IMPORTANT NOTICE

THIS OFFERING IS AVAILABLE ONLY TO INVESTORS WHO ARE (1) QIBs (AS DEFINED BELOW) PURCHASING IN RELIANCE ON THE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE US SECURITIES ACT OF 1933, AS AMENDED (THE "**SECURITIES ACT**"), PROVIDED BY RULE 144A THEREUNDER ("**RULE 144A**") OR PURSUANT TO ANOTHER EXEMPTION FROM, OR IN A TRANSACTION NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT OR (2) OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE SECURITIES ACT ("**REGULATION S**").

IMPORTANT: You must read the following disclaimer before continuing. The following disclaimer applies to the attached document following this page. You are advised to read this disclaimer carefully before accessing, reading or making any other use of the attached document. In accessing the attached document, you agree to be bound by the following terms and conditions, including any modifications to them any time you receive any information from the Republic, (as defined in the attached document), Barclays Bank PLC, Citigroup Global Markets Limited, Deutsche Bank AG, London Branch and BNP Paribas (the "**Managers**") as a result of such access.

Nothing in this electronic transmission constitutes an offer of securities for sale in any jurisdiction where it is unlawful to do so. Any securities to be offered or sold have not been, and will not be, registered under the Securities Act, or the securities laws of any state or other jurisdiction of the United States and may not be offered or sold in the United States (as defined in Regulation S), except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and any applicable state or local securities laws.

You are not authorised to and may not forward or deliver the attached document, electronically or otherwise, to any other person or reproduce such document in any manner whatsoever. Any forwarding, distribution or reproduction of the attached document in whole or in part is unauthorised. Failure to comply with this directive may result in a violation of the Securities Act or the applicable laws of other jurisdictions. If you have gained access to this transmission contrary to any of the foregoing restrictions, you are not authorised to access the attached document.

Confirmation of your representation: In order to be able to view the attached document or make an investment decision with respect to the securities, investors must be (1) Qualified Institutional Buyers ("**QIBs**") (within the meaning of Rule 144A) or (2) located outside the United States. The attached document is being sent at your request and by accepting this e–mail and accessing the attached document, you shall be deemed to have represented to the Republic and each Manager that (1) you and any customers you represent are (a) QIBs or (b) outside the United States and that the e–mail address to which the attached document has been delivered is not located in the United States, its territories, possessions (including Puerto Rico, the US Virgin Islands, Guam, American Samoa, Wake Island and the Northern Mariana Islands) and other areas subject to its jurisdiction and (2) you consent to delivery of the attached document and any amendments or supplements thereto by electronic transmission.

You are reminded that the attached document has been delivered to you on the basis that you are a person into whose possession the attached document may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not nor are you authorised to deliver the attached document, electronically or otherwise, to any other person. If you receive the attached document by e–mail, you should not reply by e–mail to this announcement. Any reply e–mail communications, including those you generate by using the "Reply" function on your e–mail software, will be ignored or rejected. If you receive the attached document by e–mail, your use of this e–mail is at your own risk and it is your responsibility to take precautions to ensure that it is free from viruses and other items of a destructive nature.

The materials relating to the offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. No action has been or will be taken in any jurisdiction by any of the Republic or the Managers that would or is intended to, permit a public offering of the securities, or possession or distribution of the attached document (in preliminary, proof or final form) or any other offering or publicity material relating to the securities, in any country or jurisdiction where action for that purpose is required. If a jurisdiction requires that the offering be made by a licensed broker or dealer and the Managers or any affiliate of the Managers is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the Managers or such affiliate on behalf of the Republic in such jurisdiction.

The attached document is only addressed to and directed at persons in member states of the European Economic Area that have implemented Directive 2003/71/EC, as amended (the "**Prospectus Directive**") who are "qualified investors" within the meaning of Article 2(1)(e) of the Prospectus Directive ("**Qualified Investors**"). In addition, in the United Kingdom the attached document is being distributed only to, and is directed only at, Qualified Investors (i) who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "**Order**") or who fall within Article 49(2)(a) to (d) of the Order, or (ii) to whom it may otherwise lawfully be communicated (all such persons being referred to as "**relevant persons**"). The attached document is directed only at relevant persons in the United Kingdom and Qualified Investors in any other member state of the European Economic Area and must not be acted on or relied on (i) in the United Kingdom, by persons who are not relevant persons, and (ii) in any member state of the European Economic Area other than the United Kingdom, by persons who are not Qualified Investors. Any investment or investment activity to which the attached document relates is available only to (i) in the United Kingdom, relevant persons, and (ii) in any member state of the European Economic Area other than the United Kingdom, Qualified Investors, and will be engaged in only with such persons.

The attached document has been sent to you in electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and consequently none of the Republic or the Managers, any person who controls them or any director, officer, employee or agent of them or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the document distributed to you in electronic format and the hard copy version available to you on request from the Managers.

THE REPUBLIC OF AZERBAIJAN

US$1,250,000,000 4.75 per cent. Notes due 2024

Issue Price: 98.051 per cent.

The US$1,250,000,000 4.75 per cent. Notes due 2024 (the "**Notes**") are being offered inside the United States to qualified institutional buyers in reliance on Rule 144A ("**Rule 144A**") under the United States Securities Act of 1933 as amended (the "**Securities Act**") (the "**Rule 144A Notes**") and outside the United States in reliance on Regulation S under the Securities Act (the "**Regulation S Notes**").

This Prospectus has been approved by the Central Bank of Ireland (the "**Central Bank of Ireland**") as competent authority under Directive 2003/71/EC as amended (including the amendments made by Directive 2010/73/EU) (the "**Prospectus Directive**"). The Central Bank of Ireland only approves this Prospectus as meeting the requirements imposed under Irish and European Union ("**EU**") law pursuant to the Prospectus Directive. Such approval relates only to the Notes of the Republic of Azerbaijan (the "**Republic**" or "**Azerbaijan**") that are to be admitted to trading on the regulated market (the "**Market**") of the Irish Stock Exchange Limited (the "**Irish Stock Exchange**") or on another regulated market for the purposes of Directive 2004/39/EC (the "**Markets in Financial Instruments Directive**") and/or that are to be offered to the public in any member state of the European Economic Area ("**EEA**") in circumstances that require the publication of a prospectus. Application has been made to the Irish Stock Exchange for the Notes to be admitted to the official list (the "**Official List**") and to trading on the Market.

The Notes will bear interest from and including 18 March 2014 at the rate of 4.75 per cent. per annum payable semi-annually in arrears on 18 March and 18 September in each year commencing on 18 September 2014. Payments on the Notes will be made in US Dollars without deduction for, or on account of, taxes imposed or levied by Azerbaijan to the extent described under "*Terms and Conditions of the Notes - Taxation*". Interest on the Notes will accrue from and including 18 March 2014 (the "**Issue Date**"). Unless previously redeemed or purchased and cancelled, the Notes will be redeemed at their principal amount on 18 March 2024.

THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT AND ARE BEING OFFERED AND SOLD IN THE UNITED STATES ONLY TO QUALIFIED INSTITUTIONAL BUYERS IN RELIANCE ON RULE 144A UNDER THE SECURITIES ACT. PROSPECTIVE PURCHASERS THAT ARE QUALIFIED INSTITUTIONAL BUYERS ARE HEREBY NOTIFIED THAT THE SELLER OF THE NOTES MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A. THE NOTES ARE NOT TRANSFERABLE EXCEPT IN ACCORDANCE WITH THE RESTRICTIONS DESCRIBED UNDER "*NOTICE TO INVESTORS*" AND "*TRANSFER RESTRICTIONS*".

An investment in the Notes involves a high degree of risk. See "*Risk Factors*" beginning on page 4.

The Notes will be offered and sold in the minimum denomination of US$200,000 and denominations which are integral multiples of US$1,000 in excess thereof. The Regulation S Notes will initially be represented by interests in a global unrestricted note certificate in registered form (the "**Regulation S Global Note Certificate**"), without interest coupons, which will be deposited with a common depositary for, and registered in the name of a nominee of, Euroclear Bank S.A./N.V. ("**Euroclear**") and Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**") on the Issue Date. Beneficial interests in the Regulation S Global Note Certificate will be shown on, and transfer thereof will be effected only through, records maintained by Euroclear or Clearstream, Luxembourg. The Rule 144A Notes will initially be represented by a global restricted note certificate in registered form (the "**Rule 144A Global Note Certificate**" and, together with the Regulation S Global Note Certificate, the "**Global Note Certificates**"), without interest coupons, which will be deposited with a custodian for, and registered in the name of a nominee of, The Depositary Trust Company ("**DTC**") on the Issue Date. Beneficial interests in the Rule 144A Global Note Certificate will be shown on, and transfers thereof will be effected only through, records maintained by DTC and its participants S. "*Clearing and Settlement*". Individual definitive note certificates in registered form (the "**Individual Certificates**") will only be available in certain limited circumstances as described herein.

The Notes are expected to be rated BBB- by Fitch Ratings Ltd ("**Fitch**") and Baa3 by Moody's Investors Service ("**Moody's**"). All references to Fitch and Moody's in this Prospectus are to the entities as defined in this paragraph. Each of Fitch and Moody's is established in the European Union and registered under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (the "**CRA Regulation**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

Joint Lead Managers

Barclays **Citigroup** **Deutsche Bank**

Co-Manager

BNP PARIBAS

This Prospectus is dated 13 March 2014

This Prospectus comprises a Prospectus for the purposes of the Prospectus Directive, and for the purpose of giving information with regard to the Republic and the Notes. The Republic accepts responsibility for the information contained in this Prospectus and confirms that (having taken all reasonable care to ensure that such is the case) the information contained in this Prospectus is to the best of its knowledge in accordance with the facts and contains no omission likely to affect the import of such information.

The Republic has not authorised the making or provision of any representation or information regarding the Republic or the Notes other than as contained in this Prospectus. Any other representation or information given or provided should not be relied upon as having been authorised by the Republic or the Managers. Each person contemplating making an investment in the Notes must make its own investigation and analysis of the creditworthiness of the Republic and its own determination of the suitability of any such investment, with particular reference to its own investment objectives and experience and any other factors which may be relevant to it in connection with such investment.

Neither the delivery of this Prospectus nor the offering, sale or delivery of any Note shall in any circumstances create any implication that there has been no adverse change, or event reasonably likely to involve any adverse change, in the condition (financial or otherwise) of the Republic since the date of this Prospectus.

This Prospectus does not constitute an offer to sell or a solicitation of an offer to buy the Notes by any person in any jurisdiction where it is unlawful to make such an offer or solicitation. The distribution of this Prospectus and the offer or sale of the Notes in certain jurisdictions is restricted by law. This Prospectus may not be used for, or in connection with and does not constitute, any offer to, or solicitation by, anyone in any jurisdiction or under any circumstance in which such offer or solicitation is not authorised or is unlawful. Persons into whose possession this Prospectus may come are required by the Republic and the Managers to inform themselves about and to observe such restrictions. Further information with regard to restrictions on offers, sales and deliveries of the Notes and the distribution of this Prospectus and other offering material relating to the Notes is set out under *"Subscription and Sale", "Summary of Provisions Relating to the Notes while in Global Form", "Clearing and Settlement" and "Transfer Restrictions"*.

Neither the Managers nor any of their directors, affiliates, advisers or agents has made an independent verification of the information contained in this Prospectus in connection with the issue or offering of the Notes and no representation or warranty, express or implied, is made by the Managers or any of their directors, affiliates, advisers or agents with respect to the accuracy or completeness of such information. Nothing contained in this Prospectus is, is to be construed as, or shall be relied upon as, a promise, warranty or representation, whether to the past or the future, by the Managers or any of their respective directors, affiliates, advisers or agents in any respect. The contents of this Prospectus are not, are not to be construed as and should not be relied on as, legal, business or tax advice and each prospective investor should consult its own legal and other advisers for any such advice relevant to it.

The distribution of this Prospectus and the offering, sale and delivery of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Republic and the Managers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of the Notes and on the distribution of this Prospectus and other offering material relating to the Notes, see "*Subscription and Sale*".

Prospective purchasers of the Notes should consult their tax advisers as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Azerbaijan of acquiring, holding and disposing of the Notes and receiving payments of principal, interest and/or other amounts under the Notes.

In this Prospectus, unless otherwise specified, references to "**$**", "**US$**" and "**US Dollars**" are to United States Dollars, references to "**AZN**" and "**Manat**" are to Azerbaijani Manat and references to "**EUR**", "**Euros**" and "**€**" are to the single currency of the participating Member States in the third stage of European Economic and Monetary Union of the Treaty Establishing the European Community, as amended from time to time.

The Central Bank of Azerbaijan's (the "**CBA**") foreign exchange rate for US Dollars on 12 March 2014 was 0.7844 AZN = US$1.00 and the CBA's foreign exchange rate for Euro on 12 March 2014 was 1.0865 AZN = EUR1.00.

In this Prospectus, unless otherwise stated, all annual information, including budgetary information relating to the Republic, is based upon calendar years. The gross domestic product and expenditure numbers relating to the Republic in this Prospectus are based on constant prices unless otherwise stated. Comparison of statistical information calculated in accordance with different methodologies may not be possible. Information provided for the first half of 2014 is preliminary.

Certain figures included in this Prospectus have been subject to rounding adjustments. Accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.

IN CONNECTION WITH THE ISSUE OF THE NOTES, DEUTSCHE BANK AG, LONDON BRANCH (THE "**STABILISING MANAGER**") OR ANY PERSON ACTING ON THE STABILISING MANAGER'S BEHALF, MAY OVER-ALLOT NOTES OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL. HOWEVER, THERE IS NO ASSURANCE THAT THE STABILISING MANAGER (OR PERSONS ACTING ON BEHALF OF THE STABILISING MANAGER) WILL UNDERTAKE SUCH STABILISATION ACTION. ANY STABILISATION ACTION MAY BEGIN ON OR AFTER THE DATE ON WHICH ADEQUATE PUBLIC DISCLOSURE OF THE TERMS OF THE OFFER OF THE NOTES IS MADE AND, IF BEGUN, MAY BE ENDED AT ANY TIME, BUT IT MUST END NO LATER THAN THE EARLIER OF 30 DAYS AFTER THE ISSUE DATE OF THE NOTES AND 60 DAYS AFTER THE DATE OF THE ALLOTMENT OF THE NOTES. ANY STABILISING ACTION OR OVER-ALLOTMENTS MUST BE CONDUCTED IN FULL COMPLIANCE WITH APPLICABLE LAWS, RULES AND REGULATIONS.

THE SECURITIES OFFERED HEREBY HAVE NOT BEEN RECOMMENDED BY ANY UNITED STATES FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

NOTICE TO INVESTORS

Because of the following restrictions, prospective investors are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of the Notes offered hereby. Each purchaser of the Rule 144A Notes offered hereby will be deemed to have represented, agreed and acknowledged that:

1. It is (a) a qualified institutional buyer within the meaning of Rule 144A (a "**QIB**"), (b) acting for its own account, or for the account of a QIB, (c) not formed for the purpose of investing in the Republic and (d) aware, and each beneficial owner of such Notes has been advised, that the sale of such Notes to it is being made in reliance on Rule 144A.

2. It understands that the Rule 144A Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB or (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act, in each case in accordance with any applicable securities laws of any State or another jurisdiction of the United States.

3. It understands that the Rule 144A Notes, unless otherwise agreed between the Republic and the Fiscal Agent in accordance with applicable law, will bear a legend to substantially the following effect:

   THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT ("**RULE 144A**") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A, THAT IS ACQUIRING THIS NOTE FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QIB, (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, OR (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER, IF AVAILABLE, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 FOR RESALES OF THE NOTES.

4. The Republic, the Registrar (as defined in "*Terms and Conditions of the Notes*"), the Managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Rule 144A Notes is no longer accurate, it shall promptly notify the Republic and the Managers. If it is acquiring any Rule 144A Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole

investment discretion with respect to each of those accounts and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each account.

5. It understands that the Rule 144A Notes will be evidenced by the Rule 144A Global Note Certificates. Before any interest in a Rule 144A Global Note Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in a Regulation S Global Note Certificate, it will be required to provide a Paying and Transfer Agent (as defined in "*Terms and Conditions of the Notes*") with a written certification (in the form provided in the Agency Agreement (as defined in "*Terms and Conditions of the Notes*")) as to compliance with applicable securities laws.

This Prospectus has been prepared by the Republic for use in connection with the offer and sale of the Notes outside the United States, the resale of the Notes in the United States in reliance on Rule 144A under the Securities Act and the admission of the Notes to the Official List and to trading on the Market. The Republic and the Managers reserve the right to reject any offer to purchase the Notes, in whole or in part, for any reason. This Prospectus does not constitute an offer to any person in the United States or to any US person other than any QIB and to whom an offer has been made directly by one of the Managers or its US broker-dealer affiliate. Distribution of this Prospectus by any non-US person outside the United States or by any QIB in the United States to any US person or to any other person within the United States, other than any QIB and those persons, if any, retained to advise such non-US person or QIB with respect thereto, is unauthorised and any disclosure without the prior written consent of the Republic of any of its contents to any such US person or other person within the United States, other than any QIB and those persons, if any, retained to advise such non-US person or QIB, is prohibited.

INTERNAL REVENUE SERVICE CIRCULAR 230 DISCLOSURE

Pursuant to Internal Revenue Service Circular 230, the Republic hereby informs you that the description set forth herein with respect to US federal tax issues was not intended or written to be used, and such description cannot be used, by any taxpayer for the purpose of avoiding any penalties that may be imposed on the taxpayer under the US Internal Revenue Code. Such description was written to support the marketing of the Notes. Taxpayers should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

The Republic is a foreign sovereign state outside the United States and the United Kingdom, and a substantial portion of the assets of the Republic are located outside the United States and the United Kingdom. As a result, it may not be possible to effect service of process within the United States and/or the United Kingdom upon the Republic or to enforce against it in the United States courts or courts located in the United Kingdom judgments obtained in United States courts or courts located in the United Kingdom, respectively, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state or territory within the United States. Although the Republic is a signatory to certain conventions on the recognition and enforcement of foreign arbitral awards, the enforcement of such awards in local courts remains largely untested. See "*Risk Factors –*

Risks relating to Azerbaijan - Foreign judgments may not be enforceable in Azerbaijan and enforcement of arbitral awards is dependent on compliance with procedural requirements".

Enforcement of foreign court judgment and arbitration awards

The Notes and the Fiscal Agency Agreement are governed by English law, and the Republic has agreed in the Notes and the Fiscal Agency Agreement that disputes arising thereunder are subject to arbitration in England. See "*Terms and Conditions of the Notes—Condition 17 (Arbitration)*". The Supreme Court of Azerbaijan will not (other than at its own discretion) enforce any judgment obtained in a court established in a country other than Azerbaijan unless such country allows for reciprocal enforcement of Azerbaijani court judgments and then only in accordance with the terms of a treaty providing for reciprocal enforcement and the Code of Civil Procedure of the Republic of Azerbaijan (the "**Civil Procedure Code**"). There is no such treaty in effect between Azerbaijan and the United Kingdom, and, therefore, the provisions of the Civil Procedure Code described below will apply. However, Azerbaijan and the United Kingdom are parties to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (the "**New York Convention**") and, accordingly, an arbitral award under the New York Convention should generally be recognised and enforceable in Azerbaijan provided the conditions to enforcement set out in the New York Convention are met. The conditions to recognition and enforcement of an arbitral award include requirements that there should be an "agreement in writing" signed by the parties, that the parties have capacity to enter into such agreement and that the agreement is valid under the law to which the parties have subjected it. The Republic believes that the agreement in the Notes and the Fiscal Agency Agreement satisfies those conditions and, therefore, subject to the satisfaction of the other conditions specified in the New York Convention, an arbitral award under the Notes or the Fiscal Agency Agreement should be recognised and enforced in Azerbaijan.

The recognition and enforcement of a foreign judgment is made by the Supreme Court of Azerbaijan and can be denied if such foreign judgment or award is contrary to the laws of Azerbaijan and in the circumstances set out in Article 465 of the Civil Procedure Code, whereby recognition and enforcement of foreign court judgments may be denied on further grounds including, *inter alia*, where:

(a) the subject of the dispute is within the exclusive jurisdiction of the courts of Azerbaijan;

(b) a party to the dispute was not given proper and timely notice of the proceedings;

(c) there is a valid judgment of a court of Azerbaijan in respect of a dispute between the same parties, involving the same subject matter and grounds or, prior to the institution of civil proceedings in a foreign court, a court of Azerbaijan began to review a case between the same parties, in respect of the same subject matter and grounds;

(d) such foreign court judgment did not enter into force according to the law of the jurisdiction where it was made;

(e) the enforcement of any such judgment contradicts the general principles of the laws or the sovereignty of Azerbaijan; or

(f) there is an absence of reciprocity with a foreign state.

FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Prospectus may constitute forward-looking statements. Statements that are not historical facts, including statements about the Republic's beliefs and expectations, are forward-looking statements. These statements are based on current plans, objectives, assumptions, estimates and projections. Therefore, undue reliance should not be placed on them. Forward-looking statements speak only as of the date that they are made and the Republic undertakes no obligation to update publicly any of them in light of new information or future events. Forward-looking statements involve inherent risks and uncertainties. The Republic cautions that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. Forward-looking statements include, but are not limited to: (i) plans with respect to implementation of economic and monetary policies, including privatisations and the pace of economic and legal reforms and development; (ii) budgetary plans, (iii) expectations about the behaviour of the economy if certain economic policies are implemented; (iii) the outlook for inflation, exchange rates, interest rates, foreign investment, trade and fiscal accounts; and (iv) estimates of external debt repayment and debt service.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

All references in this Prospectus to the "**Government**" or to the "**Milli Majlis**" are to the central government, comprising the Cabinet of Ministers of the Republic of Azerbaijan, or to the Milli Majlis of Azerbaijan, respectively; and references to the "**CIS**" are to the Commonwealth of Independent States.

References in this Prospectus to "**AZN**" and "**Manat**" are to the currency of Azerbaijan; references to "**US Dollars**", "**$**" and "**US$**" are to the currency of the United States; references to "**Euros**", "**EUR**" and "**€**" are to the single currency introduced at the start of the third stage of European Economic and Monetary Union pursuant to the Treaty establishing the European Community, as amended by the Treaty on European Union; and references to "**SDRs**" are to special drawing rights allocated by the International Monetary Fund (the "**IMF**").

Gross Domestic Product ("**GDP**") is a measure of the total value of final products and services produced in a country. "**Nominal GDP**" measures the total value of final production in current prices. "**Real GDP**" measures the total value of final production in constant prices, thus allowing historical GDP comparisons that exclude the effect of inflation. For the purposes of this Prospectus, Real GDP and real growth figures are calculated by reference to 2005 prices. Unless otherwise stated, references in this Prospectus to "**GDP**" are to Real GDP figures.

References to the "**Consolidated Budget**" are to the consolidated budget of the Government which comprises of (i) the State Budget, (ii) the budget of the Nakhchivan Autonomous Republic, (iii) the budget of the State Social Protection Fund and (iv) the budget of State Oil Fund of Azerbaijan and references to the "State Budget" are to the Budget of the Government.

References to laws, including the Budget, refer to such laws (and the Budget), as amended from time-to-time.

Unless otherwise stated, all annual information, including budgetary information for Azerbaijan, is based on calendar years. Unless otherwise stated, all budgetary and statistical information for any period ending in 2014 is preliminary and subject to revision and amendment. Certain figures included in this Prospectus have been subject to rounding adjustments; accordingly, figures shown for the same item of information may vary reflecting such rounding, and figures which are totals may not be the arithmetical aggregate of their components.

Statistical data appearing in this Prospectus has, unless otherwise stated, been obtained from the State Statistical Committee of Azerbaijan, the Ministry of Finance, the Ministry of Economy and Industry and the Central Bank of Azerbaijan (the "**CBA**"). Statistics are maintained by these sources in Manat, US Dollars or Euros, as applicable. Certain statistics recorded in currencies other than Manat have been converted into Manat at the exchange rates indicated in this Prospectus. Similar statistics may be obtained from other sources, although the underlying assumptions and methodology, and consequently the resulting data, may vary from source to source. Although every effort has been made to include in this Prospectus the most reliable and the most consistently presented data, no assurance can be given that such data were compiled or prepared on a basis consistent with international standards. However, as far as the Republic is aware and is able to ascertain from the information published by these entities, the information has been accurately reproduced and no facts have been omitted which would render the reproduced information inaccurate or misleading.

Certain Reserves Information

The reserves figures contained in this Prospectus, unless otherwise stated, are taken from reserves analyses prepared by the professional engineering staff of the State Oil Company of Azerbaijan ("**SOCAR**"). SOCAR calculates its reserves using the "Perspective and Prognosis Oil and Gas Resources Fields Reserves Classification" methodology, a system employed in the former Soviet Union, which differs significantly from the internationally accepted reserve estimation standards under the Petroleum Resources Management System sponsored by the Society for Petroleum Engineers, the American Association of Petroleum Geologists, World Petroleum Council and the Society for Petroleum Evaluation Engineers ("**PRMS**"), in particular with respect to the manner in which and the extent to which commercial factors are taken into account in calculating reserves.

The methodology used by SOCAR permits the inclusion of highly speculative reserve quantities attributable to highly speculative acreage, so reserves estimates calculated according to this methodology may be substantially higher than those calculated in accordance with PRMS. As a result, the methodology used by SOCAR differs in significant ways from PRMS standards. In addition, under this methodology, stated reserves do not necessarily correspond to economically recoverable reserves and cannot be accurately reconciled with reserves calculations performed using different methodologies.

The reserves figures included in this Prospectus may differ from figures previously published by SOCAR due to such different methodologies and standards in calculating such reserves figures. To the extent that the reserves figures included in this Prospectus show increased levels of reserves as compared to previously published figures, it is primarily a result of the differences in such methodologies and standards and does not necessarily reflect increases in reserves or in reserves that are economically viable to extract.

References in this Prospectus to "**tonnes**" are to metric tonnes. One metric tonne equals 1,000 kilograms.

Data Dissemination

In 2001, Azerbaijan subscribed to the IMF's Special Data Dissemination Standard (the "**SDDS**"), which is designed to improve the timeliness and quality of information of subscribing member countries. The SDDS requires subscribing member countries to provide schedules indicating, in advance, the date on which data will be released, (the "**Advance Release Calendar**"). For Azerbaijan, precise dates or "no-later-than dates" for the release of data under the SDDS are disseminated no later than three months in advance through the Advance Release Calendar, which is published on the Internet under the IMF's Dissemination Standards Bulletin Board. Summary methodologies of all data and data dissemination practices (metadata) to enhance transparency of statistical compilation are also provided on the Internet under the IMF's Dissemination Standards Bulletin Board. That website and any information on it are not part of this Prospectus.

EXCHANGE RATES

For ease of presentation, certain financial information included herein is presented as translated into US Dollars and Euros.

The following tables set forth the exchange rate history for the periods indicated, expressed in Manat per US Dollar and Manat per Euro, respectively, and not adjusted for inflation, as published by the CBA:

Manat to US Dollar Exchange Rate History

Year	Low	High	Average	Period End
		(Manat per US$1.00)		
2014				
(up to and including 28 February 2014)	*0.7842*	*0.7845*	*0.7844*	*0.7842*
2013	0.7843	0.7848	0.7845	0.7845
2012	0.7848	0.7863	0.7856	0.7850
2011	0.7862	0.7977	0.7864	0.7865
2010	0.7979	0.8039	0.7989	0.7979
2009	0.8015	0.8080	0.8038	0.8031
2008	0.8005	0.8455	0,8216	0.8010
2007	0.8453	0.8714	0.8581	0.8453
2006	0.8714	0.9184	0.8927	0.8714

Source: CBA.

Manat to Euro Exchange Rate History

Year	Low	High	Average	Period End
		(Manat per €1.00)		
2014				
(up to and including 28 February 2014)	*1.0594*	*1.0797*	*1.0699*	*1.0745*
2013	1.0179	1.0754	1.0423	1.0780
2012	0.9670	1.0399	1.0102	1.0377
2011	1.0168	1.1765	1.0362	1.0178
2010	0.9561	1.1666	1.0557	1.0560
2009	1.0060	1.2130	1.1204	1.1499
2008	1.0093	1.3269	1.2100	1.1292
2007	1.1239	1.2651	1.1757	1.2450
2006	1.0828	1.1651	1.1231	1.1471

Source: CBA.

As at 12 March 2014, the exchange rates published by the CBA were AZN 0.7844 = US$ 1.00 and AZN 1.0865 = €1.00, respectively.

The rates in the above tables may differ from the actual rates used in the preparation of the information appearing in this Prospectus. The inclusion of these exchange rates is not meant to suggest that any amount of the currencies specified above has been, or could be, converted into the applicable currency at the rates indicated or at any other rate.

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OVERVIEW

This overview highlights information contained elsewhere in this Prospectus. It does not contain all the information investors may consider important in making their investment decision. Therefore, investors should read this entire Prospectus carefully, including, in particular, "Risk Factors".

The Offering

Issuer:	Republic of Azerbaijan
Issue:	US$1,250,000,000 4.75 per cent. Notes due 2024
Issue Price:	98.051 per cent. of the principal amount of the Notes
Maturity Date:	18 March 2024
Fiscal Agent:	Deutsche Bank AG, London Branch
Registrar and Transfer Agent:	Deutsche Bank Luxembourg S.A.
Registrar, Paying and Transfer Agent:	Deutsche Bank Trust Company Americas
Interest:	The Notes will bear interest from and including 18 March 2014. Interest on the Notes will be payable semi-annually in arrears on 18 March and 18 September in each year, commencing 18 September 2014, at the rate of 4.75 per cent. per annum.
Form and Denomination:	The Notes will be issued in registered form, without coupons, in the minimum denomination of US$200,000 and in denominations which are integral multiples of US$1,000 in excess thereof. The Regulation S Notes will be represented by the Regulation S Global Note Certificate and the Rule 144A Notes will be represented by the Rule 144A Global Note Certificate, in each case without coupons. The Global Note Certificates will be exchangeable for Individual Certificates in the limited circumstances specified in the Global Note Certificates.
Initial Delivery of Notes:	On or before the Issue Date, the Regulation S Global Note Certificate will be deposited with Deutsche Bank AG, London Branch as common depositary for, and registered in the name of a

nominee of, Euroclear and Clearstream, Luxembourg and the Rule 144A Global Note Certificate will be deposited with Deutsche Bank Trust Company Americas as custodian for, and registered in the name of a nominee of, DTC.

Investment Considerations:	**An investment in the Notes involves certain risks. See "*Risk Factors*".**
Status of the Notes:	The Notes constitute direct, general, unconditional and (subject as provided in Condition 4 (*Negative Pledge and Other Covenants*) of the Terms and Conditions of the Notes) unsecured and unsubordinated obligations of the Republic and rank, and will rank, *pari passu* without any preference among themselves and at least *pari passu* in right of payment with all other unsubordinated obligations of the Republic, save only for such obligations as may be preferred by mandatory provisions of applicable law. The Notes are backed by the full faith and credit of the Republic.
Listing:	Application has been made to the Irish Stock Exchange for the Notes to be admitted to the official list ("**Official List**") and to trading on the Market.
Selling Restrictions:	United States, United Kingdom, Azerbaijan, the Republic of Ireland, the Russian Federation, Switzerland and Turkey. See "*Subscription and Sale*".
Governing Law:	The Notes are governed by and shall be construed in accordance with English law.
Use of Proceeds:	The Republic intends to use the net proceeds of the issue of the Notes for its general budgetary purposes. See "*Use of Proceeds*".
Ratings:	It is expected that the Notes will be rated BBB- by Fitch and Baa3 by Moody's. A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating agency. Each of Fitch and Moody's is established in the EU and registered under the CRA Regulation.

Security Codes:	The Common Code and ISIN for the Regulation S Notes and the Common Code, ISIN and CUSIP number for the Rule 144A Notes are as follows: Regulation S Notes Common Code: 104454054 ISIN: XS1044540547 Rule 144A Notes Common Code: 104654703 ISIN: US05477LAA44 CUSIP: 05477LAA4
Clearing:	Euroclear and Clearstream, Luxembourg (in the case of the Regulation S Notes) and DTC (in the case of the Rule 144A Notes).

RISK FACTORS

The following are risk factors relating to Azerbaijan and an investment in the Notes about which prospective holders of Notes should be aware. Azerbaijan believes that these factors may affect its ability to fulfil its obligations under the Notes.

These risk factors are not intended to be exhaustive and prospective holders of Notes should carefully read this Prospectus in its entirety and should consider carefully the information set forth below before making an investment in the Notes.

Risks Relating to Azerbaijan

Azerbaijan's economy and the State Budget are dependent on oil and gas production and global demand and prices for oil and gas

Azerbaijan is highly dependent on oil and gas revenues. In 2013, the hydrocarbon sector accounted for an estimated 43.4 per cent. of GDP, 92.6 per cent. of export earnings and 73.2 per cent. of fiscal revenue, according to the Ministry of Energy. Reductions in oil and gas revenues could have a material adverse effect on Azerbaijan's economy and the ability of Azerbaijan to service the Notes. Azerbaijan's oil and gas revenues are a function of the level of oil and gas production in the country and prevailing world hydrocarbon prices and since the State Budget has historically been dependent on transfers from SOFAZ, a decline in its income from oil and gas could place substantial strains on its ability to make those transfers without prejudicing its primary function, which is to act as an inter-generational reserve of the proceeds of the country's oil and gas reserves.

World hydrocarbon prices are subject to wide fluctuations caused by factors which are beyond Azerbaijan's control. These factors include, but are not limited to, political conditions in the Caucasus, the Middle East and other oil and gas producing regions, internal and political decisions of the Organisation of Petroleum Exporting Countries and other oil and gas producing countries to increase or decrease production of crude oil and gas, consumer demand, government regulations, the price and availability of alternative fuels and overall economic conditions. These, and other, factors have led to significant fluctuations in world oil prices in recent years. For example, the average spot price of crude oil (Brent) was US$ 74.46 per barrel in December 2009, US$ 91.45 per barrel in December 2010, US$ 107.87 per barrel in December 2011, US$ 109.49 per barrel in December 2012 and US$ 110.76 in 2013. If oil and gas prices were to significantly decline in the medium term, this could have an adverse effect on Azerbaijan's economy.

Many developed countries are also actively trying to develop alternative sources of energy or alternative methods of increasing domestic oil and gas production to reduce their dependence on imported oil and gas. Any significant development of either of these alternatives to imported oil and gas could adversely affect oil and gas prices and demand and the resulting oil and gas revenues of Azerbaijan. Any such unplanned reduction in revenues could negatively affect economic growth and have a material adverse effect on Azerbaijan's affairs, political and economic condition and its ability to service the Notes.

According to SOCAR and the Ministry of Energy, Azerbaijan's proven oil reserves are estimated at seven billion barrels as of 2013 and, in the absence of future discoveries or modernisation of current oil fields, production is currently expected to start trending downwards by 2018, with reserves exhausted in approximately 30 years. Oil exports are also expected to decline over the same period. Maintaining current oil production levels requires substantial investment in exploration and development from oil companies, which Azerbaijan may not be able to attract. Furthermore, future exploration for oil and gas may have to be in zones, such as deepwater fields, where extraction may prove more difficult and expensive than in the current coastal fields. Such exploration may only be economically viable on the basis of continuing elevated oil prices.

In addition, the production of hydrocarbons in Azerbaijan is highly concentrated, the Azerbaijan International Operating Company ("**AIOC**") and SOCAR accounting for substantially all of oil and gas production. The AIOC currently accounts for 17.5 per cent. of the total tax revenues of Azerbaijan. As a consequence of this concentration, any production interruptions or shortfalls that affect either of these two entities could have a material adverse effect on Azerbaijan's economy.

Azerbaijan may not be able sufficiently to expand the non-hydrocarbon sector of its economy

In recent years, the Government has attempted to diversify the economy by developing the non-hydrocarbon sector of its economy by providing incentives to industries such as agriculture, tourism and manufacturing. The non-hydrocarbon sector grew by 10.0 per cent. in 2013 as compared with 9.7 per cent. in 2012. However, development of the non-hydrocarbon sector relies to a significant degree on government spending, and therefore a reduction in the level of such government spending may adversely affect the development of the non-hydrocarbon sector. Furthermore, despite such spending, Azerbaijan may not be able to achieve the economic growth it needs to offset any decline in GDP caused by a decline in hydrocarbon production. Any failure to grow the non-hydrocarbon sectors of its economy may constrain Azerbaijan's economic growth, which may in turn result in a material adverse effect on Azerbaijan's ability to meet its debt obligations, including those under the Notes.

Azerbaijan's oil and gas exports are dependent on the BTC and BTE pipelines

Although Azerbaijan utilises other means of transport to export its hydrocarbon products, the ability of Azerbaijan to export its oil and gas to international markets will continue to be largely dependent on the Baku-Tbilisi-Ceyhan ("**BTC**") pipeline and the Baku-Tbilisi-Erzurum ("**BTE**") pipeline. There is a risk that the BTC and BTE pipelines, or any alternative export route, may be subject to shutdowns due to technical reasons, accidents, armed conflict or political tensions in the countries they pass through (including Georgia and Turkey). Any disruption to or shutdown of the pipelines may have a material adverse effect on Azerbaijan's ability to export its hydrocarbon products and, by extension, the Azerbaijan economy.

Dispute with Armenia

Azerbaijan was involved in armed conflict with Armenia in the Nagorno-Karabakh region of Azerbaijan from the late 1980s to 1994 and tensions over the area remain high. A ceasefire between Azerbaijan and Armenia was signed in 1994. As part of the international peace process, the Minsk Group was established by the Organization for Security and Co-operation in Europe ("**OSCE**") to negotiate a political settlement. Azerbaijan has repeated its commitment to peaceful settlement of the conflict through this process. Talks are ongoing, but no settlement has been reached, and rhetoric from both sides remains hostile. Over the last few years, a number of skirmishes between Armenian and Azerbaijani forces have taken place along the line of contact. As a result, there can be no guarantee that a major armed confrontation will not break out again. In addition, the conflict has resulted in approximately 1 million refugees and internally displaced persons fleeing to Azerbaijan, most of whom rely on the government for food, shelter and other necessities. An outbreak of armed conflict, which in turn could lead to an increased number of displaced persons reliant on state welfare, could have a material adverse effect on Azerbaijan's economy and its ability to service the Notes.

Relations with neighbours

Like other countries in the region, Azerbaijan could be affected by political unrest both within its borders and in surrounding countries, and any resulting military action may have an effect on the world economy and political stability of other countries. Azerbaijan is bordered by Russia to the north, Georgia to the north-west, Armenia and Turkey to the west and Iran to the south. Each of these countries has been involved in political and military disputes in recent years.

In August 2008, the conflict in the Tskhinvali Region/South Ossetia of Georgia escalated as Georgian troops engaged with local militias and Russian forces that crossed the international border. In the days that followed the initial outbreak of hostilities, Georgia declared a state of war as Russian forces launched bombing raids deep into Georgia, targeted and destroyed Georgian infrastructure, blockaded part of the Georgian coast, took control of Tskhinvali and the Abkhazia region and landed marines on the Abkhaz coast. After five days of heavy fighting, the Georgian forces were defeated, enabling the Russians to enter Georgia uncontested and occupy the cities of Poti, Gori, Senaki and Zugdidi. During this period, transit through the BTE pipeline crossing Georgia was temporarily stopped, cutting off one of Azerbaijan's principal export routes for gas. Future such occurrences whether in Georgia, in one of the Republic's other neighbours or in the region generally could have a material adverse effect on Azerbaijan's economy.

The countries adjoining the Caspian Sea have historically disagreed as to their territorial rights over the Caspian. The Caspian Sea continues to be a source of oil and gas and therefore ownership and exploration rights are valuable assets. To avoid such disputes, Azerbaijan has signed bilateral agreements with the Russian Federation and Kazakhstan regarding ownership and exploration rights in the Caspian Sea. To date, all parties have complied with the terms of such agreements. However, there is no guarantee that territorial disputes with other adjoining countries will not occur in the future which could impact on either the production from Azerbaijan's oil and gas deposits or the development of new reserves.

In addition, recent tensions between the United States and Iran, Russia and Georgia and the potential for unrest among regional militant groups could likewise lead to instability in the region. Furthermore, Azerbaijan and other countries in the region could be affected by terrorism and by military or other action taken against sponsors of terrorism in the region, which could, in turn, have an adverse effect on Azerbaijan's economy.

Corruption

Azerbaijan is a member of the Extractive Industries Transparency Initiative in relation to its state oil fund, and the Republic continues to work towards improving accountability and governance standards in the oil and gas sectors. However, independent analysts, including Transparency International, have identified crime and corruption as a problem in Azerbaijan. Of the 177 countries and territories included in the 2013 Corruption Perceptions Index published by Transparency International, the Republic ranked number 127, indicating that a perception of public sector corruption occurring within the country remains widespread. Any future allegations of corruption in Azerbaijan could have a negative effect on the ability of the Republic to attract foreign investment, and thus have a negative effect on both the economy of Azerbaijan and the ability of Azerbaijan to repay principal and make payments of interest on the Notes.

