NATIONAL BANK OF THE REPUBLIC OF MACEDONIA

Banking Regulations Department

Report on Banking System and Banking Supervision of the Republic of Macedonia in 2006

May, 2007

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ANNEX

Governor's foreword

The improvement of the overall performances of the banking system of the Republic of Macedonia registered in the past years, continued in 2006 at a faster pace. This process was marked primarily by a *significant increase in the total banks' activities, increased competition on the banking market and improvement of their operational efficiency and profitability.* The banks significantly increased their role of financial intermediaries, both through the increase in the deposit and in the total financial potential and through the intensive credit activity. The increased deposit base of banks and the further process of transformation of their low interest-bearing assets into high interest-bearing assets were the main postulates on which the financing of banks' increased volume of activities was based. Banks' dependence on the foreign sources of funds remained almost at the same level as last year.

The increased competition among banks was primarily shown by the introduction of new banking products, especially in retail banking. In that context, during 2006, banks' operations with payment cards increased significantly. Also, the interest margin narrowing, through the reduction of the lending interest rates, especially on credit products intended for the households, is one more indicator for the increased competition among banks.

Alongside the process of further deepening of the financial intermediation, banks maintained a relatively high solvent position. Their capitalization level was still significantly higher than the prescribed minimum, registering further downward trend, which reflected the accelerated credit activity.

Last year was marked also with the record high profit made by the banks in the Republic of Macedonia since the independence. Here it is important that the net interest income and the income on the basis of commissions strengthened their role in the creation of the banks' income potential, unlike past years when the income of incidental character was the main component in creating their profit.

Along with the increased volume of activities and improved profitability and efficiency, in 2006, the banks' risk profile also improved. *Credit risk* remained to be the dominant risk in the spectrum of risks the banks are facing with. *The indirect credit risk*, which arises from the exposure of the borrowers to an exchange rate risk, becomes increasingly important, having in mind the accelerated dynamics of lending in foreign currency and in Denars with foreign exchange clause during 2006. However, the quality of the banks' credit portfolio did not show signs of deterioration. On the other hand, in circumstances of a relatively high level of currency substitution in the balance sheets of banks in the Republic of Macedonia, they satisfactorily managed the *exchange rate risk,* within the framework of the prudential limits. Despite the significant growth of the capital market and the increasingly active involvement of the banks in the trading in securities, primarily the government securities, the other types of *market risks* still play marginal role in the spectrum of risks they are facing with. *Liquidity risk* was within the acceptable limits, having in mind the availability of the liquid assets for covering of the banks liabilities, the structure of the financial potential, and the maturity structure of the banks' claims and liabilities. Especially important was the trend of increasing the maturity of the banks' deposit potential, which was yet insufficient for overcoming the contractual maturity mismatch of the claims and liabilities.

In spite of the positive perceptions for the movement in the banking system, the National Bank of the Republic of Macedonia makes efforts to anticipate all risks for the banking system permanently and in a timely manner. The identification and control of the credit risk level is in the focus of the attention of the central bank, especially having in mind the credit growth during the recent years. In this context, during 2006, the National Bank undertook several activities:

- strengthening of the regulatory requirements when extending foreign currency loans and Denar loans with FX clause by the banks;

-increasing the access to information for the credit worthiness of the banks' clients, by constant improvement of the Credit Registry of the National Bank;

-strengthening of the supervisory function by making a shift towards risk based supervision;

-completion of the regulations on banks' capital adequacy, which incorporates also the market risks that the banks are exposed to during their operations;

- establishing of a new accounting framework for the banks, which will be in line with the international accounting standards and the international financial reporting standards. This project should be completed during 2007.

Regarding the cooperation with the supervisory bodies in the country, of special importance was the establishment of the interinstitutional financial stability body at the end of 2006, which consists of representatives of all supervisory and regulatory bodies in the country. The representatives in this body regularly review the developments in individual segments of the financial system, initiate certain amendments to the regulatory framework in the financial area and exchange experiences in the field of carrying out the supervisory function. As for the cooperation with the foreign supervisory bodies, in 2006, signing of a Memorandum of Understanding with the Central Banks of Greece and Montenegro was initiated, which was realized in the beginning of 2007. Hence, the number of signed Memoranda of Understanding with foreign supervisory bodies was raised to six (Memoranda of Understanding were signed with the Central Banks of Russia, Slovenia, Albania, Bulgaria, Montenegro and Greece).

