



CENTRAL BANK
OF THE REPUBLIC OF AZERBAIJAN

Financial Stability Report



2023

FINANCIAL STABILITY DEPARTMENT

Central Bank of the Republic of Azerbaijan

FINANCIAL STABILITY REPORT*

*** Based on data as of December 2023**

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

The global macroeconomic environment was marked by weak global economic recovery amid geopolitical tension and persistent tight monetary policy in most countries. In the complex macroeconomic context, the CBA implemented a policy oriented towards safeguarding macroeconomic and financial stability with its mandate.

Over the year the financial system was resilient against shocks and financial stability deepened. The CBA's macro and micro prudential policies contributed to the rise in the financial resilience of the banking sector. Banking sector capitalization measures, removal of two insolvent banks from the sector, higher prudential requirements for risk-sensitive zones and corporate governance improvements, as well as reforms to enhance monetary policy transmission had a positive effect on financial stability.

Bank lending remained robust. Amid high lending portfolio growth, changes by the CBA to the macroprudential framework and effective risk management by banks reduced credit risks of the banking sector.

The sector's resilience to market risk shocks elevated due to ongoing de-dollarization and the currency position being within the prudential requirements.

The sector's liquidity remains in a comfort zone. The application of liquidity coverage ratio has been started as a follow-up of initiatives on aligning liquidity norms to international standards. This will support resilience of financial institutions by lowering unexpected and high liquidity shortfall risk.

Profitability continued amid the banking sector expansion. The capital position of the sector, a core resilience indicator, surpasses prudential requirements and can absorb potential losses.

Positive dynamics in collections improved penetration and depth indicators of the insurance sector. The role of insurance companies as an institutional investor in the financial system is increasing.

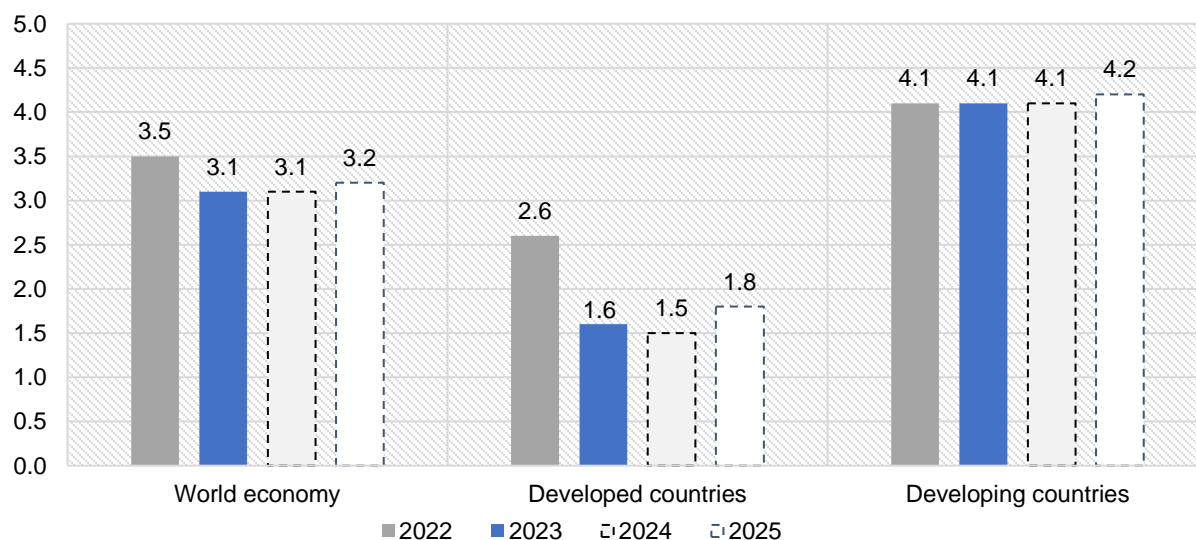
Securities market turnover increased year-over-year, driven by Repo and reverse repo operations. The potential for growth of the capital market depth remains high.

Global macroeconomic environment

Global macroeconomic conditions in 2023 were characterized by geoeconomic and geopolitical tensions, tight monetary policy by central banks in many countries, and a weak recovery in global economic activity. Most central banks raised policy rates in the first half of the year and kept them stable since inflation was higher than the target in 2023. Monetary tightening by central banks continued to weigh on global economic growth and unemployment. Whereas the IMF WEO January 2024 assessed economic growth to stand at 3.1% as of the end of 2023, this indicator was 0.4 pp lower year-over-year.

The IMF revised global economic growth outlook considering high uncertainties in the global economy. While the IMF WEO October 2023 forecasted global economic growth to stand at 2.9%, this forecast was revised up by 0.2 pp to 3.1% in January forecast. At the same time, forecasts for AEs and EMEs increased by 0.1 pp to 1.5% and 4.1% respectively.

Chart 1. Global GDP growth forecasts, %

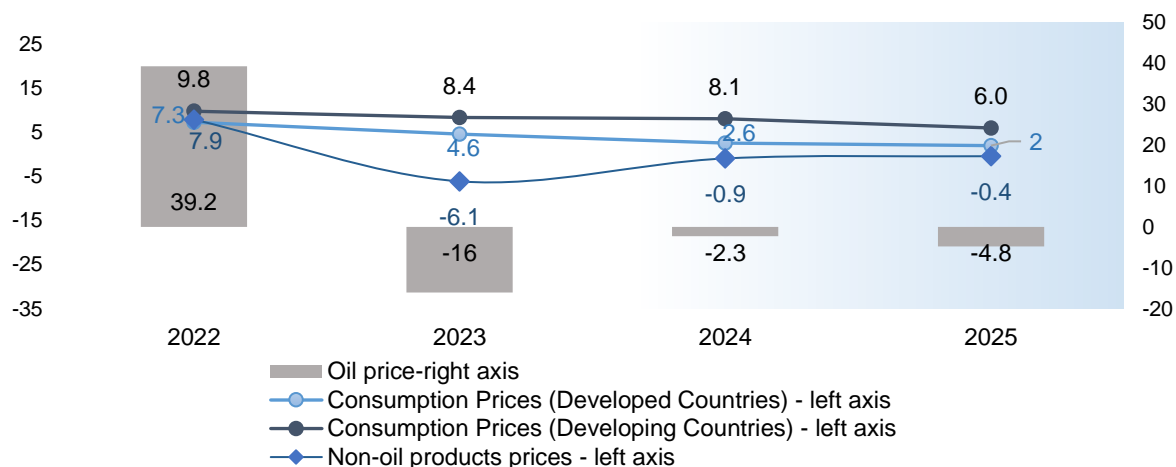


Source: IMF WEO January 2024 (updated)

Global commodity prices slid amid the tight monetary policy and slackening economic growth. According to the IMF WEO January 2024, oil and non-oil commodity prices are expected to fall in upcoming years. The average annual oil price is expected to decrease by 2.3% and 4.8%, while non-oil commodity prices are expected to decrease by 0.9% and 0.4% in 2024 and 2025, respectively. Moreover, according to the recent release by the IMF, consumer prices are expected to fall in AEs and EMEs in the

upcoming two years. Commodity prices are forecasted to depend on climate changes along with geopolitical and geoeconomic uncertainties in upcoming years.

Chart 2. Commodity price change, %



Source: IMF WEO January 2024 (updated)

Financial resilience of banks in certain AEs was under threat. With the US Federal Reserve System continued to tighten monetary policy and increase the policy rate since March 2022, cost of securities decreased in the financial sector. Certain US banks faced liquidity challenges due to the influence of this factor on the depositor conduct. Bank deposit runs in the Silicon Valley Bank and the Signature Bank also had a negative impact on financial resilience of those banks, three regional banks collapsed. At the same time, the Swiss Credit Suisse Bank encountered financial resilience challenges due to fall in stock prices, and the bank was acquired by another financial institution. Moreover, the US Silver Gate Bank shut down in March due to the decline in the value of cryptocurrency.

Global inflation decreased faster than expected. In 2023 the rapid recovery of global supply chains was a key force supporting both core and headline inflation to reach their pre-2020 average. Energy price shocks and reduced labor market tightness also dampened global inflation. It should be noted that, consumer prices are more sensitive to geopolitical shocks. The geopolitical tension around the Red Sea since November 2023, may lead to a sharp decrease in cargo traffic through the Suez Canal and, consequently, to an increase in inflation amid supply chain weakening.

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

	Fiscal balance				State debt			
	2022	2023	Forecast		2022	2023	Forecast	
			2024	2025			2024	2025
AEs	-4.3	-4.4	-4.2	-4.1	112.5	112.4	113.6	115
USA	-5.5	-6.3	-6.8	-7.1	121.7	122.2	125.8	129.1
Euro area	-3.8	-3.7	-2.8	-2.3	90.9	89.8	89.0	87.9
Japan	-7.8	-6.4	-4.0	-2.9	261.3	258.2	256.3	257.6
EMEs	-5.3	-5.8	-5.3	-5.0	65.7	67.5	69.8	72.2
Asia	-7.4	-6.8	-6.3	-6.2	75.1	79.1	82.6	86.2
Europe	-2.8	-5.8	-4.0	-3.5	32.7	36.9	37.9	38.6
Latin America	-3.9	-5.2	-4.4	-3.7	69.7	68.6	69.3	70.1
Middle East and South Africa	2.6	-1.0	-1.7	-2.0	43.0	42.5	41.2	41.6

Source: IMF, Fiscal monitor, 2023 October

While fiscal deficit and state debt are expected to increase in the USA, the indicator is forecasted to improve in the euro area and other regions. According to the IMF 2023 outlook, while in 2024 the fiscal deficit to GDP ratio is expected to decrease by 0.2 pp in AEs, by 0.9 pp in the euro area, but it is expected to increase by 0.5 pp in the USA. Energy and food price hikes urged certain governments to take actions to support the population and businesses, which caused a rise in fiscal deficit, due to additional expenses in 2023. Moreover, as high inflation eroded wages and salaries in real terms in 2021 and 2022, they were indexed, leading to an increase in public spending in AEs and EMEs.

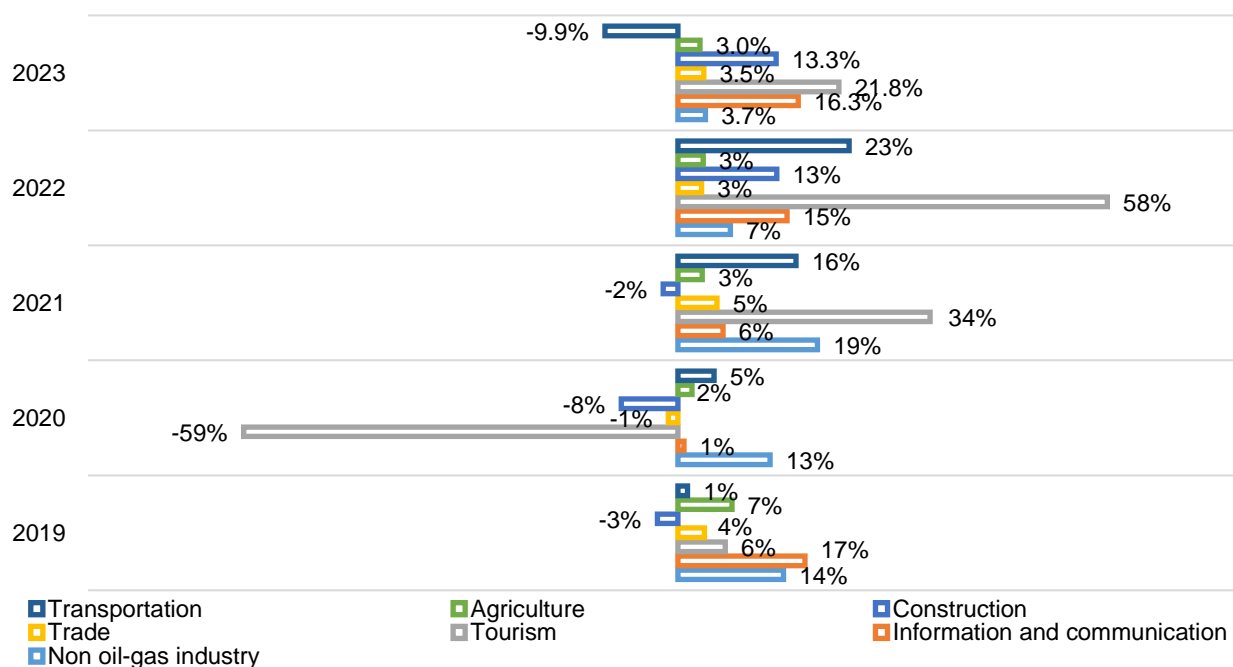
While rising interest expenses amid high interest rates reduce demand in the global economy, there was positive dynamics in the stock market. Both mortgage and refinancing expenses of companies increased, and residential and commercial construction decreased, since interest rates raised to contain high inflation through the demand channel. Nevertheless, market expectations related to the slackening of inflation and future monetary easing paved the way to the decrease in long-term interest rates and an increase in stock capitalization of companies in capital markets at the end of 2023.

Macroeconomic environment in Azerbaijan

In 2023 economic activity continued, on the backdrop of uncertainties triggered by global geopolitical and geoeconomic risks, monetary tightening in most countries and relatively weak recovery of global economic activity. The international conjuncture was favorable for Azerbaijan in terms of the balance of payments. Over the reporting year GDP increased by 1.1% in real terms to nominal AZN123B, driven by the non-oil-gas sector. The non-oil-gas sector accounted for 63% of GDP, the sector increased by 3.7%. The oil-gas value added decreased by 1.7%. Per capita GDP made AZN12.1 thousand.

All non-oil-gas areas posted growth year-over-year, excluding transport. The highest growth was in tourism (22%).

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



Source: SSC

Nominal income of the population and salaries continued rising. As of end-2023 total labor force numbered 5249.7 thousand persons, employed population numbered 4963.3 thousand persons. The number of hired labor was 1732.6 thousand persons, out of which 52% (900 thousand persons) were engaged in the public sector and 48% (833 thousand persons) in the private sector. The average monthly nominal salary of the hired labor increased by 11.2% to AZN923.1. Population income increased by 12.8% to AZN78.1B compared with the end of 2022 in nominal terms.

Annual inflation was decreasing and towards the end-year was within the target band. According to the SSC, in December 2023 annual inflation stood at 2.1%, down by 13.5 pp compared with the peak inflation rate in September 2022. Annual core inflation stood at 9.6%.

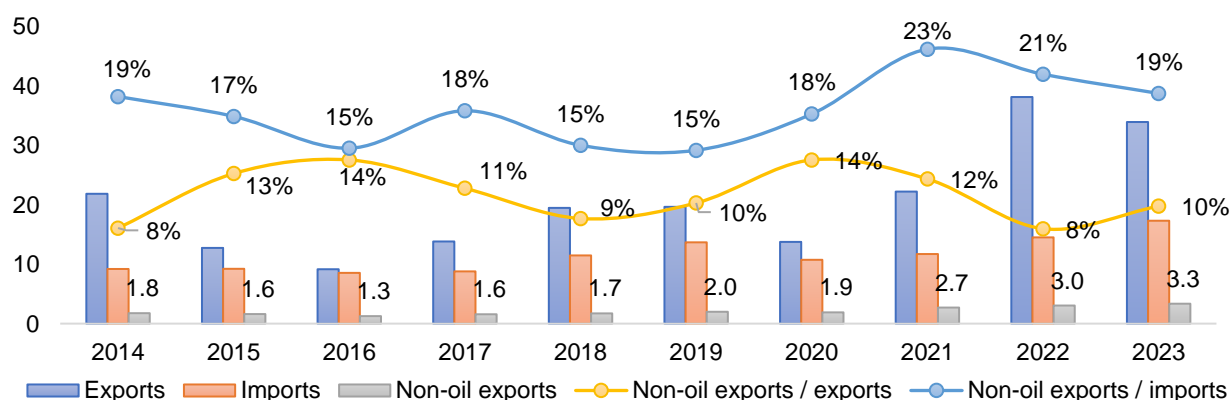
Inflation decreased, due to both internal and external factors. Lower inflation in trade partners, price slides in global commodity markets, return of international freight costs to pre-pandemic levels and anti-inflationary policy pursued in the country contributed to the drop in inflation. The strengthening of inflation-reducing factors led to a downward revision of the inflation forecast for 2024.

In 2023 the CBA implemented the monetary policy targeting price stability. Interest rate corridor parameters were discussed eight times over the year. In the first half of the year the refinancing rate was decided to be increased from 8.25% to 9%, the floor of the corridor from 6.25% to 7.5% and the ceiling from 9.25% to 10%. In the second half of the year CBA eased the monetary policy and decreased the refinancing rate from 9% to 8%. Monetary policy tools were still applied under a new configuration. Demand for liquidity absorbing standing facility of the Central Bank was higher.

To more effectively regulate money supply and allow the new operational framework to be applied effectively, changes were made to the procedure and level of differentiating reserve requirements. Deposits of legal entities are now differentiated, and reserve requirements have been increased.

The balance of payments indicators improved. Current account surplus amounted to \$8.3B, 11.5 % of GDP. Surplus on money transfers made \$1.1B.

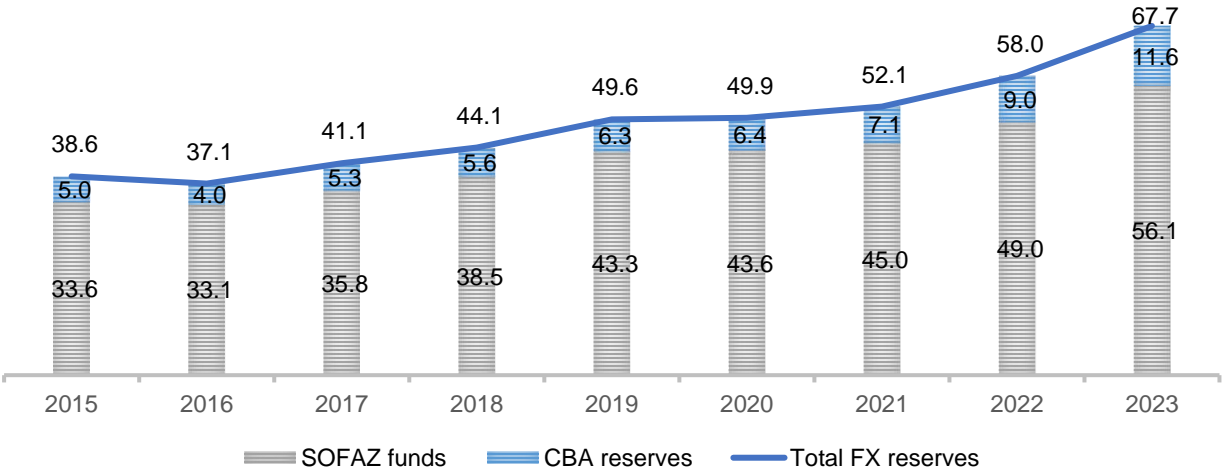
Chart 4. Import and export dynamics, billion US dollars



Source: SCC

Strategic foreign exchange reserves kept increasing at the expense of both funds of the SOFAZ and foreign exchange reserves of the CBA. Foreign exchange reserves of the CBA increased by 29% to \$11.6B, reserves of the SOFAZ increased by 14% to \$56.1B. In total, foreign exchange reserves of the country increased by 17% to \$67.7B.

