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**ABSTRACT**

of the dissertation for the degree of Doctor of Philosophy

**ORGANIZATION OF SHORT-TERM LENDING  
IN THE NON-OIL SECTOR AND ITS IMPACT  
ON BANK RISKS**

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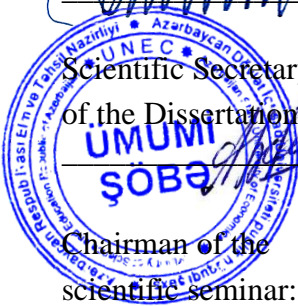
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## GENERAL CHARACTERISTICS OF THE STUDY

**The relevance of the topic.** As is known from economic literature, lending occupies a special share among the active operations of banks. According to 2020 data, up to 70% of the income of banks in the United States is generated from credit and leasing operations, up to 50% in Japan from credit operations, up to 65% in Canada from credit and factoring, up to 68% in the United Kingdom from credit operations, and up to 80% in Germany from credit and leasing operations. Such a high level of income generated from credit operations is ensured by the parameters inherent in credit itself. The main reason is that credit actively participates in the reproduction process, thereby creating new value.

At present, the process of bank lending to the economy in our country is characterized by a sluggish nature. The main reason for this is the unstable financial condition of a large part of economic entities operating in the real sector. As a result, the total volume of credit investments in the national economy has not yet reached the level observed prior to the last financial crisis. In 2015, the pre-crisis peak year, credit investments in the economy amounted to 21,730.4 million manats, while in subsequent years this indicator declined, reaching 14,530.4 million manats by the end of 2020. As a result of the recession in economic sectors, in 2015–2016 total credit investments decreased by 24.3% and 28.5% compared to the previous year, falling to 11,757.8 million manats by the end of 2017. Although a certain degree of recovery was observed in 2018–2019, the pre-crisis level has not yet been restored.

The unstable financial condition of the real sector necessitates the application of more advanced forms of lending in this sphere. One of the key conditions for achieving efficient results in a short period is the implementation of short-term lending that can provide economic entities with flexible and operational access to funds. The widespread application of various forms of short-term credit—such as overdraft, revolving credit lines, overnight loans, letters of credit, and factoring—may contribute to the development of the credit market.

As is known, there are a number of factors that limit the use of credit

resources in the credit market. Under their influence, producers and service providers in the real sector often show insufficient demand for credit resources, resulting in repeated downturns in these sectors. In many cases, such limiting factors generate banking risks, the mitigation of which has become an urgent issue.

Measures aimed at eliminating these constraints and ensuring improved access to credit resources are reflected in the “Strategic Roadmap for the Development of Financial Services in the Republic of Azerbaijan,” approved by the Decree of the President of the Republic of Azerbaijan dated 6 November 2016. This document identifies key directions for addressing the above-mentioned problems, including strengthening the capitalization and liquidity of the banking system, restructuring non-performing assets, developing the insurance market, enhancing financial inclusion, and increasing the activity of the interbank money market.

The rapid development of the non-oil sector, which has become a priority of the country’s economic policy, the continuous provision of this sector with short-term credit resources, and the mitigation of risks arising in this process have become among the most pressing issues of the present time. The progressive implementation of short-term lending in the non-oil sector as an important element of diversification policy, and the development of the real sector through this mechanism, remain highly relevant and topical issues.

**The level of research on the problem.** The necessity of applying short-term lending in the non-oil sector, its mechanisms and forms, as well as its theoretical, practical, and methodological aspects have been studied in the research works of both foreign and Azerbaijani scholars.

In the works of Azerbaijani economists such as Z.F.Mammadov, M.M.Baghirov, E.M.Sadigov, A.E.Karimov, R.A.Bashirov, Sh.A.Abdullayev, Z.H.Ibrahimov, A.A.Babayev and others, issues related to the application of important forms of lending in various sectors of the national economy have been reflected.

Representatives of the European and American economic schools, including B.Lexis, Timothy Y.Koch, J.Matuk, M.M.Yampolsky, J.M.Keynes, M.Friedman, Adam Smith, David Ricardo and others have produced numerous works addressing various aspects of lending,

its content and significance, organizational principles, its role in the economy, and its impact on economic dynamics.

At the same time, representatives of the Russian economic school such as E.V.Tikhomirova, V.I.Rybkin, G.S.Panova, N.I.Sivulski, V.M.Usoskin, V.V.Golosov, N.B.Chkhadadze, O.V.Motovilov, E.B.Shirinskaya, I.D.Mamonova, B.N.Dobrov, B.A.Chelnokov, A.V.Chinenkov and others have produced a considerable number of studies on lending under market economy conditions with various approaches and content.

The works of the above-mentioned Azerbaijani and foreign scholars devoted to credit operations, lending mechanisms, and credit technologies are of high theoretical, methodological, and practical significance. However, in these studies, the issues of the organization of short-term lending in the non-oil sector, its regulation, and its impact on banking risks have not been comprehensively addressed. For this reason, the study of the organization of short-term lending in the non-oil sector of Azerbaijan and its impact on credit (bank) risks has been set as the main objective of the present research.

**Purpose and Objectives of the Research.** The main purpose of the research is to study the organization of short-term lending in the non-oil sector of the Azerbaijani economy and its impact on bank risks, as well as to identify ways to eliminate negative trends arising from banking risks.

In order to achieve this objective, the following tasks have been set:

- to examine the theoretical and methodological issues of the organization of short-term lending in the non-oil sector of the national economy;
- to analyze the impact mechanisms of short-term lending on bank risks under market economy conditions;
- to study international experience in the development of short-term lending systems with a view to applying positive trends in the national economy;
- to analyze in detail the current state of short-term lending in the non-oil sector of the country and to examine the existing regulatory and legal framework for its application;
- to conduct an analysis of the current situation in the short-term

- lending market based on indicators for the period 2005–2020;
- to perform an econometric assessment of the current state of short-term lending, taking into account the correlation between key indicators affecting the lending process;
  - to identify sources of funding for short-term loans in order to mitigate potential banking risks arising from short-term lending;
  - to determine directions for improving mechanisms for eliminating existing risks based on comprehensive analysis.

