income is rising due to high lending rates. The CBA closely monitors borrowing trends among the population and formulates relevant regulatory policies accordingly.

Chart 19. Population's debt burden to disposable income ratio

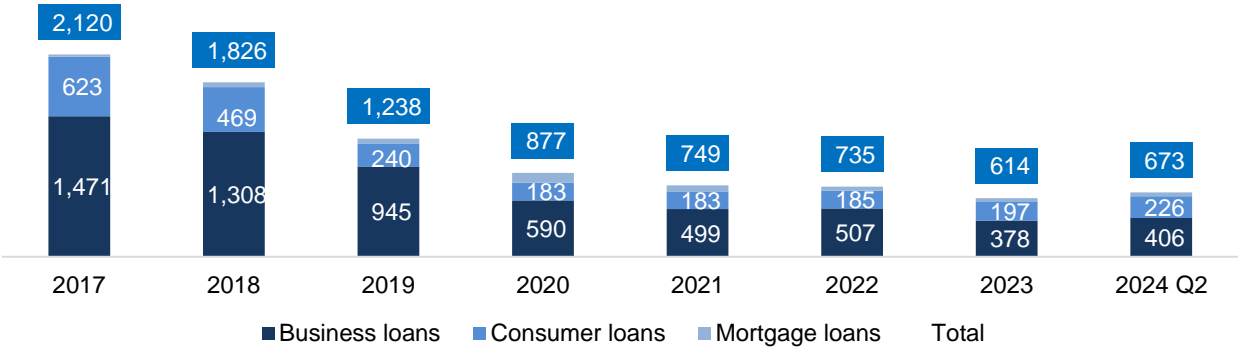


* Population's debt burden= the total outstanding amount of consumer and mortgage loans owed by individuals to credit institutions (banks and non-bank credit organizations).

Source: CBA

The NPL ratio is on historical lows of recent years. In H1 2024, while the nominal size of NPLs on the mortgage portfolio increased by 1.8% (AZN0.72M) to AZN40M, the share of NPLs in the portfolio decreased by 0.1 pp to 1%.

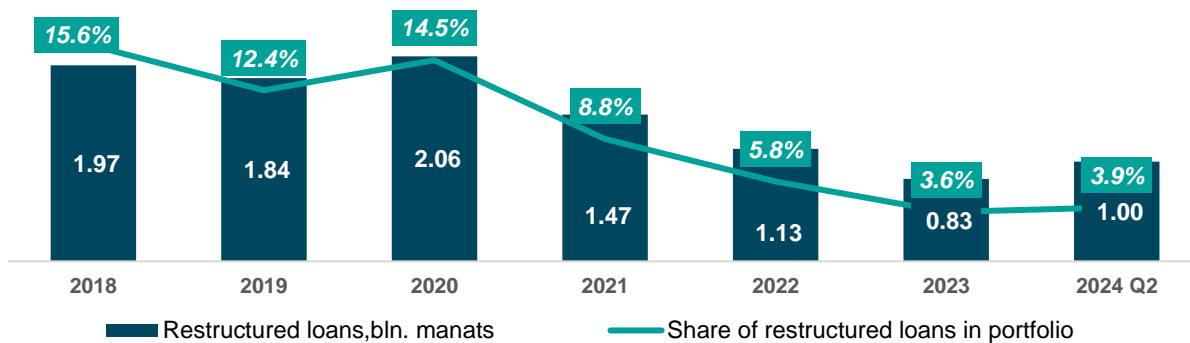
Chart 20. Sectorial dynamics of NPL portfolio, mln. manats



Source: CBA

While the restructured portfolio grew, it is not of a systemic nature. In H1 2024 the size of restructured portfolio increased by 21% (AZN0.17B) to AZN1B, driven by a limited number of borrowers on the business portfolio (AZN202M). The restructured consumer portfolio decreased (AZN27M).

Chart 21. Restructured loan portfolio, billion manats



Source: CBA

Box 1. Initiatives to improve the banking sector's regulatory framework

Initiatives are underway to modernize the regulatory and supervisory framework as part of the banking sector development component of the '2024-2026 Financial Sector Development Strategy' adopted by the CBA. A new edition of the '**Regulation on related party transactions in banks**' was approved in January 2024. The updated regulation incorporates the latest related international standards, requirements for proportional collateralization based on the risk of assets, flexible decision-making processes within the bank, as well as a more refined version of the requirements from the previous regulation, with the aim of ensuring safer and healthier banking operations with related parties and increasing transparency in these operations. The new Regulation clarifies the definition of a related party, determines the threshold for indirect participation considered in the definition, as well as determines the methodology for the calculation of the concession the requirement to prohibit preferential transactions with related parties. Related party loans are classified as significant and partially significant in terms of their amount and differential securitization is applied on such loans. Moreover, requirements have been determined on decisions-making; decision-making limits and conditions have been established for the Management Board regarding related party transactions. Total amount of credit exposures issued to all related parties by the decision of the Management Board should not exceed 1% of bank's Tier I capital. In addition, in supervising activities of banks, deadlines for eliminating identified regulatory violations in related party transactions have been established, along with enhanced reporting requirements to the Central Bank regarding related party transactions.

- To boost financial inclusion in the country and elevate access of the population and businesses to financial services irrespective of the place of residence, a regulatory framework has been expanded to introduce an agent banking model. In case third parties are involved in lending, to identify regulation in lending, according to the changes made to the '**Regulation on credit risk management in banks**' approved in May, the national postal operator, NBCIs, payment and e-money institutions may be involved in lending.

The changes to the regulation define various issues, including the credit institutions that can be involved in the lending process, activities to be carried out by them, the form of opening a bank account, requirements regarding the bank's strategy, credit policy, and related internal rules, compliance with the relevant provisions of the 'Regulation on the organization of work with payment agents,' and adherence to the customer due diligence requirements of the AML/CFT Law. Additionally, the package of changes to the regulations includes provisions aimed at reducing life insurance risks for individuals taking consumer loans. This package of changes stipulates that it is imperative to offer a life

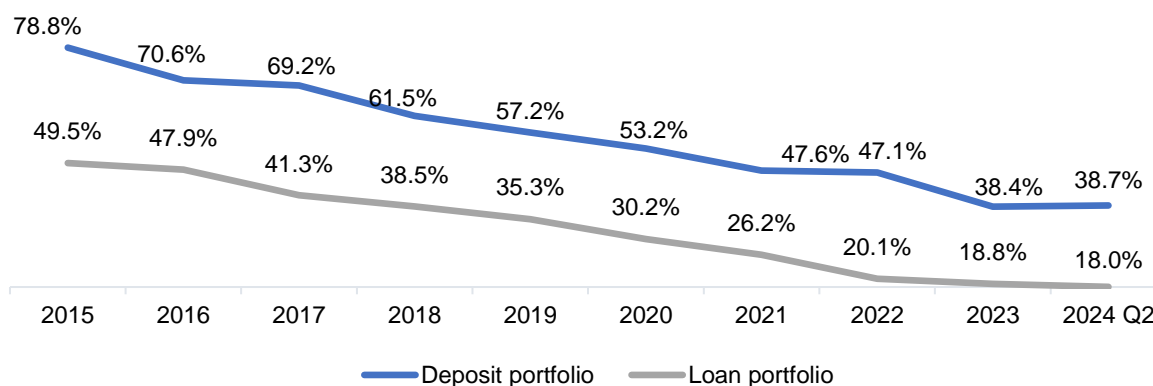
insurance contract for the relevant loan when a consumer loan agreement is proposed to individuals, the customer should be informed about the list of insurers that provide the option to enter into such an insurance agreement, and the customer should learn about the amount of the initial insurance premium that will be added to the loan amount during the insurance process.

Market risk of the banking system

The banking sector's currency position is within prudential requirements. In H1 2024 the banking system's long open currency position amounted to AZN202M, and the banking system's open currency position to total regulatory capital ratio was 3.5%, 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 made 20% (10% per currency).

De-dollarization developments are stable across the sector. During six months of the current year dollarization of the banking system's lending portfolio decreased by 0.8 pp to 18% (historical lows). In H1 2024 dollarization of the deposit portfolio slightly increased (+0.3 pp) to 38.7% compared with the beginning of the year.

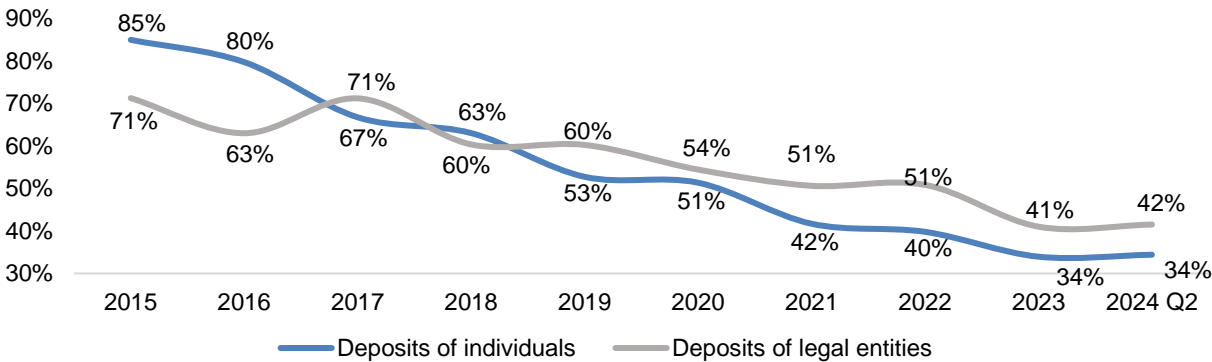
Chart 22. Dollarization of loan and deposit portfolio



Source: CBA

In H1 2024 the dollarization of the deposit portfolio was driven by demand deposits of legal entities and term deposits of individuals. Dollarization of demand deposits of legal entities (LEs) increased by 0.5 pp to 36.8%. Term deposits of LEs in a foreign currency decreased by 2.7 pp to 56.5%. The reason for the rise in foreign currency denominated demand deposits of Les is attributable to operations of companies engaged in the oil and gas sector. Compared to the beginning of the year in Half I the dollarization of term deposits of individuals increased by 1.2 pp to 35.5%, while demand deposits decreased by 0.5 pp to 33.1%.

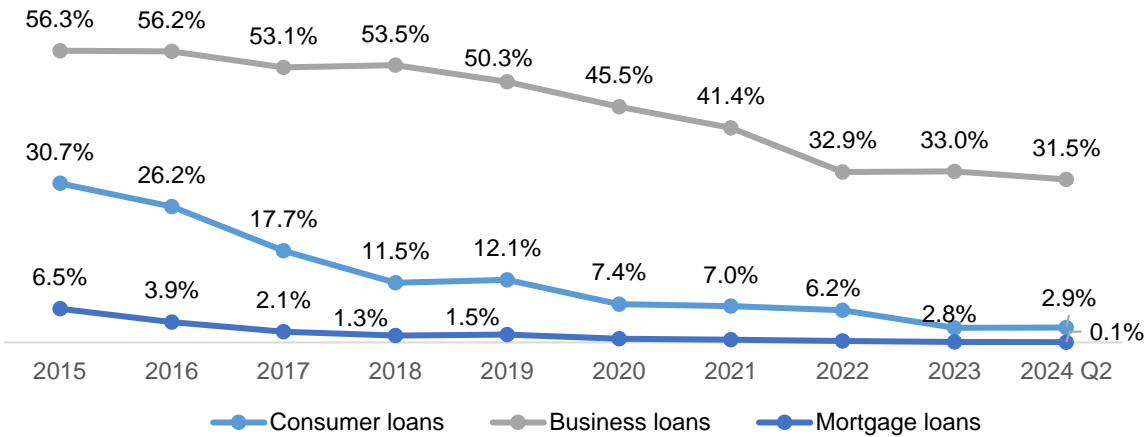
Chart 23. Dollarization of deposit portfolio



Source: CBA

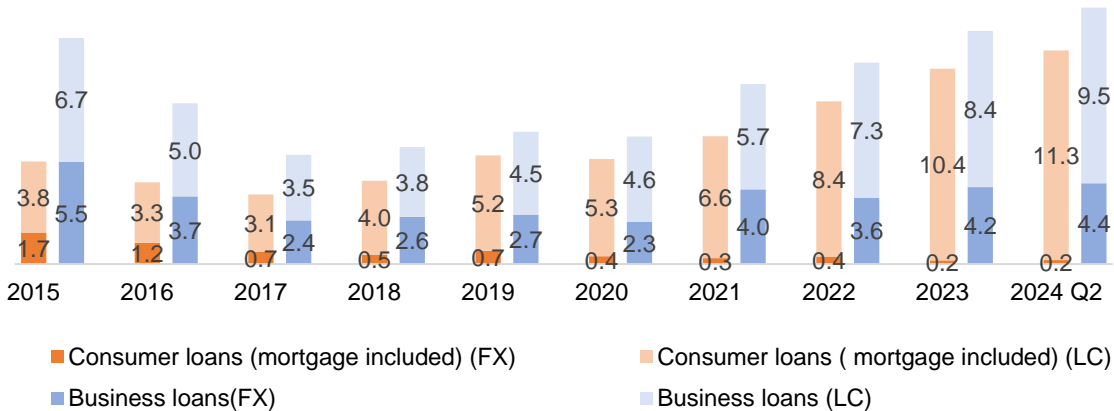
The de-dollarization of the lending portfolio continued declining. The share of national currency denominated loans in the lending portfolio kept increasing against the backdrop of the exchange rate stability of the manat and the expansion of manat lending. In H1 2024 the dollarization of the lending portfolio decreased by 0.8 pp to 18%, driven by business loans – dollarization of business loans decreased by 1.6 pp to 31.5%. Moreover, since 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. There has been no significant change in the dollarization of consumer loans.

Chart 24. Share of foreign currency loans in loan portfolio



Source: CBA

Chart 25. Currency structure and dynamics of loan portfolio, billion manats



Source: CBA

Banks’ interest rate sensitivity does not threaten their resilience. The interest rate risk was analyzed with the duration method². 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 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.

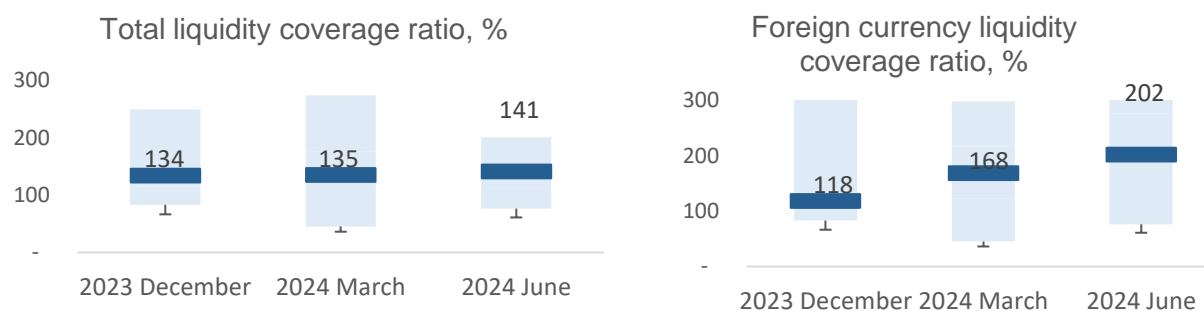
The rise in interest rates due to positive duration has a downward effect on the capital adequacy ratio (CAR). According to simulations, a 1 pp rise in an interest rate results in a 0.9 pp decrease in the CAR, which does not pose any threat to financial resilience of the banking system.

² 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: $\partial(asset) - \frac{\partial(liability) \times liability}{asset}$. During the analysis, assets and liabilities are discounted by the discount rate of the CBA.

Liquidity risk of the banking system

System's liquidity remains in a comfort zone. The sector's liquidity position has adjusted to the new monetary framework and the framework for the application of prudential tools. The instant liquidity ratio is 50%, up by 20 pp from the minimum requirement. Liquid assets account for 25% of total assets, providing an adequate buffer against potential liquidity shocks. The liquidity coverage ratio (LCR) across all banks exceed the norm. The LCR stood at 141% and 202% in aggregate and in a foreign currency respectively. The LCR makes banks more resilient against short-term liquidity shocks by maintaining an adequate level of highly qualitative liquid assets.