Ladies and Gentlemen,

We can view the year behind us as extremely favorable for the operations of the banks in the Republic of Macedonia. The favorable macroeconomic environment in 2006, evident from the positive results in the real and in the external sector, and from the maintaining of the price stability, represented a solid basis for further improvement of the overall performances of the banking system. The banking sector continued to develop at a fast pace, maintaining however, the stability and resistance to external shocks. Still, further increment of the operational efficiency and profitability of the banks, the improvement of their risk profile in circumstances of their dynamic growth and increased competition, adjustment to the new regulatory requirements in line with the international standards and practices are only a few of the challenges that the banks in the Republic of Macedonia are facing with. On its part, the National Bank will make its best effort to anticipate such movements in the banking system permanently and in a timely manner, and to strengthen its institutional capacity when exercising the supervisory and regulatory function.

Governor
and President of
the NBRM Council

Petar Goshev, MSc.

I. BANKING SYSTEM IN 2006

1. Structure of the banking system

1.1. Number of banks and savings houses

As of December 31, 2006, the banking system of the Republic of Macedonia comprised of nineteen banks[1] and twelve savings houses, which is one bank and two savings houses less, relative to the end of 2005. The reduction of the number of banks in 2006 was a consequence of the merger of "Tetovska Banka" a.d. Tetovo and "Teteks-Kreditna Banka" a.d. Skopje, when "TTK Banka" a.d. Skopje was established. On the other hand, the number of savings houses dropped as a consequence of the revoked operating license and opening of a liquidation procedure in the savings house "Kiro Kjucuk" doo Veles, as well as due to the acquisition of "Makedonska Stedilnica" a.d. Skopje by "Invest Banka" a.d. Skopje.

Feature of the banking system of the Republic of Macedonia in the past few years, has been the continuous decline in the number of institutions, with a simultaneous increase in its size. This trend of market consolidation of the banking sector also appears in other countries of Central and Eastern Europe, primarily as a result of the increased competition in banking, after the completion of the processes of integration of these countries in the European Union. By further convergence of the Republic of Macedonia to the European Union, acceleration of the process of restructuring and market consolidation of the banking system of the Republic of Macedonia may be expected, which should lead to further deepening of the financial intermediation and especially to improving of the type and the quality of financial services the banks offer.

Table 1
Structural indicators of the banking systems of individual European counties[2]

Country	Number of credit institutions / 1						Total assets of credit institutions (in millions of Euros)						Number of mergers and acquisitions					
	2001	2002	2003	2004	2005	2006	2001	2002	2003	2004	2005	2006 /2	2001	2002	2003	2004	2005	2006 /3
Czech Republic	119	84	77	70	56	57	78.188	79.232	78.004	86.525	104.950	117.100	2	2	2	3	1	0
Hungary	240	227	222	221	215	207	38.433	43.564	54.769	64.970	74.653	97.000	4	0	4	2	0	3
Latvia	39	23	23	23	23	28	7.279	7.250	8.482	11.167	15.570	22.800	1	2	1	2	3	2
Poland	758	666	660	658	739	723	133.476	116.004	103.659	131.904	152.086	189.500	9	8	2	7	3	0
Slovenia	69	50	33	24	25	30	17.782	19.995	21.541	24.462	30.049	34.900	2	3	1	1	1	1
Estonia	7	7	7	9	11	14	4.372	5.221	6.314	8.537	11.830	15.600	0	2	0	0	3	0
European Union	9.747	9.311	9.061	8.836	8.684	8.609	24.660.532	25.261.364	26.474.228	28.978.228	32.882.078	/	104	115	108	91	108	40
Macedonia / 4	38	38	36	36	34	31	1.744	1.542	1.732	1.940	2.327	2.884	3	0	0	0	1	2

1/ Including the number of branches from other countries
2/ Preliminary data
3/ Data for the number of mergers and acquisitions in the EU countries refers to the first half of 2006
4/ Including banks and saving houses

Regarding the structure, banks are dominant in the banking system, as opposed to the savings houses, whose role remains marginal. As of December 31, 2006, the share of the savings houses in the overall financial potential of the banking system equaled 1.3%, and compared with the end of 2005 it dropped by 0.1 percentage point. Savings houses retained the marginal share both in the total gross credits to the non-financial entities and in the total household deposits at the level of the banking system, which at the end of 2006 equaled 2.0% and 0.8%, respectively.

[1] Three of the nineteen banks in the Republic of Macedonia are authorized to conduct only domestic financial activities (defined in Article 45 of the Banking Law), fifteen banks are authorized to conduct all financial activities (defined in Articles 45 and 46 of the Banking Law), while the "Macedonian Bank for Development Promotion" performs specific financial activities in accordance with the Law on Establishing the Macedonian Bank for Development Promotion.
[2] Source: European Central Bank and Report on the EU Banking Stuctures (ECB), October 2006.

