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**“Impact of the changes in oil prices on
Azerbaijan Banking Sector.”**

Student:

Mammadzada Anar Hicran

Supervisor:

Faiq Nuriyev

UNEC SABA

Azerbaijan State University of Economics



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Abstract

This thesis talks about the how the changes in oil prices affected Azerbaijan banking sector. Objective of this bachelor thesis is to analyze and identify how the changes in oil industry that is main source of income influence the Azerbaijan's economy, especially through banking sector. After gaining independence, the dynamic development of the Azerbaijan economy is based on successful oil strategy. Over the past 25 years, Azerbaijan has significantly strengthened its position in the world's oil supply, because of the large-scale foreign investment attraction, exploration, production and export projects.

Today, world oil prices are the most important external factors that determine the position of the Azerbaijani economy and financial sector, the state budget, the balance of payments, foreign exchange reserves and the national currency. The level of oil prices in the world has a direct impact on state financial markets, state revenues, trade balance and the development of the non-oil sector.

In this thesis, the causes of changes in oil prices and their impact on Azerbaijan banking sector in recent years have been investigated. It can be used as an analytical basis in the determination of oil prices in order to assess the impact of the oil prices on the country's financial, especially, banking sector and the state budget, as well as to develop the socio-economic policy of the state in accordance with the conditions of future development.

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Introduction

The oil industry is one of the most important industries in the Republic. High quality of Azerbaijani oil and its products, high oil content in export, rich oil reserves play an important role in the position and development of the Azerbaijan economy.

Azerbaijan, with its great natural resources, especially oil reserves, is governed by the centralized management style by 71 years and has been adopted by Russia. After independence of the country, strategies for attracting foreign investment were identified by the sectors in order to adapt to the open market economy. On the other hand, state-owned SOCAR has become a major force in the implementation of these strategies. The State Oil Company of Azerbaijan, which has entered into agreements with more than 27 companies in 15 different countries, is the country's largest investor in both Turkey and abroad.

Oil produced in the country is divided into two parts: the first and the largest part is "BP-Azerbaijan"; and the second part is produced by SOCAR from its own resources.

Despite the world oil market's role in the global economy over the past 30 years, the world's oil market has dramatically changed because of various political and other influences. In the light of all these processes, the structure of the world's oil market, the pricing principle and the degree of liberalization have dramatically changed.

On the other hand, it should be mentioned that, factors influencing price fluctuations and pricing in the world oil market include the world's oil production and its dynamics, world oil production, demand for world oil, and so on. Changing these factors together or individually influences the world oil market and the formation of price in the world oil market. Some of these factors begin to show its impact on world oil market from the moment it

changes. In next chapters and sections, we will analyze and research the factors that affect the oil prices in world market in a more broad way.

The presence of the cutting edge economy of any nation is outlandish without an effective financial framework. Banks are budgetary organizations characterized as ventures that drawing in purchasing and selling money related resources, which manage stores, loan out these stores as credits and related with other monetary administrations (Tobin 1987). Therefore, there is no doubt that, the banking system is an important element of the Azerbaijan financial system and economy. Today, banks overwhelmingly exceed other financial intermediaries because of their assets, capital and for regional coverage.

Azerbaijan endured two major economic events in 2015 - the fall in oil prices and ultimately the devaluation of manat.

Crude oil prices in world markets hit the banking sector in Azerbaijan's economy. The loss of the national currency by 50 percent in 2015 compared with the dollar threatened the stability of the banks. Banks were exposed to millions of losses on the first day of devaluation due to poor management of the currency position. This loss seriously damaged the banks' capital, and many of the banks violated capital standards. The interconnected savings and credit markets began to shrink after significant increases in recent years, and both had a somewhat negative trend.

After the first devaluation on February 21, 2015, the volume of deposits fell by 35 percent, from \$ 7.6 billion to \$ 5 billion. During this period, the level of dollarization of savings increased from 62% to 81%. Whereas at the end of 2014 the share of dollar deposits was less - around 36-37%. Fears of devaluation and dollarization of savings led banks to restrict manat loans. As a result, the share of dollar loans rose from 27 percent to 50 percent in late 2014. Because of the devaluation, the monthly payment of dollar loans and

entrepreneurs increased by two times, which negatively affected their payment and stimulated overdue loans.

Therefore, all these processes triggered the process of bankruptcy for some banks in Azerbaijan. Because of strong relationship between oil industry and financial sector in Azerbaijan, changes in oil prices have negatively affected banking sector.

In this bachelor thesis, we analyzed all these factors, events, current problems in Azerbaijan banking sector due to the relationship between oil sector and financial sector, actions by government and other possible solutions. In order to do this, we generally used secondary data type of information.

1. Theoretical review of the problem

1.1. General Characteristics of Azerbaijan's Economy.

Azerbaijan declared its independence on 30 August 1991 upon the dissolution of the USSR for 71 years and was officially independent on 18 October 1991 upon the adoption of the Independence Act. For many years, the central governmental structure in the USSR political structure has made the economy dependent on other countries and prevented the development of fair competition. The economy of Azerbaijan, which has come to the forefront with the agriculture and industrial sector during this Union period, it has attracted attention with its unilateral development after middle years of XX century. In other words. In the years of World War II, the increase in energy demand aroused interest in oil and the field of oil industry began to develop rapidly. On the other hand, this system has caused regional disintegration along with sectoral differentiation. As a result, Azerbaijan had to struggle not only with

economic imbalances but also with regional differences, internal instability, socioeconomic crisis and the attacks of Armenia.

Azerbaijan, which opted for an open market economy to revitalize the economy, decided to abandon central planning management and use rich energy resources, to attract foreign capital, and this strategy quickly led to an increase in living standards by providing financial resources to the economy. However, in the first years of the republic, the invariable strategy maintained in the oil and natural gas sector has brought the economy to face the problem of being dependent on natural resources revenues, as well as offering advantages such as capital inflow to the country, increasing export revenues and gaining status in the international arena.

The process of independence of Azerbaijan and its first years revealed a difficult economic situation such as the closure of workplaces, the decrease in exports, the rise in prices due to the decrease in import figures and the inflation reaching 3 digits. (Elgun Oruclu - “Importance of Non-Oil Sector in Azerbaijan Economy”, Kocaeli 2016, p 16)

In the period of USSR, within the framework of central planning strategies, Azerbaijan remained a country of agriculture. The country, which lost some of its territory together with Nagorno-Karabakh in 1993, decreased the agricultural areas suitable for growing vegetables and fruits and a decline in the production of these products. Most of the lands occupied by Armenia were fertile agricultural areas. For example, 100,000 tons of grapes were produced annually in Fuzuli. The town of Zengilan had 3 grape processing plants and 3000 hectares of vineyards. Aghdam cotton; Gubadli was one of the regions known for animal husbandry. (Elgun Oruclu - “Importance of Non-Oil Sector in Azerbaijan Economy”, Kocaeli 2016, p 11)

Although there was an economic collapse in the first years of the 10-year period of 1990-2000, this could be stopped, stabilization policies were put into

practice, positive developments were observed in certain economic indicators, some economic reforms were made for development and a certain development environment was created.

In September 1994, Azerbaijan has signed “The contract of the Century”. This was one of the historical dates of Azerbaijan’s history. Having gained independence, Azerbaijan has signed a contract with Western oil companies for the first time, laid the foundation for international cooperation in the Caspian Sea, accelerated the flow of foreign investors to Azerbaijan and gave a powerful impetus to the growth of new oil and gas production.

In 2003, 'Social and Economic Development of Azerbaijani Regions' state program was prepared for 2004-2008 and 30 basic projects were realized in 10 economic geographic regions. This increased share of private sector in GNP, and investment volume reached 16.8 billion dollars.

In another state program – “Socioeconomic development for Regions”, which was accepted in the years of 2009-2015. Among the basic elements of the program, the reduction of unemployment has an important place and the development of villages around Baku as well as the activities against air pollution have been taken into consideration. At the same time, it is envisaged to strengthen non-oil sectors, to increase quality in education, to improve human resources and infrastructure, to increase support for businessmen, to promote export-oriented production, to make public more accessible to public services.

Although several reforms and actions were accepted and implemented, Azerbaijan economy remained as dependent on oil industry. As oil prices play an important role in country’s economy, changes in oil industry, fluctuations in oil prices in world market, affected economy in a bad way, especially through the devaluation of Manat. Although 1 manat to \$ 0.78 by February 21, 2015, the same day, by the decision of the Central Bank, 1 \$ dollar was determined as

1.05 manat. This was the third largest depreciation of the manat since the sudden drop in prices in 1994-1995 and 1999.

However, this was not the last one. The fourth largest devaluation took place. Thus, the rapid decline in oil prices in the world market since the end of July, 2015 has increased the pressure on the currency market and the exchange rate. As a result, the Board of the Central Bank made a decision to move AZN to the floating exchange rate regime on December 21, 2015. This decision was actually the next devaluation of manat. As of December 21, 2015, the dollar was equal to 1.55 manats. Moreover, from that day the manat continues to lose its value before the dollar. Currently, the dollar's exchange rate in Baku and the banks is 1.65-1.75 manats. (Cornelli, Svante (2015). Azerbaijan form Independence, London: Routledge Presses.)

These events had increased pressure on Azerbaijan's economy and especially in banking sector. For this reason, Azerbaijan Government decided to increase the share of non-oil sector in an economy, decrease dependence on oil industry. In order to do this, government accepted some reforms and especially "Strategic road map" plays an important role in this way. The impact of oil changes on Azerbaijan's national currency that resulted with devaluation and affected banking sector negatively, reforms and "Strategic road map" will be discussed broadly in next parts of this paper. Firstly, the reasons that sharpened the oil prices in a world economy have to be analyzed.

1.2 Key factors that affect oil prices in world market

Of all businesses on the planet, oil industry is to be sure a worldwide business which influences most nations on the planet. As the oil is the most devoured vitality, it assumes an imperative job in day-by-day lives just as economy and social advancement. Additionally, the oil business prompts innovation improvement both straightforwardly and by implication. It has been conveyed

as a method for economy and political exchange. In any case, "unrefined petroleum" when refined into different oil based goods having various traits for example gas, diesel, avionics fuel, lamp oil, and fuel oil, and others, its esteem will be expanded. The sort and nature of the unrefined petroleum itself hence control the price of raw petroleum. Once refined, substantial and light raw petroleum yield a few refined items for example fuel and diesel to serve requests at various amounts. Moreover, sharp and sweet rough are likewise estimated in an unexpected way. Anticipating or assessing oil cost later on is complex since oil is the item that is accessible all around. In contrast to different items, the nature of oil item could be made diverse to serve various necessities of purchasers. As the oil showcase is predominantly local exercises, which are conceived of collaboration from different nations, and gatherings having various requirements and conditions, a few factors at that point include both legitimately and in a roundabout way. By the by, the prices could be examined at both territorial and worldwide dimensions.

Specialists utilize various sources to follow the elements of world oil prices. Firstly, we can talk about the market bulletin boards. The most prominent of these papers are Platt's, Petroleum and Intelligences Weekly report, Petroleum Argus and others. Also, a standout amongst the most dependable information sources is the Monthly Oil Market Report (month to month oil advertise report). Main factors that affect the price

Economic growth: is the factor that emphatically connected with the price. At the point when the economy develops, oil request in our everyday lives just as interest to adapt to economy extension will increment. In the event that the world's creation is unfit to meet the development, the price of oil is certainly on an ascent. In an opposite situation, the price of oil will diminish if the economy development is insignificant in the light of oversupply of oil. It has to be

mentioned that, the international economy development rate in each locale must be mulled over.

OPEC's production capacity: In the event that the production is not in accordance with the demand, the price will be influenced as seen by the price soaring amid the past world oil emergencies. Therefore, the nations with high resources and production limit have solid arranging power for prices. Most of the producers are Organization of Petroleum Exporting Countries or OPEC has currently has 11 members. This organization could control production to be in accordance with demand. In the event that the creation of the part is excessively high or excessively low, the price will be in like manner influenced. For example, the developing and delayed strike of oil specialists in Nigeria can have outcomes in diminishing production and rising prices of the oil.

Policy of OPEC: The strategy set by OPEC likewise impacts request and supply of oil advertise at extraordinary length. As, the world's biggest oil makers and stores, the OPEC's declaration to increment or lower the manufacture level, unavoidably triggers the prices. As a noteworthy news, every OPEC's gathering is dependably in the spotlight.