The development of Azerbaijan's physical infrastructure may require further investment

While the Government has made large investments into infrastructure over the last few years, some of Azerbaijan's physical infrastructure remains in poor condition, which could constrain parts of Azerbaijan's socio-economic development plans. Particularly affected are rail networks and power transmission systems. A deterioration of Azerbaijan's physical infrastructure, if coupled with a failure to improve existing infrastructure, could harm the national economy, disrupt the transportation of goods and supplies and adversely affect the economy's competitive ranking and growth prospects, including its ability to meet GDP and other growth targets.

Azerbaijan's long history of oil and gas production has left significant environmental issues

Azerbaijan has experienced environmental issues with current and past sites of oil and gas extraction and processing, resulting from land contamination, gas flaring, the disposal of waste water and oil spills. Although the level of pollution and potential clean up is difficult to assess, Azerbaijan, like most other resource-rich regions of the Commonwealth of Independent States ("**CIS**"), is burdened with a Soviet-era legacy of environmental mismanagement. There are problems relating to the maturity of fields at past production sites, some of which have been exploited for more than 150 years. Poor environmental awareness in the past allowed a number of incidents of oil leaks due to pipeline failures. Temporary reservoirs for the storage of drilling mud, liquid waste and oil were not repaired or disposed of properly causing severe pollution of several regions, including in Baku, Absheron, Salyan, Shirvan, Muradkhanli and Neftchala. In total, an area of 100 km^2 is polluted by hydrocarbon waste products in these six regions.

At present, the legal framework in Azerbaijan for environmental protection is underdeveloped and the responsibility of current oil and gas operators in respect of both historic and ongoing environmental damage is unclear. While the Ministry of Ecology and Natural Resources of the Azerbaijan Republic monitors pollution and land contamination, the potential cost of the clean-up has not yet been assessed and SOCAR has established no contingency for environmental remediation. As a result, there is a risk that Azerbaijan could face significant environmental remediation costs in the future, which could have a material adverse impact on its ability to service the Notes.

Failure to implement economic and fiscal reforms may have a negative effect on the performance of Azerbaijan's economy

The Government continues to implement economic and financial system reforms in order to improve the legal and regulatory environment, promote the private sector, diversify the economy and facilitate access to credit. The Government is also pursuing various fiscal reforms to control expenditure and improve the tax system.

The need for substantial investment in many enterprises has driven the Government's privatisation programme. The programme has excluded certain enterprises deemed strategically significant by the Government, although major privatisations in key sectors have taken place, such as full or partial sales of certain industrial producers, financial institutions and service companies.

However, there remains a need for substantial investment in many sectors of Azerbaijan's economy and there are areas in which economic performance in the private sector is still constrained by an inadequate business infrastructure. Furthermore, the considerable amount of non-cash transactions in the economy and the significant size of the shadow economy (including underreporting of income) adversely affect the implementation of reforms and hamper the efficient collection of taxes.

Although the Government intends to proceed with its economic, financial and fiscal reforms, there can be no assurance that these reforms will be implemented or if they are so implemented that they will have the expected consequences. Failure to implement economic, financial and fiscal reforms or unexpected consequences resulting from implementation may have a negative effect on Azerbaijan's economy, affairs and political condition and its ability to service the Notes.

Azerbaijan's developing legal system

Azerbaijan's legal system is continuing to develop since it achieved independence from the Union of Soviet Socialist Republics (the "**USSR**" or "**Soviet Union**") and is therefore subject to greater risks and uncertainties than a more mature legal system. In particular, risks associated with Azerbaijan's legal system include:

- inconsistencies between and among the Constitution of Azerbaijan (the "**Constitution**") and various laws, presidential decrees, governmental, ministerial and local orders, decisions, resolutions and other acts;

- provisions in laws and regulations that are ambiguously worded or lack specificity and thereby raise difficulties when implemented or interpreted; and

- difficulty in predicting the outcome of judicial application of Azerbaijan's legislation.

The commitment of Government officials and agencies to comply with legal obligations and negotiated agreements has not always been reliable and there is a tendency for the authorities to take arbitrary action. Legal redress for breach or unlawful action may not be readily available or may be subject to significant delays. These and other factors that have an impact on Azerbaijan's legal system make an investment in the Notes subject to greater risks and uncertainties than an investment in a country with a more mature legal system.

In addition, the judicial system, judicial officials and other Government officials in the Republic may not be fully independent of external social, economic and political forces. Therefore, judicial or administrative decisions could be unduly influenced. The possible lack of judicial and administrative independence may adversely affect the willingness of foreign investors to make investments in the Republic.

Foreign judgments may not be enforceable in Azerbaijan and enforcement of arbitral awards is dependent on compliance with procedural requirements

In the absence of reciprocity arrangements, of which very few are in force, Azerbaijan's courts are unlikely to enforce a judgment of a court established in a country other than Azerbaijan, invoking statutory grounds for setting aside foreign judgments by asserting, for example, that the matter is subject to the exclusive jurisdiction of Azerbaijan's courts or the courts of the country where the foreign or non-Azerbaijani judicial decision was adopted do not enforce the decisions of Azerbaijan's courts on a reciprocal basis. Although Azerbaijan is a signatory to the New York Convention, the enforcement of such awards in local courts remains largely untested. However, Azerbaijan, the United Kingdom and the United States are parties to the New York Convention and, accordingly, an arbitral award should generally be recognised and enforceable in Azerbaijan provided the conditions to enforcement set out in the New York Convention are met. Azerbaijan's courts can be arbitrary in their decisions and the possibility cannot be excluded that judges may misapply the laws of Azerbaijan (including, *inter alia*, those concerning grounds for declining enforcement). In addition, it is difficult to predict how Azerbaijan's courts would interpret such notions as "public policy", "general principles of the laws" and "sovereignty" which could each be used as grounds for rejecting enforcement of arbitral awards.

In addition, Azerbaijan's waiver of sovereign immunity described in the Terms and Conditions constitutes a limited and specific waiver and under no circumstances shall it be interpreted as a general waiver by Azerbaijan or a waiver of immunity in respect of (a) any property, including any bank account, used by a diplomatic or consular mission of the Republic or its special missions or delegations to international organisations, or (b) property of a military character or in use for military purposes and in each case under the control of a military authority or defence agency of the Republic, or (c) property located in the territory of the Republic of Azerbaijan of which the ownership rests in the government of the Republic of Azerbaijan. Azerbaijan also reserves the right to plead sovereign immunity under the US Foreign Immunities Act of 1976 with respect to actions brought against it in any court of or in the United States of America under any United States federal or State securities law.

There is a risk that the choice of English law as the governing law of the Notes might not be applied by the courts of Azerbaijan

The Notes are expressed to be governed by English law (see "*Terms and Conditions of the Notes*"). Whilst the choice of English law to govern the Notes is explicitly allowed under the laws of Azerbaijan, the Law "On International Private Law" of the Republic provides for certain restrictions in the application of foreign law, namely:

- Article 4 prohibits the application of foreign law where it contradicts the Constitution or laws of Azerbaijan adopted by referendum;
- Article 5.1 provides for "imperative" rules of the laws of Azerbaijan to be applied irrespective of the applicable governing law; and
- Article 24.4 invalidates choices of law designed to avoid, inter alia, the application of Azerbaijan's "imperative" rules.

Whilst neither the Terms and Conditions of the Notes nor the Deed of Covenant or Fiscal Agency Agreement contain any provisions which contradict the Constitution or its laws adopted by referendum as currently in force, there can be no assurance that this will continue to be the case in the event of future amendments to the Constitution or its laws adopted by referendum. As regards "imperative" rules, the most likely general meaning of the term is the "mandatory rules of Azerbaijan laws and regulations" as used in Article 390.2 of the Civil Code of the Republic of Azerbaijan (the "**Civil Code**"). However, due to the lack of clear guidance as to the application and interpretation of "imperative" rules there can be no assurance that any applicable provisions of English law or the provisions of the Terms and

Conditions of the Notes, the Deed of Covenant and the Fiscal Agency Agreement will not be overridden by relevant provisions of the laws of Azerbaijan which could be deemed to be "imperative" rules. By way of example, certain provisions of the Terms and Conditions of the Notes dealing with waivers and the binding nature of determinations by a single party might not be enforceable in Azerbaijan.

Furthermore, although the Terms and Conditions of the Notes, the Deed of Covenant and the Fiscal Agency Agreement also provide that any non-contractual obligations arising out of or in connection with them shall be governed by English law, the Law "On International Private Law" would require a court in Azerbaijan to apply the law of Azerbaijan to certain non-contractual obligations, such as claims for compensation for damage caused in Azerbaijan or unjust enrichment that occurred in Azerbaijan.

The banking sector remains highly concentrated and underdeveloped

Azerbaijan's banking system remains highly concentrated and underdeveloped, with weak governance and underwriting standards. The International Bank of Azerbaijan, a state-controlled bank, accounts for approximately 35 per cent. of the assets of the banking sector and if it were to encounter liquidity problems there could be severe economic effects for Azerbaijan's financial system and calls for state support.

The banking sector is at present focused primarily on corporate banking. Retail and small or medium enterprise banking accounts for only a small proportion of the sector. As a result, banks are prone to cyclical performance driven by their exposure to corporate banking, and a downturn in the cycle has the potential to impact the quality of banks' assets particularly given the high concentration of deposits and loans. Dollarisation remains a problem with 50 per cent. of deposits held in foreign currency.

GDP may be volatile and inflation may continue to fluctuate or increase in the near future

According to figures compiled by the CBA, Azerbaijan's GDP has over the period of 2008 to 2013 continued to grow in real terms, increasing by 10.8 per cent. in 2008, 9.3 per cent. in 2009, 5.0 per cent. in 2010, 0.1 per cent. in 2011, 2.2 per cent. in 2012 and 5.8 per cent. in 2013. However, there can be no assurance that GDP will continue to grow and any decrease in GDP or in the rate of GDP growth in subsequent years could adversely affect Azerbaijan's development. At the same time, inflation has fluctuated widely in recent years, partly as a result of a strong increases in government revenues and, thus, spending, lack of competition and growing reliance on food imports. According to figures compiled by the CBA, Azerbaijan's inflation rate was 20.8 per cent. in 2008, 1.5 per cent. in 2009, 5.7 per cent. in 2010, 7.9 per cent. in 2011, 1.1 per cent. in 2012 and 2.4 per cent. in 2013. It is possible that Azerbaijan's inflation rate will continue to fluctuate or increase in the near future. A high rate of inflation, combined with an appreciation of the Manat, could reduce the competitiveness of the domestic economy and could adversely affect the overall economy.

Many of Azerbaijan's important businesses and enterprises operate in a weak regulatory environment

When compared to their equivalents in more developed countries, the large state-owned enterprises in Azerbaijan operate in weak regulatory environments. This leads to a lack of transparency and inefficiencies. Many state-owned enterprises are monopolies and some still carry out regulatory roles in addition to their commercial roles as well as having responsibility for social programs, such as education or healthcare, that in other countries are responsibilities of the state. Given the sizeable budgets of some state-owned enterprises (such as SOCAR), a lack of financial discipline could contribute to inflation and any transfer of social responsibilities could lead to a large increase in state spending. The absence of independent regulators across many sectors is also likely to impede the development of competition, which may have a material adverse effect on the development of Azerbaijan's economy.

Financial and statistical information published by Azerbaijan may be unreliable

Although a range of government ministries, along with the CBA, produce statistics on Azerbaijan and its economy, there can be no assurance that these statistics are completely accurate or as reliable as those compiled in more developed countries. Assumptions on which certain statistical data, such as expected GDP growth rates, future oil prices, oil production levels and exchange rates, are based may also be imprecise. As a result, such data may prove to be incorrect or imprecise. These statistics may also be limited in scope and published less frequently than those in more developed countries, such that adequate monitoring of key fiscal and economic indicators may be difficult.

In addition, comparing national and international data sources can yield inconsistencies. Prospective investors should be aware that figures relating to Azerbaijan's GDP and many other aggregate figures cited in this Prospectus may be subject to some degree of uncertainty. Furthermore, standards of accuracy, methodology and underlying assumptions may vary from ministry to ministry and from period to period. Prospective investors should be aware that none of these statistics has been independently verified by any party.

An investment in a developing country such as Azerbaijan is subject to substantially greater risks than an investment in a more developed country

An investment in a country such as Azerbaijan, which achieved independence just over 20 years ago and whose economy is still developing, is subject to substantially greater risks than an investment in a country with a more developed economy and a more mature political and legal system. Although progress has been made since the country's current Constitution came into effect in November 1995 in reforming Azerbaijan's economy and political and judicial systems, to a large extent Azerbaijan is still developing the necessary legal infrastructure and regulatory framework that is essential to support market institutions, the effective transition to a market economy and broad-based social and economic reforms. As a consequence, an investment in Azerbaijan carries risks which are not typically associated with investing in more mature markets. These higher risks include, but are not limited to, higher volatility, limited liquidity, a narrow export base and the need to develop the infrastructure necessary to accelerate economic growth in the non-oil and gas sector.

Generally, investment in securities of issuers in emerging markets, such as Azerbaijan, is only suitable for sophisticated investors who fully appreciate the significance of risks involved in, and are familiar with, investing in emerging markets and investors are urged to consult their own legal, tax and financial advisers before making an investment. Investors should also note that emerging markets such as Azerbaijan are subject to rapid change and that the information set out in this Prospectus may become outdated relatively quickly.

The disruptions recently experienced in the international capital markets have led to reduced liquidity and increased credit risk premiums for certain market participants and have resulted in a reduction of available financing. In addition, the availability of credit to entities operating within the emerging markets is significantly influenced by levels of investor confidence in such markets as a whole and so any factors that impact market confidence (for example, a decrease in credit ratings or state or central bank intervention in one market) could affect the price or availability of funding for entities within any of these markets, which in turn may have a material adverse effect on the overall economy.

Risks Relating to the Market Generally

The Notes may not be a suitable investment for all investors

Investors must determine the suitability of investment in the Notes in the light of their own circumstances. In particular, investors should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Notes and the merits and risks of investing in the Notes and the information contained in this Prospectus or any applicable supplement;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on their overall investment portfolio;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments is different from their currency;
- understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant indices and financial markets; and
- be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect their investment in the Notes and their ability to bear the applicable risks.

There is currently no active trading market for the Notes

This is the first international securities offering by Azerbaijan. Although an application has been made to list and trade the Notes on the Market, there is no assurance that such application will be accepted or that an active trading market for the Notes will develop, or, if one does develop, that events in Azerbaijan, in the region, or elsewhere will not cause market volatility or that such volatility will not adversely affect the liquidity or price of the Notes or that economic and market conditions will not have any other adverse effect. In addition, liquidity may be limited if the Republic makes large allocations to a limited number of investors. If an active trading market for the Notes does not develop or is not maintained, the market or trading price and liquidity of the Notes may be adversely affected.

If the Notes are traded after their initial issuance, they may trade at a discount to their initial offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions and the financial condition of Azerbaijan. As a result of the above factors, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

The trading market for the Notes may be volatile

The market for the Notes will be influenced by economic and market conditions and, to varying degrees, interest rates, currency exchange rates and inflation rates in the United States, Europe and other industrialised countries. There can be no assurance that events in Azerbaijan, the United States, Europe or elsewhere will not cause market volatility or that such volatility will not adversely affect the price of the Notes or that economic and market conditions will not have any other adverse effect on the market for the Notes.

Risks Relating to the Notes

The terms of the Notes may be modified, waived or substituted without the consent of all the holders of the Notes

The Terms and Conditions of the Notes contain provisions for convening meetings of holders of Notes to consider matters affecting their interest. The provisions permit defined majorities voting at a meeting or executing written consents to bind all holders of Notes including holders who did not attend and vote at the relevant meeting and/or holders who voted in a manner contrary to the majority. In addition, certain actions can be taken by less than a majority of Noteholders. For example, the holders of at least 25 per cent., in aggregate principal amount of the outstanding Notes are entitled to declare all the outstanding Notes to be immediately due and payable by providing notice in writing to the Republic at the specified office of the Fiscal Agent, whereupon the Notes shall become immediately due and payable, at their principal amount with accrued interest, without further action or formality, subject to the provisions set out in the Terms and Conditions of the Notes.

Credit ratings may not reflect all risks

As at the date of this Prospectus, Azerbaijan has been assigned a sovereign credit rating of BBB- by Fitch, BBB- by S&P and Baa3 by Moody's. A credit rating is not a recommendation to buy, sell or hold the Notes. The credit ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. Credit ratings are subject to revision or withdrawal at any time by the assigning rating agency. Azerbaijan cannot be certain that a credit rating will remain for any given period of time or that a credit rating will not be downgraded or withdrawn entirely by the relevant rating agency if, in its judgment, circumstances in the future so warrant. Azerbaijan has no obligation to inform Noteholders of any such revision, downgrade or withdrawal. A suspension, downgrade or withdrawal at any time of the credit rating assigned to Azerbaijan may adversely affect the market price of the Notes.

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued under the CRA Regulation (and such registration has not been withdrawn or suspended). Such general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement or certification, as the case may be, has not been withdrawn or suspended).

EU Savings Directive

Under Council Directive 2003/48/EC on the taxation of savings income (the "**EU Savings Directive**"), each Member State is required to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or secured by such a person for, an individual beneficial owner resident in, or certain limited types of entity established in, that other Member State. However, for a transitional period, Austria and Luxembourg will (unless during such period they elect otherwise) instead operate a withholding system in relation to such payments. Under such a withholding system, the beneficial owner of the interest payment must be allowed to elect that certain provision of information procedures should be applied instead of withholding. The rate of withholding is 35 per cent.. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to exchange of information procedures relating to interest and other similar income. The Luxembourg government has announced that Luxembourg will elect out of the withholding system in favour of automatic exchange of information with effect from 1 January 2015.

A number of non-EU countries and certain dependent or associated territories of certain Member States have adopted similar measures to the EU Savings Directive.

A proposal for amendments to the EU Savings Directive has been published, including a number of suggested changes which, if implemented, would broaden the scope of the rules described above. At a meeting on 22 May 2013, the European Commission called for the adoption of an amended EU Savings Directive before the end of 2013. Investors who are in any doubt as to their position should consult their professional advisers.

If a payment were to be made or collected through a Member State that has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to the EU Savings Directive, neither Azerbaijan nor any Paying and Transfer Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. Azerbaijan is required to maintain a Paying and Transfer Agent in a Member State (if such exists) that is not obliged to withhold or deduct tax pursuant to the EU Savings Directive or any law implementing or complying with, or introduced in order to conform to the EU Savings Directive, see "*Taxation - EU Savings Directive*."

The secondary market generally

The Notes may have no established trading market when issued and one may never develop. If a market does develop, it may not be liquid, which may have a severely adverse effect on the market value of the Notes. The market for the Notes will be influenced by economic and market conditions in Azerbaijan and, to varying degrees, interest rates, currency exchange rates and inflation rates in other countries, such as the United States, the Member States of the EU and elsewhere. There can be no assurance that events in Azerbaijan, in the region or elsewhere will not cause market volatility or that such volatility will not adversely affect the liquidity or the price of the Notes or that economic and market conditions will not have any other adverse effect. If the Notes are traded after their initial issuance, they may trade at a discount to their offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions, the political, economic or financial condition of Azerbaijan or other factors. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market.

Definitive Notes not denominated in an integral multiple of US$ 200,000 or its equivalent may be illiquid and difficult to trade

The Notes have denominations consisting of a minimum of US$ 200,000 plus integral multiples of US$ 1,000 in excess thereof. It is possible that the Notes may be traded in amounts that are not integral multiples of US$ 200,000. In each, such holder who, as a result of trading such amounts, holds an amount which is less than US$ 200,000 in his account with the relevant clearing system at the relevant time would not be entitled to trade such Notes and may not receive a Certificate in respect of such holding (should Certificates be printed) and would need to purchase a principal amount of Notes such that its holding amount to US$ 200,000.

If Certificates are issued, holders should be aware that Certificates which have a denomination that is not an integral multiple of US$ 200,000 may be illiquid and more difficult to trade than Notes denominated in an integral multiple of US$ 200,000.

Pari passu securities

There is no restriction on the amount of securities that Azerbaijan may issue ranking equally in right of payment with the Notes. The issue of any such securities may reduce the amount investors may recover in respect of the Notes in certain scenarios as the incurrence of additional debt could affect Azerbaijan's ability to repay principal of, and make payment of interest on, the Notes. For the avoidance of doubt, Azerbaijan does not understand the *pari passu* clause of the Terms and Conditions of the Notes, or any comparable provision in any other debt instrument of Azerbaijan, to require Azerbaijan to pay all items of its public debt on a ratable basis.

Fluctuations in exchange rates and interest rates may adversely affect the value of the Notes

The Republic will pay principal and interest on the Notes in US dollars. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the "**Investor's Currency**") other than US dollars. These include the risk that exchange rates may significantly change (including changes due to devaluation of the US dollar or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to US dollars would decrease the Investor's Currency-equivalent yield on the Notes, the Investor's Currency equivalent value of the principal payable on the Notes and the Investor's Currency equivalent market value of the Notes. Government and monetary authorities (including where the investor is domiciled) may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal. In addition, investment in the Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Notes.

Unsecured Obligations

Upon issue, the Notes will constitute unsecured obligations of Azerbaijan.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulation or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent:

- the Notes are legal investments for it;
- the Notes can be used as collateral for various types of borrowing; and

- other restrictions apply to its purchase or pledge of the Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of the Notes under any applicable risk-based capital or similar rules.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, after deduction of the total expenses related to the admission to trading, underwriting and selling commission, will be used by the Republic to for general budgetary purposes.

REPUBLIC OF AZERBAIJAN

Overview

Azerbaijan (officially the Republic of Azerbaijan (*Azərbaycan Respublikası*)) is located at the crossroads of Eastern Europe and Western Asia, in the South Caucasus region of Eurasia. It occupies a land area of 86,600 square km, of which 12 per cent. is forests, 1.7 per cent. is inland water and 55.1 per cent. is agricultural land. The territory also includes the Azerbaijani sector of the Caspian Sea.

The country is situated between 44° and 52° of east longitude, 38° and 42° of north latitude and Azerbaijan's capital, Baku, is located on the 40° parallel.

Azerbaijan has a 765 km border with Iran in the south, a 15 km border with Turkey in the south-west, a 390 km border with Russia in the north, a 480 km border with Georgia in the north-west and a 1,007 km border with Armenia in the west.

The country is well placed on the south-eastern border of Europe on the shores of the hydrocarbon-resource rich Caspian Sea. It has direct access to the extensive and rapidly emerging markets of the Central Asian states and the Caucasus as well as the Middle East.

Azerbaijan is comprised of the Nakhchivan Autonomous Republic, 66 administrative regions and 78 towns. The major cities in Azerbaijan are Baku, Ali-Bayramly, Ganja, Khankandi, Lankaran, Mingachevir, Naftalan, Quba, Shaki, Shusha and Sumgayit. The cities of Khankandi and Shusha and the districts of Aghdam, Fuzuli, Jabrail, Kalbajar, Lachin, Qubadly and Zangilan are presently under occupation by Armenia.

The Nakhchivan Autonomous Republic is a landlocked enclave of Azerbaijan bordering Armenia in the north and east, Turkey in the south-west and Iran in the south and west. It is an autonomous republic consisting of eight administrative districts (Babak, Julfa, Kangarli, Nakhichevan city, Ordubad, Sadarak, Shahbuz and Sharur), with its own parliament, cabinet of ministers and supreme court. Although autonomous, the Constitution and its laws are valid in Nakhchivan and Nakhchivan laws and resolutions must comply with the laws of Azerbaijan.

Population

The population of Azerbaijan was approximately 9.5 million as of 1 January 2014. Population density is estimated at approximately 109 persons per square km, with approximately 53.2 per cent. of the population living in urban areas. Baku, the capital of the country and its largest city, has an estimated population of 2.18 million. Other large cities include Ganja with an estimated population of 324,700 and Sumgayit with an estimated population of 329,000.

The following table sets forth a breakdown of Azerbaijan's population by age and gender according to the 2009 census:

Population

Age	% of Population	Male ('000s)	Female ('000s)
0-14	23.5	1,109	984
15-69	72.3	3,151	3,303
70 and over	4.2	154	221
Total	100.0	4,414	4,508
Grand Total		8,922	

Source: State Statistical Committee

According to the most recent census in 2009, the country's largest ethnic group is the Azerbaijanis (91.6 per cent. of the population). The larger minorities are Lezguins (2 per cent.), Russians (1.3 per cent.), Armenians (1.3 per cent.) and Talyshs (1.3 per cent.) with relatively small numbers of Avars, Turks, Tatars, Ukrainians, Sakhurs, Georgians, Kurds and Tats. The official language is Azerbaijani and a substantial majority of the population is Muslim.

The following table sets forth a breakdown of life expectancy for Azerbaijan's population by gender:

Life Expectancy in Azerbaijan

(years)

	For the year ended 31 December						
	2006	2007	2008	2009	2010	2011	2012
Average	72.4	73.0	73.4	73.5	73.6	73.8	73.9
Men	69.6	70.1	70.8	70.9	70.9	71.2	71.3
Women	75.1	75.8	76.1	76.1	76.2	76.5	76.6

Source: State Statistical Committee

The following table describes key social indicators for Azerbaijan and, by way of comparison, for certain other countries within the region for the years indicated:

Regional Social Indicators

	Azerbaijan	Georgia	Iran	Russian Federation	Turkmenistan	Kazakhstan
Life expectancy at birth, 2012 *(years)*	73.9	73.8	73.4	69.0	65.2	68.9
Infant mortality rate, 2012 *(per 1,000 births)*	10.8	17.8	15.1	8.9	44.8	16.7
Adult literacy rate, 2011 *(%)*	99.8	99.7	n.a.	n.a.	99.6	n.a.

Source: State Statistical Committee, World Bank

Over the past decade, substantial improvement has been achieved in the living standards of the population. An indicator of this improvement is the increase in life expectancy in both men and women, which since 2006 has increased by 1.7 years and 1.5 years respectively to 71.3 years and 76.6 years respectively in 2012. Such developments were supported by the implementation of long-term social policies, particularly in the area of public health where the state has targeted programmes towards the treatment of diabetes, blood diseases and tuberculosis, as well as promoting blood donations and developing the state's blood transfusion services.

These positive developments have also seen Azerbaijan move ahead of a number of countries in the region on some key social indicators. In addition to health programmes, the state has continued to improve education standards and secondary education is compulsory, leading to high levels of adult literacy.

History

One of the countries of the South Caucasus, Azerbaijan reappeared on the political map of the world after the collapse of the Soviet Union in 1991. Independence was regained at the cost of thousands of Azerbaijani lives lost in the Nagorno-Karabakh conflict and the Soviet attack on the Azerbaijani nationalist movement in Baku in January 1990. Yet despite its short period of independence in recent times, Azerbaijan has a long history of culture and statehood.

Today's Azerbaijan is the successor of the Azerbaijan Democratic Republic (the "**ADR**") declared on 28 May 1918 by the first Azerbaijani parliament, the National Assembly ("**Milli Majlis**"). Though short-lived (being occupied by Bolshevik Russia in 1920), the ADR was the first democratic government in the whole Islamic world. It introduced measures such as electoral rights for women, quotas in the parliament for ethnic minorities and other steps towards effective democracy which were progressive, not only in the Middle East and Eurasia, but in comparison to the mature democracies of Europe at that time.

The short-lived ADR was invaded and occupied by Soviet troops in late April 1920 and the remnants of the ADR National Army units, together with the local militia, retreated to Ganja where a major clash with joint Bolshevik/Armenian Dashnak forces took place. However, the resistance was defeated and Azerbaijan was proclaimed a Soviet Socialist Republic. A period of mass repression of the Azerbaijani people and of the country's cultural identity followed in the 1920s and 30s.

From 1922 until 1990, the Azerbaijani Soviet Socialist Republic (the "**AzSSR**") was an integral part of the Soviet Union, as one of the "founding" republics, and a major industrial and cultural centre. The disintegration of the Soviet Union brought independence to Azerbaijan, but also a serious economic and political crisis, which was compounded by ongoing aggression from the Republic of Armenia. A long and bloody military conflict began in 1988 when Armenian nationalists, backed by the former Soviet administration, launched a separatist movement in the western Azerbaijani region of Nagorno-Karabakh. See "*Republic of Azerbaijan – Bilateral Relations - Armenia*". The conflict was exacerbated further by civil conflict within Azerbaijan as political groups vied for power.

A succession of weak governments ended in 1993 when a former leader of AzSSR, Heydar Aliyev, was elected President. Aliyev's government re-established peace and stability, reinforced state infrastructure and civil rule throughout the country and launched an active foreign policy campaign aimed at the political rehabilitation of Azerbaijan internationally. Major oil and gas contracts were signed with a consortium of foreign oil companies including BP, Amoco, Total and others in 1994. From 1997 onwards, major political reforms were introduced with the aim of bringing Azerbaijan into line with international standards in the areas of the rule of law, democracy and human rights.

President Heydar Aliyev died on 12 December 2003 and his son, Ilham Aliyev, was elected President in the 2003 presidential elections. Ilham Aliyev has continued to follow the policies of his father, including European integration and democratization, although much remains to be done in this regard.

Following his election in 2003, President Ilham Aliyev launched a series of economic reforms aimed at increasing the competitiveness of the Azerbaijani economy, integrating Azerbaijan with world economic systems and ensuring long-term socio-economic development. Key to achieving these goals is the strengthening and harnessing of Azerbaijan's economic potential, the development of non-oil and gas sectors, efficient use of every region in Azerbaijan, establishing favourable conditions for employment, developing private business, increasing the scope, quality and target groups of social services, and reducing poverty.

President Ilham Aliyev was re-elected for a second term in 2008 and for a third term in 2013. The next presidential elections are due in 2018.

Constitution and Political System

The Constitution

The present Constitution was adopted by referendum on 12 November 1995 and amended by referenda in 2002 and 2009. The Constitution states that Azerbaijan is a democratic, legal, secular and unitary republic.

The President

The President of the Republic is the head of state, elected by majority vote in direct elections for a term of five years. The President represents Azerbaijan at home and abroad, is the commander-in-chief of the armed forces and President of the Security Council of Azerbaijan.

The President may negotiate international agreements on behalf of Azerbaijan, appoint and recall Azerbaijani ambassadors and envoys and receive letters of credence and letters of recall from foreign diplomatic representatives. Presidential powers include the right to initiate legislation and to veto certain legislative acts. The President determines the timing of elections to the Milli Majlis, appoints the Prime Minister in consultation with the Milli Majlis, submits the state budget to the Milli Majlis for ratification, appoints governors of the administrative regions, approves state economic and social programmes and performs other duties defined by the Constitution.

Government

The Cabinet of Ministers of the Republic of Azerbaijan is subordinate and accountable to the President. The Government of the day is dissolved on the day when a newly elected President takes office. The Prime Minister is the head of the Government and is appointed by the President in consultation with the Milli Majlis. Other members of Government are appointed by the President.

The Government includes 20 ministries and 11 state committees. As of the date of this Prospectus the Prime Minister is Artur Rasi-zade.

Parliament

The unicameral Milli Majlis is the country's legislative body and is based in Baku. Its powers include passing laws and resolutions and ratifying international agreements. The Milli Majlis is comprised of 125 members, all of whom are elected by a majority system and serve a five year term. The latest Milli Majlis elections were held in November 2010. The next elections will be in 2015.

The following table shows a breakdown of the distribution of seats in the Milli Majlis (by party as at February 2014):

Distribution of seats in the Milli Majlis

Party	**Seats held**
New Azerbaijan Party	68
Civil Solidarity Party	3
Motherland Party	1
Social Prosperity Party	1
Azerbaijan Political Party of Democratic Reforms	1
Azerbaijan Hope Party	1
Whole Azerbaijan Popular Front Party	1
Civil Union Party	1
Great Order Party	1
Azerbaijan Popular Party	1
Justice Party	1
Independent Members	42
Total:	**122**

Source: Milli Majlis

Judicial System

The Azerbaijani judicial system consists of the Constitutional Court, the Supreme Court, the Court of Appeal of the Republic of Azerbaijan and general and specialised courts. Judicial power is independent and is exercised in compliance with the Constitution, domestic legislation and ratified international agreements.

The Milli Majlis appoints the judges of the Constitutional Court, the Supreme Court and the Nakhchivan Autonomous Republic Supreme Court and courts of appeal after their nomination by the President. The President appoints judges to the Court of Appeal. Judges are appointed for an initial term of five years, during which time they are evaluated. If the evaluation is successful, their tenure is extended until the age of 65. The tenure can be extended on the recommendation of the Judicial Legal Council for a further five years, until the age of 70.

The Constitutional Court is the highest judicial body in respect of Constitutional matters and upholds the supremacy of the Constitution and protects citizens' rights and freedoms. It has jurisdiction over all matters relating to the interpretation of the provisions of the Constitution. In addition, the Law "On Constitutional Court" of 23 December 2003 enables citizens to apply directly to the Constitutional Court on matters related to violations of their rights and freedoms.

The Supreme Court is the highest court in the country and is responsible for equal administration of laws by all courts.

Legislation and regulatory development

Since independence, Azerbaijan has sought to establish a new legal framework to govern the principal areas of economic activity. The Government has completed a series of legal reforms designed to make the economy more market-oriented and to improve governance standards. See *"Risk Factors - Risks relating to Azerbaijan - Azerbaijan's developing legal system"*.

Ownership rights, basic rules for commercial relations, principles of contract and property law including particular types of contractual relationships such as sale contracts, leases, credit agreements and insurance are set out in the Civil Code, which came into effect in September 2000. The Civil Code also specifies rules governing the enforcement of obligations and the conclusion, validity, and termination of contracts. Among the provisions applicable to legal entities are provisions regulating different types and organizational forms of legal entities and the main principles of a legal entity's establishment, state registration, management, activity, liquidation and reorganisation.

The Law "On International Private Law" provides that where transactions have a foreign element (e.g., where one of the parties is a foreign person), parties to an agreement may choose a foreign law as the governing law of the transaction contracts. When a contract governed by foreign law is enforced in a local court, a local court is under a duty to take all necessary measures to determine the content of the applicable foreign law based upon official interpretation and practice. In the event that such measures: (a) do not yield a result or (b) require excessive costs and neither party presented documentary evidence confirming the content of the foreign law, a court may apply local law. See *"Risk Factors - Risks relating to Azerbaijan - There is a risk that the choice of English law as the governing law of the Notes might not be applied by the courts of Azerbaijan"*.

The basis of the Azerbaijani tax system is the Tax Code, which came into effect in January 2001. The Tax Code recognizes the existence of special tax regimes, distinct from those described above. Such regimes are, by and large, applicable to contracting and subcontracting parties in oil and gas production sharing agreements ("**PSAs**"). While tax regimes applicable under PSAs differ individually, generally they provide for lower withholding income tax rates, exemption from VAT, and simplified reporting and accounting procedures.

Additionally, as of 2008, the Tax Code has recognized tax regimes that may exist in special economic zones. Under the Tax Code, all companies operating in Azerbaijan are required to be registered. As a part of ongoing business law reforms introduced from January 2008, company registration procedures involving multiple governmental bodies were eliminated and companies are now only required to register with the Ministry of Taxes. Without formal registration, a company may not do business in Azerbaijan.

Azerbaijan has two separate insolvency regimes: one for non-bank companies and private entrepreneurs and another for banks. The insolvency of non-bank companies and private entrepreneurs is regulated by the Law "On Insolvency and Bankruptcy" dated 13 June 1997. The insolvency of banks is regulated by the Law "On Banks" dated 16 January 2004. These laws set forth the rules for declaring an individual or enterprise bankrupt, for managing and liquidating an enterprise after it has been declared bankrupt, for satisfying creditors' claims and for the bankruptcy process generally. Although Azerbaijan's first insolvency legislation following independence was adopted as early as 1994, to date there have been few insolvency or restructuring proceedings.

Banking in Azerbaijan is regulated by the Law "On Banks", the Law "On the Central Bank", and normative acts of the CBA. Both banks and non-bank credit organizations are classified as credit organizations. However, while banks are allowed to conduct all types of banking operations, under the Law "On Non-Bank Credit Organizations", non-bank credit organizations may conduct only certain types of banking operations, such as extending loans, selling and purchasing debt obligations (factoring, forfeiting), leasing, issuing guarantees, etc., and are expressly prohibited from accepting deposits.

Azerbaijani law is evolving in accordance with the Government's strategic goal of creating a welcoming environment for foreign businesses. Under the Law "On Protection of Foreign Investments" dated January 15, 1992, foreign investors are afforded equal treatment with domestic investors (a "national treatment" regime) and are afforded various guarantees, such as guarantee against deterioration of legislation, guarantee against nationalization and requisition, guarantee of compensation of damages and to repatriate profits. Azerbaijan has concluded numerous bilateral treaties on the mutual protection of investments with several more treaties currently under negotiation. Foreign investments are thus protected by guarantees provided under law. Foreign investment in Azerbaijan is regulated by a number of international treaties and agreements, and by domestic legal acts, including the Law "On Protection of Foreign Investment" dated January 15, 1992, the Law "On Investment Activity" dated January 13, 1995, the "Privatisation Law" and the Second Privatisation Program, as well as laws regulating specific sectors of the Azerbaijani economy.

The Customs Code of the Republic of Azerbaijan was adopted on 24 June 2011 and provides the regulations, rules and procedures applicable to import to and export from the territory of the Azerbaijan. In February 2011, the President signed a decree intended to simplify customs procedures, strengthen transparency in the customs administration and to shorten customs clearance times, reflecting a shift towards the Government's aim for development of foreign economic activity. A key element of those aims was the implementation of the "single-window" principle on import of goods and vehicles into the territory of Azerbaijan and authorizing the State Customs Committee to fulfill the functions of the single inspection body in relation to goods and vehicles imported.

As part of the development of the Azerbaijani economy, the state has adopted several programmes of privatisation. Privatisation of state property in Azerbaijan started in 1995 with the adoption of the State Program of Privatisation of State Property in the Azerbaijan Republic, 1995-1998. This was a mass privatisation programme intended to transfer state ownership to private individuals while limiting the inflationary impact of privatisation and it focused mainly on small-scale enterprises. Together with the Law "On State Property Privatisation", the Second State Program of Privatisation of the State-Owned Property came into effect in June 2000 and allowed for the privatisation of the remaining large-scale state enterprises and strategic parts of the telecommunications, chemical, petrochemical and metallurgy sectors. See *"The Economy - Privatisation Process"*.

Municipalities

Members of municipalities are elected in direct elections through elections held every five years. The last municipal elections were held in November 2011. Municipalities are authorised to collect local taxes and payments, approve a local budget, and implement local programmes of social security and economic development.

Bilateral Relations

Georgia

Diplomatic relations were established between Azerbaijan and Georgia on 18 November 1992. The main areas of economic cooperation with Georgia are energy, transport, the banking sector, construction, information communication technology, trade and tourism.

Besides significant direct investments into the Georgian economy, Azerbaijan actively cooperates with Georgia in the BTC oil pipeline, the BTE gas pipeline, the Baku-Tbilisi-Kars railway line and Trans Anatolian Natural Gas Pipeline ("**TANAP**") projects. As such, good relationships between Azerbaijan and Georgia are of major importance to both countries. See "*The Economy - Principal Sectors of the Economy - Energy - Oil and Gas Export Pathways*".

Armenia

A major conflict broke out between Azerbaijan and Armenia in 1988 when Armenian nationalists established a separatist movement in the western Azerbaijani region of Nagorno-Karabakh. Full-scale hostilities between the countries broke out in 1991-1992. Although a cease-fire was achieved in 1994 and both sides agreed to a dialogue and peace settlement talks, little has been achieved in resolving the conflict and the cease-fire is regularly violated.

Four United Nations ("**UN**") Security Council Resolutions (822, 853, 874 and 884) were adopted in 1993 calling for the withdrawal of Armenian forces from occupied Azerbaijani territories. The resolutions have not been complied with by Armenia. Other international organisations have called for Armenia to withdraw its forces from the occupied territories of Azerbaijan and ongoing but unconcluded settlement talks have been initiated by OSCE's Minsk Group, which meets on an ad hoc basis. The Minsk Group co-chaired by United States, Russia and France, consists of Belarus, Germany, Italy, Sweden, Finland, Turkey, Armenia and Azerbaijan. The Minsk Group has made proposals for the peace settlement but they have not been accepted by Armenia. The most recent summit of the Minsk Group took place in November 2013, which was followed by a ministerial meeting in December 2013. While ministers expressed their continued support for a settlement, the members of the Minsk Group expressed concern over the time taken to reach a settlement and recent developments on the border, including continued violence in the region. The Minsk Group has also stressed that recent incidents undermine negotiations and the prospects for peaceful resolution of the conflict. They have called on the sides to fully and unconditionally respect the terms of the ceasefire agreement. See "*Risk Factors - Risks relating to Azerbaijan - Dispute with Armenia*".

No state (with the exception of three other non-UN states: Abkhazia, South Ossetia and Transnistria) officially recognises an independent Nagorno-Karabakh.

Iran

The Islamic Republic of Iran recognised the independence of Azerbaijan in December 1991. Diplomatic relations were established between the two countries in March 1992. Officials of the two countries pay regular visits and the countries continue to cooperate on bilateral and multilateral platforms, including within the Economic Cooperation Organization ("**ECO**") and other institutions. See "*Risk Factors - Risks relating to Azerbaijan - Relations with neighbours*".

