

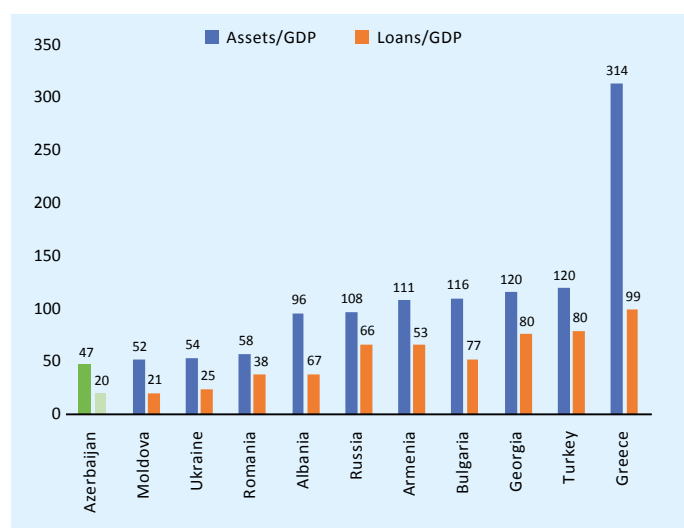
Overview of the financial sector in Azerbaijan



The financial sector in Azerbaijan mostly consists of commercial banks. Banks hold more than 90% of total financial sector assets. Other financial institutions such as insurance, stock exchange, etc. are rather small and do not have a significant influence on the health of the financial sector. Therefore, the following analysis will focus on commercial banks only¹.

The size of the banking sector relative to the economy in Azerbaijan is small. The ratio of total banking sector assets to GDP as of 2020 was 47%, which is the lowest among BSTDB member countries and the wider region. Even after excluding the oil and gas sector, the dominant sector in Azerbaijan, the total assets to non-oil GDP stands at 66%, which is still very low compared to other countries. The volume of loans extended by banks to the economy amount to only 20% of GDP, pointing to the low financial penetration in the country.

Figure 1. Total banking sector assets and loans to GDP as of 2020 (%)



Source: Websites of respective central banks, IMF World Economic Outlook Database

The concentration in the banking sector is high with the 4 largest banks holding more than 60% of total banking sector assets. At end-2020, there were 26 banks in Azerbaijan, of which 7 were majority foreign-owned and two majority state-owned banks. The sector reported a profit of AZN 568 mln in 2020 that is 12% of equity capital. Similar profitability was recorded in 2019².

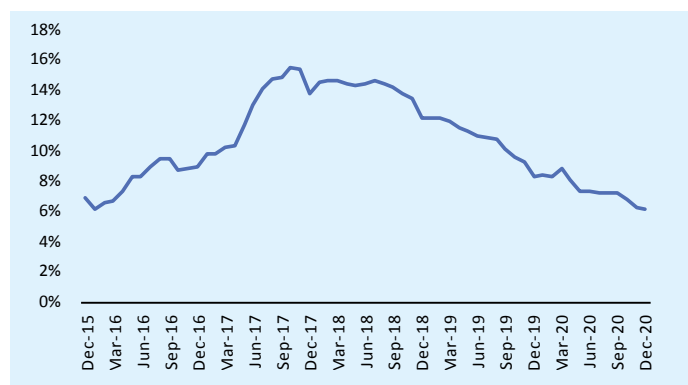
The share of loans in the total banking sector assets is relatively low at 43%, while the share of liquid assets was around 50% at the end of 2020. Banks' funding mostly consists of deposits, that account for 76% of total liabilities, of which 29% are retail deposits and 46% are corporate funds. Another 18% of the total liabilities are claims of other financial institutions and securities issued.

¹ The present analysis is limited with data availability as most of the data on financial soundness indicators is not available for Azerbaijan.

² Statistical bulletin 03/2021, Central Bank of Republic of Azerbaijan.

After the oil price drop in 2014 and consequent regional shock and economic crisis, overdue loans on banks' balance sheets started to rise and reached 16% of the total credit portfolio by the end of 2017. Since then overdue loans have declined and by the end of 2020, they accounted for 6% of total loans. It should be noted that according to IMF staff report, September 2019 overdue loans do not fully reflect actual NPLs in the system.

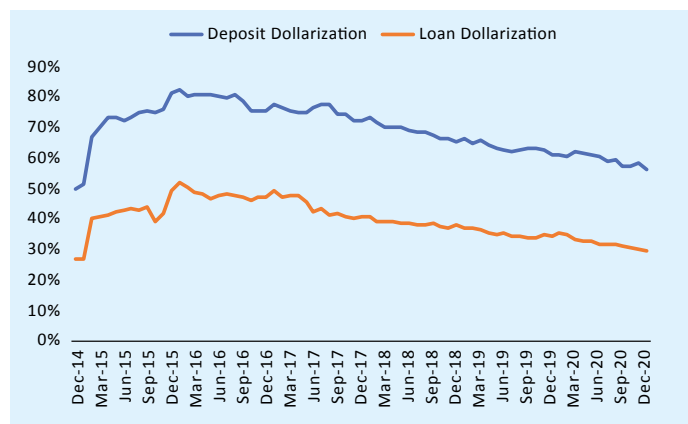
Figure 2. Overdue loans as a share of the total loans (%)



Source: Central Bank of Republic of Azerbaijan

Dollarization remains a challenge for the Azerbaijani banking sector. After the devaluation of the manat in 2015 by about 100% against the USD, dollarization jumped to 82% for deposits and 49% for loans. However, since 2015 dollarization has declined somewhat both for loans and deposits but at the end of 2020 it was still at a relatively high level. Dollarization cannot be eliminated quickly; it is a long-term challenge and as the credibility in domestic currency increase it will continue to decline further.