OPEC significantly affects its costs by altering its oil creation volumes. Every individual from the OPEC has a standard for creating different volumes of oil. Nevertheless, as a rule, this association has been overstated by its capacity to define the prices of oil and oil production. It is significant that there are persuasive global associations that can manage preposterous high oil prices. Evidently, OPEC is unfit to do as such.

Resources of main consumers: Ordinarily, every nation needs to save oil for vitality solidness and security. Vast shopper needs to keep up the correct stock dimension just to adequately fulfill the need so as to diminish the cost. The adequate oil stock will decrease the stress in the supply lack. The cost is

probably going to be mellowed. Meanwhile, when the interest surpasses the estimate, the stock at that point diminishes as the utilization rises and results in undersupply. Under such situation, the cost will at that point alter upward. Therefore, the expansive shopper, for example, the USA or European nations, have considered the oil stock.

Foreign exchange: The oil is exchanged universally and sold in USD. Along these lines, the esteem change of remote cash when contrasted and US dollar, influence the prices. When US dollar cheapens, the cost of imported rough and completed items will be less expensive when determined in neighborhood cash. On the other hand, the price when determined in USD, will be higher. The more grounded US dollar will likewise result in less oil prices. Besides, the vacillation of remote trade will make it increasingly hard for merchants to think about the cost of oil in each

We should investigate the variables as a rule and progressively nitty gritty. Various political occasions that have occurred on the planet have likewise affected the world oil advertise, specifically the world oil costs. Oil costs stayed stable until the 1970s. Be that as it may, after the world oil emergency of 1970, oil costs started to move significantly.

As it was mentioned by us, the oil stock trades that impact the elements of prices on the planet oil market and characterizing the price.

It ought to be noticed that among the elements affecting value changes and evaluating on the planet oil advertise, the level of world oil manufacture and its elements, demand for oil, and so on. Changing these elements together or separately influences the world oil showcase and the development of prices on the world market. A portion of these variables are starting to demonstrate that the world has changed its effect on the oil showcase. This undermines the impact of such factors on the procedure of value variances on the planet oil

showcase. We should take a gander at a portion of these markers, for instance, the worldwide oil demand and supply balance pointers for 2012-2016.

	2012	2013	2014	1Q15	2Q15	3Q15	4Q15	2015	1Q16	2Q16	3Q16	4Q16	2016
World demand													
OECD	45.9	46.0	45.7	46.4	45.4	46.5	46.3	46.2	46.6	45.6	46.7	46.5	46.4
Americas	23.6	24.1	24.1	24.2	24.1	24.8	24.4	24.4	24.4	24.4	25.0	24.6	24.6
Europe	13.8	13.6	13.5	13.5	13.6	14.1	13.7	13.7	13.5	13.6	14.1	13.7	13.7
Asia Pacific	8.5	8.3	8.1	8.7	7.7	7.6	8.3	8.1	8.6	7.6	7.5	8.2	8.0
DCs	28.3	29.2	30.0	30.0	30.7	31.3	30.8	30.7	30.7	31.3	32.0	31.5	31.4
FSU	4.4	4.5	4.6	4.4	4.3	4.6	5.0	4.6	4.4	4.3	4.7	5.0	4.6
Other Europe	0.6	0.6	0.7	0.7	0.6	0.7	0.7	0.7	0.7	0.6	0.7	0.8	0.7
China	9.7	10.1	10.5	10.4	11.1	10.7	11.1	10.8	10.7	11.4	11.0	11.4	11.1
(a) Total world demand	89.1	90.5	91.4	92.0	92.0	93.9	94.0	93.0	93.1	93.3	95.1	95.2	94.2
Non-OPEC supply													
OECD	21.1	22.2	24.2	25.2	24.9	25.3	25.5	25.2	25.2	24.4	24.4	24.7	24.7
Americas	16.7	18.2	20.1	21.0	20.7	21.1	21.2	21.0	20.9	20.4	20.4	20.5	20.5
Europe	3.8	3.6	3.6	3.7	3.8	3.7	3.9	3.8	3.8	3.6	3.5	3.7	3.7
Asia Pacific	0.6	0.5	0.5	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5
DCs	11.0	11.1	11.3	11.6	11.5	11.4	11.5	11.5	11.4	11.5	11.5	11.7	11.5
FSU	13.4	13.6	13.5	13.8	13.7	13.6	13.7	13.7	13.9	13.5	13.4	13.5	13.6
Other Europe	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
China	4.2	4.2	4.3	4.3	4.4	4.4	4.4	4.4	4.3	4.3	4.3	4.3	4.3
Processing gains	2.1	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Total non-OPEC supply	51.9	53.4	55.67	57.2	56.8	57.1	57.4	57.1	57.1	56.1	56.0	56.5	56.4
OPEC NGLs + non-conventional oils	5.7	5.8	6.0	6.0	6.1	6.2	6.3	6.1	6.3	6.3	6.3	6.4	6.3
(b) Total non-OPEC supply and OPEC NGLs	57.6	59.2	61.7	63.2	62.9	63.3	63.7	63.3	63.4	62.4	62.3	62.8	62.7
OPEC crude oil production (secondary sources)	31.9	31.0	30.8	31.0	31.9	32.2	32.2	31.8	32.3				
Total supply	89.6	90.2	92.4	94.2	94.8	95.5	96.0	95.1	95.7				
Balance (stock change and miscellaneous)	0.5	-0.3	1.0	2.2	2.8	1.6	2.0	2.1	2.5				

Figure 1. Oil demand and supply for 2012-2016. Source OPEC.

The table shows world oil demand toward the finish of 2008 and in the Q3 2009. Taking a gander at the table, we see that contrasted with 2008, world oil request declined in 2009 in the Americas and Europe, additionally, in Asia and Africa, this demand expanded. Japan and China, obviously, are among the nations that have prompted expanded interest in Asian nations. When all is said in done the demand for oil in these areas, in Asia and Africa, in 2009, contrasted with the earlier year, absolute world interest declined in 2009 contrasted with earlier years. Specialists connect this with various components. Some relate this to the world's oil creation change, some of which interface the OPEC's worldwide oil market and a portion of the world's oil price.

Components impacting oil costs variances on the planet showcase incorporate interest for world, oil trades, etc. just as the world's oil holds. As the world is rich with oil assets, at that point the prices will be considerably more reasonable. However, on the off chance that the world is going to come up short on oil and there is a deficiency of oil creation, at that point oil costs will rise to such an extent. In such manner, it is important to include the elements of the world oil stores to the rundown of elements that influence the price.

For the most part, world oil costs have been liable to visit changes since the revelation of oil. These progressions have shown themselves contrastingly at various occasions, and the oil price have changed every now and again through different impacts. Coming up next are instances of these impacts:

- Political occasions that occurred in various periods
- Change in world oil creation
- OPEC
- Global monetary emergency, etc.

The worldwide monetary emergency is especially striking in these variables, which is normal. Since the worldwide financial emergency is a standout amongst the most significant components, influencing world oil costs.

At such occasions, the sharp decrease in oil price is related with various political and financial reasons.

The purposes behind the sharp decay of world oil costs amid these periods can be appeared two gatherings: macroeconomic and others.

The primary gathering incorporates the accompanying elements:

- Reducing the interest for cognizant oil item.
- Decrease of mechanical generation over the most recent 10 years
- Deepening of emergency in Russia, Latin America and Europe

- Devaluation of national monetary forms
- Increase of crude materials sent out at low costs

The second gathering incorporates contradictions between real oil makers, those are the fundamental explanation behind the decrease in price. This contradiction occurred between oil exporters inside OPEC and other oil sending out nations. Nevertheless, the principle reasons are the fundamental explanations behind the sharp decrease in world oil costs.

The most noteworthy value decrease happened in 2009 affected by the worldwide financial downturn, and this was the period when the world's oil price dropped strongly.



Figure 2. World Oil prices between 2006 and 2016.

The decline in oil prices can be explained via political reasons. Some experts believe that, it was political movement of United States of Amerika with the support of United Arab Emirates in order to make financial crisis in countries such as Russia and Iran.

It tends to be reasoned that nobody can anticipate the price of oil later on with assurance. In any case, we may appraise the cost and heading of oil cost by considering different previously mentioned elements. The oil cost relies upon

various factors or circumstances happening amid a specific period. The comprehension of value component esteems imperative and most significant for arranging and overseeing vitality usage viably and speedily. Nevertheless, the examination of future oil cost is convoluted and the cost is yet always indeterminable because of a few elements. They are the primary issues that are investigated and explained by experts/ That is the reason the investigation of the specialists of various associations may fluctuate as indicated by their perspectives and speculations shaped in the gauge.

1.3 The relationship between the development of banking sector and economic sustainability.

Financial sector in the coming years increasing the awareness, taking on more responsibility for the environmental and social traces of the activities of financial institutions, and even for a livable world, various collaborations are expected between financial institutions, non-governmental organizations and public institutions. Ethical customers are the main factors driving the financial sector to take a role in sustainable development process. Increasing the awareness of the society about sustainability with the increase of education and communication opportunities, environmental and social of companies and financial institutions factors such as the beginning of monitoring of their performances, increasing social and environmental wear, and increasing the number of ethical customers. The increase in the number of customers in question prevents financial institutions from further ignoring environmental and social sustainability issues. In addition, the fact that financial institutions have to be more transparent and accountable in line with the demands of the state, non-governmental organizations, shareholders, employees and other interest groups also causes their activities to take into account the economic as well as their social and environmental consequences.

Banks' role in the economic system is, in general, the provision of funds through the adoption of deposits from customers and the use of these funds to customers who need them through loans, ie financial intermediation. From this perspective, the banks activities have no relationship with the environment. Likewise, the banking sector is considered to be one of the sectors that have the least impact on the environment when compared to sectors such as chemicals, mining, pharmaceuticals, petroleum and textiles (Thompson, 1998, p. 245).

However, the financial system, especially the banking sector, is the engine of economic growth and development. To guide the flow of funds in the globalized world, to determine international policies, to ensure macroeconomic stability

Financial institutions that play an important role can affect all humanity and can contribute significantly to the environment, human rights and social justice, even if indirectly. Because the funds needed by all enterprises, regardless of the sector, are provided through financial institutions. Therefore, the steps taken by the financial system regarding sustainable development affect and guide all other sectors. Nowadays the size of the potential of financial institutions to influence environmental and social sustainability is recognized by a wide range of something.

An alternative definition for sustainable development has been developed in order to more clearly present the relationship between sustainable development and financial institutions. According to this definition, sustainable development is the process for future generations, owning at least as much as the present generations, to capital (natural resources and human beings resources, are defined development process Commission (European Commission DG XI, 1997). This definition reveals the similarity of the sustainable development process with the capital distribution, which is the basic activity of financial

institutions. Figure 3 clearly demonstrates the role of financial institutions, in particular banks, in the process of sustainable development.

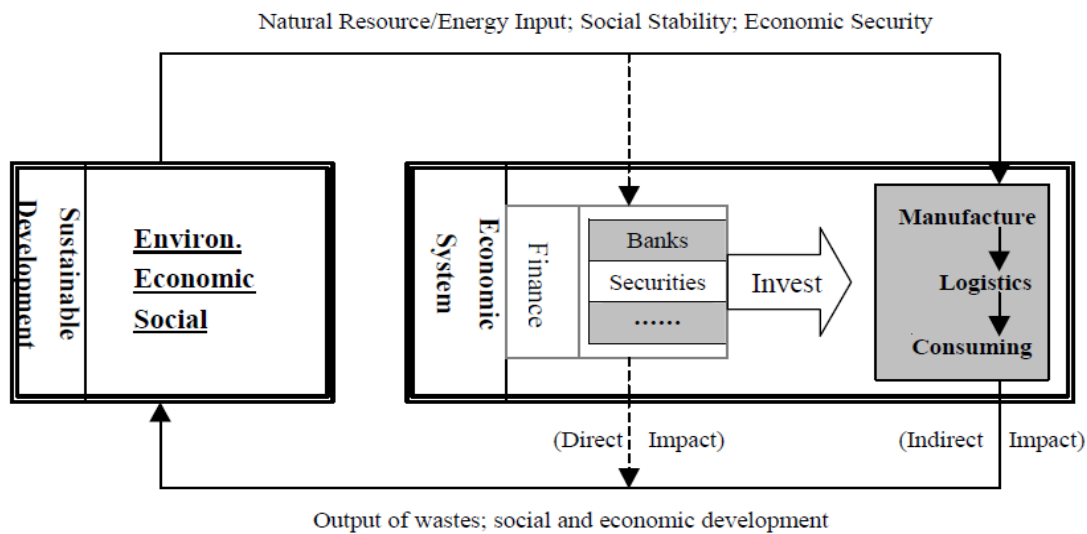


Figure 3: Role of financial institutions in the process of sustainable development

The environmental and social impacts of financial institutions arise in two ways: internal (direct) and external (indirect) (Jeuckens and Bouman, 1999, p. 26; Pinter). The impact of the internal activities of financial institutions on the environment is quite low compared to other sectors. However, considering the magnitude of the financial system, energy, water, paper and so on. The amount of waste generated by its consumption reaches a level that cannot be neglected. It is not wrong to say that the external activities of financial institutions do not affect the environment at first sight.

