National Bank of the Republic of North Macedonia
Financial Stability, Banking Regulations and Resolution Department

REPORT ON RISKS IN THE BANKING SYSTEM OF THE REPUBLIC OF NORTH MACEDONIA IN THE FIRST QUARTER OF 2021

June 2021

Contents

Summary

In the first quarter of 2021, the banking system still operates in conditions of high uncertainty caused by the pandemic, reaffirming its readiness to respond to the risks it faces, simultaneously providing further credit support to the economy. Thus, one year after the outburst of the pandemic, the economy faced the strongest third wave of infections, followed by restrictive measures, although significantly milder and more selective compared to the previous ones. In such conditions, the activities of the banking system continued to grow, although their quarterly increase was slower compared to the previous quarter, which to a certain extent is associated with seasonal effects[1]. On the side of the sources of funds, deposits continue to grow, which confirms the public confidence in the stability of the system. The higher level of capital and reserves, due to the maintenance of the profits from 2020, also significantly contributed to the quarterly growth of the sources of funds. In order to strengthen the safety, soundness and capacity of the banking system for further credit support of the economy, the National Bank adopted a decision on temporary restriction of dividend distribution and payment to shareholders in February 2021. The measure was valid until the end of 2021, but with a possibility of being revoked prematurely, depending on the circumstances with the pandemic. In the first quarter of 2021, the banks provided a solid credit growth, although at a slightly slower pace compared to the previous quarter, which to a certain extent may also be associated with the seasonal factors. Since the beginning of the crisis, the National Bank adopted a series of measures to maintain the credit cycle and favorable financial conditions in the economy, as well as to inject additional liquidity into the banking system. For this purpose, in March 2021 the policy rate was cut by additional 0.25 percentage points, to a level of 1.25%. Since the beginning of the pandemic, with the support of the National Banks' regulatory flexibility measures, the banks eased the credit burden for most of their clients, by approving certain form of easing in the loan repayment, mainly by approving a grace period or a temporary delay in the repayment of loan liabilities. As of 31.3.2021, only about 2% of total regular loans still use some form of easing in the loan repayment, which will expire in the next two quarters.

The solvency of the banking system improved. As of 31.3.2021, the capital adequacy ratio equaled 16.8%, which is slightly better compared to the end of 2020. The growth of own funds, primarily as a result of the reinvested earnings made the largest contribution to the increase in the capital adequacy ratio. All banks dispose of high-quality own funds and have a certain level of "free" own funds above the necessary regulatory and supervisory minimum. The conducted stress testing of the banking system resilience to the simulated shocks shows satisfactory resilience, similar to 31.12.2020.

In the first quarter of 2021, in conditions of further growth of the liquid assets of the Macedonian banking system, the liquidity indicators remained stable and on satisfactory level. The results of the simulations of combined liquidity shocks confirm the satisfactory volume of liquid assets, which allowed banks to smoothly carry out their business activities. They point to proper liquidity risk management by banks and a satisfactory resilience to the assumed extreme liquidity outflows.

In the first quarter of 2021, the materialization of the credit risk is somewhat higher, which is evident from the higher level of non-performing loans. This was mainly concentrated in household loans, while non-performing corporate loans remained almost unchanged.

The rate of non-performing loans minimally deteriorated and amounted to 3.5%. In the first quarter of 2021, non-performing loans to total corporate loans ratio minimally decreased to a level of 5.1%. The loan portfolio composed of households showed divergent movement, where the rate of non-performing loans deteriorated by 0.4 percentage points and as of 31.3.2021 amounted to 2.0%. Such developments stem from loans with temporarily differed payment due to pandemic. The coverage of non-performing loans with impairment decreased by several percentage points, to a level of 69.7%, which is still solid.

In the first quarter of 2021, the domestic banking system reported higher operating profit, compared to the same period last year. The higher financial result mostly stems from the reduction of impairment losses, with a significant contribution to the profit growth made by the higher non-interest income, which besides of the increase in net commission income, were largely a result of the one-off effects, amid moderate decline in net interest income. The rates of return of average assets and average equity improved, compared to the first quarter of 2020 and reached levels of 1.3% and 11.3%, respectively. Operational efficiency indicators have the same trend, given the slightly lower operating costs, compared to the same period last year.

The banking system's exposure to currency risk and risk from interest rate change in the portfolio of banking activities equal 6.9% and 9.8% of own funds, respectively, which is acceptable and far below the prescribed limits.

The dynamics and scope of vaccination, as well as the development of the pandemics itself in the following period, will largely affect the recovery pace of the economic activity and consequently, the activities of the banking system. The National Bank will continue to monitor the situation closely and appropriately undertake measures, when necessary.

[1]Banks' activities in the fourth and the first quarter of each year are usually influenced by the seasonal factors. Usually, in the fourth quarter of each year, the growth of activities of the banking system is strong and accelerated, followed by a weaker and slower growth in the first quarter of the next year, or even a decline in the activities. The influence of the seasonal factors is seen in both, lending and deposit activities.

I. Structure of the banking system

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

The number of banks in the Republic of North Macedonia remained unchanged as of 31.03.2021, compared to the previous quarter and equaled fourteen banks. Ten banks are in predominant foreign ownership, six of which are subsidiaries of foreign banks.

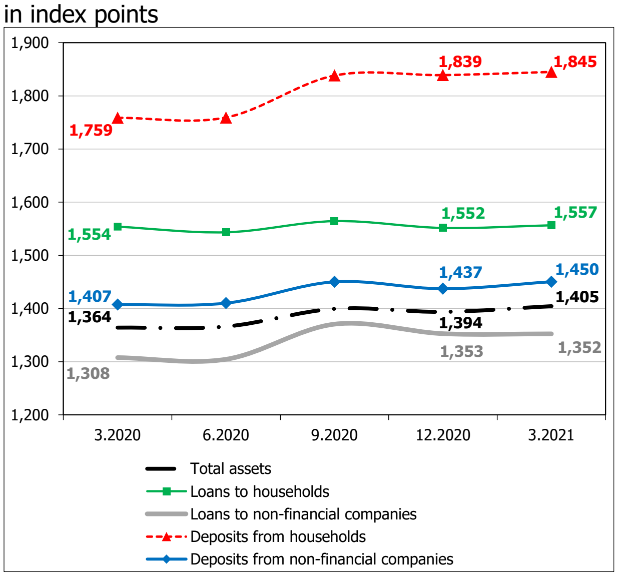
Table 1
Structure of major balance sheet positions, by banks' majority ownership (as of 31.3.2021)
in millions of denars and in %

Type of ownership	Number of banks	Capital and reserves		Assets		Loans to non-financial sector		Deposits from non-financial sector		Total revenues*		Financial result*	
		Amount	In %	Amount	In %	Amount	In %	Amount	In %	Amount	In %	Amount	In %
Banks in dominant ownership of foreign shareholders	**10**	**52,812**	**73.6%**	**425,283**	**71.7%**	**290,517**	**81.2%**	**303,737**	**69.8%**	**17,870**	**73.4%**	**5,274**	**69.6%**
- subsidiaries of foreign banks	*6*	*46,707*	*65.1%*	*356,170*	*60.1%*	*240,678*	*67.3%*	*259,101*	*59.6%*	*15,231*	*62.6%*	*4,672*	*61.7%*
- Austria	2	8,095	11.3%	70,754	11.9%	50,833	14.2%	42,382	9.7%	2,666	10.9%	315	4.2%
- Bulgaria	1	1,224	1.7%	10,638	1.8%	7,320	2.0%	7,450	1.7%	392	1.6%	18	0.2%
- Greece	1	15,400	21.5%	106,341	17.9%	73,672	20.6%	85,065	19.6%	5,328	21.9%	1,939	25.6%
- Slovenia	1	13,348	18.6%	99,018	16.7%	62,157	17.4%	80,353	18.5%	4,557	18.7%	1,794	23.7%
- Turkey	1	8,638	12.0%	69,419	11.7%	46,695	13.1%	43,852	10.1%	2,288	9.4%	605	8.0%
- other banks in dominant foreign ownership	*4*	*6,105*	*8.5%*	*69,113*	*11.7%*	*49,840*	*13.9%*	*44,636*	*10.3%*	*2,639*	*10.8%*	*602*	*8.0%*
- Bulgaria	2	2,816	3.9%	26,634	4.5%	18,198	5.1%	19,112	4.4%	1,319	5.4%	358	4.7%
- Germany	1	2,711	3.8%	35,090	5.9%	26,668	7.5%	20,373	4.7%	1,004	4.1%	195	2.6%
- Switzerland	1	578	0.8%	7,389	1.2%	4,973	1.4%	5,150	1.2%	315	1.3%	49	0.6%
Banks in dominant ownership of domestic shareholders	**4**	**18,972**	**26.4%**	**167,722**	**28.3%**	**67,257**	**18.8%**	**131,150**	**30.2%**	**6,475**	**26.6%**	**2,299**	**30.4%**
- private ownership	*3*	*16,321*	*22.7%*	*155,962*	*26.3%*	*67,238*	*18.8%*	*131,150*	*30.2%*	*6,369*	*26.2%*	*2,269*	*30.0%*
- state ownership	*1*	*2,651*	*3.7%*	*11,760*	*2.0%*	*19*	*0.0%*	*0*	*0.0%*	*106*	*0.4%*	*30*	*0.4%*
Total:	**14**	**71,784**	**100.0%**	**593,005**	**100.0%**	**357,774**	**100.0%**	**434,887**	**100.0%**	**24,344**	**100.0%**	**7,573**	**100.0%**

Source: NBRM, based on the data submitted by banks.
*Total income and financial result are calculated for the last twelve months (31.3.2020-31.3.2021).

In the first quarter of 2021, the banks predominantly owned by foreigners maintained their dominant share in the structure of major balance sheets positions of the banking system. The changes compared to the previous quarter are minimal. The share of banks in foreign ownership in the total loans to non-financial sector continues to be the most pronounced (81.2%).

Chart 1
Herfindahl index
in index points



Source: NBRM, based on the data submitted by banks.

The Herfindahl index[2], for individual categories of bank activities, registers no significant changes in the first quarter of 2021. In all remaining categories of activities, the Herfindahl index is **within the acceptable values[3]**, except in the household deposits, where it is above the acceptable level of 1800 index points.

Table 2
Indicators of concentration of major balance sheet positions in the three and the five banks with the largest share in these positions
in %

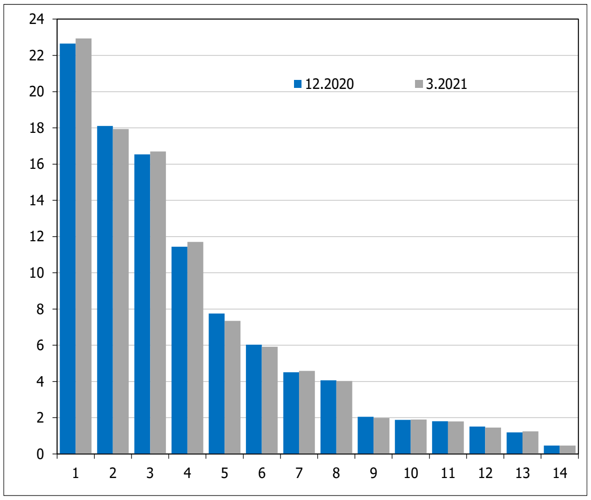
Position	31.03.2021		31.12.2020	
	CR3	CR5	CR3	CR5
Total assets	57.6	76.6	57.3	76.5
Loans to households	60.0	78.1	59.6	77.9
Loans to non-financial companies	49.3	76.7	49.6	76.5
Deposits from households	71.1	82.4	71.0	82.3
Deposits from non-financial companies	55.5	79.2	54.2	79.4
Financial result*	76.4	89.2	77.2	90.0
Total revenues*	62.8	78.6	62.9	78.6

Source: NBRM, based on the data submitted by banks.
*Total income and financial result are calculated for the last twelve months (31.3.2020-31.3.2021).

The share of the three and the five banks with the largest share in individual banks' balance sheets positions registered minimal changes, excluding the three banks with the largest share in deposits of non-financial companies (whose share increased by 1.3 percentage points in one quarter)and in financial result (whose share decreased by 0.7 percentage points)

[2] The Herfindahl index is calculated according to the formula $HI = \sum_{j=1}^{n} (S_j)^2$, where S is the share of each bank in the total amount of the analyzed category (e.g., total assets, total deposits, etc.), where *n* denotes the total number of banks in the system.
When the index ranges from 1,000 to 1,800 points, the concentration ratio is considered to be acceptable.

Chart 2
Share of individual banks in the total assets of the banking system
in %



Source: NBRM, based on the data submitted by banks.

The difference in the size of the banks according to the amount of their assets remains high, whereby the spread between the bank with highest market share (22.9%) and the bank with the lowest market share (0.5%) increased on a quarterly basis by 0.3 percentage points. Nine banks have individual market shares lower than 6% (their joint market share is 23.4%). Observed by individual bank, the first, the third and the fourth largest bank registered a more noticeable increase of the market share according to the total assets, while the second and the fifth largest bank registered a decrease. The market shares of other banks remained almost unchanged.

II. Bank risks

1. Credit risk

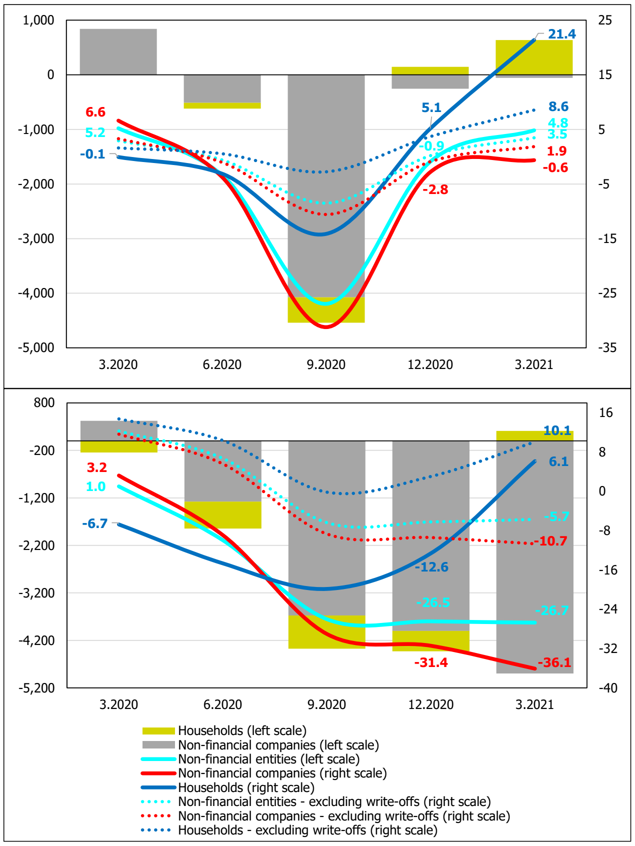
Amid protracted pandemic, it is very likely that the sustainable recovery of the real sector from the crisis will be postponed. The process of mass immunization globally and in the country is expected to enable faster resolution of the health crisis and gradual recovery of the domestic economy, but currently new risks have occurred related to the dynamics of the vaccination and the effectiveness of the vaccines to the new variants. Hence, the developments surrounding the COVID-19 pandemic still remain a significant risk factor related to the credit risk that banks are exposed to. In the first quarter of 2021, there was an increased materialization of the credit risk, which is perceived through the higher level of non-performing loans. The increase in non-performing loans mainly stems from loans, the deferred payment period of which (approved amid first and/or second wave of easing the contractual terms in 2020, for the purpose of easier dealing with the negative effects from the health and economic crisis), has already expired. This is confirmed with the creation of new non-performing loans in the first quarter of 2021, when they increased by 4.8%. The rate of non-performing loans minimally deteriorated and amounted to 3.5%. Observed by sector, the growth of non-performing loans was mainly concentrated in household loans (quarterly growth of non-performing loans of 21.4%), while non-performing corporate loans remained almost unchanged (-0.6%). However, there was a certain materialization of the credit risk within the credit portfolio of non-performing loans, due to non-fulfillment of obligations by individual corporate clients from several activities, for which the banks have eased the financial burden due to corona crisis. In the first quarter of 2021, non-performing loans to total corporate loans ratio minimally decreased to the new record low of 5.1%. The loan portfolio composed of households showed divergent movement, where the share of non-performing loans in total loans deteriorated by 0.4 percentage points and as of 31.3.2021 reached 2.0%.

The coverage of non-performing loans with impairment was maintained at a relatively high level, despite the decrease in the first quarter of 2021 (to 69.7%), which along with the satisfactory volume and quality of own funds, limited the adverse effects on the banks' solvency of a possible complete default on these loans.

Taking into account that the grace period of most of the loans which were under moratorium, expired at the end of March 2021, increased materialization of the credit risk and growth of non-performing loans can be expected in the following period. We can expect such effects from clients that deal with more pronounced financial difficulties, i.e. have unstable/ uncertain monthly income, as well as those whose income is related to activities mostly affected by the negative effects from the corona crisis. For the time being, the share of loans under moratorium is only 2.2% of total regular loans as of 31.3.2021, with a higher share of 4.3% in the corporate segment.

In the first quarter of 2021, part of the banks started to restructure the liabilities of some of the borrowers, for the purpose of easier overcoming of the negative effects of COVID-19 crisis. Yet, the share of these restructured loans due to the corona-crisis in the total regular loans to non-financial sector is minimal (0.3%) and does not represent a significant risk factor for the time being.

Chart 3
Quarterly (up) and annual (down) growth rate of non-performing loans to non-financial entities
in millions of denars in %



Source: NBRM, based on the data submitted by banks.
Note: The lines with dots show the growth of non-performing loans by excluding the effect of all mandatory write-offs made in the period 1.1.2016 - 31.3.2021. Starting from December 2019, the data also contains the collected compulsorily written-off loans.

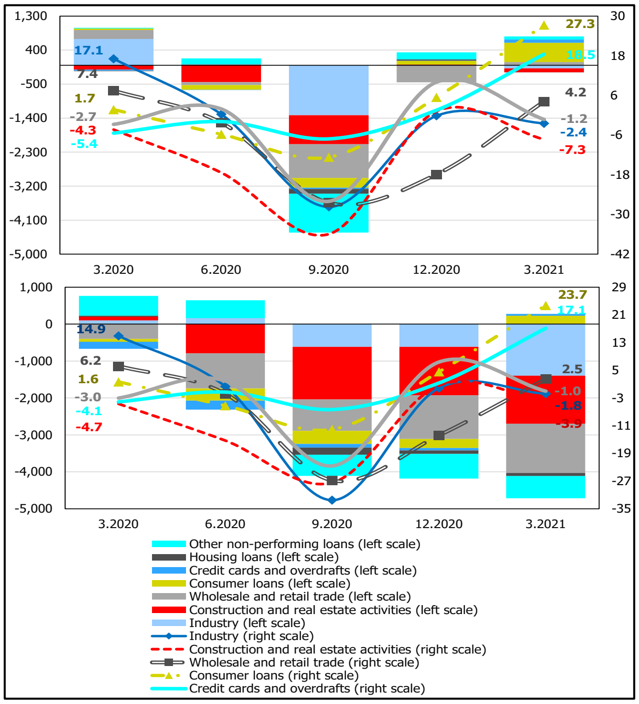
1.1. Materialization of credit risk in banks' balance sheets

In the first quarter of 2021, total non-performing loans to non-financial sector increased by 4.8% (or by denar 573 million), after their downward shift in the last quarter of 2020.

The regulatory measures undertaken by the National bank in the field of credit risk management, contributed to a slowdown in the materialization of the credit risk, at least in the field of creation of new non-performing loans. However, the grace period for more than 80% of the loans with eased contractual terms expired as of 31.12.2020 and in the first quarter of 2021 non-performing loans registered significant growth in the household segment, as well as in certain economic activities in the corporate sector. The temporary delay in the repayment of about 94% of loans that were under moratorium ended as of the end of March 2021. Taking into account the uncertainty around the duration and consequences of the COVID-19 pandemic and the subsequent uncertainty over the clients' regular loan repayment, as well as the fact that the grace period for almost all loans with amended contractual terms has expired, an increased materialization of the credit risk and growth of non-performing loans can be expected in the following period.

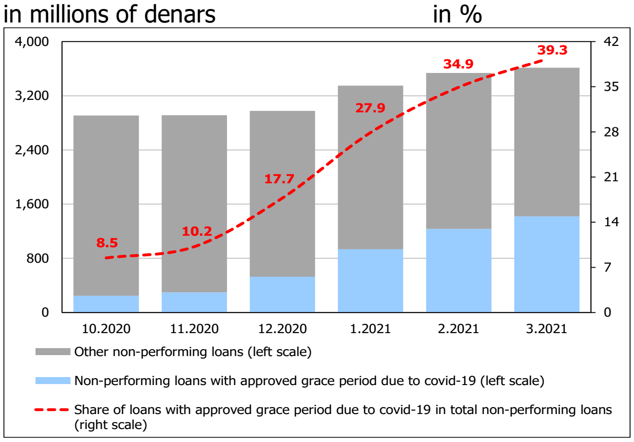
The increase in the volume of non-performing loans mainly arises from their increase in households. The non-performing credit portfolio comprised of households increased quarterly by 21.4% or

Chart 4
Quarterly (up) and annual (down) growth rate of non-performing loans, by activity (non-financial corporations) and by credit product (households)
in millions of denars in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 5
Non-performing loans to households and share of non-performing loans with approved grace period due to COVID-19 in total non-performing loans of the sector
in millions of denars in %



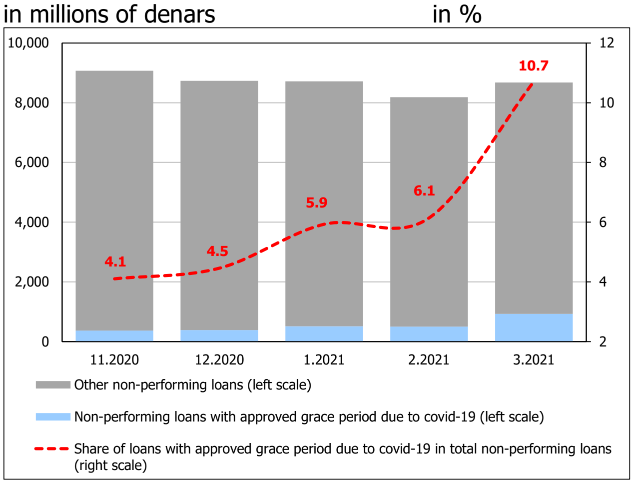
Source: National Bank's Credit Registry, based on data submitted by banks.

by denar 636 million, which is the largest growth after the period of the global financial crisis (2008 and 2009). Around 80% of the growth in non-performing loans to households accounts for the non-performing consumer loans, which increased by 27.3% or by denar 511 million. Non-performing loans also registered growth (by denar 98 million, 41.1%) as well as other consumer loans without a defined purpose (by denar 52 million, or by 28.4%). Namely, new non-performing loans to households are mainly due to default by multiple clients on individual small amounts, for which the repayment of loans was temporary *frozen* in part of 2020, due to corona crisis. Non-performing loans with previously approved easing due to corona crisis account for almost 40% of total non-performing loans to households as of 31.3.2021 and entirely determine the quarterly growth of total non-performing loans in this sector.

Non-performing corporate loans decreased by 0.6%, or by denar 55 million. In the corporate loan portfolio, non-performing loans registered different movements in individual economic activities, with a significant decline in clients from construction and textile industry, and more pronounced increase in real estate activities, chemical industry and trade activities. The decrease of non-performing loans in individual activities is due to mandatory write-offs[4]. The new non-performing loans arose mainly due to the transition of claims from several major clients to non-performing status, and which were granted a grace period due to the conditions related to COVID-19, Non-performing loans arising from loans that were under moratorium account for 10.7% of total non-performing

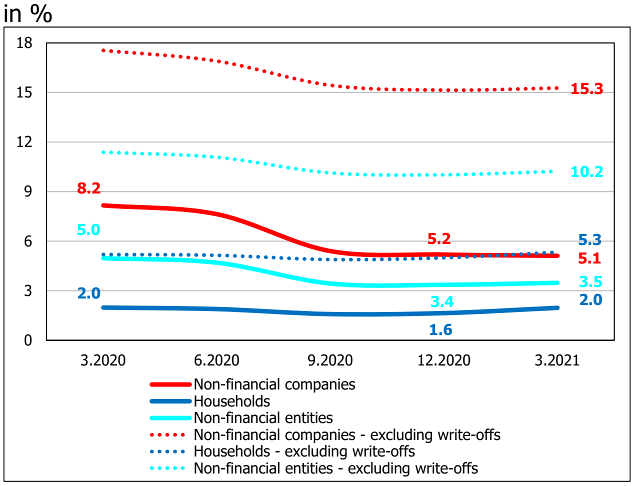
[4] If we exclude the effect of mandatory write-offs, the non-performing corporate loans register a growth of 1.9%.

Chart 6
Non-performing loans to non-financial companies and share of non-performing loans with approved grace period due to COVID-19 in total non-performing loans of the sector



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 7
Rate of non-performing loans of non-financial corporations, by sector



Source: NBRM, based on the data submitted by banks.

corporate loans. For the time being, the creation of new non-performing loans is less pronounced in corporate loan portfolio, compared to household loans, given that a relatively small part of corporate loans suffered changes in the contractual terms due to corona crisis[5].

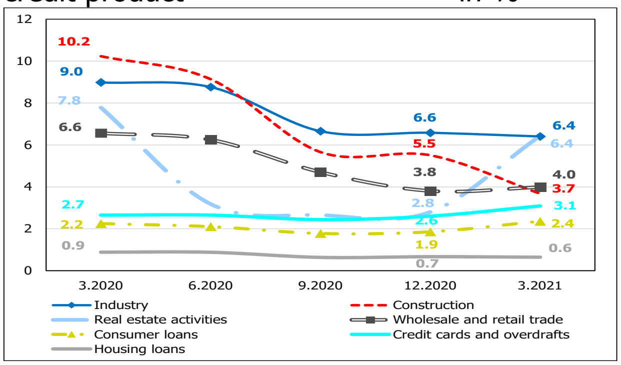
As a result of such developments, the quality of the banks' loan portfolio, measured through the share of non-performing loans in total loans to non-financial sector, deteriorated by 0.1 percentage points in the first quarter of 2021. As of 31.3.2021 this rate equaled 3.5%[6]. However, the rate of non-performing loans registered divergent movements in both segments of the banks' loan portfolio.