Russia

Diplomatic relations were established between Azerbaijan and the Russian Federation in April 1992. Meetings of the Azerbaijan-Russian Federation Intergovernmental Joint Commission on economic, scientific technical and cultural cooperation have been held every two years since 1996. The countries' Foreign Ministries consult on political matters twice a year.

The countries also cooperate closely on humanitarian issues at a central and regional level and their Presidents formed the International Humanitarian Forum, which has met in Baku every year since 2011.

Turkey

Turkey was the first state to recognise Azerbaijan's independence in November 1991 and diplomatic relations were established between the two countries in January 1992. The countries cooperate closely on economic, infrastructure, energy security, education, culture, environment, youth and sport issues.

The countries also collaborate on the BTC oil pipeline, the BTE gas pipeline, the Baku-Tbilisi-Kars railway line and the Trans Adriatic Pipeline ("**TAP**") and TANAP projects. See "*The Economy - Principal Sectors of the Economy - Energy - Oil and Gas Export Pathways*".

United States

The United States established diplomatic relations with Azerbaijan in 1992 and has expressed its commitment to strengthening democracy and the formation of an open market economy in Azerbaijan. Both countries seek new ways together to promote regional security and stability, enhance energy security, and strengthen economic and political reforms. The United States is one of three countries which co-chairs the OSCE's Minsk Group which is working to encourage a peaceful, negotiated resolution to the conflict between Azerbaijan and Armenia over Nagorno-Karabakh.

Azerbaijan and the United States cooperate in many international organizations, including the UN, Euro-Atlantic Partnership Council ("**EAPC**"), OSCE, IMF and World Bank. Azerbaijan has observer status at the Organization of American States and the World Trade Organization ("**WTO**") and is a participant in the North Atlantic Treaty Organization's ("**NATO**") Partnership for Peace programme.

The United States and Azerbaijan have a bilateral trade agreement and a bilateral investment treaty. US companies are involved in offshore oil development projects with Azerbaijan and have been exploring emerging investment opportunities in Azerbaijan in the telecommunications and other sectors. Azerbaijan has been designated as a beneficiary country under the Generalized System of Preferences ("**GSP**") programme, under which a range of products that Azerbaijan might seek to export are eligible for duty-free entry to the United States. The GSP programme provides an incentive for investors to produce in Azerbaijan and export selected products duty-free to the US market.

International Relations

Azerbaijan is a member of the UN (which it joined in March 1992) and belongs to many other international organizations. It maintains diplomatic relations with 178 countries. It has 62 diplomatic missions and nine general consulates abroad.

Regional Groupings

Azerbaijan is a member of several regional groupings. It is a founding member of GUAM (Georgia, Ukraine, Azerbaijan and Moldova), founded in October 1997 as a political, economic and strategic alliance.

It is also a founding member of the Organization of Black Sea Economic Cooperation ("**BSEC**") established in June 1992 by Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey and Ukraine. BSEC works to foster relations among member states. Azerbaijan also continues to be a member of the CIS, alongside Russia, Belarus, Ukraine, Kazakhstan, Kyrgyzstan, Moldova, Turkmenistan, Tajikistan, Uzbekistan and Armenia. The CIS works to promote coordination in areas of trade, finance, law-making and security, and to support cooperation on democratisation and cross-border crime prevention across the former Soviet republics.

Reflecting the religion of the majority of its population, Azerbaijan joined the Organization of the Islamic Conference in December 1991.

UN

A relationship between Azerbaijan and the UN was established soon after the collapse of the Soviet Union and the restoration of Azerbaijan's independence and Azerbaijan was admitted to the UN in March 1992 and the Permanent Mission of the Republic of Azerbaijan to the UN was opened in New York in May 1992.

Azerbaijan has used the platform of the UN to draw the international community's attention to the Armenian-Azerbaijan conflict and harness its potential for a peaceful settlement. In 1993, following the occupation of the Nagorno-Karabakh region and other territories in Azerbaijan, the UN Security Council adopted four resolutions (822, 853, 874 and 884) reaffirming the territorial integrity of Azerbaijan and demanding an immediate cease-fire, suspension of hostilities and withdrawal of all occupying forces from Azerbaijan. These resolutions have not been complied with.

Azerbaijan maintains cooperation with a wide range of specialised UN agencies and bodies in an active and effective manner, including UNDP, UNICEF, UNHCR, UNESCO, UNCTAD, IAEA and others.

Azerbaijan was elected as a non-permanent member of the UN Security Council for 2012-2013 in October 2011 and during this two year period Azerbaijan played an active and constructive role in the functioning of the UN Security Council.

NATO and military relationships

Azerbaijan-NATO cooperation started in March 1992 when Azerbaijan, together with 37 countries, joined the North Atlantic Cooperation Council ("**NACC**") that brought together 16 Alliance members, 15 states of the former USSR and the other countries of the former Warsaw Pact. The Partnership for Peace ("**PfP**") was introduced in January 1994 as a major initiative by NATO aimed at enhancing stability and security throughout Euro-Atlantic area. Azerbaijan was in the first wave of countries that responded to the invitation to join the Programme by signing the Framework Agreement on 4 May 1994.

PfP has proved to be very successful in developing and promoting mechanisms for defence cooperation and military interoperability between NATO and Azerbaijan. Most notably PfP has developed practical tools allowing NATO and partner nations to engage in joint crisis management and peacekeeping operations. Azerbaijan, building on enhanced representation of the partner nations at NATO, has established a diplomatic mission to the organisation and sends diplomatic staff and a Military Representative to NATO.

When NACC was transformed into the EAPC in May 1997, Azerbaijan became an active member. EAPC provides an important forum for discussions and consultations on political and security related issues.

The developing practical cooperation between Azerbaijan and NATO goes beyond the immediate responsibilities of Ministries of Defense and Foreign Affairs, covering broad areas such as border control, civil emergency planning, environmental and scientific issues and public diplomacy.

Azerbaijan has also undertaken a number of 'Partnership Goals' on defence planning and preparation of forces for peace support operations. The Individual Partnership Action Plan ("**IPAP**"), which Azerbaijan joined in 2004, enables it to hold regular political dialogues, systematise bilateral cooperation as an overarching tool and agree on new cooperation activities of mutual interest in a more flexible manner. Azerbaijan successfully completed the first (2005-2007) and second (2008-2010) cycles of its IPAP and is currently working on the third (2012-2013).

As a key component in NATO's Northern Distribution Network, Azerbaijan provides a secure route for 40 per cent. of the NATO-led International Security Assistance Force's ("**ISAF**") multi-modal transit into Afghanistan. Working closely with the US Transportation Command and the US Air Mobility Command, Azerbaijan has aided important over-flight clearances and medical evacuation flights as well as landing and refueling operations for US and NATO efforts supporting the ISAF.

Azerbaijani servicemen serve together with other NATO soldiers in Afghanistan and provide specialised training for Afghani police, border guard officers and civilian and military doctors. President Aliyev stated Azerbaijan's intention to expand its partnership with Afghanistan's national institutions beyond 2014, highlighting the long-standing friendship between the Afghan and the Azerbaijani people.

Relationship with the European Union

Cooperation with the EU is one of the central elements of Azerbaijan's foreign policy. The location of Azerbaijan at the crossroads of Europe and Asia means that Azerbaijan is well placed to develop political and economic relations with EU Member States. In 1998, the EU nominated its first Special Envoy to Azerbaijan and, in 2000, Azerbaijan established its Permanent Mission to the European Community.

On 22 June 1999, a Partnership and Cooperation Agreement (signed in April 1996) ("**PCA**") between the EU member-states and Azerbaijan came into force, signifying a higher level of cooperation between Azerbaijan and the EU. The objectives of the Agreement are as follows:

- to provide an appropriate framework for the political dialogue between the parties allowing the development of political relations;
- to support Azerbaijan's efforts to consolidate its democracy and to develop its economy and to complete the transition into a market economy; and
- to promote trade and investment and harmonious economic, social, financial, scientific, technological and cultural cooperation.

As envisaged by the PCA, the Cooperation Council determines major guidelines of cooperation and Cooperation Committee assists the Council in its activities by giving recommendations. A Subcommittee on Trade and Economic Issues works under the authority of the Cooperation Committee and discusses trade, investment and other issues related to economic cooperation under the PCA.

In 2006, Azerbaijan signed an important Action Plan within the EU's European Neighborhood Policy framework and a memorandum on strategic partnership with the EU on energy issues.

The EU supports economic reform in Azerbaijan by the transfer of relevant technical assistance and expertise through the Technical Assistance to the Commonwealth of Independent States ("**TACIS**") program. The TACIS program was established in 1991 with the purpose of providing technical assistance to the 12 countries of the former Soviet Union and Mongolia. Under the TACIS indicative program for Azerbaijan, priority is given to three areas of cooperation: infrastructure, private sector and human resources development. The key TACIS multi-country network projects related to Azerbaijan are the Transport Corridor Europe - Caucasus - Asia ("**TRACECA**") and Interstate Oil and Gas Transportation to Europe ("**INOGATE**").

TRACECA was established in May 1993 at the Conference in Brussels where ministers of trade and transport of the eight original founder states (five Central Asian states and three South Caucasus states) met. It aims to support their political and economic independence by enhancing their capacity to access European and world markets through alternative transport routes and to encourage further regional cooperation among the partner states.

INOGATE is the main regional initiative within the framework of EU assistance to newly-independent states. The signing of the umbrella agreement on establishment of interstate oil and gas transportation framework in Kiev in July 1999 by 15 states (including Azerbaijan) laid the legal basis of INOGATE.

The EU has also sought to strengthen its bilateral and multilateral cooperation with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine through the Eastern Partnership and its policies, which aims to result in the EU having safe, stable, economically strong and pro-European Eastern neighbours. This has been a particular focus of the 2013 Lithuanian Presidency of the Council of the EU. At the recently held Vilnius summit (December 2013), the participants reviewed the considerable progress made since 2011 in bringing Eastern European partners closer to the EU and agreed on an ambitious agenda to ensure the implementation of agreed commitments, in particular on political, economic and social reforms. These reforms include measures promoted by the EU to strengthen the rule of law, protect human rights and maintain judicial independence.

Azerbaijan is set to take Chairmanship of the Council of Europe's Committee of Ministers from May to December 2014, taking over from current chair, Austria. The Committee of Ministers is the Council of Europe's decision-making body. It comprises the Foreign Affairs Ministers of all the member states, or their permanent diplomatic representatives in Strasbourg. It is both a governmental body, where national approaches to problems facing European society can be discussed on an equal footing, and a collective forum, where Europe-wide responses to such challenges are formulated. In collaboration with the Parliamentary Assembly, it is the guardian of the Council's fundamental values, and monitors member states' compliance with their undertakings.

Azerbaijan has also sought to enhance its laws and regulations relating to corruption by following European regimes. Azerbaijan has ratified the Council of Europe's Civil and Criminal Law Conventions on Corruption. During 2004, it also joined the Council of Europe's Group of States against Corruption and signed up to the UN Convention against Corruption in February 2004. As part of the ASAN reforms (see "*The Economy - Overview*"), Azerbaijan has also established the State Agency for Public Service and Social Innovations. In addition to its objectives of expediting and elevating the level of professionalism in public services, the agency is tasked with increasing transparency and strengthening the fight against corruption. See "*Risk Factors - Risks relating to Azerbaijan - Corruption*".

Organisation for Security and Co-operation in Europe

Azerbaijan considers the OSCE to be a unique pan-European security organisation and with this in mind pays special importance to expanding its activities within the organisation in all fields. The OSCE plays a key role in the peace negotiations between Armenia and Azerbaijan in respect of the Nagorno-Karabakh conflict, with its Minsk Group responsible for arranging settlement talks.

Azerbaijan joined the Conference on Security and Co-operation in Europe ("**CSCE**") in January 1992 and in July 1992, Azerbaijan signed the CSCE Helsinki Final Act of 1975 at the CSCE Helsinki Summit. In December 1993, Azerbaijan joined the CSCE Charter of Paris and in November 1999 signed the Charter for European Security at the OSCE Istanbul Summit.

A delegation from the Milli Majlis participates in the Annual Sessions of the OSCE Parliamentary Assembly.

WTO Accession

Azerbaijan's Working Party with the WTO was established in July 1997 and the first meeting of the Working Party was held in June 2002. Bilateral negotiations on market access are underway on the basis of revised offers in goods and services. Multilateral work is proceeding on the basis of a Factual Summary of Points Raised since December 2008. The Factual Summary was last revised in November 2012. The 11th meeting of the Working Party took place in Geneva in February 2014, attended by a delegation from the Ministry of Finance of the Republic of Azerbaijan, and covered topics including access to the Azerbaijani goods and services markets, agricultural subsidies and improvements to the existing legislation, as well as the clarification of several issues on the foreign trade regime.

Legal Proceedings

In December 2013, a claimant incorporated in Turkey filed a request for arbitration against the Ministry of Communications and Information Technologies of the Republic of Azerbaijan pursuant to UNCITRAL Rules. The claim relates to the alleged investment of the claimant in a joint venture established in 1996 with the Ministry of Communications for investment into the Azerbaijani telecoms sector. The claimant alleges that the Ministry breached the terms of the joint venture agreement by interrupting the activities of the joint venture and amending licensing requirements in relation to data communication services. Having made an original investment of US$ 1 million, the claimant is seeking approximately US$ 431 million in damages and lost profits plus interest and the cost of proceedings. Azerbaijan rejects all claims made by the claimant and considers the request for arbitration to be without merit. As at the date of this Prospectus, no arbitral tribunal has been constituted and no venue has been selected.

THE ECONOMY

Overview

Following the restoration of independence in 1991, Azerbaijan went through a period of sharp economic decline which lasted until 1995 and during which GDP declined by approximately 58 per cent. The long-lasting military conflict with Armenia over the Nagorno-Karabakh region, a succession of weak and short-lived governments and loss of traditional markets with the collapse of the Soviet Union all contributed to the severity of this economic crisis.

Economic recovery was initiated by the signing of the PSA for the developments of Azeri-Chirag-Gunashli ("**ACG**") oil field, in 1994. Signed by then President Heydar Aliyev and a consortium of international oil companies, this contract paved the way for redevelopment of the oil industry and with it the economy of Azerbaijan. Substantial foreign direct investment to the oil industry followed, ensuring rapid knowhow transfer and providing the conditions for the acceleration of economic development. This was followed by the establishment of key state institutions that formed the backbone of the new, independent state. Trade and price controls were liberalized and the state began reforms to support growth of the market-based economy.

In the period following the initial oil boom, one of the main tasks has been the efficient use and reallocation of revenue derived from the country's oil and gas reserves. The State Oil Fund of the Republic of Azerbaijan ("**SOFAZ**") was established to channel revenues from oil exports to the priority sectors of the economy and key social and economic projects. This, along with other areas of economic policy and reform, has enabled Azerbaijan to improve its fiscal stability and to achieve sustainable growth which, in turn, has enabled the country to reform other priority areas of the economy, upgrade critical infrastructure and improve social welfare.

During the last 15 years, almost US$ 140 billion has been invested in the economy and currently the country's strategic foreign exchange reserves stand in excess of US$ 50 billion, approximately 70 per cent. of the country's current GDP. Economic growth since 2000 has transformed the country from a low income category to an upper middle income country according to the World Bank's classification. The country's poverty rate has also been reduced from above 50 per cent. during the early 2000s to 6.0 per cent. in 2012, based on internal classifications. The quality of life has also improved considerably, which is reflected in increased life expectancy, access to better healthcare, education and other social services.

Azerbaijan's development performance has been positively noted by the international community. As of the date of this Prospectus, Azerbaijan currently holds an investment grade rating from the three major international credit rating agencies (SOP, Moody's and Fitch). The economy is ranked 46th in the Global Competitiveness Report of the World Economic Forum, the highest ranking among the CIS economies. Azerbaijan has also improved its position in the UN's 2013 Human Development Index, which considers the potential human development of the population (taking into account factors such as life expectancy, education and income), rising to a rank of 82nd overall (an improvement of 11 places from 2012).

Improvements in transparency and accountability have also been made. In July 2013, the President signed an order establishing the State Agency for Public Service and Social Innovations, with the objective of making Government services more easily accessible to citizens using modern technology, reducing corruption and increasing transparency.

As part of this initiative, the agency will establish and manage the Azerbaijan service and assessment network ("**ASAN**") – a network of centres where government services are to be delivered by highly trained public servants – as well as carrying out information technology projects to better organise and manage electronic services provided by the state and to improve the integration of databases across all state agencies. All of the services in the centre are processed online. ASAN centres are expected to cover all Azerbaijani regions by the end of 2014. They may also include translation services, a laboratory, a medical service, internet cafes, post offices and photo studios in the centres.

Azerbaijan - 2020: Outlook for the future

In December 2012, Azerbaijan adopted a long-term social and economic development plan (the "**2020 Project**"), the main goals of which are to stimulate economic development through diversification of the economy and the building of competitive non-oil and gas sectors to counter the potential impact of falling oil production on growth. The 2020 Project sets out the strategic target of doubling GDP per capita to US$13,000 by 2020 and the Government plans to achieve this through diversification of the economy beyond the oil and gas sector, supporting innovation and scientific research, increasing the skills of the labour force and reforms to improve state institution efficiencies.

The 2020 Project also aims to achieve higher standards of living and lower poverty levels through Government investment in education, healthcare and cultural and social institutions. To this end the Government has also approved education funding increases year-on-year through to 2020, intended to increase participation in pre-school education, build and refurbish schools and colleges, modernise secondary education, improve teacher training and provide further support to Azerbaijani students studying abroad.

As part of the 2020 Project, the Government has proposed the development of special industrial and economic zones across Azerbaijan, the development of petrochemical complexes in Sumgayit, the processing of domestic waste in Balakhani and the development of an aluminium industry in Ganja. There are also proposals for the development of new steelworks, fertiliser factories, shipyards and cement plants. The 2020 Project also includes proposals to develop and modernise the farming industry and to establish a State Fund for the Development of Information Technologies to improve information skills in the labour force and develop entrepreneurship. See "*Risk Factors - Risks relating to Azerbaijan - The development of Azerbaijan's physical infrastructure may require further investment*" .

The Government will also be supporting and investing in the development of transport infrastructure. As well as the ongoing development of the International Sea Trade Port in Alat, Azerbaijan's rail networks are also being upgraded under a World Bank financed "Railway Modernization Project", which—upon completion—aims to cut transit times on the transport corridor to Georgia by 50 per cent. and transform Azerbaijan Railways into a financially self-sustainable operation in freight transportation by providing proper infrastructure, reducing costs and improving locomotive capacity and operational reliability. These improvements will also see updates to rolling stock and electrification of the rail network. In addition, the Baku Metro coverage will also be extended, with plans to build new stations and extended the current network. Following the completion of upgrades to a significant proportion of the road network, there are plans for new highway roads linking the regions and there will be an extensive programme of widening and reconstruction of existing roads. To support growth in tourism and business travel, works are ongoing in completing a new terminal at Heydar Aliyev International Airport in Baku, as well as updates to regional airports within Azerbaijan. Detailed costings and timetables for the 2020 Project developments are still to be established.

The early results of the 2020 Project have been positive. The targeted GDP per capita requires an annual growth rate for non-oil and gas GDP of 7.0 per cent. and this was exceeded during 2013, which saw a growth of 10.0 per cent. in non-oil and gas GDP (increasing to 60.0 per cent of GDP). This follows significant and consistent growth in the non-oil and gas sectors since 2010, which grew by 9.0 per cent. on average per annum from 2010 to 2012. Exports from the non-oil and gas sectors have also seen significant and consistent growth since 2006 and increased by a further 13.0 per cent. in the first six months of 2013. See "*Risk Factors - Risks relating to Azerbaijan - Azerbaijan may not be able to sufficiently expand the non-hydrocarbon sector of its economy*".

GDP

The following table sets forth certain information regarding Azerbaijan's GDP for the periods indicated:

Nominal GDP 2004 - 2013

For the year ended 31 December	**GDP**		**Real Growth rate**	**GDP per capita**		**GDP per capita Real Growth rate**
	AZN millions	*US$ millions*	*% change year over year*	*AZN*	*US$*	*% change year over year*
2004	8,530.2	8,680.4	10.2	1,030.4	1,048.5	9.1
2005	12,522.5	13,238.7	26.4	1,494.3	1,579.8	24.9
2006	18,746.2	20,983.0	34.5	2,208.2	2,471.6	32.7
2007	28,360.5	33,050.3	25.0	3,296.6	3,841.7	23.4
2008	40,137.2	48,852.5	10.8	4,603.7	5,603.3	9.3
2009	35,601.5	44,297.0	9.3	4,033.2	5,018.2	7.9
2010	42,465.0	52,909.3	5.0	4,753.0	5,922.0	3.7
2011	52,082.0	65,951.6	0.1	5,752.9	7,285.0	(1.2)
2012	54,743.7	69,683.9	2.2	5,966.1	7,594.3	0.8
2013	57,708.2	73,560.5	5.8	6,207.3	7,912.5	4.4

Source: Ministry of Finance, State Statistical Committee

During the early years of newly-independent Azerbaijan, there was a near total collapse of trading and economic mechanisms and relationships that were highly geared towards a centralised economy. Many sectors of the country's economy were paralysed and economic collapse, which began in 1989, became severe in the first three years after independence. However, as a result of Azerbaijan initiating a privatisation strategy, implementing an "open door" policy (based on mutually-beneficial cooperation in the country), restoring relations with other countries, attracting foreign investment, establishing a healthy investment environment and conditions suitable for entrepreneurship activity and other measures, economic degradation was stemmed by the late 1990s and Azerbaijan began to benefit from a new stage of economic development.

Between 2005 and 2008, GDP grew by 2.4 times, making Azerbaijan one of the most rapidly developing economies in the world. The fastest year on year rate of growth was recorded in

2006, when GDP increased by 34.5 per cent. The economy of Azerbaijan has continued on a solid growth path, with growth of 24.2 per cent. in the period 2008 to 2013. During this period, the non-oil and gas sectors of the economy saw growth of 47.7 per cent., with construction, transport and communications key contributors to this development. The impact of the global financial crisis on the economy was limited and, while GDP from the non-oil and gas industrial sector declined by approximately 10 per cent. in 2009, positive growth quickly returned in 2010 and by the end of that year GDP exceeded pre-2009 levels.

GDP by Sector

The following table illustrates the proportion of Azerbaijan's Nominal GDP by economic sector for the periods indicated:

Nominal GDP by Economic Sector

(per cent. of GDP)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013[1]**
Industry	49.1	51.7	53.8	49.5	46.3
Oil and gas industry	45.1	48.1	49.6	44.7	41.6
Non-oil industry	4.0	3.6	4.2	4.8	4.7
Services	29.7	27.9	27.3	29.1	30.2
Construction	7.2	8.1	8.0	10.1	11.8
Agriculture, hunting, forestry and fishing	6.1	5.5	5.1	5.1	5.3
Net taxes on products	7.9	6.8	5.8	6.2	6.4

[1] *Preliminary*

Source: State Statistical Committee, Ministry of Economy and Industry

The following table sets forth the contribution of private and public sectors to GDP for the periods indicated:

Public and Private Sector contribution to GDP

(per cent. share of GDP)

	1995	**2000**	**2005**	**2009**	**2010**	**2011**	**2012**	**2013**
Public	69.7	29.2	22.2	18.8	18.3	17.5	18.5	17.7
Private	30.3	70.8	77.8	81.2	81.7	82.5	81.5	82.5

Source: State Statistical Committee

Implementation of reforms related to the transition to a market economy has played an important role in year-on-year development of the private sector. This has helped the private sector secure a key position in the economy. The share of gross value added ("**GVA**") in GDP contributed by non-state enterprises and organisations was 30.3 per cent. in 1995, but by 2009, 2010, 2011, 2012 and 2013 had increased to 81.2 per cent., 81.7 per cent., 82.5 per cent., 81.5 per cent. and 82.5 per cent. respectively.

The following table illustrates Azerbaijan's nominal GDP by economic sector for the periods indicated:

Nominal GDP by Economic Sector

(AZN millions)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013[1]**
Mining and quarrying (including extraction of oil and gas)	15,082.3	19,376.6	24,980.0	23,605.9	23,078.7
Construction	2,420.0	3,439.7	4,141.0	5 507.9	6,828.9
Wholesale and retail trade; repairs	2,259.0	2,724.6	3,283.7	3,654.0	4,092.0
Agriculture, forestry and fishing	2,154.9	2,344.6	2,643.5	2,813.7	3,057.8
Transport and storage	2,420.0	2,368.7	2,658.8	2,693.6	2,781.6
Manufacturing (including processing of oil and gas)	1,895.9	1915.8	2,077.2	2,318.7	2,439.6
Electricity, gas, and water supply	408.6	729.2	953.5	1,148.5	1,183.2
Accommodation and food service activities	329.7	442.7	757.2	897.4	1,055.6
Communications	636.4	791.6	828.9	945.1	1,008.5
Social and other services	5,184.7	5,455.0	6,702.2	7,766.9	8,492.0
Total	**32,791.5**	**39,588.5**	**49,026.0**	**51,351.7**	**54,017.9**
Net taxes on products	2,810.0	2,876.5	3,056.0	3,392.0	3,690.3
Total GDP (in Market Prices)	**35,601.5**	**42,465.0**	**52,082.0**	**54,743.7**	**57,708.2**

[1] Preliminary

Source: State Statistical Committee

The following table illustrates Azerbaijan's real GDP by economic sector for the periods indicated:

Real GDP[1] by Economic Sector

(AZN millions)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013[2]**
Mining and quarrying (including extraction of oil and gas)	14,932.4	15,141.4	13,597.0	12,903.6	12,993.9
Construction	1,841.0	2,253.4	2,704.0	3 196.2	3,931.3
Wholesale and retail trade; repairs	1,290.5	1,423.4	1,568.6	1,719.2	1,889.4
Transport and storage	1,259.6	1,315.0	1,304.5	1,369.7	1,456.0
Agriculture, forestry and fishing	1,235.3	1,210.6	1,280.8	1,365.3	1,432.3
Manufacturing (including processing of oil and gas)	913.4	978.3	1,044.8	1,093.9	1,157.4
Accommodation and food service activities	194.7	227.8	279.3	331.8	384.9
Electricity, gas, and water supply	89.9	95.9	106.7	118.3	122.7
Communications	620.8	813.9	910.0	1054.6	1167.4
Social and other services	1,867.1	1,934.3	2,044.6	2,155.0	2,260.6
Total	**24,244.8**	**25,394.1**	**24,840.3**	**25,307.7**	**26,795.9**
Net Taxes	1,374.8	1,489.0	1,612.5	1,725.4	1,870.4
GDP	**25,619.6**	**26,883.1**	**26,452.8**	**27,033.1**	**28,666.3**

[1] Real GDP based on 2005 prices

[2] Preliminary

Source: State Statistical Committee

The mining and quarrying sector (which is predominantly made up of oil and gas extraction) was the largest contributor to the economy in the period from 2009 to 2013. The sector accounted for AZN 15.1 billion of nominal GDP in 2009 (42.4 per cent.) and this increased to AZN 23.1 billion of nominal GDP in 2013 (40.0 per cent.).

Over the same period, non-oil and gas sectors saw significant increases in their contribution to nominal GDP. This trend was seen across the largest of these sectors, which all saw increases in their contribution to GDP. Construction, including both public construction works and the development of private residential and commercial buildings, increased from AZN 2.4 billion in 2009 (6.8 per cent. of GDP) to AZN 6.8 billion in 2013 (11.8 per cent.). Despite the global financial crisis, the wholesale and retail trade sector of the economy increased from AZN 2.3 billion in 2009 (6.3 per cent.) to AZN 4.1 billion in 2013 (7.1 per cent.). In the same period, the transport sector increased from AZN 2.4 billion (6.8 per cent.) to AZN 2.8 billion (4.8 per cent.), agriculture increased from AZN 2.2 billion (6.1 per cent.) to AZN 3.1 billion (5.3 per cent.) and manufacturing increased from AZN 1.9 billion (5.3 per cent.) to AZN 2.4 billion (4.2 per cent.).

The following table illustrates real GDP growth by economic sector for the periods indicated:

Real GDP growth by Economic Sector

(% change year over year)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013[1]**
Mining and quarrying (including extraction of oil and gas)	15.2	1.4	(10.2)	(5.1)	0.7
Construction	(8.2)	22.4	20.0	18.2	23.0
Wholesale and retail trade; repairs	8.9	10.3	10.2	9.6	9.9
Transport and storage	9.3	4.4	(0.8)	5.0	6.3
Agriculture, forestry and fishing	3.5	(2.0)	5.8	6.6	4.9
Manufacturing (including processing of oil and gas)	(12.6)	7.1	6.8	4.7	5.8
Accommodation and food service activities	17.1	17.0	22.6	18.8	16.0
Electricity, gas and water supply	(8.2)	6.7	11.2	10.9	3.7
Communication	13.2	31.1	11.8	15.9	10.7
Social and other services	9.9	3.6	5.7	5.4	4.9

[1] *Preliminary*

Source: State Statistical Committee

In the period 2010 to 2013 there has been a noticeable shift in the economy as Azerbaijan's non-oil and gas sectors have seen significant growth. With oil extraction from the major ACG field reaching its plateau, the contribution of the oil and gas sector to country's GDP declined by 10.2 per cent. and 5.1 per cent. in 2011 and 2012 respectively, with very limited growth in 2013. By comparison, growth across non-oil and gas GDP was very robust in 2009, 2010, 2011, 2012 and 2013 increasing by 3.7 per cent., 7.8 per cent., 9.4 per cent., 9.7 per cent. and 10.0 per cent. respectively, which significantly contributed to the overall growth in the economy during this period.

In 2011, 2012 and 2013, nearly all sectors of the economy (excluding oil and gas) demonstrated consistent and real growth in terms of GDP contribution. The highest levels of consistent growth over that period were seen in accommodation and food services, which saw annual growth in 2011, 2012 and 2013 of 22.6 per cent., 18.8 per cent. and 16.0 per cent. respectively. In the same periods, growth rates of construction were 20. per cent., 18.2 per cent. and 23.0 per cent., while growth in communications was 11.8 per cent., 15.9 per cent. and 10.7 per cent. respectively. See "*Risk Factors - Risks relating to Azerbaijan - GDP and inflation*".

Informal Economy

As has typically been the case with other transition economies, a small portion of Azerbaijan's non-hydrocarbon economy is comprised of an informal, or shadow, economy. By its nature, it is not possible to clearly measure but official estimates put it at approximately 8 per cent. of GDP and approximately 16 per cent. of non-oil and gas GDP. The informal economy is not taken into account in the above GDP data and is only partially taxed, resulting in reduced state revenue. The Government is taking steps to address the informal economy by streamlining various regulations on non-cash transactions, amending tax laws to improve compliance, developing a mandatory life insurance programme to encourage formal sector employment as well as increasing penalties for unregistered and undeclared economic activity.

Principal Sectors of the Economy

Mining and Quarrying

The mining and quarrying sector (which is predominantly made up of oil and gas extraction) in Azerbaijan has a long history and continues to play a substantial role in the economy. In 2012, the mining and quarrying sector accounted for 43.1 per cent. of GDP. Oil and gas extraction accounted for 94.8 per cent. of the overall exports of the country in 2012. In 2013, Azerbaijan's proved reserves were estimated at 1.3 trillion cubic metres of natural gas and seven billion barrels of oil.

SOCAR is the state-owned company responsible for producing oil and natural gas in Azerbaijan. SOCAR also operates the country's refineries, runs the pipeline systems and manages the import and export of oil and gas. The members of SOCAR's management team are appointed by the President of Azerbaijan. Operating decisions are taken by SOCAR's council, with particular administrative duties delegated to the company's President.

- *Oil*

Industrial oil production in Azerbaijan began in 1848 and grew rapidly, with half of the world's oil coming from Azerbaijan by 1901. Following independence, Azerbaijan successfully encouraged foreign investment into its oil and gas industry to replace aging infrastructure and increase production, allowing Azerbaijan to once again become a significant supplier of hydrocarbons to international markets. Since 1994, Azerbaijan has signed 33 PSAs with leading oil companies and, at present, companies from 15 countries are operating in the oil and gas sector of Azerbaijan.

Total oil output was 50.8 million tonnes in 2010, 45.6 million tonnes in 2011 and 43.4 million tonnes in 2012. In 2013, output was 43.5 million tonnes and average daily oil production exceeded 625,000 barrels. In 2011 and 2012, oil exports were 38.8 million tonnes and 36.6 million tonnes respectively. In 2013, oil exports remained stable at 36.3 million tonnes.

ACG is the largest oil field in the Azerbaijan sector of the Caspian Sea, with initial oil in place of almost 17 billion barrels. Up to 10 billion barrels of this oil can be recovered over the life of the field, which may extend beyond 2050. The field is now fully operational, and oil is being produced from Chirag, Central Azeri, West Azeri, East Azeri, Deep-Water Gunashli and West Chirag platforms. By the end of the current PSA in 2024, it is estimated that output from the field will have been 4.7 billion barrels. Significant further investment will be required at that stage to improve recovery factors and recover the remaining reserves.

The PSA for the development of the ACG field, the so called the "Contract of the Century", was signed by President Heydar Aliyev and the participating international companies (BP (UK), Amoco (US), LUKoil (Russia), Pennzoil, (now Devon of US), UNOCAL (US), Statoil (Norway), McDermott (US), Ramco (US), TPAO (Turkey), Delta Nimir (now Amerada Hess of US), and SOCAR (Azerbaijan)) was signed and came into effect in 1994 with a term of 30 years. BP operates the ACG field and SOCAR holds 11.65 per cent. of the joint venture. During the contract period, total revenues for Azerbaijan are estimated to be US$ 200 billion through taxes, royalties and SOCAR's ownership share. See "*Risk Factors - Risks relating to Azerbaijan - Azerbaijan's economy is dependent on oil production and global prices for oil*".

- *Natural Gas*

In the period 2003 to 2009, gas output increased from 5.5 billion cubic metres per year to 23.7 billion cubic metres. Gas output for the period from 2010 to 2013 has remained stable, with output of 26.3 billion cubic metres in 2010, 25.8 billion cubic metres in 2011 and 26.9 billion cubic metres in 2012. Gas output in 2013 has continued this trend, with an increase over 2012 output of 9.7 per cent. in output to 29.5 billion cubic metres. Over the longer term, it is projected that gas output will increase following further development of current assets and the development of new projects.

In 2010, 2011 and 2012, gas exports were 6.2, 6.8 and 6.6 billion cubic metres respectively. Gas exports in 2013 increased to 7.3 billion cubic metres.

The largest gas field of Azerbaijan is the Shah Deniz field, one of the world's largest gas condensate fields. Estimated reserves are more than 1,200 billion cubic metres of gas and 1,111 million barrels of condensate, with the potential for further hydrocarbons at deeper geological horizons and following further exploration and assessment. BP operates the first stage of the Shah Deniz field on behalf of the other parties to the Shah Deniz PSA, which came into force in June 1996 and will expire in 2048. SOCAR holds 10 per cent. of the joint venture. It has been estimated that up to 625 billion cubic metres of natural gas are recoverable over the life of the field.

The following table sets forth the output from the first stage of the Shah Deniz field for the periods specified:

Output of the Shah Deniz field

	For the year ended 31 December						
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013 (H1 only)**
Gas Production (billion cubic metres)	3.26	7.21	6.25	6.89	6.73	7.80	4.89
Condensate Production (million barrels)	7.06	14.91	13.07	14.66	13.97	16.15	9.91

Source: State Oil Company of Azerbaijan Republic

Output from the first stage of the Shah Deniz field increased from 3.26 billion cubic metres of gas in 2007 to 7.80 billion cubic metres of gas in 2012. During the first six months of 2013, gas output was 4.89 billion cubic metres.

In December 2013, the parties to the Shah Deniz PSA made the final investment decision for the second stage development of the Shah Deniz gas field ("**Shah Deniz Stage 2**"). As operator under the Shah Deniz PSA, BP has estimated that the Shah Deniz Stage 2 project will increase gas output of the Shah Deniz field by 16 billion cubic metres per year. The Shah

Deniz Stage 2 project is also set to bring gas directly from Azerbaijan to Europe for the first time, and triggers plans to expand the South Caucasus Pipeline ("**SCP**") through Azerbaijan and Georgia, to construct the TANAP across Turkey and to construct the TAP across Greece, Albania and into Italy. This follows the signing of agreements in September 2013 between Azerbaijan and gas buyers in Italy, Greece and Bulgaria regarding the sale of just over 10 billion cubic metres of gas a year for a period of 25 years. Construction relating to Shah Deniz Stage 2 is to commence in 2014 and is planned to last through until 2018.

- Future developments - Umid and Absheron fields

Azerbaijan continues to encourage further exploration of its oil and gas reserves. Prospective development opportunities for gas have been identified at the Umid and Absheron fields. Currently wholly owned by SOCAR, commercially viable reserves were discovered at the Umid field in 2010 and has estimated reserves of 200-250 billion cubic metres of gas and 34 million barrels of condensates. The Umid development project is a joint venture between SOCAR (holding an interest of 80 per cent.) and Nobel Oil Exploration and Production (holding an interest of 20 per cent.). Nobel Oil Exploration and Production is financing the exploration activities of the joint venture. A permanent offshore platform has been constructed and a well has been drilled at a depth of 6,006 metres. Drilling has begun from the platform on a second well, which has a target depth of 6,500 metres. Production from the second well commenced in 2012. The Umid field produced 94,000 barrels of condensates and 76.6 million cubic metres of gas in 2012, increasing to 220,000 barrels of condensates and 183.1 million cubic metres of gas in 2013.

Owned as a joint venture between SOCAR, Total and Gaz de France SUEZ, commercially viable reserves were discovered at the Absheron field in 2011. The field has estimated reserves of 250-300 billion cubic metres of gas and 38 million barrels of condensates. The PSA for the Absheron field was signed in February 2009 between SOCAR (holding 40 per cent.) and Total (holding 40 per cent.), with GdF Suez subsequently joining the consortium (holding 20 per cent.). In addition to an existing well, a second well was drilled in 2011 to a depth of 6,874 metres. Production from this well is expected to commence in 2020. Two further wells are planned at estimated depths of 6,600 metres.

- Oil and Gas Transportation

Direct oil exports from Azerbaijan to its major European trade partners were made possible by the construction of the BTC pipeline, which transports crude oil via a 1,768 km (1,094 miles) pipeline expanding from the ACG field through Azerbaijan, Georgia and on to Ceyhan, a port on the south-eastern Mediterranean coast of Turkey. The majority of the funding for the construction of the BTC pipeline came from third parties, including the European Bank for Reconstruction and Development ("**EBRD**"), the International Finance Cooperation ("**IFC**") and a syndicate of commercial banks. During 2012, approximately 247 million barrels of oil from ACG fields were exported via the BTC. During 2013, the exported volumes slightly increased, with approximately 250 million barrels being transported via the pipeline (an increase of 0.7% from 2012). See "*Risk Factors - Risks relating to Azerbaijan - Azerbaijan's oil and gas exports are dependent on the BTC and BTE pipelines*".

Gas from the Shah Deniz field is exported by the SCP, a gas pipeline that transports gas to Turkey via the same route as the BTC pipeline. Exports via the SCP include supply to Turkey, which has committed to purchase 6.6 billion cubic metres of gas per year until 2021. In 2013, 9.7 billion cubic metres of gas was transported through the SCP, representing 31.7

per cent. of the total natural gas produced in Azerbaijan, and, in the year ended 31 December 2012, 7.7 billion cubic metres of natural gas was transported through the SCP, representing 28.6 per cent. of the total natural gas produced in Azerbaijan. The first deliveries of gas through the SCP pipeline commenced in September 2006.

As part of the Shah Deniz Stage 2 project, the SCP will be expanded through Azerbaijan and Georgia. The capacity of the SCP will also be expanded to extend its throughput capacity up to 25 billion cubic metres per year. Set to become a key part of the Southern Gas Corridor, TANAP will also be constructed across Turkey from the Eastern border of Turkey to its Western border and across Greece, Albania and into Italy via TAP. According to the BOTAS Gas Sales Agreement signed in October 2010, TANAP will supply six billion cubic meters of gas (equivalent to more than 80 per cent. of Azerbaijani gas exports if based on 2013 figures) per year to Turkish consumers, with sales projected to start in 2018. TAP will connect to TANAP at Kipoi in Greece and cross Greece, Albania and then under the Adriatic Sea to Southern Italy, where it will connect to the Italian gas transportation grid. Together with the planned increases in production as a result of Shah Deniz State 2, this will allow Azerbaijan to directly supply more than 10 billion cubic metres of gas per year to European consumers in Greece, Bulgaria and Italy, with supplies projected to start in 2020.

In December 2013, SOCAR (together with the Hellenic Republic Assets Development Fund) entered into an agreement to acquire 66 per cent. stake in the Greek gas transmission company, DESFA. While the transaction is conditional on approval by the European Commission Directorate General for Energy and Antitrust Policy, SOCAR's purchase of a controlling stake of DESFA is of great importance to Azerbaijan, giving it control of a European gas supplier and enhancing its role in providing energy security for Europe.

Construction

In 2013, the construction sector accounted for 11.8 per cent. of Azerbaijan's nominal GDP, compared to 10 per cent. in 2012 and 8 per cent. in 2011. The construction sector has experienced significant growth in recent years with output rising from AZN 2.55 billion in 2009 to AZN 6.82 billion in 2013. The construction sector grew by 22.4 per cent. in 2010, 20.0 per cent. in 2011, 18.2 per cent. in 2012 and 23.0 per cent. in 2013.

