

**NATIONAL BANK OF THE REPUBLIC OF MACEDONIA**  
**Financial Stability, Banking Regulations and Methodology Department**



***Report on Banking System and Banking Supervision of the  
Republic of Macedonia in 2007***

*May, 2008*

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## **Governor's foreword**

We can view the year behind us as extremely favorable for the operations of the banks in the Republic of Macedonia. The banking system continued to develop intensively, however managing to maintain the stability and resilience to external factors. Of course, favorable macroeconomic environment, which marked especially the first half of 2007, contributed to that end. The continuous strengthening of the confidence in the banking system and the increased propensity to save were manifested with further growth of the banks' deposit base. Banks used the largest portion of these sources of funds for strengthening the credit support for the private sector and, ultimately, for the economic growth in the country. This increased and deepened the role of the banks as financial intermediaries, which led to narrowing the gap in the level of financial intermediation between the Republic of Macedonia and the EU countries.

During 2007, foreign investors increased their interest in investing in the banking system. This contributed to a significant rise in the share of foreign capital in the total capital at the level of the banking system, as well as to a qualitative improvement of the shareholders' structure of banks. Financial institutions, primarily foreign banks, strengthened their dominant position in the shareholders' structure of the banks in the Republic of Macedonia.

Competition among banks strengthened, which led to introduction of new financial products of higher quality. At the same time, during 2007, banks' interest spread continued to narrow, which is another indicator of the increased competition and improved efficiency in their operations. During 2007, banks' productivity significantly increased. Thus, for the first time, the profit per employee at the level of the banking system was higher than the average annual cost per employee.

The significant growth of the banks' profit for 2007 provided for an increase in the return for their shareholders through payment of dividends, and possibility for increasing the capital, which on its part provides basis for further fast growth and higher level of security and stability in future operations.

The increased scope of activities, primarily the strengthened credit activity of banks did not cause serious deterioration of their risk profile. Banks' credit risk remained dominant in their operations. Other risks are less significant in the structure of the banks' risks. By using protective clauses, such as the foreign exchange clause and the adjustable interest rates, the amount of which depends on the decision of the bank's competent bodies, rather than on the amount of a determined reference interest rate, banks actually transfer the exchange rate risk and the interest rate risk to the real sector. Thus, they did not fully eliminate the risks in the operations, but on the contrary, they were transformed into a credit risk.

The increased credit activity, especially with households, accompanied with certain easing of the banks' lending conditions, is still manifested with the first signs of increasing the risk level of certain credit products, such as the consumer credits, credit cards and overdrafts on the basis of current accounts.

However, the existing level of banks' capital position fully covers the identified risks. Banks' solvency remains relatively high, despite the continuous trend of reducing the capital adequacy as a consequence of the increased level of their activities.

However, regardless of the favorable developments in the banking system, the National Bank of the Republic of Macedonia closely monitors the situation in the banking system. This attention is even more studious if one has in mind the turbulences on the international financial markets and the uncertainty caused by the movements of the international interest rates, as well as the increased inflationary pressures in the Republic of Macedonia at the end of 2007. All this could have negative consequences for profitability, or increase the risks related to the credit portfolio quality and failing to achieve the desired growth of the banks' scope of activities.

Ladies and Gentlemen,

We will remember the year behind us also by the complete revision of the regulatory framework pertaining to banks' operations and conduct of the supervisory function. Banks are facing a serious challenge for compliance with the new regulatory requirements, especially related to the new accounting framework, risk management and increased transparency in their operations. In this respect, the National Bank will also continue to increase its own institutional capacity in order to react timely and appropriately to the new challenges.

Petar Goshev, Msc.  
Governor and President  
of the NBRM Council

## I. BANKING SYSTEM IN 2007<sup>1</sup>

### 1. Structure of the banking system

#### 1.1. Number of banks and savings houses

**As of December 31, 2007, the banking system of the Republic of Macedonia comprised of eighteen banks and twelve savings houses.** In the second half of 2007, the founding and operating license of "Makedonska Banka" a.d. Skopje was revoked, whereby the number of banks reduced by one, relative to the end of 2006.

**Banks maintained their dominant position in the banking system, as opposed to the further marginalization of the role of the savings houses.** At the end of 2007, the share of the savings houses in the total gross-credits extended to non-financial entities and in the total households' deposits at the level of the banking system equaled 1.9% and 0.7%, respectively, which is a decline of 0.1 percentage point relative to the end of 2006. The share of savings houses in the total assets of the banking system remained unchanged compared with 2006, and equaled 1.3%.

Having in mind the insignificant role of the savings houses in the overall activities of the banking system, further analyses in this Report focus solely on the banks' operations. In order to obtain more comprehensive overview, the analysis of the operations of all banks is supplemented also with an analysis by group of banks. The principle of grouping the banks according to the size of their assets has been maintained, where large are considered those banks the assets of which exceed Denar 15 billion, the group of medium banks comprises the banks with assets ranging between Denar 4.5 and 15 billion, while the banks with assets lower than Denar 4.5 billion are included in the group of small banks. Structural changes, where one bank moved from the group of small to the group of medium banks, and one small bank was deprived of the founding and operating license, led to additional reduction of the low share of the group of small banks in the financial intermediation in the Republic of Macedonia, compared with December 31, 2006.

#### 1.2. Concentration and market share

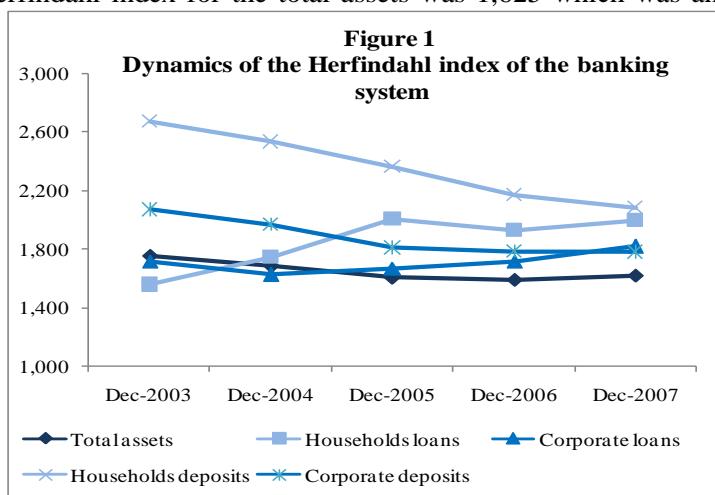
**Concentration in the banking system of the Republic of Macedonia remains relatively high and registers further increase in certain segments of banks' operations.** The group of large banks strengthened the dominant position on the banking market in the Republic of Macedonia, which led to further increase in the concentration level. The group of medium banks also continued to strengthen its market share, registering an increase in all segments, especially in the deposit activity. Relatively larger portion of the growth in the share of this group of banks in the total assets and total gross credits was due to the transfer of one bank from the group of small banks. As for the deposit activity, most of the increase in the share was caused by the strengthening of the role of the medium banks in real terms, within the deposit activity at the level of the banking system. On the other end, there was a significant further marginalization of the role of the group of small banks, according to all analyzed segments of banking operations.

**Table 1**  
**Market share of the individual groups of banks**

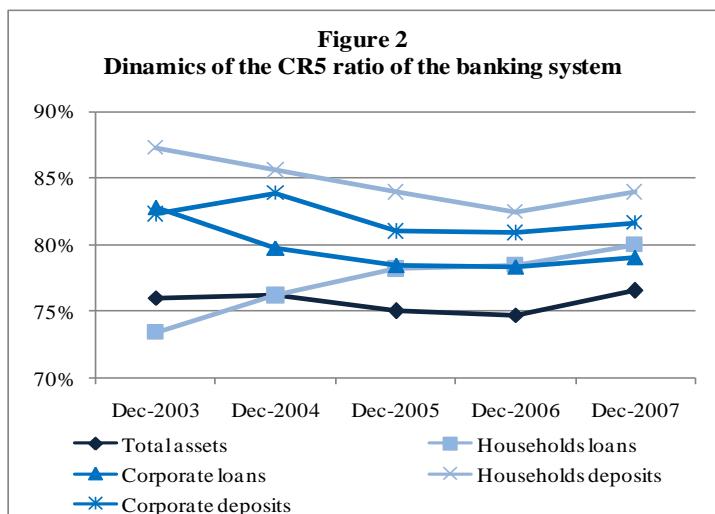
Groups of banks	Number of banks		Share in total assets		Share in total activities		Share in gross credits		Share in total deposits of non-financial entities	
	31.12.2006	31.12.2007	31.12.2006	31.12.2007	31.12.2006	31.12.2007	31.12.2006	31.12.2007	31.12.2006	31.12.2007
Large banks	3	3	66.1%	67.1%	68.1%	69.0%	69.2%	70.3%	71.8%	72.2%
Medium-size banks	7	8	23.8%	27.5%	22.4%	26.0%	24.1%	27.3%	21.2%	25.2%
Small-size banks	9	7	10.1%	5.4%	9.5%	5.0%	6.7%	2.4%	7.0%	2.6%
<b>Total</b>	<b>19</b>	<b>18</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>1</sup> The Annual Report presents data as received from the banks and data calculated by the National Bank of the Republic of Macedonia.

According to the Herfindahl index<sup>2</sup>, the level of concentration for all analyzed domains of banks' operations, except total assets and corporate deposits, is above the level which is generally considered acceptable. The highest level of concentration is present in the operations with households. Increased concentration is especially pronounced in the banks' total activities, where the downward trend common for the preceding four years, was redirected. As of December 31, 2007, the level of the Herfindahl index for the total assets was 1,625 which was an increase of 30 index points compared with December 31, 2006. At the same time, the Herfindahl index for household deposits equaled high 2,084, which, in spite of the decline relative to 2006 by 88 index points, is beyond the generally acceptable level of concentration. In the credit activity with the households, despite the relatively high level of the Herfindahl index of 2,001 points, at the end of 2007 the upward trend of concentration in this area, which started in the second half of 2006, was interrupted. However, the analysis by individual banks still indicates a very high level of concentration of household loans with one bank, of 37.4%. For comparison, the second largest share in the total credit activity with the households equaled 17.7%. Herfindahl index for the gross corporate credits continued its upward trend and on December 31, 2007 it reached the level of 1,819. This index, measured for the corporate deposits equaled 1,778 (11 index points lower relative to 2006), which is within the generally acceptable concentration level.



The analysis of the CR5<sup>3</sup> indicator points to almost identical conclusions about the relatively high level of concentration in the banking system. At the end of 2007, this indicator pointed to highest concentration of 82.3% with household deposits. The concentration level, from the viewpoint of the assets, equaled 74.4% and dropped by minimal 0.3 percentage points compared with December 31, 2006. The CR5 indicator for the household credits equaled 80.0% which is 1.5 percentage points higher compared with December 31, 2006.



<sup>2</sup> The Herfindahl index is calculated according to the equation  $HI = \sum_{j=1}^n (S_j)^2$ , where S denotes each bank's share in the

total amount of the analyzed category (for example: total assets, total deposits, etc.), while n denotes the total number of banks in the system. When the index ranges between 1,000 and 1,800 units, the level of concentration in the banking system is generally considered acceptable.

<sup>3</sup> The CR5 indicator represents the share of the assets (i.e. the category that is analyzed, e.g. corporate credits, corporate deposits, etc.) of the five credit institutions with largest assets (i.e. category that is analyzed) in the total assets (i.e. category that is analyzed) of the banking system. In the case of the Republic of Macedonia these are banks.

**Table 2**  
**Indicators of concentration and other structural features of the banking systems of individual EU Member States, the Republic of Macedonia and some countries in the region<sup>4</sup>**

Country	Herfindahl index for total assets*	CR5 indicator*	Citizens per credit institution	Citizens per ATM	Citizens per employee in the banking system	Citizens per branch	Assets per employee in the banking system (in thousands of Euros)
Republic of Macedonia (2007)	1,625	76.6	69,436	3,938	386	6,255	687
Republic of Macedonia (2006)	1,595	74.7	66,356	6,926	411	6,510	576
Poland	599	46.5	52,741	3,837	245	7,393	1,216
Czech Republic	1,106	64.1	179,725	3,122	271	5,458	3,034
Slovakia	1,131	66.9	224,622	2,704	275	4,588	2,125
Hungary	823	53.5	47,502	2,643	256	3,105	2,385
Slovenia	1,300	62	74,370	1,319	170	2,885	2,943
Lithuania	1,913	82.5	44,078	2,962	394	3,805	2,012
Latvia	1,271	69.2	84,752	2,404	196	3,751	1,947
Estonia	3,593	97.1	96,050	1,465	237	5,489	2,707
Malta	1,185	71.4	22,534	2,651	115	3,687	8,693
Cyprus	1,056	63.9	2,292	1,534	71	818	6,860
Bulgaria	707	50	239,978	2,090	287	1,379	834
Romania	1,165	60	553,353	3,605	369	4,828	873
<i>New Member states</i>	<b>1,398</b>	<b>67.7</b>	<b>48,877</b>	<b>3,058</b>	<b>243</b>	<b>4,954</b>	<b>2,083</b>
<i>EU</i>	<b>1,118</b>	<b>59.2</b>	<b>54,996</b>	<b>1,355</b>	<b>152</b>	<b>2,183</b>	<b>12,069</b>
<i>Eurozone</i>	<b>971</b>	<b>53.7</b>	<b>51,407</b>	<b>1,249</b>	<b>143</b>	<b>1,744</b>	<b>11,338</b>
Albania	1,949	75.2	185,365	6,806	752	10,718	1,203
Serbia	606	47.2	201,118	5,520	265	3,448	527
Croatia	1,294	76.7	134,468	1,604	220	3,855	2,205
Montenegro	2,042	80	65,000	396	5,242	871	

Source: ECB, EU Banking Structures, October 2007 and Central banks' web pages. The data for EU are for 2006, for Albania as of July 2006, for Montenegro as of December 2006, for Serbia as of December 2007, and for Croatia as of June 2007. New Member states do not include Bulgaria and Romania which joined the EU in 2008.

\*The data for the New Member states and the Eurozone are nonweighted averages.

**The relatively high level of concentration in the banking system is confirmed also by the comparative analysis with the banking systems of the EU countries.** The concentration level in all analyzed countries (on the level of the EU, Euro area and the new EU Member States), except in Estonia and Lithuania, was on a lower level compared with the banking system of the Republic of Macedonia. Among the selected countries in the region, the banking system of the Republic of Macedonia has a higher level of concentration (expressed through the value of the Herfindahl index for the assets) compared with the banking systems of Serbia and Croatia, and lower level of concentration compared with Albania and Montenegro. On the other hand, the CR5 indicator indicates concentration levels that are relatively close to those in the banking systems of Albania, Croatia and Montenegro, while according to the same indicator, there is a much lower concentration level in the banking system of Serbia.

**Households' access to bank services in the Republic of Macedonia improves. However, there is a room for further consolidation and increase in the activities of the banking system of the Republic of Macedonia.** The comparison of the banking system of the Republic of Macedonia according to other structural features, indicates its convergence toward the banking systems of the other countries, especially the new EU Member States and the countries which became EU Members at the beginning of 2008. The main indicators of the households' access to the banking services register improvement. Such movements are especially present in the indicator of the average number of individuals using the services of an ATM, which comes as a result of the continuous spreading of the ATM network throughout the Republic of Macedonia. The comparison with the banking systems of the countries from the region indicates almost the same level of households' access to the banking services with Montenegro, relatively better access compared with Albania and lower level of access to these services relative to Serbia and Croatia. As of December 31, 2007, one employee in the banking system of the Republic of Macedonia generates Euro 687.000, on average, while one employee in the banks of all EU Member States generates Euro 12.1 million, on average. According to the same indicator, the banking system in the Republic of Macedonia is on a relatively lower level also in comparison with the banking systems of the countries from the region, except the banking system of Serbia.

<sup>4</sup> Source: National Bank of the Republic of Macedonia and Report on the EU Banking Structures (ECB), October 2007.

### 1.3. Ownership structure of the banking system

#### 1.3.1. Shareholders' structure of the banking system according to the type of shareholders

**During 2007, financial institutions strengthened their position as dominant owners of the banks in the Republic of Macedonia.** Thus, as of December 31, 2007, financial institutions<sup>5</sup> participated with 60.4% in the ownership structure of the common shares issued by the banks, which is an increment of 16.4 percentage points relative to end 2006. The increase was accomplished at the expense of the lower share of the non-financial legal entities by 14.7 percentage points. The main reason for such shifts in the ownership structure was the acquisition of several existing banks by foreign strategic investors<sup>6</sup>. Natural persons are dominant in the ownership structure of the preference shares issued by the banks in the Republic of Macedonia, with a share of 51.4%.

**Table 3**

**Ownership structure of the banking system according to the type of shareholders**

No.	Type of shareholders	Share in common shares			Share in preferred shares		
		31.12.2005	31.12.2006	31.12.2007	31.12.2005	31.12.2006	31.12.2007
1	Natural persons	10,4%	11,7%	10,5%	64,7%	52,9%	51,4%
2	Non-finansial legal enteties	41,4%	36,7%	22,0%	21,6%	14,9%	12,8%
3	Financial institutions	39,2%	44,0%	60,4%	11,7%	31,0%	35,1%
4	Public sector, public enterprises, public institutions and social organizations	8,4%	7,0%	6,7%	1,9%	0,1%	0,1%
5	Undefined status	0,6%	0,6%	0,4%	0,1%	1,1%	0,6%
<b>Total (1+2+3+4+5)</b>		<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>	<b>100,0%</b>
<b>Total private capital (1+2+3+5)</b>		<b>91,6%</b>	<b>93,0%</b>	<b>93,3%</b>	<b>98,1%</b>	<b>99,9%</b>	<b>99,9%</b>

Note: the term "undefined status" inter alia, covers the shareholders where the bankruptcy or liquidation procedure is completed or shareholders that the banks cannot identify.

**Additional factor which influenced the increased share of the financial institutions in the banks' shareholding structures was the continuous interest of the institutional investors in trading with the shares of the banks quoted on the official market of the Macedonian Stock Exchange<sup>7</sup>.** The increased interest of the foreign institutional investors was a result of the general rise in the prices of the shares on the Macedonian Stock Exchange, recognition of the improved profitability of banks, as well as the increased economic growth in the country, which is expected to continue in the future.

**The increased interest of the foreign institutional investors, but also of the domestic natural persons in trading with banks' shares, enabled an increase in their market capitalization, which was especially evident in the first half of 2007.** However, in the last quarter of 2007, the global process of correction of price levels on the financial markets worldwide reflected on the price levels of the shares in the Republic of Macedonia. Despite the improved profitability of the banking system, this process of price correction implicitly influenced the downward correction of the prices of shares of the Macedonian banks, which was followed by a certain decline in their market capitalization. Additional element which induced the price correction of banks' shares were also some

<sup>5</sup> The following are considered to be financial institutions: domestic and foreign banks, domestic and foreign brokerage houses, investment funds, pension funds, pension funds or investment funds management companies, insurance companies, as well as the international financial institutions (EBRD, IFC, etc.) which appear as owners of shares issued by the banks in the Republic of Macedonia.

<sup>6</sup> During 2007, "Ohridska Banka" a.d. Ohrid was acquired by "Societe Generale" s.a. Paris, "Komercijalno Investicciona Banka" a.d. Kumanovo was acquired by "Milestone" ehf. Reykjavik and "Internacionalna Privatna Banka" a.d. Skopje was acquired by "Alfa Finance Holding" Sofia, upon which it was renamed into "Kapital Banka" a.d. Skopje.

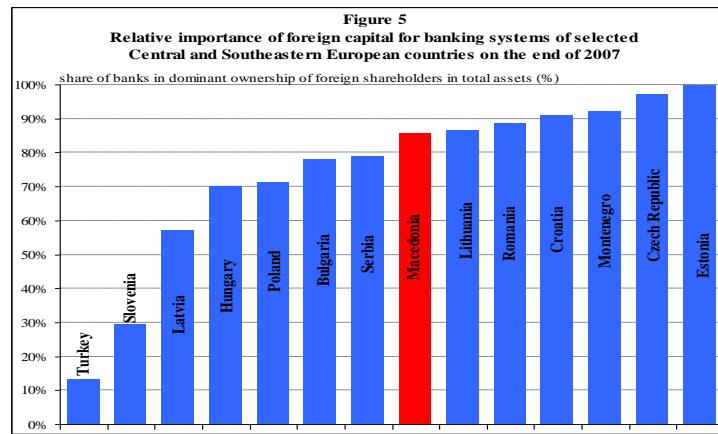
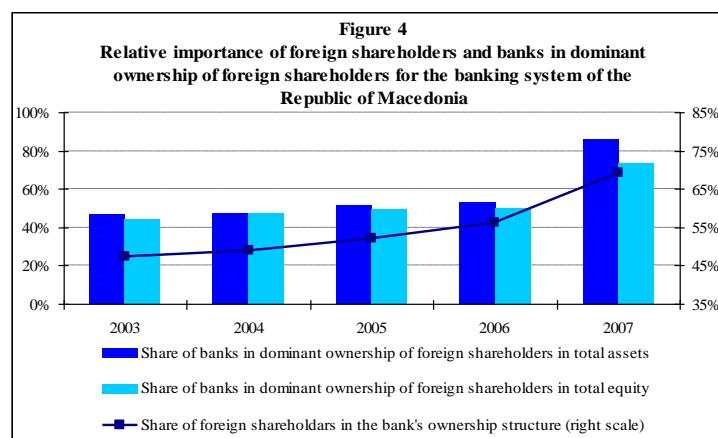
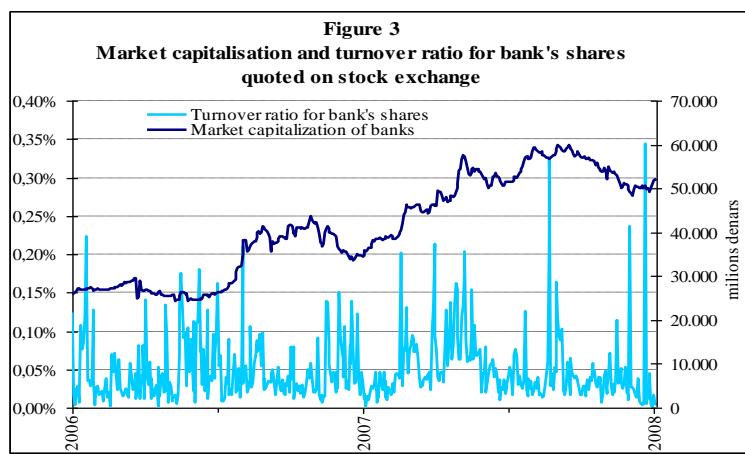
<sup>7</sup> The shares of "Investbanka" a.d. Skopje, "Komercijalno Investicciona Banka" a.d. Kumanovo, "Komercijalna Banka" a.d. Skopje, "Ohridska Banka" a.d. Ohrid, "Stopanska Banka" a.d. Bitola and "TTK Banka" a.d. Skopje are listed on the official market of the Macedonian Stock Exchange. Starting from February 2007, and in line with the change in the rules for quotation on the Stock Exchange, two of these banks ("Investbanka" a.d. Skopje and "Komercijalna Banka" a.d. Skopje) are being listed on the newly established special market segment, the so-called superquotation. On the unofficial market, in the market segment of public companies, the shares issued by "NLB Tutunska Banka" a.d. Skopje, "Sileks Banka" a.d. Skopje, "Stopanska Banka" a.d. Skopje and "UNI Banka" a.d. Skopje are being traded (starting from March 2007)..

internal factors, common for the Macedonian capital market, primarily the low market liquidity, the concentration of the portfolio investors with same geographical origin and similar investment inclinations, as well as the political and security conditions in the region. Consequently, the fall in the prices of banks' shares comes as a result of the influence of the aforementioned risk factors and does not reflect the improved economic performances of the individual banks. However, the intensification of the capital market in the past few years, accompanied with the emergence and the increased interest of the domestic institutional investors (open investment funds and pension funds), as well as the changes in the regulation aimed at increasing banks' transparency, has a strategic significance for the banking system of the Republic of Macedonia, creating new alternative for increasing the banks' capital base. This, on its part, should provide increased shock absorption capacity of the banks.

### 1.3.2. Share of foreign capital in the total capital of the banking system

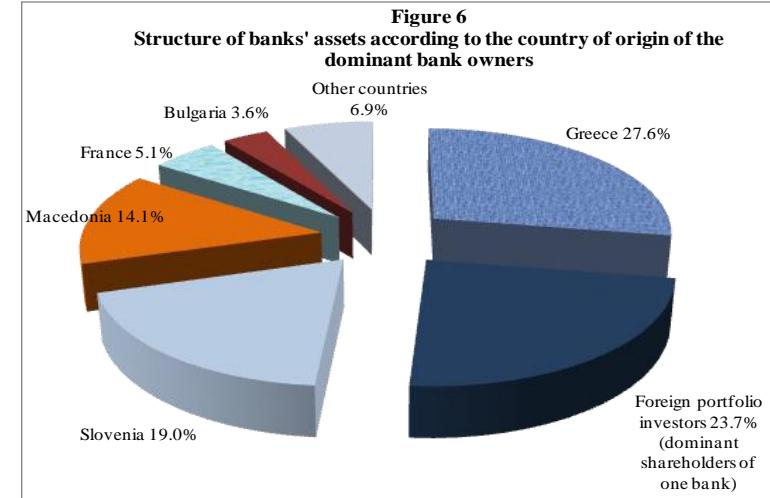
Simultaneously with the process of consolidation and reduction of the total number of banks, in the past few years the banking system of the Republic of Macedonia faced with a downward trend in the number of banks in dominant ownership of domestic shareholders, as well as a decline in their market share. At the expense of that, the market share of the banks dominantly owned by foreign shareholders continuously increased. Such movements were especially evident during 2007, when due to the transfer of a dominant portion of the capital into ownership of foreign shareholders, there was a qualitative restructuring of the ownership of three banks (one of each group of banks).

**The share of the foreign capital in the ownership structure of the banking system of the Republic of Macedonia significantly increased in 2007.** The main driving force of the increase in the share of foreign capital in the capital of banks were the acquisitions of the existing banks by foreign investors, but also the continuous inflow of foreign portfolio investments during 2007. As of December 31, 2007 the share of foreign capital in the total shareholders' capital equaled 69.1%, which is by 13.0 percentage points more compared with end 2006. During 2007, the number of banks which are dominantly owned by foreign shareholders increased from eight to eleven. At the end of 2007, eight banks were owned by foreign financial groups. The increase in the number of banks which are in dominant ownership of foreign shareholders caused their share in the total assets and in the total capital at

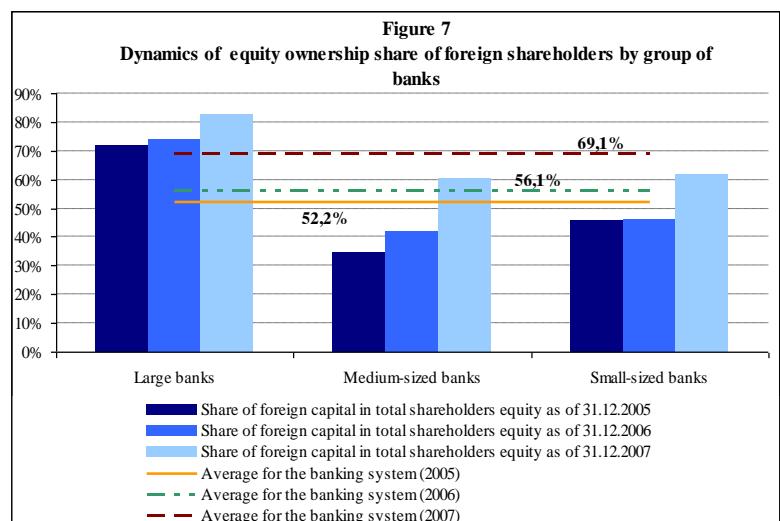


the level of the banking system to reach 85.9% and 73.3% as of December 31, 2007, which is an annual increment of significant 32.7 and 23.3 percentage points, respectively. The increased presence of foreign capital in the banks brought the banking system of the Republic of Macedonia closer to the banking systems of most countries of the region and Central Europe, with respect to the relative significance of the foreign capital, expressed through the share of the banks' assets dominantly owned by foreign shareholders in the total assets. Having in mind the experience of the analyzed countries, this trend should create additional preconditions for increasing the banks' activities, increasing the range of services, improving the corporate image, modernization of the risk management processes and additional increment of the banking system efficiency.

**As to the country of origin of the dominant bank owners, at the end of 2007, the largest part of the assets of the banking system was concentrated with the banks with dominant owners from the EU countries.** Almost half of the assets of the banking system of the Republic of Macedonia are the assets of the banks dominantly owned by shareholders from two countries, Greece 27.6% and Slovenia 19%. On the other hand, only 14.1% of the total banks' assets belong to banks dominantly owned by shareholders from the Republic of Macedonia.

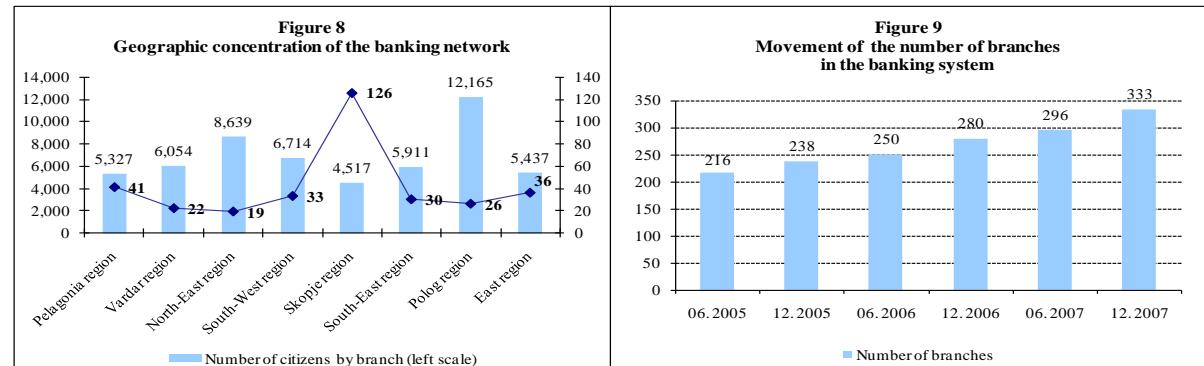


**All three groups of banks registered an increase in the share of foreign capital in 2007, but it was more significant in the groups of medium and small banks.** This is due to the acquisitions of several medium and small banks by foreign shareholders. As in the previous period, at the end of 2007, the share of foreign capital in the ownership structure of the group of large banks was the largest and at the same time higher than the average at the level of the overall banking system.

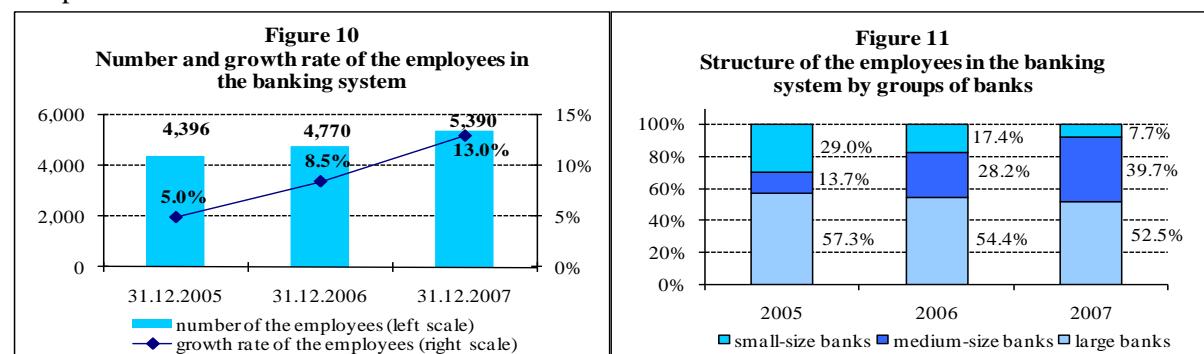


#### 1.4. Bank network and number of employees in the banking system

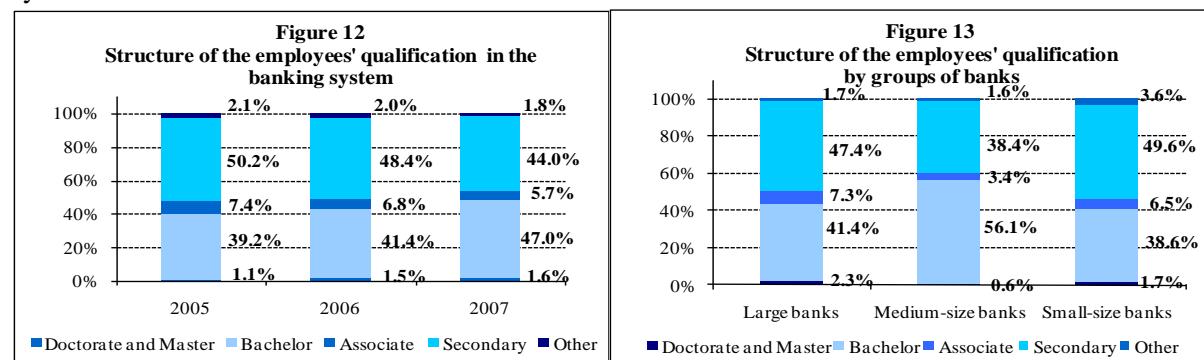
In 2007, the concentration of the bank network on the territory of the capital was maintained despite its spreading out with fifty-three new business units (one branch and fifty-two sub-branches). The spreading of the bank network was most significant in the group of medium banks, where the number of business units increased by 35.



The total number of employees in the banking system in the Republic of Macedonia continued to grow, and there was also continuation in the positive trend of qualitative improvement in the qualifications structure of the employees. At the end of 2007, the total number of bank employees reached 5,390 persons, which is by 620 persons or by 13% more compared with the end of 2006.

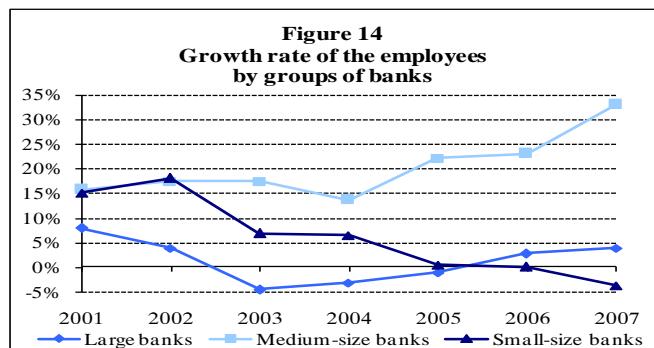


The increase in the number of bank employees was accompanied by an improved qualifications structure (rise in the number of employees with university degree), which is a result of the increased number of banks' activities, but also of the more sophisticated banks' systems for corporate governance, risk management, controls in the operations, etc. Such a qualitative shift in the educational structure of the employees should contribute to further improvement of the supply and the quality of banking services in the Republic of Macedonia, but also of the banks' risk management systems.



At the level of the individual groups of banks, continuously highest rates of growth of the number of employees are present in the group of medium banks, which also have the most favorable qualifications structure of employees. Such developments were accompanied with the increased role of the medium banks in the process of financial intermediation, and with the spreading

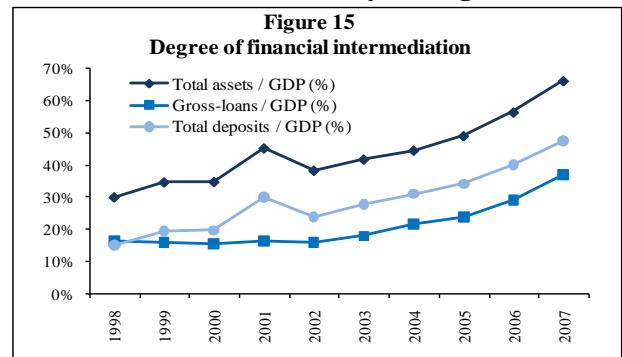
of the bank network. As opposed to that, starting from 2005 the number of employees in the group of small banks has been constantly falling, which comes as a logical consequence of the decline in the number of small banks and their market share in all segments of banking activities. In the group of large banks, the moderate increase in the number of employees, which started in the preceding year, continued. However, they retained the dominant share in the total number of employees at the level of the banking system, which equaled 52.5% at the end of 2007.



## 2. Banks' activities

### 2.1. Degree of financial intermediation

Given the continuation of the economic growth, as a trend from the previous years, the continuous strengthening of the trust in the banking system and the increased propensity to save, in 2007 the role of the banking system as a financial intermediary strengthened. The continuous upward trend in the banks' sources of funds, in conditions of increased credit demand, was a firm basis for further strengthening of the credit support for the private sector and ultimately for the economic growth in the country. Under such circumstances, the role of banks in the process of efficient channeling of the financial assets from the economic entities facing surplus to those facing deficit increased and deepened, which is clearly indicated by the main indicators through which the degree of financial intermediation is measured. At the end of 2007, the level of financial intermediation in the banking system, measured as a ratio of the total assets, gross credits and total deposits to GDP reached 66.2%, 37% and 47.4%, respectively<sup>8</sup>. As in the previous years, at the end of 2007 financial intermediation was marked with the dominance of the group of large banks, which is a logical consequence of its dominant share. Thus, as of December 31, 2007, the degree of financial intermediation of the group of large banks as a ratio of the total assets, gross-credits and total deposits to GDP equaled 44.4%, 26% and 34.3%, respectively.



**Table 4**  
**Degree of financial intermediation**

Countries	Assets/GDP	Loans/GDP	Deposits/GDP	Loans/ Deposits
<b>Macedonia-2006</b>	56.4%	29.1%	39.9%	72.9%
<b>Macedonia-2007</b>	66.2%	37.0%	47.4%	77.9%
<b>Malta</b>	599.6%	276.7%	217.0%	127.5%
<b>Cyprus</b>	512.3%	121.1%	165.3%	73.2%
<b>Latvia</b>	140.3%	95.4%	68.3%	139.7%
<b>Estonia</b>	117.6%	87.0%	58.2%	149.4%
<b>Slovenia</b>	117.3%	59.0%	71.9%	82.1%
<b>Hungary</b>	104.3%	62.6%	52.4%	119.5%
<b>Czech Republic</b>	100.7%	45.3%	68.0%	66.6%
<b>Slovakia</b>	94.9%	43.9%	61.4%	71.5%
<b>Lithuania</b>	73.1%	51.8%	36.7%	141.4%
<b>Poland</b>	69.8%	35.5%	44.8%	79.3%
<b>New member states</b>	102.1%	50.2%	57.4%	87.4%
<b>Eurozone</b>	297.6%	129.3%	107.6%	120.2%
<b>EU-25</b>	322.0%	132.0%	108.8%	121.4%
<b>Bulgaria</b>	88.9%	46.8%	61.4%	76.2%
<b>Romania</b>	52.6%	28.2%	22.0%	128.1%

Source: EU banking structures (ECB), October 2007. The data for all countries are for 2006, except for RM which include 2006 and 2007.

<sup>8</sup> In the calculation of the financial intermediation indicators, the data on the GDP for 2006 is a preliminary data, while for 2007 it is estimated data.