**Object of the Research.** The object of the research is the system of short-term lending applied in the non-oil sector of the economy of the Republic of Azerbaijan.

**Subject of the Research.** The subject of the research comprises the analysis of the current state of short-term lending applied in the national economy, its econometric assessment, its regularities, the methods for identifying factors determining its efficient application, as well as the system of economic relations formed on this basis.

**Theoretical and Methodological Foundations of the Research.** The theoretical and methodological foundations of the research are based on the works of Azerbaijani and foreign scholars and researchers, as well as practitioners dealing with short-term lending, including studies devoted to the organization, management, and regulation of this process. In addition, the research relies on resolutions adopted by the Milli Majlis of the Republic of Azerbaijan, decrees and orders of the President of the Republic of Azerbaijan, decisions of the Cabinet of Ministers, as well as methodological and regulatory acts, rules, information, and reporting indicators approved by the Board of the Central Bank of the Republic of Azerbaijan.

**Research Methods.** The research employs a systematic and comprehensive approach, analytical and synthetic accounting and analysis methods, induction and deduction methods, time series analysis, analytical and computational methods, as well as comparative analysis, comparison, synthesis, and balance methods.

**Information Base of the Research.** The information base of the research consists of annual reports of the Central Bank of the Republic of Azerbaijan and the State Statistical Committee of the Republic of Azerbaijan, legislative and regulatory acts governing the lending

process in the country, monographic studies, materials from scientific-theoretical and scientific-practical conferences of various levels, as well as personal observation materials and internet resources.

**Key Provisions Submitted for Defense.** A number of provisions derived from the results of the conducted research and analysis are submitted for defense.

1. The impact of short-term lending on bank risks under market economy conditions.
2. The results obtained from the analysis of the current state of short-term lending in the economy of Azerbaijan, as well as the outcomes of econometric assessments carried out.
3. Identification of reserve sources of short-term loans aimed at mitigating banking risks arising in the process of short-term lending.
4. Directions for improving the mechanisms for mitigating banking risks.

The scientific novelty of the research consists of the following provisions:

- Theoretical and methodological issues of short-term lending in the non-oil sector have been analyzed on the basis of approaches of various foreign and domestic scholars; its significance and role in development have been examined, and its main provisions have been substantiated.
- Banking risks arising under the influence of short-term lending in market economy conditions have been investigated; the main parameters of risk have been identified, and the economic nature of the factors generating these risks has been determined.
- Based on comprehensive analysis, positive trends of international experience in short-term lending have been identified, and proposals have been made for the application of its key elements in the national economy.
- The regulatory and legal framework of short-term lending implemented in the economy of the Republic of Azerbaijan has been extensively analyzed, and valuable proposals have been put forward for its improvement.
- Based on the dynamics of the credit market covering the period 2005–2020, the current state of short-term lending has been

comprehensively analyzed, and proposals for its improvement have been developed.

- Econometric assessment has been carried out based on key indicators characterizing the current state of short-term lending, and new proposals have been developed for its future improvement.
- Reserve sources of short-term loans aimed at mitigating banking risks have been identified, and advanced methods for their efficient use have been proposed.
- As a result of the analysis and research, ways of mitigating risks in short-term lending have been identified, and proposals for their improvement have been put forward.

**Theoretical and Practical Significance of the Research.** The theoretical and conceptual provisions obtained as a result of the research conducted in the dissertation, as well as the proposals put forward for individual parameters and the scientifically substantiated recommendations, may be widely used in the preparation of programs, forecasts, and project implementations aimed at further development, regulation, and improvement of short-term lending in the national economy of the Republic.

At the same time, the materials of the dissertation can be extensively applied in the teaching process in higher education institutions, both at bachelor's and master's levels, particularly in courses such as "Money and Banking," "Banking," "Bank Operations," "Modern Banking Products and Services," "Theoretical and Practical Aspects of the Monetary-Credit System," and related disciplines.

**Name of the Organization Where the Dissertation Was Completed.** The dissertation was carried out at Odlar Yurdu University of the Ministry of Education of the Republic of Azerbaijan.

**Implementation of Research Results.** The results of the dissertation, along with its main theoretical and practical provisions, were presented and widely discussed by the author at various international and national conferences, symposia, and seminars held during 2018–2021.

**Publications Based on the Research.** As a result of the research, 8 scientific articles and theses have been published, totaling 6.4 printed sheets.

**Scope and Structure of the Dissertation.** The dissertation consists of an introduction, three chapters, conclusions, and a list of references. It comprises 145 pages, typed with 1.5 line spacing, and includes 11 tables and 1 diagram. The reference list contains 130 sources.

The total volume of the dissertation by character count, excluding tables, references, abbreviations, cover page, and table of contents, is 216,679 characters, distributed as follows: Introduction – 12,774 characters; Chapter I – 73,054 characters; Chapter II – 74,233 characters; Chapter III – 36,336 characters; Conclusion – 10,282 characters.

## **SCIENTIFIC PROVISIONS SUBMITTED FOR DEFENSE**

### **1. The impact of short-term lending on bank risks under market economy conditions.**

The organization of short-term lending, being an integral part of the credit policy implemented by banks, is of high importance. As a component of banks' credit policy, short-term lending reflects a close interrelation between the volume of short-term credit allocated to economic entities and the planned reserves and expenditures of enterprises, as well as their utilized amounts.

