National Bank of the Republic of Macedonia

Report on the Banking Supervision and the Banking System of the Republic of Macedonia in 2003

Skopje, 2004

CONTENTS **page**

I. BANKING SUPERVISION IN 2003

1.1. Improvement of the regulatory framework

In 2003, important amendments to the legal framework which regulates the banking system operations and the conduct of the banking supervision by the National Bank, as an authorised supervisory body for licensing and conducting supervision of the operations of the banks and the savings houses in the Republic of Macedonia were made. The activities of the National Bank in this domain were primarily related to the implementation of the FSAP[1] recommendations, as well as the further compliance with the Basle standards and principles for effective banking supervision and the implementation of the European directives in the banking area. As a result, more relevant improvements were made in the following segments:

- Regulation of the cooperation of the National Bank of the Republic of Macedonia with the domestic supervisory bodies;

- Improvement of the regulation for licensing of the banks;

- Improvement of the methodology for defining the banks' capital;

- Establishment of a basis for conducting consolidated supervision;

- Liquidity risk management;

- Establishment of information security standards;

- Supervisory standards for regulating the past due claims of the banks;

- Regulation for the prudential credit exposure limits of the banks;

- Foreign exchange lending to residents.

1.1.1 Regulation of the cooperation of the National Bank of the Republic of Macedonia with the domestic supervisory bodies

The existing Law on the National Bank of the Republic of Macedonia called for a possibility for cooperation of the National Bank with the supervisory bodies of other countries regarding the supervision of the internationally active banks, but not with the domestic supervisory bodies. The amendments to the **Law on the National Bank of the Republic of Macedonia** made in July 2003, provided a legal ground for cooperation and exchange of information of the National Bank also with the domestic supervisory bodies. Consequently, all legal impediments were eliminated and an environment was created for achieving full compliance with the Principle 1 (6) of the Basle Principles for Effective Banking Supervision.

In the second half of 2003, the procedure for signing a Memorandum of Understanding with the Securities and Exchange Commission, as a body competent for conducting supervision of all participants in the operations with long-term securities began, on the basis of the current legal ground. Such agreements are expected to be signed with the Agency for Supervision of Insurance Companies and the Agency for Supervision of Fully Funded Pension Insurance.

[1] The Financial Sector Assessment Program (FSAP) was performed in the Republic of Macedonia by the joint IMF and World Bank Mission in the May-June 2003 period. Basic objective of this program, performed in many countries worldwide, is the assessment and the identification of the weaknesses and the developing perspectives and potentials of the financial system of the country.

The practice for signing Memorandums of Understanding with the supervisory bodies of other countries continued in 2003. Thus besides the already concluded Memorandums of Understanding with the Bank of Slovenia and the Central Bank of the Russian Federation, in October 2003, a Memorandum of Understanding was also concluded with the Bulgarian National Bank.

1.1.2. Improvement of the regulation for licensing of banks

The need of strengthening the legal solutions which regulate Mission and the necessity for further compliance of the Macedonian banking regulation and practices with the international supervisory standards and the European directives, and from the problems that occurred in the actual application of the provisions of the Banking Law from the year 2000. Thus, the following relevant amendments to the Banking Law made in July 2003 could be mentioned:

- In order to hinder any entity with suspicious background to become a shareholder of the banks, the limit of change in the voting shares for which a prior approval of the National Bank is needed was reduced (from 10% to 5%). As for structural changes in the voting shares in the bank from 1% to 5%, the National Bank examines only the source of funds the shares in the bank are purchased with;

- Full functioning of the mechanism of prior approval of the National Bank was ensured. The brokerage companies and the Macedonian Stock Exchange are not allowed to execute a transaction of purchasing voting shares in the bank for which a prior approval of the National Bank is required, but yet not granted. Such legal regulations provide larger cooperation and coordination among the institutions directly involved in the trade in shares of the banks and their control. Also, the regulations anticipate a felony in the case of acquisition of voting shares, without obtaining a prior approval issued by the National Bank;

- The criteria for assessing the eligibility (fit and proper) of the potential shareholder are more stringent. Therefore criteria according to which the National Bank may reject a request for prior approval for acquiring voting shares in the banks are established, with the following being more relevant: incorrectness or falseness of the submitted data, the financial and the economic standing of the person does not match the value of shares they intend to purchase, the method of their operations, i.e. the nature of the activities of such person – potential shareholder, indicates a high risk tendency, justifiable reason for suspicion in the legitimacy of the funds origin, the integrity or the real identity of the person, involvement of the bank in a group which does not enable adequate supervision, etc.

  The amendments to the licensing procedure stipulated in the Banking Law were also implemented through adequate amendments to the current by-laws in the licensing area: **the Decision on the documentation necessary for granting approvals and submitting notifications in accordance with Article 26 paragraph 4 of the Banking Law** and **the Decision on the documentation necessary for granting licenses according to the provisions of the Banking Law, the Law on Securities and the Law on Microfinancing Banks**, made in September 2003;

- Also, an obligation for the banks was stipulated for aquiring prior approval of the National Bank, in the acquisition of a capital part in another financial and non-financial institution, which exceeds 10% of the bank's guarantee capital. Such provision is aimed towards achieving full compliance with Principle 5 of the Basle principles for effective banking supervision;

- The provisions pertaining to the felony in the case of unauthorised exploitation of the word bank and/or unauthorised collection of deposits, i.e. performing banking activities without a license being granted by the National Bank were enhanced, which ensures larger compliance with Principle 2 of the Basle Principles for Effective Banking Supervision.

1.1.3. Improvement of the methodology for defining the banks' capital

The recommendation of the FSAP regarding precise definition of the banks' capital was met with the amendments to the Banking Law, thus providing a link with the methodology for determining the guarantee capital. This recommendation was implemented through the **Decision on the methodology for determining the banks' capital,** which closely defines the basic components of the capital and the requirements they need to meet in order to be included in the calculation of the banks' capital. The acceptance of this FSAP recommendation creates an environment for achieving larger compliance with Principle 6 of the Basle Principles for Effective Banking Supervision.

1.1.4. Establishment of a bases for conducting consolidated supervision

The consolidated supervision becomes more important given the presence of internationally active banks, which perform their functions on several international financial markets, as well as given the extension of the list of financial activities the banks perform through their subsidiaries. The trend of establishing banking groups imposed the need for regulating this aspect of the banks' operations and creating ground for successful performance of the supervisory function at the level of the whole group.

Therefore amendments to the Banking Law were made which allow conduct of consolidated supervision and which require the National Bank to establish the methodology for its conduct. Taking into account such provisions, the **Decision on consolidated supervision of the banks** was adopted at the end of 2003, which specifies:

- The scope of the consolidated supervision, i.e. the entities that comprise the banking group. A banking group exists when a parent entity (bank or financial holding company) exerts control over one or more financial institutions or exercises participation in these entities;

- The methods of consolidation of the financial reports of the banking group. The consolidated financial reports are prepared in line with the current accounting standards;

- The risk management rules at a level of a banking group. The bank which is a subject to consolidated supervision is responsible for monitoring the risk the banking group is exposed to and complying with the limits specified in the Banking Law and other regulations. It means establishment of an adequate risk management system at the level of the group, where each entity in the group should have adequate systems for generating data and information necessary for risk management on consolidated basis;

- The form and the contents of the reports and other information for the purpose of consolidated supervision and the deadlines for their submission to the National Bank. The bank which is a subject to consolidated supervision is responsible for submitting reports and information on the composition of the banking group, including data on each entity in the group, consolidated financial reports (balance sheet and income statement) and consolidated reports on the risk management in the banking group which are submitted to the National Bank semi-annually.

The guidelines specified in Principles 18 and 20 of the Basle Principles for Effective Banking Supervision, the European directives which regulate the conduct of consolidated supervision, as well as the practice and the experience of several foreign supervisory bodies were taken into account in the preparation of the Decision on consolidated supervision of the banks.

1.1.5. Liquidity risk management

According to the Banking Law, the National Bank is required to prescribe the methodology for identifying, assessing and managing the banks' liquidity risk. Therefore a **Decision on identifying, assessing and managing the banks' liquidity risk** was adopted, which defines the liquidity risk management method, by:

- prescribing an obligation for the banks to prepare and adopt written policy and procedures for liquidity risk management;

- prescribing an obligation for establishing an adequate organizational structure for liquidity risk management which, inter alia, includes definition of the responsibilities of the respective management bodies (Board of Directors, Risk Management Board, executive body), establishment of a special body responsible for liquidity risk management, definition of the scope of operations of each organizational unit in the bank;

- prescribing an obligation for creating adequate IT system which is to generate daily, 10-day period and monthly reports on liquidity risk monitoring and management, identify a stable level of deposits, calculate various liquidity indicators, etc.;

- prescribing an obligation for preparation and application of a Liquidity Risk Management Plan in the event of emergency;

- prescribing an obligation for preparation of a report on the maturity structure of the bank's assets and liabilities and a report of the concentration of the sources of funds. In order to meet this obligation, the National Bank prepared special Instructions, which more closely define the manner of preparation of these reports.

1.1.6. Establishment of information security standards

An integral component of the banking supervision is the supervision of the banks' IT systems. This concept becomes increasingly relevant, from the aspect of the application of the New Capital Accord and the operation risk identification and monitoring, as well as from the aspect of the reputation risk management the bank might be exposed to in the case of insufficient protection of the data which pertain to its customers. Therefore a **Decision on defining the standards for ensuring the banks' information security** which specifies all activities that are to be taken by the banks, and relate to the establishment and the maintenance of the IT system security was adopted. Such activities include establishment and implementation of an Information Security Policy, risk management and control from the aspect of information security, definition of the role of the management bodies, establishment of a reporting system which will, in particular, provide timely risk identification and undertaking adequate measures, appointment of a special person by the executive body of the bank who will be responsible for the operational management of the banks' IT system security, definition of standards which provide continuity in the operations by developing and implementing a special plan which should ensure functioning and minimization of the losses in the case of inaccessibility of the bank's IT system.

Considering the fact that the aforementioned regulation stipulates introduction of new and complex standards, a deadline was fixed for complying with the provisions of this Decision, within which the banks are to undertake all necessary activities for implementation of the stipulated information security standards.

1.1.7. Supervisory standards for regulating the past due claims of the banks'

In the first half of 2003, a new **Decision on the supervisory standards for regulating the banks' past due claims** was adopted. This Decision is a supplement to the other prudential regulations, that govern a variety of aspects such as the accounting aspects of the past due claims, the method of claims restructuring, the procedure for writing-off the claims, etc. Also, the new Decision stipulates, in more details, the procedure for extending the maturity of the due claims, thus making a distinction in the procedure, depending on whether the extension is due to the deteriorated financial standing of the customer, or only to the changes in the operations of the bank and/or the customer.

1.1.8. Regulation for the prudential credit exposure limits of the banks

In the second half of 2003, the Decision on applying Article 35 and Article 36 of the Banking Law was amended, and consequently, the name of the existing Decision changed into **Decision on bank's credit exposure limits**. The amendments to this Decision are directed towards complying with the European directive 2000/12/EC relating to the taking up and pursuit of the business of the credit institutions in the part pertaining to the monitoring and control of the large credit exposures. The major amendment to this Decision pertains to the extension of the list of deductible items that are not included in the basis for calculation of the ceilings on the banks' credit exposures to individual entities specified in the Banking Law. Deductible items, besides the existing ones, are all exposures secured with irrevocable unconditional guarantees issued by international financial institutions and first-class banks. Thus these credit exposures become credit exposures to the entities that issued the irrevocable unconditional guarantees, which are subject to the established prudential credit exposure limits of the banks.

1.1.9. Foreign exchange lending to residents

In accordance with the amendments to the Law on Foreign Exchange Operations made in July 2003, the authorised banks in the Republic of Macedonia are allowed to extend credits in foreign exchange to residents for domestic payments. The National Bank more precisely specified the terms and conditions and the manner in which the residents may conclude credit operations in foreign exchange in the **Decision on the terms and the manner of concluding foreign exchange credit operations between residents.**

This Decision calls for several terms and conditions under which the authorised banks may extend foreign exchange credits to residents. The authorised bank is required to have written procedures in place for assessing the FX and the credit risk of the resident – credit user. Also, the bank may extend credit in foreign exchange only to a customer classified in a risk category A and B, as well as to a customer which holds a first-class security instrument. The decision stipulates various methods and procedures for extending foreign exchange credits for payment of the current external liabilities and for domestic payments, as well as for extending foreign exchange credits to a resident – legal entity and a resident – natural person.

The enforcement of this Decision is more precisely prescribed by special Instructions, which regulate the method of reporting to the National Bank on the concluded foreign exchange credit operations between residents.

1.2. Activities of the banking supervision

The banking supervision of the National Bank of the Republic of Macedonia is performed through:
- Licensing, i.e. issuing founding licenses and operating approvals;
- Supervision, i.e. examination of the operations of the banks and the savings houses; and
- Undertaking corrective measures.

1.2.1. Licensing function

Within the framework of performing the licensing function, the National Bank issues the following types of licenses and approvals:

1. License for founding and operating a bank and a foreign bank subsidiary.

2. License for founding and operating a bank for microfinancing;

3. License for status changes (banks merger, division, transformation of a savings house into a bank and acquisition of a savings house by a bank);

4. License for establishing the Money and Short-term Securities Market;

5. Approval for gradual or at once acquisition of shares the total cumulative nominal amount of which equals 5%, 10%, 20%, 33%, 50% and 75% of the total number of voting shares in a bank or a savings house, regardless whether the shares are acquired by one, or more related persons, directly or indirectly;

6. Approval on change in the Statute of a bank or a savings house;

7. Approval for appointing an executive body of a bank or a savings house;

8. Approval for founding a bank and opening a branch office, subsidiary or representative office abroad.

9. Approval for change in the name, main office or the address of a bank or a savings house;

10. Approval on establishing a brokerage house authorised to operate on its behalf and for its account by a bank or savings house;

11. Approval for capital investment of a bank or a savings house in a financial or non-financial institution in the country or abroad, exceeding 10% of the bank's guarantee capital, except for capital investments of a bank in another bank and for establishing a brokerage house, authorised to operate on its behalf and for its account, for which a prior approval of the National Bank is required, irrespective of the amount of the investment relative to the guarantee capital;

12. Approval for insight in a Examination Report of the operations of a bank or a savings house;

13. Approval for amending the Decision on issuing a license for founding and operating a bank or a savings house;

14. Approval for the bank's Information Security Policy;

15. Approval for opening a representative office of a foreign bank or other foreign financial organization.

Also, the National Bank, within the framework of the licensing process, and in order to maintain and promote the transparency of the shareholder structure and the capital paid in the banks and the savings houses, verifies the sources of funds used for purchasing shares and parts in the banks and the savings houses. Thus for each acquisition of shares or parts constituting from 1% to 5% of the total number of voting shares, the banks and the savings houses shall submit a notification to the National Bank, in accordance with article 26 of the Banking Law.

Tables on the number of issued, or rejected licenses and approvals, as well as withdrawn and dismissed incomplete applications for issuing licenses and approvals, by banks and savings houses in 2002 and 2003 are given below.

Table 1
Types of licenses and approvals issued, rejected, withdrawn or dismissed by the National Bank in 2002 and 2003

Type of license (banks)	2002				2003			
	issued	rejected	withdrawn	dismissed	issued	rejected	Withdrawn	dismissed
Bank for microfinancing					1			
Acquiring 5%, 10%, 20%, 33%, 50% and 75% of voting shares	5+1*				18	6		
Statute	14				9			
Executive body	17		1		25	1	2	
Founding a branch office abroad				1				
Change in a name, main office and address	2				1			
Capital investment					2			
Insight in a report	3				4	1		
Amendment to a Decision on issuing a license to a bank	1					1		
Opening a representative office of a foreign bank or financial organization				1	1			
Total	42+1*		1	2	61	9	2	

*partial compliance

Type of license (savings houses)	2002				2003			
	issued	rejected	withdrawn	dismissed	issued	rejected	Withdrawn	dismissed
Acquiring 5%, 10%, 20%, 33%, 50% and 75% of voting shares or parts					1			
Statute	2				1			
Executive body	3				2			
Capital investment	2							
Insight in a report	1							
Amendment to a Decision on issuing a license to a bank		1						
Total	8	1			4			

The structure of the licenses and the approvals issued by the National Bank in 2003 shows a larger volume of operations compared to 2002. Thus most of the issued licenses and approvals pertain to appointing an executive body and changes in the structure of voting shares in the banks.

Furthermore, in the performance of its licensing function, in 2003, the National Bank gave a positive opinion about the evidence of the source of funds, regarding the 62 submitted notifications, in accordance with Article 26 of the Banking Law; an approval was issued for a new Statute of the Money and Short-term Securities Market, and the founding and the operating licenses of 7 banks were replaced, pursuant to Article 124 of the Banking Law.

1.2.2. On-site and off-site supervision of the operations of the banks and the savings houses

Total of 36 on-site examinations of the operations of the banks and the savings houses in the Republic of Macedonia were conducted in 2003. Full-scope examinations were carried out in 12 banks and 7 savings houses, while 10 banks were subject to 17 targeted examinations of certain segments of their operations. Also, a full-scope examination was carried out of the operations of the Money and Short-term Securities Market AD Skopje.

In 2003, the CAMELS composite rating of the banks[2] registered a trend of improving. Thus in the analysed period, one bank was given the highest composite rating “1”, the number of banks with composite rating “3” increased from 3 to 7, while the number of banks with composite rating “4” reduced from 8 to 4. The above shows the movement in the structure towards ratings which reflect lower risk degree.

Table 2
Structure of the banks and the savings houses in accordance with their composite rating

Composite rating	31.12.2002		31.12.2003		Comparasion 2003/2002	
	banks	saving houses	banks	saving houses	banks	saving houses
1	-	-	1	-	1	-
2	6	5	5	7	(1)	2
3	3	8	7	6	4	(2)
4	8	3	4	2	(4)	(1)
5	2	-	2	1	-	1
No rating	2	1	3	-	1	(1)
Total	21	17	22	16	1	(1)

Composite rating “5” was given to 2 banks, with a receiver being appointed in one of them in 2003, after which, in March 2004, a bankruptcy proceeding was introduced. The other bank which was given a composite rating “5” shows signs of improvement, due to the measures undertaken by the National Bank and the endeavours made by the management of the bank.

The on-site examinations of the banks’ operations proved that the credit risk remains dominant risk in the banks’ operations. Some banks were also facing an unfavourable assets structure due to the high amount of non-interest bearing assets, which is primarily a result of the foreclosed immovables for claims collection, accompanied by difficulties in their selling. Also, certain liquidity problems and deteriorated profitability were identified in some banks,

[2] In accordance with the Instructions for on-site supervision, and on the basis of the findings of the full-scope on-site examinations, the identified risk profile of each bank and savings house is quantified through the respective composite rating under the CAMELS rating system. This system means quantification of the financial reliability and the operations of the financial institution by determining a composite rating which ranges from “1”, which is the highest rating and denotes safe and stable operations and adequate risk management, to “5” which denotes the lowest rating, which is an indicator for a high risk bank with inadequate risk management systems.

or non-compliances with the regulations. The non-compliances with the regulations and the untidy accounting records are often a result of the weaknesses in the corporate management and the internal control and audit systems.

In 2003, the composite rating of the savings houses improved through the increase in the number of savings houses which were given a composite rating “2” and decrease in the number of savings houses with composite rating “3” and “4”. At the beginning of 2004, the operating license of the savings house which was given a composite rating “5” was revoked. In 2003, ten targeted examinations were carried out in all savings houses, in order to determine the adherence to the Decision on determining the volume and the manner of operating of the savings houses from the aspect of displaying updated lists of savings deposits.

Alongside the supervision of the banks and the savings houses, the National Bank conducts inspection of the application of the regulations in the area of foreign exchange and Denar operations. Total of 45 on-site inspections were carried out in 2003, 16 of which covered the overall operations of the banks, 13 inspections covered targeted segments of the operations of the banks, 15 inspections were carried out in savings houses, and 1 control pertains to the licensing of a legal entity for conducting money transfer. Most frequently, the adherence to the regulations setting forth the manner of conducting international payment operations and credit operations, foreign currency operations, inspection of the foreign exchange accounts, etc., were subject to targeted inspections in the banks.

1.1.1.1. Supervision of the banks’ IT system security

In 2003, the National Bank started with the implementation of a new segment of the banking supervision, which includes banks’ IT system security analysis and assessment. Therefore the following relevant activities were carried out in the last year:

- all banks in the Republic of Macedonia were submitted a questionnaire to assess the degree of development and security of the IT system in order to obtain an initial picture of this segment of the banks’ operations.

- a legal framework specifying the information security standards was adopted. This framework includes the basic guidelines and elements of the international standard **ISO/IEC 17799** and the Basle standards for operational risk management;

- a procedure for establishing supervisory procedures for analysing the banks’ IT systems was introduced.

In 2003, on-site examinations of the IT systems of 8 banks were also conducted. The on-site examinations covered the following elements:

- assessment of the confidentiality, integrity and the availability of the bank’s IT system;

- assessment of the Information Security Policy of the banks that established such written policies;

- assessment of the adequacy of the procedures for risk assessment, measurement and control with respect to the information technology;

- assessment of the role of the bank’s management from the aspect of providing a support for the implementation of the security policies and procedures.

The following was concluded, on the basis of the examinations:

- the degree of technical security and protection of the banks' computer systems is primarily at a satisfactory level. Most of the banks are in the stage of implementation of sophisticated solutions for detection and prevention of unauthorized activities by the users;

- the responsibility for the banks' IT systems security is primarily housed in the organizational part of the information technology, and it is of a secondary relevance. The accent is placed on the ability of the IT systems to operate, rather than on their security. There is no person, or organizational part in the bank responsible for ensuring of IT systems security;

- the banks are in a stage of redesigning of their software solutions, introducing new services for their customers, by the exploitation of the contemporary communication channels (Internet, cell phones). The process of introduction of new systems mainly lacks high-quality analysis and efficient organization, as well as larger involvement of the banks' management bodies with respect to risk management related thereto;

- the achievement of necessary level of segregation of duties among the employees and adequate staffing and their training is a major challenge for the banks' management bodies with respect to operational risk identification, measurement and control;

- there is no adequate documentation of the banks' IT systems, which is an additional obligation for both the software manufacturer, and the banks' teams of programmers. The process of developing, testing and verifying the quality of the banks' programs is not satisfactory;

- the internal audit of the IT systems security in most of the banks is unsuitable, and needs to be improved, particularly by employing experts and experienced staff, preparing annual IT systems audit plans, adopting written operating procedures of the Internal Audit Department, etc.

In the following period, the main challenge the banks in the Republic of Macedonia are going to face with, will be the fulfilment of the information security standards, specified by the new legal framework adopted by the National Bank. Therefore the banks are required to appoint a person responsible for the IT systems security by the end of 2004. The above will create an operational responsibility for the IT systems security management. Also, the process of adopting information security policies and a plan for continuity in the banks' operations, as well as the establishment of proper procedures for the identification, measurement, monitoring and control of the operational risk which arises from the banks' information technology should be completed by the end of 2005.