**However, regardless of the dynamics and the intensity of the growth of the banks' role, having in mind the lagging behind the European average, there is a significant room for increasing the level of financial intermediation in the Republic of Macedonia.** Confirmation of such a perception is the comparison of the banking system of the Republic of Macedonia with the banking systems of the EU countries, as well as the average levels of financial intermediation in the European Union and the Euro zone. These indicators show lowest level of financial intermediation in the Republic of Macedonia, compared with the other analyzed countries, except Romania. However, in the last few years the gap has been reducing at a faster pace, which brought the role of banks as financial intermediaries to levels closer to those common for the other analyzed countries. At the same time, the indicator of the credits to deposits ratio points to the fact that given the current level of attracted savings of the private sector, in the Macedonian banking system there is still room for increasing the credit support financed by this "traditional" source of banks' funds.

## 2.2. Balance sheet of banks

**In 2007, banks' total assets registered a significant annual growth rate of 28.5%.** As a result of such a dynamics, on December 31, 2007, it reached a level of Denar 223,659 million.

**Banks' deposits are the main driving force of the growth of assets, and at the same time the most important source for financing banks' activities.** On annual level, deposits went up by Denar 37,255 million or by 30.3%. Borrowings are the second most important category of liabilities, which on December 31, 2007 had an almost unchanged share of around 9% in the total banks' assets. These sources of funds registered annual growth of Denar 3,787 million or 24.1% which caused 7.6% of the growth of total assets. This growth is mostly a result of the increased use of foreign credit lines by several banks, the increased use of subordinated instruments by three banks and the issuance of a corporate bond by one bank. Compared with the end of 2006, the share of deposits from banks went up, which is almost entirely a result of the increase in the deposits from parent entities with three banks.

**Table 5**  
**Structure of banks' assets and liabilities**

Balance sheet	Amount in millions of denars		Structure		Annual change 31.12.2007/31.12.2006			
	31.12.2007	31.12.2006	31.12.2007	31.12.2006	In absolute amounts	In percent	In the structure (in percentage points)	Share in the increase
Cash and balances with the NBRM	15,335	11,165	6.9%	6.4%	4,170	37.3%	0.4	8.4%
Securities portfolio	35,497	24,269	15.9%	13.9%	11,228	46.3%	1.9	22.7%
Placements to banks	46,842	47,194	20.9%	27.1%	-352	-0.7%	-6.2	-0.7%
Loans to non-financial entities (net)	113,907	79,627	50.9%	45.7%	34,281	43.1%	5.2	69.2%
Accrued interest and other assets	4,912	5,060	2.2%	2.9%	-149	-2.9%	-0.7	-0.3%
Fixed assets	7,166	6,880	3.2%	4.0%	287	4.2%	-0.7	0.6%
Unallocated loan loss provisions	-0.9	-73.6	0.0%	0.0%	-73	-98.7%	0.0	-0.1%
<b>Total assets</b>	<b>223,659</b>	<b>174,117</b>	<b>100.0%</b>	<b>100.0%</b>	<b>49,542</b>	<b>28.5%</b>		
Bank deposits	10,482	6,043	4.7%	2.2%	4,439	73.5%	2.4	9.0%
Deposits of non-financial entities	160,381	123,126	71.7%	71.9%	37,255	30.3%	-0.2	75.2%
Borrowings (short-term and long-term)	19,478	15,692	8.7%	9.0%	3,787	24.1%	-0.3	7.6%
Other liabilities	6,981	5,421	3.1%	3.1%	1,561	28.8%	0.0	3.2%
Provisions for off-balance sheet items	872	648	0.4%	0.4%	223	34.5%	0.0	0.5%
Capital and reserves	25,465	23,187	11.4%	13.3%	2,278	9.8%	-1.9	4.6%
<b>Total liabilities</b>	<b>223,659</b>	<b>174,117</b>	<b>100.0%</b>	<b>100.0%</b>	<b>49,542</b>	<b>28.5%</b>		

**During 2007, simultaneously with the increase in the banks' assets, the positive trend of its restructuring continued,** aiming towards higher share of the interest-bearing, at the expense of the lower share of the low-interest-bearing and non-interest-bearing banks' assets. As a result of such movements, at the end of 2007, the share of the interest-bearing assets in the total gross-assets equaled 82.3%, which is an annual rise of 5.5 percentage points.

**In 2007, the accelerated growth of the total sources of funds reflected in further acceleration of the credit activity of the banks.** In 2007, gross-credits went up by Denar 35,098 million, or by significant 39.1% As a result of that, net-credits to non-financial entities with a share of

50.9%, strengthened the dominant position on the part of the banks' assets and caused the largest portion (69.2%) of its growth.

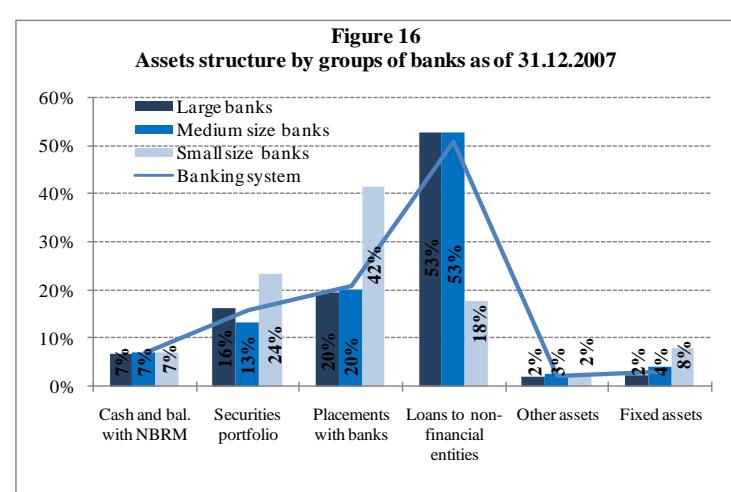
**At the same time, banks continued to be increasingly interested in investing in domestic short-term debt securities (CB bills and Treasury bills), which was manly a result of the positive assessment of the banks about the risk and return common for these financial instruments. As a result of that, the securities portfolio registered an annual increase of Denar 11,233 million, or 46.3%, and caused 22.7% of the total growth of the assets of the banking sector. Thus, this segment of banking operations increased its share and as of December 31, 2007 it forms 15.9% of the banks' total assets.**

**Table 6**  
**Market share and growth of the total assets, credits and deposits by group of banks**

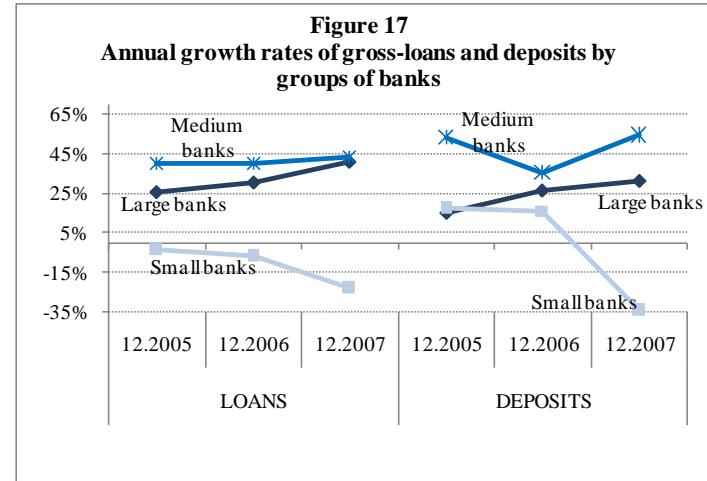
ITEMS	Amount in millions of denars		Structure		Annual change 31.12.2007/31.12.2006			
	31.12.2007	31.12.2006	31.12.2007	31.12.2006	In absolute amounts	In percent	structure (in percentage points)	Share in the increase
<b>Total assets</b>	<b>223,659</b>	<b>174,117</b>	<b>100.0%</b>	<b>100.0%</b>	<b>49,542</b>	<b>28.5%</b>		<b>100.0%</b>
- Large banks	150,122	115,122	67.1%	66.1%	35,001	30.4%	1.0	70.6%
- Medium size banks	61,571	41,368	27.5%	23.8%	20,204	48.8%	3.8	40.8%
- Small size banks	11,966	17,627	5.3%	10.1%	-5,662	-32.1%	-4.8	-11.4%
<b>Loans to non-financial entities</b>	<b>124,904</b>	<b>89,806</b>	<b>100.0%</b>	<b>100.0%</b>	<b>35,098</b>	<b>39.1%</b>		<b>100.0%</b>
- Large banks	87,774	62,143	70.3%	69.2%	25,631	41.2%	1.1	73.0%
- Medium size banks	34,083	21,651	27.3%	24.1%	12,432	57.4%	3.2	35.4%
- Small size banks	3,048	6,012	2.4%	6.7%	-2,965	-49.3%	-4.3	-8.4%
<b>Deposits of non-financial entities</b>	<b>160,381</b>	<b>123,126</b>	<b>100.0%</b>	<b>100.0%</b>	<b>37,255</b>	<b>30.3%</b>		<b>100.0%</b>
- Large banks	115,798	88,366	72.2%	71.8%	27,432	31.0%	0.4	73.6%
- Medium size banks	40,438	26,151	25.2%	21.2%	14,287	54.6%	4.0	38.3%
- Small size banks	4,145	8,609	2.6%	7.0%	-4,464	-51.9%	-4.4	-12.0%

**During 2007, the group of large banks maintained the dominant position in the structure of the banks' funds and sources of funds.** As of December 31, 2007, this group of banks participated with 67.1% in the total assets, with 70.3% in the total gross credits and with 72.2% in the total deposits. At the same time, the group of large banks, having realized the highest absolute annual growth of the assets, credit activity and deposits, was the main driving force of the annual growth of these three main on-balance sheet categories at the level of the banking system, contributing with 70.6%, 73% and 73.6%, respectively. As a result of such movements, the group of large banks strengthened its dominant position within the banking sector. On the other hand, increasingly evident is the growing role of the group of medium banks in the growth of the banks' total on-balance sheet activities and deposits. During 2007, as a result of the highest annual growth rates of the total assets, credits and deposits of this group of banks, as well as the shift of one bank from the group of small banks, the increased importance of this group of banks in the banking system was evident.

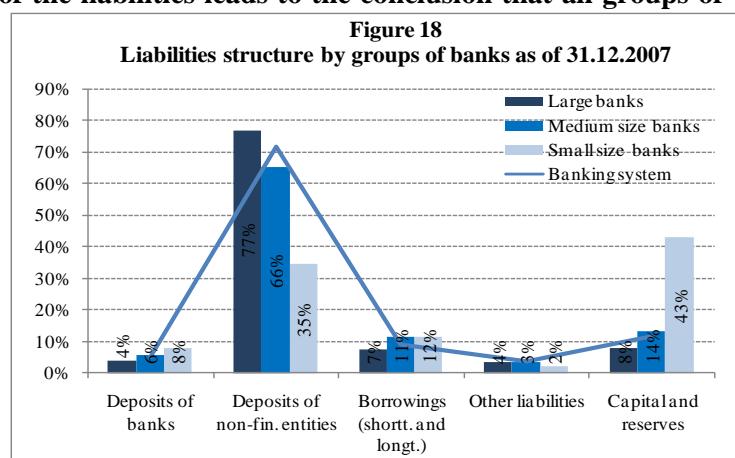
**The structural analysis of the assets and liabilities points to certain differences at the level of the individual groups of banks.** Dominant in the groups of large and medium banks are the credits to non-financial entities, with a share of 53% in the total assets of the respective group. Their share in the total assets of the respective group registered an annual rise of 5.5 percentage points in the group of large banks, and 3.3 percentage points in the group of medium banks. The main generator of such a trend is the positive dynamics of the credit activity with these two groups of banks, which is confirmed with the annual rates of



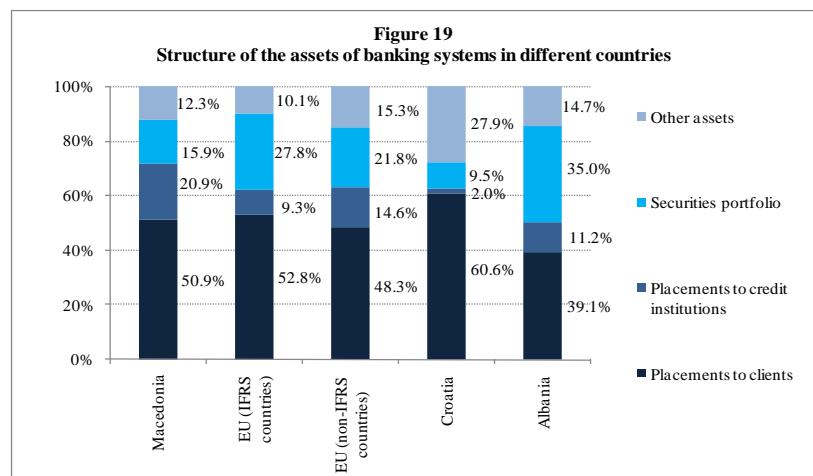
acceleration of their credit support for the private sector. On the other hand, the share of the credits in the total assets in the group of small banks is considerably lower, at the expense of the higher share of the placements with other banks and the securities portfolio. In the past year, as a result of the downward trend in the credit activity (negative rates of change of credits), this group of banks faced a trend of continuous decline of lending in the structure of their total on-balance sheet activities (fall of 9.2 percentage points compared with December 31, 2006). Such rates of change come as a result of both the structural changes in the groups of banks and of the reduced share of the credit activity in the total on-balance sheet activities of the group of small banks, which is another indicator of the continuously declining role of this group of banks in the process of financial intermediation. Qualitative changes in the ownership structure of several small banks are expected to reflect adequately on the level of financial intermediation in this group of banks.



**The analysis of the structure of the liabilities leads to the conclusion that all groups of banks finance the largest part of their activities with the deposits of non-financial entities.** However, that part is much smaller in the group of small banks, at the expense of the higher share of the capital and reserves in the total sources of funds of this group of banks. As a result of the higher growth rates of deposits, the groups of large and medium banks registered an annual growth of their share in the structure of financing of the total assets by 0.4 percentage points and 2.5 percentage points, respectively. In the group of small banks this share continuously declined and at the end of 2007, relative to the end of 2006, it equaled 14.2 percentage points, which additionally marginalizes the significance of this source of funds for the group of small banks.



**The comparative analysis of the assets structure of the banks in the Republic of Macedonia and in the EU countries and the region points to a relatively similar structure, i.e. highest share of the credit activity in the structure of the banks' total on-balance sheet activities.** In general, this share equals around 50%, while in the countries of the region it ranges between 39.1% in Albania, 52% in Serbia, 59.2% in Montenegro, up to 60.6% in Croatia. On the

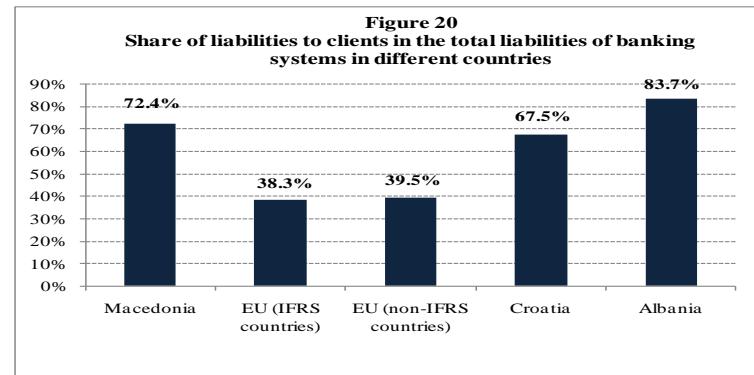


Source: Central banks' web sites.

other hand, it is evident that the banks in the EU countries have higher share of securities portfolio compared with the banks in the Republic of Macedonia.

**The structure of the sources of financing of the banks in the Republic of Macedonia is relatively similar to that of the banks in the countries of the region.** Thus, the share of the liabilities to clients in the banks' total sources of funds ranges between 67.1% in Serbia, 67.5% in Croatia, 72.4% in Macedonia and 83.7% in Albania.

**At the same time, the comparative analysis of the structure of the sources of financing of the banking activities points to significant differences between the banks in the Republic of Macedonia and those in the EU countries.** While the banking system of the Republic of Macedonia is for the largest part based on the so-called "traditional" sources of funds, the banks in the EU rather issue debt securities.



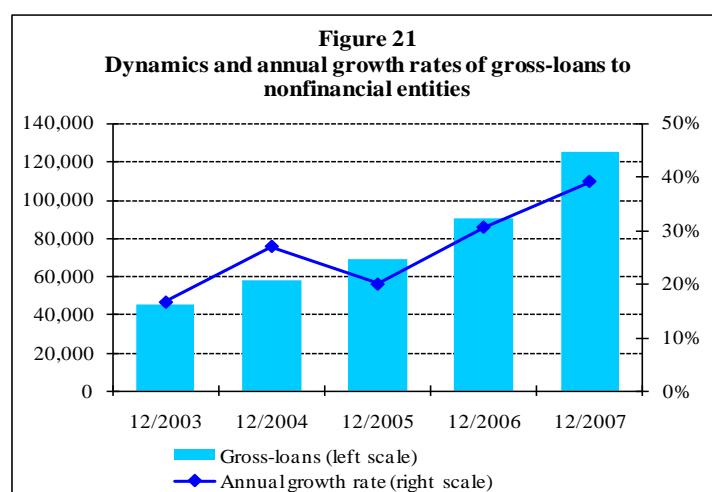
Source: Central banks' web sites.

The emergence and the expected growth of the role and the significance of the other domestic institutional investors, as an alternative option for attracting domestic savings, will impose increased level of competition for the banking sector. This could ultimately motivate the banks to orient toward other alternative sources of funds, which would move the structure of the sources toward the one common for the banking systems with higher level of development of the financial markets.

### 2.3. Credit activity of the banks - credits extended to non-financial entities

**The trend of intensive growth of the banks' credit activity continued also during 2007.** As of December 31, 2007, gross-credits to non-financial entities amounted to Denar 124,904 million, and picked up by 39.1% relative to December 31, 2006. The increased credit activity was a result of the higher households' and enterprises' demand for credits and the easing of the lending terms, due to the increased competition.

According to the results of the Bank Lending Survey, which pertains to the last quarter of 2007, in the forthcoming period the banks expect unchanged terms of lending to non-financial entities, unlike the results from the previous surveys, according to which they mainly expected easing or partial easing of the lending terms.

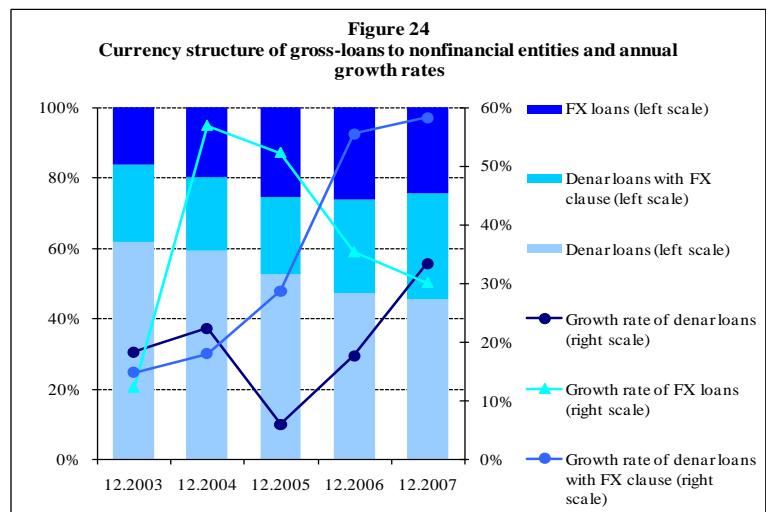
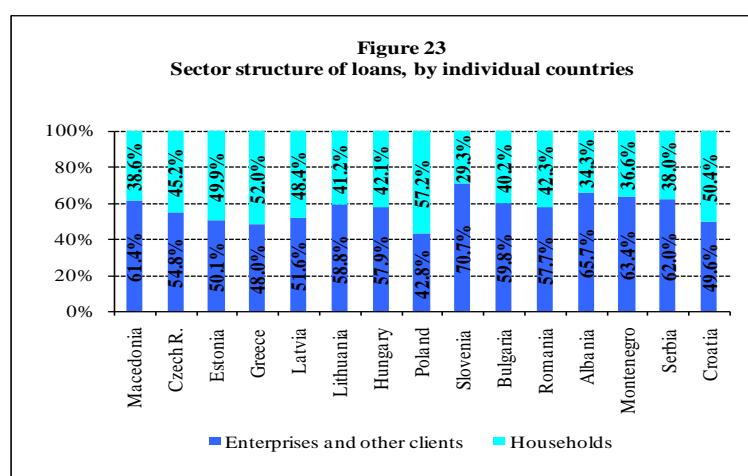
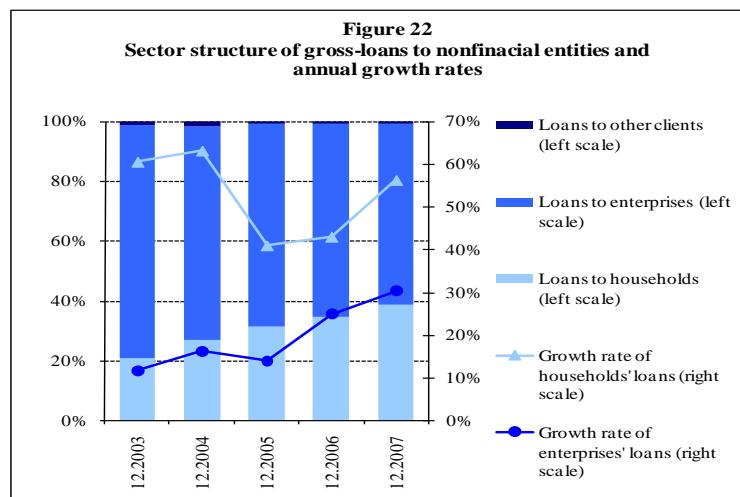


### 2.3.1. Structure of credits to non-financial entities (by sector, currency, maturity and activity/credit product)

Despite the intensive lending activity of banks with the households, corporate credits remained to be dominant in the structure of the credits from the viewpoint of the various sectors. Thus, as of December 31, 2007, the share of the corporate credits in the total gross-credits equaled 60.8%, which relative to the end of 2006, represents a decline of 4.1 percentage points. During 2007, they registered an annual rise of 30.3%, i.e. Denar 17,638 million. On the other hand, during the same period, household credits registered high annual growth of 56.2% or Denar 17,353 million, which led to an increase in their share in the total gross-credits of 4.2 percentage points (as of December 31, 2007 household credits participated with 38.6% in the total gross-credits).

**Credit activity of the banks in the Republic of Macedonia is relatively similar in its structure from the viewpoint of various sectors, with the individual EU Member States<sup>9</sup> and with the countries from the region - larger share of the credits extended to the sector "enterprises and other clients" in the total credits. Only in the banking sectors of Poland and Greece the credits extended to the household sector have a larger share, while in Estonia and Croatia this share is almost equal.**

**Denar credits with FX clause continued to grow at a faster pace also during 2007, thus strengthening their dominant position in the currency structure of the total credits.** As of December 31, 2007, the share of the credits with FX component reached 54.7% in the total gross-credits to non-financial entities. The highest annual growth rate of 58.2% was registered in Denar credits with FX clause, with their share in the currency structure reaching 30.1% (increase of 3.6 percentage points compared with the end of 2006).

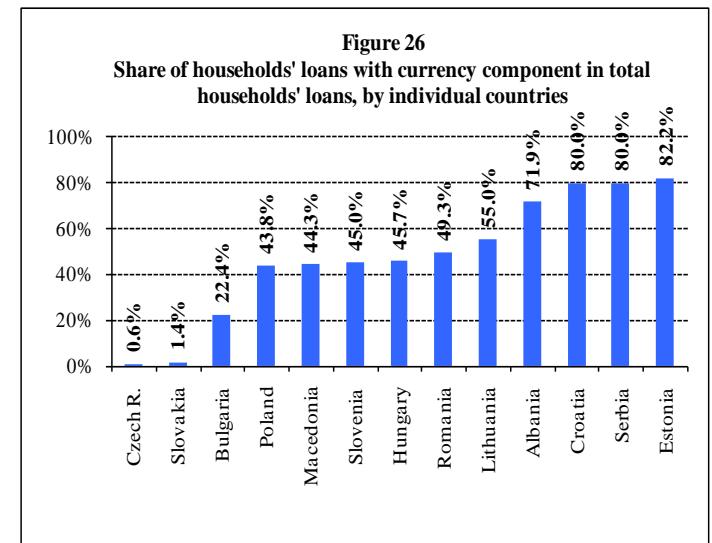
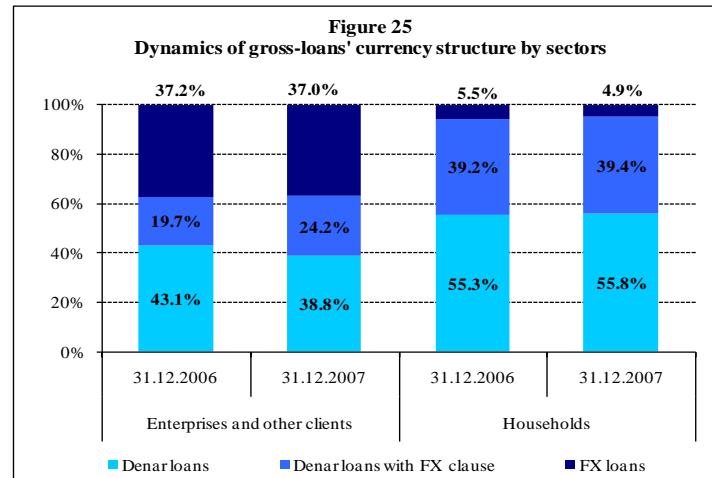


<sup>9</sup> The data are as of December 31, 2006. Source: EU Banking Structures, ECB, October 2007.

**During 2007, the share of the foreign currency and Denar credits in the total gross-credits dropped.** Compared with the Denar credits with FX clause, Denar and foreign currency credits registered a relatively more moderate annual growth of 33.4% and 30.1%, respectively, which caused a decline in their relative share in the structure of the total credits by 1.9 and 1.7 percentage points, respectively. However, Denar credits registered the highest annual growth in absolute terms (of Denar 14,162 million), creating 40.4% of the total annual growth of the gross-credits. Almost 62% of the annual growth of Denar credits in absolute terms belong to credits extended to the household sector, with the Denar credits on the basis of issued credit cards and the overdrafts on current accounts registering the fastest annual growth of 111.3%.

**The relative significance of the credits with currency component is greater with the legal entities (enterprises and other clients) compared with the households.** Thus, as of December 31, 2007, as much as 61.2% of the total credits to legal entities are credits with currency component. During 2007, credits with currency component in the sector "enterprises and other clients" grew at a rate almost 2.5 times higher compared with the Denar credits, which led to further change in the structure of the total credits to enterprises and other clients, towards increase in the share of the credits with currency component. At the same time, currency structure of the credits with the household sector did not register significant changes, having in mind the relatively equal annual growth of the Denar credits and the credits with currency component of 57.6% and 54.5%, respectively.

**Credits with currency component have a relatively low to moderate share in the total credits to households extended by the banks in the Republic of Macedonia, compared with most of the EU countries and countries of the region.** Analyzed by country, the share of the credits with currency component in the total household credits ranges between 0.6% and 82.2%<sup>10</sup>. According to this indicator, the banking sector of the Republic of Macedonia is in the middle of the list of analyzed countries (this indicator for Macedonia equals 44.3%), which points to a relatively similar currency structure of the household credits with part of the European countries (Poland, Slovenia, Hungary, etc.)

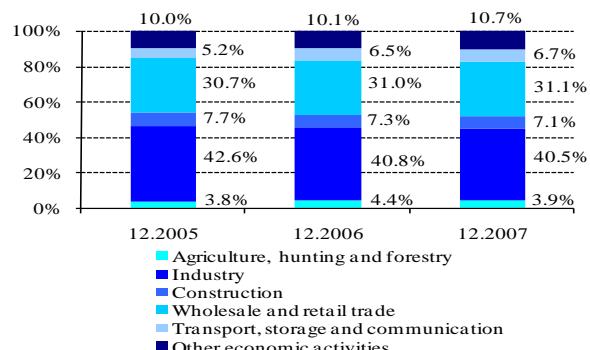


\* Note: The data on the Republic of Macedonia presented in the figure are as of 31.12.2007, whereas the data on the other countries are partly as of 31.08.2006, but partly are as of 31.12.2006.

<sup>10</sup> Data on RM are as of December 31, 2007, while data on individual countries are partially as of August 31, 2006, and partially as of December 31, 2006. Source: Financial stability reports of the national central banks; internet sites of the national central banks.

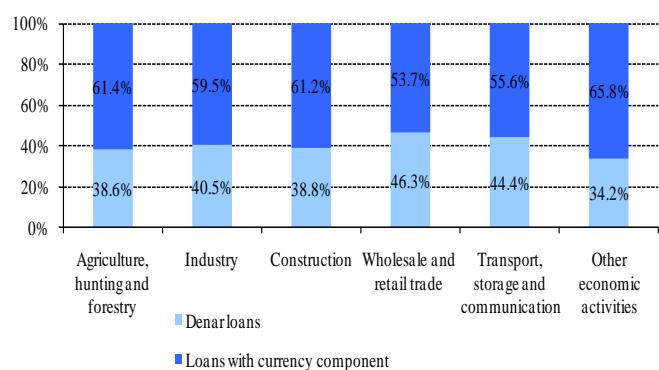
**In the structure of credits according to the activity, the share of the credits extended to "industry" is the highest.** As of December 31, 2007, the share of these credits in the total corporate credits equaled 40.5%, while the credits extended to clients in "wholesale and retail trade" also have a relatively high share (as of December 31, 2007, these credits participated with 31.1%). During 2007, the highest growth in absolute terms (of Denar 6,939 million or 29.1%) was registered in the credits in "industry", whereby these credits created 39.5% of the total annual increase in the credits to enterprises and other clients.

**Figure 27**  
Structure of the loans to enterprises and other clients, by economic activity



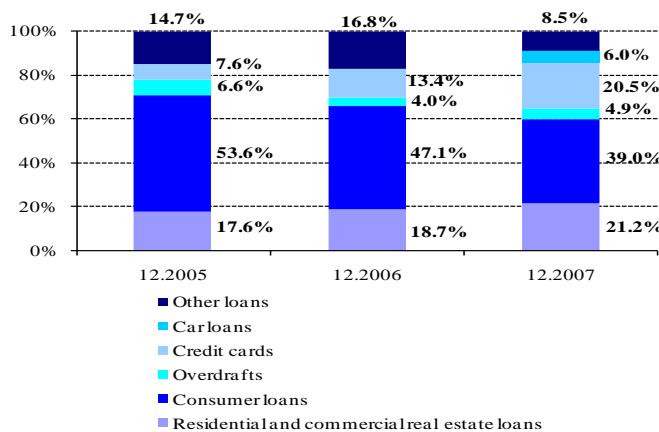
**Lending with currency component prevails in the total credits extended to enterprises in all activities.** As of December 31, 2007, the share of the credits with currency component in the three activities with the largest share in the total corporate credits ("industry", "construction", and "wholesale and retail trade"), ranges between 53.7% and 61.2%. Relatively high share of the credits with currency component is registered in "agriculture, hunting and forestry". The high share of the credits with currency component in the other activities is mostly a result of the relatively high amount of this type of credits in "hotels and restaurants" and "real estate, renting and business activities". As of December 31, 2007, as much as 71.9% of the total amount of credits with currency component in the other activities belong to these two activities.

**Figure 28**  
Currency structure of the loans to enterprises and other clients by economic activity, as of 31.12.2007



**During 2007, according to the type of credit product intended for the households, the growth of credits on the basis of issued credit cards was the fastest.** Thus, credits on the basis of credit cards registered the highest growth rate of 121.5%, and relatively high annual growth was registered also in the overdrafts on current accounts (76.6%) and in the credits for purchasing and refurbishing of homes and business premises (64%). Such relative growth rates of the use of certain types of credit products caused respective structural changes in the total household credits. The share of the credit cards significantly rose at the expense of the drop in the structural share of the consumer credits<sup>11</sup> and the share of the other credits<sup>12</sup> in the

**Figure 29**  
Structure of households' loans by bank product

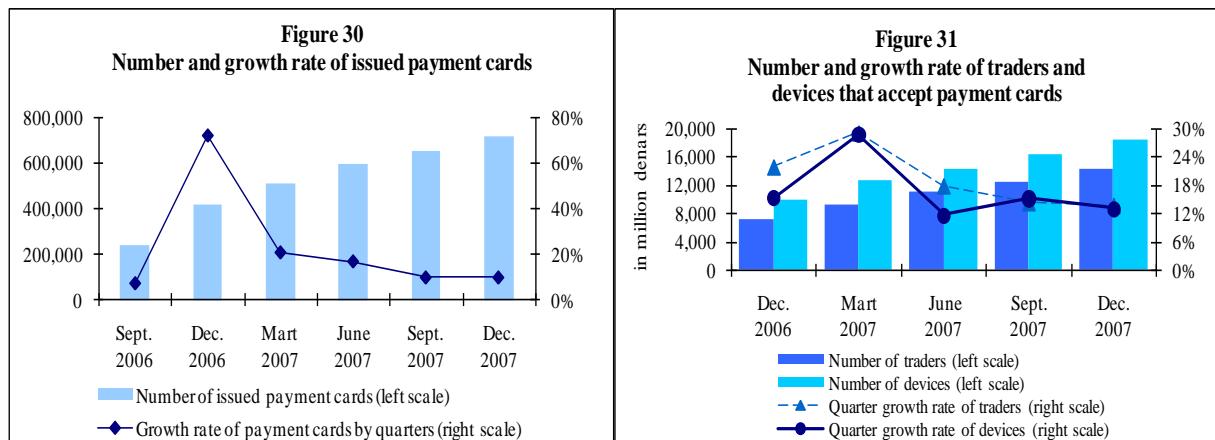


<sup>11</sup> The annual fall (in 2007) of the share of consumer credits in the total household credits is partly due to the fact that since March 31, 2007 the banks have informed NBRM in more details about the size of the automobile credits, which were previously recorded as consumer credits.

<sup>12</sup> The decline by half of "other credits" is a result of the fact that during 2007 the banks started to inform the NBRM in more details about the structure of the credits to sole proprietors, natural persons not considered to be sole proprietors, and

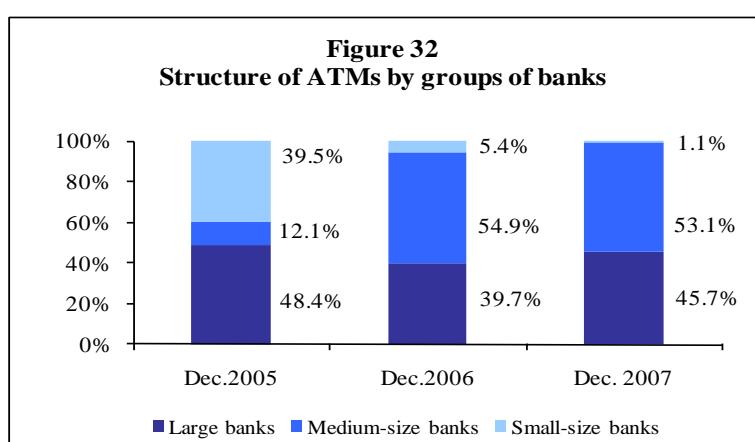
structure of the household credits. After the decline registered in 2006, the share of the overdrafts on current accounts increased again in 2007. An upward trend in the structural share in the household credits was registered also in the credits for purchasing and refurbishing of homes and business premises.

**The increase in the credits on the basis of issued credit cards follows the general upward trend in the banks' activities in the area of payment cards, which continued also during 2007.** As of December 31, 2007, the total number of issued payment cards reached the level of 716,611, which is an annual increase of 71.0%. The use of the payment cards continued to grow more rapidly, which is confirmed by the annual rise in the number and the value of transactions executed with payment cards, equaling 195.8% and 174.8%, respectively, compared with 2006. Here, 69.3% of the total number and 84% of the total value of the realized transactions pertain to the transactions for withdrawal of cash, while the rest are transactions for payments in the trade. During 2007, the average value of a single transaction for executed payments in the trade amounted to around Denar 2 thousand, while of the transactions for withdrawal of cash around Denar 5 thousand. As in the previous periods, during 2007 the group of large banks remained to be dominant, by issuing 72.5% of the total number of payment cards. Thus, as of December 31, 2007, the Herfindahl-index equaled 2000 index points, which is an indicator of a relatively high level of concentration in this segment of banks' operations, while the CR5 indicator equaled 91.3%.



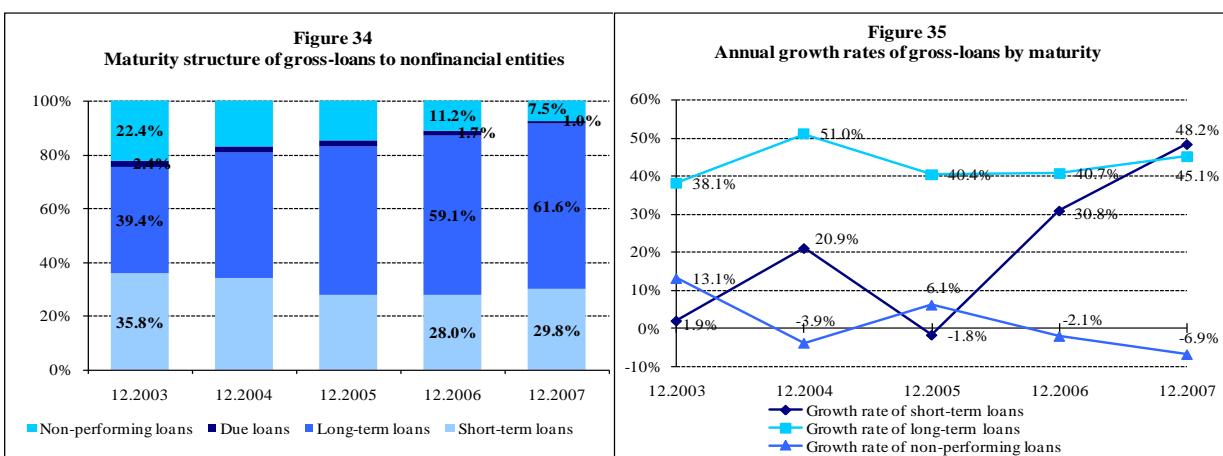
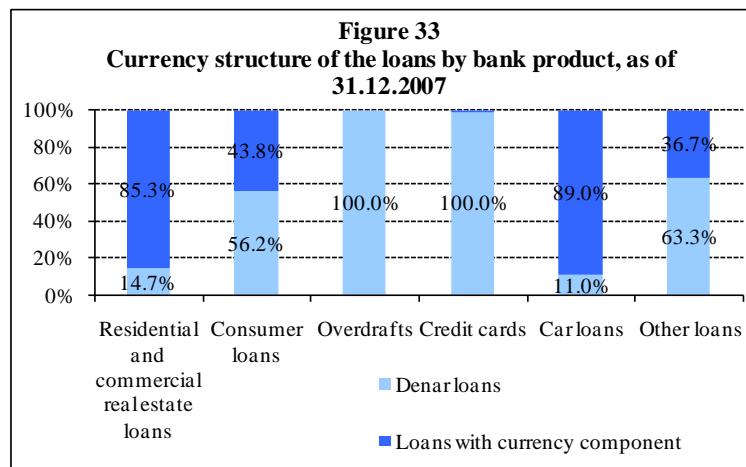
**In 2007, the number of devices and retailers that accept payment cards almost doubled.** The network of devices where payment cards are used was supplemented with 8,570 devices (ATMs and POS-terminals), which is an annual growth of 87.1%, while the number of retailers who accept cards as a payment instrument went up by 97.9%, reaching 14,243 as of December 31, 2007.