Slightly more pronounced deterioration of the non-performing to total loan ratio was registered in the household portfolio, and as of 31.3.2021, 2.0% of total loans were non-performing (increase of 0.4 percentage points compared to the previous quarter). The increase in the rate of non-performing loans is a result of the significant increase in *bad/ (non-performing)* loans, compared to the increase in total loans of this sector.

According to individual credit products, the increase in the rate of non-performing loans was most pronounced in credit cards

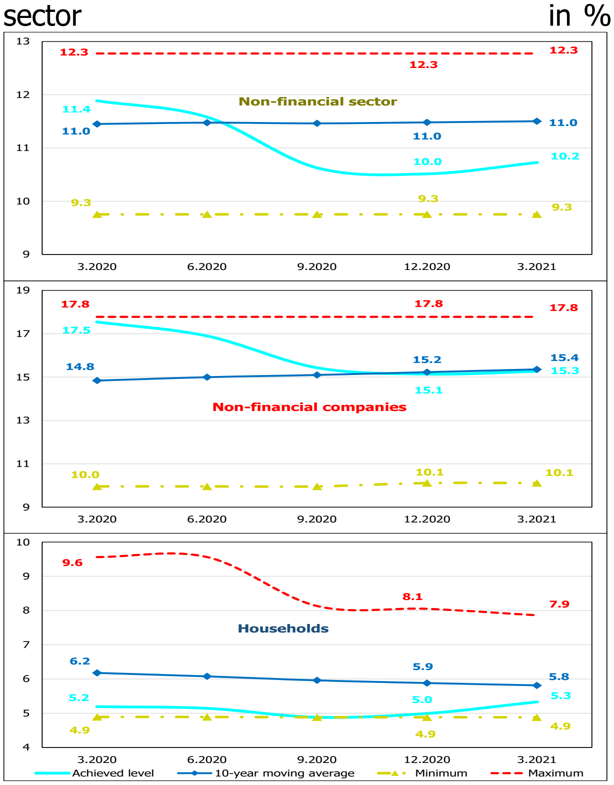
[5]As of 31.3.2021, corporate loans with approved grace period due to corona crisis accounted for 24.7% in total corporate loans, while the share of these loans in the household portfolio was 44.8%.
[6]Without the effect of the mandatory net write-offs, the share of non-performing to total loans equals 10.2% and is below the 10-year moving average (11.0%).

Chart 8
Rate of non-performing loans, by activity and credit product in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 9
Rate of non-performing loans, 10-year moving average and maximum and minimum level, by sector in %



Source: NBRM, based on the data submitted by banks.
*Note: Excluding the effect of all mandatory write-offs made in the period 1.1.2016 - 31.3.2021. Starting from December 2019, the data also contains collected compulsorily written-off loans.

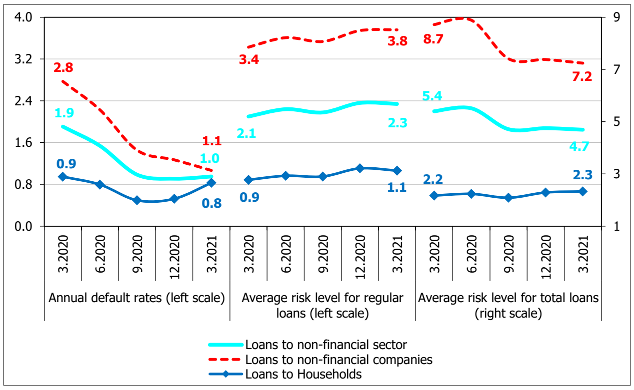
(by 1 percentage point) and consumer loans (by 0.5 percentage points), and reached 3.1% and 2.4%, respectively. The rate of non-performing loans to households (excluding the effect of mandatory net write-offs) was 5.3% and approached its 10-year moving average (5.8%).

In the corporate loan portfolio, the share of non-performing loans in total loans minimally decreased by 0.1 percentage point, to the new record low of 5.1%. Observed by individual activities, the decrease of this indicator was mostly pronounced in construction, where the rate of non-performing loans reduced to 3.7% (from 5.5% as of 31.12.2020)[7], thus registering the lowest level of the non-performing loans rate. As a result of the current growth in non-performing loans, the non-performing to total loan ratio registered significant deterioration in activities related to real estate where it reached 6.4% (from 2.8% as of 31.12.2020), amid slight deterioration in transport and storage (by 0.6 percentage points to a level of 4.8% as of 31.3.2021) and trade (by 0.2 percentage points to a level of 4.0% as of 31.3.2021). The rate of non-performing corporate loans (excluding the effect of net write-offs) was 15.3% and is almost at the level of the 10-year moving average for this rate (15.4%).

The annual default rate of regular credit exposure of households and the overall non-financial sector deteriorated, while for the companies, this rate minimally improved in the

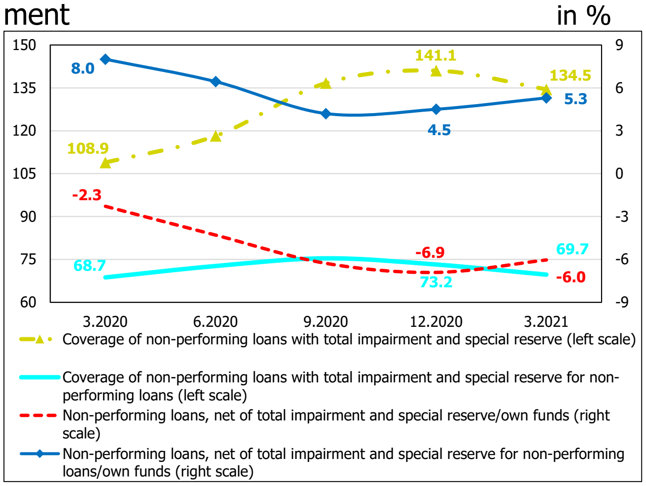
[7]The decrease of non-performing loans in construction was entirely due to mandatory write-offs of claims on one major client.

Chart 10
Annual rates of default and average risk level of performing and total loans, by sector
in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 11
Coverage of non-performing loans with impairment
in %



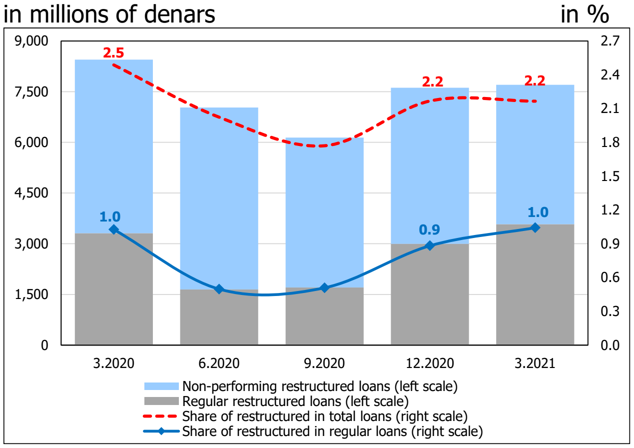
Source: National Bank's Credit Registry, based on data submitted by banks.

first quarter of 2021. Higher annual default rate in the segment of household is a result of the increased transition to non-performing status of loans whose grace period expired in the last quarter of 2020. In the following period, higher default rates of loans whose grace period expired in the first quarter of 2021 are possible.

Loans to non-financial companies accounted for 69.7% of the non-performing banks' loan portfolio, which is a lower share compared to the previous quarter (73.5%) and compared to the same quarter of the previous year (when it amounted 79.9%). Such change is a result of the increased share of non-performing loans to households. Moreover, non-performing consumer loans increased their share in non-performing households' portfolio even more (from 64.2% to 67.0% as of 31.3.2021).

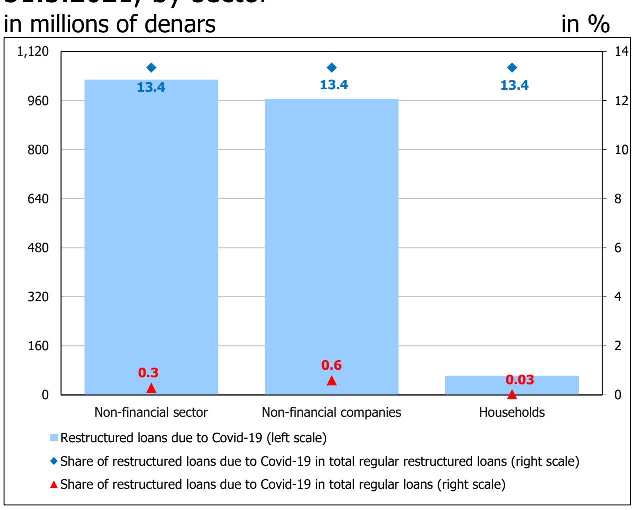
The negative effects of the possible complete default on non-performing loans, i.e. the volume of unexpected losses on this basis, have a limited impact on the solvency of the banking system. Namely, a significant portion of the non-performing loans are substantially covered with impairment (69.7%), despite the decrease compared to the previous quarter. Thus, the non-provisioned amount of non-performing loans is only 5.3% of own funds of the banking system and amid assumptions of its complete default, the solvency of the system wouldn't be jeopardized. Lower provision of non-performing loans in the first quarter of 2021 is a result of their growth, amid slight downward movement in impairment.

Chart 12
Restructured loans to non-financial entities by status



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 13
Restructured loans due to COVID-19 as of 31.3.2021, by sector



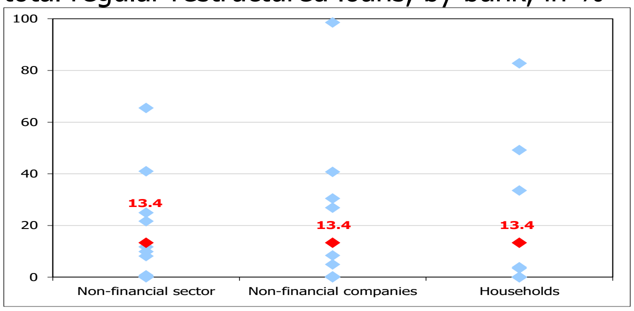
Source: National Bank's Credit Registry, based on data submitted by banks.

The restructured loans, as loans with reduced credit quality, registered low share in total loans, which equaled 2.2% as of 31.3.2021. Almost the entire restructured credit portfolio (around 94%) includes legal entities, whereby the share of these loans in total corporate loans is also low and equals 4.2%.

In the structure of restructured loans, the share of regular and non-performing loans is almost equal. Regular restructured loans in the short term can be a source of new non-performing loans. In the first quarter of 2021, regular restructured loans increased by 19.4% or by denar 582 million. According to the data submitted by banks, only small part of restructuring was a result of the negative effects of the corona crisis.

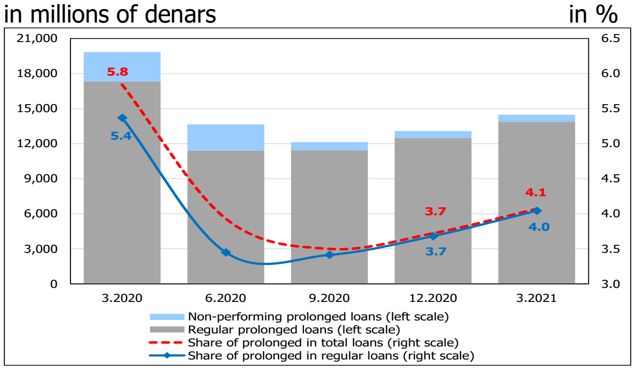
Since the grace period of loans with changed contractual terms has expired, some banks started to restructure the liabilities of some of the borrowers that still face pronounced financial difficulties. For these loans, the banks are expected to use some of the available mechanisms for amending the contractual terms to clients with deteriorated financial condition, such as extension of maturity, change of the amount and the dynamics of repayment of credit exposure, including approval of a new or extension of the existing grace period etc. Starting from 2.10.2020, each change of contractual terms due to clients' financial difficulties related to COVID-19 had a status of restructuring, which in accordance with the regulation, among other things, involves setting aside sufficient reserves for such loans. **Loans that were restructured due to the COVID-19 equaled to denar 1.028 million during the first quarter of 2021 and participated with 13.4% in**

Chart 14
Share of restructured loans due to COVID-19 in total regular restructured loans, by bank, in %



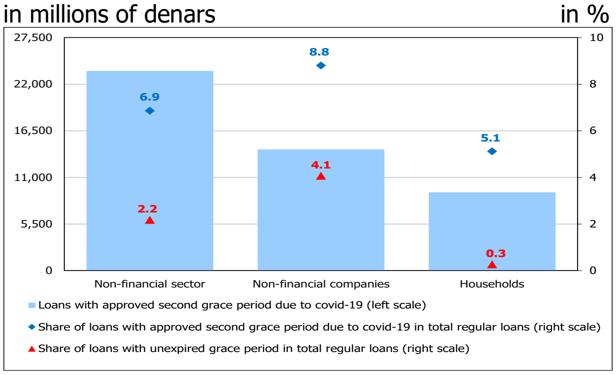
Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 15
Prolonged loans to non-financial entities by status
in millions of denars in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 16
Loans with approved second grace period due to COVID-19 on 31.3.2021, by sector
in millions of denars in %



Source: National Bank's Credit Registry, based on data submitted by banks.

regular restructured loans, with an identical percentage share in both, households and corporate portfolios. The restructured loans due to corona crisis accounted for only 0.3% of total loans and 0.5% of regular corporate portfolio. Observed by banks, the restructured loans due to corona crisis were registered in ten banks, yet the larger amount of these loans was concentrated in smaller number of banks[8] and it refers to several major clients.

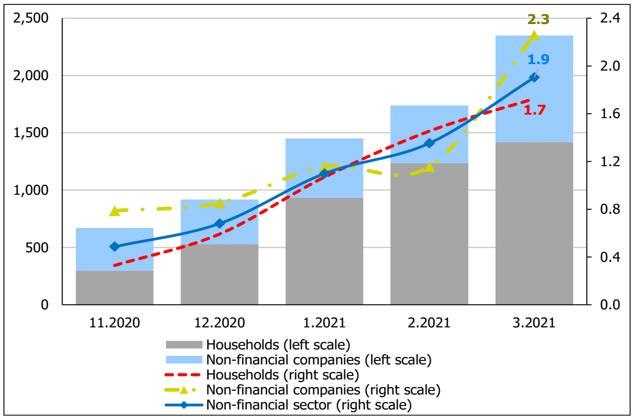
Slightly higher quarterly growth of denar 1,399 million or 10.7% was registered in total prolonged loans, where the extension of the maturity, according to the regulation, was not made due to clients' financial difficulties. The share of prolonged loans in total loans was 4.1% (3.7% as of 31.12.2020). Legal entities predominate in the prolonged loan portfolio (with a share of around 93%), while the share of these loans in total corporate loans was 7.8%.

As it was already pointed out, the grace period of most of the loans with eased credit conditions expired as of 31.3.2021 and these loans have already been in repayment. As of 31.3.2021, the grace period has not expired only for loans in the amount of denar 7,478 million, or 2.2% of total loans to non-financial sector. These loans almost entirely (93.3%) refer to non-financial companies. Data indicate that loans with unexpired grace period refer to loans which underwent second easing of contractual terms[9].

[8]Around 65% of total restructured loans due to COVID-19 were concentrated in one large bank.

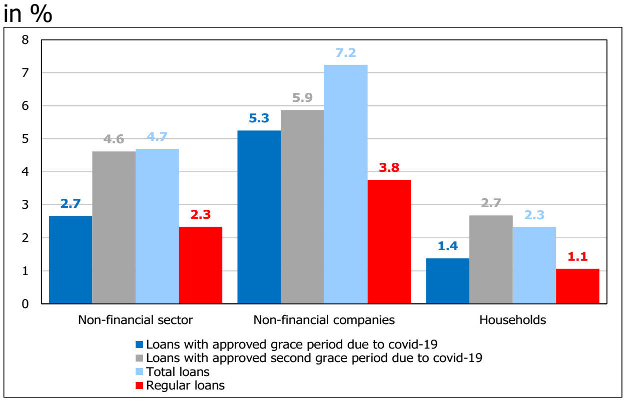
[9]The second wave of easing the contractual terms carried out in September 2020 was aimed only at clients that were most affected by the corona crisis, and consequently, it was significantly lower than the one in April and May 2020. The first wave of easing the contractual terms, as of May 2020, covered about half of the total loan portfolio of banks, i.e. 60% of loans to households and about one third of corporate loans.

Chart 17
The structure of non-performing loans with approved grace period due to COVID-19 and non-performing loan rate, by sector
in millions of denars in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 18
The average level of risk of loans with approved grace period due to COVID-19 and total loans, by sector
in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Analyzed by individual sectors, on 31.3.2021, the grace period for 4.3% of corporate and only 0.3% of household portfolio has not expired yet. In loans to non-financial companies, the grace period of around 93% of loans to non-financial companies with an unexpired grace period as of 31.3.2021, will expire by the end of the third quarter of 2021.

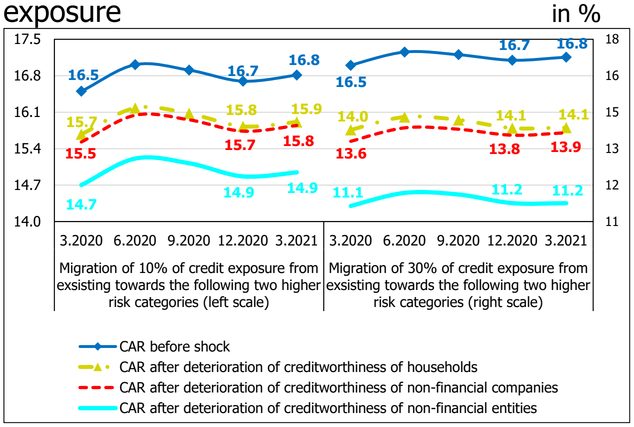
Loans with approved grace period, especially those with approved second grace period, are assessed as the most important potential source of new non-performing loans, due to the uncertainty whether these clients will be able to repay the loans regularly, after the expiry of the grace period. Credit losses from loans with approved grace period have already surfaced to a certain extent in the first quarter, yet they will be mostly visible in the remaining period of 2021. Under the extreme assumption for complete default on all loans with approved grace period, the capital adequacy ratio would be reduced by about 5 percentage points.

The banks assessed the loans with approved grace period, especially those with second grace period, as riskier and thus provided higher coverage with provisions, relative to total regular loans to non-financial sector and in certain sectors.

1.2. Stress-testing of the resilience of the banking system to increased credit risk

Chart 19
Capital adequacy ratio before and after hypothetical shocks of selected segments of credit exposure

in %



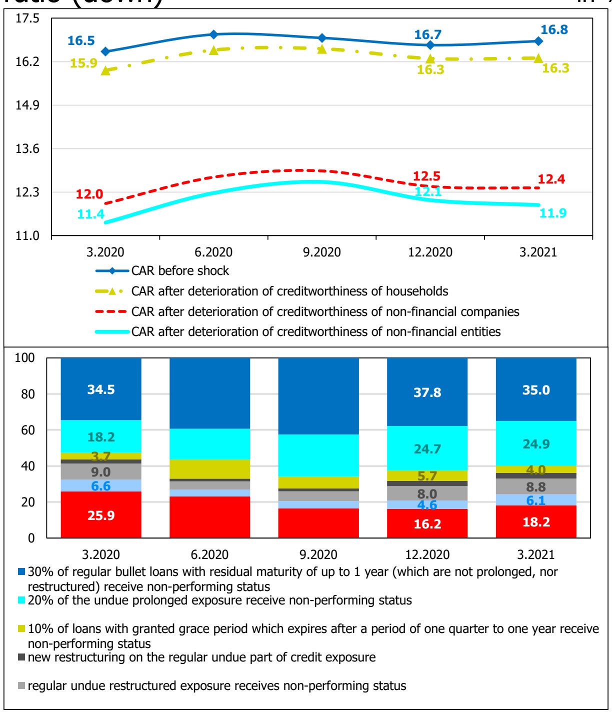
Source: National Bank's Credit Registry, based on data submitted by banks.

The results of the conducted stress testing confirm the resilience of the banking system to the simulated shocks. The capital adequacy ratio of the banking system does not go below 8% in individual hypothetical simulations. In case of the most extreme, but less possible simulation for a migration of 30% of the credit exposure to non-financial corporations, from the existing to the next two higher risk categories, the capital adequacy ratio of the banking system is reduced by 5.6 percentage points compared to the initial level of capital adequacy ratio (which is almost identical result to one in the previous quarter). Analyzed by activity assumed deterioration of the quality of credit exposure to these activities with the highest total credit exposure has the greatest effect on the capital adequacy ratio. According to individual credit products of households, the greatest negative effect on the capital adequacy ratio has the hypothetical deterioration of the consumer loans quality, as the most common credit product.

The banking system resilience is also examined by extreme simulation based on a combination of seven hypothetical shocks of worsening of the quality of the credit portfolio to the non-financial sector[10]. Even in case of this extreme simulation, the capital adequacy of the banking system does not come below the prescribed minimum. Upon this simulation, the capital adequacy ratio reduces by 4.9 percentage points to 11.9%, which is a slightly worse result compared to the end of the previous quarter (4.6 percentage points and 12.1%, respectively). The highest effect on the capital adequacy ratio is that of the assumed deterio-

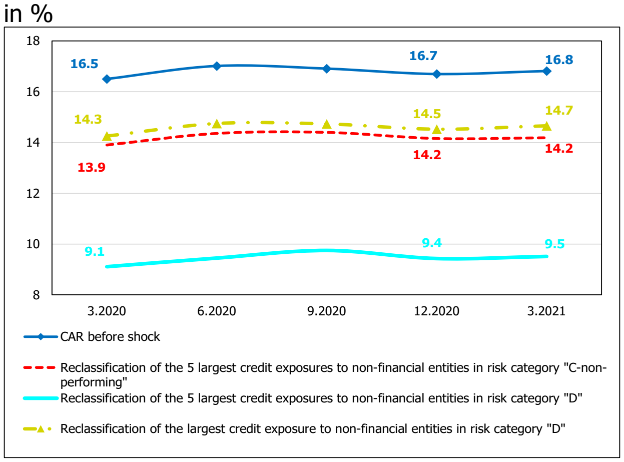
[10] The seven hypothetical shocks are the following: 1. complete default on the existing non-performing loans; 2. the total past due loans receive non-performing status; 3. the total regular undue restructured exposure receives non-performing status; 4. banks carry out new restructuring of the regular undue part of the credit exposure which according to the volume correspond with the amount of restructured exposures which received a non-performing status, from the previous item; 5. 10% of loans with approved grace period which expires after a period of one quarter to one year receive a non-performing status; 6. 20% of the undue prolonged exposure receives a non-performing status; 7. 30% of regular bullet loans with residual maturity up to one year (which are not prolonged, nor restructured) receive a non-performing status.

Chart 20
Capital adequacy ratio before and after hypothetically combined shocks of various credit exposure segment (up) and contribution of individual shocks to the reduction of the capital adequacy ratio (down)
in %



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 21
Effects on the capital adequacy ratio from reclassification of the largest credit exposures to non-financial entities (including the connected parties) in a higher risk category
in %



Source: National Bank's Credit Registry, based on data submitted by banks.

ration in the quality of bullet loans, which contributes to 35.0% of the total reduction of capital adequacy amid combined shock. In addition, the effect of the hypothetical worsening of the quality of prolonged loans (accounting for 24.9% of the total reduction of the capital adequacy ratio of the banking system) is also significant, as well as the assumed complete default on non-performing loans of the non-financial sector (18.2% of the total decline in capital adequacy in the combined shock), which registered an increased contribution compared to the previous quarter. Slight increase in the contribution is registered in past due loans (from 4.6% of the total decrease in the capital adequacy ratio on 31.12.2020 to 6.1% on 31.3.2021, respectively) as a result of loans whose grace period expired and have already been in repayment and regular restructured loans (8.8% of the total decrease in capital adequacy on 31.3.2021, compared to the contribution of 8.0% on 31.12.2020), given that in the first quarter of 2021 several banks started to reconstruct liabilities of the money-troubled clients due to COVID-19.

2. Liquidity risk

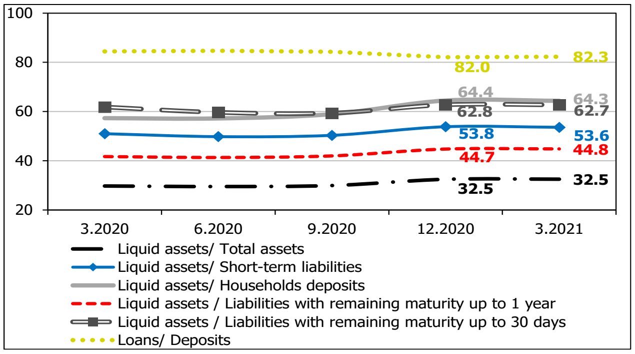
In the first quarter of 2021, amid further quarterly growth of non-financial entities' deposits, the liquid assets of the banking system increased both on a quarterly and annual basis. In the structure of liquid assets, denar assets on the account with the National Bank and the banks' placements in Macedonian Eurobonds[11] were the main generator of the quarterly growth. Such movements maintained the indicators used to monitor and assess liquidity at a stable level, exceeding the levels that match the ten-year average. In terms of currency, this quarter, the liquid assets in denars almost fully determined the growth of the total liquid assets, which resulted in improvement in the denar liquidity indicators, given simultaneous moderate deterioration of the foreign currency liquidity indicators.

The analysis of the composition of assets and liabilities, in terms of their residual contractual maturity, shows deepening of the gaps in most maturity segments, but the quarterly widening of the gap between assets and liabilities with residual contractual maturity of up to 1 year is smaller, compared to the previous quarter. Moreover, according to banks' expectations, the cumulative gap between assets and liabilities in all maturity segments is positive, which suggests that banks expect maintenance of the deposit stability as the main source of financing of their activities. The results of the stress tests indicate satisfactory resilience of the banking system to the individual assumed extreme liquidity outflows.

With the occurrence of the COVID-19 pandemic, the National Bank adopted several measures for monetary relaxation and regulatory flexibility, as a support to the banking system and the economy as a whole, in conditions of crisis. During the first quarter this year, the key interest rate was further reduced by 0.25 percentage points, to the level of 1.25%.

