NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Report on Banking System of the Republic of Macedonia in the first quarter of 2012

October, 2012

CONTENTS

FIGURES

TABLES

Summary

In the first quarter of 2012, the banking system maintained its safety and soundness. The activities of the banking system continued to increase, but at a slower pace compared to the previous quarter. Their growth was mainly supported by the growth of household deposits, primarily Denar deposits. Namely, in the first three months of 2012, the propensity to save in Denars continued, and it intensified in the last months of 2011. Thus, in only one quarter Denar deposits increased by 6.6%, as opposed to the decrease of foreign currency deposits.

Deterioration of the loan portfolio quality is present also in the first quarter of 2012, mainly due to the sector "enterprises and other customers". The growth of non-performing loans accelerated, causing an increase in their share in total loans, which as of March 31, 2012 reached 10.2%. However, the full coverage of non-performing loans with the calculated impairment and special reserve reduces the risk of major adverse effects on the banks' stability in the event of a possible further deterioration of the loan portfolio quality. The main cause of the deteriorating profitability of the banking system is the increased credit risk, through the growth of the expenditure on the basis of allocated impairment. Thus, in the first quarter of 2012, despite the growth of net interest income, the Macedonian banking system had a negative financial result of Denar 229.9 million, and the share in the total assets of banks which registered a loss reached 34.3% (15,1% as of March 31, 2011).

Despite the growth of credit risk, liquidity and solvency of the banking system further strengthened, and the results of the performed stress testing show satisfactory resilience of the banking system to the simulated shocks.

Liquidity strengthening was based primarily on the growth of the investments in Denar liquid instruments (CB bills). Liquidity indicators have improved, and also there were positive changes in the maturity structure by narrowing the maturity mismatch between assets and liabilities. As of March 31, 2012, all banks met the minimum level of liquidity ratios (value of 1) up to 30 days and up to 180 days.

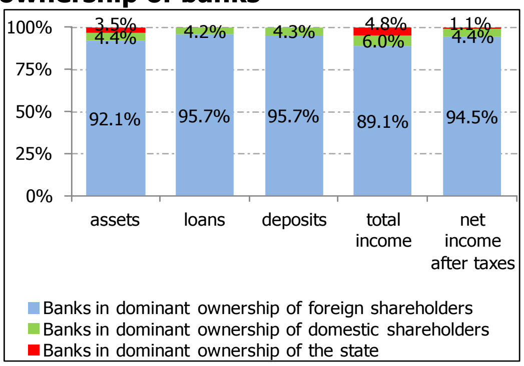
Solvency of the banking system has improved further. As of March 31, 2012, the capital adequacy ratio reached 17.5%. Growth of capital adequacy is a result of the higher growth rates of capital positions, compared with the growth of the banks' activities. This contributed to the strengthening of the "free" capital above the minimum level necessary to cover the risks. Capital required to cover the risks has increased due to the increased credit risk arising from the enterprises sector. Capital requirement for covering currency risk decreased in the first quarter of 2012, due to the narrowing of the net foreign currency position in Euros.

I. Structure of the banking system

1. Number of banks and ownership structure of the banking system

As of March 31, 2012, the banking system in the Republic of Macedonia was composed of seventeen banks and compared to December 31, 2011, the situation remained unchanged.

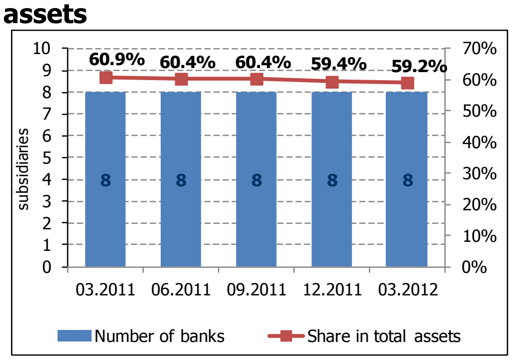
Figure 1 Structure of the major balance sheet items, according to the dominant ownership of banks



Source: NBRM, on the basis of data submitted by banks.

In the first quarter of 2012, there were no significant changes in the ownership structure of the banking system[1]. However, in the last three quarters, a slight downward trend in the market share of foreign banks' subsidiaries in the banking system's assets, was registered.

Figure 2 Nubmer ans share of foreign bank subsidiaries' assets in total assets



Source: NBRM, on the basis of data submitted by banks.

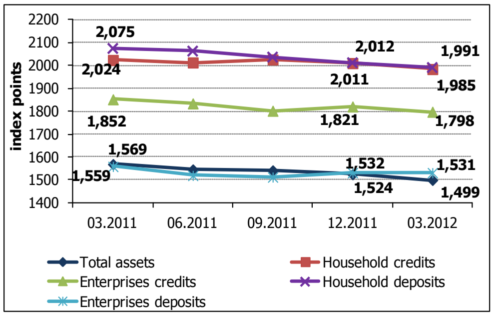
2. Concentration and market share of banks

Concentration in the banking system is high, however with a downward trend. Measured by the Herfindahl index[2], banks'

[1] Thirteen banks are in dominant ownership by foreign shareholders, eight of which are subsidiaries of foreign banks.

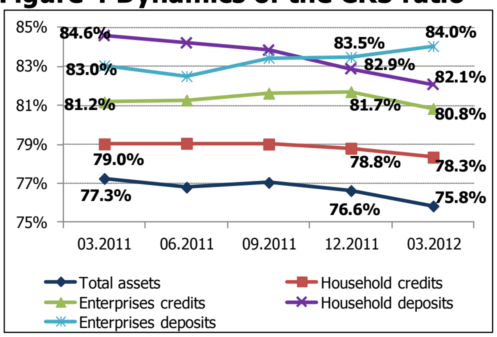
[2] The Herfindahl index is calculated according to the equation $HI = \sum_{j=1}^{n} (S_j)^2$ where S denotes each bank's share in the total amount of analyzed category (for example: total assets, total deposits etc.), while ***n*** denotes the total

Figure 3 Dynamics of Herfindahl-index



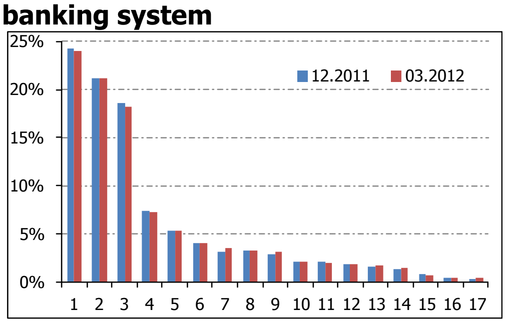
Source: NBRM, on the basis of data submitted by banks.

Figure 4 Dynamics of the CR5 ratio



Source: NBRM, on the basis of data submitted by banks.

Figure 5 Market share of individual banks in the total assets of the banking system



Source: NBRM, on the basis of data submitted by banks.

concentration with total assets and with corporate loans and deposits remained within the acceptable limits, while with household loans and deposits it is still above the acceptable upper limit.

CR5[3] indicator also points to high concentration. In all of the major balance sheet categories, CR5 indicator decreased slightly, except for corporate deposits, which noticed a slight increase in concentration, thus remaining the category with the highest concentration measured by this indicator.

Market share of individual banks in the total assets of the banking system confirms the high concentration in the banking system. Of the seventeen banks, nine constitute an individual share of up to 3% of the banks' total assets, and the total assets of these nine banks together occupy only 13.4% of the assets of the banking system.

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 considered acceptable.

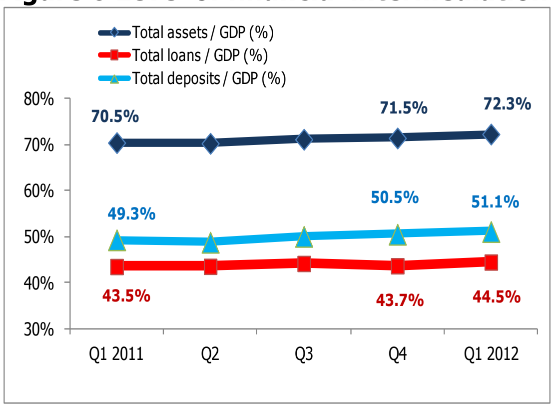
[3] CR5 index denotes assets share (i.e. analyzed category, for example, corporate loans, etc.) of the five banks with largest assets (i.e. analyzed category) in the total assets (i.e. analyzed category) of the banking system.

II. Bank activities

In the first quarter of 2012, the total assets of the banking system continued to increase, but at a slower pace compared to the previous quarter. Their growth was largely reflected through the increased investments in securities and through the moderate acceleration of the quarterly growth of banks' lending activity. The growth of deposits of non-financial entities slowed down.

1. Level of financial intermediation

Figure 6 Level of financial intermediation

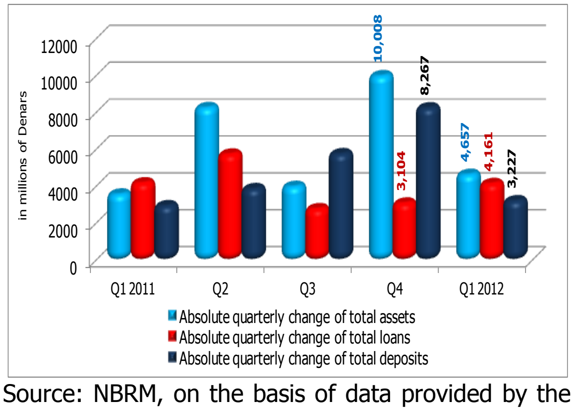


Source: NBRM, on the basis of data proveded by banks.

The banking system of the Republic of Macedonia continued to increase its significance for the country's economic activity. At the end of the first quarter of 2012, financial intermediation, measured by the ratio of total assets, loans and deposits to GDP[4] increased by 0.8 percentage points, 0.8 percentage points and 0.6 percentage points, respectively.

2. Banks' balance sheet

Figure 7 Quarterly growth of the total assets, loans and deposits of nonfinancial entities

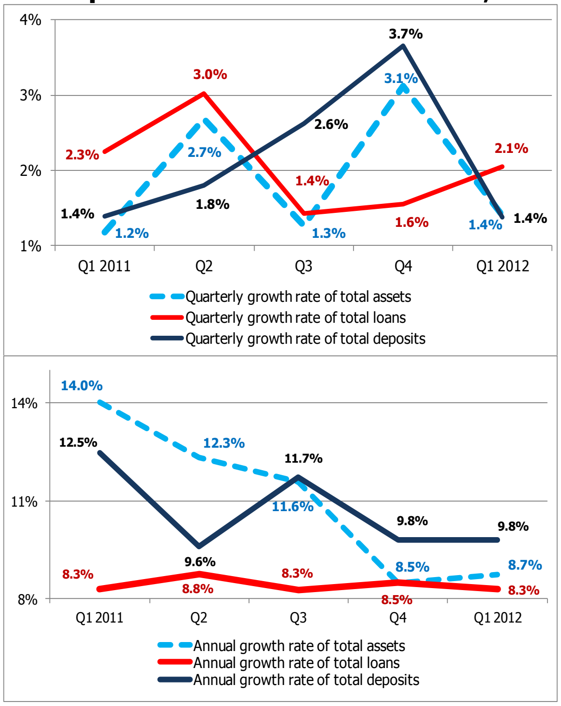


Source: NBRM, on the basis of data provided by the banks.

As of March 31, 2012, **the total assets of the banking system amounted to Denar 335,833 million (Annex 1). They continued to grow, but their growth in** absolute amount was halved compared to the growth in the previous quarter. However, the growth of total assets in the fourth quarter of 2011 was due to the significant growth of deposits which had not been registered in any other quarter of the previous year. Hence, if the comparison is made with the first three months of 2011, banks' total activities registered higher quarterly growth by Denar 1,066 million.

[4] Financial intermediation indicators for the first quarter of 2012 are calculated with quarterly data on GDP, reduced on annual level.

Figure 8 Quarterly (up) and annual (down) growth of the total assets, loans and deposits of nonfinancial entities, in %



Source: NBRM, on the basis of data provided by the banks.

Compared to the previous quarter, total assets show slower quarterly growth by 1.7 percentage points, while their annual growth slightly accelerated (by 0.2 percentage points).

The growth of the total banking activities was reflected through the growth of gross loans to non-financial entities and investments in securities. Compared to December 31, 2011, the annual credit growth rate[5] slightly decelerated (by 0.2 percentage points), while the quarterly growth rate registered acceleration (by 0.5 percentage points). In the first quarter of 2012, banks' investments in securities registered the largest quarterly increase and the largest contribution to the growth of banks' assets.

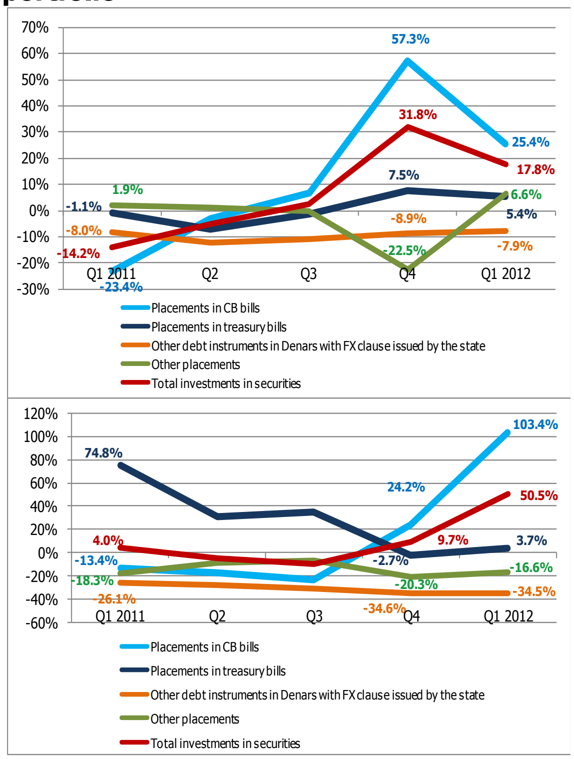
Table 1 Structure of the assets and liabilities of the banking system

Balance sheet	Amounts in millions of Denars			Structure			Change 31.03.2012/31.12.2011		Change 31.03.2012/31.03.2011	
	31.03.2011	31.12.2011	31.03.2012	31.03.2011	31.12.2011	31.03.2012	Absolute change	In percent	Absolute change	In percent
Cash and balances with NBRM	41.751	38.227	33.140	13,5%	11,5%	9,9%	-5.087	-13,3%	-8.612	-20,6%
Securities portfolio	39.012	49.831	58.716	12,6%	15,0%	17,5%	8.886	17,8%	19.705	50,5%
Placements with banks and other financial institutions	40.333	43.528	42.199	13,1%	13,1%	12,6%	-1.329	-3,1%	1.866	4,6%
Loans to non-financial entities (net)	171.481	181.017	183.597	55,5%	54,7%	54,7%	2.581	1,4%	12.117	7,1%
Gross loans to non-financial entities	190.743	202.405	206.566	61,8%	61,1%	61,5%	4.161	2,1%	15.823	8,3%
Accumulated amortization of loans to non-financial entities	(752)	(855)	(883)	-	-	-	-29	3,4%	-131	17,5%
Impairment (provisions) of loans to non-financial entities	(18.511)	(20.534)	(22.086)	-	-	-	-1.552	7,6%	-3.575	19,3%
Accrued interest and other assets	8.121	10.382	10.144	2,6%	3,1%	3,0%	-238	-2,3%	2.023	24,9%
Fixed assets	8.184	8.192	8.038	2,6%	2,5%	2,4%	-155	-1,9%	-146	-1,8%
Unallocated loan loss provisions	-1	0	0	0,0%	0,0%	0,0%	0	-	1	-100,0%
Total assets	**308.881**	**331.176**	**335.833**	**100,0%**	**100,0%**	**100,0%**	**4.657**	**1,4%**	**26.953**	**100,0%**
Deposits of banks and other financial institutions	16.501	13.861	13.654	5,3%	4,2%	4,1%	-207	-1,5%	-2.847	-17,3%
Deposits of non-financial entities	216.227	234.161	237.389	70,0%	70,7%	70,7%	3.227	1,4%	21.161	9,8%
Borrowings (short-term and long-term)	34.467	38.500	39.204	11,2%	11,6%	11,7%	704	1,8%	4.736	13,7%
Other liabilities	7.007	7.246	6.480	2,3%	2,2%	1,9%	-766	-10,6%	-528	-7,5%
Provisions for off-balance sheet items	704	819	800	0,2%	0,2%	0,2%	-19	-2,3%	97	13,8%
Capital and reserves	33.974	36.590	38.307	11,0%	11,0%	11,4%	1.718	4,7%	4.334	12,8%
Total liabilities	**308.881**	**331.176**	**335.833**	**100,0%**	**100,0%**	**100,0%**	**4.657**	**1,4%**	**26.953**	**100,0%**

Source: NBRM, on the basis of data provided by the banks.
Note: The item „placements with the Central Bank" found in Annex 1, is included in the item „cash adn balances with NBRM" in this table.

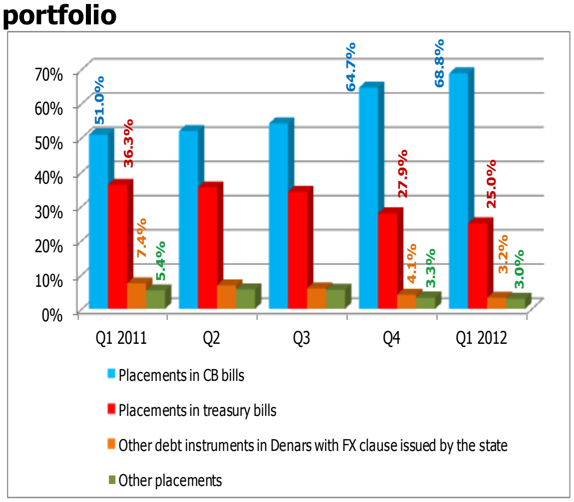
[5] More detailed analysis of the structure and movements of loans to nonfinancial entities is given in Section 3. Lending activity.

Figure 9 Quarterly (up) and annual (down) dynamics of the securities portfolio



Source: NBRM, on the basis of data provided by the banks.

Figure 10 Structure of the securities portfolio



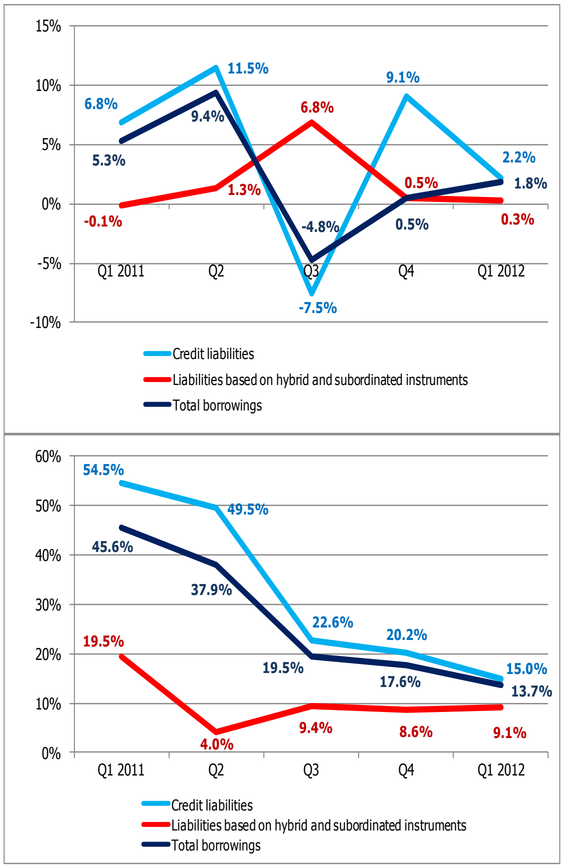
Source: NBRM, on the basis of data provided by the banks.

Banks' investments in CB bills almost entirely (92.2%) determined the quarterly increase in the total investments in securities. In the first quarter of 2012, investments in these low-risk instruments increased by Denar 8,189 million[6]. On annual basis, the growth of investments in CB bills amounted to Denar 20,544 million, while their contribution to the annual growth of the securities portfolio reached 104.2%. Banks' investments in Treasury bills increased both quarterly and annually, by Denar 751 million and Denar 516 million, respectively.

Placements with banks and other financial institutions in the first quarter of 2012 decreased by 3.1%. This movement was entirely caused by the reduced placements on the accounts with foreign banks. Placements on the accounts with domestic banks also experienced a quarterly decline of Denar 278 million, but their share in total placements with banks is small (1.1%).

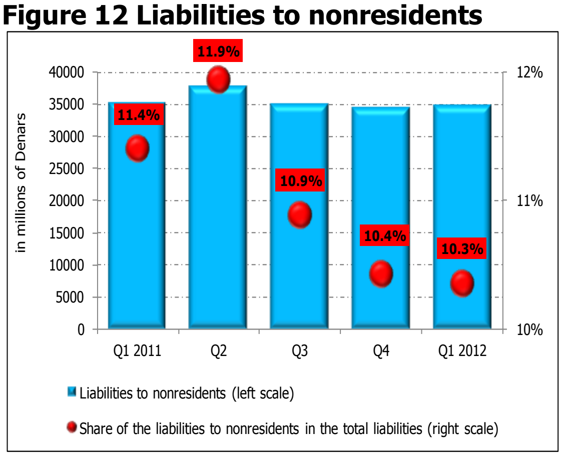
[6] In April 2012, the National Bank made changes in the operational framework for monetary policy implementation, as a result of which in April, banks' investments in CB bills reduced by Denar 7,569 million.