There has been significant growth in both the residential and commercial sectors of the construction industry. A number of large public construction projects have been undertaken in recent years, including the building of six new luxury hotels in Baku (including the Four Seasons, JW Marriott, Kempinski, Hilton, Jumeira and Fairmont) and the construction of the Baku Crystal Hall, a concert hall built to host the 2012 Eurovision Song Contest and with capacity for more than 23,000 spectators. The Government has also committed to the construction of substantial new sporting facilities in preparation for the hosting of the 2015 European Olympic Games, including building a new Olympic stadium in Baku. Public construction projects are also being carried out to support the development of Azerbaijan's transport infrastructure, such as the construction of new airports in regions for tourist development, the construction of a new terminal at Heydar Aliyev International Airport in Baku and improvements to a substantial proportion of Azerbaijan's road network. In addition, there have been a large number of construction projects to improve social services infrastructure through the building of new kindergartens, schools, hospitals and care facilities.

Significant reforms have been carried out in recent years to simplify the system of issuing permits in the construction sector. The share of people employed in the construction industry has also grown substantially from 5.4 per cent. in 2009 to 7.2 per cent. in 2013.

Wholesale and retail trade; repair

According to the State Statistical Committee, the wholesale and retail trade sector increased its contribution to real GDP from AZN 1.3 billion in 2009 to AZN 1.9 billion in 2013 and from 5.0 per cent. of real GDP in 2009 to 6.6 per cent. of real GDP in 2013. The wholesale trade sector consists mainly of local operators who deal in a wide range of local and imported goods, whilst the retail trade sector is dominated by local participants. Recently, some regional and international brands have opened retail outlets in Azerbaijan, including many international luxury retail brands in Baku.

Transport

Since 1996, there has been growth in the volume of passenger and cargo transport. The volume of freight transported by both companies and individual operators reached 210.8 million tonnes in 2012, a 3.5 per cent. increase over 2011. Contribution of transport and storage to GDP was 4.8 per cent. in 2013, 4.9 per cent. and 5.1 per cent. in 2012 and 2011 respectively.

In 2012, 11.0 per cent. of freight was transported by railway, 5.86 per cent. by sea, 0.04 per cent. by air, 27.1 per cent. by pipelines and 56.0 per cent. by road; passenger transport was 12.1 per cent. by metro and 87.6 per cent. by road.

The development of the Europe-Caucasus-Asia transport corridor, part of the TRACECA programme, was one of the country's early post-independence achievements. This vital logistic link has had a very positive impact on Azerbaijan's transport sector. In 2012, 56.8 million tonnes of freight were transported along Azerbaijan's section of the corridor (37.5 per cent. by railway, 44.3 per cent. by road, and 18.2 per cent. by sea), up 5.5 per cent. in 2012 compared with 2011.

The Baku-Tbilisi-Kars railway line will provide connections between the Trans-Europe and Trans-Asia railway networks and carry freight and passengers directly through Azerbaijan, Georgia and Turkey. It will also enhance the economic potential of the countries in this region. By transporting freight to and from European and Asian countries, this railway line will increase the volume of intermodal and container transportation.

The construction of the International Sea Trade Port in Alat will be completed, the maritime fleet will be updated and expanded, Baku-Boyuk Kasik and Baku-Yalama railways will be restored and modernized and the Baku-Tbilisi-Kars railway will be put into operation. A new air terminal, runway and hangars will be put into operation at Heydar Aliyev International Airport in Baku and a special economic zone will be created in this area. Six other international airports will be updated and there are plans for additions to the fleet of the national air carrier. Detailed costings and timetables for these planned improvements are not yet established.

Agriculture, forestry and fishing

The successful implementation of agrarian reforms has created opportunities for the development of the agricultural sector. From 1992 to 1995, the total output of agricultural products decreased on average by 12 per cent. annually, but in the period 1996 to 2006 it increased on average by 7.1 per cent. per annum. This development and reform has continued under Azerbaijan's Project 2020 and as of 2013, agriculture, forestry and fisheries account for 5.3 per cent. of the GDP.

Azerbaijan traditionally has been an agricultural products exporter to the Soviet republics. Agriculture is one of the main industries in the non-oil and gas sector that has significant export potential (particularly to long-standing trade partners such as Russia and Turkey) and the Government has undertaken a series of reforms to improve the production and processing capacity of the farmers. These include lump sum subsidies to the agricultural sector, exempting farming from tax and providing easier access to financing through subsidised loans farmers for seeds, fertilisers, livestock and lease of agricultural equipment and machinery. The Government has also supported building of a network of high capacity refrigerated units and warehouses in farming areas and has supported programmes to import more productive breeds of livestock for farmers.

These reforms have largely led to growth across the highly-diversified agricultural sector, which is not focused on any specific cash crop or one food product. In 2012, production was 2,802.2 thousand tonnes of cereals; 968.5 thousand tonnes of potatoes and 1,216.2 thousand tonnes of vegetables. Compared to 2011 figures, production of cereals increased 14.0 per cent., production of potatoes increased 3.2 per cent. and production of vegetables increased 0.1 per cent. Production of fruit and berries has increased. In 2012, 810.0 thousand tonnes of fruit and berries were produced in the country, an increase of 5.8 per cent. over 2011.

Cotton production, once an important part of the agricultural sector, has increased significantly in recent years to 66.4 thousand tonnes in 2011, an increase of 73.6 per cent. over 2010. Similar developments took place in tobacco production, where production increased to 4.2 thousand tonnes in 2012, an increase of 19.3 per cent. over 2011. Production of green tea leaves was 568 tonnes in 2012, 6.4 per cent. higher than in 2011.

Livestock farming has also increased. Since 1996 there has been an annual increase in meat and egg production. In 2012, 285.6 thousand tonnes of meat were produced; 1,719.6 thousand tonnes of milk, 1,226.7 million eggs and 16.5 thousand tonnes of wool. Compared to 2011, that represents an increase of 8.3 per cent., 6.0 per cent., 21.3 per cent. and 1.8 per cent. respectively. By the end of 2012, farms of all categories jointly held 2.7 million head of cattle, including 1.3 million cows and buffaloes and 8.6 million sheep and goats, increases over 2011 figures of 1.3, 0.8 and 0.8 per cent. respectively.

In 2012 (as in 2011), 12.4 per cent. of the total land area of Azerbaijan was covered by forests. Output of wood products was AZN 9.8 million in 2012 (AZN 9.6 million in 2011).

The commercial fishing sector has increased each year from 2009 to 2012. Fish caught commercially in 2009, 2010, 2011 and 2012 amounted to 45.1, 45.3, 47.0 and 57.6 thousand tonnes respectively.

Manufacturing

One of the Government's principal aims is to expand Azerbaijan's industrial production with a strong focus on developing the country's manufacturing sector. In 2013 and 2012, manufacturing accounted for 4.2 per cent. of Azerbaijan's nominal GDP compared to 4 per cent. in 2011.

A wide variety of goods are currently manufactured in Azerbaijan. The main areas of manufacturing in Azerbaijan include food, beverage, tobacco, light industry, metallurgy, machinery, construction and petrochemical products. As part of the Project 2020 development plans, the Government is planning to build a very large oil, gas and petrochemical complex for extraction, production and refining of oil, gas and petrochemical products. The Government also plans to boost manufacturing in the non-oil and gas sectors by the construction of fertiliser plants, shipyards, cement works and steelwork factories to increase manufacturing export capacity, as part of its long term aims to diversify the economy and grow the non-oil and gas sector. The work is on-going to establish special economic zones and industrial estates to provide yet another platform for greater non-oil production and exports. See "*The Economy - Overview - Azerbaijan 2020: Outlook for the future*". Detailed costings and timetables for these plans are yet to be established.

Accommodation and food service activities

The accommodation and food services sector of the economy remains small accounting for only 1.8 per cent. of nominal GDP in 2013, although there has been some major investment in Azerbaijan's tourism infrastructure over the last few years. The annual number of visitors to Azerbaijan has increased significantly in the past five years from 1.9 million in 2008 to 2.5 million in 2013. The number of people employed in the accommodation and food service catering sector has also increased substantially from 26,300 in 2009 to 48,900 in 2012 (1.1 per cent of the employed population).

The Government is committed to increasing tourism in Azerbaijan and is actively encouraging investment in the sector, conducting an aggressive advertising and marketing campaign aimed at increasing Azerbaijan's worldwide exposure. Due to the steadily increasing tourist visitor numbers, the hotel industry is also developing. Six international airports are being constructed in tourist regions of Azerbaijan and several five-star and four-star hotels have been built in these regions by private investors to service the growing number of visitors.

Tourist development includes the construction of a ski resort at Shahdag and Gabala, with associated hotels. In 2012, the number of hotel beds available in Azerbaijan was 32,834.

Azerbaijan does not currently have a liberalised visa policy and only citizens of Belarus, China, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Russia, Tajikstan, Ukraine or Uzbekistan do not require a visa. Citizens of Turkey and Israel are able to obtain a visa on arrival in Azerbaijan. As part of its plans for the tourism industry, the Government has started to take steps to reform its visa policy for citizens from other countries, implementing a new e-visa system in March 2013, allowing any tourist to apply for a visa online via 31 accredited tourist agencies.

Electricity, Gas, Steam and Air Conditioning Supply

As of 31 December 2012, Azerbaijan's electricity output was 22,988 GWh, an increase of 13.3 per cent. compared to 2011. Of the 2012 output, 19,537 GWh (85.0 per cent.) was attributable to thermal power plants, 1,821 GWh (7.9 per cent.) to hydro power plants and 1,630 GWh (7.1 per cent.) from other forms of generation. In 2013, electricity, gas, steam and air conditioning supply accounted for 1.9 per cent. of Azerbaijan's nominal GDP, compared to 2.0 per cent. in 2012 and 1.7 per cent. in 2011. At present, approximately 60 per cent. of the electricity generated in Azerbaijan is consumed by industrial and commercial customers.

Over the last decade, the Azerbaijani electricity industry has undergone a significant restructuring. When privatization of the distribution companies in 2002 did not bring the expected performance improvements for the power supply, the distribution sector was re-nationalised in 2006. At that time, the distribution grid was found to be in a poor condition with high network losses and frequent blackouts and brownouts. Until 2007, peak demand could also not be fully met by domestic generation and electricity had to be imported. Following the re-nationalisation and subsequent investment, Azerenerji and the Baku Electric Grid have been able to improve the quality of the power supply considerably, with distribution losses at only 10-11 per cent. and few, if any, interruptions in supply.

The following table sets forth details of electricity generation and consumption in Azerbaijan for the periods indicated:

Electricity generation and consumption in Azerbaijan

(GWh unless otherwise stated)

	For the year ended 31 December				
	2008	2009	2010	2011	2012
Electricity generation	**21,641.6**	**18,868.3**	**18,709.2**	**20,294.0**	**22,988.0**
Thermal Power Plants	19,090.0	16,289.0	15,003.0	17,317.0	19,537.0
Hydro Power Plant	2,232.0	2,308.0	3,446.0	2,676.0	1,821.0
Other	319.6	271.3	260.2	301.0	1,630.0
Export-import balance	**595.7**	**269.6**	**362.6**	**676.8**	**539.4**
Export	811.6	379.6	462.4	804.8	680.3
Import	215.9	110.0	99.8	128.0	140.9
Total supply to grid	**21,045.9**	**18,598.7**	**18,346.6**	**19,617.2**	**22,448.6**
Consumption per capita (kWh)	**2,397.1**	**2,090.4**	**2,039.1**	**2,153.1**	**2,430.8**

Source: State Statistics Committee of Azerbaijan Republic

As part of its ongoing development plans, Azerbaijan is adding to its domestic generation capacity. The 780MW "Janub" Combined Cycle Power Plant was completed in 2013, the construction of the 400MW "Shimal-2" power plant is ongoing (due to be completed by end 2014) and there are several other power plants under development. Current plans for an increase in generation capacity of approximately 50 per cent. by 2025. Azerbaijan, with support from the World Bank, is also upgrading its systems for monitoring electricity generation and distribution networks. The Supervisory Control and Data Acquisition ("**SCADA**") project consists of two phases, the first of which has already been completed and saw the installation of monitoring and communications equipment at 45 power plants and high voltage substations, along with the installation of a 1,000km fibre optic network between such facilities. The second phase of SCADA will be implemented in the period 2014 to 2018 and consists of updates to the monitoring and communications equipment of the first phase, as well as the extension of the system across the remaining facilities in the network.

Electricity is exported primarily to Russia and Georgia. Net exports in 2012 amounted to 539.4 GWh, down from net exports of 676.8 GWh in 2011. Azerbaijan is an important participant in Azerbaijan-Georgia-Turkey Power Bridge Project, a regional energy project aimed at the export of electricity from Azerbaijan and Georgia to the Turkish electricity market. The expected power export capacity to Turkey from Azerbaijan via Georgian infrastructure under this Project will be approximately 700 MW from as early as 2015.

Azerenerji JSC and Baku Electric Grid JSC are the two key companies in the Azerbaijani electricity market. Both companies are wholly state-owned. Azerenerji owns all of the generation capacity, save for some small private generators and the power plants in Nakhchivan Autonomous Republic. Azerenerji also operates most of the electricity transmission systems in Azerbaijan. With its seven subsidiary grid companies Sumgayit, Ganja, Mingachevir, Shirvan, Imishli, Shaki and Khachmaz Regional Electricity Networks, Azerenerji is also responsible for electricity distribution and sales in the whole country except for the Baku region and Nakhchivan Autonomous Republic. Baku Electric Grid JSC operates the distribution grid in Baku region and is involved in retail electricity sales to its customers. The Nakhchivan State Energy Agency is responsible for electricity generation, transmission and distribution in Nakhchivan Autonomous Republic.

The Ministry of Energy is the central executive body in the energy sector in Azerbaijan, responsible for the implementation of national energy policy regulations and licensing of generation and supply. The Tariff Council, chaired by the Minister of Economy and Industry, is the responsible authority for price regulation and tariff methodology in the electricity markets, as well as prices (tariffs), service fees and collections to which state price regulation applies. The Tariff Council is funded by the State budget and is chaired by the Minister of Economy and Industry and has representatives from other ministries.

Although Azerbaijan has had policies supporting the development of renewable energy production since 2004, other than hydroelectric generation (which constitutes eight per cent. of generation) renewable sources do not currently contribute a material amount of generation capacity.

Communications

Communication is one of Azerbaijan's most rapidly expanding sectors of the economy and is playing a vital role in the country's socio-economic development. There has been steady year-on-year growth of the communications sector since 1995. In 2009, communication sector revenue was AZN 676.2 million and in 2013 this figure reached to AZN 1,008.2 million (1.7 per cent. of GDP).

Mobile networks, high speed data links and internet, as well as other communication channels, have seen significant development to keep up with market demands, with wireless telecommunications being one of the most quickly expanding services. Demand for internet and data services has been rising with internet penetration rates of 110 per cent. at the end of 2012. By 2012, market penetration for the mobile networks was 110 per cent., with the largest network operator being Azercell. Bakcell and Azerfon are also significant network operators, with more than 20 per cent. of the market each. Mobile broadband has also seen a significant increase to 3.1 million subscriptions by the end of 2012. The number of digital telephone exchanges was 16 in 1995, but by the beginning of 2007, substitution of older stations had given rise to 520 digital exchanges and in 2012 the number of telephone exchanges reached 1,555.

Azerbaijan's first satellite, built by Orbital Sciences Corporation, was launched into orbit on 7 February 2013 from Kourou in French Guiana. The satellite will cover Europe and large parts of Asia and Africa and will transmit television, radio and the internet. The satellite has an anticipated service life of 15 years. There are plans to launch a second communications satellite in 2017.

Environment

The main environmental issues faced by Azerbaijan are water pollution and poor water quality, air pollution from industrial emissions, soil degradation, declining biodiversity and deforestation. To address these challenges, Azerbaijan has developed a national environmental policy which aims to implement sustainable development principles: the preservation of natural resources at national, regional and international levels; informed use and application of scientific technology; and the efficient exploitation of economic and human resources.

Established in 2001, the Ministry of Ecology and Natural Resources is the main body responsible for implementing the national environmental policy, as well as enforcing environmental legislation, education, research, and ecological audits. To achieve the aims of the policy, legislation aimed at adopting European standards of environmental protection has recently been introduced and the government has implemented reforms to the environmental management system.

Special emphasis is also being placed on managing the environmental profile of Azerbaijan's oil and gas exploration and exploitation projects. The Shah Deniz project, operated by BP, will be carried out to meet the requirements of local and international standards and in full compliance with ISO 14001 environmental management system certification. Under the various PSAs in force, oil and gas companies are required to work in accordance with environmental standards developed with SOCAR and the Ministry of Ecology and Natural Resources. These standards draw both on existing Azerbaijani law and international oil and gas industry standards and experience with their implementation in exploration and production in other parts of the world.

The Ministry has in recent years broadened ties with international organizations in order to resolve current environmental problems. Azerbaijan has co-operated with organisations such as the UNDP, IAED, UNEP, NATO, OSCE, the Global Foundation for the Environment, the Organization for Economic Cooperation and Development ("**OECD**"), ECO, the World Bank, the Asian Bank and the World Wildlife Foundation. An international environmental conference on the Caspian Sea is currently being planned for 2014. Azerbaijan is also party to 20 international conventions in the area of environmental protection and has ratified the UN Framework Convention on Climate Change in 1995, as well as the Kyoto Protocol in 2000. However, Azerbaijan has not committed to any firm targets for greenhouse gas emissions.

Inflation

A consumer price index ("**CPI**") is used as a broad measure of inflation in Azerbaijan. CPI statistics are collected and calculated on a monthly basis by the State Statistical Committee and published on its website on the third business day of every month. The State Statistical Committee uses the CPI data to monitor both headline inflation and core inflation. Core inflation is headline inflation net of supply-side shocks, such as abrupt or short-term price fluctuations resulting, for example, from one-off increases in public utility fees or adverse weather conditions of a temporary nature.

The following table sets forth the movement in consumer and industrial producer prices for the periods indicated:

Consumer Price Index and Producer Price Index

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013**
CPI					
annual average *(% to previous year)*	1.5	5.7	7.9	1.1	2.4
Producer Price Inflation					
annual average *(% to previous year)*	(19.4)	30.5	33.5	4.5	(3.9)

Source: State Statistical Committee

Average annual CPI inflation was 2.4 per cent. in 2013 compared to 1.1 per cent. in 2012, 7.9 per cent. in 2011, 5.7 per cent. in 2010 and 1.5 per cent. in 2009. High increases in Producer Price Inflation during 2010 and 2011 were primarily due to significant increases in oil prices in world markets compared to 2009 prices.

The following table sets forth CPI for the periods indicated across specific sectors:

Consumer Price Index

(per cent.)

	For the year ended 31 December							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
CPI								
(period average)	8.3	16.7	20.8	1.5	5.7	7.9	1.1	2.4
Food	11.9	16.2	28.7	(1.5)	7.2	10.4	0.8	2.2
Non-Food	5.3	10.5	11.5	3.4	2.3	2.6	1.0	0.8
Services	2.6	25.3	11.4	7.1	4.3	4.7	1.2	3.5
CPI								
(period ended 31 December)	11.4	19.6	15.4	0.7	7.9	5.6	(0.3)	3.5
Food	16.1	20.1	19.4	(2.6)	12.7	7.1	(1.0)	2.9
Non-Food	7.5	11.6	10.9	0.6	3.4	1.2	0.4	3.5
Services	4.3	27.6	9.7	9.1	(0.1)	5.1	0.4	4.2

Source: State Statistical Committee

Food price increases accounted for 0.4 per cent. of the average annual inflation rate, non-food products accounted for 0.3 per cent. and services for 0.4 per cent. in 2012. The average annual inflation rate for non-food products and services was 1.0 per cent. and 1.2 per cent. respectively in 2012. In December 2012, the overall price level declined by 0.3 per cent. against the corresponding period in the previous year. Changes in CPI in 2010 and 2011 were mainly due to changes in food prices.

The reduction in CPI inflation in recent years was mainly due to relatively low world food prices, a reasonable growth rate of the money supply and a stable exchange rate of AZN, resulting in the lower level of inflation seen. Higher levels of domestic food production over the period have also had a stabilising effect on prices. There were significant increases in Producer Price Inflation in 2010 and 2011, though these were primarily due to the significant increase of oil prices in world markets compared to 2009.

The CBA's current CPI inflation target is 5-6 per cent. In 2013, the CBA's target for CPI inflation was also 5-6 per cent. The CBA has sought to keep inflation within these target ranges, while also ensuring a stable exchange rate, by managing the money supply and purchasing foreign currency reserves. Azerbaijan is expected to continue experiencing a period of price stability. A number of international institutions predict Azerbaijan will keep a single-digit inflation rate in 2014. For example, the latest aide memoire of the IMF staff visit in November 2013 projected a 3.4 per cent increase in CPI for 2014. See "*Risk Factors - Risks relating to Azerbaijan - GDP and inflation*".

Wages

The following table presents data on nominal and real growth of wages, in comparison to the previous year (relevant period of previous year), during 2009-2012:

Annual Wage Growth

	For the year ended 31 December			
	2009	**2010**	**2011**	**2012**
Nominal growth of wage rate *(%)*	8.6	11.2	9.9	9.4

Source: State Statistical Committee

The following table presents data on wage levels during 2009-2012:

Average Wage Levels

	For the year ended 31 December			
	2009	**2010**	**2011**	**2012**
Average monthly nominal wage *(AZN)*	298.0	331.5	364.2	398.4
Average monthly nominal wage *(US$)*	370.8	413.0	461.2	507.1
Average monthly nominal wage by sector *(AZN)*				
Private sector	357.2	423.9	466.7	500.3
Public sector	263.4	276.4	303.3	332.9
Agriculture, forestry and fishing	134.3	160.3	196.4	201.1
Industry	413.0	458.3	526.1	599.6
Construction	440.6	505.8	519.4	587.5
Services	275.2	306.7	333.9	356.7

Source: State Statistical Committee

The average monthly wage in Azerbaijan has grown significantly in recent years. Average monthly nominal wages in dollar terms increased in each year between 2009 and 2013.

Both private and public sector wages have grown significantly during the past several years. Robust growth recorded in the non-oil and gas sector for the same period was associated with a rise in labour productivity, which reflected itself in a 40 per cent. increase in the private sector average wage rate between 2009 and 2012. Public sector wages increased by 26.4 per cent. over the same period.

The Government pursues a consistent public sector wage setting policy, which aims at sufficiently compensating increased labour productivity in the sector, while at the same time taking into account the changes in the inflation rate. In line with this policy, the government periodically issues decrees on the increase of wages of public sector employees.

The minimum monthly wage remains low in Azerbaijan compared to the level of average monthly wages. As of 1 September 2013, the minimum monthly wage rate stands at AZN 105 or 26.4 per cent. of average nominal wages. The minimum wage level is being increased by the Government every year in order to improve the welfare of citizens and strengthen the social protection of the poor.

Employment

Economic growth over the last decade has resulted in improving levels of employment and the creation of new jobs. Between 2009 and 2012, the number of people employed increased from 4.27 million to 4.45 million whilst the unemployment rate fell from 5.7 per cent. to 5.2 per cent. according to official statistics.

The Government is committed to strengthening existing employment laws so as to meet international standards. The "Employment Strategy in Azerbaijan Republic (2006-2015)" was approved by the President on 26 October 2005 and aims to ensure the efficient use of the nation's labour resources. A state programme has been developed to implement the first stage of this employment strategy. The aims of the strategy include increasing the quality and competitiveness of the employment market and strengthening the social protection of job seekers and the unemployed.

The following table sets out employment statistics for the periods indicated:

Employment

	As at 1 January			
	2009	**2010**	**2011**	**2012**
Total Population *('000s)*	8,922.4	8,997.6	9,111.1	9,235.1
Labour resources *('000s)*	5,915.7	6,015.0	6,101.2	6,166.9
Economically active population *('000s)*	4,531.9	4,587.4	4,626.1	4,688.4
Employed *('000s)*	4,271.7	4,329.1	4,375.2	4,445.3
Unemployed *('000s)*	260.2	258.3	250.9	243.1
Activity rate *(%)*	65.1	64.8	64.4	64.5
Unemployment rate *(%)*	5.7	5.6	5.4	5.2
Employed persons by sector *(%)*				
Private sector	73.1	73.6	73.9	74.0
Public sector	26.9	26.4	26.1	26.0
Agriculture, forestry and fishing	38.1	38.2	37.9	37.7
Industry	7.3	7.1	7.0	7.0
Construction	5.4	6.6	7.1	7.2
Services	49.2	48.1	48.0	48.1

Source: State Statistical Committee

The following table shows the number of people employed in various economic sectors during 2009 to 2012:

Employment by Economic Sector

('000s)

	For the year ended 31 December			
	2009	**2010**	**2011**	**2012**
Agriculture, forestry and fishing	1,628.6	1,655.0	1,657.4	1,673.8
Wholesale and retail trade; repairs	678.9	626.7	635.4	646.8
Education	361.0	349.8	349.9	349.0
Construction	229.0	287.5	308.9	321.8
Manufacturing (including processing of oil and gas)	214.2	208.9	210.3	215.6
Transportation and storage	183.6	179.1	181.8	182.7
Human health and social work activities	201.9	170.3	165.2	165.4
Other service activities	97.1	127.0	130.7	136.6
Real estate activities	86.3	69.6	71.2	74.8
Arts, entertainment and recreation	56.9	59.6	60.3	61.1
Information and communication	34.0	55.8	58.0	58.7
Professional, scientific and technical activities	45.6	45.6	46.7	54.6
Administrative and support service activities	38.7	46.5	47.4	49.2
Accommodation and food service activities	26.3	46.9	48.1	48.9
Mining and quarrying (including extracts of oil and gas)	42.7	41.5	41.2	41.8
Electricity, gas, steam and air conditioning supply	30.0	30.6	30.8	31.2
Financial and insurance activities	21.8	24.4	26.3	26.9
Water collection, treatment and supply	25.3	25.2	24.6	24.7
Total employed population	**4,271.7**	**4,329.1**	**4,375.2**	**4,445.3**

Source: State Statistics Committee

While agriculture has remained the largest employer compared with other sectors of the economy, there have been significant increases in employment in construction (from 5.4 per cent. of the employed population in 2009 to 7.2 per cent. in 2012) and in communications (from 0.8 per cent. in 2009 to 1.3 per cent. in 2012). Although the oil and gas sector is very important for the economy, it provides relatively little employment with fewer than 30,000 employed in that sector in 2012.

Social Insurance System

Poverty Assessment

Azerbaijan relies on both an income and consumption approach for assessing poverty levels. A consumption aggregate comprised of both food and non-food baskets as well as an estimated rental value of durables is an important tool for measuring poverty because the Government believes consumption is more likely to be accurately declared and less sensitive to changes than income.

Based on the consumption approach, Azerbaijan has established a poverty line at approximately 60 per cent. of the average monthly consumption per capita of all households in Azerbaijan.

The following table sets forth information about levels of poverty in Azerbaijan for the years specified:

Poverty

	For the year ended 31 December			
	2009	**2010**	**2011**	**2012**
Average monthly consumption per capita of all households in Azerbaijan *(AZN)*	129.6	147.4	173.0	202.0
Poverty line[1] *(AZN per month)*	89.5	98.7	107.2	119.3
Poverty level *(% of population)*	10.9	9.1	7.6	6.0

Source: State Statistical Committee

The Government is committed to reducing the number of poor households. The Government's efforts to reduce poverty levels have been successful. In 2012, poor households as a share of total households fell to 6 per cent. compared to 7.6 per cent. in 2011 and 9.1 per cent. in 2010.

Households classified as poor are entitled to receive a poverty family benefit or lump-sum financial assistance. Such payments are paid regardless of income and is currently paid to approximately 432,000 people. Poverty benefits are paid out of the state budget and are classified as part of the "Social Protection" expenditures within the expenditure ledger of the state budget. In 2013, Social Protection expenditures as a whole amounted to AZN 1,750.4 million or 9.2 per cent. of the overall state budget expenditures.

In addition, the Government operates a targeted social welfare scheme that is aimed at supporting individuals and families with a monthly income of less than AZN 100. In 2013, the average monthly payment was AZN 25.8 for each person and AZN 114 for each family. These targeted benefits are currently paid to 113,600 families and 589,900 individuals.

Refugees and internally displaced persons

Financial support is provided to refugees and displaced persons from the Nagorno-Karabakh conflict (in 2012, approximately 700,000 people). A wide range of support is provided from both the state budget and direct funding by SOFAZ, including housing and utility services. As this support comes from a variety of Governmental agencies it is not possible to determine accurately the overall cost of it.

Unemployment

Unemployment benefits are limited and regulated by the 2001 Law "On Employment" and the 1997 Law "On Social Insurance", which regulate the arrangements and financing of unemployment payments and benefits, as well as setting out the criteria for such entitlements. In 2013, unemployment benefits amounted to AZN 4.8 million paid to 3,200 unemployed people from the State Social Protection Fund budget.

Pensions

Azerbaijan's pension system is in balance and consists of two elements: the basic state pension and the funded pension. The basic pension is a minimum guaranteed by the state, while the funded pension consists of a further contribution from the State Social Protection Fund based on the duration of pension payments. The basic eligibility criteria for state pensions are as follows: (i) reaching the retirement age (63 for men and 59.5 for women); (ii) disability; or (iii) the death of a household's primary provider. There are currently plans to increase pension contribution payments and reduce the unfunded elements of the pension.

As at 31 December 2013, 1.27 million people were receiving the basic state pension which is AZN 100 per month. Approximately 796,700 people were receiving the pension based on age, 240,800 people based on disability and 134,000 people based on the loss of the household's primary provider. The average monthly pension (including both basic and funded elements) was AZN 170 in 2013.

Privatisation Process

Following independence from the Soviet Union, Azerbaijan has sought to transition from a fully state-owned economy to an economy where 82.5 per cent. of GDP (in 2013) is generated by the private sector. In 2013, 75.3 per cent. of the non-oil and gas sector was privately owned, up from 73.5 per cent. in 2012.

Privatisation of state property began in 1995, following the adoption of the First State Privatisation Programme. This first phase (from 1996 to 1998) took a mass-privatisation approach, mainly focusing on small-scale enterprises. The Second State Privatisation Programme began in 2000, focusing on medium- and large-scale enterprises and enabling wider participation of labour collectives.

There are several legally adopted privatisation methods in Azerbaijan, including direct sale to a strategic investor; sale by tender; sale at voucher and cash auctions; sale at general auctions; sale through bankruptcy and insolvency proceedings and sales to employees on preferential terms.

Voucher privatisation was introduced on 1 January 1997 when 32 million privatisation vouchers were issued so as to distribute 65 per cent. of all state property identified for privatisation. During specialised voucher auctions, citizens were able to bid for shares in medium- and large-scale enterprises which had been converted into joint stock companies and other state-owned assets. Individuals were also able to buy, sell, transfer or assign their vouchers through the securities market.

A state privatisation option programme was also introduced, which enabled foreign parties to take part in voucher auctions by purchasing options. Those who reinvested their net profits in Azerbaijan were able to participate in voucher auctions without being required to submit options. In total, 1,437 enterprises were privatised at voucher auctions between 1997 and 2010.

Both state privatisation vouchers and options expired on 31 December 2010. Since then, citizens and foreign investors have had equal access to the privatisation process. Individual and corporate foreign investors have the same rights as Azerbaijani citizens in respect of purchasing state-owned property.

There are no restrictions on subsequent sales of enterprises acquired by foreign purchasers or on taking long term leases of land and foreign investors' rights are equally protected under the law of Azerbaijan.

Investment tenders have proven to be another successful method of privatising medium- and large- scale enterprises, by which the prospective buyer proposes an investment programme, which will introduce reforms and measures to maintain improved productivity at the state enterprise and solve pre-existing management problems. The ownership rights of the enterprise are only transferred to the buyer following the successful implementation of the investment programme. Between 1998 and 2013, 105 enterprises have been privatised through investment tenders, resulting in a total of US$ 1.1 billion of private investment (including US$ 309.1 million of foreign investment). Foreign participation in investment tenders has included sovereign investors such as the United States, Switzerland, France and the United Kingdom. Approximately 17,000 jobs have been created or restored as part of these investment programmes. Examples of successful investment tenders include investments into Garadagh-Cement, Baku Tobacco, Moscow Hotel (now known as the Baku Flame Towers), Azerbaijan Hotel (now the Baku Hilton Hotel) and Ganja-Wine.

Since 2009, the privatisation process has been managed and overseen by the State Committee on Property Issues ("**SCPI**"). The key functions of the SCPI with respect to privatisation include attracting private investment in state-owned property, management and maintenance of state property prior to privatisation, supporting privatised enterprises, co-ordinating real estate and land registration matters and maintenance of the local real estate and address registers.

Between 1995 and 2013, approximately 50,000 small state enterprises were privatised; approximately 1,600 medium-and large-scale state enterprises were transformed into joint stock companies and approximately 6,000 plots of land have been sold. Key privatisations include Azercell Telecom LLC, which raised AZN 153.5 million and whose major shareholders are Telia Sonera dn Turkcell, and Kapital Bank, which raised AZN 27.4 million. There are currently no plans for any major privatisation in the near future.

It estimated that around 1.5 million people have directly benefited from privatisation, through the creation of over 500,000 jobs to date and the generation of approximately AZN 630.5 million in revenue between 1998 and 2013.

The following table sets forth the cumulative number of privatised enterprises between 2009 and 2013:

Number of Privatised Enterprises and Plants

(cumulative at end of the year)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013**
Small enterprises and plants	42,144	42,911	43,808	44,696	45,669
Joint Stock Companies established under large and medium size state enterprises	1,570	1,577	1,587	1,594	1,599

Source: State Property Committee

Foreign Investment

By the second half of the 1990s, Azerbaijan became a target for foreign investors. Capital inflow increased year on year from 1994 and, in 2006, foreign investment had reached US$ 5.1 billion.

Of the total foreign investment of US$ 32.7 billion directed to the country's economy during the period 2009 to 2012, 49.9 per cent. (US$ 16.3 billion) was direct investment. The remaining 50.1 per cent. (US$ 16.4 billion) was made up of portfolio investments, foreign credits not identified in direct investments and similar other financial inflows.

The focus for foreign investors has been the oil sector, which constituted 40 per cent. (US$ 13.1 billion) of the total direct investment between 2009 and 2012. The second highest area of investment was in loans to the private and public sectors of the economy, which accounted for 26.4 per cent., 41.3 per cent., 42.6 per cent. and 30.4 per cent. of total foreign investment in 2009, 2010, 2011 and 2012 respectively.

The following table shows a breakdown of foreign investment for the period 2009-2012:

Foreign Investment

(US$ millions)

	For the year ended 31 December			
	2009	**2010**	**2011**	**2012**
Total foreign investment	**5,468.6**	**8,247.8**	**8,673.9**	**10,314.0**
Oil industry	2,412.7	2,955.3	3,407.8	4,287.8
Oil bonus[1]	1.0	2.0	19.9	2.0
Financial credits	1,438.3	3,405.9	3,692.5	3,135.5
Foreign companies and joint ventures	624.4	659.6	886.0	1,094.5
Turkey	76.8	147.5	89.1	185.9
US	117.6	40.0	73.8	92.5
United Kingdom	160.0	144.0	148.8	149.3
Germany	38.8	17.0	32.5	45.6
France	4.5	6.2	14.3	14.4
UAE	43.2	30.3	75.3	92.4
Russia	50.3	11.7	35.0	21.8
Other countries	133.2	262.9	417.2	492.6
Other investments	992.2	1,225.0	667.7	1,794.2

[1]Oil Bonus consists of the fees payable by foreign oil companies to SOCAR or other relevant authorities in connection with the signing and implementation of oil and gas contracts

Source: State Statistical Committee

Where stated in the table above, "*Other Investments*" comprise portfolio investments (purchases of shares that are less than 10% of the equity and do not provide direct management authority over enterprises, bonds and other debt instruments by foreign investors), other foreign credits not identified in direct investments and similar other financial inflows.

BALANCE OF PAYMENTS AND FOREIGN TRADE

Balance of Payments

The following table sets out Azerbaijan's balance of payments and related statistics for the periods indicated:

Balance of Payments
(US$ millions)

	For the year ended 31 December				
	2009	**2010**	**2011**	**2012**	**2013[1]**
Current Account	**10,417**	**15,021**	**17,156**	**14,881**	**9,257**
Foreign Trade Balance	**14,827**	**19,712**	**24,337**	**22,181**	**15,408**
Export of goods	21,056	26,375	34,393	32,374	23,810
Oil and gas sector	19,970	25,108	32,871	30,701	22,545
Other sectors	1,086	1,267	1,522	1,673	1,265
Import of goods	(6,230)	(6,663)	(10,055)	(10,193)	(8,403)
Oil and gas sector	(700)	(838)	(1,135)	(1,043)	(811)
Other sectors	(5,530)	(5,825)	(8,920)	(9,150)	(7,592)
Balance of services	**(1,613)**	**(1,733)**	**(2,996)**	**(2,924)**	**(3,151)**
Oil and gas sector	(1,206)	(1,240)	(1,595)	(2,097)	(2,035)
Other sectors	(407)	(493)	(1,401)	(826)	(1,116)
Out of total services					
Transport	(139)	(157)	(191)	(228)	(124)
Construction	(599)	(173)	(401)	(240)	(1,177)
Primary income	**(3,519)**	**(3,467)**	**(4,860)**	**(4,327)**	**(3,052)**
Oil and gas sector	(3,307)	(3,166)	(4,622)	(4,128)	(3,058)
Other sectors	(212)	(300)	(238)	(198)	6
- Receipts	551	676	1,019	1,092	721
- Payments	(4,071)	(4,143)	(5,879)	(5,418)	(3,773)
Secondary income	**722**	**509**	**673**	**(50)**	**51**
Remittances of individuals	660	498	633	(40)	58
- Receipts	1,182	1,338	1,771	1,852	1,132
- Payments	(522)	(840)	(1,138)	(1,892)	(1,074)
Capital account	**0**	**0**	**1**	**(7)**	**(6)**
Financial account	**6,029**	**3,597**	**4,038**	**8,094**	**5,055**
Net acquisition of financial assets("+" increase; "-" decrease) of which :	6,064	5,990	6,838	11,865	8,759
- direct investment abroad	326	232	533	1,192	775
- portfolio and other investments	5,738	5,757	6,305	10,673	7,984
Net incurrence of liabilities ("+" increase; "-" decrease) of which :	35	2,393	2,800	3,771	3,704
- Direct investment in Azerbaijan	2,899	3,347	4,445	5,289	4,632
- Repatriation of investments	(2,427)	(2,787)	(2,999)	(3,287)	(2,663)
- Oil bonus	1	2	20	2	
- Portfolio and other investments	(438)	1,831	1,334	1,767	1,735
Net errors and omissions	(1,697)	(962)	(763)	(1,824)	(905)
Changes in reserve assets ("+" increase; "-" decrease)	2,691	10,462	12,356	4,956	3,291
Balance	0	0	0	0	0

[1] *First 9 months of the year*

Source: The Central Bank of the Republic of Azerbaijan

Owing to increases in oil exports, Azerbaijan's current account has been in surplus since 2005. In 2012, there was a surplus of US$ 14.9 billion and this continued into the first nine months of 2013 with a surplus of US$ 9.3 billion. A significant proportion of this surplus is attributable to the oil and gas sector, which saw a US$ 23.4 billion current account surplus in 2012. The non-oil sector showed an US$ 8.5 billion deficit in 2012, however that was fully covered by the surplus on the oil and gas current account. Revenues in the oil and gas sector can be attributed primarily to oil and natural gas exports and large foreign direct investments.

The capital and finance account deficit was US$ 8.1 billion in 2012 and US$ 5.1 billion for the first nine months of 2013 but it was fully covered by the surpluses on the current account resulting in overall balances of 21.4 per cent. and 17.0 per cent. of GDP in 2012 and the first nine months of 2013, respectively. In general, the country's balance of payments turnover has increased tenfold over the past ten years, exceeding 50 per cent. of GDP in 2012.

Foreign trade turnover amounted to US$ 42.6 billion in 2012 and US$ 32.2 billion during the first nine months of 2013, generating a positive balance of US$ 22.2 billion in 2012 and US$ 15.4 billion during the first nine months of 2013. Total exports were three times greater than imports during 2012. Exports of goods totaled US$ 32.4 billion in 2012 and US$ 23.8 billion for the first nine months of 2013. Of this, oil and gas products accounted for 94.8 per cent. of total exports of goods in 2012. US$ 30.7 billion worth of oil and gas products was exported to foreign countries in 2012 and US$ 22.6 billion during the first nine months of 2013.

In 2012, imports of goods amounted to US$ 10.2 billion. In the first nine months of 2013, imports amounted to US$ 8.4 billion. Imports related to the oil and gas sector were US$ 1.0 billion, while other sectors generated US$ 9.2 billion of imports. Similarly, during the first nine months of 2013 the breakdown was US$ 0.8 billion of imports by the oil and gas sector and US$ 7.6 billion by other sectors.