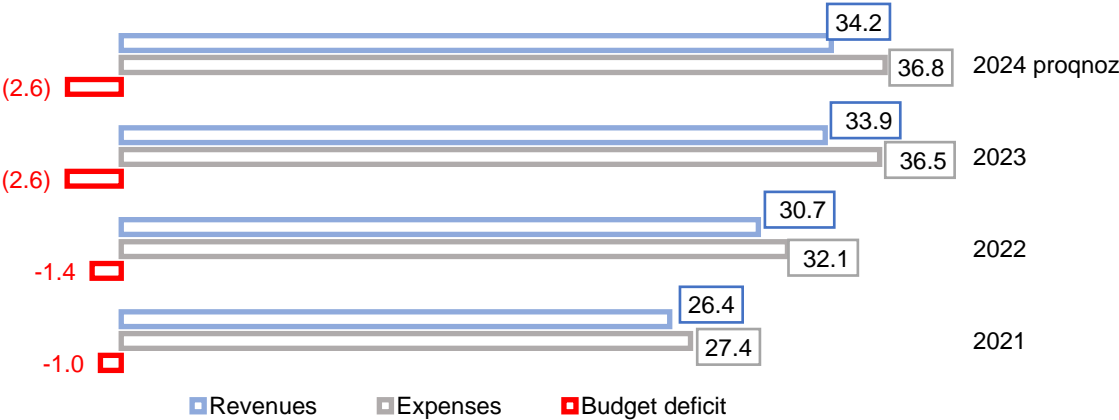
Chart 5. Foreign exchange reserves of the CBA and the SOFAZ, billion US dollars



Source: CBA, SOFAZ

Fiscal expenses were crucial in supporting economic activity. Budget expenses were channeled to supporting economic growth, improving welfare of the population, particularly to restoration of liberated territories. In 2023 state budget revenues amounted to AZN33.9B, and expenses AZN36.6B. Budget deficit made AZN2.7B, 2.2% of GDP. To accelerate the restoration of liberated territories, and support economic activity, budget revenues and expenses forecasts for 2024 were revised up to AZN34.2B and AZN36.8B respectively compared with 2022.

Chart 6. State budget revenues and expenses, billion manats



Source: CBA, SSC

Overview of the banking system

- ***The role of the banking system in financial intermediation:***

The share of the banking sector in financial intermediation remains high. The banking system functions as a core intermediary in financing of the economy. Total financial sector assets¹ amount to AZN51.9B, banks account for 94.8% (AZN49.2B) of total assets. The bank assets to GDP ratio, the core indicator characterizing financial depth of the banking sector, y.o.y. increased by 4.8 pp to 40%. At the same time, the lending portfolio to GDP ratio, another financial depth indicator, y.o.y. increased by 4.2 pp to 18.8% (the lending portfolio to GDP ratio 33.9%). The lower financial depth indicators of the Azerbaijani banking sector compared to benchmark countries are attributable to the sector's high growth potential.

As of end-2023, 23 banks are functioning in the country, two of them are state-owned banks. The number of banks with foreign capital is 9, one of those banks is a local branch of a foreign bank. The sector's service network includes 475 branches, 96 divisions, 3040 ATMs, 23.6 thousand staff. There are 5 branches per 1,000 square kilometers and 30 ATMs per 100,000 people. There have been no significant changes in the service network compared with the end of the previous year amid improved mobile applications of banks and increased digital banking services.

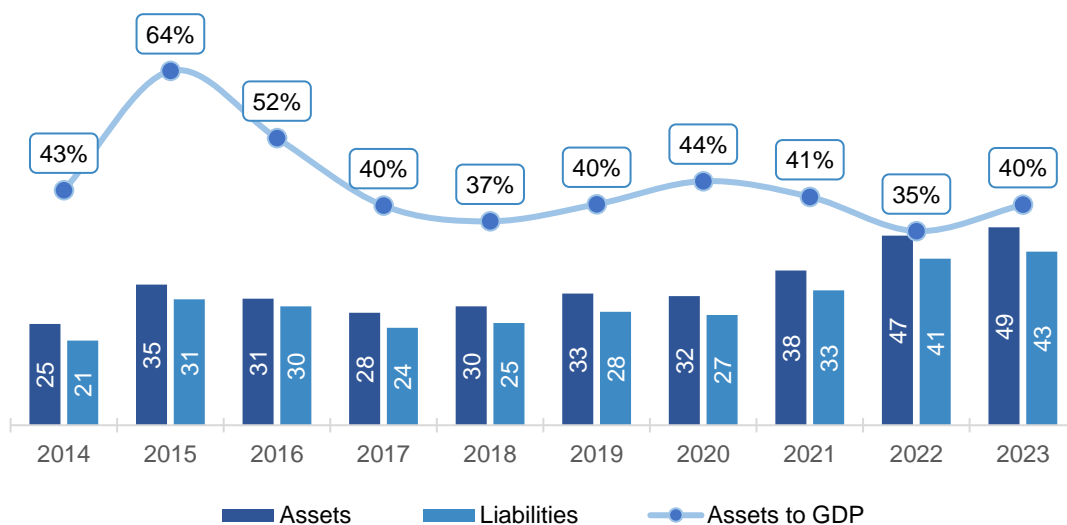
Licenses of two banks were revoked over the reporting year. Licenses of the Gunay Bank OJSC and the Mugan Bank OJSC were revoked with the decisions of the Management Board of CBA dated 16.05.2023 and 19.10.2023 respectively, because their total regulatory capital fell below the minimum requirements set for banks, total capital adequacy ratio was below 3%, they failed to provide current activities reliably and prudentially and their internal governance and control procedures were not adequate. The Gunay Bank OJSC accounted for 0.6% of total banking system assets, 1% of the lending portfolio, 0.5% of liabilities and the Mugan Bank OJSC accounted for 1.4% of assets, 2% of the lending portfolio and 1.3% of liabilities. The revocation of these banks' licenses did not threaten the financial resilience and stability of the banking sector. The Deposit Insurance Fund made compensation payments on the Gunay Bank OJSC and the Mugan Bank OJSC and as of 31.12.2023 the compensation repayable on protected deposits were paid by 97% and 92% respectively.

¹ With exception of assets of the Agrarcredit CJSC

- Dynamics of banking sector assets and liabilities

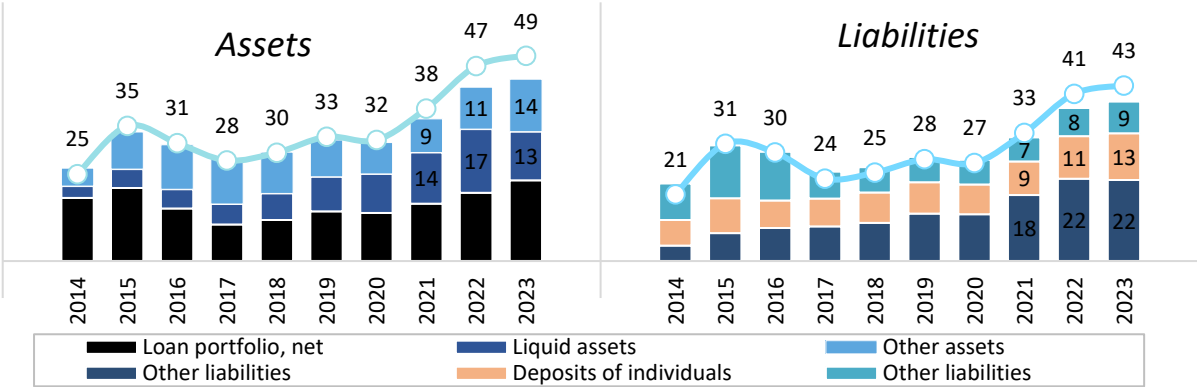
The growth of deposits of individuals, driven by high confidence in the banking system among the population, was the key factor in the expansion of banking sector assets. Banking sector assets increased by 4.5% (AZN2.1B) to AZN49.2B. Liabilities increased by 4.1% (AZN1.7B) to AZN43.1B. As of end-2023, banking sector assets comprise of net lending portfolio (44%), liquid assets (27%), deposits with financial institutions and loans from financial institutions (8.5%) and other assets (20.5%). Banking sector liabilities mainly include deposits of legal entities. Liabilities comprise of deposits of legal entities (51%), savings of individuals (29%), amounts due to financial institutions (12%) and other liabilities (8%). Banking sector assets expanded on the backdrop of the transparency of the economy, ongoing economic growth, broadening of the interbank market and rising savings of individuals, one of the core indicators of high confidence in the banking sector. Banking sector's Repo transactions increased by 5.4 times, bank deposits by 22.3% and savings of individuals by 9.6%.

Chart 7. Dynamics of banking system assets and liabilities, billion manats



Source: CBA

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

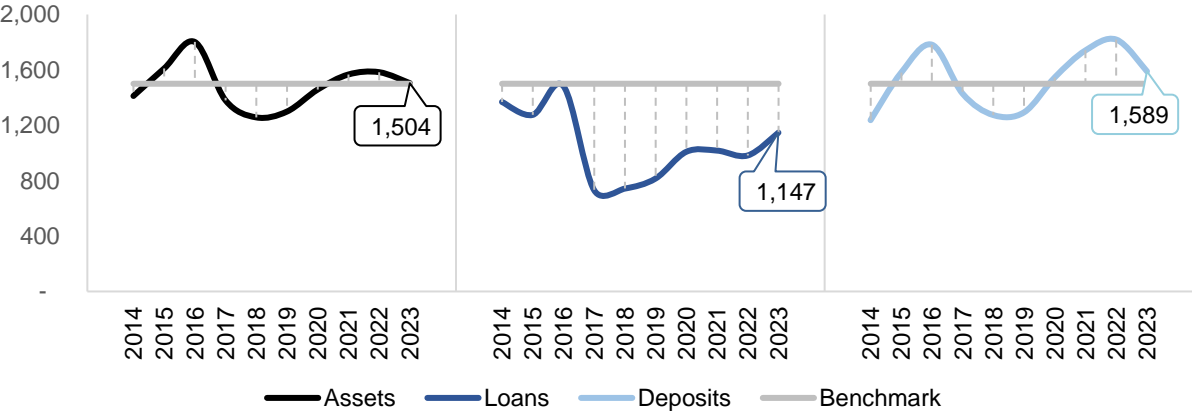


Source: CBA

- **Banking system concentration**

High concentration in the Azerbaijani banking system started declining. In 2023, the decrease of the HHI index², which is widely used in international practice, for assets and deposits, indicates a decrease in concentration level in the banking sector. As of end-2023 concentration of assets and deposits was 1504 and 1589, respectively. While the HHI on loans increased, the indicator is below 1500, due to lower concentration on loans.

Chart 9. HHI on the banking sector

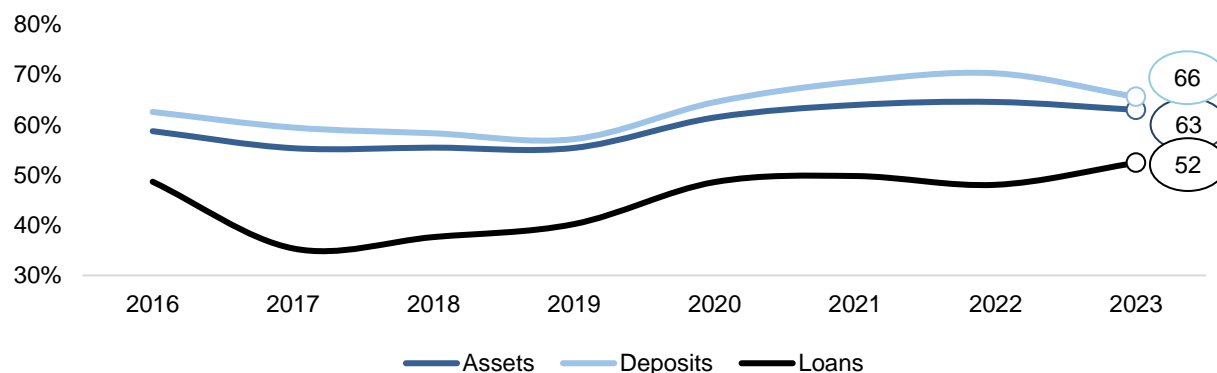


Source: CBA

² The HHI index is used in international practice to assess the level of competitiveness and concentration in markets. Based on the experience of the Department of Justice of the United States of America, markets are divided into three parts based on this index: low concentration markets (HHI < 1500), medium concentration markets (1500 < HHI < 2500), and highly concentrated markets (HHI > 2500). The value of the HHI ranges from 0 to 10,000.

The dynamics of the market share of the top three banks shows that concentration decreased in 2023. The market share of the top three banks on assets y.o.y. decreased by 2 pp. to 63%, the market share on the deposit portfolio decreased by 4 pp to 66%, and while it increased on the lending portfolio by 4 pp. to 52%. The CBA always focuses on banking sector concentration.

Chart 10. Dynamics of the market share of the top three banks

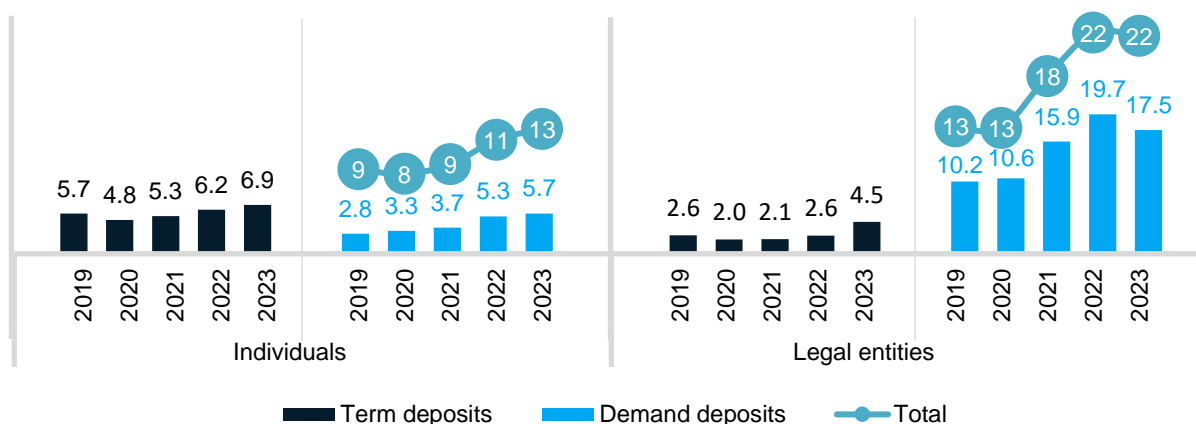


Source: CBA

- **Resources attracted across the banking sector**

While deposits of legal entities, the key financing source of the sector, did not change considerably, savings of individuals posted high growth. Deposits of individuals decreased by 1.4% (AZN311 thousand) to AZN22B, and savings of individuals increased by 9.6% (AZN1.1B) to AZN12.6B. As a result, as of end-2023 the share of deposits of legal entities in liabilities decreased by 2.8 pp. to 51%, and the share of savings of individuals in liabilities increased by 1.5 pp. to 29%. Note that, savings of individuals increased at the expense of the rise in term deposits.

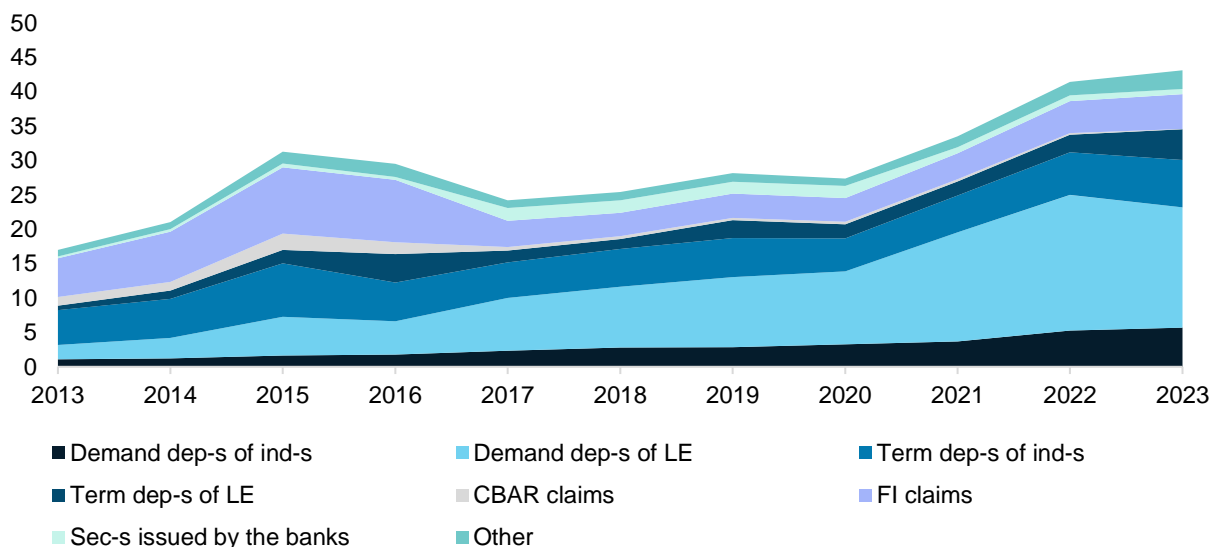
Chart 11. Dynamics of the lending portfolio of individuals and legal entities, billion manats



Source: CBA

Transition of demand deposits of legal entities into term deposits elevates asset generation potential of the banking sector. Demand deposits of legal entities decreased by 11.3% (AZN2.2B) to AZN17.5B, while term deposits of legal entities increased by 75% (AZN1.9B) to AZN4.5B. It should be noted that, amid high volatility of demand deposits of legal entities over the year term deposits increased steadily. As a result, the share of term deposits in the total deposit portfolio increased from 26% to 33%.

Chart 12. Dynamics of the structure of attracted funds, billion manats



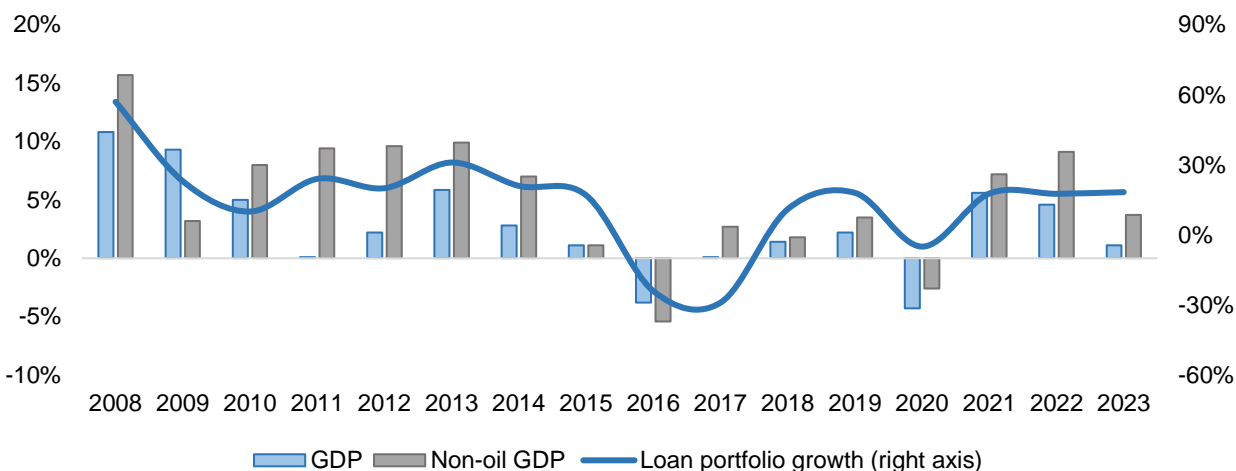
Source: CBA

Dollarization of deposits decreased on the backdrop of high confidence in the national currency. Over the year, dollarization of the total deposit portfolio decreased by 8.6 pp to 38.4%, dollarization of savings of individuals decreased by 5.8 pp. to 34%, dollarization of deposits of legal entities decreased by 10 pp to 41%. Dollarization of both term and demand deposits of individuals decreased amid higher transparency in the economy and rising confidence of the population in the national currency. Dollarization of term deposits of individuals decreased by 4.7 pp to 34.3%, and dollarization of demand deposits of individuals decreased by 7.2 pp to 33.5%.

- **Bank lending**

Bank lending remains active. Despite the fall in annual growth rate of economic activity (annual GDP growth rate +1.1%), the lending portfolio of the banking system increased by 18.3% (AZN3.6 B) to AZN23.2B.