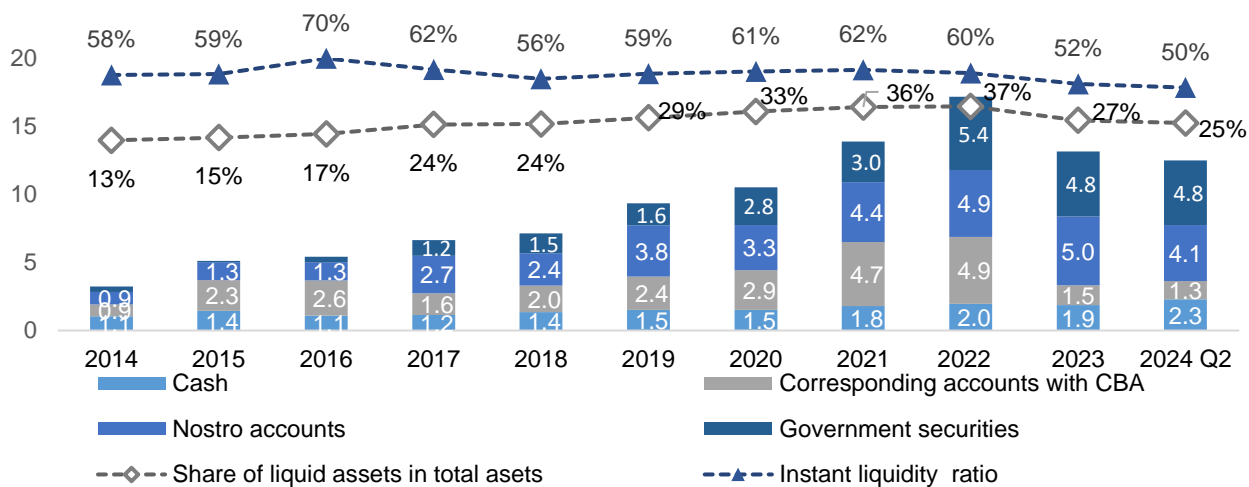
Chart 26. Liquidity coverage ratio



Source: CBA

Liquid assets of the sector slightly decreased. Over six months liquid assets decreased by 5% or (AZN0.6B) to AZN12.5B.

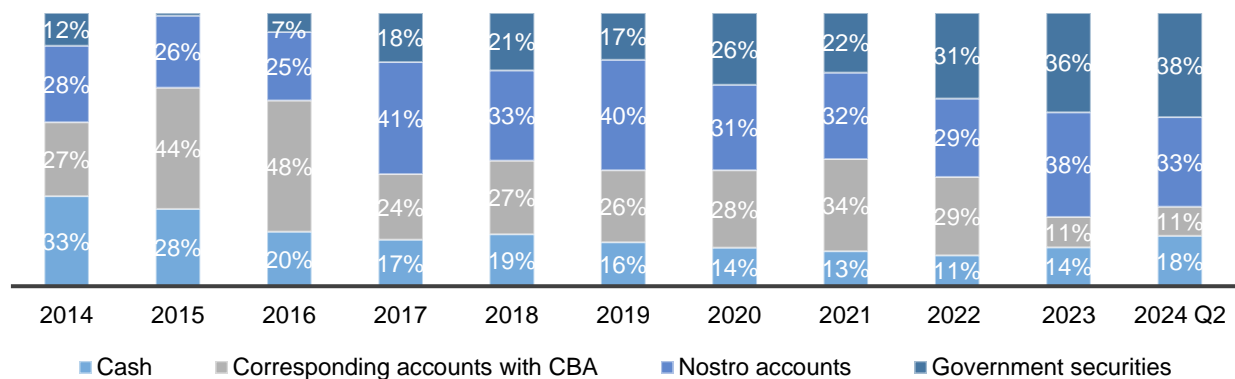
Chart 27. Dynamics of the structure of liquid assets, billion manats



Source: CBA

If to look at the structure of liquid assets 33% of them are concentrated in nostro accounts, 38% in securities, 18% in cash and 11% in correspondent accounts with the CBA.

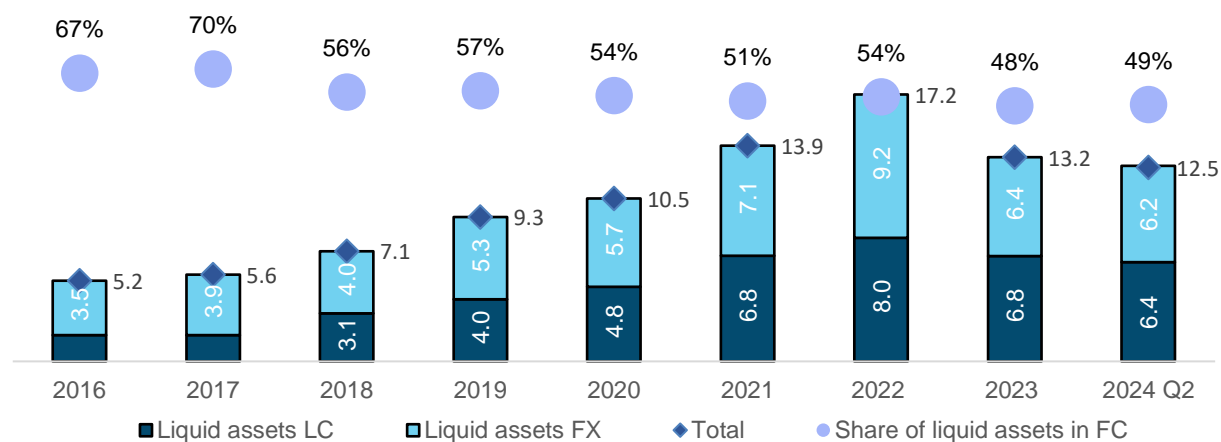
Chart 28. Dynamics of the share of liquid asset components in liquid assets



Source: CBA

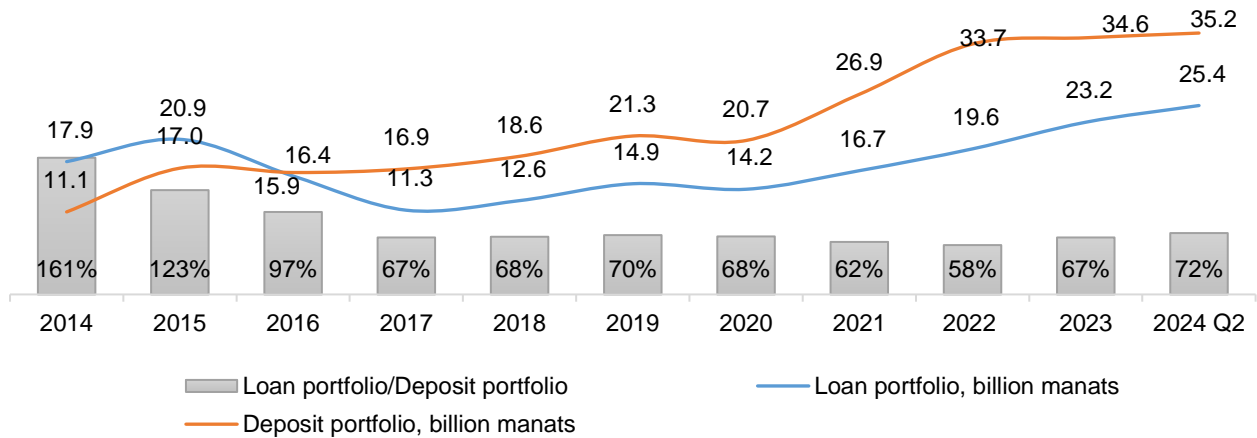
There has been no significant change in the currency structure of liquid assets. In H1 2024 the share of liquid funds in the national currency in total liquid assets was 51%, and liquid assets in a foreign currency in total liquid assets was 49%.

Chart 29. Dynamics of the currency structure of liquid assets, billion manats



The loans to deposits ratio is growing. The lending portfolio to the deposit portfolio ratio increased by 5 pp to 72%, due to the faster growth of the loan portfolio and the slower growth rate of the deposit portfolio, against the backdrop of a decrease in demand deposits of legal entities.

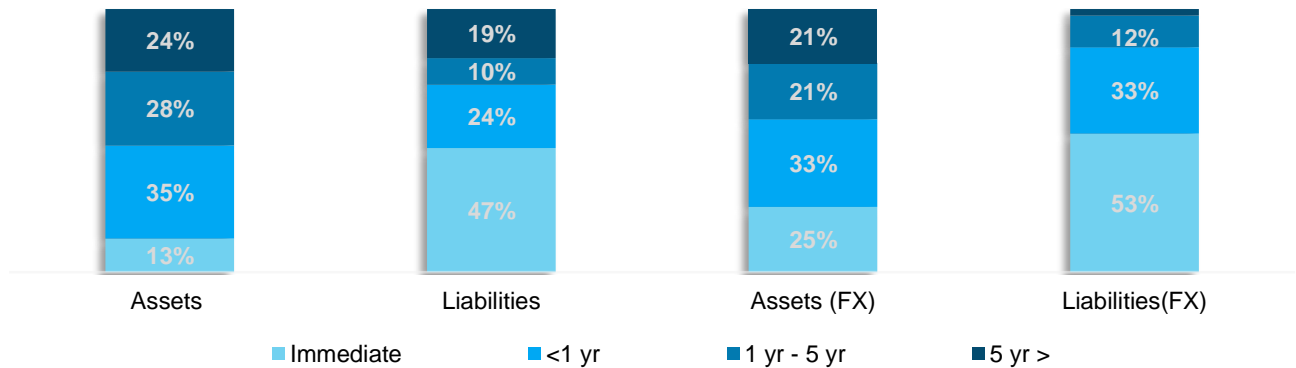
Chart 30. Dynamics of the loan to deposit ratio



Source: CBA

The share of assets with up to one year maturity in total assets was 48%, and the similar indicator for liabilities was 71%. Over six months the share of liabilities with up to one year maturity in total liabilities decreased by 14 pp. While a high share of current liabilities creates a maturity mismatch, the sector's large liquidity buffer mitigates the impact of this mismatch on liquidity risk.

Chart 31. Maturity structure of assets and liabilities

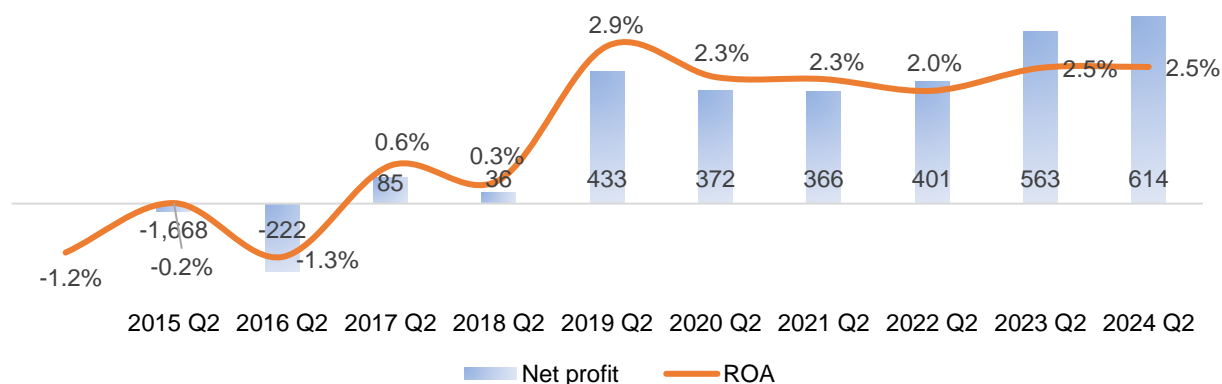


Source: CBA

Banking system profitability

Profitability indicators of the banking sector are following a positive trend. In H1 2024 banking system's net profit y.o.y. increased by 9% (AZN51M) to AZN614M. The ROA made 2.5% amid profitability of the sector.

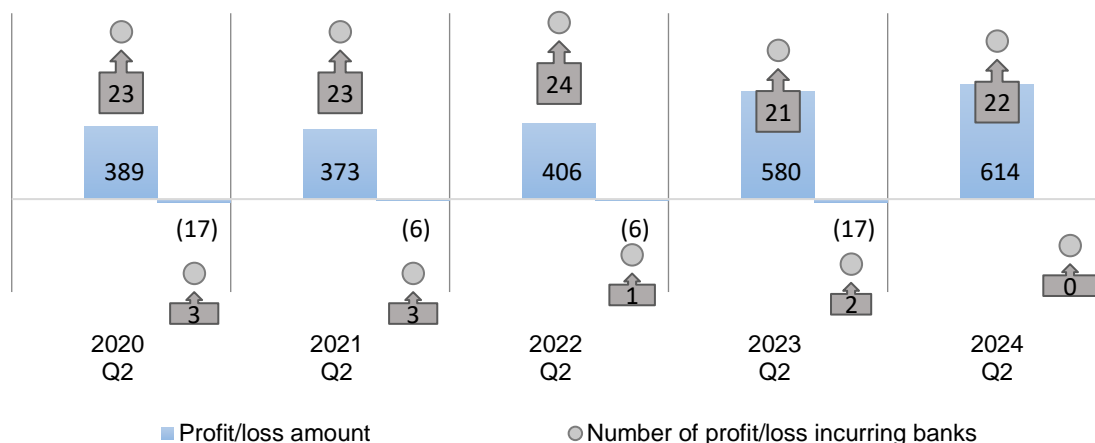
Chart 32. Banking system profitability, million manats



Source: CBA

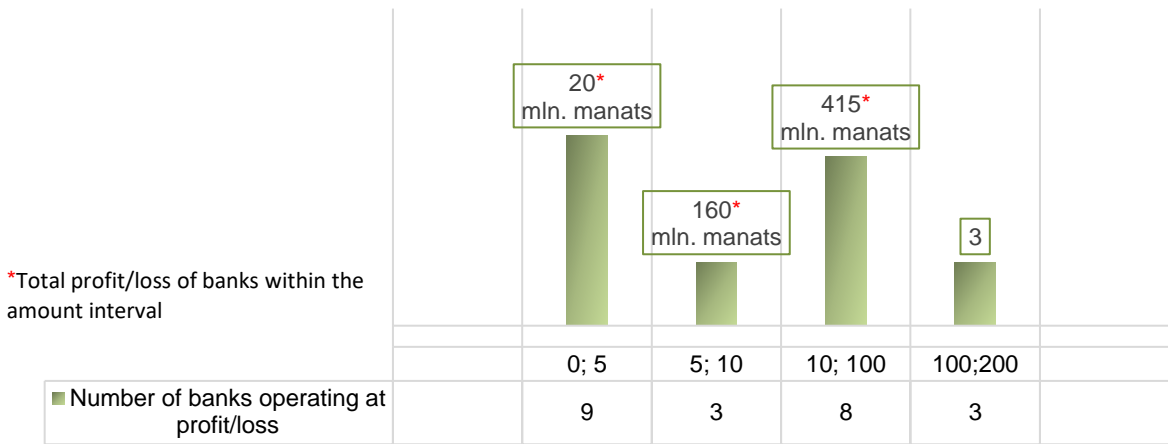
In the first half of 2024, no bank operated at a loss. Although all banks in the sector are profitable, profitability is concentrated. Three banks, which account for 63% of total assets, generate 68% of the sector's net profit.

