

At a time when many countries are in financial turmoil and see their banking sector falling apart, Azerbaijan has managed to sail through the present storm fairly unscathed. It is viewed by the IMF's mission team, which visited Azerbaijan in December 2008, as able to withstand possible future severe economic slowdown thanks to its low foreign debt and solid fiscal position.

Unlike in Russia, Kazakhstan or Ukraine, the exchange rate of the national currency, the manat, has been stable, maintaining an average of about Am4092.81 to the dollar for 500 days prior to April 25, fluctuating between a low of 4,002.50 and a high of 4231.50.

In recent years, some have derided the

limited integration of Azerbaijan in the global financial system but, according to the IMF mission: "The undeveloped financial market, the rather low dependency of domestic banks on 'hot' capital inflows, and a very strong international reserve position helped to shield Azerbaijan from the early impact of the crisis."

Similarly, some see the heavy hand of President Aliyev and his government as holding back competition in the economy, but local bankers **emeafinance** spoke to for this article all praised the authorities, National Bank included, for their speed in supporting the banking system during the global crisis.

The National Bank of Azerbaijan is

credited for providing temporary liquidity to banks as international markets have dried out and for its close monitoring of the upcoming maturities of the banks' foreign loans for 2009.

Samir Huseynov, chairman of the executive board of Texnikabank, says: "The regulators have done quite a good job at overseeing the banks' balance sheets and the way they are run."

Azerbaijan not dependent on foreign capital Huseynov says there are three reasons for Azerbaijan being less affected by the world financial crisis: first, its lack of dependency on foreign capital; second, the country's low level of foreign borrowing; and finally, the fact the sovereign had not yet issued Eurobonds on the international market.

"If we compare Azerbaijan to Kazakhstan, the financial penetration in Azerbaijan is about 26%; that is the ratio of total banking assets to GDP, while in Kazakhstan that figure stood at about 80%, so the role of the banks in the formation of GDP is less than in other countries."

Huseynov adds: "In 2006, the total foreign borrowing of Azeri companies was at about 18% of GDP. That figure went down to 12.5% in 2007, and by the end of 2008 it represented only 6.5% of GDP. Likewise, banks' dependency on global capital markets has been quite low: foreign borrowing averaged about 22% of total banking assets, whereas if you compare with Kazakhstan, total foreign borrowing in a typical Kazakh bank will constitute more than 75% of its liabilities."

Jalal Gasimov, chairman of the executive board of Bank of Baku, says: "Azerbaijan's banks and financial system had not been heavily integrated into global capital markets. The process had just started when the crisis emerged."

In fact, Azeri banks were actually reducing foreign liabilities when the crisis worsened in the fourth quarter of 2008. According to Jahangir Hajiyev, chairman of International Bank of Azerbaijan (IBA), the biggest bank in the country: "The banking system of Azerbaijan has approximately US\$2.5bn of external debt, with more than 50% borrowed by IBA, but by the end of 2008 we managed to repay in due time all our external debt, such as syndicated loans, that was borrowed from top western banks and this without any help from the government, central bank or from the ministry of finance, which owns 50.2% of IBA."

Texnikabank followed the same path late in 2008 by paying back about 70% of all its foreign borrowings from major western investment banks. Today, its total borrowings are only 13% of its total liabilities.



Firing up for the recovery

Azerbaijan's banks have so far shown resilience in the face of the credit crunch, and are preparing for the recovery, says *Philip de Leon*.

State control not always a bad thing

Faig Huseynov, chairman of Unibank, credits the central bank with the help of the president, for having pursued over the past year “a purposeful policy to minimise possible negative impacts of the financial crisis upon our banking system. The steps taken, involving the use of a full range of financial and regulatory mechanisms, were very timely and efficient”.

He adds that “the state control of the main economic sectors as well as the government’s conservative policy regarding the increment of foreign borrowings made sure, unlike Russia for example, that our strategic enterprises [such as state-owned oil and gas company Socar] have practically no short-term foreign debts with the sole exception of the banking system”.

For Huseynov, legislative and regulatory measures such as the adoption of a new progressive banking law, the establishment of a mortgage fund, the creation of a deposit insurance fund, the transition to International Accounting Standards, and so on, can be seen as qualitative achievements that have fostered growth in the banking sector.