When examining theoretical approaches to short-term lending, it becomes evident that the use of this form of lending in enterprise turnover creates conditions for the optimal management of bank credit risks. This is because such risks arise directly in connection with the capital circulation of the enterprise, i.e., the borrower. This is also related to the method of lending, which is an essential element of the credit process.

Our research into the theoretical aspects of short-term bank lending shows that this type of lending should not be equated with the movement of an enterprise's working capital. Although the parameters of short-term lending are largely determined by the regularities of the full turnover of an enterprise's working capital, it is also closely linked to the accumulation and formation of the actual volume of circulating funds of commodity producers.

The object of short-term lending in the non-oil sector refers to

those sectors and branches of the economy that have become priorities of the state's credit policy in this area. These sectors and branches consist of non-oil-related economic activities and areas in which economic diversification is being implemented.

The method of short-term lending in the non-oil sector refers to the specific techniques of credit resource participation in the enterprise's capital circulation in accordance with the principles of lending. These methods must be consistent with the rules governing both the disbursement and repayment of credit, ensuring the credit's participation in the monetary circulation of the economic entity. The lending method is one of the most important elements of the credit process and a key economic factor determining the nature of other elements of lending.

In a market economy, when short-term lending is implemented through the method of crediting account balances in a special loan account, certain shortcomings arise that lead to risks, manifested in the application of discrete and interrupted forms of fund disbursement. This contradicts the regularity of the continuous circulation of producers' capital. This becomes even more pronounced in cases involving multiple lending objects, where artificial fragmentation of the enterprise's payment turnover occurs. As a result, proper coordination and harmonization of different types of loans becomes difficult, which in turn leads to the emergence of various banking risks.

Research shows that banking risks arising in short-term lending under market economy conditions are mainly credit risks. The negative tendencies generated by these risks subsequently create conditions for the emergence of other types of risks. Therefore, considering the above, effective management of banks' credit risks becomes necessary for achieving efficient outcomes. In this direction, risk management should first of all be based on the use of a more mobile and flexible mechanism of short-term lending.

The creation of such a risk management system should be based on determining an effective lending method in line with credit policy, applying and improving modern methods of regulatory credit management, introducing more flexible and efficient lending techniques, and ensuring timely and high-quality supervision of the

proper and efficient use of credit resources.



**Figure 1. Elements of the Risk Management System**

*Source: Compiled by the author based on materials of the International Monetary Fund*

It is clear from Scheme 1 that the minimization of existing risks in banks, as well as the prevention of potential risks, is implemented through the risk management system, which has been widely applied in international practice for a long time. As illustrated, the most essential and primary elements of the risk management system are, first, the management of bank liabilities and, second, the management of bank assets. If the necessary interdependence and consistency between these two key indicators are not ensured, risks become inevitable. In banking management, the alignment of all parameters of liabilities and assets, particularly in terms of volume and maturity, is a crucial requirement. Such alignment leads to an improvement in key

performance indicators of banks, such as liquidity, competitiveness, profitability, and return on assets, which in turn ensures the minimization of risks.

International banking practice shows that banking risks arise due to a wide range of factors, including external and internal, organizational, economic, and other influences. Each risk generated under the impact of these multiple factors is organically interconnected with other types of risks. In this regard, the following types of risks are encountered in banking activity: financial risks, functional risks, and external risks related to banking operations. Such classification of risks can be found in various economic literature and research studies.

## **2. Results obtained from the analysis of the current state of short-term lending in the economy of Azerbaijan, as well as the results of econometric assessments.**

Although both long-term and short-term loans used in the credit system share the same economic nature and content, they may generate different levels of efficiency for economic entities when applied. This is because short-term loans are rapidly integrated into the payment turnover of any economic entity, creating new value, promptly satisfying the borrower's need for funds, and fulfilling their capital-formation function efficiently. They are repaid in accordance with the terms of the credit agreement concluded between the parties. Thus, on the one hand, short-term loans promptly meet the financial needs of economic entities, and on the other hand, they expand and accelerate commodity turnover, which is one of the most important indicators of the economy. Therefore, a comprehensive analysis of the current state of short-term lending in the economy and an assessment of its utilization outcomes are of significant importance.

In accordance with the aim and objectives of the study, it is necessary to analyze the dynamics of credit investments of credit institutions in Azerbaijan during 2005–2023, both in national and foreign currency, by maturity.

Another important issue consistent with the objectives of the research is the analysis of the dynamics of the share distribution between short-term and long-term loans in national currency credit allocations in Azerbaijan during 2005–2023.

**Table 1. Dynamics of the share of short-term and long-term loans in national currency credit investments of credit institutions in the Republic of Azerbaijan during 2005–2020**

Years	Total loans, mln manats	Of which in national currency, mln manats	Of which			
			Short-term loans		Long-term loans	
			Total	Share, %	Total	Share, %
2005	1441.0	542.9	353.1	65.03	189.8	34.97
2006	2362.7	1170.5	597.4	51.0	573.1	49.0
2007	4681.8	2513.7	1066.4	42.4	1447.3	57.6
2008	7191.3	3672.9	1346.9	36.7	2326.0	63.3
2009	8407.5	4886.2	1452.7	29.7	3433.5	70.3
2010	9163.4	5865.3	1523.8	26.0	4341.5	74.0
2011	9850.3	6326.5	1901.0	30.0	4425.5	70.0
2012	12243.7	8422.8	2514.3	29.8	5908.5	70.2
2013	15422.9	11076.7	2297.4	20.7	8779.3	79.3
2014	18542.6	13505.7	2494.2	18.46	11011.5	81.54
2015	21730.4	10994.5	1773.8	16.13	9220.7	83.87
2016	16444.6	8663.1	1362.4	15.7	7300.8	84.3
2017	11757.8	6953.6	1030.6	14.82	5923.0	85.18
2018	13020.3	8073.6	1510.2	18.7	6563.3	81.3
2019	15298.2	10000.8	1659.6	16.6	8341.2	83.4
2020	14530.4	10204.0	1754.2	17.2	8449.8	82.8
2021	17119,8	12696,5	2246,0	17,7	10450,5	82,3
2022	20184,0	16194,3	2838,2	17,5	13356,1	82,5
2023	23979,1	19538,7	3279,8	16,8	16258,9	83,2