1.2.3. Corrective measures undertaken against the banks and the savings houses

In order to preserve the stability and the security of any banking institution and the overall banking system, the National Bank undertakes corrective actions against the institutions that showed irregularities in their operations. In 2003, the National Bank passed 23 decisions with corrective measures against 12 banks and 2 savings houses, filed 11 requests for initiating a misdemeanour procedure against 5 banks and 1 savings house and pressed 1 criminal charge against a shareholder of a bank and persons affiliated thereto.

In early 2004, the founding license of Export-Import Banka a.d. Skopje was revoked, and it was ascertained that the conditions for opening a bankruptcy procedures were met.

The measures, and the number of banks and savings houses they were undertaken against are given below:

- a receiver was appointed in 1 bank;

- a measure for ban on extending credits, except to customers classified in a risk category A, upon prior verification of the orders by authorised persons of the National Bank was undertaken against 1 bank;

- a measure for further capitalisation was undertaken against 2 banks;

- a measure for reclassification of the claims on customers in accordance with the classifications determined by the examination report was undertaken against 3 banks and 1 savings house;

- a measure for ban on lending to customers classified in C, D and E risk categories was undertaken against 3 banks;

- a measure for ban on increasing the capital investments in other legal entities, establishing parts of a bank or otherwise expanding the network was undertaken against 1 bank;

- a measure for ban on payment of dividend from the net profit was undertaken against 1 bank;

- a measure for ban on prolonging the maturity of the already extended credits was undertaken against 1 bank;

- a measure for ban on extending new uncovered off-balance sheet exposures and placing deposits with domestic an foreign banks which constitute a coverage of credit exposures to third parties was undertaken against 2 banks;

- a measure for ban on extending credits and making other placements, other than placements in securities and sale of deposits to the National Bank was undertaken against 2 banks;

- a measure for adjustment to the ceiling on the amount of preference shares (Article 10 paragraph 1 of the Banking Law) was undertaken against 1 bank;

- a measure for adjustment to the limit for credit exposure to a single entity (Article 35 paragraph 1 of the Banking Law) was undertaken against 3 banks;

- a measure for adjustment to the credit exposure limit to an executive body, members of the Board of Directors and other bodies of the bank and to persons with special rights and responsibilities (Article 35 paragraph 3 of the Banking Law) was undertaken against 1 bank;

- a measure for adherence to the credit exposure limit to the members of the Board of Directors of the bank and the shareholders of the bank who own above 5% of the total number of voting shares, under equal conditions that apply to the other customers of the bank (Article 35, paragraph 6) was undertaken against 1 bank;

- a measure for repaying the credits extended for purchasing shares in the same bank (contrary to Article 38 paragraph 1 of the Banking Law) was undertaken against 1 bank;

- a measure for adjustment to the ceiling on the amount of the property and the capital investments pursuant to Article 39 paragraphs 1 and 2 of the Banking Law was undertaken against 3 banks;

- a measure for restricting the wages of the management and the remuneration of the members of the Board of Directors was undertaken against 1 bank;

- a measure for restricting the representation and advertisement costs was undertaken against 2 banks;

- a measure for exercising a permanent control of the enforcement of the measures imposed by the National Bank was undertaken against 2 banks;

- a measure for verification of orders by authorized employees of the National Bank was undertaken against 1 savings house;

- other measures undertaken by the National Bank are: a ban on extending new credits for repayment of old credits (1 bank), compliance with the Decision on defining and the method of determining related persons and the Decision on applying Article 35 and Article 36 of the Banking Law (2 banks), compliance with the Decision on determining and calculating open foreign exchange positions of the banks (2 banks), compliance with the Decision on determining the methodology for classification of the balance sheet and off-balance sheet asset items of the banks according to their risk degree (3 banks), compliance with the Decision on the supervisory standards for regulating the past due claims of the banks and savings houses (1 bank and 1 savings house), adjustment to the limit of the aggregate amount of capital investments in other banks, financial and non-financial institutions (1 bank), organization of the Internal Audit Department (2 banks and 1 savings house), submission of a Plan for elimination of the identified irregularities (2 banks and 2 savings houses), preparation of policies and establishment of proper practices (1 bank and 2 savings houses), preparation of anti-money laundering procedures (1 bank and 1 savings house), intensification of the procedures for collection of the due claims (4 banks), submission of a request for appointing an executive body (1 savings house), recording of the shares in the Central Depositary (1 bank), sale of the purchased own shares (1 bank), assessment of the value of the real estate given as a collateral (1 bank), submission of minutes and decisions adopted at the meetings of the Risk Management Board (1 bank), publication of the annual account statement audited by an authorized auditor (1 bank), etc.

1.3. Financial Sector Assessment Program - FSAP

In the May-June 2003 period, the joint IMF and World Bank Mission performed the so-called Financial Sector Assessment Program in the Republic of Macedonia, the main objective of which was to analyse and assess the stability, efficiency and the degree of development of the financial system of the country, as well as to identify the main problems and weaknesses in its operations. Thus an analysis was made for each segment of the financial system (banking system, insurance companies sector, capital market, pension funds), the transparency of the monetary and the financial policies, the principles underlying the anti-money laundering process and the fight against the financing of the terrorism, as well as the Basic principles for systemically important payment systems.

This report provides a summary of the conclusions and the recommendations regarding the stability of the banking system and the compliance of the banking supervision with the Core Basle Principles for Effective Banking Supervision.

General opinion of this Mission is that the banking system, i.e. the financial system as a whole, is still relatively small, with a restricted role of an intermediator in the financial developments. As a result of the permanent improvement of the regulations and the enhanced capacity of the banking supervision, the stability and the security of the banking system has been increasing over the last few years, with a group of banks characterized with relatively prudent and sound operating practices being clearly distinguished. The investments of foreign strategic investors in some banks stimulate this process even more.

The analysis of the banking system of the Republic of Macedonian made by the IMF and the World Bank team includes a stress test which was carried out on the basis of a combination of the macro risks and the identified weaknesses of the banking system. The stress test simulates large hypothetical shocks in order to examine the sensitivity of the banking system. The results of the stress test analysis indicate that the banking system is relatively stable and resilient to individual risks (credit risk, exchange rate risk, interest rate risk). Although the combination of the effects of these risks might cause certain losses with the banks, the high capitalization level of banks gives relatively sound basis for covering the potential losses, even though the stress test analysis is based on simulation of large hypothetical shocks. This conclusion is proved with the real events the banking system of the Republic of Macedonia faced with over the past years (the Kosovo crisis in 1999, the stability crisis in the Republic of Macedonia in 2001), when in spite of the large shocks, there was no systemic banking crisis.

An assessment of the compliance of the National Bank of the Republic of Macedonia with the Basle Principles for Effective Banking Supervision was made within the framework of the Financial Sector Assessment Program. General position of the FSAP team is that a considerable progress in the strengthening of the supervisory and the legal framework for the banking institutions was made with the adoption of the 2000 Banking Law and the amendments to the regulatory framework made afterwards. The conducted analysis and assessment showed that the banking supervision in the Republic of Macedonia is fully compliant with 6 principles, largely compliant with 17 principles, materially non- compliant with 3 principles, and 3 principles are not applicable, whereas the banking supervision in the Republic of Macedonia is non- compliant with one Basle principle.

The basic recommendations of the Mission could be summarized through the following:

- strengthening of the criteria for assessment of the fit and proper shareholders and the members of the banks' management bodies;
- establishment of standards for reporting and granting of an approval by the National Bank for the investments of the banks in other entities;
- establishment of bases for regulating the market risks;
- establishment of a regulation for consolidated banking supervision;
- enhancement of the range of corrective measures the Banking Supervision Department undertakes against the banks that face problems in their operation;
- strengthening of the role of the banking supervision in the anti-money laundering process and the fight against the financing of the terrorism;
- improvement of the transparency of the banks' operations through the implementation of the internationally accepted financial reporting standards; and

- improvement of the banking supervision methods by a gradual switch from a supervision based on the assessment of the formal compliance of the banks with the regulations, towards risk-based supervision.

Basle Principles for Effective Banking Supervision

1. **Objectives, autonomy, authorizations and resources of the banking supervision (Basle Principle 1).** It is considered that the legal framework clearly defines the objectives of the banking supervision and the functions and authorizations of the National Bank of the Republic of Macedonia. Even though full compliance with this principle was ascertained, the Mission recommends further strengthening of the application of the corrective measures against the banks that face problems, as well as further improvement of the operating procedures of the banking supervision. Therefore the banking supervision is advised to switch gradually from a supervision based on the assessment of the formal compliance of the banks with the regulations towards risk-based supervision.

2. **Licensing and ownership structure of the banks (Basle Principles 2 – 5).** The legal framework that regulates the licensing of the banks and the changes in the shareholder structures is permanently improving, with considerable changes being made also in 2003 after the implementation of the Financial Sector Assessment Program. These changes pertain to the strengthening of the provisions of the Banking Law regarding the unauthorized exploitation of the word "bank" which is sanctioned as a felony; new criteria for the fit and proper assessment of a shareholder were established; the limit for which a prior approval of the National Bank of the Republic of Macedonia is required for acquiring voting shares by an individual shareholder was reduced to 5%, etc. Also, the National Bank of the Republic of Macedonia amended the regulations pertaining to the banks' investments in financial and non-financial institutions, where for the investments exceeding 10% of the bank's guarantee capital, a prior approval of the National Bank of the Republic of Macedonia is required. All these amendments to the regulatory framework led to a large compliance with these principles.

3. **Prudential regulations (Basle Principles 6 – 15).** The assessments of the FSAP team show that the basic prudential standards are adequately defined and regulated by the Banking Law and its by-laws. The regulation related to the establishment of systems for market risks monitoring, control and measurement, as well as evaluation and booking of the assets and liabilities from the aspect of the market instruments is in its initial stage. Thus it was concluded that although the market risks are not relevant part of the group of risks the banks are facing with, the FSAP team advises the National Bank of the Republic of Macedonia to start with the establishment of the fundaments of the regulation for the required amount of capital for covering the market risk, which is in line with the requirements of the Basle Capital Accord. The Mission recognized a non-compliance with the Basle Principle 15 which pertains to the anti-money laundering. Although the National Bank of the Republic of Macedonia made initial steps towards the implementation of the Anti-Money Laundering Law through the preparation of supervisory procedures for anti-money laundering, yet, a variety of practical problems were recognized since the role of the National Bank of the Republic of Macedonia is not clearly defined in the Anti-Money Laundering Law.

4. **Banking supervision methods (Basle Principles 16 – 20).** The FSAP ascertained that the National Bank of the Republic of Macedonia has an effective system in place for on-site and off-site supervision of the banking system. They strongly recommend the NBRM to continue with its approach towards risk-oriented on-site and off-site

banking supervision.

5. **Accounting standards and presentation of the financial statements (Basle Principle 21).** No special accounting standards that apply only to the banks are in place in the Republic of Macedonia. According to the conclusions of the FSAP, the assets evaluation is focused on the credit portfolio. However, the Mission perceived the need of establishing detailed and standardised accounting rules for evaluation and measurement of complex financial assets in the future.

6. **Formal authorizations for undertaking corrective measures (Basle Principle 22).** The banking supervision has a variety of corrective actions defined by the Banking Law and the Law on the National Bank of the Republic of Macedonia, which the National Bank of the Republic of Macedonia undertakes in the case of identified non-compliances and irregularities in the banks' operations. The Mission recommends enhancing of the range of corrective measures of the NBRM, more clear definition of the receivership procedure; further staffing of the Unit for Banks Under Enhanced Monitoring, etc.

7. **International cooperation with the supervisory authorities of other countries (Basle Principles 23 – 25).** The regulations allow the banking supervision to be conducted on a consolidated basis. The National Bank, as an authorized supervisory body, is allowed, by the law, to cooperate and exchange information with the supervisory authorities of the countries in which, the Macedonian banks would possibly open branches or subsidiaries. However, these principles are not applicable in the Republic of Macedonia because there is no internationally active Macedonian bank. The contacts with the supervisory bodies of the countries which have banks that established their subsidiaries in the Republic of Macedonia are regulated by signing Memorandums of Understanding.

II. BANKING SYSTEM IN 2003

2.1. Structure of the banking system

2.1.1. Number of banks and savings houses

At the end of 2003, the banking system of the Republic of Macedonia consisted of 21 banks[3] and 15 savings houses. In comparison with December 31, 2002 the number of banks remained unchanged, contrary to the decrease in the number of savings houses.

Such a movement is a result of the establishment of the bank for microfinancing, Pro Business Bank a.d. Skopje (which was later re-named into Pro Credit Bank), which was licensed for founding and conducting operations in July 2003, as well as of the revoked license for conducting operations of two savings houses, Mit Stedilnica DOO Kumanovo and Dikuko DOO Skopje in May and July 2003.

On December 31, 2003, 18 out of the total number of banks were licensed for performing the financial activities specified in Article 45 and Article 46 of the Banking Law, while the remaining 3 banks were licensed for performing financial activities in the country.

In order to make more adequate analysis of their performances, the banks in the Republic of Macedonia can be categorized in three groups according to the criterion for the size of the total assets:

- large banks (the assets of which exceed Denar 15 billion);
- medium-size banks (the assets of which range from Denar 2 to 15 billion), and
- small-size banks (the assets of which are up to Denar 2 billion).

According to this criterion, as of December 31, 2003, the group of large banks consists of two banks, the group of medium-size banks consists of six banks, while 13 banks have total assets lower than Denar 2 billion thus comprising the group of small-size banks.

Observed from the aspect of the financial potential, the most significant is the group of large banks, comprising more than a half of the total banking potential, or 55.5%, while the largest group from the aspect of the number of banks is the group of small-size banks, which consists of 13 banks. At the end of December 2003, the structural features of the banking system of the Republic of Macedonia by groups of banks basically remained unchanged compared to December 2002.

The banks are still dominant in creating the banking system of the Republic of Macedonia, despite the slight increase in the share of the savings houses in the total financial potential. Thus, as of December 31, 2003, the savings houses held 1.2% of the total assets at the level of the banking system, which is an increase of 0.2 percentage points compared to December 31, 2002. From the aspect of collection of households' savings deposits of, as one of the main functions of the savings houses, their structural share at the level of the banking system

[3] On November 12, 2002, Export-Import Banka a.d. Skopje was put under a prerehabilitation procedure by appointing a trustee. Within the efforts for rehabilitating the bank, on January 08, 2003, the prerehabilitation procedure was replaced with receivership, due to which the Bank was excluded from the regular banking system of the Republic of Macedonia. In order to get real indicators for the structure, the activities and the performances of the banking system of the Republic of Macedonia, Export Import Banka a.d. Skopje is exempted from the further analysis in this Report. On January 09, 2004, the NBRM revoked the license for founding and operating the Bank

equaled 0.7%, i.e. 2.2% if only the Denar savings deposits are taken into account, with no changes being registered in comparison with the end of the previous year.

The unchanged percentage share regarding the attracted savings deposits of the households in the total savings deposits of the banking system is a result of the structural dominance of the commercial banks in all segments of the banking sector, including the attracting of the excess of the households' unmobilized funds.

2.1.2. Concentrations and market share

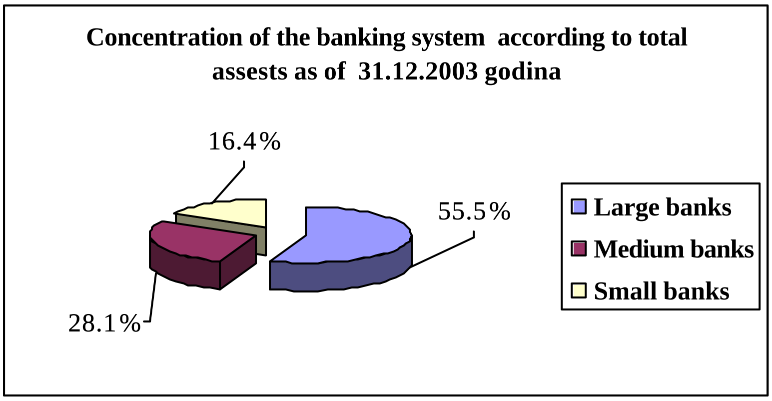
2.1.2.1. Concentration of the banking sector

At the end of 2003, the analysis of the concentration of the banking system of the Republic of Macedonia is made according to three criteria:

a) Total assets, i.e. total financial potential;
b) Bank's capital;
c) Total banking activities.

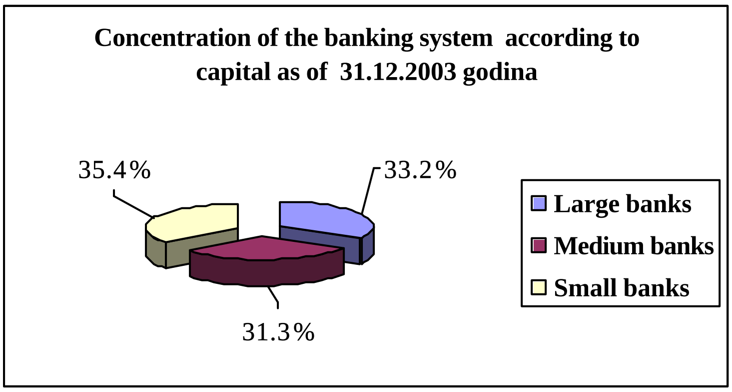
The concentration of the banking sector according to the criterion "total assets" is in favor of the group of large banks. Thus as of December 31, 2003, the net assets of this group of banks amount to 55.5% of the total net assets at the level of the banking system, contrary to the net assets of the remaining two groups, the share of which in the total net assets being equal to 44.5%. Out of these, 28.1% refer to the group of medium-size banks and 16.4% to the group of small-size banks. Compared to the same period of the previous year, no changes in the ranging of the concentration by groups of banks were registered. More significant fluctuations in the concentration, according to the assets were registered in individual group of banks, i.e. the group of medium-size banks, registered reverse trend in the concentration of the assets compared to the trend of the concentration of the assets in the small-size and large banks. Thus, the net assets of the group of medium-size banks is smaller by 2.9 percentage points on annual level, whereas the net assets of the small-size and large banks is larger by 1.5 and 1.4 percentage points, respectively during the same analyzed period. The reduced concentration on the basis of the total assets with the group of medium-size banks, is a result of the foundation of a new bank in 2003, included in the group of small-size banks, as well as to the transfer of one bank from the group of medium-size to the group of small-size banks.

Chart 1
Concentration of the individual groups of banks according to the total assets



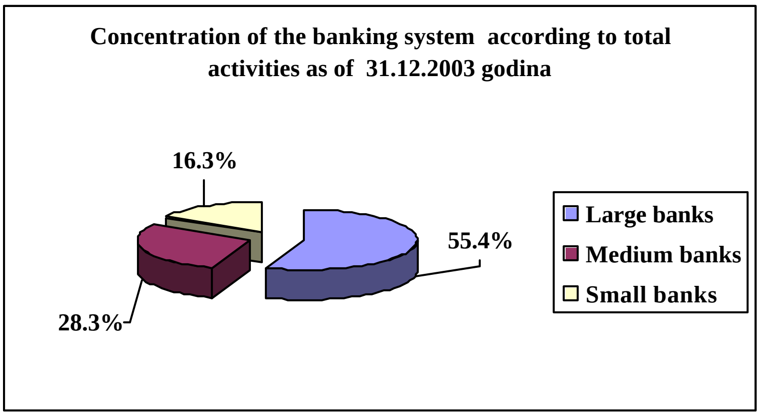
According to the second criterion, the capital strength of the banks, the concentration of the banking system by groups of banks ranges between 31.3% - 35.4%. Contrary to the total assets criterion, where the share of the group of large banks is dominant, in case of the total capital criterion, the largest share accounts for the group of small-size banks the share of which in the total capital at the level of the banking system equals 35.4%. The criterion capital strength indicates almost equal concentration by individual groups of banks. Compared to the same period of the previous year, no changes of higher significance in the concentration of the capital in the three main groups were registered.

Chart 2
Concentration of the individual groups of banks according to the equity



At the end of 2003, the total banking activities were concentrated in the group of large banks, with the share of 55.4%, which is by 2.6 percentage points more in comparison with December 31, 2002, while the increase in the concentration with the group of small-size banks equaled 2.4 percentage points, and it amounted to 16.3% as of December 31, 2003. Contrary to these groups, the group of medium-size banks registered reduced concentration by 5 percentage points, which is due to the reduced off-balance sheet activity and to the transfer of one bank to the group of small-size banks, and it equaled 28.3% as of December 31, 2003.

Chart 3
Concentration of the individual groups of banks according to the total activities



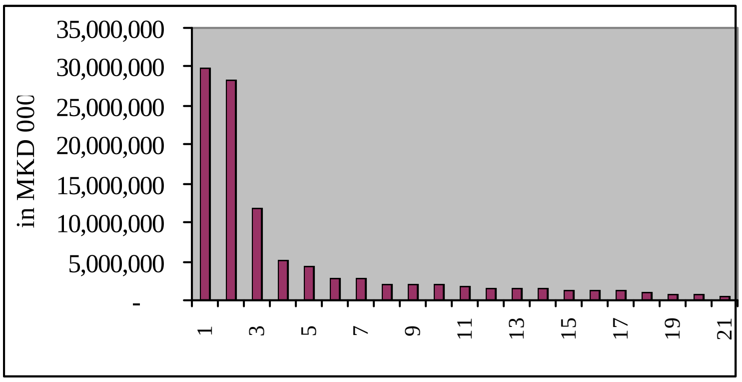
At the end of 2003, the concentration of the assets of the banks in the Republic of Macedonia expressed through the Herfindahl Index[4], points to a significant concentration[5], which analyzed on annual basis registers a trend of increase. Thus, as of December 31, 2003, the concentration at the level of all banks in the Republic of Macedonia amounts to 1,842 units, which is by 175 units more compared to December 31, 2002. The value of the Herfindahl

[4] X=i (assets of individual bank/total assets of all banks *100)²
[5] According to the Herfindahl if the Index ranges between 1,000 and 1,800 units, the concentration of the assets is considered acceptable, while it is considered significant if it exceeds 1800 units

Index for the group of large banks equals 1,618 units, which is by 153 units more compared to the end of the previous year.

2.1.2.2. Distribution of assets and capital by banks

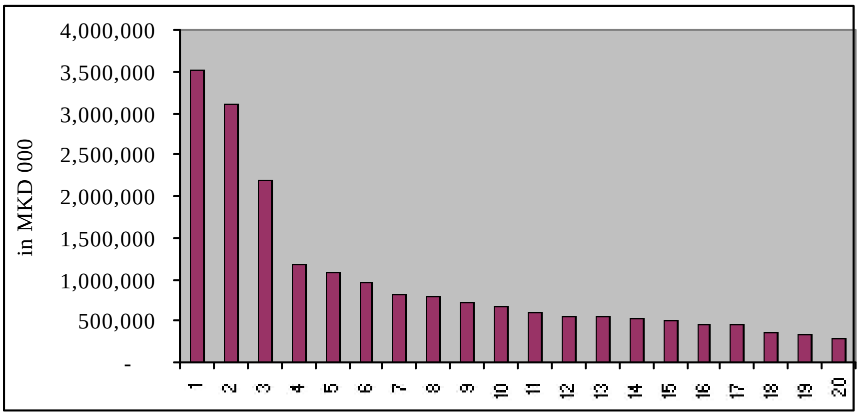
Chart 4
Distribution of assets by banks



- The distribution of assets by banks as of December 12, 2003, points to a large gap between the assets of the largest and the smallest bank, i.e. the assets of the largest bank are by 53 times larger than the assets of the smallest bank, while as of December 31, 2002 this correlation equaled 47 times.