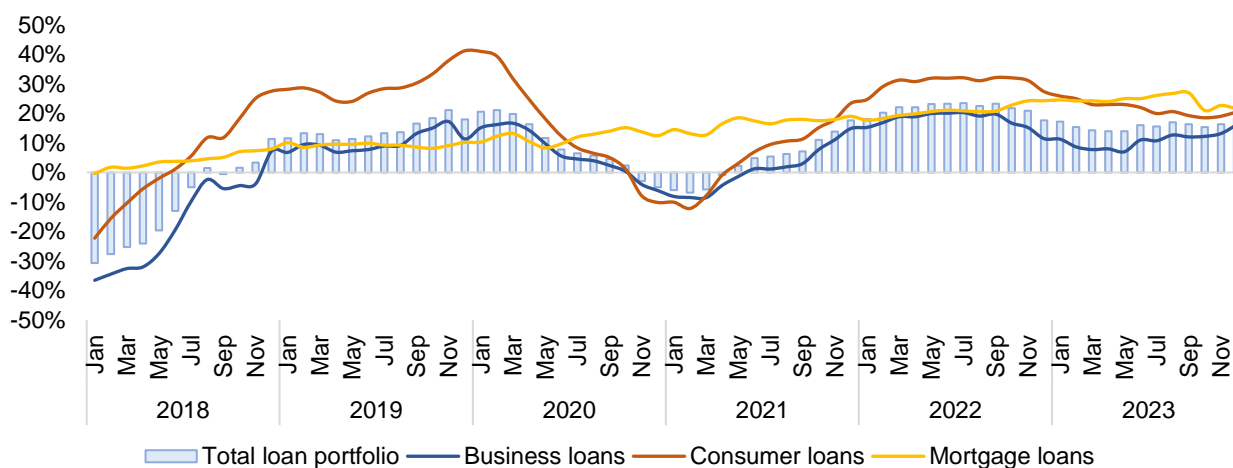
Chart 13. Comparison of the lending portfolio and GDP annual growth rate



Source: CBA

All segments of lending portfolio followed a positive trend. Consumer lending growth decreased due to regulatory tightening of consumer lending. However, the growth dynamics of the consumer lending portfolio remains high (prior to changes to the regulatory framework annual growth rate of the consumer lending portfolio was 32%, currently 20.6%). The growth rate of business loans accelerated in the second half of the year (16.2%). While the growth rate of the total lending portfolio decreased by the year-end, it grew y.o.y. by 21.6%.

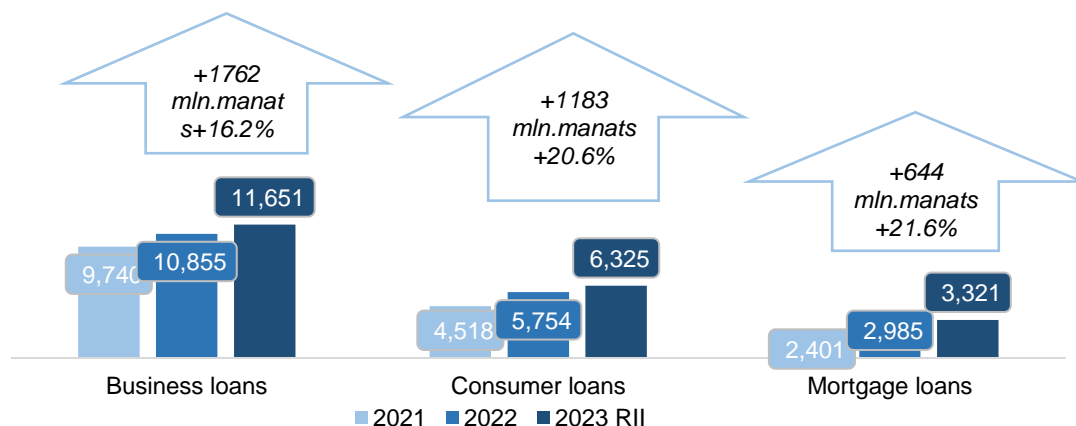
Qrafik 14. Annual dynamics of the loan portfolio, %



Source: CBA

In 2023 business loans increased by AZN1,762M to AZN12.6B. Over the reporting period, the mortgage portfolio increased by AZN644M to AZN3.6B – 47% (AZN301M) loans issued from public funds, 53% (AZN343M) from banks' own funds. The consumer loans portfolio increased by AZN1,182M to AZN6.9B.

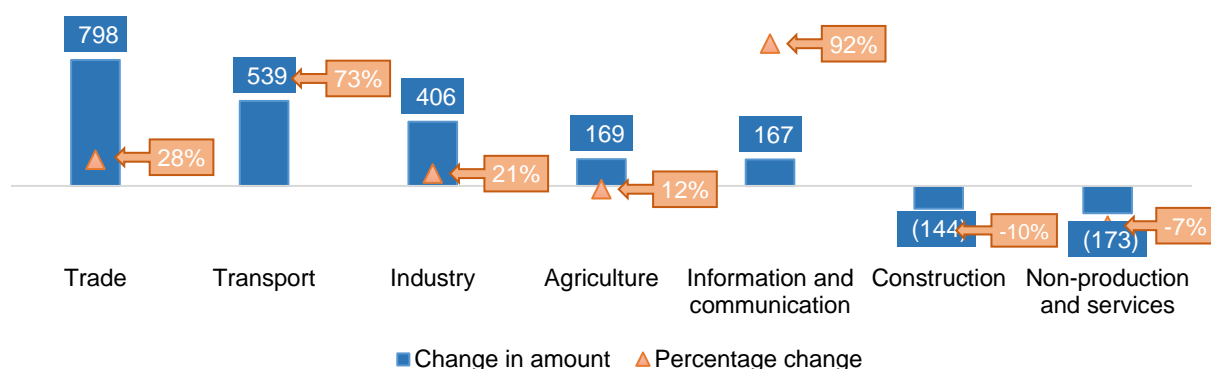
Chart 15. Loan portfolio dynamics, million manats



Source: CBA

The business portfolio continued to expand over the reporting period. Business loans accounted for 54% of total portfolio. The business loan portfolio increased due to trade, transport and industry sectors, which y.o.y. increased by 28% (AZN798M), 73% (AZN539M) and 21% (AZN406M) respectively. Growth on these three areas accounted for 84% of the total business loans portfolio. Agriculture loans increased to 12% as of the end-2023 compared with previous years. Banks have issued AZN580M worth of agriculture loans over recent three years.

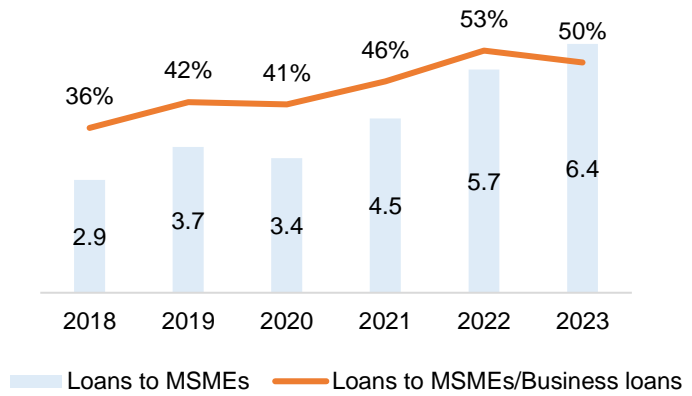
Chart 16. Dynamics of the business portfolio across economic sectors, million manats



Source: CBA

In 2023 micro, small and medium sized loans continued to increase. MSME loans y.o.y. increased by 11% (AZN0.7B) to AZN6.4B. Easing of SME standards was the key driver of the increase in MSME loans. Credit conditions surveys among banks suggest that MSME loans increase due to easing of standards on MSME loans and higher demand for MSME loans by borrowers in 2023.

Chart 17. Dynamics of MSME loans, billion manats

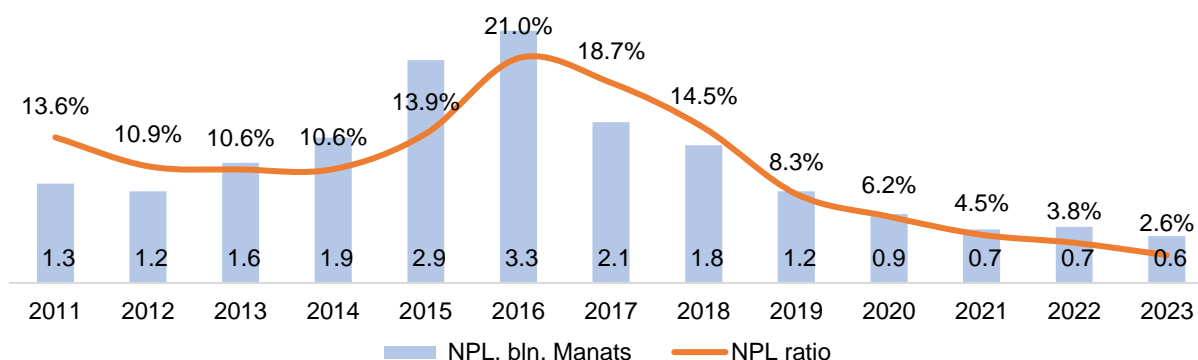


Source: CBA

Credit risk of the banking system

Credit risks subdued. The size of the non-performing loans portfolio decreased by 16.5% (AZN121M) to AZN0.6B. The share of the NPL portfolio in total portfolio decreased by 1.1 pp to 2.6%, due to the removal of two insolvent banks from the banking system and write-off of problem loans from balance sheets. The banking sector wrote off AZN125M worth of funds over the reporting year.

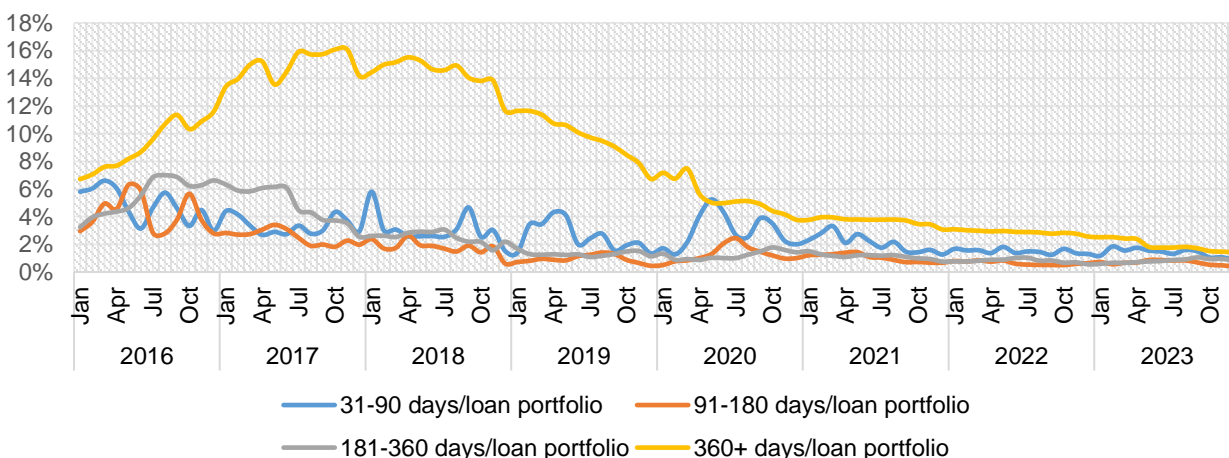
Chart 18. NPL portfolio dynamics on the banking sector



Source: CBA

In the structure of the NPL portfolio on delinquent days, the share of the loans with over one year delinquency continues to decrease. Thus, since 2017, with the recovery of the banking sector, the share of NPLs delinquent for over one year in total portfolio decreased by 11.5 pp and shifted from 12.7% to 1.4%.

Chart 19. Delinquency breakdown of the lending portfolio

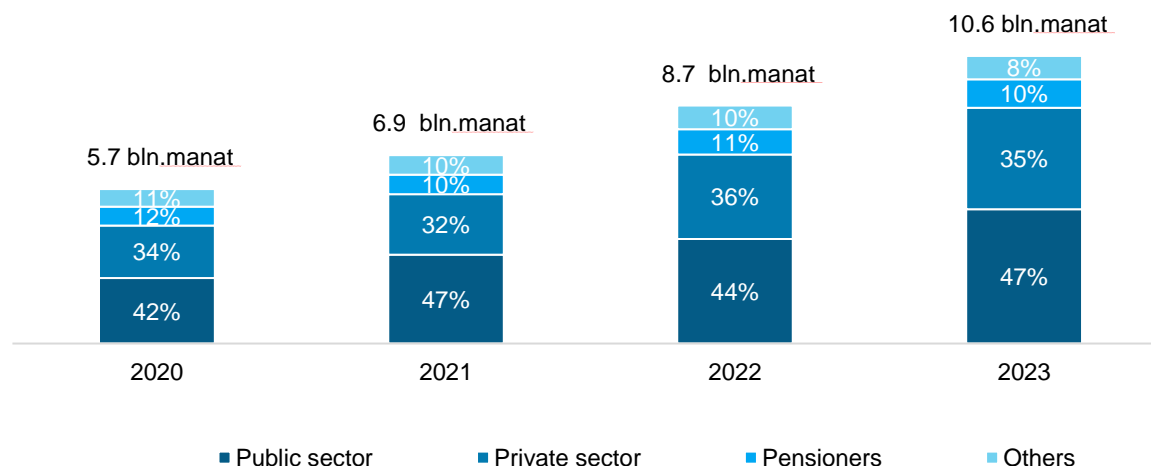


Source: CBA

NPLs on the business portfolio continues to decrease. Over the previous year NPLs on the business portfolio decreased by 25% to AZN378M. The NPL ratio on business loans decreased by 1.7 pp to 3%, due to removal of two insolvent banks from the system and write-offs.

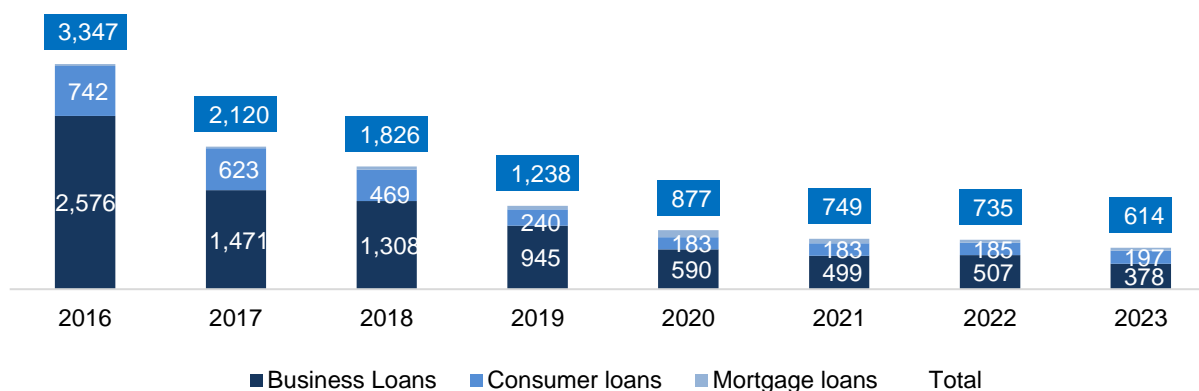
Credit risks in the consumer loans portfolio are monitored closely. The NPL portfolio on consumer loans increased by 6% in nominal terms (AZN12M) to AZN197M. Nevertheless, as consumer loans growth rate exceeds the NPL growth rate, the NPL ratio decreased by 0.4 pp to 2.8%. Note that, 47% of consumer and mortgage loans were issued to individuals with fixed income employed with the public sector.

Chart 20. Borrower structure on consumer and mortgage loans, %



Source: CBA

Chart 21. Sectorial structure of the NPL portfolio, million manats

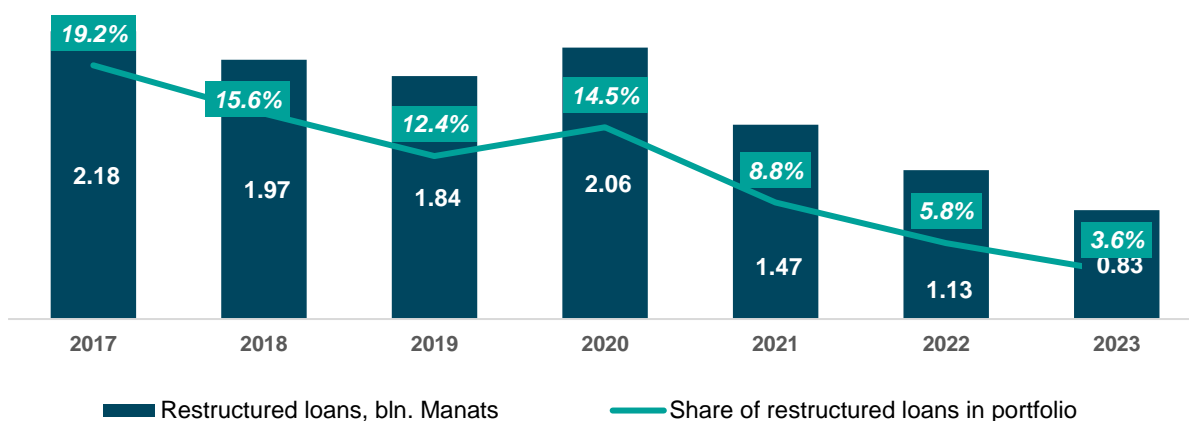


Source: CBA

NPLs in the mortgage portfolio continued decreasing. NPLs in the mortgage portfolio decreased by 8.3% (AZN3.6M) to AZN39M. Consequently, the share of NPLs in the portfolio decreased by 0.3 pp to 1.1%. The NPL ratio on the loans issued from the funds of Azerbaijan Mortgage and Credit Guarantee Fund (56%, AZN2B) was merely 0.3%.

The introduction of the new prudential framework on the restructuring portfolio had a downward effect on restructuring portfolio risks. Strict provisioning requirements for repeated loan restructuring were introduced last year (each subsequent restructuring requires assigning the asset to a riskier classification category and creating higher reserves). As a result of the introduction of the new prudential framework, in 2023 the size of the restructuring loan portfolio decreased by 27% (AZN0.3B) to AZN0.83B. The main decrease was in restructured loans in the business portfolio (AZN244M). Removal of two insolvent banks from the system also had a downward effect on the portfolio.

Chart 22. Dynamics of restructured loans portfolio, million manats



Source: CBA

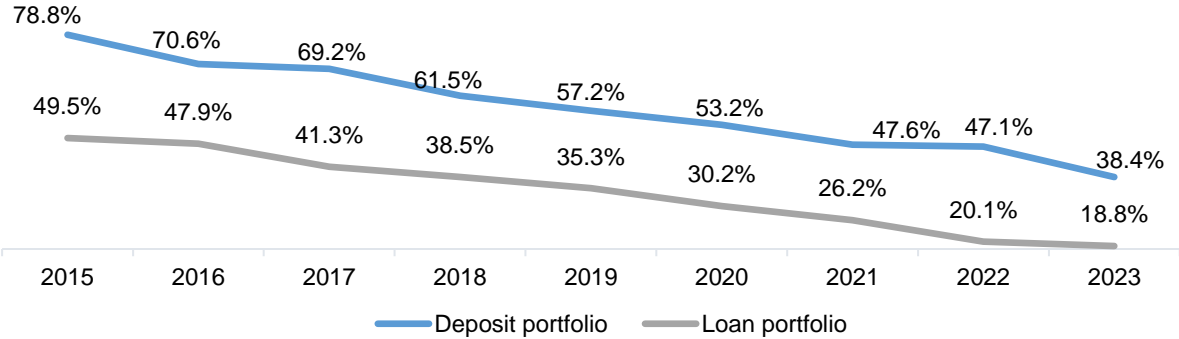
Market risk of the banking system

The currency position of the banking sector is within the prudential requirements.

In 2023 the long open currency position of the banking system was AZN203M, the banking system’s open currency position to total regulatory capital ratio being 3.6%, which is within prudential norms. Note that, according to the ‘Regulations on setting open currency position limits in banks’, the maximum limit on the aggregate open currency position to bank’s total regulatory capital on freely convertible currency is 20%.

Long-term de-dollarization continues in the sector. In 2023 dollarization of the deposit portfolio of the banking system y.o.y. decreased by 8.6 pp to 38.4%, and the lending portfolio dollarization decreased by 1.2 pp to 18.8%. Lower dollarization strengthens financial resilience of the banking system by neutralizing the effect of external shocks on the banking system.