Figure 11 Quarterly (up) and annual (down) dynamics of the total borrowings of banks



Source: NBRM, on the basis of data provided by the banks.

Figure 12 Liabilities to nonresidents



Source: NBRM, on the basis of data provided by the banks.

In the first quarter of 2012, deposits of non-financial entities[7] caused the largest portion (69.3%) of the quarterly growth of banks' total liabilities. They registered the largest absolute quarterly growth, despite the slower growth rate (by 2.3 percentage points) compared to the previous quarter. On annual basis, the increase in deposits of non-financial entities amounted to Denar 21,161 million.

As in the previous quarter, the loans[8] that banks use continued to increase and determined 15.1% of the growth of total liabilities. Credit liabilities entirely (96.4%) determined the quarterly increase in the banks' total borrowings. Relative to December 31, 2011, credit liabilities increased by Denar 678 million (or by 2.2%). The largest part of the quarterly increase in the credit liabilities was due to the quarterly increase in the banks' credit liabilities from the MBDP. The growth of these liabilities is determined by the quarterly growth of the liabilities of MBDP based on loans to non-residents.

Liabilities based on subordinated instruments increased by Denar 25 million (or 0.3%). However, their share in the structure of banks' total borrowings declined moderately, given the faster growth of the credit liabilities.

As in the previous quarter, deposits of banks and other financial institutions decreased, which is entirely due to the reduction of deposits of domestic banks by Denar 327 million (or 36.6%).

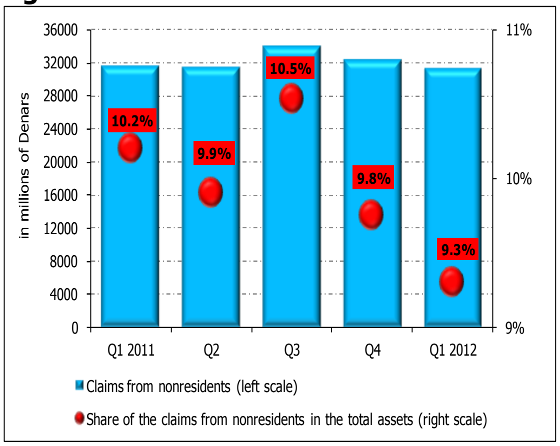
In the first quarter of 2012, liabilities to nonresidents increased by Denar 233 million (or 0.7%). However, their share in banks' total liabilities decreased by 0.1 percentage point. Deposits of non-resident financial institutions contributed with 43.9% to the growth in total liabilities to non-residents as a result of their quarterly increase of Denar 102 million (or 2.4%).

---

[7] More detailed analysis of the structure and movements of deposits of non-financial entities is given in section 4. Deposit activity

[8] Banks' total borrowings include credit liabilities and liabilities based on hybrid and subordinated instruments.

Figure 13 Claims from nonresidents



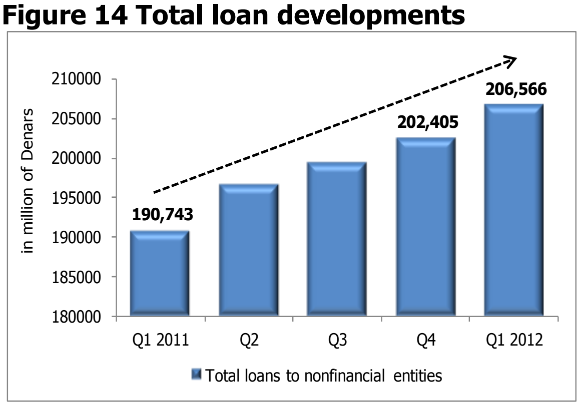
Source: NBRM, on the basis of data provided by the banks.

In the first quarter of 2012, claims from nonresidents decreased by Denar 1,045 million (or 3.2%), which caused a reduction of their share in the banks' total assets. Such movement is entirely due to the quarterly decline in the placements on the accounts with foreign banks of Denar 1,464 million, or 4.6%.

3. Banks' lending activity

In the first quarter of 2012, the annual growth rate of banks' lending activity slowed down, compared to the previous quarter, while the quarterly growth rate accelerated. Growth of total loans in the first quarter of 2012, was mostly caused by lending to companies. Yet, the banks' perceptions given in the Bank Lending Survey from May 2012, indicate tightening of credit conditions in this sector. This is a consequence of the banks' deteriorating expectations about the prospects of the companies, the collateral risks, and about the recovery of the total economic activity due to uncertainty about the debt crisis in the Euro area.

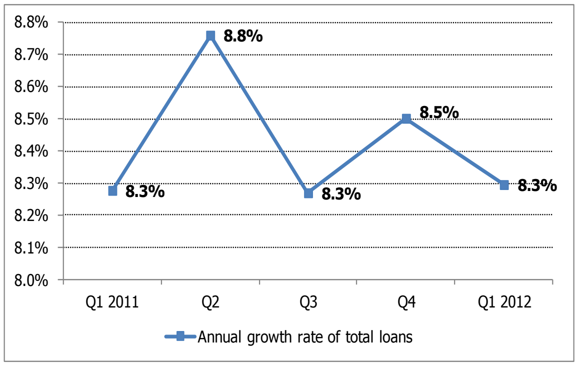
Figure 14 Total loan developments



Source: National Bank, based on data submitted by banks.

Banks' lending activity continued to grow also in the first quarter of 2012 and amounted to Denar 206,566 million.

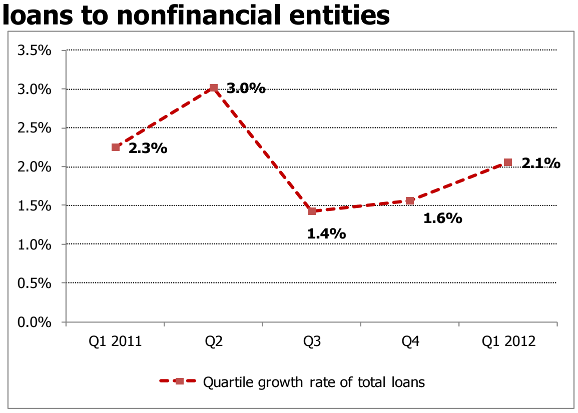
Figure 15 Annual growth rates of total loans to nonfinancial entities



Source: National Bank, based on data submitted by banks.

The annual growth rate of lending activity as of March 31, 2012 was lower compared to that at the end of 2011, but it was equal (8.3%) to the growth rate in the first quarter of 2011.

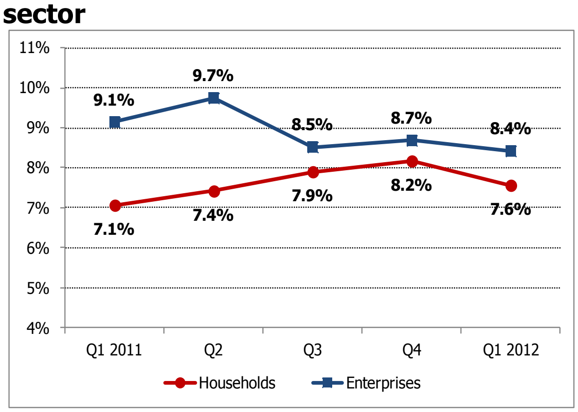
Figure 16 Quarterly growth rates of total loans to nonfinancial entities



Source: National Bank, based on data submitted by banks.

The comparison of the quarterly growth rates for the first quarter of 2011 and for 2012 also confirms the **slower growth of bank loans. However, compared to the end of 2011, in the first three months of 2012, there was a moderate acceleration of credit growth.** With the exception of two banks which registered decelerated lending activity on a quarterly basis, the lending activity growth rate by individual bank ranged from 0.2% to 55.3%, with a median of 3.3% and the third quartile of 12.2%.

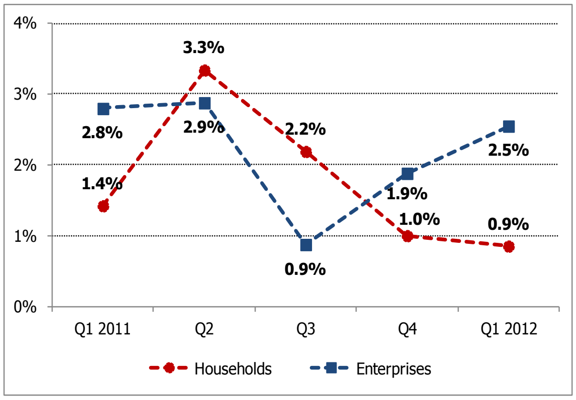
Figure 17 Annual loan growth rates, by sector



Source: National Bank, based on data submitted by banks.

As of March 31, 2012, **the structure of loans by sector remained unchanged,** with a dominant share of corporate loans of 61.7% (Annex 5). The annual growth rate of corporate loans and the corresponding quarterly rates have divergent movements as of March 31, 2012. Corporate loans registered slower annual growth, compared to December 31, 2011 and March 31, 2011. In contrast, the dynamics of corporate loans kept the quarterly uptrend which began in the previous quarter. However, in the first quarter of 2012, corporate loans defined 62.5% of the total annual credit growth.

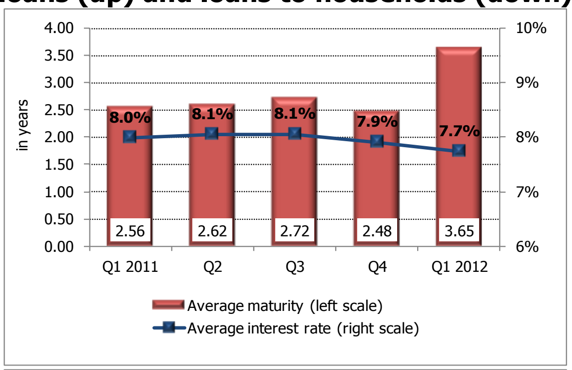
Figure 18 Quarterly loan growth rates, by sector

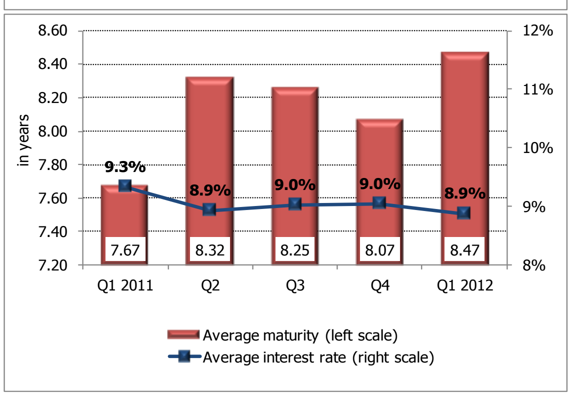


Source: National Bank, based on data submitted by banks.

On the other hand, the annual and quarterly growth rates of household loans slowed down.

Figure 19 Average weighted interest rate and maturity of newly approved corporate loans (up) and loans to households (down)





Source: National Bank, based on data submitted by banks to the Credit Registry.

In the first quarter of 2012, weighted average interest rates on new loans registered a slight decrease in both sectors, compared with the previous quarter. Compared with the first quarter of 2011, the decline in the interest rates on new corporate loans and loans to households was 0.3 percentage points and 0.4 percentage points, respectively.

In the first quarter of 2012, **the average maturity of new loans to non-financial entities increased** and reached the highest level compared with the preceding quarters. The increase in the average maturity is present in new corporate loans regardless of the currency component, but for the most part it is due to the Denar exposure with FX clause. The increase in the average maturity in the household sector, is for the most part conditioned by the loans for the purchase and renovation of residential property.

Table 2 Credit exposure by activity/credit products

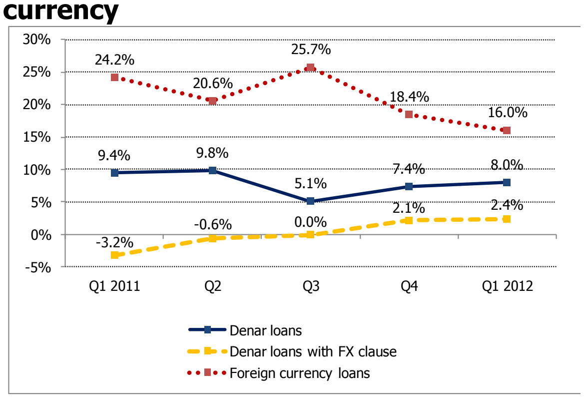
Sector	Credit products / activities	Credit risk exposure in million of Denars as of March 31, 2012	Absolute annual growth of credit risk exposure in million of Denars	Absolute quartile growth of credit risk exposure in million of Denars	Annual growth rate	Quartile growth rate	Share in the total annual growth of the credit risk exposure
HOUSEHOLDS	Residential and commercial real estate loans	19,710	2,238	357	12.8%	1.8%	7.9%
	Consumer loans	33,694	4,385	376	15.0%	1.1%	15.5%
	Overdrafts	9,488	53	38	0.6%	0.4%	0.2%
	Credit cards	21,077	-917	-196	-4.2%	-0.9%	-3.2%
	Car loans	3,083	-889	-248	-22.4%	-7.5%	-3.1%
	Other loans	1,317	337	95	34.4%	7.8%	1.2%
	Sole-proprietors	2,922	-256	-105	-8.1%	-3.5%	-0.9%
TOTAL HOUSEHOLDS		**91,292**	**4,951**	**318**	**5.7%**	**0.3%**	**17.5%**
ENTERPRISES AND OTHER CLIENTS	Agriculture, forestry and fishing	4,595	238	121	5.5%	2.7%	0.8%
	Industry	52,095	1,452	791	2.9%	1.5%	5.1%
	Construction	17,694	1,064	1,076	6.4%	6.5%	3.8%
	Wholesale and retail trade	50,671	5,013	1,510	11.0%	3.1%	17.7%
	Transport, storage, information and communication	11,738	1,157	557	10.9%	5.0%	4.1%
	Accomodation facilities and catering services	3,045	-799	-473	-20.8%	-13.4%	-2.8%
	Real estate, professional, scholar and technical activities, administrative and auxiliary services	10,100	984	12	10.8%	0.1%	3.5%
	Other sectors	4,816	313	613	6.9%	14.6%	1.1%
TOTAL ENTERPRISES AND OTHER CLIENTS		**154,755**	**9,422**	**4,206**	**6.5%**	**2.8%**	**33.2%**
TOTAL CREDIT EXPOSURE		**349,856**	**28,351**	**11,794**	**8.8%**	**3.5%**	**100.0%**

Source: National Bank, based on data submitted by banks.
Note: Developments of credit exposure by all activities and credit products are presented in more details in Annexes 12, 13 and 14.

According to the activity, the largest contribution to the growth of lending to enterprises and other clients is that of the clients from the activities "industry" (in the annual growth), "wholesale and retail" (both in the annual and quarterly growth) and "construction" (in the quarterly growth).

Consumer loans are still the most widely used credit product among households, followed by credit cards and loans for the purchase and renovation of residential and commercial properties. Consumer loans define, for the most part, the annual and quarterly increase of the exposure to households, followed by loans for the purchase and renovation of residential and commercial properties. According to the results of the Bank Lending Survey from May 2012, in the next quarter the demand for housing and consumer loans is expected to increase. Credit cards and car loans are reducing, both on annual and quarterly basis.

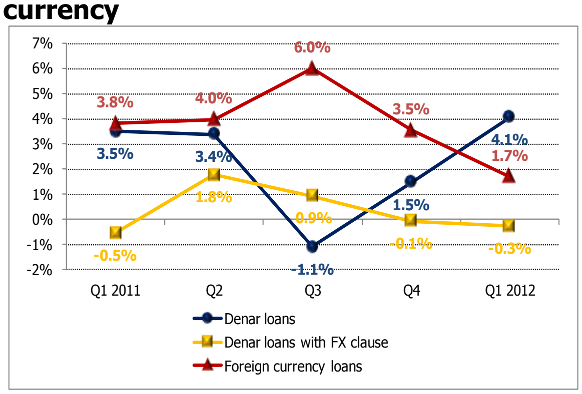
Figure 20 Annual loan growth rates, by currency



Source: National Bank, based on data submitted by banks.

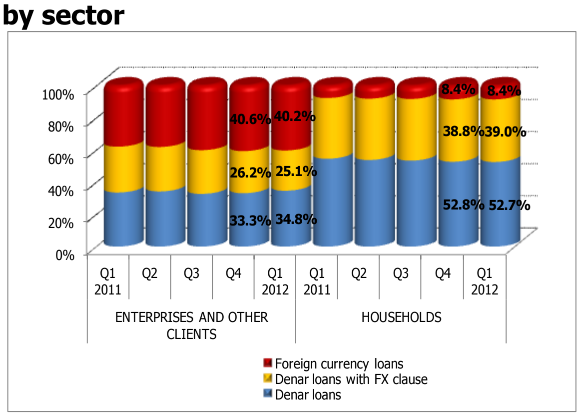
According to their currency structure, loans remained unchanged, with a share of the loans with currency component

Figure 21 Quarterly loan growth rates, by currency



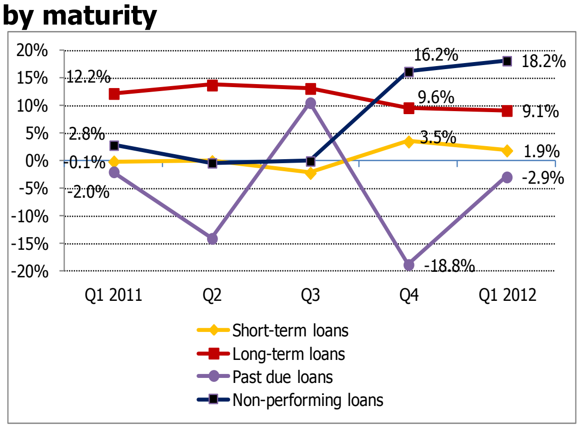
Source: National Bank, based on data submitted by banks.

Figure 22 Currency structure of loans, by sector



Source: National Bank, based on data submitted by banks.

Figure 23 Annual loan growth rates, by maturity



Source: National Bank, based on data submitted by banks.

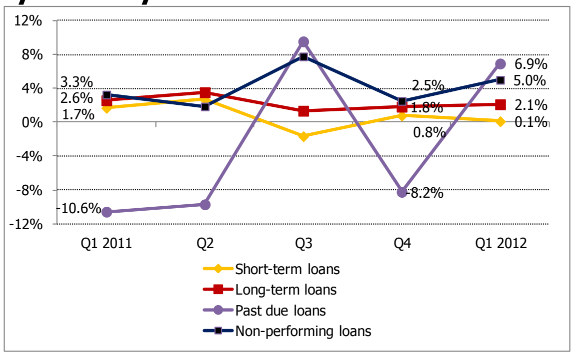
(foreign currency loans and Denar loans with FX clause) of 58.4% (Annex 5 and 5a). Despite the slower growth in the last quarter of 2011 and in the first quarter of 2012, on an annual basis, foreign currency loans continued to grow faster than Denar loans. Moreover, the foreign currency loans for payments in the country grew faster (20.5%) compared with the foreign currency loans for payments abroad (10.6%). Annual growth rate of Denar loans in the same comparative period observed acceleration, however with lower intensity. Contribution of Denar loans (40.0%) approached the contribution of foreign currency loans (50.7%) in the total credit growth on an annual basis.

In the first quarter of 2012, Denar loans registered more accelerated growth compared to the previous quarter and had the largest contribution to the total credit growth (80.6%). On the other hand, foreign currency loans continued to grow at a slower pace, achieving lower quarterly growth rate by 2.4 percentage points compared to Denar loans. Denar loans with FX clause registered negative quarterly change, same as in the last quarter of 2011.

Lending with currency component continues to be more present in the structure of loans to enterprises and other clients, while Denar loans have a higher share in the loans to households. Unlike the annual growth of loans to enterprises and other clients, which is for the most part due to foreign currency loans, the quarterly growth is almost entirely determined by the growth of Denar loans. Regarding the household credit growth, Denar loans with FX clause had greater contribution both on annual (54.4%), and on a quarterly basis (57.2%).

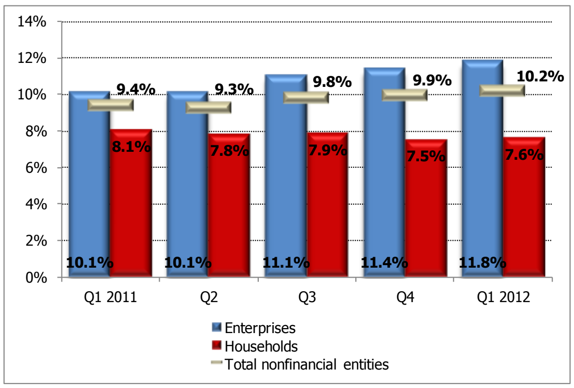
According to the maturity structure of total loans, long term loans continue to dominate with a share of about 69% (Annex 5 and 5a). In the first quarter of 2012, lending to enterprises in the long run caused 54.3% of the total annual growth of long-term loans. However, on an annual basis, as of December 31, 2011 and as of March 31, 2012, the non-performing loans

Figure 24 Quarterly loan growth rates, by maturity



Source: National Bank, based on data submitted by banks.