- The distribution of capital by banks on annual basis (2002, 2003) remained unchanged. Namely, the capital of the largest bank is by 13 times larger than the capital of the smallest bank.

Chart 5
Distribution of capital by banks



The comparative analysis between the distribution of assets by banks and distribution of capital by banks indicates larger disparity in the asset value of the largest and the smallest bank, contrary to the distribution of the capital. This is due to the relatively developed deposit base with the larger banks, which is used for financing of most of their activities.

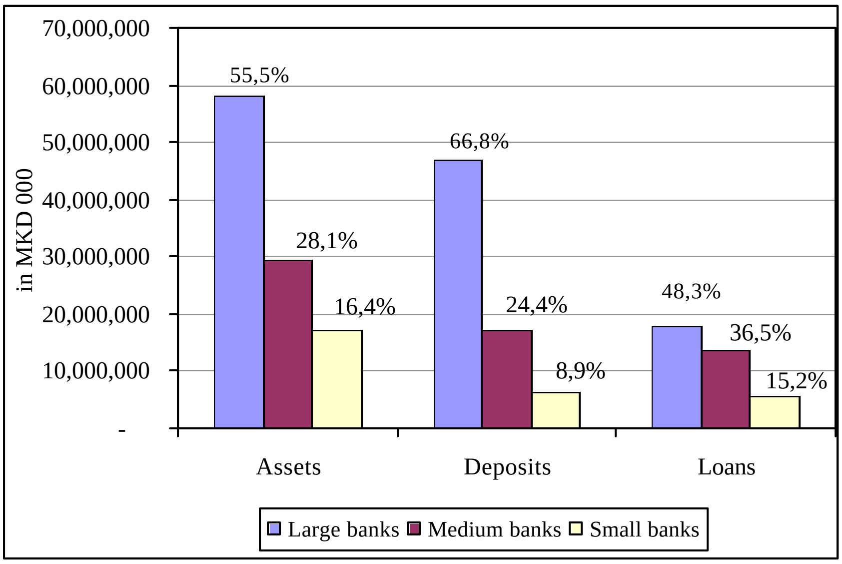
2.1.2.3. Market share of the banks

The dominance of the group of large banks in all areas of banking operations is also present in the segment of market share according to the total assets, which equals 55.5%.

If the credit activity of the banks[6] is taken into consideration, the share of the group of large banks in the total credit activity of all banks as of December 31, 2003 equals 48.3%, which is by 1.5 percentage points more compared to the end of 2002, when this share equaled 46.9%. The trend of increase in the credit activity is present also in the group of small-size banks the market share of which in accordance with the extended credits increased by 4 percentage points and equaled 15.2% as of December 31, 2003. The reduced volume of credit activity of the group of medium-size banks by 5.5 percentage points on annual basis is basically due to the transfer of one bank to the group of small-size banks and to the inclusion of the newly established bank into the same group. At the end of 2003, the market share of the group of medium-size banks equaled 36.5%.

The attracting of deposits[7] is mostly evident in the group of large banks. Namely, as of December 31, 2003, the market share of the group of large banks observed from the aspect of the deposit activity of banks, equaled 66.8%, i.e. 66.4% in the same period of the previous year. The remaining two groups of banks covered this segment with 33.2%, 24.4% of which belonged to the group of medium-size banks, while the remaining 8.8% were in the group of small-size banks, with no changes in the share compared to December 31, 2002 being registered. This is due to the increase in the deposit base in 2003, which is more apparent in the group of large banks. Namely, the deposit base with both largest banks increased by 22% at the end of 2002, while the total deposit base with the groups of the medium-size and small-size banks increased by 19.7%.

Chart 6
Market share of individual groups according to the total assets, deposits and credits

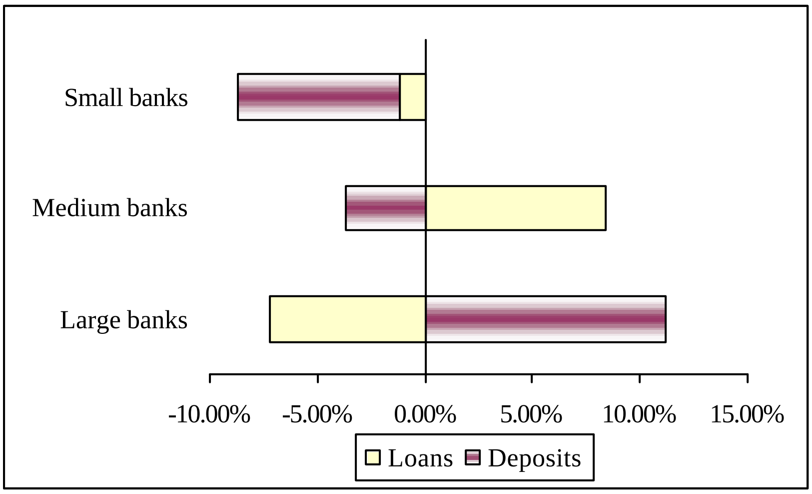


The comparison of the market share of the three groups of banks regarding their credit and deposit activities reflects certain deviations regarding their financial potential, which are more or less evident with individual groups of banks. Thus as of December 31, 2003, the analysis of the group of large banks showed larger deviation between their credit and deposit activity relative to the total assets, which ranges from negative 7.2% for the credit market share, to the positive 11.2% for the deposit market share. The stated indicators point to the fact that the activities in the two largest banks were relatively more focused on the collection of deposits, contrary to the volume of placements with the economy and the households. Concerning the group of medium-size banks, the deviation in the market share goes in opposite direction from the previous group of banks (8.4% for credits, i.e. -3.7% for deposits). The slightest deviation

[6] Credits placed in the non-financial sector (enterprises and households)
[7] Deposits originating from the non-financial sector (enterprises and households)

was registered with the group of small-size banks (-1.2% for credits and -7.5% for deposits). Compared to December 31, 2002, the deviations with the separate groups of banks according to the three criteria, market share of the credit and the deposit activity relative to the market share according to the total assets, basically remain unchanged.

Chart 7
Deviation from the market share of individual group of banks according to the total assets



2.1.3. Ownership structure

As of December 31, 2003, the degree of privatization of the banking capital in the Republic of Macedonia equaled 87%, or 91.4% if the Macedonian Bank for Development Promotion AD Skopje, which is entirely state-owned bank, is exempted from the analysis. Analyzed by individual bank, the privatization degree ranges from 66.7% to 100% within 7 banks. Compared to December 31, 2002, the degree of privatization of banks increased by 1.1 percentage point.

As of December 31, 2003, foreign capital in the Republic of Macedonia was present in 15 banks, with its percentage share ranging from 0.2% to 100%. The share of the foreign capital in the total banking capital in the Republic of Macedonia equals 47.2%, which is by 2.8 percentage points more compared to the end of December 2002.
Out of the total capital in the group of large banks, foreign investors control 51.9%. This percentage in the groups of medium-size and small-size banks equals 44.6% and 45%, respectively.

Table 3
Structural share of the banks according to the type of ownership

Type of ownership	Number of banks		Share in total capital (%)		Share in total assets (%)	
	31/12/2002	31/12/2003	31/12/2002	31/12/2003	31/12/2002	31/12/2003
Domestic private banks	12	12	50.5	46.6	54.0	51.3
State owned banks	1	1	4.9	4.8	2.0	1.8
Foreign banks	7	8	44.6	48.6	44.0	46.9
Total	20	21	100.0	100.0	100.0	100.0

Note: Banks having more than 50% of foreign capital in the structure of their capital are considered to be owned by foreign shareholders.

At the end of 2003, the eight banks that are owned by foreign shareholders cover 47% of the total assets at the level of all banks, or 48.6% of the engaged capital in the banks in the Republic of Macedonia. On the other hand, as of December 31, 2003, the twelve banks owned by domestic private shareholders, cover 51.3% of the total assets at the level of all banks, or 46.6% of the engaged banking capital.

Analyzed by groups of banks, it is ascertained that one of the banks classified in the group of large banks is owned by foreign shareholders, two banks from the group of medium-size banks and five banks in the group of small-size banks.

2.1.4. Bank network and number of employees

As of December 31, 2003, four banks out of the total number of banks in the Republic of Macedonia are located outside Skopje, with their share in the total potential of 11.8%.

On the other hand, there is a relatively wide network of branches, windows and business units. As of December 31, 2003, the banks in the Republic of Macedonia had 34 branches, 244 windows and 15 business units. Certainly, the windows of the public enterprise Makedonska Posta (Macedonian Post) (320 post-office units with 620 windows throughout the territory of the Republic of Macedonia) at the disposal of Postenska Banka AD Skopje should also be taken into consideration. Compared to December 31, 2002, the number of units increased by 13, which points to the expansion of the banks in their operations with households, strengthened competition and getting closer of the banking services to the households, which should result in better quality in the following period.

As of December 31, 2003, the number of employees at the level of all banks equals 4,595 persons, 2,522 of which in the group of large banks, 1,078 in the group of medium-size banks, while 999 persons are employed in the group of small-size banks. Compared to the end of 2002, the number of employees increased by 26 persons.

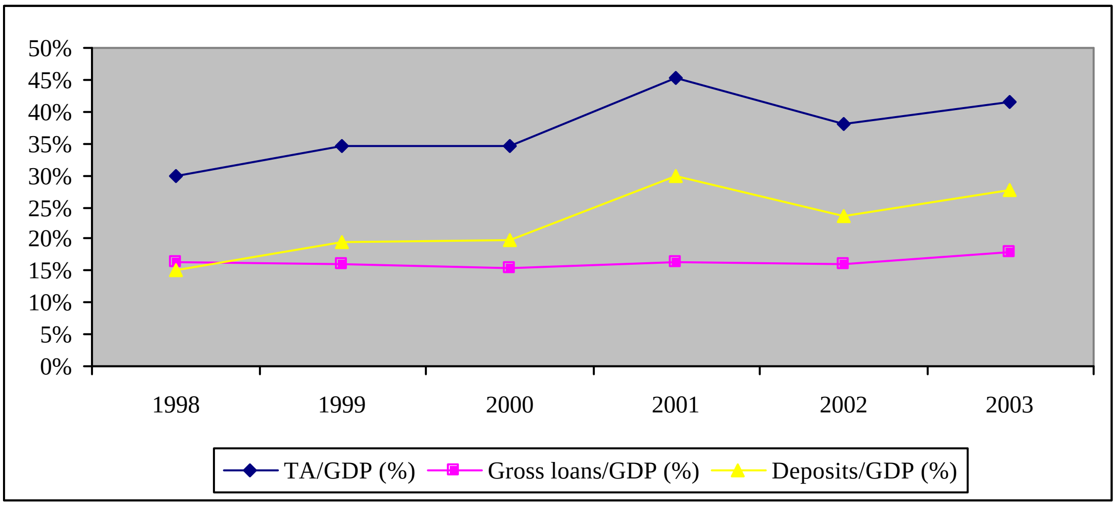
2.2. Banks' operations

The consistent macroeconomic policy and the successful accomplishment of the monetary policy objectives through the maintenance of the price stability, created favorable environment for meeting the expectations for the gradual revitalization of the economy and the intensification of the overall economic activity in the country. Therefore, conditions for intensification of the activities in the banking sector were also created. Faster economic growth in the country in 2003 was enabled, inter alia, by the increased credit support by the banking sector, which was mainly caused by the enlarged deposit base as the most significant source of funds.

The trend of increase in the deposit potential of the banks registered in the previous years, continued also in 2003. As a result, on December 31, 2003 the level of the deposit potential exceeded the highest level registered during the Euro conversion at the end of 2001. Such a trend of the deposit potential points to the continuous strengthening of the credibility of the banks in the Republic of Macedonia, which contributes for enlarging the basis for intensification of their credit activity.

The increased deposit potential of the banks in the Republic of Macedonia, as major cause for the credit activity, which aimed at supporting the total economic activity, simultaneously reflects the continuous strengthening of the level and the efficiency of the financial intermediation in the Macedonian economy. The degree of financial intermediation of the banks in the Republic of Macedonia, measured through the ratio of the total assets, the gross credits extended to clients and the total deposits to the gross domestic product, registers moderate continuous trend of increase.

Chart 8
Degree of financial intermediation



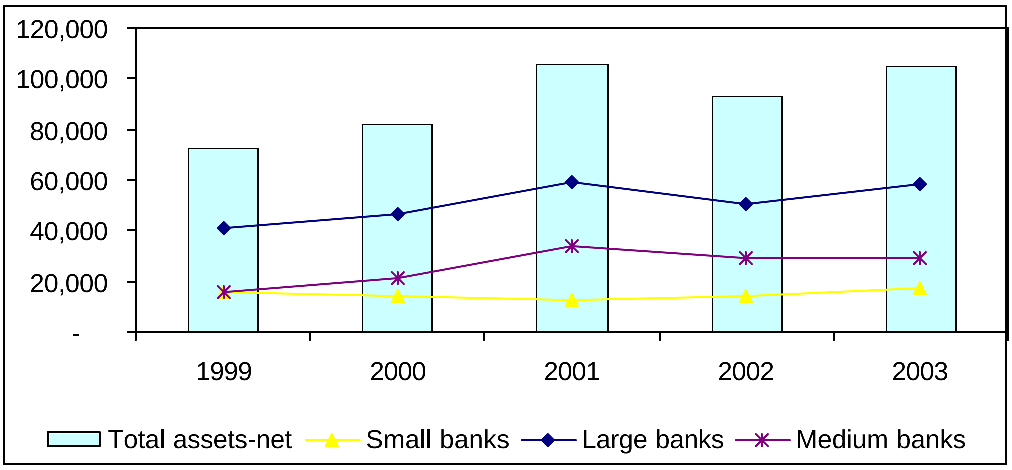
On December 31, 2003, this indicator calculated as a ratio between the total assets, the gross credits extended to clients and the total deposits with the gross domestic product[8] of the Republic of Macedonia equaled 41.4%, 17.8% and 27.7%, respectively. The level of financial intermediation determined according to the first indicator, equals about 100% in the developed countries in transition, while in the EU member states this indicator equals 250%. The comparison with the level of this indicator in the Republic of Macedonia shows that it is relatively low, pointing to the fact that there is enough room for enlarging the activities of the banks and increasing the level of efficiency of the financial intermediation in order to enable economic development of the country.

2.2.1 Banks' assets

Dynamically analyzed, in the last five years, the total assets of the banks in the Republic of Macedonia registered a continuing trend of increase, except as of December 31, 2002. The dynamics of the total assets was mainly supported by the continuing trend of increase in the total deposits, as the most significant source of funds of the banks. Analyzed by groups of banks, (large, medium-size and small-size banks), such an upward trend of the total assets of the banks is primarily due to the trend of increase in the assets of the group of large banks, having in mind its continuing dominant share in the net assets of the banks in the Republic of Macedonia of more than 54%. However, the contribution of the group of medium-size banks to the trend of increase in the total assets should not be neglected, which although with a smaller structural share than the share of the group of large banks (it ranged from minimum 21.3% to maximum 32.3% during the analyzed period), had a significant percentage share in the total increase in the net assets. On December 31, 2003 compared to December 31, 1999, 52.2% of the total increase in the net assets is a result of the increase in the assets of the group of large banks, while 42.9% is due to increased assets in the group of medium-size banks. As a result of such movements, a decrease in the share of the small-size banks in the total banks' assets in the past five years was registered. Thus at the end of 2003, this share equaled 16.3%, which is a decrease of 5.4 percentage points compared to the end of 1999. This contributes to a decline in the share of this group of banks in the financial intermediation in the country, at the expense of the increase in the share of the group of medium-size banks, which equaled 6.8 percentage points in the 1999 - 2003 period.

[8] Estimated data for 2003 by the State Statistical Office.

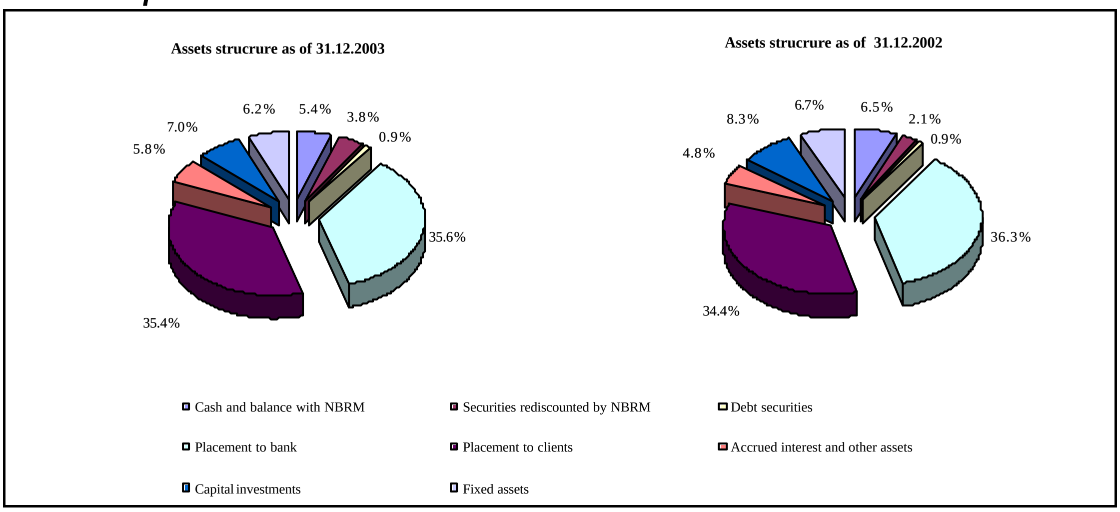
Chart 9
Movements of the total assets and of the total assets by groups of banks



As of December 31, 2003, the total banks' assets equaled Denar 104,875 million, which is an increase of Denar 11,662 million, or by 12.5% compared to December 31, 2002 (Balance sheet - Annex No.1). The increase in the assets, relative to December 31, 2002 is illustrated through the increase in both dominant segments of the total assets - the credits to clients and placements with other banks, as well as through the increase in the CB bills and the accrued interest and the other assets. No significant changes in the remaining asset items (funds and balances with the National Bank of the Republic of Macedonia, debt securities, placements in securities and fixed assets) were registered during the analyzed period. In addition, their individual share does not exceed 10% of the net assets of the banks in the Republic of Macedonia, thus not influencing the level and quality of the assets.

As of December 31, 2003, the assets structure remained almost unchanged compared to December 31, 2002. The placements with other banks retained the highest level of 35.6%, followed by the credits to clients, with their share of 35.4%. The remaining 29.0% refer to the other asset items, the individual share of which does nor register changes of higher significance in both periods of comparison. Such a structural share of the assets means that the banks retained the strategy of directing the largest portion of the households' foreign exchange savings in placements in the international first class banks, in spite of the legally based possibility for Denar and foreign exchange credit operations in the country.

Chart 10
Structure of assets



2.2.1.1. Credit activity of the banks (credits extended to non-financial entities and placements with banks)

The trend of moderate monthly positive dynamics of the credit activity continued in 2003, with increase in its intensity relative to the trend in 2002 being registered. The gradual intensification of the credit activity by the banks, especially in the second half of 2003, contributed to the strengthening of the financial potential of the private sector and the households, thus giving a positive impetus for dynamization of the economic development.

This is confirmed by the increase in the gross credits to clients (non-financial legal entities and households) which from Denar 38,769 million on December 31, 2002, reached Denar 45,186 million on December 31, 2003, i.e. an annual rate of increase of 16.6%. On December 31, 2003, the net credits to clients equaled Denar 37,111 million, which is an increase of Denar 5,041 million, or of 15.7%, compared to the end of 2002. As a comparison, the annual rate of increase in the gross credits for 2002 equaled 1.2%, while for the net credits it equaled 4.6%, which is far below the level of increase registered in 2003. This confirms the positive trend of increase in banks' lending to the private sector and the households.

Analyzed by **groups of banks** (large, medium-size and small-size banks), the increase in the gross credits is almost equally conditioned by the increase in the credits with the group of large and small-size banks, considering the fact that 55.4% of the total increase refer to the increase in the gross credits in the group of large banks, while 43.4% account for the group of small-size banks. The dominant share in the structure of the gross credits accounts for the group of large banks which equals 49.5% (48.6% - December 31, 2002), followed by the group of medium-size banks with a share of 34.5% (40.1% - December 31, 2002). The remaining 16.0% refers to the group of small-size banks (11.4% - December 31, 2002).

Table 4
Structure of the credit placements extended to non-financial entities and households

Period	Beneficiaries	Enterprises		Other clients		Households		
	Maturity	Denar	for.ex	Denar	for.ex	Denar	for.ex	Total
31/12/2002	Overdue	911	42	0	4	94	0	1,051
	Short-term	12,557	1,336	409	379	1,203	0	15,884
	Long-term	5,421	3,178	52	297	3,933	0	12,882
	Non-performing	7,073	1,129	2	125	609	15	8,953
	Gross credits	25,963	5,685	462	804	5,840	15	38,769
	Potential loan loss reserves							-6,699
	Net credits							32,070
	Credit claims entered in off-balance sheet records							10,819
	Maturity	Denar	for.ex	Denar	for.ex	Denar	for.ex	Total
31/12/2003	Overdue	805	108	1	30	137	0	1,082
	Short-term	12,713	1,665	24	60	1,732	-	16,193
	Long-term	6,914	3,918	-	98	6,853	3	17,786
	Non-performing	7,897	1,303	155	99	655	18	10,126
	Gross credits	28,329	6,994	179	287	9,376	21	45,186
	Potential loan loss reserves							-8,075
	Net credits							37,111
	Credit claims entered in off-balance sheet records							

The analysis of the placements from the aspect of the **maturity, the sector structure and the currency structure** indicates certain qualitative movements towards further intensification of the long-term credit activity, which is especially evident in the sector households in comparison with the sector enterprises, as well as towards a moderate increase in the foreign exchange credit operations of the enterprises[9].

As of December 31, 2003, observed from the **sector structure**, the dominant share still accounts for the credits extended to enterprises, the share of which in the total credits equals 78.1% (81.6% - December 31, 2002), while the share of the credits extended to households equals 20.8%, which is by 5.7% more compared to the share registered on December 31, 2002.

According to the **currency structure**, 61.6% of the total credits extended by the banks accounts for the Denar credits (60.7% - December 31, 2002), 22.2% are Denar credits with foreign exchange clause (22.5% - December 31, 2002), while the remaining 16.2% account for the foreign exchange credits placed on the basis of foreign credit lines and a small share extended to residents for payments in the country in line with the liberalization enabled by the amendments to the legislation pertaining to the foreign exchange operations (16.8% - December 31, 2002).

Analyzed by the **maturity,** the share of the short-term credits equals 35.8% (40.9% - December 31, 2002), while 39.4% account for the long-term credits (33.2% - December 31, 2002), which points to a structural movement towards an increase in the share of the long-term credits at the expense of the decrease in the share of the short-term credits. During the analyzed period, the long-term credits registered an increase of Denar 4,904 million, or 38.1%, while the short-term credits increased by Denar 309 million, or 1.9%. Analyzed by sectors, faster increase on annual basis was registered in the long-term credits extended to households (by Denar 2,923 million, or 74.3%), contrary to the registered increase in the long-term credits extended to enterprises (by Denar 2,233 million, or 26.0%).