Because the products offered by financial institutions do not have a direct impact on the environment. However, the users of these financial products can influence the environment or people with their activities. Therefore, the investments made by banks, loans and other financial products may indirectly cause the environment or people to be adversely affected. Banks' electricity, paper, etc.- the direct impact on the environment resulting from its consumption is very insignificant besides its indirect impact.

Today, there is no hesitation about the power of banks within the economic system and the importance of sustainable economic development. What is important at this point is whether banks are willing to take part in the process of sustainable development. Rationally, banks are expected to be reluctant in this regard (Jeuckens and Bouman ,1999, p.25). Because in the framework of traditional financial understanding, it is aimed to maximize shareholder value and sustainability approach, only sustainable growth, it is based on financial criteria such as sustainable profitability (Soppe, 2009, p.4). In this respect, while banks will prefer short-term and high-yield investments, investments that take into account environmental and social sustainability generally require a long-term and low return. Therefore, banks are expected to prioritize the economic consequences of their activities and to ignore long-term sustainability targets such as social stability and ecological balance. Of course, in a functioning financial system, it is not possible for sustainable investments to find funding.

In the framework of the said understanding, although financial institutions that do not accept any responsibility for their economic consequences and can cause environmental and social disasters, many banks are now involved in sustainable development process, financing sustainable investments and raising and directing their customers. Some internal and external drivers drive these banks to take a role in sustainable development rather than short-term and high-yielding investments (Jeuckens and Boumas, 1999, p. 28). Internal impulses; This is due to the awareness of employees, shareholders, board of directors about sustainable development. External the driving forces are related to the pressure of the legal regulations, the situation of the competitors, the demands of the customers, the changing expectations of other financial institutions, non-governmental organizations and the society. Today's conscious

The society questions the accountability and reliability of financial institutions and puts pressure on financial institutions to be more sensitive to social and environmental issues. In addition to the aforementioned pressures, financial institutions. There are also some incentives to encourage sustainable development. Because environmental and social awareness will contribute to the reputation of the financial institution and enter into new markets through new sustainable financial products is an important opportunity for banks.

Although the understanding of sustainable finance is becoming more widespread and the awareness of banks about sustainable development is increasing, it is not possible to say that all banks have attained the same level of sustainability. According to Jeuckens, the process of achieving sustainability of banks is carried out in four stages as Defensive Banking, Preventive Banking, Offensive Banking and Sustainable Banking. In the advocate banking stage, banks prefer to remain passive in the sustainable development process with concerns such as profitability and growth, and consider environmental sustainability as a cost to be avoided. In the Preventive Banking phase, banks are aware of the potential cost savings they can make with sustainable development (such as energy saving) and take into account only sustainability in their internal processes. At the offensive Banking stage, banks are beginning to see opportunities in the process of sustainable development (such as new sustainable financial products, new markets), and take into account the internal processes as well as sustainability in their external activities. At the stage of Sustainable Banking, all activities of the banks are sustainable and the expectation of maximum financial return is replaced by environmental, social and economic sustainability. (Jeuckens, 2001, pp. 71-74). Today, the expectations of society's awareness and sustainability are not sufficient for the dominance of the sustainable banking approach, It is seen that niche banks which cannot reach to the sustainable banking stage, but rather to a certain part of the society, can reach this stage.

2. Banking sector in Azerbaijan.

2.1 Analyzing of Main indicators of the Banking sector of Azerbaijan

The Azerbaijani Banking area has experienced a ton of changes since its commencement. Until the nineteenth century, Azerbaijan had no state focal money related administrative association. Guidelines in the financial zone began in 1861 when the State Bank of the Russian Empire opened its Baku branch. Primary job of this branch was to produce advancement of the credit framework and to expand exchange turnover the district. Amid its action, Baku branch acknowledged issue of home loan credits, exchanges on enrollment of promissory notes and other budgetary administrations. Credit-banking framework were incorporated 135 little financial offices, 28 parts of business credit banks, 8 common credit social orders, 7 contract banks and 5 banking offices.

As we mentioned above, Azerbaijan has lived under the SSCB control for 70 years. In the wake of picking up independency, Azerbaijan added to the advancement of the financial segment, lead of monetary strategy in the nation has started to build up new banks.

In 1990s, beginning with the procedure of autonomy, basic changes were made in every single budgetary framework, in the banking framework as well. The loan fees and the expulsion of the confinements in outside trade rates assumed a significant job in the fast settlement of these auxiliary changes. These basic changes in the idea of the changes gave the advancement and the development of the monetary framework and banking segment. Be that as it may, in 1990s, improvement of banking segment has prompted a noteworthy decay of monetary organizations; banks worked under expanded consideration for quite a while. Amid this period, the developing acquiring necessity and budgetary utilizing of assets for financing the state-possessed banks have quickened this procedure. In

2000s, the financial area has been presented to genuine hazard. The rebuilding of the financial segment and the money related structure of banks have turned out to be unavoidable. Thus, some extreme changes were made to the Law on Banks and in the guideline and supervision of banks was presented with another methodology (Aliyev, 2007).

In parallel with the endeavors of rebuilding and reconciliation in worldwide markets, both in the institutional structure of the banks in Azerbaijan and in administrations and items that they offer, have been actualized genuine changes. In this way, "The financial division" of the economy of Azerbaijan is available to worldwide challenge and is going by the main segments good with EU. Subsequent to making a free-advertise model, the rebuilding of the financial division in Azerbaijan was required once more. Regarding the worldwide applications, essential components of the rebuilding of the financial framework are improving the guideline and the board of the framework, changing of the strategy and time of going out on a limb and the board of the hazard, acknowledgment and decrease of issue resources, reinforcing of the capital, end and legitimate administration of the political impedance in the financial framework.

There were two fundamental methodologies of the rebuilding of banks. The primary methodology is improving and fortifying of the budgetary structure of the banks anticipate the expansion in value after some time, in addition to the benefits that would make the most effective route for the making of financial condition endeavors.

The second methodology was a transient methodology; it was identified to expand the equity. Most likely, each relying upon the event of the states of the two methodologies has favorable circumstances and inconveniences. When seeing as a strategy for designing or bank restoration, thinking about the conditions in the banks and the financial framework, obviously there are various

strategies that can be connected. The most well-known strategies for the restoration are the reinforcing of the bank capital, great administration, fortifying of the structure of the bank's investors, improving of the structure of aggressiveness, giving of a contingent arrangement to liquidity backing to the bank. The strategies for rebuilding are applications, for example, the guaranteeing of open help, appropriation of banks into open organization, consolidating, isolating, decreasing, rebuilding and privatization of advances. Currently, the country has a two-tiered banking system based on market principles (National Bank of the Republic of Azerbaijan, commercial banks and other non-bank credit organizations). At the initial stage of reforms, restructuring and restructuring of state banks were implemented, institutional formation of the private banking system was ensured. At this stage, low capital requirements, extremely liberal conditions for accessing the system were identified, and soft adjusting tools were used to regulate banking activity. Finally, the banking system was institutionalized and the number of private banks started to increase.

Proportions of concentrated recuperation of private banks actualized since 2000 in the following phase of bank changes added to combination of sturdiness of bank framework and improvement of the monetary intercession work.

From beginning of 2002, significant phase of rebuilding of bank framework began to be completed. Thinking about section of huge oil incomes in the nation, as a coherent aftereffect of fruitful oil policy, and as the banks were prepared to a compelling exchange of their money related assets to the key objectives, development plan was made for 2002-2005.

Real objectives of procedure are compelling and safe change of oil incomes to non-oil division, to build odds of access of populace and areas to bank administrations and in this base to create budgetary intercession capacity of bank framework for neediness decrease, fortify solidness and dependability of

bank framework, guarantee free and sound challenge environment in bank administrations showcase. Account bank area assumes extraordinary job in development of economy enhanced in base of incredible monetary power and money related assets of the nation and guiding assets to capitalization of non-oil part.

To get key targets decided certain obligations have been set, for example, improvement and adjustment to universal models of enactment base of banking, expanding unwavering quality and well-being of bank framework, broadening conceivable outcomes of access to bank administrations, lifting the dimension of straightforwardness in bank framework and reinforcing the market discipline, sorting out a compelling bank control.

Significant changes and institutional advancement every which way of the banking framework have conveyed to profound amount and quality changes in the segment. The all out aftereffect of changes is development of the financial framework completely adjusting to the worldwide benchmarks in monetary steadiness parameter and controls of the risk.

To animate saving in the part and increment populace's trust in the area, the deposit protection framework was made in 2007, the aggregate of stores ensured by the Deposits Insurance Fund achieved 30000 AZN which has raised multiple times.

As aftereffect of the effective advancement and modernization procedure, too pre-emergency preventive administration and 'budgetary vaccination' measures, the bank-fund part kept the equalization in the battle against worldwide emergency, insurance of money related strength was guaranteed. Accordingly, the financial framework in Azerbaijan met the worldwide emergency with high capitalization level and liquidity records. In contrast to numerous nations, Azerbaijan's financial division did not experience any disappointment and exceptional pressure, ensuring its parameters and sustainability.

Let's look at some numbers and statistical data, in order to see and to be able to analyze the situation of banking system of Azerbaijan. Before 2015, high level of the income of people (due to high prices of oil), some regulations and other factors increased the trust in banks among the population of Azerbaijan. As a result of this, credit investments in real sector, high level of deposits and such kind of active operations were familiar for most of the banks in Azerbaijan. In these years, more than 30 banks were performing and playing an important role for the financial sector and economic situation in Azerbaijan.

The advancement rate of the bank area might be characterized with the extent of the absolute advantages for the GDP. The calculations of the specialists demonstrate that the offer of all out resources in the GDP is not over 5% in the monetarily less created nations. In Azerbaijan, in 2013, the offer of all out resources in the GDP was equivalent to 35% in the bank segment.

2.2. Current position of Azerbaijan banking system, before and after devaluation.

In 2013, the absolute net assets of the banks were equivalent to 13290.81 million AZN. All things considered, the assets of one bank was about 295.35 million AZN. But, it should be mentioned that the concentration level was also high.. The complete assets of 5 banks include 60.7% of the considerable number of benefits. 39.2% of the approved capital, 61.9% of the stores, 58.2% of the credit arrangement of the banks have a place with 5 banks in the nation.

Apart from that, total currency reserves in 2014 was 14,152 mln USD, demand deposit in Azerbaijan Manat was 2278.2 mln, time deposit in AZN, 3697.9 mln, and total credit puts was 18542.6 mln in AZN. As we see these numbers and statistics, it will be useful for us to differentiate and compare it with the next years after 2014. Apart from that, in that year 45 banks was performed in Azerbaijan and this number would be decreased in next years, as a result of

banking crisis because of low oil prices and devaluations. At the end of 2014, Azerbaijan banking sector had total 10,152 mln AZN total cash in turnover, which is known as M0 from money aggregates. Apart from that, if we look at total monetary base in AZN, we can see that in 2014, we have 11,542 ml AZN. One of the most interesting part of this statistics is about the capital and profit before taxes of banks. Again, in 2014, before the sharp changes in exchange rates and 2 devaluations, total capital of 45 banks was 4,160 mln AZN and total PBIT was determined as 458 mln AZN. Such statistics data will be compared with the data after devaluation. But first, let's look at the process of devaluation and its consequences. During the time 2014-2017, decreased oil price has affected the Manat, which is the national currency of the Republic of Azerbaijan. Throughout this period, oil value variances have influenced the Azerbaijani economy and especially, banking sector through the devaluation of the manat. As a generous piece of the nation's income was coming from the oil and gas, in the midst of high oil price the nation has encountered asset fortunes and ensuing issues of monetary enhancement, prompting financial issues during low oil price. Truth be told, falling oil price in the worldwide market legitimately sway the exchange rate, since this procedure makes a shortages in the balance of payments, Azerbaijan faced with less foreign currency problem in the country.