The balance of services yielded deficits of US$ 2.9 billion and US$ 3.1 billion in 2012 and in the first nine months of 2013, respectively. In 2012, the oil and gas sector accounted for US$ 2.1 billion of the deficit and in the first nine months of 2013, it accounted for US$ 2.0 billion of the deficit in the balance of services.

Primary income, which comprises payments of employee compensation to nonresident workers and investment income, recorded a negative balance of US$ 4.3 billion in 2012 and US$ 3.1 billion in the first nine months of 2013, largely due to deficits in the oil and gas sector of US$ 4.1 billion and US$ 3.1 billion, respectively, in 2012 and in first nine months of 2013. The balance of secondary income, which includes individual remittances, has in recent years been almost negligible, yielding a negative balance of US$ 50 million in 2012 and a surplus of US$ 51 million in the first nine months of 2013.

Foreign Trade

Azerbaijani foreign trade statistics are generated by State Statistics Committee and are based on customs statistics from cargo declaration records, in accordance with international standards.[1]

Exports are an important source of foreign exchange earnings for Azerbaijan. Crude oil, oil products and natural gas are the principal Azerbaijani exports. The share of these

[1] Because such statistics are based on customs statistics from cargo declaration records, official data on volumes of exported crude oil and natural gas based on customs statistics may differ from trade figures compiled by the CBA in this section.

commodities in exports was 92.8 per cent. in 2009, 94.1 per cent. in 2010, 94.4 per cent. in 2011 and 93.1 per cent. in 2012.

However, despite the fact oil exports continue to be a major export commodity, non-oil and gas exports make up a growing proportion of exports. In 2011, while overall exports increased by 24.4 per cent., non-oil and gas exports increased by 20.3 per cent. In 2012, while overall exports declined by approximately 10 per cent., non-oil and gas exports increased by 10 per cent. Higher growth in non-oil and gas exports has continued into 2013, where they grew by 5.8 per cent. compared to the much lower growth rate of 0.3 per cent. in total exports.

Machinery and transportation equipment, followed by industrial equipment, have consistently represented largest component of Azerbaijan's imports. A lack of local production facilities and quality manufacturers created import dependence for these products, which have been imported to satisfy local demand in connection with large infrastructure projects and manufacturing. Machinery accounted for 47.4 per cent. of all imports in 2009, 40.6 per cent. in 2010, 48.4 per cent. in 2011 and 41.7 per cent. in 2012, whereas industrial goods accounted for 17.4 per cent. of imports in 2009, 21.6 per cent. in 2010, 19.7 per cent. in 2011 and 21.5 per cent. in 2012.

The following table shows the composition of imports for 2009 through 2012, using the International Standard Trade Classification ("**ISTC**"):

Principal Imports

	For the year ended 31 December							
	2009		**2010**		**2011**		**2012**	
	US$ million	*% of total*	*US$ million*	*%of total*	*US$ million*	*% of total*	*US$ million*	*% of total*
Foodstuff and live animals	639.6	10.4	864.1	13.1	988.3	10.1	958.5	9.9
Beverage and tobacco	248.6	4.1	264.8	4.0	294.8	3.0	353.2	3.7
Non-food raw materials (other than fuel)	105.6	1.7	178.2	2.7	264.5	2.7	333.8	3.5
Mineral fuel. lubricants. similar materials	64.6	1.1	73.6	1.1	83.8	0.9	84.7	0.9
Oils and fats obtained from animals and plants	66.5	1.1	84.9	1.3	80.1	0.8	96.7	1.0
Chemical goods and similar products not included in other categories	499.2	8.2	586.4	8.9	862.1	8.8	969.6	10.0
Industrial goods usually classified based on material type[2]	1,062.9	17.4	1,425.1	21.6	1,920.8	19.7	2,073.3	21.5
Machinery and transportation equipment	2,901.2	47.4	2,680.5	40.6	4,722.9	48.4	4,023.6	41.7
Various industrial products	528.2	8.5	434.0	6.6	513.9	5.3	748.1	7.7
Goods not included in other ISTC categories	6.7	0.1	8.8	0.1	24.4	0.3	11.2	0.1
Total	**6,123.1**	**100.0**	**6,600.6**	**100.0**	**9,755.9**	**100.0**	**9,652.8**	**100.0**

Source: State Statistical Committee

[2] This category includes leather, leather goods, and dressed furs; rubber goods, cork and wood manufactures (excluding furniture); paper, paperboard and articles made from paper pulp, paper or paperboard; textile yarn, fabrics, made-up articles, and related products; non-metallic mineral manufactures; iron and steel; non-ferrous metals and items manufactured from metal.

The following table shows the composition of exports from 2009 through 2012, using the ISTC:

Principal Exports

	For the year ended 31 December							
	2009		**2010**		**2011**		**2012**	
	US$ million	*% of total*	*US$ million*	*% of total*	*US$ million*	*% of total*	*US$ million*	*% of total*
Foodstuff and live animals	404.4	2.7	415.1	1.9	547.7	2.1	617.6	2.6
Beverage and tobacco	16.6	0.1	21.9	0.1	25.0	0.1	29.7	0.1
Non-food raw materials (other than fuel)	31.6	0.2	22.9	0.1	38.0	0.1	83.1	0.3
Mineral fuel lubricants. similar materials	13,639.5	92.8	20,110.1	94.1	25,089.3	94.4	22,259.2	93.1
Oils and fats obtained from animals and plants	103.6	0.7	154.8	0.7	140.7	0.5	180.8	0.8
Chemical goods and similar products not included in other categories	90.2	0.6	130.2	0.6	242.4	0.9	239.6	1.0
Industrial goods usually classified based on material type	171.3	1.2	170.8	0.8	303.7	1.1	284.4	1.2
Machinery and transportation equipment	200.9	1.4	217.8	1.0	56.6	0.2	92.5	0.4
Various industrial products	32.2	0.2	34.6	0.3	36.7	0.2	40.2	0.2
Goods not included in other ISTC categories	11.0	0.1	81.8	0.4	90.7	0.4	80.8	0.3
Total	**14,701.4**	**100.0**	**21,360.2**	**100.0**	**26,570.9**	**100.0**	**23,907.9**	**100.0**

Source: State Statistical Committee

Direction of foreign trade

The following table shows the geographical spread of Azerbaijani foreign trade turnover from 2009 through 2012:

Foreign Trade Turnover By Region

(share of total, %)

	For the year ended 31 December							
	2009		**2010**		**2011**		**2012**	
	Import	**Export**	**Import**	**Export**	**Import**	**Export**	**Import**	**Export**
Europe	56.5	52.0	53.1	59.1	57.9	71.5	49.7	52.9
Asia	35.5	30.7	39.2	29.8	32.6	18.9	39.3	38.5
America	7.2	16.0	7.0	9.5	9.1	8.6	10.4	6.7
Africa	0.5	1.3	0.3	1.5	0.2	1.0	0.4	1.8
Oceania	0.3	0.0	0.4	0.1	0.2	0.0	0.2	0.1

Source: State Statistical Committee

The following table sets out Azerbaijan's foreign trade by country groups for the years indicated:

Foreign Trade Turnover By Country

(share of total, %)

	For the year ended 31 December							
	2009		2010		2011		2012	
	Import	Export	Import	Export	Import	Export	Import	Export
EU	**26.7**	**43.7**	**25.3**	**47.3**	**32.3**	**59.4**	**27.7**	**46.8**
from this:								
Italy	2.1	25.8	1.8	33.0	2.6	35.2	2.7	23.2
Germany	9.1	0.6	9.2	0.0	8.7	2.0	8.1	4.0
France	2.3	9.0	2.1	8.7	6.2	15.2	1.9	7.4
United Kingdom	4.5	1.3	4.6	0.0	5.0	0.1	5.1	1.4
Netherlands	0.9	0.4	0.7	0.6	1.4	0.0	1.6	0.1
Others	7.8	6.6	6.9	5.0	8.4	6.9	8.3	14.7
BSEC	**42.1**	**12.3**	**37.7**	**12.8**	**37.5**	**14.2**	**37.7**	**15.5**
CIS Countries	**29.8**	**7.7**	**31.1**	**9.3**	**26.2**	**11.0**	**24.6**	**5.2**
from this:								
Russia	17.5	5.1	17.3	3.6	16.8	4.5	14.3	4.0
Ukraine	8.4	1.3	7.1	4.2	5.7	3.4	5.6	0.4
Kazakhstan	1.0	1.0	4.4	0.2	2.2	0.2	3.5	0.2
Others	2.9	0.3	2.3	1.3	1.5	2.9	1.2	0.6
ECO	**17.9**	**3.1**	**18.4**	**3.2**	**17.9**	**3.2**	**21.6**	**4.2**
GUAM	**9.4**	**4.0**	**7.9**	**6.1**	**6.7**	**5.5**	**7.0**	**2.7**

Source: State Statistical Committee

By 2013 Azerbaijan had established trading relationships with 149 countries. The main trade partner regions were the EU and the CIS, which collectively accounted for 59.0 per cent. of exports and 54.3 per cent. of imports. The main individual destinations for imports were Russia (14.1 per cent.), Turkey (13.7 per cent.), United Kingdom (12.5 per cent.), Germany (7.7 per cent.) and Ukraine (5.5 per cent.). The principal partner countries for exports in 2013 were Italy (25.0 per cent.), Indonesia (11.6 per cent.), Thailand (7.0 per cent.), Germany (5.7 per cent) and Israel (5.3 per cent.).

Azerbaijani exports are predominantly resource intensive (such as crude oil, oil products and natural gas) and destined for European markets (such as Italy and Greece) and other high income countries. The non-oil exports of Azerbaijan are primarily destined for countries with Free Trade Agreements (such as the CIS countries and Georgia) and Turkey, Iraq and Afghanistan. The main imported commodities are from the neighboring countries and countries with Free Trade Agreements with Azerbaijan. Middle and higher technology products are more common imports from Europe and developed countries.

Foreign Reserves

Azerbaijan's strategic foreign reserves are held by two main state bodies: the CBA and SOFAZ, a future generation fund established to collect the share of the Government's receipts from oil and gas exploration.

The following table sets out Azerbaijan's official reserve assets at the end of each of the years indicated:

Official Reserve Assets

(at year end, US$ billion)

	Central Bank	State Oil Fund	Total
1995	0.25	-	**0.25**
1996	0.27	-	**0.27**
1997	0.55	-	**0.55**
1998	0.47	-	**0.47**
1999	0.66	-	**0.66**
2000	0.68	0.27	**0.95**
2001	0.73	0.49	**1.22**
2002	0.72	0.69	**1.41**
2003	0.80	0.81	**1.61**
2004	1.1	0.96	**2.04**
2005	1.2	1.4	**2.6**
2006	2.5	1.4	**4.3***
2007	4.3	2.5	**7.4***
2008	6.1	11.1	**17.5***
2009	5.2	14.9	**20.3***
2010	6.4	22.7	**29.8***
2011	10.5	29.6	**40.6***
2012	11.7	33.9	**46.1***
2013	14.2	35.9	**50.1***

** including government deposits*

Source: Central Bank of Azerbaijan Republic; SOFAZ

By the end of 2013 total foreign reserves were US$ 50.1 billion, a growth of 143.3 per cent. since 2009. The growth in reserves has largely been a result of higher oil prices, which have allowed SOFAZ to accumulate greater reserves. Reserves have also increased as a result of the CBA's policy of accumulating AZN reserves to manage inflation and money aggregates.

SOFAZ holds the majority of Azerbaijan's official reserves. Since 2009, SOFAZ's share has remained stable, at 73.4 in 2009, 76.2 per cent. in 2010, 72.9 per cent. in 2011 and 73.5 per cent. in 2012.

MONETARY AND FINANCIAL SYSTEM

The Central Bank

Until 1989, the banking system of Azerbaijan was controlled by the state, with business decisions being subordinated to the political priorities of the state. The legal basis for the current banking system was established under Article 14 of the Constitutional Act "On basis of the current economic independence of the Republic of Azerbaijan" dated 25 May 1991. This law, as well as stipulating the independence of the banking system and circulation of the national monetary unit of Azerbaijan, also established the status and authority of the National Bank of Azerbaijan.

On 7 August 1992, the Law "On Banks and Banking Activity in the Republic of Azerbaijan" and the Law "On the National Bank of the Republic of Azerbaijan" were both adopted. On 15 August of the same year, the Manat (the national currency of Azerbaijan) was issued as legal tender alongside the rouble. As of 1 January 1994, the Manat was declared the only legal tender in Azerbaijan.

Following the Referendum Act of the Republic of Azerbaijan of 18 March 2009 on "Additions and Amendments to the Constitution of the Republic of Azerbaijan", The National Bank of the Republic of Azerbaijan was renamed the Central Bank of the Republic of Azerbaijan.

The CBA is independent from the state, and its Governor is nominated by the President and is appointed for a five-year term. Dr. Elman Rustamov has been the Governor of the CBA since January 1995. The First Deputy Governor of the CBA is Mr. Alim Guliyev, who was appointed to the position in September 1996. There are three further Deputy Governors of the CBA, nominated by the Governor and appointed by the President. In addition, the management of the CBA includes three Executive Directors appointed by the Governor, responsible for Risk Management, Strategic Management, Credit Supervision, Prudential Policy, Cash Management, the Treasury Department and the regional offices of the CBA.

Monetary policy framework of the CBA and 2013 results

According to Article 4 of the Law "On the Central Bank of the Azerbaijan Republic", the ultimate goal of the CBA is to ensure price stability. Intermediate targets are set to achieve that goal. The money supply and the Nominal Effective Exchange Rate ("**NEER**") are used as an intermediate target of monetary policy. Depending on the targeted inflation rate, the growth limits on the required money supply, as well as the NEER's change path, are identified. Thereafter, these indicators provide directional guidance for implementation of the monetary policy. The CBA is also responsible for the stability and development of the banking and payment systems in Azerbaijan, managing cash circulation in the economy, determining exchange rates, supervision of the banking sector and holding and managing international foreign exchange ("**FX**") reserves.

Operational targets for the CBA are determined in line with its intermediate targets. The operational targets for monetary policy are the base money and the Manat's bilateral nominal exchange rate against the US Dollar. Using these indicators as operational targets is relevant to the characteristics of the country's financial markets. Thus, using the monetary policy tools available, the CBA is able to affect the base money and bilateral exchange rate more efficiently than other potential operational targets.

Daily decisions with respect to monetary policy immediately affect the base money and the US Dollar's exchange rate against the Manat. Any changes in the base money and the Manat/US Dollar rate affect the money supply and NEER. This facilitates achievement of inflation target over chosen time periods. Operational targets serve as the basis for determining the quantitative parameters of monetary policy tools, including the number of open market transactions and the volume of CBA intervention in the FX market.

Overall, the monetary policy implemented by the CBA in recent years has allowed inflation to be reduced to a single-digit level, meeting the economy's demand for money, while preserving the country's competitiveness and financial stability. The CBA's aims during 2013 were a low single-digit level of inflation, a stable Manat exchange rate, financial stability and sustainable growth. The stable exchange rate of the Manat has helped to maintain average annual inflation (2.4 per cent. for 2013) below that of other countries in the region and the population's income growth.

Exchange rate and international competitiveness

Active use of oil revenues for development purposes has caused the supply of foreign exchange to increase substantially in the domestic FX market over the past ten years. Because the supply of foreign currency has significantly exceeded demand, the Manat's exchange rate against the US Dollar has appreciated over the last 10 years. However, the CBA has made interventions in the FX market to prevent excessive appreciation of the Manat against other currencies.

In 2013, the CBA sterilised US$ 2.5 billion in the FX market and its total foreign exchange reserves reached US$ 14.0 billion. Foreign exchange sterilisation increases the supply of the Manat. Where supply of US dollars exceeds demand in the FX market, the CBA sterilizes (acquires) the excess supply to prevent excessive appreciation of the local currency. If demand for US dollars exceeds supply, the CBA can sell foreign exchange from its reserves to prevent depreciation of the local currency. In addition to the acquisition of foreign exchange reserves, the Central Bank has also acted to sterilise those parts of the money supply that have inflationary potential by issuing short-term notes.

The Manat's NEER, reflecting the geometrical average of the change in bilateral nominal exchange rates against the currencies of the trade partner countries, increased by 5.8 per cent. in 2013 (on gross trade turnover). The Manat's real effective exchange rate, which reflects the geometrical average of the change of the bilateral real exchange rates against the currencies of trade partner countries, grew by only 4.7 per cent. over the same period on the non-oil sector. Low inflation has meant favourable international competitiveness.

Money demand and monetary aggregates

The CBA manages the Manat's exchange rate against the US dollar through its interventions in the foreign exchange markets and by announcing the official exchange rate. Through these, the CBA aims to reduce volatility in the exchange rates.

The following table sets forth certain statistics relating to monetary aggregates at the end of the periods indicated:

Monetary Aggregates

	For the year ended 31 December							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013[1]**
Currency in Circulation *(AZN millions)*	1,449.3	2,911.2	4,425.8	4,512.7	5,793.2	7,658.5	9,777.5	10,372.8
Broad Money (M2) *(AZN millions)*	2,137.7	4,401.6	6,081.0	6,169.2	8,297.5	10,997.2	13,806.4	15,214.2
Broad Money (M3) *(AZN millions)*	3,440.5	5,897.3	8,494.2	8,469.2	10,527.5	13,903.2	16,775.3	18,289.2
Broad Money (M3) *(growth year on year, %)*	86.8	71.4	44.0	(0.3)	24.3	32.1	20.7	9.0
Broad Money (M3) *(share of GDP, %)*	19.1	22.0	21.2	24.5	25.3	27.8	31.1	35.1
Reserve Money *(AZN millions)*	2,044.6	3,440.8	4,963.9	4,907.7	6,520.9	8,489.4	10,660.3	10,895.6
Growth rate *(%)*	130.8	68.3	44.3	(1.1)	32.9	30.2	25.6	2.2
Deposits in Manats *(AZN millions)*	821.0	1,902.2	2,294.2	2,353.3	3,205.3	4,280.7	5,062.5	6,197.8
Deposits in foreign currencies *(AZN millions)*	1,341.1	2,225.0	4,166.0	4,025.8	4,420.4	5,166.3	5,636.7	6,234.9
Loans in Manats *(AZN millions)*	1,170.5	2,513.7	3,672.9	4,886.2	5,865.3	6,326.5	8,422.8	10,926.6
Loans in foreign currencies *(AZN millions)*	1,192.2	2,168.1	3,518.4	3,521.3	3,298.1	3,523.8	3,820.9	4,318.7

- Where M0 = Physical cash and coins; M1= M0 + demand savings and deposits; M2 = M1 + time savings and deposits and M3 = M2 + savings and deposits in freely convertible currency
Source: CBA

With substantial economic growth during the years of 2005 to 2013, money demand has also continued to grow substantially. The monetary base expanded by 17 times during this period and totalled AZN 11.0 billion by the end of 2013. The main growth channel of base money has been the CBA's sterilisation operations in the FX market. The change in base money has affected the money supply through the money multiplier. During the last 10 years, the broad money in national currency ("**M2**") grew by 29 times and increased by 10 per cent. in 2013.

Certain qualitative changes continue to occur in the structure of the M2 monetary aggregate. The share of M0 in the money supply decreased by 20 per cent. during the last 10 years, as the economy has become more sophisticated and the use of cash has declined.

The banking system's money generating efficiency indicators are also improving as a result of the rapid development of financial innovations, especially comprehensive implementation of state-of-the-art payment systems. As a result, the Manat money multiplier increased to 1.4 having increased by 7.0 per cent. in the first 11 months of 2013.

Manat demand deposits increased 14.4 per cent., while term deposits increased by 20.0 per cent. in the first 11 months of 2013. Term deposits as a share of the total Manat deposits have increased from 17.0 per cent. in December 2003 to 60.0 per cent. in November 2013.

Monetary policy implementation tools

The CBA has used a variety of instruments to achieve established targets, such as open market operations. With the increase in the liquidity of the economy, the CBA began to liberalise capital outflows from June 2007. This initiative has helped to preserve the macro-economic balance, by sterilising the money supply that bears an inflationary potential. From 2010, capital flows were fully liberalised.

The following table sets out liquid assets and loans for the periods specified:

Liquid assets and loans

(as of 31 December, AZN millions)

	For the year ended 31 December							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013[1]**
Liquid Assets	1,074.5	1,271.9	1,713.3	1,502.6	2,330.4	2,426.2	2,625.5	2,225.6
Short-term liabilities	1,296.5	1,666.5	1,662.2	1,828.1	2,532.0	3,080.8	3,414.3	3,781.3
Total loans	2,362.7	4,681.8	7,191.3	8,407.5	9,163.4	9,850.3	12,243.7	15,245.3
Loans to public sector	218.6	657.2	989.5	1,591.7	1,467.9	838.3	1,353.4	643.3
Loans to private sector	2,144.1	4,024.6	6,201.8	6,815.8	7,695.5	9,012.0	10,890.3	14,602.0

[1] *As at 30 November.*
Source: Central Bank of Azerbaijan Republic

Given the development level of the financial markets, by April 2007 the CBA started to apply the "interest rate corridor" approach, improving monetary policy in conformity with international standards. Application of the interest rate corridor, which is an advanced form of implementation mechanism of current monetary policy, can improve the CBA's ability to affect the volume of money in the economy by providing a new operational structure. At the end of 2013, the ceiling of the interest rate corridor was 7.0 per cent. and the floor was 1.0 per cent.

Given the inflation target and the plans to support economic growth in the non-oil sector, at the beginning of 2013 the CBA decided to reduce interest rates from 5.0 per cent. to 4.75 per cent., and leave other parameters of the interest rate corridor unaltered. To sterilize the part of the money supply that has inflationary potential, the CBA continued to use its short-term notes during 2013. The average yield on notes in a recent auction on 25 December 2013 was 1.06 per cent., while the average yield from an auction in early 2013 was 1.87 per cent.

Interest Rates

The CBA's refinancing interest rate, which is the interest rate which banks have to pay when they borrow money from the CBA, influences most domestic interest rates in Azerbaijan. The following table sets forth the CBA refinancing interest rate for the periods specified:

CBA Refinancing Interest Rate

(per cent.)

2005	**2006**	**2007**	**2008**	**2009**	**01.2010 - 10.2010**	**11.2010 - 02.2011**	**03.2011 - 05.2011**	**06.2011- 11.2012**	**12.2012 - 01.2013**	**02.2013 - 12.2013**
9.0	9.5	13.0	8.0	2.0	2.0	3.0	5.0	5.25	5.0	4.75

Source: Central Bank of Azerbaijan Republic

A strong financial base has continued to develop in recent years, aided by a higher value of assets of financial institutions and the development of the insurance and leasing sectors. Interest rates are fully liberated and determined by markets. With more competition, lending rates have decreased. In the last five years, average lending rates by commercial banks have decreased from 16.4 per cent. to 14.4 per cent. The spread between lending and deposit rates is approximately 5 per cent.

Banking Sector

At independence in 1991, there were 23 corporate and commercial banks operating in Azerbaijan. In the first few years following independence, more than 200 banks were opened but many were under capitalised and had limited branch coverage. Regulatory requirements were increased as a result and the banking sector began to consolidate and restructure, becoming more highly capitalised. By 2000, the minimum capital requirements reached US$5 million. As of 1 October 2013, more than 40 banks were licensed to operate in Azerbaijan.

In recent years, the banking system has seen increased competition among market participants, restructuring of the banking system to place greater focus on the quality and reliability of services provided to customers and the formation of a group of leading banks. Integration of banks with international financial markets has grown and foreign capital and investments have increased rapidly. As the use of modern information and banking technologies has accelerated, customers have been provided with electronic and automated banking services. Azerbaijan also established the first mortgage system in the Caucasus region in 2005, under which more than AZN 520 million of mortgage loans have been granted to date.

The banking sector has also seen an increase in the market share of private banks and the market share of the country's largest and state-owned bank, the International Bank of Azerbaijan ("**IBA**"), has decreased from 43.0 per cent. in 2008 to 35.0 per cent. in 2013. Overall the market share of private banks has increased from 57.0 per cent. in 2008 to 65.0 per cent. in 2013.

The following table sets out certain data on the net income and profitability of Azerbaijan's banking sector in the periods stated:

Aggregate Profit and Loss Statement and Profitability Ratios

	For the year ended 31 December							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013[1]**
INCOME								
(AZN millions)								
Interest Income	275.0	547.3	975.2	1,034.6	1,055.3	1,099.8	1,257.8	1,505.8
Interest Expense	103.7	237.6	442.5	465.7	551.6	586.3	661.0	748.5
Net Interest Income	171.3	309.7	532.7	568.9	503.7	513.4	596.9	757.3
Non-Interest Income	131.9	209.1	283.9	258.7	271.6	321.0	367.3	389.5
Non-Interest Expense	153.5	237.9	357.8	413.18	451.3	538.4	635.8	651.0
Net Non-Interest Income	(21.6)	(28.8)	(73.9)	(154.4)	(179.7)	(217.4)	(268.5)	(261.6)
Loan loss provisions	78.2	97.2	212.2	132.9	184.0	447.3	159.7	140.1
Net Income before tax	71.6	172.1	246.0	281.1	140.1	(152.3)	169.9	355.8
PROFITABILITY RATIOS								
(%)								
Return on Average Assets	1.8	2.6	2.2	2.5	1.0	(1.2)	0.9	2.0
Return on Average Equity	13.2	17.6	16.9	17.5	7.4	(8.9)	7.1	15.4

[1] *As at 30 November.*

Source: Central Bank of Azerbaijan Republic

Deposits have exceeded AZN 6.4 billion over the five year period to the end of 2013. Over the same period, increased confidence in the banking system and a stable national currency led to a significant reduction in dollarisation, with the share of individuals' deposits in the national currency increasing from 41.0 per cent. to 62.0 per cent., and the average annual growth rate of assets, deposits and capital of the banking sector being 15.0 per cent., 28.0 per cent., and 18.0 per cent. respectively. As at 1 December 2013, the assets, credit portfolio and total capital of the banking sector exceeded AZN 20 billion, AZN 14 billion and AZN 3 billion respectively.

The following table sets out details of the non-performing loans in the Azerbaijani banking sector for the periods stated:

Non-performing Loans

	For the year ended 31 December							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013[1]**
Overdue loans *(AZN millions)*	77.7	100.3	159.8	303.5	492.9	633.8	748.8	795.0
Total outstanding loans *(AZN millions)*	2,362.7	4,681.8	7,191.3	8,407.5	9,163.4	9,850.3	12,243.7	15,245.3
Overdue loans *(% of total loans)*	3.3	2.1	2.2	3.6	5.4	6.4	6.1	5.2

[1] *As at 30 November.*
Source: Central Bank of Azerbaijan Republic

Over the five year period to 2013, the loan portfolio of the Azerbaijan banking sector has increased from AZN 7.0 billion to AZN 15.0 billion. Over the same period, the proportion of non-performing loans to the total loan portfolio increased from 2.2 per cent. in 2008 to 6.4 per cent. in 2011 before decreasing to 5.2 per cent. in 2013. Provisioning covers 83 per cent. of non-performing loans.

Overall capitalisation of the banking system has increased significantly since 2003, with total regulatory capital up from AZN 116 million to AZN 1,009 million in 2007 and AZN 3,427 million in 2013. Over the same period, capital adequacy ratios increased from 10.9 per cent. in 2003 to 19.9 per cent. in 2007 and have remained relatively stable, slightly decreasing to 18.1 per cent. in 2013. In 2013, the capital ratio of IBA (50.2 per cent. owned by the state) fell below the required regulatory level of 12.0 per cent. but had increased to 12.03 per cent. by the end of December 2013. At an extraordinary general meeting of shareholders of IBA in October 2013, a four year plan—starting in 2014—to increase share capital of the Bank was adopted. Under the plan, AZN 200 million of authorized share capital will be issued in the first year, with a further AZN 100 million per year over the next three years, resulting in a total planned increase of AZN 500 million over the four year period.

There are nine major banks in Azerbaijan, with a capitalisation of more than AZN 100 million: IBA, Pasha Bank, Xalq Bank, Kapital Bank, Bank of Baku, Express Bank, Access Bank, UNIBANK and Bank Silkway.

Ongoing institutional and infrastructural efforts to develop the banking system, have increased the banks' attractiveness for foreign investors. 22 banks have foreign shareholders, and total foreign equity investments in banks reached AZN 330 million by the end of 2012 and increased to AZN 467 million by 30 November 2013. The EBRD, the IFC, the Black Sea Trade and Development Bank, VTB Bank (Russia) and Ziraat Bankası (Turkey) are among the foreign shareholders of Azerbaijani banks. Foreign banks such as Commerzbank (Germany), Société Générale (France), FMO (Netherlands) and Yapi Kredi Bank (Turkey) also have representative offices in Azerbaijan. See "*Risk Factors - Risks relating to Azerbaijan - The banking sector*".

Banking Regulation and Prudential Standards

Following growth in the banking sector, the third generation of banking legislation was adopted in 2004 in accordance with European regulations and introducing corporate governance standards. Banks enhanced their management capacity and developed human and technological resources.

On 25 July 2012, the Management Board of the CBA decided to increase the minimum capital requirement for operating and newly launched banks up to AZN 50 million with the view of increasing the banking sector's financial stability and sustainability, and amplifying banks' financial intermediation and capacity to support the real sector, particularly the non-oil sector. Initially, the deadline for adjustment to the new capital requirement was 1 January 2014. Currently the CBA has attained the banks' capitalisation-related target, and boosted the quality and the scale of capital. Over the past 15 months, the banks' aggregate capital increased by 48 per cent. or AZN 1.0 billion and reached AZN 3.3 billion (it previously took the banking sector over 4 years to build up capital by AZN 1.0 billion).

In 2012, the CBA was tasked with minimising systemic risks in the banking sector, tackling the banking sector's ongoing issues and securing its stable performance, as well as supporting the sector and maintaining public and investor confidence. A new policy was developed for the risk-based supervision framework consistent with international best practices that identify the architecture, key business processes and a hierarchy of responsibilities and authorities within the banking supervision system. As part of this supervision, the CBA revoked the licences of the Royal Bank JSOC, which is now in the process of being liquidated. The Royal Bank had failed to maintain sufficient capital and had defaulted on payments to creditors.

The CBA is also tightening the legal and regulatory framework and the institutional structure of the supervisory function in line with the Basel Banking Supervision Committee's "Core Principles of Effective Bank Supervision". The new counter-cyclical management framework of bank supervision was actively developed, building on early warning capacities. In 2011, the CBA introduced the leverage ratio of 8 per cent., in excess of, Basel Committee recommendation of 3.0 per cent. The leverage ratio was introduced to improve the quality of bank capital and stimulate bank assets to grow in a stable fashion.

The CBA developed Corporate Governance Standards in Banks with effect from 11 June 2013 which establish the prerequisites for sustainable banking services by increasing the quality of management in banks. These reforms have taken into consideration the corporate governance recommendations put forward by the Basel Committee on Banking Supervision in the "Principles for Enhancing Corporate Governance" published in October 2010. Some of the key changes include the mandatory establishment of a remuneration committee, reforms of the structure and composition of the committees, as well as promoting a more effective approach to the meetings of the Supervisory Board. In addition, both the remuneration and risk management committees must appoint a chairperson who is a member of the Supervisory Board. In case of violation of any of the banking regulations, the CBA has the power to impose (including financial penalties) on non-compliant banks, according to the Administrative Code.

The Regulations on Risk Management in Banks were updated and entered into force on 17 December 2013 in order to strengthen the requirements for establishing a more effective risk management system, setting an operational risk management strategy and developing risk management methods and tools in banks. Meanwhile, the Regulations on Assets Classification and Loan Loss Provisioning have been tailored to the banking risk regulation.

The Consumer Finance Protection and Financial Literacy project, implemented within the framework of cooperation between the Government and the Swiss Secretariat for Economic Affairs ("**SECO**"), is now under way. The project has developed the methodology for determining actual annual interest rate. The tool will improve transparency for customers when selecting banks and banking productsand this, in turn, will improve public trust and confidence in the banking sector, reduce credit risk and help develop sound competition in the market.

Impact of the Global Banking Crisis

The CBA took preventive regulatory actions in order to minimise potential risks inherent to rapid growth during the 2008 financial crisis which enabled Azerbaijan to face the financial crisis with minimal impact. Preventive measures allowed Azerbaijan to neutralise the risks encountered by the banking sector and, as a result, no bank defaulted during the crisis. The following protection measures were adoped by the CBA:

- mandatory reserve norms (5.0 per cent.) for external borrowing were applied before the crisis to prevent excessive foreign borrowing;
- the maximum amount of insured deposits was increased from AZN 6,000 to AZN 30,000;
- regulations on risk management and corporate governance were amended;
- a stricter classification of risk-weighted assets was adopted;
- regulations for management of exposures to a single borrower or a group of connected borrowers were tightened;
- minimum requirements for the Loan to Value ratio of some loans were increased;
- earnings directed to bank capitalization were exempted from tax;
- the Organized Interbank Credit Market guarantee system was established;
- the required reserve norms were decreased from 12.0 per cent. to 0.5 per cent., thereby providing additional liquidity to the banking sector;
- the refinancing rate was decreased from 15.0 per cent. to 2.0 per cent.; and
- the period for which the CBA is able to lend to banks as a lender of last resort was increased.

Deposit Insurance Fund

In 2005, the CBA launched the Centralised Credit Registry which created favourable conditions for mitigating risks in banks and increased access to financial services. Deposit insurance was introduced to boost confidence in the banking sector and the Deposit Insurance Fund was established. The fund provides compensation for the first AZN 30,000 of each deposit covered by deposit insurance. As of December 2013, the proportion of bank deposits covered by the Deposit Insurance Fund was 89 per cent. The annual interest rate ceiling on insured deposits was decreased from 12.0 per cent. to 10.0 per cent. from 1 August 2013.

To date, the Deposit Insurance Fund has only had to provide compensation to protected depositors of Royal Bank JSOC. The fund notified deposit holders in Royal Bank JSOC in July 2012 of the revocation of the bank's licenses and liquidation. Compensation payments were paid from 1 August 2012 for the first AZN 30,000 of deposits. The amount of the compensation payments subsequently made by the Deposit Insurance Fund totaled more than

AZN 14 million, helping to ensure that more than 88 per cent. of the total amount of depositors' claims was satisfied. Although the Royal Bank payouts amounted to almost one-third of the total Deposit Insurance Fund at the time, there has been no significant impact on the continuing reserves of the Deposit Insurance Fund, as the amount paid out has already been replaced by contributions to the fund and recoveries from the liquidators of Royal Bank.

Financial Markets

The first securities in Azerbaijan's history appeared in the beginning of the 20th century. These were the shares of domestic joint-stock companies, dealing primarily with oil extraction and processing. In 1913, the newly established Baku Merchant Bank registered its first equity issue prospectus, and became the first bank in Azerbaijan to operate as a joint-stock company.

The main law regulating the market is the Civil Code. Nonetheless, market activities are also regulated under acts and rules issued by the state regulator. Created in 1998, the State Committee for Securities ("**SCS**") is the main securities market regulator in Azerbaijan.

Special attention has been given to institutional development and expansion of financial markets, and expanding legal, regulatory and institutional frameworks for new financial instruments, along with further improvement of existing financial market tools. In addition to developing financial markets, the objective has been to enhance the capability to implement monetary policy using market transactions. The CBA started issuing its notes from 2004. There has been rapid growth of the state securities market, which consists of the CBA 's notes and securities of the Ministry of Finance. This growth required closer coordination between the CBA and the Ministry of Finance and, in 2005, a Coordination Board was established, composed of representatives of both bodies. At meetings of the Board, the scope and terms of state security issues are discussed and coordinated.

In 2006, the IMF, with financial assistance from SECO, started implementing a 3-year regional project to develop the state securities market and domestic debt management. In June 2009, the State Mortgage Fund issued mortgage bonds, which was the first-ever issuance of such an instrument in the history of Azerbaijan securities market. In 2009, for the first time, the Ministry of Finance issued treasury notes with 2, 3 and 5 year maturity and callable treasury bills with 1 year maturity. In 2012, the Capital Market Modernisation Project was launched, funded by the Government, the World Bank and SECO and managed by the SCS. The main objective of this 4-year project is to increase the use of equity and corporate debt as financing and/or investment instruments through the adoption of an effective capital markets regulatory framework and infrastructure.

*CJSC "Baku Stock Exchange" ("**BSE**")*

The BSE was established in 2000 by 18 shareholders, including leading Azerbaijani banks, investment and brokerage companies and the Istanbul Stock Exchange. Currently the BSE has 19 shareholders. In addition to the stock exchange licence, the BSE has also been holding licences for depository and clearing activities.

The BSE's activities are controlled and regulated by the SCS, as well as the BSE's own internal regulations.

The BSE trading floor can be accessed only by exchange members having respective brokerage licences. Exchange members are shareholders of the exchange holding a brokerage and/or dealer licence, and any legal entity that has purchased a seat on the exchange and has a brokerage and/or dealer licence. The cost of one seat on the BSE is AZN 60,000. As of the end of November 2013, the BSE has 13 members.

Trading on the BSE is conducted electronically. Trading is carried out in real-time by means of the Electronic Trading System of the BSE. To improve the efficiency and automation of the trading and depository system, the BSE and the National Depositary Center ("**NDC**") provided remote access capabilities to the broker-dealer community in 2009. Clearing and settlement services are provided by the NDC. Clearing is performed in DVP form. The period of all settlement operations is T+0.

Both state and corporate securities may be traded on the BSE. State securities are notes of the Central Bank and T-bills and T-notes issued by the Ministry of Finance. Notes of the Central Bank are discount short-term securities entitling their holders to receive back face value (AZN 100) after 28 days. Only resident banks can purchase these securities. T-bills are discount short-term bonds entitling holders to receive back face value (AZN 100) from the issuer at the end of a specified term. The turnover periods of T-bills range from 35 days to 12 months. There are also callable treasury bills with 1 year maturity. T-notes are 2, 3 and 5 year maturity coupon bonds. T-bills can be purchased by both resident and non-resident entities and individuals.

Ownership records for notes of the Central Bank and T-bills are stored in the depository of the NDC by means of individual custody accounts. Investors can obtain information about their custody accounts through a broker or directly from NDC. At maturity date, the issuer transfers money to the investors' accounts through the NDC clearing system. Both notes of the Central Bank and T-bills are traded on the secondary market on the BSE during their turnover period. On the BSE, notes of the Central Bank are also traded within repo and reverse repo transactions. Since 24 May 2006, interbank repo transactions have been carried out.

Securities have also been issued by SOCAR. In 2012, SOCAR successfully placed its debut eurobond offering of US$ 500 million with a coupon of 5.45 per cent. SOCAR placed a further eurobond offering in 2013 of US$ 1 billion with a coupon of 4.75 per cent. The SOCAR eurobonds were issued in accordance with Regulation S and listed in London on the Main Market.

There have been new equity issues by Azərenerji ASC, Bakıelektrikşəbəkə ASC, and Aqrolizinq on the BSE. Equity issues by Azərenerji amounted to AZN 824.6 million in 2011 and AZN 200.4 million in 2012. Equity issues by Aqrolizinq amounted to AZN 15 million in 2010 and AZN 62.5 million in 2012. Bakıelektrikşəbəkə ASC issued new shares with a value of AZN 180 million in 2010.

Corporate securities trading turnover has greatly increased in the past few years. There are 3 markets for shares trading: 1st tier listing, 2nd tier listing and Alternative Trading Market ("**ATM**"). Currently 790 companies' shares are traded on the BSE, but only one has a first tier listing (DamirBank).

The ATM was created to let shares of unlisted companies be traded on the BSE. There are different requirements for first and second tier listings. The first tier listings are more suitable for large Azerbaijani and international companies and the second tier listing requirements are more suitable for growing small and medium sized Azerbaijani enterprises.

About 250 of the companies whose shares are traded on the BSE have more than 100 shareholders. The largest companies on the BSE are Azərenerji ASC, Bakıelektrikşəbəkə ASC, Azərbaycan Beynəlxalq Banki ASC, Aqrolizinq ASC, Azərbaycan İnvestisiya Şirkəti, Xalqbank ASC, Atabank ASC, Qafqaz İnkişaf Bankı ASC, AtaHolding ASC, Bank BTB ASC, Gəncəbank ASC, Yunayted Kredit Bank ASC, Azərbaycan Sənaye Bankı ASC and KapitalBank ASC.

There are currently 29 bond issues traded on the BSE, of which seven are bonds issued by Azerbaijan Mortgage Fund. In 2013, market maker institutions were introduced to the market. As of December 2013, 11 bond issues have their bid and offer prices quoted by two market makers. Maturities for corporate bonds range from one to ten years.

There are no restrictions for foreign investors in accessing the local corporate securities market. Foreign investors can participate in the transactions on BSE under the same conditions as local investors. Foreign investors can also repatriate receipts from transactions in foreign currency with corporate bonds without any restrictions.