Chart 23. Dollarization of deposit and lending portfolio

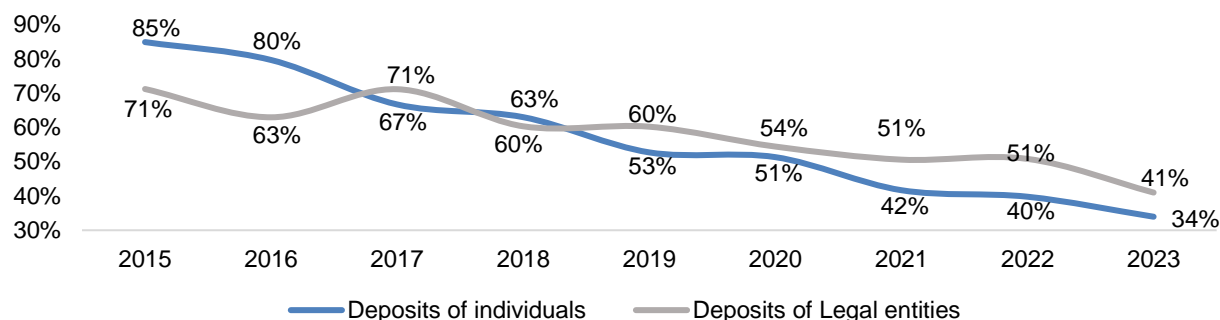


Source: CBA

Deposits of legal entities were the main driver of de-dollarization of deposits. In 2023 dollarization of total deposits of legal entities decreased by 9.8 pp to 41%. Dollarization decreased on both demand and term deposits of legal entities. Dollarization of demand deposits of legal entities decreased by 12 pp to 36.3%, of term deposits decreased by 10.9 pp. to 59.2%. Foreign currency denominated demand deposits of legal entities y.o.y. decreased by AZN3.2B in terms of amount, attributable to payments by companies functioning in the oil-gas sector.

Dollarization of the savings portfolio of individuals is in lows of recent years. Over the reporting year dollarization of savings of individuals decreased by 5.8 pp to 34%. The stability of manat and high interest rates on national currency denominated savings and deposits pave the way to the rise in term deposits of individuals in the national currency.

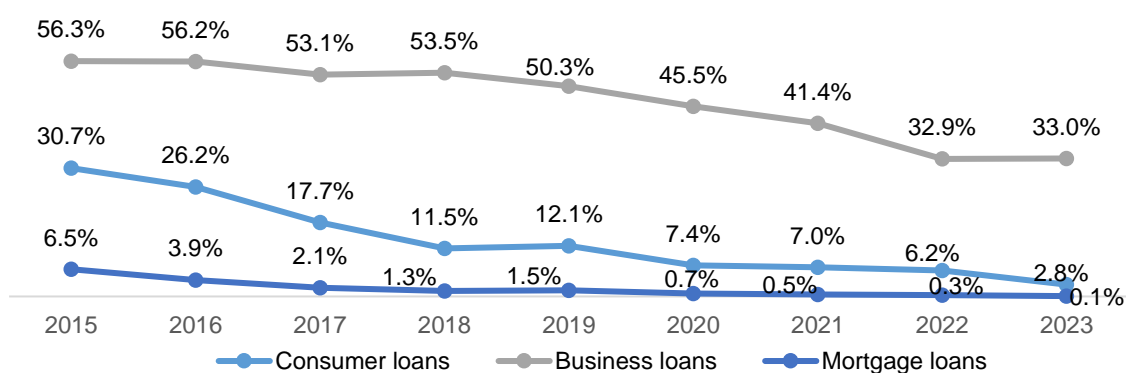
Chart 24. Deposit portfolio dollarization



Source: CBA

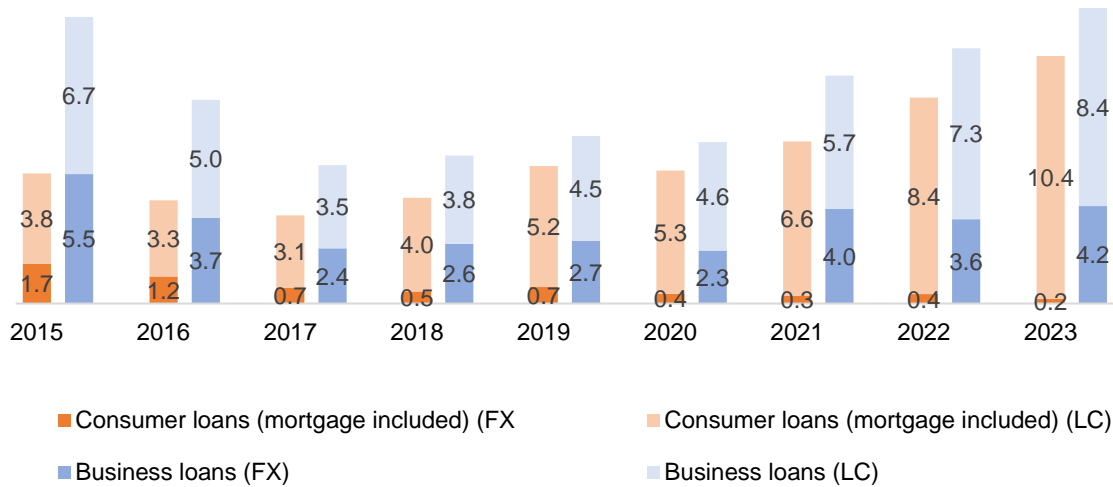
De-dollarization of the lending portfolio continued. The share of national currency denominated loans in total lending portfolio continued to increase on the backdrop of the exchange rate stability of the manat and the expansion of manat lending. Last year dollarization of the lending portfolio decreased by 1.2 pp to 18.8%, driven by consumer loans. Dollarization of consumer loans decreased by 3.4 pp to 2.8%. Limiting the granting of foreign currency denominated consumer loans to borrowers with no income in foreign currency, and assigning an additional risk weight for such loans, allowed the dollarization of the consumer portfolio to decrease to historical lows. The regulations of the CBA require mortgage loans to be issued only in the national currency, hence, the mortgage loan portfolio is nearly in the national currency. There has been no considerable change in dollarization of business loans.

Chart 25. Share of foreign currency loans in the lending portfolio



Source: CBA

Chart 26. Currency structure and dynamics of the lending portfolio, billion manats



Source: CBA

Banks' interest rate sensitivity does not threaten their resilience. The interest rate risk was analyzed with the duration method³. As most assets and liabilities are recorded at their carrying value, settlements were made over the carrying value and discounted at the CBA's refinancing rate. The main source of the maturity mismatch between assets and liabilities is that the difference between average weighted duration of loans issued and deposits attracted is about four times.

In the event of a positive duration difference, a rise in interest rates has a downward effect on the capital adequacy ratio. Simulations show that, 1 pp rise in interest rates leads to 0.9 pp fall in the capital adequacy ratio, which does not threaten financial resilience of the banking system.

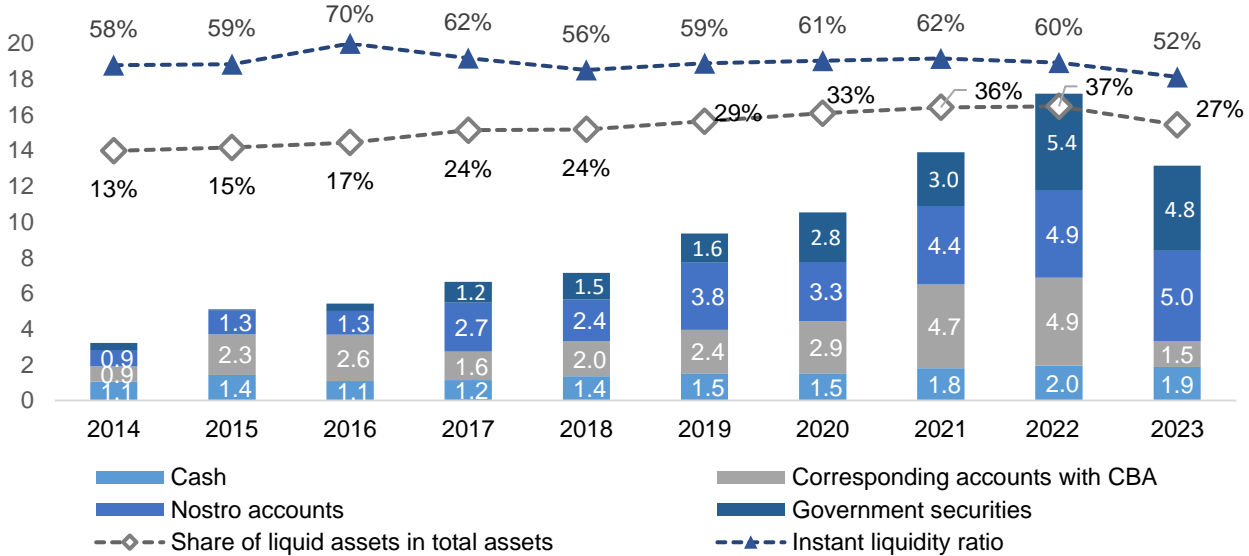
³ The duration analysis is used for measuring the weighted average term of assets and liabilities according to Macaulay duration concept. To remind, the duration gap analysis measures the sensitivity of banks to market interest rates with the following formula: $\partial(asset) - \frac{\partial(liability) \times liability}{asset}$. During the analysis, assets and liabilities are discounted by the discount rate of the CBA.

Liquidity risk of the banking system

Sector’s liquidity remains in a comfort zone. The size and share of liquid assets in total assets decreased, due to the introduction of the new monetary framework and a decline in demand deposits of legal entities. However, the instant liquidity ratio, a prudential liquidity regulation norm, is 52%, which exceeds the minimum norm by 22 pp. The liquidity coverage ratio (LCR), the new prudential liquidity requirement, is 135%, which exceeds the minimum requirement. Liquid assets account for 26.7% of total assets, providing the sector with an adequate buffer against potential liquidity shocks.

Excess liquid funds of the banking sector were sterilized amid the introduction of the new monetary framework. In 2023 liquid assets decreased by 24% or (AZN4.1B) to AZN13.2B. The share of liquid assets in total assets decreased by 10 pp to 27%. Liquid assets are concentrated in government securities (36%), nostro accounts (38%), correspondent accounts with the CBA (11%) and cash funds (14%). Banking system’s liquid assets surpass demand deposits of individuals by 2.3 times and cover 75% of demand deposits of legal entities.

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

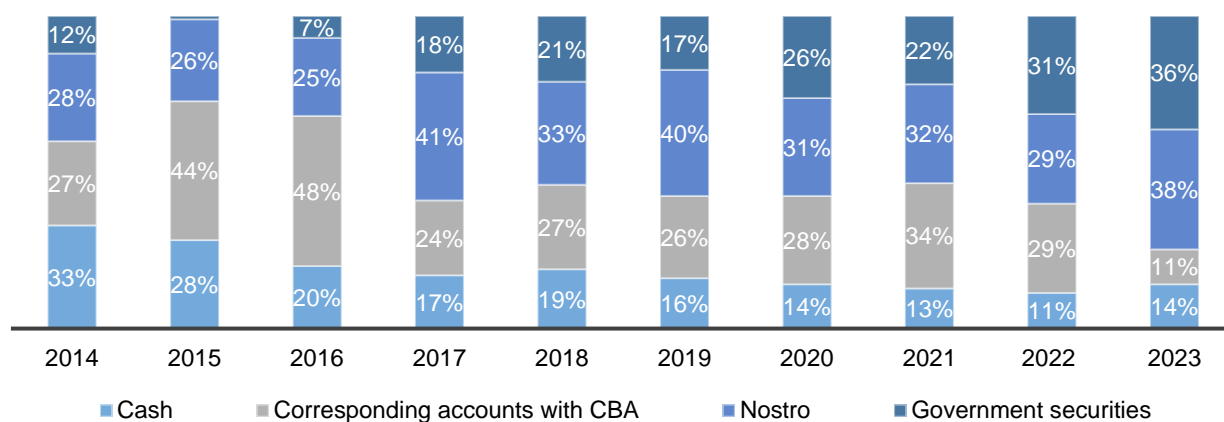


Source: CBA

The main decline across liquid asset components was in accounts with the CBA. Banks’ accounts with the CBA y.o.y. decreased by AZN4.1B to AZN1.5B resulting from changes in reserve requirements. To more effectively regulate money supply, enhance the effect of interest rates corridor on interest rates in the financial system, decrease concentration of liquidity in the banking system, and stimulate de-dollarization trends, changes has been made to reserve requirements. According to the changes made to the

'Regulation on the ratio, calculation and maintaining required reserves' by Decision 53/1 of the Management Board of the CBA⁴, required reserves have been differentiated depending on the share of related deposits and deposits of bank's related parties in total deposits in addition to total amount of deposits of legal entities in the national and foreign currencies.

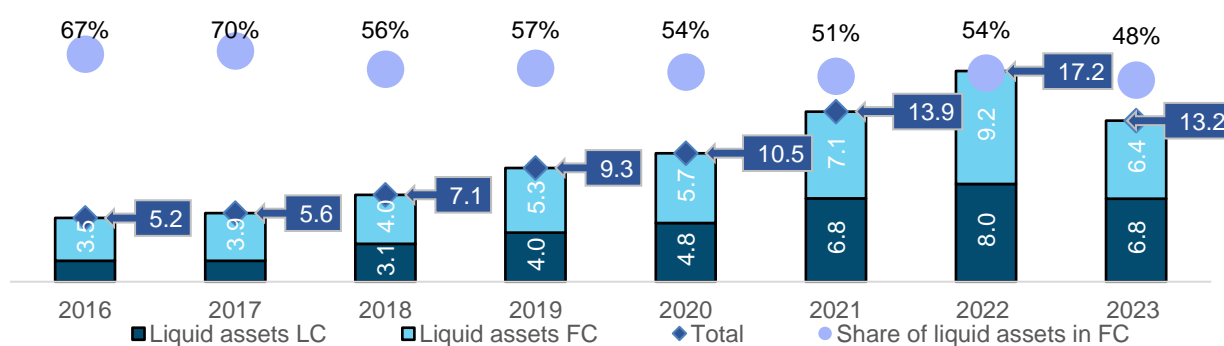
Chart 28. Dynamics of the share of liquid asset components in liquid assets



Source: CBA

The share of liquid funds in both foreign and national currencies are declining in the structure of liquid assets. Liquid assets in the national currency decreased by 15.2% (AZN1.2B) to AZN8B. Liquid assets in the foreign currency y.o.y. decreased by 31% (AZN2.9B) to AZN6.4B.

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



Source: CBA

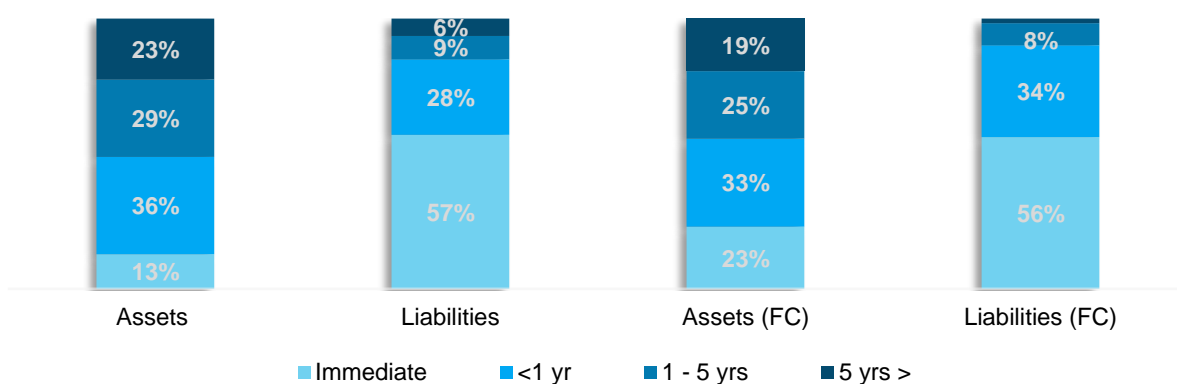
It should be noted that the reason for the drop in liquid funds in national and foreign currencies was increase in reserve requirements as part of the new monetary framework. Additionally, another factor that drove down liquid funds in foreign currency was the use

⁴ <https://www.cbar.az/press-release-4407/about-reserve-requirement-ratios>

of foreign currency denominated demand deposits by legal entities for transactions with foreign counterparties.

The share of assets with up to one year maturity in total assets was 49%, the similar indicator for liabilities stood at 85%. Maturity of 65% of liabilities being less than 90 days limits long-term financing. While the systematically increasing share of current liabilities in the balance sheet of the banking sector exacerbates maturity mismatch, large liquidity buffer of the sector prevents this mismatch from significantly resulting liquidity risk.

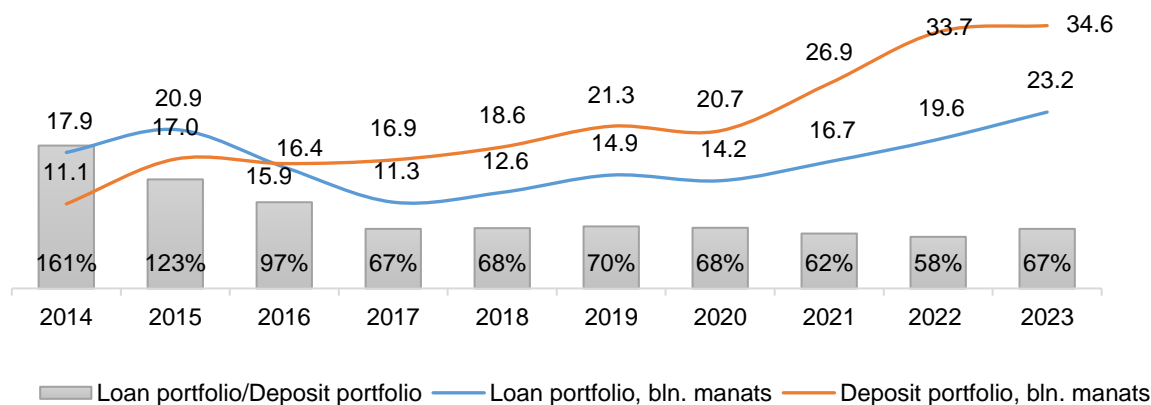
Chart 30. Maturity structure of assets and liabilities



Source: CBA

The loan to deposit ratio is increasing. As of end-2023, the lending portfolio to the deposit portfolio ratio increased by 9 pp to 67%, driven by the lending portfolio expansion and lower growth rate of the deposit portfolio in the environment of the drop in demand deposits of legal entities.

Chart 31. Dynamics of the loan to deposit ratio



Source: CBA

Box 1. Liquidity coverage ratio (LCR)

The liquidity coverage ratio (LCR) is a financial indicator designed to ensure that financial institutions maintain an adequate level of high-quality liquid assets to meet their short-term liquidity needs under stress conditions. The liquidity shortfall during the 2007-2008 financial crisis played an important role in exacerbating the crisis, prompting the LCR to be included to global regulatory frameworks as a crucial component in the aftermath of the crisis.

The main objective of the LCR is to enhance financial institutions' resilience by reducing unexpected and high liquidity shortfalls. By requiring a minimum level of liquid assets relative to short-term liabilities, central banks and regulatory authorities target safeguarding financial stability. Essentially, the LCR assesses resilience and ability of institutions to meet their liabilities under the stress lasting for 30 days.

$$LCR = \frac{\text{High quality liquid assets (HQLA)}}{\text{Net cash flow during upcoming 30 days}}$$

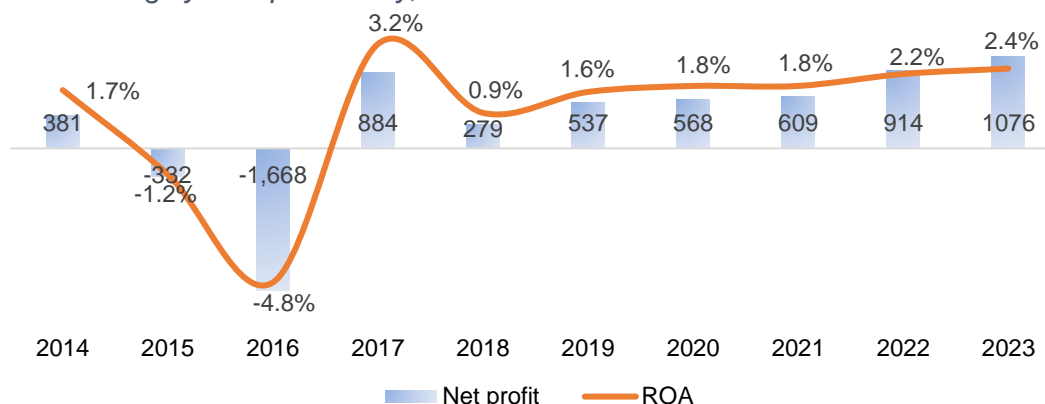
The CBA continues activities to align the banking sector regulatory framework with international standards and enhance risk management in banks. Guided by the significance of applying international practice and standards in banking regulation, the CBA with the decision of 18.10.2023 adopted the new edition of the 'Regulation on liquidity risk management in banks'. According to the decision, the Regulation took effect on 01.12.2023 and the 'Regulations on liquidity management in banks' valid since 2009 were repealed.