Exchange rate of Manat has changed strongly in February and December of 2015, the consequence of two brutal devaluations. Manat lost practically 50% of its incentive because of the devaluation, driving it to turn into the most exceedingly terrible performing money of that year. At the last months of 2016, the exchange rate of the kept on rising, bringing about a rate of 1.92 in front of USD in February 2017. In any case, in the next months, diminishing elements were identified in the manat's rate, prompting its current settled rate of 1.70 in front of the USD. Central Bank's policy over the national currency of Azerbaijan was changed during these

processes: From fixed exchange rate to the shifting one. Apart from that, bodies such as CBAR and State Oil Fund, started to participate in international exchange auctions to be able to prevent the next devaluations of the national currency.

In addition to these processes, we should give attention to dollarization process. The dollarization level expanded in 2015, the offer of foreign money named stores in absolute investment funds, and stores added up to 76.8% as of the finish of year. The offer of foreign currency designated stores in cash supply made up 59.6% as of the finish of period.

The ascent in the offer of foreign currency named stores in all out stores mostly comes from the ascent in their incentive in Manat terms. Clearly, amid 2015, Azerbaijani government spent a great deal of national cash to remunerate low salary of oil with the expectation that oil price will increment in the closest future. It didn't occur and government went to sensational depreciation the start of 2015. Beginning from 2015 oil price went down and that is the reason that national spending plan of Azerbaijan confronted second emotional shortage, so the administration made second sensational devaluation²⁶ to repay contrast between oil salary and national spending plan. As detailed by Central Bank, in 2015 resources of the financial arrangement of Azerbaijan Republic were AZN 26462.6 mln and it went up by 5.083% amid the year, contrasted with 23.53% development in 2014. Credits went somewhere around 2.65% and established AZN 21399.4 mln. In 2015, complete salary of banks (premium and non-premium livelihoods) established 1021.1 mln AZN, while all out costs of banks (premium and non-premium consumptions) made 704.5 mln AZN. Gainfulness markers (ROA and ROE) were 1.07% and 5.63%, separately.

But another problem occurs in this situation. The most important advantage of the fixed exchange rate is that it is possible to predict the currency market. It was crucial for both the households and the business to regulate their behavior. There

are other advantages: it has a positive impact on the volume of international loans and foreign trade, and it is an insurance mechanism against inflation.

The floating exchange rate was a regime that ensured flexible monetary policy, while avoiding depletion of reserves. But international trade and financial transactions are always at risk for inflation, especially in the absence of free economic relations, these risks are rising. The current structure and problems of the Azerbaijani economy do not allow the benefits of the exchange rate regime. What opportunities are there to talk about? First of all, the floating exchange rate regime is a free mechanism and there is no competitive economy and the introduction of this regime in the conditions that free market institutes are not effective. In the face of fierce regime, the major social consequences of inflation have been solely free from the monopoly-free business sector.

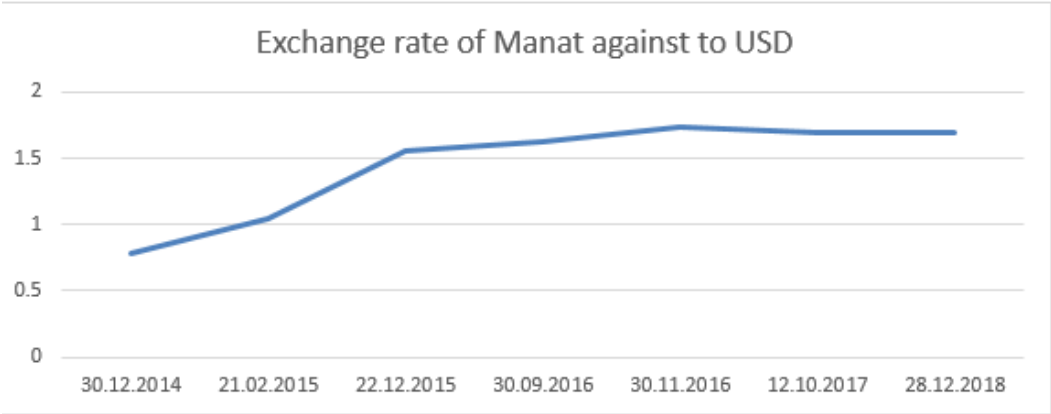


Figure 4. Exchange rate of USD in recent years. Source CBAR

In 2017, there were no noteworthy oil value changes on the international market. The pattern seen is one for the most part expanding, topping at USD 64.27/bbl on November 6, 2017. Until November, the most minimal price of oil was in June, adding up to USD 44.82/bbl. The general discouragement of oil prices in 2016 influenced the manat's rate in the start of 2017, especially in February the manat saw its most astounding rate, taking off up to 1.92 USD/manat. Be that as it may, a short time later, the manat balanced out at the swapping scale of 1.70 against the dollar.

So, the sharp decrease in oil prices had affect the national currency in a negative way. Azerbaijan economy and banking sector, faced with strict problems. The sensational drop in the price of oil in 2014 has influenced Azerbaijan's financial division to endure the most, since banking capital is reliant on oil and gas incomes. In that year, Azerbaijan owned 44 business banks, a vast number given that the nation's populace is a little more than 9 million. Central shut two of them in July. Numerous specialists call attention to that the quantity of banks in Azerbaijan does not relate to the measure of the economy, naming the ideal number to be 20-25 banks.

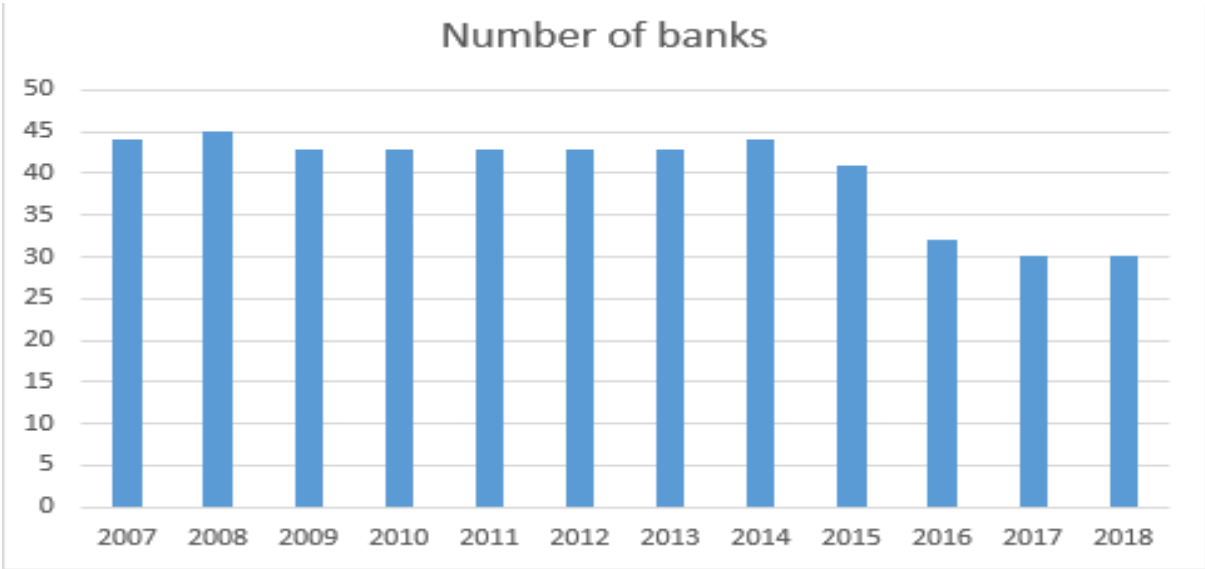


Figure 5. Number of Banks in Azerbaijan until 2015. Source CBAR.

As per the factual announcement of Central Bank in 2015, the quantity of working banks sums 41 banks. Alluding to the release of Central Bank, by contrasting with earlier years, 16 branches and 5 divisions of banks were shut in the nation. Half of the private banks, all the more absolutely 21 of them, is held of outside capital. It should be mentioned that, two of foreign venture banks have defaulted toward the finish of 2015. In 2016, the negative scenario for banks was continuing. The number of banks had decreased to 32 in 2016 and 30 in 2017.

For 2015, ROA altogether made 1.07% and ROE was 5.63%. The "oil emergency" in 2015 very affected on decrease of the operations on payment system. Overall,

6.635mln bits of exchanges were helped out through ATM machines and POS-terminals, which are 11.53 %, lower than 2014. The proportion of the all out resource can estimate the dimension of advancement of the financial division for GDP. Over the most recent 10 years the volume of banking resources expanded by 7.01% occasions and in 2015 it ended up 26.4 billion AZN. Accordingly, level of banking part complete resources for GDP was 48.64 % in 2015. Development rate of the financial part resources in the year 2006-2015 surpassed nation's GDP development rate. Because of lower oil cost in the World market, sharp reduction was seen in the development of benefits. Lately, regardless of the development of banking resources for GDP proportion Azerbaijan fall behind the previous USSR and Eastern European nations for this marker. Among the previous Soviet Union nations Azerbaijan surpasses just Kyrgyzstan with 29.5 % and Tajikistan with 29.1%. (EM Banking System Datawatch). 2015 was the time of crash supply and sharp ascent in demand after in the FX showcase. Low rate supply referenced above in inferable from scaled down foreign money pay because of droop in oil costs and the crumbled monetary circumstance in accomplice nations. Exchanges from oil incomes – the imperative wellspring of open consumptions – were fundamentally low in the midst of decreased excess of the equalization of installments. Sharp ascent in remote trade request is clarified by high dollarization. Droop in oil costs in worldwide item showcases, and the influxes of degrading in our fundamental exchange accomplices uplifted desires for the debasement of the national money in the nation activating high dollarization.

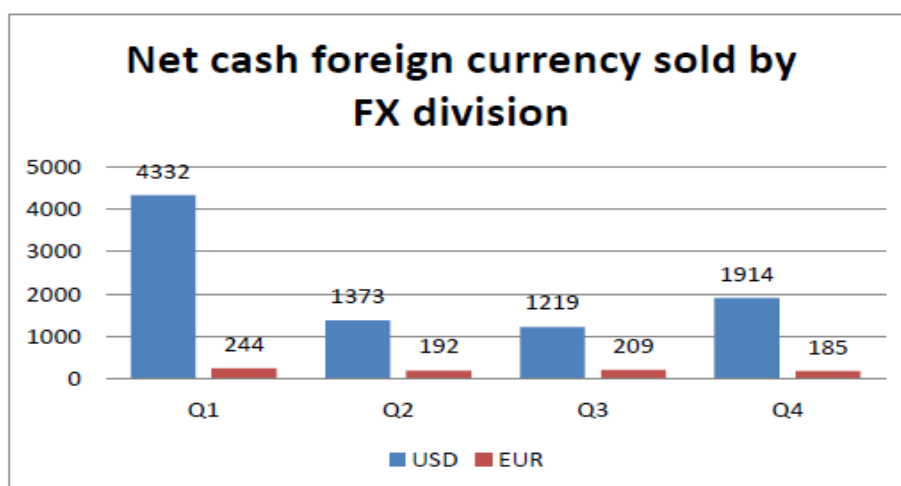


Figure 6. Net cash foreign currency sold by FX division. Source CBAR.

As indicated by CBA, foreign cash sold by banks to the populace in USD throughout the year expanded 47.4% to USD 8.8 billion. Quarter 1 represents half of net USD and 29% net EUR sold in 2015.

The Board of the CBAR chose set the exchange rate of USD against AZN at AZN 1.05 starting at 21 February 2015 in the light of the genuine weight on the FX market and conversion scale of AZN. CBA additionally moved towards pegging national cash to a double money bushel, including USD and EUR.

The FX showcase and the conversion scale of Manat began adjusting to the oil price of USD 50-55 in the outcome of the February degrading and change to another operational procedure.

Be that as it may, beginning from the finish of July, droop in oil values revived the weight on the FX market hoisting the desires on changes of the conversion standard of Manat. Progressing downgrades in exchange accomplices intensified parallel negative effect on the global aggressiveness of the national economy. National monetary forms of various exchange accomplice nations have devalued over 100% since the start of 2014.