As of December 31, 2007, the total number of ATMs at the level of the overall banking system equaled 529 and registered an annual rise of 78.1%. The group of large banks registered the largest annual growth of 105.1%, and it also contributed the most to the growth in the total number of ATMs. At the end of 2007, the number of ATMs in the group of large banks was 242. Despite the relatively smaller growth (of 72.4%), the group of medium banks maintained the largest share in the network of these devices at the level of the banking system. Small banks have minimal share also in this area of banking services.



natural persons who perform trading activities of a small scale, which were previously recorded as "other credits" with the household sector.

The analysis of the currency structure of the household credits by individual credit product, confirms the dominant share of the Denar credits. Credits on the basis of credit cards and overdrafts on current accounts are entirely in Denars. The currency component is, to the largest extent, incorporated in the automobile credits and credits for purchasing and refurbishing homes and business premises, which are normally extended with longer contractual maturity.



In conditions of a fast growth of the short-term credits, long-term credits with a share of 61.6%, still maintained the dominance in the currency structure of credits. During 2007, short-term credits registered the highest growth rate of 48.2%, thus increasing their share in the total gross-credits by 1.8 percentage points. The increase in the short-term credits was especially high in the household sector (annual growth of 98.5%), which was mostly due to the rise of credits on the basis of credit cards and overdrafts on current accounts. Short-term credits extended to the corporate sector grew at a relatively more moderate rate of 34.7%. The increment of the long-term credits was more emphasized in the household sector (annual growth rate of 48.1%), while long-term corporate credits went up by 42.3%.

**Table 7**  
Distribution of credits by individual group of banks

Groups of banks	Sector structure			Maturity structure			Currency structure		
	Enterprises	Households	Other clients	Short-term	Long-term	Due and non-performing	Denar	FX	FX indexed
Large banks	72.5%	66.7%	74.9%	76.8%	66.3%	76.2%	70.2%	77.1%	64.8%
Medium-size banks	25.5%	30.4%	2.4%	20.7%	32.0%	16.2%	25.0%	22.7%	34.5%
Small-size banks	2.0%	2.8%	22.7%	2.5%	1.7%	7.6%	4.8%	0.2%	0.7%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The dominance of the group of large banks and the further marginalization of the role of the small banks was evident in the structure of gross-credits by sector, maturity and currency. Despite the increase in the number of medium banks and their more intensive credit activity, their market share significantly lags behind the dominant presence of the large banks on the financial market.

**Table 8**  
**Structure of credits by individual group of banks**

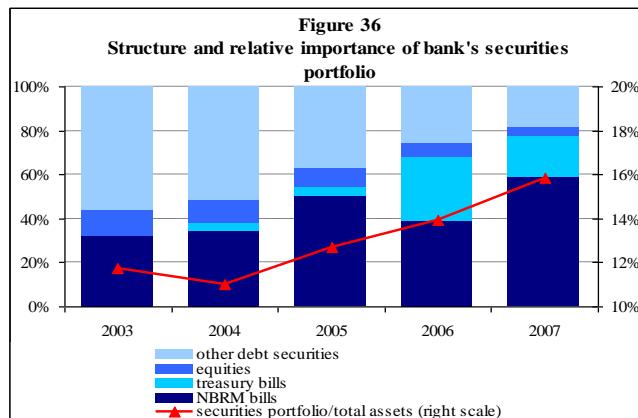
Groups of banks	Sector structure				Maturity structure				Currency structure			
	Enterprises	Households	Other clients	Total	Short-term	Long-term	Due and non-performing	Total	Denar	FX	FX indexed	Total
Large banks	62.7%	36.7%	0.7%	100.0%	32.6%	58.1%	9.3%	100.0%	45.3%	27.0%	27.7%	100.0%
Medium-size banks	56.9%	43.0%	0.1%	100.0%	22.7%	72.3%	5.1%	100.0%	41.5%	20.5%	38.0%	100.0%
Small-size banks	49.5%	44.8%	5.8%	100.0%	30.6%	42.7%	26.8%	100.0%	89.1%	2.3%	8.6%	100.0%

**According to the features of the credits (by maturity, currency and sector) extended by the individual groups of banks, it is evident that corporate lending and long-term lending have the largest relative share in all groups of banks.** The share of the long-term lending is especially high with the group of medium banks (share of 72.3%). Lending with currency component is dominant in the credit portfolios of large and medium banks, while in the group of small banks Denar lending prevails.

## 2.4. Securities portfolio

**The interest of banks in the Republic of Macedonia in investing in domestic debt securities was evident also during 2007.** Thus, at the end of 2007, banks' securities portfolio totaled Denar 35,497 million. The fast annual growth of the investments in CB bills caused an annual increase in the overall portfolio of Denar 11,233 million, i.e. 46.3% (Annex 5 - Structure of the securities portfolio). As of December 31, 2007, the share of the securities portfolio in the total assets equaled 15.9%, which is an annual increase of 2 percentage points.

**Despite the significant growth of the securities portfolio in absolute and relative terms during 2007, the non-diversification and the dominance of the CB bills and debt securities issued by the Republic of Macedonia, remained to be its main feature.** This simple structure of the banks' securities portfolio is a consequence of the low level of development of the domestic financial market on the one hand, but also of the low propensity of the banks in the Republic of Macedonia to undertake market risks or to invest in securities abroad, on the other. At the same time, the features of the securities that are dominant in the banks' portfolios (low credit risk of the issuers, short maturity and mainly held to maturity) points to the conclusion that there is an absence of elements of so-called investment portfolio, i.e. the portfolio is primarily focused on liquidity and creates limited risks for the banking system. As of December 31, 2007, CB bills had the largest share of 59.2% in the structure of the securities portfolio, their share went up by 20.0 percentage points on annual basis. The increase of the structural share of the CB bills was accompanied by a reduced share of the Treasury bills, equity instruments and other debt securities<sup>13</sup> by 10.9, 2.3 and 7.0 percentage points, respectively, on annual basis. As of December 31, 2007, the total amount of subscribed Treasury bills by the banks stood at Denar 6,530 million, which is a decline of Denar 573 million, or 8.1% relative to December 31, 2006. In the first



<sup>13</sup> The main component of the other debt securities are the bonds issued by the Republic of Macedonia which include: the bond issued in connection with the privatization of "Stopanska Banka" a.d. Skopje, the denationalization bonds, the bonds for "old foreign currency saving" and the continuous government bonds. Having in mind that most of these debt securities are issued for the purpose of solving certain structural and inherited problems, and are subject to regular annual amortization (collection of part of the nominal value), or they may be subject to early full or partial purchase, it is realistic to expect a continuous decline in their significance within the securities portfolio in the future. For example, during 2007, the Republic of Macedonia made full and early purchase of the bond for rehabilitation of "Stopanska Banka" a.d. Skopje, so that this bond is no longer part of the securities portfolio of the banking system. Part of the other securities is the corporate three-year bond issued by "Procredit Banka" a.d. Skopje at the end of 2007, by way of private placement and it was entirely purchased by "NLB Tutunska Banka" a.d. Skopje.

quarter of 2008, the rise in the interest rates on CB bills, having in mind their short maturity, makes them extremely attractive instruments for the banks from a viewpoint of the yield they produce, which imposes expectations for increasing the banks' interest in them, at the expense of reducing the interest in investing in Treasury bills.

## 2.5. Banks' deposit activities

### 2.5.1. Structure of the deposit base (by sector, maturity and currency)

**Household deposits are the main component of the banks' overall sources of financing, and they had the fastest growth during 2007.** Relative to the end of 2006, they registered the largest growth in absolute terms of Denar 22.765 million, i.e. 31.9%, which was a significant contribution (61.1%) to the increase in the banks' total deposits. At the end of 2007, their share in the total deposit base equaled 58.7%. Corporate deposits, with a share of 35.5% in the total deposit base, were the second largest source of funds. They registered an annual growth of Denar 13,529 million or 31.1% and they contributed with 36.3% to the overall deposit growth.

**The positive trend of gradual increase of the maturity of total deposits with banks continued also during 2007. However, the relatively unfavorable maturity is one of the main features of the bank deposits.** Dominant portion (94.6%) of the deposit base is with maturity of up to one year, with 51% of them being short-term deposits, while the rest are sight deposits<sup>14</sup>. On annual level, short-term deposits registered the most significant increase in absolute terms of Denar 20,965 million, which is the main driving force of the rise in the total deposits (share in the total growth of 56.3%). At the end of 2007, long-term deposits participated with 5.4% in the total deposits, which is an increase of 1.3 percentage points relative to the end of 2006. At the same time, they registered the highest annual growth rate of 70.5%, contrary to the growth rates of the sight deposits and short-term deposits of 22.3% and 34.4%, respectively. Such an increment is to a large extent (over 70%) result of the rise in the long-term household deposits, which reflects the increased confidence in the banking system.

**Denar deposits continued the commenced trend of increased share at the expense of the lower share of the foreign currency deposits. At the same time, Denar deposits with FX clause registered the highest annual growth rate.** At the end of 2007, 48.5% of the banks' deposit base are Denar deposits, 44.5% are foreign currency deposits, and 7% are Denar deposits with FX clause. For comparison, last year, Denar deposits participated with 43.9%, foreign currency deposits with 51.8% and Denar deposits with FX clause with 4.3%. Evidence of the increased interest in saving in Denars is the annual growth rate of Denar deposits of 43.9%, as opposed to the growth rate of the foreign currency deposits of 11.9%. Such a growth rate of Denar deposits contributed to the increase in the total deposits of 63.7%, which was primarily a result of the increase in the short-term household deposits, and of the increase in the corporate sight deposits. On annual basis, Denar deposits with FX clause registered the most remarkable growth rate (111.2%) due to the increment in the short-term deposits of one legal entity with three banks. However, they have the smallest structural share (7%) in the total deposits, which is the reason for their smallest contribution in the total deposit growth.

**Table 9**  
**Distribution of deposits by group of banks as of December 31, 2007**

Deposit structure as of December 31, 2007	Sectoral structure				Maturity structure			Currency structure	
	Corporates	Households	Public sector	Other clients	Sight deposits	Short-term deposits	Long-term deposits	Denar deposits	Foreign currency deposits
<b>Large banks</b>	70.5%	73.7%	69.0%	67.0%	73.3%	74.7%	39.7%	70.5%	74.3%
<b>Medium-size banks</b>	27.9%	23.8%	24.5%	22.4%	23.2%	24.0%	52.9%	26.2%	23.9%
<b>Small-size banks</b>	1.6%	2.4%	6.6%	10.6%	3.5%	1.3%	7.4%	3.2%	1.8%
<b>Total</b>	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

<sup>14</sup> For the needs of the analyses presented in the annual report, total deposits, i.e. sight deposits include demand deposits (transaction accounts of natural persons and legal entities).

At the end of 2007, the group of large banks maintained the dominant position in forming the banks' total deposits.

**Table 10**  
**Structure of the deposits of non-financial entities by group of banks as of December 31, 2007**

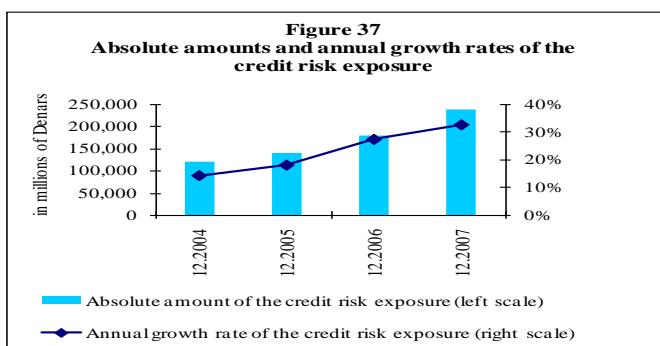
Deposit structure as of December 31, 2007	Sectoral structure					Maturity structure				Currency structure		
	Corporates	Households	Public sector	Other clients	Total	Sight deposits	Short-term deposits	Long-term deposits	Total	Denar deposits	Foreign currency deposits	Total
Large banks	34.7%	60.0%	0.9%	4.5%	100.0%	44.2%	52.8%	3.0%	100.0%	54.3%	45.7%	100.0%
Medium-size banks	39.3%	55.5%	0.9%	4.3%	100.0%	40.1%	48.5%	11.4%	100.0%	57.8%	42.2%	100.0%
Small-size banks	22.5%	55.2%	2.3%	19.9%	100.0%	59.0%	25.5%	15.5%	100.0%	69.6%	30.4%	100.0%

Regarding the deposit structure from a viewpoint of the various sectors, each individual group of banks registered more significant share of the household deposits. The analysis of the deposits' maturity structure by group of banks, indicates higher share of the short-term time deposits with the groups of large and medium banks, as opposed to the higher share of the sight deposits with the group of small banks. Deposits' currency structure within the individual group of banks registers almost even share of foreign currency and Denar deposits with the group of large banks, as opposed to the higher share of Denar deposits with the group of medium banks and especially with the group of small banks.

### 3. Risks in banks' operations

#### 3.1. Credit risk exposure

The upward trend in the total credit risk exposure of the banking sector, present in the previous years, especially intensified in 2007. Thus, on 31.12.2007 the credit risk exposure amounted to Denar 237,656 million and it was by Denar 58,468 million, or by 32.6% more relative to 31.12.2006. Simultaneously, this represented the highest annual growth rate of the exposure in the last 4 years.



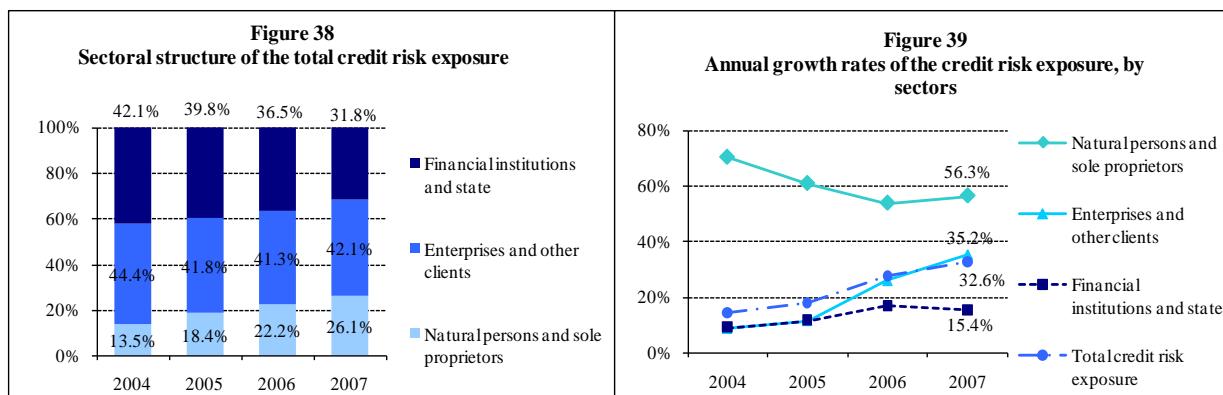
Analyzed by groups of banks, the group of large banks still dominated (participating with 70.5%) in the total credit risk exposure at the level of the banking system.

The group of medium banks registered the highest annual growth rate of the credit risk exposure (of 49.7%), which partially resulted from the transfer of one bank from the group of small banks to the group of medium banks, but also from the intensified growth in the credit risk exposure with almost all banks of this group. The credit exposure of the group of small banks registered annual downward rate, which was solely due to the transfer of one bank from the group of small to the group of medium banks, as well as to the revocation of the founding and operating license of one bank. If the effect from the transfer of the two banks from the group of small banks is excluded, than the credit risk exposure of this group of banks would register annual growth of Denar 1,560 million (or by 16%).

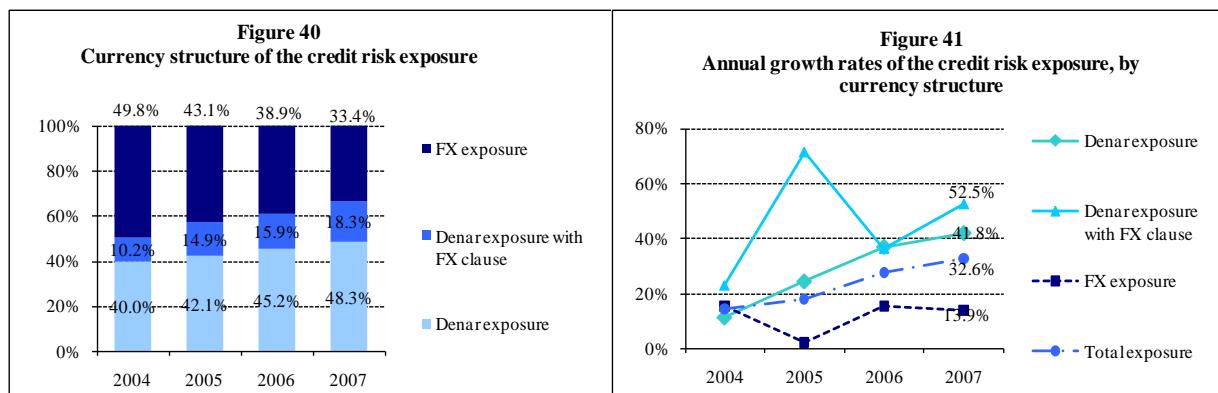
**Table 11**  
**Situation and growth in the credit risk exposure by groups of banks**

Groups of banks	Credit risk exposure (in millions of Denars)		Structure of the credit risk exposure (in %)		Annual change 31.12.2007/ 31.12.2006		
	31.12.2006	31.12.2007	31.12.2006	31.12.2007	Absolute change (in millions of Denars)	Growth rate (in %)	Share in the change (in %)
<b>Large banks</b>	124,108	167,547	69.3%	70.5%	43,439	35.0%	74.3%
<b>Medium-size banks</b>	39,283	58,819	21.9%	24.7%	19,536	49.7%	33.4%
<b>Small-size banks</b>	15,797	11,290	8.8%	4.8%	-4,507	-28.5%	-7.7%
<b>Total:</b>	<b>179,188</b>	<b>237,656</b>	<b>100.0%</b>	<b>100.0%</b>	<b>58,468</b>	<b>32.6%</b>	<b>100.0%</b>

The banks' exposure to the enterprises and other clients<sup>15</sup> had the largest and relatively stable participation of somewhat more than 40% in the sector structure of the total credit exposure of banks. Yet, in 2007 the trend of continuous increase in the structure participation of the exposure to the sector "households and traders sole proprietors" continued, for the account of the decrease in the participation of the exposure to the financial institutions and the Government. Such developments in the sector structure of the credit exposure of the banking sector were determined by the continuously higher annual growth rates of the exposure to the sector "households and sole proprietors" in the last 4 years. In 2007, the exposure to this sector registered annual growth of 56.3%, relative to the growth in the exposure to the enterprises and other clients, of 35.2% and the growth in the exposure to the financial institutions and the Government, of 32.6%.



In the currency structure of the banks' exposure to the credit risk, the participation of the Denar exposure with FX clause registered continuous increase, for the account of the decrease in the participation of the foreign currency exposure to credit risk. The Denar exposure and the exposure with FX clause registered continuously higher annual growth rates, relative to the



annual growth rates of the foreign currency exposure. As a result of that, the Denar exposure maintained and strengthened its dominant position, participating with 48.3% in the total credit risk exposure.

<sup>15</sup> Other clients include: non-profitable organizations, non-Government organizations, health and insurance funds, organizations and bodies out of the country etc.

The regular credits still represented a dominant position within the total credit risk exposure of banks, despite the registered growth in the structure participation of the other claims and the sub-balance items in the last 4 years. Namely, in the period 31.12.2004-31.12.2007, the sub-balance exposure to credit risk registered the largest growth rates (only in 2007 this item went up by 55.8%) and also the exposure based on other claims (in 2007, other claims went up by 46.2%). The high annual growth rate in the sub-balance exposure came mainly as a result of the intensified growth in the sub-balance exposure of the banking system to the activity “industry” (by 109.8%, or by Denar 3,232 million on annual level) and the Denar sub-balance exposure to credit risk based on granted framework credits based on credit cards (annual growth by 81.1%, or by Denar 3,55 million). The annual growth in the credit risk exposure based on other claims was solely due to the growth in the claims based on CB bills, as a component of the Denar exposure of banks to the activity “financial intermediation”. In the same time, these two categories (the placements in CB bills and granted credits based on credit cards) were the main careers of the growth in the total credit exposure of the banking system in Denars.

In 2007 the downward trend in the amount of the non-performing credits continued (by Denar 784 million) and on 31.12.2007 they participated with only 4% in the total exposure to credit risk.

### 3.1.1. Level of risk and indicators on the credit risk exposure at the level of banking system

The risk level of the credit portfolio of the banking system decreased. All structure indicators on the quality of the credit portfolio registered improvement. It came as a result of the improved procedures and policies of banks for credit risk management, but also to the fact that the credit portfolio of banks is relatively “young” and it is still not showing any signs of more significant worsening. Hence, although the intensified growth in the credit risk exposure in the previous period was accompanied with its quality improvement, yet the growth in the exposure shall be observed carefully, considering the fact that newly approved exposure was mostly classified in better risk categories, with fully expected initial effect of improvement in the quality of the credit portfolio.

On 31.12.2007, the participation of the exposure classified in the risk categories “C”, “D” and “E” in the total credit risk exposure equalled 5.7%, which is by 1.9 percentage points

**lower relative to 31.12.2006.** The total amount of the credit exposure classified in these risk categories was almost unchanged relative to the end of the previous year.

**Table 12**  
**Quality indicator of the credit risk exposure**

Indicator	31.12.2005	31.12.2006	31.12.2007
<b>Average level of risk</b>	8.4%	6.6%	5.3%
<b>% of C, D and E in total credit risk exposure</b>	10.9%	7.6%	5.7%
<b>% of annual change of non-performing loans in annual change of total credit risk exposure</b>	-0.8%	-0.5%	-1.3%
<b>% of net C, D and E in own funds</b>	26.1%	19.4%	17.9%
<b>Coverage ratio of C, D and E by provisions</b>	76.4%	86.8%	94.1%
<b>% of bullet loans in total gross-loans to nonfinancial entities</b>	n.a.	15.1%	14.9%
<b>% of net written-off claims during current year in total credit risk exposure at the end of previous year*</b>	1.4%	3.7%	1.6%

\*Note: The amount of net written-off claims during current year is calculated as: the amount of written-off claims during current year minus recovered written-off claims during the current year. The indicator for 2005 is calculated by using only the amount of written-off claims.

**On December 31, 2007 the average level of risk of the credit risk exposure equalled 5.3%, which was an annual decrease by 1.3 percentage points. The decrease in the risk of the exposure resulted of the 4 times lower annual growth in the total potential losses for the credit risk, compared with the growth in the total credit risk exposure.**

The indicator which shows the relation between the annual changes in the amount of the non-performing credits and the annual changes in the total credit risk exposure had negative values, which was a reflection of the continuous decrease in the absolute amount of the non-performing credits, relative to the absolute amount in the total credit risk exposure at the level of the banking sector. But, such development came mainly as a result of the high credit support to the private sector, which contributed for “rejuvenation” of the credit portfolio of banks. Thus, it is necessary for the banks to observe very carefully the development in the quality of the “new” credit risk exposure in the process of the so called “maturation” of the portfolio.

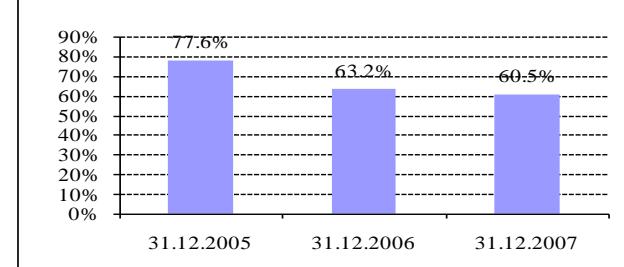
**At the end of 2007 the participation of the non-provisioned amount of the exposure classified in the risk categories “C”, “D”, “E” in the total funds decreased by 1.5 percentage points, relative to the end of 2006.** Thus, in the most extreme scenario, i.e. under assumption of total inability to collect the exposure classified in the categories of risk “C”, “D” and “E”, about 18% of the banking system own funds would be needed for loss coverage, which would cause decrease in the capital adequacy rate from 17% to 14%. In 2007 the coverage of the exposure classified in the categories of risk “C”, “D” and “E” with the total allocated provisions for potential losses (by 7.3 percentage points), where only 5.9% of the total exposure with lower quality level was not covered by provisions for potential losses.

#### **Stress-test analysis on the banks' resistance to credit risk**

The stress-test analysis on the resistance of the banking system to credit risk, which is based on the assessment of the maximal eventual growth in the credit activity, without endangering the legally defined minimal bank's solvency, showed that the growth rate of the gross-credits, at the level of whole banking system, as of 31.12.2007, equalled 60.5%.

With 9 banks, the credits may be increased by more than twice, without causing decrease in the rate of their capital adequacy under legally determined minimal level. On the other hand, by certain banks, the percent of transfer of the regular into non-performing credits (not endangering the

**Figure 44**  
**Maximum possible increase of the credit activity, without jeopardizing the banks' solvency**



banks' solvency) was within 2.1% to 271.3%. The solvency position of 8 banks would not be endangered also when transferring of more than 20% of the regular to non-performing credits.

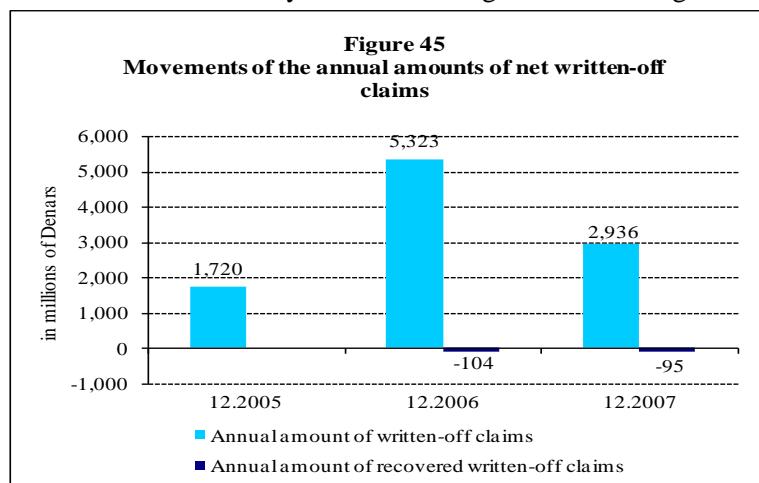
These results, in conditions of intensified credit growth, represents indicator that the banking system of the Republic of Macedonia has a capacity for further increase in the volume of credit activity, i.e. further deepening in the financial intermediation.

\*This stress -test analysis considers the assumptions that the macroeconomic environment shall remain stable and that the same structure of the newly granted credits will be kept, with respect to the level of risk and to the currency, as in 2007.

**The amount of the performed writings-off, as well as their participation in the total credit exposure at the level of the banking system registered decrease in 2007.** In order to asses the quality of the credit portfolio in real terms, i.e. to identify the eventual signs of worsening in the credit exposure of banks, the analysis of certain indicators should also consider the amount of the performed writings-off of claims by the banks. Thus, in 2007, the amount of the performed net writings-off was Denar 2,841 million and it was almost twice lower than in 2006. Simultaneously, in 2007 the participation of the performed net-writings-off of claims in the total credit risk exposure registered decrease by 2.1 percentage points at the end of 2006. In 2007, the claims based on interest were mostly written off (53.9% of the total amount of performed writings-off), followed by the claims based on principal based on credits (43.7%). If in 2007 the banks were not performing writings-off based on credits and interests, than on 31.12.2007 the participation of the exposure classified in the risk categories "C", "D" and "E" in the total credit exposure would amounted to 6.8%, which relative to 31.12.2006 would represent a decrease in this participation by only 0,8 percentage points. With respect to the currency structure, the written-off Denar claims dominated with participation of 88.5%, whereas with respect to the sector structure, the written-off claims of the enterprises and other clients participated with 88% to the total amount of written-off claims.

The group of the large banks performed the largest share of the writings-off (84.1%), which was far higher than the participation of this group of banks in the total credits of 70%. The group of medium banks participated with 9.9% of the total writings-off, relative to their participation in the total credits of 27%.

**When measuring the level of credit risk, the analysis on the manner of structuring the credits - with respect to whether it concerns the credits where there is regular payment of the principal on credits, or one-time payment when the credit is due was especially significant.** On December 31, 2007, the credits with single payment of principle represented 15,1% of the total gross credits and relative to the end of 2006 they registered decrease by insignificant 0.2 percentage points. The banks were using this type of credit product mostly with the enterprises (on 31.12.2007 the credits with single payment of principal granted to households and to other clients participated with 96.6% in the total amount of credits with single payment). Simultaneously, the credits with single payment of principal had relatively high participation in the total gross credits to enterprises and to other clients (23.4%). The credits with single payment of principal to the sector "households" were insignificant and they participated with 1.3% in the total gross credits to households.



**Table 13**  
**Indicators on the quality of the credit risk exposure by groups of banks**

Groups of banks	% of „C“, „D“ and „E“ in total credit risk exposure			% of net „C“, „D“ and „E“ in own funds			Average level of risk		
	31.12.2005	31.12.2006	31.12.2007	31.12.2005	31.12.2006	31.12.2007	31.12.2005	31.12.2006	31.12.2007
Large banks	11.7%	8.2%	6.2%	43.8%	31.1%	26.3%	9.1%	7.1%	5.8%
Medium-size banks	6.1%	3.6%	3.6%	20.8%	10.5%	11.1%	4.3%	3.4%	3.3%
Small-size banks	10.5%	12.4%	9.3%	9.8%	7.3%	3.5%	7.9%	10.3%	8.8%
Overall banking system	10.9%	7.6%	5.7%	26.1%	19.4%	17.9%	8.4%	6.6%	5.3%

The largest part (62.2%) of the credits with single payment of principal was concentrated in the group of large banks, and the participation of the group of medium banks was relatively high equaling 32.3%.

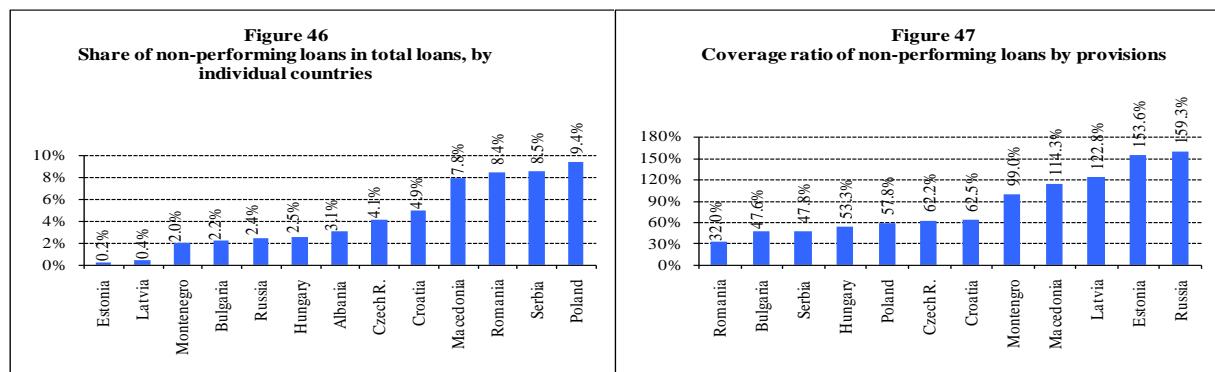
**In 2007, only in the group of medium banks, part of the indicators on the quality of exposure remained unchanged, or they registered certain minimal worsening.** Such developments in the indicators were largely due to the transfer of one bank from the group of small to the group of medium banks.

**The improvement in the indicators on the quality of the credit risk exposure in the group of large banks (in 2007) came mainly as a result of the significant growth in the total credit exposure,** which had lower credit risk when extending the credits, as well as of the relatively high amount of written-off claims in this group of banks.

**In 2007, improvement in the quality of the credit risk exposure in the group of small banks was especially significant.** Such improvement was a result of the relatively high absolute decrease in the exposure to credit risk classified in the risk categories "C", "D", "E" (by Denar 910 million), which was solely resulting from the decrease in the number of banks in this group (transfer of one bank to the group of medium banks and liquidation of one bank). Yet, if the effects of the structure change are excluded, remains the conclusion on improvement in the quality of the credit risk exposure of this group of bank, i.e. the exposure of the group of small banks with lower level of quality would register twice lower annual growth relative to the total credit risk exposure.

**The group of large banks had the largest influence on the quality of the credit risk exposure of the banking system.** Thus, on 31.12.2007, this group of banks amounted to 76.8% of the exposure classified in the risk categories "C", "D" and "E" and 70.1% of the credit risk exposure classified in the categories "A" and "B".

**The indicators on the quality of credit risk exposure in the Republic of Macedonia were on relatively high level, relative to certain European countries<sup>16</sup>.** Namely, by the indicator on the



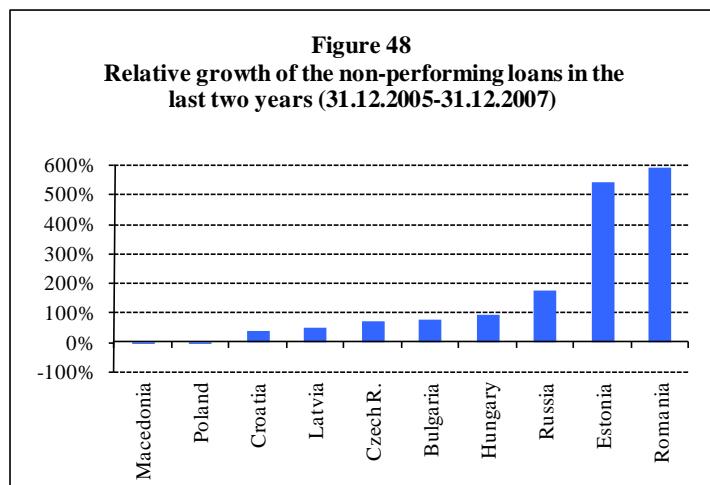
Note: The indicators for Montenegro, Estonia, Latvia, Russia, Croatia and Macedonia are as of 31.12.2007. The indicators for the other countries are as of 31.12.2006.

Note: The indicators for Macedonia, Latvia, Montenegro and Croatia are as of 31.12.2007. The indicators for the other countries are as of 31.12.2006. The indicators for Bulgaria and Romania are calculated by using the amount of provisions that are allocated for coverage of the credit risk exposure with lower degree of quality.

<sup>16</sup> Source: Global Financial Stability Report, Financial Market Turbulence- Causes, Consequences and Policies, October 2007, International Monetary Fund.

participation of non-performing credits in the total credits, the Republic of Macedonia, with 7.8%, was positioned in the upper part of the list of analyzed countries. This indicator was higher only for the banking system of Poland (9.4%), Serbia (8.5%) and Romania (8.4%). Yet, by the indicator for coverage of the non-performing credits by the allocated provisions on potential losses, the Republic of Macedonia, with 114.3%, is positioned in the lower half of the list of analyzed countries (only Latvia, Estonia and Russia registered higher level of coverage of the non-performing credits by allocated provisions), which indicated to the conclusion that there is relatively high level of coverage of the non-performing credits by the allocated provisions for potential losses.

**In the Republic of Macedonia, the amount of the non-performing credits registered decrease**, which was registered only in the banking system of Poland also, (comparison of the growth rates of non- performing credits, by certain countries, for the last two years - 31.12.2005-31.12.2007). Opposite of that, for only two years, in certain countries (as Estonia and Romania), the non- performing credits rose by more than 6 times. Yet, in the process of making conclusions as part of the comparison analysis by individual countries, no methodological differences are taken in consideration when defining the non-performing credits, as well as (non)existing of the regulatory requests or practices of banks for regular performing of writing-off of the non-performing claims by their balances.



### 3.1.1.1. Level of risk and indicators on the quality of the credit risk exposure with respect to the currency structure

**The indicators on the quality of credit risk exposure, by the currency structure registered improvement in 2007. The improvement in the indicators of the quality of the Denar exposure to credit risk was most significant. Yet, the foreign currency exposure to credit risk still registered the lowest level of risk.**

In 2007, all analyzed indicators on the quality of the Denar credit exposure registered decrease by more than 3 percentage points.

**Table 14**  
**Indicators on the quality of the credit risk exposure, by the currency structure**

Indicator	Denar credit risk exposure			Denar credit risk exposure with FX clause			FX credit risk exposure		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
% of C, D and E in total credit risk exposure	17.3%	11.2%	7.3%	11.3%	8.2%	7.8%	4.5%	3.1%	2.3%
% of non-performing loans in total credit risk exposure	12.7%	8.5%	5.1%	8.2%	7.6%	5.4%	2.2%	1.9%	1.7%
% of net written-off claims during current year in total credit risk exposure at the end of previous year*	2.5%	5.6%	2.2%	2.0%	5.4%	0.2%	0.5%	1.3%	0.3%

\*Note: The indicator for 2005 is calculated by using only the amount of written-off claims (not by using the amount of net written-off claims).

The fact that the largest part of the performed writings-off pertains precisely to the Denar claims shall be taken in consideration. If the effect from the writings-off is excluded, the participation

of the Denar exposure classified in the risk categories "C", "D" and "E" in the total Denar exposure to credit risk would amounted to 9.4%, whereas with the Denar exposure with FX clause, this participation would amounted to 8%.

**Table 15**  
**Level of concentration of credit risk exposure, by the currency structure**

Type of credit risk exposure	Date	Herfindahl-index	CR3	CR5
<b>Denar exposure</b>	<b>31.12.2007</b>	1,720	69.2%	77.3%
	<b>31.12.2006</b>	1,576	65.1%	73.9%
<b>Denar exposure with FX clause</b>	<b>31.12.2007</b>	1,892	70.5%	86.0%
	<b>31.12.2006</b>	2,233	70.3%	85.2%
<b>FX exposure</b>	<b>31.12.2007</b>	1,885	72.4%	81.6%
	<b>31.12.2006</b>	2,040	74.5%	82.9%

The analysis of the Herfindahl index and CR-indicators showed relatively high level of concentration of the exposure with respect to the currency structure, which was especially high in the credit risk exposure with currency component. This indicated to relatively high level of concentration of the undertaken credit risk, which resulted from the concentration of the exposure with currency component with several banks.

### **3.1.1.2. Risk level and indicators on the quality of the credit risk exposure to the sector "enterprises and other clients"**

**The quality of the banks' credit risk exposure to enterprises and other clients registered improvement.** Namely, in 2007 all analyzed indicators on the quality of the credit risk exposure to the sector "enterprises and other clients" registered improvement which is within 3.3 to 8.2 percentage points. Simultaneously, improvement in the risk level with the exposure to individual activities of this sector was registered<sup>17</sup>.

