Are Bank Lending Rates High in Azerbaijan?

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Debate over lending rates in Azerbaijan has persisted for years. Businesses and individual borrowers argue that bank lending rates are excessively high. Banks, however, dispute this assessment, maintaining that elevated credit risk, funding costs, and operating expenses constrain their ability to extend loans at lower interest rates. Which side, then, is better supported by the evidence? Are lending rates in Azerbaijan genuinely high, or are they an unavoidable consequence of the country’s economic conditions?

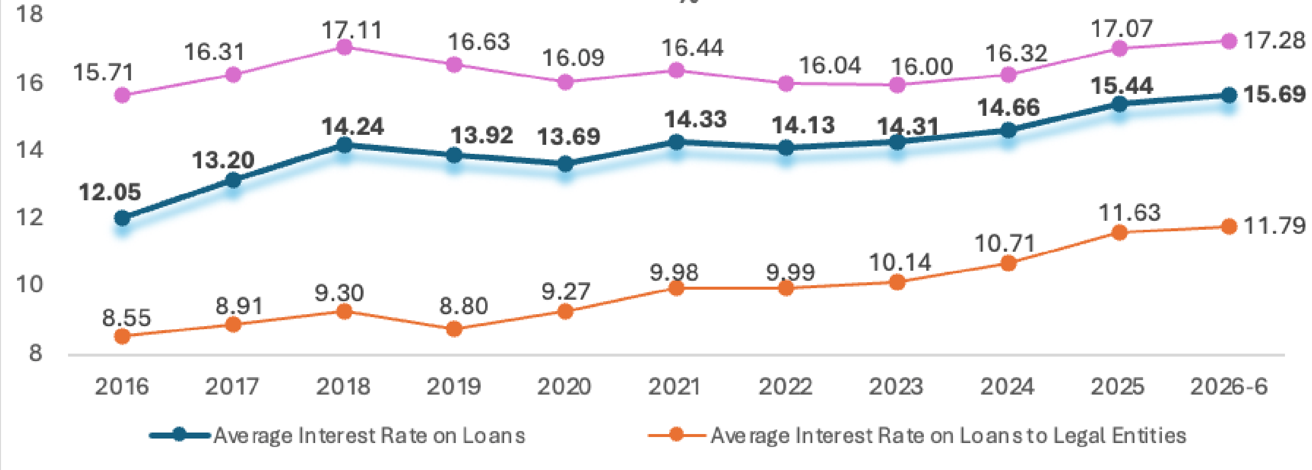
Comparison with other countries makes it difficult to unequivocally answer this question. Compared with developed economies, lending rates in Azerbaijan are several times higher. For example, lending rates generally range between 3–5% in Western European countries and around 4–9% in Eastern European countries. Among former Soviet republics, however, Azerbaijan occupies a more intermediate position. Moldova (9%), Belarus (10.9%), and Armenia (13.7%) have lower lending rates than Azerbaijan, whereas rates are higher in countries such as Georgia (15.8%), Kazakhstan (16.5%), Russia (17%), Ukraine (19.7%), and Kyrgyzstan (19.8%).

It would therefore be inappropriate to assess whether lending rates are high solely on the basis of nominal interest rates. The level of inflation in each country must also be taken into account. The same nominal lending rate can impose a substantially different financial burden on borrowers under different inflationary conditions.

To provide an objective assessment of the level of lending rates, we should first examine the factors that determine how these rates are formed. There are economic arguments supporting the positions of both borrowers and banks. Limited access to credit has long been a source of concern for households and businesses, while banks argue that high lending rates reflect elevated credit risks and costs. This article examines the factors shaping lending rates and assesses the extent to which the arguments advanced by both sides are grounded in economic fundamentals.

In an article published some time ago on Baku Research Institute's website, we noted that Azerbaijan's banking system does not face a shortage of financial resources. Over the past five years, banks' liquid assets have consistently exceeded AZN 12 billion. Nevertheless, the ratio of loans to GDP has remained within the range of only 25–30%, which is low compared with many developing economies. The problem, therefore, lies less in a shortage of funds within the banking system than in the terms by which these resources are channeled into the economy. This raises the question of why lending rates remain high despite the high level of liquidity in the banking sector.