New condition required fitting of the FX showcase and exchange rate of Manat to updated oil prices. The Board of Directors at Central Bank took a choice to move

to a gliding swapping scale routine on 21 December 2015, which instigated arrangement of the new conversion scale of Manat to the conjuncture in the FX showcase. To note, progress to the new conversion scale routine put a conclusion to the double money container of USD and EUR as an operational system.

Within the regime of floating exchange rate, Central Bank generously lessened intercessions in the FX advertise. In general, Central Bank sold USD 8.4 billion worth of net cash in 2015. The measure of Central Bank's reserves established USD 5 billion at the last months of 2015. In 2015 Central Bank's reserves added up to 90.3% of expansive cash supply in Manat (universally 10-20% least). The operational system of the Central Bank's exchange rate strategy was changed in accordance with the new regime late in 2015. In 2016, Central bank started to sell foreign exchange just via auctions. With no conversion standard related quantitative focuses as a primary concern, CBA just endeavors to smooth sharp changes and fluctuations on exchange rates. Normal weighted swapping scale on interbank activities is set to be an official rate.

Let's look and compare the numbers and statistics about the banks in the which we gave in the beginning of the section.

First, the cash money in the turnover which is known as M0. We have obtained the amount for 2014 as 10,152mln AZN. To be able to compare the numbers, we have to look at the Figure 8, which shows the changes in M0, from 2014 to 2019. As it is shown, the level of the cash money in the turnover was decreased by 5,337 mln from 2014 to 2016. After the sharp decline in oil prices and 2 devaluations of national currency of Azerbaijan. The amount for M0 became 4,776mln AZN in 2016, 6,337mln AZN in 2017, 7,490mln AZN in 2018, and 7,601mln in 2019. If we look at the percentages, it can be seen that, changes in oil prices started to show its effects from 2014. Because, growth rate of M0 was actually -2,9% at the end of 2014. And sharp devaluations in 2015, made this rate -53% in 2016.

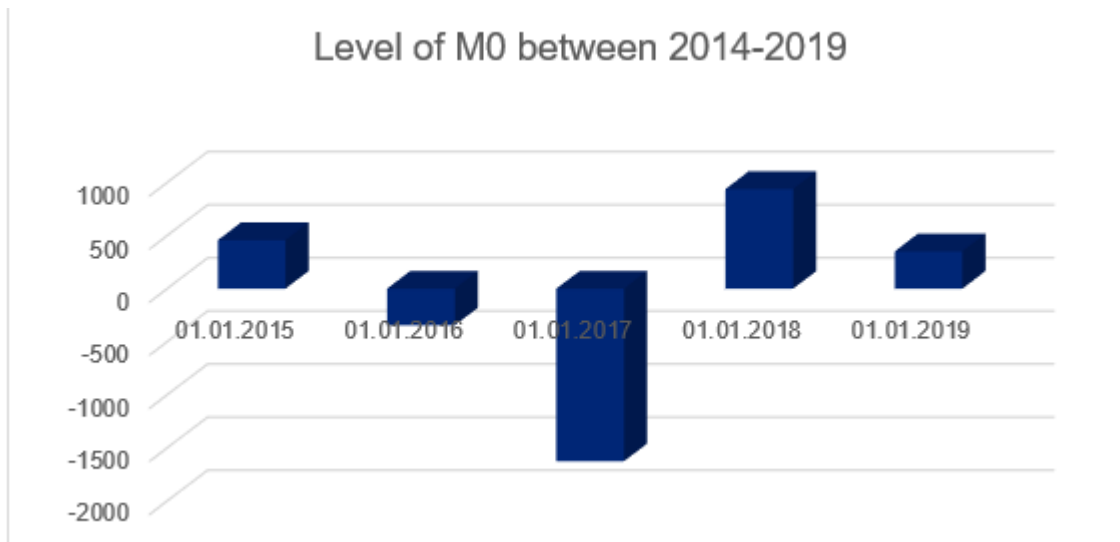


Figure 7. Level of M0 from 2014 to 2019. Source: CBAR.

Let's compare the amounts in the first month of 2015 – which is the before the devaluation – with the amounts in more updated data. Monetary base in Azerbaijan Manat, decreased by 21,9% as the compare with first month of 2015.

Comparing the deposit is one of the most interesting part of this section.

Currently, we have 45% growth, but with dollars 33.1% decrease with the compare with 01/01/2015.

Additionally, the deposits of the individual, we can see the similar situation. In current position, we have 14,3% growth, but with dollars 47,3% decrease in the comparison with 1 January, 2015. Apart from these numbers, we can compare the profits before taxes in 2015's first moth and after the years after devaluation.

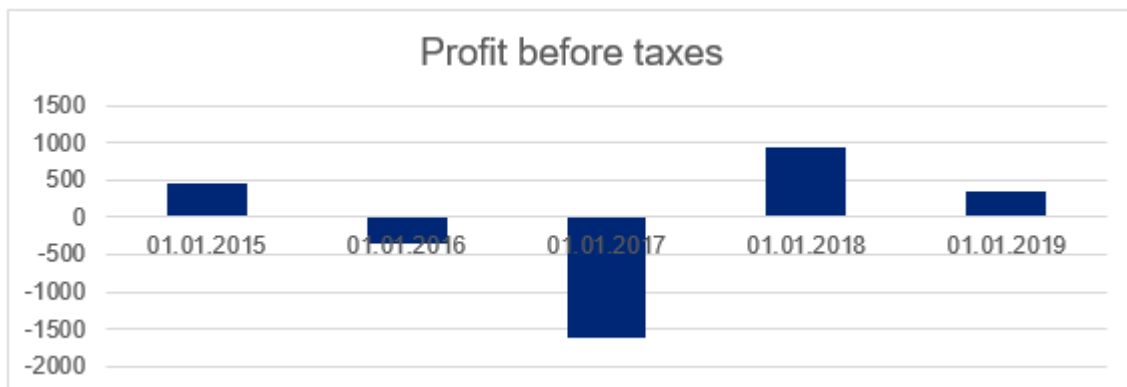


Figure 8. Profit Before Taxes of banks between 2015-2019. Source CBAR.

It can be seen that, after oil price crisis and devaluations, in the first 2 years we have loss in total. But after 2017, banks started to finalize their financial years with profit again. Current number for total profit before taxes is 351.7mln AZN.

The fixed rate catalyzed the monetary equalization in Azerbaijan and it was a significant factor in affecting GDP development. Thus, the recuperation time of the economy upgraded the trust in the national money and individuals holding cash began to spend it. The relationship between GDP of Azerbaijan and both government and individual uses is very high.

The safe conversion standard of the manat has given financial dependability to the economy in general. However, the ongoing exercises of the Central Bank demonstrate that Azerbaijan has recuperated the fixed rate and fixed it to AZN/USD to 1,7. Nevertheless, it should hold an interim between two variable numbers, which demonstrates a promising circumstance for the future insecurity of the nearby economy. This circumstance can cause issues for the Central Bank and it demonstrates a plausibility for another debasement of the cash if the weight for USD will increment and effort the limit of the money showcase.

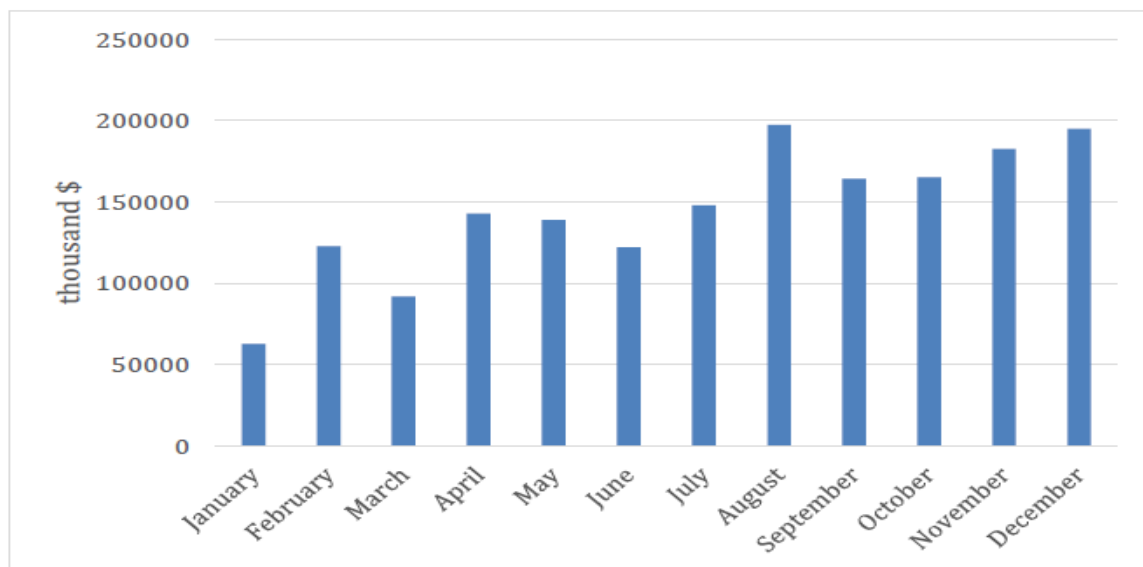


Figure 9. Demand for the United States Dollar in 2018. Source CBAR.

In the chart above, which depict the interest for USD, we likewise watch an expanding pattern which can put further weight on the national money on the off chance that it will surpass the supply of AZN. In the examination of Diagram 3, we can see a flooding interest for USD in Azerbaijan which can offers a clarification with respect to the money showcase variances and significance for the unpredictability interim for AZN. In 2017 the supply of AZN surpassed the interest for USD with a slight contrast, however if there should arise an occurrence of beating, the new devaluation of AZN can be anticipated.

2.3 The role of banking sector in the economic growth of Azerbaijan.

As we talked about the general characteristics of Azerbaijan Economy and how banking sector plays an important role in sustainable economic growth, after analyzing the banks' current situation after and before the decreased oil prices and devaluations, we have to look at the general impact of this process on the Azerbaijan's economy. In general, it have to be mentioned that loans from commercial banks for various purposes, on the one hand, enhance the business activities of individual companies and individuals and, on the other hand, improve people's living conditions (home, car, home appliances, etc.).

Of course, since credit is a type of debt, there is also a certain level of individuality for individuals and companies as well as for the whole economy, so that over-over loans can create problems for the next period: the decline in the standard of living for individuals, deflating, and a crisis or financial turbulence for the economy. Undoubtedly, this risky level can change according to time and country specificities.

At present, financial analysts utilize different pointers to quantify the weight of credit, the most generally spread (just as the least complex) of them are the credit weight of the economy and (families). The credit weight of the economy is reflected in the proportion of total credit ventures into the total national output

(GDP) to the economy, and the credit heap of family units is communicated as a proportion of advances to people to their salary. Such a basic articulation structure is appropriate for observing and breaking down the elements of the credit heap of the economy and in the meantime making examinations with worldwide correlations. Of course, since Azerbaijan is rich in oil, the credit burden of the non-oil sector should be considered separately. According to the end of 2014 the country's non-oil economy's loan burden amounts to 55.5%. According to this indicator, Azerbaijan was among the countries of Central and Eastern Europe, CIS and Baltic countries (56.3%) among the 23 countries included in the mentioned groups, and also from the world trends (the trend towards the GDP per capita GDP - is about 60%).

In 2014, similar trends were also observed in households' credit burden. In OECD countries, the average debt burden on households was up to 128.4% of revenues: 152.5% for member-countries and 63% in developing countries. In Azerbaijan, loans to households make up 19.6% of the nominal money income of the population. In 2014, the credit burden of the Azerbaijani economy (and non-oil sector) was consistent with its development level and the economy was not heavily loaded by credit. According to the results of 2014, the non-oil economy's credit burden was 55.5%, according to which Azerbaijan was located between Central and Eastern Europe and CIS and Baltic countries. This position fully corresponded to the country's development level and future goals.

