NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Report on Banking Supervision and Banking System of the Republic of Macedonia in 2004

Skopje, May 2005

CONTENT

I. BANKING SUPERVISION IN 2004

1.1. Regulatory framework of the banking supervision

An adequate regulatory framework constitutes a fundament for building a sound, stable and secure banking system. In the past, the NBRM activities were directed towards developing a regulatory framework governing the implementation of the Basel Principles for Effective Banking Supervision. After the adoption of the Banking Law in July 2000, a package of supervisory decisions was adopted, incorporating the Basel principles for banks' prudential operations and improving the regulation of the basic supervisory standards, such as calculation of the banks' capital adequacy, assessment, measurement and monitoring of the credit risk, the country risk, the credit exposure concentration limits, the exchange rate risk, etc.

In the next period, the banking supervision will be focused on the promotion of the supervisory regulations, with a view to its full compliance with the Basel banking supervision rules and approximation to the European directives that pertain to the banking.

1.1.1. Compliance of the regulatory framework of the banking supervision with the international standards

In 2004, the consulting firm PLANET Ernst & Young made a new assessment on the level of compliance of the banking regulations and the supervisory practices of the Republic of Macedonia with the international standards[1], within the technical assistance provided by the European Union. This assessment, unlike the previous ones, pertained to the compliance of the banking regulations with the European directives in the area of banking, particularly the compliance with the two basic directives in the area of banking[2].

Generally, the Report leads to the conclusion that the regulations governing the banking in the Republic of Macedonia largely follow the European directives and that there is a reasonable degree of compliance, particularly from the aspect of the terminology, the licensing process, the role of the audit, the consolidated supervision design and methods, the authorizations of the supervisory body and the types of corrective actions which could be undertaken for overcoming the stated shortcomings and irregularities in the operations of some banks. The most distinguished differences

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[1] Prior to 2004, the level of compliance of the banking regulations and the supervisory practices of the Republic of Macedonia with the international standards was assessed twice: 1) in 1999, the joint IMF and World Bank Mission made an assessment of the compliance with the Core Basel Principles for Effective Banking Supervision; and 2) in 2003, the IMF and World Bank Mission, within the Financial Sector Assessment Program, made an assessment of the stability, efficiency and the development of the financial system as a whole and its individual segments, and identified the major problems and weaknesses in its operations.

[2] The two basic directives pertain to the banking operations and the banking supervision in the European Union member states: EU Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions - codified directive and Capital Adequacy Directive 93/6/EC and 98/31/EC. The first directive governs the overall founding, operating and supervising of the credit institutions. The second directive (Capital Adequacy Directive) specifies the capital required for covering the different types of market risk arising from the banks' trading book.

between the banking regulations of the European Union and the Republic of Macedonia primarily arise from the absence of regulation for incorporating the market risk in the methodology for determining the banks' capital adequacy ratio. According to the comments in the Report, the incorporation of the market risk in the capital adequacy regulation is rather required for achieving compliance with the European directives and the Basel Capital Accord than it is actually imposed by the current situation in the banking system of the Republic of Macedonia. Although the banks are not exposed to the market risk, i.e. the involvement of the banks in market transactions in securities and other financial instruments is low, it is recommended to commence with the preparatory activities for establishing a legal framework for regulation of the market risk.

All identified shortcomings and recommendations for their overcoming stated in the Report, constitute a focus of attention of the future activities of the National Bank of the Republic of Macedonia and other government institutions, from the aspect of appropriate amendments to the existing banking regulation for the purpose of achieving higher degree of compliance and approximation to the regulations of the European Union.

1.1.2.Changes in the regulatory framework of the banking supervision

Several amendments were made to the regulatory framework of the banking supervision in the Republic of Macedonia, in 2004, that are primarily directed towards:

- Providing a legal ground for operating a Registry for data on the credit exposure of the banks and the savings houses established in the Republic of Macedonia to legal entities and natural persons - Credit Registry, as well as more precise determination of its contents and manner of operating;

- Tightening of the criteria for performing a part of the international financial activities of the banks, as well as for intermediary operations with negotiable securities;

- Improving the regulations pertaining to liquidity risk management.

a) The Credit Registry has been operating within the National Bank since 1998 on the basis of the data the banks submit to the National Bank pursuant to the Decision on determining the methodology for classification of the on-balance and off-balance sheet assets items of the banks according to their risk level. This registry primarily serves for supervisory purposes, aimed at adequate credit risk assessment of each individual borrower with the banks in the Republic of Macedonia. In order to mitigate and control the credit risk of each bank and the overall banking system, the National Bank provided an access of the banks to some information contained in the Credit Registry. However, the absence of a legal framework for operating this Registry limited its transparency, especially from the aspect of data contents, access thereto, as well as the manner of providing the required data.

The amendments to the Law on the National Bank of the Republic of Macedonia made in June 2004, provided a legal ground for operating a Registry for data on the credit exposure of the banks and the savings houses established in the Republic of Macedonia to legal entities and natural persons - Credit Registry. Based on the above, in December 2004, the National Bank Council adopted a Decision on the contents and the manner of operating the Credit Registry, and the Governor of the National Bank adopted Instructions for enforcing the Decision on the contents and the manner of operating the Credit Registry.

The legal ground in the Law on the National Bank of the Republic of Macedonia and the respective by-laws ensured the achievement of several objectives:

- implementation of some of the recommendations of the World Bank specified in the latest Memorandum of the fulfillment of the second tranche conditionalities of the FESAL Arrangement;

- larger possibilities for promoting and improving the Credit Registry by enhancing the database, primarily by including the savings houses which from now on are required to submit data necessary for maintaining the Credit Registry, as well as by enhancing the database on the credit exposure of the banks and the savings houses to natural persons; introduction of data on the prevailing activity of an individual legal entity, the structure of the currency of denomination of the credit exposure to an individual legal entity and natural person, the purpose of the credit exposure to natural persons (housing loans, consumer loans, current accounts overdrafts, loans based on issued credit cards and other loans).

b) In November 2004, the National Bank Council adopted a Decision on the necessary documentation for issuing approvals to banks and on submitting a notification on the change in the ownership structure of the voting shares, tightening the criteria for performing some financial activities of the banks abroad, as well as for intermediary operations with negotiable securities, as follows:

   - the performance of financial activities related to trade in securities for its account and for the account of customers, trade in financial derivatives and securities and precious metals items holding and management, requires electronic system in place for access to the information on the financial markets (Reuters, Bloomberg and Tenfore) and a certificate for operating on the financial markets by the staff that carry out assignments related to the aforementioned financial activities as follows: at least ACI Dealing Certificate for the staff in the front office - foreign exchange dealers and ACI Settlement Certificate for the staff in the back office;

   - the performance of financial activity of trade in foreign assets and execution of foreign exchange transactions in the country requires uniform electronic system in place for access to the information on the foreign exchange market in the Republic of Macedonia defined by the National Bank and holding of the aforementioned certificates for operating on the financial market by the staff;

- the performance of a financial activity of international payment operations and providing custodian services, and the settlement of financial activities such as trade in securities for its account and for the account of customers, trade in foreign assets and execution of foreign exchange transactions and trade in financial derivatives, requires connection to S.W.I.F.T.

The tightening of the criteria for performing some financial activities of the banks abroad and for intermediary operations with negotiable securities is one of the major prerequisites for ensuring the banks in the Republic of Macedonia an access to the financial markets in the country and abroad, and management of the risk related to the trade on the foreign exchange markets.

c) For the purposes of further promoting of the regulations which pertain to the liquidity risk management, a Supervisory Circular no. 6 - Liquidity Risk Management was developed in June 2004 after the adoption of the Decision on identifying, assessing and managing the banks' liquidity risk and the respective Instructions which established the fundaments for the liquidity risk management. The primary objective of the Circular is to provide guidelines for efficient liquidity risk management by the banks and to give an integrated review of all aspects affiliated to this process, taking into account the recommendations of the Basel Committee on Banking Supervision. The following relevant aspects encompassed by this Circular could be distinguished:

- Detailed definition of the basic elements of the liquidity risk management policy;

- Definition of the role of the bank's management bodies, particularly the Board of Directors, the Risk Management Board, the body in charge of liquidity risk management, as well as the competencies of the Internal Audit Department;

- Establishment of an adequate information system which will provide timely and permanent liquidity risk measurement, monitoring and control, as well as reporting to the bodies in charge of the liquidity risk management;

- Planning and managing the inflows and outflows of funds by determining the degree of probability for execution of each individual transaction of the bank;

- Development and monitoring of an adequate maturity structure of the banks' balance sheets;

- Determination and monitoring of the concentration of the sources of funds, especially from the aspect of determining the degree of stability of the deposit base and the deposits by deponent;

- Liquidity testing - stress scenarios for the purpose of determining the effect of the different circumstances on the bank's liquidity position, as well as on the possibility for adhering to the set limits;

- Liquidity risk management on a consolidated basis.

1.1.3. Review of the amendments to the other regulations that affect the operations of the banks and the savings houses

A new Law on Anti-Money Laundering and Ban on Proceeds from Punishable Act was adopted in July 2004. Although this Law is not directly included in the regulatory framework of the banking supervision, it is relevant for the performance of the supervisory function of the National Bank. Apart from the compliance with the international anti-money laundering rules and principles, the precise determination of the bodies in charge of monitoring the enforcement of the anti-money laundering measures and actions is more essential aspect of the Law, directly related to the performance of the supervisory function of the National Bank.

The purpose of the precise definition of the surveillance function of the National Bank in regard to the enforcement of the anti-money laundering measures and actions against banks, savings houses, exchange offices and prompt money transfer service providers, is to comply with the Basel principle 15.

1.2. Activities of the banking supervision

The banking supervision of the National Bank is performed through:

- Licensing, i.e. issuing licenses and approvals to the banks and the savings houses;

- Supervision of the operations of the banks and the savings houses; and

- Undertaking corrective measures.

The activities directed towards promoting the cooperation with the supervisory bodies in the country went on in 2004. In December 2004, the National Bank and the Securities and Exchange Commission concluded a Memorandum of Cooperation governing the contents, the terms and the manner of the mutual cooperation in the exchange of information and data and the organization of joint controls of entities related to the securities operations. This is the first Memorandum of Cooperation the National Bank concluded with other supervisory body in the country, which is an important step towards complying with the Basel principle 1(6). The primary purpose of concluding memorandums of cooperation between the supervisory bodies in the country is to enhance the efficiency in the performance of their functions.

Furthermore, in 2004, within the commenced activities for redefining the role and the competencies of the National Bank in the anti-money laundering process and with a view to fully accepting the international anti-money laundering standards, the National Bank staff attended a special training in this area provided by the Financial Services Volunteers Corps.

1.2.1. Licensing function

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

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

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

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

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

5. Approval for a change in a Statute of a bank or a savings house;

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

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

8. Approval for changing the name, main office and address of a bank or a savings house;

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

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

11. Approval for insight by a third party in an Examination Report on the operations of a bank or a savings house;

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

13. Approval for the bank's Information System Security Policy; and

14. Approval for opening a representative office of a foreign bank or other foreign financial institution in the Republic of Macedonia.

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

Tables on the number of issued and rejected licenses and approvals, as well as withdrawn applications for issuing licenses and approvals, by bank and savings house in 2003 and 2004 are given below.

Table 1
Types of issued and rejected licenses and approvals

Type of license (banks)	2003			2004		
	issued	**rejected**	**withdrawn**	**issued**	**rejected**	**withdrawn**
Bank for microfinancing	1					
Acquiring 5%, 10%, 20%, 33%, 50% and 75% of voting shares	18	6		5	2	1
Statute	9			8		1
Executive body	25	1	2	25		1
Change in a name, main office and address	1			1		
Capital investment	2					
Insight in a report	4	1		2		2
Amendment to a Decision on issuing a license to a bank		1		3		
Opening a representative office of a foreign bank or a financial organization	1					
Total	**61**	**9**	**2**	**44**	**2**	**5**

Type of license (savings houses)	2003			2004		
	issued	**rejected**	**withdrawn**	**issued**	**rejected**	**withdrawn**
Acquiring 5%, 10%, 20%, 33%, 50% and 75% of voting shares or parts	1			2		
Statute	1			5		
Executive body	2			3	2	
Change in a name, main office and address				3		
Transformation of a savings house into a bank					2	
Status change					1	
Total	**4**			**13**	**4**	

Most of the licensing activities in 2004 refer to issued approvals for banks' executive body and statute.

As for the licensing activities, in December 2004, a license was issued for reorganization of ProCredit Bank AD Skopje from bank for microfinancing, established in accordance with the Law on Banks for Microfinancing, into a bank established in accordance with the provisions of the Banking Law.

Within the framework of activities of the National Bank for verifying the source of funds used for purchasing shares and parts in banks and savings houses, in 2004, a positive opinion on the evidence for the source of funds was given to 15 submitted notifications, and 2 notifications were given negative opinion, while regarding a part of 1 notification, the opinion given was negative. Also, on the basis of the amendments to the Banking Law made in 2003, in 2004, the National Bank completed the commenced activities regarding the replacement of the banks' founding acts with decisions on issuing founding and operating license of 14 banks. The above decisions contain data on the name and the main office of the bank, the bank's shareholders which hold over 5% of the total number of shares, the amount of bank's capital, the type of activities it may perform and a confirmation of the bank's statute.

1.2.2. Supervision of the operations of the banks and the savings houses

1.2.2.1 On-site supervision of the operations of the banks and the savings houses

Total of 41 on-site examinations of the operations of the banks and the savings houses in the Republic of Macedonia were conducted in 2004. Of them, 21 were full-scope examinations of 13 banks and 8 savings houses, while 20 were targeted examinations. Also, in accordance with the provisions of Article 104 of the Banking Law, one on-site examination was carried out of the reports submitted to the National Bank by the bankruptcy trustee of Export Import Banka AD Skopje under bankruptcy, stating the amount of claims and liabilities of the Bank under bankruptcy. For the purpose of identifying the origin of the capital of one bank, two targeted examinations were carried out of customers - legal entities affiliated to the bank. In 2004, targeted examinations were conducted covering all savings houses, with a view to determining the adherence to the Decision on determining the scope and the manner of operating savings houses from the aspect of displaying updated lists of savings deposits.

The analysis of the assets quality, i.e. credit risk assessment and quantification, as a fundamental type of risk involved in the banks operations, remained dominant component of the on-site examinations. Also, the analysis of the anti-money laundering systems in place in the banks and the savings houses was a special segment of the on-site examinations, particularly from the aspect of analyzing the established "customer identification" systems, the information system adequacy, monitoring of the suspicious and affiliated transactions, reporting to the Anti-Money Laundering Directorate, the role of the management bodies and the Internal Audit Department, etc.

Certain weaknesses were identified on the basis of the on-site examinations conducted in some banks, as follows:

- relatively high credit risk manifested through improper systems for its identification and quantification and non-compliance with the prudential credit exposure limits to individual entities;

- unfavorable assets structure due to the high amount of foreclosures for collecting the claims, accompanied with difficulties in their sale;

- liquidity problems, under-capitalization, deteriorated profitability, largely resulting from the high operational costs and unfavorable assets structure from the aspect of the share of non-interest bearing assets;

- weaknesses in the internal control and internal audit system and weaknesses in the corporate governance, as well as in the practicing shareholding in the banks;

- identified weaknesses in the full application of the anti-money laundering policies and procedures owing to the insufficient experience in the identification of suspicious and affiliated transactions, the need of suitable training of the staff in the area of anti-money laundering, the need of active involvement of the banks' management bodies, etc.

No considerable structural movements in the banks, regarding their composite rating, were identified in 2004. One bank, which was not given a rating as of December 31, 2003, was given a composite rating "1" after the examination conducted in 2004, and consequently, the number of banks with such composite rating increased to 2. Also, one bank was given a composite rating 5, and, after the revocation of the founding and operating license of Export - Import Banka AD Skopje, the number of banks with the lowest composite rating remained the same. According to the composite rating system, the savings houses showed a relative improvement of the structure resulting in an increase in the number of savings houses with composite rating 2 and a reduction in the number of savings houses with lowest rating.

Table 2
Structure of the banks and the savings houses by their composite rating

Composite rating	**31.12.2003***		**31.12.2004**		**Comparison 31.12.2004/31.12.2003**	
	banks	**saving houses**	**banks**	**saving houses**	**banks**	**saving houses**
1	1	-	2	-	1	-
2	5	7	5	9	-	2
3	7	6	7	5	-	(1)
4	4	2	3	1	(1)	(1)
5	2	1	2	-	-	(1)
No rating	3	-	2	-	(1)	-
Total	**22**	**16**	**21**	**15**	**(1)**	**(1)**

* As of December 31, 2003, the total number of banks and savings houses includes both Export - Import Banka AD Skopje and Dikuko DOO Skopje savings house, even though they are exempted from all other analyses of the banking system as of December 31, 2003.

Pursuant to Articles 24 and 32 of the Law on the National Bank of the Republic of Macedonia, 36 inspections were conducted in 2004, subject of which was the application of the regulations in the area of foreign exchange and Denar operations. Out of these 36 inspections (22 of banks and 14 of savings houses), 32 were full-scope inspections of the operations of the banks and the savings houses and 4 were targeted inspections of the operations of the banks. The targeted inspections were focused on the adherence to the regulations setting forth the manner of conducting international payment and credit operations and foreign currency operations.

1.2.2.2 Supervision of the banks' information systems security (IT supervision)

In 2004, the activities of the Banking Supervision Department related to the banks' information systems security were directed towards:

- ongoing monitoring of the banks, particularly from the aspect of the degree of implementation of the information security policy;

- developing a methodology which will give the banks guidelines for more successful achievement of the standards defined in the Decision on defining the standards for ensuring the banks' information system security;

- certifying the IT supervision of the National Bank, in conformity with the international information systems security standards;

- presenting the respective standards and the methodology to the banking audience.

Four examinations of the banks' information systems security were completed in 2004, with one of them attended by an IT supervisor from the Central Bank of Slovenia, within the joint examination of a foreign bank subsidiary by the IT supervision of the National Bank of the Republic of Macedonia and the Central Bank of Slovenia. The examinations were primarily focused on:

- The degree of support and involvement of the banks' management bodies in the application of the IT system security standards;

- The undertaken and scheduled activities of the banks regarding the enforcement of the Decision on defining the standards for ensuing the banks' information security.

- The adequacy of the established IT systems security policies and procedures;

- The level of managing the activities in the process of switching from the old to the new information system or parts thereof;

- The control and the measurement of the operational risk which might arise from inadequate information systems.

The completed examinations led to the following conclusions:

- It is necessary to improve the process of measuring and analyzing the real and the identified risks for the information systems;

- In the implementation of the Business Continuity Plan, the banks are only focused on continuing the information technology in the bank, rather than on apt establishment of the most important business processes in the banks;

- The banks set up their secondary locations in the near vicinity and mostly in inadequate premises and with no security whatsoever;

- It is necessary to advance the internal control systems; and

- There is a need of an adequate information system training of the staff;

With a view to conducting a suitable examination of the banks' information systems and providing advisory guidelines for establishing proper IT systems by the banks, in 2004, the IT supervision of the National Bank acquired two international certificates for implementation of security standards and their control (CISSP - Certified

Information System Security Professional issued by the ISC and BS 7799 Lead Auditor issued by the BSI (British Standard Institute).

Besides the on-site examination of the banks' information systems security, in 2004, the National Bank kept improving the regulatory package in this area. After the adoption of the Decision on defining the standards for ensuring the banks' information systems security, the National Bank started developing detailed methodology for identification, assessment and management of the risk of insecure and inadequate information systems and establishing the fundaments for managing this type of operational risk. The above underlay the Draft Supervisory Circular for information systems security, worked out at the end of 2004. The primary goal of this Circular is to provide guidelines for effective implementation of the risk management process which might result from inadequate and insecure information systems and to provide an integrated review of all aspects related to this process.

1.2.3. Corrective measures undertaken against banks and savings houses

Within its mandates entrusted by the law and in order to preserve the stability and the security of any banking institution and the overall banking system, the National Bank undertakes corrective actions against banking institutions that showed irregularities in their operations. In 2004, the National Bank passed 28 decisions with corrective measures against 13 banks and 4 savings houses and filed 14 requests for initiating a misdemeanor procedure against 8 banks, 2 savings houses and 1 brokerage house and their persons in charge.

In the first half of 2004, the founding and operating license of Export-Import Banka a.d. Skopje was revoked, and it was ascertained that the conditions for opening a bankruptcy procedures were met, while after the revocation of the founding and operating license of Dikuko DOO Skopje, it was ascertained that it meets the conditions for introducing a liquidation procedure.

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

1. a measure for ban on performing the financial activities listed in the founding and operating license, other than collection of claims and payment of savings deposits was imposed against 1 bank and 1 savings house;

2. a measure for ban on lending to legal entities and prolonging of already extended loans was undertaken against 3 banks and 1 savings house;

3. a measure for ban on extending new loans and other forms of credit exposure to an insider and the persons affiliated thereto, as well as prolonging of already extended loans was undertaken against 2 banks;

4. a measure for ban on extending any credit exposure to borrowers classified in C, D and E risk categories was undertaken against 2 banks;

5. a measure for ban on capital investments in legal entities, establishing parts of a bank or any other branching of the bank was undertaken against 1 bank;

6. a measure for revoking the approvals issued to the members of the executive bodies was undertaken against 1 bank;

7. a measure for recapitalization was imposed against 2 banks and 1 savings house;

8. a measure for reducing the share of shareholders below 10% of the voting shares in the bank was imposed against 1 bank;

9. a measure for ban on disposing the banks' assets was imposed against 1 bank;

10. a measure for payment of dividend was imposed against 1 bank;

11. a measure for ban on improving the credit exposures classifications without prior approval of the National Bank was imposed against 1 bank;

12. a measure for filing an application for obtaining a prior approval for appointing members of the executive body was imposed against 1 bank;

13. a measure according to which the total amount of uncovered off-balance sheet items may not exceed the amount of guarantee capital was imposed against 1 bank;

14. a measure for ban on extending new uncovered off-balance sheet exposures was undertaken against 1 bank;

15. a measure for ban on lending to natural persons and legal entities, except for purchasing securities issued by the Republic of Macedonia was undertaken against 1 savings house;

16. a measure for terminating the performance of the financial activities referred to in Article 46 of the Banking Law after a specified date was imposed against 3 banks;

17. a measure for verifying orders by authorized officers of the National Bank was imposed against 2 banks and 1 savings house;

18. a measure for verifying orders by members of the Board of Directors was imposed against 1 bank;

19. a measure according to which the average total assets over a certain period may not exceed the average total assets of the preceding period was imposed against 1 savings house;

20. 3 banks were required to maintain a capital adequacy ratio of at least 16%;

21. a measure for collecting loans used for settling the liabilities of a borrower in a same bank was imposed against 1 bank;

22. a measure for cessation of extending new loans for paying old liabilities was undertaken against 1 bank;

23. a measure for allocating additional loan loss provisions on credit risk, based on findings from the completed examination was undertaken against 3 banks and 1 savings house;

24. a measure for adopting a Plan for intensifying the collection of claims classified in C, D and E risk category was imposed against 1 bank;

25. a measure for adjusting to the credit exposure limit to a single entity (Article 35 paragraph 1 of the Banking Law) was undertaken against 4 banks;

26. a measure for adhering to the credit exposure limit to a single shareholder, holding above 5% of the total number of voting shares (Article 35, paragraph 2 of the Banking Law) was undertaken against 3 banks;

27. a measure for adjusting to the credit exposure limit to an executive body, members of the Board of Directors and other bodies of the bank and to persons with special rights and responsibilities (Article 35 paragraph 3 of the Banking Law) was undertaken against 2 banks;

28. a measure for developing a plan, including a timetable, for complying with the credit exposure limit to a single entity (Article 35 paragraph 1 of the Banking Law) was imposed against 2 banks;

29. a measure for developing a plan, including a timetable, for complying with the limit on the amount of the property and the capital parts (Article 39 paragraph 1 of the Banking Law) was imposed against 3 banks;

30. a measure for complying the amount of preference shares with the legally set limits was imposed against 2 banks;

31. a measure for establishing an Internal Audit Department was imposed against 1 bank;

32. a measure for developing transactions identification, monitoring and reporting systems in accordance with the Anti-Money Laundering Law was undertaken against 1 bank and 2 savings houses;

33. Other measures: 1/ requiring an appointment of new Audit Committee members (1 bank); 2/requiring an appointment of a new responsible person in the Internal Audit Department (1 bank); 3/submission of documentation regarding a pledge and its foreclosure (1 savings house); 4/ requiring a refund from the reserve fund used for establishing a special reserve for buying back own shares to the reserve fund, improvement of software solutions for accounting records (1 bank); 5/ requiring a monthly calculation of default interest (1 bank); 6/ requiring a development of system for monitoring affiliated customers (1 bank); 7/ requiring an establishment of a prompt accounting records system (1 bank and 1 savings house); 8/ requiring a submission of monthly reviews for due liabilities (1 bank); 9/ requiring a submission of the minutes of the meetings of the Audit Committee (1 bank); and 10/ requiring a submission of reports (1 bank).