Table 2
Number of banks and savings houses and their share in the assets, gross credits, and household deposits

Year	Number of baks and saving houses			Share in total assets			Share in gross credits			Share in household deposis		
	Banks	Saving houses	*Total*	Banks	Saving houses	*Total*	Banks	Saving houses	*Total*	Banks	Saving houses	*Total*
2001	21	17	*38*	99.4%	0.6%	*100.0%*	98.5%	1.5%	*100.0%*	99.6%	0.4%	*100.0%*
2002	21	17	*38*	99.0%	1.0%	*100.0%*	97.9%	2.1%	*100.0%*	99.4%	0.6%	*100.0%*
2003	21	15	*36*	98.8%	1.2%	*100.0%*	97.6%	2.4%	*100.0%*	99.3%	0.7%	*100.0%*
2004	21	15	*36*	98.7%	1.3%	*100.0%*	97.6%	2.4%	*100.0%*	99.3%	0.7%	*100.0%*
2005	20	14	*34*	98.6%	1.4%	*100.0%*	97.8%	2.2%	*100.0%*	99.2%	0.8%	*100.0%*
2006	19	12	*31*	98.7%	1.3%	*100.0%*	98.0%	2.0%	*100.0%*	99.2%	0.8%	*100.0%*

Having in mind the insignificant influence of the savings houses on the total activities and performances of the banking system, the further analysis focuses only on the data and the indicators of banks' operations. However, the principle of classification of the banks in three groups according to the size of their assets has been maintained. Compared with December 31, 2005, four banks moved from the group of small to the group of medium banks, which is another indicator of the continuous growth of the banking system.

Table 3
Groups of banks according to their assets size

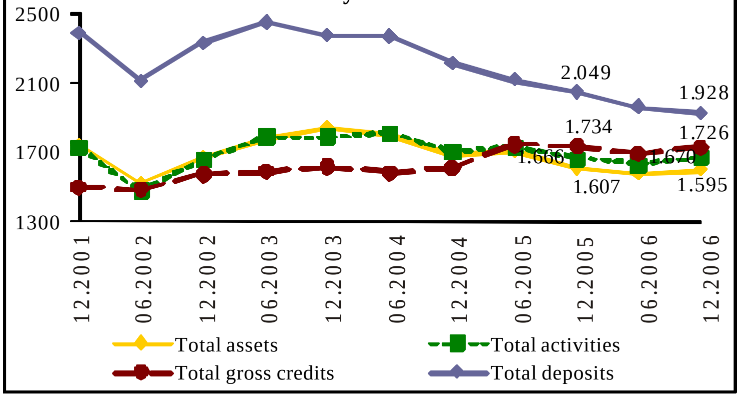
Groups of banks	Criteria of classification	Number of banks 31.12.2005	Number of banks 31.12.2006
Large banks	Assets > 15 billions of Denars	3	3
Medium-size banks	4,5 billions > Assets < 15 billions	3	7
Small-size banks	Assets < 4,5 billions of denars	14	9
Total		**20**	**19**

1.2. Concentration and market share

The concentration in the banking system of the Republic of Macedonia could be analyzed through the movement of the Herfindahl index[3] and the CR5 indicator[4].

As of December 31, 2006, the Herfindahl index regarding the total assets equaled 1,595 and compared with December 31, 2005 it registered a decline of 12 index points. The Herfindahl index measured for the total banks' activities (on-balance sheet and off-balance sheet) and for the total gross credits, indicated high, but acceptable concentration level. Only the value of the Herfindahl index measured

Figure 1
Dynamics of the Herfindahl index of the banking system



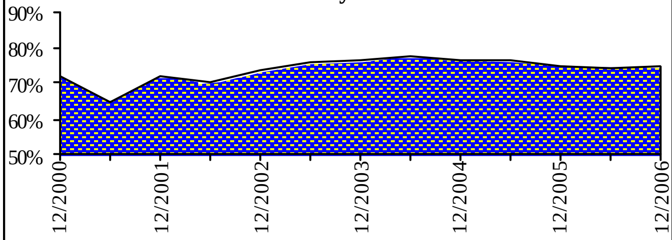
[3] The Herfindahl index is calculated according to the equation $HI = \sum_{j=1}^{n} (S)_j^2$, where S denotes each bank's share in the total amount of the analyzed category (for example: total assets, total deposits, etc.), rather than the total number of banks in the system. When the index ranges between 1.000 and 1.800 units, the level of concentration in the banking system is considered acceptable.

[4] The CR5 indicator represents the share of the assets of the five largest credit institutions (banks) in the total assets of the banking system.

for the total deposits exceeds the acceptable level, which indicates higher concentration in collecting deposits, in several banks. However, during 2006, most significant decline of 121 index points was registered exactly in the Herfindahl index measured for the total deposits.

CR5 indicator reveals insignificant decline in the banking system concentration. As of December 31, 2006, this indicator equaled 74.7%, which is by 0.3 percentage points less compared with the end of 2005.