Chart 33. Number and dynamics of banks operating at profit and loss, million manats



Source: CBA

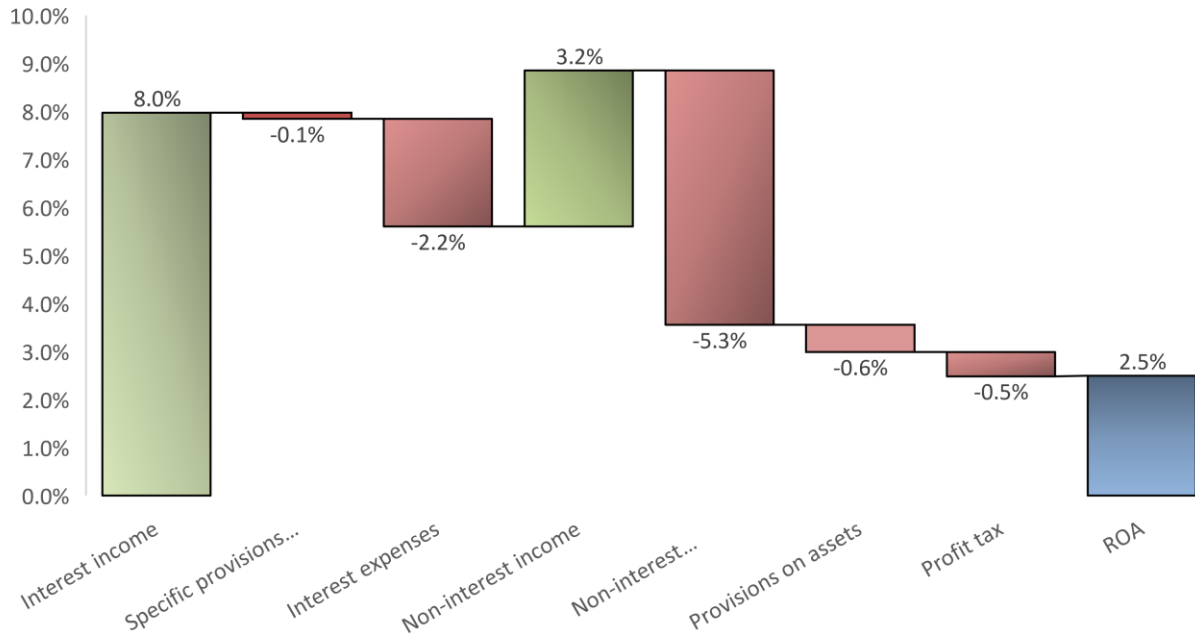
Chart 34. Distribution of banking system profitability



Source: CBA

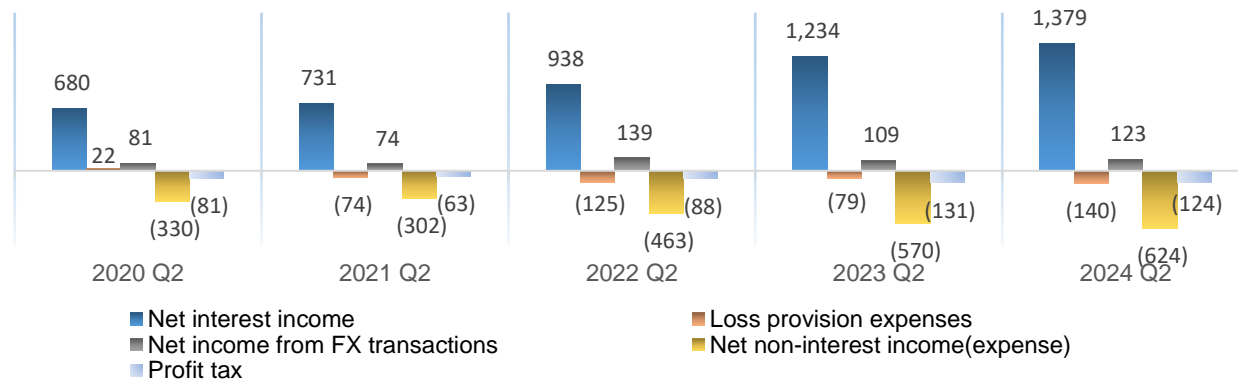
The ROA of the sector remained stable over the year (2.5%). In H1 2024 despite the year-over-year rise in the ratio of interest and non-interest expenses to average assets, the ROA remained unchanged due to rising interest income.

Chart 35. ROA decomposition across the banking system



Sector's net interest income is increasing continuously. Net interest income y.o.y. increased by 12% (AZN145M) to AZN1379M. Profit margin made 22.2% amid rising interest income.

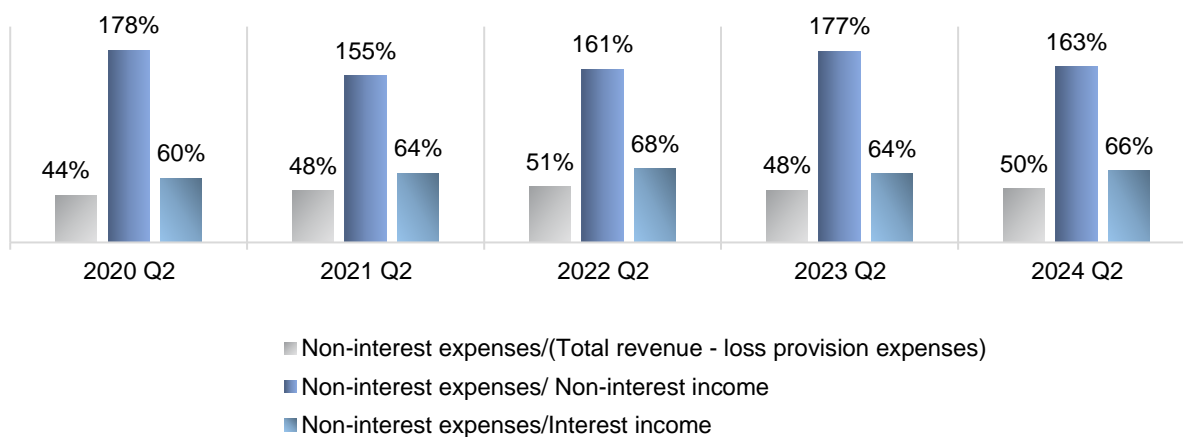
Chart 36. Decomposition and dynamics of profit across the banking system



Source: CBA

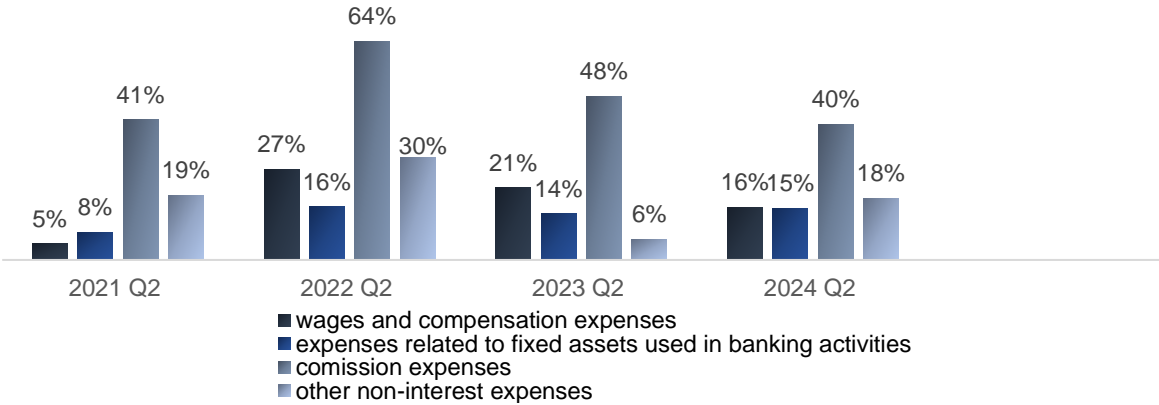
While sector’s non-interest expenses increased, efficiency improved amid rising interest and non-interest income. In H1 2024 the banking sector’s non-interest expenses to net aggregate income ratio increased year-over-year, the non-interest expenses to non-interest income ratio decreased. The main reason for the drop is that the growth rate of non-interest income is higher than that of non-interest expenses. Compared with the second half of 2023, the non-interest expenses to net aggregate income ratio increased by 1.2 pp to 50%, while the non-interest expenses to non-interest income ratio decreased by 14 pp to 163%.

Chart 37. Banking system’s efficiency indicators



Source: CBA

Chart 38. Dynamics of non-interest expenses

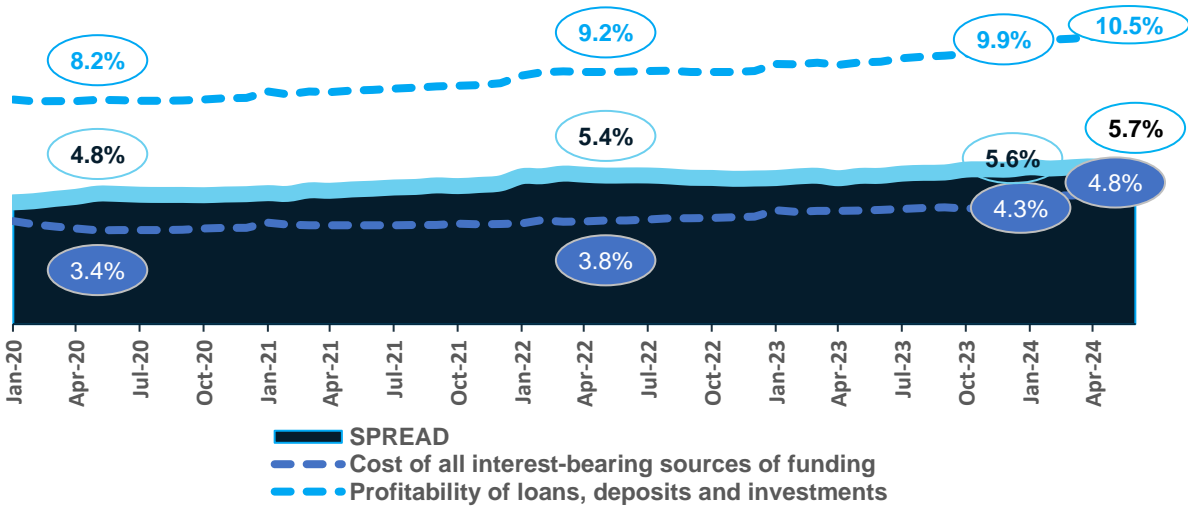


Source: CBA

Fees and commissioning expenses were the main drivers of non-interest expenses. In H1 2024 fees and commissioning expenses (33% of non-interest expenses) y.o.y. increased by 40% (AZN122M), driven by bank products such as cashback, along with the rise in cashless operations and deepening digitalization.

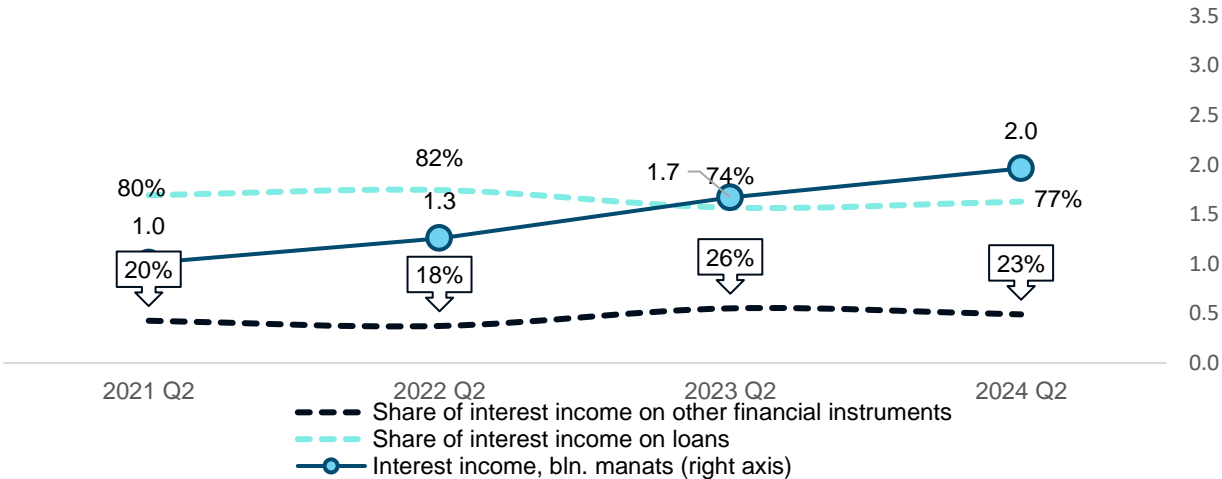
The dynamics of the banking sector’s interest spread is stabilizing. The sector’s interest rate increased by 0.1 pp to 5.7% compared with the early year amid the rise in profitability of interest-bearing assets and the rise in the cost of interest-bearing funding sources.

Chart 39. Banking system’s interest spread



Source: CBA

Chart 40. Dynamics of interest income

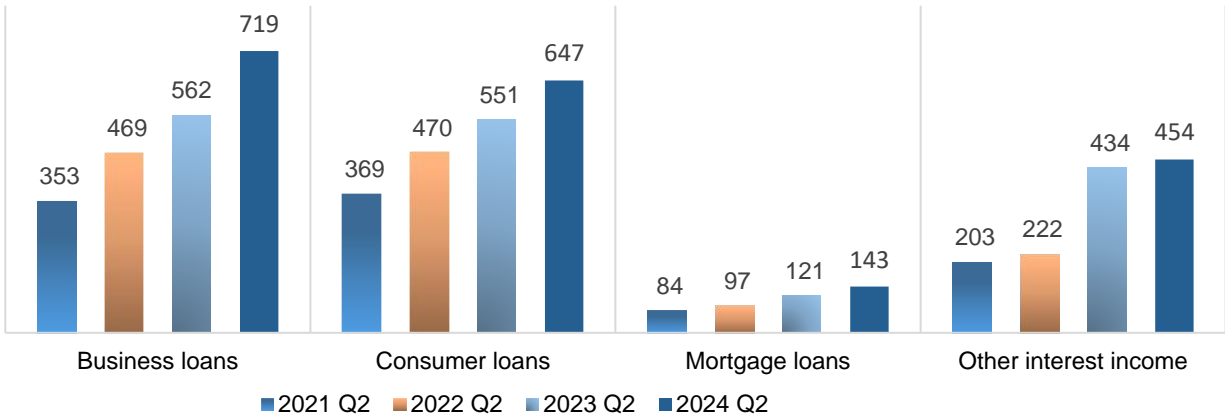


Source: CBA

While all components of banks’ interest income grew, the growth was driven by interest income on business and consumer loans. Interest income increased by 18% (AZN294M) to AZN2B – business loans (53%) and consumer loans (33%).

The structure of interest income is as follows: interest income generated on business loans 37% (AZN719M), consumer loans 33% (AZN647M), mortgage loans 7% (AZN143M) and 23% (AZN454M) other financial instruments. Interest income generated on other financial instruments include funds placed with financial institutions (AZN171M), securities (AZN214M), nostro and other interest-bearing financial instruments (AZN68M).

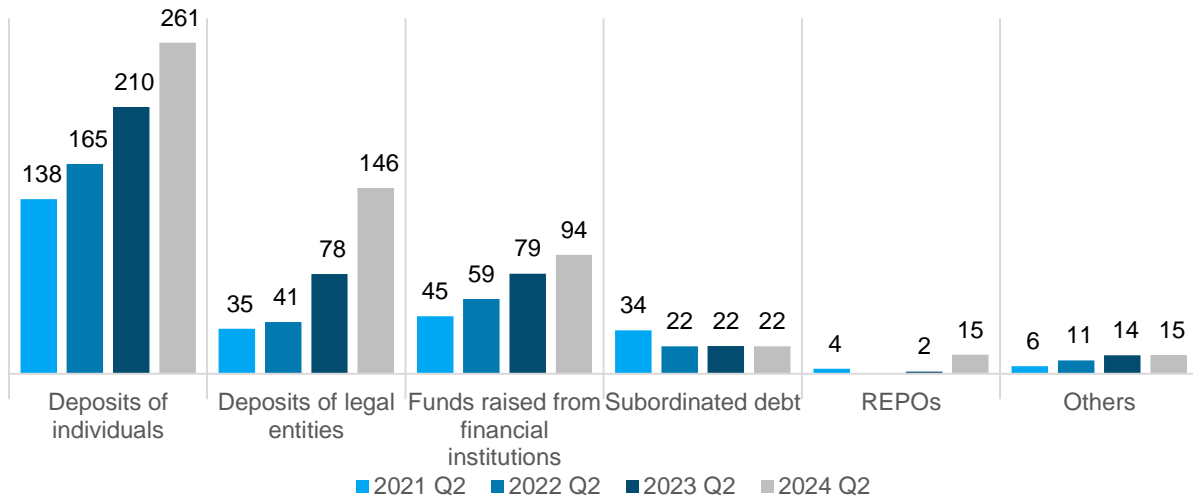
Chart 41. Structure of interest income



Source: CBA

Most banks' interest expenses are incurred on deposits. Interest expenses on deposits from individuals and legal entities, which play a crucial role in the sustainable funding of the banking sector, made up the largest share of the sector's interest expenses. In H1 2024 interest expenses of the sector y.o.y. increased by 36% (AZN146M) to AZN551.9M, interest expenses on deposits accounted for 74% (AZN407M) of total interest expenses.