1.3. Organizational structure of the banking supervision

In 2004, within the framework of the overall changes in the organizational structure of the National Bank, the organizational structure of the banking supervision was also a subject to changes. The operative implementation of the supervisory function of the National Bank was conducted by the Supervision Department which, besides the on-site and off-site supervision of the operations of each bank, was also responsible for implementing the regulatory function and for analyzing and monitoring the risks in the overall banking system. The organizational changes resulted in segregation of the supervisory function from the regulatory one, by forming two separate departments within the National Bank: the Banking Supervision Department and the Banking Regulation Department (Annex 11).

The Banking Supervision Department remained responsible for direct implementation of the supervisory function, i.e. for implementation of the function of licensing banks and savings houses, on-site and off-site supervision of their operations and undertaking corrective measures against institutions suffering problems, irregularities and which are not complied with the regulations. The Banking Supervision Department consists of 4 units:

- On-site Supervision Unit - responsible for organizing and conducting on-site examination of the operations of the banks and the savings houses in the Republic of Macedonia, i.e. supervision of the operations of the banks and the savings houses by a direct insight in their documentation;

- Off-site Supervision Unit - responsible for permanent off-site surveillance of the operations of the banks and the savings houses by compiling and analyzing the reports which are submitted to the National Bank;

- Unit of Banks under Enhanced Monitoring - responsible for intensive and continuing monitoring of the operations of banks facing major problems in their operations and against which an urgent corrective action is undertaken in order to get their operations back on track;

- General Supervisory Operations Unit - responsible for the implementation of the procedure for licensing banks and savings houses, undertaking corrective measures for overcoming the identified irregularities in their operations and participation in the procedures for revoking the issued licenses and approvals.

The Banking Regulation Department runs the activities related to establishment and advancement of the regulatory framework of the banking supervision, promotion of the supervisory practices and following of the international standards in the banking and the supervision. Also, this Department is responsible for analyzing the financial stability which, at the same time, is a new activity of the National Bank. The Banking Regulations Department consists of two units:

- Methodology Unit - responsible for operational implementation of the regulatory function, including establishment and application of the accounting framework for the banks and the savings houses; and

- Financial Stability Analysis Unit - responsible for analyzing the stability of the banking and the overall financial system, defining, developing, implementing and analyzing the financial stability indicators and monitoring the systemic risks in the banking sector, as well as analyzing other segments directly related to the stability of the banking and the overall financial system.

II. BANKING SYSTEM IN 2004

2.1. Structure of the banking system

2.1.1. Number of banks and savings houses

The banking system of the Republic of Macedonia consists of two segments: banks and savings houses. As of December 31, 2004, 21 banks and 15 savings houses operated on the territory of the Republic of Macedonia.

According to the systemic and the institutional design specified by the Banking Law, the banking system in the Republic of Macedonia could be defined as a banking system of a universal nature. On December 31, 2004, seventeen of the total number of banks were licensed to perform domestic and international financial activities referred to in Articles 45 and 46[3] of the Banking Law, 3 banks were licensed to perform only the domestic financial activities specified in Article 45 of this Law, while the Macedonian Bank for Development Promotion a.d. Skopje was established to perform specific financial activities in accordance with a special law[4].

The banks remain the most important segment of the banking system of the Republic of Macedonia, accounting for 98.7% of the total assets of the banking system, while the savings houses constitute 1.3% of the overall financial potential. The marginal role of the savings houses in the overall performances of the banking system could be illustrated through the following two aspects:

- The share of the savings houses in the total households' deposits in the overall banking system equals only 0.7%, which is the same compared to the preceding year. The savings houses are authorized to collect deposits only in domestic currency, and the Denar households' deposits with the savings houses make up only 2.3% of the total Denar deposits in the overall banking system; and

- Only 3% of the employees in the banking system in the Republic of Macedonia work in the savings houses.

Considering the marginal role of the savings houses in the banking system, the further analysis of the basic features, structure and performances of the banking system is focused on the data and the indicators for the banks' operations.

For the purposes of more comprehensive analysis of the performances of the banking system, three groups of banks are distinguished according to the size of their assets (Annex 9):

  - large banks (the assets of which exceeds Denar 15 billion);

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[3] Articles 45 and 46 of the Banking Law specify the financial activities which could be performed by the banks in the Republic of Macedonia.
[4] Macedonian Bank for Development Promotion was established in accordance with the Law on Establishing Macedonian Bank for Development Promotion ("Official Gazette of the Republic of Macedonia" no. 24/98 and 6/2000)

- medium-size banks (the assets of which range from Denar 2 to 15 billion); and

- small-size banks (the assets of which are below Denar 2 billion).

Table 3
Number of banks by group of banks and their share in the total financial potential

Group	Number of banks		Share in the financial	
	31.12.2003*	31.12.2004	31.12.2003	31.12.2004
Large banks	2	3	55.5%	66.8%
Medium-size banks	6	8	28.1%	22.0%
Small-size banks	13	10	16.4%	11.2%
Total	**21**	**21**	**100.0%**	**100.0%**

*Export - Import Bank AD Skopje is exempted from the analyses for 2003

By applying this criterion, in 2004, most of the banks were housed in the group of small-size banks (10 banks). Compared to December 31, 2003, the banking system of the Republic of Macedonia registered structural movements by the composition of each group of banks. Three banks were transferred from the category of small-size banks to the category of medium-size banks, and one medium-size bank was transferred to the category of large banks. The above developments based on the size of the banks' assets largely affect the comparison analyses made in this Report.

2.1.2. Concentration and market share

2.1.2.1. Concentration of the banking sector

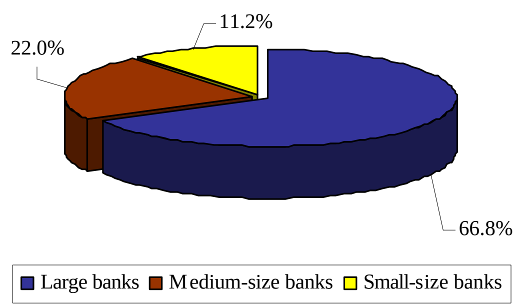
At the end of 2004, the analysis of the concentration of the banking system of the Republic of Macedonia was made on the basis of three criteria:

a) Total assets, i.e. total financial potential;

b) Amount of capital; and

c) Total banking activities (on-balance sheet and off-balance sheet activities).

Figure 1
Concentration of each group of banks by the total assets on December 31,2004



According to the above criteria, the analysis made on December 31, 2004, confirms that the concentration of the banking system is relatively high, which was a basic feature of the banking system of the Republic of Macedonia in the previous years. The share of the group of large banks, that is the share of the three largest banks of 66.8% is the most significant in the creation of the financial potential of the banking system, relative to the share of 22.0% of the group of medium-size banks and the share of 11.2% of the group of small-size banks. Compared to December 31, 2003, the structural developments in the creation of the financial potential are directed towards increasing the share of the group of large banks from 55.5% to 66.8%, conversely to the decrease in the share of the group of medium-size banks of 6.1 percentage points and the decrease in the share of the group of small-size banks of 5.2 percentage points. As previously noted, these structural developments arise from the increment in the number of the group of large banks by 1 bank, the assets of which rose to an amount of over Denar 15 billion, and the increase in the number of the group of medium-size banks by 3 banks, the assets of which rose to over Denar 2 billion, each.

With respect to the total assets, the concentration level of the banking system can also be quantified through the Herfindahl Index[5]. On December 31, 2004, the Herfindahl Index equaled 1,685, indicating a degree of acceptable concentration of the banking system of the Republic of Macedonia.

According to the second criterion - banks' capital power, the level of concentration of the banking system is lower. Although according to this criterion the group of large banks dominates, yet its share is lower and equals 42.4%, compared to the share in the total assets. Compared to December 31, 2003, the structural developments are again in favor of the group of large banks, the share of which in the total capital increased by 9.2 percentage points. Slight increment was registered in the group of medium-size banks of 1.3 percentage points, while the group of small-size banks decreased its share in the total capital by 10.4 percentage points. The rationale behind such developments is the growth in the banks' balance sheet activities, and their endeavors to approximate the larger groups.

Figure 2
Concentration of each group of banks by capital as of December 31, 2004

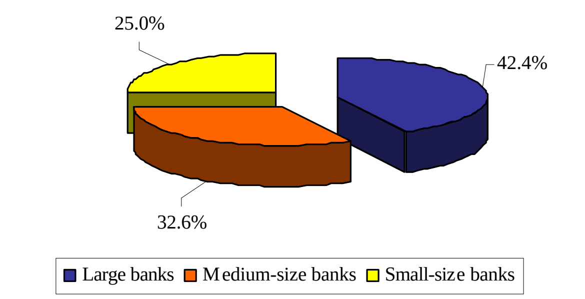
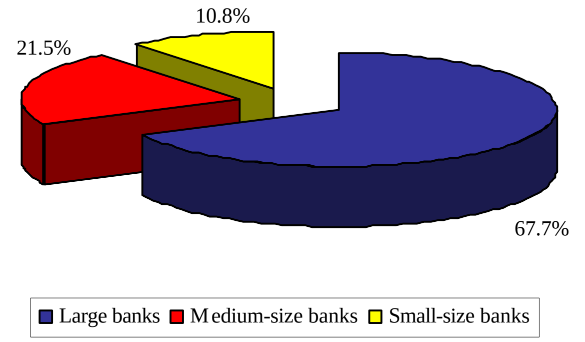


Figure 3
Concentration of the overall activities as of December 31, 2004 by group of banks



The analysis of the degree of concentration of the banking system made on the basis of the third criterion as of December 30, 2004 shows that the group of large banks again prevails. At the end of 2004, 67.7% of the total banking activities were concentrated in the group of large banks, with its share being by 12.3 percentage points higher compared to December 31, 2003. Unlike the positive development of

[5] The Herfindahl Index is an indicator of the level of concentration of the banking system which is calculated as a sum of the square of each bank's assets share in the total assets of the overall banking system. An index equal to 100 is an indicator for absence of concentration, and index equal to 10,000 is an indicator for monopoly in the banking system. If the Herfindahl Index ranges between 1,000 and 1,800 units, the concentration of the assets is considered acceptable.

this group of banks, the share of other two groups of banks in the overall banking activities went down, with the group of medium-size and small-size banks decreasing their share by 6.7 percentage points and 5.5 percentage points, respectively.

2.1.2.2. Distribution of assets and capital by bank

For the purposes of full determination of the concentration level of the banking system of the Republic of Macedonia, an analysis was made of the distribution of the assets and the capital by bank, which leads to the following conclusions:

- There is a significant gap between the amount of assets from bank to bank in the Republic of Macedonia, particularly if a comparative analysis is made of the amount of assets of the largest banks and the other banks in the country. Thus the assets of the largest bank is twice larger than the assets of the third largest bank in the Republic of Macedonia, by 5.3 times larger relative to the fourth bank, and by 70.4 times larger compared to the smallest bank in the Republic of Macedonia. Such conclusion should be supplemented with the fact that the gap between the assets of the largest and the smallest bank considerably deepens compared to the end of 2003, when it equaled 53 times. The gap indicates further expansion of the large banks, and stagnation of some small-size banks in the Republic of Macedonia.

- The capital of the largest bank in the Republic of Macedonia is by 11.3 times larger compared to the capital of the smallest bank. The capital distribution analysis from the largest to the smallest bank indicates relatively even distribution of the differences in the banks' capital, with the most significant gap in the amount of capital being registered between the third and the fourth bank (46.5%). Most of the deposit base is concentrated in the large banks, due to which the share in the capital of these banks is lower compared to their share in the assets of the banking system.

- The distribution of the assets and the capital by bank indicates large differences in the assets size, compared to the differences in the size of the banks' capital. Such differences are a result of the higher concentration of the deposit base in the larger banks in the Republic of Macedonia.

2.1.2.3. Market share of the banks

The concentration level in the banking system of the Republic of Macedonia can also be illustrated through the analysis of the banks' market share in the overall credit and deposit activity of the whole banking system.

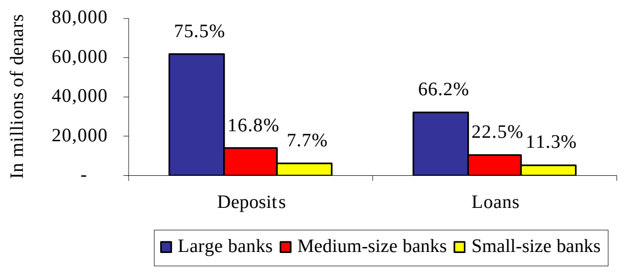
The share of the group of large banks of 66.2% in the overall credit activity[6] is the most significant. This group registers 17.9 percentage points higher share in the lending activity compared to the end of 2003, at the expense of the decrease in the share of the group of medium-size banks of 14 percentage points, and the decline in

[6] Credits placed in non-financial sector (enterprises and households).

the credit activity of the group of small-size banks from 15.2% at the end of 2003 to 11.3% at the end of 2004[7].

The group of large banks has a dominant role in the total deposit base at the level of banking system in the Republic of Macedonia. At the end of 2004, 65.5% of the total accepted deposits of the non-financial sector (enterprises and households) are deposits in the group of large banks, while the other two groups make up 16.8% (group of medium-size banks) and 7.7% (group of small-size banks).

Figure 4
Market share of each group of banks by total deposits and total loans



2.1.3 Ownership structure

The ownership structure of the banks in the Republic of Macedonia is analyzed from two aspects: 1) according to the level of privatization of the banks; and 2) according to the share of foreign capital.

Private capital dominates the ownership structure of the banking system of the Republic of Macedonia. As of December 31, 2004, the degree of privatization of the banking system in the Republic of Macedonia equaled 91.0% or 95.6% if the Macedonian Bank for Development Promotion AD Skopje[8], which is an entirely state-owned bank, is exempted from the analysis. The degree of privatization is lower in the group of medium-size banks and equals 80.1%, while the small-size and large banks enjoy approximately the same level of privatization of 95.7% and 96.4%, respectively. The degree of privatization at the end of 2004 is by 3.96 percentage points higher relative to the end of 2003.

The analysis of the ownership structure of the banking system from the viewpoint of the structure of the common and preference shares according to the category of shareholders, reveals that at the end of 2004 natural persons own 7% of the common shares and 66.5% of the preference shares at the level of the overall banking system. Legal entities in private ownership and co-operatives, together with the legal entities whose transformation was registered in the court registry, own 83.1% of the amount of issued common shares and 31.5% of the total preference shares. The public sector and the state-owned and public enterprises own 8.6% of common and 1.8% of preference shares at the level of the banking system.

[7] The changes in the market share result from the movements in the number of banks by group of banks in 2004.
[8] Macedonian Bank for Development Promotion conducts a special activity for development support by financing small-size and medium-size enterprises and export support, but solely through other domestic banks.

Table 4
Structure of banks' common and preference shares according to the category of shareholders - as of December 31, 2004

in millions of denars

No.	Description	Common shares		Preference shares	
		Amount	Share	Amount	Share
1	Natural persons	1,119	7.0%	506	66.5%
2	Legal entities in private ownership and co-operatives	7,988	49.6%	213	28.0%
3	Legal entities - transformation registered in the court registry and Decisions obtained from a Commission	5,393	33.5%	26	3.5%
I	**Total (1+2+3)**	**14,501**	**90.1%**	**746**	**98.0%**
4	Social and public enterprises	300	1.9%	2	0.3%
5	Public sector	1,079	6.7%	11	1.5%
6	Non-defined status	212	1.3%	2	0.3%
II	**Total (I+4+5+6)**	**16,093**	**100.0%**	**761**	**100.0%**

At the end of 2004, foreign capital is present in 15 banks and comprises 47.5% of the total capital of the banking system. Compared with the previous year, there is no change in the number of banks in which there is foreign capital, and therefore there are no significant changes in its share in the total capital.

Table 5
***Structural share of banks according to the type of ownership*[9]**

Type of ownership	Number of banks		Share in the capital at the level of the banking system		Share in the assets at the level of the banking system	
	31.12.2003	31.12.2004	31.12.2003	31.12.2004	31.12.2003	31.12.2004
Banks owned by domestic private shareholders	12	12	46.6%	47.5%	51.3%	50.8%
Banks owned by the state	1	1	4.8%	4.9%	1.8%	1.9%
Banks owned by foreign shareholders	8	8	48.6%	47.6%	46.9%	47.3%
Total	**21**	**21**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

From a viewpoint of grouping according to the size of the banks in the system, foreign capital has the largest share in the group of large banks of 56.9%, the share in the capital of the medium-size banks equals 34.2%, while in the group of small-size banks, its share is 48.8%. In the group of large banks, foreign capital registers an increase in its share of 5 percentage points, due to the transfer of one medium-size bank to the group of large banks, which reflected on reducing the share of the foreign capital in the group of medium-size banks. In the group of small-size banks, there is also a decline in the share of the foreign capital of 3 percentage points, since one of the banks, which were transferred to the group of medium-size banks on December 31, 2004, is with foreign capital.

Out of the total number of banks, eight are owned by foreign shareholders[10]. These banks participate with 47.6% in the total capital at the level of the overall banking system, as well as with 47.3% of the total assets. Four of these eight banks are

[9] The type of ownership is determined according to the dominant ownership of shares (over 50%) by domestic legal entities, government or foreign entities.
[10] Banks owned by foreign shareholders are banks in which the share of the foreign capital exceeds 50% of the total capital.

subsidiaries of foreign banks: Stopanska Banka a.d. Skopje (subsidiary of the National Bank of Greece - Greece), Tutunska Banka a.d. Skopje (subsidiary of Nova Ljubljanska Banka d.d. Ljubljana - Slovenia, Alpha Bank a.d. Skopje (subsidiary of Alpha Bank Athens - Greece), and T.C. Ziraat Bankasi Skopje subsidiary (subsidiary of T.C. Ziraat Bankasi - Turkey). Banks owned by domestic and private shareholders have approximately the same share in the total capital as the banks owned by foreign shareholders.

From the viewpoint of grouping according to the size, two of the eight banks owned by foreign shareholders belong to the group of large banks, two to the group of medium-size banks and four to the group of small-size banks. This restructuring is different in comparison with the previous year due to the regrouping of banks according to their size.

2.1.4. Bank network and number of employees

In the banking system of the Republic of Macedonia, the largest part of the banks' headquarters is concentrated on the territory of the capital city. Thus, seventeen banks have their headquarters located in Skopje, while only four banks have their headquarters located outside the capital city. These four banks belong to the groups of medium-size and small-size banks, comprising 11.9% of the total financial potential and 14.4% of the total capital of the overall banking system.

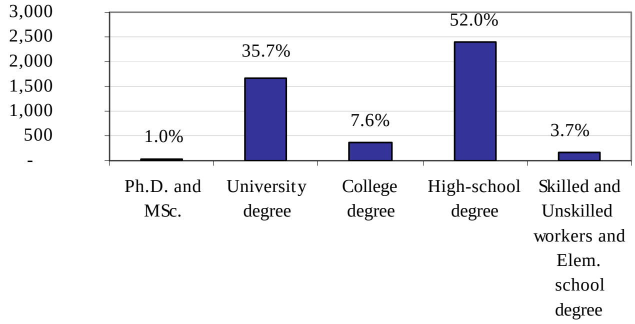
The effect high concentration of the banks on one location is mitigated by the wide bank network, which consists of forty-three branches, two hundred and sixty-six windows, forty-two business units and one credit office. Special emphasis should be put on the windows of the public enterprise Makedonska Posta (Macedonian Post) (320 post-office units with 620 windows throughout the territory of the Republic of Macedonia) which some of the banks use for performing their functions and cutting the costs. The wide banking network contributes to the improvement of the quality of Macedonian banking, by strengthening the competition, bringing their services closer to the clients, and especially expanding the banks' operations with clients.

Except for one bank, which has its representative office abroad, the organizational parts of all other banks are located on the territory of the Republic of Macedonia.

As of December 31, 2004, the total number of employees at the level of the banking system equals 4,635 persons, most of which, i.e. 57.9% in the group of large banks, 24.5% in the group of medium-size banks, and 17.6% in the group of small-size banks. Compared to the previous year, the total number of employees increased by 40 persons. Dominant category in the qualification structure of banks' employees are the

Figure 5

Qualifictaion structure of banks' employees as of December 31, 2004



employees with high-school degree (2,409 employees), followed by the employees with a university degree (1,656 employees).

2.1.5. Structure of the supply of banking services

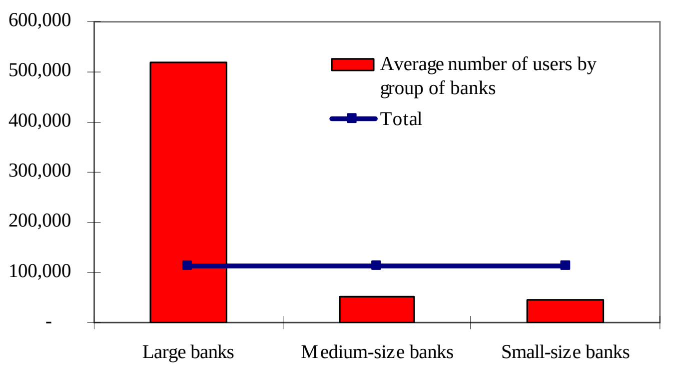
As of December 31, 2004, the average number of users of banking services by individual banks in the Republic of Macedonia is 120,694. Natural persons dominate the total average number of users (94.8%), while the remaining part of 5.2% accounts for legal entities. Most commonly used service is the banks' deposit activity, which is exploited by 70.8% of the average number of users of banking services.