**Table 16**  
**Indicators on the quality of credit risk exposure to the enterprises and other clients**

Indicators on the quality of the credit risk exposure	Datum	Industry	Agriculture, hunting and forestry	Construction	Wholesale and retail trade	Transport, storage and communication	Total credit risk exposure to enterprises and other clients
<b>Average level of risk</b>	31.12.2007	11.1%	18.1%	7.9%	7.9%	5.9%	9.2%
	31.12.2006	15.1%	19.3%	8.5%	11.4%	8.2%	12.5%
	31.12.2005	21.5%	25.2%	9.7%	14.3%	10.7%	16.5%
<b>Share of „C“, „D“ and „E“ in total credit risk exposure</b>	31.12.2007	13.0%	18.7%	11.3%	6.5%	4.5%	9.8%
	31.12.2006	18.3%	20.7%	14.9%	11.9%	6.9%	14.5%
	31.12.2005	28.8%	36.5%	23.8%	14.8%	11.5%	21.7%
<b>Share of non-performing loans in total credit risk exposure</b>	31.12.2007	9.0%	11.3%	8.5%	5.5%	4.0%	7.1%
	31.12.2006	15.0%	12.8%	10.2%	9.5%	6.4%	11.5%
	31.12.2005	22.0%	18.0%	2.7%	11.7%	10.0%	15.0%
<b>Coverage ratio of C, D and E by provisions</b>	31.12.2007	85.0%	96.8%	69.8%	121.5%	130.6%	94.8%
	31.12.2006	82.5%	93.2%	56.9%	95.8%	118.5%	86.5%
	31.12.2005	74.5%	69.1%	40.9%	96.9%	93.1%	76.4%

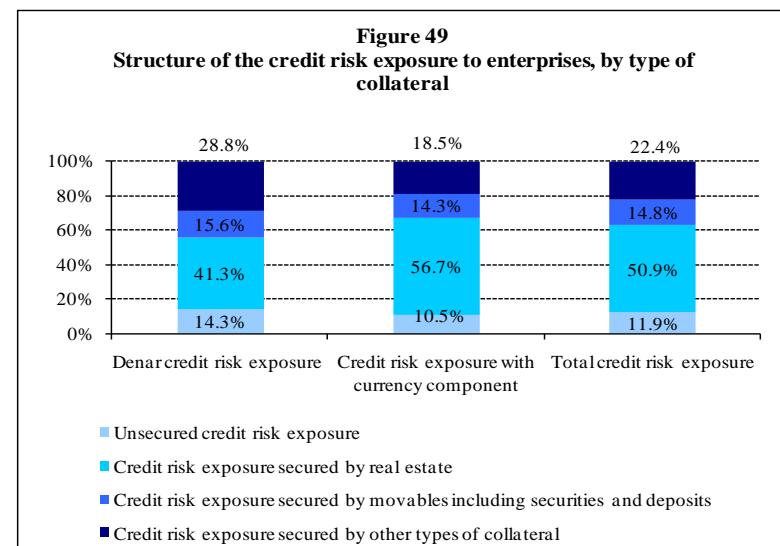
In 2007, the improvement in the indicators on the quality of credit risk exposure in the activity "industry" was most significant contributing with 22.4%<sup>18</sup> to GDP for 2007.

<sup>17</sup> The indicators on the quality of the exposure to individual activities are calculated for 5 activities, which participate with 90% to the total exposure to the sector "enterprises and other clients".

<sup>18</sup> Source: State Statistical Office, Short-term macroeconomic indicators, last report no. 3.1.8.03 dated 21.03.2008.

**The largest part of the writings-off in 2007 pertains to the claims form the enterprises and other clients.** If in 2007 the banks were not performing writings-off of claims form enterprises and other clients, than on 31.12.2007 the participation of the exposure classified in the risk categories "C", "D" and "E" in the total credit risk exposure to this sector would amounted to 12%, which compared with 31.12.2006 would represented a decrease by 2,5 percentage points.

**The largest share of the total exposure (88.1%) to enterprises was covered by certain collateral.** Half (50.9%) of the total exposure was collateralized with real-estate. By the type of the real-estate, which serves as a collateral, the business and the storage capacities had the largest part equaling 55.6%, followed by the participation of the apartments which amounted to 37.6%. Simultaneously, the uncollateralized part of the total credit risk exposure to enterprises amounted to 11.9%, when with the exposure with currency component, the percent of the of uncollateralized claims equaled 10.5%, and with the Denar exposure it was 14.3%.



**The unfavorable structure of the credit users, with respect to the level of currency risk which they are exposed to indicated that the banks' exposure with currency component to the sector "enterprises and other clients" created significant, so called indirect credit risk, which resulted from the potential currency risk which the credit users of this sector are exposed to.** Namely, as of 31.12.2007, in the currency structure of the exposure to the sector "enterprises and other clients", the exposure with currency component dominantly participated with 55.8%. On the other hand, the participation of the credits with currency component extended to enterprises and other clients, the currency risk of which with greater certainty can be assessed as covered (net exporters and credit users within which the price of products depends on the development of the prices in the foreign stock exchanges), represented only 21.9% of the total credits with currency component granted to this sector.

The concentration of the credit risk exposure to the sector "enterprises and other clients" was relatively high. Hence, the undertaken credit risk, which resulted form the exposure to certain activities, was concentrated with several banks within the banking system. Only in the exposure to the activity "transport and communications", the Herfindahl index was within the acceptable level (1,731 index points on 31.12.2007). The level of concentration with the exposure to the activities "industry" and "construction" was especially high, where the Herfindahl index was more than 2.000 index points, while the CR indicators were more than 75%.

**Table 17**  
**Level of concentration of credit risk exposure to individual activities in the sector "enterprises and other clients"**

Activity	Date	Herfindahl-index	CR3	CR5
<b>Industry</b>	<b>31.12.2007</b>	2,359	80.7%	87.3%
	<b>31.12.2006</b>	2,157	76.6%	85.5%
<b>Agriculture, hunting and forestry</b>	<b>31.12.2007</b>	1,875	68.0%	82.8%
	<b>31.12.2006</b>	1,685	62.7%	79.2%
<b>Construction</b>	<b>31.12.2007</b>	2,222	75.8%	85.0%
	<b>31.12.2006</b>	2,032	72.5%	87.8%
<b>Wholesale and retail trade</b>	<b>31.12.2007</b>	1,903	71.0%	79.6%
	<b>31.12.2006</b>	1,773	69.4%	77.6%
<b>Transport, storage and communication</b>	<b>31.12.2007</b>	1,731	58.3%	73.5%
	<b>31.12.2006</b>	2,178	64.0%	77.8%

Based on the transition matrix on non-financial legal entities<sup>19</sup>, for the period 31.12.2006-31.12.2007 (Annex no. 11 - Transition matrix on the clients - non-financial legal entities), an assessment was made on the development in the quality of the credit risk exposure, excluding the effect from the newly extended credits within one year period (31.12.2006-31.12.2007). The conclusion was that during this period, the quality of the exposure to non-financial legal entities registered improvement, quantified through the participation of the exposure classified in the risk categories "C", "D" and "E" in the total credit risk exposure from 11% on December 31, 2006, to 10.6% on December 31, 2007.

### **3.1.1.3. Level of risk and indicators on the quality of credit risk exposure to the sector "households"<sup>20</sup>**

**The improvement in the quality of the credit exposure to the sector "households" was significantly lower than the one with the enterprises** and it was within 0.2 to 0.8 percentage points. On the other hand, if the effect of the written-off claims of the sector "households" is excluded, the participation of the exposure classified in the risk categories "C", "D" and "E" in the total credit risk exposure to the households would equal 5.7%, which on annual basis would represent worsening in the quality of the exposure to this sector by 0.3 percentage points.

**Analyzed by certain credit products offered to the households, the exposure based on credits for purchase and reconstruction of residential and business premises and the exposure based on other credits registered decrease in the risk level, but on the other hand, the quality of the exposure based on consumer credits, credit cards and negative balances on the current accounts registered worsening.** The exposure based on the three credit products with higher risk level (classified in the risk categories "C", "D" and "E") registered relatively high annual growth of 52.1% (or Denar 772 million). The worsening in the quality of the exposure with certain credit products may be expected also in the following period, if the focus of the credit activity of banks precisely towards the sector "households" in the last few years is considered. The competition concerning the issuing of credit cards was significantly intensified in the last two years, when the tendency for relaxing the terms for issuing of credit cards being registered, and the capacity of banks for monitoring the credit risk with considerably dispersed number of clients and concerning the operative and information systems, was still in developing phase.

<sup>19</sup> The transition matrix on the clients - non-financial legal entities (enterprises) pertains only to the non-financial legal entities - residents, on which the banks are obliged to report separately in the Credit Registry, in accordance with Decision on the content and the method of functioning of the Credit Registry. Hence, in the making of the transition matrix, the banks' exposure to other domestic banks (including the foreign banks), to legal entities with overall exposure lower than Denar 500,000 was not taken in consideration.

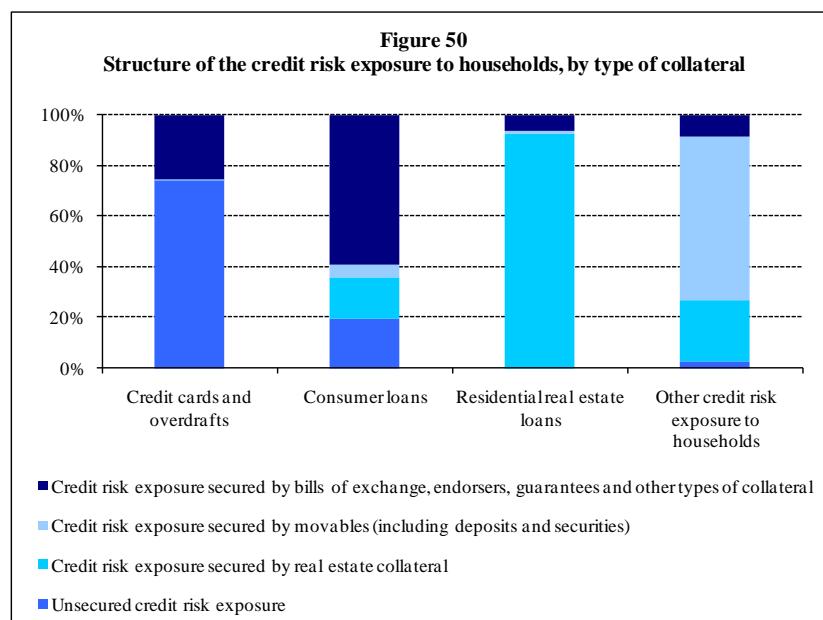
<sup>20</sup> The indicators on the quality of credit risk exposure to the sole proprietors, natural entities which are not considered as traders and the natural persons which perform small trading activities, as of 31.12.2007, are shown in Annex no. 12 at the end of the Report.

**Table 18**  
**Indicators on the quality of the credit risk exposure to households**

Indicators on the quality of the credit risk exposure	Date	Residential and commercial real estate loans	Consumer loans	Overdrafts	Credit cards	Car loans	Other loans	Total credit risk exposure to households
<b>Share of „C”, „D” and „E” in total credit risk exposure</b>	31.12.2007 31.12.2006 31.12.2005	4.5% 5.3% 6.5%	7.1% 6.6% 5.2%	6.0% 5.1% 24.4%	3.5% 3.2% 3.8%	3.6% n.a. n.a.	5.0% 6.5% 7.4%	5.1% 5.4% 7.4%
<b>Average level of risk</b>	31.12.2007 31.12.2006 31.12.2005	4.8% 5.7% 5.3%	5.3% 5.0% 4.3%	4.4% 3.8% 13.4%	3.2% 2.4% 2.9%	4.1% n.a. n.a.	5.3% 6.7% 6.5%	4.4% 4.6% 5.5%
<b>Share of non-performing loans in total credit risk</b>	31.12.2007 31.12.2006 31.12.2005	3.6% 4.7% 5.8%	5.0% 4.8% 4.4%	3.0% 3.3% 17.0%	1.9% 1.4% 1.1%	2.8% n.a. n.a.	2.2% 4.8% 5.5%	3.3% 3.9% 5.5%
<b>Coverage ratio of „C”, „D” and „E” by provisions</b>	31.12.2007 31.12.2006 31.12.2005	106.3% 107.2% 81.9%	73.7% 75.6% 82.7%	74.1% 74.3% 54.9%	90.4% 75.8% 77.7%	113.5% n.a. n.a.	106.1% 104.0% 88.8%	85.7% 84.9% 73.8%

\* Note: Banks have started reporting NBRM on commercial real estate loans and car loans since 31.03.2007.

**The total exposure to households could be more collateralized.** Thus, on 31.12.2007, 36.4% of the total credit risk exposure to the households was not collateralized. In the exposure with currency component the percent of the collateralized claims was highest equaling 93.8%, opposite of the Denar exposure, where the collateralized percent of collateralized claims was 54%. The higher competition among banks for "conquering" clients from the sector "households", especially in the area of credit cards and current (transactional) accounts, indicated potentially increased banks' exposure to credit risk of worsening in the credit ability of the households, especially having



in mind that the largest part of this exposure was collateralized<sup>21</sup> (on 31.12.2007, over 75% of the exposure based on credit cards and negative balances on the current accounts were uncollateralized). Simultaneously, the average credit risk exposure of banks on this basis to one client amounted to about two average monthly wages of the respective client<sup>22</sup>, which even more emphasized the banks' exposure to credit risk of these placements. On the other hand, the residential credits registered the highest level of collateral and they were almost solely collateralized by real estate. In the moment of extension of this credits, the correlation between the amount of the extended credit and the value of the established collateral was minimum 1:1.5, which additionally contributed to the increase in the level of safety of the banks when granting this type of credit.

<sup>21</sup> The Review of the structure of the credit risk exposure to enterprises and households by the type of established collateral is shown in Annex no. 7 and Annex no. 8.

<sup>22</sup> The Analysis is based on the data received from only 5 banks, with software limitations in several banks certain being registered, which potentially decrease the quality of the submitted data. As a result of that, this conclusion shall not be taken as granted.

**Table 19**  
**Level of concentration of the credit risk exposure to the sector "households", by individual bank products**

Bank product	Date	Herfindahl-index	CR3	CR5
<b>Residential and commercial real estate</b>	<b>31.12.2007</b>	2,155	70.5%	88.1%
	<b>31.12.2006</b>	2,954	84.2%	96.3%
<b>Consumer loans</b>	<b>31.12.2007</b>	1,778	66.1%	82.5%
	<b>31.12.2006</b>	1,721	63.2%	76.4%
<b>Overdrafts</b>	<b>31.12.2007</b>	3,122	92.6%	97.3%
	<b>31.12.2006</b>	2,613	83.6%	93.5%
<b>Credit cards</b>	<b>31.12.2007</b>	5,210	88.2%	93.8%
	<b>31.12.2006</b>	5,485	92.6%	99.1%
<b>Car loans</b>	<b>31.12.2007</b>	2,597	80.1%	93.8%
	<b>31.12.2006</b>	n.a.	n.a.	n.a.
<b>Other loans</b>	<b>31.12.2007</b>	2,494	77.3%	90.0%
	<b>31.12.2006</b>	2,393	69.6%	84.3%

There was a relatively high level of concentration with few banks also with respect to the type of credit products which are offered to the sector "households". Only with the exposure based on consumer credits, the Herfindahl-index was within the acceptable level (1.778 index points on 31.12.2007), which may be assessed as favorable circumstance, concerning the relatively high level of consumer credits (of 30.2%) in the structure of the credit risk exposure to the sector "households". The highest level of concentration with the credit cards and the negative balances on the current accounts was an additional signal on the higher credit risk which certain banks were exposed to, as a result of these banking activities.

The analysis on the quality of the so called "old credit portfolio", i.e. excluding the effect from the newly extended credits in 2007, indicated to worsening in the quality of the credit portfolio of the households. Based on the transition matrices on the natural persons<sup>23</sup>, for the period 31.12.2006-31.12.2007 (Annex no. 11 - Transition matrix on the client - natural persons), an assessment was made on the development of the quality of the credit risk exposure, excluding the effect from the newly extended credits during the period on one year (31.12.2006-31.12.2007). The conclusion was that during this period the exposure to natural persons registered worsening, measured through the participation of the exposure classified in the categories "C", "D" and "E" in the total credit risk exposure to the households. Namely, this indicator rose from 5.4%, on 31.12.2006 to 7.9% on 31.12.2007.

### 3.2. Exposure to country risk

The exposure of the banking system to country risk, as a result of the credit risk exposure to non-residents, was small. On 31.12.2007 it amounted to Denar 36,500 million and registered annual decrease of 3%. Hence, on annual basis, the participation of the country risk exposure in the total credit risk exposure registered decrease by 5.6 percentage points and on 31.12.2007 it equaled 15.4%.

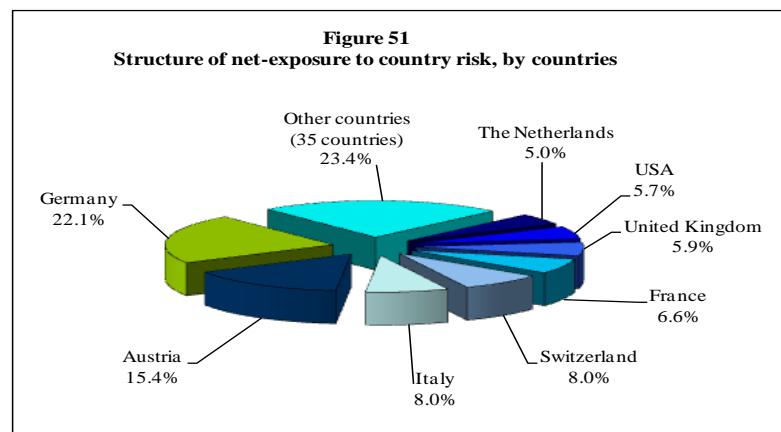
The decrease in the exposure to country risk resulted from the decrease in the placed deposits in foreign banks, which as of 31.12.2007 amounted to 96.1% of the total credit risk exposure to non-residents. On 31.12.2007, the total potential losses based on country risk amounted to Denar 60 million or 0.5% of the total potential losses. 90.2% of the total potential losses based on country risk resulted from the banks' exposure to two countries. The exposure to these countries was 0.9% of the total exposure to country risk.

The Macedonian Inter-banking System did not suffered direct implications from the USA financial crises, considering the relatively low exposure to this country (5.7% of the total

<sup>23</sup> The transition matrix on natural persons was made considering only the natural persons - residents with exposure higher than Denar 150,000, on which the banks are obliged to report to the Credit Registry, in accordance with the Decision on the content and the method of functioning of the Credit Registry.

exposure to country risk), as well as the structure of the banks' exposure to country risk (there are no investments on the American mortgage market, as well as investments in structured products).

**The banks' exposure to country risk was diverse and it resulted from the exposure to clients of total 43 countries.** The structure of the exposure by individual countries was almost unchanged relative to the previous periods. Namely, the exposure to the clients from the member-countries of the European Union, as well as from Switzerland and USA still dominated.



### 3.3. Liquidity risk

In 2007, the liquidity of banks in the Republic of Macedonia was on a satisfactory level and did not show considerable changes relative to the previous year. Most of the indicators registered improvement, which confirmed the stable liquidity position of the banking system. The insignificant decrease in some of the liquidity indicators resulted from certain qualitative structure balance sheet movements.

#### 3.3.1. Liquidity risk indicators

The analysis of the liquidity indicators for 2007 showed that the banks had on their disposal a satisfactory volume of liquid assets to meet the due liabilities.

**Table 20**  
**Liquidity indicators - first part**

Indicators	January - December 2006	January - December 2007
<b>Liquid assets /Total assets</b>	<b>36.6%</b>	<b>35.2%</b>
- Large banks	36.6%	33.5%
- Medium-size banks	37.9%	37.5%
- Small-size banks	33.7%	42.1%
<b>Highly liquid assets / Total assets</b>	<b>16.4%</b>	<b>19.1%</b>
- Large banks	12.8%	16.1%
- Medium-size banks	23.2%	23.7%
- Small-size banks	22.8%	29.7%
<b>Liquid assets /Total liabilities</b>	<b>43.8%</b>	<b>41.0%</b>
- Large banks	41.3%	37.3%
- Medium-size banks	47.0%	45.0%
- Small-size banks	56.0%	72.1%
<b>Highly liquid assets/Total liabilities</b>	<b>19.5%</b>	<b>22.3%</b>
- Large banks	14.5%	17.9%
- Medium-size banks	28.7%	28.4%
- Small-size banks	37.9%	50.8%
<b>Highly liquid assets/Total deposits</b>	<b>23.0%</b>	<b>26.3%</b>
- Large banks	16.4%	20.5%
- Medium-size banks	37.3%	35.9%
- Small-size banks	47.7%	68.1%
<b>Highly liquid assets/Sights deposits</b>	<b>48.2%</b>	<b>60.2%</b>
- Large banks	33.9%	46.1%
- Medium-size banks	86.4%	91.1%
- Small-size banks	87.0%	120.4%
<b>Liquid assets / Total liabilities (due within 30 days according expected residual maturity structure)*</b>	<b>231.5%</b>	<b>272.2%</b>
<b>Highly liquid assets / Total liabilities (due within 30 days according expected residual maturity structure)*</b>	<b>110.5%</b>	<b>149.4%</b>

\* These indicators are calculated based on the situation at the end of the two years.

**The liquid assets continued to grow in 2007, mostly as a result of the CB bills.** The average monthly amount<sup>24</sup> of the liquid assets<sup>25</sup> equaled Denar 69,650 million in 2007, which was by Denar 13,159 million, or by 23.3% more relative to 2006. The CB bills mostly contributed to the growth in the liquid assets with 44.7%, whereas the debt securities and cash and balances with NBRM equally contributed to the rest of the growth in the liquid assets. Such growth in these three components of the liquidity assets was a reason more for increase in their structure participation, on annual level, for the account of the decrease in the participation of the short-term placed assets with foreign banks. Despite these structure movements, the short-term placed assets with foreign banks in 2007 kept their dominant position in the liquid assets with 50.7% (60.6% during 2006).

**The downward trend of the average participation of the liquid assets in the total assets continued in 2007.** Thus, it reduced to 35.2% (36.6% - average monthly participation for 2006). This level of liquid assets ensured coverage of 41% of the total liabilities of the banking system, i.e. they were by 2.7 times higher than the total liabilities which shall due in 30 days, by the expectations and the empirical analysis of banks. Still, it shall be emphasized that the expectations and the empirical analysis of banks are based on positive and stable macroeconomic conditions, i.e. their certainty in eventual worsening of conditions in the macroeconomic environment is not confirmed. Analyzed by groups of banks, the group of small banks maintained the highest participation of the liquid assets in the total assets, followed by the group of medium banks and the group of large banks.

**Table 21**  
**Liquidity indicators - second part**

Indicators	January - December 2006	January - December 2007
<b>Primary sources of financing (Total banks' deposits)/ Total sources of financing</b>	<b>71.0%</b>	<b>72.5%</b>
- Large banks	78.1%	78.3%
- Medium-size banks	62.1%	66.0%
- Small-size banks	47.9%	43.6%
<b>Primary sources of financing / Total third party's sources of financing (Total liabilities)</b>	<b>84.9%</b>	<b>84.5%</b>
- Large banks	88.1%	87.3%
- Medium-size banks	76.9%	79.1%
- Small-size banks	79.6%	74.6%
<b>Secondary sources of financing/ Total sources of financing</b>	<b>10.9%</b>	<b>11.3%</b>
- Large banks	9.1%	9.5%
- Medium-size banks	16.3%	15.1%
- Small-size banks	10.1%	13.4%
<b>Secondary sources of financing/ Total liabilities</b>	<b>13.0%</b>	<b>13.2%</b>
- Large banks	10.2%	10.6%
- Medium-size banks	20.2%	18.1%
- Small-size banks	16.9%	22.9%
<b>Gross credits/Total deposits of non-financial entities*</b>	<b>72.9%</b>	<b>77.9%</b>
- Large banks	70.3%	75.8%
- Medium-size banks	82.8%	84.3%
- Small-size banks	69.8%	73.5%

\* These indicators are calculated on the basis of the stocks at the end of the two years.

**The highly liquid assets continued to grow during 2007, ensuring high coverage of the sight deposits and full coverage of the total anticipated liabilities with maturity up to 30 days.** In 2007, the highly liquid assets<sup>26</sup> amounted to Denar 37,801 million, which is half of the liquid assets. Relative to 2006, the highly liquid assets registered growth of Denar 12,570 million, or by 49.8%. The CB bills gave the largest contribution to the growth in the highly liquid assets. In the same time,

<sup>24</sup> The Analysis on the liquidity risk was based on the average amounts of the categories in the balance sheet of the banking system.

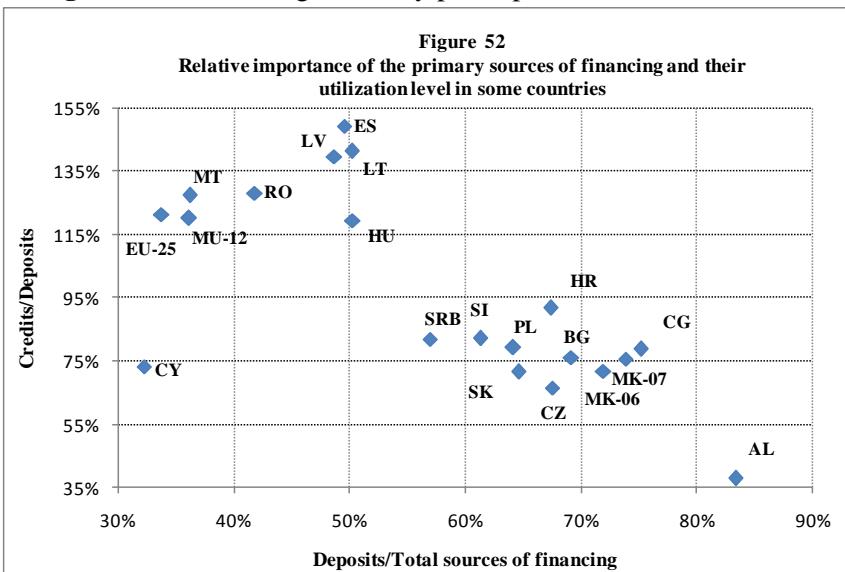
<sup>25</sup> The liquidity assets, in broader regard, includes the highly liquid assets, the short-term placed assets, with foreign banks and the placements in other categories of long-term debt securities.

<sup>26</sup> The highly liquid assets includes the cash and the balances with NBRM, the CB bills, the correspondent accounts with foreign banks and the placements in short-term securities issued by the Government.

they registered also the highest annual growth rate which enabled them a dominant average monthly participation of 37.4% (32.7% in 2006) in the structure of the highly liquid assets. This level of highly liquid assets enabled coverage of 60.2% of the sight deposits and full coverage of the total liabilities which shall due in 30 days, by the expectations of the banks. The high participation of the highly liquid assets and the low level of the deposits in the total sources of assets with the group of the small banks, relative to other groups of banks, enabled highest level of coverage of the sight deposits by highly liquid assets (120.4%).

**In the structure of the sources of financing the activities, the deposits remained dominant sources of funds during 2007.** Their average monthly participation in the total sources of

financing and in the total third party's sources of financing equaled 72.5% and 84.5%, respectively. The comparison with most of the EU member-countries showed that the banking system of the Republic of Macedonia had the largest participation of this sources in the total sources of financing. Also, in part of the EU member-countries<sup>27</sup>, the deposits from non-financial entities represented main source of financing, despite the



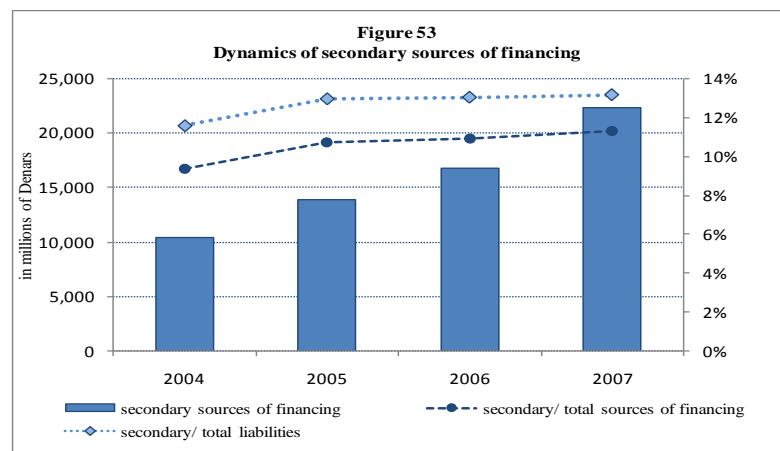
downward trend of their participation. The comparison with the countries from the region showed that except of Albania, which had larger, and Serbia, which had lower participation of the deposits to the total sources of funds, in Croatia and Montenegro this sources amounted to about 70% of the total sources, which was almost identical participation as in our country. At the end of 2007, the indicator on the correlation of the gross credits and the deposits of non-financial entities indicated that a considerable part of the lending of banks in the Republic of Macedonia was financed by the deposit base, but there still was a room for increase. The comparison with the countries from the region showed that the banks in the Republic of Macedonia had almost identical rate of deposit utilization as credits as in Montenegro, while the banks in Croatia and Serbia had somewhat higher deposit utilization as credits, and the banks in Albania had the lowest rate relative to all analyzed countries. Concerning the EU member-countries, except for the Czech Republic which registered the lowest rate of deposit utilization as credits, the Republic of Macedonia, along with 5 more EU member-countries, was in the group of countries where the utilization exceeded 82%. In the rest of the EU member-countries, the volume of granted credits was far higher than the deposits, which was due to the development of the financial markets of these countries and the broader chances for ensuring additional sources of financing. This was confirmed also by the lower participation of the deposits to the total sources of financing in the banks of these countries.

The higher growth rates of the credits than the deposits, in the last few years, within most of the analyzed countries contributed for the banks to orient towards use of additional sources of financing. Thus, in Latvia, the participation of the secondary sources in the total sources of funds exceeded 60%, while in the countries from the region, predominantly with Serbia and Croatia, the

<sup>27</sup> Source: EU Report on the Banking Sector Structure (ECB), October 2007 and the websites of the central banks of the respective countries. The data on individual countries pertains to 2006, except for the Republic of Macedonia, showing the data for 2007, while for Croatia, the data are for June 2007. The abbreviations pertain to following countries: EU-25 - all EU member-countries; MU-12 - countries from the Euro-zone; MK - Republic of Macedonia; MT - Malta; RO - Romania; LV - Latvia; ES - Estonia; LT - Lithuania; SL - Slovenia, SK - Slovakia; PL - Poland; BG - Bulgaria; CZ - Czech Republic; AL - Albania, HR - Croatia, CG - Montenegro, SRB - Serbia.

secondary sources of funds participated in the total sources of financing with 21.3% and 17.6%, respectively, in Montenegro the participation equaled 11%, which was identical with the one in our country, and in Albania was the lowest (about 4%).

**In 2007, higher use of the secondary sources of financing by the banks in the Republic of Macedonia was registered, relative to 2006.** In 2007 this sources of funds equaled Denar 22,325 million, on average monthly basis, which represented increase of Denar 5,514 million, or by 32.8% relative to 2006. However, the average monthly participation of the secondary sources of financing of 11.3% and 13.2% to the total sources of financing and to the total third party's sources of financing, respectively, indicated relatively lower level of "dependence" of the banks of this source of financing.



**In the structure of the secondary sources of financing, the long-term borrowing represented a dominant category at the level of the banking system and by certain groups of banks.** They registered the highest absolute average annual growth (Denar 2,570 million) and simultaneously they contributed mostly to the growth in the secondary sources of funds (46.6%).

This growth was mainly due to the higher use of long-term foreign credit lines<sup>28</sup> by more banks through the "Macedonian Bank for Development Promotion" AD Skopje, to the higher use of subordinated instruments by three banks, as well as the issuance of the corporate bond by one bank. The short-term borrowings registered largest annual growth of 8.7 times, which was the reason for their higher structure participation in the total secondary sources of funds on annual level.

Table 22  
Structure of secondary sources of financing by group of banks

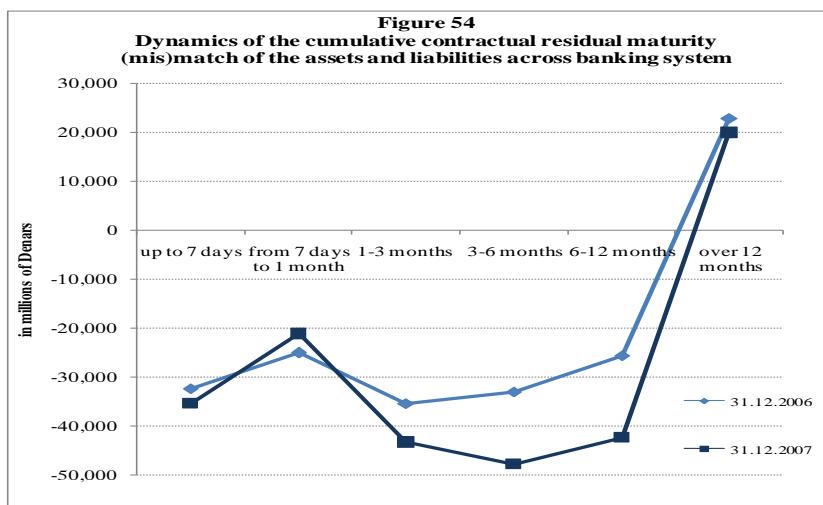
	Items	Monthly average for 2006	Monthly average for 2007
Large banks	deposits of banks	16,3%	15,1%
	short-term borrowings	1,5%	14,8%
	long-term borrowings	82,2%	70,1%
Medium-size banks	deposits of banks	23,9%	25,6%
	short-term borrowings	0,4%	1,5%
	long-term borrowings	75,7%	72,8%
Small-size banks	deposits of banks	18,5%	24,7%
	short-term borrowings	2,2%	1,1%
	long-term borrowings	79,3%	74,2%
Banking system	deposits of banks	19,2%	19,8%
	short-term borrowings	1,2%	8,8%
	long-term borrowings	79,6%	71,4%

**In 2007 the parent funding increased.** At the end of 2007, 5 banks were using funds from the parent entity for financing their own activities. These assets amounted to 37.1% of the total secondary sources of funds. Relative to the end of 2006, these funds rose by Denar 2,674 million, or by 40.2%, so the participation of these funds went up by 3.2 percentage points, whereas the number of banks rose by 2 banks. The analysis by groups of banks showed that the total secondary sources of financing were proportionally allocated by the size of the banks. Thus, the group of large banks had the largest participation (55.2%) in the secondary sources of funds in accordance with their dominant position in the market. The largest "dependence" of this source for financing the activities was registered in the group of medium banks, considering the highest average participation of 15.1% of these sources in the total sources of funds of the group of medium banks relative to the participation in the other two groups of banks.

<sup>28</sup> Italian credit line.

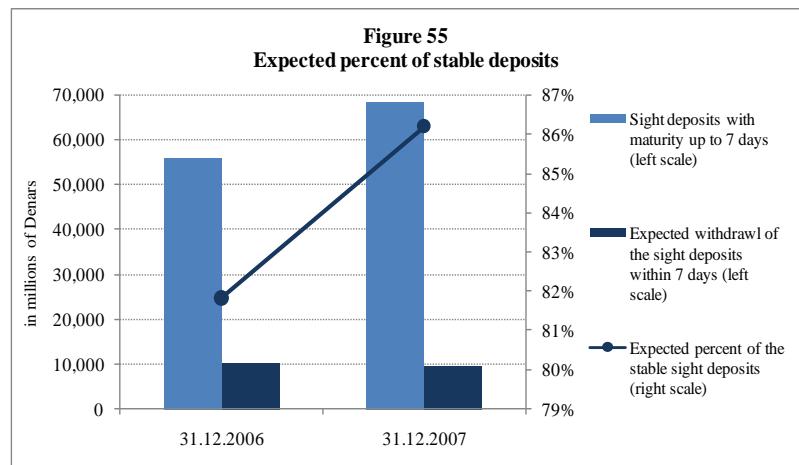
### 3.3.2. Maturity structure of the assets and liabilities

**At the end of 2007, the cumulative contractual maturity mismatch of the assets and liabilities, as in the previous year was overcome in the maturity ladder of over 12 months.** Such mismatch was largely due to the maturity mismatch between the two dominant balance sheet categories, higher participation of the credits with higher maturity relative to the deposits with higher maturity. At the end of 2007, the long-term credits equaled 85% of the time deposits<sup>29</sup>, i.e. they were by 8.9 times higher than the long-term deposits. The credit expansion which in the last few years was especially present with the new EU member-states, as well as in our country, may potentially represent a pressure on the liquidity position. Especially the previously mentioned maturity mismatch between the credits and the deposits (due to the long-term character of the credits opposite of the shorter maturity of the deposits) of the banking system in the Republic of Macedonia, may generate higher liquidity risk, in case of eventual "urgent" payment of the deposits. The unfavorable maturity structure of the primary sources of financing of banks was still present. However, within the structure of the primary sources of financing the tendency for increase in the participation of the short-term time and long-term deposits was present, for the account of the decrease in the participation of the sight deposits. The long-term deposits registered largest relative annual growth of 55.4%, whereas the short-term deposits gave the largest contribution to the growth in the primary sources of financing of 62.1%.



Despite the cumulative contractual maturity mismatch, by the empirical analysis of banks, in all maturity ladders there was a match between the anticipated maturity of the assets and liabilities, which was due to the current high stability of the sight deposits.

**The percent of the stable deposits, by the banks' assessments, continued to grow.** At the end of 2007, the percent of the stable sight deposits equaled 86.2%, which was by 4.4 percentage points higher level relative to the level from the end of 2006. Relative to the end of 2006 the banks anticipated higher level of stability of the Denar and foreign currency sight deposits, so they reached the level of 88% (81.1% - 2006) and 84% (82.5% - 2006), respectively. By the banks' expectations at the end of 2007, 13.6% of the total sight deposits may outflow within 7 days, i.e. 7.9% of the total deposits, which represented decrease by 4.3 and 3.1 percentage points, respectively, relative to the last year.



<sup>29</sup> Deposits with maturity up to one year and long-term deposits.

### Stress-test analysis of the exposure of the banking system to liquidity risk

The stress-test, performed by the National Bank of the Republic of Macedonia showed that the liquidity risk is on relatively low level. The stable liquidity position of the banking system resulted from the high level of the liquid assets and the stable deposits of banks.