Chart 42. Structure of interest expenses, million manats

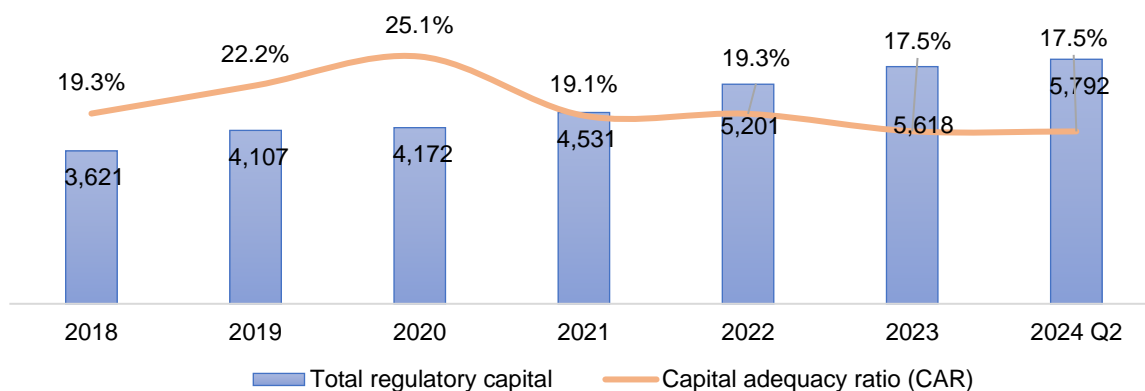


Source: CBA

Capital position of the banking sector

The sector's capital position is capable to absorb potential losses surpassing prudential requirements. In H1 2024 banking sector's total regulatory capital increased by 3.0% (AZN175M) to AZN5.8B. The CAR remained stable at 17.5%, 1.7 times higher than the minimum prudential requirement. The sector also paid AZN0.5B worth dividends in the first half of the year.

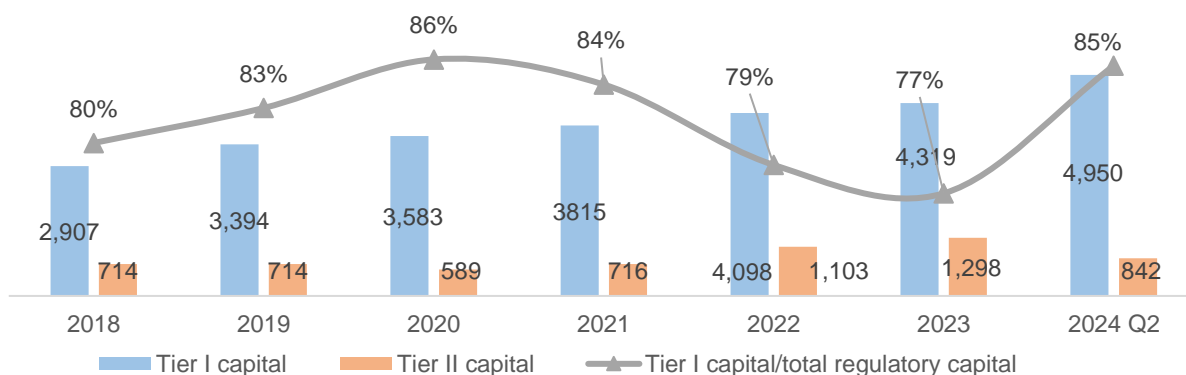
Chart 43. Dynamics of capital adequacy, million manats



Source: CBA

The growth of total regulatory capital was driven by the growth of Tier I Capital. In the first half of the year Tier I Capital increased by 15% (AZN631M) to AZN4.95B, while Tier II Capital decreased by 35% (AZN456M) to AZN842M, attributable to the transformation of the profit accumulated during the previous year to Tier I Capital.

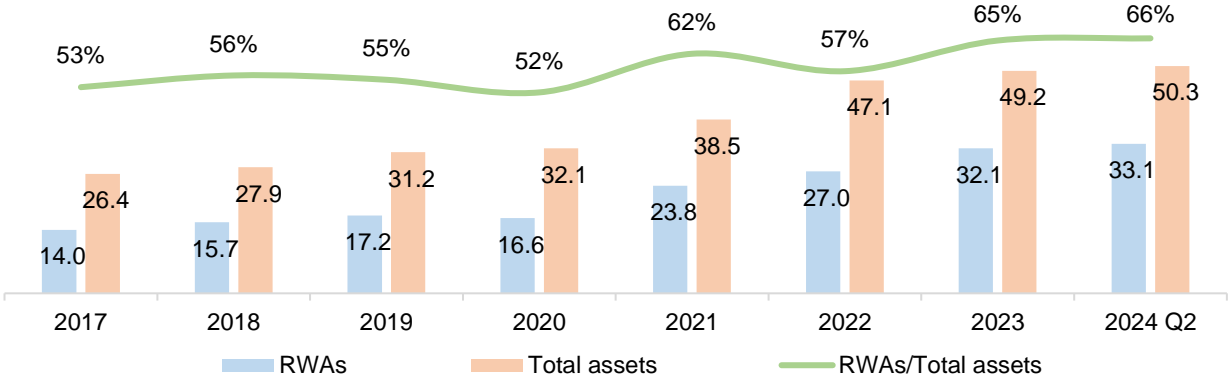
Chart 44. Dynamics of capital structure, million manats



Source: CBA

Risk weighted assets increased amid high lending. The size of RWAs increased by 3.2% (AZN1B) on the backdrop of the rise in total assets by 2.3% (AZN1.1B). As a result, the RWAs to total assets ratio increased by 0.8 pp to 66%. The growth of RWAs was driven by the lending activity of the banking sector. Breakdown of RWAs is as follows: credit risks 93.8%, operational risks 5.5% and market risks 0.7%.

Chart 45. Dynamics of assets and RWAs, million manats



Source: CBA

Table 2. Selected main banking system indicators *, million manats

	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2
Balance sheet indicators						
Total assets	44,843	45,218	45,530	49,178	48,910	50,328
Liquid assets	14,249	13,985	13,368	13,154	12,673	12,509
Lending portfolio	20,039	21,296	22,282	23,183	24,103	25,430
Business loans	10,971	11,651	12,079	12,617	13,202	13,875
Consumer loans	5,942	6,325	6,680	6,937	7,142	7,634
Mortgage loans	3,125	3,321	3,523	3,629	3,759	3,921
Total liabilities	38,994	39,306	39,539	43,115	42,612	44,086
Current liabilities	25,447	25,375	24,322	23,687	24,769	24,806
Deposits of individuals	11,719	12,473	12,418	12,582	12,869	13,880
Term deposits	6,311	6,596	6,745	6,882	7,227	7,751
Demand deposits	5,408	5,877	5,673	5,700	5,642	6,130
Deposits of legal entities	20,214	19,584	19,756	21,968	21,944	21,305
Term deposits	2,894	3,478	3,860	4,500	4,860	5,052
Demand deposits	17,320	16,106	15,896	17,468	17,085	16,253
Equity	5,849	5,913	5,991	6,063	6,297	6,242
Capital position						
Tier I Capital	4,935	4,710	4,513	4,319	5,342	4,950
Total regulatory capital	5,420	5,537	5,599	5,618	5,817	5,792
RWAs	28,505	29,995	30,301	32,085	31,954	33,126
Tier I capital adequacy	17.30%	15.70%	14.90%	13.50%	16.72%	14.94%
Total regulatory capital adequacy	19.00%	18.50%	18.50%	17.50%	18.20%	17.49%

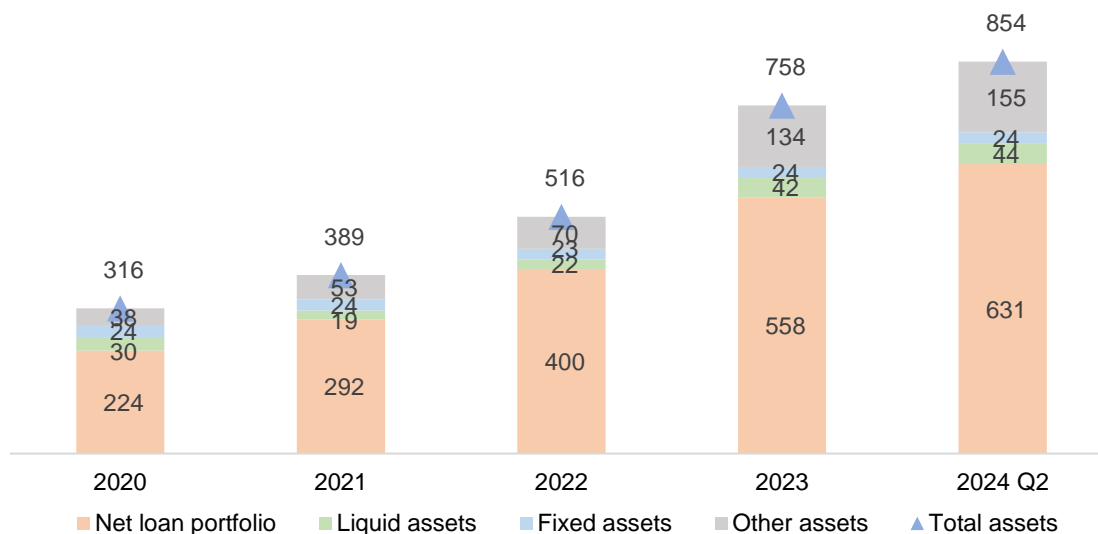
	2023 Q1	2023 Q2	2023 Q3	2023 Q4	2024 Q1	2024 Q2
<u>Profitability</u>						
Net profit	268	563	833	1076	311.472	613.976
ROA	2.30%	2.50%	0.20%	2.40%	2.54%	2.49%
ROE	20.30%	21.30 %	1.50%	20.30%	21.86%	21.37%
<u>Liquidity risk profile</u>						
Liquid assets	14,249	13,985	13,368	13,154	12,673	12,509
Share of liquid assets in total assets	31.80%	30.9%	29.4%	26.70%	25.91%	24.85%
Instant liquidity ratio	54.80%	56.6 %	55.1%	52.20%	49.97%	49.62%
LCR, total				134.47%	134.52%	140.98%
National currency				106.2%	99.61%	103.62%
Foreign currency				118.05%	168.48%	201.73%
<u>Credit risk profile</u>						
NPLs	750	730	770	614	660	672
Business loans	506	475	516	378	417	406
Consumer loans	198	215	214	197	204	226
Mortgage loans	45	40	41	39	39	40
NPL ratio	3.70%	3.40%	3.50%	2.60%	2.74%	2.65%
Business loans	4.60%	4.10%	4.30%	3.00%	3.16%	2.93%
Consumer loans	3.30%	3.40%	3.20%	2.80%	2.85%	2.97%
Mortgage loans	1.50%	1.20%	1.20%	1.10%	1.00%	1.00%
<u>Market risk profile</u>						
Asset dollarization	37.6%	35.9%	32.0%	33.7%	33.3%	32.3%
Liability dollarization	42.2%	40.0%	36.1%	37.3%	37.9%	35.9%
* Prudential reporting methodology based.						

Non-bank credit institutions

While the share of non-bank credit institutions (NBCIs) in financial sector assets increased, their role in financial intermediation remains small. In general, the market share of NBCIs in financial system assets made 1.6%³. In H1 2024 NBCIs numbered 55, and credit unions numbered 39. 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 153 persons to 3442 persons and the number of branches increased by 12 to 308.

In H1 2024 the balance sheet of the NBCI sector expanded on the backdrop of channeling attracted funds to the lending portfolio. Total assets of NBCIs increased by 13% (AZN95.5M) to AZN854M, driven by the net lending portfolio. The net lending portfolio increased by 13% (AZN72M), the growth was driven by consumer lending in terms of amount.

Chart 46. Dynamics of assets of NBCIs, million manats

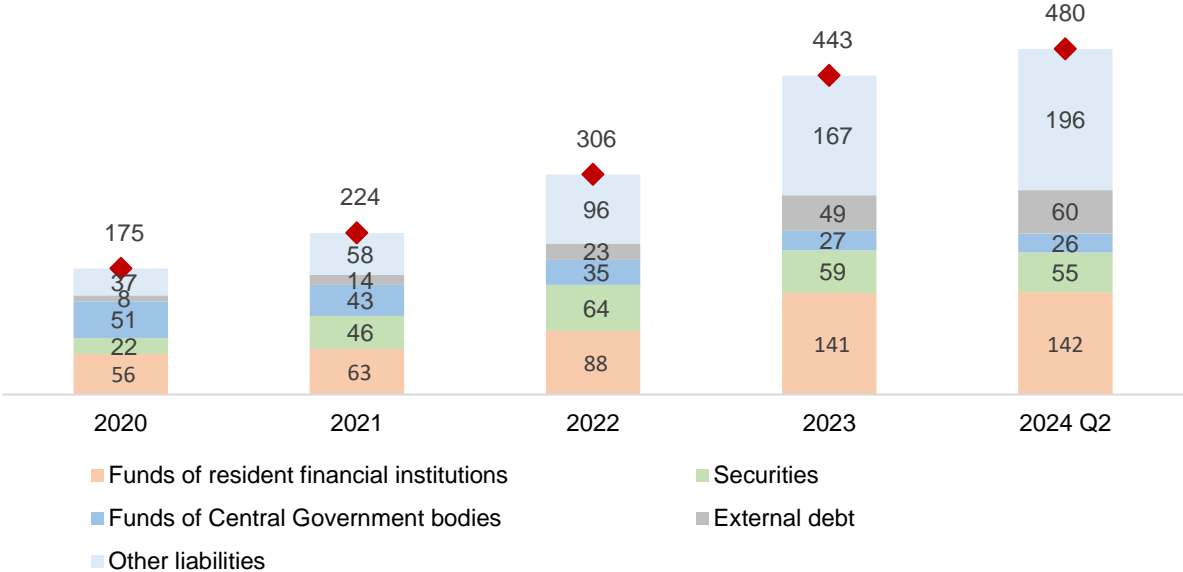


Source: CBA

Attracted funds increased amid the rise of assets of NBCIs. Total liabilities of NBCIs increased by 8.3% (AZN37M) to AZN480M, driven by loans of non-bank financial institutions and other liabilities. Loans of non-bank financial institutions increased by 21% (AZN11M), and other liabilities increased by 18% (AZN29M) compared with the end of the previous year. The most part of the rise in other liabilities is the debt issued by founders to NBCIs.

³ 'Agricredit' CJSC was skipped in the analysis of NBCIs.

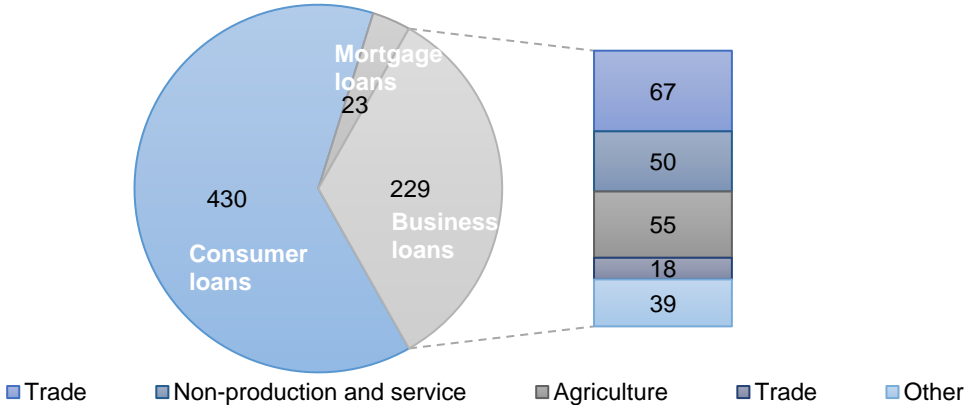
Chart 47. Dynamics of liabilities of NBCIs, million manats



Source: CBA

In H1 2024 consumer loans still took the main part in the portfolio of NBCIs. The lending portfolio increased by 13.4% (AZN81M) to AZN682M. Half year growth on consumer loans made 18.6% (AZN67M) and on business loans 1.2% (AZN2.6M). Mortgage loans nearly doubled (AZN11M). As of end of Q2 2024 the lending portfolio of NBCIs comprised of: consumer loans (63% or AZN430M), business loans 34% (AZN229M) and mortgage loans (3%, AZN23M). The business lending portfolio includes loans issued to trade (29%, AZN67M), non-production and services (22%, AZN50M) and agriculture (24%, AZN55M).