Table 6
Structure of the supply of banking services according to the average number of users as of December 31, 2004

No.	Description	Legal entities		Natural persons		Total	
		average number of users	%	average number of users	%	average number of users	%
1	Credits, letters of credit, guarantees	832	13.3%	5,976	5.2%	6,808	5.6%
2	Deposits	5,340	85.4%	80,087	70.0%	85,427	70.8%
2a	- sight deposits	5,304	84.8%	67,276	58.8%	72,579	60.1%
2b	- time deposits	37	0.6%	12,811	11.2%	12,848	10.6%
3	Cash cards (debit - credit)	80	1.3%	5,293	4.6%	5,373	4.5%
4	Current accounts	-	0.0%	23,086	20.2%	23,086	19.1%
	Total	**6,252**	**100.0%**	**114,441**	**100.0%**	**120,694**	**100.0%**

Analyzed by individual groups of banks, the average number of users of services in the group of large banks totals 543,295. This average is by 4.5 times higher than the average at the level of the overall system. The average number of users within the group of medium-size banks equals 55,802, which is twice lower relative to the total banking average. Small-size banks have 45,827 users, on average, which is far below the total banking average. This once again confirms the ascertainment that the banking system of the Republic of Macedonia is concentrated with the group of large banks.

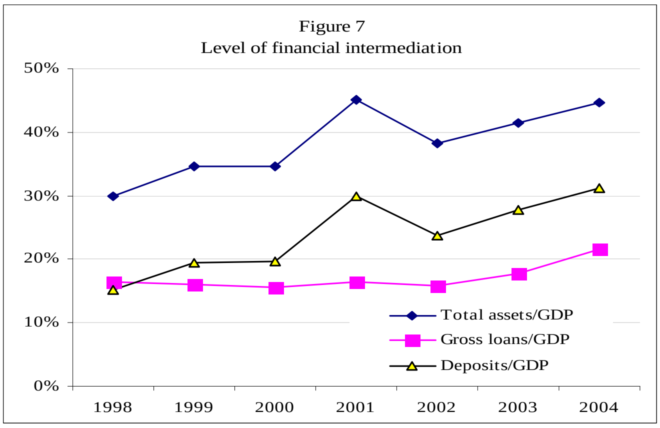
Figure 6
Structure of the average number of users-natural persons by separate groups of banks



2.2. Banks' operations

The continuous strengthening of the confidence in the banking system of the Republic of Macedonia and the increased preferences of the households for saving, directly reflected on the continuous growth of the deposit potential. During 2004, the total amount of newly collected deposits totaled Denar 12,096 million, while the increase in the gross loans to the non-financial sector ("enterprises" and "households") amounted to Denar 12.182 million. This means that during 2004, on net basis, banks in the Republic of Macedonia placed the total amount of newly collected deposits in loans. Such movements of the total deposits and the gross loans resulted in high annual growth rates of these two most significant categories of 17.2% and 26.7%, respectively.

Deposit potential, as the main cause for intensification of the banks' lending activity, had a positive influence also on the continuous increase of the degree of financial intermediation in the Macedonian economy. Thus, as of December 31, 2004 this indicator, calculated as a ratio of the total assets, the gross loans extended to clients and the total deposits to the gross domestic product[11] of the Republic of Macedonia equaled 44.6%, 21.7% and 31.1%, respectively. For comparison, on December 31, 2003, these indicators equaled 41.4%, 17.8% and 27.7%, respectively.

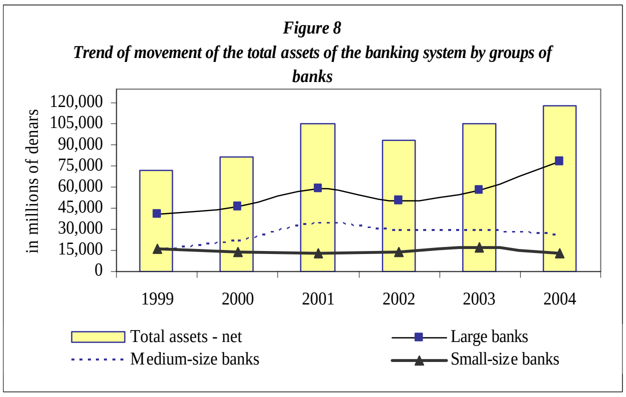


2.2.1 Banks' assets

As of December 31, 2004, banks' total assets amounted to Denar 117,985, which is an annual increase of Denar 13,110 million, or 12.5% relative to December 31, 2003 (Balance sheet - Annex 1). This represents continuation of the upward trend in the banks' assets from the previous years, which confirmed the potential for their growth in the future. Such dynamics of the total assets in the analyzed period is mainly a result of the continuing trend of increase in the total deposits, as the most significant source of funds of the banks.

Analyzed by groups of banks (large, medium-size and small-size banks), the increase in the assets of the banks in the Republic of Macedonia (as of December 31, 2004 compared with December 31, 2003) is entirely a result of the increase in the assets of the group of large banks. Thus, in the analyzed period, the total assets of the group of large banks registered an increase of Denar 20,621 million, or 35.4%, which is primarily a result of the transfer of one medium-size bank to the group of large banks, as well as to the increase in the assets of the banks consisting the group of large banks. At the same time, three banks were transferred from the group of small-size to the group of medium-size banks. Such transfers of banks from one group to another reflected on the condition and on the trend of the total assets of the groups of small-size and medium-size banks. Thus, as of December 31, 2004 compared to December 31, 2003, the group of medium-size banks registered a decline in the total assets of Denar 3,491 million or 11.9%, while the group of small-size banks registered a decline of Denar 4,021 million, or 23.4%.

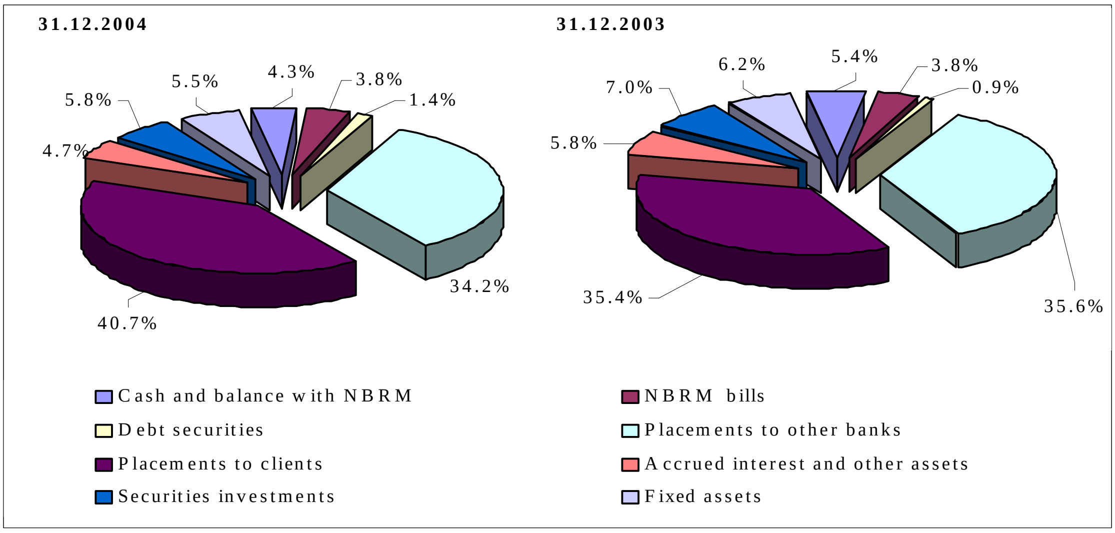
[11] Estimated data for 2004 of the State Statistical Office



Such movements also caused certain changes in the share in the total assets by groups of banks as of December 31, 2004, relative to December 31, 2003. Yet, the structure by groups of banks remained unchanged, so that the group of large banks not only retained, but it also increased its dominant position with 66.8% (55.5% - December 31, 2003). On the other hand, this caused a decline in the share of the group of medium-size banks to 22.0% (28.1% - December 31, 2003) and of the group of small-size banks to 11.2% (16.4% - December 31, 2003).

As a result of the increase in the deposit potential and the decline in the banks' lending interest rates, in the analyzed period, the loans to non-financial entities (enterprises and households) register the most intensive increase, relative to the trend of the other asset items, thus almost entirely determining the increase in the total assets relative to December 31, 2003.

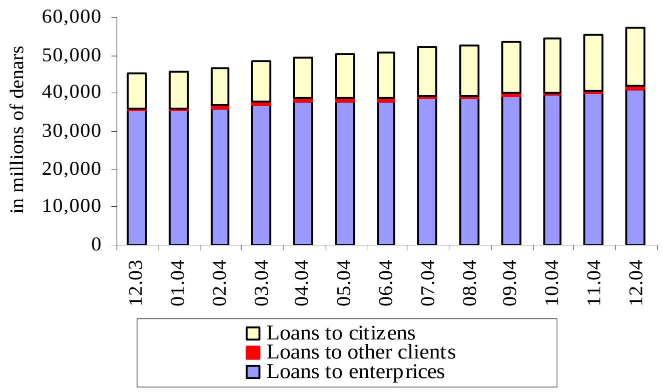
Figure 9
Structure of assets



The comparison of the position as of December 31, 2004 and that as of December 31, 2003 shows that the increase in the lending activity of banks implies certain movements in the structure of the total assets of the banks in the Republic of Macedonia. Such movements primarily pertain to the fact that the loans to the non-financial entities became dominant category, instead of the placements to other banks, which was registered as early as in the first half of 2004. Thus, as of December 31, 2004, the share of the loans to non-financial entities in the total assets equals 40.7% (35.4% - December 31, 2003), while the placements to other banks equaled 34.2% (35.6% - December 31, 2003). The share of these placements of 74.9% in the total assets determines the dominant exposure of the banking system in the Republic of Macedonia to the credit risk. The remaining 25.1% pertain to positions whose individual share is relatively small (does not exceed 10%), and which do not register significant changes in the analyzed period.

2.2.1.1. Credit activity of the banks (loans extended to non-financial entities)

Figure10
Monthly dynamics of loans



During 2004, banks' lending activity intensified, which was primarily generated by the expanded deposit potential, improved creditworthiness of clients, broadened range of loans, reduced price of loans, as well as the liberalization of the foreign exchange operations. All this resulted in an annual increase in the gross loans to clients (non-financial legal entities and households) of Denar 12,182 million, or 27.0%. Almost identical increase is registered in the analysis of the loans to non-financial entities on net basis, which relative to the end of 2003 registered an increase of Denar 10,965 million, or 29.5%. For comparison, the annual growth rate of gross loans for the period December 31, 2002 - December 31, 2003 equaled 16.6%, while the growth rate of net loans for the same period equaled 15.7%. These growth rates confirm the continuous upward trend in the banks' lending to enterprises and households also during 2004, by simultaneous improvement in the quality of placements. Such financial support for the non-financial sector by further intensification of the banks' lending activity meant a basis for stimulating the economic growth in the country.

Analyzed by **groups of banks** (large, medium-size and small-size banks), the annual increase in the gross loans is a result of the increase in the loans with the group of large banks, considering the fact that only this group registers an increase relative to December 31, 2003 (by Denar 15,536 million, or 69.2%). In contrast, the groups of medium-size and small-size banks register a negative trend in the analyzed period, i.e. a decline in the gross loans of 18.5% and 6.5%, respectively. Such movements are caused also by the aforementioned transfers of certain banks from one group to another during 2004. The structure of gross loans remained unchanged relative to the end of 2003, where dominant is the group of large banks with 66.2% (49.5% - December 31, 2003), followed by the group of medium-size banks with 22.2% (34.5% - December 31, 2003). The remaining 11.6% account for the group of small-size banks (16.0% - December 31, 2003).

As of December 31, 2004, the structural analysis observed from the viewpoint of the **sector structure**, shows that the dominant share still accounts for the loans extended to enterprises, the share of which in the total loans equals 71.5% (78.2% - December 31, 2003). The share of the loans extended to households equals 26.7% (20.8% -

December 31, 2003). Yet, despite the fact that there are no changes in the sector structure, the upward trend in the share of the loans to the households, at the expense of reducing the share of the loans to enterprises, continued also in 2004. This is confirmed by the annual growth rate of 63.2% in the loans to households, as opposed to the rate of 16.1% to the enterprises sector.

Table 7
Structure of loans to non-financial entities

In millions of denars

Date	Desription	Total	Enterprises		Households		Other clients	
			Denar	Foreign currency	Denar	reign currei	Denar	Foreign currency
31.12.2003	Due loans	1,082	805	108	137	0	1	30
	Short-term loans	16,193	12,713	1,665	1,732	0	24	60
	Long-term loans	17,786	6,914	3,918	6,853	3	0	98
	Non-performing loans	10,126	7,897	1,303	655	18	155	99
	Gross loans	45,186	28,329	6,994	9,376	21	179	287
	Loan loss provisions	-8,075						
	Net loans	37,111						
31.12.2004	Due loans	1,210	616	470	110	3	0	11
	Short-term loans	19,583	13,771	2,703	2,457	43	594	15
	Long-term loans	26,848	8,464	6,611	11,378	298	9	87
	Non-performing loans	9,727	7,297	1,089	1,026	17	187	111
	Gross loans	57,367	30,149	10,872	14,971	362	790	224
	Loan loss provisions	-9,292						
	Net loans	48,076						

According to the **currency structure** of the banks' lending activity, lending in foreign currency in the analyzed period is intensified, which is mainly a result of its liberalization in July 2003, as well as of the relatively more attractive interest rate on foreign currency, relative to that on denar loans. The annual growth rate of foreign currency loans for the period December 31, 2003 - December 31, 2004 equals 56.9%, which is significantly more compared to the growth rate for the period December 31, 2002 - December 31, 2003, when it equaled 12.3%. The more intensive growth in lending in foreign currency is especially evident in the second half of 2004, which is primarily caused by the intensive lending to enterprises. Despite such dynamics of the foreign currency loans, denar loans retained the dominant share in the loan structure, with 59.4% of the total amount of loans extended by banks (61.6% - December 31, 2003), 20.6% are denar loans with foreign exchange clause (22.2% - December 31, 2003), while the remaining part of 20.0% accounts for foreign currency loans (16.2% - December 31, 2003). Most significant annual increase in the denar loans was registered in the loans extended to households of 59.7%, in contrast to the increase of 6.4% extended to enterprises.

Analyzed by the **maturity,** long-term loans still have a dominant share in the total loans with 46.8% (relative to 39.4% - December 31, 2003), and are followed by the short-term loans with their share equaling 34.1% (relative to 35.8% - December 31, 2003)[12]. Such movements reflect continuation of the upward trend in the share of the long-term loans at the expense of the drop in the share of the short-term loans, which was registered for the first time at the end of 2003. This is confirmed with the annual growth rate of the long-term loans of 50.9%, which is almost 2.5 times higher relative to the growth rate in the short-term loans of 20.93%. Analyzed by sectors, according

[12] Due and non-performing loans are excluded from the analysis of the maturity structure of loans, due to their undefined maturity status.

to the maturity structure, faster annual growth is registered in the long-term loans to households (of Denar 4,820 million or 70.3%), in contrast to the increase in the long-term loans to enterprises (of Denar 4,243 million or 39.2%).

2.2.1.2. Placements with banks

Placements with domestic and foreign banks are the second dominant segment in the assets of the banks in the Republic of Macedonia, after the loans to non-financial entities. As of December 31, 2004, the placements with domestic and foreign banks amounted to Denar 41,331 million, i.e. 34.2% of the total banks' assets. In comparison with December 31, 2003, they registered an increase of Denar 3,030 million, or 8.1%. Foreign exchange accounts with domestic and foreign banks are still dominant in the structure of the placements with banks, equaling 96.4% (92.2% - December 31, 2003). The remaining 3.6% refer to loans extended to other banks (Balance Sheet - Annex 1).

The comparative analysis by **groups of banks** shows a proportionate relation between the banks' size and the volume of placements with domestic and foreign banks. Such structure is almost unchanged relative to that registered at the end of 2003, so that the group of large banks, which increased from two to three banks, strengthened its position, increasing its share from 62.1% (as of December 31, 2003) to 74.2% (as of December 31, 2004).

2.2.1.3. Placements in securities

As of end 2004, the securities portfolio of the banks in the Republic of Macedonia equaled Denar 13,007 million, or 11.0% of the total banks' assets, which is almost the same share relative to the end of 2003, when it equaled 11.8%. Compared on annual level, the securities portfolio registers an increase of Denar 682 million, or 5.5%, which is mainly a result of the increase in the other debt securities[13] and partially of the increase in the NBRM bills. The increase in the debt securities is due to the introduction of short-term government securities (first introduced in January 2004) on the Macedonian financial market. As of December 31, 2004, the total amount of Treasury bills stood at Denar 1,909 million[14]. Only 1/3 of the total amount were Treasury bills that the banks purchased for their account, while 2/3 were Treasury bills purchased for the account of indirect participants, i.e. banks' clients. Besides the trading in the first-introduced Treasury bills with maturity of three months, during November 2004, trading in Treasury bills with maturity of six months was introduced.

Analyzed by the structure of the securities portfolio, no significant movements relative to December 31, 2003 were registered. As of December 31, 2004, the largest portion of the securities still refers to the government bonds issued by the Republic of Macedonia on various bases and to the NBRM bills. The government bonds issued by the Republic of Macedonia amounted to Denar 6,460 million, or 49.7% of the total securities portfolio (54.4% - December 31, 2003). Out of these, 85.2% account for the government bonds issued on the basis of the restructuring of Stopanska Banka a.d.

[13] Other debt securities mainly pertain to Treasury bills, while in the Balance Sheet (Annex 1), they are part of the item Debt securities.
[14] Discounted amount.

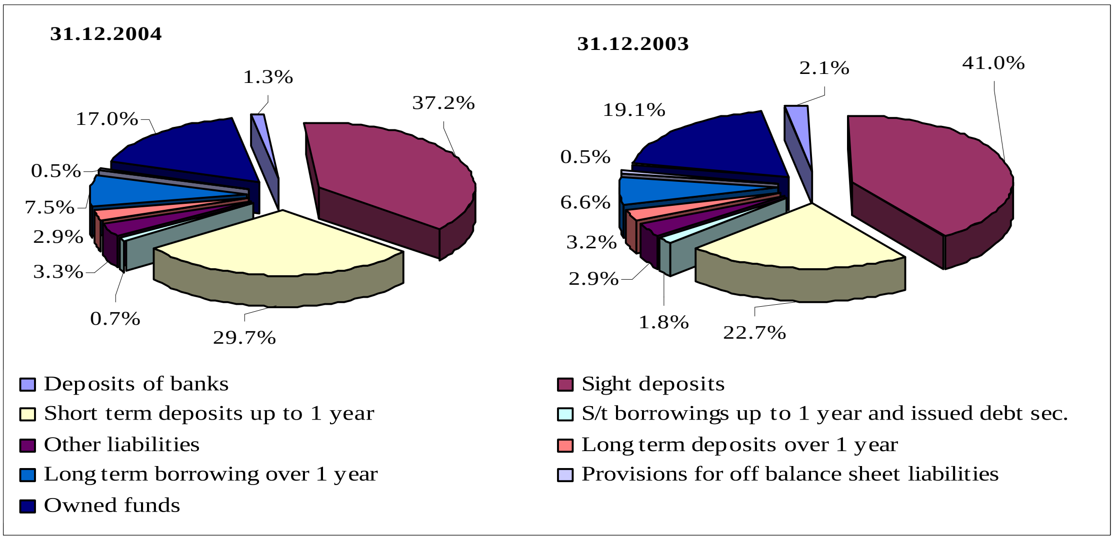
Skopje[15] with maturity of 14 years. The rest are bonds issued by the Republic of Macedonia - the Bank Rehabilitation Agency, as well as bonds issued on the basis of the "frozen" foreign exchange savings.

As of December 31, 2004, the NBRM bills amounted to Denar 4,465 million, or 34.3% of the total securities portfolio (32.3% - as of December 31, 2003). The annual increase of the NBRM bills amounts to Denar 490 million, or 12.3%, which was realized in the second half of 2004. The main reason for the increase in the NBRM bills was the increased interest of banks, due to the increase in their interest rate[16].

2.2.2. Liabilities and own funds

As of December 31, 2004, no significant changes in the structure of the banks' liabilities relative to December 31, 2003, were registered. The deposits of the non-financial legal entities and households with a share in the total liabilities of 69.8% (66.9% - as of December 31, 2003) are still the most important component of the banks' liabilities, followed by the own funds with 17.0% (19.1% - as of December 31, 2003). Same as at the end of 2003, at the end of 2004, the third most important category of sources of funds are deposits and borrowings from banks with their share in the liabilities equaling 9.5% (10.5% - as of December 31, 2003). The dominant share of 78.7% of them (63.0% - as of December 31, 2003) accounted for the long-term borrowings from foreign banks on the basis of long-term foreign credit lines.

Figure 11
Structure of liabilities



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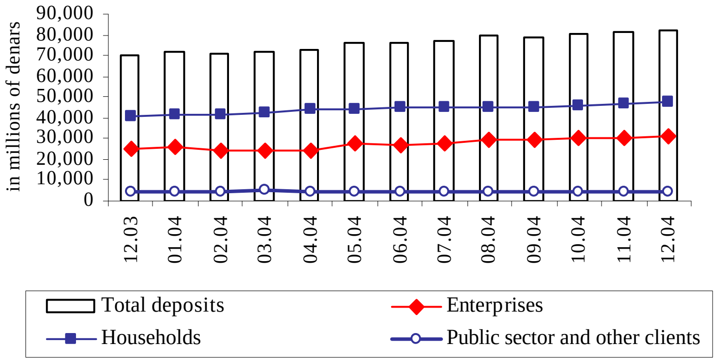
[15] Law on guaranteeing the investment of strategic investors and on assuming certain claims on end users by the Republic of Macedonia in Stopanska Banka a.d. Skopje

[16] In the second half of 2004, the National Bank increased the interest rates on the NBRM bills on three occasions - by 0.5 percentage points in mid-August and toward the end of September and by one percentage point in November. At the end of 2004, the interest rate on NBRM bills with 7-day and 28-day maturity equaled 7% and 10% p.a., respectively. Source: Quarterly report - III/2004 and IV/2004 - National Bank of the Republic of Macedonia.

2.2.2.1. Deposits of non-financial legal entities and households

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



The continuous trend of increase in the deposit potential of the banks in the Republic of Macedonia, registered in the previous year, continued also during 2004. Relative to December 31, 2003, the total deposits of the non-financial legal entities and households increased by Denar 12,096 million, or 17.2% and as of December 31, 2004 equaled Denar 82,284 million, which is the highest level of deposits registered since the monetary independence of the Republic of Macedonia and points to the conclusion that the confidence in the banks in the Republic of Macedonia grows stronger each year.