Such positive movements in 2003 point to the retained trend of intensification of the long-term credit activity that was registered in 2002. The favorable movements registered in the maturity structure of the credits in the "enterprises" sector, and in particular the "households" sector, indicate a change in the banks' strategy towards strengthening of the propensity to a long-term credit activity, which is a signal for gradual increase in the financial support of the economic growth through the bank credit activity.

Besides the credits extended to non-financial entities and households, significant share of the credit activity still accounts for the placements to domestic and foreign banks. As of December 31, 2003, the placements to domestic and foreign banks amounted to Denar 37,301 million, i.e. 35.6% of the total banks' assets. In comparison with the end of 2002, they registered an increase of Denar 3,498 million, or 10.3%. Dominant share in the structure of the placements with banks of 92.2% accounts for the foreign exchange accounts with domestic and foreign banks. The remaining 7.8% refer to the total credits approved to other banks (Balance Sheet - Annex No.1).

Analyzed by **groups of banks**, 62.1% of the structure of placements with domestic and foreign banks, refer to the share of the group of large banks (57.8% - December 31, 2002). The annual increase in the placements with domestic and foreign banks is a result of the increment of these placements with the group of large banks.

2.2.1.2. Placements in securities

As of the end of 2003, such as at the end of 2002, the banks in the Republic of Macedonia had a very poor securities portfolio. On December 31, 2003, it equaled Denar 12,325 million, or

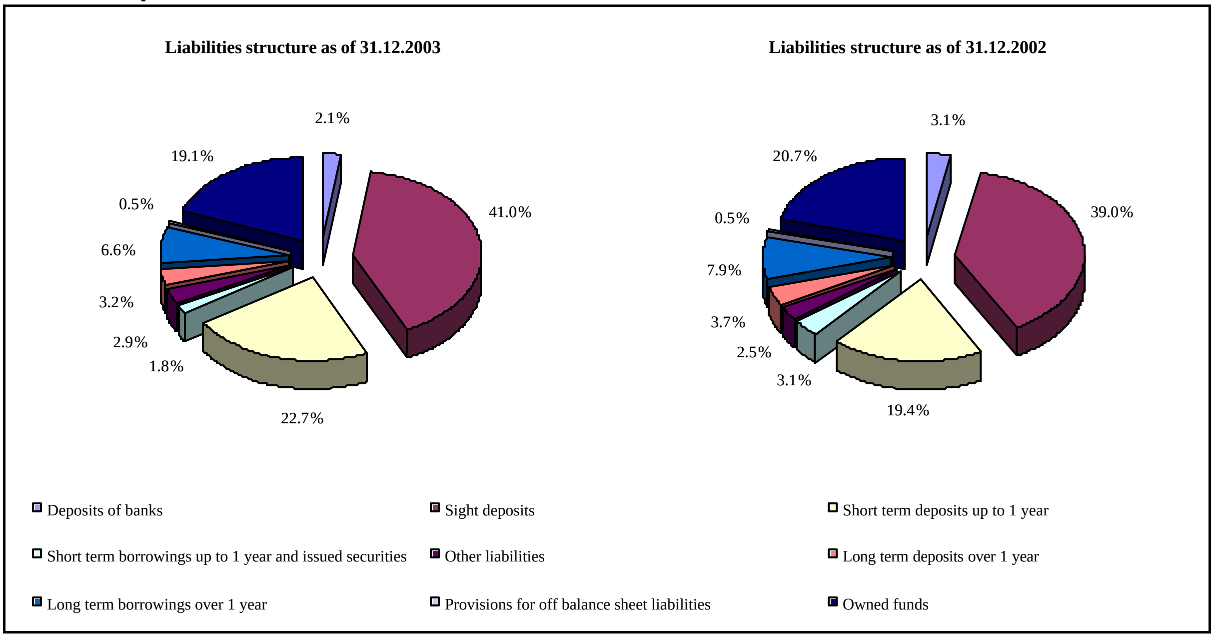
[9] Pursuant to the amendments to the Law on Foreign Exchange Operations, according to which the authorized banks in the Republic of Macedonia may extend credits in foreign exchange to residents.

11.8% of the total banks' assets in the Republic of Macedonia, which is almost the same share registered at the end of 2002 (11.3%). Analyzed by the structure, no significant movements were registered, and as of December 31, 2003, the largest portion of the securities refer to the government bonds issued by the Republic of Macedonia on various bases and the CB bills. As of December 31, 2003, the government bonds issued by the Republic of Macedonia amounted to Denar 6,706 million, or 54.4% of the total portfolio of investments in securities (65.9% - December 31, 2002). Out of these, 87.8% accounts for the government bonds issued on the basis of the restructuring of Stopanska Banka a.d. Skopje [10] with maturity of 15 years. The rest are bonds issued by the Republic of Macedonia, the Banks Rehabilitation Agency, as well as bonds issued on the basis of the "frozen" foreign exchange saving. At the end of 2003, the CB bills amounted to Denar 3,975 million[11], or 32.3% of the total portfolio investments in securities (18.6% - December 31, 2002).

2.2.2. Liabilities and own funds

As of December 31, 2003, the most significant share in the total liabilities of the banks accounted for the deposits of the non-financial legal entities and households and for the own funds, with a share of 66.9% and 19.1%, respectively. The participation of the banks' deposits and borrowings (the short-term and the long-term) in the liabilities equaled 10.5%. The dominant share of 63.0% of them, as it was registered in the previous year as well, accounted for the long-term borrowings from foreign banks on the basis of long-term foreign credit lines.

Chart 11
Structure of liabilities



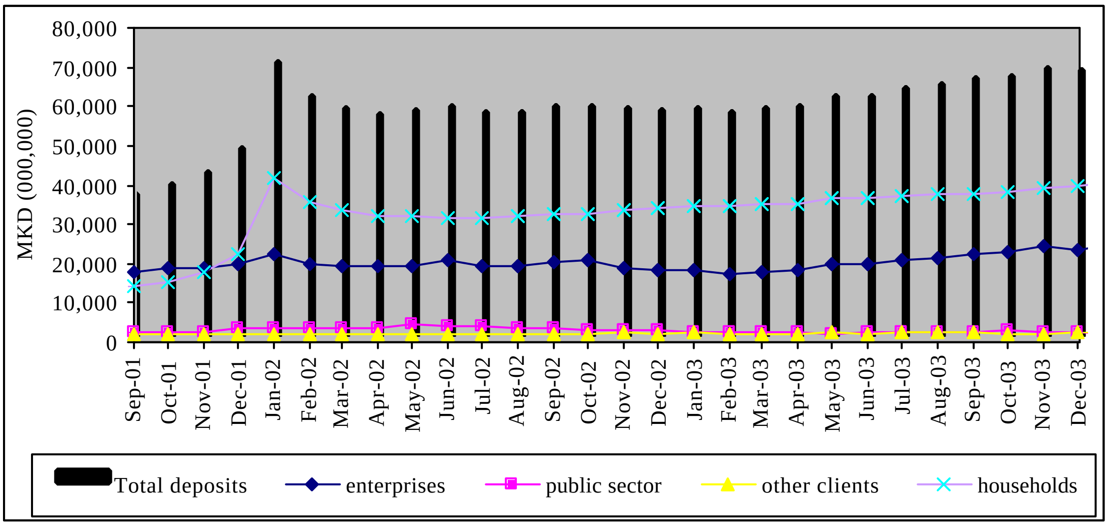
2.2.2.1. Deposits of non-financial legal entities and households

The continuous trend of increase in the banks' deposit potential in the Republic of Macedonia, which especially intensified and culminated with the Euro conversion, (December 31, 2001), persisted also in 2003, thus exceeding the highest level reached during the Euro conversion. At the end of 2003, the total deposits of the non-financial legal entities and households equaled Denar 70,188 million, which is an increase of Denar 193 million, or 0.3% compared

[10] Law on guaranteeing the investment of the strategic investors and on assuming certain claims on end users by the Republic of Macedonia in Stopanska Banka a.d. Skopje
[11] CB bills recorded in the Balance Sheet of the banks.

to December 31, 2001, i.e. of Denar 12,283 million, or 21.2%, compared to December 31, 2002. Such a positive dynamics of increase in the total deposits contributes to further strengthening of the banks' financial potential.

Chart 12
Movement of the total deposits and the deposits of non-financial legal entities and households



From the aspect of the division **by sectors**, the deposits of the enterprises and of the households registered almost identical absolute increase on annual basis (by Denar 6,370 million, or 34.3% and by Denar 6,031 million, or 17.5%, respectively). Despite the more evident increase registered in the deposits of enterprises than the increase registered in the households' deposits, the households' deposits remained dominant with their share of 57.8% (59.7% - December 31, 2002), while 35.5% account for the deposits of enterprises, which is by 3.4 percentage points more compared to the share registered on December, 31, 2002.

Analyzed **by maturity**, the short-term deposits registered more intensive increase (of Denar 5.760 million, or 31.9%) than the sight deposits (by Denar 6,600 million, or 18.2%) annually, which caused an increase in the share of the short-term deposits of 2.8 percentage points at the expense of the decrease in the share of sight deposits of 1.6 percentage points. However, despite such positive movements, towards a continuous trend of increase in the short-term deposits in 2003 with which the trend registered in 2002 persisted, the highest share according to the maturity still accounts for the sight deposits[12] which equaled 61.2% (62.8% - December 31, 2002).

Observed from the **aspect of the currency structure**, the foreign exchange and the Denar deposits registered almost identical increase, with higher increase being registered in the foreign exchange deposits. On December 31, 2003 compared to December 31, 2002, foreign exchange deposits increased by Denar 6,703 million, or 22.1%, while the increase in the Denar deposits amounted to Denar 5,581 million, or 20.2%. Such an increase is equally due to the increase in the foreign exchange deposits of both the enterprises and the households, as a response to the provisions of the new Law on Foreign Exchange Operations (for free disposal of foreign assets) and to the still present propensity of the households to save in foreign currency. According to the structural share, however, no significant changes on annual basis were registered. Thus, the share of the foreign exchange deposits in the total deposits equaled

[12] The restricted deposits being also taken into consideration.

52.7% (52.3% - December 31, 2002), while the remaining 47.3% referred to the Denar deposits, compared to 47.7% as they equaled on December 31, 2002.

Analyzed **by groups of banks** (large, medium-size and small-size banks), on December 31, 2003, in the structure of the total deposits, in the total households' deposits and in the total sight deposits, (as main categories in total deposits structure) the group of large banks had a dominant share of 66.8%, 71.1% and 65.8%, respectively. In comparison with the end of 2002, these shares remained almost unchanged. Hence, compared on annual basis, the increase in the total deposits, in the households' deposits and the increase in the sight deposits is mostly a reflection of the increase in the total deposits with the group of large banks, which equals 68.7%, 68.9% and 78.4%, respectively, of the total increase.

Table 5
Structure of the deposits of non-financial legal entities and households

in MKD (000.000)

Period	*Deposits*	*Enterprises*		*Public sector*		*Other clients*		*Households*		
31/12/2002	*Maturity*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Total*
	Sight deposits	*7,951*	*4,580*	*1,625*	*-*	*1,556*	*-*	*5,718*	*14,213*	*35,641*
	Restricted deposits	*271*	*374*	*51*	*-*	*9*	*-*	*-*	*-*	*705*
	Short-term deposits up to 1 year	*4,876*	*322*	*558*	*-*	*324*	*430*	*2,080*	*9,487*	*18,076*
	Long-term deposits over 1 year	*187*	*-*	*154*	*-*	*74*	*3*	*2,189*	*875*	*3,482*
	Total	*13,284*	*5,276*	*2,389*	*-*	*1,963*	*433*	*9,986*	*24,574*	*57,905*
	Annual rate of changes	*-4.1%*	*-39.1%*	*-32.9%*		*4.4%*	*92.9%*	*41.8%*	*-29.3%*	*-17.3%*
31/12/2003	*Maturity*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Denar*	*ForEx*	*Total*
	Sight deposits	*8,527*	*7,019*	*1,461*	*-*	*1,708*	*-*	*7,093*	*16,119*	*41,928*
	Restricted deposits	*485*	*462*	*64*	*-*	*8*	*-*	*-*	*-*	*1,020*
	Short-term deposits up to 1 year	*6,724*	*1,481*	*535*	*-*	*433*	*181*	*3,583*	*10,899*	*23,836*
	Long-term deposits over 1 year	*231*	*-*	*156*	*-*	*112*	*9*	*2,083*	*815*	*3,405*
	Total	*15,967*	*8,963*	*2,217*	*-*	*2,260*	*190*	*12,759*	*27,833*	*70,188*
	Annual rate of changes	*20.2%*	*69.9%*	*-7.2%*		*15.2%*	*-56.2%*	*27.8%*	*13.3%*	*21.2%*

2.2.2.2. Own funds

As of December 31, 2003, the banks' own funds amounted to Denar 20,075 million, accounting for 19.1% of the structure of the total sources of funds. Compared to the end of 2002, the own funds registered an increase of Denar 796 million, or 4.1%, while from the aspect of the structure, it can be ascertained that no considerable changes were registered as of 2003.

Analyzed by groups of banks (large, medium-size and small-size banks), on December 31, 2003, the own funds were almost equally distributed among the three groups of banks, i.e. the individual share of the banks equaled about 30%, with the highest portion accounting for the group of small-size banks which equaled 35.4% of the total own funds. In comparison with December 31, 2003, the structural shares by groups of banks remained almost unchanged.

2.2.3. Off-balance sheet activity of the banks

In 2003, the total off-balance sheet assets of the banks in the Republic of Macedonia equaled Denar 11,479 million, which is an increase of Denar 191 million compared to the end of 2002, due to the increase in the performance guarantees and uncovered guarantees and letters of credit of Denar 281 million and Denar 88 million, respectively. This increase was offset by the decrease in the covered off-balance sheet items of Denar 65 million and the undrawn lines of credits in the amount of Denar 113 million.
The share of risky off-balance sheet items in the total off-balance sheet assets equals 89.8%, which is almost at the same level compared to the end of 2002.

Table 6
Off-balance sheet activities

in MKD (000,000)

	31/12/2003	30/06/2003	31/12/2002	30/06/2002	31/12/2001	31/12/2000	31/12/1999
Covered off-balance sheet items	1,174	884	1,238	1,400	3,134	1,573	1,899
Performance guarantees	3,291	3,306	3,010	2,322	3,340	3,244	2,744
Unused lines of credits	422	563	536	167	155	123	65
Uncovered guarantees, letters of credit and other off-balance sheet items	6,592	5,991	6,504	8,825	8,811	9,059	9,300
Total off-balance sheet	11,479	10,744	11,288	12,714	15,440	13,998	14,008
Risk assets / total off-balance sheet assets	89.77	91.77	89.03	88.99	79.70	88.77	86.44

The previously stated indicator shows that a significant portion (89.8%) of the total off-balance sheet activities of the banks in the Republic of Macedonia bear certain credit risk and as such, they can be potentially transformed into on-balance sheet claims.

From a structural aspect, the uncovered guarantees and letters of credit have the highest share in the total off-balance sheet assets, which on December 31, 2003 accounted for 57.4% of the total off-balance sheet assets. Compared to the end of 2002, their share in the structure of the off-balance sheet assets remained unchanged.

2.3. Risks in banking operations

2.3.1. Credit risk

The credit risk plays the most important role in defining the risk profile of the banks in the Republic of Macedonia.

Analyzed through the prism of the main indicators for the movement and the quality of the credit portfolio of the banks at the end of 2003, it is evident that the slight downward trend of the credit risk continued.

The total credit exposure of the banks in the Republic of Macedonia as of December 31, 2003 equaled US Dollar 104,306 million, which is an increase of 11.9%, or of Denar 11,092 million compared to December 31, 2002 (Annex no.3). The increased credit exposure is mainly a result of the intensification of the credit activity of the banks, and is less due to the increase in their off-balance sheet activities.

The structural analysis of the credit portfolio of the banks indicates that the category "regular credits", with its share of 66.0%, remains to be the dominant component also at the end of 2003 (December 31, 2002 it equaled 68.0%). In the structure of the credit portfolio, the regular credits are followed by: other claims with a share of 13.6% (on December 31, 2002 they equaled 12.9%), non-performing loans 10.3% (on December 31, 2002 they equaled 9.7%), off-balance sheet exposure 9.6% (on December 31, 2002 it equaled 8.9%), and regular interest 0.5% (on December 31, 2002 it equaled 0.6%). Hence, it can be ascertained that in 2003, no significant changes in the structural share of the categories comprising the banks' credit exposure were registered.

As of December 31, 2003, the total claims of the banks classified in the risk categories C, D and E relative to the total credit exposure equaled 15.1% (excluding the claims classified in the risk category E for more than two quarters, which are transferred to the off-balance sheet record), which is an insignificant improvement of 0.8 percentage points in comparison with December 31, 2002.

If the claims on the Republic of Macedonia and the National Bank of the Republic of Macedonia in the total amount of Denar 8.715 million, as well the claims on foreign banks classified in the risk categories A and B in the total amount of Denar 31,716 million are excluded from the analysis, the share of the total credit exposure in the risk categories C, D and E would equal 24.7% on December 31, 2003. In comparison with December 31, 2002, this indicator registers an increase of 2.7 percentage points, while compared to December 31, 2001 (last period for which the old methodology for classification of the on-balance sheet and off-balance sheet asset items was applied), the increase equals 9 percentage points.

At the end of 2003, the coverage ratio of the total credit exposure in the risk categories C, D and E equaled 81.0% of the guarantee capital of the banks in the Republic of Macedonia, which is an increase of 3.3 percentage points in comparison with December 31, 2002. This points to a certain deterioration of the indicator, which is a result of the absolute increase of the credit exposure in the risk categories C, D and E of Denar 889 million, relative to the smaller increase in the guarantee capital which equaled Denar 319 million during the analyzed period.

If during the analysis the allocated provisions for the credit exposure classified in the risk categories C, D and E are taken into account, it can be ascertained that the uncovered share of this segment of the banks' risk exposure equals Denar 6,318 million on December 31, 2003, which represents 6.0% of the total credit portfolio, i.e. 32.5% of the guarantee capital of the Macedonian banks as of December 31, 2003. Compared to 2002, this indicator declined by of 9.1 percentage points, leading to the conclusion that despite the relatively high credit risk the banks face with, the solvency of the banks has not been endangered. Namely, if the worst case scenario is assumed where the banking placements in the risk categories C, D and E are not collected at all, then the losses would be covered with 32.5% of the guarantee capital.

The movements of the main indicators for the quality of the credit portfolio of the banks analyzed by groups of banks, point to a significant influence of the group of large banks on the level of high-risk placements at the level of the banking system. Analyzed by the ratio of credit exposure in the categories C, D and E to the total credit exposure, the worst credit portfolio accounts for the group of the small-size banks with 21.48%, followed by the group of large banks with 15.66%, while the ratio of the group of medium-size banks equals 10.65%, which is by 4.45 percentage points less than the average level of all banks. Observed from the aspect of the ratio of net C, D and E to the guarantee capital, the worst credit portfolio accounts for the group of large banks with 48.23%, followed by the group of medium-size banks with 26.37%, while the lowest indicator of 23.03% accounts for the group of small-size banks, which is by 9.47 percentage points lower than the average level of all banks. The reason for the highest share of the net placements in the risk categories C, D and E relative to the guarantee capital accounting for the group of large banks, is the lower level of capitalization of this group in comparison with the group of small-size banks.

Table 7
Indicators of the quality of the credit portfolio of the banks in the Republic of Macedonia by groups of banks

	% of C,D,E in total credit exposure					% of E in total credit exposure					% of C,D,E in guarantee capital					% of net C,D,E in guarantee capital				
	1999	*2000*	*2001*	*2002*	*2003*	*1999*	*2000*	*2001*	*2002*	*2003*	*1999*	*2000*	*2001*	*2002*	*2003*	*1999*	*2000*	*2001*	*2002*	*2003*
Large banks	42.32	39.84	43.43	17.09	15.66	8.30	12.27	6.42	2.91	7.05	267.45	174.17	194.67	132.10	141.67	125.74	72.00	99.28	63.65	48.23
Medium banks	45.95	24.58	19.16	14.62	10.65	5.01	3.23	1.59	0.85	2.33	177.65	63.90	52.99	66.65	52.43	105.86	36.72	33.37	43.78	26.37
Small banks	31.13	35.81	35.64	14.50	21.48	5.78	6.25	3.75	3.06	3.65	42.37	46.63	56.21	29.88	48.84	22.01	23.59	32.43	14.44	23.03
Indicators at the level of the banking system	**41.34**	**34.83**	**33.73**	**15.94**	**15.10**	**6.99**	**8.64**	**4.26**	**2.25**	**5.19**	**145.34**	**94.15**	**95.68**	**77.71**	**81.01**	**74.64**	**43.57**	**52.35**	**41.58**	**32.50**

Table 8
Indicators for the quality of the credit portfolio of the banks

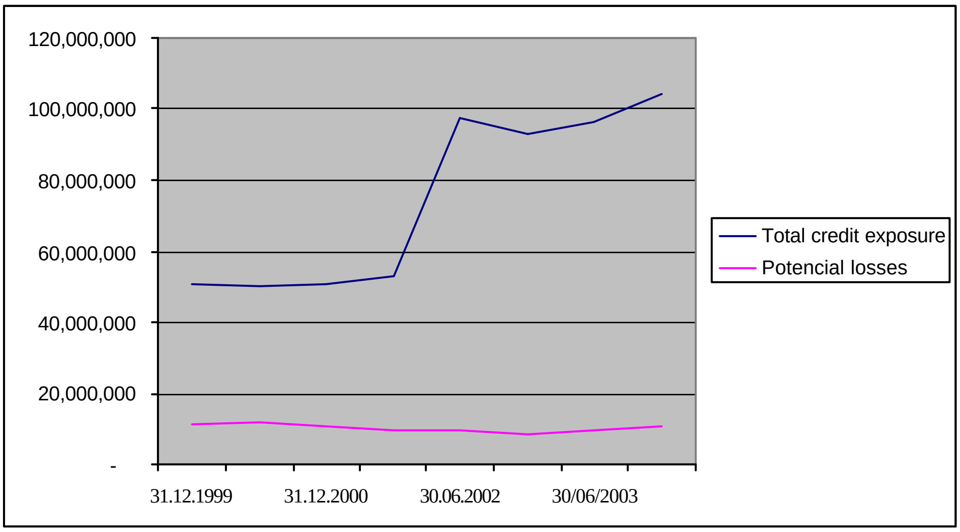
in %

Indicators	**31/12/1999**	**31/12/2000**	**31/12/2001**	**31.12.2001***	**30/06/2002**	**30.06.2002***	**31/12/2002**	**31.12.2002***	**30/06/2003**	**30.06.2003***	**31/12/200**
% of C,D,E in total credit exposure	41.3	34.8	33.73	38.2	17.41	21.54	15.94	20.50	16.41	21.19	15.1
% of D,E in total credit exposure	25.1	22.7	18.85	24.3	10.38	14.86	9.22	14.14	9.87	15.02	10.6
% of C,D in total credit exposure	34.4	26.18	29.47	27.5	14.13	13.42	13.7	12.95	12.63	11.91	9.9
% of E in total credit exposure	7.0	8.6	4.3	10.7	3.28	8.12	2.25	7.55	3.77	9.28	5.1
% of risk (potential losses/total exposure)	22.6	21.4	18.1	23.6	10.13	14.62	8.76	13.71	9.79	14.94	10.2
% of C,D,E in guarantee capital	145.3	94.2	95.7	116.2	91.82	119.6	77.71	105.67	84.61	115.9	81.0
% of D,E in guarantee capital	88.3	61.4	53.5	73.9	54.74	82.52	44.93	72.88	50.89	82.17	57.3
% of C,D in guarantee capital	120.8	70.8	83.6	83.6	74.52	74.52	66.76	66.76	65.16	65.16	53.1
% of E in guarantee capital	24.6	23.4	12.1	32.6	17.3	45.07	10.95	38.91	19.46	50.74	27.8
% of net C,D,E in guarantee capital	74.6	43.6	52.4	52.4	46.53	46.53	41.58	41.58	41.01	41.01	32.5

* Indicators for the quality of the credit portfolio in which calculation the amount of non-performing loans re-entered in the off-balance sheet record is taken into account

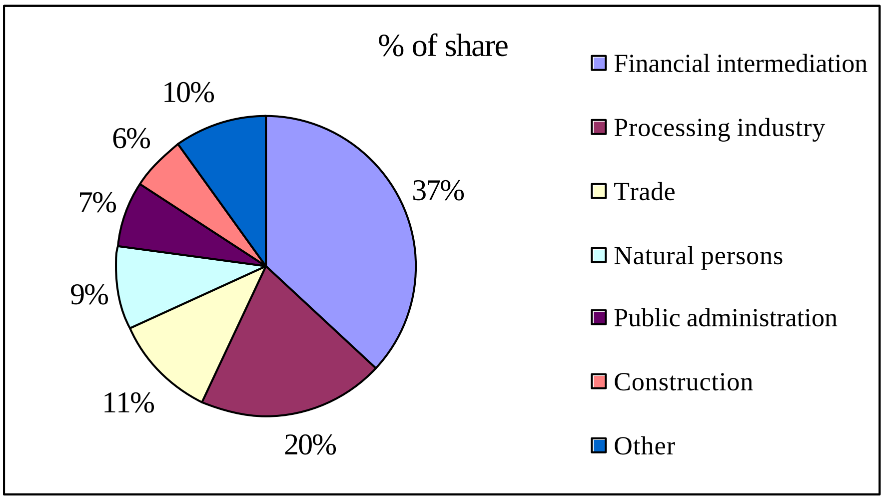
At the end of 2003, the rate of risk of the credit portfolio, which shows the correlation between the calculated potential losses and the total credit exposure equaled 10.3%, which corresponds to the risk category B. Analyzed by groups of banks, this indicator is the highest in the group of small-size banks and it equals 12.3%, followed by the group of large banks with a rate of risk of 10.8%, and the group of medium-size banks with a rate of risk of 8.3%.