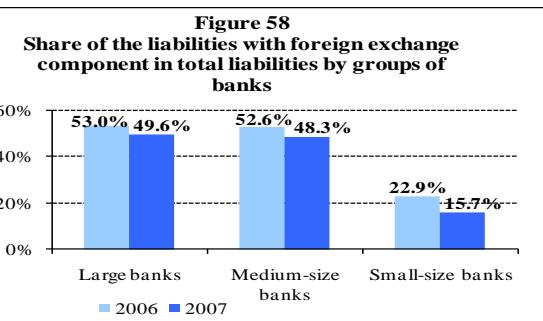
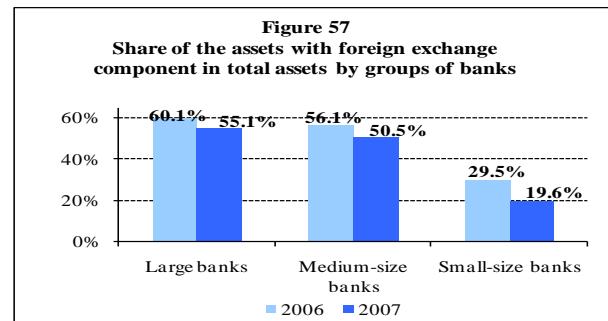
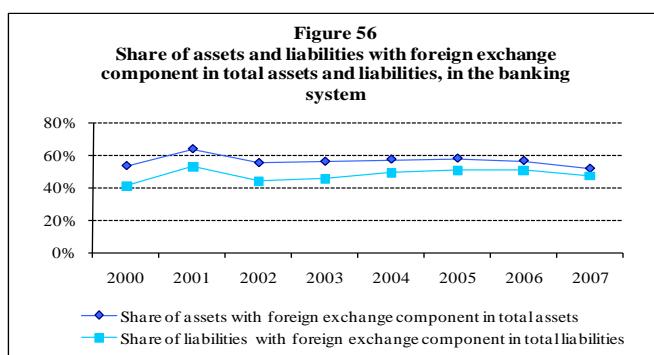
31.12.2007	Baseline	One-time withdrawal of 20% of the total households' deposits	Withdrawal of deposits of the 20 largest depositors of each bank of the banking system
Liquid assets/ Total assets	34.1%	28.0%	18.6%
Highly liquid assets/ Total assets	20.6%	13.2%	2.0%
Liquid assets/ Total liabilities	39.2%	32.6%	22.1%
Highly liquid assets/ Total liabilities	23.7%	15.4%	2.3%

The analysis was performed based on two simulations of outflow of deposits. The simulation of withdrawal of 20% of the total households' deposits out of the banking system showed that all banks have highly liquid assets on their disposal for coverage of the hypothetical withdrawal of households' deposits. The simulation of the hypothetical withdrawal of the deposits of the 20 largest depositors of each bank individually had more significant influence over the liquidity of the banks.

### 3.4. Currency risk

The high participation of the foreign currency component was still characteristic for the balances of the banking system of the Republic of Macedonia. Yet in the last 2 years downward trend was registered. Namely, at the end of 2007, the participation of the foreign currency assets<sup>30</sup> in the total assets of the banking system equaled 52.0% (Denar 116,230 million), which is a decrease of 4.7

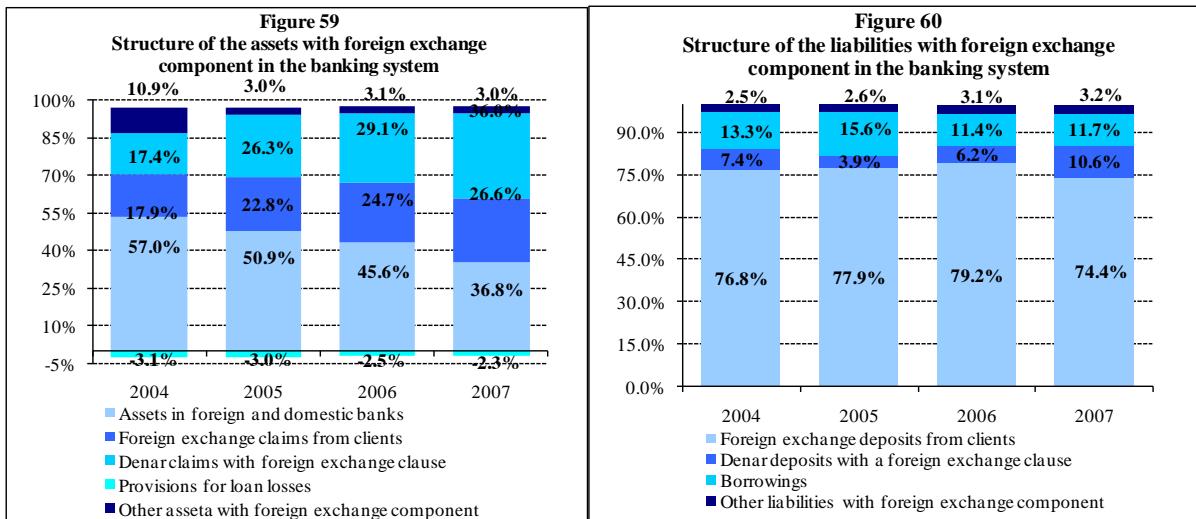
percentage points relative to 31.12.2006. On the side of the liabilities, the participation of the items with foreign currency component amounted to 47.4% (Denar 106,060 million) and it registered annual decrease of 3.2 percentage points. As a result of the more intensive growth in the participation of the foreign currency liabilities<sup>31</sup> in the period 2003-2005, as well as of the more intensive decrease in the participation of the foreign currency assets, in the last two years, there was a narrowing in the gap between the participation of the foreign currency component in the total assets and in the total liabilities at the level of the banking system, since 2004. Thus on 31.12.2007, this gap was on the lowest level in the last 8 years equaling only 4.5 percentage points, which indicated relatively high level of matching of the assets and liabilities with foreign currency component, at the level of whole banking system.



<sup>30</sup> The foreign currency assets include the assets in foreign currencies and the assets in Denars with FX clause.

<sup>31</sup> The foreign currency liabilities include the liabilities in foreign currencies and the liabilities in Denars with FX clause.

Decrease in the participation of the foreign currency component in the balances was registered also at the level of individual groups of banks. The group of large banks still registers highest participation of the foreign currency component, where the foreign currency assets and foreign currency liabilities amounted to 55.1% and 49.6% of the total assets and liabilities of this group of banks. The dominant position of the group of large banks was confirmed also with the participation of this group of banks in the total foreign currency assets and liabilities of the banking system, of 71.2% and 70.2%, respectively (almost unchanged participation relative to the previous periods).



**The Euro strengthened its dominant participation in the currency structure of total foreign currency claims and liabilities.** Such structure was logic implication of the high level of currency substitution registered in the domestic economy. The USA Dollar was still the second foreign currency by the participation in the structure of the foreign currency component of the banks' balances. Yet, relative to the end of 2006 a decrease in its participation was registered, opposite of the growth in the foreign currency component in Swiss Franks.

**Table 24**  
**Currency structure of the foreign currency assets and foreign currency liabilities**

Currency	Dec.06		Dec.07	
	Assets with foreign exchange component	Liabilities with foreign exchange component	Assets with foreign exchange component	Liabilities with foreign exchange component
Euro	84.7%	85.0%	86.8%	87.0%
American dollar	10.3%	11.4%	8.2%	9.0%
Swiss franc	1.8%	1.6%	2.7%	2.2%
Other	3.2%	2.0%	2.3%	1.8%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

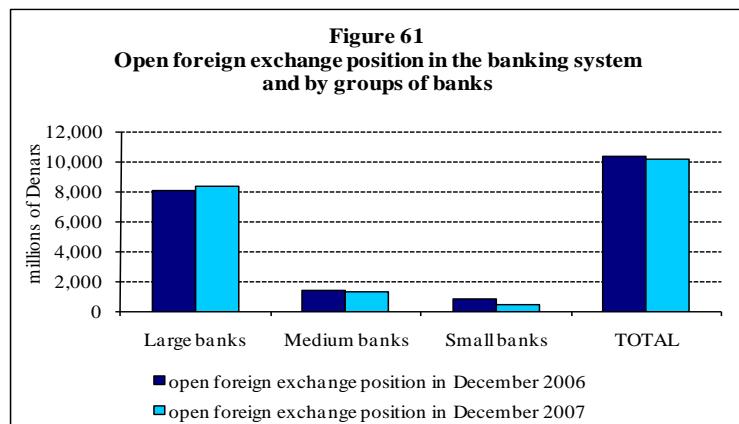
**In 2007 the trend of restructuring of the foreign currency assets continued acting towards decrease in the participation of the assets placed with domestic and foreign banks, for the account of the growth in the claims with foreign currency component placed with clients (non-financial entities).** The claims from clients in foreign currencies and with FX clause, with annual growth rates of 29.9% and 49.5%, respectively, were also the items which grew most intensively within the total assets with foreign currency component. For the account of that, the placements with other banks registered decrease of 2.7%. (Annex no. 15 - Structure of the foreign currency assets as of 31.12.2007 at the level of the banking system).

**The foreign currency deposits of the households still had the largest participation of 47.7% to the total foreign currency liabilities, despite the increase in the participation of the**

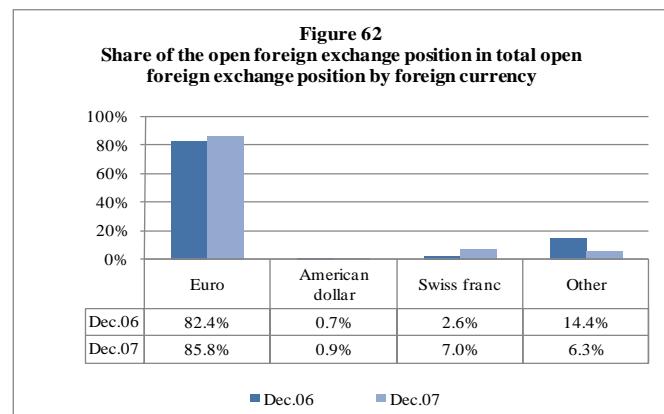
**Denar deposits with FX clause.** Such developments resulted from the significant annual growth of 111.3% of the Denar deposits with FX clause, mainly as a result of the higher amount of these deposits of one client with several banks. (Annex no. 15 - Structure of the foreign currency liabilities as of 31.12.2007 at the level of the banking system).

### 3.4.1. Open foreign currency position

At the end of 2007, the banking system of the Republic of Macedonia had long aggregate open foreign currency position in amount of Denar 10,169 million, which was 36.7% of the own funds. The long open foreign currency position was characteristic for all currencies. As in the previous periods, the largest share of the open foreign currency position (82.8%) was a result of the open foreign currency position in Euros.



On annual basis, the participation of the open foreign currency position in Euros, USA Dollars and Swiss Franks in the total open foreign currency position at the level of the banking system registered increase, relative to the decrease in the open foreign currency position in other currencies. The open foreign currency position in Euros registered largest annual growth (Denar 679 million, or 7.9%), whereas the open foreign currency position in Swiss Franks registered the largest relative growth of 185% (or Denar 492 million).



**Table 25**  
Currency structure of the open foreign currency position by groups of banks

Currency	31.12.2006				31.12.2007			
	Large banks	Medium-size banks	Small-size banks	Banking system	Large banks	Medium-size banks	Small-size banks	Banking system
<b>Euro</b>	88.0%	60.6%	65.8%	82.4%	87.6%	77.5%	72.8%	85.8%
<b>American dollar</b>	-0.1%	-3.7%	14.7%	0.7%	0.8%	-0.2%	6.6%	0.9%
<b>Swiss franc</b>	2.3%	5.0%	0.6%	2.6%	7.3%	7.7%	0.3%	7.0%
<b>Other</b>	9.7%	38.1%	18.9%	14.4%	4.4%	14.9%	20.3%	6.3%
<b>Total:</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

With respect to the groups of banks, larger structure movements were registered with the group of large banks, the open foreign currency position in Swiss Franks of which rose by Denar 439 million (the group of large banks participated with 89.2% to the total annual growth in the open foreign currency position in Swiss Franks, at the level of all banking system), or by 199% relative to 31.12.2006. More than 66% of the annual growth in the open foreign currency position in Swiss Franks, in the group of large banks was concentrated with one bank, which registered considerable growth in the foreign currency assets in Swiss Franks, i.e. in the assets placed with domestic and foreign banks and the credits in Swiss Franks (foreign currency credits and Denar credits with FX clause).

### 3.5. Insolvency risk<sup>32</sup>

The current capital position of banks, in conditions of relatively fast dynamics and intensification on the credits and total financial activities, which surely represented growth in the exposure of banks to different risks, was a solid absorber of the losses from possible materialization of these risks. In 2007, the high income in the banks' operating represented solid basis for the growth in the capital basis at the level of the banking system.

#### 3.5.1. Own funds

**The own funds of banks characterizes with relatively simple structure.** On 31.12.2007, they amounted to Denar 27,721 million, so the core capital, with participation of 92.1%, had dominant position in the structure of the own funds of banks. The largest share of the core capital (79.3%) pertains to the value of the common shares and non-cumulative preference shares and the realized premium of these shares. The banks' reserves, which were allocated from the taxed income and which serve for coverage of the losses from the risks arising from the operating, equaled 15.5%, the financial effect from the banks' so far operations (positive and negative) equaled 6.4% of the core capital, while the other positions had insignificant participation in the forming of the core capital of banks. The subordinated instruments of banks, with participation of 90.8%, gave the largest influence on the size of the supplementary 1 capital. Opposite of that the participation of these instruments in the own funds amounted to only 8.7%.

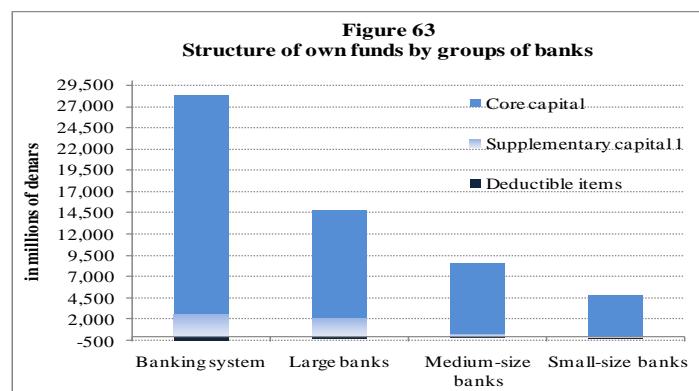
**Table 26**  
**Structure of the own funds of banks as of 31.12.2007**

	in millions of denars			
	Banking system	Large banks	Medium-size banks	Small-size banks
<b>Own funds</b>	27,721	14,656	8,480	4,586
<b>Core capital</b>	25,534	12,624	8,149	4,761
-Paid in and subscribed common and non-cumulative preference shares and premiums based on these shares	20,237	8,338	7,101	4,798
-Reserve fund	3,950	2,604	1,073	272
-Profit/Loss*	1,645	1,737	66	-158
<b>Supplementary capital 1</b>	2,642	2,209	347	86
-Subordinated instruments	2,399	2,007	306	86
Deductions from the core capital and supplementary 1 capital	455	177	17	261

\*Profit/Loss refers to the current profit/loss and retained earnings

**The dominant position of the group of large banks was confirmed also from the view of the distribution of the capital basis.** Namely on 31.12.2007, the group of large banks owned 52.9% of the total own funds, the medium banks - 30.6%, and the small banks - 16.5%.

**Relatively simple structure of the own funds at the level of the banking system, was characteristic also for all groups of banks.** Namely, over 85% of the own funds of certain groups of banks are core capital. The other positions of the own funds had very small participation in the structure, excluding the group of large banks where the subordinated instruments formed 13.7% of the own funds.



<sup>32</sup> In December 2007, with the Decision on the Methodology for Determining the Capital Adequacy ("Official Gazette of the Republic of Macedonia no. 159/2007 and 32/2008) a quality change in the method of calculating the own funds, the assets weighted with the risks and the capital adequacy rate was performed.

The distribution of the own funds of banks by certain risks showed that the banks own enough own funds for covering the risks and that there is space for undertaking additional activities. Thus, 52.9% of the own funds in the whole banking system exceeded the needed level for covering the undertaken risks. The required level for covering the credit risk was calculated as 8% of the credit risk weighted assets, whereas the needed level for covering the currency risk was calculated as 8% of the currency risk weighted assets. With individual groups of banks, the group of small banks registered highest level (88%) of own funds over the minimal required assets which indicated to the conclusion for their high capitalization relative to the current volume of activities, which reflected on their relatively lower profitability. The capital for coverage of the credit risk of all banks equaled 44% of the total own funds, opposite of the marginal participation of the capital for covering the currency risk (3.1%). In the last few years, upward trend of the participation of the capital for coverage of the credit risk in the own funds (2006 - 40.2%; 2005 - 33.5%; 2004 - 30.4%), as a result of the intensified credit activity of banks. Such relation between the capital for coverage of the credit risk and the capital for coverage of the currency risk was characteristic also for individual groups of banks.

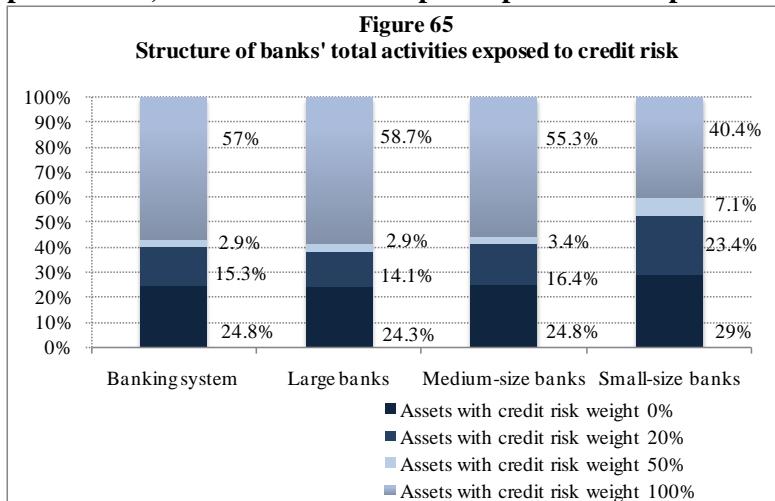
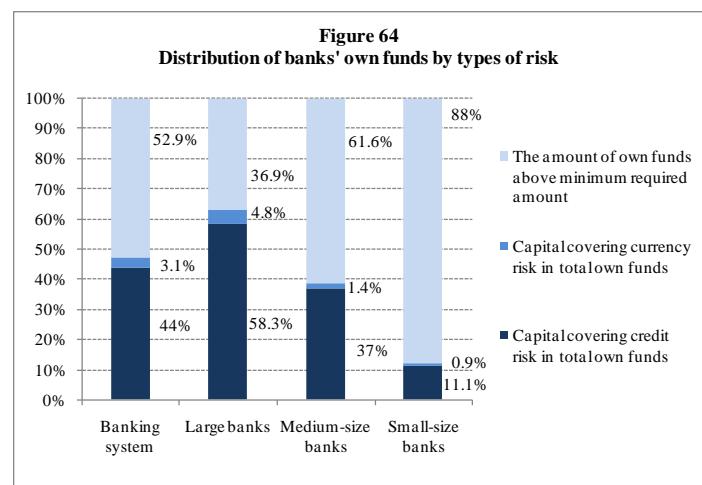
### 3.5.2. Risk weighted assets

At the end of 2007, the risk weighted assets equaled Denar 163,069 million and resulted from the credit risk weighted assets and the currency risk weighted assets.

**On 31.12.2007, the credit risk weighted assets amounted to Denar 152,375 million and with participation of 93.4% had crucial influence in the creating the risk weighted assets.** Within the credit risk weighted assets, the balance credit risk weighted assets had the dominant participation (85.2%). At the end of 2007, the capital required for coverage of the credit risk, which came as a result of this structure and level of the credit risk weighted assets, equaled Denar 12.190 million.

**The structure of the credit risk weighted assets, at the level of the banking system, as well as at the level of certain groups of banks, indicated dominant participation of the positions for risk weight of 100%.**

Within the balance assets, the claims of banks based on credits and interests dominated, whereas in the sub-balance assets, uncovered letters of credit and guarantees and the unused limits based on current accounts and credit cards dominated. The assets with risk weight of 100% had the largest participation in creating the balance assets weighted with the credit risk, making 79.1% of the total balance credit risk weighted assets, i.e. 67.3% of the total (balance and off-balance) credit risk weighted assets. At the level of individual groups of banks, the structure was mainly identical. Certain deviation was registered only with the group of small banks, where the assets with risk weight of 0% and 20% participated mostly



in the credit risk weighted assets. Such condition was a reflection of the lower participation of this group of banks in the financial intermediation and the credit activities.

**At the end of 2007, the currency risk weighted assets equaled Denar 10,695 million, which is only 6.6% of the total risk weighted assets.** It solely resulted from the aggregate foreign currency position, whereas the net position in gold did not contribute at all in the process of its creation. At the end of 2007, the capital required for coverage of the currency risk equaled Denar 856 million and it was mainly a result of the aggregate long foreign currency position of banks.

### 3.5.3. Capital adequacy

**The banking system of the Republic of Macedonia characterizes with relatively high level of the capital adequacy.** Thus, at the end of 2007, the capital adequacy ratio, at the level of all banks, equaled 17%, which represented a decrease by 1.3 percentage points relative to the end of 2006. The decrease was largely a result of the continuous process restructuring of the assets of banks acting towards participation of the assets with higher risk weight, which in the same time created higher interest income also.

**At the level of individual groups of banks, significant differences in the level of capital adequacy were registered.** The group of large banks registered lowest rate of capital adequacy, whereas the small banks registered highest capital adequacy. Such situation was in direct relation with the level of credit activity of individual groups of banks on one hand, opposite of the structure of their sources of financing on the other hand.

**Table 27**  
**Indicators on the capital adequacy, by groups of banks**

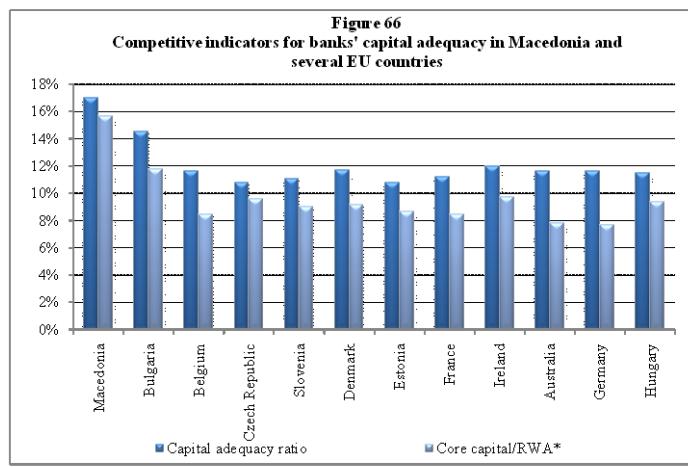
Indicators	Banking system	Large banks	Medium-size banks	Small-size banks
Own funds/risk weighted assets (CAR > 8%)	17.0%	12.7%	20.9%	66.8%
Own funds/credit risk weighted assets	18.2%	13.7%	21.7%	72.2%
Own funds/currency risk weighted assets	259.2%	168.9%	562.4%	898.1%
Credit risk weighted assets/risk weighted assets	93.4%	92.5%	96.3%	92.6%
Currency risk weighted assets/ risk weighted assets	6.6%	7.5%	3.7%	7.4%
Core capital/risk weighted assets (Tier 1 ratio)	15.7%	10.9%	20.0%	69.4%

**As a reflection of the low level of participation of the currency risk weighted assets in the total risk weighted assets, the capital adequacy ratio mainly resulted from the relation between the own funds and the credit risk weighted assets.** The analysis of the capital adequacy ratio at the level of individual banks indicated the same conclusion. Due to the domination of the core capital within the total own funds of banks, higher level of approximation of the capital adequacy ratio and the Tier 1 ratio was registered, which was especially characteristic for the group of medium and the group of small banks.

**Generally, the banking system of the Republic of Macedonia characterizes with relatively high level of capital adequacy, which can be confirmed by the comparison with the banking system of certain EU countries EU<sup>33</sup>.** Thus, the banking systems of all analyzed countries of the EU, excluding Bulgaria, characterizes with capital adequacy rate under 12%. The difference in the level of the capital adequacy of banks in the Republic of Macedonia, relative to the banking systems of EU countries, was due to their relatively high level of capitalization, relative to the financial intermediation which they realized.

<sup>33</sup> Source: EU Report on the Banking Sector Structure (ECB), November 2007. The data on the member-countries of EU pertains to 2006.

The comparison with the banking systems of the countries from the area indicated relatively similar levels of capital adequacy (14% in Croatia, 18.1% in Albania, 21.3% in Montenegro and 24.7% in Serbia). Hence, the conclusion was that, mainly, at the level of whole banking system, there was still enough volume of capital base for supporting the further intensification in the credit activity of banks, but with different level and volume, considering the different level of the capital adequacy ratio in individual groups of banks.



## **Stress - test analysis of the stability of the banking system to hypothetical shocks - as of December 31, 2007**

The results from the stress-test analysis indicated satisfying level of resistance of the banking system to isolated credit shock, as well as to different combinations of hypothetical shocks to credit, interest and currency risk. The stress-test analysis, performed as of 31.12.2007, was based on hypothetical scenarios which remained the same relative to the previous quarters.

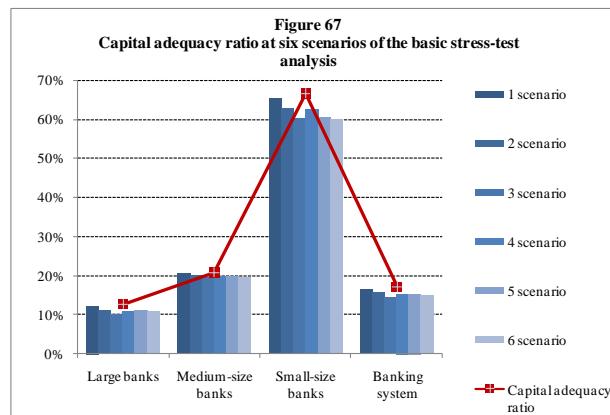
The possible exposure of the banking system to isolated credit shock (application of three scenarios for isolated credit shock, which implied increase in the credit exposure calcified in the risk categories "C", "D" and "E" by: 10%, 30% and 50%) would cause decrease in the rate of capital adequacy to 16.5%, 15.4% and 14.4%, respectively.

The next simulation, which implies combination of credit and interest shock (increase of the credit exposure in the risk categories "C", "D" and "E" by 30% and growth in the domestic interest rates by 5 percentage points) resulted in fall in the rate of the capital adequacy of the banking system by 1.8 percentage points.

The combination of credit risk and foreign currency shock (increase in the credit exposure in the risk categories "C", "D" and "E" by 50% and the depreciation of the foreign currency rate of the Denar against the Euro and the USA Dollar by 20%) would cause fall in the rate of the capital adequacy of the banking system to 15.3%.

In the most extreme scenario, which represented a combination of the hypothetical shock on the side of the credit risk, foreign currency risk and the risk of interest rate (increase in the credit exposure in the risk categories "C", "D" and "E" by 50%, the depreciation of the exchange rate of the Denar relative to the Euro and the USA Dollar by 20% and increase in the domestic interest rates by 5 percentage points), the coefficient of capital adequacy of the banking system would equal to 15.1%.

At the level of certain groups of banks, not one of these scenarios caused a decrease in the rate of the capital adequacy under 8%. Simultaneously, the solvency position of any bank was not questioned. Most significant decrease in the rate of the capital adequacy in the groups of large and medium banks was registered after the appliance of the third scenario for isolated credit shock (increase in the credit exposure in the risk categories "C", "D" and "E" by 50%), whereas in the group of small banks, the most significant negative effect was registered after the appliance of the sixth scenario. Simultaneously, as a result of the expressed credit activity and the lowest level of capital adequacy, and before the performance of all six simulations, the lowest capital adequacy after the stress-test analysis especially significant in the appliance of the scenario conclusion that this group of banks registered relative banks, especially the large banks with higher dynamics pay greater attention to the implementation of stress-test.

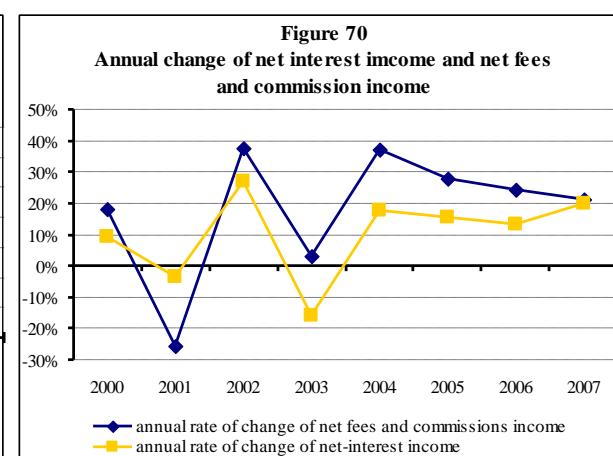
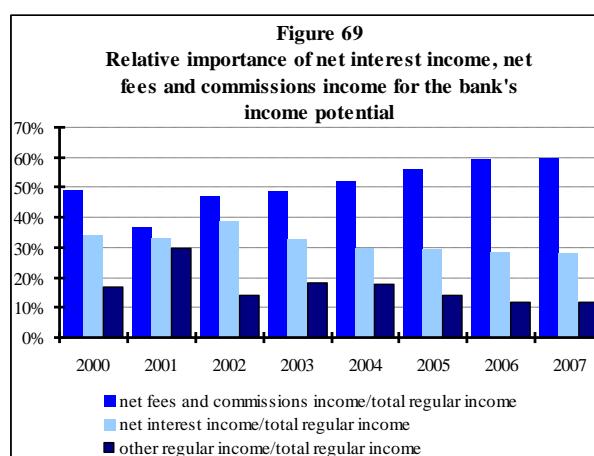
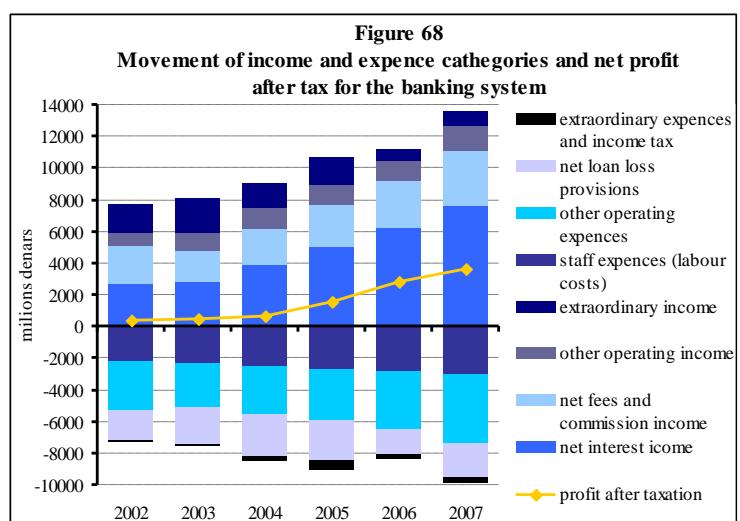


### 3.6. Profitability

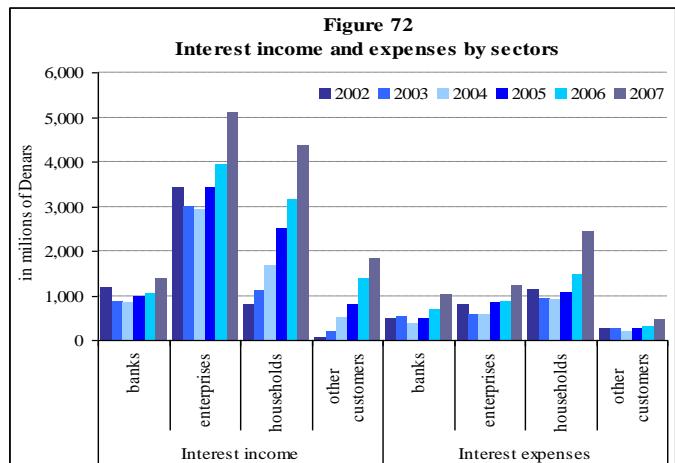
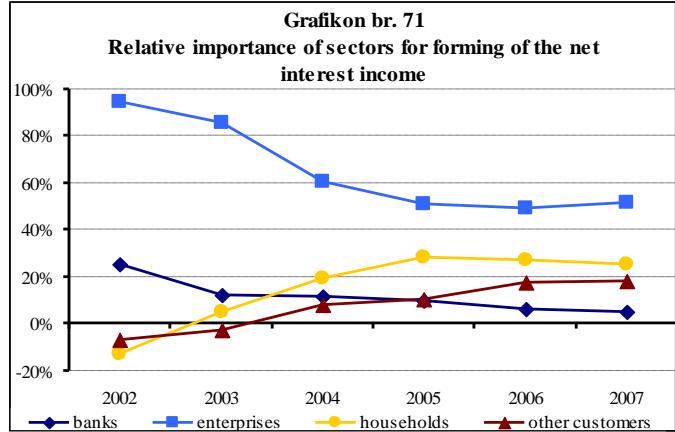
The continuous growth in the area of activities of banks, followed by the decrease in their risk profile and the positive macroeconomic ambient, which was especially high in the first half of 2007, enabled for the banks to maintain the trend of improvement in the profitability and efficiency in the operating, in the previous year. The significant volume of realized profit in 2007 created a possibility for the banks to increase their capital basis, despite ensuring adequate return for its shareholders through payment of dividends, to increase its capital base also, and ensuring with that a basis for further dynamic growth and higher level of safety and stability in the further operations. This becomes more significant also when considering the higher variability and turbulences in the international financial markets. The uncertainty caused from the developments in the international interest rates with which the liabilities of banks based on borrowings were indexed, the inflation pressures in the Republic of Macedonia, which stared in the second half of 2007, the upward trend of the basic domestic interest rates, after all, may cause negative pressure on the net interest income as basic income component. Also, they may cause an increase in the risks connected with the quality of the portfolio and non-realization of the desired growth in the volume of activities, which would reflect to the profitability of banks.

#### 3.6.1. Structure of the income and expenditure and indicators on the profitability and efficiency in the operating

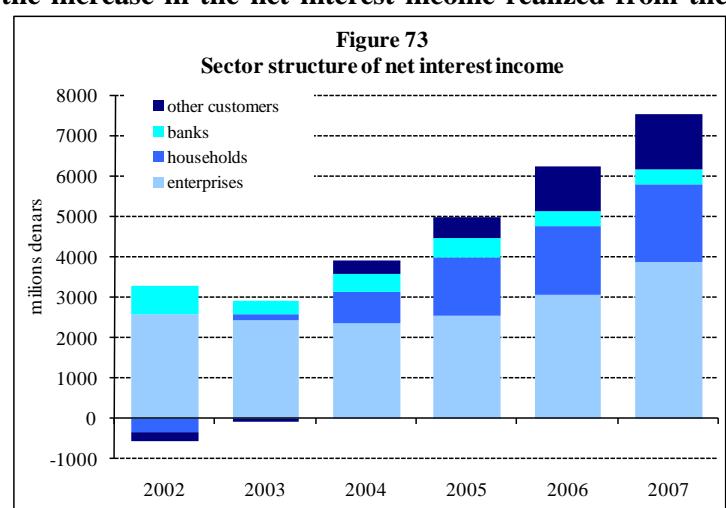
In 2007, the total income at the level of the banking system equaled Denar 3,650 million and relative to 2006 it rose by Denar 850 million, i.e. by 30.4%. The realized profit was mainly determined by the growth in the realized income of regular banking activities and of the continuous improvement of the operating efficiency. Fourteen banks registered profit of their operating, and 4 banks registered losses and at the end of 2007 they created 2.6% of the total assets at the level of the banking system. The positive performances of the banking system in 2007 reflected on the operating of the individual groups of banks. Namely, in 2007, all groups of banks registered profit in their operating. The group of large banks kept its dominant position in the banking system creating 73.2% of the cumulative financial result of banks. The group of medium and the group of small banks participated with 26.4% and 0.4%, respectively, in the total profit at the level of the banking system.



In 2007, the incomes from regular operating were the main generator of the profitable operating of banks, and they created 93.4% of the total income of banks. These income components registered annual growth rate of 21%, which was by 2.5 percentage points more relative to the growth rate in 2006. In the structure of the regular income in 2007, the net interest income was the dominant component participating with 59.7%, which in 2007 registered annual growth rate of 21.2% creating 60.2% of the annual growth of the total regular income. The net incomes from the fees remained the second item, by significance, in creating the income in the banking system, and on annual basis they registered growth of 20.0% participating with 27.1% in the total annual growth of the regular income. As a result of such development, in 2007 the upward trend in the relative significance of the net interest income continued in the structure of the banks' income, for the account of the decrease in the relative participation of the net income from fees and other income. The intensive growth of the credit activity in the previous period was the main generator of this process, followed with continuous process of conversion of the low income bearing assets into high income bearing assets, in conditions when the banks were performing insignificant or they were not performing any financial activities which created non-interest bearing income. The enrichment of the variety of banking products, the launching of new activities and the improvement in the processes of risk management should contributed to the broadening of the sources of income, and with that also an additional room for increase in the price competition in the banking system.

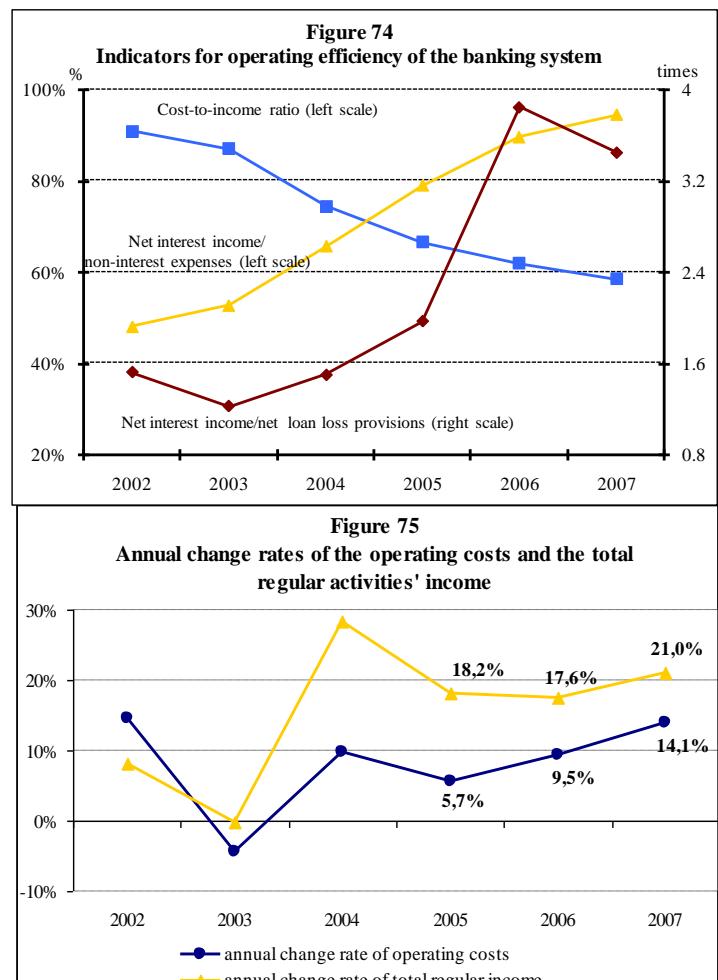


In 2007 the trend of moderate decrease in the participation of the net interest income of banks continued, for the account of the increase in the net interest income realized from the enterprises, households and other clients. This trend of change in the structure of the net interest income by the sector, was due to the continuous structure changes in the assets of the banking system, acting towards increase in the participation of the credits to non-financial entities, for the account of the decrease in the participation of the placements in foreign banks. Namely, the structure changes of the assets, especially the growth in the credits and the investments in Treasury bills and Government bonds determined the income of interest realized from the households, enterprises and other clients to grow more dynamically in the last few years, relative to the growth in the income from interest realized of banks. On the other hand, the changes in the sector structure of the sources of financing of banks also influenced the changing in the sector structure of the net interest income, especially the growth in the

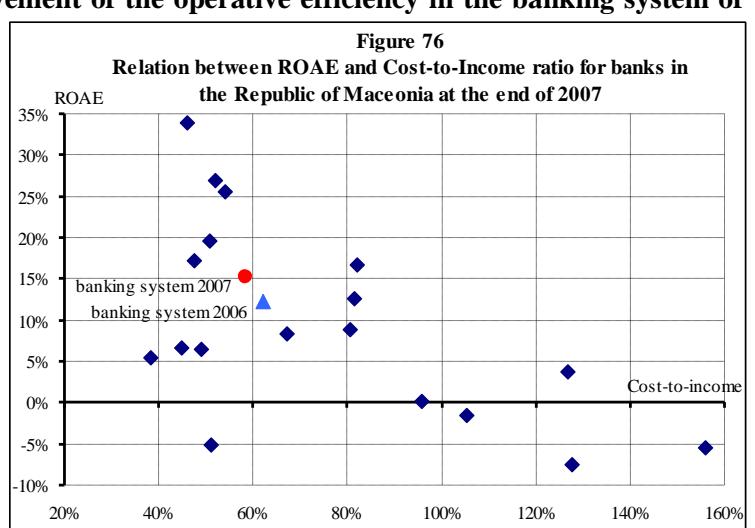


long-term borrowings and subordinated foreign deposits, the costs of which depend on the development of the reference interest rates in the international financial markets. In 2007, the interest rates in the domestic money market and the reference interest rates in the international financial markets developed differently. It contributed to more dynamic growth in the expenditures for interest of banks in 2007, relative to previous years. The higher participation of the foreign borrowing, in conditions of higher uncertainty in the international financial markets, even more elevated the significance of these expenditures for interest. Yet, the sector "enterprises" still registers the highest absolute amount of the income and expenditure based on interest and the operations with this sector created the dominant part of the interest income.

