https://doi.org/10.58225/tim.2025-2-19-24

Sh.N.Mammadov
head teacher, Azerbaijan University of Architecture and Construction
ORCİD 0009-0006-0483-0628
shaban.mammadov@azmiu.edu.az
I.I.Guliyev
master student, Azerbaijan Architecture and Construction University
ORCİD 0009-0002-9071-9424
ilqarquliyem@gmail.com

Məqalə redaksiyaya daxil olub 08.04.2025
The article was received by editorial board on 08.04.2025
Статья принята к печати 08.04.2025

CURRENT STATE OF FİNANCİAL STABİLİTY İN AZERBAİJAN

Abstract

Financial stability plays a pivotal role in ensuring the resilience of national economies and the sustainability of financial systems, particularly in emerging markets. In the case of Azerbaijan, the evolution of financial stability has been closely tied to structural reforms in the banking sector, macroeconomic fluctuations, and global economic dynamics. This paper explores the current state of financial stability in Azerbaijan through the lens of institutional frameworks, market dynamics, and systemic risks.

The study analyzes the recent performance of the banking and non-banking financial sectors, identifies key macroeconomic and regulatory factors influencing financial stability, and evaluates the resilience of the financial system in the face of internal and external shocks. Special attention is given to the Central Bank of Azerbaijan's policy responses, prudential regulation practices, and the gradual integration of ESG (Environmental, Social, and Governance) principles into financial supervision.

The research employs a qualitative-analytical approach, utilizing data from national sources such as CBAR, as well as international financial institutions (IMF, World Bank, BIS). The findings suggest that although significant progress has been made in enhancing financial stability since the 2015 devaluation crisis, challenges such as inflationary pressure, external economic dependence, and institutional gaps remain.

The paper concludes with a set of recommendations aimed at strengthening the financial architecture of Azerbaijan and ensuring sustainable financial stability through regulatory modernization and proactive risk management.

Keywords: *financial stability, Azerbaijan, banking system, macroeconomic risks, systemic risk, regulatory policy, ESG.*

INTRODUCTION

In recent decades, financial stability has emerged as a critical component of sustainable economic development, particularly for economies undergoing structural transformation (IMF, 2022). Financial stability is generally understood as a condition in which the financial system - including institutions, markets, and infrastructure - is capable of withstanding shocks and maintaining its core functions, such as credit allocation, payment facilitation, and risk management (BIS, 2021). A stable financial system fosters macroeconomic equilibrium, encourages long-term investment, and strengthens public confidence in financial institutions (Levine, 2005).

In the case of Azerbaijan, ensuring financial stability has become increasingly vital, especially in the aftermath of the 2015 devaluation crisis, which exposed systemic vulnerabilities in the banking sector. Since then, Azerbaijan has implemented a number of structural reforms and regulatory adjustments aimed at stabilizing its financial architecture. These efforts include prudential regulation, improved supervisory frameworks, and monetary policy enhancements (CBAR, 2023).

Nevertheless, emerging challenges such as inflationary pressure, high dependence on energy exports, and limited diversification continue to pose risks to financial resilience. Furthermore, global disruptions - including geopolitical tensions and climate-related financial threats - highlight the need for robust financial institutions and proactive policy frameworks (World Bank, 2023).

This study aims to assess the current state of financial stability in Azerbaijan by examining key economic indicators, institutional responses, and prevailing systemic risks. The research adopts a qualitative-analytical methodology, relying on data from national sources such as the Central Bank of Azerbaijan (CBAR) and international organizations like the IMF and BIS. The paper is structured as follows: Section 2 outlines the structure of Azerbaijan’s financial system; Section 3 identifies major risks to financial stability; Section 4 analyzes regulatory responses; and Section 5 concludes with policy recommendations.

Financial Stability in Azerbaijan: Current Landscape

The financial system of Azerbaijan has undergone significant transformations since the early 2000s, transitioning from a post-Soviet legacy structure to a more market-oriented and regulated framework. As of 2023, the country’s financial landscape is composed of the Central Bank of the Republic of Azerbaijan (CBAR), commercial banks, non-bank financial institutions (NBFIs), insurance companies, and capital market entities. Among these, the banking sector remains the dominant pillar, accounting for more than 90% of total financial system assets (CBAR, 2023).