Figure 25 Nonperforming loans in total loans



Source: National Bank, based on data submitted by banks.

had a significant acceleration of the annual growth rates, which amounted to 16.2% and 18.2%. As of March 31, 2012, the growth of non-performing loans was almost entirely conditioned by the growth of non-performing loans to enterprises, most of which are foreign currency loans.

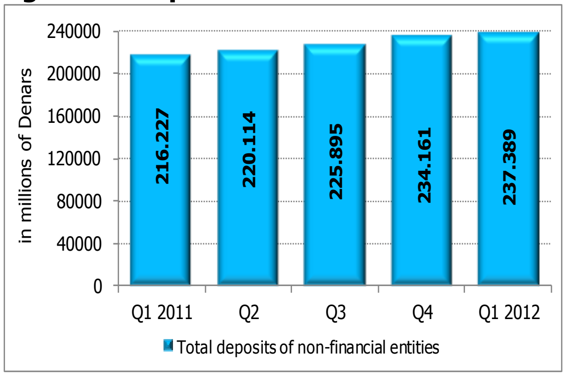
As of March 31, 2012, the quarterly growth rate of non-performing loans doubled, while that of past due loans registered the most significant growth (from -8.2% to 6.9%), which may be indicative of continuing growth of non-performing loans.

Accelerated growth of non-performing loans caused growth of their share in the total loans to nonfinancial entities by 0.8 percentage points on annual level (0.3 percentage points in just one quarter of 2012, versus the increase of 0.6 percentage points over entire 2011). This movement was a consequence of the growth of non-performing loans to companies, whose share in total corporate loans increased by 1.7 percentage points annually, in contrast to the reduction of the share of non-performing loans to households in the total loans to households.

4. Banks' deposit activity

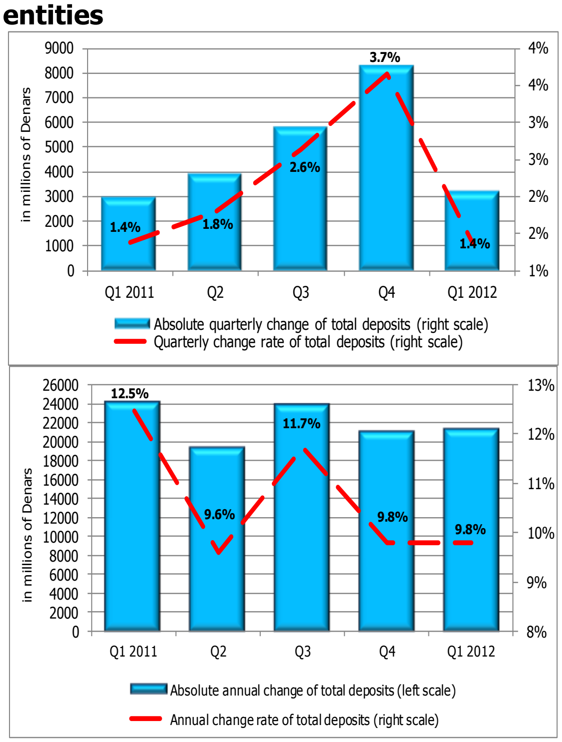
In the first quarter of 2012, deposit activity growth continued, but at a slower pace compared to December 2011. Households were the main carrier of the quarterly growth of the banks' deposit base. Moreover, the growing interest of depositors in saving in domestic currency, which intensified in late 2011, continued in the first quarter of 2012. It has contributed to a significantly faster quarterly growth of Denar deposits compared to foreign currency deposits, which have reduced.

Figure 26 Deposits of nonfinancial entities



Source: NBRM, on the basis of data provided by the banks.

Figure 27 Quarterly (up) and annual (down) growth of deposits of nonfinancial entities



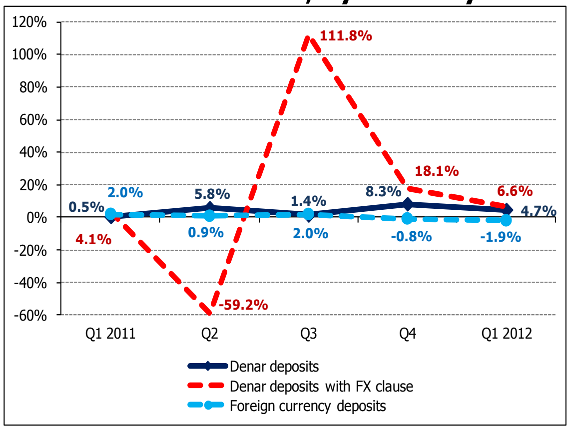
Source: NBRM, on the basis of data provided by the banks.

As of March 31, 2012, the total deposits of nonfinancial entities amounted to Denar 237,389 million, and compared to December 31, 2011, they increased by Denar 3,227 million, or 1.4%.

In the first quarter of 2012, quarterly growth rate of total deposits of non-financial entities slowed down (by 2.3 percentage points) compared to the growth realized in the fourth quarter of 2011 (Annex 8). However, compared to the first quarter of 2011, the quarterly growth rate is unchanged. The annual growth rate was slower compared to the same quarter of the previous year, and it was unchanged compared to December 31, 2011.

In the first quarter of 2012, saving in domestic currency was most attractive for depositors. Denar deposits registered the highest absolute quarterly growth of Denar 5,208 million and fully determined the quarterly growth of banks' total deposit base. Denar deposits growth is almost entirely (93.9%) due to the increase of household Denar deposits.

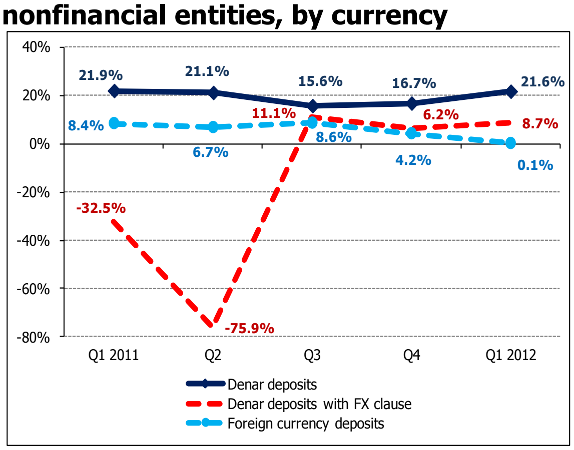
Figure 28 Quarterly dynamics of deposits of nonfinancial entities, by currency



Source: NBRM, on the basis of data provided by the banks.

On the other hand, foreign currency deposits continued to decline, and in the first quarter of 2012, they plunged by Denar 2,283 million. Foreign currency deposits of households contributed with 57.8% and foreign currency deposits of enterprises with 37.0% in the quarterly reduction of total foreign currency deposits. Denar deposits with FX clause registered slower growth (of Denar 302 million) compared to the end of 2011, and contributed with 9.4% to the quarterly growth of total deposits of non-financial entities.

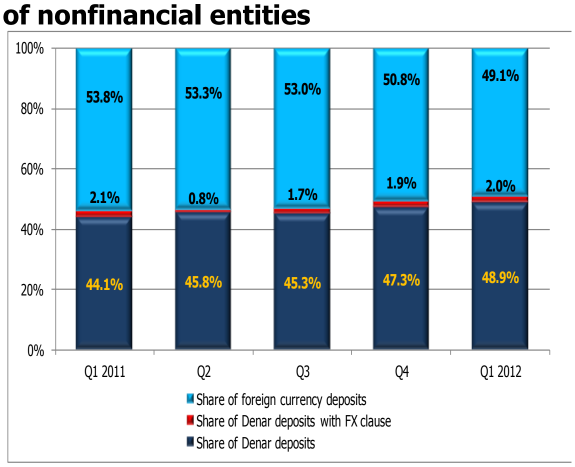
Figure 29 Annual dynamics of deposits of nonfinancial entities, by currency



Source: NBRM, on the basis of data provided by the banks.

Annual growth rates also show the highest growth of Denar deposits (in the amount of Denar 20,602 million), which had the largest contribution (97.4%) to the annual growth of total deposits. Annual growth rate of foreign currency deposits slowed down, making their contribution to the annual growth of total deposits low (0.8%).

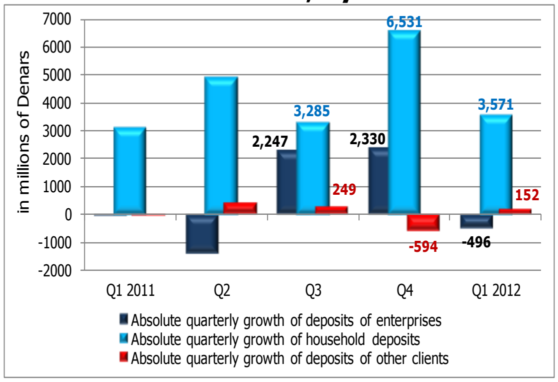
Figure 30 Currency structure of deposits of nonfinancial entities



Source: NBRM, on the basis of data provided by the banks.

These developments have led to increased participation of Denar deposits in total deposits, which as of March 31, 2012 equaled 48.9% and reached the level common for the period before 2008.

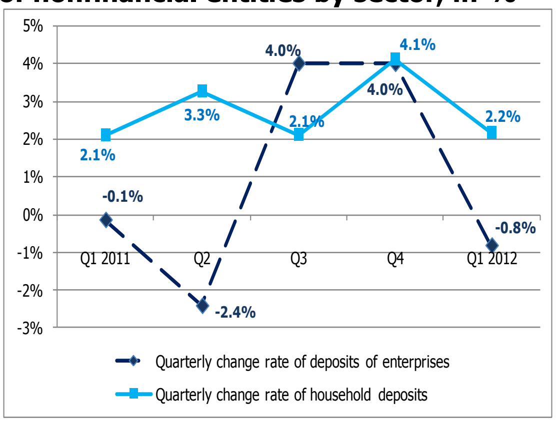
Figure 31 Quarterly dynamics of deposits of nonfinancial entities, by sector



Source: NBRM, on the basis of data provided by the banks.

Household deposits had the highest absolute quarterly growth, although lower than in the fourth quarter of 2011 (but higher compared to March 31, 2011). As in previous quarters, these deposits remained the main driver of growth of the banks' deposit base (with a contribution of 110.7%). Moreover, there was a shift of deposits to longer terms and in Denars (growth is equally distributed between short and long-term Denar deposits of households).

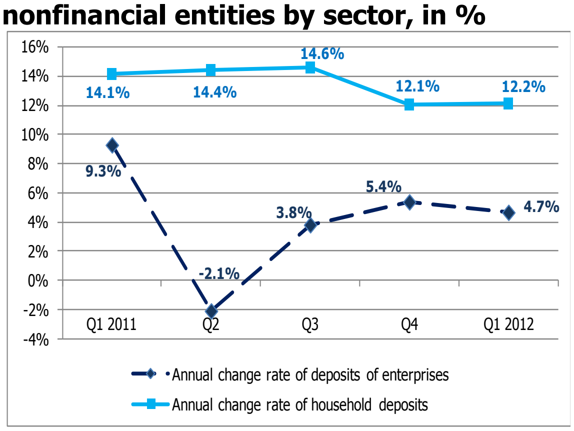
Figure 32 Quarterly dynamics of deposits of nonfinancial entities by sector, in %



Source: NBRM, on the basis of data provided by the banks.

Compared with the uptrend in the previous two quarters, as of March 31, 2012, corporate deposits decreased. The quarterly decline in corporate deposits is entirely due to the decrease of their foreign currency deposits (by Denar 845 million, or 3.9%). Moreover, short-term foreign currency deposits of enterprises fully determined the quarterly decrease of their foreign currency deposits.

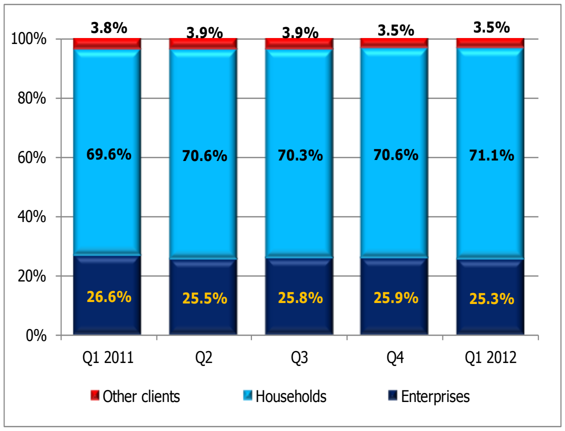
Figure 33 Annual dynamics of deposits of nonfinancial entities by sector, in %



Source: NBRM, on the basis of data provided by the banks.

On an annual basis, household deposits grew nearly three times faster compared with corporate deposits. The annual growth of household deposits amounted to Denar 18,298 million (or 12.2%), making these deposits determine 86.5% of the annual growth of the total deposit base. Corporate deposits registered an annual growth of Denar 2,693 million (or 4.7%) and a contribution of 12.7% to the growth in total deposits.

Figure 34 Sector structure of the depoits of nonfinancial entities

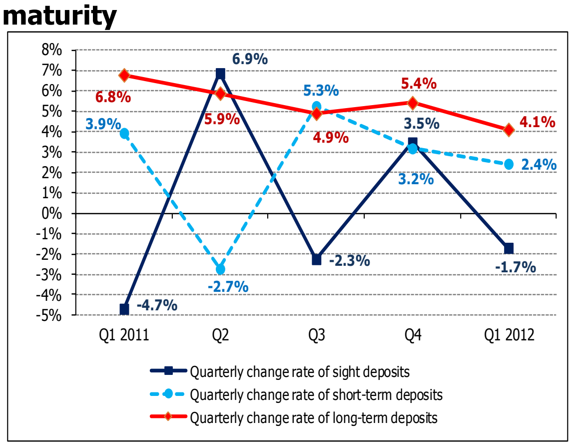


Source: NBRM, on the basis of data provided by the banks.

As a result of such developments, the dominant share of household deposits in the sector structure of the deposits has strengthened.

The growth of deposits of non-financial entities in the first quarter of 2012, was mainly determined by the increased short-term savings. Short-term deposits registered the highest absolute quarterly growth of Denar 2,831 million and determined 87.7% of the total deposits growth. The growth of short-term deposits was completely caused by the increase in short-term Denar deposits.

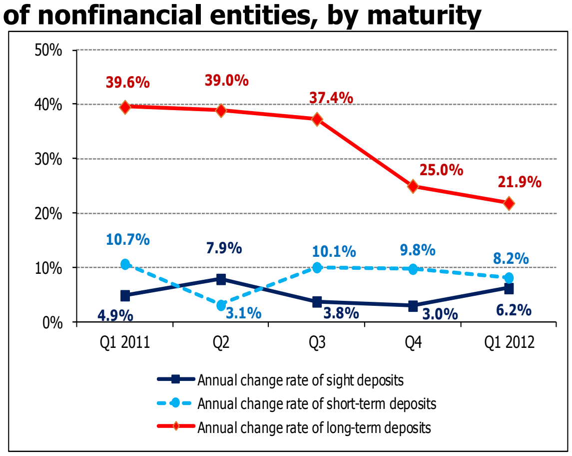
Figure 35 Quarterly dynamics of the deposits of nonfinancial entities, by maturity



Source: NBRM, on the basis of data provided by the banks.

Sight deposits decreased by Denar 1,294 million, which was fully determined by the household sight deposits. Long-term deposits explain 52.4% of the quarterly growth of total deposits. These deposits grew at the highest rate and experienced absolute quarterly increase of Denar 1,690 million, which was mainly influenced by the growth of the long-term household deposits.

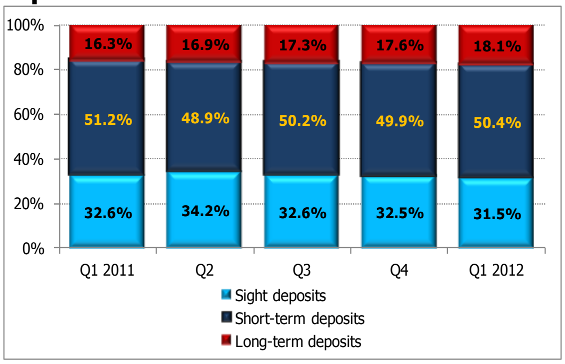
Figure 36 Annual dynamics of the deposits of nonfinancial entities, by maturity



Source: NBRM, on the basis of data provided by the banks.

On an annual basis, the growth of short-term and long-term deposits slowed down, and it stood at Denar 9,068 million and Denar 7,699 million, respectively. Moreover, short-term deposits had the highest contribution (42.9%) in the annual growth of banks' total deposits, while the contribution of long-term deposits was lower and amounted to 36.4%. Unlike their quarterly decrease, sight deposits increased by Denar 4,394 million on an annual basis.

Figure 37 Maturity structure of the deposits of nonfinancial entities



Source: NBRM, on the basis of data provided by the banks.

In the first quarter of 2012, **short-term deposits remained dominant in the structure of total deposits of non-financial entities.**

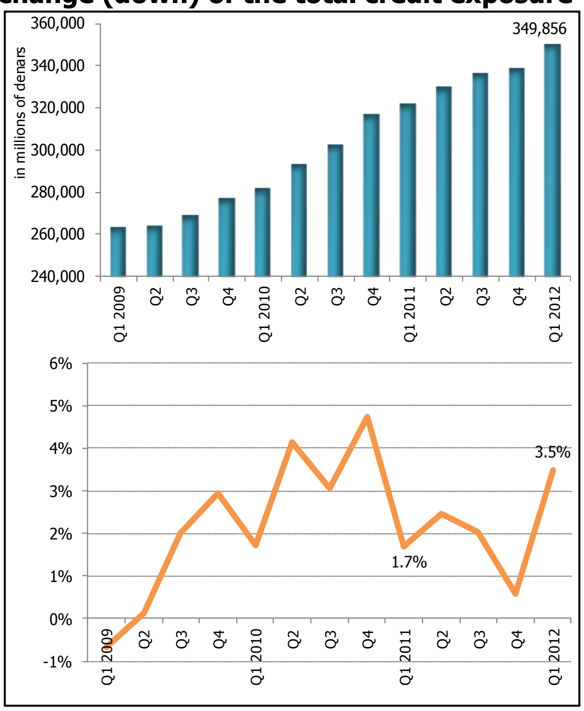
III. Bank risks

1. Credit risk

In the first quarter of 2012, the credit risk exposure increased, primarily due to the increased credit risk exposure to the sector "enterprises and other clients". Increased credit risk corresponds to the economic slowdown. High credit growth in the risk category D, which occurred in the first quarter of 2012, maintained the uptrend in non-performing loans and contributed to their increased share in total loans. However, there is full coverage of non-performing loans with calculated impairment and special reserve.

1.1. Quality of the loan portfolio of the banking system

Figure 38 Amount (up) and quarterly change (down) of the total credit exposure

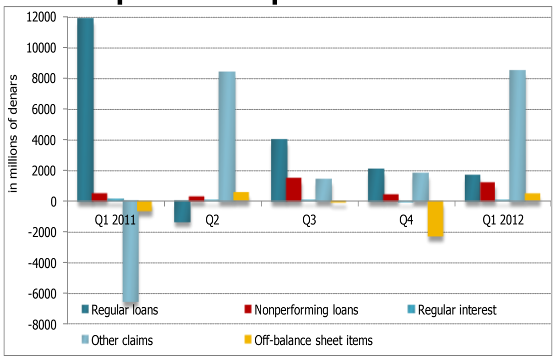


Source: National Bank, based on data submitted by banks.

In the first quarter of 2012, the credit exposure of the banking system grew rapidly. On a quarterly level, total credit exposure increased by Denar 11,794 million, of which 56% represents growth of the credit exposure to financial institutions[9]. Exposure to non-financial entities[10] also reported quarterly growth, which is mainly due to the credit exposure to the sector "enterprises and other clients" (of Denar 4,206 million or 2.8%), primarily from the increase in the credit exposure to the activities "wholesale and retail" and "construction". Quarterly credit exposure to households[11] grew moderately (Denar 318 million or 0.3%) primarily under the influence of the growth in the credit exposure based on consumer loans and loans for the purchase and renovation of residential property (growth of 1.1% and 1 9%, respectively).

[9] Credit exposure to financial institutions grew by Denar 6,599 million in the first quarter of 2012. In its framework, investments in CB bills registered a quarterly growth of Denar 8,189 million, while banks' assets on accounts in foreign banks decreased by Denar 1,464 million.
[10] Exposure to non-financial entities represents the total credit exposure, decreased by the exposure to the activities "financial activities and insurance activities" and "public administration and defense, compulsory social insurance." In the first quarter of 2012, exposure to non-financial entities increased by Denar 4,524 million.
[11] Credit exposure to households represents the exposure to natural persons and sole proprietors.