The structural share of separate **groups of banks** in the total deposit potential at the end of 2004, relative to the end of 2003, shows an increase in the share of the group of large banks at the expense of reducing the share of the groups of medium-size and small-size banks. The strengthened position of the group of large banks is a result of the increase in the number of large banks by one bank, as well as of the increase in the deposits by individual banks within the group. Thus, as of December 31, 2004, the share of the group of large banks in the structure of the total deposits, as well as in the households' deposits, sight deposits and foreign currency deposits (as main categories of total deposits) equaled 75.5%, 77.2%, 71.1%, and 81.6%, respectively. In comparison with the end of 2003, the increase in these categories of deposits is almost completely a reflection of the increase in the total deposits in the group of large banks, having in mind the insignificant increase in the group of small-size banks and the decline in the group of medium-size banks.

The analysis **by sectors** shows that also in 2004, the dominant share of 57.7% in the total deposits still accounts for the households' deposits (58.8% - as of December 31, 2003). Enterprises deposits participate with 37.4%, which is by 1.9 percentage points more relative to their share as of December 31, 2003. Deposits of other clients and of the public sector have relatively small shares in the banks' total deposit potential of 2.9% and 2.0%, respectively, which is continuation of their annual downward trend. On annual level, most significant increase of Denar 6,914 million or 17.0% is registered in the households' deposits and the enterprises' deposits of Denar 5,825 million, or 23.4%. In contrast to them, the deposits of the public sector and of other clients register a decline of 24.5% and 4.1%, respectively.

Compared on annual basis, **the currency structure** of the banks' deposit potential did not register any significant changes. As of December 31, 2004, the share of the foreign currency deposits in the total deposit potential equaled 54.4% (52.7% - as of December 31, 2003), the share of the denar deposits equaled 40.4% (42.9% - as of December 31, 2003), while that of the denar deposits with foreign exchange clause equaled 5.3% (4.4% - as of December 31, 2003). In the analyzed period, foreign currency deposits registered the fastest increase of Denar 7,749 million, or 21.0%, with their share in the increase of the total deposits equaling 64.1%. Most important in the increase of the foreign currency deposits is the upsurge in the households' foreign currency deposits of 67.5%, while the share of the enterprises' foreign currency deposits equals 30.8%. In the analyzed period, denar deposits registered an increase of Denar 3,118 million, or 10.4%, while the increase in the denar deposits with foreign exchange clause amounted to Denar 1,228 million, or 39.7%. This points to the continuously emphasized propensity of the households to save in foreign currency.

Table 8
Structure of the deposits of non-financial legal entities and households

In millions of denars

Date	Description	Total	Enterprises		Households		Public sector		Other clients	
			Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency
31.12.2003	Sight deposits	41,928	8,527	7,019	7,093	16,119	1,461	-	1,708	-
	Restricted deposits	1,020	485	462	-	-	64	-	8	-
	Short-term time deposits up to one year	23,836	6,724	1,481	3,583	10,899	535	-	433	181
	Long-term time deposits over one year	3,405	231	-	2,083	815	156	-	112	9
	Total	**70,188**	**15,967**	**8,963**	**12,759**	**27,833**	**2,217**	**-**	**2,260**	**190**
	Rate of change of deposits relative to 31.12.2002	21.2%	20.2%	69.9%	27.8%	13.3%	-7.2%		15.2%	-56.2%
31.12.2004	Sight deposits	42,817	9,016	6,700	7,450	17,393	744	-	1,514	-
	Restricted deposits	1,039	344	561	-	-	128	-	6	-
	Short-term time deposits up to one year	35,025	9,637	4,089	5,278	14,530	702	-	472	318
	Long-term time deposits over one year	3,403	409	-	1,718	1,137	99	-	31	8
	Total	**82,284**	**19,406**	**11,350**	**14,447**	**33,059**	**1,673**	**-**	**2,024**	**326**
	Rate of change of deposits relative to 31.12.2003	17.2%	21.5%	26.6%	13.2%	18.8%	-24.5%		-10.5%	71.9%

Analyzed **by maturity**, as of December 31, 2004, sight deposits registered a decrease. Nevertheless, this category of deposits is still dominant in the total deposits, with its share equaling 53.3% (61.2% - as of December 31, 2003) The share of the short-term deposits equaled 42.6% and registered an increase relative to December 31, 2003 (34.0%). The remaining 4.1% account for long-term deposits (4.9% - as of December 31, 2003). Such qualitative changes from the viewpoint of the maturity of deposits, are a result of the much faster growth of the short-term deposits (of Denar 11,189 million, or 46.9%) relative to the increase in the sight deposits (of Denar 909 million, or 2.1%). Analyzed by sectors, short-term deposits of enterprises and households register an almost even increase on annual level of Denar 5,521 million (67.3%) and Denar 5,325 million (36.8%), respectively.

2.2.2.2. Own funds

As of December 31, 2004, the banks' own funds amounted to Denar 20,023 million, accounting for 17.0% in the structure of the total sources of funds. Compared to the end of 2003, the own funds registered a decline of Denar 51 million, or 0.3%. Analyzed by groups of banks (large, medium-size and small-size banks), as of December 31, 2004, the structure of own funds changed, due to the increase in the share of the group of large banks at the expense of the decline in the share of the other two groups of banks. Thus, the highest share in the total own funds accounts for the group of large banks with 42.2%, the share of the medium-size banks equals 32.7%, while the share of the group of small-size banks equals 24.9%. For comparison, as of December 31, 2003 the own funds were almost equally distributed among the three groups of banks, with the highest portion accounting for the group of small-size banks which equaled 35.4%. These were followed by the group of large banks with 33.2% and the group of medium-size banks with 31.3%. Such structural change in the share of individual groups of banks in the banks' total own funds is a reflection of the transfer of certain banks from one into another group of banks during the course of 2004.

2.2.3. Off-balance sheet activities of the banks in the Republic of Macedonia

At the end of 2004, the total off-balance sheet assets, i.e. the total potential liabilities of the banks in the Republic of Macedonia equaled Denar 12,073 million. Most significant share was that of the uncovered guarantees and letters of credit (55.5%) and performance guarantees (26.2%). Relative to the end of 2003, the off-balance sheet activities register an increase of Denar 594 million, or 5.2%, which is to a large extent a result of the increase in the extended unused lines of credit in the amount of Denar 700 million.

The share of risky off-balance sheet items in the total off-balance sheet assets equals 91.0%, which is an increase of Denar 683 million (6.6%) compared to the end of 2003. This indicator shows that a significant portion of the total off-balance sheet activities of the banks in the Republic of Macedonia represents an exposure to credit risk and as such, they can be potentially transformed into on-balance sheet claims. Yet, despite the fact that these off-balance sheet items represent credit risk for banks, their average risk classification as of December 31, 2004 ranges between risk categories "A" and "B", which indicates moderate, even low level of risk of these potential claims.

Table 9
Off-balance sheet activities

In millions of denars

Description	31.12.1999	31.12.2000	31.12.2001	31.12.2002	31.12.2003	31.12.2004
Covered off-balance sheet items	1,899	1,573	3,134	1,238	1,174	1,085
Performance guarantees	2,744	3,244	3,340	3,010	3,291	3,163
Unused lines of credits - obligation for lending	65	123	155	536	422	1,122
Uncovered guarantees, letters of credit	9,300	9,059	8,811	6,504	6,592	6,703
Total off-balance sheet activity	14,008	13,998	15,440	11,288	11,479	12,073
Share of the total off-balance sheet activities in the total off-balance sheet assets	86.4%	88.8%	79.7%	89.0%	89.8%	91.0%

The aforementioned is confirmed by the conclusions that are reached if the dynamics of the off-balance sheet items are analyzed from the aspect of their approval, closing, paying by the bank, and consequently, their collection. Very small portion of the potential claims of banks are materialized (Annex 3). Thus, off-balance sheet items which the banks were called to pay, relative to the newly extended off-balance sheet claims for 2004, equal 2.7%. In the period from December 31, 2003 to December 31, 2004, off-balance sheet items in the total amount of Denar 20,441 million were approved, while the banks were called to pay a total amount of Denar 556 million. In the analyzed period, Denar 304 million of that amount were collected, which is 54.7% of the amount of the off-balance sheet items that the banks were called to pay during 2004.

2.3. Risks in banking operations

2.3.1. Credit risk

Credit risk is still the dominant risk to which the banks in the Republic of Macedonia are exposed. The basis for drawing such a conclusion is the share of the banks' credit operations in their overall activities, as well as the analysis of the main indicators of the quality of the banks' credit portfolio in 2004.

The total credit exposure of the banking system as of December 31, 2004 stood at Denar 119,179 million, which is an increase of 14.3% relative to December 31, 2003. Such an increase means continuation of the upward trend in the banks' credit portfolio present in the last five years. Thus, the total credit exposure of the banking system in the period from December 31, 1999 to December 31, 2004 increased by 135.4%, or if the change in the methodology for determining the total credit exposure, which started to be applied during 2002 is taken into account[17], this increment equals 42.3%.

The most significant share in the structure of the credit portfolio is that of the regular loans (70.1%), while the non-performing loans participate with 9.0%. The share of all other categories (other claims, regular interest and off-balance sheet claims) equals 20.9%. Such a structure points to an increase in regular loans of 4.1 percentage points relative to 2003, at the expense of the decline in the other categories of credit exposure.

As of December 31, 2004, dominant influence on the banks' total credit exposure is that of the group of large banks, with its share equaling 69.1%. Compared with December 31, 2003, the group of large banks registers an increase in its share of 12.7 percentage points, at the expense of the decline in the share of the other two groups of banks in the total credit exposure of the banking system as of December 31, 2004. The reason behind these structural changes is the increase in the number of banks, which, in line with the amount of their total assets as of December 31, 2004 belong to the group of large banks, as well as the decline in the group of small-size banks by three banks.

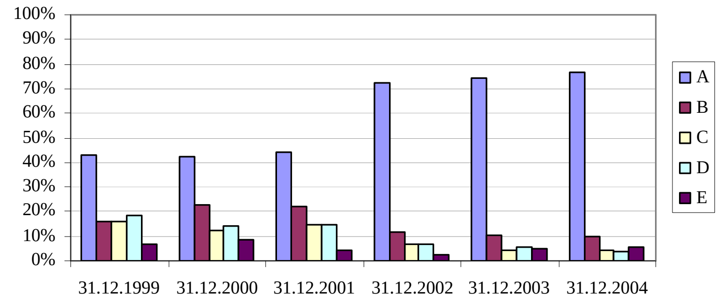
2.3.1.1. Structure of the credit portfolio

From the viewpoint of the level of risk of the credit portfolio, the highest share is that of the claims categorized in risk category "A" (76.7%). Credit exposure categorized in risk categories "C", "D" and "E" equals 13.2% of the banks' total exposure as of

[17] The total credit exposure is reduced by the amount of the claims on the Republic of Macedonia and on the National Bank of the Republic of Macedonia, which as of December 31, 2004 amounted to Denar 12,144 million, and by the amount of the claims on foreign banks in the total amount of Denar 34,978 million, which, in line with the previous methodology, were not included in the banks' credit portfolio.

December 31, 2004. The average level of risk related to the credit portfolio, expressed as a ratio between the calculated potential losses and the total credit exposure, equals 9.7%, which corresponds to the average risk category "B". What is important is the fact that the credit exposure categorized in risk categories "A" and "B" registered an increase of 16.8% relative to December 31, 2003, while the total credit exposure of banks categorized in risk categories "C", "D" and "E" remained at almost the same level as on December 31, 2003. This means that the accomplished growth of the credit portfolio during 2004 is primarily a result of the increase, i.e. the approval of credit exposures categorized in low-risk categories. If an analysis is made of the structure of the claims categorized in risk categories "C", "D" and "E" and their movement relative to the previous year, one may conclude that the amount of the credit exposure categorized in the risk categories "C" and "E", increased by Denar 1,555 million, at the expense of the decline in the credit exposure categorized in risk category "D" by Denar 1,543 million. Such a movement confirms the conclusion about the almost unchanged share of the credit exposure categorized in these three risk categories as of December 31, 2004 relative to December 31, 2003.

Figure 13
Structure of the total credit exposure by separate risk categories



As of December 31, 2004, the total credit exposure in risk categories "C", "D" and "E" is covered with the guarantee capital of the banks in the Republic of Macedonia, which is evident from the indicator of their share in the guarantee capital of 81.3% (Annex 4). Given the insignificant changes in the amount of the guarantee capital and the amount of the credit exposure categorized in risk categories "C", "D" and "E", this indicator remained at almost the same level as on December 31, 2003.

The net amount of credit exposure categorized in risk categories "C", "D" and "E"[18], i.e. the unprovisioned part of this segment of credit exposure, equals 29.5% of the banks' guarantee capital, which means that despite the relatively high exposure to credit risk, solvency of the banks in the Republic of Macedonia is not being jeopardized. Even in the event of complete non-collection of the claims which as of December 31, 2004 are categorized in risk categories "C", "D" and "E", it would be possible to cover the losses with approximately one third of the banks' guarantee capital. Analyzing by separate groups, the unprovisioned amount of the claims categorized in the risk categories "C", "D" and "E" is the highest in the group of large banks (48.5%), while in the other two groups it is at the level of 13.2% (group of medium-size banks) and 17.9% (group of small-size banks). The differences in the level of this indicator by groups of banks are primarily a result of the amount of the guarantee capital and the share of the capital in the total sources of funds. The group of large banks has a diversified structure of sources of funds in which the deposit base

[18] Credit exposure reduced by the amount of allocated loan loss provisions

has a significant share, contrary to the group of medium-size banks, and primarily the group of small-size banks, where capital is the dominant source of financial potential.

As of December 31, 2004, the group of large banks has the most significant influence on the quality of the credit portfolio of the banking system of the Republic of Macedonia, while the group of small-size banks has the most unfavorable credit portfolio. Thus, the indicators set at the level of the group of small-size banks regarding the share of the claims categorized in risk categories “C”, “D” and “E” (21.3%), regarding the share of the claims categorized in risk category “E” (8.3%) and regarding the ratio of the allocated loan loss provisions (14.5%) to the total credit exposure, are the highest among the three groups of banks.

Table 10

Description	% of E in the total credit exposure				
	2000	2001	2002	2003	2004
Large banks	12.3	6.4	2.9	7.1	5.5
Medium-size banks	3.2	1.6	0.9	2.3	5.0
Small banks	6.3	3.8	3.1	3.7	8.3

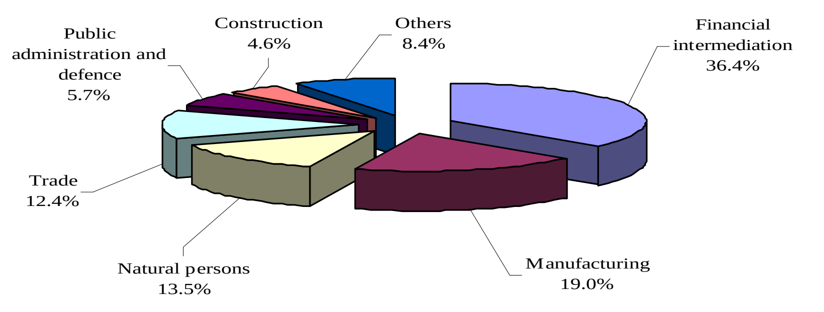
Relative to the previous year, all three groups of banks register an improvement in almost all indicators measuring the credit portfolio quality. An exception is the indicator of the share of the credit exposure categorized in the risk category “E”, which in the groups of medium-size and small-size banks registers an increase of 2.7 percentage points, i.e. 4.6 percentage points, respectively. From the total increase of the claims categorized in the risk category “E”, 70.6% are a result of the increase in this category of claims in the groups of medium-size and small-size banks.

Table 11
Indicators of the quality of the credit portfolio of the banks in the Republic of Macedonia by groups of banks

Description	% of C, D and E in the total credit exposure					% of C, D and E in the guarantee capital					% of net C, D and E in the guarantee capial				
	2000	*2001*	*2002*	*2003*	*2004*	*2000*	*2001*	*2002*	*2003*	*2004*	*2000*	*2001*	*2002*	*2003*	*2004*
Large banks	39.8	43.4	17.1	15.7	13.1	174.2	194.7	132.1	141.7	129.9	72.0	99.3	63.7	48.2	48.5
Medium-size banks	24.6	19.2	14.6	10.7	10.1	63.9	53.0	66.7	52.4	40.4	36.7	33.4	43.8	26.4	13.2
Small-size banks	35.8	35.6	14.5	21.5	21.3	46.6	56.2	29.9	48.8	50.7	23.6	32.4	14.4	23.0	17.9
At the level of the banking system	**34.8**	**33.7**	**15.9**	**15.1**	**13.2**	**94.2**	**95.7**	**77.7**	**81.0**	**81.3**	**43.6**	**52.3**	**41.6**	**32.5**	**29.5**

2.3.1.2. Credit exposure by sectors

Figure.14
Structure of the credit exposure by sectors as of December 31, 2004



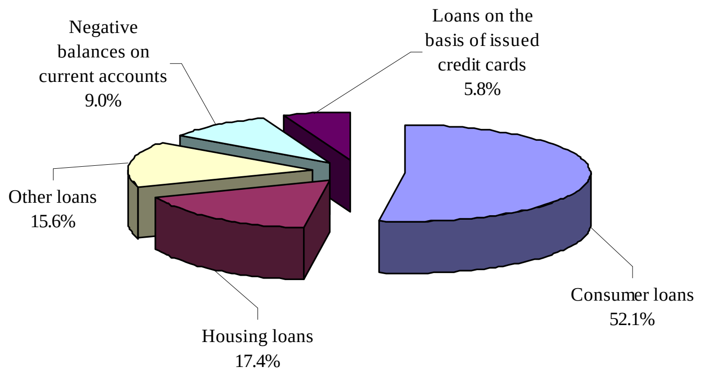
The analysis of the structure of the credit exposure by individual sectors shows that the highest exposure of the banks is to the sector “financial intermediation” (36.4%), which bears the lowest level of risk. The largest part of this exposure is to the National Bank, on the basis of purchased NBRM bills, as well as to foreign banks on the basis of time deposits and sight deposits. The second sector of exposure of the banking system is the "manufacturing" with a share of 19%, followed by the exposure to "households" (13.5%) and "trade" (12.4%). The share of all other sectors is smaller than 6% of the total credit exposure of the banking system as of December 31, 2004.

The most significant sectors[19] with which the credit exposure is concentrated, also have the larges influence on the average risk related to the banks' credit portfolio (risk category "B"). It should be emphasized that the exposure to almost all sectors is in the risk categories "A" and "B".

Analyzed by separate groups of banks, the group of large banks has a dominant share in almost all sectors. The share of this group of banks in the most important sectors is 68% (financial intermediation), 66.9% (manufacturing) and 66.9% (households). The group of large banks has a share of over 60% in the total credit exposure to fourteen sectors. The other two groups of banks have the largest share only in three sectors, which have an insignificant influence on the structure of the total credit exposure by sectors[20].

Credit exposure to natural persons should be emphasized as an especially important segment of the credit portfolio of the banks in the Republic of Macedonia. As it has already been emphasized, this category of credit exposure participates with 13.5% in the total credit exposure. Consumer loans have the highest share in the structure of these claims (52.2%), followed by housing loans (17.4%) and other loans (15.6%). Also in this case, the group of large banks has the most important influence on the structure of the banks' credit exposure to the "households" sector.

Figure 15
Structure of the banks' credit exposure to natural persons by purpose as of December 31, 2004



This group has a dominant share (over 67%) in all types of claims on households, except in the category "other loans", where the group of medium-size banks has the largest share (53.1%). The reason behind the high share of the group of medium-size banks lies in the characteristics of these banks to give credit support for clients - natural persons who, in line with the Company Law, are considered as sole proprietors or natural persons performing trading activity of a small scope. Claims on these clients mostly participate in the category "other loans".

[19] The credit exposure to the sector "financial intermediation" has an average risk category "A", the exposure to the "manufacturing" is on average categorized in the risk category "B", while the credit exposures to households are, on the average, in the risk category "B".
[20] The group of medium-size banks has the largest share in the sectors: "fishing" (59.3%) and "hotels and restaurants" (51.3%), while the group of small-size banks has the largest share in the credit exposure to the sector "agriculture, hunting and forestry" (24.2%). These three sectors together have a share of 2.3% in the total credit exposure of banks as of December 31, 2004.

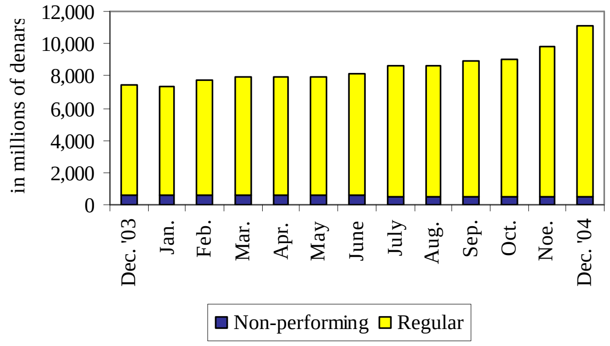
2.3.1.3. Analysis of the credit activity of banks in foreign currency with residents

In line with the amendments to the legal regulations in the area of foreign exchange operations from October 2003, banks in the Republic of Macedonia are allowed to conclude credit operations in foreign exchange with residents for payment of due external liabilities, as well as for domestic payments, in a manner and under the terms defined in the aforementioned legal framework.

As of December 31, 2004, total foreign currency loans to residents, regardless of the source of funds and the purpose (including domestic payments), stood at Denar 11,114 million. Compared with the outstanding amount of extended foreign currency loans for international payments as of October 31, 2003 (immediately after the aforementioned regulations became effective), foreign currency loans register an increase of 51.9%. The comparison with the end of the previous year points to an increase in the total loans to residents in foreign currency of 50.2%.

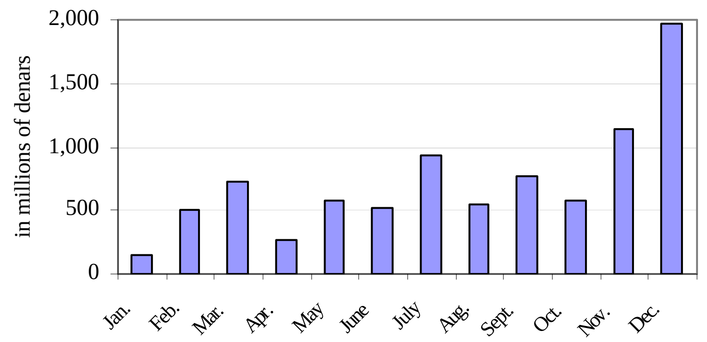
Especially positive is the fact that the increase in the total foreign currency loans is accompanied by an increase in the regular foreign currency loans, as well as a continuous moderate increase in their share in the total foreign currency loans, with parallel decline in the amount of non-performing loans. As of December 31, 2004, 95.3% of the total foreign currency loans are of a regular character, which is an increase of 2.8 percentage points relative to the end of the previous year.

Figure 16
Monthly dynamics of the regular and the non-preforming foreign currency loans to residents



During 2004, banks in the Republic of Macedonia concluded credit operations in foreign currency with residents in a total amount of Denar 8,689 million, which is 18.6% of the total newly extended loans of banks in this period. Analyzed by months, the highest level of extended loans was reached in December, whereas the lowest amount of concluded credit operations in foreign currency was registered in January. During 2004, foreign currency loans in the amount of Denar 5,014 million were collected, of which Denar 4,886 million pertain to collected regular foreign

Figure17
Newly extended foreign currency loans to residents during 2004



currency loans, whereas the remaining portion of Denar 128 million refers to collection of non-performing foreign currency loans.