Following the dual devaluation of 2015, which triggered systemic stress across the banking sector, Azerbaijan implemented a range of regulatory and structural reforms. Several undercapitalized banks were closed or merged, prudential supervision was tightened, and transparency standards were raised. The Financial Stability Council and Financial Monitoring Service were empowered to enhance macroprudential oversight, while the deposit insurance system was expanded to protect small depositors (World Bank, 2020).

In recent years, the Central Bank has also promoted financial inclusion and encouraged digitalization within the banking system. As a result, the share of non-cash transactions has steadily increased, and mobile banking platforms have become widely used. Nevertheless, access to financial services in rural areas remains limited, and credit penetration among small and medium-sized enterprises (SMEs) is relatively low (ADB, 2022).

The non-bank financial sector, including leasing and microfinance institutions, remains underdeveloped but shows gradual improvement in regulation and market participation. The insurance market is growing steadily, particularly in the compulsory insurance segment, yet it continues to face challenges in product diversification and public awareness.

Capital markets in Azerbaijan are still in an early stage of development. Although the Baku Stock Exchange operates with government and corporate securities, market liquidity remains limited. Institutional investor participation is weak, and secondary market activity is minimal. Nonetheless, ongoing reforms - such as the modernization of legal infrastructure and introduction of ESG-compliant instruments - indicate potential for future expansion (OECD, 2023).

Overall, while Azerbaijan has made progress in strengthening its financial system since 2015, structural weaknesses such as a narrow financial base, low financial literacy, and dependency on hydrocarbon revenues continue to constrain long-term financial stability. Further development of diversified financial markets and improved regulatory enforcement will be essential for enhancing resilience and attracting sustainable investment.

Key Risks Affecting Financial Stability in Azerbaijan

Despite notable progress in improving the regulatory framework and macroeconomic environment, Azerbaijan's financial system continues to face a range of internal and external risks that may undermine long-term stability. These risks span across macroeconomic volatility, sectoral vulnerabilities, institutional inefficiencies, and emerging global trends such as ESG-related exposures.

Azerbaijan's economy remains highly dependent on hydrocarbon exports, with oil and gas revenues accounting for over 85% of total export earnings and a significant share of budget revenues (State Statistical Committee, 2023). This dependence makes the financial system vulnerable to commodity price shocks, as witnessed during the 2015–2016 oil price slump and the 2020 pandemic-driven downturn.

Inflationary pressures have resurfaced in the post-pandemic period, driven by rising food and energy prices. Although the Central Bank has adopted inflation targeting mechanisms, price volatility continues to pose a challenge to monetary policy effectiveness and investor confidence (IMF, 2023).

The stability of the national currency, the Azerbaijani manat, is a key factor in preserving financial stability. The 2015 devaluation episodes significantly weakened public confidence in banks and triggered a sharp decline in deposit dollarization. Although exchange rate stability has improved in recent years, any renewed volatility may reignite systemic risks, especially in the context of foreign-currency-denominated loans and liabilities (CBAR, 2023).

Moreover, Azerbaijan's current account surplus is largely driven by oil exports, rendering the balance of payments sensitive to global market fluctuations. Weak diversification of the export base continues to constrain external resilience.

The banking sector remains moderately concentrated, with a few large banks dominating market activity. While capital adequacy and liquidity ratios have improved, challenges persist regarding asset quality and credit risk management - particularly in SME lending and consumer credit portfolios (World Bank, 2022).

Institutionally, gaps in coordination between regulatory bodies, limited enforcement capacity, and a lack of comprehensive risk disclosure mechanisms undermine transparency and oversight. Although the Financial Monitoring Service and Central Bank have intensified macroprudential supervision, data gaps and weak inter-agency integration limit the effectiveness of early warning systems.

Emerging risks related to environmental, social, and governance (ESG) factors are increasingly relevant for Azerbaijan. The financial sector has yet to fully integrate climate-related risks into its strategic planning and risk management frameworks. Physical risks such as droughts, floods, and environmental degradation may impact agriculture-dependent regions, while transition risks - related to carbon pricing or regulatory shifts - may affect energy-intensive sectors (UNDP, 2022).

Efforts to align with international ESG standards remain in early stages, and limited awareness among financial institutions poses challenges to effective implementation. Nonetheless, ongoing reforms indicate a growing recognition of sustainable finance as a long-term priority.