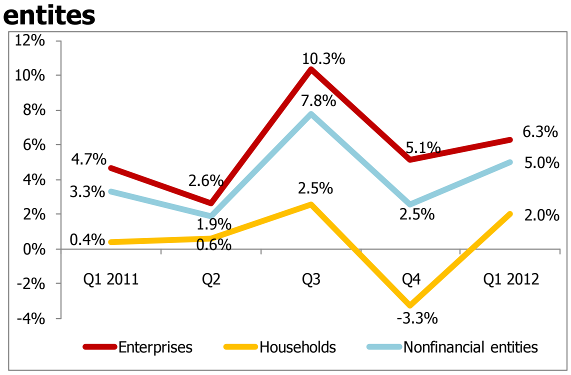
Figure 39 Quarterly absolute change of credit exposure components



Source: National Bank, based on data submitted by banks.

Regular loans are still dominant in the structure of the credit exposure of the banking system (65%), while 71.7% of the quarterly growth of the total credit exposure is based on other claims (Annex 12). The quarterly increase in the item "other claims" (Denar 8,462 million or 16.4%) is almost entirely due to the banks' investments in CB bills. Regular loans in this quarter rose by Denar 1,646 million, or 0.7%, mostly in the sector "enterprises and other customers" (quarterly growth of Denar 2,623 million or 2.4%).

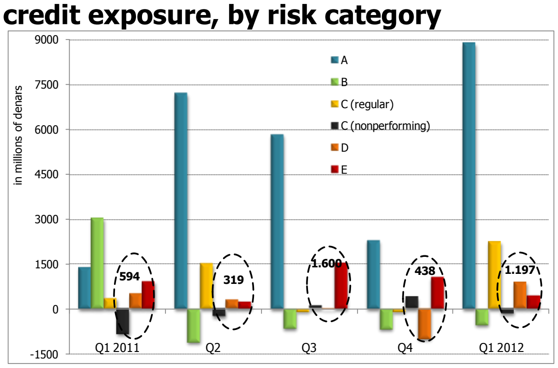
Figure 40 Quarterly change rates of nonperforming loans to nonfinancial entites



Source: National Bank, based on data submitted by banks.

Non-performing loans increased by Denar 1,005 million, or 5.0%, which contributed to their increased share in gross loans of 0.3 percentage points. Carrier of the growth are the enterprises, where non-performing loans increased by Denar 888 million (6.3%). Carrier of the growth of non-performing loans were the activities "wholesale and retail" (with a share of 59.2%) and "chemical industry, production of building materials, production and processing of fuels and pharmacy" (with a share of 24 3%).

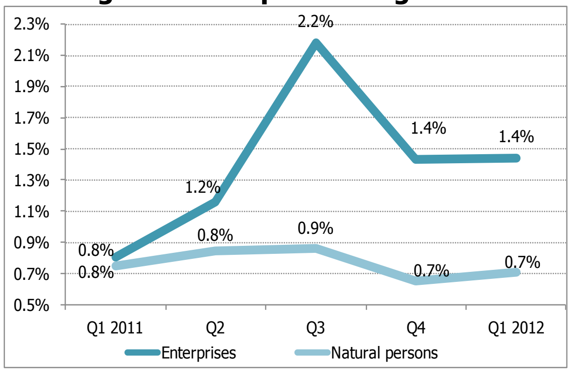
Figure 41 Quarterly absolute change of credit exposure, by risk category



Source: National Bank, based on data submitted by banks.

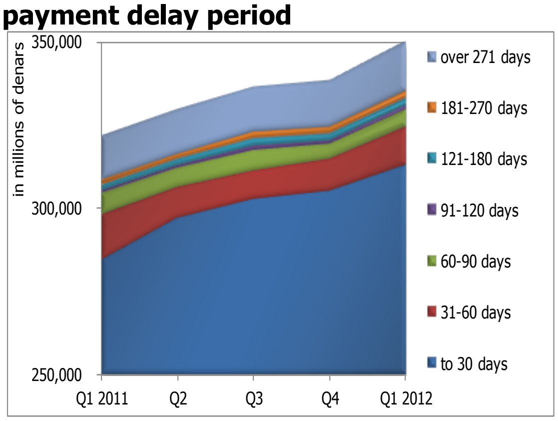
Unlike the previous quarter when credit exposure with non-performing status grew as a result of the growth of the exposure in risk category D, carrier of the growth in this quarter is the risk category D. Non-performing exposure in risk category D, grew by Denar 893 million or 30.5% on a quarterly basis, mostly in the sector "enterprises and other clients" (Annex 13).

Figure 42 Migration of credit exposure from regular to nonperforming status



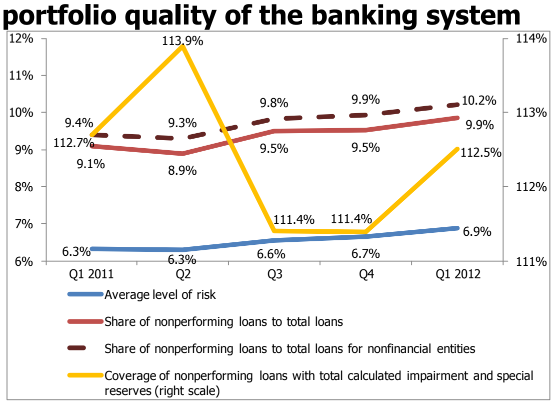
* As of 31.03.2012 is included credit exposure which was registered on 31.03.2012 and which was excisted on 31.12.2011 година. New credit exposure approved during the firsr quarter od 2012 is not included.
Source: National Bank, based on data submitted by banks.

Figure 43 Credit exposure structure by payment delay period



Source: National Bank, based on data submitted by banks.

Figure 44 Indicators for the credit portfolio quality of the banking system



Source: National Bank, based on data submitted by banks.

Transition matrix for the movement of credit exposure from regular to non-performing status for the period December 31, 2011 - March 31, 2012, confirms the deterioration of the quality of the loan portfolio in the first quarter of 2012 (Annex 15).

The deterioration is more evident with enterprises, where 1.4% of the credit exposure which was regular as of December 31, 2011, became non-performing as of March 31, 2012 (0.7% with natural persons).

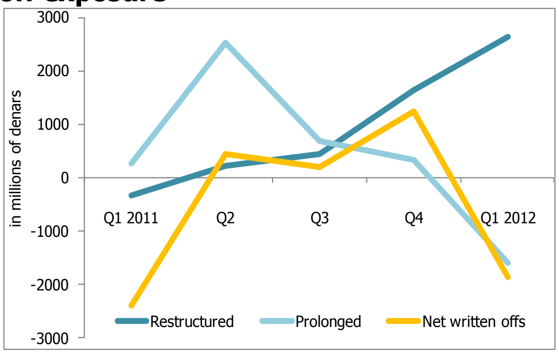
Credit exposure with payment delay period of over 90 days accounts for 5.8% in the total credit exposure as of March 31, 2012. Compared to the end of 2011, this exposure has increased by Denar 1,581 million (or 8.4%). Most of its increase is a result of the credit exposure with payment delay period of more than 271 days, which registered a quarterly increase of Denar 1,023 million or 7.4%.

Banks' loan portfolio quality deteriorated in the first quarter of 2012 (Annex 16). A major cause of the deterioration was the credit exposure to the sector "enterprises and other clients". The greatest deterioration in the credit exposure quality indicators is registered in the exposure to the activity "accommodation and food service activities", where the average level of risk increased by 3.8 percentage points on a quarterly basis (Annex 20). This activity has the highest percentage of average risk (28.6%), but its share in the total credit exposure to the sector "enterprises and other clients" equals 2%.

Deterioration of the loan portfolio quality indicators of households was slower (Annex 19), where the worst deterioration was registered in car loans (0.7 percentage points higher level of risk).

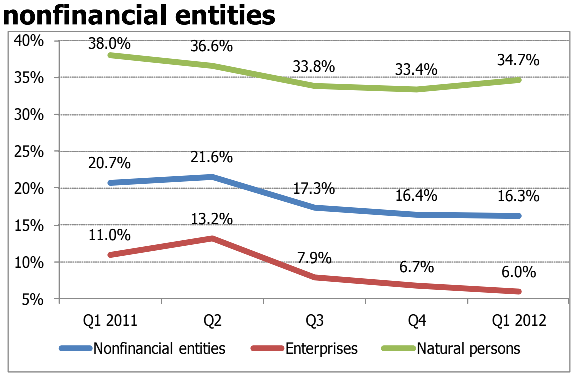
In terms of currency structure, the highest level of risk and deterioration of credit risk indicators is present in the credit exposure in Denars with FX clause (Annex 18).

Figure 45 Quarterly change of restructured, prolonged and net written off exposure



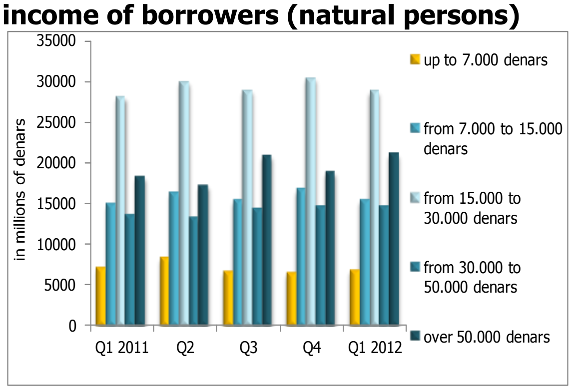
Source: National Bank, based on data submitted by banks.

Figure 46 Share of uncollateralized exposure in the total credit exposure to nonfinancial entities



Source: National Bank, based on data submitted by banks.

Figure 47 Credit exposure, by monthly income of borrowers (natural persons)



Source: National Bank, based on data submitted by banks.

Calculated impairment and special reserve experienced faster growth compared to non-performing loans, which contributed to a further increase (by 1.1 percentage points) in the coverage of non-performing loans with impairment and special reserve. In line with the more prominent deterioration of loan portfolio quality of the sector "enterprises and other customers", the growth of the calculated impairment and special reserve is largely arising from the exposure to this sector (Annex 14).

Another indicator of the downward trend in the quality of exposure to enterprises is the accelerated growth of the restructured[12] exposure, in which enterprises had a dominant share with quarterly growth of Denar 2,623 million (50.4%). Also, prolonged credit exposure has been driven by this sector, but in the opposite direction, with a decrease of Denar 1,602 million (-7.2%). **Quarterly movements in net write-offs** had a negative sign, as a result of the written-off credit exposure of Denar 25 million, versus the collected one in the amount of Denar 41 million.

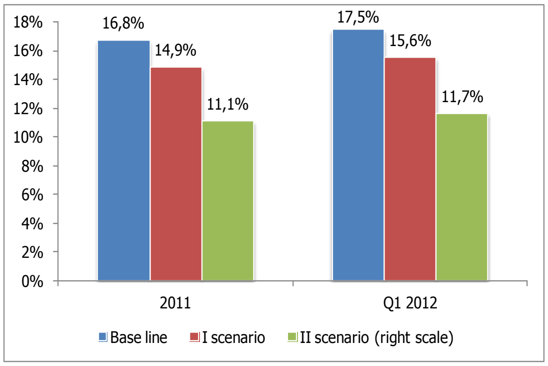
The share of the uncollateralized in the total credit exposure has a slight downward trend. The uncollateralized credit exposure increased by Denar 554 million (1.4%), which was due to the growth in the uncollateralized credit exposure to natural persons. Among enterprises, an increase in the collateralized credit exposure in the amount of Denar 4,957 million (3.5%) was registered.

In the structure of credit exposure to natural persons, an increase was registered in the exposure to customers with higher monthly income, mostly among the persons with income above Denar 50,000. However, still the majority (58.8% at the end of the first quarter of 2012) of the credit exposure to natural persons is to persons with income up to Denar 30.000 (Annex 21). If the exposure based on

[12] Restructuring of the claim means establishing new credit exposure by the bank to replace the existing, with resulting significant changes to contractual terms that are due to the deteriorating financial condition of the borrower.

loans for residential and commercial properties is excluded, the share of credit exposure to natural persons with such income would be 70.2%.

Figure 48 Capital adequacy ratio, before and after the simulation



Source: the National Bank, based on data submitted by banks.

Table 3 Results from the simulations

	Indicator	Credit exposure to "enterprises and other customers" and to "households"	Credit exposure of the banking system
Base line	Capital adequacy in the banking system	17,5%	
	% of C, D and E in total cedit exposure	12,1%	8,7%
	Average level of risk	9,6%	6,9%
I scenario	Capital adequacy in the banking system	15,5%	
	% of C, D and E in total cedit exposure	16,8%	12,1%
	Average level of risk	11,6%	8,3%
II scenario	Capital adequacy in the banking system	10,9%	
	% of C, D and E in total cedit exposure	26,4%	18,8%
	Average level of risk	15,6%	11,2%

Source: the National Bank, based on data submitted by banks.

1.2. Stress test of the resilience of the banking system to higher credit risk

Stress test was carried out through assumed migration of **10% (scenario I) and 30% (scenario II)** of credit exposure of each risk category to the two next higher risk categories, distributed equally. Simulations are conducted simultaneously for the sector of enterprises and other clients (and individual activities within this sector) and the household sector (and individual credit products within this sector) and for the overall credit exposure (Annex 22).

Results show that the banks' resilience remains satisfactory in this quarter, as well.

The simulations of credit exposure to both sectors (enterprises and other clients and of natural persons), showed the fastest quality deterioration:

- in the exposure to real estate activities within the sector of enterprises and other clients, where the average risk level would increase by 2.7 percentage points in case of scenario I and by 8 percentage points in case of scenario II and

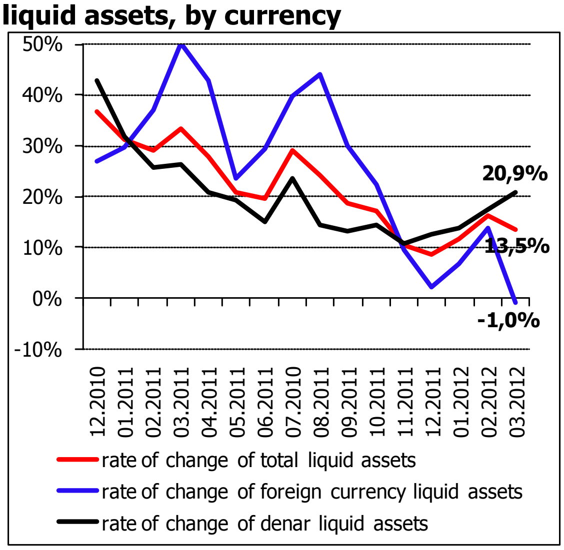
- in the exposure based on overdrafts and credit cards of natural persons where the average risk level would increase by 2 percentage points in case of scenario I and by 6.1 and 5.9 percentage points, respectively in case of scenario II.

In case of both scenarios, capital adequacy ratio of the banking system would not fall below the capital requirement of 8%. In case of scenario I, the capital adequacy ratio of any bank would not fall below 8%, and in case of scenario II, four banks would experience such fall (five banks at the end of 2011).

2. Liquidity risk

In the first quarter of 2012, banks in the Republic of Macedonia maintained their liquidity position strong and stable. In the first quarter of 2012, liquid assets increased primarily due to the investments in Denar liquid instruments, i.e. in CB bills, encouraged by the difference in the yield between Denar and foreign currency financial instruments. Liquidity ratios of the overall banking system improved, particularly the Denar position ratios. In the first quarter of 2012, the funding sources experienced positive developments of their maturity structure, in terms of decrease of short-term funding sources and increase of long-term funding sources, thus narrowing the maturity mismatch between assets and liabilities. Deposits of nonfinancial entities were major generators of the quarterly growth of the banks' sources of funding, and strengthened the dominant structural share. Stress-test analyses show satisfactory resilience of the banking system to simulated liquidity shocks. As of the first quarter of 2012, banks meet the minimum liquidity ratio (in a value of 1) of up to 30 days and up to 180 days.

Figure 49 Annual rate of change of banks' liquid assets, by currency

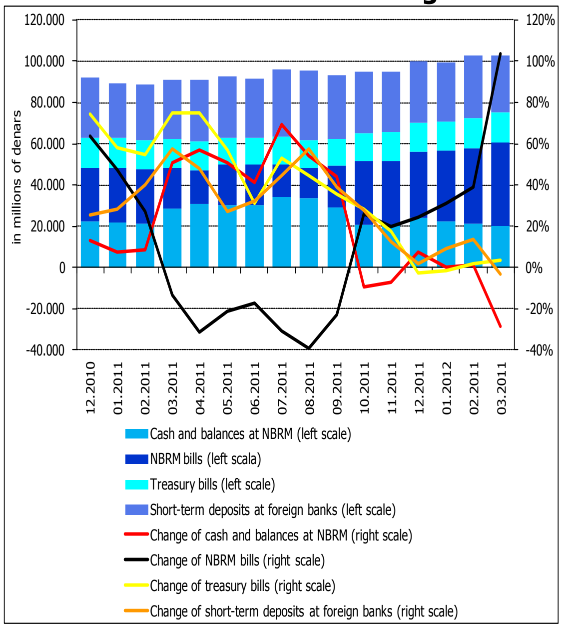


Source: the National Bank, based on data submitted by banks.

At the end of the first quarter of 2012, liquid assets[13] of the overall banking system totaled Denar 102,968 million and registered a quarterly growth of 2.8% or Denar 2,757 million. Observed annually, the increase of liquid assets is faster and totals Denar 12,249 million, i.e. 13.5%. Major driver of the increase of liquid assets in the first quarter of 2012 is the rise of banks' investments in CB bills that registered a quarterly growth of 25.4%, as of March 31, 2012. The annual growth rate equals 103.4%. This actually made the Denar liquid assets[14] increase annually by 20.9% as of March 31, 2012 (a quarterly growth of 9.9%), compared to the foreign liquid assets that fell by 1.0% on annual basis (a quarterly decrease of 11.1%). Somewhat above half of the annual increase of Denar liquid assets was concentrated in the first quarter of 2012. The fall of foreign liquid assets mainly results from the decrease of correspondent accounts and short-term placements in foreign banks that, in the first quarter of 2012, declined by Denar 2,204 million, or 7.4%. In April 2012, the National Bank modified its operational monetary policy framework by extending the available investment

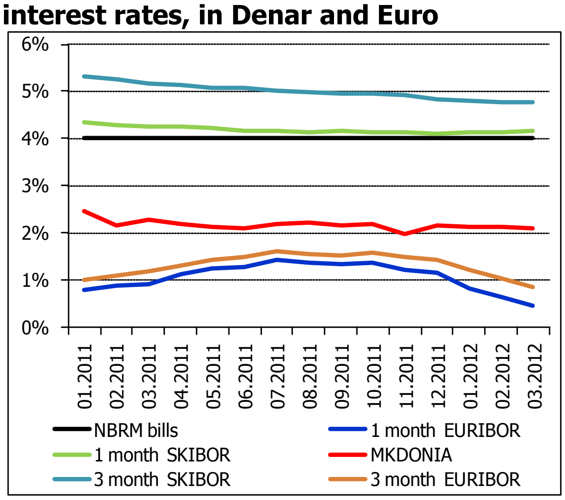
[13] Liquid assets include cash and cash equivalents on accounts with the National Bank, CB bills, correspondent accounts and short-term deposits with foreign banks and placements in short-term securities issued by the government.
[14] For the purposes of banks' liquidity analyses, assets and liabilities in Denars with FX clause are included in Denar assets and liabilities.

Figure 50 Structure of banks' liquid assets - absolute amounts and annual growths



Source: the National Bank, based on data submitted by banks.

Figure 51 Movements of reference interest rates, in Denar and Euro

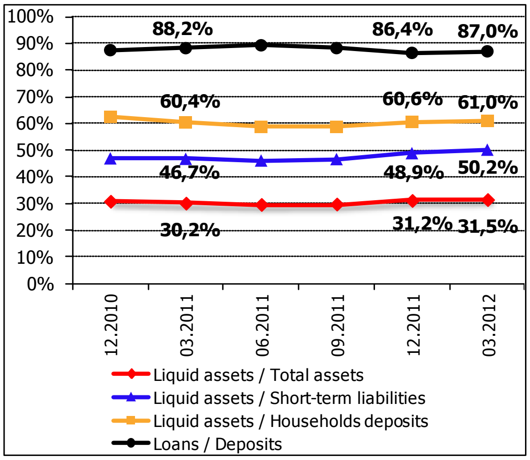


Source: the National Bank and www.euribor.org

options for the banks, introducing regular weekly repo operations with banks, available seven-day deposit facilities and by reducing the CB bill auction frequency from once a week to once in the reserve requirement period (28 days), and simultaneously, by switching the type of auction tender - from fixed interest rate and unlimited volume tender to maximum interest rate and limited volume tender. These changes, while expected to increase the flexibility in the conduct of monetary policy and to accelerate the activities and trade on the interbank market, are likely to change the structure of banks' liquid assets.