Figure 2
Movement in the share of the assets of the five largest banks in the total assets of the banking system



The relatively high level of banking system concentration is confirmed also by the comparative analysis of the identical indicators of banking system concentration for the EU Member States. Except for Lithuania and Estonia, all other analyzed countries have lower level of concentration compared with the level of banking system concentration in the Republic of Macedonia. The comparison with the other structural features of the banking systems of the EU Member States indicates that the banking system of the Republic of Macedonia has sufficient room for further consolidation, increasing of the activities and operational efficiency. The main indicators of the households' access to banking services show that the banks and savings houses in the Republic of Macedonia, on average, render services to a larger number of citizens compared with the EU countries, having in mind the density of the population of the countries analyzed. This is firmly supported by the indicator of the average number of citizens who use the services of one ATM and the indicator of the average number of citizens serviced by one bank employee in the Republic of Macedonia. The analysis of the average size of the assets generated by one employee in the banking system indicates the lower operational efficiency of the banks in the Republic of Macedonia relative to the EU Member States. As of December 31, 2006, one employee in the banking system of the Republic of Macedonia generates Euro 576.000, on average, while one employee in the banks of all EU Member States generates Euro 9.3 million, on average.

Table 4
Indicators of the structural features of the banking systems of individual EU Member States and the Republic of Macedonia[5]

Country	Herfindahl index for total assets*	CR5 indicator*	Population density (citizens per squared kilometer)	Citizens per credit institution	Citizens per ATM	Citizens per employee in the banking system	Citizens per branch	Assets per employee in the banking system (in thousands of Euros)
Republic of Macedonia (2006)	1,595	74.7	80	66,356	6,926	411	6,510	576
Republic of Macedonia (2005)	1,607	75	79	59,745	12,938	438	7,414	502
Poland	650	48.6	119	51,613	4,743	249	7,511	995
Czech Republic	1,155	65.3	130	182,540	3,712	269	5,601	2,766
Slovakia	1,076	67.7	110	234,222	3,166	271	4,717	1,834
Hungary	795	53.2	109	46,918	3,063	270	3,231	2,000
Slovenia	1,369	63	97	80,034	1,437	171	2,887	2,563
Lithuania	1,838	80.6	53	43,773	3,402	447	4,154	1,715
Latvia	1,176	67.3	36	100,013	2,628	220	3,925	1,486
Estonia	4,039	98.1	29	122,500	771	172	1,034	8,506
Malta	1,330	48.6	1271	22,443	2,675	119	3,706	8,039
Cyprus	1,029	59.8	90	1,938	1,761	70	797	5,590
New Member countries in European Union	***1,446***	***65.2***	***99***	***46,905***	***3,462***	***249***	***5,087***	***1,771***
EU countries	***1,153***	***59.7***	***174***	***75,268***	***2,015***	***182***	***3,377***	***9,319***
Eurozone Member countries	***1,000***	***54.4***	***159***	***64,376***	***1,327***	***143***	***2,529***	***12,882***

** Data for the New Member countries in European Union and the Eurozone Member countries are nonweighted average*

[5] Source: National Bank of the Republic of Macedonia (hereinafter: National Bank) and Report on the EU Banking Structures (ECB), October 2006.

The relatively high level of concentration in the banking system of the Republic of Macedonia is confirmed also by the analysis of the market share of the individual groups of banks in the total assets, total on-balance sheet and off-balance sheet activities, total gross credits and total deposits of non-financial entities at the level of the banking system. Compared with the end of 2006, as a result of the transfer of four banks from the group of small to the group of medium banks, the market share of the group of medium banks increased, at the expense of the market share of the group of small banks, which declined.

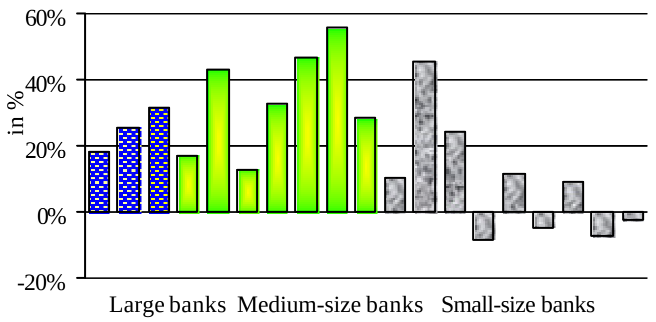
Table 5
Concentration of the banking system by group of banks

Groups of banks	Share in total assets		Share in total activities		Share in gross credits		Share in total deposits of non-financial entities	
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	31.12.2005	31.12.2006	31.12.2005	31.12.2006
Large banks	66,1%	66,1%	67,7%	68,1%	69,2%	69,2%	73,1%	72,2%
Medium-size banks	12,3%	23,8%	11,7%	22,4%	11,6%	24,1%	11,5%	20,9%
Small-size banks	21,6%	10,1%	20,6%	9,5%	19,2%	6,7%	15,4%	6,9%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

