

IV. SUPERVISION OF BANKS AND SAVINGS HOUSES

4.1. Banking supervision

The supervisory function of the National Bank of the Republic of Macedonia is performed through the following three aspects:

- licensing function, i.e. processing of the submitted applications for issuing licenses and approvals, in accordance with the regulations;
- supervisory control of banks and savings houses; and
- undertaking corrective actions against banking institutions in which irregularities have been identified.

During the first half of 2000, a total number of 29 on-site examinations were performed, 15 of which were full-scope examinations, 13 were partial examinations and 1 control is underway. Full-scope examination of the overall operations was conducted in 8 banks and 7 savings houses, whereas a control of separate segments of the operations was conducted in 10 banks and 3 savings houses. The scope of control function of the National Bank of the Republic of Macedonia includes the inspection of the enforcement of the foreign exchange operations principles. Thus, in the first half of 2000, 62 examinations were performed. The overall foreign exchange operations of the banks was covered by 6 examinations, 7 examinations were performed in separate segments of the foreign exchange operations, 2 examinations covered the operations of 2 savings houses, 14 examinations of the deposited foreign exchange savings, and the other 33 examinations refer to the operations of the authorized exchange offices.

During the first half of this year, Arthur Andersen independent auditing house conducted a diagnostic study of the four largest banks in the Republic of Macedonia, excluding “Stopanska Banka”, a.d. Skopje, upon request of the World Bank, in the framework of the FESAL II arrangement. The fact that these are banks with 34% share in the total activities of the banking system, leads to the conclusion that this project covered a significant part of the total banking system of the Republic of Macedonia.

4.2. Banking system structure

At the end of the first half of 2000, the banking system of the Republic of Macedonia consisted of 21 banks, 1 foreign bank branch and 19 savings houses, of which 15 banks and the foreign bank branch have a full license for conducting payment operations, international credit and guarantee activities, whereas the operating license of the other 6 banks pertains only to domestic banking operations. Compared to December 31, 1999, the number of institutions from the first segment has reduced, due to the final decision to revoke the operating license of “Almako Banka” a.d. Skopje and the introduction of bankruptcy procedure. The number of institutions in the second segment registered an increase, which is a result of the licenses issued by the National Bank of the Republic of Macedonia for founding two new savings houses:

- “Zegin Viktorija i drugi” Ltd. Skopje, savings house,
- “Moznosti” Ltd. Skopje, savings house

and the commenced operations of the “Al Kosa” a.d. Stip, savings house, for which the National Bank of the Republic of Macedonia issued an operating license on November 09, 1999.

As for the main structural characteristics of the banking system of the Republic of Macedonia, at the end of the first half of 2000 compared to the previous period, they remained

unchanged. Several criteria indicate that there are still high concentrations in the banking system, regional asymmetry, dominant position of banks relative to savings houses, unfavorable qualifications structure of the employees in the banking institutions, which influence the competitiveness and efficiency of the banking system of the Republic of Macedonia.

In the first half of this year, structural relations between the two major segments of the banking system confirm the structural dominance of banks in the banking system of the country. Their share of 98.9% in the total assets once again confirms the marginal role of savings houses in the system (they cover 1.1% of the total financial assets), which may well be illustrated by their share in the mobilization of available funds from households, which in accordance with the legal regulations represents one of their major functions. Namely, as of June 30, 2000, the share of savings houses in the total amount of collected households' deposits equaled 2.6%. If only Denar deposits are taken into consideration, the share of savings houses equals 5.6%, and is unchanged compared to the same period of the last year.

The analysis of the banking system structure based on the scope of operations, i.e. their market share, the size of the financial assets and own funds available to individual banks, indicates that its structure is asymmetric. The share of the three largest banks in the Republic of Macedonia in the total bank operations and in the collected financial assets equals 64.5% and 62%, respectively. Considering the capital strength, the share of the three largest banks in the Republic of Macedonia equals 33.4%, which is by 5 percentage points lower compared to December 1999.

The ownership structure of banks in the Republic of Macedonia is analyzed from two aspects:

- a) Level of privatization of banks
 - b) Share of foreign capital
- a) On the basis of the data that the banks submit to the National Bank of the Republic of Macedonia, the level of privatization of the banking capital in the Republic of Macedonia equaled 80.4% as of June 30, 2000, which compared to December 31, 1999 represents an increase of 3.6 percentage points. If the two banking institutions which are fully state-owned are excluded from the analysis: "Macedonian Bank for Development Support" and the branch of "T.C. Ziraat Bankasi" from the Republic of Turkey, the level of privatization of the rest of the banking capital in the Republic of Macedonia equals 90.6% or 3.9 percentage points more compared to December 31, 1999. According to the bank-by-bank analysis, the level of privatization ranges between 72.1 % and 100% with 6 banks.
 - b) At the end of the first half of 2000, the share of foreign capital in the total equity capital of the banks in the Republic of Macedonia equaled 33.3%, which is a significant increase of 14 percentage points compared to the end of December 1999. This is primarily due to the structural changes in the shareholder structure of Stopanska Banka a.d. Skopje, i.e. the entrance of new shareholders: National Bank of Greece, International Finance Corporation and European Bank for Reconstruction and Development. Thus, the share of foreign capital in the ownership structure of this bank, which previously was entirely in domestic ownership, reached 85%. The bank-by-bank analysis indicates that foreign capital is present in 15 banks, with a share between 0.3% to 100%.

4.3. Banking system performances

4.3.1. Assets quality

One of the most significant problems of the banks in the Republic of Macedonia, also present in the first half of 2000, is the low assets quality, or high credit risk. With the other financial instruments being underdeveloped and banks relying fully on classical banking functions, assets quality of the Macedonian banks totally depends on the level of credit risk incorporated in their operations. Hence, the credit risk plays crucial role in determining the total financial risk of the banks in the Republic of Macedonia.