The Regulation outlines the application of the ratio both on a foreign currency and in aggregate. On the date the Regulation takes effect banks whose LCR ratio is 100% or more in aggregate and separately in foreign currency should ensure that the ratio does not fall below that limit. To avoid sharp pressure on the liquidity position of the banks whose LCR ratio is below 100%, the ratio will be applied stepwise within 18-24 months. Until the LCR ratio is maintained at 100% for each bank, the application of the current instant liquidity ratio with improved composition will continue. It should be noted that, considering historical indicators, more conservative outflow rates than those presented in the Basel III standards have been applied when the LCR was introduced.

Banking system profitability

Profitability continues to increase on the backdrop of the banking sector expansion. In 2023 net profit of the banking system y.o.y. increased by 17.7% (AZN162M) to AZN1076M. The ROA reached the peaks of recent six years (2.4%) amid the rise in the sector's profitability.

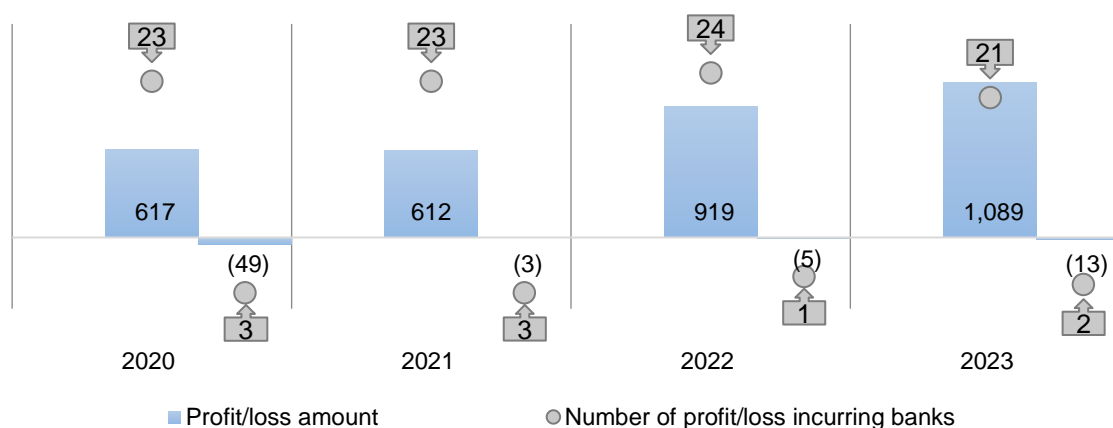
Chart 32. Banking system profitability, million manats



Source: CBA

21 banks operated at a profit, while 2 operated at a loss with two banks removed from the sector in 2023. Profit of 21 banks operating at a profit amounted to AZN1089M, and the loss of two banks operating at a loss was AZN12.7M.

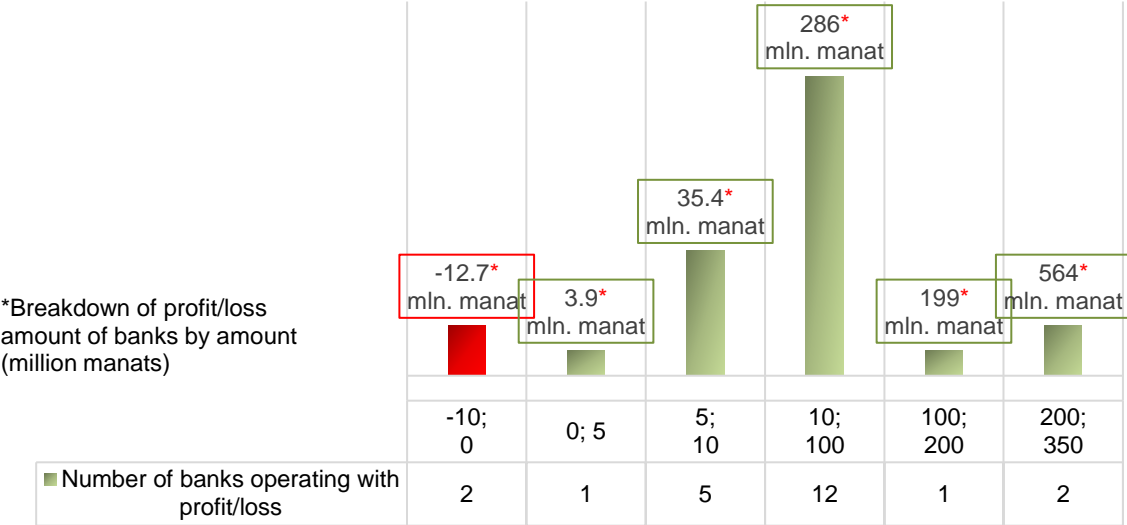
Chart 33. Number and dynamics of banks operating at a profit and at a loss, million manats



Source: CBA

Although most banks of the sector operated at a profit, profitability was concentrated. 12 out of 23 banks earned AZN10M – AZN100M profit, assets of those twelve banks accounted for 29.1% of total assets of the sector. 71% of net profit of the sector was concentrated in three banks, which together hold 63% of sector's assets.

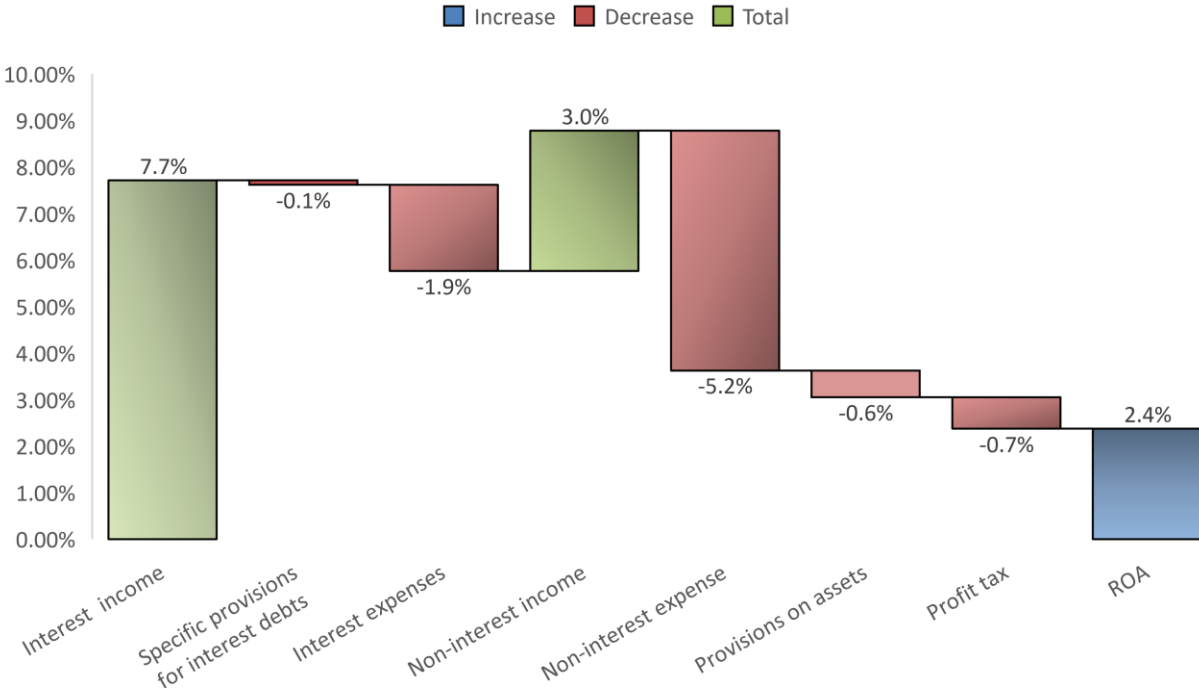
Chart 34. Distribution of banking system profitability



Source: CBA

ROA of the sector increased by 0.2 pp to 2.4% amid banking sector’s high interest income. While interest income accounted for 6.6% of average assets in 2022, the same indicator made 7.7% in 2023, the key driver of ROA. Despite the rise in the sector’s interest and non-interest income to average assets ratio in 2023 relative to 2022, sector’s ROA increased amid rising interest income. The share of interest expenses in average assets made 0.3 pp, and non-interest expenses increased by 0.6 pp to 1.9% and 5.2% respectively relative to 2022.

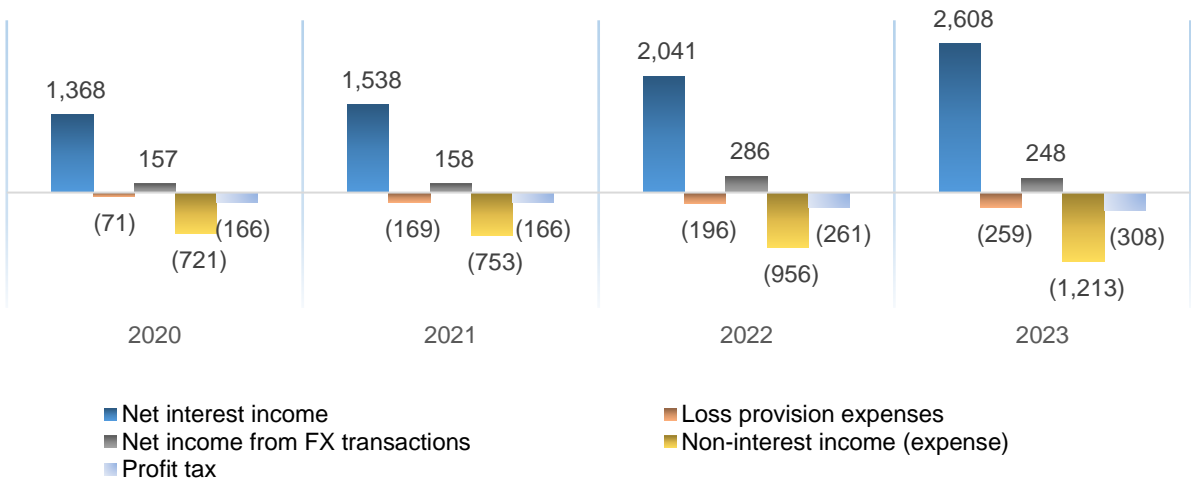
Chart 35. ROA decomposition across the banking system



Source: CBA

Sector’s interest income is increasing on an ongoing basis. Net interest income increased by 1.9 times (AZN1.24B) vs 2020, and by AZN567M (28%) vs 2022 and provided the rise in nominal banking sector profitability. Profit margin stood at 22.1% amid rising interest income.

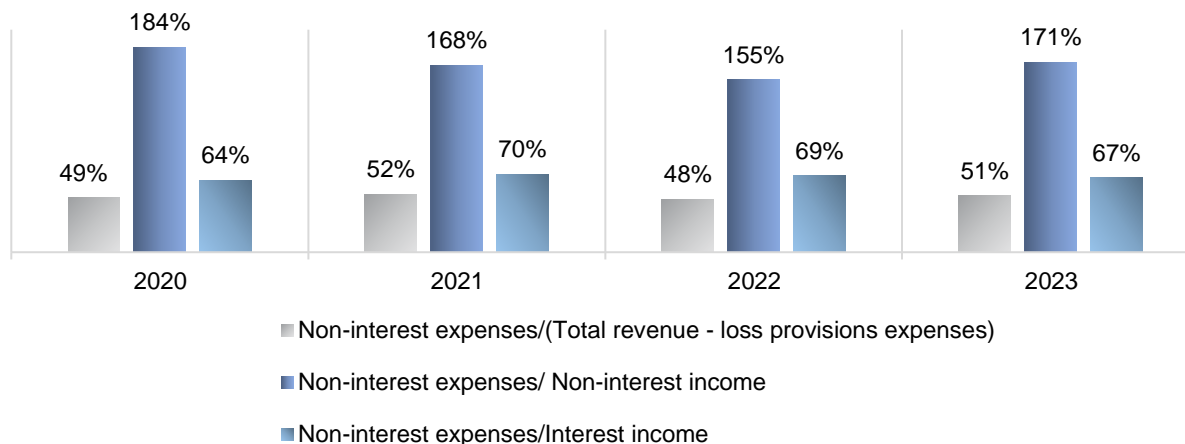
Chart 36. Decomposition and dynamics of profit across the banking system



Source: CBA

Sector's non-interest expenses increased amid the banking sector expansion and introduction of new products. The banking sector's non-interest expenses to total income and non-interest income ratio increased year-over-year in 2023, since the rate of growth of non-interest expenses was higher than that of non-interest income, which, in its turn, deteriorated efficiency indicators. The non-interest expenses to total income ratio y.o.y. increased by 3 pp to 51%, and the non-interest expenses to non-interest income ratio increased by 16 pp to 171%.

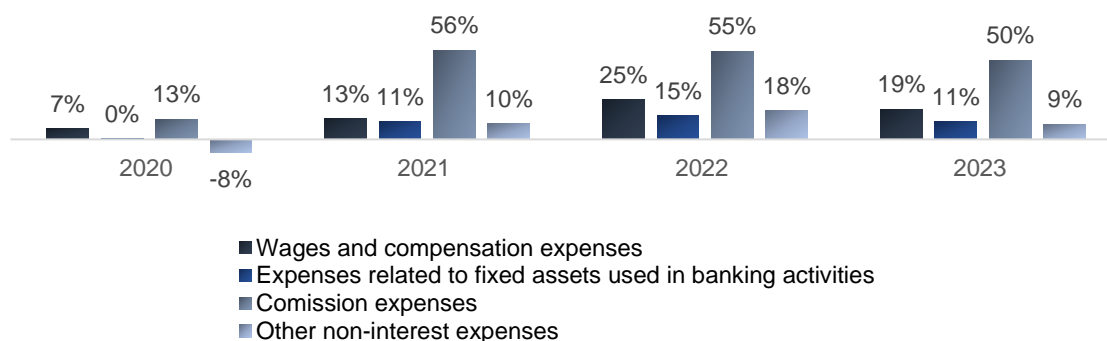
Chart 37. Banking system's efficiency indicators



Source: CBA

Non-interest expenses increased due to the rise in salaries, and rising fees and commissioning expenses on the services supplied. Salaries (37% of non-interest expenses) y.o.y increased by 19% (AZN139M). At the same time, fee and commissioning expenses on services supplied (32% of non-interest expenses) increased by 50% (AZN244M), driven by banks' products like cashback, double VAT, along with the rise in cashless transactions and the deepening of digitalization.

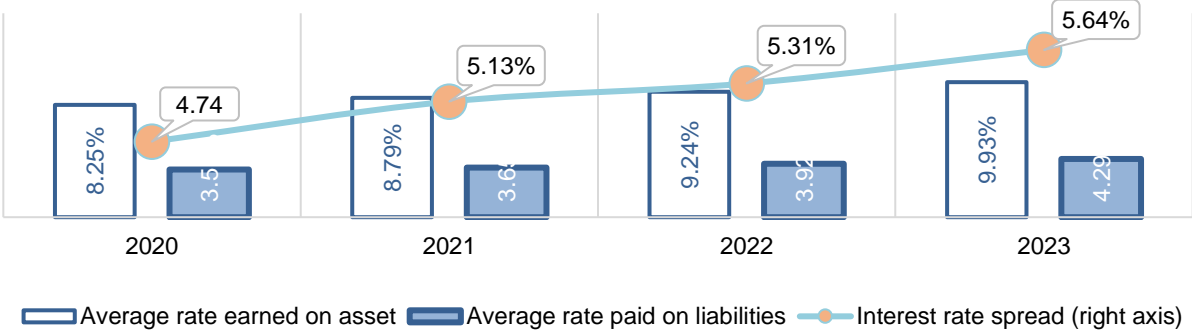
Chart 38. Dynamics of non-interest expenses



Source: CBA

The interest spread continues to increase on the backdrop of increase in revenues earned from the interest earned on assets. The stable growth of the interest spread across the banking system has continued over recent years. Despite the rise in interest bearing liabilities of the sector year-over-year, interest income contributes to the interest spread growth with a higher growth rate. Interest income contributes to the growth of the interest spread at a higher rate. The sector’s interest spread y.o.y. increased by 0.33 pp to 5.64%.

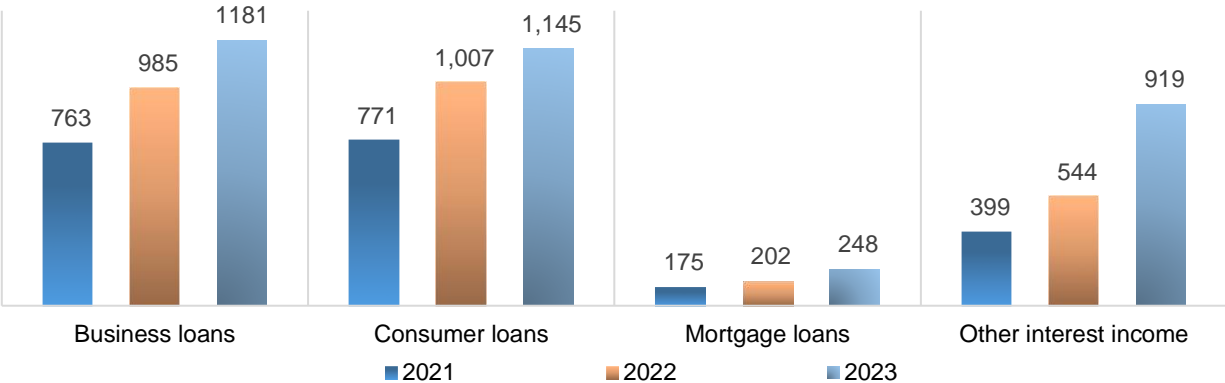
Chart 39. Banking system’s interest spread



Source: CBA

Despite an increase in all components of banks' interest income, the increase in interest income from other financial instruments was particularly notable. Interest income of the sector increased by 28% (AZN754M) to AZN3.5B. Interest income is broken down as follows: business loans (34%, or AZN1.18B), consumer loans (33%, or AZN1.15B), mortgage loans (7%, AZN248M) and other financial instruments (26%, or AZN919M).

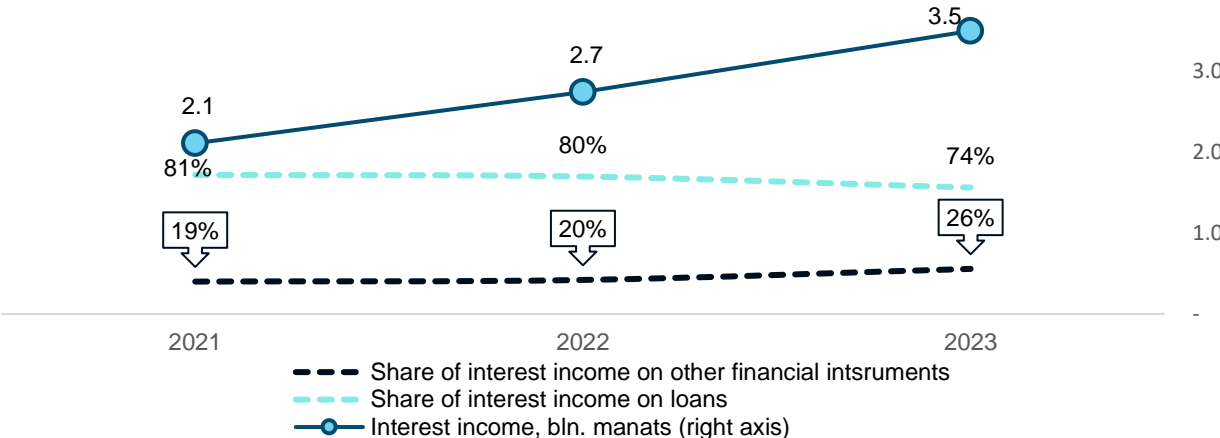
Chart 40. Interest income structure, million manats



Source: CBA

Interest income on other financial instruments included funds placed with financial institutions (AZN357M), securities (AZN432M), and interest-bearing nostro and other interest-bearing financial instruments (AZN130M).