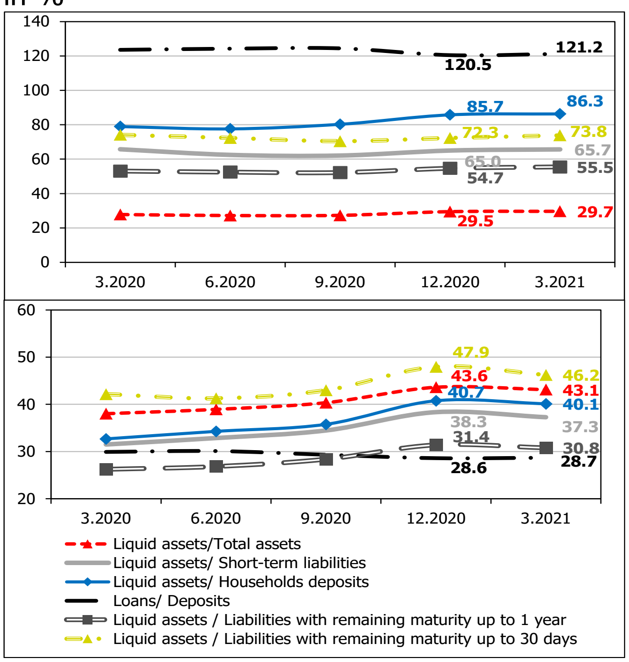
[11] In March 2021, the Ministry of Finance issued the eight Eurobond, worth Euro 700 million with maturity of seven years and it was issued at a historically lowest interest rate of 1.625%.

Chart 22 Liquidity indicators of the banking system
in %



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

Chart 23
Banking system liquidity ratios according to currency structure, Denars (top) and FX (bottom)
in %



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

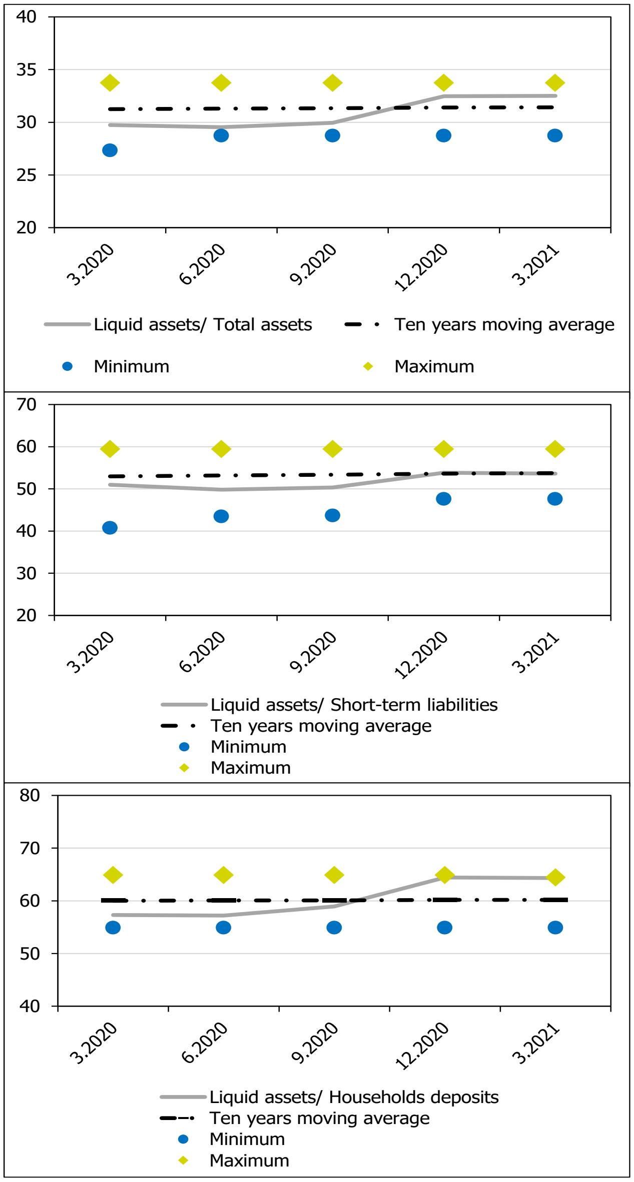
2.1. Liquidity indicators

In the first quarter of 2021, in conditions of further growth of the liquid assets of the Macedonian banking system, the liquidity indicators[12] remained at a stable and satisfactory level. Moreover, most of the indicators used to analyze liquidity came closer to their maximum values. Namely, the proper liquidity risk management of banks is confirmed by the relatively stable share of liquid assets in the total bank assets (which remained unchanged at the level of one third) and the coverage of short-term liabilities and household deposits with liquid assets, which also remained stable (over 50% and 60%[13], respectively). The loan-to-deposit ratio at the level of the banking system is stable and is around 80%, which additionally points to acceptable frames of liquidity risk the banks are exposed to and their stable liquidity management.

In terms of currency features of liquid assets and liabilities, in the first quarter of 2021, liquidity indicators manifested divergent movements. Namely, amid faster growth of denar liquidity[14], which determined over 90% of the total quarterly increase in liquid assets in the first quarter of 2021, denar liquidity indicators improved. In contrast, the foreign exchange liquidity indicators decreased moderately compared to the previous quarter. Denar liquidity indicators remain at a higher level compared to the foreign currency liquidity indicators, due to the higher structural share of liquid assets in denars in total liquid assets of banks. The risks from the lower level of the foreign currency liquidity indicators are mitigated by the

[12] The calculation of liquidity ratios of the banking system does not include resident interbank assets and liabilities.
[13] Analyzed by bank, as of 31.3.2021, the share of liquid in total assets ranges between 19.6% and 51.7%, with a median of 25.9% (March 2020: between 19.1% and 44.2%). The coverage of short-term liabilities with liquid assets ranges between 40% and 68.8%, with a median of 51.1% (March 2020: between 38.9% and 83.9%), and the coverage of household deposits with liquid assets ranges between 35.4% and 84.9%, with a median of 65.3% (March 2020: between 28.4% and 95.7%). The Development Bank of North Macedonia AD Skopje is excluded from this analysis.
[14] Claims and liabilities with FX clause are considered as denar claims and liabilities, since their cash flow is in denars. Moreover, this growth entirely results from the quarterly increase in the funds on the account with the National Bank by Denar 23,776 million.

Chart 24
Liquid assets/total assets (top), liquid assets/short-term liabilities (middle) and liquid assets/household deposits (bottom)
in %



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

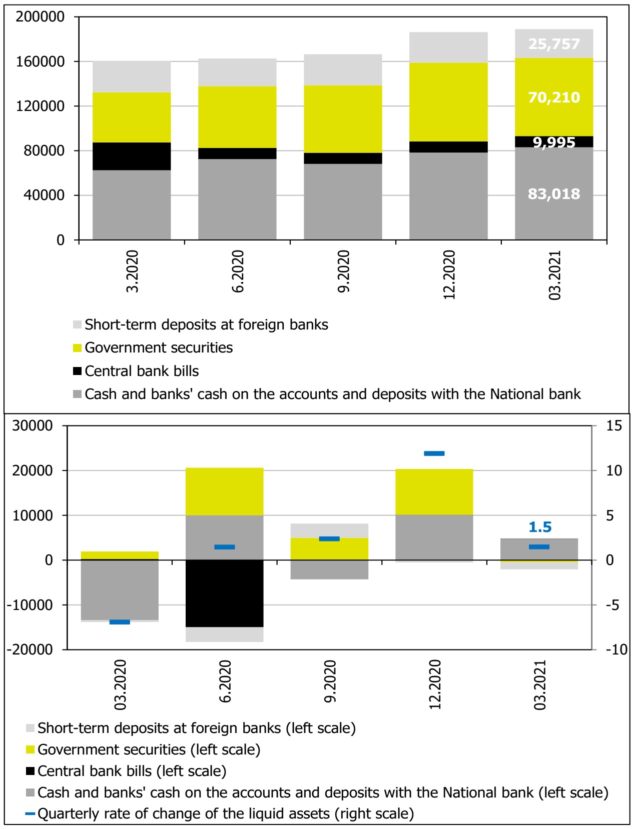
possibility that banks have at their disposal to provide the required foreign currency liquid assets at any time, through the National Bank interventions on the foreign exchange market. In this regard, readily available are the funds from the repo line of the European Central Bank (ECB) which last year, for the first time granted the National Bank access to foreign exchange liquidity in euros, with adequate collateral, in a total amount of Euro 400 million[15]. This instrument is especially important, because it provides fast, simpler and more favorable access to liquidity in euros, taking into account the uncertainty of the current global crisis and of possible major disturbances on the international financial markets due to the shock from the coronavirus. Thus far, the National Bank has not used funds from the approved repo line, given the constant maintenance of both the denar and the foreign currency liquidity of the banking system at an appropriate level.

2.2. Dynamics and composition of liquid assets

At the end of the first quarter of 2021, the liquid assets[16] of the banking system amounted to Denar 188,980 million and registered a quarterly growth of 1.5% (or by Denar 2,741 million), while compared to the same period of 2020, there is a solid rapid growth of 17.9% (or by Denar 28,740 million). Such quarterly increase in the banks' liquidity, analyzed by individual financial instruments that make up liquid assets, was most pronounced in the banks' assets on the denar account with the National Bank, whose growth amounts to Denar 23,845 million, or

[15] The deadline for using the funds from the repo line is until March 2022. For more details please visit: http://nbrm.mk/ns-newsarticle-soopstenie-18082020.nspx and https://nbrm.mk/ns-newsarticle-soopstenie-04022021.nspx .
[16] The liquid assets encompass: 1) assets and claims on the National Bank, which include cash, assets on the accounts of banks with the National Bank, deposit facility with the National Bank and CB bills; 2) short-term deposits with foreign banks, including the assets of the banks on their correspondent accounts abroad and 3) the carrying amount of the investments in securities issued by central governments, i.e. government securities issued by the Republic of North Macedonia and issued by foreign countries. For the purposes of analyzing the liquidity, assets and liabilities in denars with foreign exchange clause are considered denar assets and liabilities.

Chart 25
Liquid assets, structure (top) and growth (bottom)
in millions of denars and in %



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

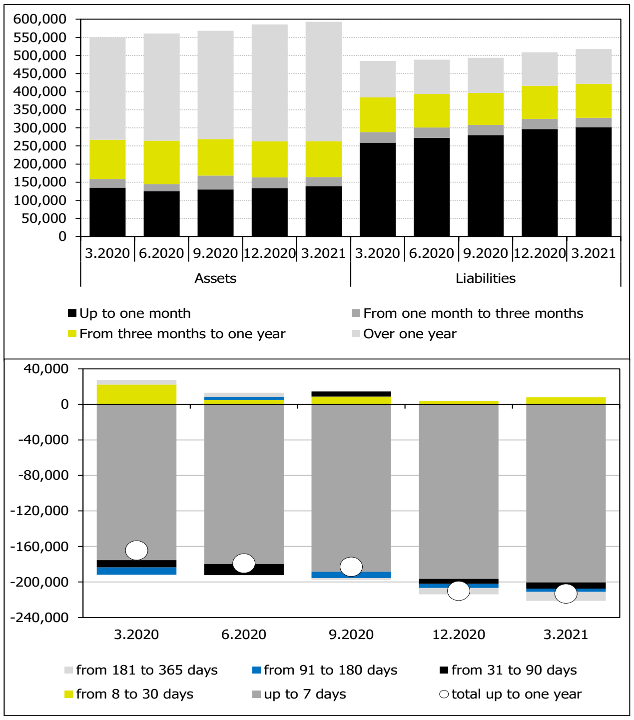
by 133.3%. Also, the placements in government bonds in foreign currency (Macedonian Eurobonds) increased by Denar 3,478 million, or by 18.3%. In contrast, with the exception of treasury bills placements, which remained almost unchanged[17], the other financial instruments that make up liquid assets predominantly registered a quarterly decline. The largest quarterly decrease of Denar 17,581 million, or by 38.8%, was registered in the banks' placements in deposit facilities with the National Bank (overnight and seven-day). At the same time, a significant decrease was also registered in the banks' foreign currency assets (by Denar 1,601 million, or by 19.3%), the placements in treasury bills (by Denar 3,182 million or by 17.6%) and the placements in short-term deposits with foreign banks (by Denar 1,619 million or by 5.9%).

2.3. Maturity structure of assets and liabilities

In the first quarter of 2021, changes in the structure of assets and liabilities, according to their residual maturity, further deepened the gap between assets and liabilities with residual contractual maturity up to one year. The largest contribution to the deepening of the total gap (up to one year) was made by the gap between assets and liabilities with residual contractual maturity up to seven days, which is a result of the reduced placements in deposit facilities with the National Bank and the growth of liabilities on demand. In this maturity segment there is still major mismatch between banks' assets and liabilities according to their contractual residual maturity (which further deepened in the first quarter of the year, amid growth of demand

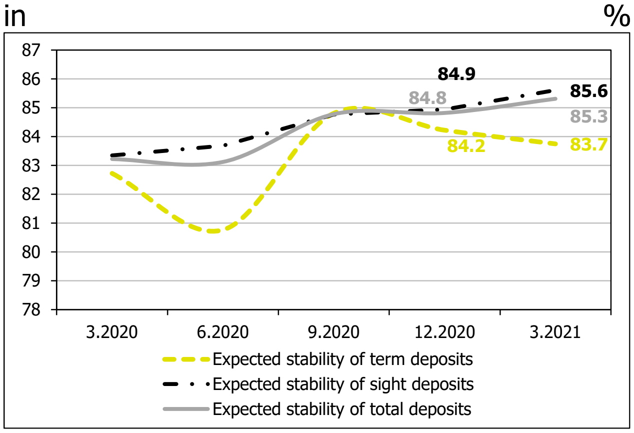
[17] During the first quarter of 2021, the National Bank continued to offer CB bills in unchanged amount (Denar 10,000 million) and fixed interest rate. In March 2021, in conditions of stable movements on the foreign exchange market and moderate dynamics of inflation, and amid still present uncertainty for the health crisis and its impact on the path of economic recovery, it was decided to relax the monetary policy by reducing the key interest rate by 0.25 percentage points, to the historically lowest level of 1.25%.

Chart 26
Composition of assets and liabilities of banks according to their contractual residual maturity (up) and the gap between assets and liabilities, with contractual residual maturity of up to one year (down)
in % and in millions of denars



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

Chart 27
Expected stability of deposits with residual maturity of up to three months, by banks
in %



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

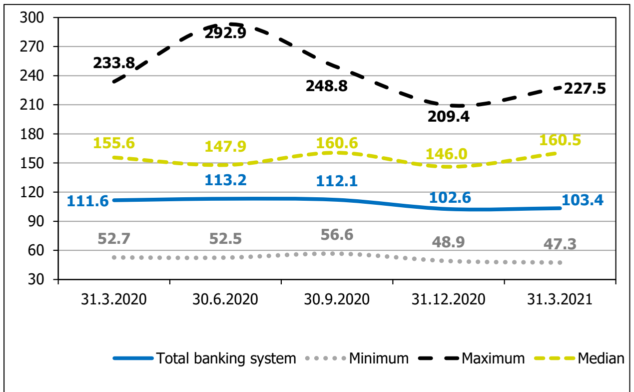
deposits, by 1.9%, and fall in short-term deposits, by 1%, and long-term deposits, by 0.2%), which usually results from the inclusion of the banks' liabilities on demand and without maturity. Moreover, the growth of the total gap up to one year was also affected by the gap between assets and liabilities with residual maturity between six and twelve months, which in turn is a consequence of the fast decline in the placements in debt instruments held to maturity (primarily in the placements in treasury bills). As usual, only the maturity segment from eight days to one month registered a positive gap, which stems from the fact that the investments in CB bills belong to this maturity segment.

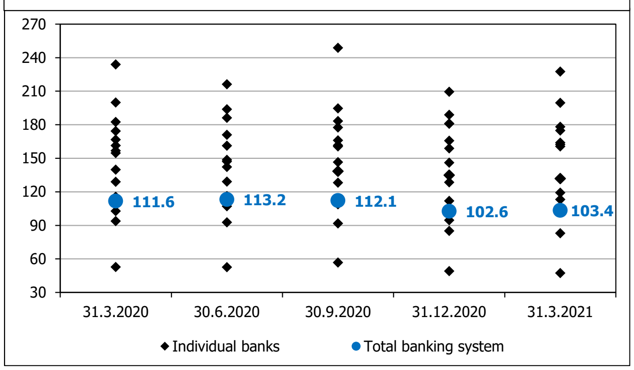
According to banks' expectations, the cumulative gap between assets and liabilities in all maturity segments is positive, which suggests that banks expect maintenance of the deposit stability as the main source of financing of their activities (for more details see the Annexes to this Report). Namely, at the end of the first quarter of 2021, banks expect high stability of deposits, i.e. that 83.7% of term deposits with residual maturity up to three months (84.2% as of 31.12.2020) will remain in banks, whereby greater stability is expected for total deposits and demand deposits (85.3% and 85.6%, respectively). The further retention of the high propensity of the private sector to keep the free assets on the bank accounts is especially important and largely depends on the expectations for stabilization of the situation in the domestic economy amid still present risks and uncertainty arising from the COVID-19 pandemic.

2.4. Stress-simulations for liquidity shocks

On 31.3.2021, the results of the conducted stress simulations for liquidity

Chart 28
Reduction of liquid assets after the simulation for combined liquidity shocks (after all shocks), total banking system (up) and by bank (down)
in %





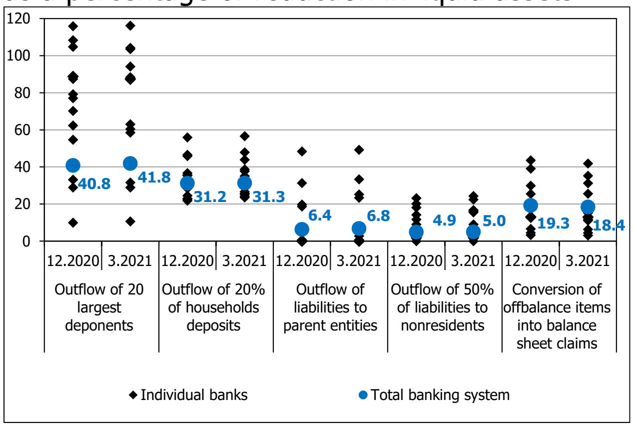
Source: National Bank, based on data submitted by banks.

shocks show that the banking system is characterized by a stable liquidity position, i.e. it has sufficient liquid assets to respond appropriately to the individual simulated cash outflows. The resilience of the Macedonian banking system to liquidity shocks is confirmed by the results of all individual simulations of liquidity shocks, with the liquid assets being fully used (103.4% on 31.03.2021) only in case of significantly extreme simulation of liquidity shock, which covers combined outflows[18] of funds from banks on several bases. Considering the extremity of assumption, for the purpose of this simulation, the usual coverage of liquid assets is extended with other financial instruments[19] owned by banks, for which it is estimated that banks will quickly and easily collect or turn into cash. In such a case, in combination with the assumed shocks, the liquid assets of the banking system would not be fully utilized (specifically, to cover the liquidity outflows, it would take 95% of the available liquid assets, according to the expanded definition), so the banking system would still have a certain amount of liquid assets at its disposal.

At individual simulations of liquidity shocks, the high level of liquidity which Macedonian banks have at their disposal provides settlement also of all assumed, individual, extreme liquidity outflows. The sharpest decline in liquid assets occurs amid outflow of the deposits of the twenty largest depositors, but the importance of this simulation to individual banks is different, given the differences in

[18] The simulation assumes outflow of: deposits of the twenty largest depositors, 20% of household deposits, liabilities to parent entities (liabilities on subordinated instruments and hybrid capital instruments are excluded from the simulation as, according to the regulations for calculating capital adequacy, their repayment is regulated), 50% of the liabilities to non-residents (excluding liabilities to non-resident parent entities of banks which are already covered by one of the previous simulations) and conversion of certain off-balance sheet liabilities of the banks (uncovered letters of credit, irrevocable credit lines and unused limits based on credit cards and approved overdrafts on transaction accounts) into balance sheet claims. The simulations of liquidity shocks exclude the Development Bank of North Macedonia AD Skopje.
[19] Financial instruments that comprise liquid assets, also include the following financial instruments: assets in the guarantee fund in KIBS, long-term deposits in foreign banks, money market instruments issued by foreign non-government issuers, loans with contractual residual maturity of up to 30 days and the effect of reducing the reserve requirement for foreign currency liabilities of banks, which is allocated in foreign currency due to the simulated outflow of households' foreign currency deposits.

Chart 29
Contribution of shocks to the decline in liquid assets in the simulation of a combined liquidity shock, by bank
as a percentage of reduction in liquid assets



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

the degree of concentration of deposits. On the contrary, simulated materialization of reputation risk and loss of confidence of the population in the banks represented by an outflow of 20% of household deposits shows a significantly greater similarity in the results for individual banks, thereby confirming the importance of deposits to the financing of the banks' activities. In the case of assumed conversion of certain off-balance sheet liabilities of the banks into on-balance sheet claims[20], the banks would spend slightly less than 20% of their liquid assets, which although less compared to the simulations of outflow of deposits[21], yet this assumed reduction in liquid assets can be considered significant. The small share of liabilities to non-residents, as well as to parent entities in the structure of the total sources of funding for banks, causes moderate impact of the shocks associated with them on the overall result of this simulation.

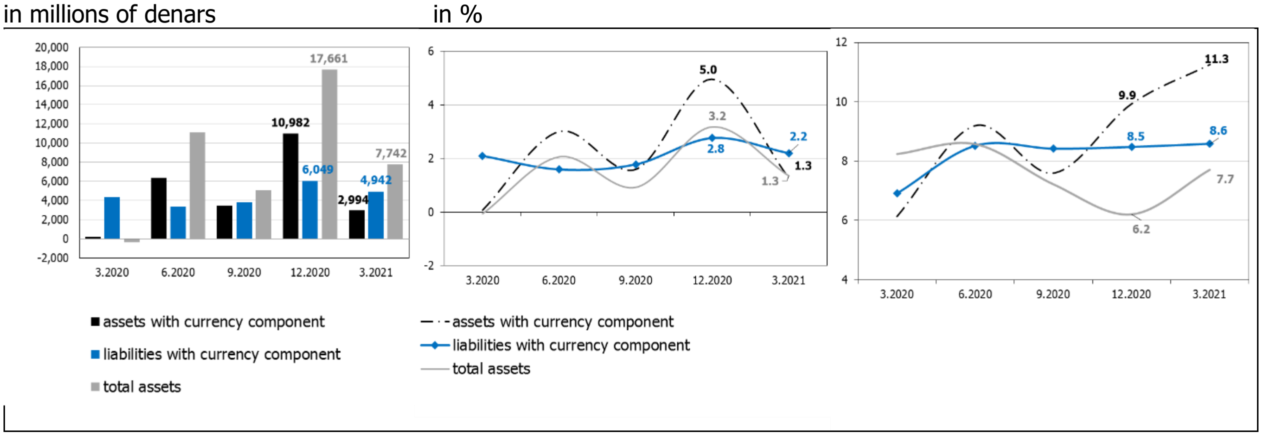
[20] Outflow is assumed as a result of the migration of some off-balance sheet liabilities of the banks (uncovered letters of credit, irrevocable credit lines and unused limits based on credit cards and approved overdrafts on transaction accounts) into on-balance sheet claims.
[21] During a simulation of outflow of the deposits of the 20 largest depositors, the liquid assets of the banking system are reduced by 41.8%, while in case of assumed outflow of 20% of the household deposits, liquid assets are reduced by 31.3%.

3. Currency risk

As of 31.3.2021, the banking system in the Republic of North Macedonia reduced the already low level of direct exposure to currency risk, which is evident from the reduced ratio between the open currency position and own funds and the share of the gap between assets and liabilities with currency component in the own funds. In contrast, the indirect exposure to currency risk, which arises from the presence of currency component loans in the banks' loan portfolios, is at a relatively high level. However, bearing in mind the dominant share of the euro in the banks' activities with currency component, the probability of materialization of direct and indirect exposure of banks to currency risk is minimal, given the implementation of the strategy of maintaining a stable nominal exchange rate of the denar against the euro.

Analyzed by individual bank, as of 31.3.2021, all banks were in line with the prescribed limit of 30% for the aggregate currency position to own funds ratio.

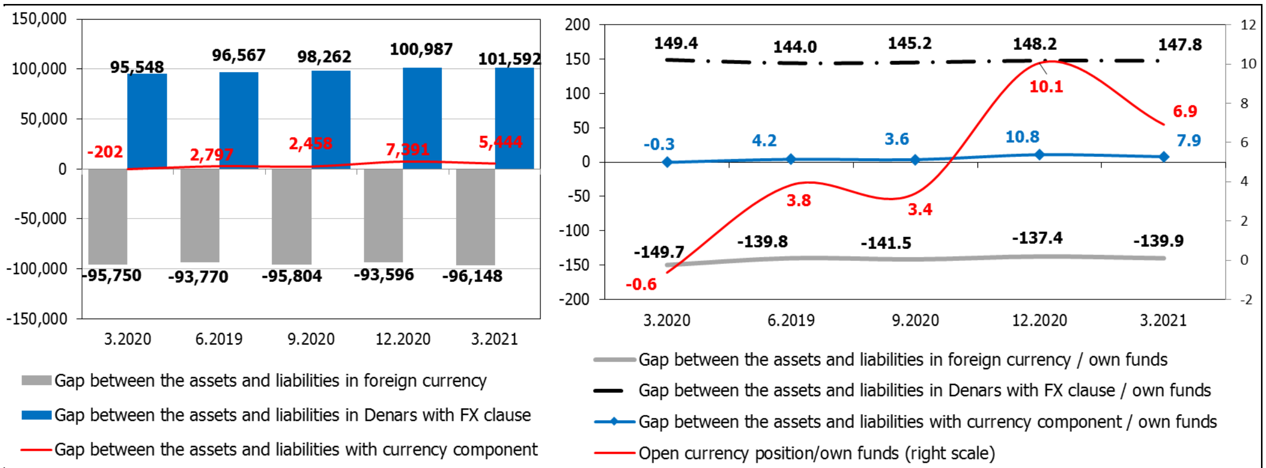
Chart 30
Quarterly (left and middle) and annual (right) growth of total assets and of assets and liabilities with currency component *
in millions of denars in %



Source: National Bank, i.e. the report on open currency position based on data submitted by banks.
*The assets are on a net basis, reduced by the impairment of claims that are classified in risk categories "C", "D" and "E", in accordance with the regulations on currency risk management. "DBNM" is not included in the analysis, because pursuant to the legislation, the regulations for the open foreign exchange position do not apply to the "DBNM".