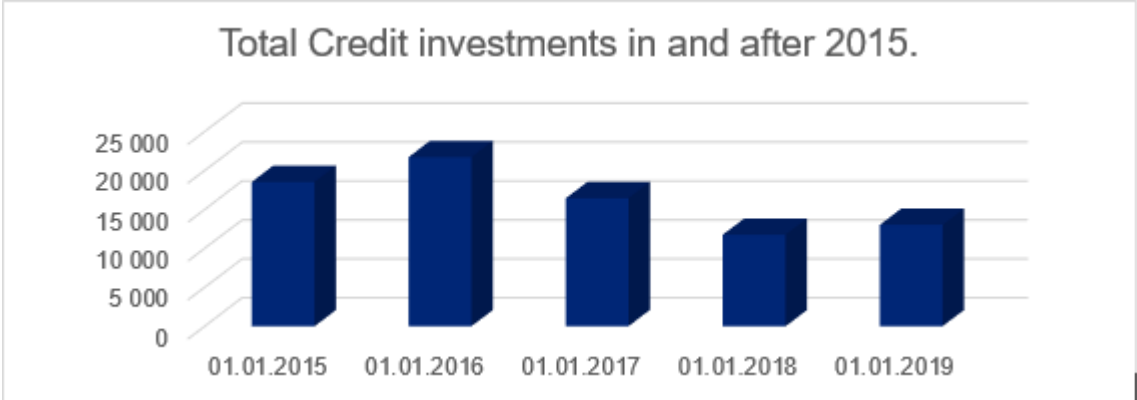


Figure 11. Total Credit investments between 2015 and 2019. Source CBAR.

As mentioned above, decreasing in oil prices and as a result of this tendency, 2 devaluations in Azerbaijan, posed bank in a difficult situations that we analyzed in previous sections with statistical data. There is no doubt that it has affected the total credit investment by banks in a bad and negative way.

Most of the loans to the economy of Azerbaijan, of banking organizations. Thus, while the volume of loans allocated to the economy of Azerbaijan in 2017 was 16.4% of GDP, the ratio of loans allocated to private sector by banks to GDP was 16.3%. In 2015, the most lending sector in Azerbaijan's economy was "Trade and Service", and the sector where the least credit was allocated was "Energy, Chemistry and Natural Resources". Thus, the volume of loans allocated to "Trade and Service" sector amounted to 337 million manat and 34.2 million manat to "Energy, Chemistry and Natural Resources" sector. In the past period, "Trade and service" area was the most lending area with 262.8 million manat, while "Energy, Chemistry and Natural Resources" area was recorded as the least lending economy with 50.9 million manat. As of November 1, 2016 credit investments by banks and non-bank credit organizations in the economy of Azerbaijan accounted for 27.2% - 15 billion USD. 820 mln. (Central Bank of Azerbaijan). The amount of overdue loans at the beginning of November 2016 is estimated at \$ 1 billion. 375.6 mln. manat (8.8% decrease) or 8.7% of all loans. As of November 1, banks have 5 bln. 528.8 mln. manat (decrease by 24.2%) or 34.9% of all loans, 9 billion AZN by private banks. 817.9 mln. (29.2% decrease) or 62.1% of all loans. The remaining amount fell on non-bank credit organizations. At the end of November, the total amount of loans was \$ 8 billion. 509.5 mln. manat (decrease by 22.6%) in national currency, 7 bln. 310.5 mln. manat (31.9% decrease) in foreign currency. The share of loans in foreign currency at the end of 10 months is 46.2% versus 49.4% in 2015.

As of November 1, 2016, 2 bln. 483.3 mln. manat (15.7% of all loans), trade and service sector, 366.4 mln. Manat (2,3%) is accounted for energy, chemical and natural resources sector, 402,8 mln. manat (2.5%), agriculture and processing industry, 1 bln. 820.4 mln. manat (11.5%) of real estate, 1 bln. 211.1 mln. manat (7,7%), industry and production sector, 1 bln. 164.9 mln. (7.4%) of transport and communication, 5 bln. 906.1 mln. manat (37.3%), and the remaining amount fell to the share of other sectors. Nevertheless, the portfolio of households in the field of crediting of households declined by 29.6% in January-October. (Source: Interfax) In 2017, credit investment on the proportion of the industries was as this. Transport and communication 18%, industry and production sector 15%, trade and services 35%, chemical and natural resource was 7%, Agriculture and processing industry 7%, real estate was 18%. It shows the priorities of the government. Because, as fluctuations and changes in oil prices led Azerbaijan into economic and banking crisis, it has gave attention to non-oil sector. Especially, Tourism (which is a part of trade and services), Real estate (could be construction) and so on. But, after 2017, we again face with the problems: Reductions in the assets of the banking sector took place. In comparison with the corresponding period of last year (30.06.2017) 6.8 percent decrease in the assets of the banking sector was registered. If on 30.06.2017 the volume of assets amounted to 30.04 billion manats, this figure was 28 billion manat on 30.06.2018.



Figure 12. Banks total assets between 2015 and 2019. (Source FIMSA)

Apart from that, the decline in the loan portfolio of banks was also observed. If the total loan portfolio of the banks was at the level of 13.46 billion manats in the last year's half-year figures, this figure amounted to 11.71 billion manat for six months of this year. In other words, a 13 percent reduction in lending was recorded. This means that banks on consumer and business loans can not promote attractiveness for market participants. Bank insolvents, which can not sell loans, have also attracted attention with considerable declines in the attractiveness of deposits. The conversation goes with banks' deposit attraction. If during the second half of 2017 the volume of deposits in the banks amounted to 3.99 billion manats, then for the same period this year, the total amount of deposits made up 1.18 billion manat. This, however, gives rise to a 70.5% decline in deposits. This may be due to the weakening of the citizens' savings in savings, the decrease in trust in banks and so on. But, as we have seen, the problems in the banking sector are not related only to attracting and selling resources. At the same time, he has shown himself in institutional issues. Thus, the decline in the banks' activity resulted in the reduction of some of their structures. It is true that there were less than 16,000 employees working in all banks.

But 49 of the bank branches are closed. All this suggests that the banking sector's ability to feed economically weakens. The level of supply of the "blood-vessel" economy does not allow him to speak optimistically for the dynamic development. The analysis of this situation gives rise to the fact that the monetary authorities of the state prepare preventive measures to change this situation. Otherwise, the situation of economic stagnation will follow the banking sector. Because, the recent trends in the banking sector indicate a shrinking economy.

3. Result. Current problems of banking sector and solutions.

3.1. The reasons that prevent development of banking sector.

Measures to protect the dynamics of the banking system's development in 2014-2015 and to optimize the cost of loans for economic entities continued. The Central Bank has taken complex measures to reduce credit interest rates in an active dialogue with the banking community. It has also done considerable work in the country in the area of financial intermediation, further modernization of payment systems and other activities. Only in 2014 the price stability was ensured in the country, inflation was kept at a single level. At the same time as a result of the capitalization process, the banks' risk-enhancing stability has been intensified. On the other hand, substantial sustainability indicators have significantly exceeded the minimum requirements, and a satisfactory level of asset quality has been achieved. Access to financial resources and services has increased as a result of expanding the country's regional banking network and non-bank credit organizations.

The banking system of Azerbaijan maintained a positive dynamics of growth in key indicators in the background of the complicated processes in the global economy in 2014, demonstrated stability and sustainability. The financial stability policy implemented by the Central Bank during the relevant period was aimed at maintaining financial sustainability of the banking system and expanding financial intermediation. As a result of the implemented policy, a roadmap for capitalization of banks has been implemented, the banking sector's competitiveness has risen and the financial depth has increased. Meanwhile, positive dynamics in financial indicators of this system continued, with non-oil GDP growth of 7.6% in 2014, loans to the economy by 56.1% and banks' capital by 12.9%. The main focus of the Central Bank was the acceleration of the growth rate of the banking sector with the growth rate of the economy,

stabilization of credit expansion in that period (7). In 2014, the level of use of various types of banking services has increased, and the growth dynamics of the number of deposits, loans, products and borrowers has continued. Measures were taken by the Central Bank to strengthen the system of protection of bank services consumers' interests in order to expand access to these services and increase the trust of the population and corporate sector to the banks. The attractiveness of the banking system for foreign investors in the country was maintained in 2014, with the number of foreign capital banks operating during this period reaching 23 and the volume of foreign capital investments in the banking sector equaled to 105.2 mln. manat (23%) and increased by 566.8 mln. manat.

The banks managed to maintain their rating determined by the leading rating agencies in the background of complicated macroeconomic processes.

The resource base of the banking system increased in 2014 due to funds attracted from domestic and foreign markets. During the relevant period, the resources attracted by banks from domestic and foreign sources increased by 23.7% (AZN 4026 million) to 21023 million manat. reached AZN. The share of attracted funds from legal (financial and non-financial) organizations and physical persons in the formation of the resource base of banks was higher, total deposits and deposits (including deposits of financial institutions) increased by 23.9% to 15453.4 mln. and reached 73.5% of total liabilities. During that period, the population's deposits increased by 12% to AZN 7188.4 million. and their share in the liabilities of banks was 29%. On the other hand, the corporate sector deposits in 2014 were 41% or \$ 1148 million. manat and increased to 3966.9 mln. manat (in 2013 the growth was 0.6%). Term deposits of corporate sector increased by 66%, demand deposits - by 33%, share of this sector's deposit base increased to 16%

Growth rate of banks' assets was stabilized, positive changes in the structure of bank assets continued. Thus, the assets of the banking sector in 2014 were 4797 mln. manat or 23.5% to 25182 mln. reached AZN. Also, bank loans amounted to \$ 2999 million. manat or 21% to 17174 mln. The growth rate of the net loan portfolio in the previous year was 26%. Over the past 10 years, the share of loans in assets amounted to an average of 70%, and in 2014, the share of liquid assets and investment in assets rose to 28%, with the background of stabilization of the loan portfolio growth rate in 2014. In addition to the

In 2014, the share of liquid assets and investment in assets increased against the backdrop of the stabilization of the loan portfolio growth rate to 28%.

The main source of growth of the loan portfolio in the sector was the deposits of the population and deposits of the corporate sector. The volume of long-term loans increased by 21% - to 14611.3 mln. manat. By the end of 2014, the share of long-term loans in the structure of the loan portfolio was 79%, the growth rate of loans in national currency (22%) exceeded the growth rate of loans in foreign currency (16%). The share of loans in manat portfolio was 73%. Financial support for the economic growth of the banking sector continued. In 2014, the banks had a priority for crediting various industries in the economy.

Economic development in Azerbaijan has affected the growth of credit and investment in the economy. Compared to 2010, the volume of investment investments in the economy in 2015 increased by 2.4 times to 21,730.4 million compared to 2010. manat. 24.4% of the relevant funds were short and 75.6% were long-term loans. During the comparable period, the volume of short-term loans increased by 2.1 times and long-term loans by 2.5 times. Most of the funds, or rather the long-term loans, were directed to the economy in the form of public investment and related to investment infrastructure projects in line with state programs. Short-term loans consisted of investment investments by the private sector.

The volume of loans of various types of loans to the economy, compared to 2010, increased by 1.6 times in 2014 to 21890.6 million dollars. manat or 27907.5 mln. US dollar. These loans are \$ 9175.7 million. manat (\$ 11697.7 million), foreign currency - \$ 12750 million. and \$ 16209.8 million for internal sources. (Banco.az)

So, as a result of this statistics, it can be seen that, Azerbaijan banking sector was in a good position, and the whole economy as well. But after the changes – decreases in oil prices that trigger the devaluation process in the country, made the situation worse. In chapter 2, we looked at how situation changed. Let's analyze the current problems in front of banking sector in Azerbaijan.

While certain improvements are taking place in the development of the banking sector in Azerbaijan, the indicators characterizing the activity of this sector have been developed and are at a relatively low level in contrast to developing countries. The indicators include the ratio of bank assets to GDP, the level of lending to the economy, ie the ratio of loans to GDP and the level of monetization of the economy.

One of the major shortcomings in the banking sector in Azerbaijan is the low level of capitalization and banking assets in the banking sector. Thus, according to the indicators of 2015, the aggregate assets of the banking sector of Azerbaijan amounted to \$ 25.98 billion and the aggregate capital of banks - \$ 4.3 billion. However, in Russia, this figure amounted to \$ 1758.3 billion, Ukraine - \$ 159.8 billion, Kazakhstan - \$ 154 billion, Belarus - 41.24 billion dollars. (7; 39). Based on current practice, the level of development of the banking sector in each country is characterized by the ratio of its aggregate assets to GDP in the country. Although the level of this indicator is 42% in the country, it is 102% in the CIS countries, 63.5% in Ukraine, 75% in Russia, 52% in Moldova; In Eastern European countries, between 60% and 100%. Also, the level of the relevant indicator in developed countries is much higher: in the UK,

this figure is 5% higher than in the United States at 450% in 2013. The fact that the banking sector's assets are so large in general has a positive or negative impact on the economy creates some disagreements.