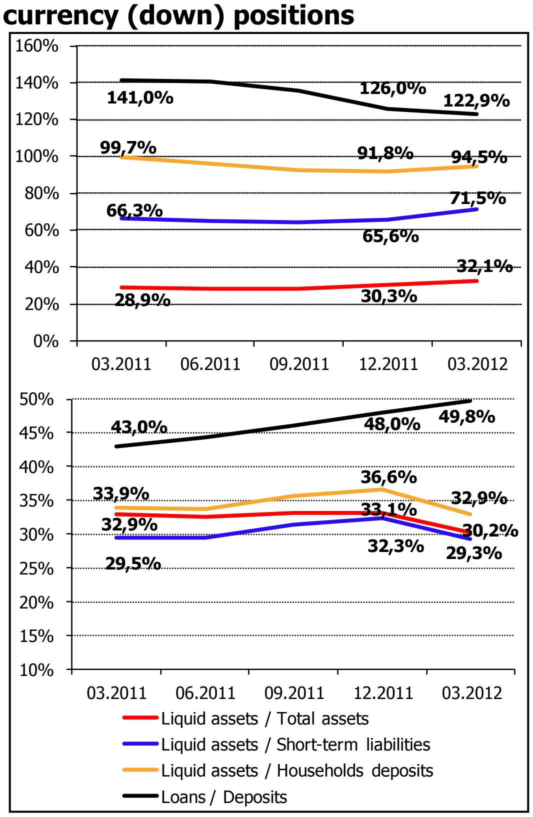
One of the key reasons why banks invest their liquid assets in the available financial instruments is their yield that primarily depends on the movements of policy rates. In the second half of 2011, and particularly the first quarter of 2012, EURIBOR as a reference interest rate on the money market in the euro area and a benchmark for the yield on short-term placements in foreign banks was falling, while the Denar interest rates demonstrated greater stability. Such interest rate dynamics, along with the risks surrounding the euro area and the uncertainty clouding the debt crisis and the effects on financial institutions actually tend to increase the demand for Denar instruments and increased banks' demand for CB bills.

Figure 52 Banking system's liquidity ratios



Source: the National Bank, based on data submitted by banks.

Figure 53 Banking system's liquidity ratios for Denar (up) and foreign currency (down) positions



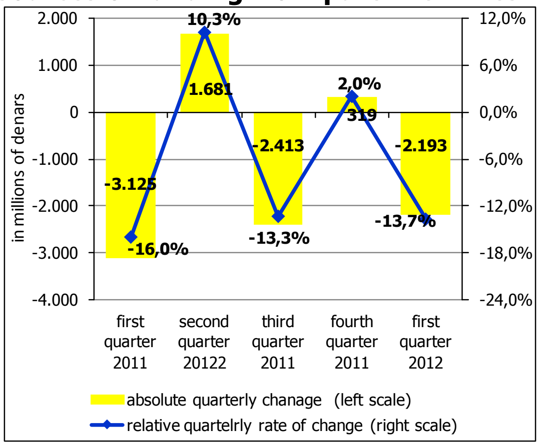
Source: the National Bank, based on data submitted by banks.

In the first quarter of 2012, banks' liquidity ratios[15] indicated moderate upward trend (see Annex 23). Liquidity ratios improved primarily due to the faster growth of liquid assets relative to both total assets and short-term liabilities and various deposit categories.

The increase of Denar component of liquid assets improved the Denar liquidity indicators in the first quarter of 2012. On the other hand, the lack of increase of placements with foreign banks tends to decrease the foreign currency liquidity ratios. The pace of liquidity ratios by currency was under the influence of the change in the liquid assets structure and the changes in the structure of banks' funding sources in the first quarter of 2012, particularly the increase of Denar deposits and of total Denar liabilities, vis-à-vis the fall of foreign currency deposits and foreign currency liabilities.

[15] The calculation of liquidity ratios of the overall banking system does not take into account the resident interbank assets and liabilities.

Figure 54 Quarterly growth of used sources of funding from parent entities



Source: the National Bank, based on data submitted by banks.

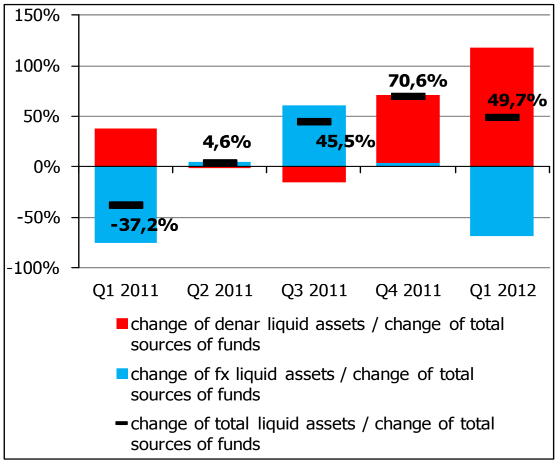
In the first quarter of 2012, deposits of nonfinancial entities still dominated the structure of funding sources of the banking system. Also, above two thirds of the quarterly increase of total funding sources was triggered by the increase of nonfinancial entities' deposits. Besides, the downward trend of funding sources used from parent entities of domestic banks continued. Thus, in the first quarter of 2012, the funding sources (other than equity) used from parent entities decreased by Denar 2,193 million or by 13.7%, thus reducing their share in total sources of funding to 4.1%. These sources decreased primarily due to the fall of used short-term and long-term loans from parent entities. The annual decrease of used funding sources of domestic banks from their parent entities was valued at Denar 2,606 million, i.e. 15.9%.

Table 4 Banks' sources of funds

Types of sources of funds	31.12.2010		31.12.2011		Quarterly change	
	Ammount (in millions of denars)	Share in structure	Ammount (in millions of denars)	Share in structure	Absolute	Relative
Deposits of non-financial enteties	**234.821**	**72,0%**	**238.022**	**71,0%**	**3.201**	**1,4%**
-o.w. parent enteties	49	0,0%	108	0,0%	59	100,0%
Deposits of financial institutions	**13.169**	**4,0%**	**13.421**	**4,0%**	**252**	**1,9%**
-o.w. parent enteties	4.414	1,4%	4.467	1,3%	53	1,2%
Loans, issued debt securities subordinated liabilities and hybrid capital instruments	**38.840**	**11,9%**	**39.281**	**11,7%**	**441**	**1,1%**
-o.w. parent enteties	11.437	3,5%	9.164	2,7%	-2.272	-19,9%
Equity and reserves	**39.299**	**12,1%**	**39.870**	**11,9%**	**571**	**1,5%**
Other sources of financing	**0**	**0,0%**	**4.438**	**1,3%**	**4.438**	**100,0%**
-o.w. parent enteties	0	0,0%	48	0,0%	48	100,0%
Total sources of financing	**326.129**	**100,0%**	**335.031**	**100,0%**	**8.903**	**2,7%**
Long-term sources of financiang	**106.302**	**34,8%**	**113.663**	**33,9%**	**7.361**	**6,9%**
-o.w. parent enteties	8.897	2,9%	8.186	2,4%	-711	-8,0%
Shrot-term sources of financing	**180.528**	**59,1%**	**177.061**	**52,8%**	**-3.467**	**-1,9%**
-o.w. parent enteties	7.003	2,3%	5.553	1,7%	-1.450	-20,7%
Equity and reserves	**39.299**	**12,9%**	**39.870**	**11,9%**	**571**	**1,5%**
Other sources of financing	**0**	**0,0%**	**4.438**	**1,3%**	**4.438**	**100,0%**
-o.w. parent enteties	**0**	**0,0%**	**48**	**0,0%**	**48**	**100,0%**
Total sources of financing	**305.290**	**100,0%**	**335.031**	**100,0%**	**29.741**	**9,7%**

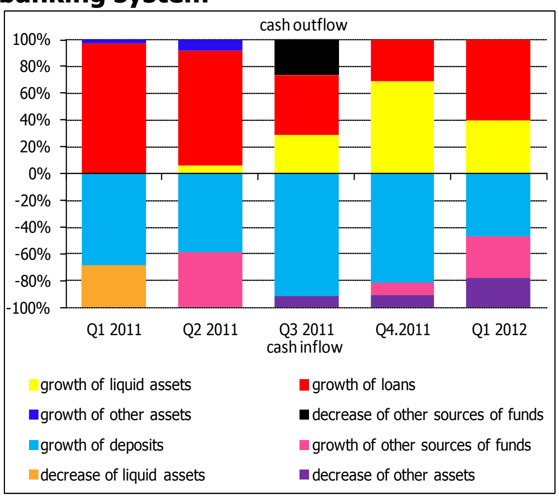
Source: Data are submitted by banks based on special request of the National Bank. Therefore, differences could appear in the on-balance sheet data submitted by banks regularly, under the Decision on submission of data on the account balances and flows in the banks' charts of accounts and in the financial statements ("Official Gazette of the Republic of Macedonia" no. 126/2011).

Figure 55 Quarterly growth of liquid assets /quarterly growth of total funding sources



Source: the National Bank, based on data submitted by banks.

Figure 56 Structure of cash flows of the banking system



Source: the National Bank, based on data submitted by banks.

*The category of other assets includes assets other than credits to nonfinancial entities not included in the category of liquid assets (long-term placements in foreign and domestic banks, foreign currency reserve requirement, foreclosed assets, fixed assets, etc.). The category of other sources of funding includes funding sources other than nonfinancial entities' deposits (equity and reserves, financial institutions' deposits, borrowings, subordinated instruments, etc.).

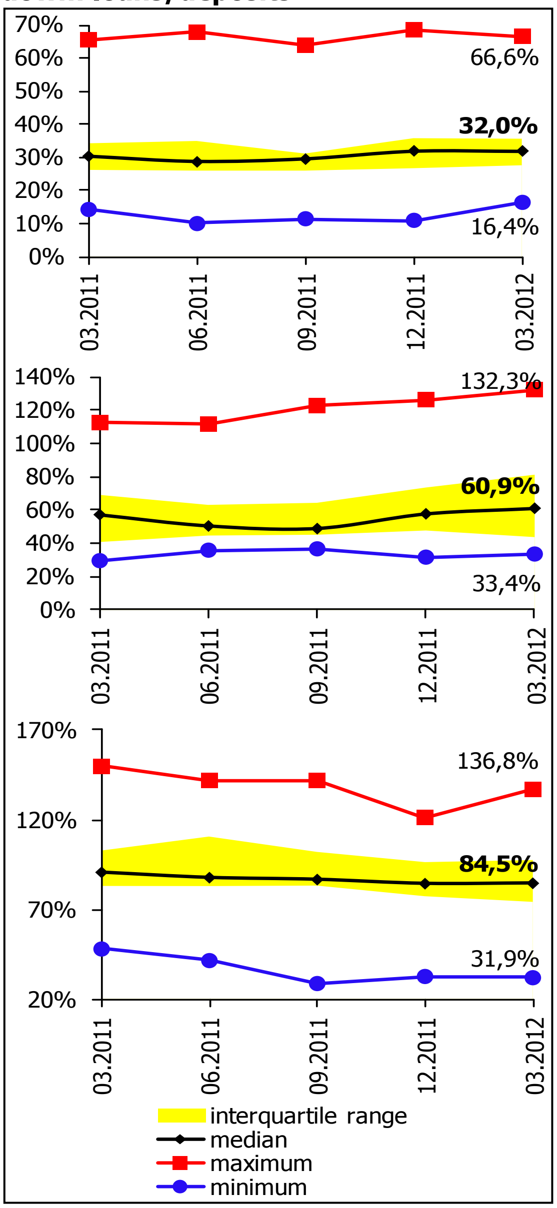
The maturity structure of funding sources registers a quarterly fall of short-term funding sources, at the expense of the increase of long-term sources of funding, which is to act towards greater sustainability and predictability of the sources of funding of the domestic banks. Additionally, these changes in the maturity structure of funding sources reduced the liquidity risk for the banks due to the greater mismatch of contractual maturity of assets and liabilities.

In the first quarter of 2012, banks preferred to place their new funding sources in Denar liquid instruments. Annual liquid assets growth -to- total funding sources ratio equaled 49.7% in the first quarter of 2012, but its currency structure shows that investments in Denar liquid instruments fully determined this indicator, while the contribution of investments in foreign currency liquid assets is negative, illustrating the banks' propensity to convert foreign currency liquid assets into Denar financial assets.

The first quarter of 2012 witnessed greater diversity of cash inflows[16] in the banking system. Thus, compared to 2011, when the deposit growth constituted most of the banks' cash inflow, in the first quarter of 2012, the increase of other (nondeposit) sources of funds also substantially contributed to the cash inflows of the banking system. The greatest contribution to the growth of other sources of funding of the overall banking system, with a share of almost two thirds in the overall quarterly growth was made by a medium-size bank that used long-term loans from nonresident institutional creditors (EIB). In the first quarter of 2012, cash outflows of the overall banking system were mainly aimed to lending (60.1% of cash outflows) and to increase liquid assets (39.9% of cash outflows).

[16] Cash inflows and cash outflows of the banks in any quarter are obtained indirectly, i.e. through quarterly change of balance sheet accounts of the banks. The effect on banks' cash flows of the expenses and income that are not cash outflow and inflow (for example, loan write-offs, revaluation of securities available for sale or held for trading, depreciation of fixed assets, net exchange rate differentials, etc.) is an integral part of the change of on-balance sheet items of the respective income or expense.

Figure 57 Selected liquidity ratios, by bank
up: liquid assets/total assets
middle: liquid assets/short-term liabilities
down: loans/deposits



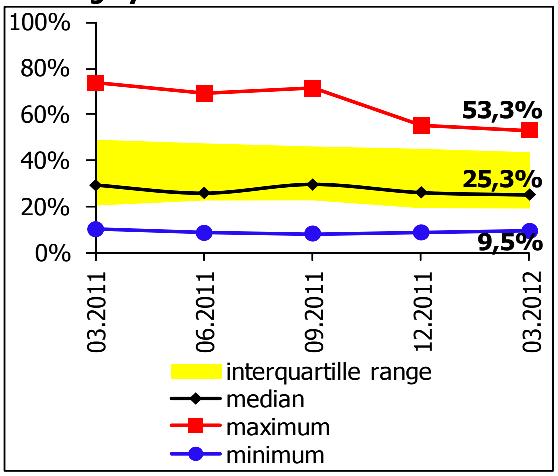
Source: the National Bank, based on data submitted by banks.

In the first quarter of 2012, the increase of deposits registered the largest share of the cash inflows of eight banks, and most of the cash inflows in four banks originate from the growth of other - non-deposit funding sources. Cash inflows in the remaining five banks were mostly provided through the cut of certain categories of assets, indicating that these banks are in the process of so called financial deleverage. On the other hand, in the first quarter of 2012, seven banks concentrated their cash outflows in credits to nonfinancial entities, five banks invested in liquid assets and three banks reported a decrease of deposits, while two other banks reported that their cash outflows are caused by the cut of other nondeposit sources of funds.

In the first quarter of 2012, **liquid assets of ten banks increased** in a range of 0.2% to 76.9%. Analyzing the other seven banks that account for 33.8% of the total assets of the banking system as of March 31, 2012, liquid assets decreased in a total amount of Denar 1,395 million. The fall, by bank, ranged from 2.2% to 13.0%. Four banks that make up 25.3% of the total assets of the banking system as of March 31, 2012 reported an annual fall of liquid assets (in a range of 0.7% to 20.3%). On the other hand, liquid assets of thirteen banks increased annually (in a range of 3.3% to 98.1%).

Larger banks' preference to invest in liquid financial assets entailed positive developments in the banks' liquidity ratios in the first quarter of 2012. Thus the coverage of short-term liabilities with liquid assets on a quarterly and annual basis increased in 9 and 13 banks, respectively. Although the median of the share of liquid assets in the total assets on a quarterly basis did not change, this indicator, however, increased in the banks with lower value, thus reducing the interquartile range. Eight banks reported that more than a third of their assets are in the form of liquid financial assets, reaffirming the relatively strong liquidity position of the Macedonian banking system. At the end of the first quarter of 2012, the credit -to- deposit ratio of four banks

Figure 58 Concentration of deposits in the banking system



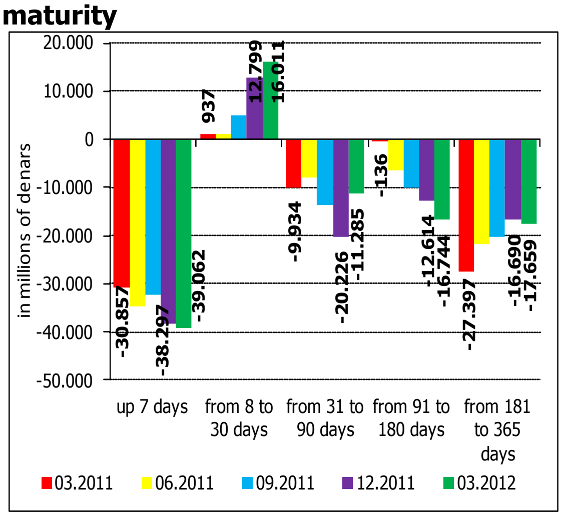
Source: the National Bank, based on data submitted by banks.
Share of the 20 largest depositors in the average deposit base for the last month.

exceeds 100%, indicating that these banks provided credits to nonfinancial entities through both deposits and other funding sources, most frequently loans from foreign financial institutions, including parent entities.

The banking system is characterized by relatively high deposit concentration that somewhat decreased on both annual and quarterly basis. As of March 31, 2012, the share of deposits of the 20 largest depositors in the total deposits by bank ranges from 9.5% to 53.3%, with a median of 25.3%. Compared to the last quarter, the median of such share reduced by 1.0 percentage point. The fall of median is even more evident on annual basis (fall of 4.1 percentage point). Furthermore, the maximum concentration reduced steeply (from 73.8% to 53.3%), indicating **higher competition on the resident deposit market**.

The lower level of banks' liquidity risk in the first quarter of 2012 is also evident through the improved maturity profile of their assets and funding sources. Changes were aimed to increase the share of both liabilities with longer contractual maturity and assets with short-term maturity. The contractual residual maturity of banks' liabilities remained longer compared to banks' assets (Annex 24).

Figure 59 Structure of banks' assets and liabilities, by contractual residual maturity

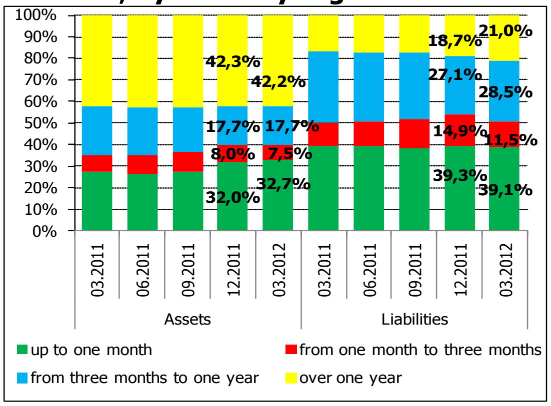


Source: the National Bank, based on data submitted by banks.

The first quarter of 2012 witnessed a reduction of maturity mismatch between assets and liabilities with contractual maturity from one to three months, while other maturity segments reported increase of maturity mismatch. The gap between contractual maturity of assets and liabilities is positive only in the residual maturity bucket of 8 to 30 days.

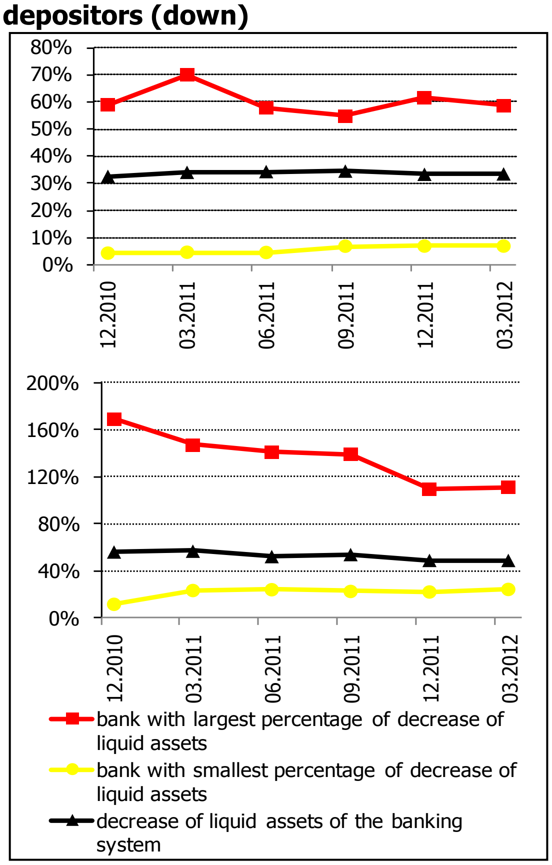
Banks expect to preserve deposit stability, maintaining the assets/liabilities gap in all maturity segments by expected maturity, positive (Annex 25). Banks expect at least 85.3% of deposits with residual maturity of up to three months to demonstrate stability, and to remain in

Figure 60 Contractual residual maturity (mis)match between assets and liabilities, by maturity segment



Source: the National Bank, based on data submitted by banks.

Figure 61 Results from the simulation for withdrawal of 20% of household deposits (up) and withdrawal of deposits of the twenty largest depositors (down)



Source: the National Bank, based on data submitted by banks.

the banks in the next three month, which actually means that banks expect only 4.8% outflow of the total nonfinancial entities' deposits.