The following table highlights some volume figures of the BSE for the indicated periods:

Trade Volumes on the Baku Stock Exchange

	For the year ended 31 December			
	2010	**2011**	**2012**	**2013**[1]
Turnover of BSE				
(AZN millions)	2,230.3	8,429.6	9,001.8	7,041.20
(US$ million)	2,795.2	10,717.9	11,467.3	8,976.5
(weight in GDP, %)	5.36	16.84	16.67	13.52
Turnover of BSE on the market segments *(AZN millions)*				
T-bills (placement)	359.5	239.08	141.74	88.65
T-bills (secondary market)	96.6	41.57	25.71	30.53
Notes (placement)	223.6	642.52	859.03	279.85
Notes (secondary market)	5.5	12.55	210.73	43.96
Repo transactions	837.7	5,781.97	6,856.47	5,522.18
Corporate bonds (placement)	101.4	198.87	60.71	109.18
Corporate bonds (secondary market)	164.6	530.33	343.41	564.90
Equities (placement)	425.8	974.39	488.03	385.20
Equities (secondary market)	15.6	8.35	15.96	16.75
Average interest rate on T-bills *(%)*	2.64	3.09	3.90	3.41
Average interest rate on Notes *(%)*	1.11	2.19	1.84	1.22
Average interest rate on Corporate Bonds *(%)*	5.00	6.04	8.48	10.90
US$ exchange rate by the end of the period *(AZN)*	0.7979	0.7865	0.7850	0.7844

[1] As at 30 November 2013.
Sources: BSE, State Statistical Committee, Central Bank of Azerbaijan Republic

Foreign Exchange Market

The Baku Interbank Currency Exchange ("**BBVB**") was formed by the CBA and the state's credit institutions in 1993 and resulted in the formation of an organized currency market in 1994. At first, currency trading was conducted primarily for the members of BBVB in foreign currencies, including the US dollar, the German mark, Russian ruble and other currencies of the post-Soviet countries. Since that initial activity, the foreign exchange market has grown to become an important part of the financial system, with turnover of BBVB for the year to 1

July 2013 at US$ 15 billion. The BBVB launched an online system in 2002 for trades (the Bourse E-System of Trade ("**BEST**") and in 2005 allowed simple to derivatives to be traded.

In 2010, the volume of foreign exchange market transactions was AZN 25.8 billion, in 2011 it was AZN 25.2 billion, in 2012 it was AZN 33.4 billion and in 2013 it was AZN 36.4 billion. The volume for US$ transactions, internal bank transactions ("**IBT**"), increased to US$ 20.3 billion in 2011, US$ 27.5 billion in 2012, and US$ 30.5 billion in 2013. The volume for Euro transactions of IBT totalled EUR 2.0 billion in 2011, EUR 2.3 billion in 2012 and EUR 2.8 billion in 2013. The open interbank foreign exchange market(OpIFEM) had a volume for US$ transactions of US$ 6.7 billion in 2011, US$ 10.2 billion in 2012 and US$ 10.8 billion in 2013. The volume for EUR transactions, totaled to EUR 403 million in 2011, EUR 467.3 million in 2012 and EUR 418,8 million in 2013. The volume for BEST US$ transactions increased to US$ 1.2 billion in 2011, US$ 0.9 billion in 2012, and US$ 0.54 billion in 2013. The volume for EUR transactions, totaled to EUR 7.3 million in 2011, EUR 0.3 million in 2012 and EUR 0.9 million in 2013.

Securities Market

CBA notes

The first auction held by the CBA for issuing and placement of notes was on 14 September 2004. The CBA held 51 auctions to sell notes during 2010, with an issuance volume of AZN 311 million, of which about AZN 261 million were put-up in auction. Total placement volume was AZN 223.8 million. The average weighted yield rose from 1.00 per cent. at the first auction to 2.08 per cent. at the last auction. The volume of outstanding notes at year-end totalled AZN 24.2 million.

The volume of issued CBA notes significantly increased in 2011. The CBA held 51 auctions on placement of issued notes in 2011. Total volume auctioned was approximately AZN 777 million, against demand of AZN 642.5 million. The volume of outstanding notes at year end was of AZN 50.2 million. The average weighted yield increased from 2.20 per cent. at the first auction to 2.77 per cent. at the end of year.

The volume of issued CBA notes also increased in 2012. The CBA held 52 auctions, totalling AZN 860.2 million. Outstanding notes at year end totalled AZN 47.4 million. The average weighted yield was 2.84 per cent. at the first action and had fallen to 1.87 per cent. at the end of the period. The secondary market turnover for notes totalled AZN 210.7 million.

In 2013, the CBA issued notes for the amount of AZN 1.5 billion. The volume placed at the auctions was about AZN 340 million. By the end of period, the volume of outstanding notes totalled AZN 20.0 million. The average weighted yield during the period decreased from 1.76 per cent. at the first auction to 1.06 per cent. at the last.

Government Short-Term Securities Market

The Ministry of Finance started issuing Government short-term securities ("**GSTS**") from 1996. As the GSTS market developed, the Ministry of Finance decided to increase domestic borrowing. At the 2010 auctions, the volume of GSTS issued was AZN 1.3 billion, of which AZN 360 million was placed. The average weighted yield of GSTS ranged from 0.68 per cent. at the first auction to 5.00 per cent. during the year.

The volume of GSTS issued by Ministry of Finance decreased in 2011 and number of auctions held was 112 (against 157 held during the corresponding period in 2010). Total GSTS volume issued during the year amounted to AZN 500 million and the volume placed at auctions was AZN 239 million. During the period, average weighted yield ranged from 0.73 per cent. to 5.00 per cent.

The issue volume of GSTS in 2012 remained the same as 2011. Over the year, the total issue of GSTS amounted to AZN 500 million. The volume placed during the 75 auctions was AZN 141.7 million. Average weighted yield ranged between 1.46 per cent. and 5.00 per cent. during the year.

In 2013, 119 auctions were held by the Ministry of Finance, and issued volume of GSTS was AZN 556 million, of which AZN 98 million was placed. Average weighted yield for GSTS ranged from 1.46 per cent. to 4.25 per cent. during the year.

REPO and Reverse REPO Auctions

For the purpose of absorbing surplus liquidity, the CBA uses tools such as REPO and reverse-REPO auctions. An Interbank REPO market was formed in late 2006. Following that, commercial banks could implement REPO transactions between themselves. The volume of REPO auctions decreased in 2010 (against the volume in 2009) with the volume of transactions totaling AZN 837.7 million. The yield for REPO transactions ranged from 1.0 per cent. rose to 1.5 per cent. during the year. The maturity of REPO transactions varied from one-day to 30 days.

The volume of REPO transactions significantly increased during 2011. Total volume of REPO and Reverse-REPO transactions was AZN 5.8 billion. The volume of Interbank REPO during 2011 totalled AZN 29.3 million. The rate of one-day REPO transactions in the market was 1.0 per cent.

The volume of REPO transactions continued to increase during 2012, amounting to AZN 6.8 billion. The volume of Interbank REPO during the year totalled AZN 12.7 million. The yield for one-day REPO transactions ranged from 1.0 per cent. to 1.7 per cent. during 2012.

The volume of REPO transactions amounted to AZN 6.6 billion during the first eleven months of 2013. Maturity of transactions was 1, 4, 14, 15 and 17 days. No Reverse-REPO transactions were made during the period. In 2013, the volume of the Interbank REPO market was nearly AZN 11.2 million. The yield on REPO transactions varied from 1.0 per cent. to 3.7 per cent. during 2013.

Corporate Bond Market

The corporate bond market has been rapidly growing in the last few years. The total turnover of the market more than doubled in 2010. The total volume of placed bonds was AZN 101.4 million, and the secondary market volume amounted to AZN 164.6 million. More than AZN 82 million of placed bonds were Azerbaijan Mortgage Fund bonds. Maturity for AMF bonds was 7 and 9 years. The yield for AMF bonds ranged from 3.00 to 3.25 per cent. The bonds issued by other companies had a maturity of between 1-2 years and the yield ranged from 12.5 to 15.0 per cent. There have been 56 new corporate bond issues since 2008, amounting to AZN 630.4 million. Of this amount AZN 300 million were AMF bonds. As of December

2013, the outstanding number of bonds is 29, amounting to AZN 365.6 million. The prices for 11 bond issues are quoted by market makers.

In 2011, the total volume of placed bonds increased to AZN 198.9 million (of which AMF bonds was AZN 77.4 million). The volume of secondary market had also increased to AZN 530.3 million. Issued bonds had a maturity between 1 and 5 years (AMF bonds 6-7 years) and the yield of 8.00 to 15.00 per cent.

The placement volume of corporate bonds sharply decreased in 2012, amounting to AZN 60.7 million. AMF bonds placement volume was AZN 36.2 million. The secondary market volume also decreased to AZN 343.4 million. Maturity for corporate bonds excluding AMF bonds ranged from 1 to 5 years. During the period, issued bonds had a yield between 9.5 per cent. and 15.0 per cent.

In 2013, the total volume of placed bonds amounted to AZN 152.8 million (of which AZN 57.3 million are AMF bonds). With the market makers actively participating in the corporate bonds market, the volume of secondary market increased to AZN 790.9 million. The yields for bonds ranged from 7.0 to 15.0 per cent. Maturities were between one and ten years.

Equities Market

The primary market volume of shares had greatly increased in 2010, reaching AZN 426 million. The largest issue of the year was done by Bakielektriksebeke OJSC, amounting to AZN 180 million. There were 43 new share issues during the year. The secondary market volume for shares was AZN 15.6 million.

The issued volume of shares totalled AZN 981.6 million (27 new issues) in 2011. The total volume of placed shares was AZN 974.4 million. Azerenerji OJSC issued shares with an amount of AZN 824.6 million. The secondary market volume decreased to AZN 8.4 million.

The primary market volume of shares decreased to AZN 488.0 million in 2012. Azerenerji OJSC performed another large stock issue of AZN 200.0 million. There were 37 new share issues during the year. The secondary market volume had doubled since the last year, amounting to AZN 16.0 million.

In August 2012, the CBA increased the minimum capital requirement for banks from AZN 10.0 million to AZN 50.0 million, effective 1 January 2014. Later in the year, the CBA extended the deadline to 1 January 2015. To reach to the minimum capital requirement, banks increased their equity capital by issuing new shares. In 2013, there were 29 new share issues totalling AZN 423.1 million. The secondary market volume amounted to AZN 21.4 million during the same period.

PUBLIC FINANCE

The Budgetary Process

The 2002 Law "On Budget System" (the "**Budgetary System Law**") sets out the procedures governing Azerbaijan's budgetary system and regulates the preparation, adoption, execution and monitoring of the state budget. Azerbaijan aims to follow international best practice in its budgetary procedures.

The Budgetary System Law calls for preparation of a medium-term socio-economic development strategy, as well as medium-term budget indicators. A draft budget is now prepared not only for the upcoming year, but also contains certain economic and budgetary projections for the next three years.

Azerbaijan's fiscal year is from 1 January to 31 December. A draft state budget is prepared twice a year, which allows forecast adjustments based on socio-economic changes. The initial draft budget is prepared in March-April and in July-August, the draft state budget is adjusted to reflect real events and expected developments.

The Budgetary System Law also contains a framework for co-ordinating the relationship between the state budgets, local government budgets and the budgets of other state funds such as SOFAZ and the State Social Protection Fund. Though oil and gas sales constitute significant share of the consolidated state revenues, the state budget is relatively immune to the changes in the international price of oil and gas products by virtue of predetermined transfers into the budget from SOFAZ. The only volatile component of the state budget that depends on oil and gas is the taxes paid by the oil companies, which makes up a minor share of the overall state budget revenues.

The Budgetary System Law also ensures transparency at all stages of the budgetary process. The draft budgets together with all assumptions are published. Quarterly updates showing the actual implementation of the state budget are also published.

The Cabinet of Ministers prepares the draft state budget and submits it to the President. The Cabinet of Ministers is also responsible for the implementation of the state budget.

The draft budget is prepared using information and spending requests gathered from other ministries and agencies. Input on the budget process is received from the Ministry of Finance, the Ministry of Economy and Industry, Ministry of Taxes, State Customs Committee, the CBA, State Statistical Committee, State Social Protection Fund, SOFAZ, all central executive bodies, local executive bodies and all local financial bodies.

In accordance with the Budgetary System Law, preparation of a draft budget begins 11 months prior to the next budget year and is initiated by a decision of the Cabinet of Ministers published towards the end of January each year.

During March, the Ministry of Finance develops its medium-term budget forecast (revenue, expenditure, deficit and financing) and the Ministry of Economy and Industry prepares the investment programme. Following any necessary corrections and adjustments, the final draft of the consolidated budget and consolidated budget indicators for the next three years are submitted to the Cabinet of Ministers by the Ministry of Finance and the Ministry of

Economy and Industry before 15 September and, after discussions in the Cabinet of Ministers, these are submitted to the President before 25 September of each year.

The President then submits the draft budget to Milli Majlis for discussion before 15 October. Milli Majlis published the main budget indicators in the press within 10 days and approves the budget no later than 20 December. Within one month of approval, monthly and quarterly breakdown of budget revenues and expenditures and budget indicators are presented by the Ministry of Finance to the various bodies that provide budget revenues.

Treasury

The State Treasury Agency of the Ministry of Finance was given the target of increasing the fiscal efficiency of Azerbaijan in Decree 48 of 9 February 2009 of the President "On measures to improve activity of the Ministry of Finance of the Republic of Azerbaijan".

The State Treasury Agency is the executive body responsible for the implementation of state budget cash and the accounting of the financial operations, assuming obligations for budget expenses on behalf of the state before budget organisations, controlling management, entry and use of public funds.

The Treasury Management Information System ("**TMIS**") has been developed which plays a leading role in enhancing transparency, automating accountability of the state budget funds, widening the scope of treasury implementation services, management and control improvements. Currently, around 90 per cent. of the state budget operations are linked to TMIS. TMIS offers a clear advantage over previous systems by ensuring that all types of banking transactions are concluded in real-time via a single treasury account of the State Treasury Agency in the CBA. The system also enables direct transfer of budget and extra budget receipts to the central treasury and their automatic registration.

Budget indicators

The budget for 2014 has two major aims: a social aim, targeting improvements in public social services, and an infrastructure aim, which includes upgrading key public infrastructure.

Substantial measures have been taken to improve the financial security of the population. Basic pensions, minimum wage rates, targeted social assistance and allowances paid to refugees and internally displaced persons, have all been increased.

Considerable work has been done to enhance the country's physical infrastructure such as the building of new schools and other educational institutions, hospitals, sports and recreation complexes and roads.

2014 Forecasted State Budget Revenues

Budget revenues in 2014 are forecasted to be AZN 18.4 billion compared with AZN 19.5 in 2013, an decrease of 5.6 per cent. One of the reasons for the forecasted decline is that the 2014 state budget assumes that oil extraction in 2014 will be less than in 2013 and, as a result, transfers from SOFAZ will be reduced in line with the Government's plans to reduce the SOFAZ's support of the State Budget in the medium term.

In 2014, revenue from the Ministry of Taxes is forecasted at AZN 7.1 billion compared with AZN 6.7 billion in 2013., an increase of 6.0 per cent. compared with 2013.

The Government's objective to increase revenue generation from the non-oil sector and gradually to decrease the reliance on transfers from SOFAZ for budget purposes. Transfers from SOFAZ in 2014 are forecasted to be AZN 9.3 billion, which is AZN 2.0 billion (17.7 per cent.) less than in 2013. The reduction in transfers in 2014 will be the principal reason behind the forecasted increase in the budget deficit to AZN 1.7 billion from the AZN 382 million surplus in 2013.

2014 Forecasted State Budget Expenditures

In 2014, the forecasted budget expenditure is AZN 20.1 billion compared with AZN 19.1 billion in 2013. This reflects a 5.2 per cent. increase on 2013 The state budget balances a social development target with the need to upgrade the country's public infrastructure. Significant share of the expenditures is directed towards raising economic potential, ensuring energy, food, environmental and transport security, further promoting entrepreneurship and agricultural activity. In light of the continuous spillover from the global financial and debt crisis, bold steps are taken to ensure employment and fulfill state social programs.

Social orientated expenses forecasted in the 2014 state budget increased by 15.9 per cent. and stand at a level of AZN 4.8 billion, which includes education (AZN 1.7 billion), social protection expenditures (AZN 2.1 billion) and public health (AZN 725.6 million), culture art information and sport expenditures (AZN 311.4 million).

A significant share of the expenditures (31.2 per cent.) is directed to finance public infrastructure projects. Public investment expenditures are directed at establishing and rebuilding infrastructure in the industrial, transport, energy, agricultural sectors, at building sporting and cultural facilities and to the financing of capital expenditures and other measures proposed by various state programmes.

Public Accounts

The following table sets forth a summary of the actual revenues and expenditures, and the overall balance of the state budget, for the periods indicated:

Public Accounts

(AZN millions)

	2009	2010	2011	2012	2013
Revenues of consolidated budget	**14,465.7**	**19,444.0**	**23,225.7**	**22,338.4**	**22,807.1**
State budget revenues	10,325.9	11,403.0	15,700.7	17,281.5	19,494.6
Revenues of Nakhchivan AR	71.5	50.1	49.2	56.0	64.9
Revenues of State Social Protection Fund	575.4	639.5	718.4	877.3	997.2
Revenues of State Oil Fund	8,407.9	13,266.4	15,757.4	13,673.2	13,600.4
Expenses of consolidated budget	**12,275.0**	**13,641.3**	**17,540.7**	**20,072.7**	**22,256.5**
State budget expenditure	10,503.8	11,765.9	15,397.5	17,416.5	19,112.6
Expenditures of Nakhchivan AR	319.5	281.4	303.5	318.8	343.7
Expenditures of State Social Protection Fund	1,699.4	1,768.6	2,125.1	2,457.0	2,588.3
Expenditures of State Oil Fund	5,284.9	6,372.6	9,549.5	10,544.0	12,545.8
Expenditures on projects financed from external loans	517.4	547.0	730.7	1,000.0	881.8
Consolidated budget surplus (deficit)	**2,190.7**	**5,802.7**	**5,685.0**	**2,265.7**	**550.6**

Source: Ministry of Finance

Revenues

The following table sets out information about the state budget revenues for the periods indicated:

State Budget Revenues
(AZN millions)

	2010	2011	2012	2013[1]	2014[2]
From Tax Ministry	**4,292.8**	**5,471.9**	**6,025.5**	**6,664.1**	**7,102.0**
Tax Revenues	4,091.5	5,052.3	5,404.7	5856.8	6,498.0
Direct Taxes	2,237.9	3,117.4	3,340.7	3520.3	3,458.5
Personal Income Tax	590.2	715.7	813.0	828.4	882.0
Corporate Profit Tax	1,429.9	2,134.0	2,252.0	2,394.7	2,217.0
Corporate Property Tax	101.8	103.9	105.1	121.6	132.0
Corporate Land Tax	35.3	35.3	30.6	32.0	48.0
Road Tax (for local persons)	15.2	28.1	28.6	24.4	49.5
Simplified Tax (uniform tax for small business)	65.5	100.4	111.4	119.2	130.0
Indirect Taxes	1,853.6	1,934.9	2,064.0	2,336.5	3,039.5
VAT	1,271.5	1,387.7	1,483.6	1,723.2	2,139.0
Excise (for domestic goods)	452.0	417.4	454.6	491.9	784.5
Mining Tax	130.1	129.8	125.8	121.4	116.0
Non-Tax Revenues	201.3	419.6	620.8	807.3	604.0
Administrative Fees	89,8	106,8	103.4	123.2	123,0
Others	111,5	312,8	517.4	684.1	481,0
From Customs Committee	**1,101.7**	**1,141.5**	**1,208.3**	**1,383.2**	**1,510.0**
Tax Revenues	883.5	909.1	977.8	1,085.0	1,180.0
VAT	811.0	834.7	883.4	986.1	1,070.0
Excise	62.9	62.2	76.9	81.4	90.0
Road Tax (for fernier)	9.6	12.2	17.5	17.5	20.0
Non-Tax Revenues: Customs Duty	218.2	232.5	230.6	298.2	330.0
Other Revenues of State Budget.	**6,008.5**	**9,087.3**	**10,047.7**	**11,447.3**	**9,772.0**
Official Transfers principally from SOFAZ	5,915.0	9,000.0	9,905.0	11,350.0	9,337.0
State Property Incomes	5.4	5.1	5.2	6.5	5.0
Non-budget revenues of budget financed organizations	0	0	0.0	0	400.0
Others	88.1	82.2	137.5	90.8	30.0
Total Revenues of State Budget	**11,403.0**	**15,700.7**	**17,281.5**	**19,494.6**	**18,384.0**

[1] *Preliminary*
[2] *Forecast*
Source: Ministry of Finance

The Government's principal sources of revenues are taxes, in particular corporate profit tax and VAT, and transfers from state entities such as SOFAZ.

Total revenues have grown from AZN 11.4 billion in 2010 to AZN 19.5 billion in 2013. Revenues experienced year on year growth in each year in that period. Transfers to the state budget, principally from SOFAZ, increased from AZN 5.9 billion in 2010 to AZN 11.4 billion in 2013 but is forecast to decline to AZN 9.3 billion in 2014. An Action Plan on coordination of preparation, execution and control of state budget and extra budgetary state funds adopted by the Cabinet of Ministers in July 12, 2004 regulates the transfers from extra budgetary funds to and from the state budget. Since the Government's objective is to decrease the reliance on oil revenues, it is envisaged that transfers from SOFAZ to the state budget will continue to decline from 2014 onwards.

Expenditure

The following table sets out information about state budget expenditure for the periods indicated:

State Budget Expenditure

	2010	2011	2012	2013[1]	2014[2]
Total Budget Expenditure *(AZN millions)*	**11,765.9**	**15,397.5**	**17,416.5**	**19,112.6**	**20,063.0**
Share in GDP *(%)*	27.71	29.56	32.26	33.12	34.26
Budget Expenditure per capita *(AZN millions)*	1,291.4	1,667.3	1,861.4	2,095.9	2,094.3
Budget Expenditure in functional classification *(AZN millions)*					
General Public Services	794.2	1,071.9	1,027.0	1,627.1	1,997.5
Defence	1,185.2	1,345.3	1,400.7	1,476.7	1,637.4
Law-enforcement[3]	668,5	710,3	929,2	1,049.3	1,240.3
Education	1,180.8	1,268.5	1,453.2	1,434.1	1,653.4
Health	429,2	493,4	609,4	618.9	725.6
Social Protection	1,123.0	1,495.4	1,769.6	1,750.4	2,072.2
Culture and Sport[4]	168.4	189.8	240.8	274.9	311.4
Housing and Community Amenities	199.9	312.3	437.9	398.3	457.1
Fuel and Energy Complex	0.0	0.0	0.0	2.4	3.5
Agriculture, Forestry and Fishing	372.1	444.7	468.2	488.1	562.9
Industry and Construction[5]	4,146.9	5,866.3	5,783.7	6,931.9	6,282.0
Transport and Communication	55.1	61.6	85.4	110.5	121.4
Other Economic Activity	115.9	118.3	185.5	266.8	328.2
Other	1,326.7	2,019.7	3,025.9	2,683.2	2,670.1
Deficit (surplus) / in AZN million	**(362.9)**	**303.2**	**(135.0)**	**382.0**	**(1,679.0)**
Share in GDP (%)	(0.85)	0.58	(0.25)	0.66	(2.87)
Financing of Deficit (AZN million)	**362.9**	**83.1**	**675.4**	**166.4**	**1,679.0**
External and domestic issuance	105.5	(109.2)	45.3	(43.0)	829.0
Grants	0.0	0.0	12.0	0.0	20.0
Non-budget revenues of state budget financed organizations	114.6	135.9	118.0	174.2	0.0
Privatization	56.7	56.4	35.1	35.2	30.0
Others	86.1	0.0	465.0	0.0	800.0

[1] *Preliminary*
[2] *Forecast*
[3] *Court, security, law-enforcement, prosecutor expenditures*
[4] *Culture, art, information and sport expenditures*
[5] *Includes public capital investment*
Source: Ministry of Finance

In 2013, the Government's largest areas of spending were (i) industry and construction expenditures, which accounted for 36.3 per cent. of expenditures; (ii) social protection which accounted for 9.2 per cent. of expenditures; (iii) education which accounted for 7.5 per cent. of expenditures and (iv) defence which accounted for 7.7 per cent. of expenditures in 2013. Social protection includes retirement, survivor and disablity pensions, unemployment payments and the costs associated with the social costs of the Nargorno-Karabakh refugees and internally displaced persons from the conflict.

Taxation

The Azerbaijan taxation system is governed by the Tax Code (see "*The Republic of Azerbaijan - Constitution and Political System - Legislation and regulatory development*"). The tax system consists of state taxes, taxes of the autonomous republic and local (municipal) taxes. The principal taxes forming the state budget revenues are personal income tax, corporate profit tax, value added tax, simplified tax and excise tax.

The Government is methodically introducing measures aimed at the increase of non-oil revenues as a proportion of state budget revenues, which can be seen from the forecasts of the 2014 state budget.

Personal Income Tax

Since 2001, personal income tax rates have been changed from a five tiered progressive tax rate system (12.0, 20.0, 25.0, 30.0 and 35.0 per cent.) to a system with only two levels: 14.0 per cent. for individuals with taxable income below AZN 2,500 and 25.0 per cent. for taxable income above AZN 2,500 in 2013.

Corporate Income Tax

Over the last 20 years, the rate of corporate income tax has been decreased significantly. After Azerbaijan gained its independance, the Milli Majlis has made a number of amendments to Azerbaijan's tax laws with the aim of increasing tax compliance and establishing an internationally competitive investment environment. The rate of corporate profit tax currently stands at 20.0 per cent., down from 35 per cent. in 1992.

Dividends paid by resident enterprises are subject to tax at the source of payment, at a rate of 10.0 per cent. If dividends have been taxed at 10.0 per cent. prior to being received by beneficial owners, then that dividend income is not be subject to additional income tax.

Value Added Tax (VAT)

In general, except for some specific exclusions (such as agricultural production), all business activity in Azerbaijan is subject to VAT. VAT is currently set at 18.0 per cent. and has been at this level since 2000. From 1992 to 2000, VAT was set at the rate of 20.0 per cent.

VAT is levied on all goods sold in, or imported into, Azerbaijan, as well as on services rendered and works undertaken in Azerbaijan. The Government intends to further reform regulations related to the VAT taxable base.

Simplified Tax

Legal and physical persons whose annual turnover does not exceed AZN 120,000 can benefit from the simplified tax payment regime and not pay VAT. The taxable base for the simplified tax is the gross revenue obtained for goods (works, services etc.) and property provided by the taxpayer, as well as non-sales related incomes within the reporting period. The simplified tax is payable at the rate of 4.0 per cent. in Baku and 2.0 per cent. in other cities and regions of Azerbaijan.

Excise duties

In recent years, the Government has limited the number of goods subject to excise tax and decreased the tax rates. Currently excise tax is levied on all types of alcoholic beverage, tobacco products, oil products, light vehicles (excluding specially appointed motor vehicles with special signs and equipment), leisure and sports yachts and other luxury transport vehicles at varying rates (according to the size of the engine, year etc.).

State Oil Fund of the Republic of Azerbaijan

SOFAZ was established in 1999 and has the following two main objectives:

- Ensuring intergenerational equality with regard to the country's oil wealth;
- Preservation of macroeconomic stability

SOFAZ is a legal entity separate from the Government or the CBA. SOFAZ's operation is guided by the Constitution and laws of Azerbaijan, Presidential Decrees and Resolutions and the SOFAZ Regulations. SOFAZ has a three-tier governance structure, with the President as its supreme governing and reporting authority. Its activities are overseen by a supervisory board and operational management is vested in the Executive Director. The supervisory board consists of representatives of both executive and legislative powers, including the Prime Minister and vice-speaker of the Parliament.

The major sources of income for SOFAZ include:

- proceeds from sale of Azerbaijan's share of hydrocarbons;
- income from investments;
- bonuses paid under the terms of PSAs;
- acreage fees paid by foreign investors for use of the contract areas in connection with the development of hydrocarbon resources;
- dividends paid under the terms of PSAs;
- revenues generated from the transit of oil and gas over the territory of Azerbaijan; and
- revenues generated from the transfer of assets from investors within the framework of oil and gas agreements.

Financial Activities

SOFAZ's assets stood at AZN 28.15 billion (US$ 35.88 billion) as of 1 January 2014 having grown from AZN 11.96 billion (US$ 14.90 billion) in 2009. From 2001 to 2013, AZN 79.6 billion (US$ 99.2 billion) was received by SOFAZ and approximately AZN 2.1 billion of this amount was derived from investment income.

Expenditure Directions

Pursuant to the underlying objectives of SOFAZ, part of its assets are transferred to the state budget and part are used to fund investment and social projects. In the period from 2001 to 2013, AZN 45.2 billion was transferred to the state budget and AZN 4.6 billion was used to finance various investment and social projects. In the medium term, the Government plans that SOFAZ transfers will reduce year on year. See *"Public Finance - The Budgetary Process - 2014 State Budget Forecasted Revenues"*.

SOFAZ has been involved in financing of the following projects:

- BTC pipeline
- Improvement of social condition of refugees and displaced persons from the Nagorno-Karabakh conflict
- Baku-Tbilisi-Kars railway
- Oguz-Qabala-Baku water pipeline
- Samur-Absheron irrigation system
- "STAR" Oil Refinery Complex
- Education of Azeri youth abroad
- Statutory capital of Azerbaijan Investment Company

Investment Policy

SOFAZ's investment and risk management policies are approved annually by the President and are overseen by the Supervisory Board. The major underlying principle of SOFAZ's investment strategy is to implement a conservative policy aimed at minimising the probability of substantial drawdowns and generating stable revenues.

SOFAZ invests only in overseas assets. Approximately 80 per cent.of its assets are held in investment grade fixed income securities with the remainder in equities, real estate and gold. According to its current investment policy, SOFAZ can invest up to 5 per cent. of its investment portfolio in each of these asset classes.

SOFAZ has invested approximately US$ 3 billion in the US, including in US Treasury, Federal Home Loan Bank, Fannie Mae and Freddie Mac bonds, as well as in US corporate debt and equities. As of 30 November 2013, approximately 3 per cent. of SOFAZ's total assets were managed by four external managers: Deutsche Asset & Wealth Management, International Bank for Reconstruction and Development, UBS Global Asset Management and State Street Global Advisors.

In 2013, 50.0 per cent. of SOFAZ's assets have been invested in assets denominated in US dollars; 40.0 per cent. in assets denominated in Euros; 5.0 per cent. in assets denominated in GBP and 5.0 per cent. in assets denominated either in currencies of Russia, Turkey and countries with the long-term country ratings of not less than the credit ratings A (Standard & Poor's, Fitch) or A2 (Moody's).

Reporting System

SOFAZ's financial activities are regularly audited by a reputable international firm of auditors and may also be examined by the Chamber of Accounts, established by Milli Majlis. Information and press releases, as well as quarterly and annual statements on SOFAZ's revenues and expenditures are regularly published in the local press and posted on SOFAZ's web-site both in Azerbaijani and English.

*Extractive Industries Transparency Initiative ("**EITI**")*

EITI is a global standard ensuring transparency and accountability of payments/allocations made by extractive industry companies to government and payments/allocations received by the governments of resource-rich countries. EITI was launched at the World Summit for Sustainable Development in 2002 in Johannesburg.

SOFAZ is closely involved in the EITI implementation in the country. The Government declared its willingness to join EITI and support the international efforts for higher transparency in the extractive industries at the EITI Lancaster House Conference on 17 June 2003.

On 15 March 2005, Azerbaijan published its first EITI report, thus initiating the practical implementation of EITI principles. Since then, the Government has published 17 EITI reports. The reports have been disclosed on the EITI Azerbaijan's website and the Fund's website.

SOFAZ was a winner of the 2007 UN Public Service Award in the category of "Improving transparency, accountability and responsiveness in the Public Service" for the successful implementation of the EITI. SOFAZ is the first governmental agency in Eastern Europe and CIS to win this award.

Azerbaijan participates actively in the EITI and has shown its support by initiating and tabling a UN General Assembly Resolution on EITI, which was unanimously adopted in 2008.

Azerbaijan is the first ever country to complete Validation, the EITI's quality assurance process which verifies compliance with EITI principles and criteria. The EITI Board designated Azerbaijan as the first EITI Compliant country at the 4th EITI International Conference in 2009 in Doha.

Azerbaijan was also awarded the "EITI Award 2009" for its commitment to EITI principles and criteria and its achievements in EITI implementation.

Azerbaijan was elected as an EITI International Board member in 2006, 2009, 2011 and 2013 at the International EITI Conferences (held every two years). The Executive Director of SOFAZ is representing Azerbaijan in the EITI Board.

PUBLIC DEBT

Overview

The Ministry of Finance classifies public debt as "domestic" or "external" according to two criteria: place of issue and residency. In relation to the former, all instruments issued for the domestic market, regardless of the status of their holder (domestic or foreign) are classified as "domestic debt". In relation to the latter, all instruments, regardless of the market they are issued for are classified as either "external" or "domestic" according to the residency status of the holder.

As at 1 January 2014, public debt was US$ 9.4 billion, of which 64.6 per cent. or US$ 6.1 billion was external debt, and the balance, US$ 3.3 billion was the domestic debt. Public debt includes full provision for all state guaranteed debt without any reductions made for the likelihood of the guarantees being called.

Most of the recent increase in public debt can be attributed to increases in domestic debt in the form of an increased number of state guarantees. These were temporary measures to provide assistance to some key public enterprises that faced liquidity problems following the global financial crisis.

The following table sets certain key statistics with regard to Public Debt for the periods 2010-2013:

Public Debt

	For the year ended 31 December			
	2010	**2011**	**2012**	**2013**
Public debt *(US$ millions)*	**6,661.8**	**7,431.8**	**9,589.0**	**9,378.7**
Domestic Public Debt	2,804.5	2,615.1	3,880.6	3,319.8
External Public Debt	3,857.3	4,816.7	5,708.4	6,058.9
Principal Payments *(US$ millions)*	**573.1**	**918.8**	**620.4**	**1,569.6**
Domestic Public Debt	321.0	612.0	290.1	855.3
External Public Debt	252.1	306.8	330.3	714.3
Interest Payments *(US$ millions)*	**124.0**	**187.5**	**171.5**	**165.3**
Domestic Public Debt	57.1	114.4	74.1	70.6
External Public Debt	66.9	73.1	97.4	94.7
Total Public Debt Service *(US$ millions)*	**697.1**	**1,106.3**	**791.9**	**1,734.9**
Domestic Public Debt	378.1	726.4	364.2	925.9
External Public Debt	319.0	379.9	427.7	809.0
Total Public Debt/GDP *(%)*	**12.6**	**11.3**	**13.8**	**12.7**
Internal Public Debt /GDP	5.3	4.0	5.6	4.5
External Public Debt/GDP	7.3	7.3	8.2	8.2
Total Public Debt/Budget Revenue *(%)*	46.9	37.4	43.6	37.7
Total Public Debt Service/Budget Revenue *(%)*	4.9	5.6	3.6	7.0
External Public Debt Service/Exports *(%)*	1.2	1.1	1.4	2.7

Source: Ministry of Finance

Debt management

The Law "On the Public Debt", which was adopted and approved by the Milli Majlis, has been improved and expanded in accordance with recommendations and proposals from various ministries and IMF experts. This law expands the authority of the Ministry of Finance in determining Azerbaijan's public debt policy, provides for measures to reduce the risks associated with increased public debt, establishes a debt repayment reserve fund as well as debt limits and changes the definitions of certain terminology related to public debt to conform to international standards.

The Public Debt Management Agency of the Ministry of Finance was established by the Order of the President dated 9 February 2009 (№ 48) and mandated to secure the implementation of any borrowing on behalf of the sovereign in accordance with the legislation, to implement issuance of public debt securities, to administer registry of public debt, state guarantees and debt of foreign countries to Azerbaijan, as well as manage assets of the state treasury.

Domestic debt

The domestic debt of Azerbaijan comprises three categories: (i) securities issued by Azerbaijan (T-bills and other obligations); (ii) rescheduled Government debt owed to the National Bank of Azerbaijan; and (iii) state guaranteed debt. The State Budget Law contains a specific line item setting forth the ceiling for State domestic debt to be issued for each year.

The main components of public domestic debt are as followings:

- state bonds;
- state securities issued in the amount of written off principal debt of the CBA for centralised credit resources;
- securities issued for repayment of the amount of centralised credit resources borrowed from the CBA to cover the budget deficit in the period of 1992-1996; and
- state guaranteed loans.

State guaranteed loans constitute a major share of public domestic debt.

Currently, the Ministry of Finance issues T-bills and T-notes issued with maturity from 35 days to 3 years with yield ranging from 1.50 to 4.25 per cent.

The following table sets forth outstanding domestic public debt for the periods indicated:

Domestic Public Debt

(AZN millions)

	For the year ended 31 December			
	2010	**2011**	**2012**	**2013**
Obligations to the CBA	131.6	123.8	117.7	104.7
Obligations under Promissory notes to the CBA	255.4	255.4	255.4	255.4
Obligations under Government T-Bills and Bonds	278.0	159.4	204.6	156.1
Obligations under Government Guarantee	1,572.7	1,518.2	2,468.6	2,088.2
Total Domestic Public Debt	**2,237.7**	**2,056.8**	**3,046.3**	**2,604.4**

Source: Ministry of Finance

The following table sets forth the marketable Internal Public Debt securities (T-bills, T-notes and Government Bonds) outstanding for the periods indicated:

Marketable Domestic Public Debt Securities by Maturity

(AZN millions)

	For the year ended 21 December			
	2010	**2011**	**2012**	**2013**
T-bills (1 month maturity)	19.5	0.0	0.0	0.00
T-bills (3 month maturity)	77.0	7.0	6.9	0.00
T-bills (6 month maturity)	38.0	8.7	1.0	0.00
Government bonds (1 year maturity)	70.0	62.0	104.4	4.05
Government bonds (2 years maturity)	9.5	4.8	9.3	13.10
Government bonds (3 years maturity)	24.0	36.9	43.0	98.95
Government bonds (5 years maturity)	40.0	40.0	40.0	40.00
Total	**278.0**	**159.4**	**204.6**	**156.10**

Source: Ministry of Finance

With the objective of mitigating the adverse impact of the 2008 financial crisis on Azerbaijan's economy, amendments were made to the Law "On the Central Bank of Azerbaijan Republic" adopted on 19 June 2009 authorising the CBA to finance economically important projects as well as to grant targeted sovereign guaranteed loans to banks and enterprises. As a result, some state enterprises were provided with targeted sovereign guaranteed loans by the CBA in the years between 2009 and 2012. The size of the guaranteed domestic debt has been declining since the beginning of 2013. There have been no sovereign guaranteed loans made in 2013. As at 1 January 2014 the amount of domestic debt amounts to AZN 2.6 billion (amounting to 4.5% of GDP) and of this amount AZN 2.08 billion is sovereign guaranteed debt (amounting to 3.6% of GDP). See "*Monetary and Financial System - The Central Bank*".

Apart from one instance with one of the state enterprises which faced temporary problems with meeting its obligations, there were no instances of sovereign guarantees being called.

External state and state guaranteed debt

As at 1 January 2014, Azerbaijan had US$ 6.1 billion of outstanding external state and state guaranteed debt ("**ESSGD**"), which corresponds to 8.2 per cent. of the country's GDP and approximately US$ 639.3 per capita. These loans are primarily financing investment projects. Investment projects cover the following infrastructure sectors: energy (53.6 per cent. of total ESSGD), industry and power engineering (27.6 per cent. of total ESSGD), transport (8.7 per cent. of total ESSGD), economy and finance (3.9 per cent. of total ESSGD), agriculture and amelioration (3.5 per cent. of total ESSGD), socio-cultural (2.2 per cent. of total ESSGD) and other sectors (0.5 per cent. of total ESSGD).

The following table sets out the external state and state guaranteed debt for the years stated:

Outstanding External State and State Guaranteed Debt

(US$ millions)

	For the year ended 31 December			
	2010	**2011**	**2012**	**2013**
Medium and long term debt	3,848.8	4,816.7	5,708.4	6,058.9
World Bank	1,059.5	1,271.7	1,638.5	1,647.2
European Bank of Reconstruction and Development	285.4	270.5	239.5	212.2
Islamic Bank of Development	211.1	463.9	519.9	538.7
Japan Bank of International Cooperation	455.5	575.0	659.8	575.5
Other	1,837.3	2,235.6	2,650.7	3,085.3
Short-term debt	8.5	0.0	0.0	0.0
TOTAL	**3,857.3**	**4,816.7**	**5,708.4**	**6,058.9**

Source: Ministry of Finance

The following table sets out composition of external state and state guaranteed debt by type for the years stated:

External State and State Guaranteed Debt by Type

(US$ millions)

	For the year ended 31 December			
	2010	**2011**	**2011**	**2012**
State debt	1,816.8	2,604.3	3,330.2	3,924.5
Guaranteed Debt	2,040.5	2,212.4	2,378.2	2,134.4
TOTAL	**3,857.3**	**4,816.7**	**5,708.4**	**6,058.9**

Source: Ministry of Finance

The following table sets out the external state and state guaranteed debt by currency composition for the years stated:

External State and State Guaranteed Debt by Currency

	For the year ended 31 December							
	2010		**2011**		**2012**		**2013**	
	US$ millions	*% of total*	*US$ millions*	*% of total*	*US$ millions*	*% of total*	*US$ millions*	*% of total*
US$	1,247.1	32.3	1,728,3	35.9	2,437.0	42.7	2,855.9	46.9
EUR	1,119.6	29.0	1,457,8	30.3	1,495.0	26.2	1,746.6	28.2
JPY	455.5	11.8	575,0	11.9	659.8	11.6	575.5	10.5
SDR	885.3	23.0	914,9	19.0	935.5	16.4	708.0	11.4
CHF	22.9	0.6	10,8	0.2	9.4	0.2	3.2	0.1
Other	126.9	3.3	129.9	2.7	171.7	3.0	169.7	2.9
TOTAL	**3,857.3**	**100.0**	**4,816.7**	**100.0**	**5,708.4**	**100.0**	**6,058.9**	**100.0**

Source: Ministry of Finance

The following table shows debt service for the external state and state guaranteed debt by type of creditor for the years stated.