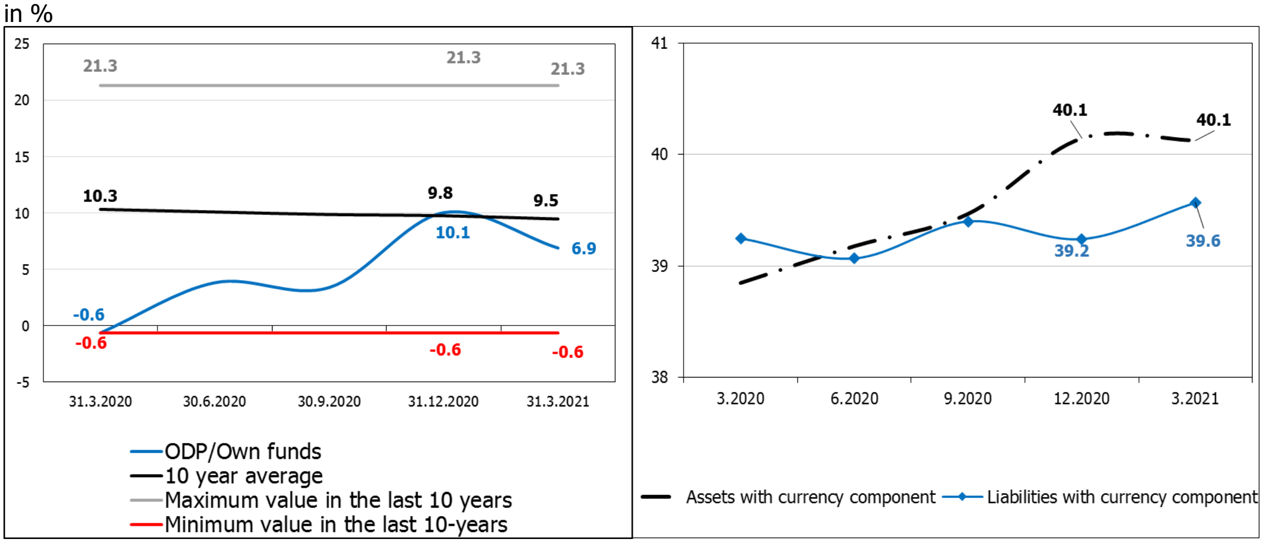
As of 31.3.2021, the gap between assets and liabilities with currency component was positive and amounted to Denar 5,444 million, which is a decrease of 26.4% or by Denar 1,948 million, compared to 31.12.2020. This reduction in the gap results from the higher increase in the liabilities (which increased by 2.2% or by Denar 4,942 million)[22] compared to the growth of assets with currency component (assets increased by 1.3% or by Denar 2,994 million)[23]. The narrowing of the gap between assets and liabilities with currency component on the one hand, and the growth of own funds (0.9% or by Denar 602 million) on the other, reduced the ratio of the gap between assets and liabilities with currency component with banks' own funds. Thus, at the end of the first quarter of 2021, the ratio of the gap between assets and liabilities with currency component and banks' own funds equaled 7.9%, which is a quarterly fall of 2.9 percentage points, while the open currency position equaled 6.9% of the own funds of the banking system, and is lower by 3.2 percentage points compared to 31.12.2020[24].

Chart 31
Structure of the gap between assets and liabilities with currency component (left) and share of the assets and liabilities with currency component in own funds (right)
in millions of denars in %



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

Chart 32
Ten year average of the OCP/own funds ratio (left), and share of the assets and liabilities with currency component * in the total banks' assets (right)
in %



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

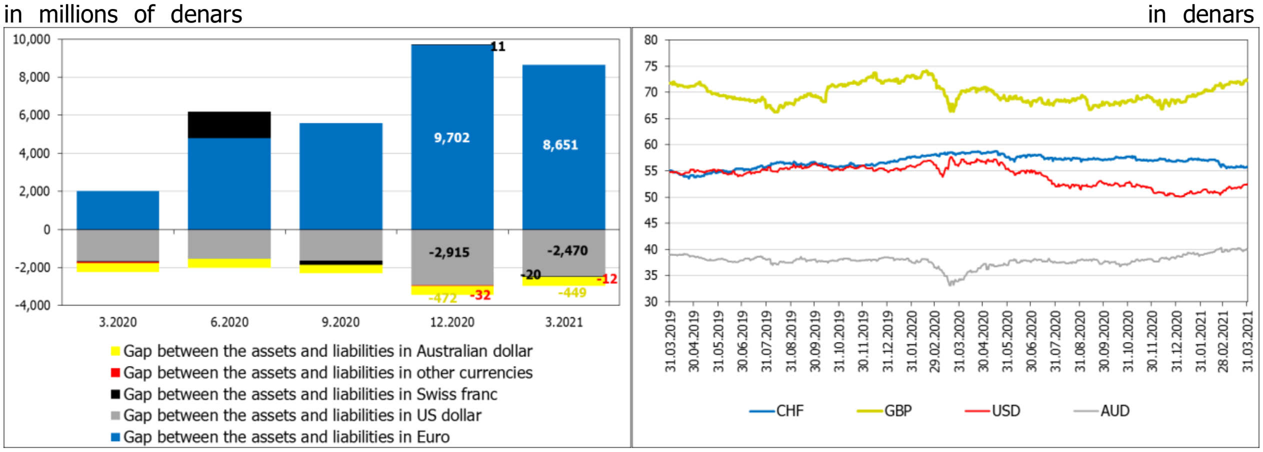
[22] The growth of liabilities with currency component was mostly conditioned by the growth of current accounts in foreign currency by Denar 3,384 million, with a certain influence of the growth of deposits from non-residents and natural persons in foreign currency, by Denar 1,075 million and Denar 624 million, respectively.
[23] Assets with currency component increased mostly as a result of the increased investments in domestic Eurobonds, by Denar 3,479 million, the growth of foreign currency deposits by Denar 2,898 million, as well as the growth of loans with a currency component by Denar 1,864 million (of which Denar 1,032 million are in foreign currency). On the other hand, the current accounts in foreign banks and the foreign currency assets decreased by Denar 4,548 million and Denar 1,601 million, respectively.
[24] The gap between assets and liabilities with currency component represents the difference between the balance sheet assets and liabilities with currency component, while the open currency position, besides the gap between balance sheet assets and liabilities with currency component, includes the gap between off-balance sheet assets and liabilities with currency component.

*Within the assets, claims are shown on a net basis i.e. adjusted for the impairment. The analysis does not include DBNM AD Skopje.

The faster relative growth of liabilities with currency component (by 2.2%) relative to the growth of total assets, i.e. liabilities (by 1.3%), conditioned the growth of its share in the total banks' liabilities by 0.3 percentage points. In contrast, the share of assets with currency component in total assets remained unchanged (the growth of assets with currency component and of total assets is equal and amounts to 1.3%).

Analyzed by currency, the reduction of the gap between assets and liabilities with currency component is due to the narrowing of the positive gap between assets and liabilities in euros and Euroclause (by Denar 1,051 million)[25] and the widening of the negative gap between assets and liabilities in or denominated in US dollars (by Denar 908 million)[26].

Chart 33
Dynamics and structure of the gap between assets and liabilities with currency component, by currency (left) and movement of the denar against the US dollar, Swiss franc, British pound and Australian dollar (right)
in millions of denars in denars



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

In the first quarter of 2021, the value of the exchange rate of the British pound, as well as of the US and the Australian dollar, against the euro (consequently of the denar as well), moved upward. From the analyzed currencies, only the value of the exchange rate of the Swiss franc registered a certain decrease in the third month of the year, generally maintaining the same and stable trend of movement.

[25] Due to the faster growth of liabilities in euros and in denars with Euroclause (which equals Denar 2,108 million and results almost equally from the growth of current accounts and other short-term liabilities and from the growth of deposits from non-residents in euros), relative to the growth of assets in euros and in denars with Euroclause (which equals Denar 1,057 million and is mostly due to the increased investments in domestic Eurobonds by Denar 3,479 million and to the growth of loans in euros and in denars with Euroclause by Denar 1,576 million, amid reduction of current accounts in euros.

[26] Due to the faster growth of liabilities (which amounts to Denar 2,710 million and mainly results from the growth of current accounts and other short-term liabilities) relative to the growth of assets (which amounts to Denar 1,802 million and is due to the growth of the deposits in dollars) in US dollars and dollar clause.

Table 3
Currency structure of assets and liabilities with currency component
in %

Currency	31.12.2020		31.3.2021	
	Assets	Liabilities	Assets	Liabilities
Euro	90.8	89.5	90.1	88.5
US dollar	5.8	6.8	6.5	7.8
Swiss franc	1.3	1.4	1.3	1.3
Australian Dollar	0.7	0.9	0.7	0.9
British pound	0.5	0.6	0.5	0.6
Other	0.9	0.9	0.9	0.9
Total	**100.0**	**100.0**	**100.0**	**100.0**

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

Table 4
Classification of banks according to the share of the open foreign currency position by currency and the aggregate foreign currency position in the own funds

Items	Number of banks										
	Open currency position by currency /own funds										Aggregate currency position / own funds
	Euro		US Dollar		Swiss franc		Australian Dollar		Other		
	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	
under 5%	6	1	9	4	8	4	7	2	10	3	7
from 5% to 10%	2										2
from 10% to 20%	2										2
from 20% to 30%	2										2
over 30%											

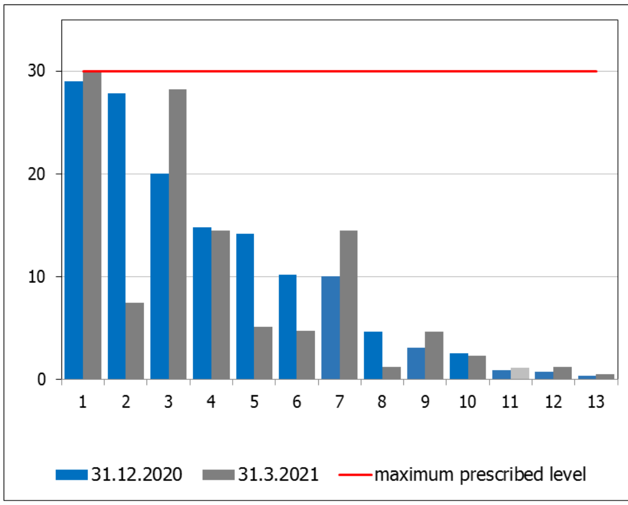
Source: National Bank, based on data submitted by banks.

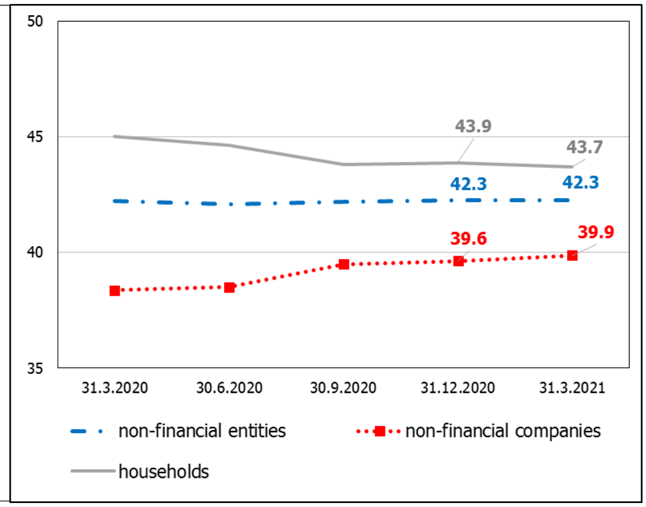
Maintaining a stable nominal exchange rate of the denar against the euro is a key factor for maintaining low probability of materialization of the indirect currency risk, having in mind that more than 99% of the loans with currency component are denominated in euros or are in denars with Euroclause. As of 31.3.2021, the share of loans with currency component in total loans to non-financial companies increased by 0.2 percentage points, compared to the share of these loans to households which decreased by 0.2 percentage points. The share of loans with currency component in the total loans to non-financial entities is unchanged.

As of 31.3.2021, all banks were in line with the prescribed limit of 30% for the aggregate currency position to own funds ratio. All banks (except one) registered a long currency position, whereby the highest share of the aggregate currency position in the own funds, registered in an individual bank, almost reached the prescribed limit and amounted to 29.9%, while the lowest share was 0.5% of the bank’s own funds.

Chart 34
Aggregate currency position to own funds ratio, by bank* (left) and loans with FX component to total loans ratio (right)

in % in %



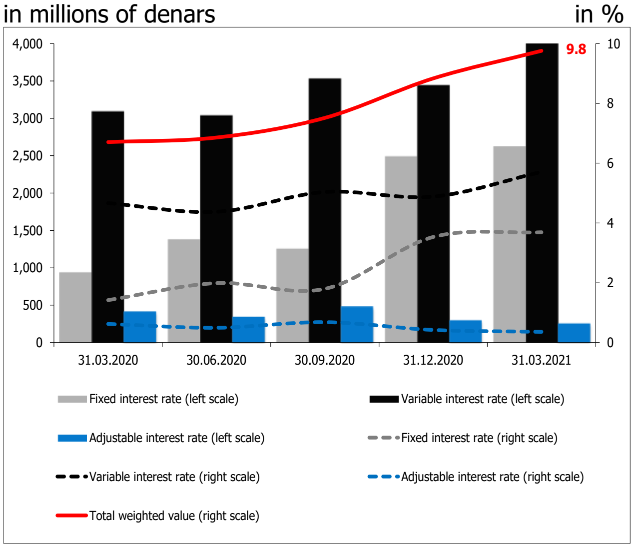


Source: National Bank, based on data submitted by banks.
*Columns with lighter shades, refer to the banks that have a short foreign currency position, but shown in absolute value.

4. Interest rate risk

In the first quarter of 2021, the exposure of the banking system to the interest rate risk in the banking book increased, due to the growth of the weighted value of the banking book, which increased its share in own funds. The increase in the total weighted value of the banking book mostly results from the positions with variable interest rate, where the gap between interest-sensitive assets and liabilities widened, primarily due to the growth of the placements in loans with this type of interest rate and their shifting from the blocks with shorter to the blocks with longer period until next interest rate revaluation. Also, the weighted value of the banking book with fixed interest rate registered a quarterly growth, which is a consequence of the redistribution in the structure of the gap, from the blocks with shorter maturity to the blocks with longer maturity. The total (non-weighted) gap is positive, which, on an aggregate basis, exposes the banking system to the risk of reducing interest rates. The significant presence of the loans with variable and adjustable interest rates continues to expose banks to indirect credit risk from the exposure of their clients to the risk of increasing interest rates.

Chart 35
The total weighted assets of the banking book*, by interest rate type, in absolute amount (left scale) and relative to own funds (right scale)
in millions of denars in %

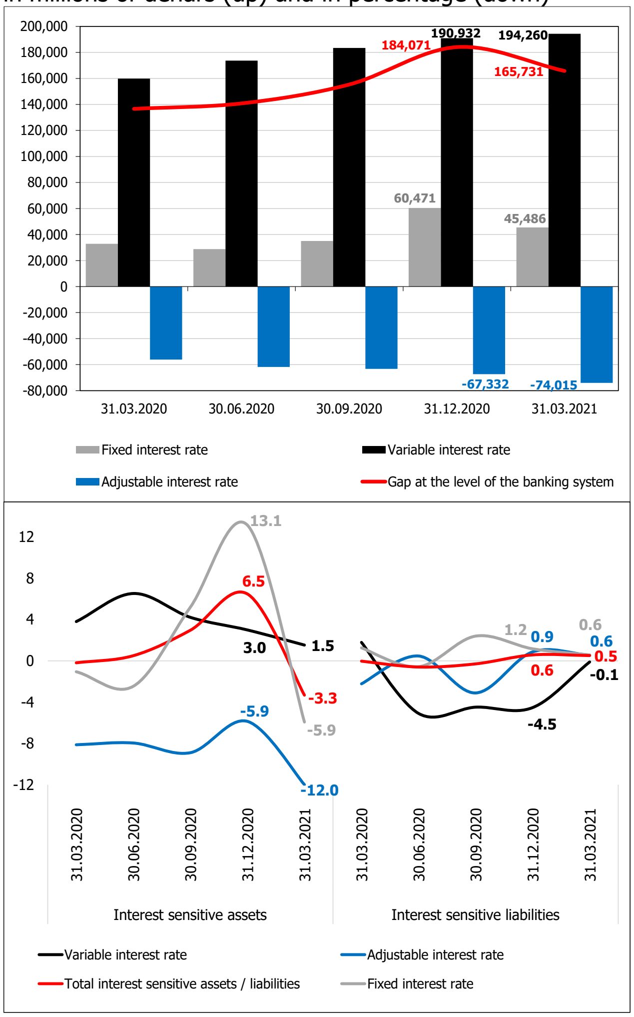


Source: National Bank, based on data submitted by banks.
*The total weighted value of the banking book denotes the potential loss of the economic value of this portfolio, amid assumed unfavorable interest shock of ±2 percentage points.

The total weighted assets of the banking book registered a quarterly increase of Denar 711 million or by 11.4%. This, despite the growth of own funds (of 0.9%), increased the ratio between the weighted value of the banking book and the own funds by 0.9 percentage points, to the level of 9.8%. At the same time, the level of this ratio, used to measure the exposure of the banking system to the interest rate risk in the banking book, exceeded even more the level of the average calculated for the last 10 years (5.1%) and became equal to the calculated maximum value, for the last 10 years. Analyzing by bank, this ratio ranges from 0.6% to 17.6%, and is below the level of the prescribed threshold of 20.0%[27]. Analyzing the type of interest rate, the quarterly growth of the total weighted value of the banking book mostly results from the increase in the weighted value of the portfolio with variable interest rate (Denar 619 million or 18%) and partially from the growth of the portfolio with fixed interest rate (Denar 134 million or by 5.4%).

[27] According to the regulation, when total weighted value of the banking book to own funds ratio exceeds 20%, the bank is required to propose measures to reduce this ratio, and the National Bank may also require allocation of appropriate amount of capital for covering the interest rate risk in the banking book.

Chart 36
Interest-sensitive assets and liabilities by type of interest rate, gap (up) and quarterly growth (down)
in millions of denars (up) and in percentage (down)

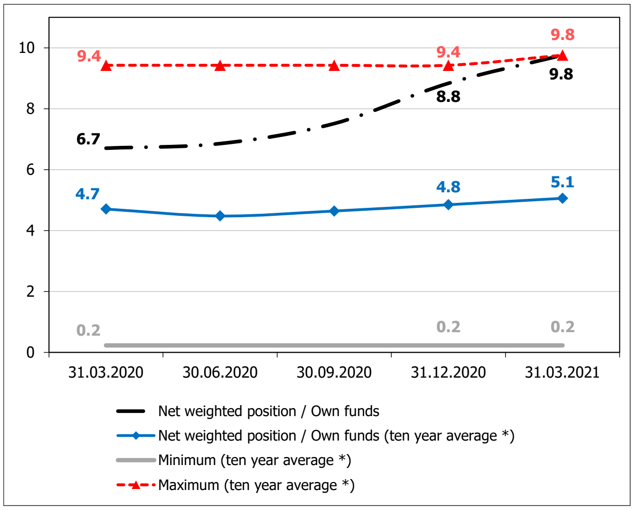


Source: National Bank, based on data submitted by banks.

The growth of the weighted value of the portfolio with variable interest rate is due to the increase in the gap between the asset and liabilities items with this type of interest rate amid simultaneously present redistribution in the structure of the gap, from the blocks with shorter (up to one month) to the blocks with longer residual maturity (3 - 6 months). Such changes in the gap with variable interest rates mostly result from the changes in the placements in loans with this type of interest rate. The growth of the weighted value of the portfolio with fixed interest rate, amid significant narrowing of the (positive) gap with this type of interest rate, results from the redistribution in the structure of the gap, from the blocks with shorter maturity (up to three months and from 6 - 12 months) to the blocks with longer maturity (from 1 - 4 years and from 5 - 7 years), mostly due to the reduction of the placements in short-term deposits and the changes in the maturity structure of the placements in government securities (fall in the placements in treasury bills and simultaneous growth of the placements in government bonds). In contrast, the weighted value of the portfolio with adjustable interest rate decreased (by Denar 43 million or by 14.3%). The reduction of the weighted value of this portfolio, amid simultaneous widening of the negative gaps with this type of interest rates, results from the reduction of the placements in loans with adjustable interest rates, which was present more in the blocks with longer period until next interest rate revaluation (from six months to three years and from four to five years).

The total non-weighted gap between the interest-sensitive assets and liabilities registered a quarterly fall of 10% or Denar 18,340 million. This is mostly due to the narrowing of the **positive gap between the positions with fixed interest rate** (which registered a quarterly fall of 24.8% or by Denar 14,985 million) mostly due to the reduction of the placements in term

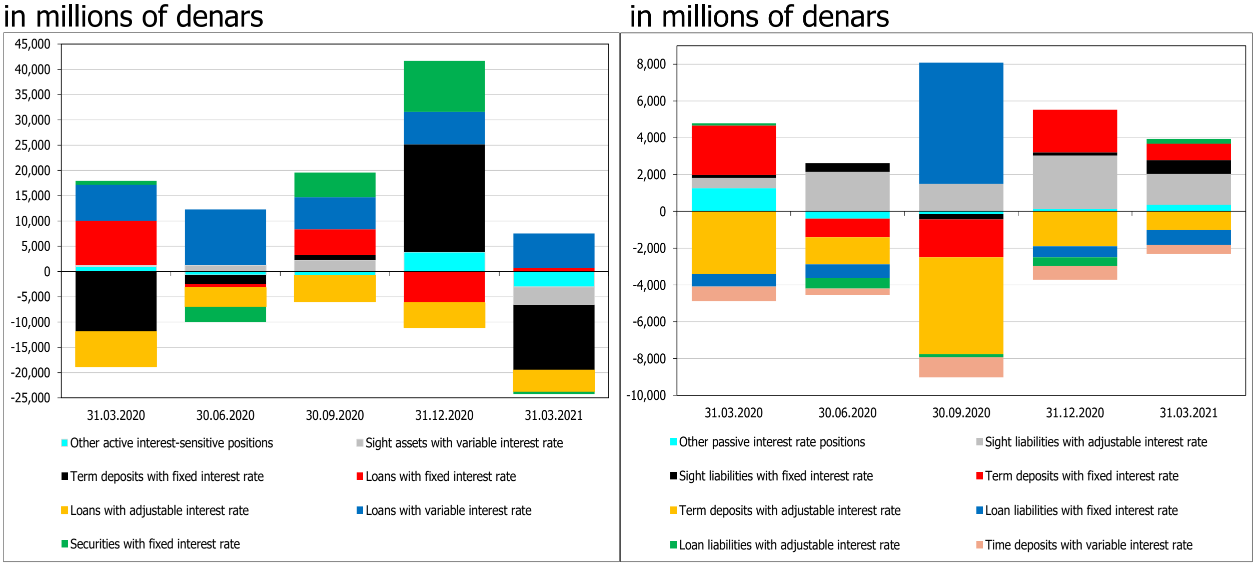
Chart 37
Net weighted position / own funds*
in %



Source: National Bank, based on data submitted by banks.
*As of 31.3.2020, the data for the average, minimum and maximum are calculated for the last nine years. Namely, data on the interest rate risk in the banking book are available starting from 2010.

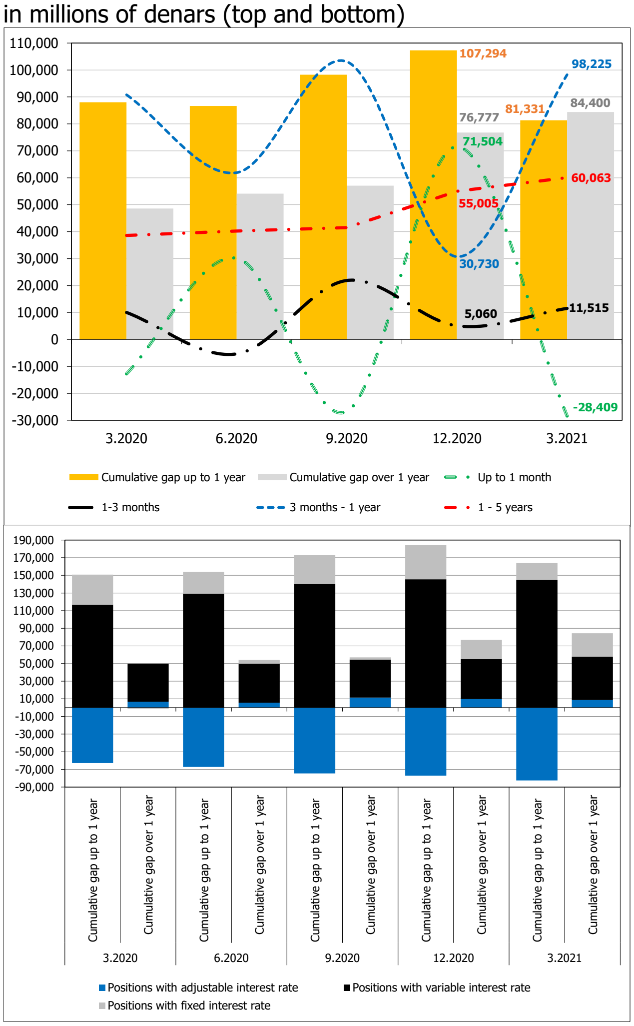
deposits with this type of interest rate (mostly due to the deposit facilities with the National Bank, and partially due to the placements in short-term deposits in foreign banks). **The negative gap between assets and liabilities with adjustable interest rate** widened (by Denar 6,683 million or by 9.9%), mostly due to the reduction of the placements in loans, with this type of interest rates. **The positive gap between assets and liabilities with variable interest rate** widened by Denar 3,328 million or by 1.7%, resulting from the quarterly increase in the placements in loans with variable interest rate.