Regulatory Framework and Institutional Capacity in Azerbaijan

A well-functioning regulatory and institutional framework is essential for maintaining financial stability, especially in emerging economies where market discipline may be underdeveloped. In

Azerbaijan, the Central Bank of the Republic of Azerbaijan (CBAR) serves as the primary regulator and supervisor of the banking system, while additional oversight functions are shared with institutions such as the Financial Monitoring Service (FMS) and the Ministry of Finance. Since the 2015 devaluation crisis, CBAR has significantly enhanced its macroprudential supervision and monetary policy tools. Capital adequacy requirements have been revised, stress-testing procedures institutionalized, and liquidity management tools improved to bolster systemic resilience (CBAR, 2023). In addition, CBAR's inflation-targeting regime and interest rate corridor have strengthened monetary policy transmission and price stability. The establishment of the Financial Stability Council, coordinated by CBAR, has contributed to better macroprudential coordination and policy coherence. The Council plays a crucial role in systemic risk monitoring and inter-agency dialogue, although its legal powers remain limited. The Financial Monitoring Service (FMS), restructured in 2020, has adopted a risk-based approach to AML/CFT (Combating the Financing of Terrorism) supervision. This approach targets higher-risk institutions and transactions while enhancing transparency and compliance culture. Recent cooperation with international bodies such as MONEYVAL and the Financial Action Task Force (FATF) has supported the alignment of national frameworks with global standards (FMS, 2022). Despite progress, challenges remain in terms of data integration, cross-border transaction monitoring, and technological adaptation. Azerbaijan has undertaken multiple legal reforms aimed at harmonizing financial regulation with international standards. These include revisions to the “Law on Banks,” “Law on Insurance,” and the adoption of Basel III-aligned prudential norms. However, the practical enforcement of regulations remains uneven, particularly among non-bank financial institutions. Institutional fragmentation - such as overlapping responsibilities between supervisory bodies - has occasionally resulted in regulatory blind spots. Additionally, limitations in judicial independence and contract enforcement reduce investor confidence and hinder effective dispute resolution (World Bank, 2021). An emerging dimension of institutional development in Azerbaijan is the gradual integration of ESG (Environmental, Social, Governance) considerations into regulatory discourse. CBAR has launched awareness campaigns and begun pilot assessments of climate-related financial disclosures. However, ESG remains in its early stages of development, and financial institutions lack clear guidance on implementation.

Moreover, digitization and supervisory modernization are gaining momentum. The introduction of digital regulatory platforms, e-reporting, and early-warning systems are enhancing the speed and accuracy of supervisory responses.

CONCLUSION

The assessment of financial stability in Azerbaijan reveals a complex but evolving landscape shaped by post-crisis reforms, macroeconomic shifts, and regulatory transformation. The country’s financial system, heavily dominated by the banking sector, has shown notable improvement in areas such as capital adequacy, monetary policy effectiveness, and institutional oversight. The Central Bank of Azerbaijan has played a central role in stabilizing the system through prudential regulation and inflation-targeting mechanisms. However, the analysis also highlights persistent structural vulnerabilities. The economy’s dependence on hydrocarbon exports renders it susceptible to external price shocks and balance-of-payments volatility. Despite improvements in financial supervision, issues related to institutional coordination, transparency, and legal enforcement continue to limit overall systemic resilience. Furthermore, capital markets remain underdeveloped, and non-bank financial institutions contribute only marginally to financial intermediation. The integration of ESG principles into the financial regulatory framework is still in its early stages, indicating the need for strategic alignment with global standards. Overall, while Azerbaijan has made measurable progress in enhancing financial stability since the 2015–2016 crisis period, the system remains exposed to both domestic and global risks. Continued attention to regulatory modernization, diversification of financial instruments, and institutional strengthening will be essential to ensure long-term financial resilience and economic sustainability.

References:

1. Asian Development Bank (ADB). (2022). Azerbaijan: Country Partnership Strategy 2022–2026. https://www.adb.org

2. Bank for International Settlements (BIS). (2021). Annual Economic Report. https://www.bis.org

3. Bank for International Settlements (BIS). (2022). Financial Stability and Systemic Risks. https://www.bis.org

4. CBAR – Central Bank of the Republic of Azerbaijan. (2023). Financial Stability Review. https://www.cbar.az

5. Financial Monitoring Service (FMS). (2022). Annual Report on AML/CFT Measures in Azerbaijan. https://www.fms.gov.az

6. International Monetary Fund (IMF). (2022). Global Financial Stability Report. https://www.imf.org

7. International Monetary Fund (IMF). (2023). Inflation Dynamics in the Caucasus and Central Asia. https://www.imf.org

8. Levine, R. (2005). Finance and Growth: Theory and Evidence. *In P. Aghion & S. Durlauf (Eds.),* Handbook of Economic Growth (Vol. 1A, pp. 865–934). Elsevier.