**In 2007 the trend of improvement in the indicators for operative efficiency of banks continued.** The operative costs registered annual growth of Denar 912 million, i.e. by 14.1%. In 2007, the costs for the employees and the costs for services remained the dominant items in the structure of the operative costs participating with 41.9% and 20.0%, respectively or 27.6% and 23.4%, respectively of the total growth in the operative costs. Same as in the last few years, the annual growth in the operative costs was more moderate relative to the growth in the income categories, which resulted in improvement in the indicator of the relation between the operative costs and the total regular income (so called cost-to-income indicator), which on annual basis reduced by 1.6 percentage points and at the end of 2007 it amounted to 58.4%. Simultaneously, the coverage of the non-interest expenditure with net interest income on annual basis also increased by 4.8 percentage points equaling 94.5% at the end of 2007.

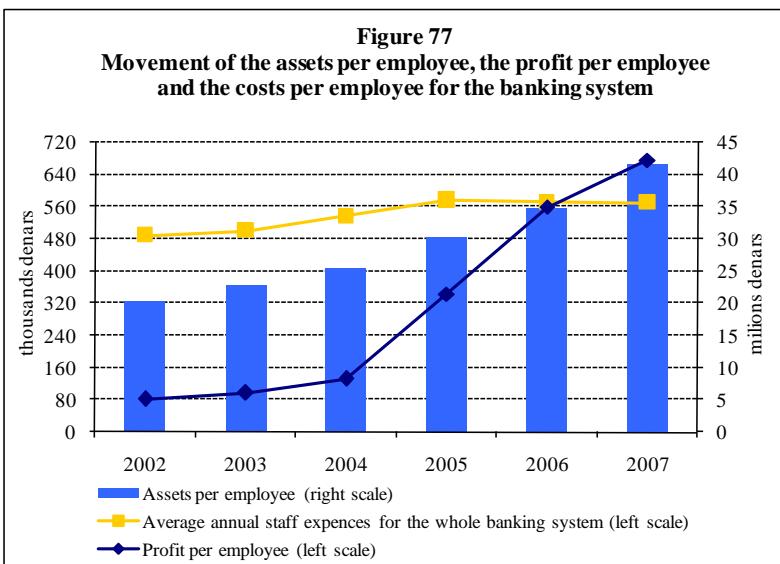


**Despite the trend of improvement of the operative efficiency in the banking system of the Republic of Macedonia, there was still room for further improvement by certain banks.** Namely, there was significant interdependence of the size of "cost-to-income" indicator and the return of the average capital, so in the banking system of the Republic of Macedonia there were several banks which showed considerably small efficiency in the operating, having high value of the "cost-to-income" indicator, and in the same time they were in the zone of non-profitable operating. According to this, the future performances of the

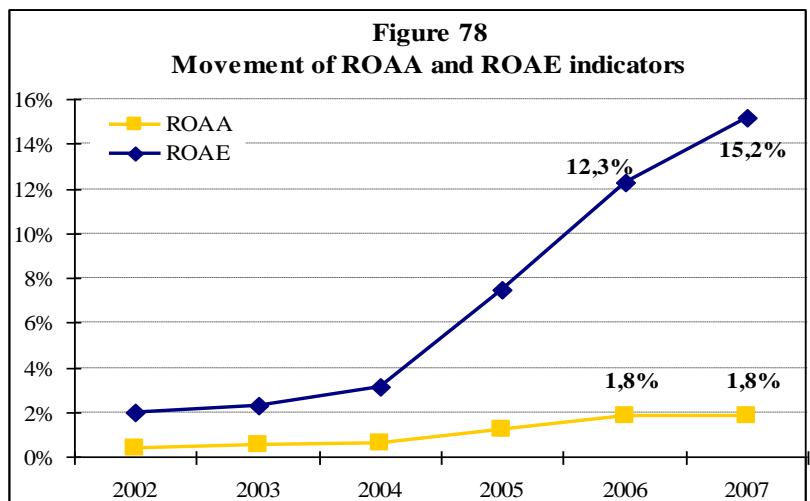


banks and their profitable operating are in direct dependence of the capability of the management to control the operative costs and to maintain them in the planned frames.

**The growth in the assets and in the profit realized by the banks in the Republic of Macedonia caused improvement also in the indicators of the productivity in the banking system.** Namely, at the end of 2007, for the first time in the last few years, the profit per employee at the level of the banking system was higher than the average annual cost per employee<sup>34</sup>. In the same time, the assets by employee also continued increasing and in 2007 it registered growth by 19.7% relative to the end of 2006.



**The growth in the profit in 2007 contributed for most of the indicators for profitability at the level of the banking system to register improvement.** Thus, at the end of 2007, the indicator on the return of the average own funds (ROAE) amounted to 15.2% registering improvement of 2.9 percentage points, relative to 2006, whereas the indicator on the return of average assets (ROAA), in conditions of intensive growth in the activities kept the level of 2006. The trend of improvement in the indicators on the profitability at the level of the banking system mainly resulted from the positive developments of these indicators with the group of large banks. Namely, with the group of large banks, all indicators on the profitability and efficiency registered improvement, relative to 2006. Opposite of this group of banks, the group of medium banks and the group of small banks registered moderate worsening in the indicators on profitability in operating. In the group of medium banks, the significant growth in the operative expenditures and the worsening in the indicators for operative efficiency were the main reason for the decrease in the profit potential. The group of small banks, due to the low volume of activities and the decrease in the relative significance within the total banking system, registered decrease in the realized income, and with that, a decrease in the profitability. Yet, **the positive dynamics in the performances of the group of large banks, at the level of the banking system enabled amortization of the effects from worsening in the indicators on the profitability with the group of medium and the group of small banks.**

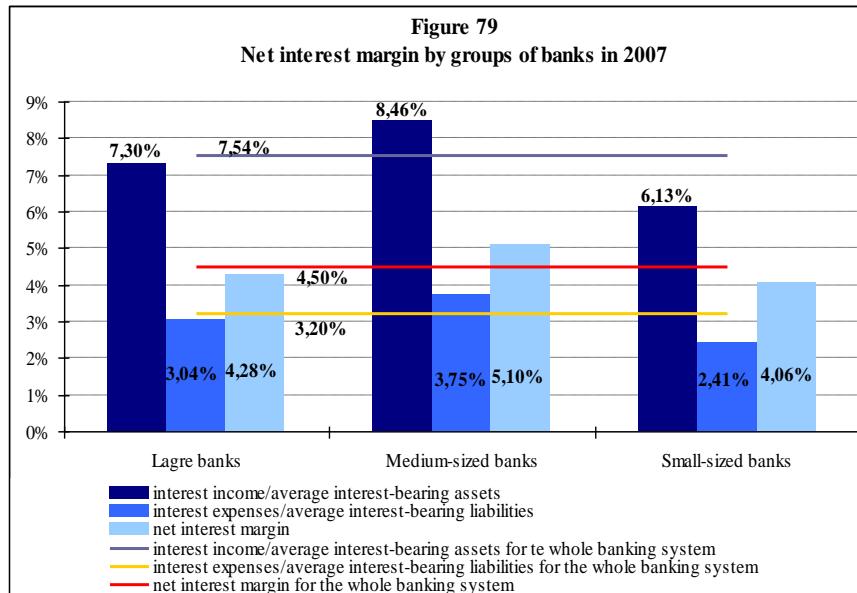


<sup>34</sup> Expenditures per employee shall mean costs for wages, costs for contributions based on wages and other different costs based on the labor agreements.

**Table br. 28**  
**Indicators on the profitability and efficiency in the banks' operating**

Indicator	Banking system		Large banks		Medium-sized banks		Small-sized banks	
	2006	2007	2006	2007	2006	2007	2006	2007
Rate of return of average assets (ROAA)	1,8%	1,8%	1,8%	2,0%	2,2%	1,8%	0,4%	0,1%
Rate of return of average equity (ROAE)	12,3%	15,2%	19,6%	24,5%	12,9%	12,1%	1,1%	0,3%
Cost-to-income ratio	62,0%	58,4%	57,2%	52,3%	63,5%	68,3%	86,8%	74,3%
Non-interest expenses/Total regular income	63,6%	60,3%	58,5%	54,1%	65,4%	69,9%	87,9%	77,0%
Labour costs/Total regular income	26,2%	23,2%	24,6%	21,4%	26,8%	25,5%	33,5%	30,4%
Loan loss provisions/Net interest income	26,0%	29,0%	32,4%	31,2%	11,7%	18,7%	27,8%	62,7%
Net interest income/Average assets	4,0%	3,8%	3,7%	3,7%	4,9%	4,3%	3,4%	3,3%
Net interest income/Total regular income	57,1%	57,0%	56,4%	58,4%	63,1%	56,7%	46,5%	44,9%
Net interest income/Non-interest expenses	89,7%	94,5%	96,4%	107,9%	96,5%	81,1%	52,9%	58,3%
Financial result/Total regular income	25,6%	27,5%	27,7%	31,8%	28,9%	23,9%	5,9%	1,8%
Number of employees	5.010	5.390	2.726	2.831	1.413	2.142	871	417
Assets per employee (millions denars)	34,75	41,50	42,23	53,03	29,28	28,74	20,24	28,69
Financial result per employee (millions denars)	0,56	0,68	0,70	0,94	0,58	0,45	0,08	0,04

The amount of the interest bearing assets of banks in the Republic of Macedonia was mainly exceeding the amount of interest bearing liabilities, which enabled realization of an adequate amount of the net interest margin for covering the non-interest expenditures of banks. This made room for narrowing of the interest spread and higher capacity for absorbing the shocks on the profitability, in case of unexpected developments in the interest rates, especially those on the side of liabilities. The net interest margin in 2007, at the level of the banking system equaled 4.5 percentage points. By individual groups of banks, the group of medium banks realized the highest net interest

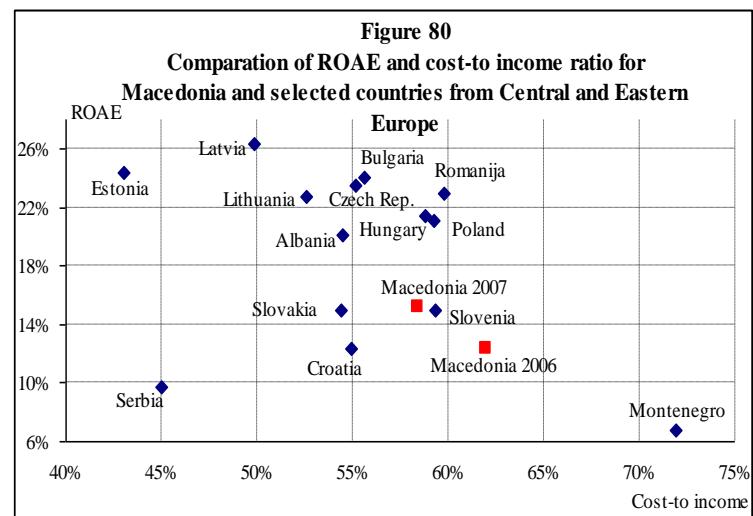


margin in 2007, in amount of 5.1 percentage points, and it represented the only group of banks with net interest margin over the average value of the total banking system. In the same time, the interest bearing assets of this group of banks created relatively largest income. The interest bearing assets of the group of small banks created the lowest relative income, but in the same time the interest bearing liabilities of this group of banks registered the lowest price, i.e. they created relatively lowest expenditures based on interest.

The improvement in the profitability and the efficiency approximated the banks in the Republic of Macedonia to the banks from the countries in the region and from Central and East Europe<sup>35</sup>. Namely, the banking system of the Republic of Macedonia was gradually approximating to the value of the return on equity and of the cost-to-income indicator, characteristic for the banking systems of some of the analyzed countries. Relative to the countries from the region, the banking system of the Republic of Macedonia registered higher rate of return on equity than in Croatia, Serbia and Montenegro, and it had an identical level with the one in Slovenia. It was registered that this process of value approximation of the indicators on profitability and efficiency

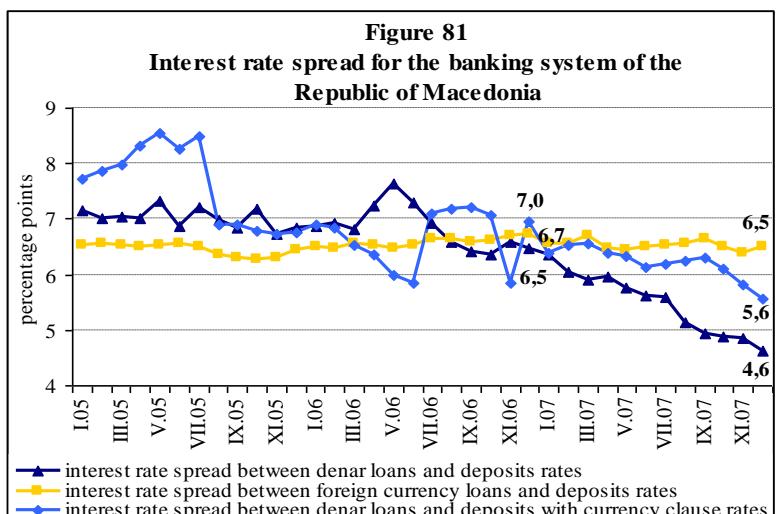
<sup>35</sup> Indicators on the analyzed countries are for 2006 and they are calculated on the basis of the financial reports prepared in accordance with the International Financial Reporting Standards (ISFR), excluding the data on Hungary, which are calculated on the basis of the financial reports, prepared in accordance with the local accounting policies and standards.

had more significant dynamics with the ROAE, relative to the cost-to-income indicator. Yet, the general conclusion was that the countries from the Baltic region and from Central Europe registered better profitability indicators, relative to the countries from the Balkans. Hence, there were considerable chances for further improvement in the profitability in the banking system of the Republic of Macedonia also, especially if the banks which are still on the margins of the profitability achieve to reach the level of activities which would be adequate for performing better financial results, in the following period.



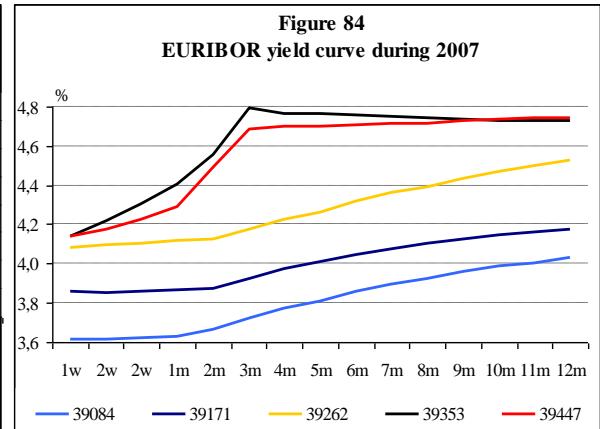
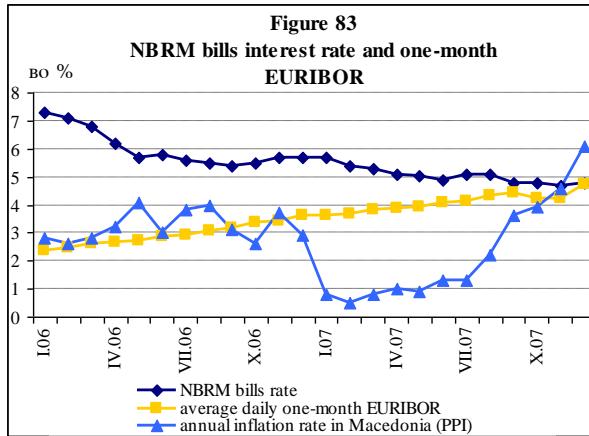
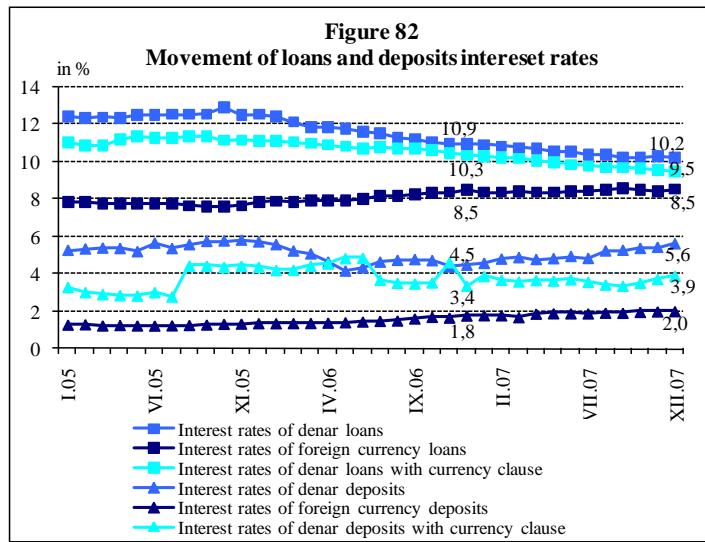
### 3.6.2 Interest rate movement and interest rate spread

In 2007, the trend of squeezing the weighted lending and deposit interest rate spread<sup>36</sup> continued. It was due equally to the constant decrease in the interest rates on credits, as well as to the increase in the interest rates on the deposits, especially in the second half of 2007. These movements of the interest rates, although with different intensity, were registered with both Denar and foreign exchange interest rates. The decrease in the interest rates on credits, although with smaller intensity than in 2006, was evident also in 2007, with it being more apparent with the Denar credits and the FX indexed loans, than the interest rates on the foreign currency loans, which were more constant in their movement. The interest rate on the deposits mainly registered an upward trend, showing larger degree of sensitivity to the macroeconomic movements in domestic economy and the international financial markets in the second half of 2007. Despite the decline in the CB bills rates during the preceding year, however, the rise in the annual inflation rate in the last quarter of 2007 contributed to an upward trend of the interest rates on the Denar deposits, thus proving the enhanced competitiveness in the banking system. On the other hand, the increase in the interest rates on the international financial markets caused an upward trend of the foreign currency interest rates on the deposits in the Republic of Macedonia, simultaneously resulting in certain limitation of further more apparent drop of the interest rates on the foreign currency credits. The financial markets crisis (primarily on the mortgage market and the structural products market) in USA, caused negative consequences and turbulence also on the European financial markets, which in conditions of more restrictive monetary policy in the Euro zone (motivated from the enhanced inflation pressure in the second half of 2007), caused



<sup>36</sup> Weighted lending interest rate is the average credit rate of all sectors and all maturities, while the weighted deposit interest rate is the average rate of the deposits of all sectors and all maturities. However, the weighted lending and deposit interest rates are shown separately according to the currency of the credits or deposits, with the interest rate spread of the Denar interest rates including also the interest rates on the credits and the foreign currency indexed deposits.

bigger uncertainty among the market participants, increase in the interest rates and corrections of the price levels of the financial instruments. These developments, although having no direct financial consequences for the banks in the Republic of Macedonia, due to an absence of exposure towards mortgage markets in the USA and the European stock exchanges, may still have indirect negative consequences evident through increase in the costs for using foreign sources of financing or, eventually, increase in the risk premiums. It will certainly cause a need for increasing the interest rate ranges, motivated from the maintenance of the registered profitability level.



However, the fact that the interest rate movement was stabilized on the international financial markets in the last quarter of 2007, and even the yield curve on EURIBOR registered flattening, evidenced also in the beginning of 2008, should also be taken into consideration. This points to the market participants' expectations for decrease in the short-term interest rates in the Euro zone, which, if happens, would effect on the movement of the foreign exchange interest rates with the banks in the Republic of Macedonia. Hence, the banks in the Republic of Macedonia that will be able to continue with the interest rate range narrowing without having effects on the profitability, will have bigger possibility for activities growth and increase in the market share.

## II. BANKING SUPERVISION IN 2007

*The NBRM mission in performing the banking supervision*

*Our mission is to conduct supervision on the institutions licensed by the NBRM, focused on maintaining safe and sound banking system and providing protection to the depositors. Instead of having an approach according to which no bank can bankrupt, we focus on the prevention of a systemic banking crisis. We apply a supervisory approach based on risks, in line with the best international practices and standards, simultaneously leaning on the principles of independence, integrity, professionalism, efficiency and transparency.*

*October, 2007*

### 1. Legal framework of the banking supervision

The legal framework represents the basis for efficient banking supervision, and also a main precondition for monitoring and realization of the banking supervision mission of the NBRM.

The significance of appropriate banking regulations in place is proven also in the Basle principles for Efficient Banking Supervision, as well as in the internationally accepted standards for establishing and maintenance of an efficient banking system and banking supervision. These principles stress the need of establishing clearly defined rules regulating the functioning of the banking system, as well as performing the banking supervision.

In order to enable larger harmonization with these principles, as well as with the regulations and the EU practice, in 2007 the following laws from the area of the banking system functioning, and more, of the financial system, were adopted: **Banking Law, Law on Consumer Protection In Case Of Consumer Loan Agreement and Law on the Payment Operations.**

#### 1.1. Review of the Banking Law and the bylaws adopted on the basis of this Law

The new Banking Law (adopted in June 2007) provides significant qualitative promotion of the banking regulations and supervision in the Republic of Macedonia. This Law is based on the provisions and the standards prescribed in the European Directive 2006/48 for founding and operating of credit institutions<sup>37</sup> and European Directive 2006/49 for capital adequacy of the investment firms and credit institutions<sup>38</sup>. The most significant amendments and improvements in the Banking Law pertain to the following:

- strengthening of the criteria for licensing the shareholders with a qualified holding in a bank<sup>39</sup>, as well as the members of the Supervisory Board and the Board of Directors;
- strengthening of the corporate governance in banks;
- establishing the bases for the application of the New Basle Capital Agreement (BASLE II);

<sup>37</sup> Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions (recast)

<sup>38</sup> Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions (recast)

<sup>39</sup> According to the Banking Law, qualified holding in a bank denotes direct or indirect ownership of at least 5% of the total number of shares or issued voting shares in a bank, or which it makes possible to exercise a significant influence over the management of that bank.

- promotion and strengthening of the banks' risk management systems, especially the management of the credit risk, liquidity risk, currency risk, market risk and the IT risk;
- promotion of the manner of conducting supervision and inspection;
- reconciliation of the banks' accounting standards and rules with the International Accounting Standards and International Financial Reporting Standards;
- prescribing the contents of the audit on banks;
- tightening of the corrective actions and increasing the efficiency of the procedure for bank's exclusion from the banking system;
- defining the manner of opening and operating of a foreign banks' branch office.

These areas are also regulated by appropriate bylaws adopted on the basis of this Law. Namely, pursuant to the Banking Law, the NBRM Council was obliged to adopt all bylaws within a nine-month period after its enforcement. Accordingly, as of the end of February 2008, 23 bylaws were passed, thus encircling the legal framework pertaining to the banking supervision. Part of these bylaws entered into force instantly, while some of them had delayed implementation. The necessity for a delay in the application of part of the regulations arises from the following:

- They introduce new significant changes requiring suitable time period for banks adjustment to the new requirements, through introducing new internal procedures and systems, new information technologies, etc.;
- The application of the new accounting framework, based on the international accounting standards and the international standards for financial reporting will commence on January 01, 2009, while the efficient implementation of the part of the supervisory standards and requests is directly connected to the application of the new accounting rules and practices of the banks.

By encircling the numerous bylaws, thus making significant changes in the banks operating, the banking industry and the NBRM face with the challenge of their implementation.

### **1.1.1. Improvement of the prudent requests and the criteria regarding the licensing**

The new Banking Law provides significant strengthening of the criteria, on the basis of which suitability of the shareholders with qualified holding in a bank is estimated (the so-called "fit and proper" criteria). The Law envisages application of the same criteria for assessing the shareholders with qualified holding, regardless whether the assessment is made in a procedure for founding a new bank, or in case of change in the ownership structure of a bank which already operates in the country. The criteria, inter alia, include the assessment of the risk the entity, intending to acquire qualified holding in the bank, can have on its stability, safety and reputation, i.e. its operating in conformity with the regulations. The Banking Law clearly identifies the entities/persons that may not become shareholders with qualified holding in a bank as follows: person sentenced to imprisonment for crime in the area of finances and banking, who was imposed a misdemeanor sanction i.e. ban on performing a profession, activity or duty, against whom a bankruptcy proceeding has been initiated, who does not enjoy any reputation, and who fails to comply with the provisions of this Law and the regulations and the measures imposed by the Governor of the NBRM.

The **Decision on issuing license to a bank** precisely defines the documents, the data and the information, the manner of their submission and the procedure for their assessment during the issuance of licenses<sup>40</sup>. Despite the fact that the general licensing criteria used for licensing are defined in the Banking Law, however, the Decision, in details and precisely, incorporates the minimal criteria commonly used by the supervisory bodies. Those criteria pertaining to the contents of the strategic and operational plan for the future bank's operating, are also included, as well as the policies and the

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<sup>40</sup> License for: founding and operating of a bank; founding and operating of a bank controlled by a foreign bank, or foreign entity having holding in other foreign bank; opening a branch office; and status changes.

procedures for managing different types of risks and estimating the suitability of the potential shareholders and the members of the bank's management and inspection bodies.

The **Decision on issuing approvals** defines in details the documents, the data and the information, the manner of their submission and the procedure for their assessment in case of an issuance of different types of approvals<sup>41</sup>. In this domain, two novelties prescribed in the new Banking Law and this Decision are especially significant. The first one pertains to the issuance of approval for conducting specified financial activities. Compared to the previous regulations, where the basic criteria for issuing approval for conducting certain financial activity was the capital amount, the new Banking Law and this Decision, besides the amount of own funds, takes into consideration also the assessment of the request for issuing approval, the bank's readiness for commencing certain new financial activity, meaning, *inter alia*, the analysis of the appropriateness of the personnel, the technical equipment and information system, necessary for conducting new activity, inclusion of the new financial activity in the system of internal control and the money laundering prevention system in the bank, the suitability of written policies and the procedures for performing financial activities, etc. The second novelty of higher importance is the introduction of the requirement for obtaining prior approval from the NBRM for appointing a member of the bank's Supervisory Board. In the decision-making procedure for issuing approval for a member of a Supervisory Board, *inter alia*, the level of knowledge of the regulations from the banking area and/or finance, the candidate's reputation, etc. is also assessed.

### **1.1.2. Strengthening of the bank's corporate governance in the banks**

The Banking Law defines the framework for corporate governance in banks. This Law regulates the competencies of the bank bodies (General Meeting of Shareholders, Supervisory Board, Board of Directors, Risk Management Committee and Auditing Committee), as well as the role and the scope of activities of the Internal Audit Department and the person/organizational unit responsible for controlling the adherence of the bank's operations to the regulations. The Law defines the terms and the conditions the persons with special rights and responsibilities should fulfill<sup>42</sup>.

Besides the basic principles for good corporate governance in a bank determined with the Banking Law, such principles are stipulated also in some bylaws, especially those pertaining to the management of individual risks. However, the largest significance for the establishment of good corporate practices in the banks is the adoption of the **Decision on the basic principles of the corporate governance in a bank**. The Decision incorporates the latest Basle principles of good corporate governance in the banks, dating February 2006 (Enhancing Corporate Governance for Banking Organizations) and the corporate practices, stipulated in the regulations of other EU countries. This Decision prescribes the qualifications and the expertise required from the bank's Supervisory Board members, their competencies and responsibilities, it regulates the cooperation between the bank's Supervisory Board and the Board of Directors, the correlations between the Supervisory Board, Board of Directors, the internal audit and the external audit, the role and the scope of activities of the person/organizational unit responsible for controlling the compliance of the bank's operating with the regulations, with the requirement for transparency of the bank's corporate structure being also defined. Also, the Decision prescribes the bank's requirement for preparation and adoption of the corporate governance code, the code of ethics and rewarding program, as well as regular preparation of the corporate governance report in the bank, which is an integral part of its annual report.

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<sup>41</sup> Approval for: amendments to the bank's statute; performing certain financial activities; appointing members of the Supervisory Board; appointing members of the Board of Directors, founding a subsidiary, branch office, or representative office of a bank abroad, or acquiring capital parts in bank; establishing or acquiring capital parts in non-bank financial institution, or non-financial institution, exceeding 10% of the bank's own funds; opening representative office of a foreign bank; change of the bank's title and main office.

<sup>42</sup> Pursuant to the Banking Law, a person with special rights and responsibilities is a natural person who is a member of the Supervisory Board, member of the Board of Directors, member of the Auditing Committee, member of the Risk Management Committee and other managers as defined by the bank's Statute.

### **1.1.3. Improvement of the methodology for determining the capital adequacy and establishing the basis for the implementation of the Basle Capital Agreement (BASEL II)**

Having in mind the characteristics of the banking system of the Republic of Macedonia, the complexity of the activities the banks perform and the risks they are exposed to in their operating, the NBRM adopted a plan for application of the new Basle Capital Agreement (BASEL II) with the time frame as follows:

- Application of the first pillar (Pillar 1 - Minimum capital requirements):
  - o Preparation of regulations enabling application of the standardized approach for credit risk assessment - 2009;
  - o Preparation of regulations enabling application of the basic indicator and/or standardized approach for operational risk assessment - 2008;
- The application of the second pillar (Pillar 2 - Supervisory review) already commenced by the establishment of the new methodology for risk assessment oriented supervision, prescribing in details the risk management system, as well as by prescribing the requirement for the banks to establish internal process of capital adequacy assessment;
- Application of the third pillar (Pillar 3 - Market Discipline). By adopting the **Decision on reports and data disclosure by the bank**, the initiation of the formal process of gradual application of this pillar under the new Basle Capital Agreement was marked. This Decision determines the data and the reports the banks are obliged to disclose on a regular basis, and which pertain to: the bank's operations, the bank's shareholders' structure, the amount of the own funds and the capital adequacy and the risk management systems and processes.

During the preparation of the stated time frame, the NBRM took into consideration the recommendations given from the Basle Committee on Banking Supervision and the Committee of European Banking Supervisors (CEBS) to harmonize the implementation of the New Capital Agreement with the characteristics and the capacity of the banking system and the banking supervision of the country. In that direction, the new supervisory approach<sup>43</sup> defined in the development plan for the NBRM's banking supervision promotion and the adoption of the new regulations for risk management is of great importance. Their implementation enables strengthening of the NBRM's supervision capacity, as well as that of the banks, as a precondition for initiation of the application of more developed approaches for determining the capital adequacy, in line with BASEL II.

In the period until the commencement of the application of the first pillar (Pillar 1 - Minimum capital requirements), the capital adequacy ratio is set by applying the methodology defined in the **Decision on the methodology for determining the capital adequacy**, which represents fully implements the Basle Capital Agreement (BASLE I). The Banking Law and this Decision give the possibility to include all material risks the banks are exposed to in determining the capital adequacy, and not only those explicitly stated in the Decision on the methodology for determining the capital adequacy. Namely, also other risks can be included when determining the amount of the capital requirement for risk coverage, if the bank or the NBRM finds necessary due to the character, the type and the scope of the activities the bank performs.

### **1.1.4. Development and enhancement of the banks' risk management systems**

The Banking Law introduces clear obligation for the banks to establish and maintain appropriate risk management system, that should include the credit risk, the liquidity risk, the interest rate risk, the currency risk, the market risk, the concentration risk, the operational risk, as well as all other material risks the banks are exposed to in their operating. On the basis of these general provisions in the Banking Law, the **Decision on the risk management**, representing sublimated presentation of the core principles for risk management is passed. The Decision stipulates the

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<sup>43</sup> Transiting to a risk assessment oriented supervision.

elements that the risk management system should at minimum contain, and which refer to the: rules for risk management, the appropriate organizational structure and the efficient information system.

The banks shall be required, at least on an annual basis, to perform stress tests, in order to estimate the possible influence of one or more internal or external risk factors on the value of the assets and the liabilities of the banks, i.e. its solvency. Especially significant novelty is the banks' requirement for establishing a process of internal determining and assessment of the required capital adequacy, depending on their risk profile. Thus, conditions for appropriate implementation of the first two principles of the second pillar (Pillar 2 - Supervisory review) of the new Basle Capital Agreement (Basle II) are created.

The **Decision on managing banks' liquidity risk** sets forth the components of the liquidity risk management system, the policy for the liquidity risk management and the characteristics of the organizational structure for liquidity risk management, which, *inter alia*, means defining of the competencies and the responsibilities of the appropriate bank bodies. Also, this Decision gives detailed directions for the manner of conducting stress tests on the bank's liquidity and monitoring the maturity structure. In direction of appropriate monitoring of the liquidity, pursuant to the Decision, the banks are required to prescribe and to comply with the internal liquidity indicators and the ranges of their movement, and to report to the NBRM on a monthly basis. This approach, actually, accepts the international trend for qualitative assessment of the liquidity risk management systems.

The **Decision on managing the currency risk** introduces the requirement for banks to establish a system for managing currency risk and adopt a policy and relevant procedures for identifying, measurement, monitoring and control of this risk. The most significant amendment to this Decision pertains to limiting the value of the indicators measuring the bank's exposure to the currency risk. Namely, the current limits for the open currency position by currency are revoked, with the banks being bounded to set fort internal limits for the open currency position by currency. Using the example of several countries which preserved the approach of limiting the indicators measuring the bank's exposure to the currency risk, the new Decision preserved only the limit pertaining to the correlation between the aggregate currency position and the bank's own funds, which reduced from 50% to 30%.

The **Decision on the bank's information system security** defines the criteria for the information system security, such as confidentiality, integrity, availability, as well as the process of managing the information system security. The Decision, also determines the manner in which the banks should establish the Business Continuity Plan and the relevant alternative location through development and implementation of the Business Continuity Plan. With this Decision, the NBRM, for the first time, introduces security standards referring to the e-banking systems, through defining two additional criteria: user identity verification and irrevocability of the transactions. Also, the Decision regulates the criteria that the bank's a outsourcing company should fulfill regarding the development and maintenance of the information system, in case of conclusion of a contract with a bank for executing such services, as well as the procedures the bank should implement before concluding the contract.

#### **1.1.5. Improvement of the methodology for credit risk management**

The **Decision on credit risk management** prescribes precisely the manner and the basic criteria for classifying on-balance sheet and off-balance sheet assets items of the bank according to the risk degree, the method of determining and the amount of the impairment and the special reserve, as well as the scope and the contents of the policy and the relating procedures for the credit risk management. Besides the prudent aspects of the assets classification according to the credit risk volume, when determining the level of the asset impairment, the Decision has appropriate element of the new accounting framework, based on the International Financial Reporting Standards and the International Accounting Standards also incorporated. Namely, two-level approach in the classification of the exposure to the credit risk is envisaged:

- a) Supervisory approach, based on the classification of the exposure risk, on the basis of a variety of objective and subjective criteria. On the basis of these criteria, the bank is obliged to classify the exposure/credit in one of the five risk categories: „A“, „B“, „C“, „D“ and „E“. Also, the new Decision anticipates the possibility for determining an impairment i.e. special reserve within certain limits, not as fixed percentage i.e. amount;
- 6) Method of determining the required impairment, i.e. special reserve in line with IAS. After classification of the credit risk exposure in one of the stated risk categories is performed, the bank, additionally and more precisely, sets forth the amount of the impairment, i.e. special reserve, within the projected limits for the appropriate risk category, by determining the current value of the future money flows of the suitable exposure.

The Decision envisages obligatory classification, on individual basis, of each important item of the bank (the total exposure to a client higher than Denar 300,000, i.e. Denar 150,000 for a savings houses, or which exceeds 0.007% of the total credit risk exposure of the bank). The bank can classify all other exposures on a group basis (retail credit portfolio), through creation of homogenous portfolios, according to a credit risk similarity originating from the individual credit risk exposures.

Within the regulating of the manner of the credit risk management, the **Decision on exposure limits** was adopted. This Decision sets forth the manner of calculating and monitoring the exposure limits prescribed in the Banking Law. Beside the exposure on the basis of the credit risk, when calculating the exposure limits, the exposure based on market risk, i.e. the exposure arising from its trade portfolio is also included. Integral part of the Decision on exposure limits is also the defining of the method of determining and monitoring of the limits on investments in the non-financial institutions, as part of the bank's total exposure to individual person/entity. This Decision incorporates the provisions under the EU Directives 2006/48 and 2006/49 pertaining to the manner of defining the exposure and the individual limits.

For the purpose of appropriate application of the exposure limits, stipulated in the Banking Law and the Decision on exposure limits, the Banking Law defines the "connected persons/entities" and "persons/entities connected to the bank". These definitions are elaborated in details in the **Decision on the method of determining connected persons/entities**. The Decision is completely in line with the EU Directives, and especially with the Basle Principle No. 11 which refers to the exposures to connected persons/entities. The cases of determining the connected persons/entities, defined in this Decision, do not exclude the existence of other cases of connected persons/entities. In that direction, the Decision states that the bank, or the NBRM has the right to determine also other cases of connected persons/entities, if it is in compliance with the provisions and the definitions under the Banking Law.

### **1.1.6. Improvement in the manner of conducting supervision and inspection**

The Banking Law provides legal basis for gradual transition from a supervision based on the assessment of compliance with the regulations, to a supervision which is more oriented to risk assessment and their management. The scope and the contents of the supervision, as well as the procedures and the activities that should be implemented by authorized persons of the NBRM are set forth in details in a **Decision on the manner of conducting supervision and inspection**. Other amendment to the Banking Law and this Decision of higher significance, refers to the explicit right of the NBRM to perform inspection over the operations of the persons/entities connected to the bank, other persons/entities in the banking group, as well as to the bank's outsourcing companies.

Besides the supervision to individual bank, the Banking Law also prescribes the manner in which the consolidated supervision is implemented. The so-far legal framework and the bylaws enabled implementation of consolidated supervision to a banking group by the NBRM, with the obligations and the responsibilities of the parent entity and the members of the banking group not being precisely defined, nor in those of individual financial bodies. The new Banking Law:

- precisely defines the existence of a banking group;

- sets forth the responsibilities of the parent entity;
- defines the supervisory standards the banking group is obliged to comply with<sup>44</sup>;
- clearly defines the obligation of the bank subject of a consolidated supervision, to establish and maintain appropriate risk management systems;
- precisely states the manner of cooperation and exchange of information among the supervisory bodies competent for the operating of the individual banking group members.