Chart 13
Movement of the credit exposure and calculated potential losses of the banks



The total credit exposure of the banks in the analyzed December 31, 1999 – December 31, 2003 period increased by Denar 53.672 million or by 1.1 time, which is primarily due to the amended methodology according to which the volume of the total exposure of banks is enlarged. During the same period, the identified potential losses for credit risk together with the potential losses from the country risk decreased by Denar 705 million or by 6.2%, equaling Denar 10,719 million as of December 31, 2003. In 2003, the potential losses due to the country risk equaled Denar 11.6 million, which is a decline of Denar 11.6 million relative to 2002.

Chart 14
Structure of the credit exposure by sectors

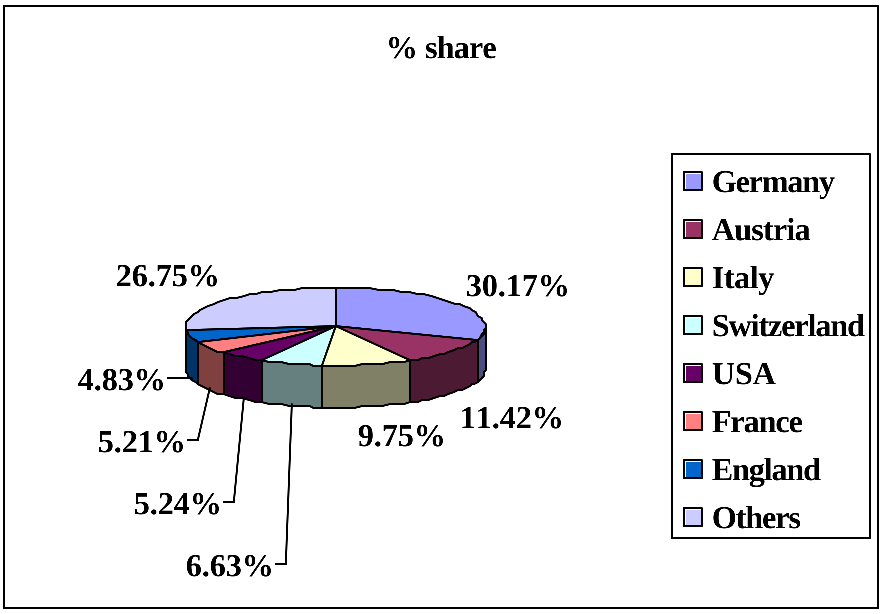


The structure of the exposure of the banks by sectors shows a dominant share of the exposure in the sector financial intermediation of 37%, and it refers to the exposure to the National Bank of the Republic of Macedonia on the basis of purchased CB bills and placements to foreign and domestic banks. Larger concentration of the placements is evident in the sector of the processing industry with a share of 20%, followed by the sectors "trade" with a share of 11%, "households" 9%, "public administration and defense" 7%, and by the sector "construction" with a share of 6%. The rest of the funds of 10% are placed in 12 sectors.

2.3.2. Country risk

The total net exposure to the country risk (the total credit exposure of the customer reduced by the amount of the potential losses) as of December 31, 2003 equaled Denar 31,195 million, while the total exposure to the country risk equaled Denar 31,206 million on gross basis, or 29.9% of the total credit exposure. The amount of the potential losses from the country risk equals Denar 11.6 million, i.e. the indicator measuring the level of exposure to the country risk equals only 0.04%. This is due to the fact that the most frequent cases of exposure to a foreign entity, are those of the Macedonian banks being exposed to foreign first class banks with a contractual maturity of up to three months.

Chart 15
Structure of the credit exposure by countries

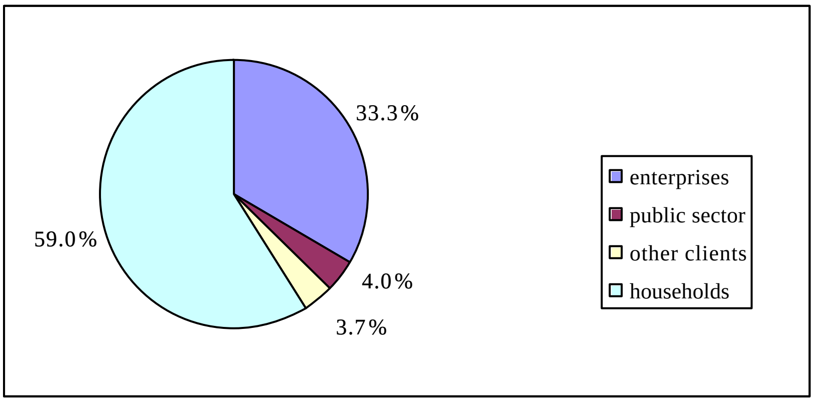


The chart shows that the Macedonian banks are primarily exposed to customers – foreign persons from Germany, Austria, Italy, Switzerland, the USA, France and England. The category "other" accounts for 26.8% of the exposure to country risk and pertains to 28 countries. This category shows high risk dispersion by countries ranging up to 4.6%.

2.3.3. Liquidity risk

Liquidity risk occurs when the bank is not able to provide sufficient amount of funds to repay its short-term liabilities at the moment of their maturity, or provides its necessary funds at extremely high costs. The stability of the banks primarily depends on the liquidity risk management quality, from both the aspect of providing favourable structure of the sources of funds, as well as from the aspect of maintaining certain level of liquid assets as a protection from the liquidity risk. Therefore the favourable trend of the general situation in the country in 2003 meant more efficient liquidity forecasting and management for the banks in the Republic of Macedonia, i.e. maintenance of a satisfactory liquidity position. Within the overall social and economic environment in the country, the credibility of the banking system has been strengthened which is shown through the trend of continuous increment in the deposit base in the analyzed period. The permanent enhancing of the propensity to save in the banks, at the end of 2003 resulted in a volume of the banks' deposit base over the level registered at the end of 2001, during the Euro conversion. On the other hand, the unfavourable maturity structure of the deposit base of the banks in the Republic of Macedonia and the trends it registered over the last period, primarily in the households' deposits (which with their average monthly share of 59% in 2003 and 56.8% in 2002 constitute a dominant category), indicate a high degree of sensitiveness depending on the level of political and economic stability in both the country and the near surrounding, which, for the banks, means a need of further maintenance of prudential approach towards the liquidity risk management.

Chart 16
Deposit base by sectors (average for 2003)



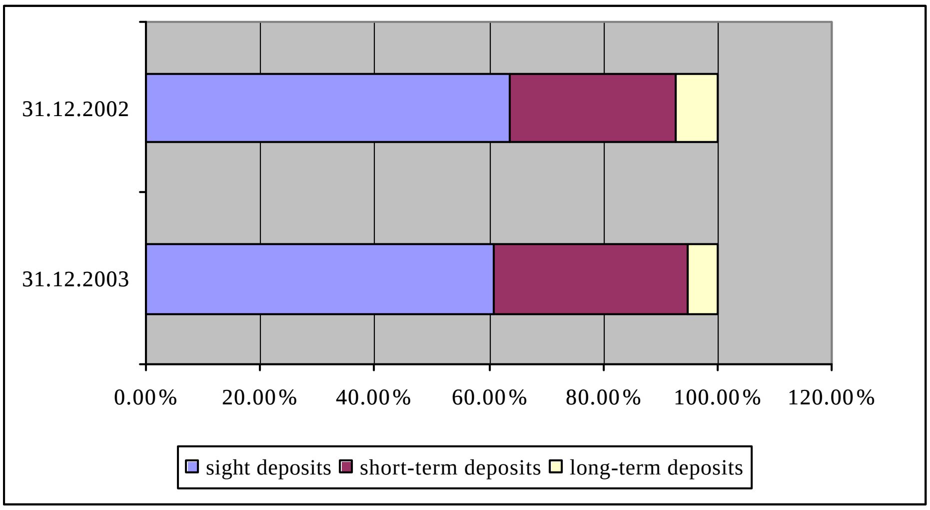
One of the most important aspects in the liquidity management is matching of the maturity between the funds and the sources of funds. In 2003, the National Bank of the Republic of Macedonia established the terms and conditions and the elements necessary for the banks' liquidity risk identification, assessment and management with a Decision. The Decision requires minimum necessary standards for prudential liquidity management. In the process of liquidity risk management, the Decision stipulates an establishment and maintenance of an adequate maturity structure of the assets and the liabilities from the aspect of harmonization of the assets and liabilities items according to their residual maturity, as well as planning and managing the inflows and the outflows of funds in line with the expectations based on historical data. As for the maturity compliance monitoring, the banks are required to prepare monthly reports on the maturity structure of the assets and the liabilities (agreed and expected) in Denars, foreign exchange and at an aggregate level and to submit them to the National Bank of the Republic of Macedonia. Thus an important banks' liquidity risk management instrument was established.

2.3.3.1. Primary sources of funds (deposits of non-financial entities)

At the end of 2003, the primary sources of funds, i.e. the deposits of the non-financial entities, amounted to Denar 70,189 million, which is an increase of 21.2% on annual basis. The continuous monthly upward trend of both the households' deposits and the enterprises' deposits resulted in an average monthly share of the primary sources of funds of 64.4% in the total sources of funds of the banks in the Republic of Macedonia in 2003, which is by 2.4 percentage points higher relative to the monthly average for 2002. An increment of 2 percentage points was registered also in the share of these sources in the structure of the foreign sources of funds (i.e. the total liabilities of the banks), which in 2003 equaled 80.6%, on average.

Notwithstanding the positive movements registered in the maturity structure of the primary sources of funds directed towards redistribution of the deposits from the sight deposits accounts to the short-term time deposits accounts, the maturity structure of the deposit base is considered to be unfavourable from the aspect of liquidity management and forecasting. In the analyzed period, the sight deposits accounted for 61% in the total deposit base, on average monthly basis, which is a fall of 2.9 percentage points compared to their average monthly share in 2002. On the other hand, the short-term time deposits register an average monthly share of 33.5% in the analyzed period, or 4.6 percentage points more compared by 2002.

Chart 17
Maturity structure of the primary sources of funds

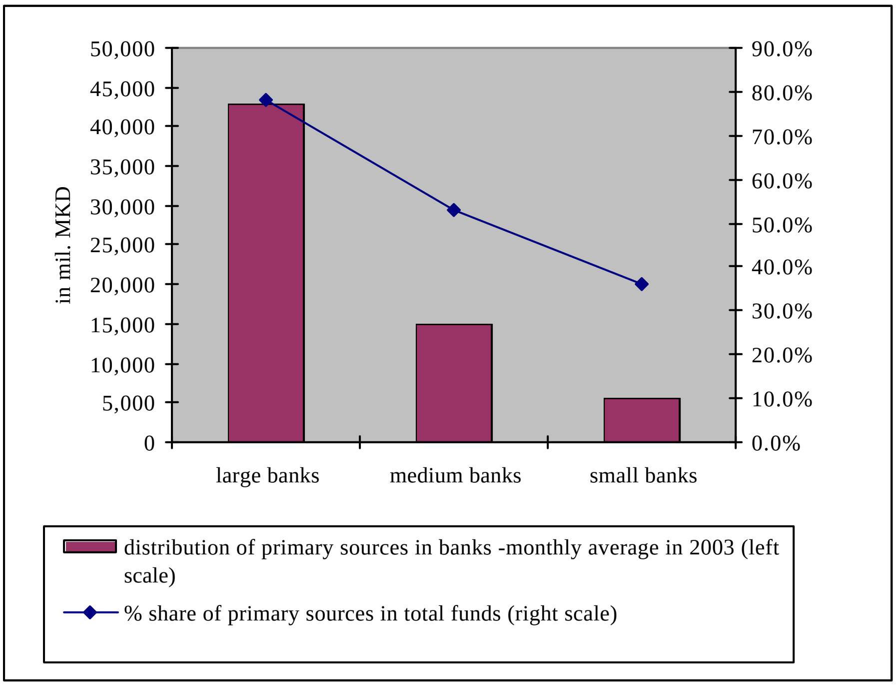


Given the larger social and economic stability and the strengthened credibility of the banking system, perceived through the positive trends of the propensity to save, the banks are facing the challenge of active participation in the creation of the maturity structure of the deposits as primary sources of funds. The need of further operational restructuring of the banks and acceptance of the “customer oriented” concept, i.e. the supply of services which will be directed towards keeping the deposits in the banking system on a longer run is evident.

The currency structure of the primary sources of funds is in favour of the foreign exchange deposits due to the larger propensity of the households to keep their savings in foreign currency. Thus in 2003 the foreign exchange deposits make up 53.5% of the total deposits of the non-financial entities, on average monthly basis.

The comparative analysis of the groups of large, medium-size and small-size banks indicates proportional relation between the size of the banks and the volume of collected deposits. Thus in 2003, two thirds, on average, of the total deposit base of the banks in the Republic of Macedonia were concentrated in the group of large banks (i.e. the two largest banks). If only the households’ deposits are taken into account, the analysis shows an average monthly concentration of 72%. Such indicators prove the confidence of the depositors in these banks, but simultaneously indicate that these banks are mostly exposed to a liquidity blow, considering the sensitiveness of these deposits depending on the circumstances in the country and the neighbouring countries. The group of medium-size banks accounts for 23.6% of the total deposit potential, i.e. 20.3% of the households’ deposits. The group of small-size banks (which is the largest group and encompasses more than a half of the banks in the Republic of Macedonia) attracts only 8.8% of the total deposits of the non-financial entities, and only 7.7% of the households’ deposits.

Chart 18
Distribution of the primary sources of funds by groups of banks

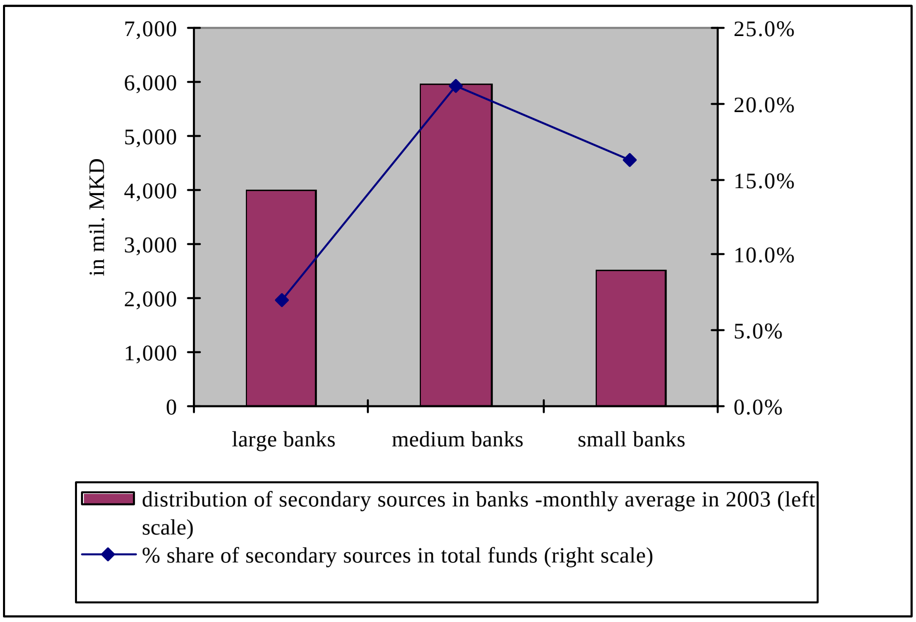


2.3.3.2. Secondary sources of funds

In the analyzed period, the exploitation of the secondary sources of funds is inconsiderably lower compared to the last year. In 2003, these funds made up 12.8% of the total sources of funds, on average (13.7% in 2002), i.e. 16% of the total liabilities of the banks. The structural analysis of these sources shows dominant share of 81.1% of the borrowings, which are primarily long-term credit lines withdrawn from foreign banks and placed in the form of long-term credit placements, particularly intended for development and investments.

The concentration of 67.6% of the total deposits of the non-financial entities in the group of large banks results in such a structure of their sources of funds, 78.3% which constitute of these deposits. It lowers the contingency of these banks upon secondary sources of funds. Thus in 2003, these sources made up 7% of the liabilities of the group of large banks, or 7.9% of their liabilities. The contingency of the group of medium-size and the group of small-size banks upon the secondary sources of funds is considerably larger. In the analyzed period, the group of medium-size and the group of small-size banks financed 21.2% and 16.3%, of their activities from these source of funds, respectively

Chart 19
Distribution of the secondary sources of funds by groups of banks



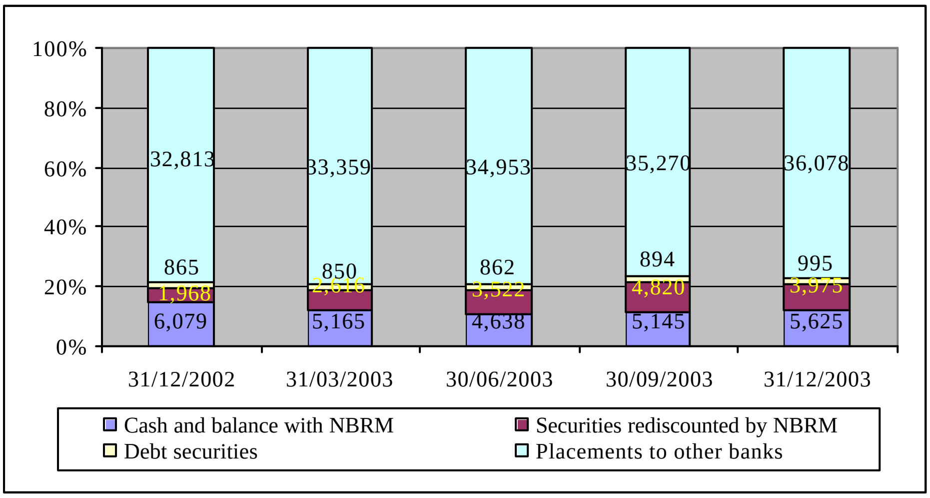
2.3.3.3. Liquid assets and highly liquid assets

The stability of the banks is related to the maintenance of certain level of liquid assets as a protection against the liquidity risk. The level of liquid assets should correspond to the size of the bank, quantified from the aspect of the amount and the maturity of its liabilities, in order to cover the possible unpredictable outflows of funds. In 2003, the liquid assets registered a high share, defined in a wider sense of the word[4], in the structure of the total assets of the banks in the Republic of Macedonia. The average share of the liquid assets in the total assets of the banking system equaled 45% in the analyzed period. Compared to the recorded amount in 2002, a decrease of 1.4 percentage points is registered, which corresponds with the moderate positive dynamics of financial support of the economy through banking loans.

The analyzed period registers no considerable movements in the liquid assets structure. The funds on correspondent accounts with foreign banks further dominate with an average monthly share of 69.5% in the total liquid assets of the banks. The banks in the Republic of Macedonia held 11%, of their liquid assets in cash, and 8.3% in CB bills on average monthly basis. The residue pertains to debt securities, accounts with domestic banks and short-term credits of banks.

[4] The liquid assets, in a wider sense, covers the cash and the balances with the National Bank of the Republic of Macedonia, the CB bills, the short-term debt securities, the short-term credits and balances on the accounts with domestic and foreign banks.

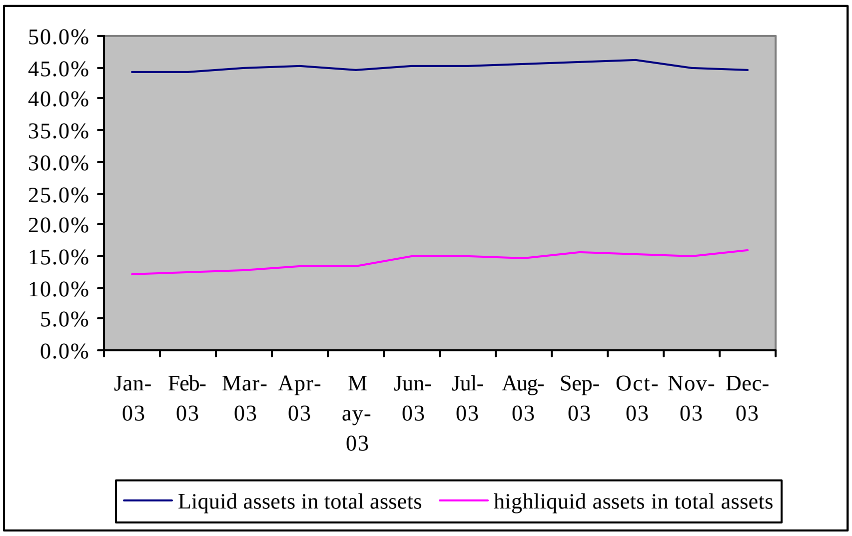
Chart 20
Structure of liquid assets



The highly liquid[5] assets, i.e. the portion of assets which can most easily and most promptly be converted into cash, in 2003, constituted 14.2%, on average monthly basis, of the total assets of the banks in the Republic of Macedonia, thus ensuring an average degree of sight deposits coverage of 36.2%, and mitigates the expected outflow of the sight deposits within a 30-day period.