Chart 38
Quarterly changes of the interest sensitive assets (left) and liabilities (right), by type of instrument and type of interest rate
in millions of denars



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

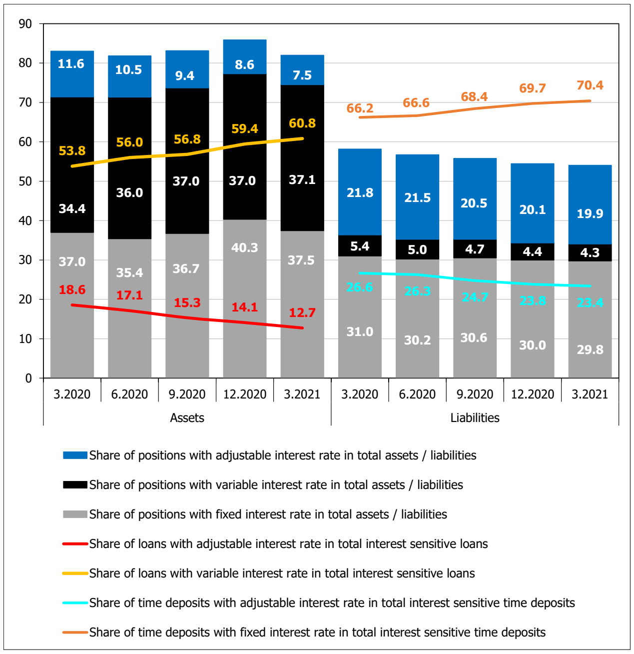
Chart 39 Asset-liability gap, by period until next interest rate revaluation (top) and gap structure by interest rate type (bottom)
in millions of denars (top and bottom)



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

Analyzing the period until the next reassessment of the interest rate level, the narrowing of the total gap between the interest sensitive assets and liabilities is due to the expansion of the gap up to one year, by Denar 25,963 million. The gap narrowing of the gap between interest-sensitive asset and liabilities items for up to one year results mostly from the reduced placements in time deposits (deposit facilities with the National Bank and short-term deposits in foreign banks) and in treasury bills. At the same time, the gap over one year widened to certain extent, which is mostly conditioned by the growth of placements in government bonds (with fixed interest rate positions) and placements in loans with variable interest rate.

Chart 40
Structure of assets and liabilities, by type of interest rate
in %



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

The indirect exposure to interest rate risk, which arises from the presence of loans with adjustable and variable interest rates, remains significant. As of 31.3.2021, the cumulative share of these loans in the total loans is 73.5% unchanged condition compared to 31.12.2020), whereby 60.8% of the total loans have variable interest rate, while 12.7% are with adjustable interest rate. This exposes banks to indirect credit risk from their clients' exposure to interest rate risk. The trend of reduction of the share of the positions with adjustable interest rate in interest-sensitive assets continued also in the first quarter of 2021, with both interest sensitive assets and interest sensitive liabilities. For more details about the structure of interest-sensitive items of the banks see Annexes to this Report.

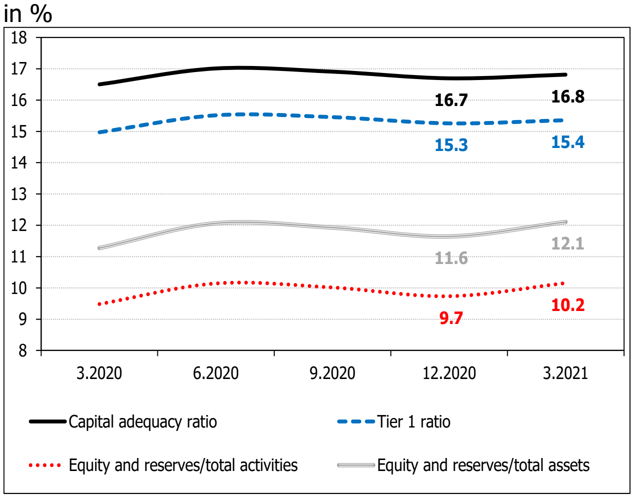
5. Insolvency risk

At the end of the first quarter of 2021, the indicators for solvency and capitalization of the banking system improved. The capital adequacy ratio registered a minimal quarterly increase by 0.1 pp, to a level of 16.8%, as a result of the higher growth of banks' own funds than the risk exposure. The growth of risk weighted assets was concentrated the most in credit risk weighted assets, while the growth of own funds was mostly due to retained earnings in own funds (in two banks), and to a lesser extent arose from the issued new subordinated instruments (in one bank). The new amount of own funds was used to meet the minimum capital requirements in accordance with the supervisory assessment, as well as to meet the capital requirements for credit risk coverage, for which part of the free capital was used (capital above the regulatory and supervisory minimum). Thus, the share of free capital in own funds decreased from 9.1% at the end of 2020 to 8.4%. In addition, 44% of the own funds of the banking system account for the capital supplements determined according to the supervisory assessment and for the capital buffers, which in turn are especially important in conditions of crisis episodes, when they can be used to deal with challenges of different nature and intensity. The conducted stress testing of the banking system resilience to the simulated shocks further shows satisfactory resilience, similar to 31.12.2020.

5.1. Solvency and capitalization ratios of the banking system

At the end of the first quarter of 2021, all solvency and capitalization indicators of the banking system improved, due to the more pronounced increase in capital positions compared to the increase in the activities of the banking system. Thus, the own funds, the Tier I capital and the capital and reserves registered a quarterly growth of 0.9%, 0.8% and 5.3%, respectively, while the increase in the on-balance sheet assets, the risk weighted assets and the total (balance sheet and off-balance sheet) activities of banks was more moderate and amounted to 1.3%, 0.1% and 0.9%, respectively. The growth of capital positions largely stems from the retention of profits in the banks' capital positions.

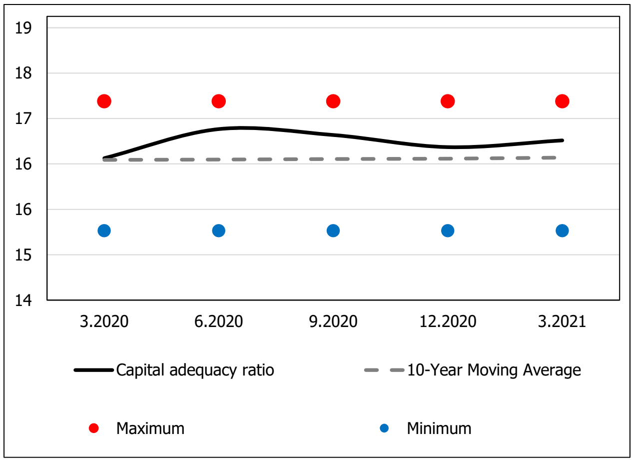
Chart 41
Solvency ratios
in %



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

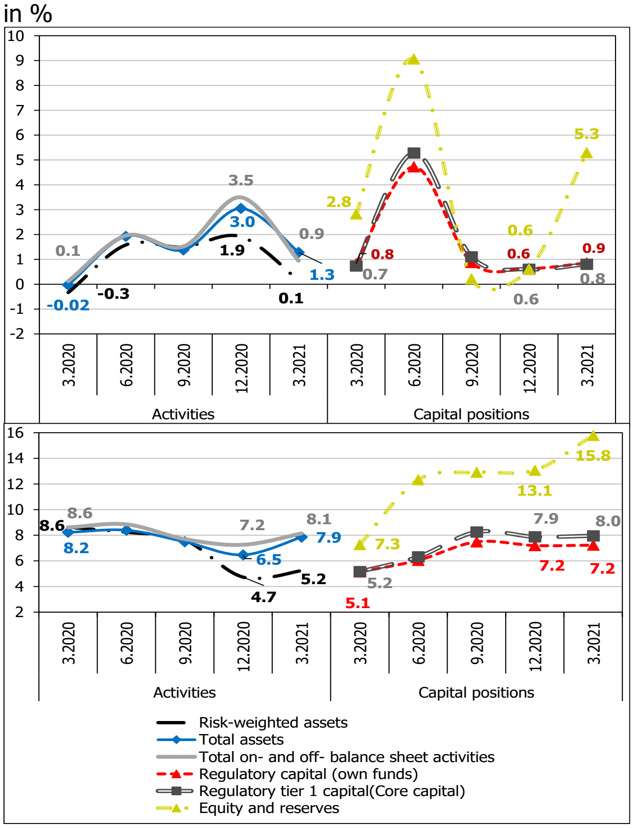
Like other central banks, the National Bank in February 2021 adopted a measure to temporarily limit the distribution and payment of dividends to bank shareholders. This measure

Chart 42
Movement of the capital adequacy ratio of the banking system
in %



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

Chart 43
Growth of components of solvency ratios, quarterly (top) and annual (bottom)
in %

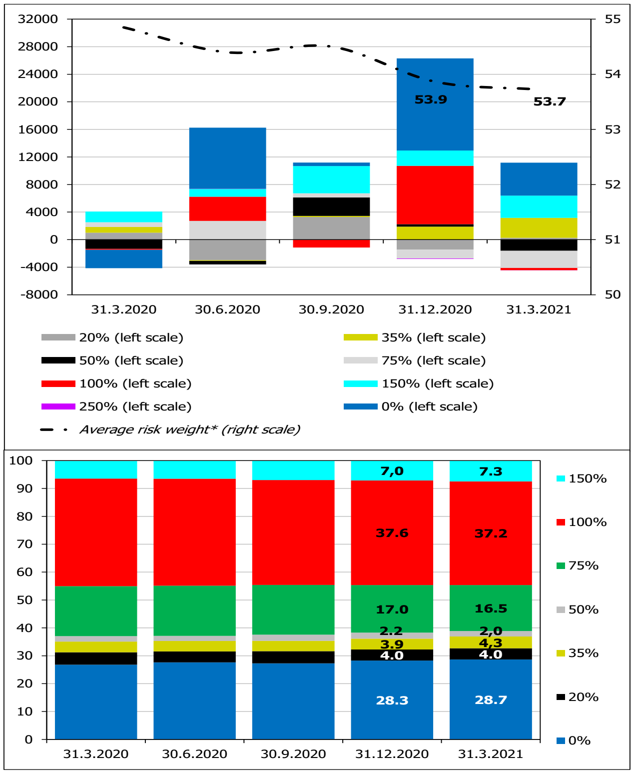


Source: National Bank, based on the data submitted by banks.

shall be valid until the end of 2021, with a possibility to be temporarily terminated, depending on the situation with the pandemic for preventive purposes, and to further increase and maintain the banking system resilience and stability, as well as support the lending activity, amid uncertainty around the further course of the health crisis.

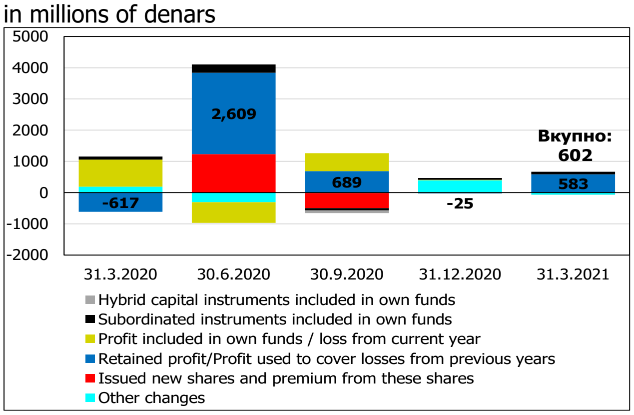
In the first quarter of 2021, the capital adequacy ratio at a level of the banking system equaled 16.8% and is higher by 0.1 pp compared to 31.3.2021, i.e. by 0.3 pp compared to the calculated ten-year average of this ratio (which is 16.5%). Analyzed by bank, as of 31.3.2021, the capital adequacy ratio is higher by 14% with all banks. At the same time, the capital and reserves and total assets ratio, i.e. the total activities of the banking system increased by 0.5 pp each and as of 31.3.2021 amounted to 12.1% and 10.2%, respectively. Quarterly increase of 0.1 pp was also registered in the Tier 1 capital and the common equity Tier 1 capital, which on 31 March 2021 reached levels of 15.4% and 15.3%, respectively, and are more than twice

Chart 44
Quarterly changes (top) and structure (bottom) in the total on-balance sheet and off-balance sheet exposure, by risk weights
in millions of denars in %



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

Chart 45
Structure of the quarterly growth of own funds
in millions of denars



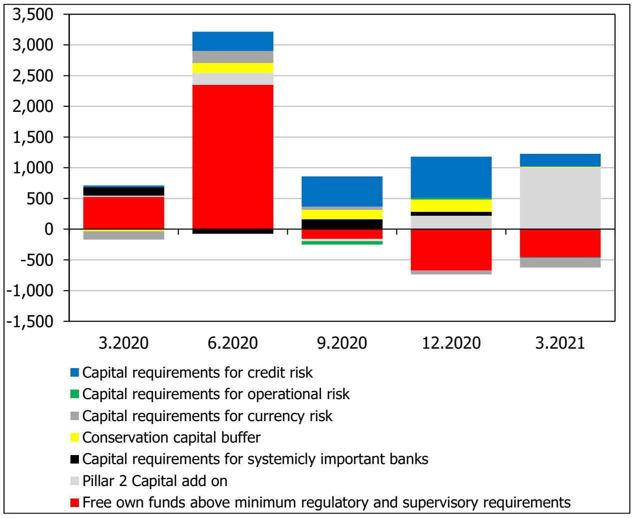
Source: National Bank, based on the data submitted by banks.

higher than the prescribed minimum of 6% and 4.5% respectively[28].

In conditions of an uncertainty about the further course of the health crisis and slower lending activity of the banking system, the risk weighted assets significantly decelerated the quarterly growth. The total risk weighted assets increased by only 0.1% or by Denar 613 million, which almost entirely resulted from the growth of the credit risk weighted assets of Denar 2,609 million, or by 0.7%. Operating risk weighted assets and other risk weighted assets increased minimally, while currency risk weighted assets decreased significantly (by 22.9%, or by Denar 2,023 million), as a result of the reduction of the aggregate foreign exchange position (narrowing of the gap between assets and liabilities with currency component)[29]. The largest growth in the total on-balance sheet and off-balance sheet exposure of the banking system was registered in the banks' activities that are included with risk weight of 0% (by Denar 4,778 million, or 2.4%), as a result of more pronounced quarterly growth of the liquid assets of the banking system (funds and banks' assets with the National Bank, as well as the banks' placements in domestic long-term securities[30]). Significant increase (of Denar 3,230 million) was recorded in the positions with a weight of 150%, mostly as a result of the increase in the small loans portfolio (mostly due to the increase in the banks' lending activity with households, based on consumer loans). At the same time, although slightly lower, significant quarterly growth was also recorded in the positions with a risk weight of 35% (by Denar 2,881 million), as a result of the increase in the claims covered by residential buildings. **Such movements in the credit risk weighted assets contributed to lowering the average**

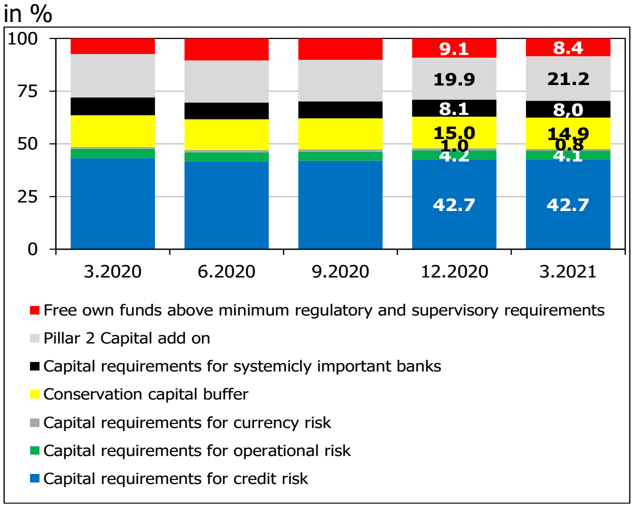
[28] The banks are required to calculate the borrowing rate on a semi-annual basis (as a ratio between the Tier 1 and the total on-balance sheet and off-balance sheet exposure), which for the second half of 2020 is 10.8% (10.7%, for the second half of 2019).
[29] More details in the section concerning the currency risk of this Report.
[30] More details in the section concerning the liquidity risk of this Report.

Chart 46
Quarterly growth of own funds, by the requirement for covering risks and for maintaining the required capital buffers
in millions of denars



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

Chart 47
Structure of own funds, by the requirement for covering risks and for maintaining the required capital buffers
in %



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

level of bank risks (as measured by the credit risk-weighted assets to total on-balance and off-balance sheet exposure ratio) by 0.2 pp, up to 53.7%.

5.2. Quality of own funds of the banking system

The structure analysis of the banking system's own funds shows that the sector has high-quality capital positions, which provide it with satisfactory resilience to potential stressful scenarios. As of 31.3.2021, the highest-quality layer of the own funds of the banking system (the common equity Tier I capital) accounts for 90.9% of the total own funds, the additional Tier I capital accounts for only 0.4%[31] of the own funds of the banking system, while the Tier II capital makes up 8.7%.

In the first quarter of 2021, the own funds of the banking system increased by Denar 602 million, or 0.9% (slight acceleration compared to the previous quarter), which mostly stems from the retention of profits in the own funds of two banks (from the group of large and small banks), and in a slightly smaller part of the issued new subordinated instrument of one bank from the group of medium-sized banks (by Denar 153 million).

For more details about the level of own funds by group of banks see annexes to this report.

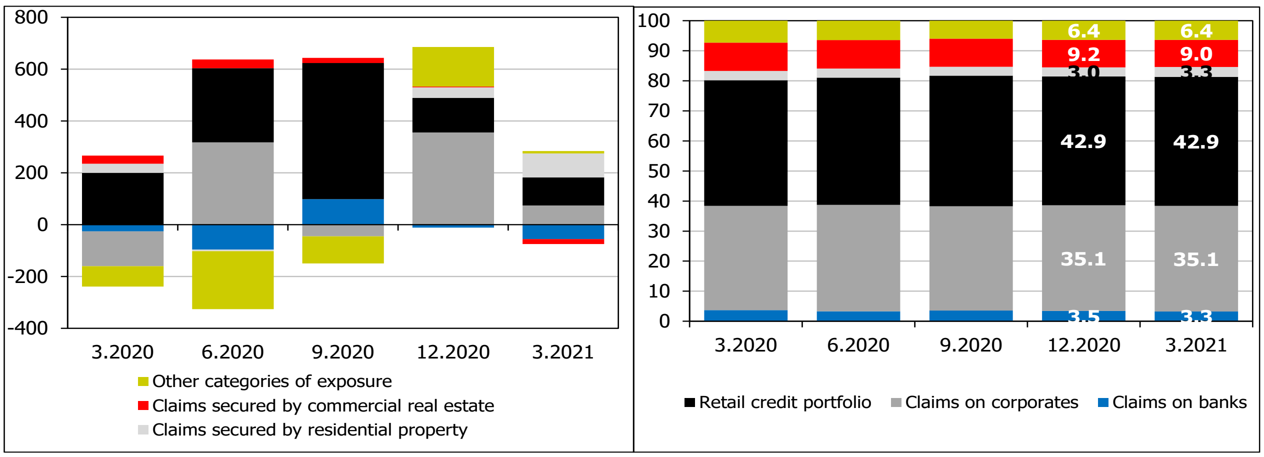
The quarterly increase of own funds was fully used to meet the capital requirements set out in the supervisory assessment (pillar 2), as well as to meet the capital requirements to cover credit risk, whose amounts increased, at almost unchanged amounts of capital requirements to

[31] Only one bank has issued instruments Additional Tier I capital.

meet the capital buffers[32] and capital buffers of the systemically important banks[33].

Thus, the own funds above the required level for covering all these requirements registered a decrease and as of 31.3.2021 they accounted for 8.4% of the total own funds of the banking system. The level of own funds over the capital requirement for covering risks remain relatively high and make up almost half of the total own funds of the banking system.

Chart 48
Quarterly growth rates (left) and structure (right) of capital requirements for credit risk, by exposure category
in millions of denars (left) and in % (right)



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

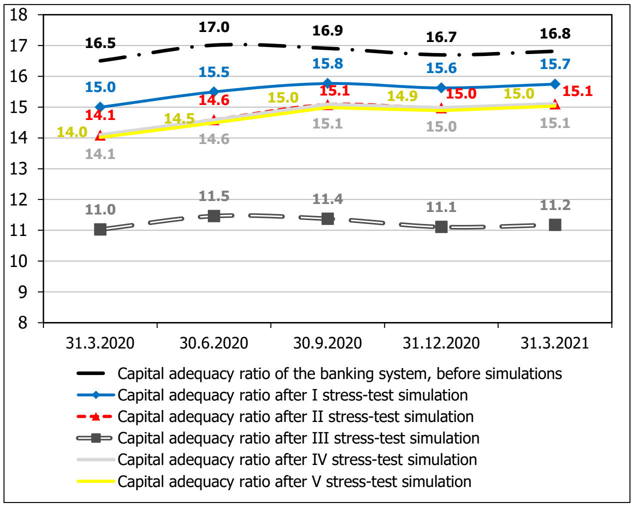
5.3. Stress-testing of the banking system resilience to hypothetical shocks

The banking system shows a satisfactory level of resilience to the conducted regular simulated shocks, which assume extreme materialization of the credit risk (isolated, or in combination

[32] From the four capital buffers specified by the Banking Law, for the time being all banks are required to meet the capital conservation buffer, while the seven banks identified as systemically important banks are also required to meet an appropriate rate of capital buffer for systemically important banks.

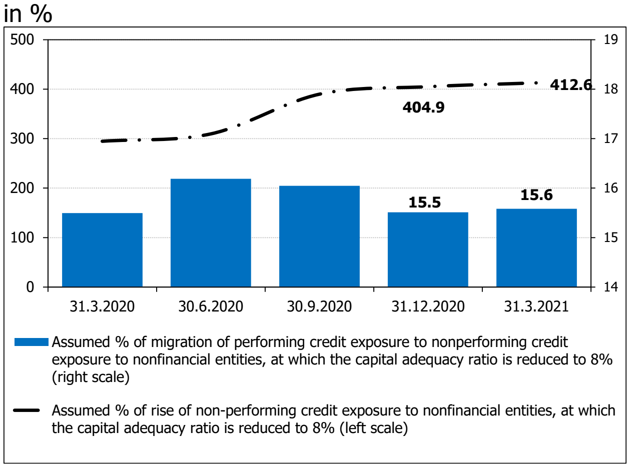
[33] Pursuant to the regulations, an approval, not later than 30 April of each year, the National Bank identifies the systemically important banks and determines the rates of capital buffer that these banks should maintain. Systemically important banks were required not later than 31 March of the following year to comply with the established capital buffer rates for systemically important banks. According to the data as of 31.12.2021, seven banks have been identified as systemically important banks, the same as in the preceding year (which should meet the determined rate of capital buffer for systemically important bank, not later than 31.3.2022). For more information visit: https://www.nbrm.mk/content/Regulativa/Lista_identifikuvani_sistemski_znacajni_banki_2020.pdf

Chart 49
Results of stress-test simulations
in %



Source: National Bank, based on data submitted by banks[34].

Chart 50
Necessary deterioration of the quality of credit exposure to cause a decline in the capital adequacy of the banking system to 8%
in %



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

with materialization of the currency and/or the interest rate risk). The results of the conducted regular stress-testing of the resilience of the banking system and of the individual banks to simulated shocks are similar compared to 31.12.2020. Namely, in all simulations, conducted as of 31.3.2021, the capital adequacy ratio is at the same level as at the end of 2020, or is minimally higher, by 0.1 pp. The capital adequacy of the banking system does not fall below 8% in any of the simulations, although individual banks reveal hypothetical need for recapitalization in the simulated extreme shocks.

Hypothetical shocks on the part of the credit risk had the greatest impact on the solvency of the banking system. The results of the reverse stress test show that it takes growth of 412.6% of non-performing loan exposure, i.e. migration of 15.6% from regular to non-performing loan exposure for the capital adequacy of the banking system to drop to 8%. However, these are rather extreme and less likely simulations, especially in the short term, given that in the first quarter of 2021, the non-performing credit exposure to non-financial entities registered a quarterly growth of 4.8%. On the other hand, in the second quarter of 2021, only 0.5% of the regular credit exposure to the non-financial sector received a non-performing status. Although, for the time being, the banking sector showed appropriate readiness to respond to the risks and to overcome the negative effects of the health crisis, the challenges are still present. The circumstances remain highly uncertain, as well as the risks which are mainly related to the the current pandemic and its termination.

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[34] Stress testing includes the following simulations:
I: Increase in non-performing loan exposure to non-financial entities by 50%;
II: Increase in non-performing loan exposure to non-financial entities by 80%;
III: Migration of 10% of the regular to non-performing loan exposure to non-financial entities;
IV: Increase in non-performing loan exposure to non-financial entities by 80% and increase in interest rates from 1 to 5 percentage points;
V: Increasing the non-performing credit exposure to non-financial entities by 80% depreciation of the Denar exchange rate by 30%, and increase in interest rates from 1 to 5 pp.

III. Major balance sheet changes and profitability of the banking system

1. Bank activities

In the first quarter of 2021, the banking system continued operating in uncertain environment, when one year after the outburst of the pandemic, the economy faced the strongest third wave of infections, followed by restrictive measures, although significantly milder and more selective compared to the previous ones. Under such conditions, the balance sheet of the banking system continued to grow, although its quarterly increase was slower compared to the previous quarter.