*Source: The table was compiled by the author.*

The data in Table 1 show that in 2011, compared to the previous year, the share of short-term loans increased by 4%, reaching 30%. This indicator represents the highest level of the share of short-term loans over the analyzed period, including the final year of the study. Subsequently, this indicator demonstrated a generally declining trend, decreasing year by year: 29.8% in 2012, 20.7% in 2013, 18.46% in 2014, 16.13% in 2015, 15.7% in 2016, 14.82% in 2017, followed by a temporary increase to 18.7% in 2018, then 16.6% in 2019, 17.2% in 2020, 17.7% in 2021, 17.5% in 2022, and finally declining again to 16.8% in 2023.

The analysis shows that the downward trend in the studied indicator is associated with the objectives and priorities of the credit system policy. The preference of creditors for financing long-term

projects and programs, their interest in prioritizing such investments, and the efficient use of both own and attracted resources in a long-term strategic framework have contributed to this tendency. As a result, over the last ten years of the analyzed period, the share of long-term loans has exceeded that of short-term loans, accounting for more than 80%. The main reasons for this include the volatility of short-term lending volumes, as well as the fact that the reallocation of funds in this type of lending is more difficult and riskier for creditors.

One of the important indicators requiring analysis is the dynamics of credit institutions' foreign currency credit allocations by maturity in the Republic during 2005–2023 (Table 2).

**Table 2. Dynamics of the Share of Short-Term and Long-Term Loans in Foreign Currency Credit Allocations of Credit Institutions in the Republic of Azerbaijan during 2005–2020**

Years	Total loans, mln manats	Of which in national currency, mln manats	Of which			
			Short-term loans	Long-term loans		
			Total	Share, %	Total	Share, %
2005	1441.0	898	560.1	62.4	337.9	37.6
2006	2362.7	1192.2	544.6	45.7	647.6	54.3
2007	4681.8	2168.1	583.1	27.0	1585.0	73.0
2008	7191.3	3518.4	949.0	26.9	2569.4	73.0
2009	8407.5	3521.3	907.2	25.7	2614.0	74.3
2010	9163.4	3298.1	1043.3	31.6	2254.8	68.4
2011	9850.3	3523.8	1050.2	29.8	2473.6	70.2
2012	12243.7	3820.9	994.0	26.0	2826.9	74.0
2013	15422.9	4346.3	1038.1	23.9	3308.2	76.1
2014	18542.6	5037.0	1437.2	28.5	3599.8	71.5
2015	21730.4	10735.9	3523.5	32.8	7212.4	67.2
2016	16444.6	7781.4	2115.6	27.2	5665.9	72.8
2017	11757.8	4804.2	1070.7	22.3	3733.5	77.7
2018	13020.3	4946.7	1184.9	24.0	3761.8	76.0
2019	15298.2	5297.4	1259.1	23.7	4038.2	76.3
2020	14530.4	4326.4	720.7	16.6	3605.7	83.4
2021	17119.8	4423.4	955.9	21.6	3467.4	78.4
2022	20184.0	3989.7	770.8	19.3	3218.8	80.7
2023	23979.1	4440.4	811.4	18.3	3629.0	81.7

*Source:* The table was compiled by the author based on data from the Central Bank of the Republic of Azerbaijan.

**It can be seen from Table 2 that the share of foreign currency credit allocations (in manat equivalent) within total credit investments during 2005–2023 was volatile.**

The analysis of the table shows that during the studied period, the share of short-term loans in foreign currency credit allocations demonstrated a declining trend. This indicator reached its highest level in 2005, amounting to 62.4%. In subsequent years, the share of short-term loans decreased year by year, reaching 18.3% in 2023, the final year of the analysis. Starting from 2006, the indicator declined for four consecutive years. Thus, compared to the previous year, the decrease amounted to 16.7% in 2006, 18.7% in 2007, 0.10% in 2008, and 1.2% in 2009.

As a result of the positive economic trends emerging in the direction of overcoming the negative effects of the 2008–2009 crisis, the volume of short-term loans increased by 136.1 million manats in 2010 compared to the previous year, and consequently, their share increased by 5.9%, reaching 31.6%. During the following three years, the share of short-term loans again declined. Thus, in 2011 it decreased by 1.8% to 29.8%, in 2012 by 3.8% to 26%, and in 2013 by 2.1% to 23.9%.

During the subsequent crisis years—2014 and 2015—due to increased dollarization of loans, declining public confidence in banks, reduced preference of creditors for long-term lending, and other factors, the share of short-term loans increased. Compared to the previous year, the indicator increased by 4.6% in 2014 to 28.5%, and by 4.3% in 2015 to 32.8%.

In the following years, namely the recovery period after the crisis, lending trends changed, and the share of short-term loans began to decline again. Thus, compared to the previous year, the indicator decreased by 5.6% in 2016 to 27.2%, and by 4.9% in 2017 to 22.3%. Although a slight increase of 1.7% was observed in 2018, a decline resumed in subsequent years. In 2019, the indicator decreased by 0.3% to 23.7%, and in 2020 it fell by 7.1%, reaching 16.6%, the lowest level observed during the analyzed period. In 2021, the indicator increased by 32.6% compared to the previous year, reaching 21.6%, but in the following two years it declined again, reaching 18.3% in 2023. It

should be noted that during the analyzed period, the share of long-term loans reached its highest level in 2020, accounting for 83.4%.