Chart 48. Loan portfolio structure of NBCIs, million manats

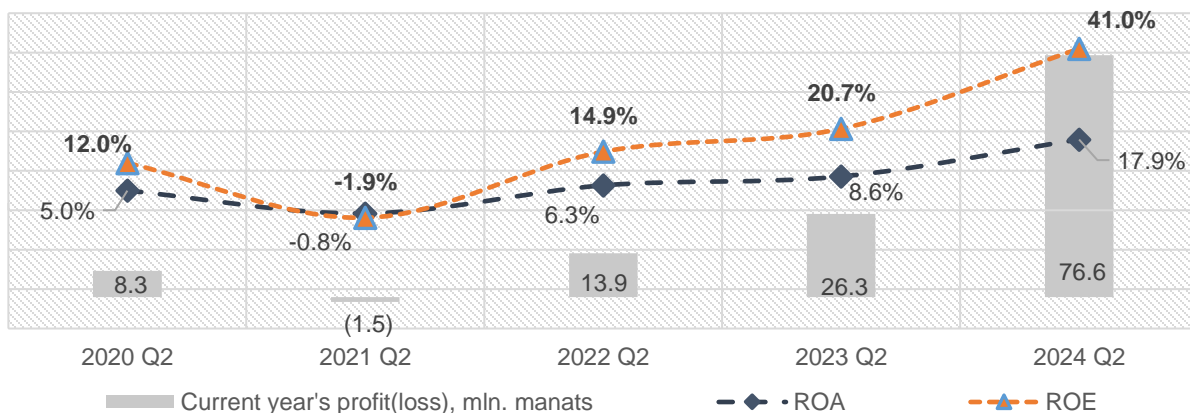


Source: CBA

The quality of the lending portfolio deteriorated amid the NPL portfolio growth. In H1 2024 the sector's NPL portfolio increased by 30% to AZN96.6M compared to the end of the previous year. The NPL ratio increased by 1.8 pp to 14.2%, driven by consumer loans. The NPL portfolio increased by 3 pp to 14.8 % on consumer loans and by 0.6 pp to 14.5% on business loans.

Profitability of the NBCI sector is growing. In H1 2024 NBCIs generated AZN76.6M worth profit, y.o.y. up by about 191%, driven by operational efficiency of credit institutions in addition to rising interest income pushed by the lending portfolio growth. The share of non-interest income in aggregate income shifted to 25% from 14%. Amid the profitability growth of the sector ROA and ROE doubled to 17.91% and 41% respectively compared to June 2023.

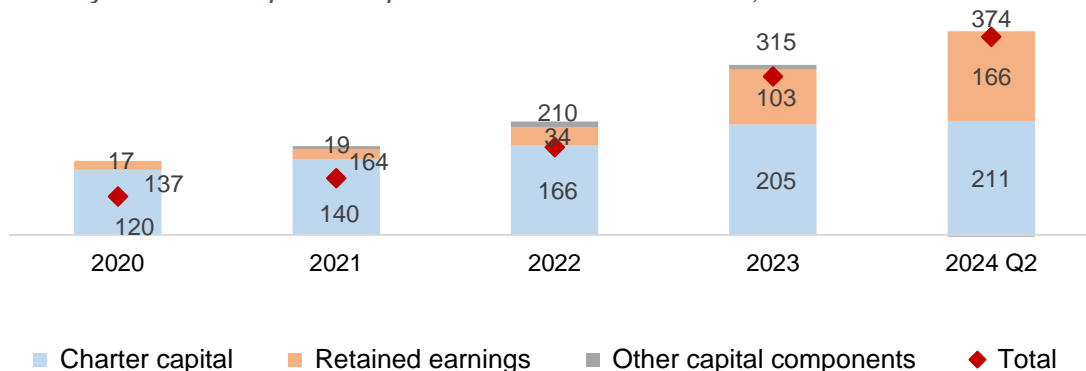
Chart 49. NBCIs' profitability indicators



Source: CBA

The capital position of the sector expanded against the backdrop of retained earnings. NBCI's capital increased by 19% (AZN59M) to AZN374M, owing to both capital injection and retained earnings. Over six months retained earnings increased by about 61% (AZN63M) to AZN166M, and authorized capital increased by 3.4% (AZN6.9M) to AZN211M.

Chart 50. Dynamics of capital components across NBCI sector, million manats



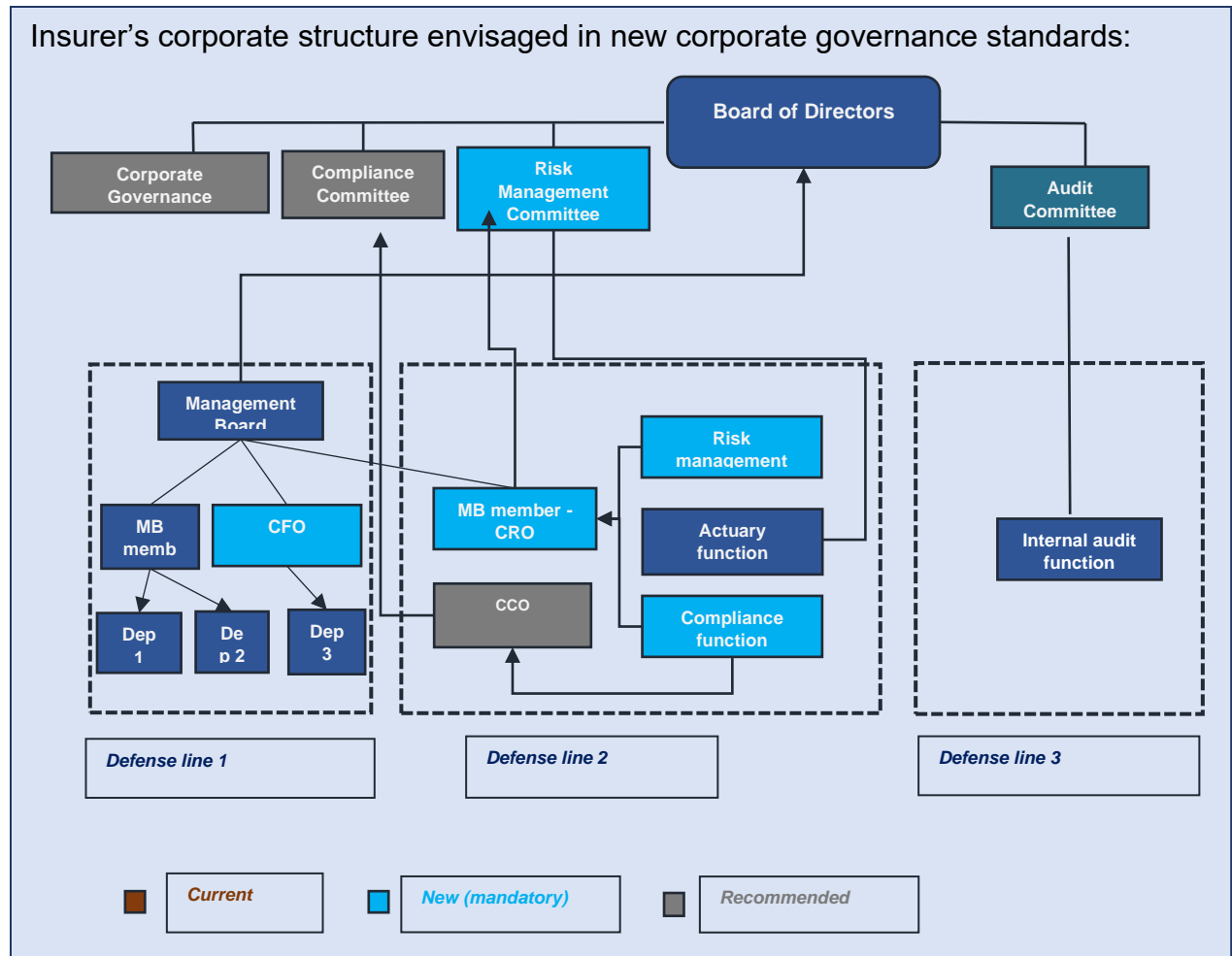
Source: CBA

Insurance sector

As of end of the first half of 2024, the Azerbaijani insurance market hosts 17 insurance and one reinsurance companies. Of insurance companies 5 are life and 12 are non-life companies. 23 insurance brokers and 483 insurance agents also contribute to activities of the insurance sector.

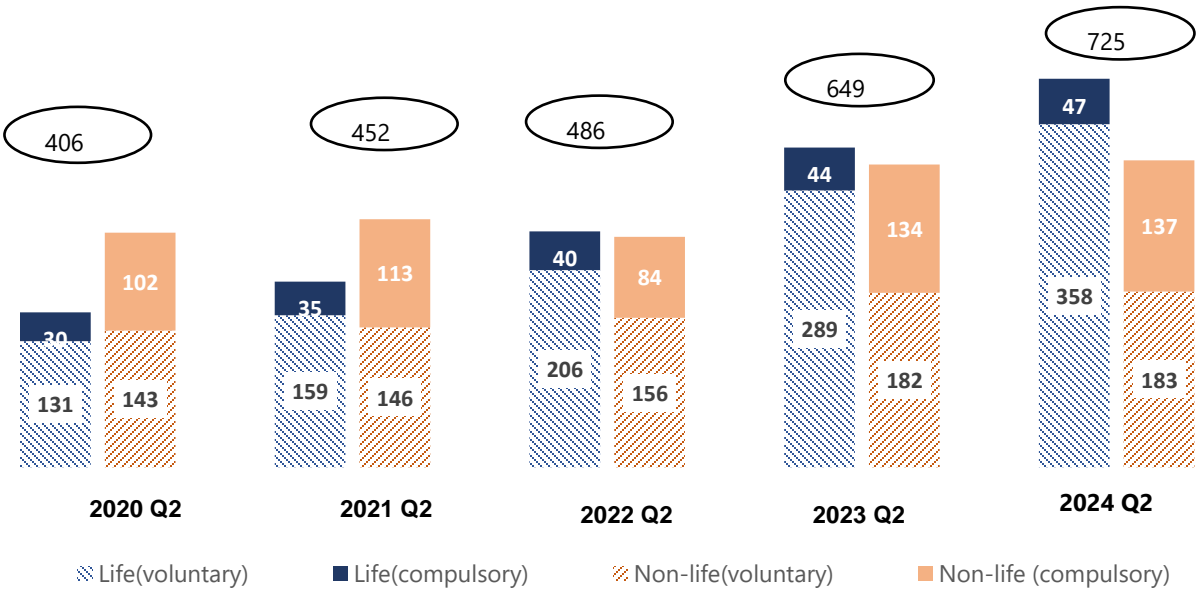
Box 2. New corporate governance standards for insurers

Corporate governance standards are now applied in insurers to effectively manage governance, internal control, and risks in insurers (reinsurers). The Management Board of the Central Bank of the Republic of Azerbaijan with its decision of 21 February 2024 approved the 'Corporate governance standards in insurers'. Aligned with progressive international practices in corporate governance, these standards aim at organizing reliable, transparent governance and reporting system in insurers and maintaining internal control and risk management effectiveness. Under new standards risk management, corporate governance (recommendation) and compliance (recommendation) committees are established in subordination to the Board of Directors of insurers. 3 defense lines ensure the risk management system. Defense line 1 – includes structural units responsible for identification, evaluation, management, reporting and monitoring of risks that pose direct risks to the insurer and risks on products, services, activities, processes, and systems at an initial phase, including insurer's branches and divisions. Defense line 2: includes structural units engaged in at least risk management, compliance and actuary functions directly involved in internal control in the insurer (reinsurer). Defense line 3: includes the structural unit engaged in the internal audit function authorized to assess Defense lines 1 and 2. With the establishment of defense lines, efficient risk management and operational transparency are expected to be achieved. In addition, a reward system has been created for employees in exchange for their professional activities. Rewards may be paid in the form of cash, shares, or other financial instruments.



The insurance sector is realizing its growth potential. Insurance premiums collected in H1 2024 y.o.y. increased by 12% (AZN76M) to AZN725M. Insurance premiums derived from life insurance classes (56%) and non-life insurance classes (44%). Life insurance premiums increased by 21 % to AZN405M, driven by voluntary insurance classes, and non-life insurance premiums increased by 1.3% to AZN320M, driven by compulsory insurance classes. Voluntary insurance classes increased by 15% (AZN70M) to AZN541M, compulsory insurance classes increased by 3% (AZN6M) to AZN184M. Voluntary insurance classes grew because of endowment life insurance – 93% (AZN65M). Although premiums increased across the sector, the growth was driven by a limited number of companies – 77% of the growth was generated by three insurers (out of which 56% was generated by one company).

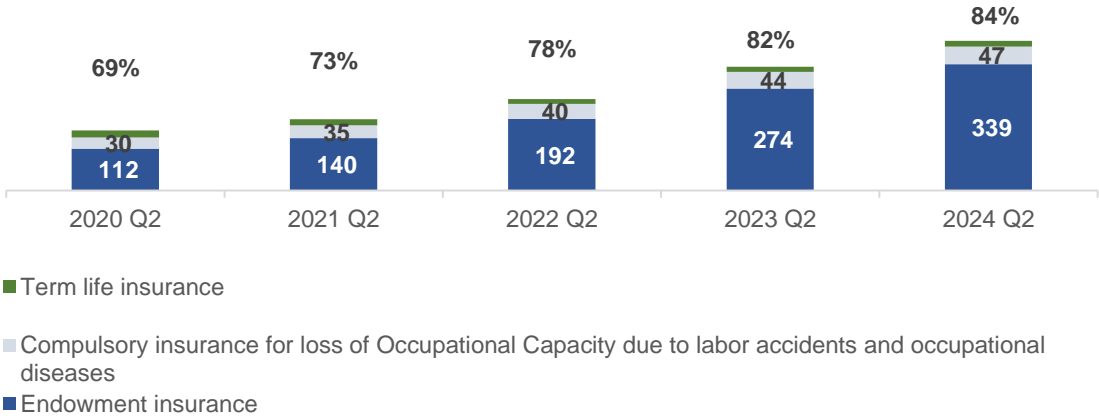
Chart 51. Dynamics of insurance premiums, million manats



Source: CBA

The main driver of life insurance growth was endowment life insurance. Insurance premiums collected on endowment life insurance y.o.y. increased by 24% (AZN65M) to AZN339M. Insurance premiums collected on the insurance class in question accounted for 84% of total insurance premiums. Over recent five years the share of that insurance class in life insurance premiums shifted to 84% from 69%.