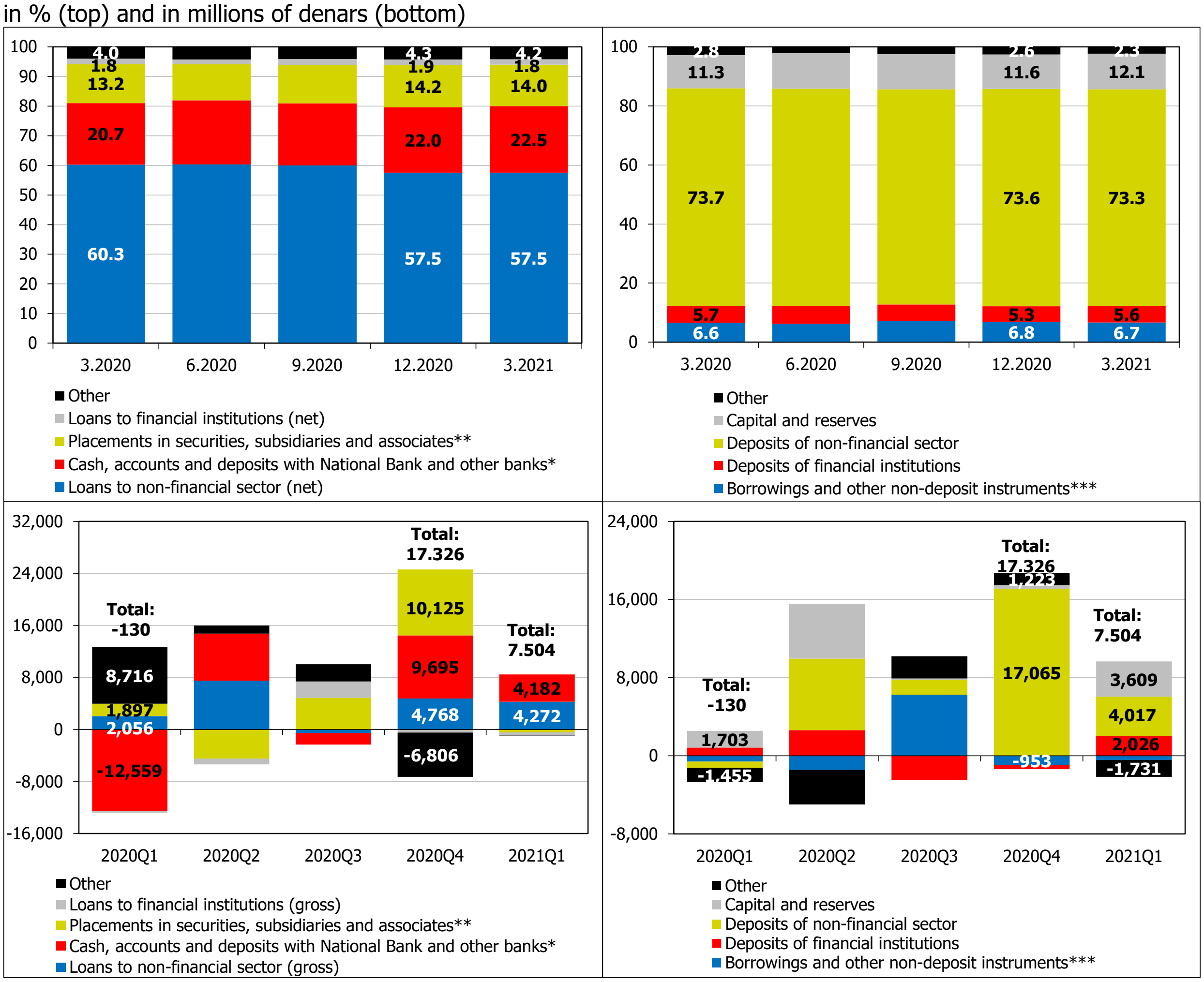
On the side of the sources of funds, the deposits continue to grow, which confirms the public confidence in the stability of the banking system. The changes with the deposits partly reflect the greater restraint from spending / investing in conditions of uncertainty, as well as the Government measures to deal with the consequences of the health crisis, which provide additional funds in the economy. From a sectoral point of view, household deposits contributed, almost entirely, to the quarterly deposit growth, while the corporate deposits decreased. The changed currency preferences of depositors since 2020 maintained in the first quarter of 2021, reflected by the higher absolute and percentage growth of foreign currency, compared to denar deposits. Observing maturity, demand deposits entirely determined the total deposit growth amid annual fall in long-term deposits. The higher level of capital and reserves, due to reinvested earnings of 2020, also significantly contributed to the quarterly growth of the sources of funds. In February 2021, the National Bank adopted a measure on temporary restriction of dividend distribution to the bank shareholders. The measure is valid until the end of 2021, but with the possibility of its early abolition, depending on the pandemic, in order to prevent and enable further increase and maintenance of both, resilience and stability of the banking system, as well as support the lending activity, in conditions of uncertainty about the further course of the health crisis.

In the first quarter of 2021, the banks also provided solid credit growth, although slightly slower compared to the previous quarter. Most of the annual growth of loans was aimed at households, predominantly in denars, although the lending to companies also increased. In order to encourage lending activity, the National Bank since the beginning of the crisis has adopted a series of measures, creating conditions to reduce financing costs through loans from banks, as well as to provide additional liquidity For the banking system. During the first quarter this year, the key interest rate fell by additional 0.25 pp, reducing to the level of 1.25%. Since the beginning of the pandemic, supported through the National Banks' regulatory flexibility measures, the banks eased the credit burden for most of their clients, mainly by approving a grace period or a moratorium of the repayment of loan liabilities. On 31.3.2021, the share of these loans was reduced to 2.2% of the total regular loans to the non-financial sector. Besides the lending activity with the non-financial sector, in the first quarter of 2021, a more significant growth was also registered in the banks' denar assets on the account with the National Bank.

The vaccination dynamics in the coming period, as well as the possibilities for the continuation of policies to support the real sector, while necessary, will greatly affect

the dynamics of the economic activity recovery and consequently, the activities of the banking system.

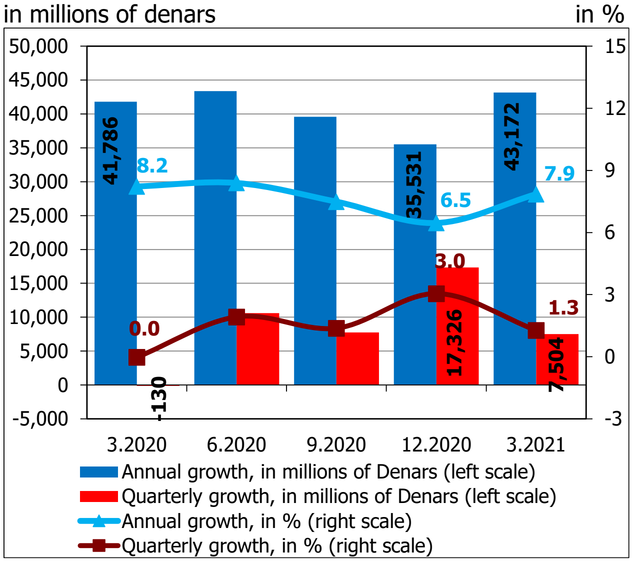
Chart 51
Structure of the assets (top left) and liabilities (top right) and structure of the quarterly changes of the assets (down left) and liabilities (down right) of the banking system
in % (top) and in millions of denars (bottom)



Source: National Bank, based on data submitted by banks.
Note: * Cash, accounts and deposits with the NBRNM and other banks also include the assets in the guarantee fund of KIBS, as well as the reserve requirement in foreign currency; **Other investment includes placements in equities and investment in subsidiaries, associates and joint ventures; ***Other issued non-deposit instruments include issued subordinated and hybrid capital instruments.

In the first quarter of 2021, the balance sheet of the banking system continued to grow (by Denar 7,504 million or by 1.3%), but slower compared to the preceding quarter (Denar 17,326 million or

Chart 52
Assets of the banking system

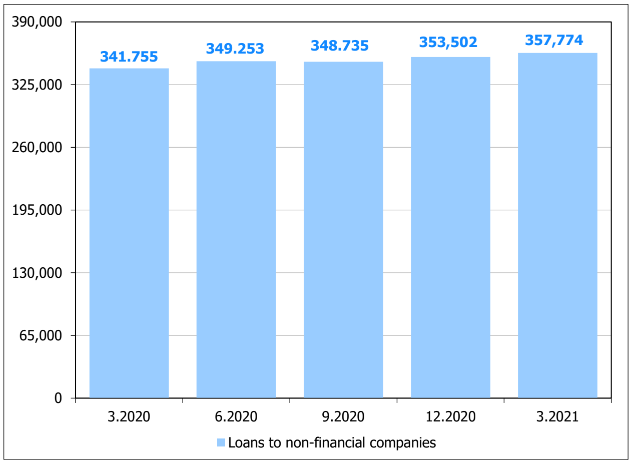


Source: National Bank, based on data submitted by banks.

by 3%)[35]**.** On annual basis, the assets of the banking system registered intensified increase and mounted by Denar 43,172 million, or 7.9% In the assets, the highest quarterly growth was recorded in loans to non-financial entities and bank assets on the Denar account with the National Bank, while on the liabilities side, the increase in deposits of non-financial and financial entities and in capital and reserves contributed the most to the liabilities growth.

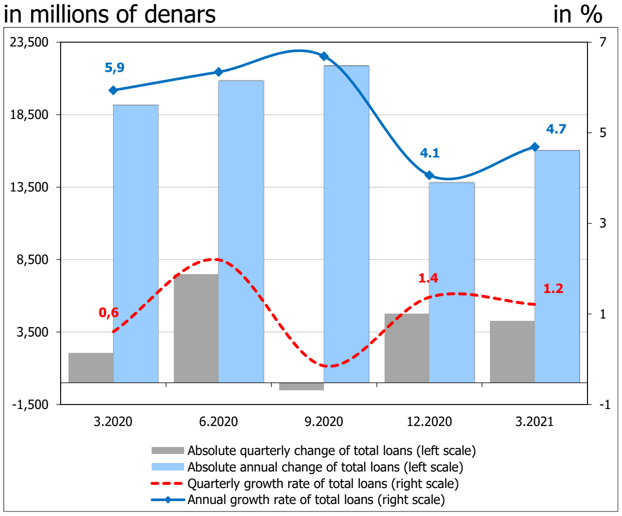
[35] The movements of the banks' activities, in the fourth and the first quarter of each year are usually influenced by the seasonal factors. Usually, in the fourth quarter of each year, the growth of activities of the banking system is strong and accelerated, followed by a weaker and slower growth in the first quarter of the next year, or even decline in the activities. The influence of the seasonal factors is seen in both, lending and deposit activities.

Chart 53
Amount of loans to non-financial entities
in millions of denars



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

Chart 54
Growth of loans to non-financial entities
in millions of denars in %



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

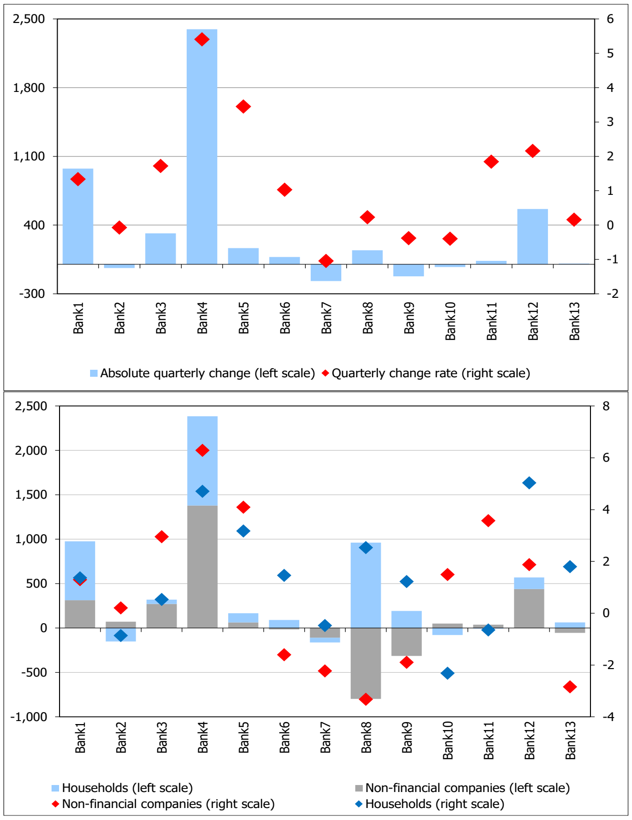
1.1. Loans to non-financial entities[36]

In the second quarter of 2021, the lending to the non-financial sector increased by Denar 4,272 million, or by 1.2%, which is an acceleration compared to the previous quarter (1.4%). The slowdown in the quarterly credit growth rate stems from corporate lending, where banks, according to the results of the Lending Survey in the first quarter of 2021, reported a tightening of credit conditions at the same time reduced credit demand. Analyzed by bank, nine out of thirteen banks[37] realized intensified lending activity compared to the previous quarter. However, only three banks (two large and one medium-sized) contributed with about 92% to the total quarterly growth of loans to non-financial entities.

[36] Loans to non-financial entities include loans to resident and non-resident non-financial entities, including loans to private and public non-financial companies, central government, local government, non-profit institutions serving households (loans to other clients), sole proprietors and natural persons (loans to households).
[37] DBNM AD Skopje is not taken into account due to its specific activities, which hardly include direct lending to companies.

Chart 55 Growth of total loans to non-financial entities (top) and loans to non-financial corporations and households (bottom), by bank

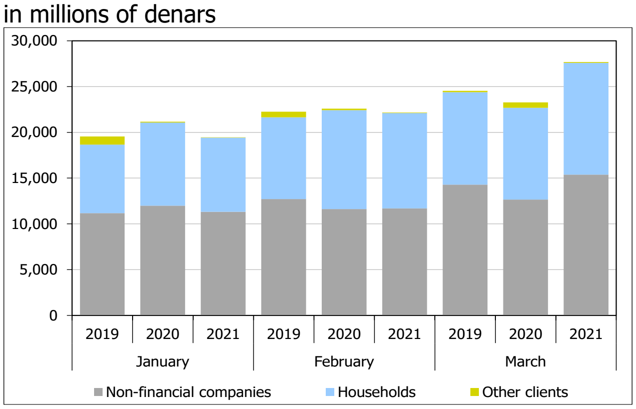
in millions of denars in %



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

Chart 56 New loans by individual sectors

in millions of denars



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

The volume of new loans in the first quarter of 2021 increased. On a monthly basis, in March 2021 there was a certain revival of the banks' lending activity, in both segments of the loan portfolio. Thus, the amount of newly approved loans in the first quarter of 2021 increased by 3.3%, compared to the same quarter of 2020, with a more pronounced increase in newly approved corporate loans (by 5.8%), amid lower growth of new household loans (by 2.8%).

The quarterly growth of the lending activity mostly resulted from lending to households, while the contribution of loans to non-financial companies was smaller.

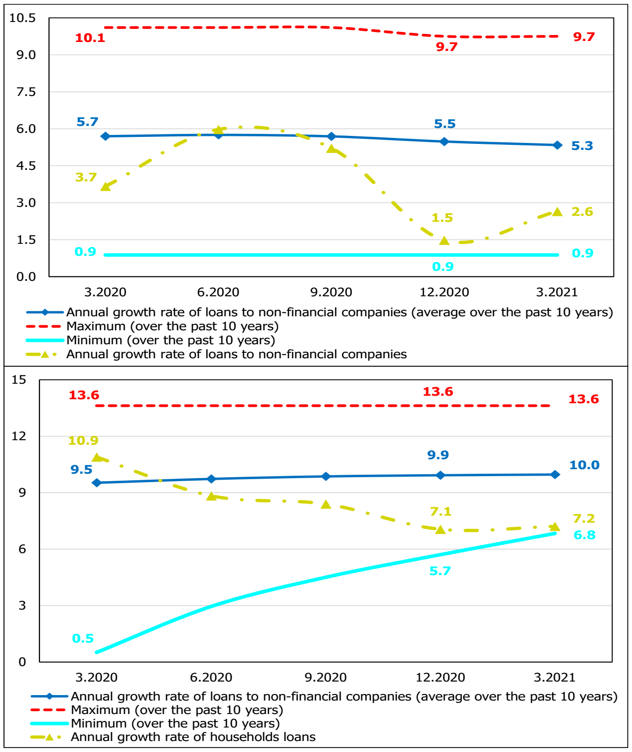
Loans to non-financial corporations increased by Denar 1,334 million, or by 0.8%, compared with the growth of 1.1% in the last quarter of 2020. However, the annual growth rate of corporate loans (excluding the effect of net write-offs) accelerated to 2.6% (1.5% on 31.12.2020), diverging from the minimum value of annual growth of corporate loans realized in the last 10 years (0.9%), but is still below the level of its ten-year moving average (5.3%).

The slowdown in the credit growth of non-financial corporations corresponds to the movements in this the credit market segment[38] where there is a stronger net tightening of the conditions for granting corporate loans[39]. At the same time, in the first quarter of 2021, banks point

[38] Analyzing the individual conditions for corporate lending, banks point to further net tightening in the non-interest revenues and in the collateral requirements, given slight net tightening with the interest rate on loans. The other credit conditions (size and maturity of loans) are assessed mainly as unchanged credit conditions by banks.

[39] Source: Bank Lending Survey in the first quarter of 2021.

Chart 57
Ten-year moving average of annual growth rates of loans to non-financial corporations (top) and household loans (bottom)
in %



Source: National Bank, based on the data submitted by banks.
*Note: Excluding the effect of all mandatory write-offs made in the period 1.1.2016 - 31.3.2021. Starting from December 2019, the data also contains collected compulsorily written-off loans.

to pronounced net decrease in the total demand of corporate loans, compared to the previous quarter. For the second quarter of 2021, banks expect small net tightening of the credit conditions for approving corporate loans, amid net increase in the credit demand by companies.

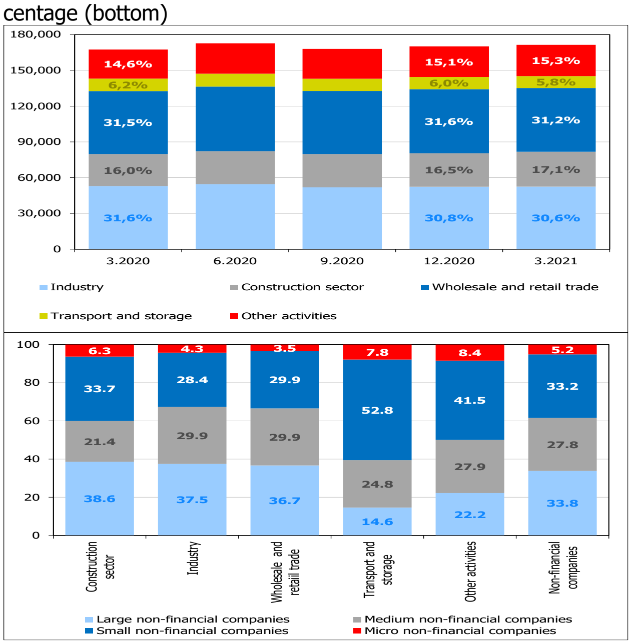
According to the economic activity of the clients, the structure of loans to non-financial companies is predominated by loans approved to clients from trade activity and industry. Analyzing the size of non-financial corporations[40], as of 31.3.2021, most of the approved corporate loans refer to large and small enterprises, which account for about one third of the total corporate loans. The share of medium-size enterprises is also similar (27.8%).

As opposed to the weaker lending support to enterprises, **the quarterly growth rate of household loans accelerated in the first quarter of 2021** and amounted to 1.6%, at growth of these loans by Denar 2,968 million (growth in the last quarter of 2020 was 1.3% or Denar 2,401 million). The annual growth of household loans (excluding the effect of net write-offs) is almost unchanged (7.2%) compared to the previous quarter, with four quarterly dates below the 10-year moving average of the annual growth rates of these loans (10.0%), and in this quarter it is even closer to the minimum value of its 10-year moving average (the difference between the two growth rates is only 0.4 pp).

The larger credit growth of households is mostly a result of the increased demand for loans, amid simultaneously eased credit conditions. Namely, in the second quarter of 2021, banks point to pronounced net easing of the credit

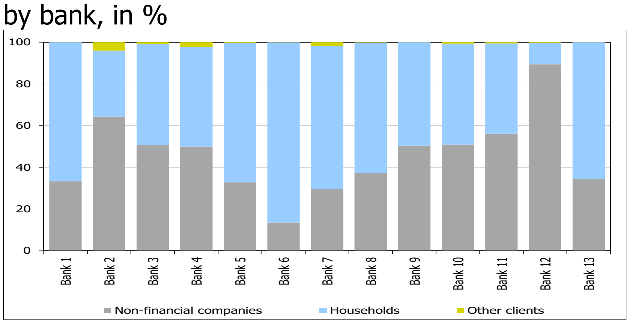
[40] The criteria for Classification of entities by size (into large, medium, small and micro) are defined in Article 470 of the Law on Trade Companies.

Chart 58
Structure of loans to non-financial companies, by individual activities (top) and according to the size of the company (bottom)
in millions of denars and in percentage in signs (top) and in percentage (bottom)



Source: National Bank's Credit Registry, based on data submitted by banks.

Chart 59
Sectoral structure of loans to non-financial entities, by bank, in %



Source: NBRM, based on the data submitted by banks.

conditions in household loans[41] which is registered in all types of loans. On the demand side, banks point to net increase in the demand for the total household loans as a result of the increased interest for consumption loans. As a contrast, the demand for housing and other loans registered a net decrease in the first quarter of 2021.

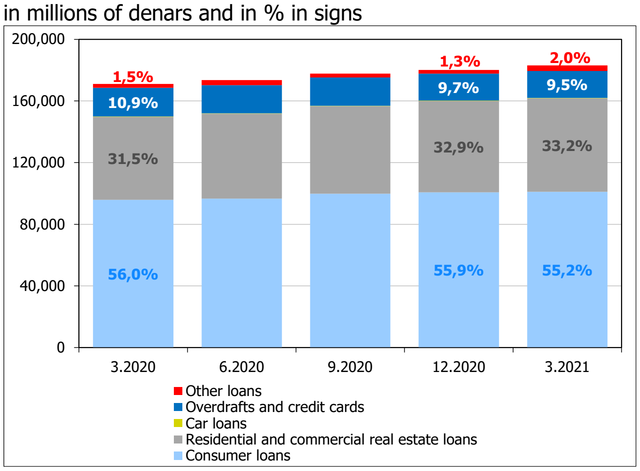
In the next quarter, banks expect net easing of credit conditions, amid further net increase in households' demand for loans.

Household loans[42] remained dominant (with a share of 51.5%) in the total loans structure, which additionally increased (by 0.3 pp) in the first quarter of 2021. By credit product, 64.7% of the loans to natural persons are intended for financing the non-identified consumption by natural persons (consumer loans, overdrafts and credit cards).

In the first quarter of 2021, denar loans[43] made the largest contribution (57.9%) to the growth of total loans to non-financial corporations, while the contribution of foreign currency loans[44] and denar loans with foreign exchange clause [45] is evidently smaller (22.9% and 19.3%, respectively). The currency structure of total loans remained almost the same compared to the previous quarter. The largest structural share is still that of denar loans with an identical

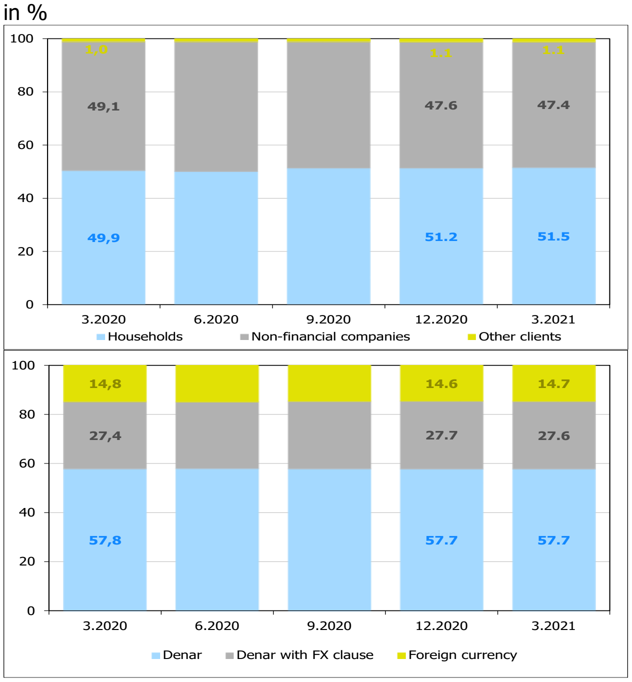
[41] In terms of individual credit conditions, there is more pronounced net easing in the interest rate on household loans, commissions on housing loans and loan maturity with consumer loans. The credit condition "collateral requirement" registers net tightening in housing loans, as opposed to the slight net easing in consumer loans.
[42]Among the individual credit products, in housing lending, banks generally managed to maintain the pre-crisis growth trend. As of 31.3.2021, the annual growth of housing loans was 13%, which is relatively similar to the one registered the preceding year (as of 31.3.2020, when it amounted to 14.1%. On the other hand, as of 31.6.2021, the annual growth of consumer loans was 5.5%, which is significantly lower compared to the annual growth of 12.9% as of 31.3.2020. Analyzed quarterly, analyzed in the first quarter of 2021, housing and consumer loans increased by 2.5% and 0.3%, respectively.
[43] Denar loans increased quarterly by Denar 2.473 million (or 1.2%), largely as a result of household loans (growth of Denar 2.009 million, or 2.0%), and to a lesser extent of the increase in loans to non-financial corporations (of Denar 388 million, or 0.4%).
[44] Foreign currency loans increased quarterly by Denar 977 million, or 1.9%, resulting from corporate loans (growth Denar 28 million) 0.3% 1,054 million, or 2.7%), as opposed to slight decrease of the foreign currency household and other clients loans (by Denar 28 million, or 0.3%, and Denar 43 million, or 2.7%, respectively).
[45] Denar loans with FX close grew up quarterly by Denar 822 million, or 0.8%, namely, corporate loans increased by Denar 988 million (or 1.4%) whilethe corporate loans reduced by Denar 108 million (or 0.4%).

Chart 60
Structure of loans to natural persons, by product
in millions of denars and in % in signs



Source: National Bank's Credit Registry, based on data submitted by banks.

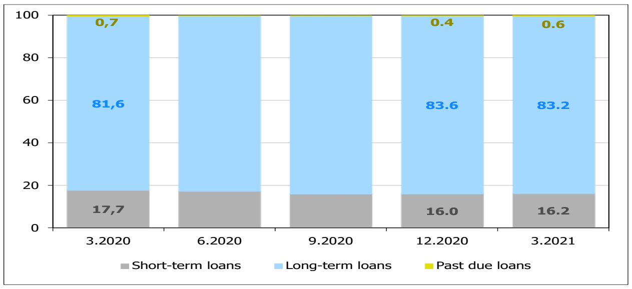
Chart 61 Structure of total loans, by sector (top) and currency (middle), and structure of regular loans, by maturity (bottom)*
in %



percentage share as in the last quarter of 2020 (57.7%).

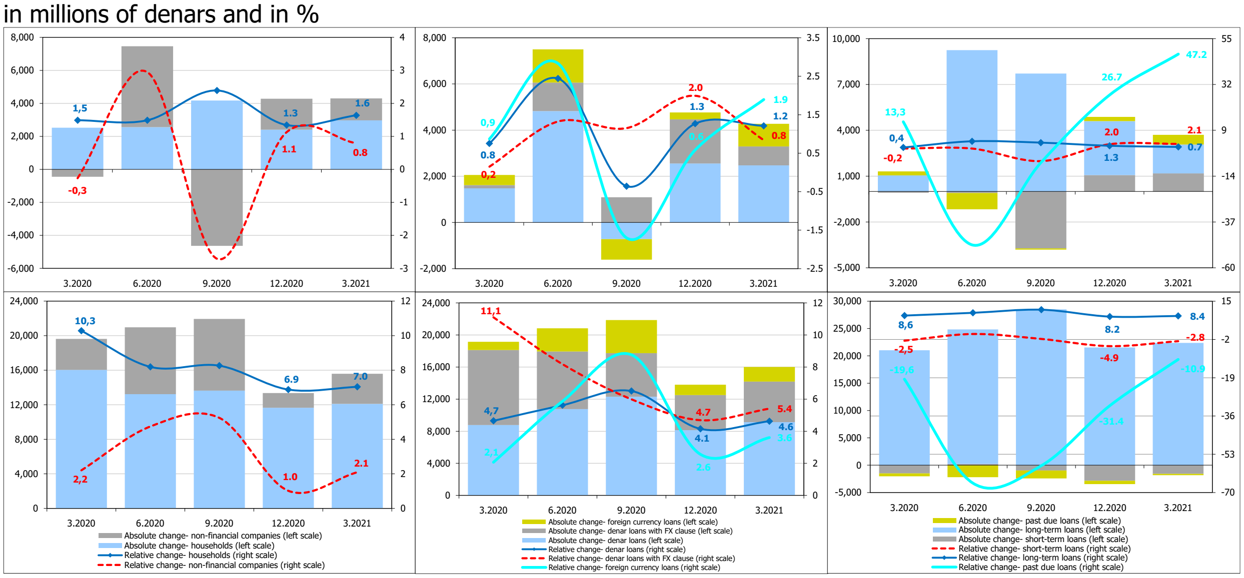
Credit portfolio maturity continued increasing in the first quarter of 2021, through moderate growth of long-term lending (by 0.7%, or by Denar 1.893 million), which as of 31.3.2021 made up 83.2% of the structure of total performing[46] loans. The growth of long-term loans fully results from household loans. The increased lending activity of banks partly resulted from the growth of short-term loans (by 2.1%, or by Denar 1,176 million), which, in turn, was largely due to loans to non-financial corporations, and to a lesser extent to household loans. At the same time, the overdue loans increased (by 47.2%, or Denar 630 million)[47], which is to a certain extent a consequence of the loans whose grace period approved due to the COVID crisis[48] has expired, and some of the clients are not able to continue with regular payment.