Regarding credit allocations to the energy, mining, chemical, and natural resources sectors of the economy, an increasing trend was observed in 11 out of the 19 analyzed years, excluding 2006, 2010, 2011, 2013, 2014, 2017, 2020, and 2022. The share of credit allocations to this sector was 13% in 2005 but decreased to 3.1% by 2023.

Credit allocations to agriculture, forestry, and horticulture increased in most years, except for the crisis years of 2015–2017 and 2023. While the share of this sector in total credit allocations was 6.7% at the beginning of the period, it declined to 2.2% by the end of the period.

In the construction sector, which holds a significant share in GDP, an increasing trend in credit allocations was observed in 16 out of the 19 years, excluding 2016–2018. Although the share of credit allocations to this sector was 5.7% at the beginning of the period, it declined slightly to 4.7% by the end. This is mainly due to the fact that corporate construction companies operating in the country possess sufficient own financial resources.

One of the important sectors of the economy is industry and manufacturing. Credit allocations to this sector showed an increasing trend in most years, except for 2011, 2015–2017, and 2021. While its share was 5.8% at the beginning of the period, it increased to 8.5% in 2020 but declined again to 5.0% by the end of the period. This reflects both the growing role of the sector in the economy and its expanding scale.

Another important sector is transport and communication. Credit allocations to this sector decreased in 2009, 2010, 2011, 2016, 2017, 2019, and 2020, while an increase was observed in the remaining years. Although its share was 8.89% at the beginning of the period, it declined to 5.83% by the end of the period. A similar statement applies again: this sector generally operates profitably and largely finances its activities through its own resources.

Households represent one of the most important sectors of the economy. The data show that the share of this sector in total credit

allocations increased from 27% at the beginning of the period to 58.4% by the end, which is the highest among all sectors. This is mainly due to high demand for working capital and relatively low savings held by the population. During the analyzed period, an increasing trend was observed in most years, except for 2009, 2016, 2017, and 2020.

The only sector that consistently demonstrated growth throughout the entire period is real estate construction and purchase (including mortgage lending). Its share increased from 2.67% at the beginning of the period to 15.1% in 2023. This is mainly due to its growing role in improving social welfare and increasing demand in this area. The state also actively participates in this sector through expanding mortgage lending and financing social housing projects.

One of the important indicators for this study is also the dynamics of credit allocations to other sectors, public organizations, government institutions, and financial-sector-related instruments such as letters of credit, guarantees, factoring operations, overdrafts, and loans to the financial sector.

The econometric analysis of key indicators related to short-term lending shows that an increase in total credit allocations by 1% leads to a 0.67% increase in nominal GDP. It was also found that a 1% increase in credit allocations in national currency leads to a 0.50% increase in nominal GDP, while a 1% increase in foreign currency credit allocations leads to a 0.08% increase in nominal GDP. Furthermore, it was determined that a 1% increase in short-term credit allocations results in a 0.70% decrease in nominal GDP, whereas a 1% increase in long-term credit allocations leads to a 0.80% increase in nominal GDP. In addition, it was found that a 1% increase in free bank reserves is associated with a 0.37% increase in total credit allocations to the economy.

### **3. Identification of Reserve Sources of Short-Term Loans in Order to Mitigate Banking Risks Arising in Short-Term Lending**

In order to prevent risks that may arise in the process of short-term lending, banks must adopt a more rigorous approach to this type of lending, ensure continuous monitoring of the financial condition of economic entities using short-term loans, and coordinate the timing of fund availability with their subsequent reallocation to other economic

agents. In other words, banks must continuously ensure the alignment and consistency of a number of parameters of their assets and liabilities.

To avoid exposure to risks during short-term lending, banks must maintain static liquidity on a continuous basis. This is a form of liquidity defined for a specific point in time and a specific date. At the same time, banks must also monitor dynamic liquidity in order to avoid potential risks in short-term lending operations. As is known from economic literature, dynamic liquidity reflects liquidity parameters forecasted for a longer future period and defined for a specific moment in time based on projections. Dynamic liquidity exists in two forms: short-term and long-term liquidity. Short-term liquidity is generally determined on the basis of forecasts covering a period of 1–3 months regarding the bank's activity. Long-term liquidity, in turn, is determined on the basis of forecasts covering a period from six months up to one year.

One of the important factors in eliminating risks in short-term lending is the creation of reserve sources through the use of free bank reserves in the form of overdraft (contokorrent) credit facilities. Analysis of the main indicators for the period 2005–2023 shows that free bank reserves, which form an essential component of the money market and hold a significant share in the national economy, have demonstrated a growing trend over the analyzed period (Table 3).

**Table 3. Dynamics of Credit Allocations to the Economy of the Republic of Azerbaijan and Free Bank Reserves in Correspondent Accounts during 2005–2020 (mln manats)**

№	Years	Total credit allocations	Increase/decrease compared to previous year (%)	Free bank reserves	Increase/decrease compared to previous year (%)	Credit allocations in case of concurrent credit application	Increase in relation to total credit allocations (%)
1	2005	1441.0	-	207.8	-	1648.8	+14.4
2	2006	2362.7	+63.96	384.3	+84.5	2747.0	+16.3
3	2007	4681.8	+98.4	194.5	-49.4	4876.3	+4.2
4	2008	7191.3	+53.6	306.0	+57.3	7497.3	+4.3
5	2009	8407.5	+17.0	371.6	+21.4	8779.10	+4.4
6	2010	9163.4	+9.0	704.6	+90.0	9868.0	+7.7
7	2011	9850.3	+7.5	725.6	+3.0	10575.9	+7.4
8	2012	12243.7	+24.3	740.6	+2.1	12984.3	+6.1
9	2013	15422.9	+26.0	592.2	+20.0	16015.1	+3.8
10	2014	18542.6	+20.2	785.1	+32.6	19327.70	+4.2
11	2015	21730.4	+17.2	2089.9	+166.2	23820.3	+9.6
12	2016	16444.6	-24.3	2111.0	+1.0	18555.6	+12.8
13	2017	11757.8	-28.5	1554.6	-26.4	13312.4	+13.22
14	2018	13020.3	+10.7	2080.8	+33.8	15101.1	+16.0
15	2019	15298.2	+17.5	2543.2	+22.2	17841.0	+16.6
16	2020	14530.4	-5.02	3054.6	+20.1	17585.0	+21.0
17	2021	17119.8	+17.8	173.4	+16.0	17293.2	+1.0
18	2022	20184.0	+17.9	1389.2	+701.2	21573.2	+6.9
19	2023	23979.1	+18.8	5050.8	+263.6	29029.9	+21.1