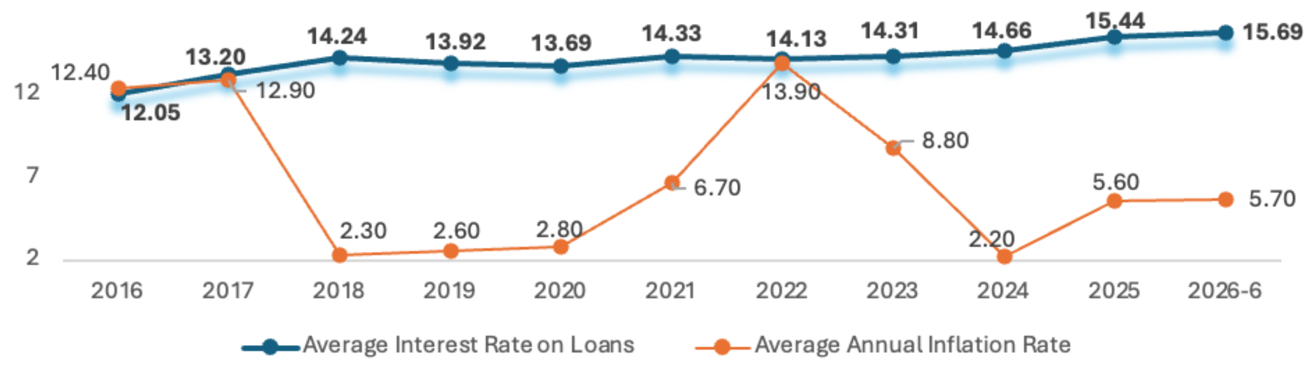
Figure 1. Average Interest Rate on Loans Denominated in Domestic Currency, %



Source: Central Bank of the Republic of Azerbaijan

As shown in *Figure 1*, the average interest rate on loans denominated in domestic currency has increased over the past decade. Although average lending rates declined during certain periods, the overall trend has been upward, reaching 15.7% in the first half of 2026. This increase is largely attributable to the persistently high interest rates on loans to individuals. Overall, between 2016 and 2026, the average interest rate on loans to businesses and other legal entities rose from 8.55% to 11.79%, while the corresponding rate for loans to individuals increased from 15.71% to 17.28%.

Figure 2. Average Interest Rate on Loans Denominated in Domestic Currency and Average Annual Inflation, %



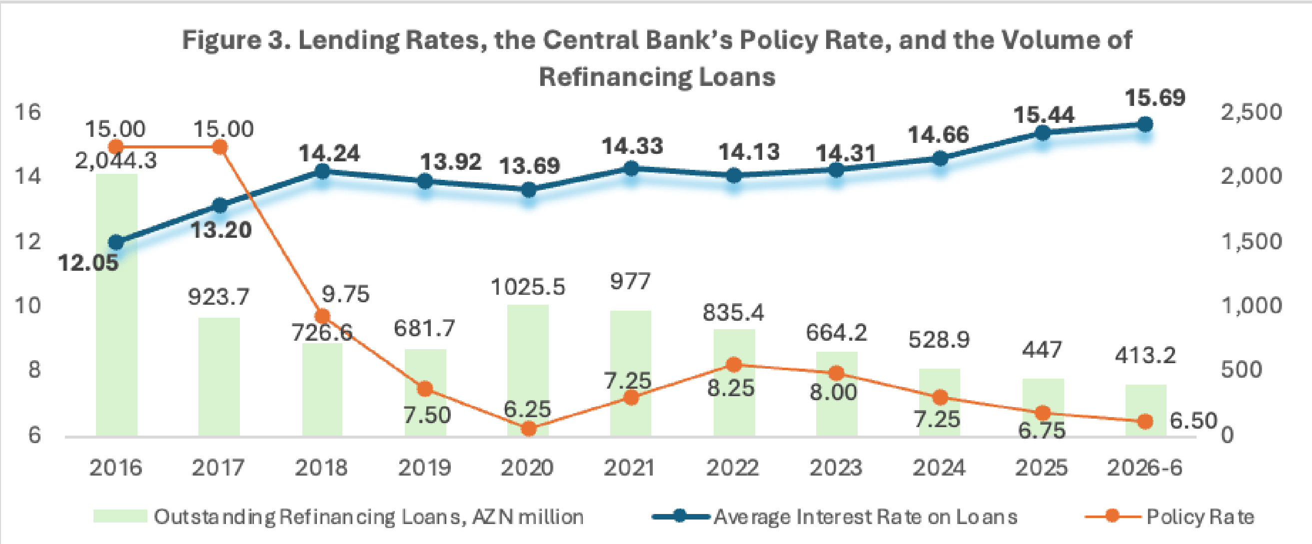
Source: Central Bank of the Republic of Azerbaijan