The manner of conducting the consolidated supervision is more precisely regulated with the **Decision on consolidated supervision**. This Decision represents a foundation for establishing efficient mechanisms for cooperation and exchange of data and information among the competent supervisory bodies, the manner of preparation of consolidated financial and supervisory reports of the banking group, adherence to the supervisory standards stipulated in the Banking Law, as well as the manner of reporting to the NBRM.

#### **1.1.7. Reconciliation of the accounting standards and rules with the International Accounting Standards (IAS) and the International Financial Reporting Standards IFRS.**

Within the project intended for implementing the IAS and IFRS in the banking system in the Republic of Macedonia, new accounting framework providing accounting solutions for modern types of activities the banks perform was prepared.

The new accounting framework incorporates the Methodology for recording and evaluating the accounting items and preparation of the financial statements (the Methodology), the Instructions for the types and the contents of the banks' financial statements and the Banks' Chart of Accounts. The Methodology is based on the IAS and the IFRS, and it stipulates the criteria for classification, measurement, recognition and disclosure of each on-balance sheet item. The Instruction prescribes the model of the banks' financial statements and notes to those statements, as well as the contents of their items. The Chart of Accounts represents a single system of accounts according to which the banks maintain their accounting, and classify the data in their trade books. The banks are obliged to maintain trade books, the business and accounting documentation and to prepare financial reports according to the new Methodology, starting from January 01, 2009.

The new accounting framework is expected to contribute to higher reality and objectivity of the financial statements of the banks, and thus increase in the transparency of the banking system of the Republic of Macedonia, as well as easier comparability of the financial statements of the domestic banks with the financial statements of the banks from other countries applying the IFRS.

#### **1.1.8. Prescribing the contents of the bank audit**

As part of the efforts for increasing the banks' transparency and market discipline in performing the banking activities and risk management, the Banking Law provided strengthening of the role of the external auditor. The Banking Law defines the minimum criteria the auditing company should meet in order to audit the operations and the annual financial statements of the banks in the Republic of Macedonia. The NBRM has the right not to accept the auditing company determined by the bank, if it finds that the company fails to meet the envisaged criteria.

Also, the Banking Law enlarges the external audit scope, with a special accent being put on the assessment of the risk the banks face with in their operations and the manner of their management. The auditing company, inter alia, should estimate the functioning of the internal control systems and the internal audit conduct, harmonized with the regulations, appropriateness of the accounting policies and procedures, information system security etc. The external audit scope is more

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<sup>44</sup> The Banking Law makes no difference between the supervisory standards on individual and consolidated basis, i.e. the banking group is obliged to comply with and to adhere to the provisions of this Law which defines the supervisory standards and risk management.

precisely regulated in the **Decision on the scope of the audit of the operation and the annual financial statements of a bank**, which states precisely the form of the audit report.

### **1.1.9. Tightening of the corrective measures and improved efficiency of the procedure for exclusion of a bank from the banking system**

One of the more important qualitative changes, included in the new Banking Law refers to the type of the measures the NBRM can undertake against a bank, banking group, shareholder, or bank body, as well as the manner and the procedure for their undertaking. The Law gives possibility for a selection from wide range of measures, with the selection depending, inter alia, on the gravity of the illegitimacy, or irregularity and its effect on the safety and the soundness of the bank, its depositors and the overall banking system. Thus the Law accepts an approach of grading the measures undertaken against the banks, ranging from giving recommendations, warnings, or concluding protocols, through banning or restricting certain activities, or transactions, limiting the exposure growth, to introducing administration and revoking the founding and operating license.

Within the corrective measures, the mechanism of withdrawal of an approval (a shareholder with qualified holding, a member of the Supervisory Board, or Board of Directors, etc.) by the NBRM, in instances when the terms and the conditions on the basis of which the license is issued are no longer met, is of great importance. With the reference of the aforementioned, another significant mechanism introduced in the Banking Law is the possibility for limiting the rights arising from the shares, in case when the shares are acquired contrary to the Banking Law, or if the previous issued approval for acquiring shares in a bank is withdrawn. After the voting right is revoked, the shareholder is given a possibility to sell such shares within a certain time frame. If the shareholder fails to observe the stated measure, the NBRM is entitled to limit also the right of dividend and sell the shares on the behalf of the shareholder through a public stock exchange auction. Also the shareholder failing to sell the shares within the certain time frame may not be or become a shareholder in another bank. This mechanism is expected to improve the efficiency of the exclusion of the incompetent shareholders (failing to meet the fit and proper criteria) from the banking system.

In case of introduction of an administration to a bank<sup>45</sup>, two mechanisms are envisaged:

- in an instance when there are conditions to improve the bank's position and achieve the required level of liquidity and own funds, **a rehabilitation to a bank** is carried out, containing activities intended for improvement of its financial standing, in order to resume its operating;

- as a contrary, if no conditions for improvement of the bank's standing exist, there is a possibility, before its founding and operating license is revoked, to conduct **transfer of part or all its deposits, credits and other assets and liabilities to another bank** in the Republic of Macedonia. This mechanism is expected to increase the efficiency when the bank is excluded from the banking system. Also, the purpose of the citizens and other economic agents should manage freely with their own deposits and funds on the basis of used credits, instead being creditors and debtors in the bankruptcy or liquidation procedure against the bank.

The terms and the procedure for the implementation of these two mechanisms are regulated in details in the **Decision on the terms and the procedure for implementing the Rehabilitation Plan and Assets & Liabilities Transfer Plan**.

Especially significant instrument that the new Banking Law provides for the NBRM is the possibility for introducing an infraction procedure and impose an infraction sanction. In this manner, the efficiency of the NBRM in imposing measures and improvement in the situation in the banking system increases. The Banking Law envisages a possibility for stating an infraction against a bank, responsible persons in the bank, all legal entities that are obliged to comply with the Banking Law

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<sup>45</sup> The Banking law defines the terms and the conditions under which the Governor may adopt a decision on introducing an administration to a bank, which are mainly related to instances of jeopardizing the bank's solvency.

(shareholders with qualified holding, brokerage houses, auditing companies, persons/entities connected to the bank), as well as the responsible persons in those legal entities.

#### **1.1.10. Regulating the manner of opening and operating of a foreign bank branch office**

The Banking Law enables foreign banks to conduct banking and other financial activities on the territory of the Republic of Macedonia through opening branch offices. Thus the possibility for attendance of foreign banks in the Republic of Macedonia is broaden with a new organizational and business form, thus enabling larger liberalization for access of foreign banks and higher degree of openness of the banking market in the Republic of Macedonia.

The Banking Law makes difference in the treatment of the branch offices of the banks coming from the EU member states and the branch offices of the banks originating from other countries. Thus a bank from the EU member state can start operating in the Republic of Macedonia through a branch office, after the two months period from the day the NBRM receives an notification from the competent body of the parent country expires. With this regard, the provision under the EU Directive 2006/48 is completely accepted, which regulates the opening and operating of branch offices of banks from EU. However, this chapter of the Banking Law, pertaining to the branches of the banks from the EU member states, will start implementing after the day the Republic of Macedonia becomes a full member of the European Union. Until then, the provisions of the Banking Law referring to the branch offices of any other foreign bank will be applied to these branch offices.

For opening a foreign bank branch, prior approval from the Governor is required, after the prescribed criteria are fulfilled. Thus only a foreign bank rated BBB at minimum, according to the rating of the Standard & Poor's, Fitch IBCA and Thomson Bank Watch, or Baa2 according to the Moody's rating, can open a branch in the Republic of Macedonia. Also, the foreign branch bank is required to hold monetary assets of at least Denar 120 million, being treated as the branch office's own funds. This amount has to be maintained at the level of at least 5% of the total deposits of the branch in the Republic of Macedonia.

In direction of specifying the prudent and regulatory requirements for the foreign banks branches, the NBRM adopted a **Decision on the method of operating of a foreign bank branch**, prescribing in details the implementation of the provisions of the Banking Law pertaining to the supervisory standards, the Board of Directors, the reports, the accounting and the audit, the bank secret, the supervision, the inspection and the measures.

#### **1.1.11. Specifying the prudent requirements for the savings houses**

The operating of the savings houses, according to the new Banking Law is specified in the **Decision on the terms and the manner of operating of the savings houses**, covering the manner of application of the supervisory standards from the aspect of the allowed exposure limits, the banking activities conduct (extending credits and collecting deposits (and investments. Regarding the implementation of the supervisory standards, this Decision envisages lower exposure limits for savings houses to credit risk, as well as for the investments of the savings houses in land, buildings and equipment.

The Decision envisages also the criteria the savings house should meet when conducting bank activities, through establishing written policies and procedures within the area of crediting, collecting deposits and risk management arising from their operating.

### **1.2. Review of the bylaws arising from the Banking Law on Consumer Protection In Case Of Consumer Loan Agreement**

Among the activities for reconciliation of the domestic legislation with the European directives within the area of protection of the consumer loans users from unjust credit terms

(Directive 87/102/EEC<sup>46</sup>, amended with the directives 90/88/EEC<sup>47</sup> and 98/7/EC<sup>48</sup>), in 2007 Law on Consumer Protection In Case Of Consumer Loan Agreement was adopted. NBRM, as a supervisory body competent for the operating of the banks and the savings houses in the country, was actively included in the preparation of this law. On the basis of this Law, **Decision on the methodology for calculating the annual rate of total costs** and the **Decision on the method and the procedure for supervision of banks and savings houses related to consumer protection in consumer loans agreements** were adopted.

The **Decision on the methodology for calculating the annual rate of total costs** is primarily intended for protecting the interest of the natural persons, the consumer loans users, which are mainly considered as less knowledgeable about the bank and financial activities. Hence, this Decision sets forth the single rules the credit services providers should observe when offer consumer credits, through prescribing the requirement for single calculation of the annual rate of the total costs of the consumer credits, as well as through prescribing the requirement for disclosing this rate and a variety of other costs related to the approval, utilization and payment of the credits. In this manner, the decision-making of the consumer in the selection of the consumer credit provider will facilitate, through increasing the transparency in their operating and providing comparison base of the terms the providers offer.

The **Decision on the method and the procedure for supervision of banks and savings houses related to consumer protection in consumer loans agreements** regulates the oversight of the implementation of the Law on Consumer Protection In Case Of Consumer Loan Agreement by the banks and the savings houses. The NBRM implements this specific type of oversight within the regular supervision, through on-site and off-site control on banks and the savings houses, in a manner and procedure determined in accordance with the Banking Law and the Decision on the manner of conducting supervision and inspection. Additionally, the NBRM can also perform on-site examination on the credit mediators, which on behalf of the bank/savings houses perform activities related to concluding of agreements for consumer loans.

### 1.3. Review of the bylaws arising from the Law on Payment Operations

In September 2007, the Law on Payment Operations was adopted. This Law specifies certain provisions in function of more efficient execution of the payment operations in the country, as well as determining the operations and the oversight of the payment systems. The new Law is prepared in line with the European Regulations and standards in that domain, with the Directive 98/26/EC for the settlement finality and the settlement system, the Directive 97/9/EC for cross-border credit transfer and the Core Principles for the systematically important payment systems (BIS, Basle).

The new Law on Payment Operations introduces the term "transaction account", denoting unique and unrepeatable numeric data identifying the participant in the payment operations, and serves for such participant to make payments. Regulating the manner of forced collection from the transaction accounts of the participants in the payment operations (including natural persons, as well), this Law represents a significant step towards increasing the financial discipline of the legal entities and the natural persons in the settlement of their liabilities. Namely, when acting upon the decision on forced collection, the collection can be performed from all available funds of the payment operations' participant with the carrier of the payment operations. In the case of lack of funds for complete enforcement of the decision on forced collection, according to the previously defined mechanism, a blockage of the turnover performed through the accounts of that participant with all other carriers of the payment operations, until the complete enforcement of the decision is made.

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<sup>46</sup> Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.

<sup>47</sup> Council Directive 90/88/EEC of 22 February 1990 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.

<sup>48</sup> Directive 98/7/EC of the European Parliament and of the Council of 16 February 1998 amending Directive 87/102/EEC for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit.

In line with the provision of the Law on the Payment Operations, in 2007 the NBRM adopted seven addition decisions and instructions, which prescribed in details the following:

- standard for construction of accounts of the participants in the payment operations and assigning leading number of the carriers of the payment operations;
- the amount of small interbank payment;
- the type of data and the manner of submission of data on performed activities in the payment operations to the NBRM;
- the type of data and the manner of submitting the data on the turnover in the internal and external clearing to the NBRM;
- the manner of maintenance and the contents of the single registry of transaction accounts;
- the manner and the procedure for opening and closing transaction;
- the procedure for correction of error made by the carrier of the payment operations;
- criteria and the standards for the payment operations operating; and
- the manner and the methodology for the payment systems oversight.

The Payment Operation Law, for the first time regulates the operations of the companies issuing electronic money. The issuance of the electronic money, as financial activity, may be performed by the banks in the Republic of Macedonia, the branch offices of the banks originating from the EU member states, or foreign banks and electronic money issuing companies, which having obtained a founding and operating license from the NBRM. The electronic money issuing company is founded with a initial capital of at least Denar 70 million, with the company's capital has to be maintained at the level of 2% of the liabilities on the basis of issued electronic money.

Pursuant to the provisions of the Law on the Payment Operations, in December 2007 the NBRM Council adopted the **Decision on the terms and the manner of operating of electronic money issuing company**. This Decision sets forth the implementation of the provisions under the Banking Law to this companies (referring to the own funds, the founding, shareholders, approvals, bank bodies, the accounting, the audit, the internal audit, the measures, etc), as well as the type of funds the electronic money issuer can invest in (only in liquid and low risk funds), the investments volume, the methodology for valuating funds, the methodology for risk management arising from the electronic money issuance and investments, as well as the contents of the reports and the manner of their maturity to the NBRM. With the regulation of the electronic money, the Directive 2000/46/EC for founding, operating and supervision on institutions issuing electronic money and the Directive 2006/68 in this domain, covering the credit institutions operations (banks and electronic money issuing companies) were completely implemented.

## **2. ACTIVITIES OF THE BANKING SUPERVISION**

### **2.1. Licensing - issuing licenses and approvals to banks and savings houses**

The licensing represents one of the most important links in the banking supervision process. Using the essence of the licensing as a starting point, meaning issuing licenses and approvals for conducting financial activities for acquiring status of a shareholder with qualified holding, or a member of the bank's bodies, the licensing represents a mean of the banking supervision for ex ante influence on the stability of the banking system in the country. In line with the new Banking Law, the banks which were founded and operating until the day the Law enters into force, are required to comply with the provisions of the new Law regarding the statute, the amount of the initial capital, the financial activities and bank bodies, within eighteen months from its enforcement. Also, in accordance with the Law, the current shareholders with qualified holding in bank were obliged to harmonize with the strengthen criteria for a shareholder, for which, they were obliged to submit a request for obtaining an approval from the NBRM, within four months from the day of its enforcement.

As a result of such provisions of the Banking Law, in 2007, especially in the second half, the number of submitted applications for obtaining approvals significantly increased. The largest portion

of the issued approvals referred to the performed reconciliations with the banks' statute, harmonization of the current shareholders with qualified holding in a bank with the provisions of the Law, as well as appointing members of the Supervisory Board and the Board of Directors. A table presenting the number of issued, i.e. non-issued licenses and approvals, as well as the withdrawn applications for issuing licenses and approvals in 2007 is given below.

Type of license/approval (banks)	Issued	Refused	Withdrawn/stopped
Acquiring shares in a bank the cumulative nominal amount of which equals, or exceeds 5%, 10%, 20%, 33%, 50% and 75% of the total number of issued voting shares	8	1	1 stopped
Harmonization of the current shareholders with qualified holding with the provisions of the Banking Law	26	1	5 withdrawn / 4 stopped
Amendments to the statute	26	/	/
Appointing the members of the Board of Directors	17	/	1 stopped
Change in title and main office	/	/	1 put at stand-by
Inspection in the minutes	6		2 stopped
Approval for the Information System Security Policy	2	/	/
Appointing members of the Supervisory Board	17	/	/
<b>Total</b>	<b>102</b>	<b>2</b>	<b>13</b>

Type of/approval (savings houses)	Issued	Refused	Withdrawn/stopped
Amendments to the Statute/Company Agreement	3		1 stopped
<b>Total</b>	<b>3</b>	<b>/</b>	<b>/</b>

## 2.2. Supervision on the banks and savings houses' operations

In 2007, a total number of 12 on-site examinations over the operations of banks and savings houses in the Republic of Macedonia were made. Of them, 8 were examinations of the overall operating of 3 banks and 5 savings houses, whilst 4 examinations were of partial character. Regular monthly controls and savings houses, from the aspect of posting of updated lists of saving deposits continued also in 2007.

In 2007, the trend of higher increase in the activities of the banks in the Republic of Macedonia continued. In such conditions, the assessment of the internal control system and the adequacy of the technical, organizational and personnel of the banks necessary for adequate support of such a dynamic growth, was the focal point of the NBRM during performing the on-site examination. Having in mind the credit growth dynamics witnessed in the last period, the NBRM continued, with a special attention, to monitor the manner in which the banks manage the credit risk, especially within the natural persons crediting domain, as well as the crediting in FX indexed loans and the long-term crediting, where the banks registered more dynamic growth in 2007. The credit expansion in these segments means higher exposure also to the risks, such as the operational risk, the risk of change in the interest rates and the risk of foreign exchange rates, which also were the main objective of the on-site examinations of the bank's operations.

It can be concluded from the on-site examinations that the process of establishing risk management systems is underway in a large number of banks. The corporate governance, including also the internal control systems and the internal audit role register improvement. However, in some banks the on-site examination revealed certain weaknesses in the manner in the function of the internal control and the risk management system. In that direction, the NBRM gave several recommendations, especially in the area of establishment, or strengthening of the policies and

standards for managing individual risks, enhancing of the practices and standards for extending and monitoring of credits, enhancing the security of the information system, improvement of the money laundering prevention systems and strengthening of the internal control systems, as well as the operating of the internal audit departments.

### **2.3. Corrective actions undertaken against banks and savings houses**

For the purpose of maintaining the soundness and safety of the banking system and providing protection to the banks and savings houses' depositors, in 2007 the Governor of the NBRM undertook a range of corrective actions against banks, savings houses, bank or bank body shareholder, in instances when irregularities and impropriety in the operations were detected. This in 2007 the "Makedonska banka" AD Skopje was revoked the founding and operating license, with the terms for initiating a liquidation procedure being met. Twelve decisions on corrective actions against five banks and one written warning and one recommendation for one bank were stated. Also, the NBRM submitted five requests for pressing misdemeanor charges against two banks and two legal entities (bank shareholders) and their persons in charge, and it lodged three criminal charges, with one of them being pressed against a person with special rights and responsibilities in bank and two criminal charges against persons in charge in legal entities (bank shareholders). The review of the type and the number of undertaken actions in 2007 is given in Annex no. 18.

## **3. PROMOTION OF THE INSTITUTIONAL CAPACITY OF THE SUPERVISORY FUNCTION**

### **3.1. Supervision Development Plan**

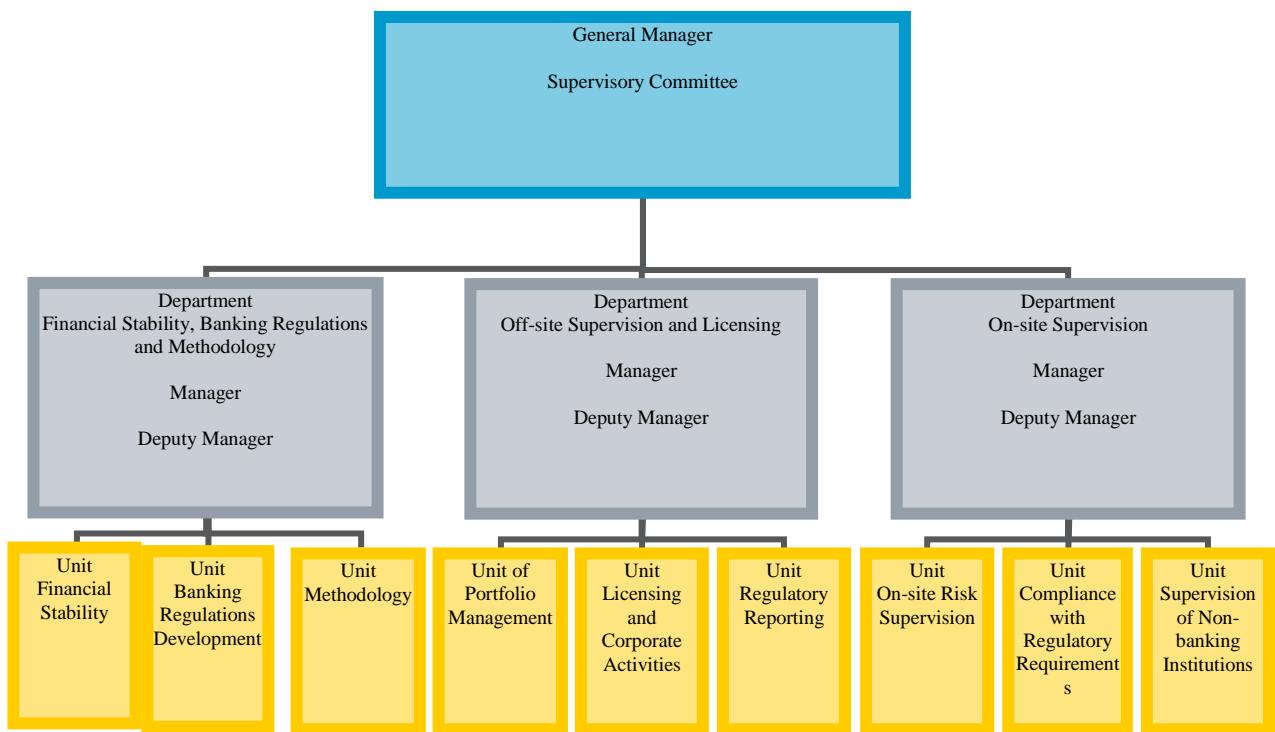
In January 2006, the NBRM adopted the Supervision Development Plan. In the first quarter of 2006, a foreign consultant was engaged in order to assist the NBRM in the realization of the plan. The main objective of the plan was to carry out a transition from the compliance oriented supervision towards risk based supervision.

The activities related to the Supervision Development Plan continued also in 2007, through development of the methodologies and the procedures for on-site examination, in line with the new approach. In 2007, these procedures were tested during the on-site examination on several banks. In the beginning of January 2008, the supervisory procedures and methodologies were adopted by the Governor of the NBRM.

Within the Plan, the supervisors training process, related to the Supervision Development Plan, commenced in March 2007.

#### **3.1.1. Organizational restructuring of the supervisory function**

Within the activities related to the implementation of the Supervision Development Plan, just before the end of 2007 the activities for organizational restructuring of the supervisory function of the NBRM were finalized. Thus Division for Supervision, Banking Regulations and Financial Stability was established comprising of three departments: Off-Site Supervision and Licensing, On-Site Supervision and Department for Financial Stability, Banking Regulations and Methodologies. Simultaneously, the concept of "portfolio managers" and 'specialist" for certain risks, was introduced. A Supervisory Committee was also established, representing the highest body within the Division, which is responsible for approving the findings and the recommendations from the departments within the Division. The Supervisory Committee is accountable for its operations to the Governor of the NBRM.



### **3.1.2. Credit Registry of the NBRM**

In the second half of 2007, the NBRM initiated activities for internal development of new, improved Credit Registry. Thus, at the end of 2007, a detailed plan of activities and measures for the realization of the project "New Credit Registry of NBRM" was prepared. The project anticipates widening of the type and the scope of the data the registry contains, lowering of the announced individual exposure threshold, shortening the deadlines for submitting and processing of data, increase in the frequency of reporting and promotion of the reporting forms from the registry. The activities related to the replacement of the current with a new, improved Credit Registry, which also represent an element of the IMF Stand-by Arrangement, are planned to be finalized until the end of August 2008.

## **A N N E X**

## Balance sheet

in millions of denars

ASSETS	31.12.2006				31.12.2007			
	Group of large banks	Group of medium-size banks	Group of small-size banks	Total	Group of large banks	Group of medium-size banks	Group of small-size banks	Total
<b>CASH AND BALANCE WITH NBRM</b>	<b>7,341</b>	<b>2,348</b>	<b>1,476</b>	<b>11,165</b>	<b>10,171</b>	<b>4,320</b>	<b>844</b>	<b>15,335</b>
Denar cash	5,765	1,735	1,305	8,805	8,189	3,599	743	12,532
Foreign currency cash	1,576	612	170	2,358	1,982	719	100	2,801
Precious metals and other kind of cash	0	2	1	3	0	2	1	3
<b>CB BILS</b>	<b>6,069</b>	<b>2,204</b>	<b>1,183</b>	<b>9,457</b>	<b>14,151</b>	<b>5,031</b>	<b>1,817</b>	<b>20,999</b>
<b>DEBT SECURITIES</b>	<b>8,072</b>	<b>3,579</b>	<b>1,629</b>	<b>13,281</b>	<b>9,542</b>	<b>2,896</b>	<b>645</b>	<b>13,082</b>
Checks and bills of exchange	42	56	35	134	42	27	4	73
Government securities denar nominated	5,612	39	43	5,694	5,390	1	19	5,410
Other debt securities	2,417	3,484	1,551	7,453	4,110	2,867	622	7,599
<b>PLACEMENTS TO OTHER BANKS</b>	<b>32,337</b>	<b>9,850</b>	<b>5,008</b>	<b>47,194</b>	<b>29,524</b>	<b>12,349</b>	<b>4,969</b>	<b>46,842</b>
Accounts with domestic banks	4,702	1,610	583	6,895	5,239	2,093	250	7,582
Accounts with foreign banks	27,041	7,657	2,111	36,810	23,309	9,518	2,256	35,083
Short-term loans and other claims on domestic banks and other financial institutions	57	168	164	389	69	186	209	465
Short-term loans and other claims on foreign and domestic banks in foreign exchange	165	412	329	906	215	530	187	932
Past due loans and claims on banks	0	0	0	0	0	0	0	0
Long-term loans and other claims on domestic banks and other financial institutions	294	3	824	1,120	616	1	928	1,545
Long-term loans and other claims on foreign banks and other financial institutions	0	0	823	823	0	0	1,015	1,016
Non-performing loans on banks	77	1	174	252	76	21	124	221
<b>PLACEMENTS TO CLIENTS</b>	<b>54,355</b>	<b>20,502</b>	<b>4,770</b>	<b>79,627</b>	<b>79,186</b>	<b>32,575</b>	<b>2,146</b>	<b>113,907</b>
Enterprises	34,413	12,954	2,602	49,969	49,111	18,751	1,020	68,881
Other customers	400	61	1	461	436	19	5	460
Households	19,183	7,753	2,341	29,277	30,710	14,192	1,263	46,165
Non-performing loans to clients	8,147	883	1,069	10,099	7,517	1,121	760	9,398
Reserves for potential loan losses	-7,788	-1,149	-1,243	-10,179	-8,588	-1,507	-902	-10,997
<b>ACCRUED INTEREST AND OTHER ASSETS</b>	<b>2,713</b>	<b>962</b>	<b>1,385</b>	<b>5,060</b>	<b>3,098</b>	<b>1,581</b>	<b>234</b>	<b>4,913</b>
Accrued interest	493	204	90	788	646	341	41	1,029
Non-accrual interest and other claims	3,643	172	454	4,269	3,422	206	198	3,826
Reserves for potential losses for interest	-3,648	-182	-459	-4,288	-3,446	-221	-200	-3,867
Other claims	125	176	266	568	762	520	7	1,289
Foreclosures	2,034	542	1,084	3,660	1,665	620	427	2,712
Net commission relations	-27	-1	-97	-125	-41	-4	-265	-310
Net internal relations	0	0	0	0	0	0	0	0
Other assets	93	49	47	190	89	118	26	234
<b>SECURITIES INVESTMENTS</b>	<b>624</b>	<b>262</b>	<b>641</b>	<b>1,527</b>	<b>747</b>	<b>311</b>	<b>358</b>	<b>1,415</b>
Securities in foreign currency available for sale	154	2	74	230	183	2	64	249
Securities in foreign currency held up to maturity	0	0	0	0	0	0	0	0
Equity investments in domestic currency	470	260	565	1,295	563	309	294	1,167
Reserves for purchased owned shares	0	0	2	2	0	0	0	0
<b>FIXED ASSETS</b>	<b>3,610</b>	<b>1,684</b>	<b>1,586</b>	<b>6,880</b>	<b>3,704</b>	<b>2,510</b>	<b>952</b>	<b>7,166</b>
Buildings	3,193	1,239	1,534	5,966	3,232	1,694	890	5,817
Equipment	2,479	739	691	3,909	2,746	1,225	353	4,323
Intangible investments	235	140	50	425	225	221	37	483
Other means of operation	88	14	15	117	150	22	5	177
Means of operation in preparation	171	156	27	355	163	229	5	397
Correction of value of fixed assets	-2,556	-605	-731	-3,892	-2,812	-880	-338	-4,031
<b>Non-allocated reserves for potential losses</b>	<b>0</b>	<b>-24</b>	<b>-50</b>	<b>-74</b>	<b>0</b>	<b>-1</b>	<b>0</b>	<b>-1</b>
<b>TOTAL ASSETS</b>	<b>115,122</b>	<b>41,368</b>	<b>17,627</b>	<b>174,117</b>	<b>150,122</b>	<b>61,571</b>	<b>11,966</b>	<b>223,659</b>

## Balance sheet

in millions of denars

LIABILITIES	31.12.2006					31.12.2007			
	Group of large banks	Group of medium-size	Group of small-size banks	Total	Group of large banks	Group of medium-size	Group of small-size	Total	
<b>DEPOSITS OF BANKS</b>	<b>3,904</b>	<b>1,852</b>	<b>286</b>	<b>6,043</b>	<b>5,851</b>	<b>3,685</b>	<b>946</b>	<b>10,482</b>	
Denar sight deposits	155	3	31	189	151	9	11	171	
Foreign currency sight deposits of domestic banks	303	114	4	421	241	214	0	456	
Foreign currency sight deposits of foreign banks	223	278	0	500	216	309	590	1,115	
Short-term denar deposits	718	586	113	1,417	1,285	1,155	202	2,642	
Short-term foreign currency deposits	364	871	0	1,235	260	855	0	1,115	
Short-term foreign currency deposits of foreign banks	2,141	0	0	2,141	3,698	1,142	0	4,840	
Long-term denar deposits	0	1	139	140	0	1	143	144	
Long-term foreign currency deposits	0	0	0	0	0	0	0	0	
<b>SIGHT DEPOSITS</b>	<b>42,158</b>	<b>10,233</b>	<b>4,766</b>	<b>57,157</b>	<b>51,187</b>	<b>16,220</b>	<b>2,447</b>	<b>69,853</b>	
Denar sight deposits of enterprises	9,382	2,581	911	12,874	14,556	4,552	703	19,812	
Denar sight deposits of public sector	468	169	454	1,091	561	116	79	756	
Denar sight deposits of other customers	1,428	335	266	2,029	1,774	540	208	2,522	
Denar sight deposits of citizens	7,539	1,500	1,334	10,374	10,144	3,544	483	14,172	
Restricted denar deposits	342	165	19	527	398	356	2	755	
Foreign currency sight deposits of enterprises	6,012	1,525	568	8,105	6,786	1,999	411	9,196	
Foreign currency sight deposit of citizens	16,401	3,812	1,189	21,402	16,553	4,880	555	21,988	
Restricted foreign currency deposits	586	145	25	756	416	232	4	653	
<b>SHORT TERM DEPOSITS UP TO 1 YEAR</b>	<b>44,501</b>	<b>13,296</b>	<b>3,076</b>	<b>60,873</b>	<b>61,158</b>	<b>19,624</b>	<b>1,056</b>	<b>81,839</b>	
Denar short term deposit of enterprises	10,122	3,603	909	14,633	12,078	6,379	120	18,577	
Denar short term deposits of public sector	415	5	40	460	386	5	16	408	
Denar short term deposits of other customers	812	71	67	950	1,358	106	26	1,490	
Denar short term deposit of citizens	10,047	2,561	1,273	13,880	19,490	5,516	683	25,689	
Foreign currency short term deposits of enterprises	5,607	2,864	19	8,490	6,944	2,484	4	9,432	
Foreign currency short term deposits of other customers	82	487	21	590	80	273	18	371	
Foreign currency short term deposits of citizens	17,416	3,707	748	21,870	20,821	4,861	189	25,871	
<b>SHORT TERM BORROWINGS UP TO 1 YEAR AND ISSUED DEBT SECURITIES</b>	<b>76</b>	<b>40</b>	<b>114</b>	<b>230</b>	<b>2,624</b>	<b>182</b>	<b>2</b>	<b>2,808</b>	
Short-term denar borrowings of domestic banks	76	30	114	221	0	182	2	184	
Short-term borrowings of foreign banks	0	10	0	10	2,615	0	0	2,615	
Short-term denar borrowings of other customers	0	0	0	0	9	0	0	9	
<b>OTHER LIABILITIES</b>	<b>1,616</b>	<b>633</b>	<b>246</b>	<b>2,495</b>	<b>2,038</b>	<b>1,047</b>	<b>110</b>	<b>3,194</b>	
Payable interest	329	155	40	524	457	278	35	771	
Other liabilities in denars	680	295	140	1,114	690	399	50	1,139	
Other liabilities in foreign currency	322	75	17	415	427	146	10	583	
Temporary accounts	285	108	50	442	464	223	14	702	
<b>LONG TERM DEPOSITS OVER 1 YEAR</b>	<b>1,707</b>	<b>2,622</b>	<b>767</b>	<b>5,096</b>	<b>3,454</b>	<b>4,594</b>	<b>642</b>	<b>8,690</b>	
Denar long term deposits of enterprises	235	169	74	478	399	432	0	830	
Denar long term deposits of public sector	0	49	0	49	0	113	0	113	
Denar long term deposits of other customers	32	195	175	402	363	325	261	949	
Denar long term deposits of citizens	544	715	390	1,649	1,320	1,385	302	3,007	
Foreign currency long term deposits of enterprises	0	6	0	7	0	43	0	44	
Foreign currency long term deposits of other customers	248	17	1	266	248	38	1	288	
Foreign currency long term deposits of citizens	648	1,470	127	2,245	1,124	2,257	78	3,460	
<b>LONG TERM BORROWINGS OVER 1 YEAR</b>	<b>8,836</b>	<b>5,085</b>	<b>1,540</b>	<b>15,461</b>	<b>8,440</b>	<b>6,824</b>	<b>1,406</b>	<b>16,671</b>	
Long term borrowings of NBMM	1,404	874	23	2,301	916	638	5	1,560	
Long term denar borrowings of domestic banks	635	117	234	986	589	584	5	1,179	
Long term foreign currency borrowings of domestic banks and other financial institutions	320	1,020	34	1,373	752	1,687	0	2,440	
Long term borrowings of foreign banks	4,505	1,909	1,143	7,557	3,801	2,273	1,344	7,418	
Long term borrowings of others customers	435	553	89	1,078	374	546	51	971	
Long term foreign currency borrowings of other customers	0	459	0	459	0	490	0	490	
Long term borrowings of enterprises	0	0	17	17	0	0	0	0	
Long term issued securities, subordinated deposits and hybrid capital instruments	1,538	153	0	1,690	2,007	606	0	2,613	
<b>PROVISIONS FOR OFF BALANCE SHEET LIABILITIES</b>	<b>576</b>	<b>50</b>	<b>22</b>	<b>648</b>	<b>769</b>	<b>87</b>	<b>15</b>	<b>872</b>	
<b>EQUITY AND RESERVES</b>	<b>9,839</b>	<b>6,735</b>	<b>6,613</b>	<b>23,187</b>	<b>11,931</b>	<b>8,343</b>	<b>5,191</b>	<b>25,465</b>	
Equity capital	7,641	5,856	5,899	19,396	8,452	7,142	4,798	20,393	
Reserve fund	2,037	1,275	333	3,645	2,604	1,126	273	4,004	
Revaluation reserves	130	4	202	335	121	0	0	121	
Unallocated profit from previous years	30	151	13	194	752	566	32	1,350	
Other funds	1	8	399	408	1	0	410	411	
Loss	0	-558	-108	-666	0	-491	-185	-677	
Current loss	0	0	-125	-125	0	0	-137	-137	
<b>NET INCOME AFTER TAXES</b>	<b>1,907</b>	<b>821</b>	<b>197</b>	<b>2,925</b>	<b>2,672</b>	<b>963</b>	<b>152</b>	<b>3,787</b>	
<b>TOTAL LIABILITIES, EQUITY AND RESERVES</b>	<b>115,122</b>	<b>41,368</b>	<b>17,627</b>	<b>174,117</b>	<b>150,122</b>	<b>61,571</b>	<b>11,966</b>	<b>223,659</b>	