1.3. Distribution of assets and capital by bank

The analysis of the asset distribution indicates that there are large differences among the individual banks. Thus, at the end of 2006, the assets of the largest bank were 90 times larger than the assets of the smallest bank and compared with the end of the preceding year this difference increased (on December 31, 2005 it was 74 times larger). The increasing difference in the amount of the assets is evident also at the level of the groups of large and small banks. The average amount of the assets of the group of large banks is 19.6 times larger than the average assets of the group of small banks, while on December 31, 2005 this difference was 19.4 banks. On the other hand, the differences in the assets distribution among the banks from the group of large banks and the banks from the group of medium banks are reducing. Namely, the difference between the assets of the largest bank and the smallest medium bank reduced from 10.2 times on December 31, 2005, to 9.3 times at the end of 2006. The reasons for such movements are the higher annual growth rates of banks' assets, which are an integral part of the group of medium banks, compared with the assets growth rates of the banks from the group of large banks. Higher assets growth rates are typical both at the level of individual banks from the group of medium banks and at the level of the whole group of medium banks. Thus, the average assets of the group of medium banks registered an annual growth rate of 30.8%, as opposed to the growth of 24% registered in the average assets of the group of large banks[6].

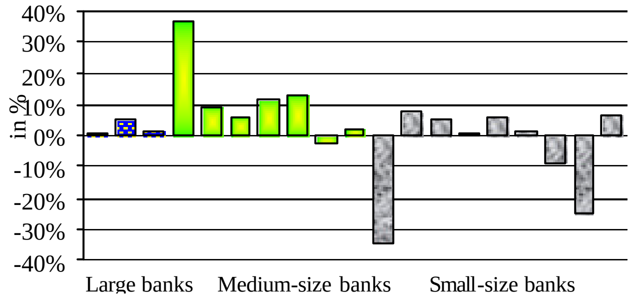
Figure 3
Growth rate of total assets by groups of banks in 2006



[6] The calculation is on the basis of the changed structure of the groups of banks as of December 31, 2006.

The analysis of the distribution of capital by individual banks indicates relatively smaller differences compared with the distribution of assets. As of December 31, 2006, the bank with the largest capital had 16 times larger capital than the banks with the smallest capital Smaller differences in the capital distribution among banks are a result of the relatively high capitalization rate of the small banks. Besides, the differences in the distribution of the capital among the banks from the group of large banks and the other banks indicate a downward trend, which is a result of the recapitalization of several medium banks during 2006.

Figure 4
Growth rate of capital by groups of banks in 2006



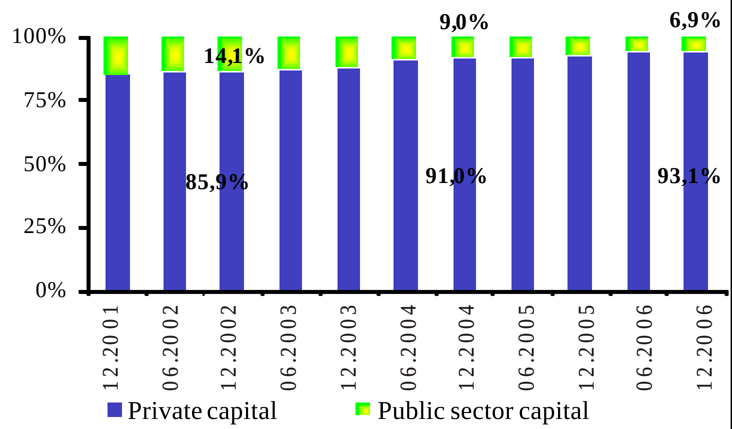
1.4. Ownership structure of the banking system

The ownership structure of the banking system may be analyzed from three aspects: 1) the share of the private capital in the shareholders' capital of the banking system; 2) the type of shareholders in the banking system and 3) the presence of foreign capital in the banking system.

1.4.1. Share of the private capital in the shareholders' capital of the banking system

As of December 31, 2006, the share of the private capital in the total shareholders' capital[7] of the banking system equaled 93.1%, i.e. 98.4% if "Macedonian Bank for Development Promotion" a.d. Skopje, which is an entirely state-owned bank, is excluded from the analysis. Compared with the end of 2005, the share of the private capital went up by 1.3 percentage point, which is a result mainly of the sale of minority packages of shares in several banks on the stock exchange, by the Pension and Disability Insurance Fund in the first half of 2006. As of December 31, 2006, except in "Macedonian Bank for Development Promotion" a.d. Skopje, the public sector, public enterprises and institutions of the central and local government own shares in eight banks. Except for "Postenska Banka" a.d. Skopje, where the public enterprise "Makedonski Posti" Skopje owns one-third of the issued common shares, in the other seven banks the packages of shares are minor, and are aggregately below 5% of the total shares issued.