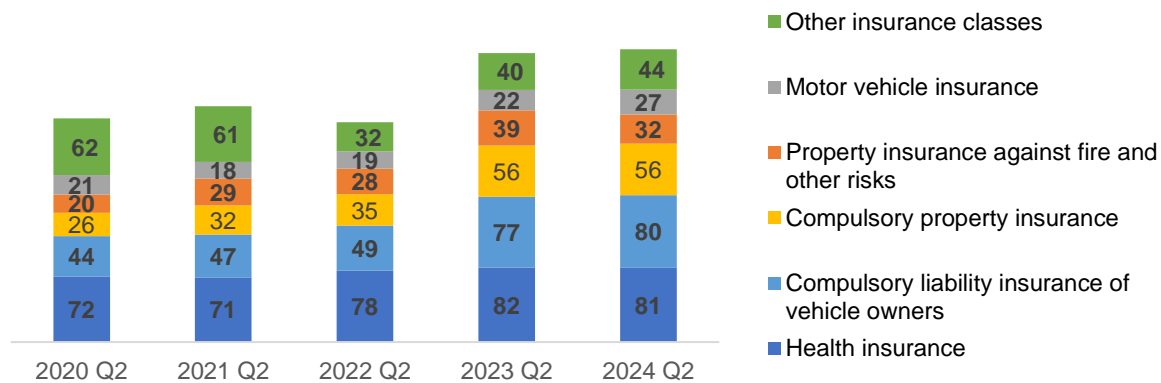
Chart 52. Insurance premiums for life insurance classes, million manats



Source: CBA

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 both on medical insurance, and compulsory civil liability insurance for motor vehicle owners accounted for 25% of non-life insurance premiums. The main reason for the growth in non-life insurance premiums was the insurance of vehicles. Premiums collected on this insurance class y.o.y. increased by 23% (AZN5M) to AZN27M. Over recent five years the share of medical insurance premiums in non-life insurance premiums decreased to 25% from 29%, instead the share of compulsory civil liability insurance for motor vehicle owners shifted to 25% from 18%, and the share of compulsory real estate insurance shifted to 18% from 11%.

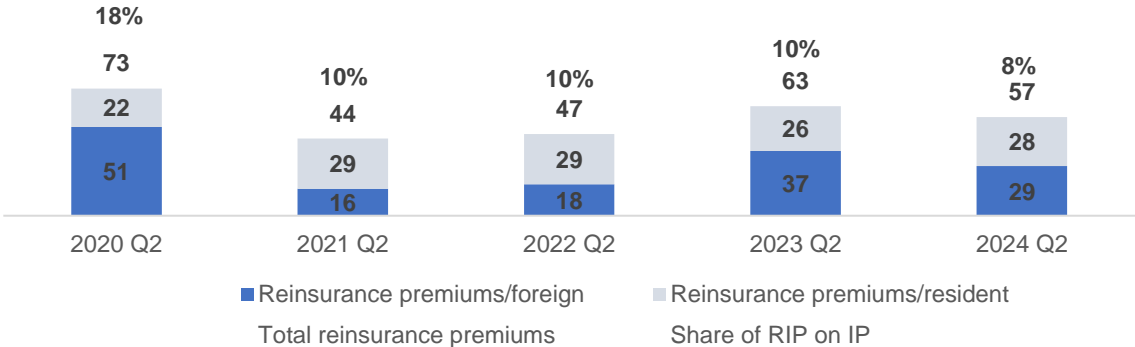
Chart 53. Insurance premiums for non-life insurance classes, million manats



Source: CBA

The share of reinsurance premiums calculated on agreements transferred to reinsurance remains low in total insurance premiums. In H1 2024 reinsurance premiums transferred to reinsurance y.o.y. decreased by 10% (AZN6M) to AZN57M. Reinsurance premiums accounted for 8% of insurance premiums. Life insurance classes accounted for 5% (AZN3M) and non-life insurance classes accounted for 95% (AZN54M) of transferred reinsurance premiums. Reinsurance premiums transferred on life insurance accounted for 1% of insurance premiums collected on life insurance and 1%, those transferred on non-life insurance accounted for 17% of insurance premiums collected on non-life insurance.

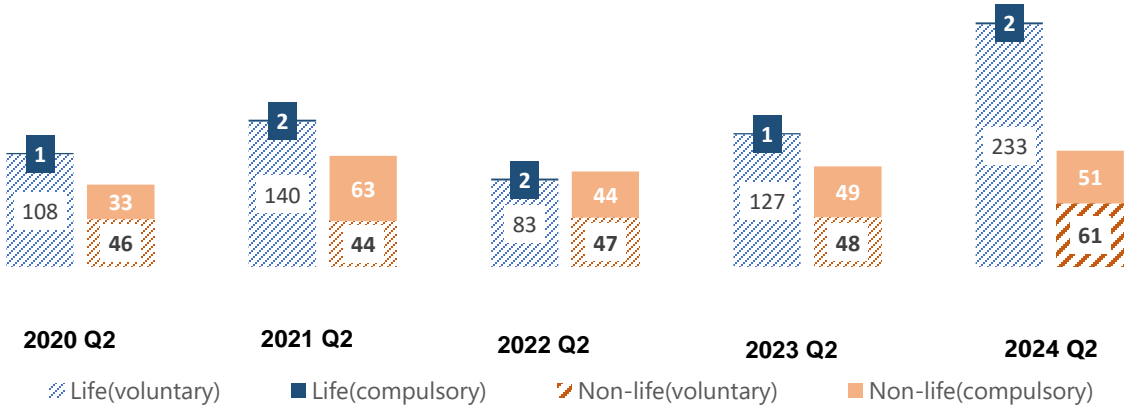
Chart 54. Reinsurance premiums for resident and foreign reinsurers (RI)



Sources: CBA

In H1 2024 insurance payments increased. Insurance payments y.o.y. increased by 54% (AZN122M) to AZN347M. Insurance payments include those from life insurance classes (68%) and 32% from non-life insurance classes. Insurance payments on life insurance increased by 84% to AZN235M and on non-life insurance increased by 15% to AZN112M. Both life and non-life insurance grew at the expense of voluntary insurance classes.

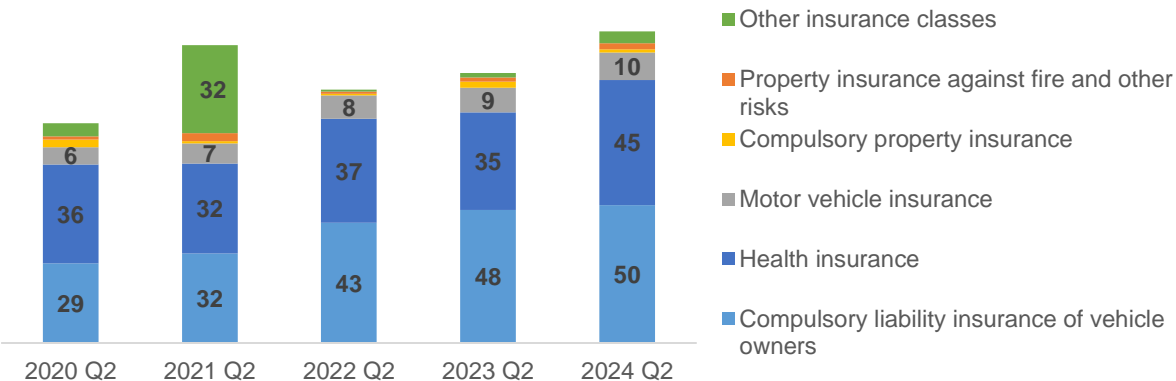
Chart 55. Dynamics of insurance payments, million manats



Source: CBA

Growth of insurance premiums on life insurance was driven by endowment life insurance. Payments on endowment life insurance y.o.y. increased by 82% to AZN232M. Insurance payments made on this insurance class accounted for 99% of insurance payments made on life insurance.

Chart 56. Insurance payments for non-life insurance classes, million manats



Source: CBA

The main drivers of insurance payments on non-life insurance were medical insurance and compulsory civil liability insurance for motor vehicle owners. Insurance payments on both compulsory insurance classes accounted for over 40% of non-life insurance payments. The medical insurance was the main force of the growth in insurance payments on non-life insurance. Insurance payments on medical insurance increased by 29% to AZN45M. Over recent five years the share of medical insurance in non-life insurance payments decreased to 40% from 45%, instead the share of compulsory civil liability insurance for motor vehicle owners increased to 44% from 36%.

Box 3. Catastrophic risks in the insurance sector

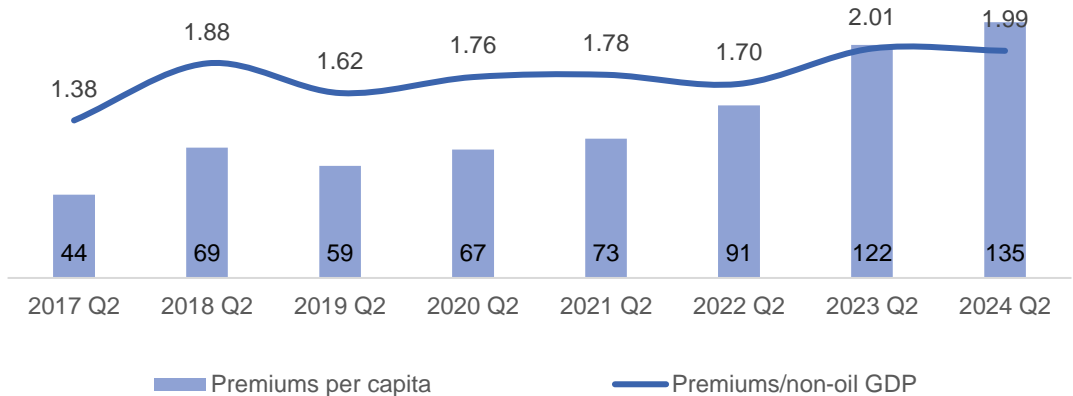
Catastrophic risks pose serious threats to insurance and reinsurance companies, as such events, while rare, can result in substantial financial losses. To prevent the financial deterioration of insurers and reinsurers due to insurance payments triggered by catastrophic events, it is crucial to establish reserves for these risks. These reserves act as a financial safeguard against unexpected, large-scale losses, helping to protect the companies' ongoing operations and maintain their financial stability. The Management Board of the Central Bank of the Republic of Azerbaijan with its decision of 13 March 2024 approved the 'Regulation on creation of insurance reserves on life and non-life insurance'. The main amendment to the Regulation is the creation of insurance reserves by insurance (reinsurance) companies. For the purposes of this regulation, the catastrophic risk is defined as an earthquake risk.

The order for calculation of reserves on catastrophic risks:

Securitization on catastrophic risks is calculated on insurance agreements issued and valid as of the reporting date. The upper limit of the reserve for catastrophic risks should not exceed 150% of the highest amount of net base insurance premiums calculated for catastrophic risks as of the end of the last five calendar years prior to the reporting date. In the event of a catastrophic risk for which coverage has been provided, this reserve may be reduced by the amount of insurance (reinsurance) payments made for the catastrophic risks covered under the insurance (reinsurance) agreement.

Positive dynamics in premiums elevated insurance sector's penetration and depth indicators. Per capita insurance premiums y.o.y. increased by 11% to AZN135. Note that, the '2024-2026 Financial Sector Development Strategy' approved by the CBA, set per capita insurance premiums as AZN135, AZN150 and AZN195 and the aggregate insurance premiums to GDP ratio at 1.90%, 1.95% and 2.15% for 2024, 2025 and 2026 respectively.

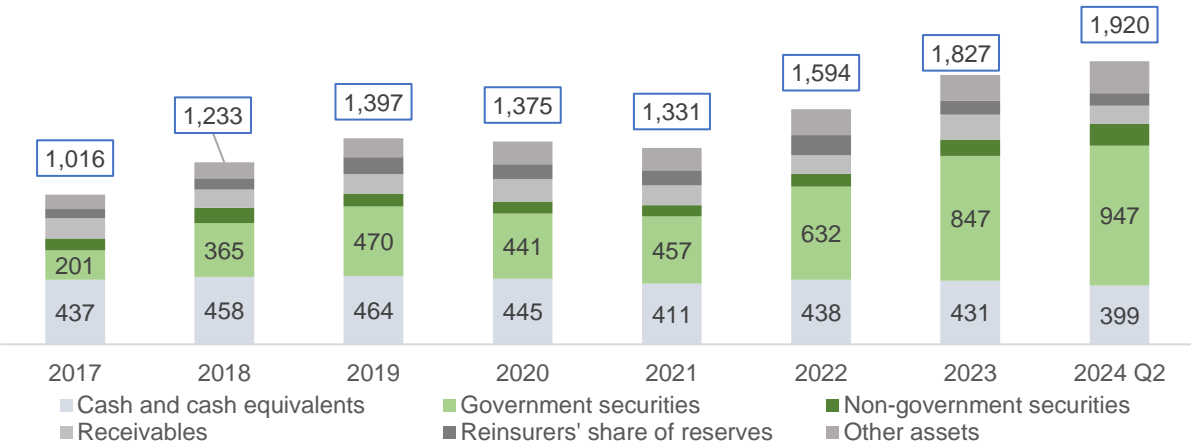
Chart 57. Insurance sector penetration



Source: CBA

Sector’s assets posted growth amid the market expansion. In H1 2024 insurance sector assets increased by 5% (AZN93M) to AZN1,9B. Assets are comprised of government securities (49%, AZN947M), bank funds (21%, AZN399M), non-government securities (8%, 1AZN48M) and receivables (7%, AZN125M).

Chart 58. Asset structure and dynamics

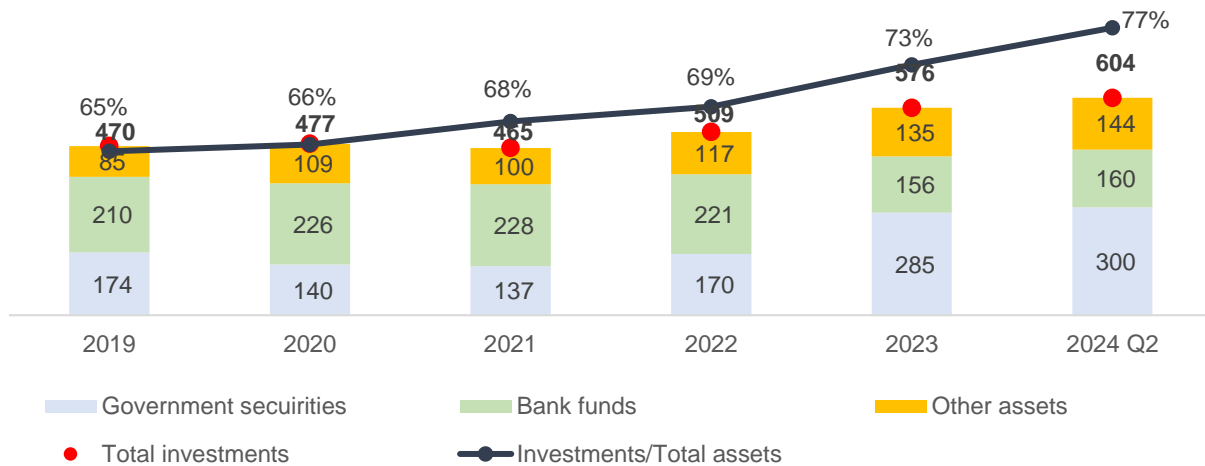


Source: CBA

Although insurance companies’ investment options are limited, they are realizing their potential as institutional investors. Insurance company investments increased by 6% (AZN94M) to AZN1602M compared with the end of the previous year, driven by government securities (AZN100M). In general, the investment portfolio accounts for 91% of life insurance companies and 77% of non-life insurance companies. Insurance

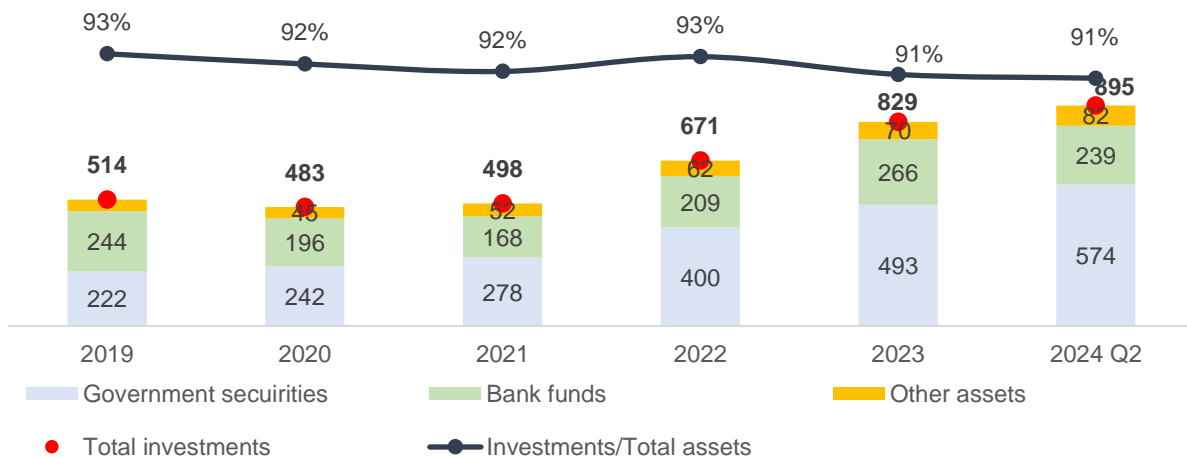
companies' investment assets mainly include government securities and bank funds. In H1 2024 the insurance sector generated AZN58M worth income from investment activities, 8% of total income.