The second aspect of the analysis of the foreign currency loans to residents pertains to the structure of these loans according to the category of borrowers: net-exporters (residents who realized higher foreign exchange inflow relative to the outflow and/or the analysis of whom, performed by the bank, shows that they will realize net inflow sufficient to settle their total foreign currency liabilities), natural persons and others[21]. In the analyzed period, 78.3% of the total foreign currency loans are extended to residents in the category “others”, only 16.3% pertain to net-exporters, while the remaining portion of 5.4% are extended to natural persons. Such a structure of users of foreign currency loans increases the level of credit risk to which banks are exposed, due to the fact that most of the users of foreign currency loans are not hedged against exchange rate risk.

It is important to emphasize that at the moment of their extending, all foreign currency loans to residents are categorized in risk categories “A” and “B” (in accordance with the legal framework for their extension). As of December 31, 2004, only 4.7% of the total foreign currency loans to residents are non-performing, while in 2004, only 1% of the foreign currency loans became non-performing.

The analysis of the structure of the sources of funds for financing the credit activity in foreign currency points to a gradual reduction in the amount of the foreign currency credit lines that the banks use for financing foreign currency loans. As of December 31, 2004, 43.5% of the total foreign currency loans were financed from foreign credit lines used for the account of clients, contrary to 2003, when this ratio equaled 55%.

2.3.2. Country risk

The total gross exposure to the country risk[22] as of December 31, 2004 equaled Denar 35,278 million, while the total credit exposure to the country risk on gross basis equals Denar 35,766 million, or 30% of the total credit exposure. The largest share, i.e. 98.6% of the exposure to abroad is towards foreign banks, while only 1.4% of the total exposure to the country risk accounts for the exposure to foreign non-financial institutions.

Such a structure of the banking system exposure to the country risk, as well as the fact that the largest part of this exposure is towards foreign first-class banks, or it is with contractual maturity of up to three months, determines low amount of potential losses for a country risk, which as of December 31, 2004 equals only Denar 13 million, i.e. 0.04% according to the indicator measuring the degree of exposure to a country risk. The largest share (99.5%) of the allocated potential losses for country risk refers to the exposure towards four countries.

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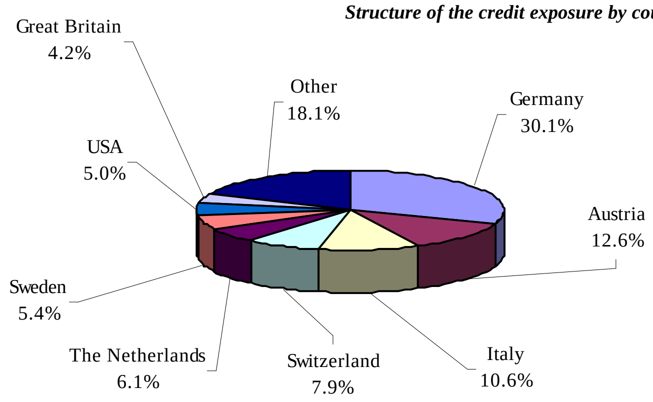
[21] In line with the Instructions for enforcing the Decision on the terms and the manner of concluding foreign exchange credit operations between residents, the category “others” encompasses all residents with whom the bank concluded credit operations in foreign currency, and who are not included in the group net-exporters or natural persons.

[22] The total credit exposure of the client, reduced by the amount of the potential losses for credit risk.

As of December 31, 2004, the Macedonian banks placed part of their assets in 34 foreign countries. The largest portion was placed in the following countries: Germany, Austria, Italy, Switzerland, the Netherlands, Sweden, Great Britain and the USA[23], the share of which in the total credit exposure as of December 31, 2004 equals 81.9%. The exposure to other individual countries does not exceed 3.8% of the total exposure to a country risk.

Figure 18
Structure of the credit exposure by countries



2.3.3. Liquidity risk

During 2004, the banks in the Republic of Macedonia maintained satisfactory liquid position. The changes in the monetary policy, in connection with the increase in the interest rate on CB bills and the rate of allocation of reserve requirement, influenced in direction of increasing the banks' Denar liquidity and investments in highly liquid assets. Thus in 2004, the average monthly amount[24] of highly liquid assets of the banks in the Republic of Macedonia equals Denar 15,300 million, compared to Denar 14,050 million in 2003. Despite the high share of the liquid assets in the total banks' assets, on December 31, 2004, the contractual residual maturity of the banks' assets and liabilities mismatches, primarily as a result of the unfavorable maturity structure of the deposit potential, with regard to the dominant share of the sight deposits, contrary to the maturity structure of the loans. However, the residual maturity of the anticipated inflows and outflows, as an indicator reflecting the banks' liquidity position, shows high level of maturity harmonization between the assets and the liabilities of the banks, which is primarily due to the high rate of stability of the sight deposits. On the other hand, the continuing increase in the deposit base as a dominant source of funds of the banks enables lower use of secondary sources of funds.

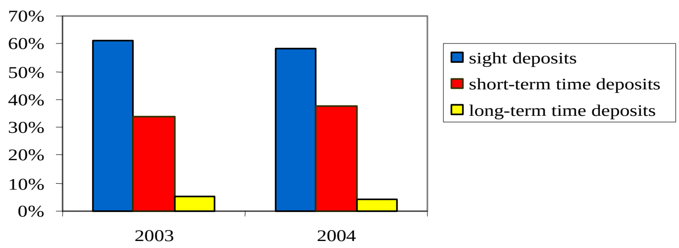
2.3.3.1. Primary sources of funds (deposits of non-financial entities)

In 2004, the average amount of the primary sources of funds, i.e. the average amount of the deposits of the non-financial entities, equaled Denar 76,484 million, which is an increase of Denar 13,005 million, or 20.5% compared to the monthly average in 2003. The upward trend of the total deposits registered in 2003 continued also in 2004, except in February and September, when minimal monthly decrease was registered. The average monthly share of the primary sources of funds in the total average sources of funds of the banks in the Republic of Macedonia registered an increase from 64.4% in 2003 to 69.0% in 2004, primarily as a result of the continuing trend of increase in the deposits of both, households and enterprises. The increment of the

[23] The risk weight for the banks' exposure towards foreign entities originating from these countries equals 0.
[24] For the needs of this report, the "average monthly amount" denotes average of the balances registered at the end of each month during the analyzed period.

primary sources of funds caused larger participation of these sources in the total others sources of funds by 4.7 percentage points in comparison with the average in 2003, thus reaching 85.3%.

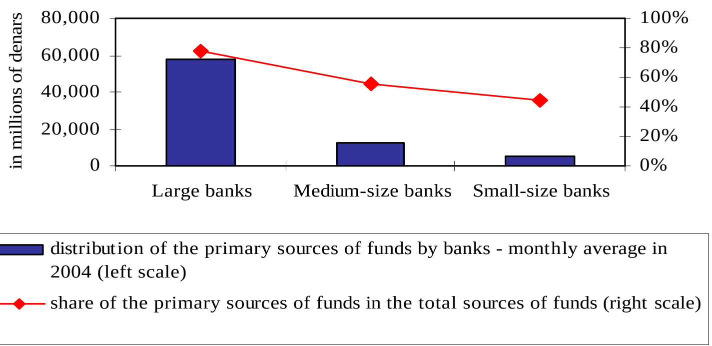
Figure 19
Maturity structure of the primary sources of funds



From the aspect of the maturity, the short-term time deposits register intensified average annual increase (34.1%), in comparison with the increase in the sight deposits (14.8%), while the long-term deposits dropped by 1.5%. The qualitative movements towards redistribution of the sight deposits into the short-term time deposits had positive effect on the maturity structure of the primary sources of funds. Thus in 2004, the share of the sight deposits in the total deposit base equaled 58.2% on average (61.0% - 2003 average), while the short-term time deposits participated with 37.4% (33.7% - 2003 average). Despite the extending of the deposits' maturity in 2004, it was not sufficient for overcoming the contractual maturity mismatch of the assets and the liabilities.

The currency structure of the primary sources of funds continues to be in favor of foreign currency deposits, which speaks for the larger preference of the household for saving in foreign exchange, although the Denar interest rates are more attractive. In 2004, the monthly average share of the foreign currency deposits equaled 54.2% of the total deposits of the non-financial entities in comparison with 53.5% in 2003.

Figure 20
Distribution of the primary sources of funds by groups of banks



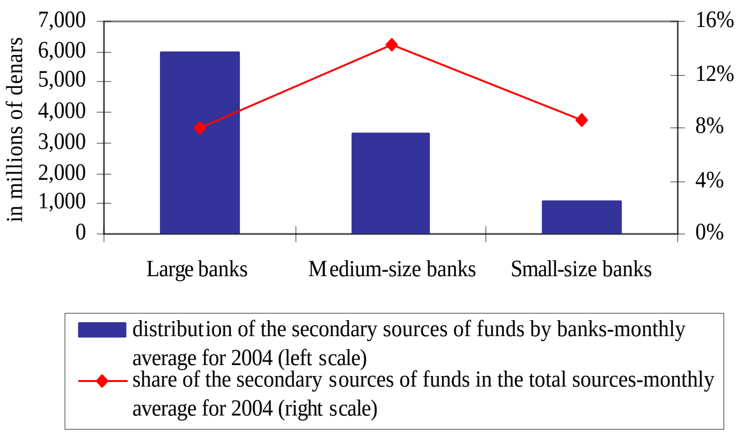
The comparison analysis by groups of banks on annual basis (2004 compared to 2003) does not indicate any structural changes. Namely, the proportionate correlation between the size of the banks and the volume of the collected deposits was preserved. Thus in 2004, the largest share, i.e. 75.8% of the total deposit potential accounts for the group of large banks, while 16.8% and 7.4% accounts for the groups of medium-size and small-size banks, respectively. Such a distribution has direct influence also on the share of the primary sources of funds in the total sources of funds, which in 2004 equals 77.4%, 55.2% and 44.4% for the groups of small-size, medium-size and large banks, respectively.

In 2004, concentration of the households' deposits with the group of large banks in the amount of 77.8% of the total households' deposits was registered (72.0% - average in 2003). Also, the largest part, or 73.3% of the total sight deposits are concentrated with the group of large banks (65.7% - average in 2003). The aforementioned concentration of the deposits with the group of large banks speaks for the confidence of the depositors with these banks. Simultaneously, this is an indicator that the group of large banks is responsible for the intermediation function and the stability of the total banking system. In 2004, the group of large banks participated with 15.4% in the total households' deposits (20.3% - average in 2003), while the participation of the group of small-size banks in the total households' deposits, although the largest, equals only 6.9% (7.7% - average in 2003). Within the sight deposits, on average 18.5% refer to the group of medium-size banks (24.6% - average in 2003), and 8.3% to the group of small-size banks (9.7% - average in 2003).

2.3.3.2. Secondary sources of funds

In 2004, the continuing trend of increase in the deposits as primary sources of funds determined lower use of the secondary sources of funds. The average share of the secondary sources of funds in the total sources of funds equals 9.3% in 2004, which is less by 3.5 percentage points than the monthly average registered in 2003. Their average share in the total liabilities of the banks equaled 11.6%, which is by 4.4 percentage points less compared to their average share in 2003. The dominant share in the structure of the secondary sources of 83.1% still accounts for the short-term and the long-term borrowings (83.1% - monthly average in 2003). The largest portion of them (71.7%) refers to long-term borrowings based on long-term credit lines withdrawn from foreign banks and placed in form of long-term credit placements, primarily aimed at supporting the economic development and the investments in the country.

Figure 21
Distribution of the secondary sources of funds by groups of banks



Analyzed by groups of banks, in 2004 proportionate correlation between the size of the banks and the volume of the secondary sources of funds is registered. Thus the largest portion of the secondary sources of funds of 57.5% accounts for the group of large banks, followed by the group of medium-size banks with a share of 31.9% and the group of small-size banks with its share being equal to 10.6%. In contrast to 2004, in 2003 the largest part of the secondary sources of funds of 47.8% accounted for the group of medium-size banks, followed by the group of large banks with 31.9% and the group of small-size banks with 20.1% of the total secondary sources of funds. Such redistribution is mainly due to the transfer of one bank from the group of medium-size to a group of large banks, as well to the transfer of three banks from the group of small-size, to the group of medium-size banks.

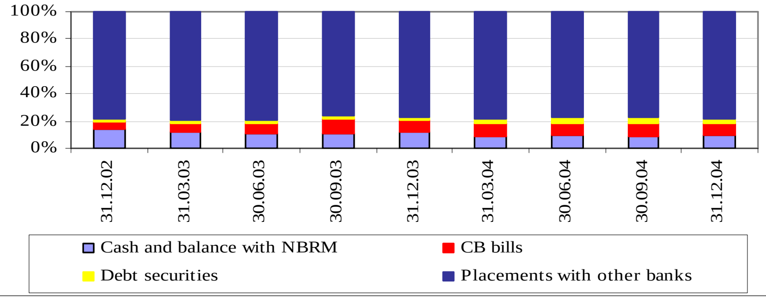
When comparing 2004 with 2003, the changes in the composition of the groups of banks are mainly the reason for the lower use of secondary sources of funds with the groups of medium-size and large banks. Thus during the analyzed period, the group of medium-size banks financed 14.2% of its activities with the secondary sources of funds, followed by the group of small-size banks with 8.6% and the group of large banks with 8.0%. For comparison, these correlations in 2003 equaled 21.2%, 16.3% and 7.0% for the groups of medium-size, small-size and large banks, respectively. The share of the secondary sources of funds in the total liabilities equals 9.1%, 19.8% and 14.7% for the group of large, medium-size and small-size, respectively. These correlations point to the larger dependence on these alternative sources of funds with the groups of small-size and medium-size banks, primarily due to the lower share of the primary sources of funds in the total sources of funds with these two groups of banks relative to the group of large banks.

2.3.3.3. Liquid assets and highly liquid assets

In 2004, the average share of the liquid assets, defined in broaden sense[25], in the structure of the total assets equaled 43.1%, which is by 1.9 percentage points less compared to the average share registered in 2003. Such a decrease is due to the increase in the share of the loans as less liquid category. However, it is assessed that the share of the liquid assets is still high.

No changes of higher significance in the share of the liquids assets' components were registered during the analyzed period. The funds on the correspondent accounts with foreign banks continue to be dominant item, with their average share in the total liquid assets of the banks being equal to 68.6% (69.5% in 2003). The banks in the Republic of Macedonia kept 9.8% of their liquid assets in funds on monthly average, while 8.8% in form of CB bills. The remaining share refers to debt securities[26], accounts with domestic banks and short-term loans of banks.

Figure 22
Structure of the liquid assets



In 2004, the share of the highly liquid assets in the total assets[27] of the banks in the Republic of Macedonia equals 13.8%, which is almost the same as the monthly average in 2003 when it equaled 14.2%. Such a share of the highly liquid assets in the total assets

[25] The liquid assets, in broaden sense, encompasses the funds and the balances with the National Bank of the Republic of Macedonia, the CB bills, the short-term debt securities, the short-term credits and balances on the accounts with domestic and foreign banks

[26] The debt securities item mostly refers to the debt Government bonds, followed by the Government bills as the second largest item, with the share of cheques and bills of exchange being minor.

[27] It is defined as sum of the funds and the balances with the National Bank, CB bills and sight deposits on accounts with domestic and foreign banks.

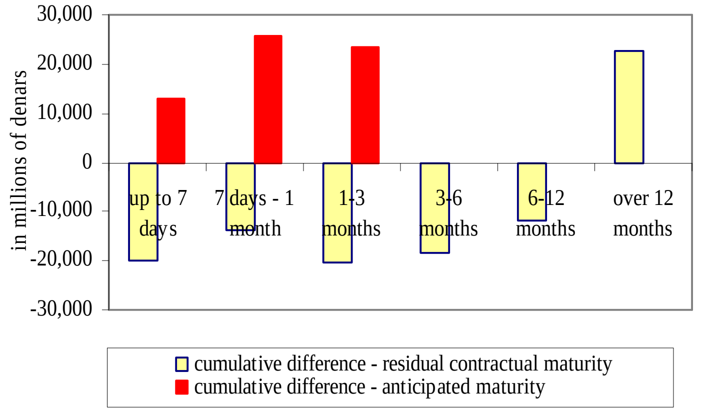
ensures average coverage of the sight deposits of 34.5% and complete amortization of the expected cumulative outflow of sight deposits within a period of both, up to one and up to three months.

The average share of the highly liquid assets in the total assets by groups of banks in 2004 is almost identical to 2003. The highest share of the highly liquid assets in the total assets accounts for the group of small-size banks and it equals 21.5% (21.7% in 2003). It is followed by the group of medium-size banks with 19.4% (17.8% - monthly average for 2003), while the lowest share accounts for the group of large banks with 10.7% (10.3% - monthly average in 2003). Such a presence of the highly liquid assets is in direct correlation with the rate of anticipated stability of the sight deposits by individual groups of banks, where high rate of stability means possibility for keeping less liquid assets and their investment in profitable bank products.

2.3.3.4. Maturity structure of the assets and liabilities

At the end of 2004, the dominance of the short-term sources of funds, especially of the sight deposits compared to the longer term nature of the loans, determined contractual residual[28] maturity between the assets and the liabilities. On December 31, 2004, the cumulative residual maturity non-compliance between the funds and the sources of funds with maturity of seven days, amounts to Denar 20,118 million, which is by Denar 1,116 million less in comparison with the cumulative difference registered on December 31, 2003. The level of coverage of the seven-day sight deposits with liquid assets (funds and placements with other banks with maturity of up to seven days) equals 50.7% (45.6% - December 31, 2003). However, besides the unfavorable maturity structure of the deposit potential, the analysis of the movement of these deposits according to the so-far experience, shows a continuous stability. The percentage of the stable part of the sight deposits with seven-day maturity at the level of the banking system equals 74.6%, which is by 5.8 percentage points more than the percentage registered on December 31, 2003. Such a level of stable sight deposits with maturity of up to seven days at the level of the banking system is mostly a reflection of the high level of stable sight deposits with the group of large banks of 83.4%. This level with the group of medium-size and the small-size banks equals 46.9%, and 54.2%, respectively. The improved stability of the deposit core means lower outflow of the deposits. Thus according to the expectations

Figure 23
Cumulative differential between the total assets and liabilities according to the contractual and anticipated maturity - as of December 31, 2004



[28] The contractual residual maturity of separate assets and liabilities items represents the remaining period from the end of the reporting period until their actual contractual maturity, i.e. the maturity determined in accordance with the concluded agreement between the bank and its client.

of the banks in the Republic of Macedonia, in 2004 only 14.9% of the total deposits could have register an outflow, which is by 4.3 percentage points less relative to December 31, 2003.

Analyzed by groups of banks, the contractual residual maturity mismatch is due to the non-compliance with the group of large banks, the most dominant one, and to a smaller extent, with the group of small-size banks. Contrary to them, the group of medium-size banks registers maturity cumulative match in all maturity blocks.

The picture for real liquid position would be incomplete if only the contractual residual maturity structure is analyzed. Namely, a completely different picture for the liquidity position of the banks can be obtained if the residual anticipated maturity structure is taken into account during the analysis[29]. Analyzed from the aspect of the anticipated residual maturity structure, positive cumulative difference in all maturity blocks can be stated, which is primarily a result of the matching with the group of large banks, as well as of the *positive* differential with the groups of medium-size and small-size banks to the lower extent.

2.3.3.5. Maturity structure of the Denar and the foreign exchange denominated assets and liabilities

The analysis of the assets and liabilities' maturity structure from the aspect of the Denar and the foreign exchange liquidity according to the residual contractual maturity structure, points to a negative liquidity Denar gap, which can cumulatively be overcome in the maturity block exceeding 12 months, as well as to a negative liquidity foreign exchange gap, with exception to both, the block of seven days - up to one month and the block exceeding twelve months. The negative Denar liquidity gap of up to seven days equals Denar 12,549 million, while in foreign exchange it equals Denar 7,568 million. Analyzed by groups of banks, the negative liquidity gap is mostly caused by the maturity structure of the Denar and the foreign exchange nominated assets and liabilities in the group of large banks.

The analysis of the anticipated residual maturity structure gives different picture for the Denar and the foreign exchange liquidity positions. On December 31, 2004, analyzing at the level of the banking system and by groups of banks, the negative Denar and foreign exchange liquidity gaps with maturity of up to seven days according to the anticipated maturity is overcome completely. Thus the excess of Denar liquid assets with maturity of up to seven days equals Denar 2,115 million, while the excess of the 7-day foreign exchange liquid assets amounts to Denar 10,675 million. For example, on December 31, 2003 the negative Denar liquidity gap with maturity of up to seven days amounted to Denar 197 million, while the excess foreign exchange liquid assets with same maturity equaled Denar 6,387 million. When analyzing the residual maturity structure of the Denar and foreign exchange denominated assets and liabilities, the identification of the stable level of Denar and foreign currency deposits is regarded as essential component. On December 31, 2004,

[29] The anticipated residual maturity of the individual assets and liabilities items denotes the remaining period from the end of the reporting period until their contracted maturity, i.e. period in which the bank assesses that there will be inflows and outflows of funds based on its claims and liabilities (according to the bank's experience, the established process of liquidity risk management, etc.)

the level of stable Denar and foreign currency deposits with maturity of up to seven days equals 78.3% and 71.7%, respectively. Such a level of stable Denar and foreign currency deposits is primarily in correlation with the high level of stable Denar and foreign currency sight deposits in the group of large banks, equaling 87.7% and 80.2%, respectively. In the group of medium-size banks this level equals 57.3% and 38.2% for the Denar and the foreign currency deposits, respectively, while in the group of small-size banks it equals 49.0% for the Denar and 59.8% for the foreign currency deposits.

2.3.4. Exchange rate risk

The exchange rate risk is a possibility that the bank will register material and financial loss on the assumed positions in separate currencies (open long and short positions) due to the changes in the cross-currency value of the national currency.

2.3.4.1. Analysis of the banks' open foreign exchange position

At the end of 2004, the foreign exchange assets of the banks in the Republic of Macedonia equaled Denar 68,251 million, which is 57.8% of the total net assets. The foreign exchange liabilities equaled Denar 58,257 million, or 49.4% of the total liabilities. The comparison with the situation registered at the end of 2003 indicates a continuation of the trend of increase in total foreign assets and liabilities also in 2004, as well as in their share in the total assets and liabilities at the level of the banking system. This trend of continuing increase is s result of the still evident preference of the households to save in foreign currency. The short-term character of these savings, obliges the banks to keep large amount of liquid foreign assets with foreign banks. Besides the aforementioned, starting from October 2003, when the legal framework for foreign exchange crediting of residents was adopted, the increase in the approved foreign exchange loans to residents by the banks also has larger influence on the increase in the total foreign assets.