After devaluation, the amount for aggregate capital became 3,594mln AZN in 2016 and 1,909mln AZN in 2017. After that, it started to increase again, but anyway, today it is close to its value in 2015 with the total 4,243mln AZN total aggregate capital. This uncertainty, fluctuations could create new problems and difficulties in the operations of banks.

For instance, one of the main problem for the Azerbaijan banks is to limited access to financial reserves, mainly to money. Because of the reasons mentioned above, especially strong and high-valued foreign banks do not give credits or do not support the financial well-being of the Azerbaijan's banks.

The country's banking sector has been experiencing serious problems lately. One of the main reasons for the current situation is the shortcomings in the structure of aggregate assets of the banking sector. 25% of bank assets are liquid assets such as cash and cash equivalents. The main part, approximately 75% of the assets are credits and loans which issued by banks.

It should be noted that the structure of banks' assets in the country differs dramatically, while the share of loans in assets of some commercial banks is higher than 90%. In general, the increase in assets due to the expansion of the banking sector lending is a positive factor in the economy.

In this situation, the banking sector will ensure the diversification of the economy and the redistribution of resources from the export sector to the economy. However, the high share of overdue loans in the structure of loans in the banking sector and the recent increase in credit quality have a negative impact on the growth of bank assets.

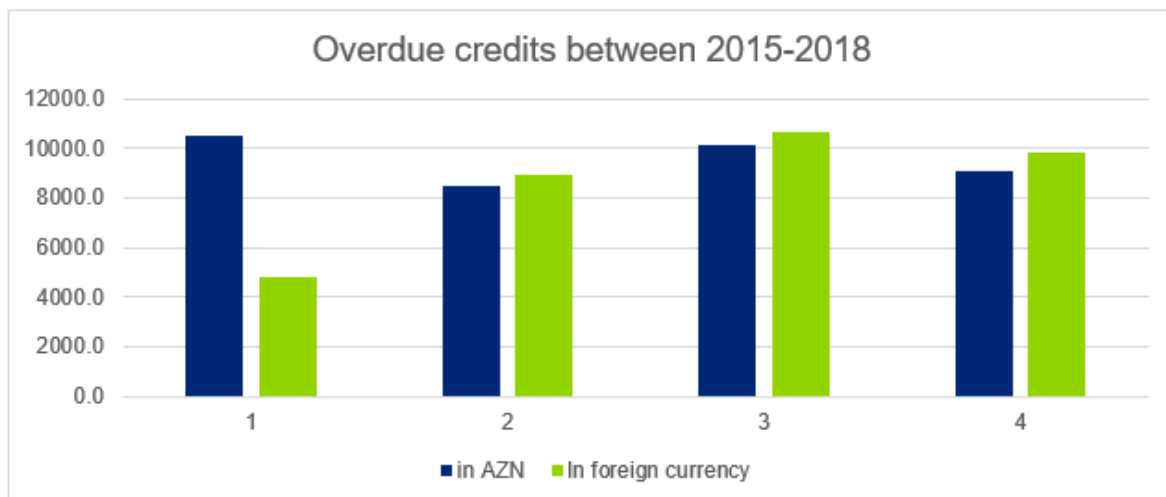


Figure 14. Overdue credits in between 2015-2018. Source CBAR.

Other important factors affecting the development of this sector of the country are related to the fact that the share of investments in the structure of banks' securities is fairly small, only 5-7%. Thus, in Kazakhstan and Russia, where the share of aggregate assets in GDP is higher than in CIS, banks' transactions with securities are often higher than in Azerbaijan's banking system. It should be noted that in the last year \$ 6,482 million and \$ 5,997 million were traded in Kazakhstan and \$ 153,667.95 million and \$ 187, 294.85 million in Russia respectively. As a result, the formation of assets in the banking sector in Kazakhstan and Russia was 10-15% and 24-30%, respectively. As a result, the major problems in this sector are the limited range of services available in the banking services market. Secondly, the high level of service fees available for existing services and, as a result, the high share of cash assets in the financial transactions of the economic entities, the cash flow in circulation and the mass share of the total money supply.

The level of capitalization observed recently in the country's banking system does not allow the banks to operate extensively in the economy. As a result of this factor, the Central Bank has demanded banks to be able to compensate for the risks and unforeseen losses that may arise in the current circumstances. Banks with a high capitalization level are stable during the crisis and have more

ability to continue their business. Also, the necessity of increasing capitalization level in practice is justified by a number of reasons. Firstly, implementation of macroeconomic regulation goals is made possible by the activity of large banks. Secondly, large banks are highly resistant to crisis, and assets of such banks are agile diversified, have higher quality, and attract faster investment than external sources.

In the field of bank lending and investment, the situation in the country has created serious concerns. The fact that most of the population is in debt to the banks is becoming increasingly serious. And people's cars, jewelry, homes and other real estate are in debt to the banks. While the Central Bank puts the need to lower interest rates, but the situation that has emerged with far-off statistics shows a different picture, interest rates remain high. Additional steps should be taken to improve this sector, specific steps should be taken to reduce the interest rates of both business and other loans by creating special funds.

The number of people owed to credit institutions in the country amounts to 2,414,122 people, of which 2 million 381 thousand 592 are individuals. After the recession, the international rating agency Fitch has published forecasts for the CIS and Georgian banking sector for 2017. The agency's forecast on banking sector of Kazakhstan, Azerbaijan and Belarus is more prominent in terms of its negative outlook. There is a sharp devaluation of the national currencies of these countries and a very high level of foreign currency lending. On the other hand, there is pressure on the capital and liquidity of the country's banks and the resulting deterioration in asset quality.

The high level of credit interest rates in the country is conditioned both by internal and external factors. The Central Bank should increase the volume of centralized loans, primarily for them, to demand lower interest rates from banks. The most important thing is that all banks should benefit from this money. From this point of view, it is also important to attract the cheapest financial resources

from abroad. Consumer loans make up over 30% of the loan portfolio. The ability of the national banks to access the foreign market remains weak, and the foreign markets are blocked by the country's market.

The liberalization of the banking sector also comes from a special need, which should create conditions for the entry of other foreign banks, artificial barriers should be eliminated, the banking sector should be competitive, and credit interest rates should be reduced. The Central Bank's access to centralized credit resources should be expanded and commercial banks should be allowed to use the centralized credit resources more widely.

So, these were the concrete problems stand up against the banking system of Azerbaijan. Azerbaijan government, in order to increase diversifications in the economy and improve the conditions of bank, has to be do some regulations. Let's look at some of them in next sections.

3.2. Strategic Road Map (General information. Financial services)

First and one of the most important action by government is preparing Strategic road map. In order to prevent the further economic crisis due to changes in oil prices, as mentioned above, we have to strength the current situation of our financial sector, especially, banking system.

The Strategic Road map for National Economic Outlook covers 3 periods, covering short, medium and long haul periods: by 2020, by 2025 and after 2025. This Strategic Road map has been set up by considering flexible adjustment to forms that are discernible in the worldwide economy and financial advertises just as new difficulties and open doors for supporting the post-oil monetary model. This report has been arranged dependent on the standards of flexibility, intensity, advancement furthermore, support for monetary improvement.

Let's look at and analyze the actions which are determined in strategic road map's financial services section.

The way that oil price degraded beginning from the second half of 2014 likewise influenced Azerbaijani economy. Because of decrease in oil incomes, the outside money inflow into the nation diminished and the way that inertial interest for remote cash surpassed the money supply expanded the weight on the swapping scale of AZN. Cheapening was done for multiple times in 2015 so as to adjust the circumstance in the cash showcase, and to guarantee the vital supportability of the parity of installments and nation's global dissolvability. While dollarization in store and credit portfolio happened following the main downgrading, the expulsion of money related assets from bank framework was watched following the second devaluation. Under the states of debilitating economic growth, the movement, which had been seen in the financial part for quite a while, declined. The debilitated dissolvability of the borrowers was a precondition for the expansion of credit dangers. The banks began rebuilding the credits to deal with the current dangers including alleviating the obligation of the borrowers. Despite the fact that the moves, which were taken, brought about certain positive results, the continuation of the macroeconomic vulnerabilities expanded the expenses for credit chance stores, which the banks caused.

(Strategic Road Map,Baku,Azerbaijan,2016)

Significant works were performed amid that period with the point of building up the monetary markets foundation, and, in the meantime, State Program for "Advancement of securities advertise in the Republic of Azerbaijan in 2011–2020" was received. Inside the structure of the State Program, works went for restoring the budgetary markets were begun. In the principal phase of the State Program covering 2011–2014, important conditions were made for the modernization of securities advertise foundation, improvement of the administrative legitimate structure for this reason, reinforcing of the material and specialized base just as for the advancement of human capital in the securities advertise. Progresses in the direction of the foundation of the systems for powerful assurance of budgetary administration shopper rights and

instruction of the populace have been performed, and current scholarly devices have been utilized to improve money related education.

SWOT analysis of the current situation in the financial – banking sector.

Strengths: Accessibility of a solitary controller for the guideline of and power over money related markets; Establishment of monetary market and foundations; Creation of key budgetary framework components; Existence of essential components of risk control ; Modern stage in security markets.

Weaknesses: Delicate position of the bank framework's capital. High credit dangers of the banks. Lack of lawful systems for guideline and offers of non-performing resources. Lack of supporting instruments for market chance administration in the banks. Lack of compelling instruments for development and rebuilding of the banks. Lack of operational components for lender rights security, shortcomings in the hierarchical – legitimate systems of vowing relations; Poor availability of budgetary administrations; Underdevelopment of the non-bank monetary portion; Low money related literacy.

Opportunities: Changes in monetary parts are among the administration needs; Deposits are completely safeguarded; High volume of key money saves; Developed media transmission foundation and expansive administration organize are accessible

Threats: Instability in oil price proceed; Business animation isn't reestablished; Asset quality is exacerbated; The rebuilding system of the banks isn't finished; The dangers, which the banks are presented to, cause unpredictability in the whole money related markets; Economic liveliness of exchange accomplices is debilitated

The key vision for the improvement of Azerbaijan's budgetary division by 2020 is to set up a monetary framework with an advancement potential that is

supportable against inner and outer stuns, profoundly centered around hazard the executives forms and secured by solid foundation components.

The fruition of the underlying works for structure a monetary framework and the changes led to build up the framework and the staff potential that has been made have established the framework for the progress of the money related framework to another advancement arrange.

Amid the period until 2020, the monetary organizations, particularly the banks, will be revived, the liquidity and capitalization issues of the budgetary establishments will be understood, and moves will be made for rebuilding non-performing resources. Essential conditions will be made for the inclusion of guarantors and financial specialists in security market, the foundation will be extended, and boosting activities will be recognized. For effective task of the money related foundations, new framework components, for example, credit agencies will be set up and the lawful structure will be improved. The monetary framework will be coordinated towards the procedure of further developed hazard the executives, straightforwardness in money related administrations and responsibility will be expanded, and control components that help client arranged administrations and digitalization will be built up. In the meantime, the instruction level in the division of monetary administrations just as the system for the customer's money related proficiency and assurance of rights will be improved.

Long – term vision for money related administrations for 2025 is to have a hearty, versatile and adjusted budgetary framework that is empowered by a settled administrative lawful system and that gives a wide scope of monetary administrations for all client sections.

The goals of liquidity and capitalization challenges in 2016-2020 and improvement of regulative and administrative framework will permit setting new focuses for the advancement of the money related framework by 2025.

Inside this period, it is imagined to assemble a budgetary framework with solid banks, well-working money related markets, sound hazard the executives rehearses in consistence with Basel III necessities, increasingly effective and digitalized forms and a higher quality workforce.

By 2025, the monetary administrations division will be involved firmly situated and differentiated money related organizations and display relentless development area would be watched, alongside less difference in execution over the banks. Thus, banks will develop and enhancing their item portfolio and new non-bank money related foundations will begin to rise. Different money related items offered by these establishments will build openness to options in purchaser advances and drive up the challenge inside the segment.

Correspondingly, an assortment of new ad credits will rise for corporate customers.

By 2025, value and securities showcases in Azerbaijan will have just achieved a productively working state. The bank segment will be acquired full consistence with the necessities of Basel III gauges by 2025. Sound credit chance evaluation components, scoring models, corporate administration structures and hazard forms in accordance with universal benchmarks will guarantee upgraded chance administration abilities in budgetary organizations.