The comparative bank-by-bank analysis by banks indicates the lowest structural share of highly liquid assets in the total assets of the group of large banks, with its monthly average being equal to 10.3% in the analyzed period. The group of medium-size banks follows with 17.8%, while 21.7% of the assets of the group of small-size banks are highly liquid. Furthermore, the analysis shows that such situation corresponds with the expected stability of the sight deposits by individual groups of banks within the period of up to 1 month.

Chart 21
Movement of the liquid and the highly liquid assets in 2003



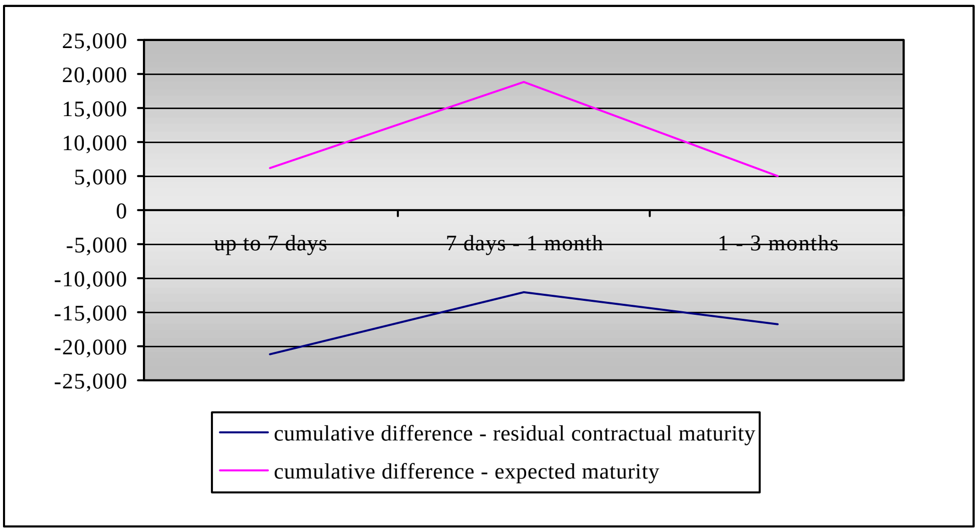
[5] Defined as a sum of the cash and the balances with the National Bank of the Republic of Macedonia, the CB bills and the sight deposits with domestic and foreign banks.

2.3.3.4. Maturity structure of the assets and the liabilities

Relevant instrument in the liquidity management is the matching of the maturity between the funds and the sources of funds through defined maturity blocks. An initial criterion is the matching of the contractual residual maturity[6] of the individual claims and liabilities within each maturity block. The incorporation of the possibility for collection of the claims within the maturity dates and the level of stable deposits, which will not be withdrawn within their maturity, are as much important.

The unfavourable maturity structure of the deposit potential of the banks, as well as the orientation towards long-term lending in 2003, resulted in a residual maturity mismatch between the funds and the sources of funds on an extremely short run (up to 7 days), at the end of the year. The maturity mismatch in the first maturity block is so significant that could be overcome within a period of over 12 months on cumulative basis. The incorporation of the level of expected stability of the deposit base resulted in an expected maturity match of the assets and the liabilities of the banks in the Republic of Macedonia on a short run. The banks in the Republic of Macedonia expect that only 19.2% of the total deposits, or 29.7% of the sight deposits will be withdrawn within 7 days, which corresponds with the average volume of highly liquid assets the banks maintain in 2003, covering 22% of the total deposit potential, or 36.2% of the sight deposits.

Chart 22
Maturity structure – cumulative difference



The bank-by-bank analysis indicates that the contractual residual maturity mismatch between the funds and the sources of funds of the banks in the Republic of Macedonia is caused by the group of large banks and partly by the group of medium-size banks. On the other hand, the group of small-size banks reaches consensual residual maturity match in all maturity blocks. Such situation is explained through the structure of the sources of funds of the individual groups of banks, i.e. the dominant share of 78.3% of the deposits of the non-financial entities in the structure of the sources of funds of the group of large banks, unlike the dominant share of the own funds of 43.3% in the structure of sources of funds of the group of small-size banks. On the other hand, the group of large banks expects stability of 77% of the sight deposits and 86% of the total deposit base with maturity of up to 7 days, as well as their stability of 75% and 77.7%, respectively, with maturity of up to 30 days, which is a basic

[6] Residual maturity of the claims and the liabilities denotes the remaining period from the reporting month to their actual maturity.

determinant of the expected maturity match of the individual assets and liabilities items of this group of banks.

2.3.4. Profitability

2.3.4.1. Income statement structure

The achievement of a satisfactory level of profitable operations is a relevant precondition in the maintenance of the stability in the banking system. The provision of an adequate level of capital base for covering the risks the banks face with during their operations is primarily determined by their profitability potential. Not only the internal factors such as maximization of the income from the performance of the banking activities and minimization of the operational costs can affect the banks efficiency, but also the surrounding in which the banks operate and which they should adjust to.

At the end of 2003, the banks in the Republic of Macedonia showed positive financial result in the amount of Denar 448 million, on aggregate basis, compared to the first half of the year when the financial result was negative and equaled Denar 418 million, on aggregate basis. Out of 21 banks in the Republic of Macedonia, 17 banks which make up 93.7% of the banks' total financial potential showed net income in total amount of Denar 1,420 million in their balance sheets, while 4 banks showed loss in the amount of Denar 972 million.

The analysis of the financial result for 2003 by individual groups of banks indicates that it is primarily due to the group of large banks, accounting for 51.4% of the total income at a level of overall banking system.

Table 9
Financial result by groups of banks

in MKD 000

Large banks	Medium banks	small banks	Total
230,239	131,499	86,345	448,083

The positive financial result of the banks for 2003 shown in the above table is based on the extraordinary income which amount to Denar 2,136 million. The income from the regular banks' operations (net interest income after provisioning and the net income based on fees) which amounts to Denar 2,129 million is not sufficient to cover the general and the administrative expenses in the amount of Denar 4,281 million. Hence the financial result of the banks would be negative, if the presented aggregate extraordinary income are excluded. However, despite these general conclusions, it should be mentioned that few banks have profitability which is fully based on the income from the regular operations, and have stable profitable position.

At the end of 2003, compared to the end of 2002, the total ***interest income*** of the banks was reduced by Denar 267 million or by 4.9%. The comparative analysis of the interest income in the analyzed periods indicates a general reduction of the interest income on all bases, excluding the interest income from the households which registers an increment of Denar 301 million or 38.2%. The alleviation of the registered fall in the gross interest income in 2003 was somehow affected by the cancelled income based on non-performing interest which was by Denar 267 million or 35.7% lower.

In 2003, given the stable environment, the credit support by the banks moderately enhanced, which is due to the further growth in the deposit potential, the higher interest in using banking credits, with diversified interest rates and terms of using, and the liberalization of the extension of foreign exchange credits being registered. With respect to the sector structure, the households sector becomes more relevant, with a strengthened preference of the banks to lend on a long run being evident.

The fall in the interest income in 2003 relative to 2002 is a reflection of the general reduction in the level of interest rates in the economy which at the end of 2003 was reduced to the lowest level ever. The downward trend of the banks' interest rates creates a favourable environment aimed at stimulating the economic development. The ascertained flexibility of the interest rate policy of the banks is considered to be a partial response, that is further adjustment of the banks to the changes in the monetary policy design, the higher level of savings in the banking system and the lower costs of the sources of financing, as well as the further rise in the degree of competitiveness within the banking system. The measures of the National Bank of the Republic of Macedonia aimed at relaxing of the monetary policy in 2003, included reduction in the discount rate, the interest rate on the Lombard credit, the interest rate on the compulsory reserve, as well as in the average weighted interest rate on the basic instrument in the conduct of the monetary policy in the country, the CB bills auctions.

Considering the propensity of the banks to maintain high foreign exchange position abroad, the reduction in the interest rates of the European Central Bank and the US Federal Reserves respectively influenced the decline in the total interest income resulting from the foreign exchange component of the banks' credit portfolio.

The total ***interest expenditures*** of the banks in 2003, compared to the interest expenditures registered at the end of 2002 dropped by Denar 373 million or by 12.5%.

The structural analysis of the interest expenditures in the analyzed period indicates that this reduction is a result, in particular, of the decrease in the interest expenditures of the enterprises as well as in the interest expenditures of the households in the amount of Denar 237 million or 29.8%, or Denar 203 million or 17.8%, respectively, with the interest expenditures of the banks registering an increase of Denar 59 million or 12.3%. This is partially due to the larger volume of used long-term borrowings by the banks, in the form of credits extended by foreign banks in 2003 compared to 2002.

The year 2003 is characterized with the achievement of higher level of savings, as a result of the stronger credibility of the banking system, as well as the growing importance of the savings, as a basis for inducing the credit activity of the banks and the economic growth of the country. The increase in the total deposit potential of the banks is a result of the higher volume of savings of both the households and the enterprises. From the aspect of the maturity of the deposit base, the propensity to short-term saving is evident, while from the aspect of the structure of the currency of denomination, one can conclude that the foreign exchange deposits remain dominant. Generally speaking, the decrease in the interest expenditures is a result of the reduction in the deposit interest rates in 2003. This movement was induced by the relaxing of the monetary policy in the country, on the one hand, and the reduction in the interest rates defined by the European Central Bank and the US Federal Reserve Bank, on the other, which is a basis for the calculation of the interest rates on the foreign exchange deposits which constitute a significant portion of the total deposit base of the banks in the Republic of Macedonia. With respect to the structural layout of the individual categories of interest expenditures in the banks' income statement, the interest expenditures of the households remain dominant and equal 35.7%, while the interest expenditures of the enterprises account for 21.3%. As a result of the increase registered in the interest expenditures of banks, their share almost reaches the level of the interest expenditures of the enterprises and equals 20.3%.

The net interest income after provisioning for 2003 amounts to Denar 202 million and went down by Denar 429 million or by 68% compared to 2002. Given the higher net interest income by Denar 106 million or by 4.4%, the above fall was a result of the amount of net provisions higher by Denar 535 million or 29.8%. Due to the larger volume of allocated provisions in 2003 compared to 2002, the share of the net interest income after provisioning in the total income dropped from 11.4% to 3.8%.

The total ***income generated on other bases*** (net income from fees, dividends, net income from securities, net capital income, net interest rate differentials and other income) in 2003 compared to 2002 went up by Denar 250 million or by 5.1%. Within these frameworks, ***the net income generated from fees***, as income from the regular operations, plunged by Denar 361 million or by 15.8% on annual basis. Thus their share in the "total other income" of 46.7% in 2002 dropped to 37.4% in 2003. On the other hand, the category other income increases its share in the "total other income" from 46.1% in 2002 to 56.4% in 2003, primarily on the basis of the increase in the extraordinary income, primarily due to the return on provisions.

The "**other expenditures**" *(general and administrative expenses and other expenditures) went down by Denar 240 million or by 4.7% on annual basis, caused by the decline in the expenditures incurred on other bases in the amount of Denar 445 million or 46.8%. This primarily originates from the reduced expenses based on taxes and revenue fees. The wage expenses remain dominant in general and the administrative expenses, the share of which equals 53.8%. In comparison with 2002, this category registers an increase of 3%.*

2.3.4.2. Indicators for profitability and efficiency of the banks

The second level of the analysis of the profitability of the Macedonian banks and the estimation of their efficiency is the calculation and the analysis of the main indicators, which reflect the performances of these two aspects of the banks' operations.

Table 10
Indicators of the profitability and the efficiency of the banks

Indicators	*2002*	*2003*	*2002**	*2003**
Return on average assets (ROAA)	*0,40%*	*0,45%*	*1,46%*	*1,74%*
Return on average equity (ROAE)	*2,06%*	*2,28%*	*6,90%*	*8,89%*
Operational costs/ total income	*0,91*	*0,90*	*0,76*	*0,74*
Wage expenses/ total income	*0,40*	*0,43*	*0,33*	*0,36*
Expenditures for allocation of loan loss provisions/Net interest income	*0,74*	*0,92*	*0,55*	*0,56*
Net interest income/operational costs	*0,48*	*0,53*	*0,72*	*0,60*
Total number of employees	*4.569*	*4.595*	*2.781*	*3.908*
Reported financial result/Total number of employees	*0,087 mil.MKD*	*0,098 mil.MKD*	*0,35 mil.MKD*	*0,36 mil.MKD*
Total net assets/Total number of employees	*20,4 mil.MKD*	*22,8 mil.MKD*	*23,4 mil.MKD*	*25,2 mil.MKD*

*The indicators refer only to the banks, which registered profit from their operations in 2002 and 2003

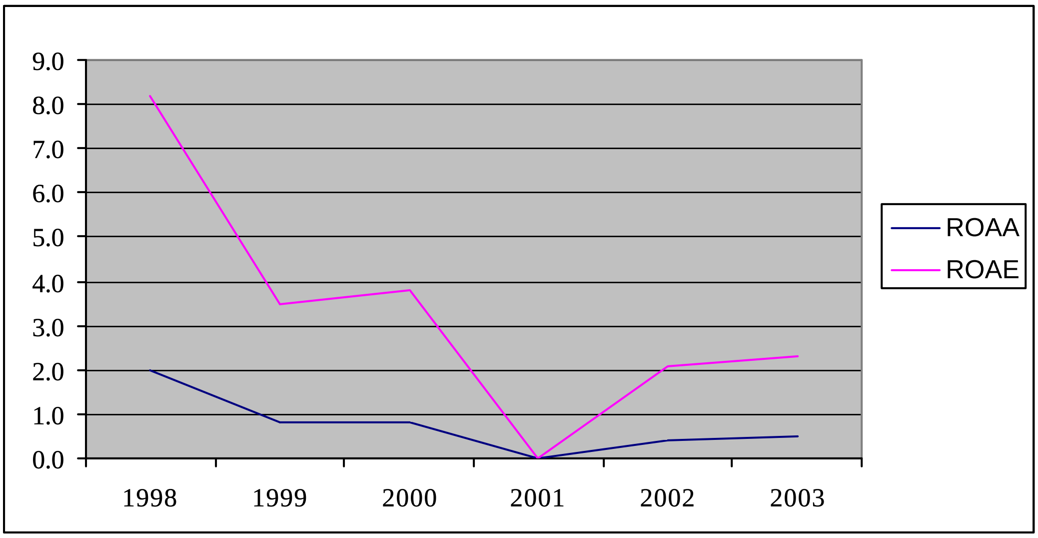
The higher profit registered by the banks in the Republic of Macedonia in 2003 on aggregate level compared to 2002, resulted in higher values of the indicators of the rate of return on assets (ROAA) and the rate of return on equity (ROAE). Thus in 2003, 100 units of assets of the banks in the Republic of Macedonia generated 0.45 units of profit, while 100 units of equity of the banks in the Republic of Macedonia generated 2.28 units of profit. If only the banks which generated profit from their operations in 2003, comprising 93.7% of the total financial potential of all banks, are taken into consideration, it is evident that the rate of return on assets and the rate of return of equity in 2003 are significantly higher and set at the level of 1,74%, i.e. 8.89%, respectively.

Table 11
Indicators for profitability and efficiency by groups of banks

Indicators	***Large banks***		***Medium banks***		Small banks	
	2002	***2003***	***2002***	***2003***	***2002***	***2003***
Return on average assets (ROAA)	*0,16%*	*0,42%*	*2,13%*	*0,45%*	*-2,72%*	*0,56%*
Return on average equity (ROAE)	*1,38%*	*3,46%*	*9,32%*	*2,04%*	*-6,13%*	*1,31%*
Operational costs/ total income	*0,96*	*0,91*	*0,67*	*0,87*	*1,54*	*0,91*
Wage expenses/ total income	*0,47*	*0,45*	*0,27*	*0,41*	*0,60*	*0,41*
Expenditures for allocation of loan loss provisions/Net interest income	*0,72*	*0,81*	*0,62*	*0,77*	*1,00*	*1,55*
Net interest income/operational costs	*0,23*	*0,37*	*0,83*	*0,96*	*0,61*	*0,42*
Total number of employees	*2.700*	*2.522*	*1.117*	*1.078*	*752*	*995*
Reported financial result/Total number of employees	*0,031 mil.MKD*	*0,091 mil.MKD*	*0,12 mil.MKD*	*0,12 mil.MKD*	*-0,48 mil.MKD*	*0,087 mil.MKD*
Total net assets/Total number of employees	*18,7 mil.MKD*	*23,1 mil.MKD*	*25,9 mil.MKD*	*27,3 mil.MKD*	*18,5 mil.MKD*	*17,3 mil.MKD*

The analysis by individual groups of banks indicates that the highest rate of the return on assets was realized in the group of small-size banks, which is due to the lowest level of average assets, while the highest rate of return on equity was registered in the group of large banks, as a result of the higher amount of profit registered with this group of banks, having in mind that the average level of equity, did not differ significantly relative to the other groups of banks. The groups of large and small-size banks were more profitable in 2003 compared to 2002, which is not the case with the group of medium-size banks, which registered lower level of return on assets and return on equity compared to 2002.

Chart 23
Movements of the indicators ROAA and ROAE



Moderate improvement in the banks' efficiency is evident from the decrease in the amount of the required operational costs for generating income of one Denar, not only on general level, but also with banks registering profit from their operations. On the other hand, the amount of wage expenses, representing the dominant part of the operational costs, required for generating income of one Denar, increased in 2003, compared to 2002. The analysis by groups of banks indicates that in 2003, compared to 2002, the groups of large and small-size banks recorded higher efficiency in their operations according to the both stated indicators, which is not the case with the group of medium-size banks.

In 2003, the loan loss provisions to net interest income ratio at the level of all banks equaled 0.92, thus showing that the net interest income in this period is almost completely used for absorbing the risk from the executed placements. The deterioration of this indicator in 2003 in comparison with 2002, is due to the higher increase in the loan loss provisions relative to the increase in the net interest income registered with all groups of banks (this indicator is especially unfavorable for the group of small-size banks, which was set at the level of 1.55 for 2003). This indicator is significantly more favorable for the banks generating profit and remained unchanged in both years of comparison, which is directly conditioned by the higher quality of their credit portfolio (the net provisions with these banks comprise more than a half of the registered net interest income).

The share of the net interest income, i.e. the income generated from conducting traditional banking operations in covering the operational costs, is, in general terms, higher in 2003 than the share registered in 2002. Such a trend of increase is a result of the movements in the profit and loss accounts of the large and the medium-size banks. However, the fact that despite the growth registered with large banks, this indicator is extremely low, is also worth mentioning. Thus in 2002 and 2003, this indicator was set at the level of 0.23, i.e. 0.37 respectively. Concerning the group of medium-size banks, it is characteristic that in 2003 the operational costs were almost fully covered by the net interest income (0.96).

In 2003, higher profit per employee in the banks in the Republic of Macedonia on general level was registered, with the banks that reported profit from their operations, as well as analyzing by separate groups of banks (the group of small-size banks recorded loss per employee in 2002). The highest gain per employee was registered in the group of medium-size banks, which was set at the level of Denar 0.12 million per employee for both comparison years. This indicator is much more favorable for the banks showing profit, and in 2003 it was set at the level of Denar 0.36 million per employee. Also, higher amount of net assets per employee on general level is ascertained in 2003, which is a result of the registered increase in the net assets per employee with the groups of large and medium-size banks, while the group of small-size banks registered a decrease from Denar 18.5 million as it equaled in 2002, to Denar 17.3 million of net assets per employee in 2003. It is characteristic that in 2003 this ratio with the group of medium-size banks equaled Denar 27.3 million per employee, which is higher in comparison with the banks generating profit.

As of December 31, 2003, the total number of employees in the banks in the Republic of Macedonia equaled 4,595 persons, which is an increase of 26 employees compared to December 31, 2002. However, no significant changes in the qualification structure of the employees relative to the previous years were registered, i.e. it is estimated as unfavorable from the aspect of the increase in the level of the efficiency of the banks.

Table 12
Qualification structure of the employees in the banks

As of 31.12.2003 godina	Total number of employee	Ph.D & M.Sc		University degree		Advanced specialist's training		Intermediate specialist's training		High-skilled, Low-skilled & under-skilled	
		Number	%	Number	%	Number	%	Number	%	Number	%
Banks	4,595	37	0.8	1,464	31.9	371	8.1	2,520	54.8	203	4.4

2.3.5 Capital adequacy / Insolvency risk

2.3.5.1 Banks' capital

For the purpose of defining the banks' capital more precisely, and in order to relate it more closely to the methodology for determining the guarantee capital, in the second half of

2003, the National Bank started with prescribing a methodology for determining the banks' capital. The new methodology defines the main conditions the banks' capital should meet: to be unconditionally irreversible, to be completely or immediately at disposal for covering the bank's losses, and in case of bankruptcy, i.e. liquidation, to be fully and unrestrictedly at disposal for covering the loss and servicing the liabilities to its creditors. There are also precise definitions of the capital components, i.e. those influencing its increase and the components representing deductible items.

At the end of 2003, the capital of the banks in the Republic of Macedonia defined according to the methodology of the National Bank equaled Denar 19,971 million (Euro 325.8 million), which is by Denar 777.7 million, or by 4.1% more compared to the end of 2002. Analyzed by groups of banks, having in mind the insignificant increase in the capital with the group of large banks by Denar 26 million and the decrease in the capital with the medium-size banks by Denar 293.4 million, the increase in the total capital base is a result of the increase in the capital of the small-size banks of Denar 1,045 million. This increase is mainly due to their recapitalization through new issues of shares, reinvestment of the profit registered in 2002, and payment of capital for the purpose of founding of the ProCredit Bank AD Skopje.

From the aspect of the structural analysis of the capital according to the share of separate groups of banks, it is evident that the share of the capital of the small-size banks increased by 4 percentage points, i.e. it equals 35.5%. The share of the capital of the medium-size and the large banks equals 31.3%, i.e. 33.2%, respectively, and in comparison with December 31, 2002, it registers a decrease of 2.8 percentage points, i.e. 1.2 percentage points, respectively.

Regarding the distribution of the capital base by banks, it ranges from Denar 3,527 million (Euro 57.5 million) with the bank registering the highest level of capital, to Denar 278 million (Euro 4.5 million), with the bank registering the lowest level of capital.

As of December 31, 2003, the level of coverage of the on-balance sheet assets with the banks' capital equaled 19%, which is a drop by minimal 1.6 percentage points in comparison with the end of 2002. This decrease is due to the higher increase in net assets (12.5%) in 2003, contrary to the increase in the capital base of 4.1% in 2003.