Chart 59. Investment activities of non-life insurance companies, million manats



Source: CBA

Chart 60. Investment activities of life insurance companies, million manats

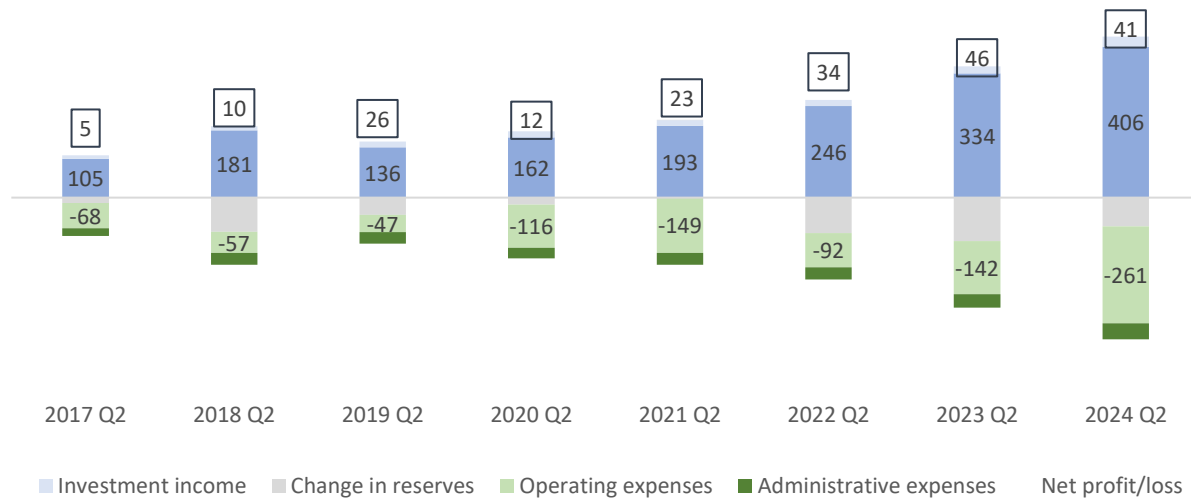


Source: CBA

Profitability of insurance companies increased. In H1 2024 net profit of the insurance sector y.o.y. increased by 20% (AZN16M) to AZN98M. Against the backdrop of returned insurance premiums and cost of supply of works, profitability of life insurance companies decreased by AZN5M to AZN41M, that of non-life insurance companies increased by

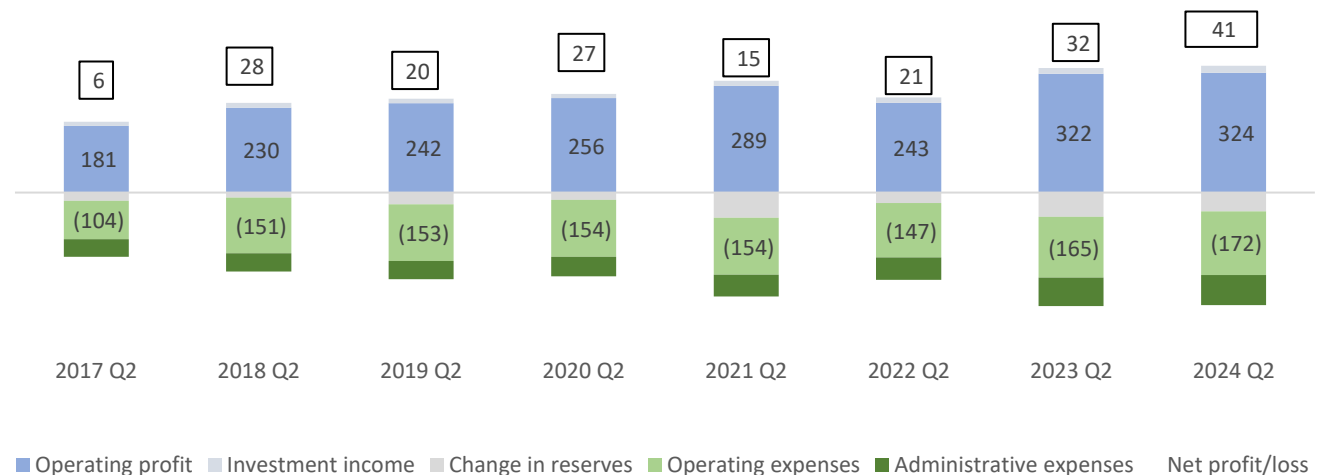
AZN9M to AZN41M, and that of the reinsurance company increased by AZN12M to AZN15M.

Chart 61. Life insurance profitability



Source: CBA

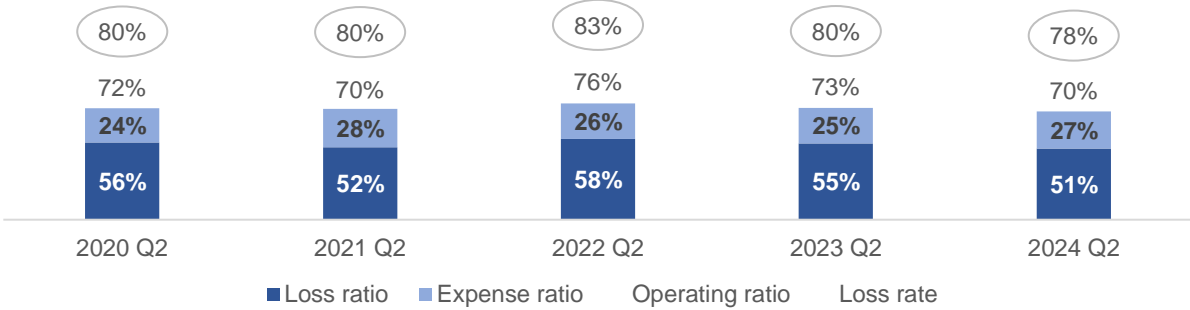
Chart 62. Non-life insurance profitability



Source: CBA

The sector's loss ratio decreased by 2 pp. In H1 2024 the loss ratio of the insurance sector y.o.y. decreased by 2 pp to 78%. This decrease was largely driven by lower loss ratios in several high-market-share insurance classes, which contributed to the overall reduction in the sector's loss rate.

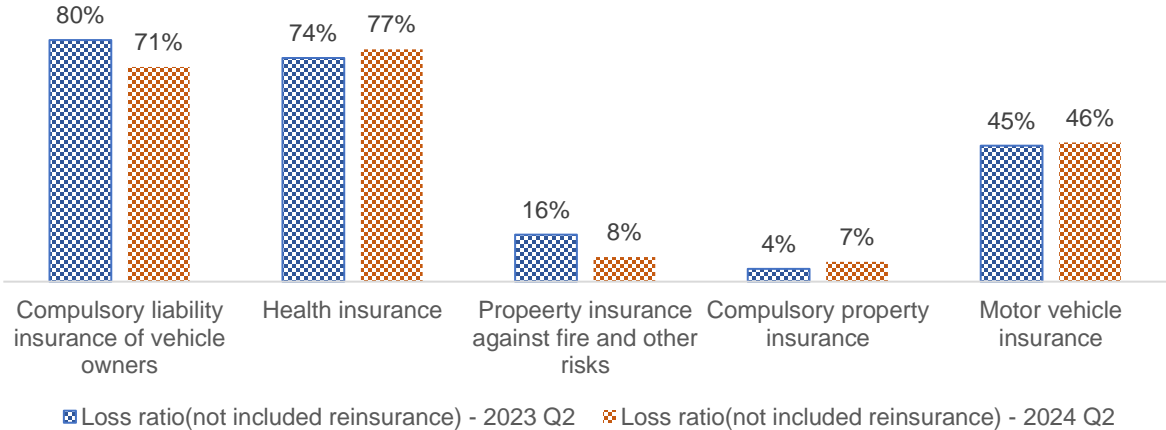
Chart 63. Insurance sector's loss rate



Source: CBA

While the loss ratio decreased on high-market-share insurance classes, the loss ratio for medical insurance increased and remained elevated. A new regulation on insurance premiums regarding compulsory civil liability insurance for motor vehicle owners took effect in Q4 2022. According to the new rule, additional ratios on underwriting risk factors were introduced for the calculation of insurance premiums. As a result of a 30% average rise in insurance premiums the loss ratio on that insurance class dropped by 9 pp to 71%. The cost ratio on that insurance class made 32%, and the loss ratio stood at 103%. The loss ratio for medical insurance y.o.y. increased by 3 pp to 77% during this reporting period (the 12 months prior to July 1, 2024), driven by a 20% increase in insurance payments made for claims. The expense ratio for this insurance class was 25%, while the loss ratio stood at 102%. Insurers (reinsurers) establish stabilization reserves for insurance classes where the loss ratio exceeds 100%. Thus, a loss ratio exceeding 100% impacts profitability of insurers (reinsurers) both directly and indirectly.

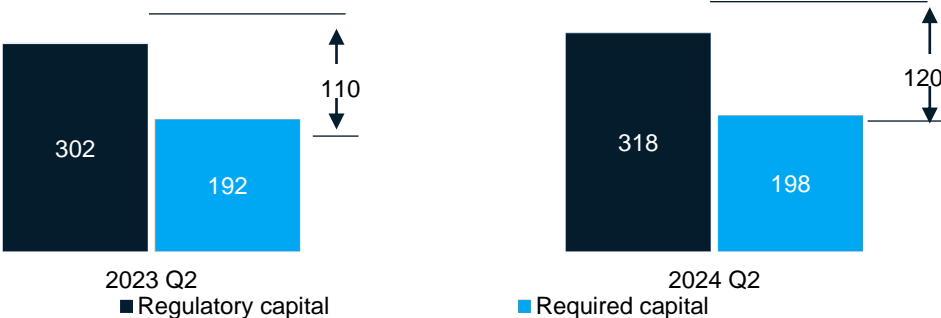
Chart 64. Loss ratio across insurance classes



Source: CBA

The insurance sector’s capital position is in a comfort zone exceeding prudential requirements. In H1 2024 insurance sector’s total regulatory capital y.o.y. increased by 5% (AZN16M) to AZN318M, required capital increased by 3% (AZN6M) to AZN198M, capital buffer increased by 9% (AZN10M) to AZN120M.

Chart 65. Total regulatory and required capital, million manats



Source: CBA

Box 4. Assessing insurers as systemically important insurers

The Management Board of the Central Bank of the Republic of Azerbaijan approved the 'Criteria for assessing an insurer as a systemically important insurer' on 31 January 2024 to oversee insurers posing systemic risk to the financial market under a special regime, align the regulatory framework and supervisory processes with the sector's evolving risk profile, and ultimately strengthen the sector's financial resilience.

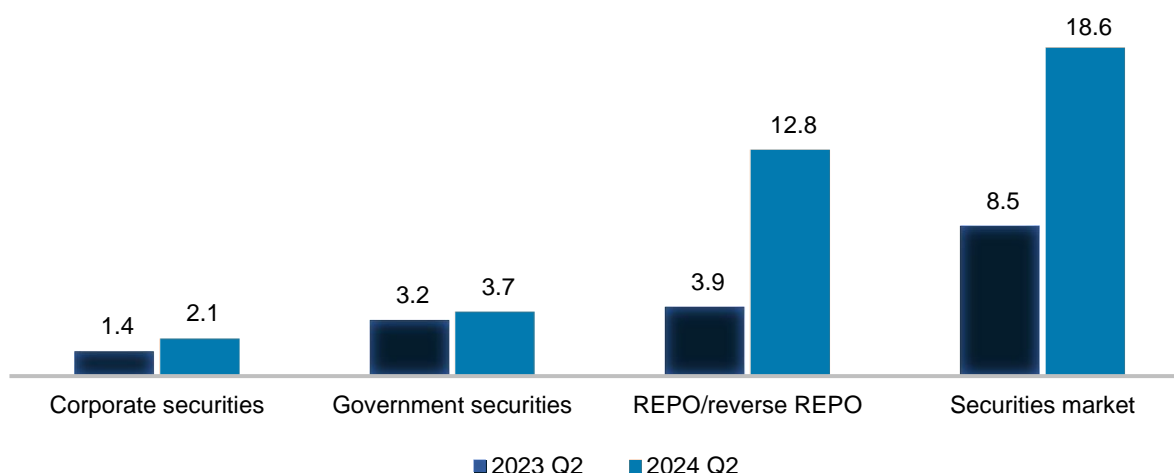
The systemic importance of insurers is defined separately for life and non-life insurance. The systemic importance of reinsurers exclusively engaged in reinsurance activities is assessed together with insurers engaged in non-life insurance. The systemic importance of the insurer is assessed through the indicators specified in the below table (category, indicators and weights assigned to those indicators):

N	Category	Indicator	Weight (%)
1.	Scope	Total assets	20
		Insurance premiums	10
		Number of insurance agreements	10
2.	Diversification	Liabilities of the insurer due to financial institutions	6.67
		Assets placed by the insurer with financial institutions	6.67
		Reinsurance premiums	6.67
3.	Substitutability	Insurance premiums on specific insurance (reinsurance) types	30
4.	Complexity	Diversity of insurance (reinsurance) portfolio	10

Capital market

The securities turnover increased year-over-year, driven by repo/reverse repo operations. Trade turnover of the securities market y.o.y. increased by 1.2 times (AZN10.1B) to AZN18.6B due to repo/reverse repo operations. The amount of repo/reverse repo operations y.o.y. increased by 2.3 times (AZN8.9B) to AZN12.8B. The introduction of the new monetary policy operational framework conditioned the growth of repo/reverse repo operations. Corporate securities increased by 53% (AZN0.7B), and government securities increased by 15% (AZN0.5B) to AZN2.1B and AZN3.7B respectively.

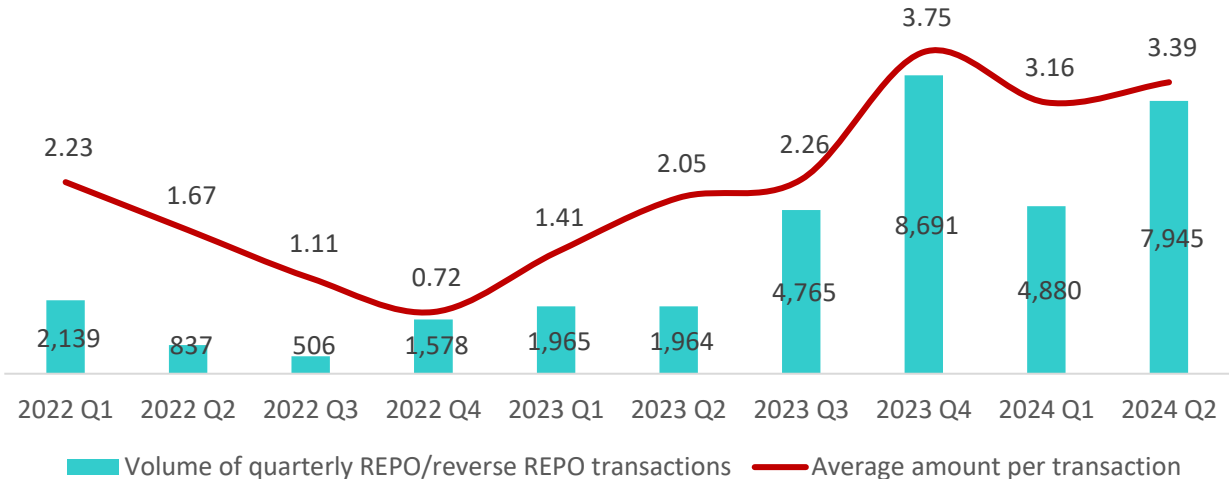
Chart 66. Capital market turnover, billion manats



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. In the first half of this year, the volume of repo/reverse repo operations amounted to AZN12.8B, with AZN7.9B accounted for in the second quarter. Overall, since the second quarter of last year, there has been a noticeable increase in both the volume of quarterly operations and the average amount per transaction.