So as to verify these imagined focuses in 2025 and past, experts with abnormal state learning and aptitudes will be set up through advanced education organizations, private preparing establishments, administrative specialists and market players. By mulling over the most recent digitization inclines in the area, these instructive and preparing organizations will guarantee improving the mechanical information of the members.

The accomplishment of the predetermined key targets requires AZN 115 million investments. The usage of activities in the Strategic Roadmap will be subsidized by utilizing the accompanying sources: Government spending plan; Funds of

Central Bank; Off-spending reserves; National Fund for Entrepreneurship Support and assets from other legislative credit and venture associations; Local spending plans; Funds of neighborhood establishments, undertakings and associations independent of their sort of possession; Foreign direct speculation; Securities showcase; Credits from the nation's financial framework; Loans, gifts and specialized help given by global associations and remote nations; Other sources not restricted by law. So as to guarantee the viable spending of assets for need focuses on, the financial limits will be set up inside the system of execution based planning process. A bigger bit of the required supports will be given to the detriment of the restructuring of the current spending plans, joint financing activities of private part and different speculators.

The Strategic Roadmap will be checked and assessed to guarantee effective usage through required apparatuses, forms and different assets. Amid observing and assessment, spotlight will be put on the execution of center activities, expected outcomes and pointers versus needs, and furthermore consistence with the fulfillment timetable will be checked. The observing and assessment will be completed as per techniques dependent on worldwide strategies

The yearly movement projects of the work gatherings will be concurred with the coordination unit and affirmed by the fundamental official association.

Delegates of the coordination unit will partake in the quarterly gatherings of the work gatherings.

The principle official association will submit quarterly work advance reports to the coordination unit something like 10 days before the work gathering's quarterly gathering. By considering broad examination and assessment of quarterly reports incorporating exchanges held in the quarterly gathering of the working gathering, the coordination unit will submit quarterly checking outcomes and its suggestions for the following time frame to the fundamental official association inside 10 days following the gathering date. The

coordination unit and the primary official association will take activities to guarantee that the observing outcomes and suggestions are contemplated by the working gathering in its day by day exercises.

3.3. Solutions and recommendations.

As an international organization that defines international standards for the banking and credit sector's activities, working with the Financial Action Task Force (FATF) and preparing and adopting new legislative documents to ensure compliance with international standards in accordance with FATF recommendations, will help to increase efficiency.

Financial Monitoring Service has also adopted a number of normative acts to increase financial transparency in the country. Thus, the requirements for the preparation of internal control systems for legalization of money laundering or other property and terrorist financing by the monitoring participants and other persons involved in monitoring have been adopted and subject to these requirements, monitoring subjects are considered as:

- Preparation of internal rules and procedures;
- Those responsible for organizing internal control should have professional qualifications and experience in accordance with the requirements set by the Financial Monitoring Service;
- Ensure that regular trainings are provided to employees;
- Creating an internal audit system.

Strengthening co-operation with relevant authorities in terms of increasing financial transparency, legalization of crime or other property laundering and combating terrorist financing is one of the strategic priorities of the Financial Monitoring Service. The Law on Banks and the Central Bank's "Internal Audit and Internal Audit Regulations" require the banks to have internal audit services

and ensure the availability and adequacy of the internal controls to ensure the security of the bank's assets, and the bank's ability to provide shareholders, controlling authorities and the public to confirm the accuracy, completeness and integrity of periodic reports. Implementation of internal control and internal audit in ensuring transparency of banks' activities is considered to be one of the most important issues.

Banking in the modern economy is increasingly important in social life and banks are deeply penetrating the real sector at different levels of their activities. Changes in the world have a significant impact on the content of the banking business. The development of the private sector, entrepreneurial activity and the growth of the population's income in the country have led to the need for servicing of commercial banks and its development.

Internal controls in the Bank's operations are an important tool for timely detection and prevention of potential errors, shortcomings and losses, minimizing bank risks. Risks in this sector are characterized by the deterioration of the economic situation in the country, non-repayment of loans, changes in securities, high inflation, loss of resources as a result of loss of resources, probability of loss and uncertainty. Domestic audit should be designed to improve the efficiency of internal control and risk management systems in banks. Internal audit should be regarded as an important tool to help the bank achieve its goals in assessing and improving the effectiveness of risk management, surveillance and management processes.

Analysis of the financial statements of leading companies indicates that the occurrence of risks associated with improper control of internal control often causes the companies to become bankrupt. From this point of view, assessment of risk in internal control processes of management improvement is a crucial criterion.

Establishing internal control mechanisms to ensure the transparency of banks' operations is considered necessary in terms of reliability, efficiency and compliance with banking legislation. Improving the legal framework to improve the efficiency of the financial and banking sector, the application of international standards and control mechanisms comes from necessity.

Inflation process, increasing the level of "dollarization" of the economy, state dotes that do not serve to increase profitability of production, low cost of investment and so on. such negative tendencies once again indicate that the functioning of the macro and microeconomic processes in the banking system of the country (Azerbaijan) is not fully implemented, although concrete measures have been taken by the relevant structures.

Modern analysis shows that in monetary policy, the organization directly depends on the solution of economic problems, the level of credit investments, the concentration of bank capital, the change in the average interest rate on loans and deposits, the ability to attract resources and many factors.

Over the past years, the process of aging and merging of banks has been on the one hand and on the other hand, some weakly capitalized banks have been closed. As the work done in this direction, the amount of minimum capital requirements for banks has been increased by the Central Bank. The requirements for the minimum capital of banks for activity were determined as 50 million manat after devaluation.

Certain measures have been taken to improve the health of private banks through their consolidation, capitalization and other measures. In order to strengthen sound competition in the banking sector, the foreign investment in the local banking system has been further liberalized. The continuation of this process will contribute to the increase of competition in the banking sector of Azerbaijan and, in addition, to the banks' access to financial resources.

The result of our analysis of the problem of adequate monetary and credit policy is that the policy should be shaped as a result of moderate inflation and investment in the real sector. In modern conditions, priority should be the interest rate policy that stimulates production, secondly, the expansion of CBA's participation in open market operations, and the third - the current regulation of money circulation and the role of mandatory reserves. (Nargiz Salimzada – “The role of state regulation in ensuring the stability of the banking sector”, Baku, 2016, p.46)

Despite the slight downward interest rates on loans, taking into account the rate of inflation, they are still not favorable for entrepreneurs. Interest rates are primarily explained by the fact that the offer in the credit market is smaller than the demand, high cost of attracted funds, limited foreign financial resources, and high margin on credit operations.

World practice shows that modernized management and strategic planning are of exceptional importance in the proper selection and achievement of goals and objectives. Adoption of management decisions in any business area requires accurate assessment of the situation, in-depth analysis of internal and external factors, and preparation of possible developmental processes. In order to stabilize the monetary policy and direct its banking activities to be more efficient, modeling and micro-economic processes should be linked to this policy with other strategic dimensions. To this end, specific interactions between the various economic bodies and the Central Bank should be considered. Special attention should be paid to the establishment of effective information exchange systems with the economic entities and the prior consent of the measures to be taken in case of necessity to prepare substantiated decisions on monetary, credit and foreign exchange policies.

The harmonization of bank supervision norms with the Basel Committee's standards and international experience, application of the control reporting

system that meets these standards and its automation, improving the methodology for non-bank organizations should be considered as one of the most important tasks.

In the near future, the development of strategic programs for banking activity development should be achieved. Undoubtedly, the implementation of these measures should be reflected in the strategic program for the expansion of international cooperation and the development of human resources in different areas of activity. Without the team of highly qualified managers, the most progressive ideas and innovations are also unsuccessful. Therefore, the professional training of cadres should be of great importance.

The financial sector continues to play a leading role in electronic commerce, and continues to play a role as a catalyst for the future globalization and liberalization of the global economy. Significant decline in credit risk management and increased efficiency in the management of the Internet can create favorable conditions for emerging markets to enter international financial markets.(Nargiz Salimzada – “The role of state regulation in ensuring the stability of the banking sector”, Baku, 2016, p.25)

In order to increase the investment activity of economic entities and banks in the near future, the donor function of banks should be increased.

In summary, trends in the development and improvement of banks' activities as well as banking sector are summarized as follows:

In the direction of institutional development of the banking system:

- Creating favorable conditions for the development of micro-crediting institutions that will lend to individuals, small and medium-sized businesses;
- expansion of network of banking branches and banking services in regions through encouragement of creation of regional financial institutions;
- expansion of non-bank credit organization network.

In the direction of restructuring and privatization of state banks:

- Reduction and privatization of the state in the capital of the International Bank, as well as improving the regulation and management of the Bank's shareholders, as well as future shareholders.

In the direction of development of private banks:

- Gradual increase of the minimum required capital of private banks;
- Setting certain conditions for directing their resources to the real sector in parallel with the liberalization of foreign capital participation.

In the direction of increasing the regulatory potential of the Central Bank:

- Improving banking supervision and maintaining transparency,
- Adjustment of prudential standards of the Central Bank to international standards in accordance with economic development,
- Providing necessary support for the creation of specialized banks for the development of priority areas for the development of the country. In the direction of developing banking infrastructure:

- Harmonization of legislative acts on banking activities with other normative legal acts;
- Improvement of internal control and internal audit; Improvement and development of intrabank payment system; Full application of international financial reporting standards;
- Improvement of human resources management systems in banks;
- Stimulation of cashless settlements;
- Improving corporate governance and risk management systems in banks;
- Establishment of centralized simplified register of hostages.

In our view, maximizing the use of macroeconomic benefits from both monetary and fiscal expansions and focusing on the development of domestic investment, non-oil sector and regions is of particular relevance.

Conclusion

As a result, the country mentioned in the first sections of the economic history and after the empirical study as a result of the strong dependence on natural resources in the Azerbaijani economy and Dutch Syndrome advocates the existence of the negative results. Graphical results reflecting the statistical data and the findings based on the experiment show that, in the Azerbaijan economy, fuel revenues have an important place in the country's revenues, this dependence creates a constraint on economic growth in the long run and has a serious impact on the banking sector.

In other words, although there is a positive relationship between the oil industry sector, the agricultural sector and the service sector and economic growth in the short term, it affects the growth of oil production negatively in the long term. In short, while natural resource dependence has a negative impact on Azerbaijan economy in the long term, non-oil sectors have an increasing effect.

Oil funds in Azerbaijan, unfortunately, were directed to more infrastructure projects. Oil revenues have led to a certain strengthening in the exchange rate of manat, where there is no need for proper management. In addition, as a result of the increase in public consumption, the monopoly in production relations further strengthened. However, it would be possible to carry out serious activities for the development of the non-oil sector. The dependence on the oil caused the manat's devaluation.

At the same time, demand in all sectors of the country's economy narrowing and circulation. In terms of income, the situation is not satisfactory. All this showed that the steps taken to diversify the economy in Azerbaijan have

either been delayed or not explained properly. The result has resulted in such complications. All this adversely affected the banking sector. As shown in the previous sections, banks' activity was complicated, some banks stopped their operations, and most importantly, there was a sharp decline in the banks' lending to the economy.

The dynamic development of the country involves systematic and rapid reforms in the banking sector, including the introduction of new banking technologies, the introduction of new services, and the greater involvement of economic entities in the banking and financial circulation. The work done in the last part of the thesis was discussed.

Increased public confidence in the banking system, "financial literacy" raising the level; Psychological methods should be used to increase public confidence in banks. In the years of crisis, the confidence of the population to banks is inevitable. Crisis leads to some concern about the need for citizens to keep funds in banks. In this sense, Azerbaijan is no exception. It is crucial to take advantage of the opportunities of the media.

The role of the banking and financial sector in the diversification of the economy

to increase the business opportunity to obtain long-term loans.

And the other offer is the training of the staff in banks. Special attention should be paid to improvement. Funds should be allocated for staff training and advanced training courses in leading countries in order to increase their knowledge and skills at advanced universities in the world.

In comparison with other countries, we have several times more credit interest rates. Businesses or individuals in need of funding are required to receive a loan regardless of high interest rates. Then there are problems when returning those

funds. It is important to raise the risk of potential risks in the banking sector and to limit the risks in the appropriate regime.

Finishing the thesis, the banking sector is more successful I believe in regulated development. Hopefully, these difficulties in the banking sector and in our economy will soon be resolved and stability will soon be restored.

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