Figure 24
Total foreign assets and foreign liabilities at the end of the last five years

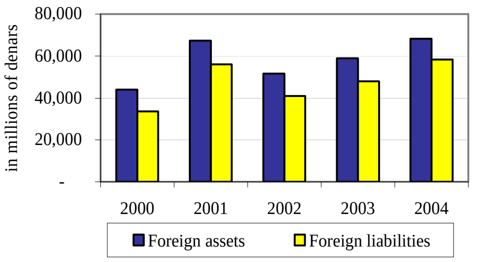
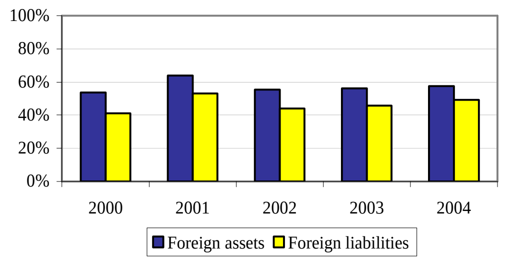


Figure 25
Share of the foreign assets and foreign liabilities in the total assets at the end of the last five years, in percentages



The analysis by separate groups of banks (large, medium-size and small-size banks) indicates a proportionate correlation between the size of the banks and the size of the foreign assets and liabilities (figures 26 - 27). The change relative to December 31, 2003 is a result of the structural movement by separate groups of banks, i.e. transfer of one bank from the group of medium-size to the group of large banks, and transfer of three banks from the group of small-size to the group of medium-size banks.

Figure 26
Share of the foreign assets of the separate groups of banks in the total assets

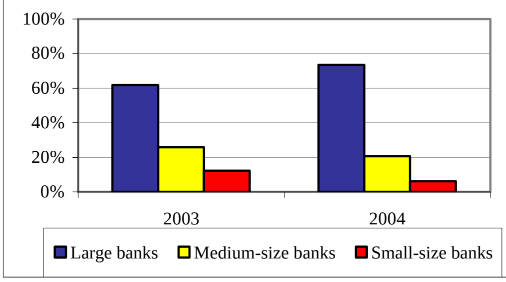
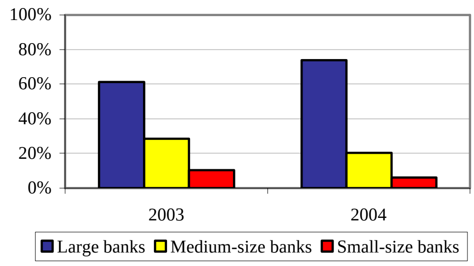


Figure 27
Share of the foreign liabilities of separate groups of banks in the total liabilities



The comparison analysis of both, the foreign assets and liabilities structure indicates that on December 31, 2004 in comparison with December 31, 2003, no changes of higher significance were registered. The dominant share within the foreign assets still accounts for the assets deposited in domestic and foreign banks, while within the foreign liabilities, the dominant share accounts for the households' deposits.

Table 12
Structure of the foreign assets and foreign liabilities - as of December 31, 2004

in million of Denars

Foreign assets	Amount	31.12.2004	Foreign liabilities	Amount	31.12.2004
FX cash, checks and debt market securities	1,547	2.3%	Foreign currency deposits of banks	789	1.4%
Assets in foreign and domestic banks	38,878	57.0%	Foreign currency deposits of households	32,556	55.9%
Foreign exchange claims	12,191	17.9%	Foreign currency deposits of enterprises, public sector and other clients	9,753	16.7%
Denar claims with foreign exchange clause	11,846	17.4%	Foreign assets of foreign entities	2,431	4.2%
Provisions for loan losses	-2,104	-3.1%	Denar assets of banks, households, enterprises and foreign entities with a fx clause	4,322	7.4%
Trading securities	102	0.1%	Foreign exchange credits of banks	7,734	13.3%
Securities held up to maturity	5,502	8.1%	Other liabilities	671	1.2%
Other assets - other accounts	288	0.4%			
Total assets	**68,251**	**100.0%**	**Total liabilities**	**58,257**	**100.0%**

Such a structure is a result of the aforementioned households' propensity to save in foreign currency, which on the other hand, conditions the banks to hold larger amount of liquid foreign assets with foreign banks.

At the end of 2004, the aggregate open foreign exchange position relative to the aggregate guarantee capital of the banks, equals 51.2%, which is by 7 percentage points less in comparison with the position registered at the end of 2003. The exposure of the banking system towards the Euro, as the dominant currency in the foreign assets and liabilities structure, equals 43.9% of the guarantee capital, compared to 50.6% on December 31, 2003.

The analysis by groups of banks points to the dominant influence of the group of large banks on the long aggregate open foreign exchange position, as well as on the long open foreign exchange position relative to the Euro at the level of the entire banking sector. Namely, the aggregate open foreign exchange position relative to the guarantee capital equals 79.7% for the group of large banks, 35.3% for the group of medium-size banks and 19.0% for the group of small-size banks. The analysis of the long position towards the Euro equals 74.2% for the group of large banks, followed by the group of medium-size banks with 25.7% and the group of small-size banks with 11.5%. Such an influence is mainly due to the structure of foreign assets of one bank, with which besides the share of the assets with foreign and domestic banks of 47.0%, the share of the long-term foreign exchange Government bond for bank rehabilitation denominated in Euros, is also deemed significant.

As of December 31, 2004, three banks exceeded the legally prescribed limit of 50% for long, i.e. 10% for short aggregate open foreign exchange position. The exceeding of the limit of the aggregate long open foreign exchange position is mainly due to the aforementioned long-term Government bond with one bank denominated in Euros.

2.3.5 Capital adequacy / Insolvency risk

2.3.5.1 Capital

The capital of the banks in the Republic of Macedonia, defined pursuant to the methodology of the National Bank of the Republic of Macedonia, equals Denar 19,905 (Euro 324.7 million) at the end of 2004, which is an insignificant decrease of Denar 66 million, or 0.3% in comparison with the end of 2003. The reason for the decrease in the capital of the banks given the increase in all its elements in comparison with the previous year, should be found in the amount of the deductible items, i.e. in the higher amount of unallocated special reserve for potential losses at the end of 2004 compared to 2003.

On December 31, 2004, certain changes in the share of separate groups of banks in the total banks' capital are registered. Contrary to December 31, 2004, when all groups of banks had almost identical share of capital, with the largest one being recorded by the group of small-size banks (35.4%), on December 31, 2004, the group of large banks registered a significant increase of 9.2 percentage points, with its share being equal to 42.2%. The share of the capital in the group of medium-size bank retained almost the same level registered in the previous year, while the share of the capital of the group of small-size banks registered a decrease of 10.4 percentage points and it equaled 25%. The reason for this can be found in the change in the number of banks in certain groups of banks on December 31, 2004 in comparison with December 31, 2003.

Table 13
Level of capitalization of the banks as of December 31, 2004[30]

in millions of Denars

Description	Capitalization rate (net)	Capitalization rate (gross)	Capital adequacy
Lagre banks	10.7%	9.8%	15.1%
Medium-size banks	25.0%	23.2%	34.0%
Small-size banks	37.7%	33.6%	45.1%
Total banks	**16.9%**	**15.4%**	**23.0%**

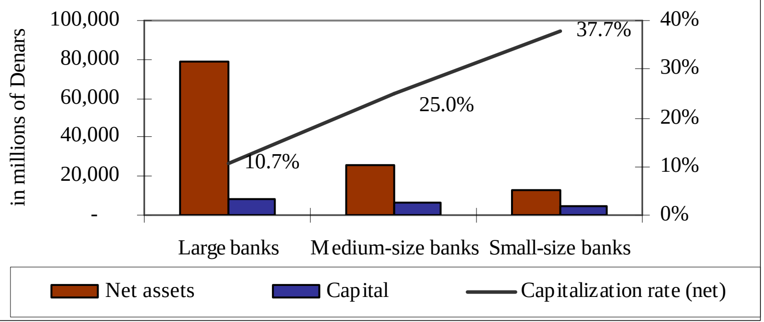
[30] The capitalization rate (net) represents a correlation between the capital and the net assets. The capitalization rate (gross) is a correlation between the capital and the gross assets. The capital adequacy is correlation between the guarantee capital and the risk-weighted assets and the aggregate open foreign exchange position

Regarding the distribution of the capital base by separate banks, it varies within a range of Denar 278 million with the bank with the lowest level of capital, up to Denar 3,151 million with the bank registering the highest level of capital.

At the end of 2004, the level of coverage of the net on-balance sheet assets with the banks' capital equals 16.9% and in comparison with the end of 2003 it dropped by 2.1 percentage points. If the total activities of the banks are taken into account, i.e. the total on-balance sheet and off-balance sheet assets, then the level of capitalization would equal 15.3%.

Figure 28

Level of net assets, capital and capitalization rate as of December 31, 2004, by groups of banks



The capitalization rate is the highest with the group of small-size banks as a result of the structure of the sources of financing of the banks encompassed in this group of banks, in which the dominant share accounts for the capital. On the other hand, the most significant source of funds of the group of large banks accounts for the deposit base, due to which this group of banks has the lowest level of capitalization, which on the other hand means that this group registers higher level of financial intermediation. From the aspect of the movement of this indicator relative to the previous year, its lowering with the group of small-size banks can be registered, only as a result of the reducing of the number of banks comprising this group.

2.3.5.2 Capital adequacy ratio of the banks in the Republic of Macedonia

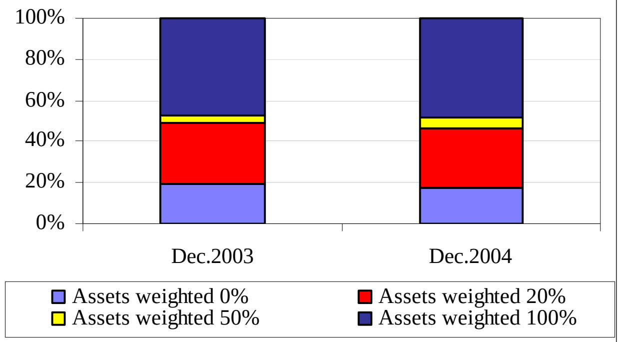
The capital adequacy ratio, as one of the most significant prudent indicators for the banks' operating, reflects the necessary level of the banks' capital for covering the losses originating from the level of risk of the assets. In accordance with the methodology of the National Bank, the capital adequacy ratio depends on three components necessary for its calculation: the guarantee capital, the risk-weighted assets and the aggregate open foreign exchange positions.

As of December 31, 2004, the guarantee capital of the banks in the Republic of Macedonia amounted to Denar 19.397 million, which is a decrease of Denar 44 million, or 0.2%, compared to December 31, 2003. Also in this case the reason for the decrease is the higher amount of non-allocated special reserve for potential losses[31] by Denar 634 million as of December 31, 2004 compared to December 31, 2003, although the core and the additional capital, as the most significant components of the guarantee capital, register an increase relative to the previous year (US Dollar 581 million). Observed by separate groups of banks, the most significant share in the guarantee capital of the banking system accounts for the larger banks (42.8%).

[31] Pursuant to the Methodology for determining the guarantee capital, the unallocated special reserve for potential losses is considered as a deductible item.

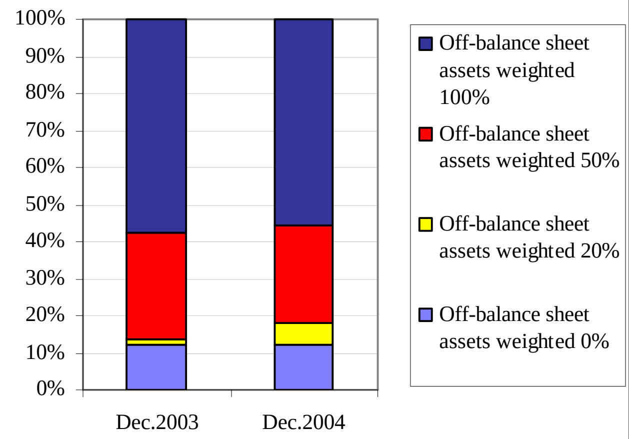
As of December 31, 2004, the risk-weighted assets amounted to Denar 73,626 million, which is by Denar 9,251 million more compared to December 31, 2003. Denar 68,615 of the total risk-weighted assets refer to the risk-weighted on-balance sheet assets, Denar 7,765 to the risk-weighted off-balance sheet assets, while the deductible items which according to the methodology for determining the risk-weighted assets are reducing its amount, equal Denar 2,754 million. The largest share also in the risk-weighted assets (64.9%) accounts for the group of large banks, which is an increase of 14.4 percentage points compared to December 31, 2003. At the expense of the increase in the risk weighted assets in the group of large banks, the remaining two banks register a decrease of 9.3 percentage points (the group of medium-size banks) i.e. 5.1 percentage points (the group of small-size banks).

Figure 29
Share of the risk-weighted on-balance sheet assets in the total assets



The share of the risk-weighted on-balance sheet assets in the total on-balance sheet assets equal 57.1%. The dominant share in the structure of the risk-weighted on-balance sheet assets of the banks in the Republic of Macedonia on December 31, 2004, accounts for the assets with risk weight 100% (50.7%), and in comparison with the previous year, the share of the items with the highest risk-weight registers an increase of 1.8 percentage points.

Figure 30
Share of the risk-weighted off-balance sheet assets in the total off-balance sheet assets



Small structural movements were registered in the off-balance sheet assets weighted according to the level of risk in comparison with December 31, 2003. The share of the risk-weighted off-balance sheet asset items in the total off-balance sheet operating of the banks at the end of 2004 equal 64.3%, which is by 3 percentage points less in comparison with the end of the previous year. As well as during the other periods, the structure is dominated by the items with a factor of conversion 100%[32], and their share equals 55.5%.

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[32] Uncovered letters of credit and guarantees, confirmed letters of credit and other off-balance sheet items, as well as the other non-stated off-balance sheet assets related with assumed potential liabilities which are not encompassed in the items with lower factor of conversion.

Pursuant to the amendment to the methodology for determining the capital adequacy the implementation of which commenced on March 31, 2002, the calculation of the capital adequacy ratio also incorporates the exchange rate risk, i.e. the aggregate open foreign exchange position is taken into account, which on December 31, 2004 equals Denar 10,594 million. The dominant share in the aggregate open foreign exchange position accounts also for the group of large banks and it equals 68.6%.

As a result of the movement of the guarantee capital, the risk-weighted on-balance sheet and off-balance sheet assets and the aggregate open foreign exchange position, the capital adequacy ratio of the banks in the Republic of Macedonia equals 23.0% on December 31, 2004, which is by 2.8 percentage points less than the ratio registered at the end of in 2003.

Analyzed by group of banks, on December 31, 2004, the lowest capital adequacy ratio accounted for the group of large banks (15.1%), in comparison with the capital adequacy ratio registered by the group of small-size banks (45.1%). The reasons for the high capital adequacy ratio of the small-size banks are identical to those referring to their high capitalization rate - poor volume of activities, primarily of the credit activity, whereas the small amount of others' sources of funds, i.e. the dominant share of the own funds in their total financial potential.

Table 14
Capital adequacy of the banks

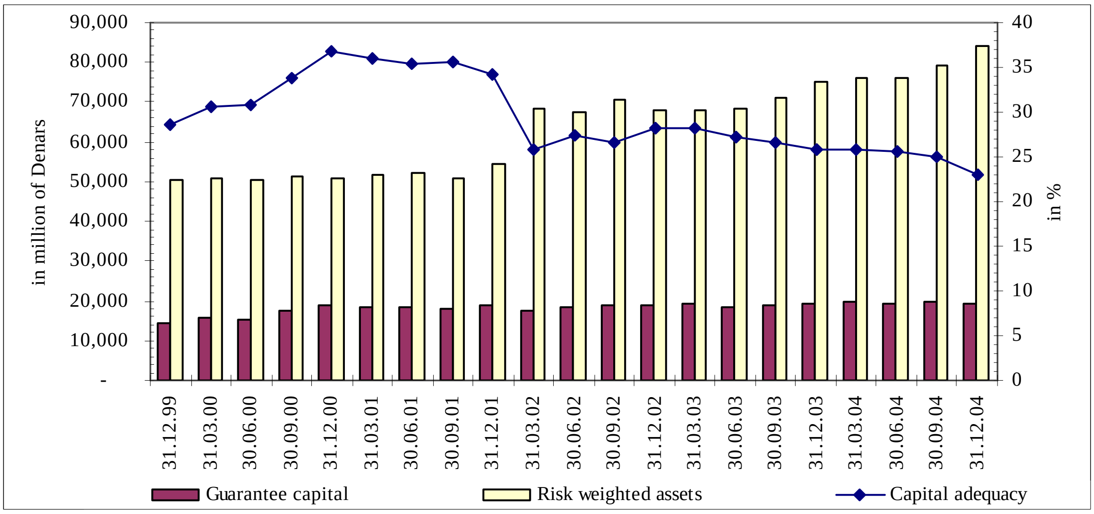
Capital adequacy ratio	Number of banks		
	31.12.2002	**31.12.2003**	**31.12.2004**
below 8%	0	0	0
from 8% to 12%	0	0	0
from 12% to 20%	2	3	4
from 20% to 30%	4	3	3
from 30% to 50%	8	8	9
from 50% to 100%	4	6	5
exceeding 100%	2	1	0

As of December 31, 2004, all banks fulfill the prescribed minimal capital adequacy level. Similar to the end of 2002 and 2003, also in 2004 the banks the capital adequacy of which is within the range of 30 - 50% (nine banks) and 50-100% (five banks) are the dominant ones. However, certain structural movement of the banks from a range with higher capital adequacy to a range of lower capital adequacy can be stated. The fact that on December 31, 2004 there are no more banks with capital adequacy exceeding 100% should be stressed.

The analysis of the movement of the capital adequacy ratio indicates that during the past years the banking system of the Republic of Macedonia has been maintaining this ratio on a relatively high and stable level exceeding 30%. The capital adequacy ratio registers larger decrease at the beginning of 2002, as a result of the amendment to the methodology for its calculation, with a trend of gradual decrease being registered in the following two years since then.[33] Such a trend can be deemed as positive, from the aspect of improvement of the degree of financial intermediation of the banks in the Republic of Macedonia and increase in their efficiency. Namely although the relatively high and stable capital adequacy ratio is indicator for the stable solvent position of the banks in the Republic of Macedonia, such a level is simultaneously indicator for the low level of financial intermediation.

[33] The capital adequacy ratio registered an average decrease of 0.3 percentage points on a quarterly basis.

Figure 31
Movement of the guarantee capital, risk weighted assets and the capital adequacy ratio



The constant intensification of the credit activity of the banks, primarily in the sector "households", should also be taken into consideration in this regard. However, further intensification of the credit activity should continue with enduring strengthening of the banks' internal systems and procedures for identification, measurement and control of risks, thus minimizing the possible realization of the risks in losses which will be, at the worst, on the burden of the capital.

2.3.6. Profitability

The ensuring adequate level of profitability represents a significant precondition for the maintenance of the amount of the banks' capital originating from their operating. Basically, the profitability potential of the banks is conditioned by several factors such as: the structure of the balance sheet, the level of risk, the dynamics of the economy development and the demand for loans from the real sector and households, the monetary policy of the country, etc.

In 2004, the banks in the Republic of Macedonia showed positive financial result from their operating in the amount of Denar 1,247 million, which is an increase of Denar 799 million, or 178.3% in comparison with the previous year. This increase is an indicator for the significant improvement of the banks' profitability position in 2004. For example, despite the decrease in the number of banks that registered positive financial result (from seventeen to sixteen banks), sixteen banks generated higher profit by Denar 594 million (in 2004 compared to 2003). Also, the total amount of the loss registered by the banks having negative financial result (five banks) is lower by Denar 205 million (in 2004 compared to 2003).

Analyzed by groups of banks, the group of large banks had the larger influence on the total profit as of December 31, 2004[34]. The increase in the positive financial result with this group of banks in the amount of Denar 802 million determines also the total

[34] The average share of this group of banks in certain categories comprising the financial result registered at the level of the banking system exceeds 65% as of December 31, 2004.

increase in the profitability of the banking system. On December 31, 2004, the group of small-size banks showed negative financial result in the amount of Denar 93 million. This is due to the fact that three out of the five banks which showed loss at the end of 2004 belong to the group of small-size banks. Because of this situation, also the other indicators for the profitability of this group of banks are on lower level than those of the remaining two groups of banks, as well as of the banking system on the whole.

Table 15
Financial result by group of banks

in millions of Denars

Description	31.12.2003	31.12.2004
Large banks	230	1,032
Medium-size banks	131	309
Small-size group banks	86	(93)
Total	**448**	**1,247**

2.3.6.1 Profit and loss account structure

On December 31, 2004, the profit and loss account structure of the banks in the Republic of Macedonia (Annex 2) indicates a relatively unfavorable income structure having in mind that the registered financial result originates from the irregular income categories (income on other basis and extraordinary income). The incomes generated from the regular operations are not sufficient for covering the operational costs made by the banks. Such a situation deserves special attention, although the positive effect recorded in 2004 should be stressed, because besides the fact that high share in the total profit at the level of the banking system still accounts for the irregular income categories (22.4%), their dominance is decreasing for the account of the income generated from the banks' regular operating. Thus the extraordinary income decreased by Denar 623 million, while the net interest income after provisioning and the net income originating from provisioning registered an increase of Denar 1,769 million. Although the regular income in the amount of Denar 3,898 million is still insufficient for covering the operational and administrative costs (Denar 4,776 million), this correlation registers an increase from 49.7% in 2003 to 81.6% in 2004. The movements registered in the income structure of the banks are a result of the improvement of the placements structure (from the aspect of profitability) at the level of the banking system.

The total **interest income** of the banks in 2004 amounts to Denar 5,920 million, which is an increase of Denar 759 million, or 14.7% compared to 2003. Its structure is dominated by the income based on interest from enterprises and households (77.5%), with the households' interest income registering constant increase, which is an indicator for the continuation of the initiated trend of strengthening of the credit support to the sector "households"[35].

The **interest expenditure** of the banks in 2004 equals Denar 2,310 million. In comparison with 2003, this category registered a decrease of Denar 315 million as a result of the decrease in all types of interest expenditures, with the most significant drop being registered in the interest expenditures of both, banks (30.2%) and others[36] (31.2%).The decrease in the interest expenditures of banks is due to the decrease in the amount of short-term borrowings from domestic and foreign banks, as well as to

[35] As of December 31, 2004, the households' loans registered an increase of 63.2% in comparison with December 31, 2003.
[36] This category encompasses the expenditures based on interest of the public sector, foreign entities, other clients.

the movement of the interest rates on the interbank Money Market, which in 2004 show a downward tendency[37].

From the aspect of the interest expenditures structure, the interest expenditures of the sector households preserve their dominance in the level of expenditures based on interest (38.6%). However, despite the decrease in the expenditures on this basis in comparison with 2003, the interest expenditures of households register an increase in their share in the total interest expenditures of the banks in 2004 (2.9 percentage points). Hence, besides the increase in the deposit potential of the banks, especially in the sector households, the downward trend in the interest expenditures commenced in the previous years, and which continued in 2004[38], influence on the decrease in the interest expenditures of the banking system of the Republic of Macedonia.

The increase in the interest income and the decrease in the interest expenditures as of December 31, 2004, enabled also an increase in the **net interest income** of Denar 1,074 million, or 42.3%. Positive movements in the profit and loss account of the banks in the Republic of Macedonia in 2004 were also registered with the **net provisions**, which amount to Denar 1,979 million, which is a decline of 15.2% compared to 2003. The decline in the provisions registered in 2004 is logical result of the decrease in the level of risk of the banks' credit portfolio.