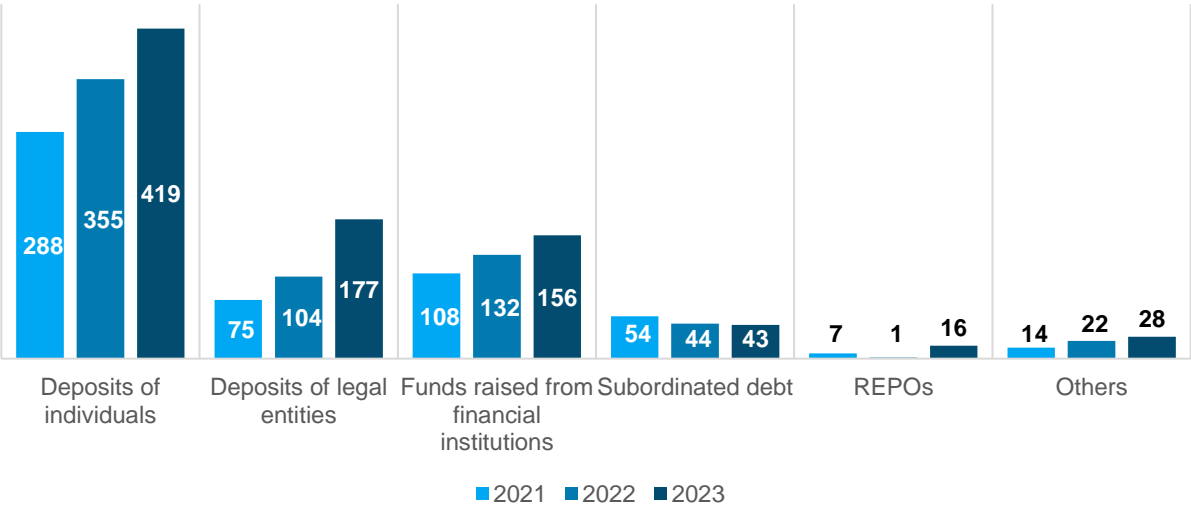
Chart 41. Interest income dynamics



Source: CBA

Interest expenses on deposits constitute the main part of banks’ interest expenses. Interest expenses on deposits of individuals and legal entities, that account for a considerable part of banking sector’s sustainable finance, constituted the main share of sector’s interest expenses. Sector’s interest expenses increased by 28% (AZN182M) to AZN839M, interest expenses on deposits accounted for 71% (AZN596M) of this amount.

Chart 42. Structure of interest expenses, billion manats

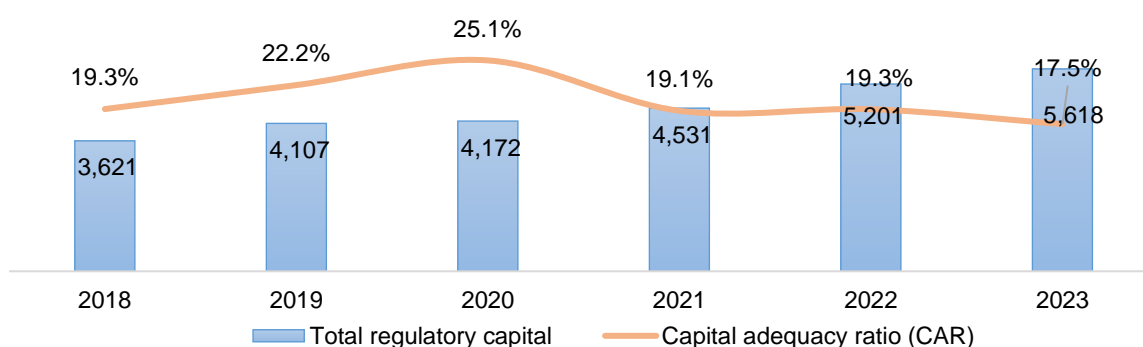


Source: CBA

Capital position of the banking system

The sector's capital position can absorb potential losses, surpassing prudential requirements. Total regulatory capital of the banking sector increased by 8.0% (AZN417M) to AZN5.6B. The capital adequacy ratio (CAR) decreased by 1.8 pp. to 17.5%, 1.7 times higher than the minimum requirement. The CAR decrease was attributable to the rise in RWA amid high lending dynamics.

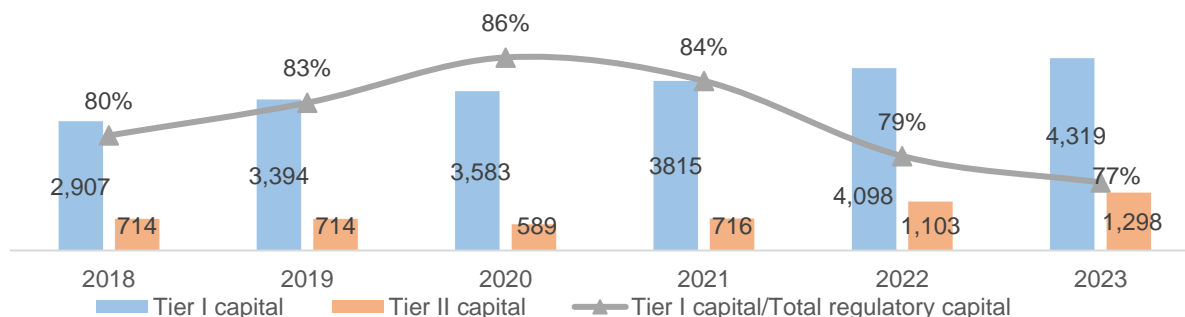
Chart 43. Dynamics of capital adequacy, million manats



Source: CBA

The rise in total regulatory capital was driven by the rise in Tier I Capital. Tier I Capital increased by 5.4% (AZN221M) to AZN4.3B, and Tier II Capital increased by 18% (AZN195M) to AZN1.3B, attributable to banks' internal profit generation. High quality Tier I Capital increased at the expense of channeling of retained earnings of 2022 to net profit, and Tier II Capital increased at the expense of profit of the current year.

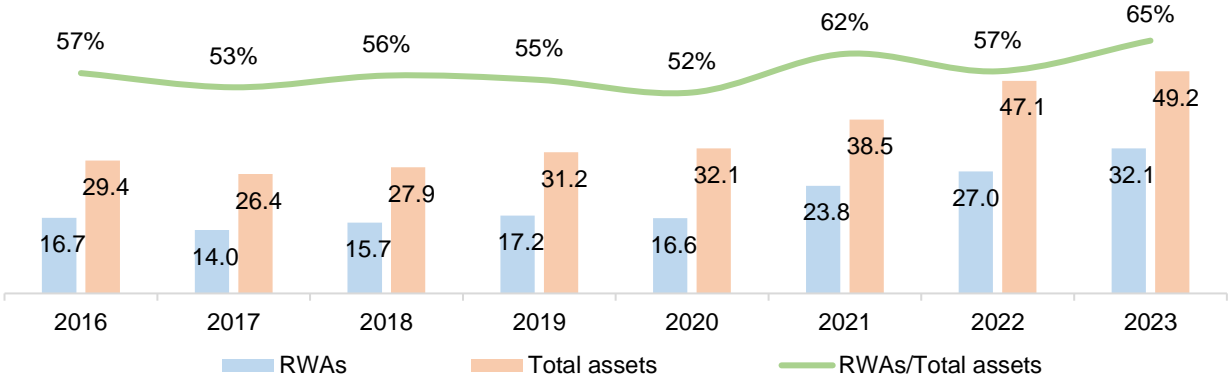
Chart 44. Dynamics of capital structure, million manats



Source: CBA

Risk weighted assets increased amid high lending dynamics. RWAs increased by 19% (AZN5.1B) against the backdrop of 4.5% (AZN2.1B) increase in total assets. As a result, the RWAs to total assets ratio increased by 8 pp to 65%. RWAs increased on the backdrop of lending activity of banks. 93.8% of RWAs were formed on credit risks, 5.5% on operational risks and 0.7% on market risks.

Charts 45. Dynamics of assets and RWAs, million manats



Source: CBA

Assessment of banking system resilience

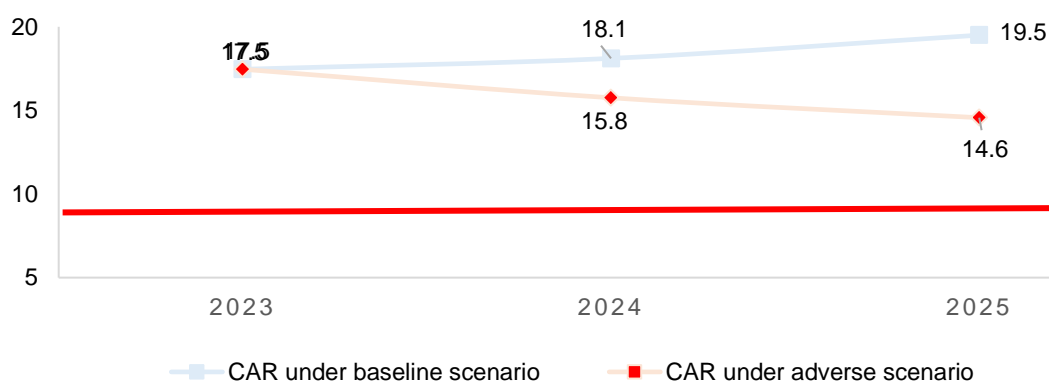
Banking sector resilience to external shocks was assessed through stress testing.

A top-down stress testing was conducted to evaluate banks' capital resilience and define relevant mitigation and policy measures under various unfavorable macro finance scenarios.

To determine the impact of macroeconomic factors on banks' resilience under stress-test conditions, a pessimistic scenario was developed, considering the baseline scenario and the extreme but plausible approach. Macroeconomic indicators forecasted based on scenarios, were integrated into the econometric satellite models, and the dependent variables were projected for coming years (NPL ratios, interest rates, etc.). Simulations were performed based on projected dependent variables to assess credit, interest rate, exchange rate, and securities' repricing risks. The financial situation of banks for the following years was then evaluated on a dynamic basis.

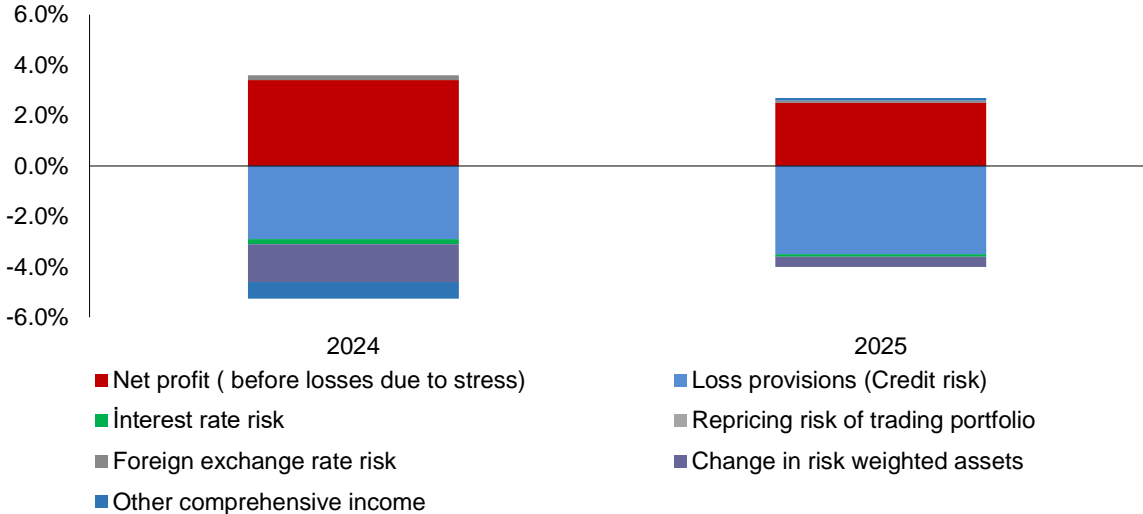
Based on stress testing findings, banking sector's current capital buffer can absorb potential losses. Under the baseline scenario, the CAR stands at 18.1% in 2024 with stable growth in the following year enabling it to reach 19.5% in 2025. Under the pessimistic scenario, the banking sector's CAR will decrease by 1.7 pp and 1.2 pp. to 15.8% and 14.6% in 2024 and 2025, respectively. Overall, whereas the banking sector has undergone capital erosion according to stress testing, its CAR exceeds minimum requirements.

Chart 46. Banking system's capital adequacy according to stress testing



Source: CBA

Chart 47. Channels of impact on the CAR under the pessimistic scenario



Source: CBA

According to stress testing findings, main channels of the impact on banks’ capital adequacy included the credit risks and changes in RWAs.

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

	2022 Q4	2023 Q1	2023 Q2	2023 Q3	2023 Q4
Balance sheet indicators					
Total assets	47,055	44,843	45,218	45,530	49,178
Liquid assets	17,242	14,249	13,985	13,368	13,154
Lending portfolio	19,594	20,039	21,296	22,282	23,183
Business loans	10,855	10,971	11,651	12,079	12,617
Consumer loans	5,754	5,942	6,325	6,680	6,937
Mortgage loans	2,985	3,125	3,321	3,523	3,629
Total liabilities	41,433	38,994	39,306	39,539	43,115
Current liabilities	27,048	25,447	25,375	24,322	23,687
Deposits of individuals	11,483	11,719	12,473	12,418	12,582
Term deposits	6,204	6,311	6,596	6,745	6,882
Demand deposits	5,279	5,408	5,877	5,673	5,700
Deposits of legal entities	22,280	20,214	19,584	19,756	21,968
Term deposits	2,578	2,894	3,478	3,860	4,500
Demand deposits	19,702	17,320	16,106	15,896	17,468
Equity	5,622	5,849	5,913	5,991	6,063
Capital position					
Tier I Capital	4,098	4,935	4,710	4,513	4,319
Total regulatory capital	5,201	5,420	5,537	5,599	5,618
RWAs	26,977	28,505	29,995	30,301	32,085
Tier I capital adequacy ratio	15.2%	17.3%	15.7%	14.9%	13.5%
Total regulatory capital adequacy ratio	19.3%	19.0%	18.5%	18.5%	17.5%

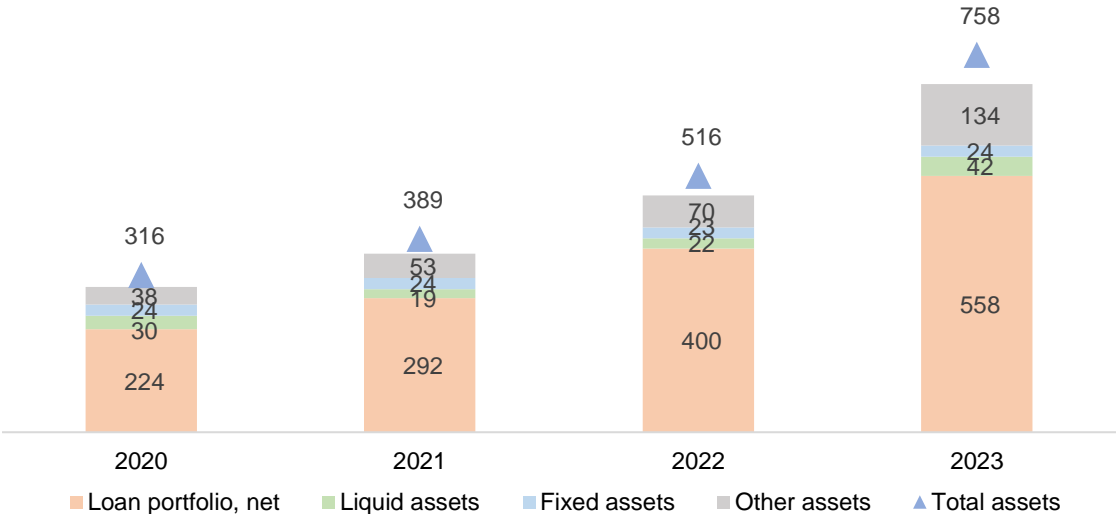
	2022 Q 4	2023 Q1	2023 Q2	2023 Q3	2023 Q4
Profitability					
Net profit	914	268	563	833	1076
ROA	2.2%	2.3%	2.5%	0.2%	2.4%
ROE	18.9%	20.3%	21.3%	1.5%	20.3%
Liquidity risk profile					
Liquid assets	17,242	14,249	13,985	13,368	13,154
Liquid assets to total assets	36.6%	31.8%	30.9%	29.4%	26.7%
Instant liquidity ratio	59.9%	54.8%	56.6%	55.1%	52.2%
Credit risk profile					
Non-performing loans	735	750	730	770	614
Business loans	507	506	475	516	378
Consumer loans	185	198	215	214	197
Mortgage loans	43	45	40	41	39
Non-performing loans ratio	3.8%	3.7%	3.4%	3.5%	2.6%
Business loans	4.7%	4.6%	4.1%	4.3%	3.0%
Consumer loans	3.2%	3.3%	3.4%	3.2%	2.8%
Mortgage loans	1.4%	1.5%	1.2%	1.2%	1.1%
Market risk profile					
Assets dollarization	40.5%	37.6%	35.9%	32.0%	33.7%
Liabilities dollarization	45.0%	42.2%	40.0%	36.1%	37.3%
* Calculated based on prudential reporting methodology.					

Non-bank credit institutions

Although the share of non-bank credit institutions in (NBCIs) in financial sector assets increased, their role in financial intermediation remains small. The market share of NBCIs in the financial system in terms of assets constituted 1.5%⁵. In 2023 licenses of three NBCIs were revoked, and new licenses were issued for two NBCIs. Accordingly, the number of active NBCIs decreased to 94 from 95. 15 out of currently active NBCIs are with foreign capital, and in 12 of them the share of foreign capital is over 50%. As of end 2023 NBCIs numbered 54, and credit unions (CUs) numbered 40. The number of NBCI employees increased by 430 persons to 3289 persons and the number of branches increased by 9 to 296.

In 2023 the balance sheet of the NBCI sector expanded driven by net lending portfolio. Total assets of NBCIs operating throughout the country increased by 47% (AZN242M) to AZN758M, owing to the net lending portfolio. The net lending portfolio increased by 40% (AZN158M), at the expense of consumer loans (6+3%, or AZN100M).

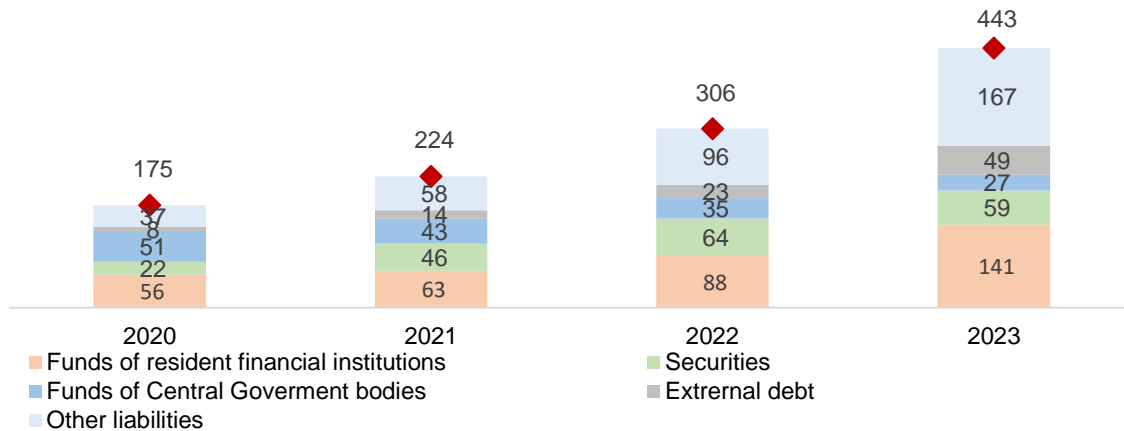
Chart 48. Dynamics of assets of NBCIs, million manats



Source: CBA

⁵ The Agrarcredit CJSC was excluded from the analysis of NBCIs.