Figure 2 calls into question the relationship between lending rates and inflation. One of the main arguments is that high lending rates are driven by elevated inflation. However, data from at least the past decade do not support this argument. As the figure shows, there is no clear systematic relationship between the dynamics of inflation and lending rates.

For example, between 2018 and 2020, inflation remained within the relatively low range of 2–3%, while the average lending rate was close to 14%. Conversely, in 2022, although inflation rose to approximately 14%, lending rates remained virtually unchanged. More notably, in 2023 and 2024, inflation fell sharply from 8.8% to 2.2%, yet lending rates not only failed to decline but moved onto an upward trajectory. In the first half of 2026, inflation stood at 5.7%, while the average lending rate reached 15.7%.

These findings indicate that the level of lending rates in Azerbaijan cannot be explained by inflation alone. Other factors, including banks' funding models, credit risk, the institutional environment, operating costs, and market characteristics, also play an important role in determining lending rates.

One of the most widely used mechanisms for influencing lending rates globally is central bank monetary policy. According to this framework, a reduction in the policy rate should lower banks' funding costs and, in turn, lead to a decline in lending rates. It is therefore not surprising that monetary authorities in most countries adjust policy rates when they seek either to stimulate economic activity or to restrain it in periods of high inflation. However, the dynamics observed in Azerbaijan's banking sector suggest that this relationship is not as strong as might be expected.



Source: Central Bank of the Republic of Azerbaijan
Note: The Central Bank's policy rate is presented based on year-end figures for the respective year.

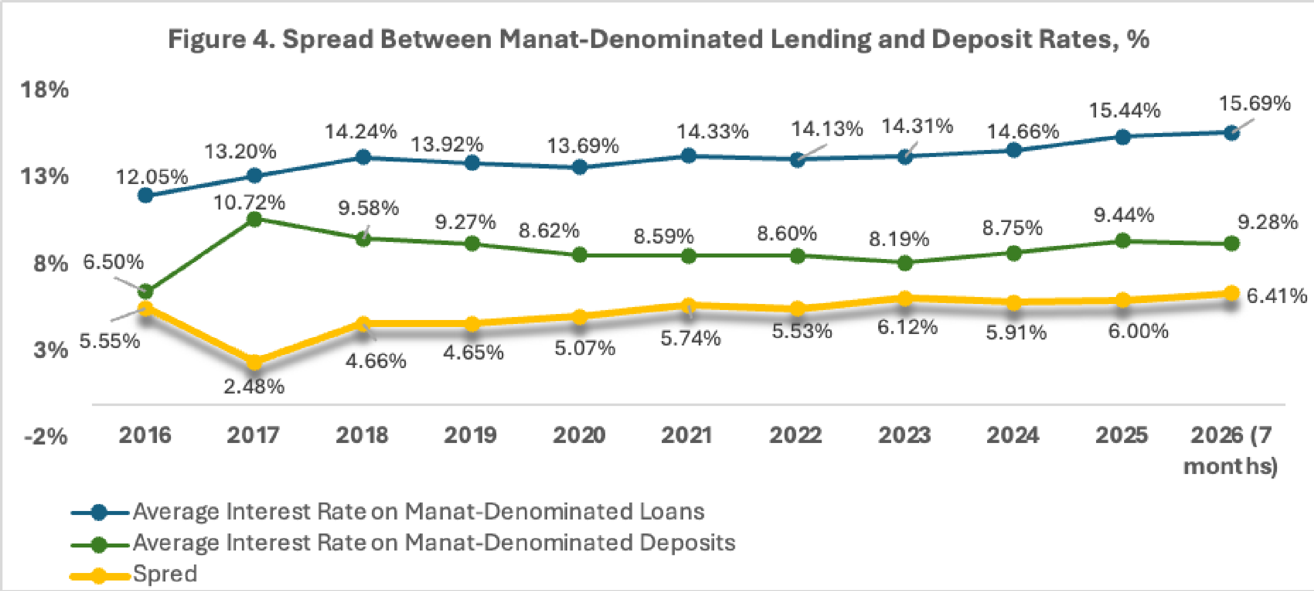
As shown in *Figure 3*, between 2016 and 2026 the Central Bank reduced its policy rate from 15% to 6.5%. Despite this, the average lending rate increased from 12% to 15.7%. This suggests that the impact of the Central Bank's monetary policy instruments on the formation of lending rates is limited. One possible explanation for this weak transmission is the declining share of Central Bank resources in banks' loan portfolios.