The net interest income after provisioning, as income generated from the performance of the banks' basic function corrected by the anticipated credit risk, amounts to Denar 1,630 million on December 31, 2004. This amount registers the highest increase among the individual categories of the profit and loss account relative to the previous year (Denar 1,428 million, or 8 times), thus having a significant influence on the shown total positive financial result at the level of the entire banking system of the Republic of Macedonia.

Besides the interest income, the second component of the income originating from the regular operating of the banks is the **net income based on commissions**. In 2004, this income category amounts to Denar 2,268 million, which is an increase of Denar 341 million compared to 2003. The increase is a result of the higher volume of services provided by the banks in the area of domestic and international payment operations, their credit activity, foreign exchange operations, etc.

In 2004, the net income based on **dividends, securities, capital gains and exchange rate differentials** equaled Denar 652 million, which is an increase of 2 times in comparison with the previous year. The dividends and the net gains based on securities have minor share in this group of income and they mostly originate from the income generated by the group of large banks on this basis. Contrary to 2003 when the banks shown net capital loss, in 2004 capital gain in the amount of Denar 182 million was registered. This level of capital gain is only a result of the capital gain shown by the group of large banks, because the remaining two groups registered a net

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[37] In 2004, the interest rates on the interbank Money Market ranged from 5.59% to 8.63%, compared to 2003, when they reached the level of above 15%, annually.

[38] The weighted short-term Denar deposit interest rate (up to three months) in 2004 ranged from 6.72% in January to 6.25% in December 2004, while the average weighted deposit interest rate on the households' foreign currency deposits (up to three months) reduced from 2.11% to 1.93% during the respective period.

capital loss also in 2004. The highest share of the net exchange rate differentials in the amount of Denar 412 million accounts for this group of banks, while all groups of banks showed a net gain on this basis.

As aforementioned, the total income of the banks originating from their regular operating are not sufficient to cover the operational costs registered in 2004, because of which the profitability potential of the banks originates from the generated **other income** (income on other basis and extraordinary income), which are irregular. However, besides the stated positive movements with the interest income and the income based on commissions, the lower influence of the extraordinary income on the total financial result should be stressed as a positive trend. Thus this income which equals Denar 1,513 million in 2004 registered a decrease relative to 2003, because of which its share in the total income of the banks declined from 39.6% in 2003 to 22.4% in 2004.

The total amount of other expenditures **(general and administrative expenses and other expenditures)** of the banks in 2004 amounts to 5,326 million, with the dominant share of these expenditures of 89.7% accounting for the general and administrative expenses. Thus almost half of the total amount of other expenditures refers to expenditures based on paid wages. This category of expenditures registers an increase of 8%, or Denar 185 million compared to 2003, given the increase in the number of the employees of only 0.9% (40 persons) as of December 31, 2004 compared to the previous year. As a result of the increase of the expenditures based on wages (Denar 185 million), as well as to the increase in the costs of services (Denar 136 million), the total other expenditures in 2004 registered an increase of 10.5% compared to 2003.

As a result of such movements with the banks' income and expenditures, positive financial result was presented at the end of in 2004, which is by 2.8 times higher the result registered in 2003. It should be ascertained again the improved profitability of the banks primarily as a result of the positive trends with the income originating from the banks' regular operating in 2004. Also the possibilities for improving the profitable operating of the banks in the Republic of Macedonia should also be taken into consideration, since only 40% of the total financial potential of the banking system on December 31, 2004 is placed with non-financial entities. Such a distribution of the financial potential indicates the possibility of the banks to improve their profitable position through reallocation of the low interest assets and intensification of the credit activity towards the real sector and the households in the Republic of Macedonia.

2.3.6.2. Banks' Profitability and Efficiency Indicators

The positive trends of the main categories of the banks' aggregate profit and loss account as of December 31, 2004, reflected positively on the indicators for the banks' profitability.

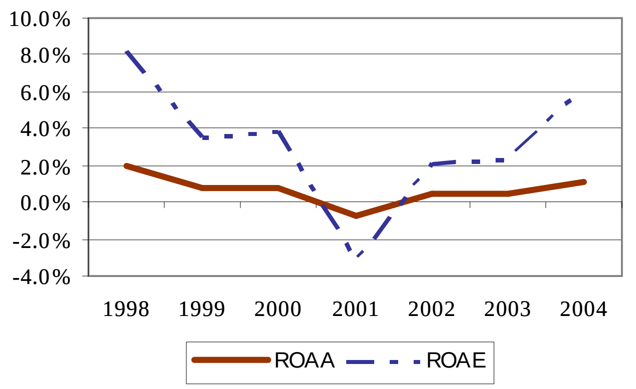
Table 16
Indicators for the banks' efficiency and profitability

Indicator	*2002*	*2002**	*2003*	*2003**	*2004*	*2004**
Rate of return on average assets (ROAA)	0.4%	1.5%	0.5%	1.7%	1.1%	1.9%
Rate on return on average equity (ROAE)	2.1%	6.9%	2.3%	8.9%	6.2%	11.4%
Operational costs / total income	91.0%	76.0%	90.0%	74.0%	78.8%	67.3%
Wage expenses / total income	40.0%	33.0%	43.0%	36.0%	36.8%	31.9%
Loan loss provisions / net interest income	74.0%	55.0%	92.0%	56.0%	54.8%	41.1%
Net interest income / operational costs	48.0%	72.0%	53.0%	60.0%	67.8%	73.7%
Number of employees	4,569	2,781	4,595	3,908	4,635	3,804
Financial result / number of employees (in millions of Denars)	0.09	0.35	0.10	0.36	0.27	0.53
Total assets / number of employees (in millions of Denars)	20.40	23.40	22.80	25.20	25.46	28.96

* The indicators only refer to the banks that registered positive financial result

As a result of the net income as of December 31, 2004, the rate of return on average assets and the rate of return on average equity registered positive values (1.1% and 6.2%, respectively). Such values indicate that 100 units of assets of the banks in the Republic of Macedonia generate 1.1 unit of profit, i.e. 100 units of equity generate 6.2 units of profit. The registered rates of return on assets and equity significantly improved in comparison with the previous five years, with their value approaching to the values registered in 1998, when the ROAA and the ROAE equaled 2% and 8.2%, respectively[39]. The improvement is especially evident if during the analysis only the banks that shown positive financial result at the end of 2004 are taken into consideration, with the rates of return on both, average assets and average equity being equal to 1.9% and 11.4%, respectively.

Figure 32
Movements of the indicators ROAA and ROAE



The analysis of the indicators for the level of profitability by individual banks points to an existence of positive trends with both, the group of large and medium-size banks, while the largest portion of the profitability indicators registered at the level of small-size banks evidenced a downwards tendency compared to the previous year (Table 17). Thus all profitability indicators of the banks comprising the group of large banks register an improvement on December 31, 2004, in comparison with December 31, 2003, and only two indicators with the group of medium-size-banks deteriorated. The ROAA and the ROAE are the highest with the group of large banks, with the difference being especially high with the ROAE. The reason for such a difference is the high share of the group of large banks in the total financial result presented on December 31, 2004, given the lower relative share of the capital in the sources of financing with this group of banks in comparison with the other two groups of banks.

[39] The high amount of the rates of return on assets and equity in 1998 is primarily a result of the high level of lending interest rates.

The correlation among separate cost categories (operational costs and wage expenses) and the total income registered in 2004 are of special importance for the level of profitability and efficiency of the banks in the Republic of Macedonia. Both indicators register a decrease, not only at the level of the banking system, but by individual groups of banks, as well, with exception to the group of small-size banks.

The improvement in the quality of the credit portfolio is a reason for the favorable trend of the indicator for the provisioning relative to the net interest income, which is reduced by 37.2 percentage points, i.e. 19.2 percentage points in 2003 relative to 2002.

Positive movements can be ascertained also with the indicator for the correlation between the net interest income and the operational costs. Namely, although the net interest income from conducting regular banking operations is not sufficient for covering the operational costs, this indicator registers a significant improvement compared to 2003 (14.8 percentage points). Observed by separate groups of banks, this indicator registers the largest improvement in the group of large banks (27.2 percentage points), while the coverage of the operational costs with the net interest income is the lowest with the group of small-size banks (49.8%). The group of medium-size banks registers almost complete coverage of the operational costs with the net interest income (94.3%), although this indicator worsened by 1.7 percentage points compared to 2003.

Table 17

Indicators for the profitability and the efficiency by group of banks

Indicator	*Large banks*		*Medium-size banks*		*Small-size banks*	
	2003	*2004*	*2003*	*2004*	*2003*	*2004*
Rate of return on average assets (ROAA)	0.4%	1.4%	0.5%	1.3%	0.6%	-0.7%
Rate on return on average equity (ROAE)	3.5%	11.9%	2.0%	4.9%	1.3%	-1.8%
Operational costs / total income	91.0%	74.5%	87.0%	75.0%	91.0%	104.7%
Wage expenses / total income	45.0%	34.6%	41.0%	36.2%	41.0%	47.8%
Loan loss provisions / net interest income	81.0%	59.6%	77.0%	31.8%	155.0%	83.6%
Net interest income / operational costs	37.0%	64.2%	96.0%	94.3%	42.0%	49.8%
Number of employees	2,522	2,684	1,078	1,136	995	815
Financial result / number of employees (in millions of Denars)	0.09	0.38	0.12	0.27	0.09	-0.11
Total assets / number of employees (in millions of Denars)	23.1	29.38	27.3	22.84	17.3	16.17

The profit registered in 2004 has positive influence also on the indicators for the productivity of the banking system. Thus in 2004, one employee in the banking system generates profit of Denar 0.27 million, with the employees in the group of large banks registering the highest profit of Denar 0.38 million per employee. This group of banks registers also the highest increase in the profit per employee of Denar 0.29 million, which is almost a double increase than the profit registered at the level of the entire banking system. As a result of the negative financial result shown by the group of small-size banks, this correlation has a negative value with this group, and it deteriorated in comparison with 2003.

Also the indicator for the correlation between the total assets and the number of employees in the banking system in the Republic of Macedonia in 2004 improved in comparison with 2003. However, the fact that the improvement of this indicator is only a result of the improved productivity of the group of small-size banks, with one employee in this group generating assets higher than Denar 6.3 million in 2004 compared to 2003, should be especially emphasized. The reason for such a situation is the higher increase in the total number of employees with this group of large banks (12.4%) relative to the increase in the total number of employees with this group of banks (6.4%). The remaining two groups of banks register a deteriorated productivity measured through the total net assets / number of employees correlation.

ANNEX

Annex 1

BALANCE SHEET OF THE BANKS IN THE REPUBLIC OF MACEDONIA

in millions of Denars

ASSETS	31.12.2004		31.12.2003	
	Amount	%	Amount	%
CASH AND BALANCE WITH NBRM	5,100	4.3%	5,625	5.4%
Cash in Denars	3,641	71.4%	4,097	72.8%
Cash in foreign currency	1,455	28.5%	1,523	27.1%
Precious metals and other kind of cash	4	0.1%	5	0.1%
CB BILLS	4,465	3.8%	3,975	3.8%
DEBT SECURITIES	1,653	1.4%	995	0.9%
Checks and bills of exchange	131	7.9%	159	16.0%
Denar Government securities	958	57.9%	817	82.1%
Other debt securities	565	34.2%	19	1.9%
PLACEMENTS TO OTHER BANKS	40,331	34.2%	37,301	35.6%
Accounts with domestic banks	3,824	9.5%	3,383	9.1%
Accounts with foreign banks	35,043	86.9%	30,994	83.1%
Short-term loans and other claims on domestic banks and other financial institutions	382	0.9%	1,362	3.7%
Short-term loans and other claims on foreign banks and other financial institutions	35	0.1%	339	0.9%
Past due loans and other claims on banks	0	0.0%	46	0.1%
Long-term loans and other claims on domestic banks and other financial institutions	164	0.4%	182	0.5%
Long-term loans and other claims on foreign banks and other financial institutions	579	1.4%	722	1.9%
Non-performing loans on banks	303	0.0%	274	0.7%
PLACEMENTS TO CLIENTS	48,076	40.7%	37,111	35.4%
Enterprises	32,635	67.9%	26,123	70.4%
Other clients	716	1.5%	213	0.6%
Households	14,290	29.7%	8,725	23.5%
Non-performing loans on clients	9,727	20.2%	10,126	27.3%
Special reserve for loans	-9,292	-19.3%	-8,075	-21.8%
ACCRUED INTEREST AND OTHER ASSETS	5,583	4.7%	6,061	5.8%
Interest claims	524	9.4%	487	8.0%
Suspended interest and other claims	4,815	86.2%	4,101	67.7%
Interest special reserve	-4,845	-86.8%	-4,140	-68.3%
Other claims	291	5.2%	1,127	18.6%
Foreclosures	4,800	86.0%	4,430	73.1%
Net commission relations	-129	-2.3%	-91	-1.5%
Net internal relations	-2	0.0%	-3	0.0%
Other assets	129	2.3%	149	2.5%
SECURITIES INVESTMENTS	6,889	5.8%	7,355	7.0%
Securities in foreign currency available for sale	250	3.6%	195	2.7%
Securities in foreign currency held up to maturity	5,502	79.9%	5,889	80.1%
Equity investments in domestic currency	1,136	16.5%	1,233	16.8%
Special reserve for repurchase of owned shares	0	0.0%	38	0.5%
FIXED ASSETS	6,523	5.5%	6,453	6.2%
Buildings	4,987	76.4%	4,726	73.2%
Equipment	3,414	52.3%	3,128	48.5%
Intangible investments	407	6.2%	383	5.9%
Other means of operation	93	1.4%	164	2.5%
Means of operation in preparation	720	11.0%	668	10.4%
Correction of value of fixed assets	-3,098	-47.5%	-2,616	-40.5%
UNALLOCATED LOAN LOSS PROVISIONS	-634	-0.5%	0	0.0%
TOTAL ASSETS	117,985	100%	104,875	100%
OFF-BALANCE SHEET ASSETS	12,073		11,479	

Annex 1

BALANCE SHEET OF THE BANKS IN THE REPUBLIC OF MACEDONIA

in millions of Denars

LIABILITIES	31.12.2004		31.12.2003	
	Amount	%	Amount	%
BANK DEPOSITS	**1,537**	**1.3%**	**2,195**	**2.1%**
Denar sight deposits	42	2.7%	47	2.2%
Sight deposits in foreign currency of domestic banks	217	14.1%	272	12.4%
Sight deposits in foreign currency of foreign banks	456	29.7%	287	13.1%
Short-term time deposits in Denars	570	37.1%	979	44.6%
Short-term time deposits in foreign currency	120	7.8%	476	21.7%
Long-term time deposits in Denars	127	8.3%	123	5.6%
Long-term time deposits in foreign currency	3	0.2%	10	0.5%
SIGHT DEPOSITS	**43,856**	**37.2%**	**42,947**	**41.0%**
Sight deposits in Denars of enterprises	9,016	20.6%	8,527	19.9%
Sight deposits in Denars of the public sector	744	1.7%	1,461	3.4%
Sight deposits in Denars of other customers	1,514	3.5%	1,708	4.0%
Sight deposits in Denars of households	7,450	17.0%	7,093	16.5%
Restricted deposits in Denars	478	1.1%	558	1.3%
Sight deposits in foreign currency of legal entities	6,700	15.3%	7,019	16.3%
Sight deposits in foreign currency of households	17,393	39.7%	16,119	37.5%
Restricted deposits in foreign currency	561	1.3%	462	1.1%
SHORT-TERM DEPOSITS UP TO ONE YEAR	**35,025**	**29.7%**	**23,836**	**22.7%**
Short-term deposits in Denars of enterprises	9,637	27.5%	6,724	28.2%
Short-term deposits in Denars of public sector	702	2.0%	535	2.2%
Short-term deposits in Denars of other customers	472	1.3%	433	1.8%
Short-term deposits in Denars of households	5,278	15.1%	3,583	15.0%
Short-term deposits in foreign currency of legal entities	4,089	11.7%	1,481	6.2%
Short-term deposits in foreign currency of other customers	318	0.9%	181	0.8%
Short-term deposits in foreign currency of households	14,530	41.5%	10,899	45.7%
SHORT-TERM BORROWINGS UP TO ONE YEAR AND ISSUED DEBT SECURITIES	**845**	**0.7%**	**1,872**	**1.8%**
Short-term borrowings of NBRM	0	0.0%	0	0.0%
Short-term borrowings in Denars of domestic banks	271	32.1%	987	52.7%
Short-term borrowings in foreign currency of domestic banks	0	0.0%	0	0.0%
Short term borrowings of foreign banks	574	67.9%	884	47.2%
OTHER LIABILITIES	**3,868**	**3.3%**	**3,083**	**2.9%**
Payable interest	253	6.6%	171	5.5%
Other liabilities in Denars	2,856	73.9%	2,416	78.4%
Other liabilities in foreign currency	578	15.0%	341	11.1%
Other deferred credits	180	4.6%	156	5.1%
LONG-TERM DEPOSITS OVER ONE YEAR	**3,403**	**2.9%**	**3,405**	**3.2%**
Long-term deposits in Denars of enterprises	409	12.0%	231	6.8%
Long-term deposits in Denars of public sector	99	2.9%	156	4.6%
Long-term deposits in Denars of other customers	31	0.9%	112	3.3%
Long-term deposits in Denars of households	1,718	50.5%	2,083	61.2%
Long-term deposits of other customers	8	0.2%	9	0.3%
Long-term deposits in foreign currency of households	1,137	33.4%	815	23.9%
LONG-TERM BORROWINGS OVER ONE YEAR	**8,819**	**7.5%**	**6,920**	**6.6%**
Long-term borrowings of NBRM	1,016	11.5%	373	5.4%
Long-term borrowings in Denars of domestic banks	166	1.9%	132	1.9%
Long-term borrowings in foreign currency of domestic banks	538	6.1%	69	1.0%
Long-term borrowings of foreign banks	6,177	70.0%	5,434	78.5%
Long-term borrowings of other customers	923	10.5%	912	13.2%
Long-term borrowings of non-financial legal entities	0	0.0%	0	0.0%
PROVISIONS FOR OFF-BALANCE SHEET ITEMS	**610**	**0.5%**	**542**	**0.5%**
OWNED FUNDS	**20,023**	**17.0%**	**20,075**	**19.1%**
Equity capital	19,237	96.1%	18,445	91.9%
Reserve fund	2,714	13.6%	2,674	13.3%
Revaluation reserves	52	0.3%	51	0.3%
Unallocated profit from previous years	148	0.7%	422	2.1%
Other funds	1	0.0%	1	0.0%
Loss	-1,497	-7.5%	-1,518	-7.6%
Unallocated loan loss provisions	-634	-3.2%	0	0.0%
TOTAL LIABILITIES	**117,985**	**100.0%**	**104,875**	**100.0%**

Annex 2

INCOME STATEMENT

in millions of denars

INCOME STATEMENT	31.12.2004		31.12.2003	
INTEREST INCOME	***5,920***	***100.0%***	***5,161***	***100.0%***
banks	832	14.1%	880	17.0%
enterprises	2,924	49.4%	2,999	58.1%
households	1,662	28.1%	1,088	21.1%
others	717	12.1%	675	13.1%
cancelled income	-215	-3.6%	-481	-9.3%
INTEREST EXPENDITURE	***-2,310***	***100.0%***	***-2,625***	***100.0%***
banks	-373	16.1%	-534	20.3%
enterprises	-551	23.8%	-560	21.3%
households	-891	38.6%	-936	35.7%
others	-189	8.2%	-275	10.5%
insurance premium	-306	13.3%	-320	12.2%
NET INTEREST INCOME	***3,609***	***100.0%***	***2,536***	***100.0%***
NET PROVISIONS	***-1,979***	***100.0%***	***-2,334***	***100.0%***
Provisions	-2,813	142.1%	-3,298	141.3%
Provisions recovery	834	-42.1%	964	-41.3%
NET INTEREST INCOME AFTER PROVISIONING	***1,630***	***100.0%***	***202***	***100.0%***
NET FEES AND COMMISSION INCOME	***2,268***	***100.0%***	***1,927***	***100.0%***
Fees and commission income	2,627	115.8%	2,234	115.9%
Fees and commission expenses	-359	-15.8%	-307	-15.9%
DIVIDENDS	***28***	***100.0%***	***80***	***100.0%***
NET INCOME FROM SECURITIES	***30***	***100.0%***	***5***	***100.0%***
NET CAPITAL INCOME	***182***	***100.0%***	***-38***	***100.0%***
NET FOREIGN EXCHANGE DIFFERENTIALS	***412***	***100.0%***	***274***	***100.0%***
OTHER INCOME	***2,209***	***100.0%***	***2,902***	***100.0%***
Other income	696	31.5%	766	26.4%
Extraordinary income	1,513	68.5%	2,136	73.6%
GENERAL AND ADMINISTRATIVE EXPENSES	***-4,776***	***100.0%***	***-4,281***	***100.0%***
Salary	-2,487	52.1%	-2,302	53.8%
Depreciation	-736	15.4%	-637	14.9%
Material expenses	-348	7.3%	-336	7.9%
Services	-926	19.4%	-790	18.5%
Business trip expenses	-59	1.2%	-49	1.1%
Representation expenses	-219	4.6%	-167	3.9%
OTHER EXPENSES	***-550***	***100.0%***	***-539***	***100.0%***
Other expenses	-525	95.5%	-507	94.0%
Extraordinary expenses	-25	4.5%	-33	6.0%
GROSS INCOME	***1,433***		***531***	
INCOME TAX	***186***		***83***	
NET INCOME AFTER TAXATION	***1,247***		***448***	

Annex 3

Off-balance Activities

in millions of denars

	31.01.2004	29.02.2004	31.03.2004	30.04.2004	31.05.2004	30.06.2004	31.07.2004	31.08.2004	30.09.2004	31.10.2004	30.11.2004	31.12.2004	31.12.2003-31.12.2004
A. Off-balance sheet assets at the end of the preceding month	**11,446**	**11,644**	**11,688**	**11,216**	**11,671**	**11,614**	**11,640**	**11,655**	**11,573**	**11,255**	**11,457**	**11,384**	**11,644**
1. Covered	1,204	1,096	944	951	944	918	942	1,130	945	914	1,055	1,143	1,204
2.Uncovered	10,242	10,548	10,744	10,265	10,727	10,696	10,698	10,525	10,628	10,341	10,402	10,241	10,242
B. Newly extended off-balance sheet items	**1,646**	**1,502**	**1,382**	**1,818**	**1,247**	**1,169**	**1,910**	**1,618**	**1,446**	**2,403**	**1,994**	**2,306**	**20,441**
1. Covered	278	205	229	230	201	320	257	304	204	458	441	361	3,488
2.Uncovered	1,368	1,297	1,153	1,588	1,046	849	1,654	1,314	1,242	1,945	1,553	1,946	16,954
C. Closed off-balance sheet items in the current month C=A+B-D-F	**1,430**	**1,427**	**1,749**	**1,250**	**1,267**	**1,099**	**1,815**	**1,683**	**1,732**	**2,184**	**2,038**	**2,067**	**19,938**
D. Off-balance sheet items at the end of the current month	**11,644**	**11,688**	**11,216**	**11,671**	**11,614**	**11,640**	**11,655**	**11,573**	**11,255**	**11,457**	**11,384**	**11,592**	**11,592**
1. Covered	1,096	944	951	944	918	942	1,130	945	914	1,055	1,143	1,085	1,085
2.Uncovered	10,548	10,744	10,265	10,727	10,696	10,698	10,525	10,628	10,341	10,402	10,241	10,507	10,507
E. Off-balance sheet items at the expense of the bank, as of the end of the preceding month	**2,855**	**2,855**	**2,871**	**2,959**	**3,063**	**3,044**	**3,051**	**3,118**	**3,107**	**3,128**	**3,115**	**3,117**	**2,855**
F. Off-balance sheet items at the expense of the bank in the current month	18	31	105	113	37	44	81	17	32	17	29	31	556
G. Collected off-balance sheet items at the expense of the bank in the current month	4	9	13	8	22	24	13	7	4	15	23	30	172
H. Collected off-balance sheet items at the expense of the bank in the previous periods	14	6	4	1	34	13	1	21	7	16	4	12	132
I. Off-balance sheet items at the expense of the bank, as of the end of the current month I=(E+F)-(G+H)	**2,855**	**2,871**	**2,959**	**3,063**	**3,044**	**3,051**	**3,118**	**3,107**	**3,128**	**3,115**	**3,117**	**3,106**	**3,106**