Though far from being picture perfect Azerbaijan has made noticeable strides in improving its business climate. For instance, in just one year in the World Bank’s Ease of Doing Business report Azerbaijan made a commendable leap forward from 97th to 33rd.

Important measures have been adopted such as a one-stop shop for business start-ups, which began operating in January 2008, halving the time, cost and number of procedures to start a business and resulting in business registrations increasing by 40% in the first six months.

Also, a new economic court in Baku helps speed contract enforcement with the average time to resolve a case declining by 30 days. Legislative efforts continue and IBA’s Hajiyev mentions that parliament approved an anti-money laundering law in February 2009, which will bring more transparency and trust for foreign investors coming to Azerbaijan.

He adds: “IBA was among the first to support this law and is already a signatory to the World Economic Forum Partnering Against Corruption Initiative (PACI) launched in 2004. Since becoming a signatory, we adopted our own internal procedures in conformity with anti-money laundering requirements.”

A chance to take stock

Any crisis can lead to positive changes and Azeri banks have engaged on a path of

consolidating their positions and managing what had been unbridled growth.

Huseynov of Texnikabank says: “We look at 2009 and 2010 as an opportunity to foster institutional development and growth.

Over the past several years we experienced tremendous growth at triple digit rates: our assets went from US\$17mn in 2003 to over US\$500mn in 2008, so we want to make sure we are institutionally ready to carry this weight.”

The banks are also working on improving and fine-tuning their modus operandi to be ready to catch the anticipated economic rebound fully prepared. This includes a greater focus on domestic clients, the fine-tuning of lending procedures and educational efforts.

Jalal Gasimov, chairman of Bank of Baku, says: “Our strategy for 2009 is for stability and quality while preserving the efficiency of our operations.”

“We managed to repay all our external debt without any help from the government.”

Jahangir Hajiyev, International Bank of Azerbaijan

Azeri banks have shifted their focus onto core activities such as retail banking and nurturing its customer base. Hajiyev says: “We have the trust of account holders and household deposits are steadily growing.” This could be because IBA is a state-controlled bank, but the trend is confirmed by other large, privately-owned banks we spoke with.

Huseynov says: “The key element for our ability to weather the storm was our loyal and expanding customer base. We have the largest network of branches among private banks in Azerbaijan and our number of customers is rising. We try to diversify the products we offer to our customers and this is why we were able to maintain our deposit levels at decent levels. Our funding was quite diversified and our priority is to continue the diversification of our funding base.”

This effort has been accompanied by efforts to offer extended services as well as easier banking access.

Huseynov says: “We are now giving more attention to retail depositors. We have a much more extensive branch network right now, which will let us attract more retail deposits. The VIP Branch has been launched to provide specific and personalised services to major depositors. We have opened the first branch that offers ‘longer hours’ services available to our customers until late every day. We recently



Jahangir Hajiyev, International Bank of Azerbaijan

started new deposit campaigns and they are being quite successful.”

As a result, the number of branches almost doubled to reach 24, and the deposit base of Unibank rose by a third despite challenging market conditions.

Fine tuning lending procedures

For Gasimov of Bank of Baku, the number one priority is to maintain the quality of its loans. “On a daily basis we are measuring the performance of each loan expert, each branch, each product and each partner that allows us to detect fraud faster and to secure the bank from losses” which is done “via the implementation of various metrics for performance measurement and risk management.”

Bank of Baku also reconsidered the motivation systems for loan experts by “switching the focus from the quantity of loans issued to the quality of portfolios under management. We also changed the motivation system for the problem loan collection department, assigning different weights for the bad loans of different maturity and of different product groups.” Huseynov of Texnikabank says Azeri banks still have work to do on their risk management systems. “We need to have better IT and technology to improve our management ability. Therefore, we have invested in new European banking software

that will give us more analytical tools on how to manage the bank's liquidity." Texnikabank also hired a consulting company to make recommendations on how to improve risk management procedures. International collaboration is also seen as a top priority "with institutions such as the EBRD, IFC, and ADB because they tend to not only provide funding but also technical assistance and we want to utilise their experience in other countries which would bring value to us in terms of taking the bank forward".

Preparing for the rebound

Besides consolidating their existing market shares, Azeri banks are already looking beyond 2009.