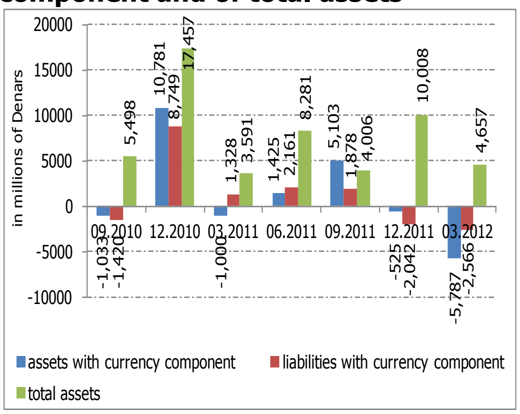
Resilience of the banking system to simulated liquidity shocks is also confirmed by the results of the simulations for disruption of the stability of deposit as a major banks' source of funding. The first quarter of 2012 would also register somewhat larger vulnerability of banks in case of withdrawal of deposits of the 20 largest depositors outside the banking system, compared to the withdrawal of 20% of household deposits, primarily indicating relatively high concentration of deposits in some banks. The withdrawal of deposits of the twenty largest depositors would reduce the liquid assets of the overall banking system by 49.1% that would, in turn, decrease the share of liquid assets in the total assets from 31.5% to 18.7%. Thus, 33.4% of liquid assets would be sufficient to absorb withdrawal of 20% of household deposits, and the share of liquid assets in the total assets of the overall banking system would reduce by 8.4 percentage points.

On the other hand, due to the relatively modest share of liabilities to parent entities in the banking system's funding sources, its resilience to the hypothetical withdrawal of these funding sources is larger. Thus, the simulations indicate that if all parent entities withdraw their deposits/loans from banks (except for subordinated and hybrid capital assets, the payment of which requires National Bank's approval), liquid assets of each bank would reduce in the range of 0.02% to 49.6% or 7.2% at the level of the banking system. The share of liquid assets in the total assets in case of this simulation would fall by 2.3 percentage points.

3. Currency risk

In the first quarter of 2012, the gap between assets and liabilities with currency component narrowed, and decreased the banks' exposure to currency risk. Such reduction was caused by the lower gap between assets and liabilities in Euro, which is still the most used foreign currency in the banks' operations. The lower level of currency risk is also notable through the lower share of gap between assets and liabilities with currency component in the banks' own funds.

Figure 62 Quarterly growth of assets and liabilities with currency component and of total assets



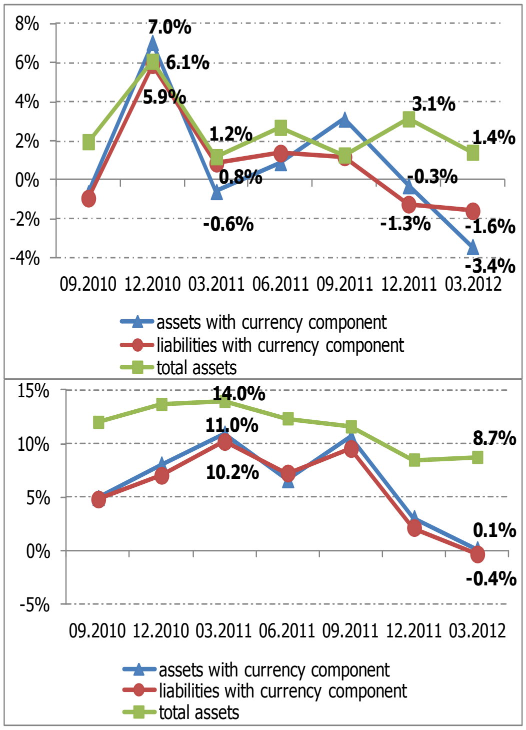
Source: the National Bank, based on data submitted by banks.

The gap between assets and liabilities with currency component reduced by 37.7% and totals Denar 5,321 million. This gap narrowed due to the faster decrease of assets with currency component compared to the decrease of liabilities with currency component. Assets with currency component decreased primarily due to the lower foreign currency assets (in the amount of Denar 4,489 million or by 4.3%)[17], while the decrease of assets with FX clause was slower (by Denar 1,298 million or by 2.0%)[18].

[17] Foreign currency assets decreased due to the fall of foreign currency cash (Denar 1,607 million or by 38.9%), current accounts with foreign banks (Denar 1,130 million or by 15.2%), foreign currency reserve requirement (Denar 1,108 million or by 7.8%), deposits with other banks (Denar 1,054 million or by 9.7%), etc. Observing the foreign currency deposits with other banks, the largest changes were noted in deposits with maturity of up to one month, which reduced by Denar 1,722 million (Annex 26).

[18] Placements in treasury bills in Denars with FX clause and loans in Denars with FX clause reduced by Denar 611 million or by 24.6% and Denar 526 million or by 0.9%, respectively.

Figure 63 Quarterly (up) and annual (down) growth of assets and liabilities with currency component and of total assets



Source: the National Bank, based on data submitted by banks.

On the other hand, liabilities with currency component reduced mostly due to the lower household foreign currency deposits (Denar 1.022 million or 1.2%), foreign currency deposits of nonfinancial institutions (Denar 848 million or by 8.1%) and foreign currency credit liabilities (Denar 752 million or 4.0%).

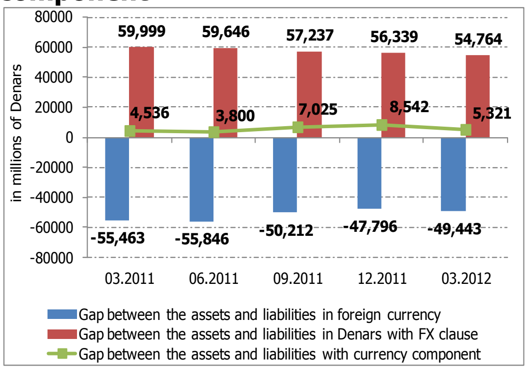
Table 5 Currency structure of and gap between assets and liabilities with currency component

Item	Amount (in millions of Denars) 31.12.2011	Amount (in millions of Denars) 31.03.2012	Share in total asstes 2011	Share in total asstes 31.03.2012
Assets in Denars with FX clause	63,732	62,434	19.2%	18.6%
Assets in foreign currency	105,354	100,864	31.8%	30.0%
Assets with currency component	169,085	163,298	51.1%	48.6%
Total assets	**331,176**	**335,833**	**100.0%**	**100.0%**
Liabilities in Denars with FX clause	7,393	7,670	2.2%	2.3%
Liabilities in foreign currency	153,150	150,307	46.2%	44.8%
Liabilities with currency component	160,543	157,977	48.5%	47.0%

Source: the National Bank, based on data submitted by banks.

The share of assets and liabilities with currency component in the total assets equals 48.6% and 47.0%, respectively. Compared to the preceding quarter, these shares went down by 2.4 and 1.4 percentage points, respectively.

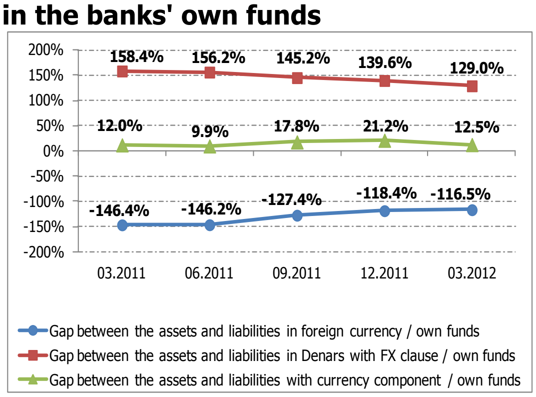
Figure 64 Structure of the gap between assets and liabilities with currency component



Source: the National Bank, based on data submitted by banks.

At the end of the first quarter of 2012, the negative gap between foreign currency assets and liabilities enlarged by Denar 1,647 million, while the positive gap between assets and liabilities in Denar with FX clause narrowed (by Denar 1,575 million). The larger gap between foreign currency assets and liabilities arises from the various paces of decrease of foreign currency assets and liabilities, while the reduction of the gap between assets and liabilities with FX clause results from the decrease of assets with FX clause and the increase of liabilities with FX clause. Such changes reduced the gap between assets and liabilities with currency component.

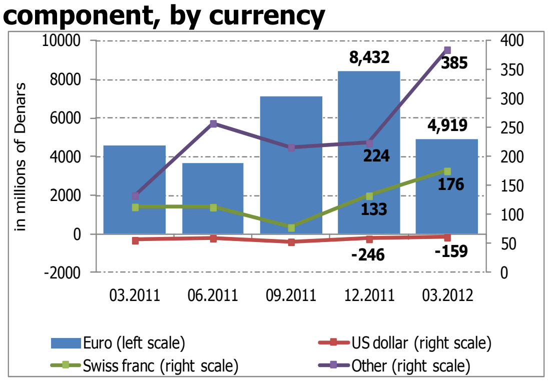
Figure 65 Share of gap between assets and liabilities with currency component, in the banks' own funds



Source: the National Bank, based on data submitted by banks.

Consequently, the ratio between this gap and banks' own funds also reduced by as much as 8.6 percentage points. The reduction of this ratio also indicates a **downward trend of the banks' exposure to currency risk.** The minor exposure is also confirmed through the minimum capital requirement "used" for covering the ccurrency risk (3.0% of own assets).

Figure 66 Dynamics of the gap between assets and liabilities with currency component, by currency



Source: the National Bank, based on data submitted by banks.

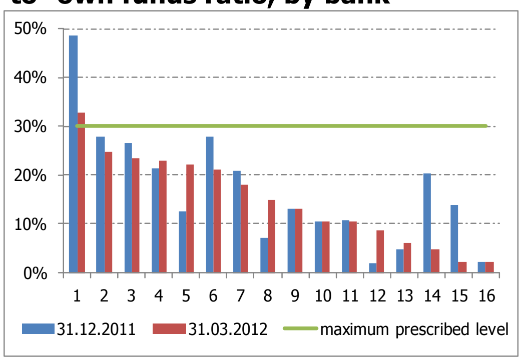
The narrowed gap between assets and liabilities with currency component results from the lower gap between assets and liabilities in Euro. The gap between assets and liabilities in Euro reduced by Denar 3,513 million or by 41.7% compared to the preceding quarter. The gap between assets and liabilities in US Dollar also reduced, while the gap between assets and liabilities in Swiss Francs keeps on extending.

Table 6 Currency structure of and gap between assets and liabilities with currency component

Currency	31.12.2011			31.03.2012		
	Currency structure of the assets with currency component	Currency structure of the liabilities with currency component	Currency structure of the gap between assets and liabilities with currency component	Currency structure of the assets with currency component	Currency structure of the liabilities with currency component	Currency structure of the gap between assets and liabilities with currency component
Euro	88.9%	88.4%	98.7%	88.4%	88.3%	92.4%
US dollar	7.2%	7.8%	-2.9%	7.4%	7.7%	-3.0%
Swiss franc	1.9%	1.9%	1.6%	2.0%	2.0%	3.3%
Australian dollar	0.4%	0.4%	0.1%	0.5%	0.5%	1.5%
Other	1.6%	1.5%	2.5%	1.7%	1.5%	5.7%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: the National Bank, based on data submitted by banks.

Figure 67 Aggregate currency position -to- own funds ratio, by bank



Source: the National Bank, based on data submitted by banks.

One of sixteen banks that report on their aggregate currency position exceeded the aggregate currency position limit (30% of own funds) as a result of the long position in Euro. this noncompliance with the limit was overcome in May 2012.

Table 7 Currency structure of and gap between assets and liabilities with currency component

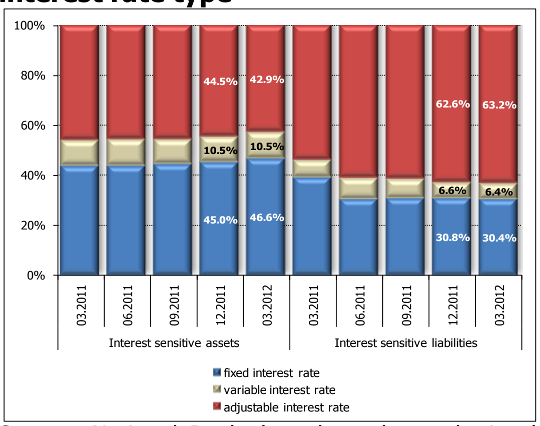
Open currency position by currency /own funds	Number of banks							
	Euro		US Dollar		Swiss franc		Other	
	Long	Short	Long	Short	Long	Short	Long	Short
under 5%	3	2	11	3	11	3	14	
from 5% to 10%	1	1	1					
from 10% to 20%	3	1					1	
from 20% to 30%	4							
over 30%	1							

Source: the National Bank, based on data submitted by banks.

4. Interest rate risk in the banking book

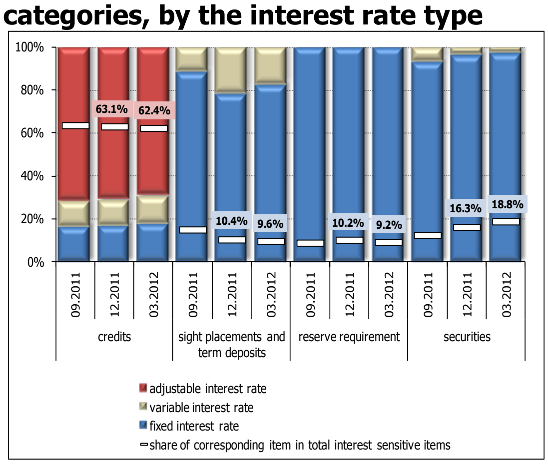
In the first quarter of 2012, the banks exposure to interest rate risk in the banking book remained very low. The reason for the limited importance of this risk is the banks' common practice to apply the adjustable interest rates[19] in most of the key products - credits and deposits. By avoiding this risk, the banks transfer it on the bank products users (credits), transforming it into the indirect credit risk. The interest rate risk in the banking book would get another dimension and significance in case of possible amendments to the regulations[20], with which framework for the use of the clauses for unilateral adjustment of the interest rates will be established.

Figure 68 Structure of the interest sensitive assets (above) and interest sensitive liabilities (below) by the interest rate type



Source: National Bank, based on data submitted by banks.

Figure 69 Interest sensitive assets by categories, by the interest rate type



Source: National Bank, based on data submitted by banks.

4.1. Structure of the interest sensitive assets and liabilities

On March 31,2012, in the structure of the interest sensitive assets, the positions with fixed interest rates (46.6%) took over the lead from the positions with adjustable interest rates (42.9%), primarily because of the larger presence of the fixed interest rates with the securities and credits. On the other hand, the adjustable interest rates additionally strengthened their role in the structure of the interest sensitive liabilities (63.2%).

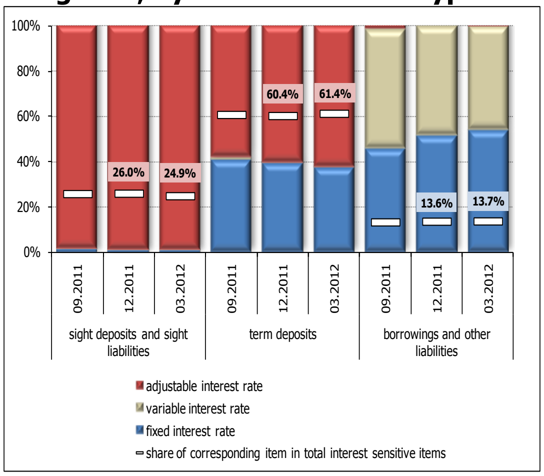
The adjustable interest rates, with their share of 68.7%, are present only with the credits, which are the most common financial instrument in the interest sensitive bank assets (62.4%). With the other financial instruments (sight deposits, time deposits, reserve requirement, securities and CB bills) which create the other part of the interest sensitive assets, the fixed interest rates prevail.

---

[19] The adjustment of the level of the interest rates is usually performed unilaterally by referring to the changes in the banks' interest rate policy.

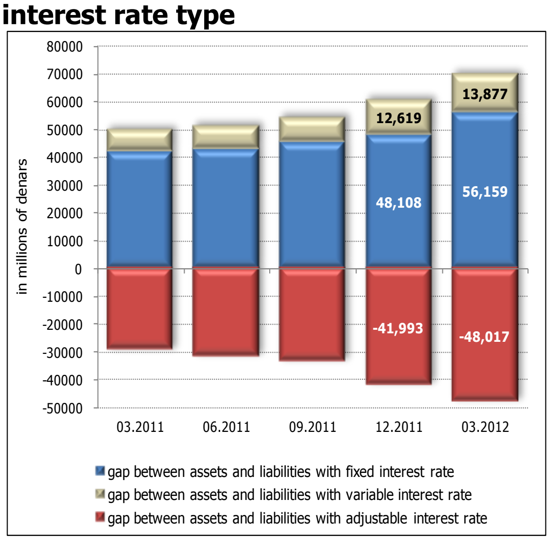
[20] The current legislation for this domain fails to contain provisions on the manner of determining and change of the interest rates, or a definition on the variable interest rates. These interest rates are defined in the National Bank bylaws on managing interest rate risk in the banking book.

Figure 70 Interest sensitive liabilities by categories, by the interest rate type



Source: National Bank, based on data submitted by banks.

Figure 71 Gap between the interest sensitive assets and liabilities, by the interest rate type



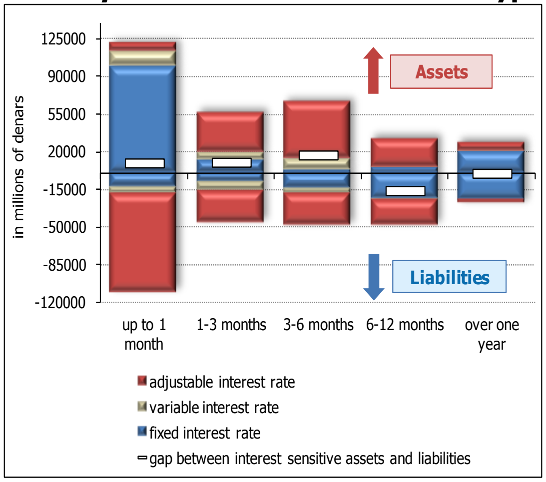
Source: National Bank, based on data submitted by banks.

As for the interest sensitive liabilities, the interest rate types vary. Almost all of the sight deposits are with adjustable interest rates (99.1%), with these interest rates having the largest share also in the time deposits (62.7%), which are also the most common financial instrument in the interest sensitive liabilities structure. These two categories of financial instruments almost fully create the liabilities with adjustable interest rates (99.8%). The largest share (53.6%) of the borrowings and the subordinated debt accounts for the positions with fixed interest rate, followed by the positions with variable interest rates (45.7%).

The gap between the interest sensitive assets and liabilities is positive with the positions with fixed and variable interest rates, while negative with the positions with adjustable interest rates. Compared to the end of 2011, the gap widened with all interest rate types. The positive gap with the positions with fixed interest rates arises from the dominant role of this type of interest rate in most items of the interest sensitive assets, i.e. the allocated reserve requirement (100%), securities (97.2%) and the bank investments in deposits (92.9%). The positive gap with the positions with adjustable interest rates is a result of the sight deposits (58%), the largest share of which is with variable interest rates. The negative gap with the positions with adjustable interest rates arises from the fact that this type of interest rate prevails in the time deposits, and it encompasses almost fully the sight liabilities.

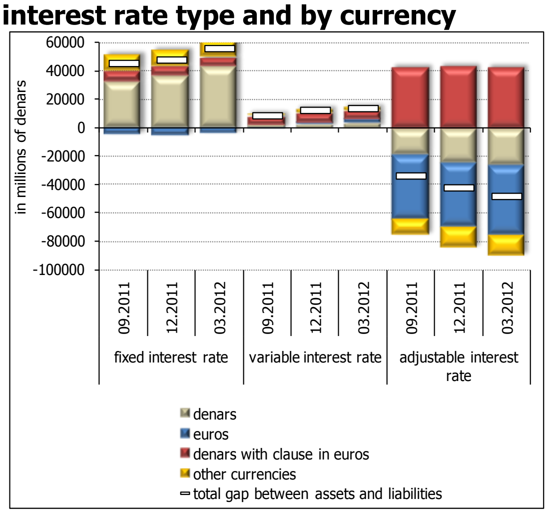
The bank exposure to interest rate risk is the largest in the one-to-three-months maturity segment. In the maturity segments with shorter maturity (to three months), there is bigger balance between the interest sensitive assets and liabilities. The adjustable interest rates are present with both the assets and the liabilities in almost all maturity segments. The interest sensitive assets in the maturity segment up to one month, where the

Figure 72 Absolute amount of interest sensitive assets and liabilities by the maturity structure and interest rate type



Source: National Bank, based on data submitted by banks.

Figure 73 Gap between the interest sensitive assets and liabilities by the interest rate type and by currency



Source: National Bank, based on data submitted by banks.

positions with fixed interest rates dominate[21], are exception. On the interest sensitive liabilities side, the positions with fixed interest rates are most present in the segments with longer maturities, mainly because of the time deposits with residual maturity of over six months, while the main place in the maturity segments with smaller maturity accounts for the positions with adjustable interest rats, because of the sigh deposits. The maturity structure of the adjustable interest rates mirrors the banks expectations for the period until the next "adjustment" of the amount of the interest rates (from three to six months for the assets with adjustable interest rates, and for one month for the liabilities with adjustable interest rates).

Observed from currency aspect, the gap between the interest sensitive assets and liabilities is positive with the positions in Denars and in Denars with FX clause, while negative with the positions in Euros. In the first quarter of 2012, the Denar positions have higher contribution in the creation of more evident positive gap with the fixed interest rates, mainly because of the Treasury bills and the CB bills. On the other hand, the negative gap with the adjustable interest rates is due to the positions in Euros resulting from the fact that most of the term Euro deposits has adjustable interest rates.