External State and State Guaranteed Debt Service

(US$ millions)

	For the year ended 31 December			
	2010	**2011**	**2012**	**2013**
World Bank				
Principal (PR)	9.9	11.6	26.3	341.3
Interest (IN)	8.5	9.7	12.1	12.0
Total	18.3	21.3	38.4	353.3
JIBC				
PR	24.9	21.5	17.2	13.2
IN	4.0	3.4	3.3	2.6
Total	28.9	24.9	20.5	15.8
IMF				
PR	12.6	19.1	13.0	9.7
IN	0.0	0.2	0.0	0.0
Total	12.6	19.4	13.0	9.7
EBRD				
PR	27.8	30.9	30.06	30.0
IN	4.8	4.2	5.6	4.8
Total	32.6	35.1	35.6	34.8
Others				
PR	176.9	223.6	243.7	320.1
IN	49.7	55.6	76.4	75.3
Total	226.6	279.2	320.1	395.4
Total PR	**252.1**	**306.8**	**330.3**	**714.3**
Total IN	**66.9**	**73.1**	**97.4**	**94.7**
GRAND TOTAL	**319.0**	**379.9**	**427.7**	**809.0**

Source: Ministry of Finance

Increased debt servicing in 2013 was the result of a one-off principal repayment on the outstanding World Bank loans in the amount of US$ 300 million, which was a condition to the Republic's qualification to an upper-middle income category (qualification from the International Development Association (IDA) recipient country category) and associated decision by the World Bank.

The following table shows the projected debt service for the external state and state guaranteed debt for the years 2014 to 2023:

Projected External State and State Guaranteed Debt Service

(US$ millions)

	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Principal	446.8	470.0	476.1	481.3	438.4	390.6	356.9	286.8	253.6	252.9
Interest	64.8	58.4	51.7	45.0	38.3	31.9	26.1	20.9	17.1	13.5
Total	**511.7**	**528.4**	**527.8**	**526.4**	**476.7**	**422.5**	**383.0**	**307.7**	**270.7**	**266.4**

Source: Ministry of Finance

Cooperation with International Financial Institutions

World Bank Group

Azerbaijan has been a member of the World Bank Group ("**WBG**") since September 1992. The country is an active member of all five WBG institutions: IBRD, the International Development Association, Multilateral Investment Guarantee Agency, the IFC and the International Centre for Settlement of Investment Disputes ("**ICSID**").

The WBG strategy in Azerbaijan has evolved over time as the country rapidly moved from a low-income to higher middle-income country classification. WBG's early engagement through its private and public arms focused on assisting the country to put in place both the infrastructure needed to realise rapid growth in oil and gas exports, and a credible framework to manage the resource flows in effective and transparent manner. More recently the WBG's strategy formulated around two pillars: strengthening the non-oil economy, and improving effectiveness of social and community services. In line with growing complexity of the economy, Azerbaijan's demand for traditional WBG services, including lending instruments and policy advice, gradually evolved towards more analytical and knowledge-intensive product programs.

The WBG has been actively involved in structural reforms, public expenditure management, agriculture, private sector development, institution and capacity building, education, transportation, health, sanitation and governance. Since the beginning of the engagement the WBG has provided financing for 44 projects in different sectors totaling over US$ 3 billion. The WBG's portfolio currently consists of 17 active projects with total commitment of more than US$ 2.5 billion. Projects approved by WBG's Board of Directors in fiscal year 2013 (July-June) amounted to US$ 297 million. A few more projects are in the pipeline and expected to be approved before the end of fiscal year in July. The strong collaboration between the WBG and Azerbaijan is evidenced by the momentous reduction in the poverty rate from 50.0 per cent. in 2001 to 5.6 per cent. in 2012.

The Board of Directors approved the latest World Bank Group Azerbaijan Country Partnership Strategy ("**CPS**") for FY2011-13 in October 2010. The strategy aims to support the 2020 Project, by supporting the building of a competitive non-oil economy and the strengthening of social and municipal services. The recent CPS Progress Report confirmed that the strategic vision of the Government remains centered on economic diversification and service delivery and is anchored in good governance.

International Finance Corporation

As the private sector arm of the WBG, the IFC plays a critical role in supporting the diversification agenda in Azerbaijan. The corporation has invested more than US$ 408 million in 69 projects in the financial services, infrastructure and manufacturing sectors, and helped mobilise funding from other lenders. IFC's initial engagement started during early stages of oil and gas development projects in early 2000s, where it provided significant financing for development ACG oilfield in Caspian. IFC also provided US$ 125 million direct funding and an additional US$ 125 million mobilisation from other lenders in supporting the BTC pipeline that runs more than 1700 km from the shore of the Caspian Sea to the port of Ceyhan in the Mediterranean Sea in Turkey.

Over time IFC's strategic focus has shifted towards supporting development of the non-oil private sector. This strategy involves (i) promoting competition in the banking sector, establishing joint ventures in the non-banking financial sector, technical assistance to private local banks for institutional capacity building; (ii) improving access to finance; (iii) supporting SME financing by providing credit lines to local private banks for onward-lending; (iv) enhancing the business climate and reducing impediments to foreign investments; (v) supporting agri-business and food-processing; and (vi) creating conditions for public private partnerships.

In addition to investment programs, IFC's advisory services are equally important for the development of the private sector. IFC implements advisory programs to increase resource efficiency, improve the business climate and strengthen financial markets. In recent years advisory services have focused on building a strong financial markets infrastructure to support private sector and SME growth. Other program highlights include a leasing development project, an SME linkages program, corporate governance projects, as well as planned programs aimed at developing the housing finance market and improving the business enabling environment.

The SOFAZ is the second largest investor in the IFC Asset Management Company. The funds are used to support private sectors projects in Latin American and African countries. While the arrangement allows Azerbaijan to support fellow nations in the developing world, it also enables SOFAZ to further diversify its portfolio.

IMF

Azerbaijan became an IMF member in September 1992. Its first use of IMF financing started with a SDR 58.5 million program under the Systemic Transformation Facility. Early programs in the mid-1990s focused on macroeconomic stabilisation and first generation structural reforms. Over the years up to 2005, IMF provided an additional SDR 290.0 million in financing, mostly through the Enhanced Structural Adjustment Facility and Extended Credit Facility to support economic programmes aimed at moving toward a stable and sustainable macroeconomic position. Azerbaijan has since repaid all its IMF loans and has no outstanding financial obligations to the IMF.

The IMF has been active in providing technical assistance to the Government in building national institutions and developing technical capacity. The IMF has provided technical assistance in wide range of fields, including public debt and expenditure management, fiscal and tax policy and management, banking, monetary policy and statistics.

The consultation on Article IV of the IMF's Articles of Agreement was concluded in May 2013. The IMF Board of Directors welcomed Azerbaijan's rapid growth and defences against external instability. They commended the growth in non-oil and gas sector economic activity and the Government's Project 2020 vision of making Azerbaijan a competitive and diversified economy. The most recent staff report following the IMF staff visit in November 2013 commended the Government for its fiscal consolidation efforts and concluded that the near-term growth prospects are positive. The next Article IV discussions are scheduled to the first half of March 2014.

EBRD

Azerbaijan joined the EBRD in September 1992. As of 1 June 2013, the EBRD had 60 active investments in Azerbaijan, totaling € 645 million, of which 43.0 per cent. of EBRD investments are in the private sector.

Azerbaijan's cooperation with EBRD is focused on the following strategic priorities: non-oil private sector development, financial sector, infrastructure, natural resources and support for small and medium size enterprises.

Asian Development Bank

Azerbaijan joined the Asian Development Bank ("**ADB**") in December 1999 and a liaison office was established in Baku in early 2002. In 2004 a full Representative Office was set up and an active programme was initiated. ADB's operations in Azerbaijan are undertaken in line with the Government's own development strategies to reduce poverty and promote sustainable and inclusive economic growth.

ADB financing is primarily focused on infrastructure projects that are implemented jointly with the Government. These projects are predominantly in the areas of water and sanitation, energy and transport.

ADB also provides significant support to private sector activity, predominantly in the development of the financial sector.

From 2001 to 2012, ADB approved 18 loans, totalling US$ 1.4 billion, about US$ 14.3 million grants for financing technical assistances and a total of US$ 93.0 million in non-sovereign financing for Azerbaijan.

Islamic Development Bank

Azerbaijan joined the Islamic Development Bank ("**IDB**") in 1992. IDB's activities in Azerbaijan have been targeted at improving agriculture development through reconstruction of canal and drainage systems, power generation and road construction. Since 1992, a total of 59 projects were approved by the IDB Group amounting to US$ 1.3 billion. These include 37 projects from IDB ordinary funds totalling US$ 1.2 billion, 15 projects from Islamic Corporation for Development of Private Sector totalling US$ 113 million, 3 projects from Islamic Trade Finance Corporation totaling US$ 39 million and 4 projects from Special Assistance resources totaling US$ 2 million.

Currently, there are five active projects with IDB.

TERMS AND CONDITIONS OF THE NOTES

The following is the text of the terms and conditions of the Notes which, subject to amendment and completion and except for the text in italics, will be endorsed on each Note Certificate (if issued).

The U.S.$1,250,000,000 4.75 per cent. Notes due 2024 (the "**Notes**", which expression includes any further notes issued pursuant to Condition 13 (*Further Issues*) and forming a single series therewith) of the Republic of Azerbaijan (the "**Republic**") are constituted by and subject to, and have the benefit of, a deed of covenant dated on or about 13 March 2014 (the "**Deed of Covenant**"). A fiscal agency agreement dated on or about 13 March 2014 (the "**Fiscal Agency Agreement**") has been entered into in relation to the Notes between the Republic, Deutsche Bank AG, London Branch, as fiscal agent (the "**Fiscal Agent**"), Deutsche Bank Luxembourg S.A., as registrar and transfer agent in respect of the Unrestricted Notes (as defined in the Fiscal Agency Agreement), and Deutsche Bank Trust Company Americas, as registrar and transfer agent in respect of the Restricted Notes (as so defined) (each, a "**Registrar**" or "**Transfer Agent**", as the case may be) and as paying agent (the "**Paying Agent**" and together with the Fiscal Agent, the "**Paying Agents**").

In these Conditions, "Registrars", "Transfer Agents", "Fiscal Agent" and "Paying Agents" mean and include each Registrar, Transfer Agent, Fiscal Agent and Paying Agent and shall include any successors appointed from time to time in accordance with the provisions of the Fiscal Agency Agreement and any reference to an "**Agent**" or "**Agents**" shall mean any or all (as applicable) of such persons.

Certain provisions of these Conditions are summaries of the Fiscal Agency Agreement. The Fiscal Agency Agreement includes the form of the Notes. Copies of the Fiscal Agency Agreement are available for inspection during usual business hours at the principal office of the Fiscal Agent (presently at Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom) and at the specified offices of each of the other Agents. The holders of Notes are bound by and are deemed to have full notice of the provisions of the Fiscal Agency Agreement.

References to "**Conditions**" are, unless the context otherwise requires, to the numbered paragraphs of these terms and conditions.

1. Form and Denomination

The Notes are in registered form in minimum denominations of U.S.$200,000 or any amount in excess thereof which is an integral multiple of U.S.$1,000.

*Notes sold to QIBs in the United States in reliance on Rule 144A under the Securities Act will be represented by a restricted global note[3] (the "**Restricted Global Note**"). Notes sold to investors outside the United States in reliance on Regulation S under the Securities Act will be represented by an unrestricted global note (the "**Unrestricted Global Note**", and together with the Restricted Global Note, the "**Global Notes**"). The Unrestricted Global Note will be deposited with, and registered in the name of a nominee for, a common depositary for Euroclear ("**Euroclear**") and Clearstream, Luxembourg ("**Clearstream, Luxembourg**"). The Restricted Global Note will be deposited with a custodian for, and registered in the name of, Cede & Co., as nominee for The Depository Trust Company ("**DTC**").*

[3] ***Note:*** Assuming that the 144A tranche is $500,000,000 or below

Ownership of beneficial interests in the Restricted Global Note will be limited to persons that have accounts with DTC or persons that may hold interests through such participants. Ownership of beneficial interests in the Unrestricted Global Note will be limited to persons that have accounts with Euroclear or Clearstream, Luxembourg or persons that may hold interests through such participants. Beneficial interests in the Global Notes will be shown on, and transfers thereof will be effected through, records maintained in book-entry form by DTC and its participants or by Euroclear, Clearstream, Luxembourg and their participants as applicable. Global Notes will be exchangeable for Notes in definitive form only in certain limited circumstances specified in the Global Notes.

2. Status

The Notes constitute direct, general, unconditional and (subject as provided in Condition 4 (*Negative Pledge and Other Covenants*)) unsecured and unsubordinated obligations of the Republic and rank, and will rank, *pari passu* without any preference among themselves and at least *pari passu* in right of payment with all other unsubordinated obligations of the Republic, save only for such obligations as may be preferred by mandatory provisions of applicable law. The Notes are backed by the full faith and credit of the Republic.

3. Register, Title and Transfer

(a) *Register*

Each Registrar will maintain a register (the "**Register**") in respect of the Notes in accordance with the provisions of the Fiscal Agency Agreement. In these Conditions, the "**Holder**" of a Note means the person in whose name such Note is for the time being registered in the Register (or, in the case of a joint holding, the first named thereof) and "**Noteholder**" shall be construed accordingly. A certificate (each a "**Note Certificate**") will be issued to each Noteholder in respect of its registered holding or holdings of Notes only in certain limited circumstances. Each such Note Certificate will be numbered serially with an identifying number which will be recorded in the Register.

(b) *Title*

Title to the Notes will pass by and upon registration in the Register. Each Noteholder shall (except as otherwise required by law) be treated as the absolute owner of such Notes for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing on the Note Certificate relating thereto (other than the endorsed form of transfer) or any notice of any previous loss or theft of such Note Certificate) and no person shall be liable for so treating such Holder.

(c) *Transfers*

Subject to paragraphs (e), (f) and (g) below, a Note may be transferred in whole or in part in an authorised denomination upon surrender of the relevant Note Certificate, with the endorsed form of transfer duly completed, at the specified office of the relevant Registrar or the relevant Transfer Agent, together with such evidence as such Registrar or, as the case may be, such Transfer Agent may reasonably require to prove the title of the transferor and the authority of the persons who have executed the transfer form (the "**Transfer Form**"); provided, however, that a Note may not be transferred unless the principal amount of Notes transferred and (where not all of the Notes held by a Holder are being transferred) the principal amount of the balance of Notes not transferred are authorised denominations. Where not all the Notes represented by the surrendered Note Certificate are the subject of the transfer, a new Note Certificate in respect of the balance of the Notes will be issued to the transferor.

(d) *Registration and Delivery of Note Certificates*

Subject to paragraphs (e) and (f) below, within five Business Days (as defined below) of the surrender of a Note Certificate in accordance with paragraph (c) above, the relevant Registrar will register the transfer in question and deliver a new Note Certificate of the same aggregate principal amount as the Notes transferred to each relevant Holder at its specified office or (as the case may be) the specified office of the relevant Transfer Agent or (at the request and risk of any such relevant Holder) by uninsured first class mail (airmail if overseas) to the address specified for the purpose by such relevant Holder. In this paragraph, "**Business Day**" means a day on which commercial banks are open for business (including dealings in foreign currencies) in the city where the relevant Registrar or (as the case may be) the relevant Transfer Agent has its specified office.

Where some but not all the Notes in respect of which a Note Certificate is issued are to be transferred, a new Note Certificate in respect of the Notes not so transferred will, within five Business Days of the surrender of the original Note Certificate in accordance with paragraph (c) above, be mailed by uninsured first class mail (airmail if overseas) at the request of the Holder of the Notes not so transferred to the address of such Holder appearing on the Register.

(e) *No Charge*

Registration or transfer of a Note will be effected without charge by or on behalf of the Republic, the relevant Registrar or the relevant Transfer Agent but against payment by the Holder of such indemnity as the relevant Registrar or (as the case may be) such Transfer Agent may require in respect of any tax or other duty or governmental charge of whatsoever nature which may be levied or imposed in connection with such registration or transfer.

(f) *Closed Periods*

Noteholders may not require transfers to be registered during the period beginning on the 15th calendar day before the due date for any payment of principal or interest in respect of such Notes.

(g) *Regulations Concerning Transfers and Registration*

All transfers of Notes and entries on the Register are subject to the detailed regulations concerning the transfer of Notes scheduled to the Fiscal Agency Agreement. The regulations may be changed by the Republic with the prior written approval of the relevant Registrar. A copy of the current regulations will be mailed (free of charge) by such Registrar to any Noteholder who requests in writing a copy of such regulations.

4. Negative Pledge and Other Covenants

(a) *Negative Pledge*

So long as any Note remains outstanding (as defined in the Fiscal Agency Agreement) the Republic shall not create or permit to arise or subsist any Lien (as defined below) (other than a Permitted Lien (as defined below)) upon the whole or any part of its existing or future assets or revenues to secure any Public External Indebtedness (as defined below) of the Republic or any other Person (as defined below) in respect thereof unless, at the same time or prior thereto, the Republic's obligations under the Notes are secured equally and rateably therewith or have the benefit of such other arrangement as may be approved by an Extraordinary Resolution or a Written Resolution (as defined in Condition 12 (*Meetings of Noteholders and Modifications*)) of the Noteholders.

(b) *Other Covenants*

So long as any Note remains outstanding, the Republic shall duly obtain and maintain in full force and effect all governmental approvals (including any exchange control and transfer approvals) which may be necessary under the laws of the Republic for the execution and delivery by it of, and performance of its obligations under, the Notes and the Fiscal Agency Agreement and duly take all necessary governmental and administrative action in the Republic in order to perform or comply with all or any of its obligations under the Notes and the Fiscal Agency Agreement (including, without limitation, to make all payments to be made under the Notes as required by these Conditions and the Fiscal Agency Agreement).

(c) *Certain Definitions*

For the purposes of these Conditions:

"**External Indebtedness**" means all Indebtedness in a currency other than the lawful currency of the Republic.

"**Guarantee**" means any guarantee of or indemnity in respect of indebtedness or other like obligation.

"**Indebtedness**" means all obligations for money borrowed or raised (whether or not evidenced by bonds, debentures, notes or other similar instruments) denominated or payable, or which at the option of the relevant creditor or holder thereof may be payable.

"**Lien**" means any lien, pledge, hypothecation, mortgage, security interest, charge or other encumbrance or arrangement having a similar legal and economic effect including, without limitation, anything analogous to any of the foregoing under the laws of any jurisdiction.

"**Permitted Lien**" means:

(i) any Lien upon property to secure Public External Indebtedness or any Guarantee of Public External Indebtedness incurred for the purpose of financing the acquisition or construction of such property and any renewal and extension of such Lien which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, provided that the principal amount of the Public External Indebtedness secured thereby is not increased;

(ii) any Lien existing on property at the time of its acquisition (and not created in contemplation of such acquisition) to secure Public External Indebtedness or any Guarantee of Public External Indebtedness and any renewal and extension of such Lien which is limited to the original property covered thereby and which secures any renewal or extension of the original secured financing, provided that the principal amount of the Public External Indebtedness secured thereby is not increased;

(iii) any Lien securing Public External Indebtedness or any Guarantee of Public External Indebtedness incurred for the purpose of financing all or part of the costs of the acquisition, construction, development or exploitation of a project (including any renewal or extension thereof provided that the principal amount secured by any such additional encumbrance does not exceed the principal amount outstanding and secured by the original encumbrance), provided that (a) the holders of such Public External Indebtedness or Guarantee expressly agree to limit their recourse to the assets and revenues (including insurance proceeds) of such project as the principal source of repayment of such Public External Indebtedness and (b) the property over which such Lien is granted consists solely of such assets and revenues or revenues or claims which arise from the operation, failure to meet specifications, exploitation, sale or loss of, or failure to complete, or damage to, such properties;

(iv) any Lien on any assets securing Public External Indebtedness or any Guarantee of Public External Indebtedness which arises pursuant to any order or attachment, distraint or similar legal process arising in connection with court proceedings so long as the execution or other enforcement thereof is effectively stayed and the claims secured thereby are being contested in good faith by appropriate proceedings; and

(v) any Lien arising by operation of law, provided that such Lien is not created or permitted to be created by the Republic to secure any Public External Indebtedness or any Guarantee of Public External Indebtedness.

"**Person**" means any individual, company, corporation, firm, partnership, joint venture, association, unincorporated organisation, trust or any other juridical entity, including, without limitation, a state or agency of a state (including the Ministry of Finance and Council of Ministers of the Republic) or other entity (including the Central Bank of the Republic), whether or not having separate legal personality.

"**Public External Indebtedness**" means External Indebtedness which (i) is in the form of, or represented by, bonds, notes, or other securities thereof and (ii) is, or is capable of being, quoted, listed or ordinarily purchased and sold on any stock exchange, automated trading system or over the-counter or on any other securities market.

5. Interest

Each Note bears interest on its principal amount from and including 18 March 2014 (the "**Issue Date**") at the rate of 4.75 per cent. per annum (the "**Rate of Interest**"). Interest is payable semi-annually in arrear on 18 March and 18 September in each year commencing on 18 September 2014 (each an "**Interest Payment Date**") until maturity. Interest due on an Interest Payment Date will accrue during the immediately preceding Interest Period (as defined below) and will be paid subject to and in accordance with the provisions of Condition 7 (*Payments*).

Each Note will cease to bear interest from the due date for redemption unless, after surrender of such Note, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at the rate specified above (after as well as before judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant holder of Notes and (b) the day which is seven days after notice has been given to the holders of Notes that the Fiscal Agent has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any failure in the subsequent payment to the relevant holders under these Conditions).

The amount of interest payable in respect of each Note subject to Condition 7 (*Payments*) shall be calculated by applying the Rate of Interest to the principal amount of such Note, dividing the product by two and rounding the resulting figure to the nearest cent (half a cent being rounded upwards).

If interest is required to be calculated for any period other than an Interest Period, it will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed.

Each period beginning on (and including) the Issue Date or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date is herein called an "**Interest Period**".

6. Redemption, Purchase and Cancellation

(a) *Final Redemption*

Unless previously redeemed, or purchased and cancelled, the Notes will be redeemed at their principal amount on 18 March 2024, subject as provided in Condition 7 (*Payments*).

(b) *No other Redemption*

The Republic shall not be entitled to redeem the Notes other than as provided in paragraph (a) above.

(c) *Purchase and Cancellation*

The Republic may, directly or indirectly or through any of its agencies or instrumentalities, at any time purchase Notes in the open market or otherwise at any price. Any Notes so purchased may be cancelled or held and resold. Any Notes so purchased, while held by or on behalf of the Republic, shall not entitle the holder to vote at any meeting of holders of Notes or with respect to any resolution of Noteholders and shall not be deemed to be outstanding for the purposes of calculating quorums at meetings of holders of Notes. Any Notes so cancelled will not be reissued.

7. Payments

(a) *Principal*

Payment of principal in respect of each Note and payment of interest due other than on an Interest Payment Date will be made to the person shown in the Register at the close of business on the Record Date (as defined below) and subject to the surrender (or, in the case of part payment only, endorsement) of the relevant Note Certificate at the specified office of the relevant Registrar or of the Paying and Transfer Agents.

(b) *Interest*

Payments of interest due on an Interest Payment Date will be made to the persons shown in the Register at close of business on the Record Date.

(c) *Method of Payment*

Payments of principal and interest in respect of the Notes will be made by transfer to the requested account of the Holder or by United States Dollar cheque drawn on a bank that processes payments in United States Dollars and mailed to the Holder by uninsured first class mail (airmail if overseas), at the address appearing in the Register at the opening of business on the relevant Record Date (as defined below) or, upon the request of a Noteholder to the specified office of an Agent not later than the 15th day before the due date for any such payment, by transfer to a United States Dollar account maintained by the payee with a bank that processes payments in United States Dollars.

(d) *Payments Subject to Fiscal Laws*

All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations of the Republic, but without prejudice to the provisions of Condition 8 (*Taxation*).

(e) *No Commissions*

No commission or expenses shall be charged to the Noteholders in respect of any payments of principal or interest in respect of the Notes.

(f) *Payments on Business Days*

Where payment is to be made by transfer to a United States Dollar account, payment instructions (for value the due date, or, if the due date is not a Business Day, on the next succeeding Business Day) will be initiated and, where payment is to be made by a United States Dollar cheque, the cheque will be mailed on the due date for payment or, if the due date is not a Business Day, for value the next succeeding Business Day. A Noteholder shall not be entitled to any interest or other payment in respect of any delay in payment resulting from the due date for a payment not being a Business Day, the Holder being late in surrendering its Certificate (if requested to do so) or a cheque mailed in accordance with this Condition 7 arriving after the due date for payment or being lost in the mail.

(g) *Partial payments*

If an Agent makes a partial payment in respect of any Note, the relevant Registrar shall procure that the amount and date of such payment are noted on the Register.

(h) *Record Date*

Payment in respect of a Note will be made to the person shown as the Holder in the Register at the opening of business in the place of the relevant Registrar's specified office on the 15th day before the due date for such payment (the "**Record Date**").

"**Business Day**" in respect of the Notes means a day (not including Saturday or Sunday) on which commercial banks are open for general business in both New York City and in the city in which the Fiscal Agent has its specified office.

(i) *Agents*

The Republic has initially appointed the Fiscal Agent, the Paying Agents, the Registrars and the Transfer Agents named above. The Republic reserves the right under the Fiscal Agency Agreement by giving to the relevant Agent concerned at least 90 days' prior written notice to that effect, provided that (i) the notice shall not expire less than 45 days before any due date for the payment of interest; and (b) so long as any of the Notes is outstanding notice shall be given under Clause 19 of the Fiscal Agency Agreement (*Notices*) at least 30 days before the removal or appointment of an Agent, to vary or terminate the appointment of any such Agent and appoint another Agent or additional or other Agents outside the United States, provided that, it will at all times, and while any Note is outstanding, maintain (i) a Fiscal Agent, (ii) a Paying and Transfer Agent with a specified office in a European Union member state that will not be obliged to withhold or deduct tax pursuant to European Union Council Directive 2003/48/EC on the taxation of savings income in the form of interest payments or any law implementing or complying with, or introduced in order to conform to, such Directive; and (iii) a Registrar outside the United Kingdom.

Notice of any such termination or appointment and of any change in the specified office of any Agent will be given in accordance with Condition 14 (*Notices*) as soon as practicable.

8. Taxation

All payments of principal and interest in respect of the Notes shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the Republic or any regional or local subdivision or any authority thereof or therein having power to tax (together "**Taxes**"), unless such withholding or deduction is required by law. In that event, the Republic shall pay such additional amounts as will result in the receipt by the holders of Notes of such amounts as would have been received by them had no such withholding or deduction been required, except that no such additional amounts shall be payable in respect of any Note:

(a) to a holder, or to a third party on behalf of a holder, if such holder is liable to such Taxes in respect of such Note by reason of having some connection with the Republic other than the mere holding of such Note; or

(b) if the Note is surrendered for payment more than 30 days after the Relevant Date (as defined below), except to the extent that the holder would have been entitled to such additional amounts on surrender of such Note for payment on the last day of such period of 30 days; or

(c) where any withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to the European Union Directive 2003/48/EC on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note to another Paying Agent in a member state of the European Union.

For the purpose of these Conditions, "**Relevant Date**" means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received by the Fiscal Agent on or prior to such due date, the date on which (the full amount plus any accrued interest having been so received) notice to that effect has been given to the holders of Notes.

Any reference in these Conditions to payments of principal or interest in respect of the Notes shall be deemed to include any additional amounts which may be payable under this Condition 8 or any undertaking given in addition to or substitution for it under the Fiscal Agency Agreement.

9. Events of Default

If any of the following events occurs and is continuing:

(a) *Non-payment*

The Republic fails to pay any principal on any of the Notes within 15 days of the due date for payment or any interest or additional amounts on any of the Notes within 30 days of the due date for payment; or

(b) *Breach of Other Obligations*

The Republic does not perform or comply with any one or more of its other obligations under the Notes, which default is incapable of remedy or, if capable of remedy, is not remedied within 45 days after notice of such default has been given to the Republic (with a copy to the specified office of the Fiscal Agent) by any Holder; or

(c) *Cross-acceleration; Payment default*

(i) The holders of any Public External Indebtedness of the Republic accelerate such Public External Indebtedness or declare such Public External Indebtedness to be due and payable, or required to be prepaid (other than by a regularly scheduled required payment), prior to the originally stated maturity thereof; or

(ii) The Republic fails to pay in full any principal of, or interest on, any Public External Indebtedness when due (after expiration of any originally applicable grace period) or any Guarantee of any Public External Indebtedness given by the Republic shall not be honoured when due and called upon (after the of any originally applicable grace period);

provided that the aggregate amount of the relevant Public External Indebtedness or Guarantee in respect of which one or more of the events mentioned above in this paragraph (c) shall have occurred equals or exceeds U.S.$50,000,000 or its equivalent in other currencies; or

(d) *Moratorium*

The Republic suspends payment of, or admits its inability to pay, its Public External Indebtedness or any part thereof or declares a general moratorium on or in respect of its Public External Indebtedness or any part thereof, or anything analogous to the foregoing occurs; or

(e) *Unlawfulness or Invalidity*

The validity of the Notes or the Deed of Covenant is contested by the Republic or the Republic shall deny any of its obligations under the Notes or the Deed of Covenant or it is or becomes unlawful for the Republic to perform or comply with all or any of its obligations set out in the Notes or the Deed of Covenant or any of such obligations shall be or become unenforceable or invalid; or

(f) *IMF*

The Republic ceases to be a member of the IMF or ceases to be eligible to use the general resources of the IMF,

then the Fiscal Agent shall, upon receipt of written requests to the Republic (with a copy to the specified office of the Fiscal Agent) from holders of not less than 25 per cent. in aggregate outstanding principal amount of the Notes, declare the Notes due and payable, in each case at their principal amount together with accrued interest, without further formality. Upon such declaration by the Fiscal Agent, the Fiscal Agent shall give notice thereof in the manner provided in the Fiscal Agency Agreement to the Republic and to the holders of the Notes in accordance with Condition 14 (*Notices*). After any such declaration by the Fiscal Agent, if all amounts then due with respect to the Notes are paid (other than amounts due solely because of such declaration) and all other defaults with respect to the Notes are cured, such declaration may be annulled and rescinded by holders of not less than 50 per cent. in aggregate outstanding principal amount of the Notes (the "**Required Percentage**") by written notice thereof to the Republic (with a copy to the specified office of the Fiscal Agent) or by the passing of a resolution by the holders of not less than the Required Percentage.

10. Prescription

Claims in respect of principal and interest will become void unless made within a period of 10 years in the case of principal and five years in the case of interest from the appropriate Relevant Date.

11. Replacement of Notes

If any Note Certificate is lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the relevant Registrar or the relevant Transfer Agent, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Republic may reasonably require. Mutilated or defaced Note Certificates must be surrendered before replacements will be issued.

12. Meetings of Noteholders and Modification

(a) *Meetings of Noteholders*

The Fiscal Agency Agreement contains provisions for convening meetings of Noteholders to consider matters affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of any of these Conditions (having been approved by the Republic) or any provisions of the Fiscal Agency Agreement. Such a meeting may be convened by Noteholders holding not less than 10 per cent. in principal amount of the Notes for the time being outstanding. The quorum for any meeting convened to consider an Extraordinary Resolution will be two or more persons holding or representing a clear majority in principal amount of the Notes for the time being outstanding or at any adjourned meeting two or more persons being or representing Noteholders whatever the principal amount of the Notes held or represented; provided however, that any proposals relating to a Reserved Matter may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than 75 per cent. in principal amount of the Notes for the time being outstanding, or at any adjourned meeting, 25 per cent. in principal amount of the Notes for the time being outstanding, form a quorum. Any Extraordinary Resolution duly passed shall be binding on Noteholders (whether or not they were present at the meeting at which such resolution was passed).

The holder of a Global Note will be treated as being two persons for the purposes of any quorum requirements of a meeting of Noteholders and, at any such meeting, as having one vote in respect of each U.S.$1,000 in principal amount of Notes for which the relevant Global Note may be exchanged.

(b) *Extraordinary Resolution*

In these Conditions "**Extraordinary Resolution**" means:

(i) in relation to any Reserved Matter:

(A) a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority consisting of not less than 75 per cent. of the outstanding principal amount of the Notes for the time being outstanding; or

(B) a resolution in writing signed by or on behalf of holders of not less than 75 per cent. of the outstanding principal amount of the Notes for the time being outstanding.

(ii) in relation to any other matter:

(A) a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority consisting of not less than 66.67 per cent. of the outstanding principal amount of the Notes for the time being outstanding; or

(B) a resolution in writing signed by or on behalf of holders of not less than 66.67 per cent. of the outstanding principal amount of the Notes for the time being outstanding.

(c) *Reserved Matter*

In these Conditions "**Reserved Matter**" means any proposal to:

(i) change any date, or the method of determining the date, fixed for payment of principal or interest in respect of the Notes, to reduce the amount of principal or interest payable on any date in respect of the Notes or to alter the method of calculating the amount of any payment in respect of the Notes on redemption or maturity or the date for any such payment;

(ii) effect the exchange or substitution of the Notes for, or the conversion of the Notes into, shares, bonds or other obligations or securities of the Republic or any other person or body corporate formed or to be formed;

(iii) reduce or cancel the principal amount of the Notes;

(iv) vary the currency or place of payment in which any payment in respect of the Notes is to be made;

(v) amend the status of the Notes under Condition 2 (*Status*);

(vi) amend the obligation of the Republic to pay additional amounts under Condition 8 (*Taxation*);

(vii) amend the Events of Default set out in Condition 9 (*Events of Default*);

(viii) amend the law governing the Notes, the courts to the jurisdiction to which the Republic has submitted in the Notes, the Republic's obligation to maintain an agent for service of process in England or the Republic's waiver of immunity in respect of actions or proceedings brought by any Noteholder set out in Condition 16 (*Governing Law*);

(ix) modify the provisions contained in the Fiscal Agency Agreement concerning the quorum required at any meeting of the Noteholders or any adjournment thereof or concerning the majority required to pass an Extraordinary Resolution or the percentage of votes required for the taking of any action;

(x) modify or cancel the Deed of Covenant;

(xi) change the definition of "Extraordinary Resolution" or "outstanding" in the Conditions and/or Fiscal Agency Agreement;

(xii) instruct any Noteholder or committee appointed on behalf of all Noteholders pursuant to Condition 12(d) (*Meetings of Noteholders; Noteholders' Representative Committee*) to withdraw, settle or compromise any proceeding or claim being asserted pursuant to Condition 9 (*Events of Default*);

(xiii) confer upon any committee appointed pursuant to Condition 12(d) (*Noteholders' Representative Committee*) any powers or discretions which the Noteholders could themselves exercise by Extraordinary Resolution; or

(xiv) amend this definition.

(d) *Noteholders' Representative Committee*

(i) Appointment: The Noteholders may, by a resolution passed at a meeting of Noteholders duly convened and held in accordance with the Fiscal Agency Agreement by a majority of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, or by notice in writing to the Republic (with a copy to the Fiscal Agent) signed by or on behalf of the holders of at least 50 per cent. in aggregate principal amount of the Notes then outstanding, appoint any persons as a committee to represent the interests of the Noteholders if any of the following events shall have occurred:

(A) an Event of Default;

(B) any event or circumstance which would, with the giving of notice, lapse of time, the issuing of a certificate and/or fulfilment of any other requirement provided for in Condition 9 (*Events of Default*) become an Event of Default;

(C) any public announcement by the Republic to the effect that the Republic is seeking or intends to seek a restructuring of the Notes (whether by amendment, exchange offer or otherwise); or

(D) with the agreement of the Republic, at a time when the Republic has reasonably reached the conclusion that its debt may no longer be sustainable while the Notes are outstanding,

In appointing a person or persons as a committee to represent the interests of the Noteholders, the Noteholders may instruct a representative or representatives of the committee to form a committee with any person or persons appointed for similar purposes by other affected series of debt securities. Such committee shall if appointed by notice in writing to the Republic, give notice of its appointment to all Noteholders in accordance with Condition 14 (*Notices*) as soon as practicable after the notice is delivered to the Republic.

(ii) Powers: Such committee in its discretion may, among other things, (A) engage legal advisers and financial advisers to assist it in representing the interests of the Noteholders, (B) adopt such rules as it considers appropriate regarding its proceedings and (C) enter into discussions with the Republic and/or other creditors of the Republic. The Republic shall pay any reasonably incurred fees and expenses of any such committee (including, without limitation, the fees and expenses of the committee's legal advisers and financial advisers, if any) within 30 days of the delivery to the Republic of a reasonably detailed invoice and supporting documentation.

(e) *Outstanding Notes*

For the purposes of (i) ascertaining the right to attend and vote at any meeting of Noteholders and (ii) Condition 9 (*Events of Default*), Condition 12(f) (*Modification*) and Schedule 3 (*Provisions for Meetings of Noteholders*) to the Fiscal Agency Agreement, those Notes (if any) which are for the time being held by or on behalf of the Republic shall (unless and until ceasing to be so held) be deemed not to remain outstanding.

(f) *Modification*

The Fiscal Agent may agree, without the consent of the Noteholders, to any modification of any of the provisions of the Fiscal Agency Agreement which is in its opinion of a formal, minor or technical nature or is made to correct a manifest error. Any such modification shall be binding on the Noteholders and, if the Fiscal Agent so requires, such modification shall be notified to the Noteholders as soon as practicable thereafter in accordance with Condition 14 (*Notices*). Notwithstanding any provision contained in these Conditions or the Fiscal Agency Agreement, no modification or amendment of these Conditions or the Fiscal Agency Agreement may be made without the prior written consent of the Republic.

(g) *Written Resolution*

A resolution in writing (a "**Written Resolution**") will take effect as if it were an Extraordinary Resolution if it is signed (i) by or on behalf of all Noteholders who for the time being are entitled to receive notice of a meeting of Noteholders under the Fiscal Agency Agreement or (ii) if such Noteholders have been given at least 21 days' notice of such resolution, by or on behalf of persons holding three-quarters of the aggregate principal amount of the outstanding Notes, in the case of a Reserved Matter, or 66.67 per cent. of the aggregate principal amount of the outstanding Notes, in the case of a matter other than a Reserved Matter. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

13. Further Issues

The Republic may from time to time, without notice to or the consent of the holders of Notes, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects save for the date for and amount of the first payment of interest thereon) so as to be consolidated and form a single series with the Notes.

Noteholders should note that additional securities that are treated as a single series, other than for tax purposes may be treated as a separate series for U.S. federal income tax purposes. In such a case, the new securities may be considered to have been issued with original issue discount, as defined in the U.S. Internal Revenue Code of 1986, as amended, and the U.S. Treasury regulations issued thereunder, which may affect the market value of the Notes since such additional securities may not be distinguishable from the Notes.

14. Notices

All notices to Noteholders may be delivered in person or sent by mail or facsimile transmission to them at their respective addresses or facsimile numbers reflected in the Register (or any other manner approved by the relevant Registrar which may be by electronic transmission). Any such notice shall be deemed to have been given, in the case of a letter delivered by hand, at the time of delivery, or in the case of a letter sent by mail, at the time of dispatch, except that, so long as the rules of the Irish Stock Exchange so require, notices must be sent to the Companies Announcement Office of the Irish Stock Exchange.

So long as any of the Notes are represented by the Unrestricted Global Note, notices required to be published in accordance with Condition 14 (Notices) may be given by delivery of the relevant notice to Euroclear and Clearstream, Luxembourg for communication by them to the relevant accountholders, provided: (i) that such notice is also delivered to the Irish Stock Exchange; and (ii) so long as the Notes are admitted to trading on the Irish Stock Exchange, a notice shall be sent to the Companies Announcement Office of the Irish Stock Exchange. So long as any of the Notes are represented by the Restricted Global Note, notices required to be published in accordance with Condition 14 (Notices) may be given by delivery of the relevant notice to DTC for communication to the relevant accountholders provided that: (i) such notice is also delivered to the Irish Stock Exchange plc and (ii) so long as the Notes are admitted to trading on the Irish Stock Exchange, a notice shall be sent to the Companies Announcement Office of the Irish Stock Exchange.