9. MONEYVAL. (2021). Azerbaijan: Mutual Evaluation Report. Council of Europe. https://www.coe.int/en/web/moneyval

10. North, D.C. (1990). Institutions, Institutional Change and Economic Performance. Cambridge University Press.

11. OECD. (2022). ESG Integration in Financial Supervision: A Global Perspective. https://www.oecd.org

12. OECD. (2023). Capital Markets in Eurasia: Assessment and Outlook. https://www.oecd.org

13. State Statistical Committee of the Republic of Azerbaijan. (2023). *Macroeconomic Indicators*. https://www.stat.gov.az

14. Stiglitz, J.E. (2010). Freefall: America, Free Markets, and the Sinking of the World Economy. W.W. Norton & Company.

15. UNDP. (2022). Climate Risk and Financial Stability in the South Caucasus. United Nations Development Programme. https://www.undp.org

16. World Bank. (2020). Azerbaijan Financial Sector Assessment. https://www.worldbank.org

17. World Bank. (2021). Doing Business Report: Azerbaijan. https://www.doingbusiness.org

18. World Bank. (2023). Global Economic Prospects: Europe and Central Asia. https://www.worldbank.org

Ş.N.Məmmədov
müəllim, Azərbaycan Memarlıq və İnşaat Universiteti
ORCİD 0009-0006-0483-0628
İ.İ.Quliyev
magistrant, Azərbaycan Memarlıq və İnşaat Universiteti

ORCİD 0009-0002-9071-9424

Azərbaycanda maliyyə sabitliyinin cari vəziyyəti

Xülasə

Maliyyə sabitliyi milli iqtisadiyyatların dayanıqlılığının və maliyyə sistemlərinin davamlı fəaliyyətinin təmin olunmasında mühüm rol oynayır, xüsusilə də keçid və inkişaf mərhələsində olan ölkələr üçün. Azərbaycanın nümunəsində maliyyə sabitliyinin formalaşması bank sektorunda aparılan struktur islahatlar, makroiqtisadi dəyişkənliklər və qlobal iqtisadi dinamika ilə sıx şəkildə əlaqəlidir. Bu məqalədə Azərbaycanda maliyyə sabitliyinin mövcud vəziyyəti institusional çərçivələr, bazar mexanizmləri və sistemli risklər prizmasından təhlil olunur.

Tədqiqat çərçivəsində bank və qeyri-bank maliyyə sektorlarının son dövrlərdəki fəaliyyət göstəriciləri təhlil edilmiş, maliyyə sabitliyinə təsir göstərən əsas makroiqtisadi və normativ amillər müəyyənləşdirilmiş və ölkənin daxili və xarici şoklara qarşı davamlılıq səviyyəsi qiymətləndirilmişdir. Xüsusi diqqət Azərbaycan Mərkəzi Bankının siyasət reaksiyalarına, prudensial nəzarət mexanizmlərinə və ESG (Ətraf mühit, Sosial və İdarəetmə) prinsiplərinin tədricən tətbiqinə yönəldilmişdir.

Tədqiqat CBAR, IMF, Dünya Bankı və BIS kimi milli və beynəlxalq mənbələr əsasında analitik-metodoloji yanaşma ilə aparılmışdır. Əldə olunan nəticələr göstərir ki, 2015-ci il devalvasiya böhranından sonra maliyyə sabitliyinin gücləndirilməsi sahəsində mühüm irəliləyişlər əldə olunsa da, inflyasiya təzyiqləri, xarici iqtisadi asılılıq və institusional boşluqlar hələ də mövcuddur.

Məqalə Azərbaycanda maliyyə arxitekturasının möhkəmləndirilməsi və risk əsaslı tənzimləmə vasitəsilə dayanıqlı maliyyə sabitliyinin təmin olunmasına yönəlik tövsiyələrlə yekunlaşır.

Açar sözlər: *maliyyə sabitliyi, Azərbaycan, bank sistemi, makroiqtisadi risklər, sistemli risk, tənzimləyici siyasət, ESG.*