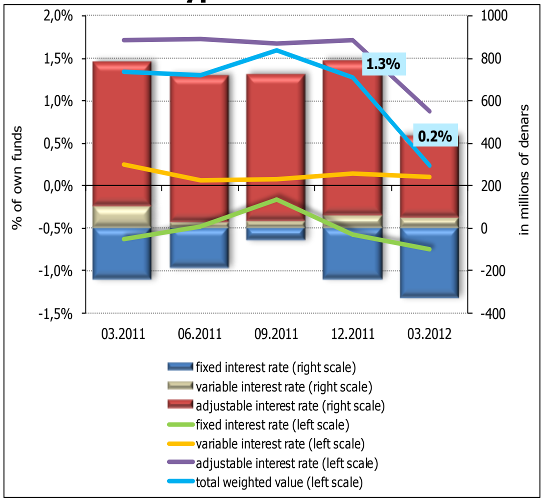
4.2. Weighted value of the banking book

The marginal significance of the interest rate risk in the banking book arises from the bank practice to use the adjustable interest rates mainly with credit and deposit banking products. On March 31,2012, the total weighted value of the banking book equals Denar 102 million, which is substantial drop of Denar 437 million (or 81%)[22]

[21] The main role of the fixed interest rates in the maturity segment up to one month arises from the characteristics of the basic monetary policy instruments (reserve requirement and CB bills have contractual maturity of up to one month) and the instruments on the domestic money market, together with the apparent preference of the banks to invest their foreign exchange liquid assets on a short-run as deposits with foreign banks.

[22] This drop is due to the corrections in the reporting forms made by several banks, with the unused credit limits and unused credit cards limits. Namely, during several reporting periods after the adoption of the Decision on interest rate risk in the banking book ("Official Gazette of the Republic of Macedonia" no. 163/2008 and 144/2009), part of

Figure 74 Net weighted value and ratio between the total weighted value of the banking book and own funds by the interest rate type



Source: National Bank, based on data submitted by banks.

compared to the end of 2011 (Annex 28). Such movements increased the yield on the net weighted position with fixed interest rate in the creation of the total weighted value of the banking book. Hence, the ratio between the weighted value of the banking book and the own funds[23] reduced to minimal 0.2%. By banks, this ratio ranges between 0.1% and 7.2%, with median of 1.4%, with the highest ratio being registered with one bank failing to apply adjustable interest rates.

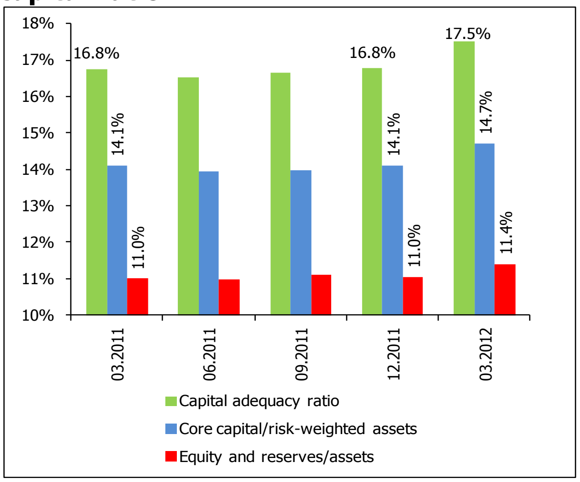
---

the banks have been reporting unused credit limits and unused credit card limits as other (classical) off-balance sheet positions (on the assets' side) exposed to interest rate risk, although, actually, they do not calculate interest on these positions, as a result of which they do not represent interest sensitive positions.

[23] Pursuant to the Decision on managing interest rate risk in the banking book ("Official Gazette of the Republic of Macedonia" no. 163/2008 and 144/2009), the ratio of the total weighted value of the banking book to the banks' own funds can equal maximum 20%.

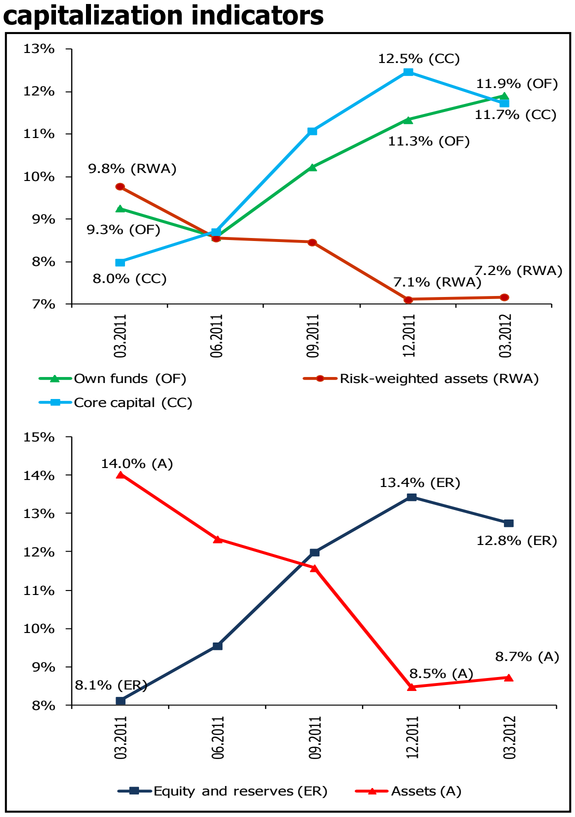
5. Insolvency risk

Figure 75 Indicators for solvency and capitalization



Source: National Bank, based on data submitted by banks.

Figure 76 Annual growth rates of the components of the solvency and capitalization indicators



Source: National Bank, based on data submitted by banks.

The solvency and the capitalization of the banking system registers an improvement, as a result of the higher growth rates of the capital positions, compared to the intensified bank activities. The increase in the own funds is mainly due to the retaining of part of the gain for 2011 in the banks' reserve fund and the performed capitalization with two banks. Additionally, the allowed amount of subordinated instruments that can be included in the calculation of the own funds registered certain increase. The largest portion of the increase in the own funds the banks used for strengthening of the "free" capital over the minimal risk coverage level. The capital requirement for risk coverage registered certain rise, which was almost fully due to the increase in the capital requirement for credit risk coverage arising from the corporate sector. The capital requirement for currency risk coverage went down in the first quarter of 2012 because of the narrowing of the net foreign currency position in Euros.

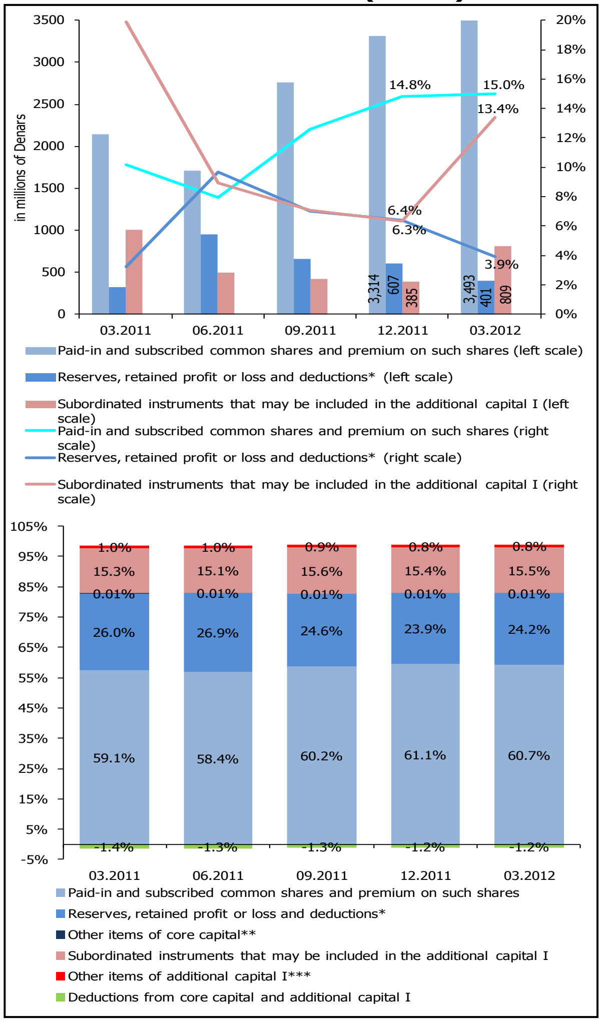
5.1. Indicators for solvency and capitalization of the banking system

The indicators for the solvency and capitalization of the banking system remained high and registered an improvement. On annual basis (March 31,2011 - March 31,2012), the capital adequacy increased by 0.7 percentage points, while the ratio of the core capital[24] and the risk weighted assets increased by 0.6 percentage points.

After three consecutive quarters of continuing fall in the annual growth rates of the assets and the risk weighted assets, in the first quarter of 2012, the annual increase in the bank activities registered certain acceleration. Simultaneously, after a longer period, the annual

[24] It is the core capital after the deductable items from the sum of the core and the additional capital.

Figure 77 Annual changes of the selected items from the own funds (above) and the structure of the own funds (below)



Source: National Bank, based on data submitted by banks.

Note: *Deductions include: Loss at the year-end/current loss, own shares, intangible assets, net negative revaluation reserves, difference between the amount of calculated and allocated impairment loss/special reserves;

**Includes: positions arising from consolidation (positive positions) and other positions that may be included in the core capital;

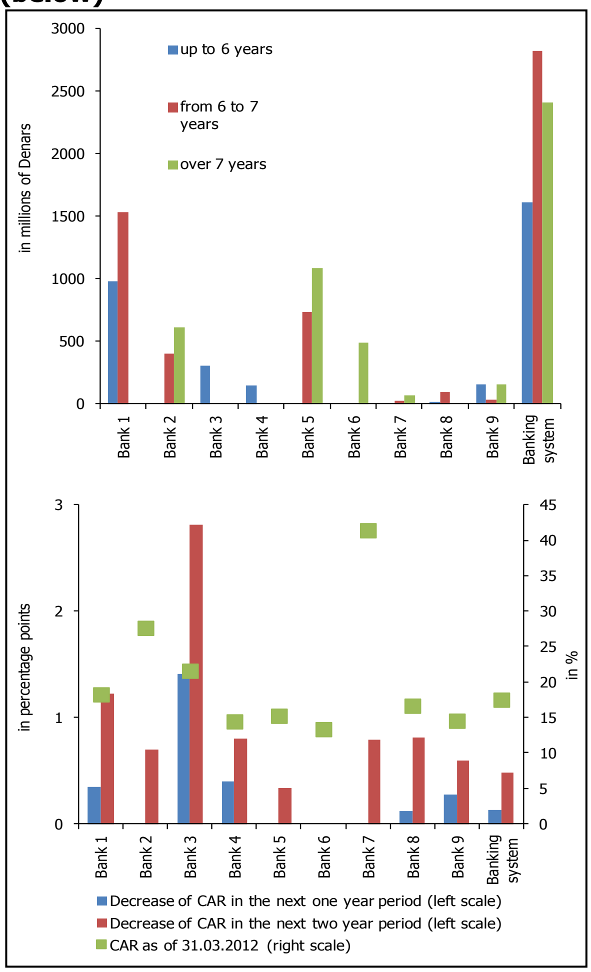
***Includes: paid-in and subscribed cumulative preference shares and premium on such shares, revaluation reserves and hybrid capital instruments.

growth rates of the capital and reserves and the core capital of the banks registered certain deceleration. However, **the annual growth rates of the own funds, the core capital and the capital and reserves are substantially higher (by near 50%) compared to the annual growth rates of the total assets and risk weighted assets.** The annual growth rates of the assets an the risk weighted assets, are higher by 0.2 and 0.1 percentage points, respectively, compared to the annual increase registered within December 31,2010 - December 31,2011 period. Simultaneously, the annual increase in the core capital and the capital and reserves is smaller by 0.8 and 0.6 percentage points, respectively compared to the increase registered in December 31,2010 - December 31,2011 period. However, the realized annual growth rates of the banks capital positions are two-diggit, as opposed to the registered annual one-diggit increase in the activities, indicating further improvement of the indicators for the solvency and capitalization of the banking system.

In the first quarter of 2012, the banks' own funds increased by Denar 2,085 million, or by 5% (on annual basis, the own funfs augmented by Denar 4,700 million, or 11.9%). More than a half of this increase arises from the retainence of part of the gain registered in 2011 in the banks capital. Thus the item "reserves and retained gain or loss", of the banks' core capital, registered quarterly growth of Denar 1,212 million, which arises from the retaining of part of the realized gain in 2011 in reserve funds, with two large banks. As a contrast, one bank from the group of small banks, for the realized loss in 2011, increased the acumulated loss of the previous years.

In the first quarter of 2012, two banks from the group of medium-size banks were capitalized, in the total amount of Denar 1,105.5 million, giving more significant contribution to the increase in the banks' own funds. With one bank, the capitalization was fully conducted by the parent entity, while the other bank, increased its capital by both, parent entity and EBOR.

Figure 78 Structure of the amount of the subordinated instruments included in the additional capital I, by their residual maturity, as of March 31,2012 (above) and decrease in the capital adequacy (CA) in the following period on the basis of the entering of the subordinated instruments in the last five years until the maturity date, while the other remained unchanged (below)



Source: National Bank, based on data submitted by banks.

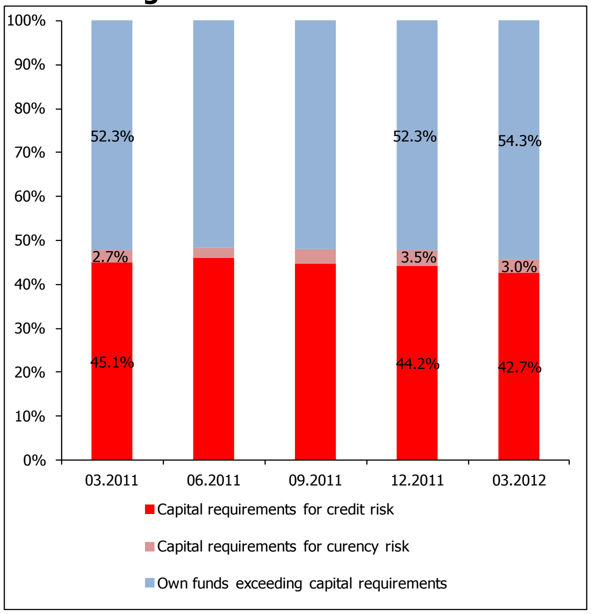
More substantial change in the banks' core capital in the first quarter of 2012 was registered in the item "loss at the end of the year, or current loss". This deductable item of the core capital increased by Denar 604 million, as a result of the registered negative financial result in the first quarter of 2012.

In the first three months of 2012, the amount of the subordinated instruments that can be part of the additional capital I increased by Denar 364 million. Most of this increase is not a result of new investments in form of subordinated instruments, but to the increase in the core capital as a result of the performed capitalization with one bank from the group of medium-size banks, because of which the allowed amount of additional capital I, that can be included in the own funds[25] also increased. Only one bank from the group of small-size banks issued new subordinated instrument, in the amount of Denar 15 million, but largest portion of this amount can not include in the own funds. With one medium-size bank, the subordinated instrument entered the last four years until the due date, thus causing fall in the value at which it is included in the own funds calculation by Denar 49 million[26], while with other bank from the large bank group, the amount of the subordinated instruments included in the calculation of the own funds registered an increase of Denar 9 million, which is due to the exchange rate differentials.

More details about the movements of the own funds of the individual groups of banks are given in Annex no. 29.

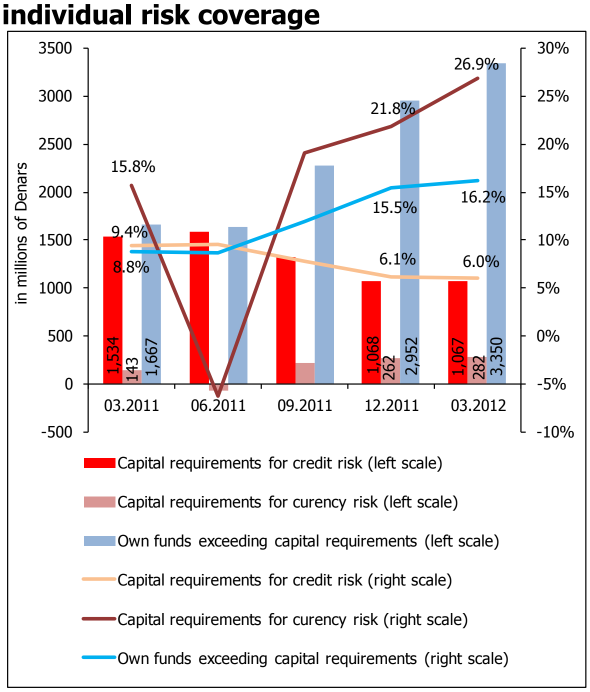
[25] According to the regulations, the amount of the subordinated instruments which are part of the additional capital I should not exceed 50% of the amount of the banks' core capital.
[26] According to the regulations, when calculating the own funds, in the last five years to the due or payment date, the subordinated instrument is discounted by 20% every year.

Figure 79 Own funds structure by their use for covering individual risks



Source: National Bank, based on data submitted by banks.

Figure 80 Annual absolute percentage change in the own funds, by the use of individual risk coverage



Source: National Bank, based on data submitted by banks.

From the aspect of the use of the banking system's own funds for covering individual risks, in the first quarter of 2012, further strenghtening of the "free" capital over the minimal capital requirement for risk coverage was registered. Thus the own funds over the minimal capital requirement level for risk coverage increased by Denar 1,966 million, or by 8.9%.

In the first quarter of 2012, the capital requirement for risk coverage increased by Denar 118 million, or 0.6% (on annual basis, the capital requirement for risk coverage increased by Denar 1,349 million, or 7.2%), **which was fully contributed by the increase in the capital requirement for credit risk coverage.** The capital requirement for credit risk coverage went up by Denar 254 million. The largest portion of the quarterly rise in the capital requirement for credit risk coverage arises from the banks credit activities with the enterprises. The larger MBDP placements with the domestic banks is partial reason for the additional engagement of the capital requirement for credit risk coverage.

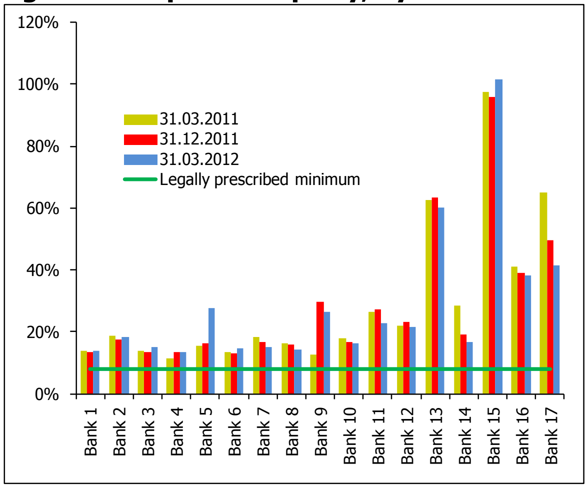
The capital requirement for currency risk coverage registered quarterly drop of Denar 135 million. The decrease in the capital requirement for currency risk coverage arises from the quarterly narrowing of the net foreign currency position in Euros, which is due to the larger decrease in the Euro assets (of Denar 3,941 million), compared to the decrease in the Euro liabilities (of Denar 1,089 million)[27]**.**

More details on the movements of the capital requirement for risk coverage, by groups of banks are provided in Annex no. 30.

The bank-by-bank analysis indicate solid level of solvency and capitalization of individual banks. In the first quarter of 2012, the banks with higher market share

[27] Determined pursuant to the effective Decision on and the Instructions for the methodology for determining the capital adequacy.

Figure 81 Capital adequacy, by banks



Source: National Bank, based on data submitted by banks.
Note: The banks order is provided by the share of each bank in the total assets of the banking system, on March 31,2012.

increased the capital adequacy ratio. The banks in the Republic of Macedonia have capital adequacy ratio that is at least two-thirds higher than the legaly prescribed 8%. In the first quarter of 2012, the six banks having the largest market share, by the assets size (total market share of 79.9% on March 31,2012), increased the capital adequacy (except one bank, which preserved the capital adequacy at the same level). Almost all other banks registered certain decrease in the capital adequacy ratio.

5.2. Stress-testing of the resilience of the banking system to simulated hypothetical shocks

On March 31,2012, the conducted stress-test simulations for the resilience of the banking system and the individual banks in the Republic of Macedonia to possible shocks, showed that the banking system and the individual banks are generally resilient to the influence of these shocks. After the conducted simulations, one bank registered decrease in the capital adequacy below 8%.