[46] The analysis of maturity structure of loans excludes non-performing loans.
[47] It should be borne in mind that overdue loans account for a minimum of 0.6% of total regular loans.
[48]Banks have made it possible to temporarily defer loan repayments, once and / or twice in 2020, to make it easier to deal with the negative effects of the health and economic crisis. According to the data submitted by banks, the grace period of most of these loans is already expired. Loans that are still under moratorium (with expired grace period) on 31.3.2021 account for 2.2% of total regular loans. According to individual sectors, on 31 March 2021, the grace period has not yet expired with 4.3% of corporate loans and only 0.3% of household loans. The portfolio that still remains with the expired grace period refers almost entirely to corporate clients. Namely, the expiration period of the approved grace period for the loans that are in the grace period on 31.3.2021 is usually until the end of September 2021 for the loans of non-financial corporations.



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

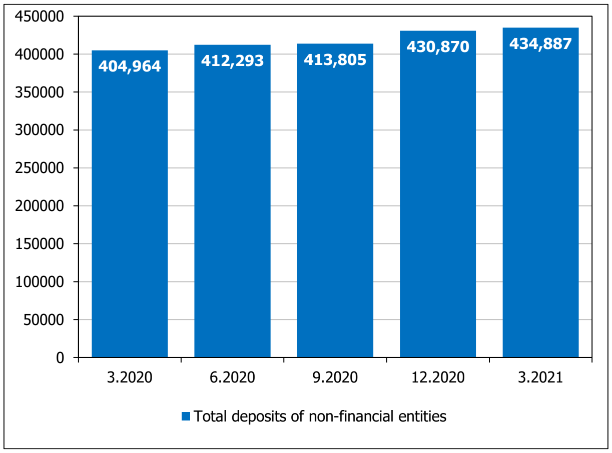
Chart 62
Quarterly (top) and annual (bottom) growth of loans, by sector, currency and maturity
in millions of denars and in %



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

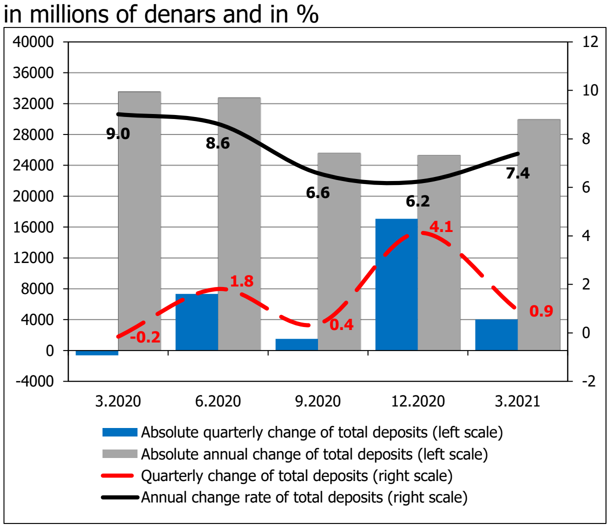
1.2. Deposits of non-financial companies

Chart 63 Deposits of non-financial entities
in millions of denars



Source: NBRM, based on the data submitted by banks.

Chart 64
Change of deposits of non-financial entities
in millions of denars and in %



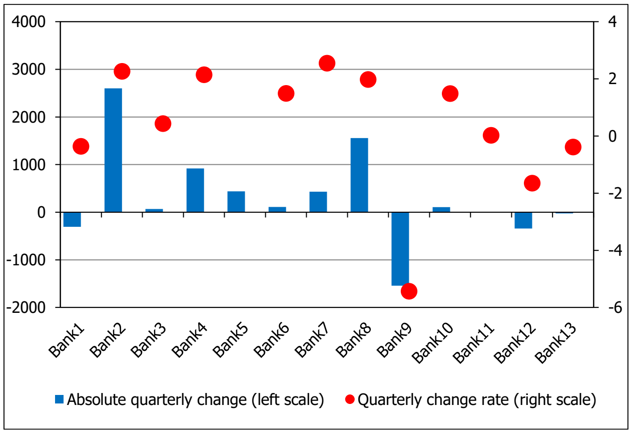
Source: NBRM, based on the data submitted by banks.

Despite the global uncertainty caused by the pandemic, in the first quarter of 2021, deposits of non-financial entities increased (by Denar 4,017 million, or 0.9%), at a slower pace though compared to the end of 2020 (growth of 4.1%). On the other hand, on annual basis, the total banks' deposit potential was growing rapidly (growth rate of 7.4%, compared to 6.2% as of 31.12.2020), partly reflecting the higher restraint from consumption and investment in conditions of uncertainty, as well as the government economic measures to deal with the consequences of the health crisis, as a support to companies and households to improve their liquidity. Analyzed by bank, three large banks generate the quarterly growth of deposits.

Households as major depositor in the Macedonian banking system (share of 67.6% in total deposits), in the first quarter of 2021, increased their assets in banks by Denar 4,779 million, or 1.7% (2.3% in the last quarter of 2020). Despite the slower quarterly growth, the growth of household deposits on annual basis (Denar 14,164 million, or 5.1%) accelerated compared to 31.12.2020 (4.5%).

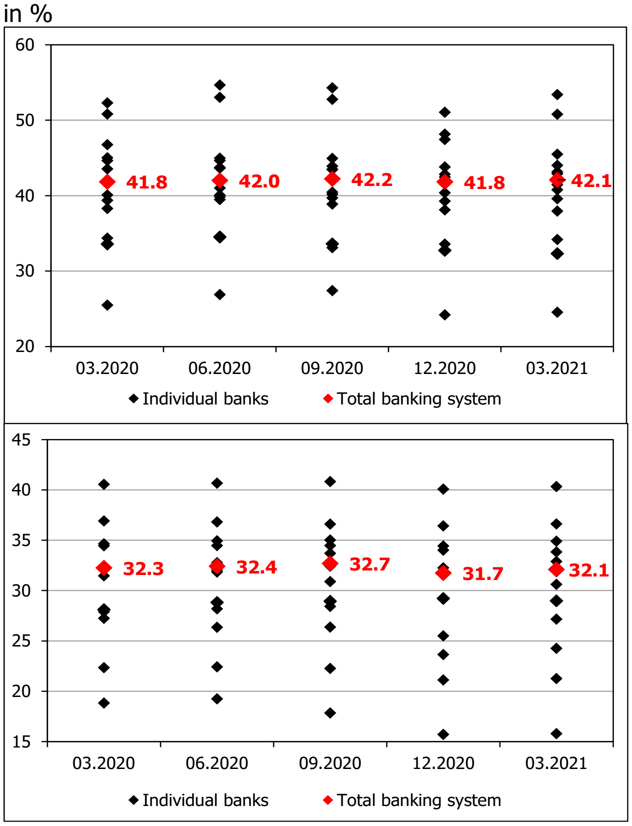
Deposits of non-financial corporations decreased quarterly by Denar 1.418 mil-

Chart 65
Growth of deposits of non-financial entities, by bank
in millions of denars and in %



Source: NBRM, based on the data submitted by banks.

Chart 66 Share of total foreign currency deposits (top) and foreign currency household deposits (below) in total deposits
in %



Source: NBRM, based on the data submitted by banks.

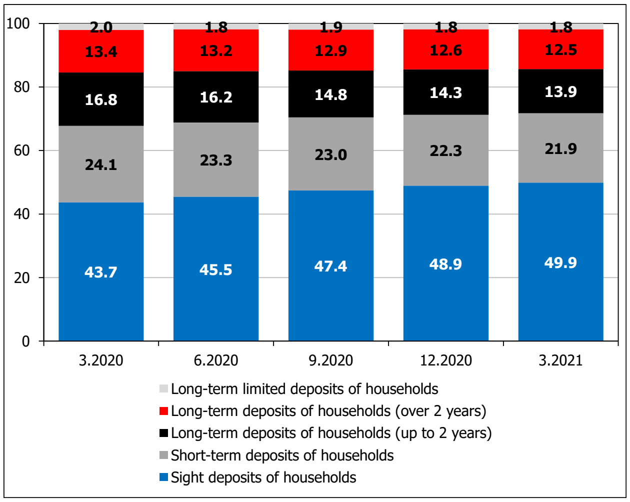
lion or 1.1%. This movement of corporate deposits is typical for the first quarter of the year and is influenced by seasonal factors. On annual basis, deposits of non-financial corporations accelerated the growth from 10.9% as of 31.12.2020, to 12.9%, as of 31.3.2021.

The protracted COVID-19 pandemic somewhat changed the currency and maturity preferences of depositors, as seen through a decline of long-term deposits, with the foreign currency deposits making the greatest contribution to the growth of total deposits. However, euroization level remained relatively stable.

Analyzing by currency, the largest contribution to the quarterly growth of the deposit base was made by foreign currency deposits (70.6%), which increased by Denar 2.836 million, or 1.6%. Actually, the changed currency preferences of depositors from 2020 remained in the first quarter of 2021. The quarterly growth of foreign currency deposits is largely due to the growth of demand deposits of the household sector. **Denar deposits** registered a modest quarterly increase (of Denar 1,175 million, or 0.5%). The increase in denar deposits resulted from household (demand) deposits, while denar corporate deposits dropped quarterly. As a result, the share of denar deposits in total deposits decreased to 57.8% at the end of the first quarter of 2021 (58.1% as at 31.12.2020), while the share of foreign currency deposits increased to 42.1 % (41.8% as at 31.12.2020).

Analyzing maturity, demand deposits fully contributed to the growth of total deposit base and in the first quarter of 2021 registered an absolute quarterly increase of Denar 4,903 million, or 1.9%, reflecting the growth of household deposits. On the other hand,

Chart 67 Maturity structure of household deposits
in %

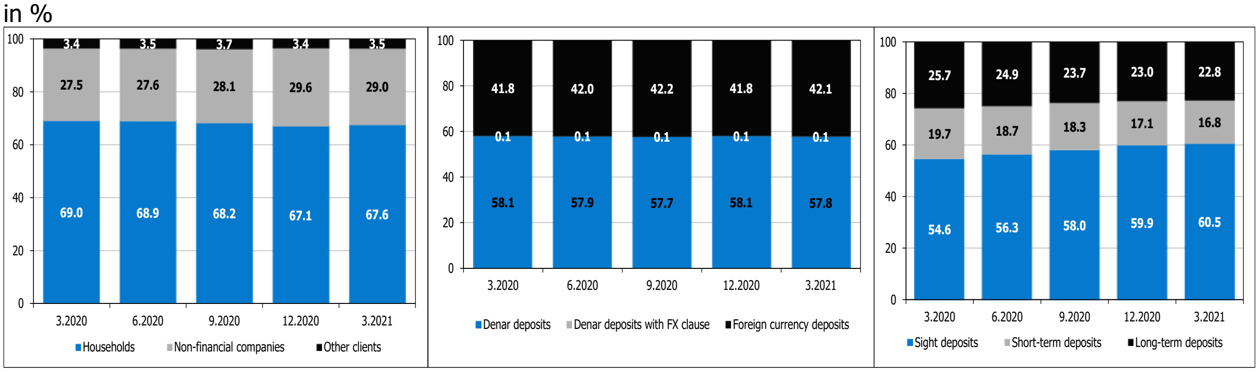


Source: NBRM, based on the data submitted by banks.

long-term[49] deposits insignificantly decreased by Denar 171 million on a quarterly basis, or by 0.2%, while short-term[50] deposits registered slightly faster decrease of Denar 714 million, or 1%, in both sectors.

Analyzing household deposit maturity, in the first quarter of 2021, there was an increase in the structural share of demand deposits (from 48.9% as of 31.12.2020, to 49.9% as of 31.3.2021). An opposite trend was observed in short-term and long-term deposits, whose share in the maturity structure of household deposits decreased (from 22.3% and 28.7% as of 31.12.2020 to 21.9% and 28.2% as of 31.3.2021, respectively).

Chart 68 Structure of total deposits, by sector (left), currency (middle) and maturity (right)
in %

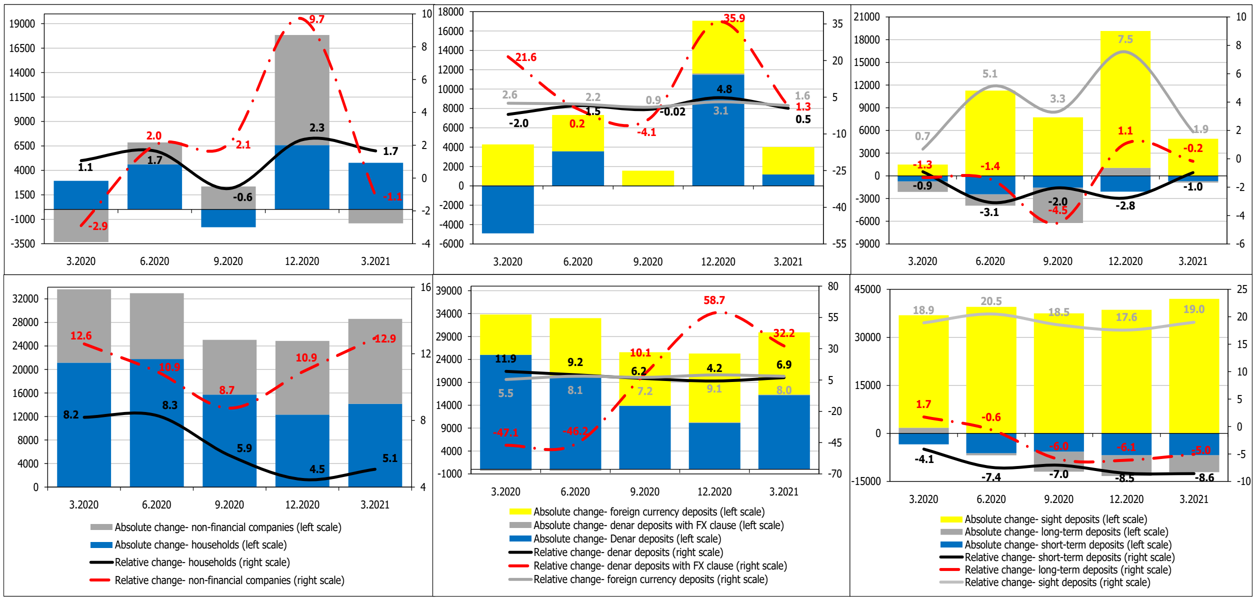


Source: NBRM, based on the data submitted by banks.

[49]The quarterly decrease in long-term deposits is largely due to the decrease in deposits of non-financial corporations of Denar 237 million, or 1.8% (where the contribution of foreign currency deposits was almost twice as high as the denar deposits and amounted to 63.4% and 36.5%, respectively), followed by the decrease of household deposits of Denar 124 million, or 0.1% (where denar deposits made the largest contribution of 87.8%).

[50]The quarterly decrease in short-term deposits largely stemmed from the decrease in deposits of non-financial corporations of Denar 552 million, or 7.1% (where the contribution of denar deposits was almost the highest and amounted to 89%). The decline in short-term deposits of the household sector was minor, amounting to Denar 197 million, or 0.3% (fully conditioned by the decline in denar deposits).

Chart 69 Quarterly (top) and annual (bottom) deposit growth by sector, currency and maturity
in millions of denars and in %

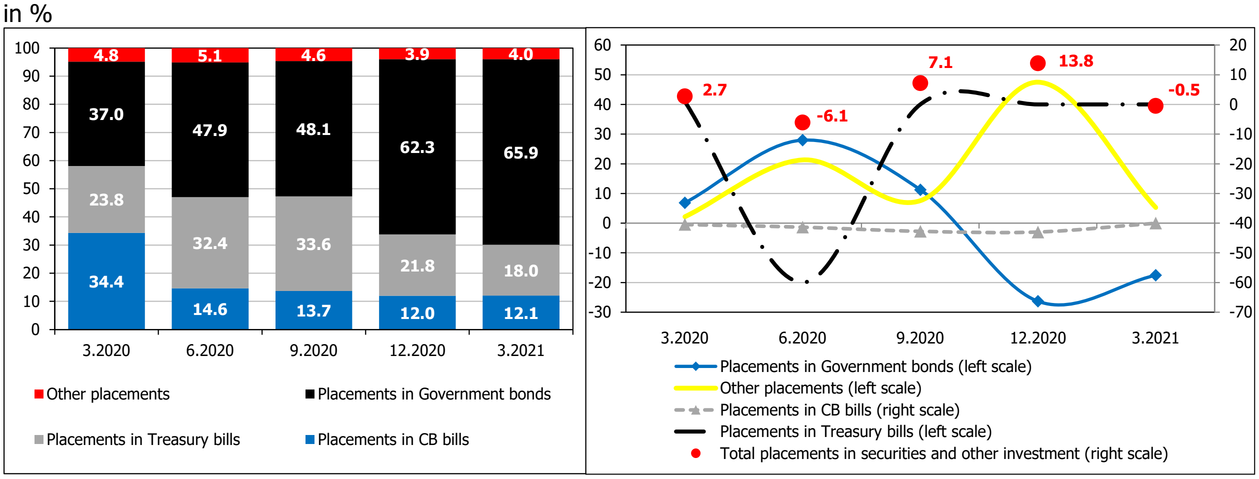


Source: NBRM, based on the data submitted by banks.

1.3. Other activities

In the first quarter of 2021, banks' placements in debt securities and other investments[51] (net book value) decreased by Denar 435 million (or 0.5%), which contributed to decreasing of their share in total assets of banks up to 14.0% as of 31.3.2021 (from 14.2% as of 31.12.2020). Such movements were entirely driven by the faster quarterly decrease of banks' investment in treasury bills (of Denar 3,182 million or 17.6%) amid increase in banks' investment in government bonds (of Denar 2,747 million, or 5.3%). Banks' investments in CB bills remained almost unchanged compared to the last quarter of 2020, which corresponds to the unchanged supply of CB bills (in the amount of Denar 10 billion). Such developments contributed to the quarterly increase of the share of investment in government bonds in total placements in debt securities and other banks' investment from 62.3% as of 31.12.2020 to 65.9% as of 31.12.2021, at the expense of the decrease in the share of placements in treasury bills (from 21.8% as of 31.12.2020 to 18% as of 31.3.2021).

Chart 70
Structure (left) and quarterly growth (right) of placements in debt securities and other investments
in %



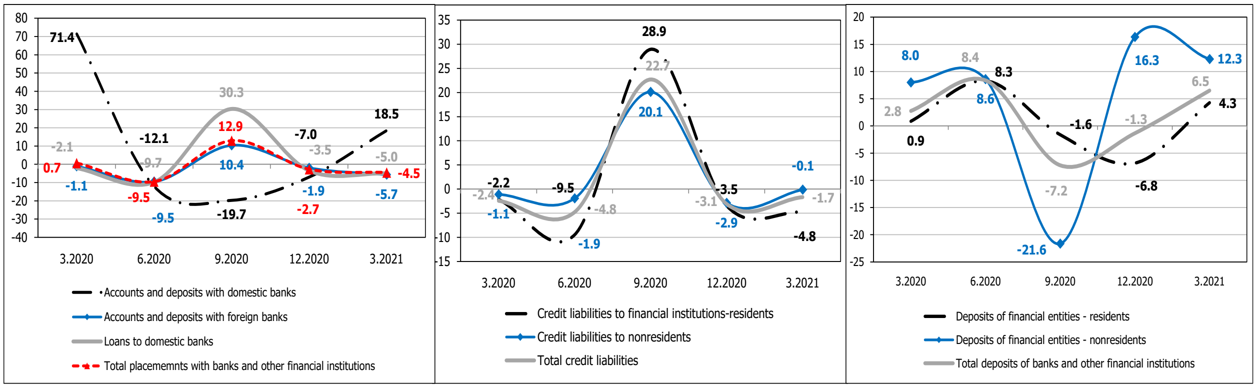
Source: NBRM, based on the data submitted by banks.

In the first quarter of 2021, placements with banks and other financial institutions decreased by Denar 1,910 million, or 4,5%. This decrease was mostly due to the Denar 4,471 million decrease of banks' assets on correspondent accounts in foreign banks (while increasing time deposits abroad[52]), and to a lesser extent the decrease in loans granted to domestic banks (of 523 million, or 5.0%[53]), while placements on accounts and deposits with domestic banks increased (by Denar 243 million, or 18.5%)[54].

Total **banks' loan liabilities** decreased by Denar 567 million, or 1.7% quarterly, which is almost entirely due to reduced loan liabilities to domestic banks[55].

[51] Other investment includes placements in equities and investment in subsidiaries, associates and joint ventures.

Chart 71 Quarterly growth of claims on financial institutions (left), loan liabilities (middle) and deposits of financial institutions (right)
in %



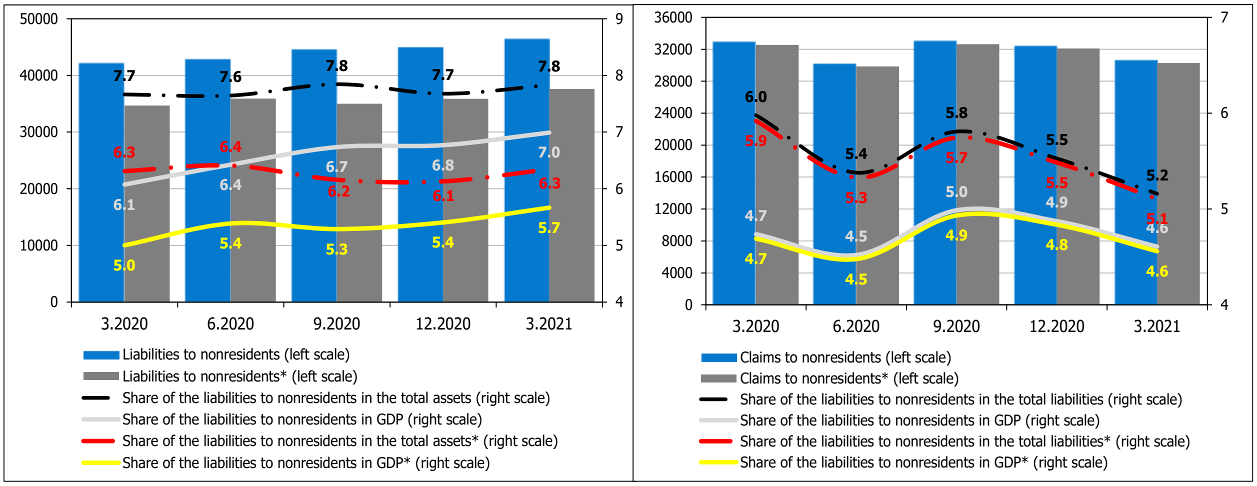
Source: NBRM, based on the data submitted by banks.

Deposits from banks and other financial institutions remain a small source of banks' financing, accounting for 5.6% of total liabilities as of 31 March 2021. The growth of deposits of banks and other financial institutions (of Denar 2,026 million, or 6.5%) is almost equally due to the increase in short-term foreign currency deposits of non-resident financial companies (of Denar 1,052 million), and the current accounts of pension funds (of Denar 915 million, of which Denar 752 million in foreign currency and Denar 163 million in denars).

The scope of banking system activities with non-residents is constantly small, with bank-to-bank differences. Thus, in the first quarter of 2021, the banking system's liabilities[56] exceed its claims on non-residents. Domestic banks' liabilities to non-residents went up annually by Denar 1,471 million, or 3.3%, and their share in total banking system liabilities increased to 7.8%[57] (7.7% as at 31.12.2020). This increase mostly arises from the higher short-term deposits (up to one month) in foreign currency of non-resident financial corporations - parent entities of a large bank and a medium-sized bank, and less to the increased foreign currency liabilities to financial companies on the basis of a subordinated loan of a medium-sized bank. Contrary to liabilities, banks' claims on non-residents decreased by Denar 1,764 million (5.5%) quarterly, entirely reflecting the decrease in funds on accounts in foreign banks.

[52] The growth of time deposits up to one month abroad amounted to Denar 1,445 million, overnight deposits to Denar 840 million and time deposits from three months to one year to Denar 469 million.
[53] The fall in long-term loans of domestic banks stems from the loans of DBNM AD Skopje placed in domestic banks, based on an approved credit line from the EIB, intended for financing domestic non-financial companies.
[54] The growth of funds on accounts and deposits with domestic banks almost entirely reflects the growth of foreign currency account balances with licensed domestic banks of one large and one small bank.
[55] The quarterly decrease in loan liabilities to domestic banks is due to the fall of loan liabilities in foreign currency with maturity of two to five years to DBNM (of Denar 434 million).
[56] As of 31.3.2021, eight of fourteen banks owe more than they claim on non-residents.
[57] If DBNM AD Skopje is excluded from the analysis, the share of liabilities to non-residents in total liabilities would be 6.3%.