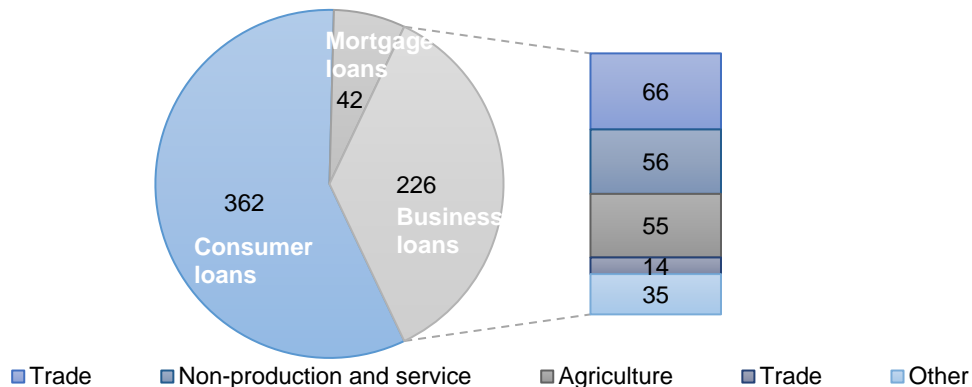
Chart 49. Dynamics of liabilities of NBCIs, million manats



Source: CBA

Funds attracted from banks and other financial institutions increased assets of NBCIs. Total NBCI assets increased by 45% (AZN137.5M) to AZN443M, driven by the loans of resident and non-resident banks and other financial institutions (AZN80M). The share of other liabilities was high in the rise in NBCI liabilities as well. Other liabilities y.o.y. increased by 73% (AZN70.5M), the main part of which was comprised of the debt provided to NBCIs by founders.

Chart 50. Lending portfolio structure of NBCIs, million manats



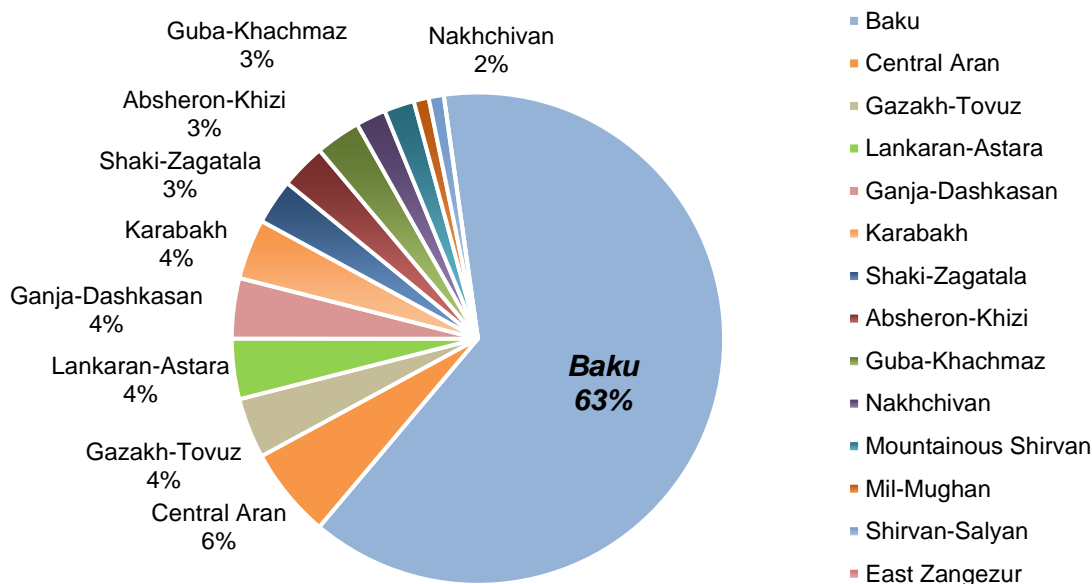
Source: CBA

In 2023 consumer loans continued to take the main portion of the NBCIs' portfolio. The lending portfolio increased by 36% (AZN160M) to AZN601M. Consumer loans y.o.y. increased by 38% (AZN100M), business loans by 28% (AZN49.3M). Property (mortgage) loans accounted for the remaining part of the growth. As of end-2023 the NBCIs' lending portfolio was comprised of consumer loans (60.3%, or AZN362M), business loans (37.6%, AZN226M) and mortgage loans (2.1%, or AZN12.5M). Trade accounted for

29.1% (AZN66M), non-production and services for 24.7% (AZN56M) and agriculture for 24.4% (AZN55M) of the business portfolio.

The lending portfolio quality improved amid the portfolio growth. In 2023 the sector’s NPL portfolio increased by 11.6% to AZN74.3M. The NPL ratio decreased by 2.7 pp. to 12.4%. The NPL portfolio decreased by 0.5 pp to 11.8 % on consumer loans and by 5.3 pp to 13.9% on business loans.

Chart 51. Lending portfolio distribution across economic regions

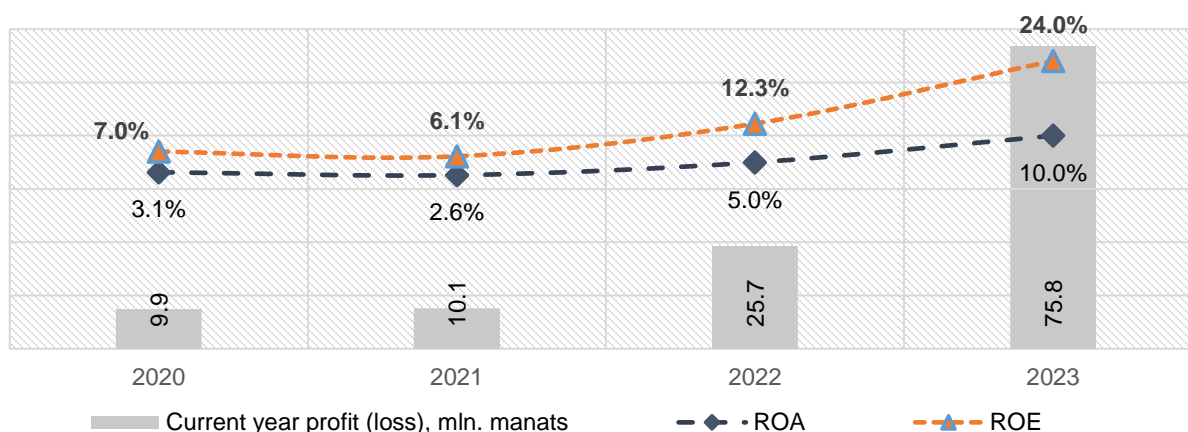


Source: CBA

NBCIs are engaged in regional lending more actively than banks. In 2023 loans issued across economic regions accounted for 37% of the lending portfolio. The similar indicator stood for 23% for banks.

Profit of the NBCI sector reached historical highs. In 2023 NBCIs earned high profit, y.o.y. up by three times. In addition to the increased interest income from the growth of the loan portfolio, the improvement in operational efficiency of credit institutions was one of the main factors contributing to high profitability of the sector. Sector's ROA and ROE indicators y.o.y. increased by two times to 10% and 24% respectively.

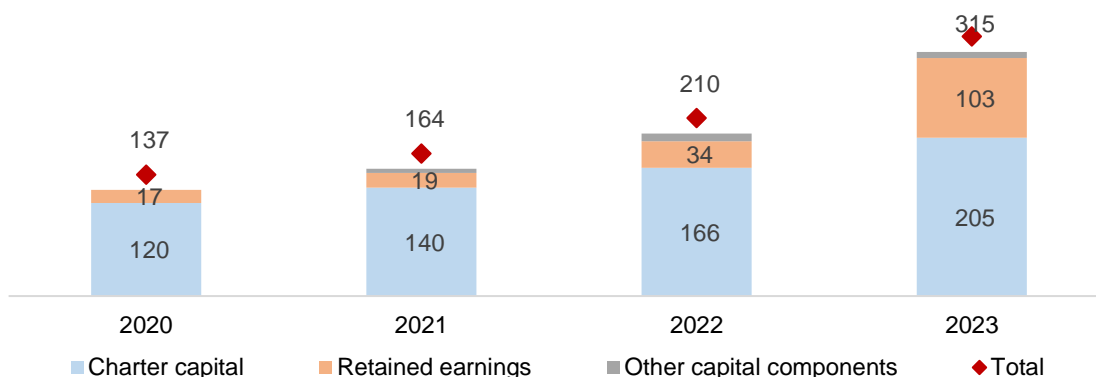
Chart 52. NBCIs' profitability indicators



Source: CBA

The sector's capital position continues to follow a positive trend amid rising profitability. NBCI's capital increased by 50% (AZN105M) to AZN315M, driven by both capital injection and profit generation of the NBCI sector. Retained earnings increased by about three times (AZN69M) to AZN103M, and charter capital increased by 23% (AZN39M) to AZN205M.

Chart 53. Dynamics of capital components across the NBCI sector, million manats



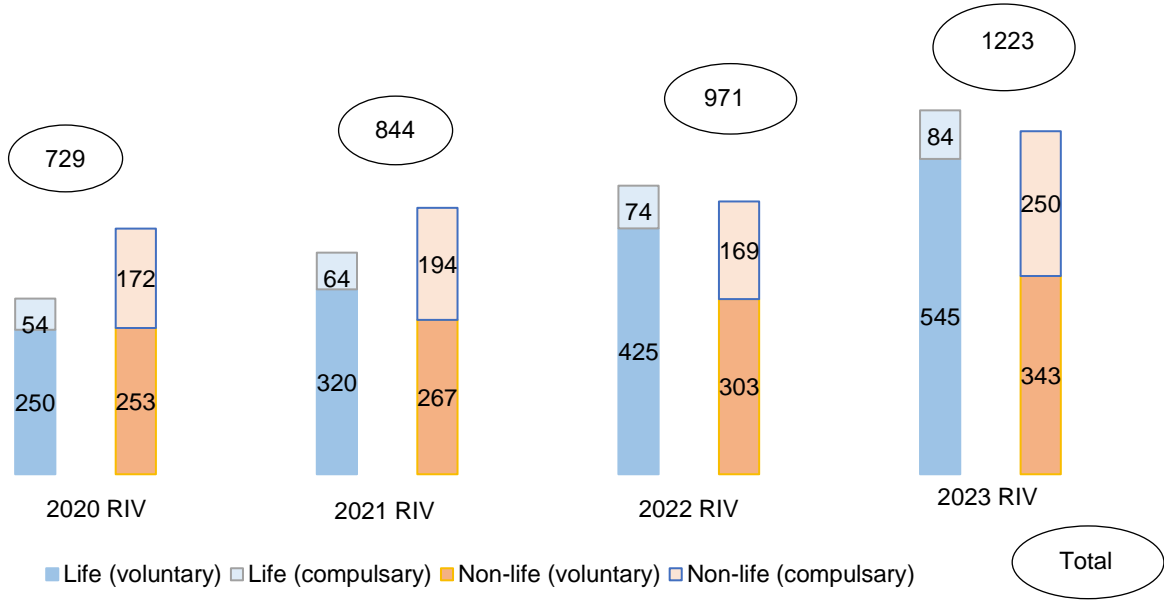
Source: CBA

Insurance sector

As of end-2023 there were 18 insurance and one reinsurance companies in the Azerbaijani insurance market – 5 life and 13 non-life insurance companies. Insurance sector activities were also provided through 24 insurance brokers and 481 insurance agents.

The growth potential of the insurance sector is being realized. As of end-2023 insurance premiums collected y.o.y increased by 26% (AZN252M) to AZN1223M. Life insurance premiums increased by 26 % to AZN629M, and non-life insurance premiums increased by 26% to AZN593M. Life insurance increased at the expense of voluntary insurance classes, and non-life insurance at the expense of compulsory insurance classes. While insurance premiums collected in the sector increased, the growth stemmed from the limited number of companies.

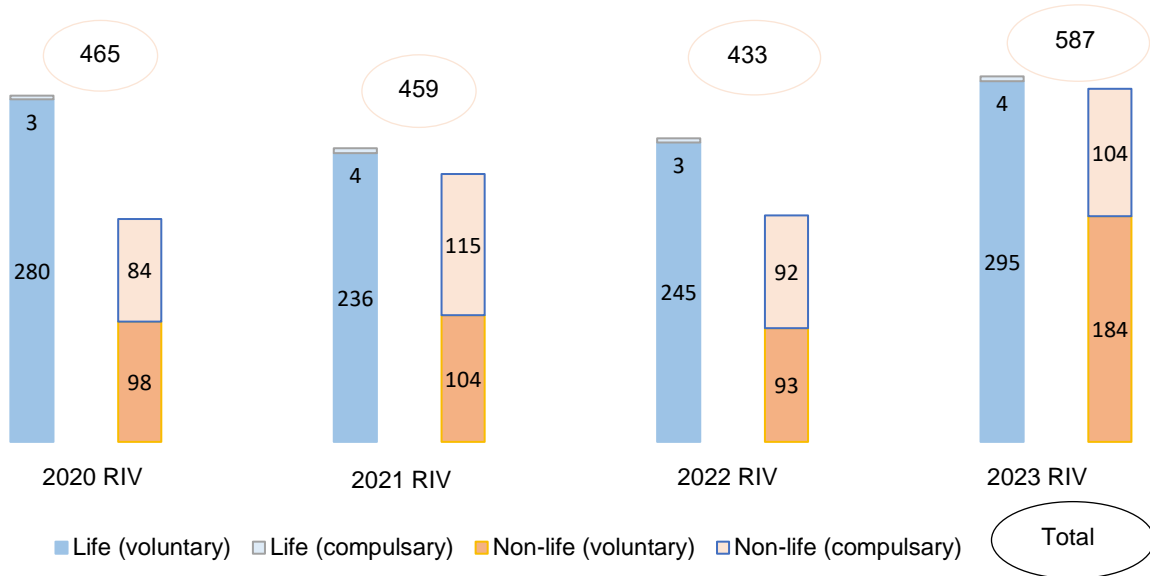
Chart 54. Dynamics of insurance premiums, million manats



Source: CBA

Insurance payments increased in 2023. Payments y.o.y. increased by 36% (AZN154M) to AZN587M mainly on endowment life insurance (AZN50M) and fire and other risks insurance (AZN74M).

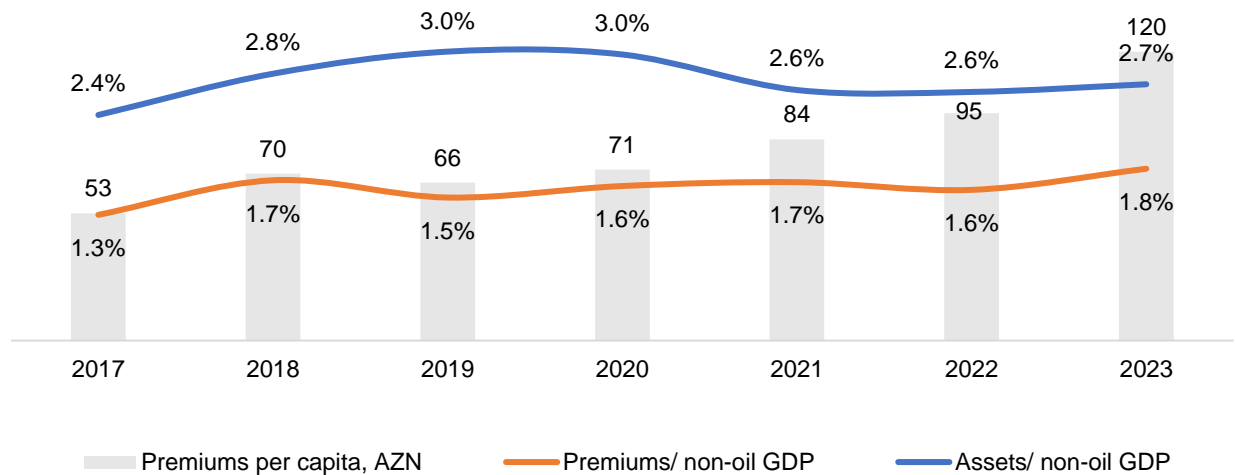
Chart 55. Dynamics of insurance payments, million manats



Source: CBA

Positive dynamics in collections improved penetration and depth indicators across the insurance sector. Per capita insurance premiums increased by 26.3% to AZN120 compared with the end of the previous year.

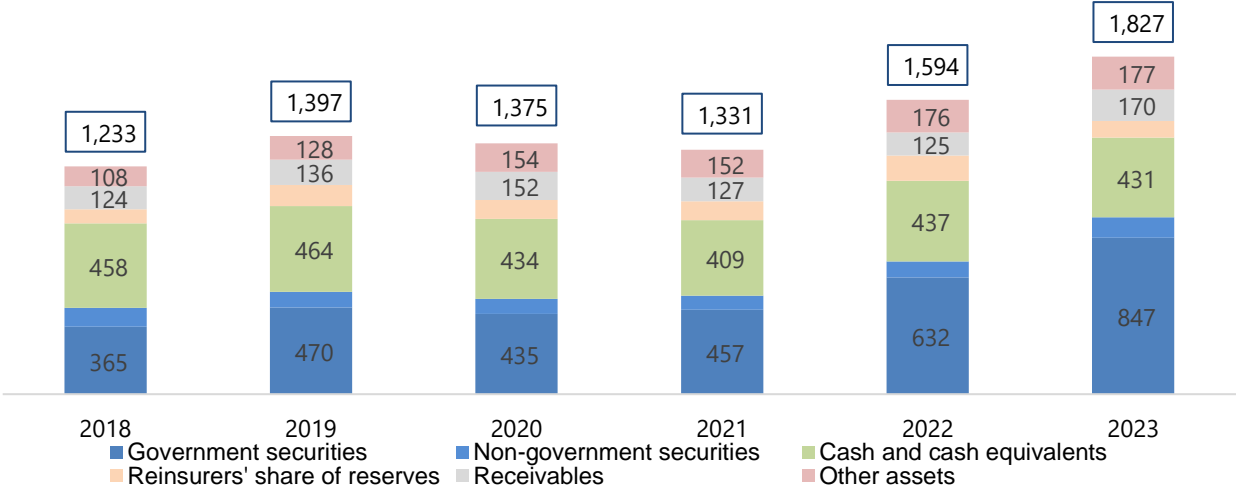
Chart 56. Insurance sector penetration



Source: CBA

Sector's assets follow a positive trend amid the market expansion. Insurance sector assets increased by 15% (AZN233M) to AZN1,827M – government securities 46% (AZN847M), bank funds 24% (AZN431M) and receivables 9% (AZN170M).

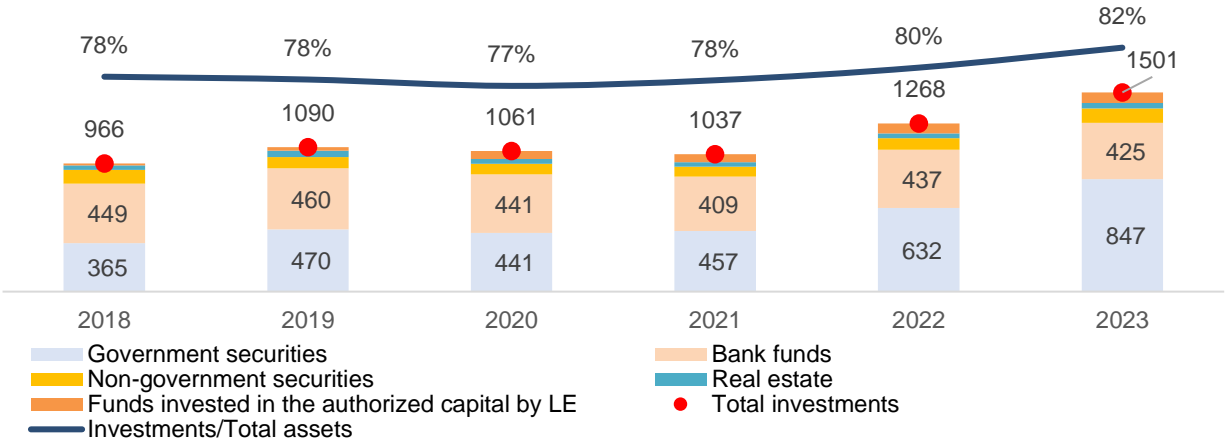
Chart 57. Asset structure and dynamics



Source: CBA

Insurance companies are realizing their potential as institutional investors. Insurance company investments increased by 18% (AZN233M) to AZN1,501M compared to the end of the previous year, driven by government securities (AZN215M). In general, the investment portfolio accounts for 91% of life insurance company assets and 73% of non-life insurance company assets. Investment assets of insurance companies mainly comprise of government securities and bank funds. In 2023 the insurance sector earned AZN85M worth income from investment activities (6% of total income). A new 'Regulation on investment operations of insurers' was approved by the decision of the Management Board of the CBA dated 25 October 2023 to increase the effectiveness of investment activities of insurance companies. The new Regulation outlines instances regarding investment procedures by investment companies and determines diversification ratios in total regulatory capital and requirements for the quality of invested assets.