Table 8 Results from the stress-test simulations for the resistance of the banking system and individual banks to hypothetical shocks

No. of simulation	CAR at the level of banking system, before simulation			Number of banks with CAR before simulation below the CAR of the overall banking system before simulation			CAR at the level of banking system, after simulation			Bank with lowest CAR, after simulation			Number of banks with CAR after simulation below the CAR of the overall banking system after simulation (number of banks with CAR after simulation below 8%)		
	03.2011	12.2011	03.2012	03.2011	12.2011	03.2012	03.2011	12.2011	03.2012	03.2011	12.2011	03.2012	03.2011	12.2011	03.2012
1	16.8%	16.8%	17.5%	7	7	8	16.1%	16.0%	16.7%	10.9%	12.7%	12.8%	7 (0)	7 (0)	8 (0)
2	16.8%	16.8%	17.5%	7	7	8	14.7%	14.4%	15.0%	9.9%	11.0%	11.0%	6 (0)	6 (0)	10 (0)
3	16.8%	16.8%	17.5%	7	7	8	13.3%	12.8%	13.3%	8.4%	8.0%	6.7%	7 (0)	7 (0)	9 (1)
4	16.8%	16.8%	17.5%	7	7	8	14.8%	14.5%	15.2%	9.9%	11.0%	11.5%	7 (0)	6 (0)	10 (0)
5	16.8%	16.8%	17.5%	7	7	8	13.2%	12.6%	13.2%	8.7%	8.7%	7.8%	7 (0)	7 (0)	9 (1)
6	16.8%	16.8%	17.5%	7	7	8	13.3%	12.7%	13.4%	8.8%	8.7%	8.5%	7 (0)	7 (0)	8 (0)
7	16.8%	16.8%	17.5%	7	7	8	16.6%	16.7%	17.3%	11.0%	13.2%	13.5%	7 (0)	7 (0)	8 (0)
8	16.8%	16.8%	17.5%	7	7	8	14.1%	14.1%	14.8%	8.7%	9.6%	10.5%	7 (0)	8 (0)	6 (0)

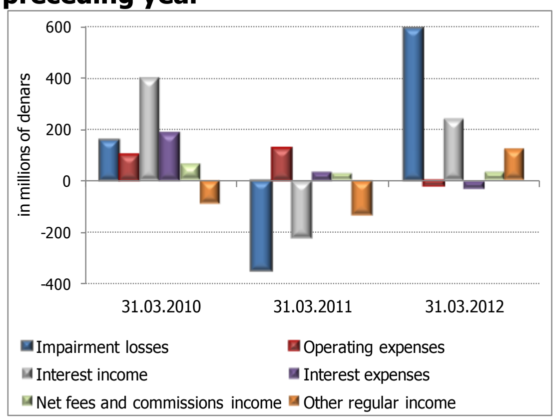
Source: National Bank, based on data submitted by banks.

This stress test analysis is based on the implementation of eight hypothetical simulations, of which:
- three simulations for isolated credit shock (increase in the credit risk exposure classified in the risk categories C, D and E by 10%, 30% and 50%),
- fourth simulation as a combination of the credit and interest rate shock (increase in the credit exposure in the risk categories C, D and E of 30% and increase in the interest rates on the individual lending and deposit, on-balance sheet and off-balance sheet items of 1 to 5 percentage points),
- fifth scenario as a combination of credit and foreign exchange shock (increase in the credit exposure in the risk categories C, D and E of 50% and depreciation in the Denar exchange rate compared to the Euro and the US Dollar of 20%),
- sixth simulation as a combination of shocks on the side of the credit risk, the foreign exchange risk and the interest rate risk (increase in the credit exposure in the risk categories C, D and E of 50%, depreciation of the Denar exchange rate compared of the Euro and the US Dollar of 20% and increase in the domestic interest rates of 5 percentage points),
- seventh simulation, appreciation of the Denar exchange rate relative to the Euro and the US Dollar in the amount of 20%,
- eighth simulation, simultaneous reclassification in the risk category C of the five largest credit exposures to non-financial entities (including also the connected entities).

6. Profitability

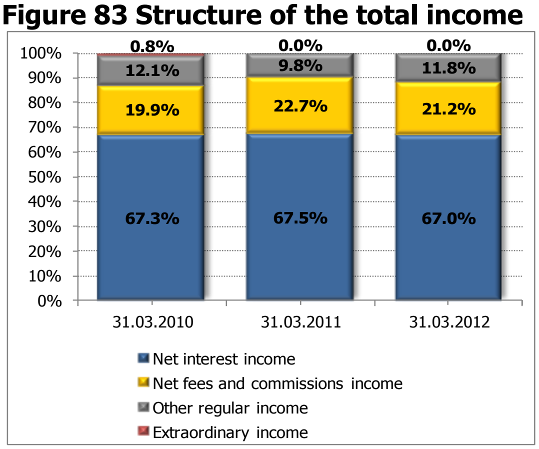
In the first quarter of 2012, the Macedonian banking system registered total negative financial result of Denar 229.9 million. This loss is greater by Denar 149.4 million, compared to the same period of the previous year. The main reason for the greater financial loss is the larger credit risk losses, despite the increase of the net interest income. Having in mind the relatively high increase in the exposure in the risk category D (one third of which usually goes to the risk category E), further rise in the credit losses may be expected. The number of banks registering negative financial result in the first three months of 2012 increased to nine, whose share in the total assets reached 34.3% compared to 15.1% on March 31,2011.

Figure 82 Absolute increase/decrease in the main income and expenditures, compared to the same period of the preceding year



Source: National Bank, based on data submitted by banks.

Figure 83 Structure of the total income



Source: National Bank, based on data submitted by banks.

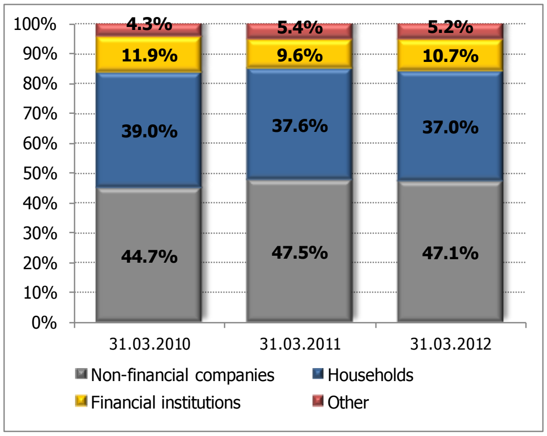
The main factor for deterioration of the realized financial result of the banking system is the substantial increase in the impairment, which fully offset the increase in the net interest income and other regular income. The annual increase in the impairment is higher by 1.4 times from the annual increase in the total bank income and it is a result of the deterioration of the credit portfolio quality compared to the end of March 2011.

6.1. Income and expenditures structure of the banking system

In the first quarter of 2012, **banks' total income** (total regular income[28] and extraordinary income) went up by Denar 418.1 million, i.e. by 11.6%. The increase in banks' total income is due to the increase in almost all income components, except to the decrease in the extraordinary income, which have minor share in the total income structure (Annex 3). The net interest income augmented by Denar 263.7 million, i.e. by 10.8%, as a result of the increase in the net interest income, which corresponds to the rise in the newly extended credits, while the interest expenditure declined on annual basis. The increase in the other regular income (of Denar 121.3 million, or 34.4%), is generated by the net income growth based on exchange rate differentials and higher income based on

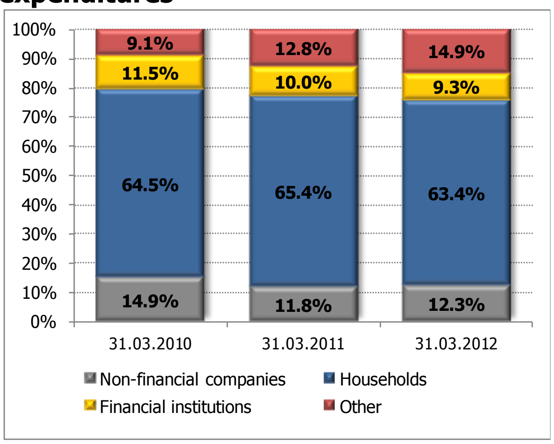
[28] The total regular income included: the net interest income, net income from commissions and fees and other regular income (net income from trading, net income from financial instruments recorded at fair value, net income from exchange rate differentials, income based on dividends and capital investments, profit based on sale of financial assets available for sale, capital gains realized based on sale of assets, released provisions for off-balance sheet assets, releasing other provisions, income on other basis, income based on unpaid previously written-off claims and losses due to sale of financial assets available for sale).

Figure 84 Sector structure of the interest income



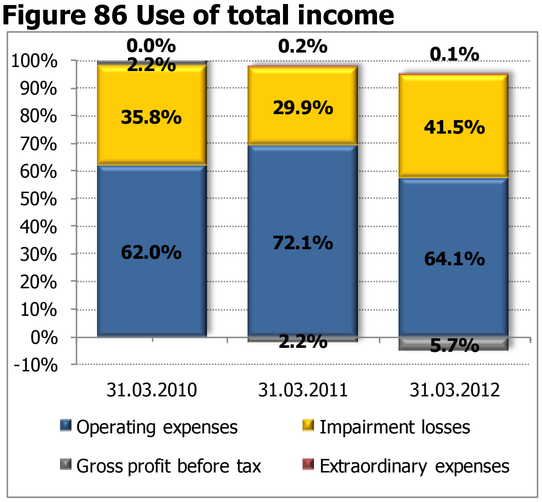
Source: National Bank, based on data submitted by banks.

Figure 85 Sector structure of the interest expenditures



Source: National Bank, based on data submitted by banks.

Figure 86 Use of total income



Source: National Bank, based on data submitted by banks.

collected previously written-off claims. The increase in the net income based on commissions and fees is moderate (33.3 million, or 4.1%).

In the first three months of the year, no noticeable changes in the **structure of the total income** were registered. The dominant share of 67% accounts for the net interest income, while moderate increase in the income structure of 2 percentage points accounts for the banks' other regular income.

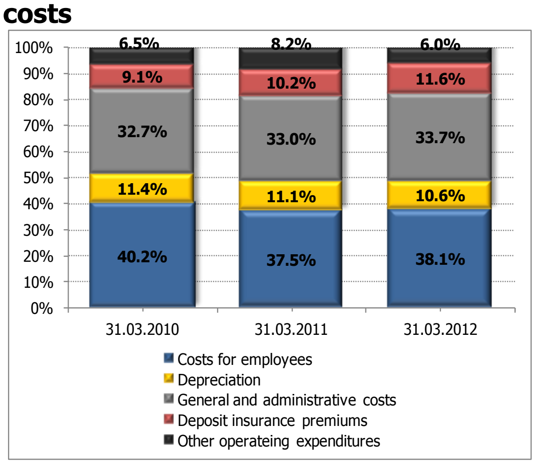
In the first quarter of the year, **the interest income** registered annual increase of Denar 236.6 million, i.e. 5%, which is a result of the realized annual credit growth despite the decrease in the lending interest rates. The largest contribution to the increase in the interest income, as well as the largest share in the structure of the interest income accounts for the interests of the non-financial companies. The interest income from the non-financial companies increased by Denar 119.7 million, or 5.5%, which is a result of the credit growth to the corporate sector.

The interest income from households and the financial institutions also registered annual increase. The interest income from households augmented by Denar 83.4 million, or 4.9%, which also corresponds to the larger credit activity to the household sector. The interest income from the financial institutions went up by Denar 80.9 million, i.e. 18.6%, which is due to the larger bank investments in CB bills given the steadiness of the interest rate. The interest income from investments in Treasury bills is included in the category "interest income from other entities", which growth dynamics intensified and reduced to 3.5% on annual basis.

Interest expenditures registered annual fall of Denar 27 million, or by 1.2% which is due to the decrease in the interest expenditures for the household sector and the financial companies. In the interest expenditures structure, in line with the dominant share of the household deposits in the total banks deposits, dominate the interest expenditures of the household sector. However, as a result of the more intensive decrease in the interest expenditures of the household sector, and the financial companies compared to the total interest expenditures, their share in the structure of the interest expenditures went down by 2 percentage points and 0.7 percentage points, respectively. In contrast, the share of the interest expenditures to the nonfinancial companies and other sectors registered moderate rise of 0.5 percentage points and 2.1 percentage points, respectively.

Most of the total income has been spent for covering the operational costs[29] of the banks, which share in the total income fell by 8 percentage points, whereas the share of the impairment expenditures increased.

Figure 87 Structure of the operational costs

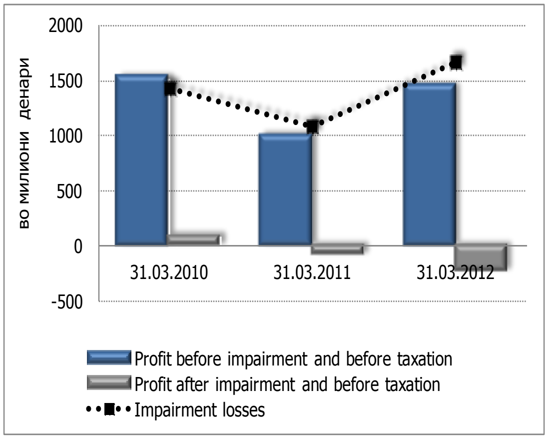


Source: National Bank, based on data submitted by banks.

The largest share in the **operating costs** structure accounts for the employee expenses and general administrative costs. Their share in the total operating cots remained at the same level as in the previous year. However, within the operational costs, the largest annual increase of Denar 32.5 million, or 12.2% was registered with the deposit insurance premiums, which corresponds to the annual increase in the total deposits of financial and non-financial entities. More apparent annual decrease with individual components of the operating costs was registered with the expenses for special reserve for the off-balance exposure of Denar 47.9 million, or 33.3%.

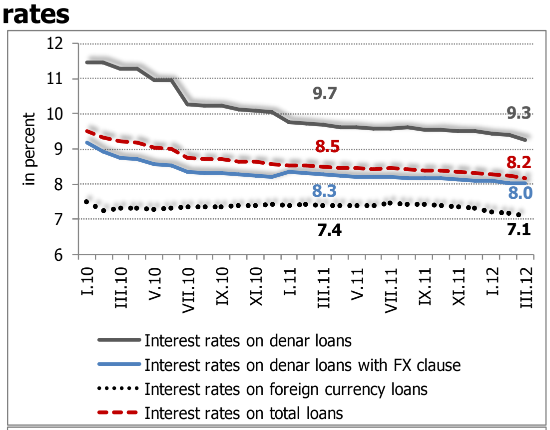
[29] The operating costs include: the employee expenses, depreciation, general and administrative costs, deposit insurance costs, deposits and other expenditures, except extraordinary expenditures.

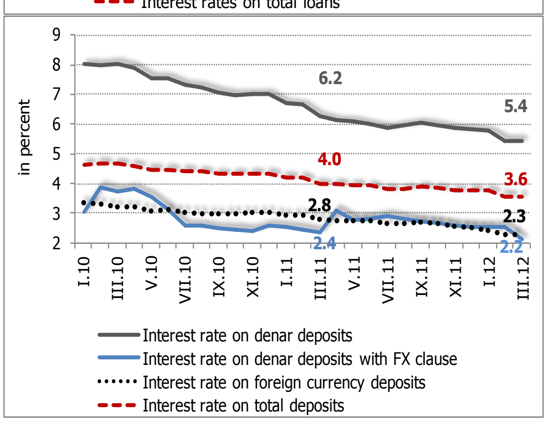
Figure 88 Pre-impairment and pre-taxation gain, gain after the impairment and before taxation



Source: National Bank, based on data submitted by banks.

Figure 89 Movement of the lending (above) and deposit (below) interest rates





Source: National Bank, based on data submitted by banks.

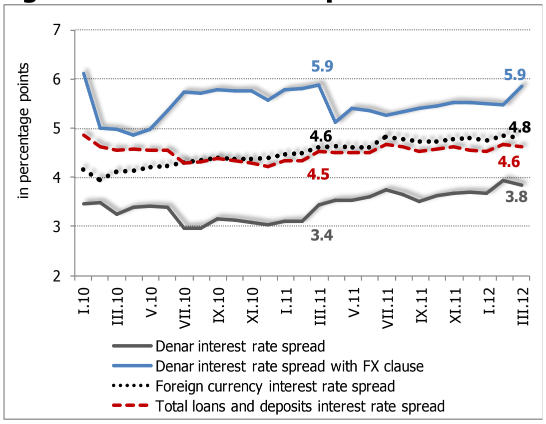
The impairment is the main factor for the banks negative financial results. At the level of the entire banking system, the impairment registered substantial rise of Denar 592.2 million, (54.8%), compared to March 2011, which is due to the deterioration of the banks' credit portfolio. If we analyze the amount of the gain before allocation of the impairment, then a positive financial result of Denar 1,446.7 million is registered, which is higher by Denar 442.8 million, i.e. 44.2% compared to the preceding year.

6.2. Movement of the interest rates and the interest rate spread of the banking system

The trend of gradual decrease in the lending and the deposit interest rates continued also in the first quarter of 2012. The most evident decrease in the lending interest rates compared to March 2011 was registered with the interest rates on Denar and FX credits of 0.4 percentage points and 0.3 percentage points, respectively. More intensive decrease was registered with the deposit interest rates, primarily with the Denar and the foreign currency deposits of 0.8 percentage points and 0.5 percentage points, respectively.

More intensive decrease in the deposit compared to the lending interest rates resulted in larger interest rate spreads between the interests on credits and deposits in Denars and in foreign exchange of 0.4 percentage points and 0.2 percentage points, respectively. Such movements of the interest rates and consequently, the interest rate spreads, cause approximation to the interest rate spreads in Denars, foreign exchange and in Denars with FX clause.

Figure 90 Interest rate spread



Source: National Bank, based on data submitted by banks.

6.3. Indicators for the profitability and the efficiency of the banks

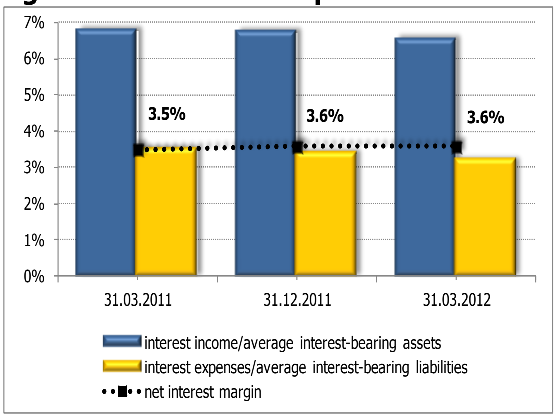
The realized negative financial result of the banks in the first three months of the year contributed towards **deterioration of the basic indicators for the banks' profitability, although the operational efficiency of the banking system increased.**

Table 9 Indicators for the profitability and the efficiency in the operations of the banking system

Indicators	Banking system	
	31.03.2011	31.03.2012
Rate of return of average assets (ROAA)	-0.1%	-0.3%
Rate of return of average equity (ROAE)	-1.0%	-2.5%
Cost-to-income ratio	72.1%	64.1%
Non-interest expenses/Total regular income	78.5%	70.6%
Labour costs /Total regular income	27.0%	24.4%
Labour costs /Operating expenses	37.5%	38.1%
Impairment losses of financial and non-financial assets /Net interest income	44.4%	62.0%
Net interest income /Average assets	3.2%	3.2%
Net interest income /Total regular income	67.5%	67.0%
Net interest income /Non-interest expenses	86.0%	94.9%
Non-interest income/Total regular income	38.7%	33.0%
Financial result/Total regular income	-2.2%	-5.7%

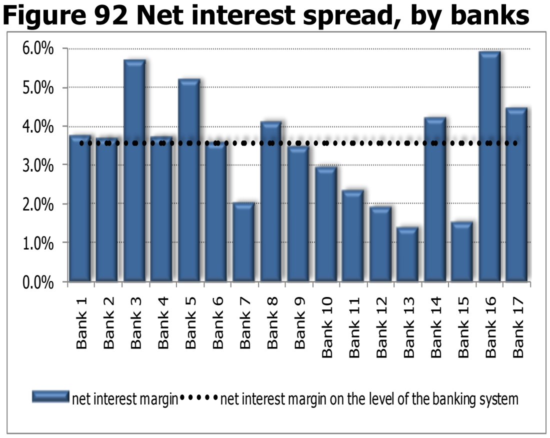
Source: National Bank, based on data submitted by banks.

Figure 91 Net interest spread



Source: National Bank, based on data submitted by banks.

Figure 92 Net interest spread, by banks



Source: National Bank, based on data submitted by banks.

In the first quarter of 2012, the negative values of the **rate of return on assets (ROAA) and rate of return on equity (ROAE)** deepened**.** Deterioration can also be evidenced with the profit margin[30] of the banking sector.

62% of the net interest income are spent on covering the banks impairment, compared to the preceding year, when this ratio equaled 44.4%. With other financial indicators, such as the operational efficiency, there is an improvement, except to the group of small banks (Annex 1). Namely, in the first quarter of the year, moderate decrease in the part of the total regular income was registered, which is used for operational costs coverage. Similar conclusion can be derived from the other indicators for the correlation between the individual types of expenses and the total regular income, which registered an improvement compared to the same period of the preceding year.

The net interest spread[31] remained unchanged compared to the end of the previous year, as a result of almost equal rise in the net interest income and the average interest bearing assets[32].

Eight out of the total 17 banks registered lower net interest spread than the net interest spread realized at the level of the banking system.

[30] The profit margin is a ratio of the gain (loss) of the operations and the total regular income.
[31] The net interest margin is calculated as a ratio between the net interest income and the average interest bearing assets. For comparison purposes, the interest expenditures between the net interest income and expenditures for the first quarter are reduced on annual basis.
[32] The average interest bearing assets is calculated as arithmetical mean of the amounts of the interest bearing assets at the end of the respective quarter of the current year and at the end of the preceding year.

ANNEX