## INCOME STATEMENT

in millions of denars

Income statement	31.12.2006				31.12.2007			
	Group of large banks	Group of medium-size banks	Group of small-size banks	Total	Group of large banks	Group of medium-size banks	Group of small-size banks	Total
<b>INTEREST INCOME</b>	<b>6,114</b>	<b>2,099</b>	<b>1,340</b>	<b>9,553</b>	<b>8,363</b>	<b>3,793</b>	<b>532</b>	<b>12,688</b>
Banks	547	326	180	1,053	665	550	172	1,386
Enterprises	2,502	1,023	415	3,940	3,397	1,605	108	5,110
Citizens	1,986	575	606	3,167	2,754	1,437	166	4,356
Other	1,207	231	177	1,615	1,708	335	134	2,177
Reversed interest	-128	-56	-38	-222	-160	-134	-48	-342
<b>INTEREST EXPENSE</b>	<b>-2,236</b>	<b>-699</b>	<b>-376</b>	<b>-3,311</b>	<b>-3,461</b>	<b>-1,504</b>	<b>-159</b>	<b>-5,125</b>
Banks	-494	-140	-32	-666	-772	-236	-10	-1,018
Enterprises	-625	-204	-44	-873	-835	-374	-10	-1,219
Citizens	-1,025	-274	-169	-1,468	-1,720	-636	-78	-2,433
Other	-92	-81	-131	-304	-135	-259	-61	-455
<b>NET INTEREST INCOME</b>	<b>3,878</b>	<b>1,400</b>	<b>964</b>	<b>6,242</b>	<b>4,902</b>	<b>2,288</b>	<b>373</b>	<b>7,563</b>
<b>NET PROVISIONS</b>	<b>-1,255</b>	<b>-115</b>	<b>-253</b>	<b>-1,623</b>	<b>-1,528</b>	<b>-428</b>	<b>-234</b>	<b>-2,190</b>
Provisions	-1,765	-211	-258	-2,234	-2,145	-579	-301	-3,024
Recovery, regarding provisions	510	120	55	685	617	151	67	836
Nonallocated provisions for potential losses	0	-24	-50	-74	0	-1	0	-1
<b>NET INTEREST INCOME AFTER PROVISIONS</b>	<b>2,623</b>	<b>1,285</b>	<b>711</b>	<b>4,619</b>	<b>3,374</b>	<b>1,860</b>	<b>139</b>	<b>5,374</b>
<b>NET FEES AND COMMISSION INCOME</b>	<b>2,015</b>	<b>550</b>	<b>409</b>	<b>2,974</b>	<b>2,461</b>	<b>899</b>	<b>208</b>	<b>3,568</b>
Fees and commission income	2,228	695	521	3,444	2,768	1,107	294	4,170
Fees and commission expenses	-213	-145	-112	-470	-307	-208	-86	-602
<b>DIVIDENDS</b>	<b>4</b>	<b>15</b>	<b>7</b>	<b>26</b>	<b>18</b>	<b>32</b>	<b>7</b>	<b>57</b>
<b>NET INCOME, REGARDING THE SECURITIES</b>	<b>17</b>	<b>3</b>	<b>16</b>	<b>36</b>	<b>108</b>	<b>0</b>	<b>0</b>	<b>108</b>
<b>NET CAPITAL INCOME</b>	<b>130</b>	<b>11</b>	<b>49</b>	<b>190</b>	<b>22</b>	<b>319</b>	<b>-13</b>	<b>328</b>
<b>NET FX INCOME</b>	<b>321</b>	<b>133</b>	<b>38</b>	<b>492</b>	<b>362</b>	<b>175</b>	<b>4</b>	<b>541</b>
<b>OTHER INCOME</b>	<b>780</b>	<b>227</b>	<b>249</b>	<b>1,256</b>	<b>713</b>	<b>410</b>	<b>260</b>	<b>1,383</b>
Other income	297	83	130	510	220	111	166	497
Extraordinary income	483	144	119	746	493	298	94	886
<b>OPERATING EXPENSES</b>	<b>-3,567</b>	<b>-1,219</b>	<b>-1,239</b>	<b>-6,025</b>	<b>-3,946</b>	<b>-2,360</b>	<b>-530</b>	<b>-6,837</b>
Salary	-1,690	-602	-569	-2,861	-1,794	-1,028	-252	-3,074
Depreciation	-494	-122	-129	-745	-503	-239	-46	-788
Material expenses	-219	-87	-89	-395	-254	-153	-55	-462
Services	-621	-260	-331	-1,212	-714	-620	-130	-1,464
Business trip expenses	-35	-16	-16	-99	-37	-26	-7	-70
Representation expenses	-177	-62	-68	-307	-231	-166	-26	-422
Insurance premium	-331	-69	-37	-437	-414	-127	-15	-556
<b>OTHER EXPENSES</b>	<b>-248</b>	<b>-90</b>	<b>-138</b>	<b>-476</b>	<b>-297</b>	<b>-254</b>	<b>-37</b>	<b>-588</b>
Other expenses	-243	-84	-135	-462	-289	-252	-23	-563
Extraordinary expenses	-5	-6	-3	-14	-8	-2	-14	-25
<b>GROSS INCOME / LOSS</b>	<b>2,075</b>	<b>914</b>	<b>103</b>	<b>3,092</b>	<b>2,815</b>	<b>1,081</b>	<b>38</b>	<b>3,934</b>
<b>TAXES</b>	<b>-168</b>	<b>-95</b>	<b>-29</b>	<b>-292</b>	<b>143</b>	<b>118</b>	<b>23</b>	<b>284</b>
<b>NET INCOME AFTER TAXES</b>	<b>1,907</b>	<b>819</b>	<b>74</b>	<b>2,800</b>	<b>2,672</b>	<b>963</b>	<b>15</b>	<b>3,650</b>

## Credit structure of non-financial entities

in millions of Denars

Date	Description	Total	Total		Enterprises		Households		Other clients	
			Denar	FX	Denar	FX	Denar	FX	Denar	FX
31.12.2006	Due loans	1,521	1,024	497	703	481	321	15	-	1
	Short-term loans	25,153	20,996	4,157	14,902	4,122	5,830	25	264	10
	Long-term loans	53,034	35,311	17,723	13,824	15,937	21,450	1,636	37	150
	Non-performing loans	10,098	8,850	1,248	7,197	1,120	1,545	32	108	96
	<b>Total gross loans</b>	<b>89,806</b>	<b>66,181</b>	<b>23,625</b>	<b>36,626</b>	<b>21,660</b>	<b>29,146</b>	<b>1,708</b>	<b>409</b>	<b>257</b>
	Reserves for potential losses	-10,179								
	<b>Total net loans</b>	<b>79,627</b>								
31.12.2007	Due loans	1,270	956	314	614	293	341	16	1	5
	Short-term loans	37,270	30,842	6,427	19,226	6,397	11,602	21	15	9
	Long-term loans	76,966	54,235	22,731	22,105	20,247	31,972	2,212	158	272
	Non-performing loans	9,398	8,125	1,273	5,934	1,108	1,950	93	242	72
	<b>Total gross loans</b>	<b>124,904</b>	<b>94,158</b>	<b>30,745</b>	<b>47,878</b>	<b>28,045</b>	<b>45,865</b>	<b>2,342</b>	<b>415</b>	<b>358</b>
	Reserves for potential losses	-10,997								
	<b>Total net loans</b>	<b>113,907</b>								
Increase 31.12.2007/ 31.12.2006	Absolute increase in gross loans	35,098	27,977	7,120	11,252	6,385	16,719	634	6	101
	Increase in %	39.1%	42.3%	30.1%	30.7%	29.5%	57.4%	37.1%	1.5%	39.4%
	Growth structure		79.7%	20.3%	63.8%	36.2%	96.3%	3.7%	5.8%	94.2%

## Annex 4

## Structure of the annual increase in the gross loans of the non-financial agents by sector, currency, activity and type of credit product

Sectors	Activities/banking products	Credit structure 31.12.2007 (in %)				Rate of change 31.12.2007/31.12.2006 (in %)			
		Denar loans	FX indexed loans	FX loans	Total	Denar loans	FX indexed loans	FX loans	Total
e n t e i g a l e s	<b>Agriculture, hunting and forestry</b>	3.6%	3.4%	4.6%	3.9%	-1.4%	44.9%	25.9%	16.2%
	<b>Industry</b>	39.4%	36.3%	44.1%	40.5%	10.9%	98.1%	29.3%	29.1%
	<b>Construction</b>	6.6%	12.2%	4.7%	7.1%	10.3%	63.4%	15.0%	26.5%
	<b>Wholesale and retail trade</b>	34.5%	31.2%	27.2%	31.1%	22.9%	48.5%	31.2%	30.3%
	<b>Transport, storage and communication</b>	7.1%	7.5%	5.8%	6.7%	16.8%	61.9%	49.6%	35.1%
	<b>Other</b>	8.8%	9.4%	13.6%	10.7%	47.4%	55.5%	26.9%	38.1%
	<b>Total:</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>17.0%</b>	<b>59.6%</b>	<b>29.6%</b>	<b>30.1%</b>
H o u s e h o l d s	<b>Residential and commercial real estate loans</b>	5.5%	39.3%	58.9%	21.2%	58.6%	58.3%	114.5%	64.0%
	<b>Consumer loans</b>	38.8%	41.9%	16.2%	39.0%	2.2%	70.4%	-51.2%	19.7%
	<b>Overdrafts</b>	8.7%	0.0%	0.0%	4.9%	76.7%	0.0%	-100.0%	76.6%
	<b>Credit cards</b>	36.3%	0.0%	0.2%	20.5%	121.7%	0.0%	-48.6%	121.5%
	<b>Car loans</b>	1.2%	11.0%	22.2%	6.0%	n.a.	n.a.	n.a.	n.a.
	<b>Other loans</b>	9.6%	7.7%	2.4%	8.5%	31.1%	-54.6%	-87.0%	-26.7%
	<b>Total:</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>57.6%</b>	<b>57.0%</b>	<b>37.2%</b>	<b>56.2%</b>

## Securities portfolio structure

No.	Securities portfolio	Ammount (millions denars)		Structure		Annual change 31.12.07/31.12.06		
		31.12.2007	31.12.2006	31.12.2007	31.12.2006	Absolute change	In percent	Participation in change
<b>1</b>	<b>Debt securities (1.1+1.2+1.3)</b>	<b>34,139</b>	<b>22,783</b>	<b>96.2%</b>	<b>93.9%</b>	<b>11,356</b>	<b>49.8%</b>	<b>101.1%</b>
1.1	NBRM bills	20,999	9,457	61.5%	41.5%	11,542	122.1%	102.8%
1.2	Government securities (1.2.a+1.2.b+1.2.v+1.2.g+1.2.d)	12,700	13,127	37.2%	57.6%	-427	-3.3%	-3.8%
1.2.a	- Bond for privatization of Stopanska banka AD Skopje	3,676	4,332	10.8%	19.0%	-656	-15.1%	-5.8%
1.2.b	- Bond for rehabilitation of Stopanska banka AD Skopje, issued by Banks Rehabilitaiton Agency	0	76	0.0%	0.3%	-76	-100.0%	-0.7%
1.2.v	- Bond for frozen foreign currency savings and denationalization	1,734	1,287	5.1%	5.6%	447	34.8%	4.0%
1.2.g	- Treasury bills	6,530	7,103	19.1%	31.2%	-573	-8.1%	-5.1%
1.2.d	- Treasury bonds (continuous government securities)	760	330	2.2%	1.4%	430	130.5%	3.8%
1.3	Other debt securities	440	199	1.3%	0.9%	241	121.1%	2.1%
<b>2</b>	<b>Equity securities (2.1+2.2+2.3)</b>	<b>1,358</b>	<b>1,481</b>	<b>3.8%</b>	<b>6.1%</b>	<b>-123</b>	<b>-8.3%</b>	<b>-1.1%</b>
2.1	Equities in domestic non-financial legal enteties	436	457	32.1%	30.9%	-21	-4.6%	-0.2%
2.2	Equities in domestic banks and other financial organizations	731	844	53.8%	57.0%	-113	-13.4%	-1.0%
2.3	Other equity securities	191	180	14.1%	12.2%	11	6.1%	0.1%
<b>3</b>	<b>Total securities portfolio (1+2)</b>	<b>35,497</b>	<b>24,264</b>	<b>100.0%</b>	<b>100.0%</b>	<b>11,233</b>	<b>46.3%</b>	<b>100.0%</b>

## Structure of banks deposits

Date	Descriptions	Total	Total		Enterprises		Households		Public sector		Other clients	
			Denar	Foreign currency								
31.12.2006	Sight deposits	55,875	26,368	29,507	12,874	5,834	10,374	21,402	1,091	0	2,029	2,271
	Restricted deposits	1,283	527	756	362	756	0	0	162	0	3	0
	Short -term time deposits up to one year	60,873	29,923	30,950	14,633	8,490	13,880	21,870	460	0	950	590
	Long term time deposits over one year	5,096	2,578	2,518	478	7	1,649	2,245	49	0	402	266
	<b>Total</b>	<b>123,127</b>	<b>59,396</b>	<b>63,731</b>	<b>28,347</b>	<b>15,087</b>	<b>25,903</b>	<b>45,517</b>	<b>1,762</b>	<b>0</b>	<b>3,384</b>	<b>3,127</b>
31.12.2007	Sight deposits	68,445	37,261	31,184	19,812	7,043	14,172	21,988	756	1	2,522	2,151
	Restricted deposits	1,409	755	653	571	653	-	-	176	-	8	-
	Short -term time deposits up to one year	81,839	46,164	35,675	18,577	9,432	25,689	25,871	408	-	1,490	371
	Long term time deposits over one year	8,690	4,899	3,791	830	44	3,007	3,460	113	-	949	288
	<b>Total</b>	<b>160,381</b>	<b>89,079</b>	<b>71,303</b>	<b>39,791</b>	<b>17,172</b>	<b>42,867</b>	<b>51,319</b>	<b>1,452</b>	<b>1</b>	<b>4,969</b>	<b>2,810</b>
Change 31.12.2007/31. 12.2006	Absolute change of deposits	37,254	29,683	7,572	11,444	2,085	16,964	5,802	-310	1	1,585	-317
	In %	30.3%	50.0%	11.9%	40.4%	13.8%	65.5%	12.7%	-17.6%		46.8%	
	Participation in change	100.0%	79.7%	20.3%	30.7%	5.6%	45.5%	15.6%	-0.8%	0.0%	4.3%	-0.9%

## Structure of the exposure to households by type of collateral as of December 31, 2007

Type of collateral Type of exposure to credit risk	Uncollateralized part of the exposure to credit risk	Movables	Securities	Appartments	Bussines premises	Other real estate	Guarantees from banks and other entities	Money deposit	Endores/bill of exchange	Other type of collateral	Total collateralized part of the exposure to credit risk (in thousand of Denars)	% share of the collateralized part of the exposure to credit risk	
Exposure based on residential and commercial real estate loans	Denar exposure	0	12,983	0	916,970	989	1,102	0	10,278	413,118	2,141	1,357,581	100.0%
	Exposure with currency component	0	2,028	1,212	7,394,704	651,330	114,738	2,545	44,655	51,270	149,052	8,411,535	100.0%
Exposure based on consumer loans	Denar exposure	2,722,458	1,958	253,242	1,395,477	12,855	2,167	0	432,657	6,500,249	747,626	9,346,231	77.4%
	Exposure with currency component	1,257,064	6,945	1,535	1,603,768	201,218	694	2,966	356,382	4,174,432	391,145	6,739,084	84.3%
Exposure based on overdrafts	Denar exposure	4,251,586	10	0	0	0	0	0	4,550	1,111,829	134,480	1,250,869	22.7%
	Exposure with currency component	0	0	0	0	0	0	0	0	0	0	0	
Exposure based on issued credit cards	Denar exposure	13,585,981	0	0	0	0	0	0	14,018	4,413,090	437,007	4,864,115	26.4%
	Exposure with currency component	115,070	0	0	0	0	0	0	4,198	15,701	0	19,899	14.7%
Exposure based on car loans	Denar exposure	0	211,656	0	31,465	0	0	0	1,735	45,863	5,285	296,004	100.0%
	Exposure with currency component	0	2,527,292	0	31,785	13,939	12,892	0	363	4,462	1,184	2,591,917	100.0%
Other exposure	Denar exposure	162,283	105,325	773	126,159	0	337	0	124,739	1,986	198,813	558,132	77.5%
	Exposure with currency component	25,692	842,409	156,307	930,341	100,011	423,589	0	510,756	314,061	2,116	3,279,590	99.2%
Total:	Denar exposure	20,722,308	331,932	254,015	2,470,072	13,844	3,606	0	587,976	12,486,135	1,525,352	17,672,932	46.0%
	Exposure with currency component	1,397,826	3,378,674	159,054	9,960,598	966,498	551,913	5,511	916,354	4,559,926	543,497	21,042,024	93.8%

**Note 1:** Exposure with currency component encompasses the foreign currency exposure and FX indexed exposure.

**Note 2:** The collateralized part of the exposure to credit risk pertains to the amount of the exposure to the amount of the value of the collateral. The remaining is the uncollateralized part of the exposure to credit risk.

**Note 3:** Exposure by individual types of credits encompasses: principle, interest and other claims and off-balance sheet items.

## Annex 8

**Structure of the exposure to non-financial legal entities according to the type of collateral as of December 31, 2007**

Type of collateral	Exposure to legal entities			
	Denar exposure	Exposure with currency component	Total (in thousands of Denars)	Structure of the collateralized part of the exposure according to the type of collateral
<b>Neobezbeden del od izlo`enosta na krediten rizik</b>	<b>3,812,467</b>	<b>4,614,377</b>	<b>8,426,845</b>	
<b>Movables</b>	<b>2,517,020</b>	<b>4,668,005</b>	<b>7,185,024</b>	<b>11.5%</b>
<b>Securities</b>	<b>728,009</b>	<b>382,658</b>	<b>1,110,667</b>	<b>1.8%</b>
<b>Mortgage on real estate loans</b>	<b>2,316,377</b>	<b>2,321,781</b>	<b>4,638,158</b>	<b>7.5%</b>
<b>Mortgage on real estate loans with other type of collateral</b>	<b>457,919</b>	<b>1,489,995</b>	<b>1,947,914</b>	<b>3.1%</b>
<b>Apartments</b>	<b>3,702,655</b>	<b>7,262,586</b>	<b>10,965,242</b>	<b>17.6%</b>
<b>Bussines premises and storages</b>	<b>3,402,848</b>	<b>12,819,312</b>	<b>16,222,160</b>	<b>26.1%</b>
<b>Production facilities</b>	<b>820,664</b>	<b>787,288</b>	<b>1,607,953</b>	<b>2.6%</b>
<b>Other real estate</b>	<b>307,747</b>	<b>285,305</b>	<b>593,052</b>	<b>1.0%</b>
<b>Guarantees from banks and other entities</b>	<b>318,262</b>	<b>2,063,333</b>	<b>2,381,595</b>	<b>3.8%</b>
<b>Money deposits</b>	<b>900,483</b>	<b>1,241,227</b>	<b>2,141,710</b>	<b>3.4%</b>
<b>Other type of collateral</b>	<b>7,346,412</b>	<b>6,091,786</b>	<b>13,438,198</b>	<b>21.6%</b>
<b>Total share of the exposure to credit risk</b>	<b>22,818,396</b>	<b>39,413,276</b>	<b>62,231,672</b>	<b>100.0%</b>
<b>Percentage share of the collateralized part of the exposure to credit risk</b>	<b>85.7%</b>	<b>89.5%</b>	<b>88.1%</b>	

**Note 1:** The exposure with currency component encompasses the foreign exposure and FX indexed exposure.

**Note 2:** The collateralized part of the exposure to credit risk pertains to the exposure amount to the amount of the collateral value. the rest is the uncollateralized part of the exposure to credit risk

Annex 9

**Indicators for the credit exposure quality**

in millions of Denars

Items	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006	31.12.2007
A	67,337	77,686	91,394	108,913	143,707	198,617
B	11,018	10,871	12,025	16,487	21,931	25,484
C	6,269	4,602	4,826	4,473	3,807	4,469
D	6,497	5,735	4,191	4,420	3,435	3,219
E	2,094	5,413	6,744	6,403	6,308	5,867
Total credit exposure	93,214	104,306	119,179	140,696	179,188	237,656
Potential losses	8,166	10,719	11,591	11,753	11,762	12,690
Total C, D and E	14,860	15,749	15,761	15,296	13,550	13,555
Total D and E	8,591	11,148	10,935	10,823	9,743	9,086
Total C and D	12,766	10,336	9,017	8,893	7,242	7,688
% of C, D, E in the total credit exposure	15.9	15.1	13.2	10.8	7.6	5.7
% of D, E in the total credit exposure	9.2	10.7	9.2	7.7	5.4	3.8
% of C, D in the total credit exposure	13.7	9.9	7.6	6.3	4.0	3.2
% of D in the total credit exposure	7.0	5.5	3.5	3.1	1.9	1.4
% of E in the total credit exposure	2.3	5.2	5.7	4.6	3.5	2.5
% of C in the total credit exposure	6.7	4.4	4.1	3.2	2.2	1.9
% of risk (potential loss/total exposure)	8.8	10.3	9.7	8.4	6.6	5.3
Net positions in C, D, E (less adequate provisions)	7,950	6,318	5,715	5,565	4,573	4,961
Own funds	19,122	19,441	19,397	21,292	23,604	27,721
% of C, D, E in own funds	77.7	81.0	81.3	71.8	57.4	48.9
% of D, E in own funds	44.9	57.3	56.4	50.8	41.3	32.8
% of C, D in own funds	66.8	53.2	46.5	41.8	30.7	27.7
% of D in own funds	34.0	29.5	21.6	20.8	14.6	11.6
% of E in own funds	11.0	27.8	34.8	30.1	26.7	21.2
% of C in own funds	32.8	23.7	24.9	21.0	16.1	16.1
% of net C, D and E in own funds	41.6	32.5	29.5	26.1	19.4	17.9
Capital adequacy	28.1	25.8	23.0	21.3	18.3	17
Total country risk exposure (net)	29,438	31,195	35,278	35,589	37,235	36,109
Potential country risk losses	8	12	13	42	45	60
% of potential country risk losses/total country risk exposure	0.03	0.04	0.04	0.1	0.1	0.2

Annex 10

**Structure of the exposure to credit risk, by individual risk category**

Risk category	Exposure to credit risk (in millions of Denars)			Absolute change (in millions of Denars)		Rate of change (in %)		Structure (in %)		
	31.12.2005	31.12.2006	31.12.2007	31.12.2006/31.12.2005	31.12.2007/31.12.2006	31.12.2006/31.12.2005	31.12.2007/31.12.2006	31.12.2005	31.12.2006	31.12.2007
A	108,913	143,707	198,617	34,794	54,910	31.9%	38.2%	77.4%	80.2%	83.6%
B	16,487	21,931	25,484	5,444	3,552	33.0%	16.2%	11.7%	12.2%	10.7%
C	4,473	3,807	4,469	-665	662	-14.9%	17.4%	3.2%	2.1%	1.9%
D	4,420	3,435	3,219	-985	-217	-22.3%	-6.3%	3.1%	1.9%	1.4%
E	6,403	6,307	5,867	-96	-440	-1.5%	-7.0%	4.6%	3.5%	2.5%
<b>Total:</b>	<b>140,696</b>	<b>179,188</b>	<b>237,656</b>	<b>38,492</b>	<b>58,468</b>	<b>27.4%</b>	<b>32.6%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Annex 11

Transition matrix for clients- natural persons

Risk category 31.12.2006	Number of clients			Risk category on 31.12.2007					
	31.12.2006	Settled and written off	31.12.2007*	A	B	C	D	E	Total
<b>A</b>	29,235	7,558	21,677	86.8%	8.6%	3.0%	1.1%	0.5%	100.0%
<b>B</b>	7,243	1,992	5,251	28.1%	62.3%	7.3%	1.5%	0.7%	100.0%
<b>C</b>	1,538	763	775	25.0%	19.9%	37.7%	8.8%	8.6%	100.0%
<b>D</b>	350	140	210	12.9%	6.7%	14.8%	49.0%	16.7%	100.0%
<b>E</b>	501	180	321	5.0%	2.2%	1.9%	9.3%	81.6%	100.0%
<b>Total</b>	<b>38,867</b>	<b>10,633</b>	<b>28,234</b>	<b>72.7%</b>	<b>18.8%</b>	<b>4.8%</b>	<b>1.9%</b>	<b>1.8%</b>	<b>100.0%</b>
Risk category 31.12.2006	Amount of credit exposure (in thousands of Denars)			Risk category on 31.12.2007					
	31.12.2006	Settled and written off	31.12.2007*	A	B	C	D	E	Total
<b>A</b>	13,287,238	1,625,584	11,661,654	88.8%	7.6%	2.7%	0.7%	0.3%	100.0%
<b>B</b>	3,687,448	61,590	3,625,858	20.0%	71.0%	7.1%	1.3%	0.7%	100.0%
<b>C</b>	588,504	129,305	459,199	21.4%	26.5%	38.0%	10.1%	4.1%	100.0%
<b>D</b>	159,845	2,402	157,443	9.5%	7.1%	22.5%	48.9%	12.0%	100.0%
<b>E</b>	221,399	58,961	162,438	5.1%	1.6%	1.3%	8.2%	83.9%	100.0%
<b>Total</b>	<b>17,944,434</b>	<b>1,877,841</b>	<b>16,066,593</b>	<b>69.7%</b>	<b>22.3%</b>	<b>4.9%</b>	<b>1.6%</b>	<b>1.4%</b>	<b>100.0%</b>

Transition matrix for clients- nonfinancial legal entities

Risk category 31.12.2006	Number of clients			Risk category on 31.12.2007					
	31.12.2006	Settled and written off	31.12.2007*	A	B	C	D	E	Total
<b>A</b>	7,056	1,073	5,983	87.9%	6.7%	3.3%	0.6%	1.6%	100.0%
<b>B</b>	1,739	329	1,410	21.9%	69.8%	5.3%	1.6%	1.4%	100.0%
<b>C</b>	388	75	313	12.8%	10.2%	31.9%	20.1%	24.9%	100.0%
<b>D</b>	219	45	174	2.9%	5.2%	3.4%	58.0%	30.5%	100.0%
<b>E</b>	494	96	398	0.8%	0.5%	0.0%	1.0%	97.7%	100.0%
<b>Total</b>	<b>9,896</b>	<b>1,618</b>	<b>8,278</b>	<b>67.8%</b>	<b>17.3%</b>	<b>4.5%</b>	<b>2.7%</b>	<b>7.7%</b>	<b>100.0%</b>
Risk category 31.12.2006	Amount of credit exposure (in thousands of Denars)			Risk category on 31.12.2007					
	31.12.2006	Settled and written off	31.12.2007*	A	B	C	D	E	Total
<b>A</b>	72,488,592	1,097,095	71,391,497	95.2%	4.0%	0.6%	0.1%	0.0%	100.0%
<b>B</b>	16,965,961	546,601	16,419,360	21.2%	70.3%	6.0%	1.9%	0.5%	100.0%
<b>C</b>	3,395,544	123,322	3,272,222	4.3%	27.7%	57.5%	8.8%	1.6%	100.0%
<b>D</b>	2,217,314	98,216	2,119,098	3.4%	0.5%	1.8%	50.6%	43.7%	100.0%
<b>E</b>	5,399,622	937,216	4,462,406	0.0%	7.9%	0.0%	0.8%	91.3%	100.0%
<b>Total</b>	<b>100,467,033</b>	<b>2,802,450</b>	<b>97,664,583</b>	<b>73.4%</b>	<b>16.1%</b>	<b>3.4%</b>	<b>1.8%</b>	<b>5.3%</b>	<b>100.0%</b>

\* This column includes the clients the banks were exposed to on December 31, 2006 and the clients the banks are still exposed to on December 31, 2007 as well as the total amount of credit exposure of those clients. The column does not include those new clients to which the banks in the meantime established credit exposure and the amount of that exposure.

Annex 12

**Indicators for the quality of the exposure to credit risk by sole proprietors, natural persons not considered as proprietors and natural persons that perform small scale commercial activity as of December 31, 2007**

Indicator	Agriculture	Trade	Other service activities	Other activities	Total exposure to sole proprietors
<b>Average level of risk</b>	4.6%	6.7%	3.7%	4.3%	5.1%
<b>Share of C, D and E in the total exposure to credit risk</b>	5.4%	6.6%	2.3%	3.8%	5.0%
<b>Coverage of C, D and E with allocated loan loss provisions</b>	85.0%	100.9%	163.7%	112.6%	102.1%
<b>Share of non-performing loans in the total exposure to credit risk</b>	4.5%	5.8%	1.8%	2.1%	3.9%

Annex 13

**Contractual residual maturity structure of the assets and liabilities as of 31.12.2007**

in thousands of denars

Ref.no.	Description	up to 7 days	from 7 days to 1 month	1 - 3 months	3 - 6 months	6 - 12 months	over 12 months	Total
<b>Assets</b>								
1	Cash and balances with the NBRM	13,670,011	-	-	-	-	8,960,634	<b>22,630,645</b>
2	Securities of the NBRM and RM securities	5,466,743	17,735,223	3,884,913	998,858	433,588	5,179,007	<b>33,698,332</b>
3	Debt securities and other payment instruments	133,422	326,601	2,351	-	-	58,225	<b>520,599</b>
4	Placements with other banks	21,987,215	9,705,764	3,716,469	303,380	491,425	3,358,267	<b>39,562,520</b>
5	Placements to clients	4,423,462	6,539,544	9,822,962	14,151,094	24,826,272	65,142,543	<b>124,905,877</b>
6	Accrued interest	644,165	374,376	38,248	18,140	2,678	3,777,903	<b>4,855,510</b>
7	Other assets	1,376,587	481,985	194,577	88,261	69,237	253,649	<b>2,464,296</b>
8	Placements in own securities and capital investments	9,739	251,606	-	-	13,252	1,041,036	<b>1,315,633</b>
9	<b>Total assets(1+2+3+4+5+6+7+8)</b>	<b>47,711,344</b>	<b>35,415,099</b>	<b>17,659,520</b>	<b>15,559,733</b>	<b>25,836,452</b>	<b>87,771,264</b>	<b>229,953,412</b>
<b>Liabilities</b>								
10	Deposits from banks	1,808,993	788,211	2,009,294	413,221	489,761	186,227	<b>5,695,707</b>
11	Sight deposits	68,710,293	191,859	177,115	142,537	243,912	342,460	<b>69,808,176</b>
12	Short-term deposits with up to 1 year	7,471,464	17,730,590	33,406,996	16,185,316	11,723,882	160,566	<b>86,678,814</b>
13	Short-term borrowings with up to 1 year	178,545	12,244	-	-	2,614,977	-	<b>2,805,766</b>
14	Issued debt securities	-	-	-	-	-	300,000	<b>300,000</b>
15	Other liabilities	1,269,586	1,044,427	431,222	49,283	143,326	68,289	<b>3,006,133</b>
16	Long-term deposits with over 1 year	238,550	139,740	296,260	523,916	2,040,403	7,763,426	<b>11,002,295</b>
17	Long-term borrowings with over 1 year	220,323	155,108	449,654	439,071	946,132	11,848,693	<b>14,058,981</b>
18	Off-balance sheet items	3,230,624	1,136,585	3,088,317	2,220,582	2,194,496	4,786,735	<b>16,657,339</b>
19	<b>Total liabilities</b>	<b>83,128,378</b>	<b>21,198,764</b>	<b>39,858,858</b>	<b>19,973,926</b>	<b>20,396,889</b>	<b>25,456,396</b>	<b>210,013,211</b>
20	<b>Difference (9-19)</b>	<b>(35,417,034)</b>	<b>14,216,335</b>	<b>(22,199,338)</b>	<b>(4,414,193)</b>	<b>5,439,563</b>	<b>62,314,868</b>	<b>19,940,201</b>
21	<b>Accumulation of the difference</b>	<b>(35,417,034)</b>	<b>(21,200,699)</b>	<b>(43,400,037)</b>	<b>(47,814,230)</b>	<b>(42,374,667)</b>	<b>19,940,201</b>	

Annex 14

**Expected residual maturity structure of the assets and liabilities as of 31.12.2007**

in thousands of denars

Ref. no.	Description	up to 7 days	from 7 days to 1 month	from 1 month to 3 months	Total
<b>Assets</b>					
1	Cash and balances with the NBRM	13,016,693	52,799	2,000	<b>13,071,492</b>
2	Securities of the NBRM and RM securities	5,406,752	17,794,919	3,598,249	<b>26,799,920</b>
3	Debt securities and other payment instruments	133,351	326,601	2,351	<b>462,303</b>
4	Placements with other banks	19,677,166	9,948,534	4,472,794	<b>34,098,494</b>
5	Placements to clients	2,623,105	6,126,807	9,090,923	<b>17,840,835</b>
6	Accrued interest	514,784	356,533	170,109	<b>1,041,426</b>
7	Other assets	1,280,315	349,076	201,733	<b>1,831,124</b>
8	Placements in own securities and capital investments	9,739	251,606	-	<b>261,345</b>
9	<b>Total assets (1+2+3+4+5+6+7+8)</b>	<b>42,661,905</b>	<b>35,206,875</b>	<b>17,538,159</b>	<b>95,406,939</b>
<b>Liabilities</b>					
10	Deposits from banks	984,115	687,931	1,543,774	<b>3,215,820</b>
11	Sight deposits	9,478,533	2,651,847	2,370,803	<b>14,501,182</b>
12	Short-term deposits with maturity up to one year	3,623,900	5,727,106	15,368,889	<b>24,719,895</b>
13	Short-term borrowings with maturity up to one year	23,545	12,244	-	<b>35,789</b>
14	Issued debt securities	-	-	-	-
15	Other liabilities	849,985	1,080,921	430,321	<b>2,361,227</b>
16	Long-term deposits with maturity over one year	113,003	61,775	149,364	<b>324,141</b>
17	Long-term borrowings with maturity over one year	220,326	155,052	449,680	<b>825,058</b>
18	Off-balance sheet items	337,424	399,028	855,996	<b>1,592,448</b>
19	<b>Total liabilities (10+11+12+13+14+15+16+17+18)</b>	<b>15,630,831</b>	<b>10,775,903</b>	<b>21,168,827</b>	<b>47,575,561</b>
20	<b>Difference (9-19)</b>	<b>27,031,074</b>	<b>24,430,972</b>	<b>(3,630,668)</b>	<b>47,831,378</b>
21	<b>Accumulated difference</b>	<b>27,031,074</b>	<b>51,462,046</b>	<b>47,831,378</b>	

**Structure of foreign assets and foreign liabilities**

<b>Foreign assets</b>	<b>Amount (in millions of Denars)</b>			<b>Structure of foreign assets</b>			<b>Change rate 2005-2006</b>	<b>Change rate 2006-2007</b>
	<b>31.12.2005</b>	<b>31.12.2006</b>	<b>31.12.2007</b>	<b>31.12.2005</b>	<b>31.12.2006</b>	<b>31.12.2007</b>		
Cash and checks and debt market securities	2,026	2,439	2,887	2.5%	2.5%	2.5%	20.4%	18.4%
Assets in foreign and domestic banks	41,348	43,949	42,757	50.9%	45.6%	36.8%	6.3%	-2.7%
Foreign currency claims	18,480	23,813	30,939	22.8%	24.7%	26.6%	28.9%	29.9%
Foreign currency indexed claims in Denars	21,384	27,975	41,830	26.3%	29.1%	36.0%	30.8%	49.5%
Value correction	-2,457	-2,396	-2,730	-3.0%	-2.5%	-2.3%	-2.5%	13.9%
Securities for sales	59	74	58	0.1%	0.1%	0.0%	25.4%	-21.6%
Other assets - other accounts	349	432	488	0.4%	0.4%	0.4%	23.8%	13.0%
<b>Total foreign assets</b>	<b>81,189</b>	<b>96,285</b>	<b>116,229</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>18.6%</b>	<b>20.7%</b>

<b>Foreign liabilities</b>	<b>Amount (in millions of Denars)</b>			<b>Structure of foreign liabilities</b>			<b>Change rate 2005-2006</b>	<b>Change rate 2006-2007</b>
	<b>31.12.2005</b>	<b>31.12.2006</b>	<b>31.12.2007</b>	<b>31.12.2005</b>	<b>31.12.2006</b>	<b>31.12.2007</b>		
Foreign currency deposits of banks	1,437	2,147	2,680	2.0%	2.5%	2.5%	49.4%	24.8%
Foreign currency deposits of households	39,305	44,905	50,542	55.8%	52.3%	47.7%	14.2%	12.6%
Foreign currency deposits of enterprises, public sector and other clients	11,688	15,373	17,454	16.6%	17.9%	16.5%	31.5%	13.5%
Foreign assets of foreign entities	3,881	7,752	10,955	5.5%	9.0%	10.3%	99.7%	41.3%
Foreign currency indexed deposits in Denars	2,731	5,333	11,267	3.9%	6.2%	10.6%	95.3%	111.3%
Foreign currency loans of banks	11,017	9,825	12,441	15.6%	11.4%	11.7%	-10.8%	26.6%
Other liabilities - other accounts	385	551	721	0.5%	0.6%	0.7%	43.1%	30.9%
<b>Total foreign liabilities</b>	<b>70,444</b>	<b>85,885</b>	<b>106,060</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>21.9%</b>	<b>23.5%</b>

**Own funds as of December 31,2007**

in millions of denars

No.	Description	TOTAL
<b>CORE CAPITAL</b>		
1	Paid in and subscribed common and non-cumulative preference shares and premiums based on these shares	20,237
1.1	Face value	16,873
1.1.1	Face value of common shares	16,763
1.1.2	Face value of non-cumulative preference share	110
1.2	Premium	3,364
1.2.1	Premium based on common shares	3,349
1.2.2	Premium based on non-cumulative preference shares	16
2	Reserve and retained profit/loss	5,594
2.1	Reserve fund	3,950
2.2	Retained profit	1,145
2.3	Accumulated loss from previous years	677
2.4	Current profit	1,177
3	Positions as a result of consolidation (positive items)	0
3.1	Minority share	0
3.2	Reserves based on exchange rate differentials	0
3.3	Other differences	0
4	Deductions	350
4.1	Loss at the end of the year, or current loss	146
4.2	Intangible assets	175
4.3	Own common and non-cumulative preference shares	28
4.4	Difference between the amount for the required special reserves for potential losses and the allocated special reserves	1
5	Common shares, retained gain and deductions	25,356
6	Amount of other positions that can not be included in the core capital	125
<b>I</b>	<b>Core capital</b>	<b>25,534</b>
<b>SUPPLEMENTARY CAPITAL I</b>		
7	Paid in and subscribed cumulative preference shares and premiums for these shares	243
7.1	Face value of the cumulative preference shares	154
7.2	Premium based on cumulative preference shares	89
7.3	Own cumulative preference shares	0
8	Hybrid capital instruments	0
9	Subordinated instruments	2,399
10	Amount of subordinated instruments that can be part of the supplementary capital 1	2,399
<b>II</b>	<b>Supplementary capital 1</b>	<b>2,642</b>
<b>DEDUCTIONS FROM THE CORE CAPITAL AND SUPPLEMENTARY CAPITAL I</b>		
11	Investments in capital of other banks or financial institutions exceeding 10% of the capital of those institutions except to the institutions under no.14	305
12	Investments in subordinated and hybrid capital instruments in other instruments of the institutions under no.11	0
13	Aggregate amount of capital investments, subordinated and hybrid instruments and other instruments exceeding 10% of (I+II)	0
14	Direct investments in the capital of other insurance and reinsurance companies and pension funds management companies	150
15	Investments in financial instruments issued by companies under no 14 included in their capital	0
16	Amount of exceeding the limits for investments in non-financial institutions	0
17	Positions resulting from consolidation (negative items)	0
<b>III</b>	<b>Deductions from the core capital and supplementary capital 1</b>	<b>455</b>

**Capital adequacy ratio as of December 31, 2007**

in millions of denars

No.	Description	TOTAL
<b>I</b>	<b>CREDIT RISK WEIGHTED ASSETS</b>	
1	On-balance sheet assets weighted by credit risk	129,754
2	Off-balance sheet assets weighted by credit risk	22,620
<b>3</b>	<b>Credit risk weighted assets (1+2)</b>	<b>152,375</b>
4	Capital requirement for credit risk coverage (8% of no. 3)	12,190
<b>II</b>	<b>CURRENCY RISK WEIGHTED ASSETS</b>	
5	Aggregate foreign currency position	10,695
6	Net-position in gold	0
<b>7</b>	<b>Currency risk weighted assets (5+6)</b>	<b>10,695</b>
8	Capital requirement for currency risk coverage (8% of no.7)	856
<b>III</b>	<b>RISK WEIGHTED ASSETS (3+7)</b>	<b>163,069</b>
9	Capital requirement for risk coverage (4+8)	13,046
<b>IV</b>	<b>OWN FUNDS</b>	<b>27,721</b>
<b>V</b>	<b>CAPITAL ADEQUACY RATIO</b>	<b>17.00%</b>

**Review by group of banks**

	<b>Large banks (asset over 15 billion denars)</b>	<b>Medium banks (asset between 4.5 - 15 billion denars)</b>	<b>Small banks (asset lower than 4.5 billion denars)</b>
1	Komercijalna banka AD Skopje	1 Alfa banka AD Skopje	1 Eurostandard banka AD Skopje
2	NLB Tutunska banka AD Skopje	2 Investbanka AD Skopje	2 Kapital banka AD Skopje
3	Stopanska banka AD Skopje	3 Izvozna i kreditna banka AD Skopje	Komercijalno investiciona banka AD Kumanovo
		4 Ohridska banka AD Ohrid	Macedonian Bank for Development
		5 Prokredit banka AD Skopje	4 Promotion AD Skopje
		6 Stopanska banka AD Bitola	5 Postenska banka AD Skopje
		7 TTK banka AD Skopje	6 Sileks banka AD Skopje
		8 UNI banka AD Skopje	7 Ziraat bankasi AD Skopje

\* Banks are in alphabetical order