Figure 5
Trend of privatization level of the banking system



Analyzed by groups of bank, the share of the private capital is lowest in the group of small banks (81.8%), which is a result of the inclusion of the "Macedonian Bank for

[7] For the purpose of analyzing the ownership structure, the shareholders' capital is taken as a sum of the total nominal value of the common shares and the total nominal value of the preference shares issued by the banks in the Republic of Macedonia.

Development Promotion" a.d. Skopje in this group. The share of the private capital in the total capital of the groups of large and medium banks exceeds 99%.

1.4.2. Shareholders' structure of the banks according to the type of shareholders

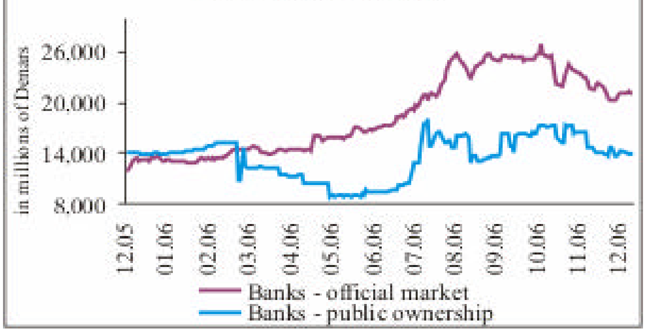
Table 6
Ownership structure of the shares issued by banks according to individual types of shareholders

No	Shareholders	Share in common shares			Share in priority shares		
		31.12.2004	31.12.2005	31.12.2006	31.12.2004	31.12.2005	31.12.2006
1	Natural persons	11,2%	10,4%	11,7%	64,5%	64,7%	52,9%
2	Non-financial legal entities	42,8%	41,4%	36,7%	23,4%	21,6%	14,9%
3	Financial institutions	36,2%	39,2%	44,0%	10,1%	11,7%	31,0%
4	Public sector, public enterprizes and social nonfinancial enterprizes	8,8%	8,4%	7,0%	1,7%	1,9%	0,1%
5	Non-defined status	0,8%	0,6%	0,6%	0,1%	0,1%	1,1%
	Total (1+2+3+4+5)	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**
	Total private capital (1+2+3+5)	***91,4%***	***91,6%***	***93,0%***	***98,3%***	***98,1%***	***99,9%***

Note: the term "undefined status" inter alia, covers the shareholders where the bankruptcy procedure is completed or shareholders that the banks cannot identify.

During 2006, the downward trend in the share of the non-financial entities in the ownership structure of the common and priority shares issued by the banks in the Republic of Macedonia became more intensive. Thus, as of December 31, 2006, financial institutions[8] were dominant in the ownership structure of the common shares issued by banks, with a share of 44.0%, and they were followed by the non-financial legal entities with a share of 36.7%. On annual basis, the share of the financial institutions in the common shares of banks went up by 4.8 percentage points, at the expense of the decline in the share of the non-financial legal entities by 4.7 percentage points. On the other hand, natural persons maintained the dominant position in the ownership structure of the priority shares issued by the banks in the Republic of Macedonia, with a share of 52.9%, despite the upward trend in the share of the financial institutions.

Figure 6
Trend of market capitalization of banks (common shares) during 2006



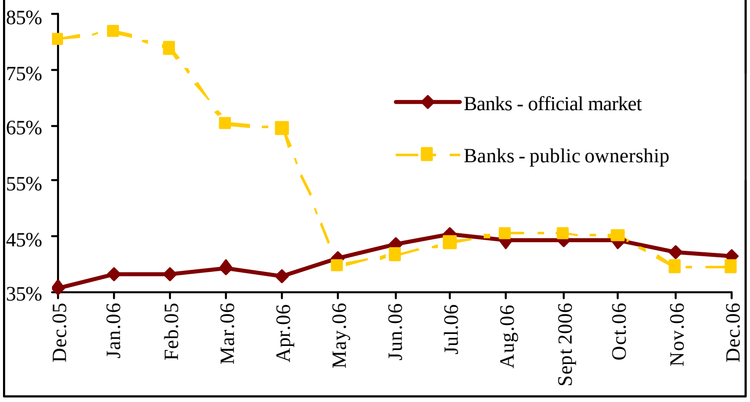
The increase in the share of the financial institutions in the ownership structure of the banking system was rather a result of purchasing the existing banks' shares by foreign institutional investors than of purchasing shares from new issues. As of December 31, 2006, six banks were listed on the official market[9] of the Macedonian Stock Exchange. These six banks take 34.5% of the total capital, i.e. 39.0% of the total assets at the level of the

[8] As financial institutions are considered domestic banks, foreign banks, domestic and foreign brockerage houses, investment funds, pension funds, pension funds or investmnent funds management companies, insurance companies, as well as the international financial institutions (EBRD, IFC, etc.) which appear as owners of shares issued by the banks in the Republic of Macedonia.