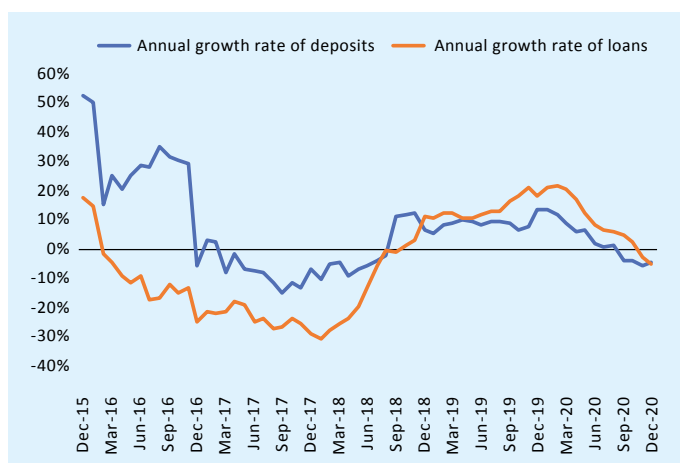
Figure 3. Dollarization for loans and deposits



Source: Central Bank of Republic of Azerbaijan

The economic crisis of 2015 led to the failure of some of the financial institutions, more than 10 commercial banks were closed in 2016. Bank closures and cleaning up of banks' balance sheets from bad loans resulted in the size of the banking system shrinking significantly by around 20% in 2016-2017. This, in turn, was reflected in the negative growth rates of credit and deposit aggregates. For 2015 and 2016 the total credit portfolio of the banking system decreased by 40%. The growth of the banking sector that started in 2018 was hit again in 2020 as the COVID-19 related challenges worsened. For the whole of 2020, loans declined by 5% and deposits declined by 4.4%. Despite significant shock to the economy and financial sector dollarization continued to decline in 2020. One reason for the latter is that Azerbaijan was able to maintain stability in the foreign exchange market and manat did not lose value against USD in contrast to other countries in the region.

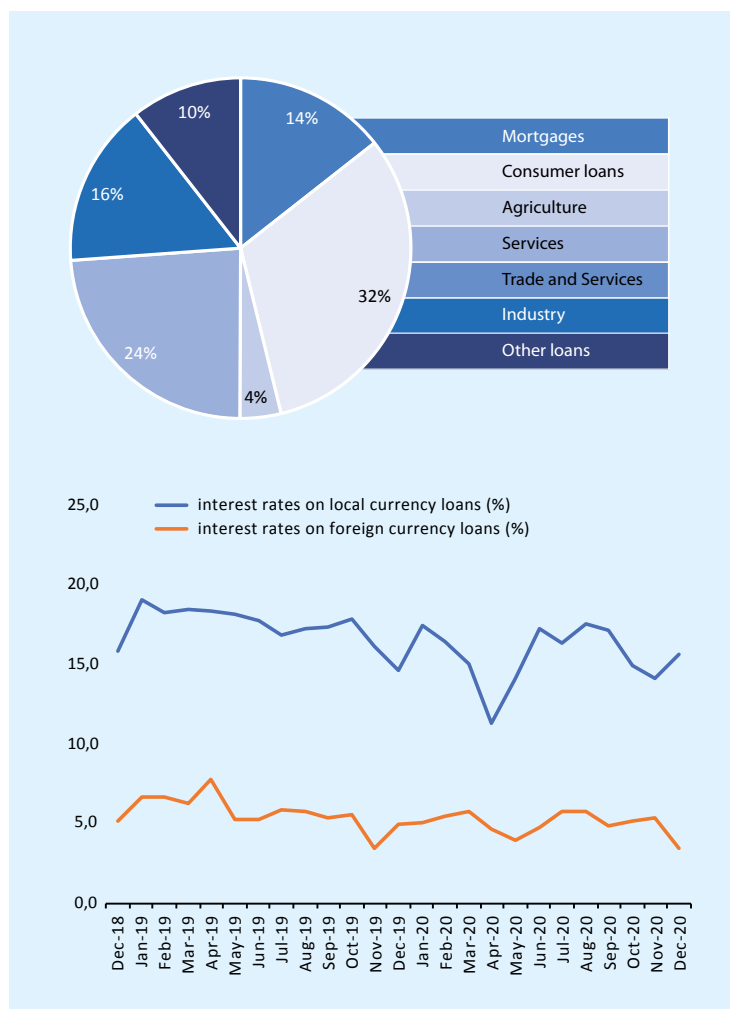
Figure 4. Growth rates of loans and deposits



Source: Central Bank of Republic of Azerbaijan

Loans to households in 2020 accounted for 46% of the total credit portfolio, out of which 32% were consumer loans and 14% – mortgages. The share of corporate borrowers in total loans is 51%, a level that is relatively low compared with peer countries. The trade and services sector has the largest share in corporate loans with 25% of the total portfolio. A relatively lower share of total loans is invested in other sectors such as industry and agriculture. Interest rates are relatively stable for the last two years both for manat and US dollar loans. In 2020 interest rates on manat loans were 15.6% while for foreign currency loans they were 5% on average.

Figure 5. The structure of the credit portfolio and interest rates



Source: Central Bank of Republic of Azerbaijan

To conclude, the banking sector in Azerbaijan is a relatively small sector of the economy with loans amounting to only 20% of GDP, out of which around half are loans granted to households. Although the exact data on actual NPLs is not available, the volume of overdue loans in banks' balance sheets indicates that the level of NPLs remains a challenge for the banking sector. Another challenge of the banking sector is dollarization which, while declining for the last 5 years, is still at a relatively high level.