Chart 67. Dynamics of REPO operations, mln. manats

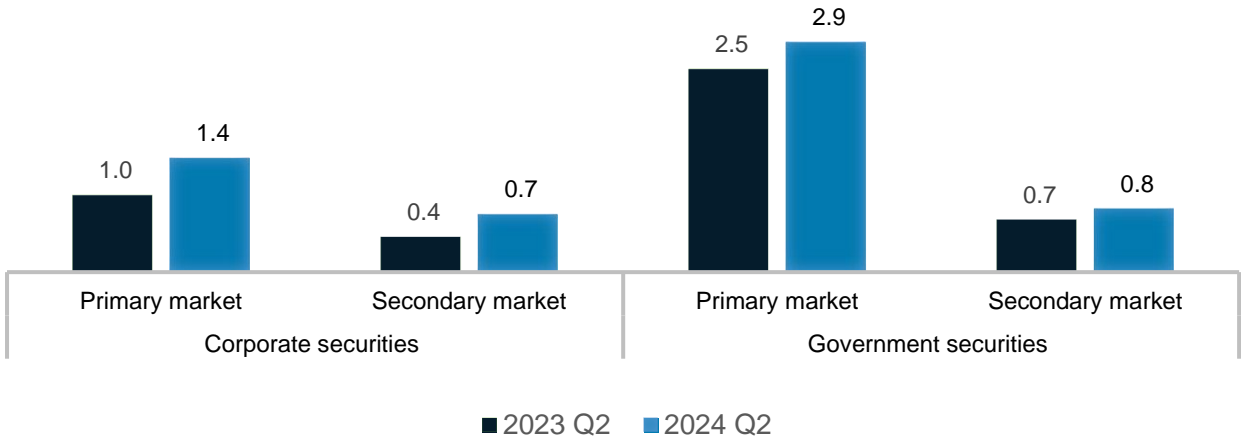


Source: CBA

Trade turnover of securities increased both on primary and secondary markets.

Primary market turnover of corporate securities y.o.y increased by 48% (AZN0.5B) to AZN1.4B, and the secondary market turnover increased by 64% (AZN0.3B) to AZN0.7B. Compared to the end of the first six months of last year primary market turnover of the government securities market increased by 13% (AZN0.3B), the secondary market turnover increased by 21% (AZN0.1B) to AZN2.9B and AZN0.8B respectively.

Chart 68. Size of primary and secondary market operations, billion manats

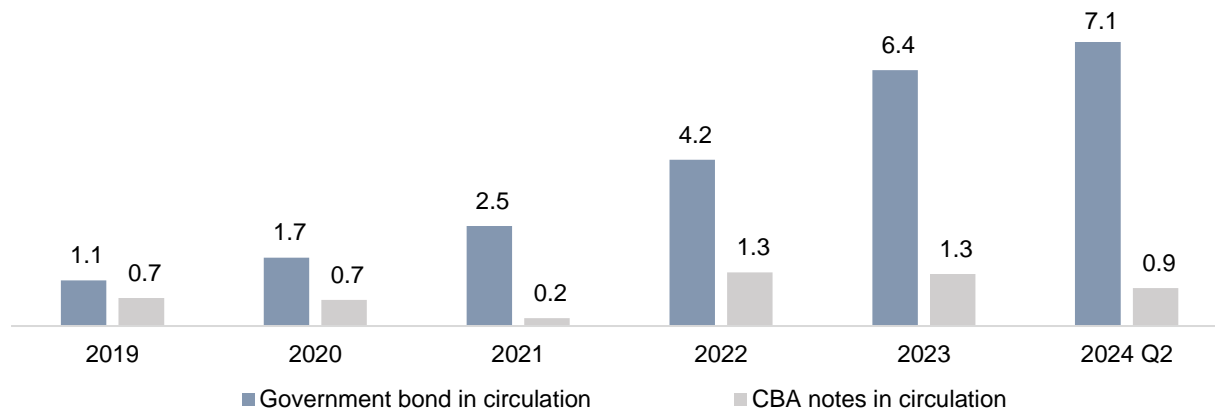


Source: CBA

The amount of government securities in circulation increased. Compared to the end of last year the amount of government securities in circulation increased by 4.6% to AZN8B, driven by government bonds. In H1 2024 the amount of government bonds in

circulation increased by 11% (AZN0.7B) to AZN7.1B compared to the end of last year. The amount of government bonds increased at the expense of the issuance of long-term government securities.

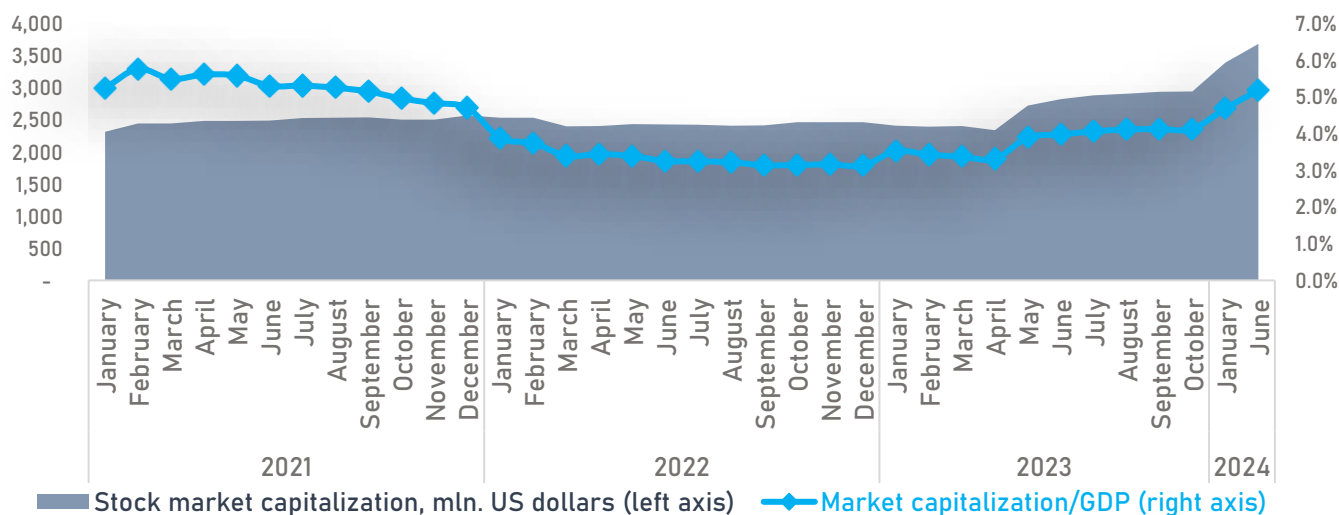
Chart 69. Dynamics of government bonds in circulation, billion manats



Source: CBA

Capitalization of the stock market continues its positive trend. Compared to the end of last year capitalization of the stock market increased by 25% to \$3.7B.

Chart 70. Stock market capitalization (mln. US dollars) vs penetration

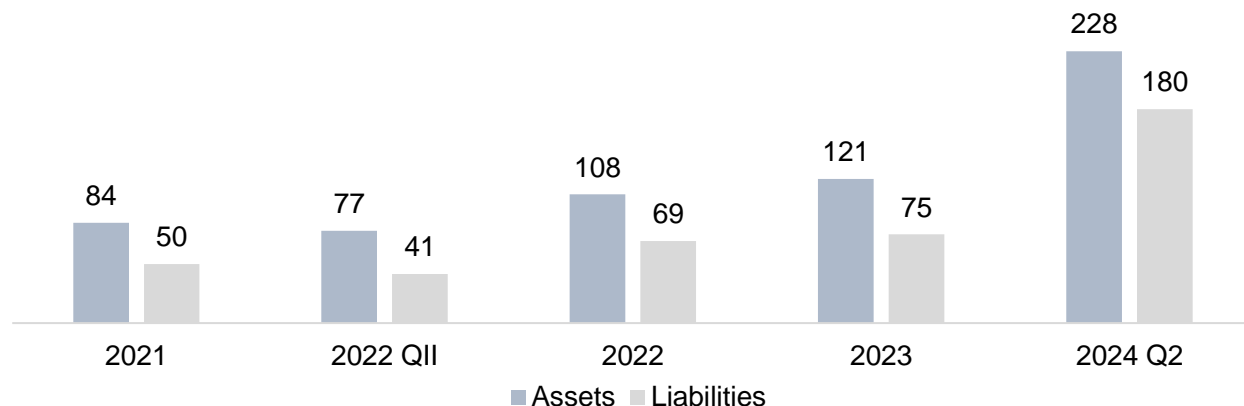


Source: CBA

Balance sheets of investment companies expanded. Compared to the end of 2023 investment company assets increased by 89% (AZN107M) to AZN228M, and liabilities

increased by 1.4 times (AZN105M) to AZN180M, driven by the rise in the amount of repo/reverse-repo operations. Repo market operations more than doubled year-over-year.

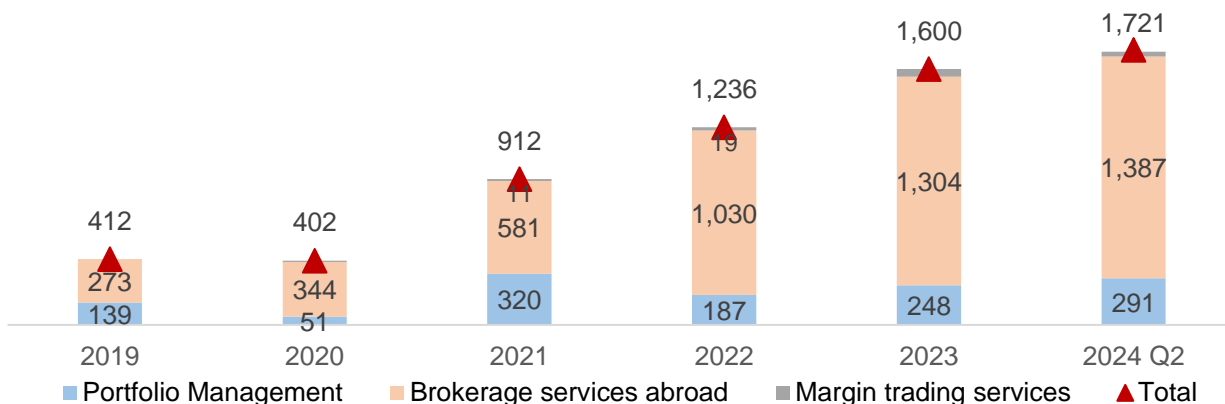
Chart 71. Dynamics of investment companies balance sheets, million manats



Source: CBA

Client assets of investment companies expanded. Compared to the end of 2023 client assets of investment companies increased by 8% (AZN121M) to AZN1,721M, owing to brokerage services in a foreign market. Client assets on brokerage services in the foreign market increased by 6.4% (AZN83M).

Chart 72. Dynamics of customer assets of investment companies, million manats

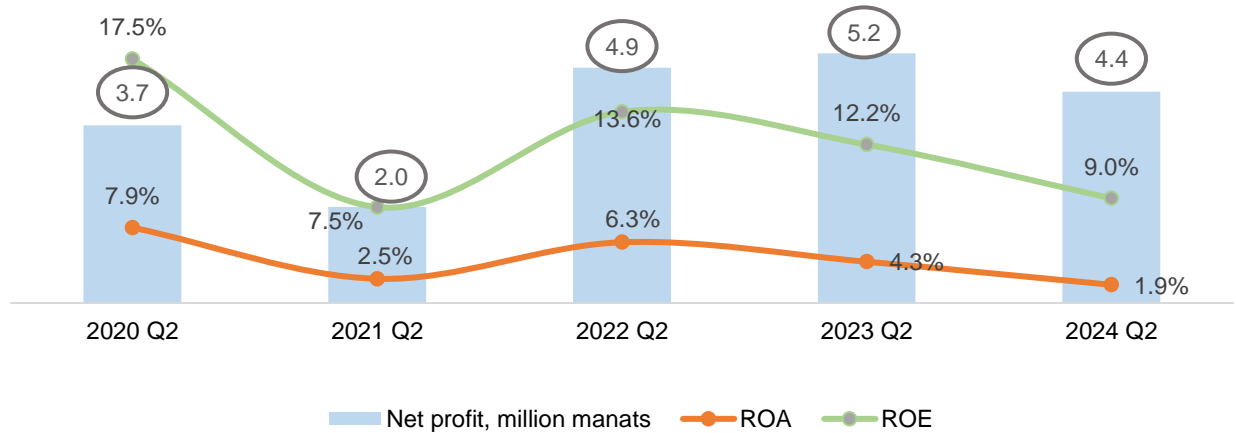


Source: CBA

Profitability of investment companies decreased. In H1 2024 investment companies' net profit amounted to AZN4.4 M, y.o.y down by 15.4%. Net profit of investment companies decreased, owing to high administrative expenses on certain companies. A rise in assets and liabilities amid the decline in net profit of the sector led to the drop in

profitability indicators. ROA y.o.y. decreased by 2.4 pp to 1.9%, and ROE decreased by 3.2 pp to 9%.

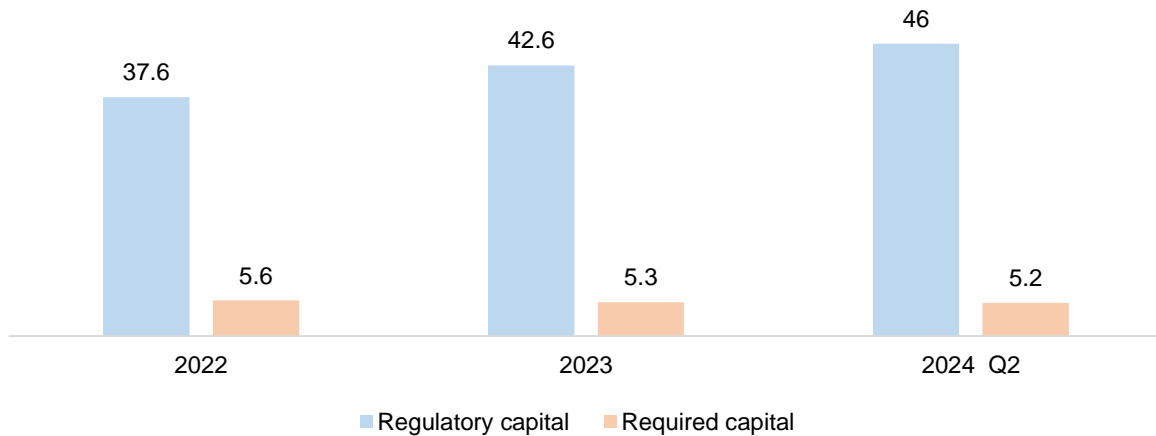
Chart 73. Profitability of investment companies



Source: CBA

The capital position of investment companies is in a comfort zone. As of end-H1 2024 total regulatory capital of the sector amounted to AZN46M, and required capital amounted to AZN5.2M, attributable to investment companies' sufficient capital buffer.

Chart 74. Dynamics of regulatory and required capital, million manats



Source: CBA

In H1 2024 the CBA took several regulatory, supervisory, and development-oriented actions. Examples of regulatory and supervisory actions – work has been completed on the automated receipt and analysis of prudential reports from investment companies through the portal since March of this year. Additionally, reports are now collected through a single portal. Requirements for ensuring information security at the central depository for licensed entities in the securities market, joint-stock investment funds, and investment fund managers have come into effect.

The 'Regulation on provision of investment services (operations) by investment companies and banks' and the 'Regulation on the development and submission of reports of investment companies and banks engaged in investment services (operations)' were approved over the year. Additionally, the 'Corporate governance standards in investment companies' and 'Regulation on conducting attestation for the acquisition of qualification certificates to provide investment services (operations) and investment fund management' were approved. Finally, to stimulate public offering of shares, the service fee for opening deposit accounts for shares has been waived.

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