15. Currency Indemnity

If any sum due from the Republic in respect of the Notes or any arbitration award or any order or judgment given or made in relation thereto has to be converted from the currency (the "**First Currency**") in which the same is payable under the Conditions or such award, order or judgment into another currency ("**Second Currency**") for the purpose of (i) making or filing a claim or proof against the Republic, (ii) obtaining an award, order or judgment in any arbitral tribunal or court or (iii) enforcing any award, order or judgment given or made in relation to the Notes, the Republic shall indemnify each Noteholder on the written demand of such Noteholder addressed to the Republic and delivered to the Republic or to the principal office of the Fiscal Agent, against any loss suffered as a result of any discrepancy between (i) the rate of exchange used for such purpose to convert the sum in question from the First Currency into the Second Currency and (ii) the rate or rates of exchange at which such Noteholder may in the ordinary course of business purchase the First Currency with the Second Currency upon receipt of a sum paid to it in satisfaction, in whole or in part, of such award, order, judgment, claim or proof provided that, for the avoidance of doubt, nothing in this Condition 15 shall entitle a Noteholder to recover or retain anymore than the sums due from the Republic under the Notes.

16. Governing Law

(a) *Governing Law*

The Notes and the arbitration agreement at Condition 17 (*Arbitration*) (including any non-contractual obligations arising out of or in connection with the Notes and the arbitration agreement) are governed by, and shall be construed in accordance with, English law.

(b) *Agent for Service of Process*

The Republic has appointed the Ambassador of the Republic to the Court of St. James's at the Embassy of the Republic, currently located at 4 Kensington Court, London W8 5DL, as its agent for service of process in relation to any proceedings ("**Proceedings**") before the English courts permitted by the Rules in connection with an arbitral proceeding pursuant to Condition 17, or in connection with the enforcement of any arbitral award rendered pursuant to Condition 17 and hereby undertakes that, in the event of the Ambassador of the Republic to the Court of St James's ceasing so to act or ceasing to be located in England, it will appoint another person as its agent for the service of process in England for such purposes as soon as reasonably practicable thereafter. Nothing in this paragraph shall affect the right of any Noteholder to serve proceedings in any other manner permitted by law.

(c) *Consent to arbitration, etc.*

Subject to Condition 16(d) (*Waiver of State Immunity*), the Republic has irrevocably and generally consented in respect of any arbitration to the giving of any relief or the issue of any process in connection with such arbitration including (without limitation except as provided in Condition 16(d) (*Waiver of State Immunity*), below), the making, enforcement or execution against any assets whatsoever (irrespective of their use or intended use) of any order or judgment which may be made or given in support of or in connection with such arbitration.

(d) *Waiver of State Immunity*

Except as provided below in this Condition 16(d), to the extent the Republic may in any jurisdiction claim for itself or its assets or revenues immunity from suit, arbitral process or award, judgment, execution, attachment (whether in aid of execution, before judgment or otherwise) or any other legal process in respect of, in support of or in connection with (i) any arbitration proceedings to resolve a dispute under Condition 17 or (ii) any Proceedings, and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Republic or its assets or revenues, the Republic agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction (and consents generally to the giving of any relief or the issue of any process in connection with such Proceedings) The Republic does not waive any immunity with respect to: (a) any property, including any bank account, used by a diplomatic or consular mission of the Republic or its special missions or delegations to international organisations, (b) property of a military character or in use for military purposes and in each case under the control of a military authority or defence agency of the Republic or (c) property of the government of the Republic located in the territory of the Republic. The Republic reserves the right to plead sovereign immunity under the U.S. Foreign Sovereign Immunities Act of 1976 with respect to actions brought against it in any court of, or in, the United States of America under any United States federal or state securities law.

17. Arbitration

Any dispute arising out of or in connection with the Notes (including any dispute as to the existence, termination or validity or any non contractual obligations arising out of or in connection with the Notes) (a "**Dispute**"), shall be referred to and finally settled by arbitration in accordance with the London Court of International Arbitration ("**LCIA**") Rules (the "**Rules**") as in force at the date of the Notes and as modified by this Condition, which Rules shall be deemed incorporated into this Condition. The number of arbitrators shall be three, one of whom shall be nominated by the claimant(s), one by respondent(s) and the third of whom, who shall act as Chairman, shall be nominated by the two party nominated arbitrators, provided that if the claimant or respondent fail to nominate an arbitrator within the time limits specified by the Rules or the party-nominated arbitrators fail to nominate a Chairman within 30 days of the nomination of the second party nominated arbitrator, such third arbitrator shall be appointed by the LCIA. The seat of arbitration shall be London, England and the language of arbitration shall be English. Sections 45 and 69 of the Arbitration Act 1996 shall not apply.

18. Rights of Third Parties

No person who is not a Noteholder has any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any of the Terms and Conditions of the Notes.

19. Provision of Information

The Republic shall, during any period in which it is not subject to or in compliance with the reporting requirements of Section 13 or 15(d) of the United States Securities Exchange Act of 1934 (the "**Exchange Act**") nor exempt from reporting pursuant to Rule 12g3 2(b) under the Exchange Act, duly provide to any holder of a Note which is a "**restricted security**" within the meaning of Rule 144(a)(3) under the Securities Act or to any prospective purchaser of such securities designated by such Noteholder, upon the written request of such Noteholder or (as the case may be) prospective Noteholder addressed to the Republic and delivered to the Republic or to the specified office of the relevant Registrar, the information specified in Rule 144A(d)(4) under the Securities Act.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE IN GLOBAL FORM

The Global Note Certificates

The Notes will be evidenced on issue by the Regulation S Global Note Certificate (deposited with, and registered in the name of a nominee for, a common depositary for Euroclear and Clearstream, Luxembourg) and the Rule 144A Global Note Certificate (deposited with a custodian for, and registered in the name of Cede & Co. as nominee of, DTC).

Beneficial interests in the Regulation S Global Note Certificate may be held only through Euroclear or Clearstream, Luxembourg at any time. See "*Clearing and Settlement – Book-Entry Ownership*". By acquisition of a beneficial interest in a Regulation S Global Note Certificate, the purchaser thereof will be deemed to represent, among other things, that it is not a US person, and that, if it determines to transfer such beneficial interest prior to the expiration of the 40-day restricted period, it will transfer such interest only to a person whom the seller reasonably believes (a) to be a non-US person in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S or (b) to be a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate (if applicable). See "*Transfer Restrictions*".

Beneficial interests in the Rule 144A Global Note Certificate may only be held through DTC at any time. See "*Clearing and Settlement – Book-Entry Ownership*". By acquisition of a beneficial interest in the Rule 144A Global Note Certificate, the purchaser thereof will be deemed to represent, among other things, that it is a QIB and that, if in the future it determines to transfer such beneficial interest, it will transfer such interest in accordance with the procedures and restrictions contained in the Agency Agreement. See "*Transfer Restrictions*".

Beneficial interests in each Global Note Certificate will be subject to certain restrictions on transfer set forth therein and in the Agency Agreement, and with respect to Rule 144A Notes, as set forth in Rule 144A, and the Notes will bear the legends set forth thereon regarding such restrictions set forth under "*Transfer Restrictions*". A beneficial interest in the Regulation S Global Note Certificate may be transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate in denominations greater than or equal to the minimum denominations applicable to interests in the Rule 144A Global Note Certificate and only upon receipt by the Registrar of a written certification (in the form provided in the Agency Agreement) to the effect that the transferor reasonably believes that the transferee is a QIB and that such transaction is in accordance with any applicable securities laws of any state of the United States or any other jurisdiction.

Beneficial interests in the Rule 144A Global Note Certificate may be transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note Certificate only upon receipt by the Registrar of a written certification (in the form provided in the Agency Agreement) from the transferor to the effect that the transfer is being made to a non-US person and in accordance with Regulation S.

Any beneficial interest in the Regulation S Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in the Rule 144A Global Note Certificate will, upon transfer, cease to be an interest in the Regulation S Global Note Certificate and become an interest in the Rule 144A Global Note Certificate, and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Rule 144A Global Note Certificate for as long as it remains such an interest. Any beneficial interest in the Rule 144A Global Note Certificate that is transferred to a person who takes delivery in the form of an interest in the Regulation S Global Note Certificate will, upon transfer, cease to be an interest in the Rule 144A Global Note Certificate and become an interest in the Regulation S Global Note Certificate and, accordingly, will thereafter be subject to all transfer restrictions and other procedures applicable to beneficial interests in the Regulation S Global Note Certificate for so long as it remains such an interest. No service charge will be made for any registration of transfer or exchange of Notes, but the Registrar may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith. Except in the limited circumstances described below, owners of beneficial interests in Global Note Certificates will not be entitled to receive physical delivery of the Individual Certificates. No Notes will be issued in bearer form.

Legends

The holder of an Individual Certificate may transfer the Notes evidenced thereby in whole or in part in the applicable minimum denomination by surrendering it at the specified office of the Registrar or any Paying and Transfer Agent, together with the completed form of transfer thereon. Upon the transfer, exchange or replacement of a Rule 144A Individual Certificate bearing the legend referred to under "*Transfer Restrictions*", or upon specific request for removal of the legend on a Rule 144A Individual Certificate, the Republic will deliver only Rule 144A Individual Certificates that bear such legend, or will refuse to remove such legend, as the case may be, unless there is delivered to the Republic and the Registrar such satisfactory evidence, which may include an opinion of counsel, as may reasonably be required by the Republic that neither the legend nor the restrictions on transfer set forth therein are required to ensure compliance with the provisions of the Securities Act.

Amendments to Terms and Conditions of the Notes

Each Global Note Certificate contains provisions that apply to the Notes that they evidence, some of which modify the effect of the Terms and Conditions of the Notes. The following is a summary of those provisions:

Payments

Payments of principal and interest in respect of Notes evidenced by a Global Note Certificate will be made against presentation for endorsement by the Fiscal Agent and, if no further payment falls to be made in respect of the relevant Notes, surrender of such Global Note Certificate to or to the order of the Fiscal Agent or such other Paying and Transfer Agent as shall have been notified to the relevant Noteholders for such purpose. A record of each payment so made will be endorsed in the appropriate schedule to the relevant Global Note Certificate, which endorsement will be prima facie evidence that such payment has been made in respect of the relevant Notes. All payments in respect of Notes represented by a Global Note will be made to, or to the order of, the person whose name is entered on the Register at the close of business on the Clearing System Business Day immediately prior to the date for payment, where "**Clearing System Business Day**" means Monday to Friday inclusive except 25 December and 1 January.

Meetings

The holder of each Global Note Certificate will be treated as being two persons for the purposes of any quorum requirements of, or the right to demand a poll at, a meeting of Noteholders and in any such meeting as having one vote in respect of each integral US$1,000 in principal amount of Notes.

Cancellation

Cancellation of any Note required by the Conditions of the Notes to be cancelled will be effected by reduction in the principal amount of the applicable Global Note Certificate.

Exchange for Individual Certificates

Exchange

Each Global Note Certificate will be exchangeable, free of charge to the holder, in whole but not in part, for Individual Certificates if: (i) it is held by or on behalf of a clearing system and such clearing system is closed for business for a continuous period of 14 calendar days (other than by reason of holidays, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so, by the holder giving notice to the Registrar or (ii) if the Republic would suffer a material disadvantage in respect of the Notes as a result of a change in the laws or regulations (taxation or otherwise) of any jurisdiction referred to in Condition 7 of the Terms and Conditions of the Notes which would not be suffered were the Notes in definitive form, by the Republic giving notice to the Registrar and the Noteholders, in each case of its intention to exchange the relevant Global Note Certificate for Individual Certificates on or after the Exchange Date (as defined below) specified in the notice.

The Registrar will not register the transfer of, or exchange of interests in, a Global Note Certificate for Individual Certificates for a period of 15 calendar days ending on the date for any payment of principal or interest in respect of the Notes.

"**Exchange Date**" means a day falling not later than 60 calendar days after that on which the notice requiring exchange is given and on which banks are open for business in the city in which the specified office of the Registrar or the relevant Paying and Transfer Agent is located.

Delivery

If any of the events in paragraph (i) or (ii) of "*Exchange*" above occurs, the relevant Global Note Certificate shall be exchangeable in full for Individual Certificates and the Republic will, free of charge to the Noteholders (but against such indemnity as the Registrar or any relevant Paying and Transfer Agent may require in respect of any tax or other duty of whatever nature which may be levied or imposed in connection with such exchange), cause sufficient Individual Certificates to be executed and delivered to the Registrar for completion and despatch to the relevant Noteholders. A person having an interest in a Global Note Certificate must provide the Registrar with (a) a written order containing instructions and such other information as the Republic and the Registrar may require to complete, execute and deliver such Individual Certificates and (b) in the case of the Rule 144A Global Note Certificate only, a fully completed, signed certification substantially to the effect that the exchanging holder is not transferring its interest at the time of such exchange or, in the case of simultaneous sale pursuant to Rule 144A, a certification that the transfer is being made in compliance with the provisions of Rule 144A to a QIB. Individual Certificates issued in exchange for an interest in the Rule 144A Global Note Certificate shall bear the legend applicable to transfers pursuant to Rule 144A, as set out under "*Transfer Restrictions*".

CLEARING AND SETTLEMENT

Custodial and depositary links are to be established between DTC, Euroclear and Clearstream, Luxembourg to facilitate the initial issue of the Notes and cross-market transfers of the Notes associated with secondary market trading. See "*Book-Entry Ownership*" and "*Settlement and Transfer of Notes*" below.

Investors may hold their interests in a Global Note Certificate directly through DTC, Euroclear or Clearstream, Luxembourg if they are accountholders (the "**Direct Participants**") or indirectly (the "**Indirect Participants**" and, together with Direct Participants, the "**Participants**") through organisations which are accountholders therein.

Euroclear and Clearstream, Luxembourg

Euroclear and Clearstream, Luxembourg each hold securities for their customers and facilitate the clearance and settlement of securities transactions through electronic book-entry transfer between their respective accountholders. Indirect access to Euroclear and Clearstream, Luxembourg is available to other institutions which clear through or maintain a custodial relationship with an accountholder of either system. Euroclear and Clearstream, Luxembourg provide various services including safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream, Luxembourg also deal with domestic securities markets in several countries through established depositary and custodial relationships. Euroclear and Clearstream, Luxembourg have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Their customers are worldwide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations.

DTC

DTC has advised the Republic as follows: DTC is a limited purpose trust company organised under the laws of the State of New York, a "banking organization" under the laws of the State of New York, a member of the US Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC was created to hold securities for its Participants and facilitate the clearance and settlement of securities transactions between Participants through electronic computerised book-entry changes in accounts of its Participants, thereby eliminating the need for physical movement of certificates. Participants include securities brokers and dealers, banks, trust companies, clearing corporations and certain other organisations. Indirect access to DTC is available to others, such as banks, securities brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a DTC Direct Participant, either directly or indirectly.

Investors may hold their interests in the Rule 144A Global Note Certificate directly through DTC if they are Direct Participants in the DTC system, or as Indirect Participants through organisations which are Direct Participants in such system.

DTC has advised the Republic that it will take any action permitted to be taken by a holder of Notes only at the direction of one or more Direct Participants and only in respect of such portion of the aggregate principal amount of the Rule 144A Global Note Certificate as to which such Participant or Participants has or have given such direction. However, in the circumstances described under "*Summary of Provisions Relating to the Notes while in Global Form – Exchange for Individual Certificates*", DTC will cause its custodian to surrender the Rule 144A Global Note Certificate for exchange for Individual Certificates (which will bear the legend applicable to transfers pursuant to Rule 144A).

Payments through DTC

Payments of principal and interest in respect of a Global Note Certificate registered in the name of, or in the name of a nominee for, DTC will be made to the order of such nominee as the registered holder of such Note.

Book-Entry Ownership

Euroclear and Clearstream, Luxembourg

The Regulation S Global Note Certificate evidencing Regulation S Notes will have an ISIN and a Common Code and will be registered in the name of a nominee for, and deposited with a common depositary on behalf of, Euroclear and Clearstream, Luxembourg.

The address of Euroclear is 1 Boulevard du Roi Albert 11, B-1210 Brussels, Belgium, and the address of Clearstream, Luxembourg is 42 Avenue J.F. Kennedy, L-1855, Luxembourg.

DTC

The Rule 144A Global Note Certificate evidencing the Rule 144A Notes will have an ISIN, Common Code and a CUSIP number and will be deposited with a custodian (the "Custodian") for, and registered in the name of Cede & Co. as nominee of, DTC. The Custodian and DTC will electronically record the principal amount of the Notes held within the DTC System.

The address of DTC is 55 Water Street, New York, New York 10041, United States of America.

Relationship of Participants with Clearing Systems

Each of the persons shown in the records of DTC, Euroclear or Clearstream, Luxembourg as the holder of a Note evidenced by a Global Note Certificate must look solely to DTC, Euroclear or Clearstream, Luxembourg (as the case may be) for its share of each payment made by the Republic to the holder of such Global Note and in relation to all other rights arising under such Global Note Certificate, subject to and in accordance with the respective rules and procedures of DTC, Euroclear or Clearstream, Luxembourg (as the case may be). The Republic expects that, upon receipt of any payment in respect of Notes evidenced by a Global Note Certificate, the common depositary by whom such Note is held, or nominee in whose name it is registered, will immediately credit the relevant Participants' or accountholders' accounts in the relevant clearing system with payments in amounts proportionate to their respective beneficial interests in the principal amount of the relevant Global Note Certificate as shown on the records of the relevant common depositary or its nominee. The Republic also expects that payments by Direct Participants in any clearing system to owners of beneficial interests in any Global Note Certificate held through such Direct Participants in any clearing system will be governed by standing instructions and customary practices. Save as aforesaid, such persons shall have no claim directly against the Republic in respect of payments due on the Notes for so long as the Notes are evidenced by such Global Note Certificate and the obligations of the Republic will be discharged by payment to the registered holder of such Global Note Certificate in respect of each amount so paid. None of the Republic, the Fiscal Agent or any other Paying and Transfer Agent will have any responsibility or liability for any aspect of the records relating to or payments made on account of ownership interests in any Global Note Certificate or for maintaining, supervising or reviewing any records relating to such ownership interests.

Settlement and Transfer of Notes

Subject to the rules and procedures of each applicable clearing system, purchases of Notes held within a clearing system must be made by or through Direct Participants, which will receive a credit for such Notes on the clearing system's records. The ownership interest of each actual purchaser of each such Note (the "**Beneficial Owner**") will in turn be recorded on the Direct and Indirect Participants' records.

Beneficial Owners will not receive written confirmation from any clearing system of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which such Beneficial Owner entered into the transaction.

Transfers of ownership interests in Notes held within the clearing system will be effected by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates evidencing their ownership interests in such Notes, unless and until interests in any Global Note Certificate held within a clearing system are exchanged for Individual Certificates.

No clearing system has knowledge of the actual Beneficial Owners of the Notes held within such clearing system and their records will reflect only the identity of the Direct Participants to whose accounts such Notes are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers. Conveyance of notices and other communications by the clearing systems to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

The laws of some jurisdictions may require that certain persons take physical delivery in definitive form of securities. Consequently, the ability to transfer interests in a Global Note Certificate to such persons may be limited. As DTC can only act on behalf of Direct Participants, who in turn act on behalf of Indirect Participants, the ability of a person having an interest in a Rule 144A Global Note Certificate to pledge such interest to persons or entities that do not participate in DTC, or otherwise take actions in respect of such interest, may be affected by a lack of a physical certificate in respect of such interest.

Trading between Euroclear and/or Clearstream, Luxembourg Participants

Secondary market sales of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg to purchasers of book-entry interests in the Notes held through Euroclear or Clearstream, Luxembourg will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream, Luxembourg and will be settled using the procedures applicable to conventional Euronotes.

Trading between DTC Participants

Secondary market sales of book-entry interests in the Notes between DTC Participants will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to United States corporate debt obligations in DTC's Same-Day Funds Settlement system in same-day funds, if payment is effected in US dollars, or free of payment, if payment is not effected in US dollars. Where payment is not effected in US dollars, separate payment arrangements outside DTC are required to be made between the DTC participants.

Trading between DTC seller and Euroclear/Clearstream, Luxembourg Purchaser

When book-entry interests in Notes are to be transferred from the account of a DTC Participant holding a beneficial interest in the Rule 144A Global Note Certificate to the account of a Euroclear or Clearstream, Luxembourg accountholder wishing to purchase a beneficial interest in the Regulation S Global Note Certificate (subject to the certification procedures provided in the Agency Agreement), the DTC participant will deliver instructions for delivery to the relevant Euroclear or Clearstream, Luxembourg accountholder to DTC by 12 noon, New York time, on the settlement date. Separate payment arrangements are required to be made between the DTC Participant and the relevant Euroclear or Clearstream, Luxembourg Participant. On the settlement date, the custodian of the Rule 144A Global Note Certificate will instruct the Registrar to (i) decrease the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note Certificate and (ii) increase the amount of Notes registered in the name of the nominee of the common depositary for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note Certificate. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, Luxembourg, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

Trading between Euroclear/Clearstream, Luxembourg seller and DTC Purchaser

When book-entry interests in the Notes are to be transferred from the account of a Euroclear or Clearstream, Luxembourg accountholder to the account of a DTC Participant wishing to purchase a beneficial interest in the Rule 144A Global Note Certificate (subject to the certification procedures provided in the Agency Agreement), the Euroclear or Clearstream, Luxembourg Participant must send to Euroclear or Clearstream, Luxembourg delivery free of payment instructions by 7.45 p.m., Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, Luxembourg, as the case may be, will in turn transmit appropriate instructions to the common depositary for Euroclear and Clearstream, Luxembourg and the Registrar to arrange delivery to the DTC Participant on the settlement date. Separate payment arrangements are required to be made between the DTC Participant and the relevant Euroclear or Clearstream, Luxembourg accountholder, as the case may be. On the settlement date, the common depositary for Euroclear and Clearstream, Luxembourg will (a) transmit appropriate instructions to the custodian of the Rule 144A Global Note Certificate who will in turn deliver such book-entry interests in the Notes free of payment to the relevant account of the DTC Participant and (b) instruct the Registrar to (i) decrease the amount of Notes registered in the name of the nominee of the common depositary for Euroclear and Clearstream, Luxembourg and evidenced by the Regulation S Global Note Certificate; and (ii) increase the amount of Notes registered in the name of Cede & Co. and evidenced by the Rule 144A Global Note Certificate.

Although DTC, Euroclear and Clearstream, Luxembourg have agreed to the foregoing procedures in order to facilitate transfers of beneficial interests in Global Note Certificates among Participants and accountholders of DTC, Euroclear and Clearstream, Luxembourg, they are under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Republic, the Fiscal Agent or any other Paying and Transfer Agent will have any responsibility for the performance by DTC, Euroclear, Clearstream, Luxembourg or their respective Direct or Indirect Participants of their respective obligations under the rules and procedures governing their operations.

Settlement of Pre-issue Trades

It is expected that delivery of Notes will be made against payment therefor on the Issue Date, which could be more than three business days following the date of pricing. Under Rule 15c6-1 under the Exchange Act, trades in the United States secondary market generally are required to settle within three business days ("**T+3**"), unless the parties to any such trade expressly agree otherwise.

Accordingly, purchasers who wish to trade Notes in the United States on the date of pricing or the next succeeding business days until three days prior to the Issue Date will be required, by virtue of the fact the Notes initially will settle beyond T+3, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Settlement procedures in other countries will vary.

Purchasers of Notes may be affected by such local settlement practices and purchasers of Notes between the relevant date of pricing and the Issue Date should consult their own advisers.

TAXATION

The following is a summary of certain tax consequences resulting from the purchase, ownership and disposition of the Notes and is not intended to reflect the individual tax position of any beneficial owner. This summary is based upon the laws, regulations, rulings and decisions now in effect, all of which are subject to change.

Persons considering the purchase of the Notes should consult their own tax advisers concerning the application of Azerbaijani tax laws to their particular situations as well as any consequences of the purchase, ownership and disposition of the Notes arising under the laws of any other taxing jurisdiction.

Such laws and regulations are subject to change or varying interpretations, possibly with retroactive effect. As with other areas of Azerbaijani legislation, tax law and practice in Azerbaijan is not as clearly established as that of more developed jurisdictions. It is possible, therefore, that changes may be made in the law or in the current interpretation of the law or current practice, including changes that could have a retroactive effect. Accordingly, it is possible that payments to be made to the holders of the Notes could become subject to taxation in ways that cannot be anticipated as at the date of this Prospectus.

Azerbaijani Tax

Under existing Azerbaijani laws and regulations, payments of principal and interest on the Notes to non-residents of the Republic of Azerbaijan, as well as any capital gain realised on disposal, sale, exchange or transfer thereof by non-residents of the Republic of Azerbaijan is not subject to taxation in Azerbaijan, so no withholding or any other Azerbaijani tax applies to any such payment and gain as of the date hereof. There are no stamp duties or registration or other taxes payable in Azerbaijan in connection with any transfer of the Notes.

EU Savings Directive

On 3 June 2003, the European Council of Economics and Finance Ministers adopted the EU Savings Directive. Pursuant to the EU Savings Directive and subject to a number of conditions being met, Member States are required, since 1st July 2005, to provide to the tax authorities of another Member State, inter alia, details of payments of interest within the meaning of the EU Savings Directive (interest, premium or other debt income) made by a paying agent located within its jurisdiction to, or for the benefit of, an individual resident in that other Member State or to certain limited types of entities established in that other Member State (the "**Disclosure of Information Method**").

For these purposes, the term "**paying agent**" is defined widely and includes in particular any economic operator who is responsible for making interest payments, within the meaning of the Savings Directive, for the immediate benefit of individuals.

However, during a transitional period, certain Member States (the Grand-Duchy of Luxembourg and Austria), instead of using the Disclosure of Information Method used by other Member States (unless the relevant beneficial owner elects for the Disclosure of Information Method, or unless the Member State elects otherwise during this transitional period) withhold an amount on interest payments. The rate of such withholding tax is currently 35%.

This transitional period will end at the end of the first full fiscal year following the later of (i) the date of entry into force of an agreement between the European Community, following a unanimous decision of the European Council, and the last of Switzerland, Liechtenstein, San Marino, Monaco and Andorra, providing for the exchange of information upon request as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released on 18 April 2002 (the "**OECD Model Agreement**") with respect to interest payments within the meaning of the Savings Directive and the simultaneous application by those same countries of a withholding tax on such payments at the rate applicable for the corresponding periods mentioned above and (ii) the date on which the European Council unanimously agrees that the United States of America is committed to exchange of information upon request as defined in the OECD Model Agreement with respect to interest payments within the meaning of the EU Savings Directive.

In April 2013, the Luxembourg Government announced its intention to abolish the withholding system with effect from 1 January 2015, in favour of automatic information under the EU Savings Directive.

A number of non-EU countries and dependent or associated territories have agreed to adopt similar measures (transitional withholding or exchange of information) with effect since 1 July 2005.

The European Commission has proposed certain amendments to the EU Savings Directive which may, if implemented, amend or broaden the scope of the requirements described above.

Pursuant to the terms and conditions of the Notes, if a payment under a Note were to be made or collected through a Member State which has opted for a withholding system under the EU Savings Directive and an amount of, or in respect of, tax is withheld from that payment, neither the Republic nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Notes, as a result of the imposition of such withholding tax. The Republic will be required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the EU Savings Directive.

US Federal Income Taxation

The following is a description of the principal US federal income tax consequences of the acquisition, ownership, disposition and retirement of Notes by a US Holder (as defined below) thereof. This description only applies to Notes held by a US Holder as capital assets and does not address, except as set forth below, aspects of US federal income taxation that may be applicable to holders that are subject to special tax rules, such as: certain financial institutions; insurance companies; real estate investment trusts; regulated investment companies; grantor trusts; tax-exempt organisations; persons that will own Notes through partnerships or other pass through entities; dealers or traders in securities or currencies; holders that have a functional currency other than the US dollar; certain former citizens and long-term residents of the United States; or holders that will hold a Note as part of a position in a straddle or as part of a hedging, conversion or integrated transaction for US federal income tax purposes.

Moreover, this description does not address the US federal estate and gift tax or alternative minimum tax consequences of the acquisition, ownership, disposition or retirement of Notes or the Medicare surtax on "**net investment income**", and does not address the US federal income tax treatment of holders that do not acquire Notes as part of the initial distribution at their initial issue price. Each prospective purchaser should consult its tax adviser with respect to the US federal, state, local and foreign tax consequences of acquiring, holding and disposing of Notes.

This description is based on the Internal Revenue Code of 1986, as amended (the "**Code**"), final, temporary and proposed US Treasury Regulations, administrative pronouncements and judicial decisions, each as available and in effect on the date hereof. All of the foregoing are subject to change, possibly with retroactive effect, or differing interpretations which could affect the tax consequences described herein.

For purposes of this description, a US Holder is a beneficial owner of Notes who for US federal income tax purposes is: (i) a citizen or resident of the United States; (ii) a corporation organised in or under the laws of the United States or any state thereof, including the District of Columbia; (iii) an estate the income of which is subject to US federal income taxation regardless of its source; or (iv) a trust (A) that validly elects to be treated as a US person for US federal income tax purposes or (B)(1) the administration over which a US court can exercise primary supervision and (2) all of the substantial decisions of which one or more US persons have the authority to control.

If a partnership (or any other entity treated as a partnership for US federal income tax purposes) holds the Notes, the tax treatment of the partnership and a partner in such partnership generally will depend on the status of the partner and the activities of the partnership. Such partner or partnership should consult its own tax adviser as to its consequences.

Internal Revenue Service Circular 230 Disclosure

Pursuant to Internal Revenue Service Circular 230, the Republic hereby informs each taxpayer that the description set forth herein with respect to US federal tax issues was not intended or written to be used, and such description cannot be used, by any taxpayer for the purpose of avoiding any penalties that may be imposed on the taxpayer under the US Internal Revenue Code. Such description was written to support the promotion or marketing of the Notes. Taxpayers should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

Interest

It is expected and this discussion assumes that the Notes will be issued with no more than a *de minimis* amount of original issue discount. Therefore, interest paid to a US Holder on a Note, including any additional amounts with respect thereto as described under *"Terms and Conditions of the Notes— Taxation* " will be includible in such holder's gross income as ordinary interest income at the time it accrues or is received, in accordance with such holder's usual method of tax accounting. In addition, interest on the Notes will be treated as foreign source income for US federal income tax purposes which may be relevant to certain holders in calculating their foreign tax credit limitation. US Holders should consult their own tax advisers regarding the availability of foreign tax credits.

Sale, Exchange or Retirement

Upon the sale, exchange or retirement of a Note a US Holder will recognise taxable gain or loss equal to the difference, if any, between the amount realised on the sale, exchange or retirement, other than accrued but unpaid interest which will be taxable as such to the extent not previously included as income, and such holder's adjusted tax basis in the Note. A US Holder's adjusted tax basis in a Note generally will equal the cost of the Note to such holder. Any gain or loss recognised on the sale, exchange or retirement of a Note will be capital gain or loss. In the case of a non-corporate US Holder, the maximum marginal US federal income tax rate applicable to the gain will be lower than the maximum marginal US federal income tax rate generally applicable to ordinary income if such holder's holding period for the Notes exceeds one year (i.e., such gain is long-term capital gain). Any gain or loss realised on the sale, exchange or retirement of a Note generally will be treated as US source gain or loss, as the case may be. The deductibility of capital losses is subject to limitations under the Code.

US Backup Withholding Tax and Information Reporting

Backup withholding tax and information reporting requirements apply to certain payments of principal of, and interest on, an obligation and to proceeds of the sale or redemption of an obligation, to certain non-corporate holders of Notes that are US persons. The payor will be required to withhold backup withholding tax on payments made within the United States, or by a US payor or US middleman, on a Note to a holder of a Note that is a US person, other than an exempt recipient, such as a corporation, if the holder fails to furnish its correct taxpayer identification number or otherwise fails to comply with, or establish an exemption from, the backup withholding requirements. The backup withholding tax rate is currently 28%.

Backup withholding is not an additional tax. A holder generally will be entitled to credit any amounts withheld under the backup withholding rules against such holder's US federal income tax liability provided the required information is furnished to the Internal Revenue Service in a timely manner.

Foreign Asset Reporting

Certain US Holders who are individuals are required to report information relating to an interest in the Notes, subject to certain exceptions (including an exception for Notes held in accounts maintained by US financial institutions). US Holders are urged to consult their tax advisors regarding their information reporting obligations, if any, with respect to their ownership and disposition of the Notes.

The above description is not intended to constitute a complete analysis of all tax consequences relating to the ownership of Notes. Prospective purchasers of Notes should consult their own tax advisers concerning the tax consequences of their particular situations.

SUBSCRIPTION AND SALE

Barclays Bank PLC, Citigroup Global Markets Limited, Deutsche Bank AG, London Branch and BNP Paribas (the "**Managers**") have, in a subscription agreement dated 13 March 2014 (the "**Subscription Agreement**") and made between the Republic and the Managers upon the terms and subject to the conditions contained therein, agreed to subscribe and pay for the Notes at their issue price of 98.051 per cent. of their principal amount less a combined management, underwriting and selling commission of 0.05 per cent. of their principal amount. The Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

United States

The Notes have not been and will not be registered under the Securities Act, the securities laws of any State or other jurisdiction of the United States. Each Manager has represented and agreed that the Notes may not be offered or sold in the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

The Subscription Agreement provides that the Managers may, directly or through their respective US broker-dealer affiliates, arrange for the offer and resale of Notes within the United States only to QIBs in reliance on Rule 144A.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

United Kingdom

Each Manager has represented, warranted and agreed that:

(a) (i) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (ii) it has not offered or sold and will not offer or sell the Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the FSMA by the Republic; and

(b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Republic; and

(c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Republic of Ireland

Each Manager has agreed that:

(a) it will not underwrite the issue of or place the Notes, otherwise than in conformity with the provisions of the Irish European Communities (Markets in Financial Instruments) Regulations 2007 (Nos. 1 to 3), including without limitation, Regulations 7 and 152 thereof or any codes of conduct used in connection therewith;

(b) it will not underwrite the issue of or place the Notes, otherwise than in conformity with the provisions of the Irish Central Bank Acts 1942 - 1999 (as amended) and any codes of conduct rules made under Section 117(1) thereof;

(c) it will not underwrite the issue of, or place or do anything in Ireland in respect of the Notes otherwise than in conformity with the provisions of the Irish Prospectus (Directive 2003/71/EC) Regulations 2005 and any rules issued under Section 51 of the Irish Investment Funds, Companies and Miscellaneous Provisions Act 2005, by the Irish Central Bank and Financial Services Regulatory Authority (the "**Financial Regulator**"); and

(d) it will not underwrite the issue of, place or otherwise act in Ireland in respect of the Notes, otherwise than in conformity with the provisions of the Irish Market Abuse (Directive 2003/6/EC) Regulations 2005 and any rules issued under Section 34 of the Irish Investment Funds, Companies and Miscellaneous Provisions Act 2005 by the Financial Regulator.

Russian Federation

Each Manager has represented and agreed that it has not offered or sold or transferred or otherwise disposed of, and will not offer or sell or transfer or otherwise dispose of, any Notes (as part of their initial distribution or at any time thereafter) to, or for the benefit of, any persons (including legal entities) resident, incorporated, established or having their usual residence in the Russian Federation, or to any person located within the territory of the Russian Federation, unless and to the extent otherwise permitted under Russian law.

Switzerland

The Notes may be offered in Switzerland on the basis of a private placement, not as a public offering. The Notes will neither be listed on the SIX Swiss Exchange nor are they subject to Swiss law. This Prospectus therefore neither constitutes a prospectus within the meaning of Art. 652a and 1156 of the Swiss Federal Code of Obligations or Arts. 32 et seq. of the Listing Rules of the SIX Swiss Exchange, nor does it comply with the Directive for Notes of Foreign Borrowers of the Swiss Bankers Association.

Turkey

This Prospectus does not constitute an offer of securities to the public in Turkey. Neither this Prospectus nor any other offering or marketing material related to the offering of the Notes may be utilized in connection with any general offering to the public within the Republic of Turkey without the approval of the Capital Markets Board of Turkey (the "**CMB**"). Pursuant to Article 15(d)(ii) of Decree No. 32 regarding the Protection of the Value of the Turkish Currency, the purchase and sale of the Notes by residents of Turkey must be conducted by the banks and/or licensed intermediary institutions authorized pursuant to the CMB regulations.

The Republic of Azerbaijan

Persons resident in Azerbaijan may acquire Notes as long as the sales take place outside Azerbaijan and any Manager may sell Notes on a private placement basis to a limited number of investors resident in Azerbaijan.

General

No action has been or will be taken in any jurisdiction by the Republic or the Managers that would, or is intended to, permit a public offering of the Notes, or possession or distribution of this Prospectus or any other offering material, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Prospectus comes are required by the Republic and the Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Prospectus or any other offering material relating to the Notes, in all cases at their own expense.

TRANSFER RESTRICTIONS

Each purchaser of Rule 144A Notes, by accepting delivery of this Prospectus and the Notes, will be deemed to have represented, agreed and acknowledged that:

1. It is (a) a QIB, (b) acting for its own account, or for the account of a QIB, (c) not formed for the purpose of investing in the Republic, and (d) aware, and each beneficial owner of such Notes has been advised, that the sale of such Notes to it is being made in reliance on Rule 144A.

2. It understands that the Rule 144A Notes have not been and will not be registered under the Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB or (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S under the Securities Act, in each case in accordance with any applicable securities laws of any State or another jurisdiction of the United States.

3. It understands that the Rule 144A Notes, unless otherwise agreed between the Republic and the Fiscal Agent in accordance with applicable law, will bear a legend to substantially the following effect:

   THIS NOTE HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE US SECURITIES ACT OF 1933 (THE "**SECURITIES ACT**") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE SECURITIES ACT ("**RULE 144A**") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A, THAT IS ACQUIRING THIS NOTE FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT, (3) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER, IF AVAILABLE, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 FOR RESALES OF THE NOTES.

4. It acknowledges that the Republic, the Registrar, the Managers and their affiliates, and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Rule 144A Notes is no longer accurate, it shall promptly notify the Republic and the Managers. If it is acquiring any Notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each of those accounts and that it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each account.

5. It understands that the Rule 144A Notes will be evidenced by the Rule 144A Global Note Certificate. Before any interest in a Rule 144A Global Note Certificate may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in a Regulation S Global Note Certificate, it will be required to provide a Paying and Transfer Agent with a written certification (in the form provided in the Agency Agreement) as to compliance with applicable securities laws.]

GENERAL INFORMATION

1. Clearing Systems

The Notes have been accepted for clearance through Euroclear, Clearstream, Luxembourg and DTC. The Common Code and ISIN for the Regulation S Notes and the Common Code, ISIN and CUSIP number for the Rule 144A Notes are as follows:

Regulation S Notes
Common Code: 104454054
ISIN: XS1044540547

Rule 144A Notes
Common Code: 104654703
ISIN: US05477LAA44
CUSIP: 05477LAA4

2. Admission to Trading

Arthur Cox Listing Services Limited is acting solely in its capacity as listing agent for the Republic in relation to the Notes and is not itself seeking admission of the Notes to the Official List of the Irish Stock Exchange or to trading on the regulated market of the Irish Stock Exchange for the purposes of the Prospectus Directive.

It is expected that admission of the Notes to the Official List and to trading on the Market will be granted on 18 March 2014 (or the next business day), subject only to the issue of the Global Note. Transactions will normally be effected for settlement in US Dollars and for delivery on the third working date after the day of the transaction.

3. Authorisation

The creation and issue of the Notes has been authorised by Azerbaijan, acting through the Ministry of Finance of Azerbaijan.

4. Litigation

Except for the matter disclosed on page 31 of this Prospectus, the Republic is not and has not been involved in any Governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Republic is aware) during the previous 12 months which may have, or have had in the recent past, a significant effect on the Republic's financial position.

5. Address

The address of the Republic is: The Republic of Azerbaijan, (acting through the Ministry of Finance of the Republic of Azerbaijan), 83 Samed Vurgun Street, Baku 1022, Republic of Azerbaijan. The telephone number of the Issuer is +994 493 81 03.

6. Significant Change

There has been no significant change in relation to the Republic's (i) tax and budgetary systems, (ii) gross public debt, (iii) foreign trade and balance of payment figures, (iv) foreign exchange reserves, (v) financial position and resources and (vi) income and expenditure figures of the Republic since the fiscal year ended 31 December 2013.

7. Documents available for inspection

For so long as any of the Notes are outstanding, electronic copies of the following documents may be inspected (and in the case of (a), obtainable) during normal business hours at the Specified Office of each Fiscal Agent:

(a) this Prospectus;

(b) the Fiscal Agency Agreement;

(c) the Deed of Covenant; and

(d) the Budget for the year ending 31 December 2014.

8. Azerbaijani Taxation

As more particularly described in "*Taxation - Azerbaijani Tax*", there are no Azerbaijani withholding taxes levied on payments of principal or interest in respect of the Notes paid to foreign tax residents.

9. Interested Persons

No person involved in the offering of the Notes (the "**Offering**") has any interest in the Offering which is material to the Offering.

10. Estimated Expenses

The estimate of the total expenses related to admission to trading is €5,000.

11. Managers Transacting with the Republic

Certain of the Managers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for, the Republic in the ordinary course of business.

12. Language

The language of the Prospectus is English. Certain legislative references and technical terms have been cited in their original language in order that the correct technical meaning may be ascribed to them under applicable law.

THE REPUBLIC

Ministry of Finance of the Republic of Azerbaijan
83 Samed Vurgun Street
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CO-MANAGER

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United Kingdom

REGISTRAR, PAYING AGENT AND TRANSFER AGENT

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Trust and Agency Services
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REGISTRAR AND TRANSFER AGENT

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