Texnikabank plans to tap into international capital markets once the situation improves, not just for the sake of funding but also to develop the bank's image and expand its international relations.

"We were the first ever Azeri bank to technically issue about US\$200mn-worth of Eurobonds. Then we decided to stay away from such a large exposure to foreign borrowings but we went ahead just for the sake of the experience and to get the bank's name known in the international community. We issued a Eurobond worth US\$26mn on the London Stock Exchange, which helped the bank go through a quite lengthy due diligence process, during which we identified the strengths and weaknesses

of the bank and, as we tried to address all these issues, we were more or less ready for the crisis."

Hajiyev from IBA says that his bank is still able to borrow abroad, for example from the Middle East, and that "we are going to expand abroad as it is the right time to buy banks, make acquisitions in EU countries and in Turkey."

He adds: "We have a very successfully subsidiary bank in Russia – IBA Moscow – that is among the top 200 banks in Russia. We are now working on obtaining a licence to have a subsidiary in Qatar. So the policy of the management of the bank is to use our competitive advantage and use this opportunity to expand and strengthen our operations."

Diversifying the economy

One of the sectors attracting most interest from Azeri bankers is agriculture. Hajiyev says: "Traditionally and historically we have been an agricultural country so there are good prospects for any foreign investors will be in agriculture and agricultural processing."

Huseynov says: "The key is that we have a strong market for agricultural products in Russia. Historically we used to just sell fruit and vegetables but now we see a need for packaging these fruit and vegetables and improving this industry tremendously."

Hajiyev mentions several projects financed in collaboration with US Ex-Im Bank, such as drip irrigation, using a new technology for cotton, which has resulted in the doubling of the production of cotton for its clients in a matter of a few years. "We are also financing our first environmental project on soil rehabilitation of the Absheron Peninsula, which suffers from years of oil drilling by providing financing for soil remediation equipment."

Gasimov sees telecoms, agriculture, and microbusiness lending as good sectors. He adds: "Retail loans will have a huge market potential once the markets get stabilized and individuals increase their spending. High interest rates inherent to these products and weak competition will make retail loan products very attractive."

Regarding construction, which had been a booming sector in Azerbaijan but has slowed down considerably since the credit crunch began, Huseynov of Texnikabank considers the slowdown as healthy. He says: "I don't think it will pick up anytime soon. Baku resembles a construction yard as a lot of buildings have been built and that's enough. I think the growth in construction will now be in infrastructure: highways, bridges, schools

and hospitals funded by government spending. Other sectors with growth potential could be the telecom sector and we could see a slight pickup in the manufacturing sector, primarily light industry."

Future challenges but a promising market

One beneficial aspect of the global financial crisis is the cooling down of the economy. Falling food and commodity prices will help tame inflation and the IMF even ventures to say that it could decline to 9% by the end of 2009, from a high of 20% in 2008.

Huseynov says: "The global economy and our country in particular have experienced over the past years high GDP growth with high real estate price increases and an immense increase in consumer demand. All this has been heating the economy and caused inflation as well as other adverse trends. So, the slowdown and normalisation of growth can even turn out to be positive factors in the end – only, however, if they occur smoothly and stay controllable."

This said, despite efforts to diversify the economy to non-oil sectors such as agriculture, construction and services, Azerbaijan remains highly dependent on the price of oil. The National Bank has identified possible sources of turbulence for 2009: the uncertain oil price and global demand; declining investment flows around the globe and the impact of the crisis on its neighbours such as Russia. This latter point partly refers to remittances that come from migrant workers.

For Huseynov the major challenge for Azerbaijan is the lack of a properly functioning equity market that would foster greater transparency and allow companies to obtain additional sources of funding for their business.

"Interest rates are close to 20% per year for a normal business loan and that is quite high, therefore, it would be ideal to enable small and medium-sized enterprises, or even bigger corporations, to have access to funding through equity, IPOs and the stock market. It will be crucial in the next five years to develop the equity market."

Nevertheless, bankers we spoke with for this article are all very upbeat. Gasimov of Bank of Baku says: "Azerbaijan, with its very stable political and economic systems and outlook, presents a brilliant opportunity for successful investments. The market has room to grow and return rates on investments usually achieve significant levels."

Hajiyev concludes saying that, "as any country, we have our own problems but nevertheless it is manageable".



Faig Huseynov, Unibank