**Source:** The table was compiled by the author based on data from the Central Bank of Azerbaijan.

It can be seen that during the analyzed period, growth was recorded in all years except 2007, 2013, and 2017. Compared to the previous year, this increase amounted to 84.9% in 2006, 57.3% in 2008, 21.4% in 2009, 89.6% in 2010, 2.98% in 2011, 2.06% in 2012, 32.6% in 2014, 166.2% in 2015, 1.0% in 2016, 34.0% in 2018, 22.2% in 2019, 20.1% in 2020, 16.0% in 2021, eightfold in 2022, and 3.6 times in 2023.

The balances of free bank reserves formed in correspondent accounts at the end of the reporting year indicate that these amounts are not generated suddenly but accumulate gradually on a daily and monthly basis throughout the year. If these funds are directed into the credit process in the form of contokorrent lending from the beginning of the year, this potential could significantly improve both the condition of credit institutions and borrowers. As a result, key macroeconomic indicators of the national economy—such as GDP growth, employment levels, reduction of poverty, and maintenance of inflation within targeted levels—could all improve.

The analysis also shows that another important source for the formation of reserve funds for short-term lending in order to mitigate risks may be the funds held in special accounts under mandatory reserve requirements established by the Central Bank. Considering that in developed countries such as the United Kingdom, Canada, and Luxembourg there is no requirement for banks to maintain minimum reserves at the Central Bank, the requirement for mandatory reserves in the banking system of our country could also be reconsidered. These funds could instead be actively used by credit institutions in daily operations.

To analyze the impact of mandatory reserve requirements on total credit allocations, let us consider their dynamics (Table 4).

The data in Table 4 show that during 2005–2023, the amount of mandatory reserve requirements exhibited volatility. Thus, over the 19-year period, this indicator increased in 11 years, while in the remaining 8 years it decreased. The increases compared to the previous year were 151% in 2006, 59% in 2007, 2.45% in 2010, 382.3% in 2011, 54.5% in 2012, 48% in 2013, 45.2% in 2014, 211.6% in 2016, 15.4% in 2018, 1.5% in 2019, 13.0% in 2022, and 3.0% in 2023.

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Nö	Years	Total credit allocations	Increase/decrease compared to previous year (%)	Free bank reserves	Increase/decrease compared to previous year (%)	Credit allocations in case of concurrent credit application	Increase in relation to total credit allocations (%)
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5	2009	8407.5	+17.0	371.6	+21.4	8779.10	+4.4
6	2010	9163.4	+9.0	704.6	+90.0	9868.0	+7.7
7	2011	9850.3	+7.5	725.6	+3.0	10575.9	+7.4
8	2012	12243.7	+24.3	740.6	+2.1	12984.3	+6.1
9	2013	15422.9	+26.0	592.2	+20.0	16015.1	+3.8
10	2014	18542.6	+20.2	785.1	+32.6	19327.70	+4.2
11	2015	21730.4	+17.2	2089.9	+166.2	23820.3	+9.6
12	2016	16444.6	-24.3	2111.0	+1.0	18555.6	+12.8
13	2017	11757.8	-28.5	1554.6	-26.4	13312.4	+13.22
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15	2019	15298.2	+17.5	2543.2	+22.2	17841.0	+16.6
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17	2021	17119.8	+17.8	173.4	+16.0	17293.2	+1.0
18	2022	20184.0	+17.9	1389.2	+701.2	21573.2	+6.9
19	2023	23979.1	+18.8	5050.8	+263.6	29029.9	+21.1

**Source:** The table was compiled by the author based on data from the Central Bank of Azerbaijan.

It can be seen from the table that decreases occurred in the following years. Compared to the previous year, the decrease amounted to 33.1% in 2008, 91% in 2009, 79.2% in 2015, 4.41% in 2017, 9.6% in 2020, and 20.8% in 2021. The analysis shows that the declines observed in 2008–2009 and during the 2015 crisis were caused by the negative effects of the financial crises. In other years—namely 2017, 2020, and 2021—the reduction in mandatory reserve requirements was associated with the decline in total credit allocations in those periods.

Research indicates that if, during the analyzed period, the funds held under mandatory reserve requirements by credit institutions had been directed into credit allocations, total credit investments would have increased significantly. Specifically, credit allocations would have grown by 8.9% in 2006 to 2,573.3 mln manats, by 7.15% in 2007 to 5,016.6 mln manats, by 3.11% in 2008 to 7,415.2 mln manats, by 1.1% in 2009 to 8,498.2 mln manats, by 0.2% in 2010 to 9,184.3 mln manats, by 1.02% in 2011 to 9,951.1 mln manats, by 0.86% in 2012 to 12,350.0 mln manats, by 1.01% in 2013 to 15,579.9 mln manats, by 10.12% in 2014 to 18,870.6 mln manats, by 0.2% in 2015 to 21,777.8 mln manats, by 0.9% in 2016 to 16,592.3 mln manats, by 1.2% in 2017 to 11,899.0 mln manats, by 1.25% in 2018 to 13,183.3 mln manats, by 1.1% in 2019 to 15,463.6 mln manats, by 1.02% in 2020 to 14,679.9 mln manats, by 0.36% in 2021 to 17,182.1 mln manats, by 0.35% in 2022 to 20,254.4 mln manats, and by 0.30% in 2023 to 24,051.6 mln manats.