Annex 4

INDICATORS FOR THE CREDIT PORTFOLIO QUALITY

in millions of denars

Items	31.12.1999	31.12.2000	31.12.2001	31.12.2001*	31.12.2002	31.12.2002*	31.12.2003	31.12.2004
A	21,617	21,530	23,303	23,303	67,337	67,337	77,686	91,394
B	8,083	11,432	11,844	11,844	11,018	11,018	10,871	12,025
C	8,218	6,121	7,891	7,891	6,269	6,269	4,602	4,826
D	9,175	7,122	7,740	7,740	6,497	6,497	5,735	4,191
E	3,541	4,372	2,260	6,095	2,094	7,440	5,413	6,744
Total credit exposure	**50,634**	**50,576**	**53,040**	**56,875**	**93,214**	**98,560**	**104,306**	**119,179**
Potential losses	**11,424**	**10,842**	**9,609**	**13,444**	**8,166**	**13,512**	**10,719**	**11,591**
total C, D, E	**20,934**	**17,615**	**17,892**	**21,727**	**14,860**	**20,206**	**15,749**	**15,761**
total D, E	**12,716**	**11,494**	**10,001**	**13,836**	**8,591**	**13,937**	**11,148**	**10,935**
total C, D	**17,393**	**13,243**	**15,632**	**15,632**	**12,766**	**12,766**	**10,336**	**9,017**
% of C, D, E in total credit exposure	**41.34**	**34.83**	**33.73**	**38.20**	**15.94**	**20.50**	**15.10**	**13.22**
% of D, E in total credit exposure	**25.11**	**22.73**	**18.85**	**24.33**	**9.22**	**14.14**	**10.69**	**9.18**
% of C, D in total credit exposure	**34.35**	**26.18**	**29.47**	**27.48**	**13.70**	**12.95**	**9.91**	**7.57**
% of D in total credit exposure	**18.12**	**14.08**	**14.59**	**13.61**	**6.97**	**6.59**	**5.50**	**3.52**
% of E in total credit exposure	**6.99**	**8.64**	**4.26**	**10.72**	**2.25**	**7.55**	**5.19**	**5.66**
% of C in total credit exposure	**16.23**	**12.10**	**14.88**	**13.87**	**6.73**	**6.36**	**4.41**	**4.05**
% of risk (potential loss / total exposure)	**22.56**	**21.44**	**18.10**	**23.64**	**8.76**	**13.71**	**10.28**	**9.73**
Net items in C, D, E (less the respective provisions)	**10,751**	**8,152**	**9,789**	**9,789**	**7,950**	**7,950**	**6,318**	**5,715**
Guarantee capital	**14,404**	**18,708**	**18,699**	**18,699**	**19,122**	**19,122**	**19,441**	**19,397**
% of C, D, E in guarantee capital	**145.34**	**94.15**	**95.68**	**116.19**	**77.71**	**105.67**	**81.01**	**81.25**
% of D, E in guarantee capital	**88.28**	**61.44**	**53.48**	**73.99**	**44.93**	**72.88**	**57.34**	**56.37**
% of C, D in guarantee capital	**120.75**	**70.79**	**83.60**	**83.60**	**66.76**	**66.76**	**53.17**	**46.49**
% of D in guarantee capital	**63.70**	**38.07**	**41.39**	**41.39**	**33.98**	**33.98**	**29.50**	**21.61**
% of E in guarantee capital	**24.59**	**23.37**	**12.09**	**32.60**	**10.95**	**38.91**	**27.84**	**34.77**
% of C in guarantee capital	**57.05**	**32.72**	**42.20**	**42.20**	**32.79**	**32.79**	**23.67**	**24.88**
% of net C, D, E in guarantee capital	**74.64**	**43.57**	**52.35**	**52.35**	**41.58**	**41.58**	**32.50**	**29.46**
Capital adequacy	**28.70**	**36.73**	**35.26**	**35.26**	**28.10**	**28.10**	**25.80**	**23.03**
Total exposure to country risk (net)					**29,438**		**31,195**	**35,278**
Potential losses for country risk					**8**		**12**	**13**
% of potential losses for country risk / total exposure to country risk					**0.03**		**0.04**	**0.04**

* indicators for the credit portfolio quality including the recorded non-performing loans in the off-balance sheet records

Annex 5

CONTRACTUAL MATURITY STRUCTURE OF THE ASSETS AND THE LIABILITIES
as of December 31, 2004

in millions of denars

Ref.no.	Description	up to 7 days	from 7 days to 1 month	from 1 month to 3 month	3 - 6 months	6 - 12 months	over 12 months	Total
1	2	3	4	5	6	7	8	9
	Assets							
1	Cash and balances with the NBRM	4,646	5	6	2	0	3,977	**8,637**
2	Securities of the NBRM and the Republic of Macedonia	2,184	2,562	378	206	310	5,813	**11,453**
3	Debt securities and other payment instruments	68	51	20	10	3	102	**255**
4	Placements with other banks	17,332	16,582	792	202	616	1,273	**36,797**
5	Placements with clients	2,722	2,388	5,707	6,986	12,092	26,990	**56,885**
6	Accrued interest	308	90	65	6	0	4,904	**5,373**
7	Other assets	958	393	50	88	164	332	**1,986**
8	Placements in equity securities and capital investments	0	0	0	6	43	1,291	**1,340**
9	**Total assets (1+2+3+4+5+6+7+8)**	**28,217**	**22,072**	**7,019**	**7,507**	**13,228**	**44,683**	**122,726**
	Liabilities							
10	Banks' deposits	819	306	234	68	41	132	**1,600**
11	Sight deposits	42,892	586	43	71	73	169	**43,833**
12	Short-term deposits with maturity of up to 1 year	2,990	12,941	12,113	3,686	3,286	89	**35,105**
13	Short-term borrowings with maturity of up to 1 year	57	79	21	354	333	0	**845**
14	Issued debt securities	0	0	0	0	0	0	**0**
15	Other liabilities	949	626	111	5	29	39	**1,759**
16	Long-term deposits with maturity of over 1 year	105	382	177	254	545	1,985	**3,448**
17	Long-term borrowings with maturity of over 1 year	2	174	160	333	800	7,101	**8,571**
18	Off-balance sheet items	519	585	572	1,027	1,516	672	**4,892**
19	**Total liabilities (10+11+12+13+14+15+16+17+18)**	**48,334**	**15,679**	**13,430**	**5,799**	**6,623**	**10,188**	**100,054**
20	**Difference (9-19)**	**-20,118**	**6,392**	**-6,411**	**1,708**	**6,605**	**34,495**	**22,672**
21	**Accumulation of the difference**	**-20,118**	**-13,725**	**-20,136**	**-18,428**	**-11,824**	**22,672**	

Annex 5/a

EXPECTED MATURITY STRUCTURE OF THE ASSETS AND THE LIABILITIES
as of December 31, 2004

in millions of denars

Ref. No.	Description	up to 7 days	from 7 days to 1 month	from 1 month to 3 month	TOTAL
1	2	3	4	5	6
	Assets				
1	Cash and balances with the NBRM	4,587	5	6	4,598
2	Securities of the NBRM and the Republic of Macedonia	2,204	2,662	445	5,311
3	Debt securities and other payment instruments	67	50	21	138
4	Placements with other banks	16,852	16,960	798	34,611
5	Placements with clients	2,085	2,399	4,347	8,831
6	Accrued interest	245	129	148	523
7	Other assets	452	158	65	675
8	Placements in equity securities and capital investments	0	0	0	0
9	**Total assets (1+2+3+4+5+6+7+8)**	**26,494**	**22,364**	**5,830**	**54,687**
	Liabilities				
10	Banks' deposits	575	355	167	1,096
11	Sight deposits	10,638	1,657	325	12,620
12	Short-term deposits with maturity of up to 1 year	1,549	6,495	6,996	15,041
13	Short-term borrowings with maturity of up to 1 year	30	79	21	130
14	Issued debt securities	0	0	0	0
15	Other liabilities	722	637	115	1,474
16	Long-term deposits with maturity of over 1 year	70	57	125	252
17	Long-term borrowings with maturity of over 1 year	4	172	160	336
18	Off-balance sheet items	115	133	168	416
19	**Total liabilities (10+11+12+13+14+15+16+17+18)**	**13,704**	**9,585**	**8,077**	**31,365**
20	**Difference (9-19)**	**12,790**	**12,779**	**-2,247**	**23,322**
21	**Accumulation of the difference**	**12,790**	**25,569**	**23,322**	

Annex 6

CONCLUDED CREDIT OPERATIONS IN FOREIGN CURRENCY WITH RESIDENTS
as of December 31, 2004

in millions of denars

Ref. No.	DESCRIPTION	Regular loans	Regular interest	Non-performing loans	Non-accrual interest	Other claims	Total
1	2	3	4	5	6	7	8=(3+4+5+6+7)
1	Balance of credit operations in foreign currency at the end of the previous month - initial balance	9,274	41	522	209	1	10,048
2	Concluded credit operations in foreign currency in the current month	1,966	76	0	9	3	2,054
3	Collected credit operations in foreign currency in the current month	539	81	7	1	3	631
4	Transferred credit operations in foreign currency from regular to non-performing loans and vice versa	-9	0	12	0	0	3
5	Written off credit operations in foreign currency	0	0	0	10	0	10
6	Exchange rate differential 6=7-(1+2+4-3-5)	-100	8	-5	-1	0	-98
7	Balance of credit operations in foreign currency at the end of the month	10,592	44	522	206	1	11,365

Annex 7

Guarantee capital of the banks in the Republic of Macedonia
as of December 31, 2004

in millions of denars

No.	Description	Total
A	**CORE CAPITAL**	
1	Issued common and preference shares or paid-in funds	18,792
2	Reserves	2,714
3	Retained undistributed income	148
4	Income according to interim financial statement discounted by 50%	0
5	Uncovered loss from previous years	-1,497
6	Current loss	0
7	Goodwill	0
8	**CORE CAPITAL**	**20,157**
B	**ADDITIONAL CAPITAL**	
9	Issued cumulative preference shares	446
10	Revaluation reserves	52
11	Hybrid capital instruments	0
12	Subordinated debts	0
13	**TOTAL ADDITIONAL CAPITAL**	**498**
14	Additional capital included in the guarantee capital	**498**
C	**GUARANTEE CAPITAL**	
15	**Gross guarantee capital**	**20,655**
16	Capital investments in banking and non-banking financial institutions	-624
17	Unallocated special loan loss provisions and country risk losses	-634
17.1	Unallocated non-accrual interest	-18
17.2	Unallocated special potential loss reserves	-616
	GUARANTEE CAPITAL	**19,397**

Annex 8

Legal framework of the banking supervision

Laws:

1. Law on the National Bank of the Republic of Macedonia ("Official Gazette of the Republic of Macedonia" no. 3/2002, 51/2003, 85/2003 and 40/2004);
2. Banking Law ("Official Gazette of the Republic of Macedonia" no. 63/2000, 37/2002, 51/2003 and 85/2003);
3. Law on Establishment of Macedonian Bank for Development and Promotion ("Official Gazette of the Republic of Macedonia" no. 24/98 and 6/2002)
4. Law on Microfinancing Banks ("Official Gazette of the Republic of Macedonia" no. 61/2002).

Decisions:

1. Decision on the documentation necessary for granting approvals and submitting notification on the change in the ownership structure of the voting share ("Official Gazette of RM" no. 85/2004);
2. Decision on the documentation necessary for granting licenses according to the provisions of the Banking Law, the Law on Securities and the Law on Microfinancing Banks ("Official Gazette of the Republic of Macedonia" no. 68/2003 - revised text);
3. Decision on the supervisory standards for regulating the banks and the savings houses' past due claims ("Official Gazette of the Republic of Macedonia" no. 19/2003);
4. Decision on determining the methodology for classification of the on-balance and off-balance sheet asset items of banks according to the their risk level ("Official Gazette of the Republic of Macedonia" no. 21/2002 - revised text);
5. Decision on the methodology for determining risk weighted assets of the banks ("Official Gazette of the Republic of Macedonia" no. 50/2001);
6. Decision on the amount and the method of establishing special reserves for coverage of the banks’ potential losses ("Official Gazette of the Republic of Macedonia" no. 50/2001);
7. Decision on issuing authorizations to the banks for performing international payment operations and international credit activities and authorization for performing foreign currency operations in the Republic of Macedonia (“Official Gazette of the Republic of Macedonia” no. 65/96, 16/2001 and 85/2001);
8. Decision on the manner of conducting surveillance of the application of the regulations governing the foreign exchange and the Denar operations and undertaking measures against banks (“Official Gazette of the Republic of Macedonia” no. 44/02 and 80/02);
9. Decision on the manner of conducting supervision on banks and procedure for eliminating the identified irregularities ("Official Gazette of the Republic of Macedonia" no.111/2000);
10. Decision on the dynamics of adjusting the amount of the initial capital of the savings houses in compliance with the provisions of the Law on Banks and Savings Houses (“Official Gazette of the Republic of Macedonia” no. 49/98);

11. Decision on the methodology for determining the bank guarantee capital ("Official Gazette of the Republic of Macedonia" no. 77/2000);
12. Decision on determining and calculating the banks' open foreign exchange positions ("Official Gazette of the Republic of Macedonia" no. 103/2001 - revised text);
13. Decision on determining the scope and the manner of operating the savings houses ("Official Gazette of the Republic of Macedonia" no. 111/2000, 80/2002 and 66/2003);
14. Decision on defining and the method of determining related persons according to the provisions of the Banking Law ("Official Gazette of the Republic of Macedonia" no. 28/2001);
15. Decision on the methodology for determining the banks' net debtors ("Official Gazette of the Republic of Macedonia" no. 28/2001);
16. Decision on the methodology for determining the banks' capital ("Official Gazette of the Republic of Macedonia" no. 66/2003);
17. Decision on the terms and the manner of concluding foreign exchange credit operations between residents ("Official Gazette of the Republic of Macedonia" no. 66/2003);
18. Decision on defining the standards for ensuring the banks' information security ("Official Gazette of the Republic of Macedonia" no. 77/2003);
19. Decision on consolidated supervision of banks ("Official Gazette of the Republic of Macedonia" no. 84/2003);
20. Decision on identifying, assessing and managing the banks' liquidity risk ("Official Gazette of the Republic of Macedonia" no. 84/2003);
21. Decision on the credit exposure limits of bank ("Official Gazette of RM" no. 1/2004 - revised text);
22. Decision on the contents and the manner of functioning of credit registry ("Official Gazette of RM", no. 61/2004).

Annex 9

Review of banks by group of banks
as of December 31, 2004

Group of large banks	Group of medium-size banks	Group of small-size banks
1. Komercijalna Banka AD Skopje	1. Alpha Banka AD Skopje	1. Eurostandard Banka AD Skopje
2. Stopanska Banka AD Skopje	2. Export and Credit Bank AD Skopje	2. Internacionalna Privatna Banka AD Skopje
3. Tutunska Banka AD Skopje	3. Investbanka AD Skopje	3. Komercijalno investiciona Banka AD Kumanovo
	4. Makedonska Banka AD Skopje	4. Postenska Banka AD Skopje
	5. Macedonian Bank for Development Promotion AD Skopje	5. Radobank AD Skopje
	6. Ohridska Banka AD Ohrid	6. Silex Banka AD Skopje
	7. ProCredit Banka AD Skopje	7. Teteks Kreditna banka AD Skopje
	8. Stopanska Banka AD Bitola	8. Tetovska banka AD Tetovo
		9. T.X. Ziraat Bankasi, subsidiary Skopje
		10. Univerzalna Investiciona Banka AD Skopje

Annex 10

Banks and savings houses in the Republic of Macedonia
as of December 31, 2004

I. BANKS

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

Alfa banka a.d. Skopje
Dame Gruev 1
1000 Skopje
tel ++ 389 2 3116 433
fax ++ 389 2 116 830; 2 3135 206

UNI banka a.d.Skopje
Maksim Gorki 6
1000 Skopje
tel ++ 389 2 3286 100
fax ++ 389 2 368 000

Eurostandard banka a.d. Skopje
ul. Vasil Glavinov br.12, kat 2 TCC Plaza
1000 Skopje
tel ++ 389 2 3228 444
fax ++ 389 2 3224 095

Investbanka a.d.Skopje
Makedonija 9/11
1000 Skopje
tel ++ 389 2 3114 166
fax ++ 389 2 3135 367

Izvozna i kreditna banka a.d.Skopje
bul. Partizanski Odredi br. 3, blok 11
1000 Skopje
tel ++ 389 2 3122 207
fax ++ 389 2 3122 393

Komercijalna banka a.d.Skopje
Dimitar Vlahov 4
1000 Skopje
tel ++ 389 2 3107 107; 2 3111 133
fax ++ 389 2 3113 494

Makedonska banka a.d. Skopje
Bul. VMRO 3-12/2
1000 Skopje
tel ++ 389 2 3117 111
fax ++ 389 2 3117 191

Ohridska banka a.d. Ohrid
Makedonski prosvetiteli 19
6000 Ohrid
tel ++ 389 46 206 600; 46 265 330
fax ++ 389 46 254 130; 46 254 133

ProKredit banka a.d. Ohrid
Marks i Engels 3,10/45
1000 Skopje
tel ++ 389 02 3219 900; 02 3219 948
fax ++ 389 02 3219 901

Radobank a.d. Skopje
Jurij Gagarin 17
1000 Skopje
tel ++ 389 2 3093 300
fax ++ 389 2 3080 453; 2 3093 217

Sileks banka a.d. Skopje
Gradski zid blok 9 lokal 5
1000 Skopje
tel ++ 389 2 3115 288; 2 3115 880; 2 3112 699
fax ++ 389 2 3114 891; 2 3224 844

Stopanska banka a.d. Bitola
Dobrivoe Radosavljevic 21
7000 Bitola
tel ++ 389 47 207 500
fax ++ 389 47 207 515; 47 207 541; 47 207 513

Stopanska banka a.d. Skopje
11 Oktomvri 7
1000 Skopje
tel ++ 389 2 3295 295
fax ++ 389 2 3114 503

Teteks - Kreditna banka a.d. Skopje
Naroden Front 19/a
1000 Skopje
tel ++ 389 2 3236 400
fax ++ 389 2 3131 419

Tetovska banka a.d. Tetovo
Marsal Tito 14
1200 Tetovo
tel ++ 389 44 335 280
fax ++ 389 44 335 274

Tutunska banka a.d. Skopje
12-ta Udarna brigada b.b.
1000 Skopje
tel ++ 389 2 3105 601; 2 3105 606; 02 3105 649
fax ++ 389 2 3105 630; 2 3105 681

T.X. Ziraat bankasi podruznica Skopje
Zeleznicka 8
1000 Skopje
tel ++ 389 2 3111 337
fax ++ 389 2 3110 013

Makedonska banka za poddrska na razvojot a.d. Skopje
3-ta Makedonska Brigada, b.b. 1000 Skopje
tel ++ 389 2 3114 840; 2 3115 844
fax ++ 389 2 3239 688

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

Komercijalno investiciona banka a.d. Kumanovo
Plostad Nova Jugoslavija bb
1300 Kumanovo
tel ++ 389 31 475 100; 31 426 455
fax ++ 389 31 420 061

Internacionalna Privatna Banka a.d. Skopje
27 Mart 1
1000 Skopje
tel ++ 389 2 3119 191; 2 3124 288
fax ++ 389 2 112 830; 2 3134 060

Postenska banka a.d. Skopje
Marks i Engels 3
1000 Skopje
tel ++ 389 2 3112 862; 2 3163 354
fax ++ 389 2 3220 389; 2 3163 054

II. SAVINGS HOUSES

AL KOSA a.d. Stip
Vanco Prke bb
2000 Stip
tel ++ 389 32 392 960
fax ++ 389 32 393 163

AM d.o.o. Skopje
ul. Luj Paster Palata Makedonija, lokal 6
1000 Skopje
tel ++ 389 2 3223 770
fax ++ 389 2 3223 770

Bavag d.o.o. Skopje
11 Oktomvri 23/1
1000 Skopje
tel ++ 389 2 3134 362
fax ++ 389 2 3135 328

Fersped d.o.o. Skopje
Veljko Vlahovic, 11
1000 Skopje
tel ++ 389 2 3149 325; 02 3149 336
fax ++ 389 2 3149 350

Graganska stedilnica d.o.o. Skopje
Dame Gruev 10
1000 Skopje
tel ++ 389 2 3118 585
faks ++ 389 2 3118 585

Inko d.o.o. Skopje
Dimitrija Cupovski 23
1000 Skopje
tel ++ 389 2 3114 182
fax ++ 389 2 3223 277

Interfalko d.o.o. Skopje
Bul. Partizanski odredi 123
1000 Skopje
tel ++ 389 2 3062 546
fax ++ 389 2 3062 546

Kiro Cucuk d.o.o. Veles
Car Samoil 1
1400 Veles
tel ++ 389 43 212 638; 043 212 639
fax ++ 389 43 232 637

Mak BS d.o.o. Skopje
Dame Gruev blok 2/3
1000 Skopje
tel ++ 389 2 3131 190
fax ++ 389 2 3166 466

Makedonska stedilnica a.d. Skopje
Kliment Ohridski 58 b
1000 Skopje
tel ++ 389 2 3121 370
fax ++ 389 2 3121 408

Malesevka a.d. Berovo
Marsal Tito 10/A
2330 Berovo
tel ++ 389 33 470 755
fax ++ 389 33 470 755

Moznosti d.o.o. Skopje
bul. Jane Sandanski br.111
1000 Skopje
tel ++ 389 2 2401 051
fax ++ 389 2 2401 050

Mladinec d.o.o. Skopje
Bul. G.Delcev 11 Lamela A/1, DTC Mavrovka
1000 Skopje
tel ++ 389 2 3238 712
fax ++ 389 2 3237 521

Peon d.o.o. Strumica
Marsal Tito bb
2400 Strumica
tel ++ 389 34 321 927
fax ++ 389 34 345 706

FULM stedilnica d.o.o. Skopje
ul. Mito Haxivasilev br.48
1000 Skopje
tel ++ 389 2 3115 244; 2 3131 106
fax ++ 389 2 3115 653