Due to the war in the neighborhood and the adverse external shock that affected the Macedonian economy, the upward trend in the assets quality of the banks, which started in 1996, was halted in 1999. Consequently, at the end of 1999, total credit exposure of the banks classified in the risk categories C, D, and E, went back to the level from the first quarter of 1997.

As of June 30, 2000, the basic indicators of the assets quality of the banks show that it slightly improved in the first six months of 2000. As of June 30, 2000, the total amount of items classified in the risk categories C, D, or E, equaled Denar 19.627 million, which is 39.1% of the total credit exposure, or 127.7% of the guarantee capital of the banks in the Republic of Macedonia. For comparison purposes, at the end of 1999 banks' credit exposure classified in the risk categories C, D, and E, had a share of 41.3% in the total credit exposure, or a share of 145.3% in the guarantee capital of the banks. The indicator of the share of claims, classified in risk categories D and E, in the total credit portfolio of the banks equaled 24.0% at the end of June 2000, which is a decrement of 1.1 percentage point compared to the end of 1999. However, compared to the end of 1998, the period before the deterioration in the quality of the banks' credit portfolio, this indicator is by 6.7 percentage points higher. If the provisions for credit exposure classified in the risk categories C, D, and E are taken into account in the analysis of the quality and the structure of the credit portfolio, it can be concluded that as of June 30, 2000, the uncovered portion of this segment of the risk exposure of the banks was 18.3% of the total credit portfolio, or 59.01% of the guarantee capital of the Macedonian banks.

The conclusion of the deterioration in the credit portfolio quality can be confirmed through the quantification of the risk rate of credit portfolio of the Macedonian banks, showing the ratio of the calculated potential losses to the total credit exposure. On June 30, 2000 this indicator equaled 23.1%, which almost corresponds to the risk category B (25%). For comparison purposes, at the end of December 1999 this indicator equaled 22.6%, while at the end of December 1998 it was 17.5%.

4.3.2. Capital adequacy

At the end of the first half of 2000, the level of capitalization of the banking institutions in the Republic of Macedonia, quantified through numerous indicators, was as follows:

- 1. Rate of capitalization, as a ratio between the banks' own funds and the assets of banks.**
This indicator quantify the correlation between the volume of banks' balance activities and the amount of their capital.

As of June 30, 2000, the average coverage level of the balance sheet activities with the banks' and savings houses' own funds equaled 21.96% which represents an increase of 1.23 percentage points compared to the end of December 1999. Such increase of this indicator in the analyzed period December 1999 - June 2000 is a result of the higher increase in the own funds (6.2%) compared to the increase in the total assets (0.4%) in the same period.

- 2. Second level of analysis of banks' capitalization is analyzed through quantification of the capital adequacy ratio, as internationally accepted supervisory standard.** At the end of

the first half of 2000, the total amount of guarantee capital of banks operating on the territory of the Republic of Macedonia amounted to Denar 15,451 million and compared to December 31, 1999 it increased by Denar 1,047 million or by 7.3%. As of June 30, 2000, the risk-weighted assets of Macedonian banks amounted to Denar 50,264 million and compared to end December 1999 they remained unchanged. As of June 30, 2000, the relation between the guarantee capital and the total risk weighted assets of Macedonian banks renders an adequate average capital adequacy ratio of 30.9%. As of June 30, 2000 compared to September 30, 1999, the capital adequacy ratio was by 10.8 percentage points higher. If the end of December 1999 is taken as a comparison base, it can be concluded that the increase of this ratio during the first half of 2000 equaled 2.2. percentage points.

4.3.3. Analysis of the profitability of banks in the Republic of Macedonia and assessment of their efficiency

As of June 2000, the aggregated income statement of the Macedonian banks indicated that the total positive financial result in the first six months of 2000 equaled Denar 470.6 million.

At the end of June 2000, out of 21 banks and one foreign bank branch operating in the Republic of Macedonia, 19 achieved positive financial result in their operations, while the remaining three banks achieved negative financial result.

The profitability and efficiency of the banks in the Republic of Macedonia can be assessed through several indicators given in the text below:

The rate of return on average assets (ROAA) calculated as a ratio between the banks' financial result in the first half of 2000 and the average assets in the same period, equaled 1.3%¹⁹, implying that 100 units of assets of the Macedonian banks generate 1.3 units of net profit. Relative to the rate of return on average assets of 0.8%, calculated as of December 31, 1999, the rate in the first half of 2000 is higher, indicating an improvement in the profitability potential of the Macedonian banks. According to the international standards, the rate of return on average assets should exceed 1%.

Rate of return on average equity (ROAE), calculated as a ratio between the net profit of the banks in the first half of the year and the average own funds of the banks in the same period, equaled 6.11%²⁰, compared to 3.5% that at the end of 1999. According to the international standards, the rate of return on average equity should range from 5% to 10%.

Another indicator reflecting the banks' profitability potential and efficiency is the one which can be calculated as a ratio between the operational costs (Other expenditures in the income statement) and the total income (net interest income based on provisions plus other revenues). As of June 30, 2000, this indicator equaled 0.82, indicating that the Macedonian banks had to assume operational costs in the amount of Denar 0.82 in order to generate revenue of one Denar. Simultaneously, expenditures for wages in the amount of Denar 0.34 were needed to generate one-Denar revenue.

¹⁹ Indicator (ROAA) is given at annual level, i.e. the financial result shown for the first six months is multiplied by 2.

²⁰ Indicator (ROAE) is given at annual level, i.e. the financial result shown for the first six months is multiplied by 2.