[9] The shares of „Investbanka“ AD Skopje, „Komercijalno investiciona banka“ AD Kumanovo, „Komercijalna banka“ AD Skopje, „Ohridska banka“ AD Ohrid, „Stopanska banka“ AD Bitola and „TTK banka“ AD Skopje are listed on the official market of the Macedonian Stock Exchange. Starting from February 2007, and in line with the change in the rules for quotation on the Stock Exchange, two of these banks („Investbanka“ AD Skopje and „Komercijalna banka“ AD Skopje) are being listed on the newly established special market segment, the so-called superquotation. Three of the banks that are listed on the official market - „Komercijalna banka“ AD Skopje, „Ohridska banka“ AD Ohrid and „Stopanska banka“ AD Bitola, are an integral part of the stock exchange index MBI-10.

banking system. In addition, on the market of companies in public ownership[10], the shares of three other banks were traded. As a result of the increased interest of the foreign institutional investors and of domestic natural persons in the trade with banks' shares, in 2006 the turnover of banks' shares increased, the number of concluded transactions went up and their market capitalization registered a significant increase. Additionally, the dispersion of the shareholders' structure of several banks increased, by increasing the number of their shareholders. This raised the average number of shareholders by bank in the Republic of Macedonia, which as of December 31, 2006 equaled 557 persons, as opposed to 498 persons at the end of 2005. At the end of 2006, in two banks the number of owners of common shares exceeded 1000 persons, and in two other banks it exceeded 500.

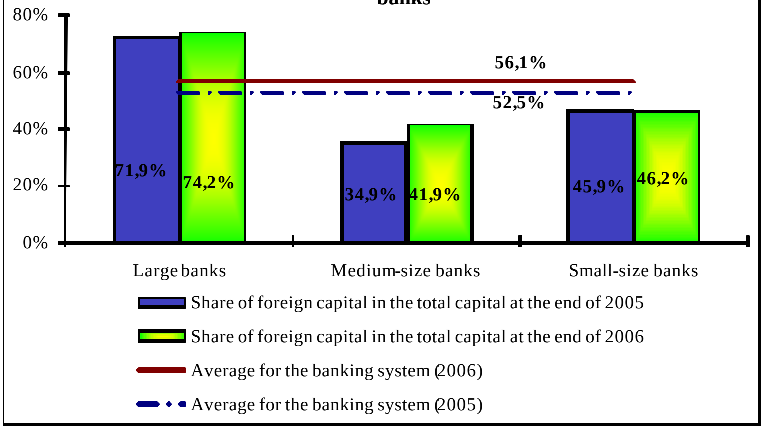
Figure 7
The ratio of market capitalization of banks (common shares) to total market capitalization of the shares on Macedonian stock exchange



1.4.3. Share of foreign capital in the banking system

At the end of 2006, the share of the foreign capital in the total shareholders' capital of the banking system of the Republic of Macedonia equaled 56.1%. Compared with December 31, 2005, the share of foreign capital registered an increase of 3.6 percentage points, which is due to the interest of the foreign portfolio investors in trading with banks' shares. Foreign capital is present in seventeen banks, and its share in the individual banks ranges between 0.02% and 100% in four banks. At the end of 2006, compared with the end of 2005, all groups of banks registered an increased share of the foreign capital in the total shareholders' capital.

Figure 8
Share of foreign capital in total shareholder capital by groups of banks



From the total number of banks in the Republic of Macedonia, eight are owned by foreign shareholders[11], while four of these eight banks are owned by foreign banks. In 2006, the upward trend in the share of the banks owned by foreign shareholders in the total assets and in the total capital at the level of the banking system, continued. With the acquisition of

[10] On the market of companies in public ownership, the shares of the shareholding companies with special reporting requirements are traded, and according to the Law on Securities (Official Gazette of RM No. 95/2005), those are the shareholding companies with equity exceeding a Denar equivalent of Euro 1.000.000 and with more than 100 shareholders. By the end of 2006, the shares of „NLB Tutunska banka" AD Skopje, „Sileks banka" AD Skopje and „Stopanska banka" AD Skopje were traded on this segment of the unofficial market.
[11] Banks owned by foreign shareholders are banks in which the foreign shareholders own more than 50% of the total number of issued shares.

"Ohridska Banka" a.d. Skopje by "Societè Generale" s.a. Paris, the dominance of banks owned by foreign shareholders became even more evident, in the first half of 2007.