Over the past decade, the volume of refinancing loans has fallen from AZN 2 billion to AZN 413 million. The share of this source of funding in banks’ loan portfolios has declined from 12% to 1%. As a result, changes in the policy rate are not fully transmitted to lending rates.

Therefore, to explain why lending rates remain high, attention should be directed toward banks’ actual sources of funding, the cost of these resources, credit risks, and the structural characteristics of the banking sector.

A common counterargument to the claim that lending rates are high is that the resources mobilized by credit institutions are themselves costly. An analysis of banks’ liability structures shows that deposits constitute the dominant source of funding. According to official data, the share of deposits in total liabilities increased from 70% to 79.4% between 2016 and 2026. In 2023, this figure even exceeded 87%.

From this perspective, the cost of deposits can be regarded as a key component influencing the cost of credit resources. Indeed, over the past decade, a certain relationship can be observed between average deposit rates and average lending rates. Both indicators have displayed an upward long-term trend: the average interest rate on manat-denominated deposits increased from 6.5% to 9.3%, while the average lending rate rose from 12.1% to 15.7%.



Source: Central Bank of the Republic of Azerbaijan

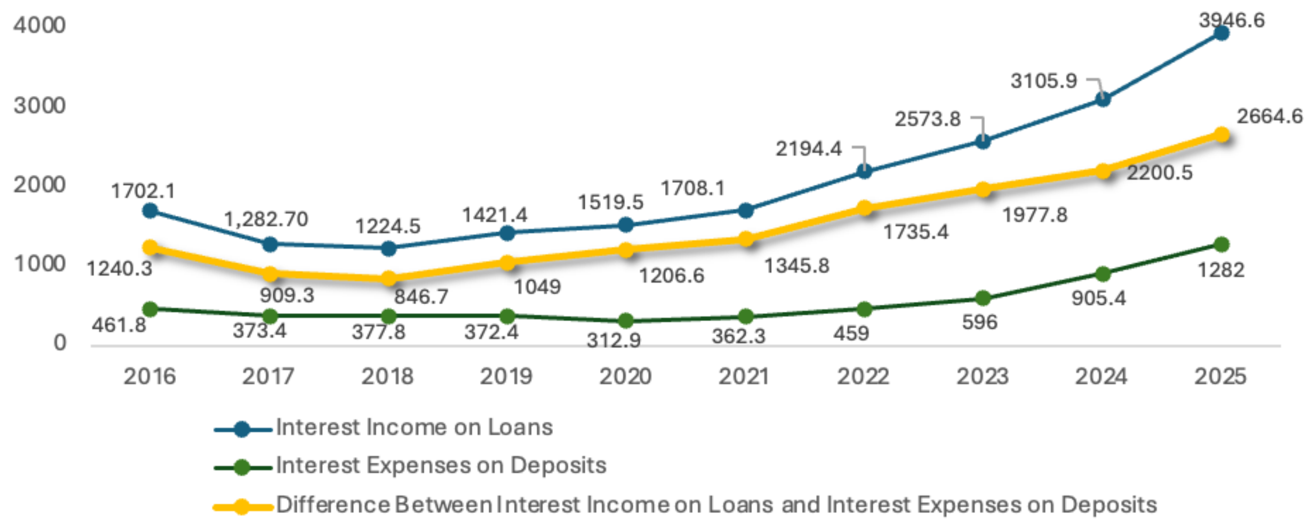
At first glance, as shown in *Figure 4*, the increase in lending rates can be directly attributed to the rising cost of deposits. However, another indicator—namely, the interest rate spread (*the difference between lending and deposit rates – author*)—somewhat weakens this argument. The reason is that lending rates have increased more rapidly than deposit rates, resulting in a wider spread.