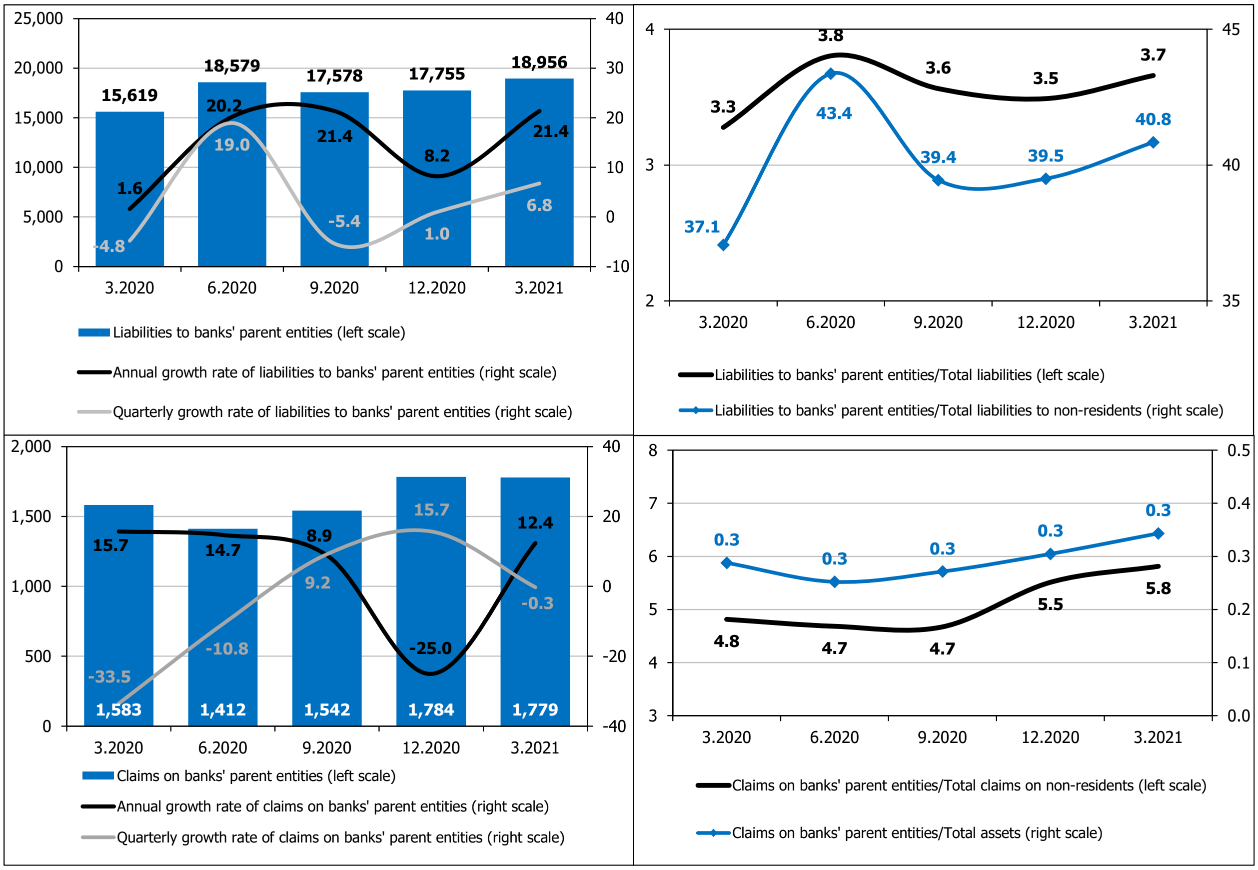
Chart 72
Liabilities to (left) and claims on (right) non-residents
in millions of denars and in %



Source: NBRM, based on the data submitted by banks.
Source for GDP: State Statistical Office.
*Without the share of DBNM AD Skopje

Borrowing from parent entities is not a significant source of financing the domestic banks' activities, although bank-to-bank differences can be observed. In the first quarter of 2021, banks' liabilities to their parent entities increased by Denar 1,202 million (or 6.8%), which is mostly due to the increase in short-term deposits of financial entities with one large and one small bank, and less to the increase in subordinated instruments with one medium-size bank. Thus, the share of banks' liabilities to parent entities (including subordinated liabilities and hybrid capital instruments) in total liabilities of the domestic banking system, and in liabilities to non-residents increased to 3.7% and 40.8%, respectively. Claims on parent entities account for only 0.3% of the total assets of the banking system, while their share in total claims on non-residents is 5.8%. Compared to 31.12.2020, claims on parent entities decreased by Denar 5 million or 0.3%.

Chart 73
Liabilities to (top) and claims on (bottom) banks' parent entities
in millions of denars and in %



Source: NBRM, based on the data submitted by banks.

2. Profitability

In the first quarter of 2021, the domestic banking system reported higher operating profit, compared to the same period last year. The higher financial result mostly derives from the reduced impairment costs (mainly for financial assets). Much of the reduction in impairment costs is due to the lower number of banks compared to the first quarter of 2020. Higher non-interest income also had a significant contribution to the profit growth, amid a moderate decline in net interest income.

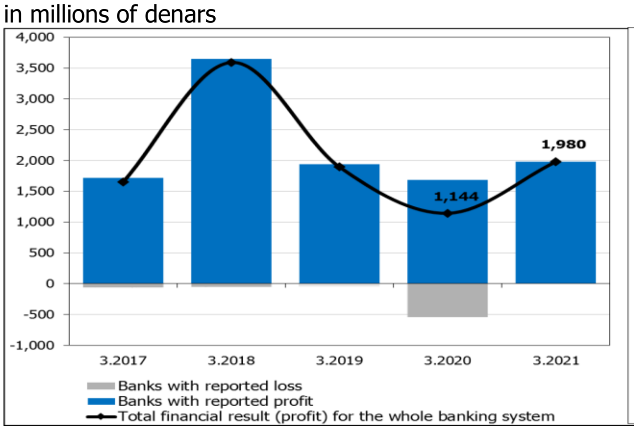
The banking system profitability ratios are improving compared to the first quarter of 2020. Operational efficiency indicators have the same trend, given the slightly lower operating costs, compared to the same period last year.

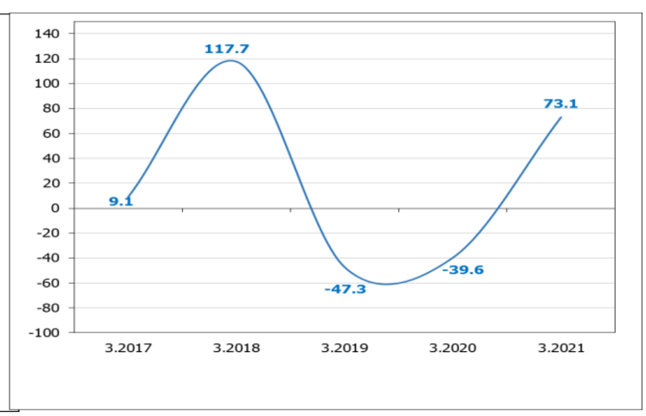
In the first three months of 2021, the National Bank cut the interest rate on CB bills to 1.25%. Consequently, the trend of decreasing interest rates with banks continued. However, the interest rate spread did not quite change, given the nearly identical decrease in the average lending and deposit interest rates.

2.1. Banking system profitability and efficiency ratios

In the first quarter of 2021, the banking system generated operating gain of Denar 1,980 million, which is by Denar 836 million higher compared to the same period of the previous year. The improved financial result mostly stems from the reduction of impairment costs (primarily from financial assets), which decreased by Denar 608 million, or 39.5%, compared to the first quarter of 2020. Much of the reduction of the impairment costs mainly stems from the higher collection and release of impairment, but also from the reduction in the number of banks by one, compared to the same period last year. Drivers of the profit growth also include the net commission income (with growth of 12.2% or Denar 145 million, mainly due to the increased volume of payment services), other regular revenues (with growth of 19.8% or Denar 121 million), as well as lower operating costs (decrease of 0.4% or Denar 12 million). Net interest income decreased by 1.4% or Denar 52 million. Analyzed by bank, all banks reported positive financial operating result.

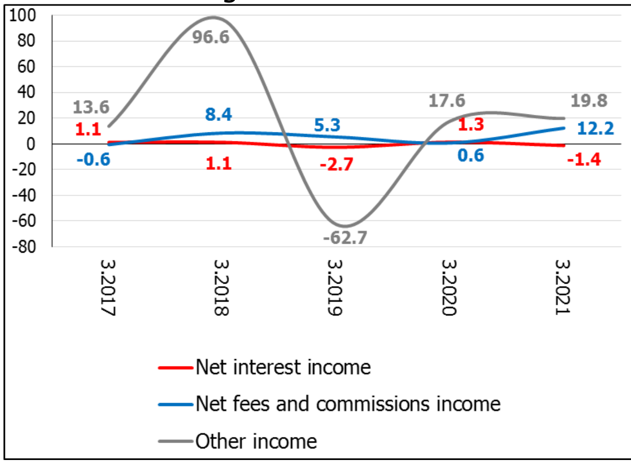
Chart 74 Total profit recognized by banks (left) and annual growth (right)
in millions of denars

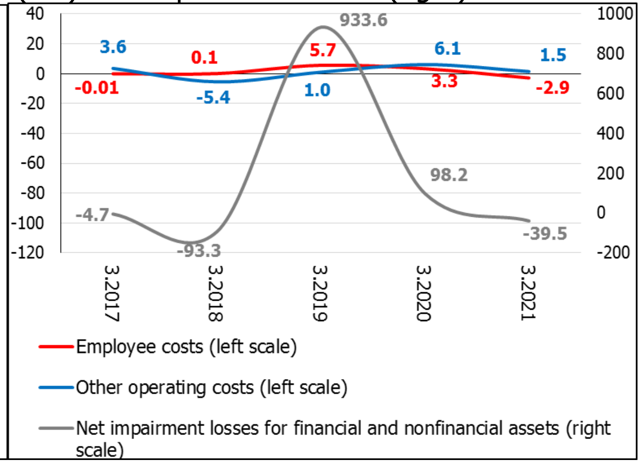




Source: NBRM, based on the data submitted by banks.

Chart 75 Annual growth rate of the main income (left) and expenditure items (right) of banks

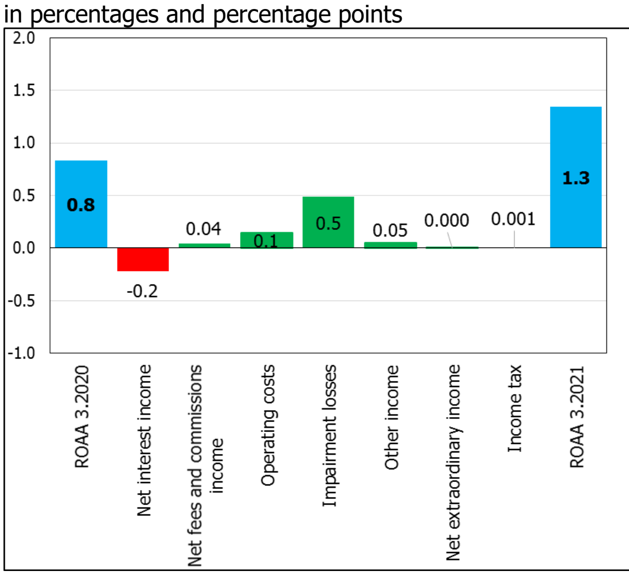


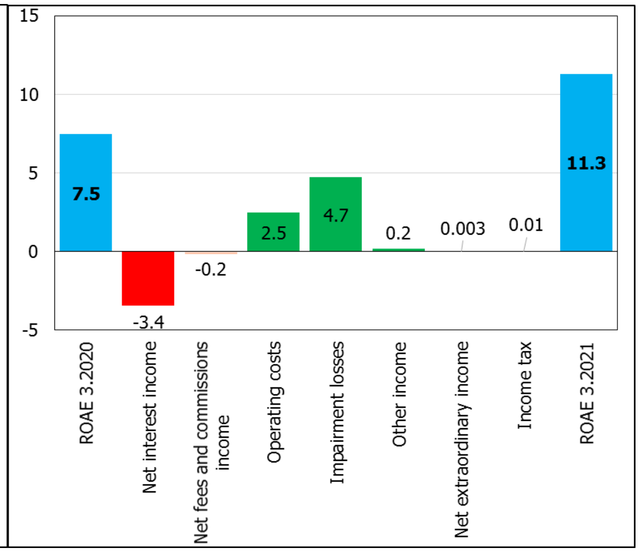


Source: NBRM, based on the data submitted by banks.

Chart 76 Decomposition of rates of return on average assets (left) and average equity (right)

in percentages and percentage points

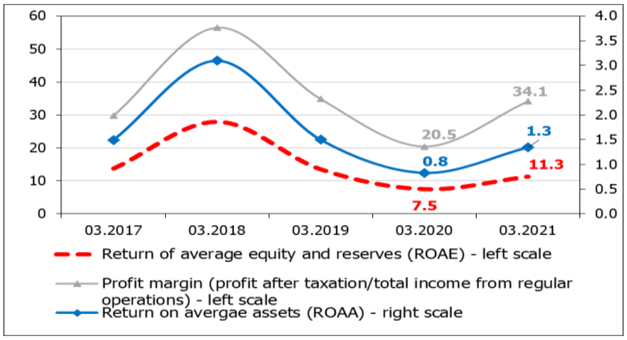




Source: NBRM, based on the data submitted by banks.

Note: The chart shows changes in individual components of profitability expressed as a share in average assets i.e. average equity and reserves. The green and red bars indicate a positive and negative contribution to the growth of ROAA/ROAE, respectively, in percentage points. ROAA and ROAE are expressed in percentages.

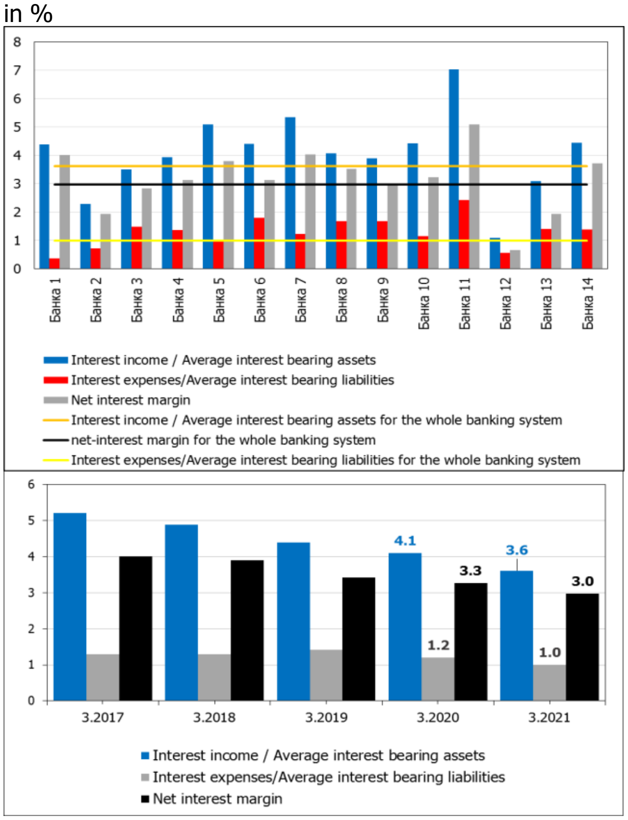
Chart 77
Rates of return on average assets and on average equity and reserves and profit margin
in % in %



Source: NBRM, based on the data submitted by banks.

The profit growth in the first three months of 2021 improved the main profitability ratios[58] of the banking system. Compared to the same period of the previous year, average assets, average equity and total income increased, but their relative growth was much slower than the growth of banks' net profit[59]. Thus as of 31.3.2020, the rate of return on average assets and average equity increased by 0.5 and 3.8 pp, respectively, while the growth of profit margin was 13.6 pp.

Chart 78
Net interest margin by bank, as of 31.3.2020 (top)* and of the banking system (bottom)
in %



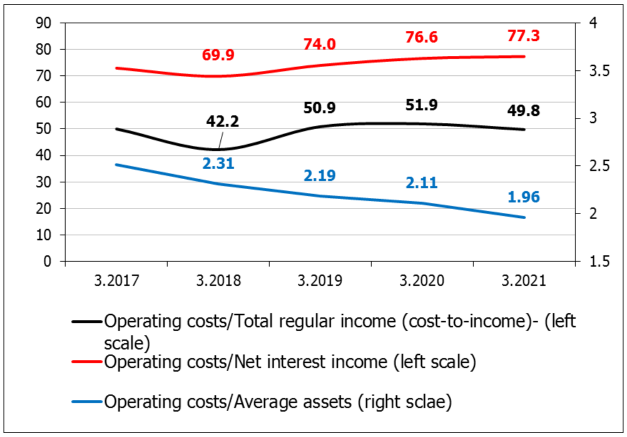
Source: NBRM, based on the data submitted by banks.
* Indicators of the banking system are shown in lines.

Amid ongoing interest rate cut, the net interest margin also went down. In the first quarter of 2021, this indicator decreased by 0.3 pp on an annual basis to 3.0%, amid decrease in net interest income (of 1.4% or Denar 52) and increase in the average interest-baring assets (of 8.4% or Denar 38,876 million). Thereby, the decrease in net interest income resulted from the higher annual decline in interest income (of Denar 211 million, or 4.4%), compared to the decrease in interest expenses (of Denar 159 million or 16.6%).

In the first quarter of 2021, as usual, the greatest positive contribution to the formation of net interest income was made by financial intermediation with households. Net interest income from households increased by Denar 117 million or 5.5% annually.
Interest income from this sector registered an annual decline which was significantly slower compared to the decrease in interest expenses.[60] In the government sector, net interest income was higher by Denar 89 million, or 48.6% compared to the same period last year. On the other hand, net interest income from non-financial entities decreased by Denar 96

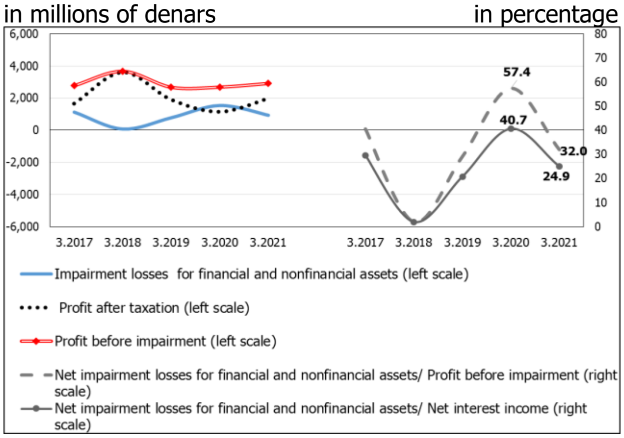
[58] Profitability and efficiency ratios of the banking system and bank groups are presented in the Annexes to this Report.
[59] Average assets and average equity increased by 7.2% and 14.4%, respectively, while the growth of total revenues was 3.8%. On the other hand, the banks' net profit was higher by 73.1% compared to 31.3.2020.
[60] Interest income from households decreased by 0.2% or Denar 5 million, while interest expenses from this sector decreased by Denar 121 million, or 26.3%, compared to the first three months of the previous year.

Chart 79
Operational efficiency ratios
in %



Source: NBRM, based on the data submitted by banks.

Chart 80
Impairment costs to gain and to net interest income ratios
in millions of denars in percentage



Source: NBRM, based on the data submitted by banks.

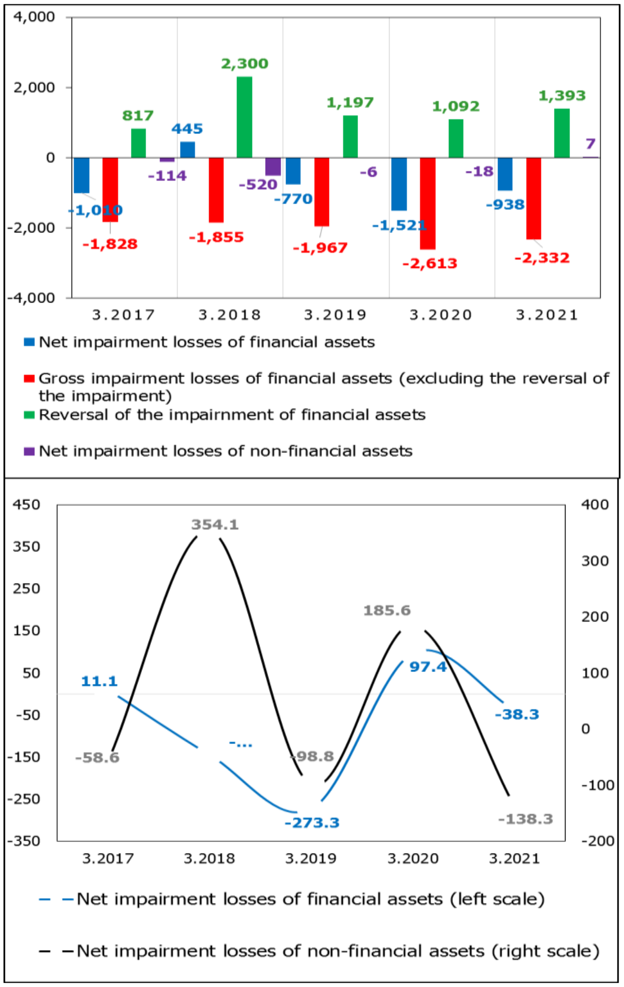
million or 6.4% compared to the same period last year. In all other sectors (financial institutions, non-profit institutions serving households and non-residents), interest expenses exceed interest income.

The operating efficiency ratios of the banking system improved, resulting from the reduced operating expenses (of 0.4%, or Denar 12 million[61]), amid simultaneous growth of the banks' total regular income[62] and average assets. Thus, the share of operating expenses in total regular income and in average assets decreased by 2.1pp and 0.1 pp, respectively. On the other hand, the share of operating expenses in net interest income increased by 0.7 pp, resulting from the faster decline in net interest income, compared to the decrease in operating expenses.

In the first quarter of 2021, impairment costs for financial and non-financial assets decreased by Denar 608 million or 39.5%. The reduction of these costs mostly results from the reduced impairment costs of financial assets (with a contribution of 95.5%), which on a net basis decreased by 38.3% or Denar 583 million. This decrease is primarily due to the reduced number of banks (by one), compared to the first quarter of 2020.

[61]Analyzing the operating costs, the largest decrease was recorded in the costs for employees (of Denar 36 million, or 2.9%).
[62]The increase in total regular income of banks results from the growth of non-interest income, primarily net income from fees, but also other regular income (such as capital gains from the sale of assets, income from collected previously written off claims and net income from trading).

Chart 81
Amount of impairment costs of financial and non-financial assets (top) and annual growth rates of impairment costs of financial and non-financial assets (bottom)
in millions of denars and in %

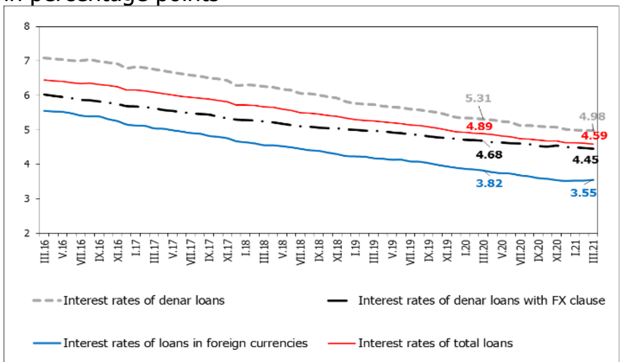


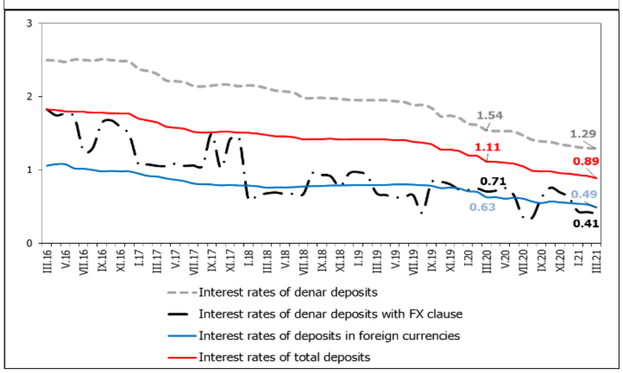
Source: NBRM, based on the data submitted by banks.

The net impairment cost of non-financial assets decreased compared to the same period in 2020 by three and a half times or by Denar 25 million and as of the first quarter of 2021 it has had a status of income item in the amount of Denar 7 million[63].

[63] The net impairment is positive (negative in the same period of the previous year) and results from the larger impairment release compared to the impairment cost of non-financial assets. Thus, the impairment cost of non-financial assets decreased from Denar 25 million (for the first half of 2020) to Denar 8 million (for the first quarter of 2021), while the release of this impairment increased from Denar 7 million (as of 31.3.2020) to Denar 15 million (as of 31.3.2021).

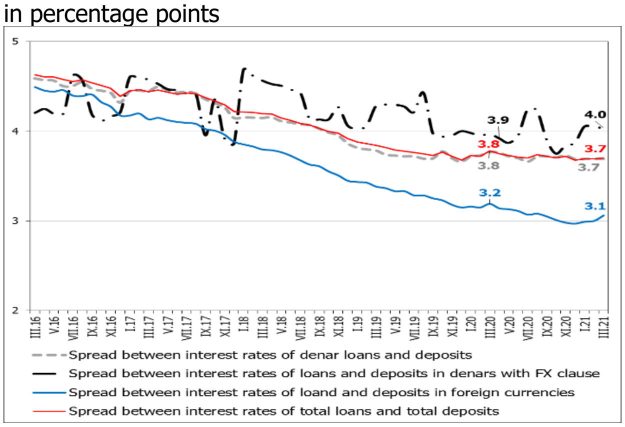
Chart 82
Lending (top) and deposit interest rates (bottom)
in percentage points





Source: NBRM, based on the data submitted by banks.

Chart 83
Interest spread
in percentage points



Source: NBRM, based on the data submitted by banks.

2.2. Movements in interest rates and interest rate spread

Given the further easing of monetary policy[64], in the first quarter of 2021, the trend of steady reduction of the banks' interest rates continued. Thus, compared to the same period in 2020, the weighted average lending and deposit interest rate of banks decreased by 0.3 percentage points each and amounted to 4.6% and 0.9%, respectively.

Also, analyzed by currency features, the decrease in weighted average interest rate on Denar and foreign currency loans of 0.3 percentage points and in denar deposits and denar deposits with foreign exchange clause was nearly identical. Slightly lower decline (of 0.2 percentage points) was registered in the average interest rates on denar loans with foreign currency clause and foreign currency deposits.

Given almost identical decrease of weighted average lending and weighted average deposit interest rates, the interest rate spread did not changed significantly i.e. narrowed by only 0.05 percentage points, compared to the same period of the previous year.

[64] In March 2021, the CB bills interest rate was cut by 0.25 pp to 1.25%.

ANNEXES