As of December 31, 2003, the capitalization rate of the group of large banks equaled 11.4%, which is a decrease of 7.6 percentage points compared to the average capitalization rate at the level of all banks in the Republic of Macedonia. The average capitalization rate of the group of medium-size banks is higher relative to the average rate at the level of all banks by 2.2 percentage points, contrary to the small-size banks the capitalization rate of which is higher by 22.1 percentage points than the average. Such a discrepancy in the capitalization rate by groups of banks is a result of the more diversified structure of the sources of financing, primarily of the more developed and larger deposit base with the large banks, in comparison with the medium-size and especially with the small-size banks, which have more simple structure of the sources of financing of their activities, with significant share of the own sources of funds, which denotes lower level of financial intermediation.

Table 13
Level of capitalization of the banks as of December 31, 2003

in MKD (000,000)

	BANK	Net assets	Provisions for potential losses	Gross assets	Owned funds	Guarantee capital	Risk weighted assets	Aggregate Open foreign exchange position	Capitalization rate - net (%)	Capitalization rate - gross (%)	Capital adequacy (%)
1	2	3	4	5=3+4	6	7	8	9	10=6/3	11=6/5	12=7/(8+9)
1.	Large banks	58,237	5,132	63,369	6,637	6,503	32,544	7,033	11.40	10.47	16.43
2.	Medium banks	29,440	2,270	31,710	6,256	6,064	20,175	1,400	21.25	19.73	28.11
3.	Small banks	17,199	1,838	19,037	7,079	6,874	11,655	2,446	41.16	37.19	48.75
4.	Total (4=1+2+3)	104,876	9,240	114,116	19,972	19,441	64,374	10,879	19.04	17.50	25.83

As of December 31, 2003, the level of coverage of the on-balance sheet and off-balance sheet banks' assets with their capital equaled 17.2%, which is a minimal decrease of 1.2 percentage points in comparison with December 31, 2002.

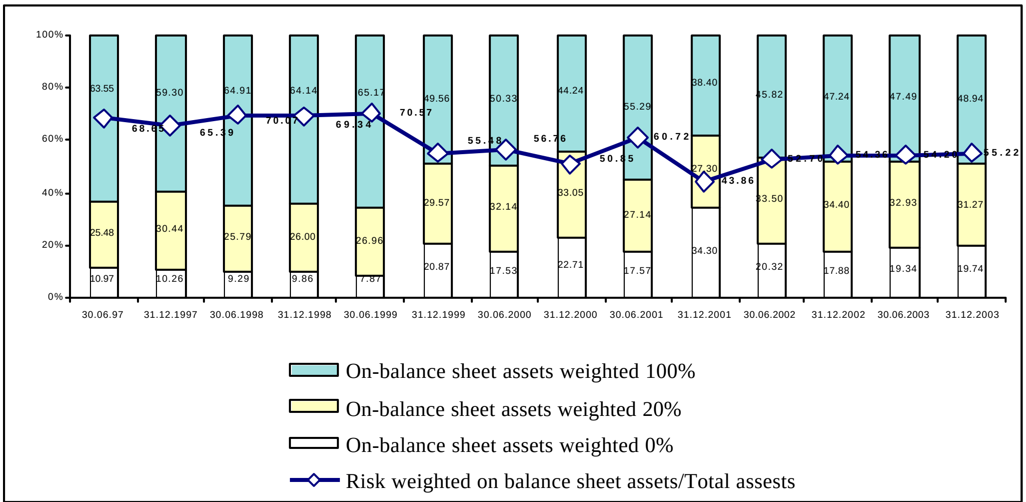
2.3.5.2. Banks' capital adequacy ratio

The capital adequacy ratio, as one of the most important prudential instruments in the banks' operations, reflects the necessary level of capital intended for covering the losses originating from the undertaken level of risk in their operations. In accordance with the methodology of the National Bank of the Republic of Macedonia, the ratio is determined by the correlation among the three components necessary for its calculation: the guarantee capital, the risk-weighted assets and the aggregate open foreign exchange position.

At the end of 2003, the guarantee capital of the banks in the Republic of Macedonia amounted to Denar 19.441 million, which is by Denar 319 million higher compared to the end of 2002 (Annex 5). This is due to the higher level of core capital at the end of 2003, i.e. to the issued common and preferred shares, which are the dominant component in the guarantee capital structure. The possibility for including hybrid capital instruments and the subordinated liabilities in the guarantee capital was used by only one bank, which in 2002 registered an issue of a subordinated instrument, which was completely transformed into equity in the second half of 2003.

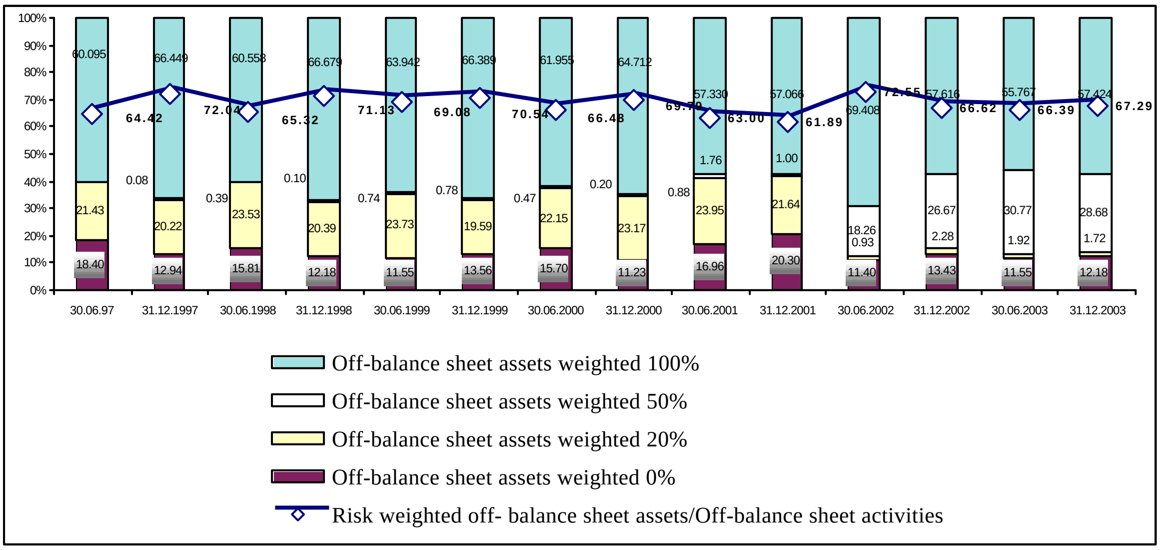
At end of 2003, the risk-weighted assets amounted to Denar 64.375 million, which is by Denar 7,037 million more compared to the end of December 2002.

Chart 24
Structure of the risk-weighted on-balance sheet assets of banks



The chart showing the structure of the risk-weighted balance sheet assets of the banks in the Republic of Macedonia indicates that as of December 31, 2003, the share of the on-balance sheet asset items, which involve certain level of risk, equals 55.2%, which is almost the same level registered at the end of 2002[16]. Generally observed, it can be concluded that the structure of the risk-weighted assets remained almost the same compared to the end of 2002. The dominant share still accounts for the assets with a risk weight of 100%.

Chart 25
Structure of the risk weighted off-balance sheet assets of banks



As in the risk-weighted assets, in the off-balance sheet assets weighted according to the level of risk, no significant structural changes relative to 2002 were registered. Thus the share of the risk off-balance sheet asset items in the total off-balance sheet operations of the banks at the end of 2003 equaled 67.3%, which is almost the same level registered in the previous year when it equaled 66.6%. The items with factor of conversion of 100% dominate the structure, as it was the case in the previous periods, and their share equals 57.4%.

In the calculation of the capital adequacy ratio, the open aggregate open foreign exchange position, which equaled Denar 10,878 million as of December 31, 2003, is also taken into consideration.

As a result of the movement of the guarantee capital, the risk-weighted on-balance sheet and off-balance-sheet asset items and the aggregate open foreign exchange position, the average rate of capital adequacy of banks in RM as of December 31, 2003 equals 25.8%, which is a decrease of 2.3 percentage points in comparison with the end of 2002.

Analyzed by groups of banks, the capital adequacy ratio of the group of large banks is lower relative to the capital adequacy ratio at the level of all banks in the Republic of Macedonia by 9.4 percentage points. On the contrary, the average capital adequacy ratio of the group of medium-size banks increased by 2.3 percentage points compared to the average level of all banks in the Republic of Macedonia. The difference is even more evident in the group of small-size banks, the average capital adequacy ratio of which is by 23 percentage points higher compared to the average capital adequacy ratio at the level of all banks. The reasons

[16] The banks' assets weighted with 50%, referring to the claims from the local administration, Government funds and agencies secured with guarantees and securities of this entities, is not included in the analysis of the structure of the risk weighted on-balance sheet assets as of December 31, 2003, due to its negligible share of 0.05%.

for the higher capital adequacy ratio of the small-size banks are identical to those referring to their high capitalization rate - poor volume of activities, primarily the credit activity contrary to the dominant share of the capital in their total financial potential.

Table 14
Average capital adequacy ratio by groups of banks

in %

	December 31, 2002	**December 31, 2003**
Group of large banks	*19.1%*	*16.4%*
Group of medium-size banks	*28.7%*	*28.1%*
Group of small-size banks	*56.4%*	*48.8%*

As of December 31, 2003, all banks met the prescribed minimum of 8%[17]. Analyzed by banks, as of December 31, 2003, as well as at the end of 2002, the banks with a capital adequacy ratio ranging from 30% to 50%, as well as banks with capital adequacy ratio ranging from 50% to 100% are dominant.

It is evident that certain structural movement of the banks from a level of higher capital adequacy to a level of lower capital adequacy was registered. Thus in 2003, the number of banks with a capital adequacy ranging from 12% to 20% increased from two to three banks, contrary to the decrease in the number of banks with capital adequacy ranging from 20% to 30%, from four to three banks. During the same period, the number of banks with capital adequacy exceeding 100% decreased from two to one bank, while the number of banks with capital adequacy ranging from 50% to 100% increased from four to six banks.

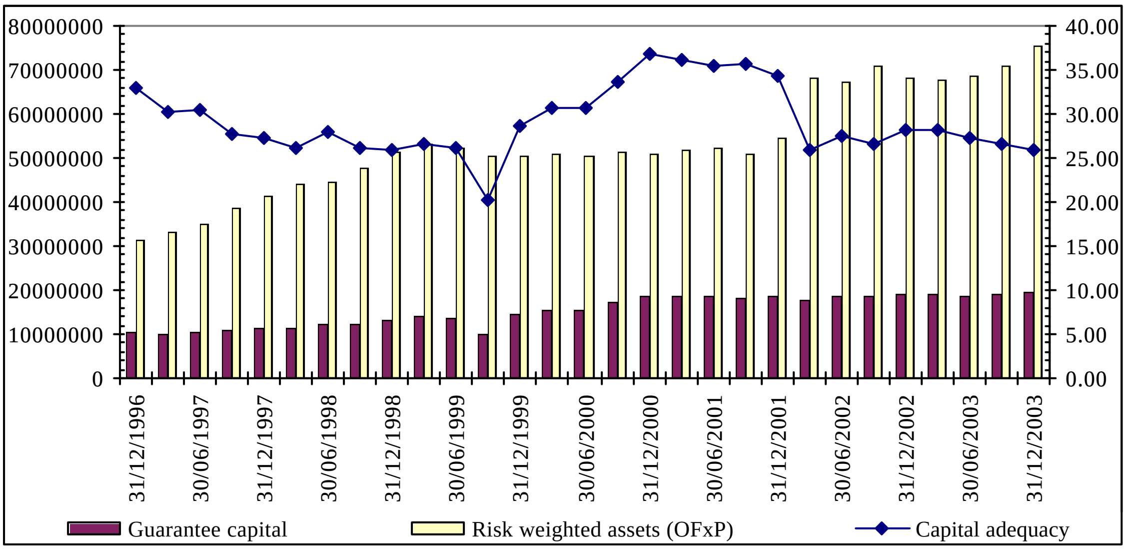
Table 15
Capital adequacy of the Banks in Republic of Macedonia in time periods

Capital adequacy ratio	Number of banks	
	December 31, 2002	December 31, 2003
below 8%	0	0
from 8 to 12%	0	0
from 12 to 20%	2	3
from20 to 30%	4	3
from 30 to 50%	8	8
from 50 to 100%	4	6
exceeding100%	2	1

The analysis of the movement of the capital adequacy ratio indicates that the average capital adequacy ratio of the banks in the Republic of Macedonia, starting from March 31, 2002 when the capital adequacy ratio equaled 25.9%, until December 31, 2003 when it equaled 25.8%, registered a relatively stable trend of movement.

[17] Export Import bank AD Skopje is excluded from the analysis. Basically, it is an insolvent bank with a capital adequacy being below 8%.

Chart 26
Movement of the guarantee capital, risk-weighted assets and the capital adequacy ratio



The relatively high capital adequacy is an indicator for stable solvency of the banks in the Republic of Macedonia, simultaneously representing an indicator for the poor efficiency in conducting financial intermediation. The challenge of having more adequate balance between the stability and the efficiency, tending towards improved efficiency is a task the banks will face with in the forthcoming period. The fulfillment of this task will inevitably lead to a decrease in such high capital adequacy ratio.

This movement is already noticeable with most of the banks, which started with an intensified credit activity, primarily with the households. However, the intensification of the credit activity and the decrease in the capital adequacy ratio must be followed by adequate internal systems and procedures of banks for identifying, measuring, monitoring and controlling the risks, primarily of the credit risk. In this manner, the possible materialization of the risks into losses, which would be burden on the capital, would be prevented. In that direction, the National Bank of the Republic of Macedonia will also act towards maintenance of the stability and reliability of the banking system as a whole, by providing permanent monitoring of the banks' operations.

APPENDIX

Appendix 1

ASSETS

BALANCE SHEET
OF THE BANKS IN THE REPUBLIC OF MACEDONIA

MKD (000,000)

ASSETS	31/12/2003		31/12/2002	
	amount	%	amount	%
CASH AND BALANCE WITH NBRM	**5,625**	**5.4%**	**6,079**	**6.5%**
Denar cash	4,097	72.8%	4,399	72.4%
Foreign currency exchange cash	1,523	27.1%	1,675	27.6%
Precious metals and other kind of cash	5	0.1%	5	0.1%
Compulsory reserve and other balances with NBRM	0	0.0%	0	0.0%
SECURITIES REDISCOUNTED BY NBRM	**3,975**	**3.8%**	**1,968**	**2.1%**
DEBT SECURITIES	**995**	**0.9%**	**865**	**0.9%**
Checks and bills of exchange	159	16.0%	164	19.0%
Government securities denar nominated	817	82.1%	674	78.0%
Other debt securities	19	1.9%	26	3.0%
PLACEMENTS TO OTHER BANKS	**37,301**	**35.6%**	**33,803**	**36.3%**
Accounts with domestic banks	3,383	9.1%	1,559	4.6%
Accounts with foreign banks	30,994	83.1%	29,338	86.8%
Short-term loans and other claims on domestic banks and other financial institutions	1,362	3.7%	1,623	4.8%
Short-term loans and other claims on foreign and domestic banks in foreign exchange	339	0.9%	294	0.9%
Past due loans and claims on banks	46	0.1%	0	0.0%
Long-term loans and other claims on domestic banks and other financial institutions	182	0.5%	194	0.6%
Long-term loans and other claims on foreign banks and other financial institutions	722	1.9%	748	2.2%
Non-performing loans on banks	274	0.7%	47	0.1%
Reserves for potential losses for claims on banks	0	0.0%	0	0.0%
PLACEMENTS TO CLIENTS	**37,111**	**35.4%**	**32,070**	**34.4%**
Enterprises	26,123	70.4%	23,445	73.1%
Other customers	213	0.6%	1,140	3.6%
Households	8,725	23.5%	5,231	16.3%
Non-performing loans on clients	10,126	27.3%	8,953	27.9%
Reserves for potential loan losses	-8,075	-21.8%	-6,699	-20.9%
ACCRUED INTEREST AND OTHER ASSETS	**6,061**	**5.8%**	**4,504**	**4.8%**
Accrued interest	487	8.0%	554	12.3%
Non-accrual interest and other claims	4,101	67.7%	3,710	82.4%
Reserves for potential losses for interest	-4,140	-68.3%	-3,766	-83.6%
Other claims	1,127	18.6%	881	19.6%
Foreclosures	4,430	73.1%	2,998	66.6%
Net commission relations	-91	-1.5%	-89	-2.0%
Net internal relations	-3	0.0%	0	0.0%
Other assets	149	2.5%	216	4.8%
SECURITIES INVESTMENTS	**7,355**	**7.0%**	**7,734**	**8.3%**
Securities in foreign currency available for sale	195	2.7%	207	2.7%
Securities in foreign currency held up to maturity	5,889	80.1%	6,290	81.3%
Equity investments in domestic currency	1,233	16.8%	1,237	16.0%
Reserves for purchased shares	38	0.5%	0	0.0%
FIXED ASSETS	**6,453**	**6.2%**	**6,211**	**6.7%**
Buildings	4,726	73.2%	4,354	70.1%
Equipment	3,128	48.5%	2,715	43.7%
Intangible investments	383	5.9%	218	3.5%
Other means of operation	164	2.5%	157	2.5%
Means of operation in preparation	668	10.4%	921	14.8%
Correction of value of fixed assets	-2,616	-40.5%	-2,155	-34.7%
NON-ALLOCATED RESERVES FOR POTENTIAL LOSSES	**0**	**0.0%**	**-20**	**0.0%**
TOTAL ASSETS	**104,875**	**100.0%**	**93,213**	**100.0%**
OFF-BALANCE SHEET ITEMS	**12,021**		**12,620**	

LIABILITIES

BALANCE SHEET
OF THE BANKS IN THE REPUBLIC OF MACEDONIA

MKD (000,000)

LIABILITIES	31/12/2003		31/12/2002	
	amount	%	amount	%
DEPOSITS OF BANKS	**2,195**	**2.1%**	**2,924**	**3.1%**
Denar sight deposits	47	2.2%	378	12.91%
FX sight deposits of foreign banks	272	12.4%	583	19.92%
FX sight deposits of domestic banks	287	13.1%	269	9.19%
Short-term denar deposits	979	44.6%	797	27.25%
Short-term FX deposits	476	21.7%	771	26.36%
Long-term denar deposits	123	5.6%	116	3.96%
Long-term FX deposits	10	0.5%	12	0.40%
SIGHT DEPOSITS	**42,947**	**41.0%**	**36,347**	**39.0%**
Denar sight deposits of enterprises	8,527	19.9%	7,951	21.87%
Denar sight deposits of public sector	1,461	3.4%	1,625	4.47%
Denar sight deposits of other customers	1,708	4.0%	1,556	4.28%
Denar sight deposits of households	7,093	16.5%	5,718	15.73%
Restricted denar deposits	558	1.3%	331	0.91%
FX sight deposits of enterprises	7,019	16.3%	4,580	12.60%
FX sight deposits of households	16,119	37.5%	14,213	39.10%
Restricted FX deposits	462	1.1%	374	1.03%
SHORT TERM DEPOSITS UP TO 1 YEAR	**23,836**	**22.7%**	**18,076**	**19.4%**
Denar short term deposits of enterprises	6,724	28.2%	4,876	26.97%
Denar short term deposits of public sector	535	2.2%	558	3.09%
Denar short term deposits of other customers	433	1.8%	324	1.79%
Denar short term deposits of households	3,583	15.0%	2,080	11.50%
FX short term deposits of enterprises	1,481	6.2%	322	1.78%
FX short term deposits of other customers	181	0.8%	430	2.38%
FX short term deposits of households	10,899	45.7%	9,487	52.48%
SHORT TERM BORROWINGS UP TO 1 YEAR AND ISSUED DEBT SECURITIES	**1,872**	**1.8%**	**2,917**	**3.1%**
Short-term borrowings of NBRM	0	0.0%	0	0.00%
Short-term denar borrowings of domestic banks	987	52.7%	958	32.85%
Short-term FX borrowings of domestic banks	0	0.0%	0	0.00%
Short-term borrowings of foreign banks	884	47.2%	1,959	67.14%
Short-term denar borrowings of other customers	0	0.0%	0	0.00%
Short-term borrowings of enterprises	0	0.0%	0	0.00%
Issued debt securities and other short-term liabilities	0	0.0%	0	0.00%
OTHER LIABILITIES	**3,083**	**2.9%**	**2,296**	**2.5%**
Payable interest	171	5.5%	179	7.77%
Other liabilities in FX	2,416	78.4%	1,826	79.52%
Other liabilities in denars	341	11.1%	161	7.01%
Temporary accounts	156	5.1%	131	5.69%
LONG TERM DEPOSITS OVER 1 YEAR	**3,405**	**3.2%**	**3,482**	**3.7%**
Denar long term deposits of enterprises		6.8%	187	5.36%
Denar long term deposits of public sector	156	4.6%	154	4.42%
Denar long term deposits of other customers	112	3.3%	74	2.14%
Denar long term deposits of households	2,083	61.2%	2,189	62.88%
FX long term deposits of other customers	9	0.3%	3	0.09%
FX long term deposits of households	815	23.9%	875	25.12%
LONG TERM BORROWINGS OVER 1 YEAR	**6,920**	**6.6%**	**7,402**	**7.9%**
Long-term borrowings of NBRM	373	5.4%	398	5.37%
Long-term denar borrowings of domestic banks	132	1.9%	177	2.39%
Long-term FX borrowings of domestic banks	69	1.0%	27	0.37%
Long-term borrowings of foreign banks	5,434	78.5%	5,383	72.72%
Long-term denar borrowings of other customers	912	13.2%	931	12.58%
Long-term borrowings of enterprises	0	0.0%	0	0.00%
Assumed long term FX borrowings	0	0.0%	16	0.21%
Long term issued securities, subordinated deposits and hybrid capital instruments	0	0.0%	470	6.35%
PROVISIONS FOR OFF BALANCE SHEET ITEMS	**542**	**0.5%**	**490**	**0.5%**
OWNED FUNDS	**20,075**	**19.1%**	**19,279**	**20.7%**
Equity capital	18,445	91.9%	17,168	89.05%
Reserve fund	2,674	13.3%	2,505	12.99%
Revaluation reserves	51	0.3%	53	0.28%
Unallocated profit from previous years	422	2.1%	237	1.23%
Other funds	1	0.0%	1	0.01%
Loss	-1,518	-7.6%	-666	-3.45%
Non-allocated reserves for potential losses	0	0.0%	-20	-0.11%
CURRENT FINANCIAL RESULT	**0**	**0.0%**		

Appendix 2

INCOME STATEMENT

- -

MKD (000,000)