This would have led to improved efficiency in the activities of both credit institutions and borrowers. As a result, economic activity would have increased, and the level of key macroeconomic indicators playing an important role in the country's economic life would have risen. Thus, mandatory reserve requirements could be considered one of the important factors both in mitigating potential banking risks and in forming reserve sources for short-term lending.

#### **4. Directions for Improving the Mitigation of Banking Risks**

One of the important directions for improving the mitigation of risks in short-term lending in banks is the proper analysis of potential risks and the implementation of appropriate preventive measures. In our view, the following measures are essential for this purpose:

- determination of the level of potential risks in the bank;

- identification of the level and nature of risks that may arise in individual banking operations;
- identification of factors affecting the level of risks in short-term lending;
- identification of factors generating banking risks in short-term lending and establishment of a forecasting (early warning) system for this purpose;
- identification of negative trends and factors generating banking risks and preparation of a comprehensive action plan to minimize their impact for implementation;
- preparation of analytical materials on the risk level of banking operations;
- implementation of an effective risk management system based on decisions derived from conducted analyses;
- development of a banking risk management strategy;
- systematization of tactical approaches to each type of risk within the framework of the main directions of the risk management strategy, etc.

As is known from international experience, reserves used to compensate for losses arising from banking risks are divided into two groups: general reserves and specific (targeted) reserves.

One of the approaches used in mitigating banking risks in short-term lending is the use of targeted reserves. The distinctive feature of targeted reserves is that they are identified for each credit operation and for each potential risk individually. In order to carry out such identification, each credit operation and the nature and level of associated risks are analyzed separately. The possible amount of losses for each operation is determined, and targeted reserves are used to cover and prevent these losses. As can be seen, targeted reserves are directed toward covering losses arising from each specific credit operation and each type of risk.

In our view, in order to more effectively prevent potential risks in short-term lending in our country, targeted reserves should be formed based on the following parameters:

- organization of loan classification, which is necessary for the formation of reserves against potential losses for each type of loan;
- development of the above-mentioned classification based on established criteria, where these criteria should reflect the degree of

credit risk; depending on the level of credit risk, loans should be divided into several groups;

- determination of the degree of credit risk based on key indicators on which it depends, including the level of loan collateral, maturity of repayments, the source of funds (own or borrowed), and the extension period of credit agreements;
- classification of loans granted to borrowers according to the quality of collateral, including: over-collateralized loans, adequately collateralized loans, insufficiently collateralized loans, and unsecured loans. When carrying out this classification, the quality of collateral (i.e., real security) must also be taken into account, including its market value, asset value, and liquidity level;
- refusal to accept guarantees provided by other economic entities as collateral in order to avoid credit risks;
- assessment of credit risk for the entire loan amount during phased repayment of principal under credit agreements;
- formation of targeted reserves for the full loan amount, despite the fact that repayment is carried out in stages under pre-agreed conditions;
- regular adjustment of the volume of targeted reserves in response to changes in relevant parameters;
- continuous monitoring and control of indicators and indicator systems used to determine the level of credit risk groups;
- allocation of funds for the creation of targeted reserves for each loan operation regardless of the level of bank profitability.

We believe that the formation and utilization of targeted reserves in the proposed form and according to the specified parameters may ensure the compensation of losses arising from banking risks.

In our view, one of the key issues in improving the mitigation of banking risks in short-term lending is related to the structure of banks' capital base. As is known, a bank's capital base consists of two main components: equity capital and attracted funds. In this structure, increasing the share of equity capital through strengthening the capitalization level of banks is one of the most important prerequisites. As the level of capitalization increases, banks gain greater flexibility in their operations, conduct larger-scale expansionary lending activities, and are able to extend such policies both vertically and horizontally.

Consequently, higher profitability is achieved, which creates conditions for preventing potential risks.

Another important direction in improving risk mitigation in short-term lending is the restructuring of non-performing assets. The analysis of banking sector activity in our country shows that following the two devaluations in 2015, the volume of non-performing assets increased significantly across the banking system and individual banks. The resulting situation, including the dynamics of restructured loans, indicated a deterioration in the quality of banks' loan portfolios and contributed to the growth of non-performing loans.

The development of the insurance market is also one of the key directions in improving risk mitigation. In this regard, issues of particular importance include the insurance of deposits, savings, loans, and banking risks. A well-developed insurance market helps banks to protect themselves against risks and reduces uncertainty. At the same time, the insurance market accumulates free monetary resources in the form of internal savings, thereby creating a new investment channel that plays a multiplier role in ensuring sustainable economic development.

One of the important steps in improving the management of risks arising in short-term lending is the regulation of the deposit market. The significance of this market is substantial for several reasons. On the one hand, it provides income to holders of free funds; on the other hand, it forms the capital base of banks and transforms into credit resources that satisfy the financial needs of various sectors of the economy. In addition, the interest rate policy formed in the deposit market has a decisive impact on the overall credit policy of banks. Specifically, the higher the interest rate on deposits accepted for the formation of loan capital, the higher the interest rates on bank lending to the economy. As a result, in many cases, the annual interest rates on loans granted to various sectors of the real economy exceed their profitability levels. This becomes an obstacle to sectoral development, reduces economic activity, and generates various types of risks. Therefore, there is a need to regulate interest rates in the deposit market in our country through both economic and administrative mechanisms.