Chart 58. Investment portfolio structure and dynamics, million manats

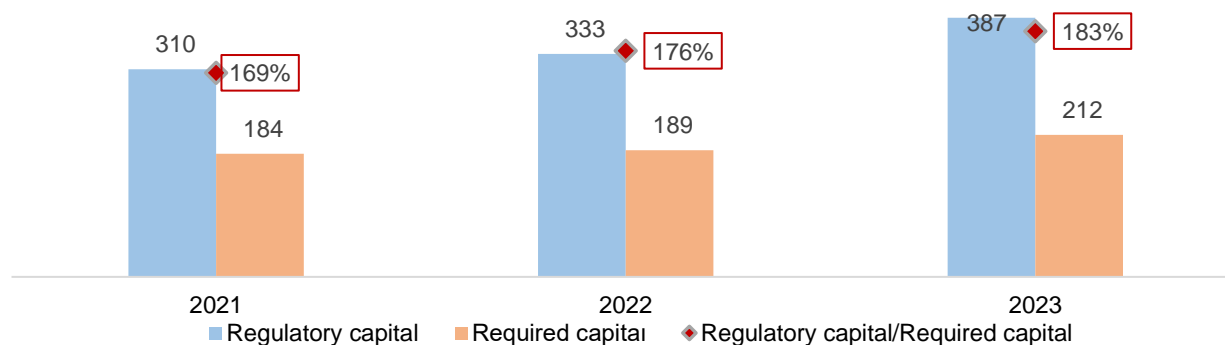


Source: CBA

Profitability of insurance companies increased. Both life and non-life insurance companies generated more profit year-over-year. Growth in non-life insurance companies was more noticeable. The reason for the increase in both groups was the rise in main operating income.

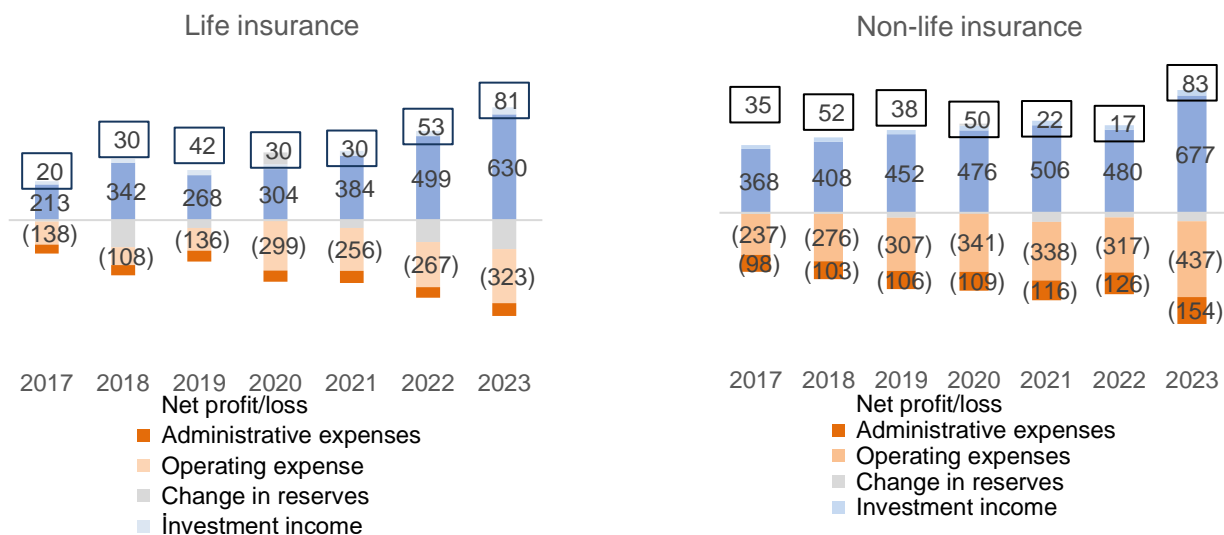
Over the reporting year sector's total regulatory capital and capital buffer grew. In 2023 insurance sector's total regulatory capital increased by 12% (AZN54M). The total regulatory capital to required capital ratio increased by 7 pp to 183%.

Chart 60. Dynamics of total regulatory capital and required capital



Source: CBA

Chart 59. Insurance sector profitability

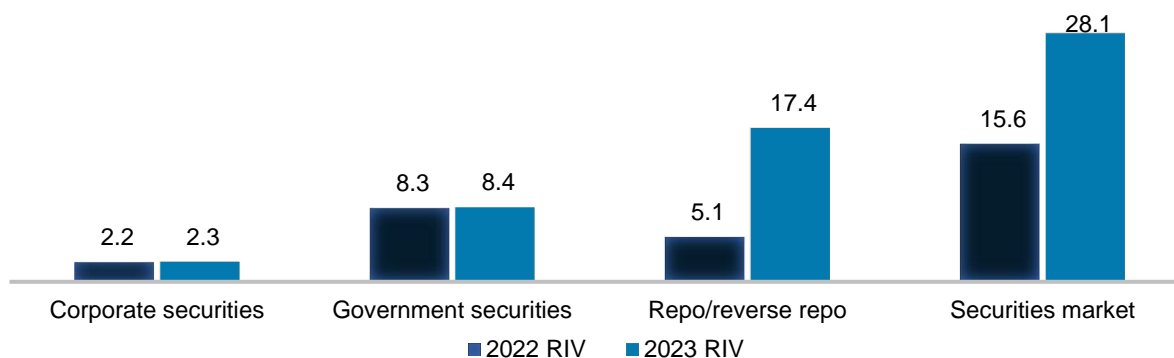


Source: CBA

Capital market

The turnover of securities increased year-over-year owing to Repo and reverse Repo operations. Trade turnover of the securities market y.o.y. increased by 80% to AZN28.1B, due to Repo and reverse Repo operations. Repo and reverse Repo transactions y.o.y. increased by 2.3 times (AZN12.3B) to AZN17.4B. The introduction of the new monetary framework also contributed to the growth of Repo and reverse Repo transactions. There has been no considerable change in the size of government and corporate securities market over the reporting year.

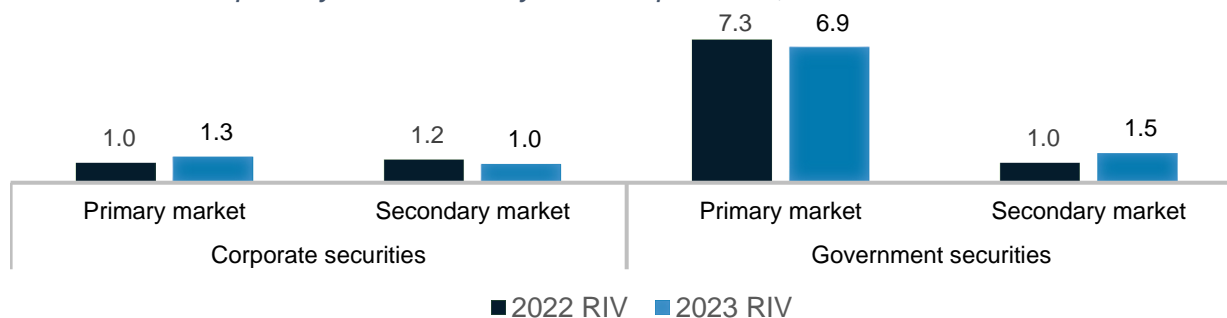
Chart 61. Capital market turnover, billion manats



Source: CBA

The primary market was more active on the corporate securities market and the secondary market was more active on the government securities market. The primary market turnover of the corporate securities market increased by 32% to AZN1.3B, and the secondary market turnover of the government securities market increased by

Chart 62. Size of primary and secondary market operations, billion manats

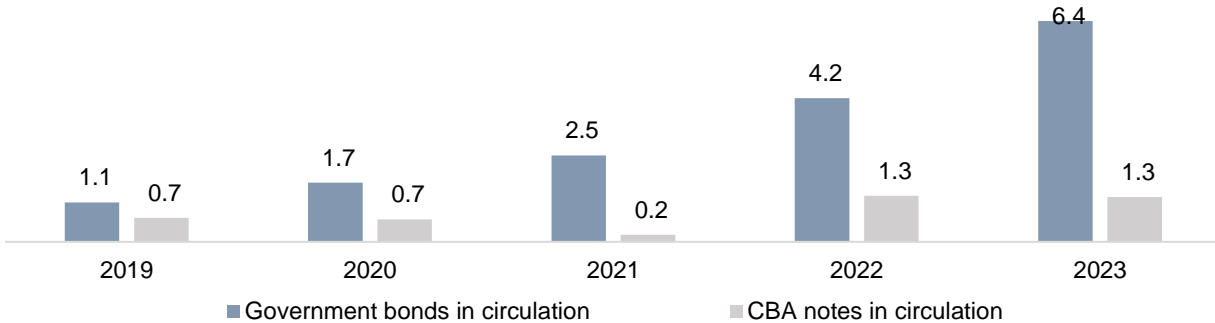


49% to AZN1.5B.

Source: CBA

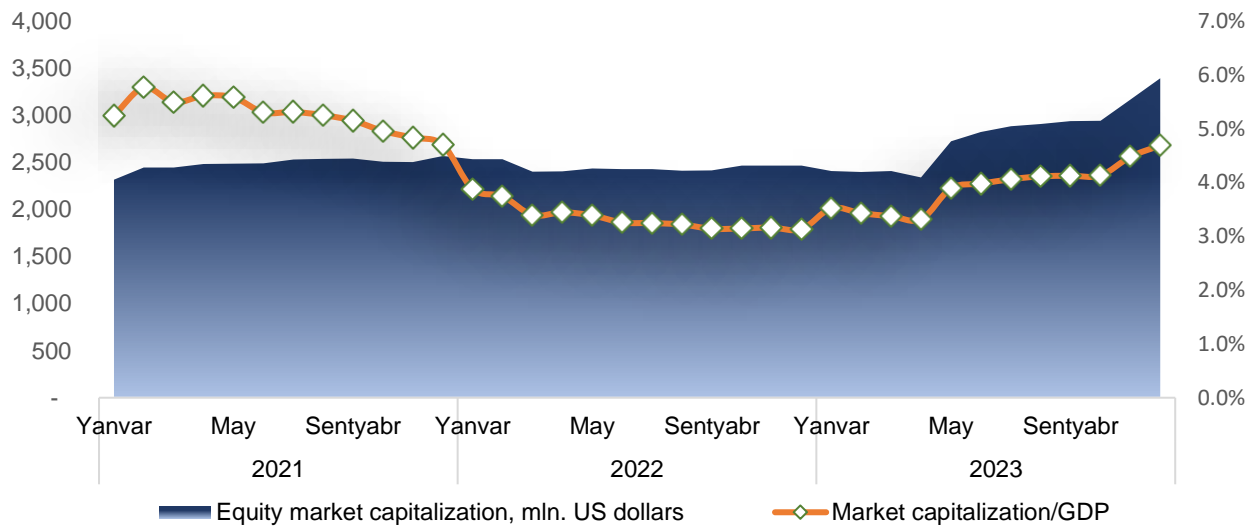
The volume of government securities in circulation increased by 40% to AZN7.7B y.o.y., driven by government bonds. In 2023 government bonds in circulation y.o.y. increased by 53% (AZN2.2B) to AZN6.4B. Government bonds increased at the expense of the issuance of long-term government securities.

Chart 63. Dynamics of government bonds in circulation, billion manats



Source: CBA

Chart 64. Stock market capitalization (in million US dollars) and penetration

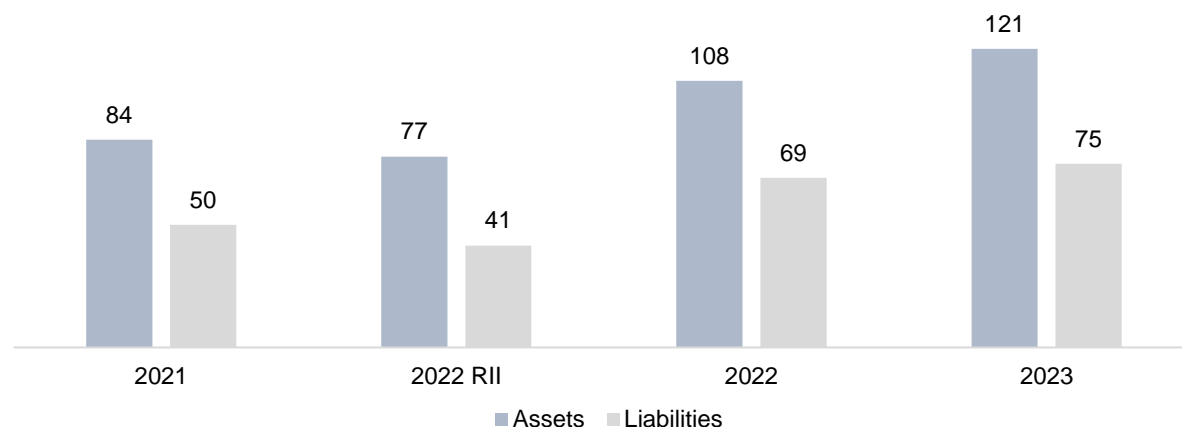


Source: CBA

The potential for the growth of capital market depth remains high.

Balance sheets of investment companies expanded in 2023. Investment company assets y.o.y. increased by 12% to AZN121M, and liabilities increased by 9% to AZN75M.

Chart 65. Dynamics of investment company balance sheets, million manats

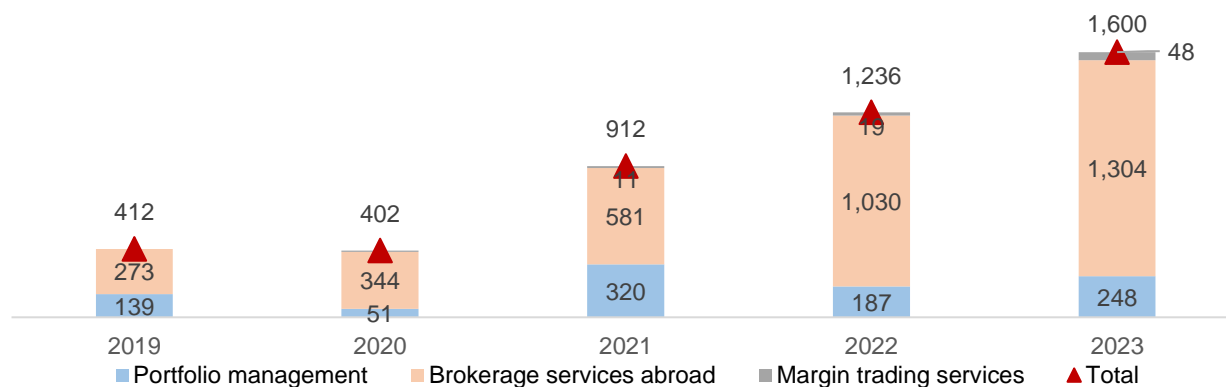


Source: CBA

Investment companies' customer assets expanded over the period. Customer assets of investment companies y.o.y. increased by 29% (AZN360M) to AZN1,600M, due to broker services in the foreign market. Customer assets on broker services in the foreign market increased by 27% (AZN274M). Although customer asset growth is a positive development, customer assets are highly concentrated in the sector.

Profitability of investment companies decreased. In 2023 net profit of investment companies amounted to AZN7.7M, y.o.y. down by 16%. Growth of assets and liabilities amid the drop in net profit of the sector, contributed to the fall in profitability indicators. ROA y.o.y. decreased by 2.0 pp to 6.4%, and ROE decreased by 6.7 pp to 16.5%.

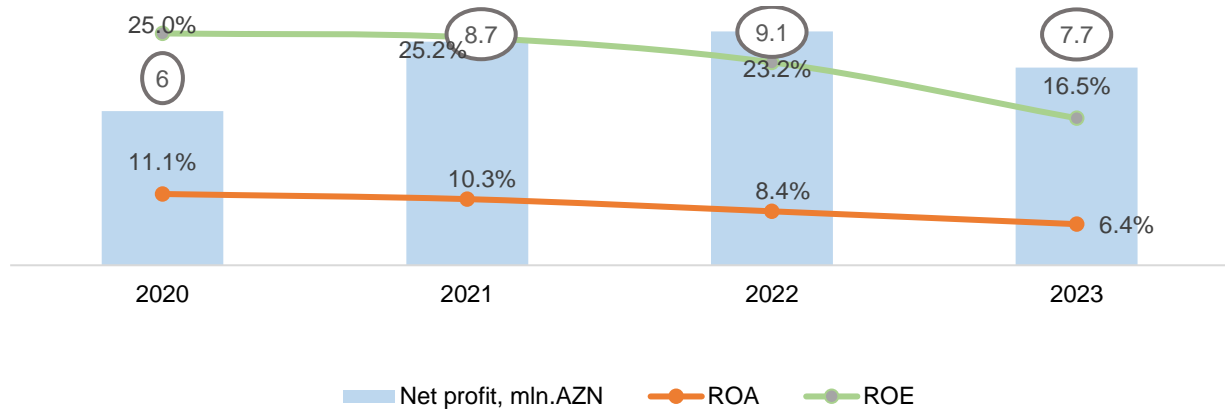
Chart 66. Dynamics of customer assets of investment companies, million manats



Source: CBA

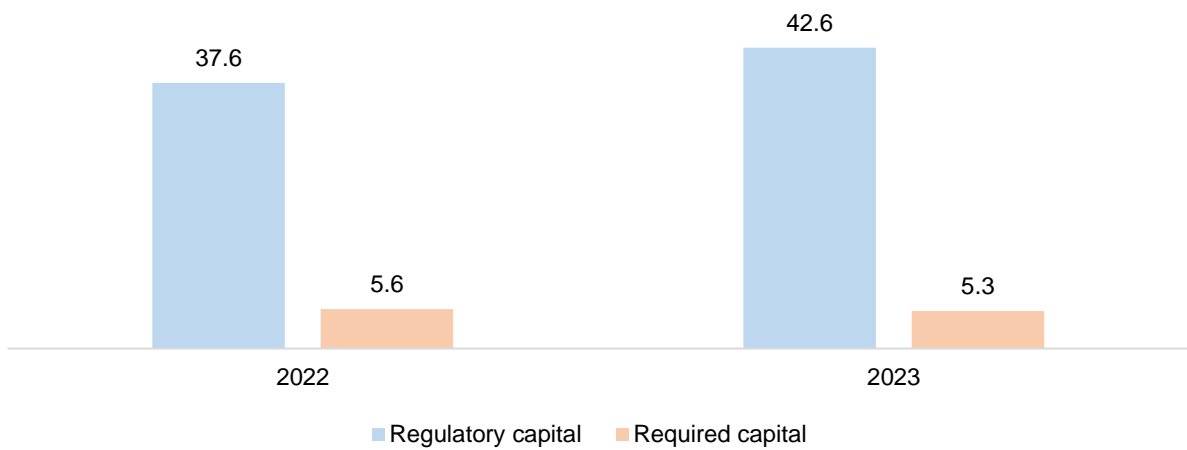
The capital position of investment companies is in a comfort zone. As of end-2023 sector’s total regulatory capital amounted to AZN42.6M, and required capital amounted to AZN5.3M, attributable to the fact that investment companies have a sufficient capital buffer.

Chart 67. Profitability of investment companies



Source: CBA

Chart 68. Dynamics of total regulatory capital and required capital, million manats



Source: CBA

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