	31/12/2003		31/12/2002	
	amount	%	amount	%
INTEREST INCOME	***5,161***	***100.0%***	***5,428***	***100.0%***
Banks	880	17.0%	1,178	21.7%
Enterprises	2,999	58.1%	3,404	62.7%
Households	1,088	21.1%	787	14.5%
Other	675	13.1%	806	14.9%
Reserved interest	-481	-9.3%	-748	-13.8%
INTEREST EXPENSE	***-2,625***	***100.0%***	***-2,999***	***100.0%***
Banks	-534	20.3%	-476	15.9%
Enterprises	-560	21.3%	-798	26.6%
Households	-936	35.7%	-1,139	38.0%
Other	-275	10.5%	-254	8.5%
Insurance premium	-320	12.2%	-333	11.1%
NET INTEREST INCOME	***2,536***	***100.0%***	***2,430***	***100.0%***
NET PROVISIONS	***-2,334***	***100.0%***	***-1,798***	***100.0%***
Provisions	-3,298	141.3%	-2,738	152.3%
Recovery, regarding provisions	964	-41.3%	940	-52.3%
NET INTEREST INCOME AFTER PROVISIONS	***202***	***100.0%***	***631***	***100.0%***
NET FEES AND COMMISSION INCOME	***1,927***	***100.0%***	***2,287***	***100.0%***
Fees and commission income	2,234	115.9%	2,685	117.4%
Fees and commission expenses	-307	-15.9%	-398	-17.4%
DIVIDENDS	***80***	***100.0%***	***41***	***100.0%***
NET INCOME, REGARDING THE SECURITIES	***5***	***100.0%***	***2***	***100.0%***
NET CAPITAL INCOME	***-38***	***100.0%***	***-47***	***100.0%***
NET FX INCOME	***274***	***100.0%***	***356***	***100.0%***
OTHER INCOME	***2,902***	***100.0%***	***2,259***	***100.0%***
Other income	766	26.4%	474	21.0%
Extraordinary income	2,136	73.6%	1,785	79.0%
OPERATING EXPENSES	***-4,281***	***100.0%***	***-4,059***	***100.0%***
Salary	-2,302	53.8%	-2,235	55.1%
Depreciation	-637	14.9%	-412	10.2%
Material expenses	-336	7.9%	-363	8.9%
Services	-790	18.5%	-815	20.1%
Business trip expenses	-49	1.1%	-62	1.5%
representation expenses	-167	3.9%	-173	4.3%
OTHER EXPENSES	***-539***	***100.0%***	***-1,001***	***100.0%***
Other expenses	-507	94.0%	-952	95.1%
Extraordinary expenses	-33	6.0%	-49	4.9%
GROSS INCOME / LOSS	***531***		***470***	
TAXES	***83***		***74***	
NET INCOME / LOSS	***448***		***396***	

Appendix 3

INDICATORS FOR THE QUALITY OF THE BANKS IN THE REPUBLIC OF MACEDONIA

INDICATORS FOR THE QUALITY OF THE BANKS IN THE REPUBLIC OF MACEDONIA

MKD (000,000)

Items	31/12/1999	31/12/2000	31/12/2001	31.12.2001*	30/06/2002	30.06.2002*	31/12/2002	31.12.2002*	30/06/2003	30.06.2003*	31/12/2003
A	21,617	21,530	23,303	23,303	68,660	68,660	67,337	67,337	69,537	69,537	77,686
B	8,083	11,432	11,844	11,844	11,892	11,892	11,018	11,018	10,959	10,959	10,871
C	8,218	6,121	7,891	7,891	6,854	6,854	6,269	6,269	6,296	6,296	4,602
D	9,175	7,122	7,740	7,740	6,923	6,923	6,497	6,497	5,868	5,868	5,735
E	3,541	4,372	2,260	6,096	3,198	8,333	2,094	7,440	3,633	9,473	5,413
Total Credit Exposure	50,634	50,576	53,040	56,875	97,526	102,661	93,214	98,560	96,293	102,133	104,306
Potential Losses	11,424	10,842	9,609	13,444	9,876	15,011	8,166	13,512	9,422	15,263	10,719
Total C,D,E	20,934	17,615	17,892	21,727	16,975	22,110	14,860	20,206	15,797	21,637	15,749
Total D,E	12,716	11,494	10,001	13,836	10,121	15,256	8,591	13,937	9,500	15,341	11,148
Total C,D	17,393	13,243	15,632	15,632	13,777	13,777	12,766	12,766	12,164	12,164	10,336
C,D,E/Total Credit Exposure (%)	41.34	34.83	33.73	38.20	17.41	21.54	15.94	20.50	16.41	21.19	15.10
D,E/Total Credit Exposure (%)	25.11	22.73	18.85	24.33	10.38	14.86	9.22	14.14	9.87	15.02	10.69
C,D/Total Credit Exposure (%)	34.35	26.18	29.47	27.48	14.13	13.42	13.70	12.95	12.63	11.91	9.91
D/Total Credit Exposure (%)	18.12	14.08	14.59	13.61	7.10	6.74	6.97	6.59	6.09	5.75	5.50
E/Total Credit Exposure (%)	6.99	8.64	4.26	10.72	3.28	8.12	2.25	7.55	3.77	9.28	5.19
C/Total Credit Exposure (%)	16.23	12.10	14.88	13.87	7.03	6.68	6.73	6.36	6.54	6.16	4.41
Potential Losses/Total Credit Exposure (%)	22.56	21.44	18.10	23.64	10.13	14.62	8.76	13.71	9.79	14.94	10.28
Net Items in C, D and E	10,751	8,152	9,789	9,789	8,602	8,602	7,950	7,950	7,656	7,656	6,318
Guarantee Capital	14,404	18,708	18,699	18,699	18,487	18,487	19,122	19,122	18,669	18,669	19,441
C,D,E/Guarantee Capital (%)	145.34	94.15	95.68	116.19	91.82	119.60	77.71	105.67	84.61	115.90	81.01
D,E/Guarantee Capital (%)	88.28	61.44	53.48	73.99	54.74	82.52	44.93	72.88	50.89	82.17	57.34
C,D/Guarantee Capital (%)	120.75	70.79	83.60	83.60	74.52	74.52	66.76	66.76	65.16	65.16	53.17
D/Guarantee Capital (%)	63.70	38.07	41.39	41.39	37.45	37.45	33.98	33.98	31.43	31.43	29.50
E/Guarantee Capital (%)	24.59	23.37	12.09	32.60	17.30	45.07	10.95	38.91	19.46	50.74	27.84
C/Guarantee Capital (%)	57.05	32.72	42.20	42.20	37.07	37.07	32.79	32.79	33.73	33.73	23.67
Net Items in C, D and E/Guarantee Capital	74.64	43.57	52.35	52.35	46.53	46.53	41.58	41.58	41.01	41.01	32.50
Capital Adequacy Ratio	28.70	36.73	35.26	35.26	27.50	27.50	28.10	28.10	27.20	27.20	25.80
Total Exposure on the Country Risk					27,981		29,438		30,087		31,195
Potential Losses for Country Risk					137		8		23		12
Potential Losses for Country Risk/Total Exposure on the Country Risk					0.49		0.03		0.08		0.04

* Indicators for the quality of the credit portfolio which includes the amount of the non-performing receivables transferred into the off-balance sheet records

Appendix 4

CONTRACTUAL MATURITY STRUCTURE OF THE ASSETS AND THE LIABILITIES

MKD (000,000)

No	Description	up to 7 days	from 7 days to 1 month	from 1 month to 3 month	3 - 6 month	6 - 12 month	over 12 months	Total
1	2	3	4	5	6	7	8	9=1+2+3+4+5+6+7+8
	Assets							
1	Cash and balances with the NBRM	5,304	3	3	1	0	3,265	8,576
2	Securities of the NBRM and the Republic of Macedonia	1,036	2,939	142	185	302	6,077	10,681
3	Debt securities and other payment instruments	125	61	28	14	5	47	281
4	Placements with other banks	13,269	17,426	1,115	639	538	1,266	34,254
5	Placements with clients	2,334	2,120	4,944	5,758	8,745	21,312	45,213
6	Accrued interest	303	125	68	57	33	4,160	4,746
7	Other assets	946	413	240	38	184	568	2,388
8	Placements in own securities and capital investments	0	0	0	8	48	1,371	1,427
9	**Total assets (1+2+3+4+5+6+7+8)**	23,317	23,087	6,539	6,700	9,856	38,067	107,566
	Liabilities							
10	Banks' deposits	806	828	325	78	78	6	2,120
11	Sight deposits	40,775	1,037	625	199	208	70	42,913
12	Short-term deposits with up to 1 year of maturity	1,196	10,348	8,055	2,079	2,153	5	23,836
13	Short-term borrowings with up to 1 year of maturity	86	249	646	353	532	6	1,872
14	Issued debt securities	0	0	0	0	0	0	0
15	Other liabilities	943	659	164	462	220	343	2,792
16	Long-term deposits with over 1 year of maturity	165	454	179	324	539	1,744	3,405
17	Long-term borrowings with over 1 year of maturity	61	194	213	511	951	5,122	7,052
18	Off-balance sheet items	519	165	1,010	625	848	1,941	5,108
19	**Total liabilities (10+11+12+13+14+15+16+17+18)**	44,551	13,933	11,216	4,631	5,530	9,237	89,099
20	**Difference (9-19)**	-21,234	9,154	-4,677	2,068	4,326	28,830	18,467
21	**Accumulation of the difference**	-21,234	-12,080	-16,757	-14,689	-10,363	18,467	0

Appendix 4

EXPECTED MATURITY STRUCTURE OF THE ASSETS AND THE LIABILITIES

MKD (000,000)

No	Description	up to 7 days	from 7 days to 1 month	from 1 month to 3 month	TOTAL
1	2	3	4	5	6
	Assets				
1	Cash and balances with the NBRM	4,660	33	98	4,792
2	Securities of the NBRM and the Republic of Macedonia	1,216	2,910	172	4,299
3	Debt securities and other payment instruments	131	54	28	213
4	Placements with other banks	13,437	17,276	1,235	31,948
5	Placements with clients	1,183	2,124	4,003	7,310
6	Accrued interest	231	184	193	608
7	Other assets	450	169	272	891
8	Placements in own securities and capital investments	0	0	0	0
9	**Total assets (1+2+3+4+5+6+7+8)**	**21,308**	**22,750**	**6,002**	**50,060**
	Liabilities				
10	Banks' deposits	746	836	260	1,842
11	Sight deposits	12,729	2,989	8,603	24,321
12	Short-term deposits with up to 1 year of maturity	709	4,974	8,643	14,326
13	Short-term borrowings with up to 1 year of maturity	86	249	646	982
14	Issued debt securities	0	0	0	0
15	Other liabilities	755	682	287	1,725
16	Long-term deposits with over 1 year of maturity	14	123	473	610
17	Long-term borrowings with over 1 year of maturity	15	194	221	430
18	Off-balance sheet items	65	92	743	900
19	**Total liabilities (10+11+12+13+14+15+16+17+18)**	**15,118**	**10,141**	**19,877**	**45,136**
20	**Difference (9-19)**	**6,190**	**12,610**	**-13,875**	**4,924**
21	**Accumulation of the difference**	**6,190**	**18,800**	**4,924**	0

Appendix 5

GUARANTEE CAPITAL OF THE BANKS IN THE REPUBLIC OF MACEDONIA

MKD (000,000)

No	Description	Total
A	**CORE CAPITAL**	
1	Issued common and preferred shares or paid-in funds	18,169
2	Reserves	2,674
3	Retained undistributed income	422
4	Income accordant to interim financial statement discounted by 50%	
5	Uncovered loss in the previous years	-1,518
6	Current loss	0
7	Goodwill	0
8	**TOTAL CORE CAPITAL**	**19,747**
B	**ADDITIONAL CAPITAL**	
9	Issued cumulative preference shares	276
10	Revaluation reserves	51
11	Hybrid capital instruments	
12	Subordinated debts	
13	**TOTAL ADDITIONAL CAPITAL**	**327**
14	Additional capital included in the guarantee capital	**327**
V	**GUARANTEE CAPITAL**	
15	**Gross guarantee capital**	**20,074**
16	Capital investments in banks and non-banking financial institutions	-633
17	Non-allocated reserves for potential losses	
17.1	Non-allocated non-accrual interest	
17.2	Non-allocated reserves for credit losses	
	GUARANTEE CAPITAL	**19,441**

Appendix 6

LEGAL FRAMEWORK OF THE BANKING SUPERVISION

Laws:

1. Law on the National Bank of the Republic of Macedonia ("Official Gazette of the Republic of Macedonia" No. 3/2002 and 51/2003)
2. Banking Law ("Official Gazette of the Republic of Macedonia" No. 63/2000, 37/2002 and 51/2003)
3. Law on Wstablishment of Macedonian Bank for Development and Promotion ("Official Gazette of the Republic of Macedonia" No.24/98 and 6/2002)
4. Law on Microfinancing Banks ("Official Gazette of the Republic of Macedonia" No.61/2002)

Decisions:

1. Decision on the documentation necessary for granting approvals and submitting notification in accordance with Article 26 paragraph 4 of the Banking Law ("Official Gazette of the Republic of Macedonia" No. 68/2003 - Revised text)
2. Decision on the documentation necessary for granting licenses according to the provisions of the Banking Law, the Law on Securities and the Law on Microfinancing Banks ("Official Gazette of the Republic of Macedonia" No.68/2003 - revised text)
3. Decision on the supervisory standards for regulating the banks' past due claims ("Official Gazette of the Republic of Macedonia" No.19/2003)
4. Decision on determining the methodology for classification of the on-balance and offbalance sheet asset items of banks according to the their risk level ("Official Gazette of the Republic of Macedonia" No.21/2002 - revised text)
5. Decision on the methodology for determining risk weighted assets of the banks ("Official Gazette of the Republic of Macedonia" No.50/2001)
6. Decision on the amount and the method of establishing special reserves for coverage of the banks' potential losses ("Official Gazette of the Republic of Macedonia" No.50/2001)
7. Decision on issuing authorizations to the banks for performing international payment operations and international credit activities and authorization for performing foreign currency operations in the Republic of Macedonia ("Official Gazette of the Republic of Macedonia" No. 65/96, 16/2001 and 85/2001)
8. Decision on the manner of conducting surveillance of the application of the regulations governing the foreign exchange and the Denar operations and undertaking measures against banks ("Official Gazette of the Republic of Macedonia" No. 44/02 and 80/02)
9. Decision on the manner of conducting supervision on banks and procedure for eliminating the identified irregularities ("Official Gazette of the Republic of Macedonia" No.111/2000)
10. Decision on the dynamics of adjusting the amount of the initial capital of the savings houses in compliance with the provisions of the Law on Banks and Savings Houses ("Official Gazette of the Republic of Macedonia" No. 49/98)
11. Decision on the methodology for determining the bank guarantee capital ("Official Gazette of the Republic of Macedonia" No.77/2000)
12. Decision on determining and calculating the banks' open foreign exchange positions ("Official Gazette of the Republic of Macedonia" No.103/2001 - revised text)
13. Decision on determining the scope and the manner of operating the savings houses ("Official Gazette of the Republic of Macedonia" no. 111/2000 and 80/2002)

14. Decision on defining and the method of determining related persons according to the provisions of the Banking Law ("Official Gazette of the Republic of Macedonia" No.28/2001)
15. Decision on the methodology for determining the banks' net debtors ("Official Gazette of the Republic of Macedonia" No.28/2001)
16. Decision on bank's credit exposure limits ("Official Gazette of the Republic of Macedonia" no. 1/2004 - revised text)
17. Decision on the methodology for determining the banks' capital (Official Gazette of the Republic of Macedonia No. 66/2003)
18. Decision on the terms and the manner of concluding foreign exchange credit operations between residents (Official Gazette of the Republic of Macedonia No. 66/2003)
19. Decesion on defining the standards for ensuring the banks' information security ("Official Gazette of the Republic of Macedonia" no. 77/2003)
20. Decision on consolidated supervision of banks ("Official Gazette of the Republic of Macedonia" no. 84/2002)
21. Decision on identifying, assessing and managing the banks' liquidity risk ("Official Gazette of the Republic of Macedonia" no. 84/2003)

Appendix 7

Banks and Savings Houses in the Republic of Macedonia as of 31.12.2003

I. BANKS

Banks licensed to perform financial activities stipulated under Articles 45 and 46 of the Banking Law

Alfa banka a.d. Skopje
Dame Gruev , 1
1000 Skopje
Fax: 02 3116 433
Phone: 02 3116 830; 02 3135 206

UNI banka a.d. Skopje
Maksim Gorki, 6
1000 Skopje
Fax: 02 3132 186; 02 3230 268
Phone: 02 3286 100

Eurostandard banka a.d. Skopje
Vasil Glavinov, 12/2
1000 Skopje
Fax: 02 3224 095
Phone: 02 3228 444

Investbanka a.d. Skopje
Makedonija, 9/11
1000 Skopje
Fax: 02 3135 367
Phone: 02 3114 166

Izvozna i kreditna banka a.d. Skopje
Partizanski odredi, 3 / 11
1000 Skopje
Fax: 02 3122 393
Phone: 02 3122 207

Komercijalna banka a.d. Skopje
Dimitar Vlahov, 4
1000 Skopje
Fax: 02 3113 393
Phone: 02 3107 107; 02 3111 133

Makedonska banka a.d. Skopje
Bul. VMRO, 3-12/2
1000 Skopje
Fax: 02 3117 191
Phone: 02 3117 111

Ohridska banka a.d. Ohrid
Makedonski prosvetiteli, 19
6000 Ohrid
Fax: 046 254 130; 046 254 133
Phone: 046 206-600; 046 265-330

ProKredit banka a.d. Skopje
Marks Engels, 3 - 10 / 45
1000 Skopje
Fax: 02 3219 901
Phone: 02 3219 900; 02 3219 948

Radobank a.d. Skopje
Jurij Gagarin, 17
1000 Skopje
Fax: 02 3080 453; 02 3093 217
Phone: 02 3093 300

Sileks banka a.d. Skopje
Gradski zid, blok 9, lokal 5
1000 Skopje
Fax: 02 3114 891; 02 3224 844
Phone: 02 3115 288; 02 3115 880; 02 3112 699

Stopanska banka a.d. Bitola
Dobivoe Radosavljevic, 21
7000 Bitola
Fax: 047 207 515; 047 207 541; 047 207 513
Phone: 047 207 500

Stopanska banka a.d. Skopje
11 Oktomvri, 7
1000 Skopje
Fax: 02 3114 503
Phone: 02 3295 295

Teteks Kreditna banka a.d. Skopje
Naroden Front 19/a
1000 Skopje
Fax: 02 3131 419
Phone: 02 3131 407; 02 3131 155; 02 3127 449

Tetovska banka a.d. Tetovo
Marsal Tito 14,
1200 Tetovo
Fax: 044 335 274
Phone: 044 335 280

Tutunska banka a.d. Skopje
12-ta Udarna brigada, b.b.
1000 Skopje
Fax: 02 3105 630; 02 3105 681
Phone: 02 3105 601; 02 3105 606; 02 3105 649

T.X.Ziraat bankasi - subsidiary - Skopje
Zeleznicka, 8
1000 Skopje
Fax: 02 3110 013
Phone: 02 3111 337

Macedonian Bank for Development and Promotion a.d. Skopje
3-ta Makedonska brigada, b.b.
1000 Skopje
Fax: 02 3239 688
Phone: 02 3114 840; 02 3115 844

Banks licensed to perform financial activities stipulated under Article 45 of the Banking Law

Komercijalno investiciona banka a.d. Kumanovo
Plostad Nova Jugoslavija, b.b.
1300 Kumanovo
Fax: 031 420 061
Phone: 031 475 100; 031 426 455

Internacionalna Privatna Banka a.d. Skopje
27 Mart , 1
1000 Skopje
Fax: 02 3112 830; 02 3134 060
Phone: 02 3119 191; 023124 288

Postenska banka a.d. Skopje
Marks Engels, br.3
1000 Skopje
Fax: 02 3220 389; 02 3163 054
Phone: 02 3112 862; 02 3163 354

II. Savings Houses

AL KOSA a.d. Stip
Vanco Prke, b.b.
2000 [tip
Fax: 032 393 163
Phone: 032 390 573; 032 392 960

AM d.o.o. Skopje
Luj Paster, lokal 6
1000 Skopje
Fax: 02 3223 770
Phone: 02 3223 770

Bavag d.o.o. Skopje
11 Oktomvri, 23/1
1000 Skopje
Fax: 02 3135 328
Phone: 02 3134 362

Fersped d.o.o. Skopje
Velko Vlahovic , 11
1000 Skopje
Fax: 02 3219 234
Phone: 02 3219 230; 02 3219 233

Gra|anska stedilnica d.o.o. Skopje
Dame Gruev, 10
1000 Skopje
Fax: 02 3118 585
Phone: 02 3118 585

Inko d.o.o. Skopje
Dimitrije Cupovski, 23
1000 Skopje
Fax: 02 3223 277
Phone: 02 3114 182

Interfalko d.o.o. Skopje
Bul Partizanski odredi, 123
1000 Skopje
Fax: 02 3062 546
Phone: 02 3062 546

Kiro Kucuk d.o.o. Veles
Car Samoil, 1
1400 Veles
Fax: 043 232 637
Phone: 043 231 199

Mak - BS d.o.o. Skopje
Dame Gruev,blok 2/3
1000 Skopje
Fax: 02 3166 466
Phone: 02 3131 190

Makedonska stedilnica a.d. Skopje
Bul. Sveti Kliment Ohridski, 58b
1000 Skopje
Fax: 02 3121-408
Phone: 02 3121-370

Malesevka a.d Berovo
Marsal Tito , 10/a
2330 Berovo
Fax: 033 470 755
Phone: 033 470 755

Moznosti d.o.o. Skopje
Bul.Jane Sandanski, 111
1000 Skopje
Fax: 02 2401 050
Phone: 02 2401 051

Mladinec d.o.o. Skopje
Bul. G.Delcev, 11
Lamela A/1, DTC Mavrovka
1000 Skopje
Fax: 02 3237 521
Phone: 02 3238 712

Peon d.o.o. Strumica
Marsal Tito,b.b.
2400 Strumica
Fax: 034 345 706
Phone: 034 321 927

FULM Stedilnica d.o.o. Skopje
Mito Hadzivasilev Jasmin, 48
1000 Skopje
Fax: 02 3115 653
Phone: 02 3115 244; 02 /3131 106

Appendix 7

Groups of Banks and Savings Houses in the Republic of Macedonia as of 31.12.2003

Group of large banks	Group of medium-size banks	Group of small-size banks
1. Komercijalna banka a.d. Skopje	1. Tutunska banka a.d. Skopje	1. T.X. Ziraat bankasi Skopje
2. Stopanska banka a.d. Skopje	2. Ohridska banka a.d. Ohrid	2. Izvozna i kreditna banka a.d. Skopje
	3. Stopanska banka a.d. Bitola	3. MBPR a.d. Skopje
	4. Alfa banka a.d. Skopje	4. UNI banka a.d. Skopje
	5. Makedonska banka a.d. Skopje	5. Radobank a.d. Skopje
	6. Investbanka a.d. Skopje	6. Tetovska banka a.d. Tetovo
		7. Komercijalno Investiciona banka a.d. Kumanovo
		8. Eurostandard banka a.d. Skopje
		9. Po{tenska banka a.d. Skopje
		10. Teteks Kreditna banka a.d. Skopje
		11. Sileks banka a.d. Skopje
		12. ProKredit banka a.d. Skopje
		13. Internacionalna Privatna Bank a.d. Skopje