## **Conclusion:**

1. Credit operations play a significant role in the activities of both credit institutions and other economic entities. For credit institutions, loans represent the main source of income, while for economic entities they serve as an essential mechanism for compensating shortages in working capital. Credit institutions, in the process of conducting lending operations, provide loans to various economic entities and individuals through widely applied economic methods in practice, ensuring their use in accordance with required principles and subsequent repayment. In this way, loans participate in the capital circulation of economic entities when necessary, contributing to the creation of new value. On the one hand, credit ensures the continuity of economic activity of enterprises; on the other hand, it enhances economic activity in the economy and contributes to the growth of gross domestic product.
2. The conducted research has revealed that the occurrence of banking risks is inevitable during the implementation of short-term lending. It has been determined that all modern forms of short-term lending applied in the non-oil sector are transitional in nature. For this reason, the organic interconnection between them is weak. At the same time, these lending forms are not always able to meet the demand of economic entities for borrowed funds in a timely and flexible manner. Consequently, the probability of banking risk occurrence increases in short-term lending operations. In some cases, loans granted to economic entities are repaid at the stage when the borrower's capital turnover cycle has already been completed. For this reason, credit risks in banking activity acquire a non-technological character.
3. The research has also shown that, in international practice, systems and approaches to short-term lending are not based on administrative decisions issued by higher authorities, but rather on long-term relationships established between banking systems and their clients over many years. In general terms, it can be stated that in most foreign countries, short-term lending systems are characterized by well-established and differentiated parameters. As a result of analyzing these lending models, their economic significance, efficient usage mechanisms, and applicability in the national context have been

examined. The implementation and expansion of advanced short-term lending instruments such as credit lines, overdrafts, and current account (kontokorrent) facilities have been recommended.

4. It has been substantiated by the research that a sound legal and regulatory framework is of crucial importance for ensuring the effectiveness of lending activities in any country. Such a framework ensures that credit operations are implemented in accordance with international standards and, at the same time, aligned with the priorities of national economic policy. A well-developed legal and regulatory framework also ensures the proper functioning of both credit institutions and supervisory authorities in this field.
5. Econometric evaluation of the relationships between key short-term lending indicators has been conducted. Based on data for Azerbaijan's economy for 2005–2020, it has been determined that a 1% increase in the nominal volume of total credit investments leads to a 0.67% increase in nominal GDP. It has also been found that a 1% increase in credit investments in national currency results in a 0.50% increase in nominal GDP, while a 1% increase in foreign currency credit investments is associated with a 0.08% increase in nominal GDP. Furthermore, it has been established that a 1% increase in short-term credit investments leads to a 0.70% decrease in nominal GDP, whereas a 1% increase in long-term credit investments results in a 0.80% increase in nominal GDP. In addition, it has been determined that a 1% increase in free banking reserves is associated with a 0.37% increase in total credit investments in the economy.
6. The study has found that, in order to mitigate potential risks in short-term lending in the non-oil sector, banks should adopt a more stringent lending approach, ensure continuous monitoring of the financial dynamics of borrowers, and coordinate the timing of fund availability with their subsequent reallocation to other economic entities. In other words, banks must maintain a consistent balance between their assets and liabilities across multiple parameters to ensure resilience against potential risks in short-term lending.
7. It has been determined that the existence of a specialized financial mechanism is a necessary condition for mitigating risks arising in short-term lending operations. In this regard, the establishment of

general and targeted reserves in banks, improvement of capital structure, restructuring of non-performing assets, expansion of insurance coverage for banking operations, regulation of the deposit market, and enhancement of financial inclusiveness have been recommended as key directions.

**The following articles and abstracts have been published on the topic of the dissertation research:**

1. E.M.Seyidov. «Qeyri-neft sektorunda qısamüddətli kreditləşmənin metodologiyası» // Odlar Yurdu Universitetinin Elmi və Pedaqoji Xəbərləri, Bakı şəh., 2020-ci il, №56.
2. E.M.Seyidov. “Qısamüddətli kreditləşmə müəssisənin pul dövriyyəsinin elementi kimi” // Azərbaycan Respublikası İqtisadiyyatının Davamlı İnkişafında İnnovasiyaların Rolü. İSSN: 1682-9123. Naxçıvan şəh. 29.02.2020, №141
3. E.M.Seyidov. “Qısamüddətli kreditləşmənin metodları və onların kredit risklərinə təsiri” // Kooperasiya elmi-praktiki jurnal (İSSN: 2218-91-49), Bakı şəhəri, 25.09.2020-ci il, №3(58)
4. E.M.Seyidov. “Azərbaycanda qısamüddətli kreditləşmənin mütərəqqi xarici formalarının tətbiqi zəruriliyi” // Odlar Yurdu Universiteti. Müasir təhsilin inkişafında Beynəlmilləşmənin rolu, Bakı şəhəri, 03.05.2019-cu il, №1.
5. E.M.Seyidov. “Qısamüddətli kreditləşmənin xarici təcrübəsi” // Naxçıvan Universiteti. Elmi Əsərlər (İSSN: 2616-4248), Naxçıvan şəh., 2018-ci il, №4(11)
6. Э.М.Сейидов. «Особенности краткосрочного кредитования в нефтяном секторе Азербайджана» // Вопросы управления и экономики: современное состояние актуальный проблем (İSSN: 2587-8638), Москва, 2020, №1(29)
7. Э.М.Сейидов. «Основные формы краткосрочного кредитования в негосударственном секторе Азербайджана» // Экономика & Держава (İSSN: 2306-6806), Киев, 2019, №4.
8. E.M.Seyidov. «Qeyri-neft sektorunda qısamüddətli kreditləşmənin prioritet istiqamətləri» // Naxçıvan Universiteti. Elmi Əsərlər (İSSN: 2616-4248), Naxçıvan şəh., 2021, №3(22)





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