In 2017, the spread stood at 2.48%, while from 2018 onward it generally fluctuated within the range of 4.5–6%. In recent years, the gap has widened again: The spread increased from 5.53% in 2022 to 6.12% in 2023. Although it declined to 5.91% in 2024, it rose again to 6.00% in 2025 and reached 6.41% in the first seven months of 2026.

This pattern makes it difficult to explain high lending rates solely in terms of banks' funding costs. Higher deposit rates may increase the cost of banks' funding. However, the persistently wide gap between lending and deposit rates indicates that other factors also exert a substantial influence on the final cost of credit. Therefore, to assess the extent to which lending rates are economically justified, it is necessary to examine separately the factors underlying the interest rate spread, including credit risk, operating costs, banks' pricing policies, and profit margins.

Among the factors influencing lending rates, subjective considerations such as banks' pursuit of higher profits should also be taken into account. The increase in banks' interest income in recent years lends support to this view. Between 2016 and 2026, banks' interest income from loans increased by 132%, from AZN 1.7 billion to AZN 3.9 billion, while interest expenses rose from AZN 462 million to AZN 1.3 billion. Over the same period, the difference between interest income and interest expenses increased from AZN 1.2 billion to AZN 2.7 billion. Thus, banks' interest income from lending increased 2.3-fold over the past decade.

Figure 5. Dynamics of Banks' Interest Income and Expenses, AZN Million



Source: Central Bank of the Republic of Azerbaijan

This finding makes it difficult to explain high lending rates solely in terms of banks' costly funding. Admittedly, banks' interest expenses have increased substantially in recent years. However, as lending activity and interest income have expanded at a faster pace, the gap between banks' interest income and interest expenses has also widened. This suggests that factors other than banks' funding costs play an important role in the determination of lending rates.

Taken together, these indicators do not allow for a simple or unequivocal answer to the question of whether lending rates in Azerbaijan are high. From an international comparative perspective, lending rates are indeed high. However, their elevated level cannot be explained solely by banks’ high funding costs, inflation, or the Central Bank’s monetary policy.

Statistics from recent years show that lending interest rates are determined not only by banks’ funding costs, but also by credit risk, operating costs, the competitive structure of the market, and banks’ pricing policies. In particular, the continued widening of the gap between lending and deposit rates in recent years suggests that the high cost of credit cannot be explained solely by the cost of deposit funding.

From this perspective, reducing lending rates requires more than focusing solely on the Central Bank’s interest-rate decisions. Lower lending rates also depend on reducing banks’ credit risks and operating costs, strengthening competition in the financial market, improving the infrastructure for lending, and enhancing the operational efficiency of banks.

In other words, lending rates in Azerbaijan are high, but the solution is not simply to “lower interest rates.” The key challenge is to create the economic and institutional conditions that enable banks to extend credit at lower cost and with less risk.