Figure 9
Structure of the banking system assets by the dominant ownership of the banks

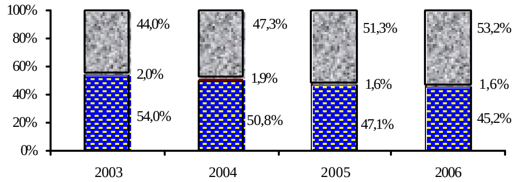
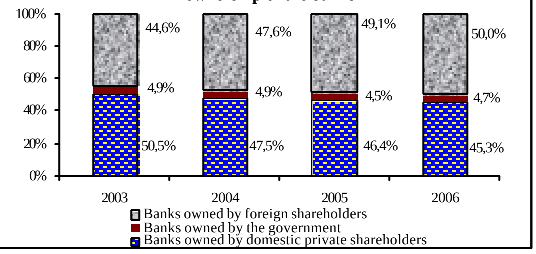


Figure 10
Structure of the banking system capital by the dominant ownership of the banks



1.5. Bank network and number of employees in the banking system

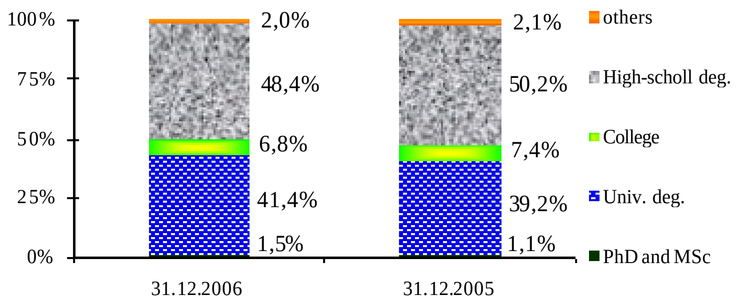
The geographic distribution of the banks in the Republic of Macedonia is characterized by a significant concentration on the territory of the capital. Thus, the head offices of sixteen banks are located in Skopje, while only three are located outside the capital. As of December 31, 2006, these three banks participated with 9.1% in the total assets, i.e. with 12.0% in the total capital at the level of the banking system. Compared with the end of 2005, as a result of the merger of two banks and hence the establishing of a new bank with a head office located in Skopje, the concentration of the banks in the capital became even more evident.

The high concentration of the banks' head offices in the capital is being mitigated with the relatively wide bank network, through which the financial services for the broader public are provided. The bank network in the Republic of Macedonia consists of seventy-six branches, two hundred and twenty sub-branches, fifteen business units, and five windows, plus three hundred and thirty-eight post-office units through which one bank performs its activities. With the development and accepting of the new technologies in banking, internet and e-banking appear as alternative channels for distribution of the banking services, so that by end 2006 such services were offered by nine banks, while they are expected to expand in the forthcoming period.

As of December 31, 2006, the total number of employees in the banking system of the Republic of Macedonia equaled 5,010 persons and compared with December 31, 2005 it registered an increase of 463 persons, or 8.3%. The largest portion of the employees in the banking system are absorbed by the group of large banks, while the largest annual growth in the number of employees, of 25.1%, was registered in the group of medium banks. Here, 30% of the annual increase in the employees in the group of medium banks is a result of the structural movement of several banks from the group of small banks to the group of medium banks, while the remaining 70% of the annual increase are a result of the higher employment in the existing banks in the group of medium banks.

The continuous growth of the number of employees in the banking system is accompanied with gradual improvement of their qualification structure. Thus, during 2006, the share of the employees with a university degree in the total number of employees in the banking system went up by 2.2 percentage

Figure 11
Qualification structure of banks' employees



points, at the expense of the employees with a high-school degree, whose share dropped by 1.8 percentage points. The trend of gradual change in the qualification structure of the bank personnel, in terms of increasing the number of employees with a university degree, is a necessary precondition for improving the quality of banking operations.

1.6. Structure of the supply of banking services

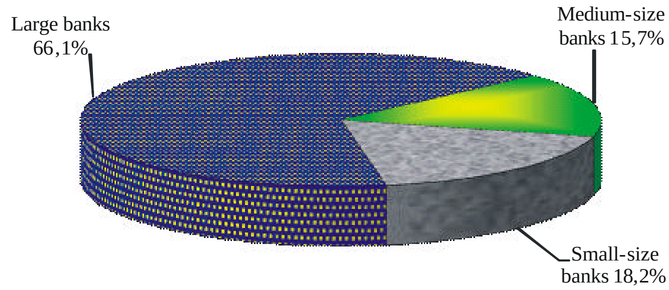
As of December 31, 2006, the average number of users of banking services by individual bank equaled 197,186 persons, which is an increase of 25.2% i.e. 39,745 persons compared with December 31, 2005. At the end of 2006, natural persons comprised the largest part of the total average number of users of banking services, with a share of 95.7%. During 2006, the growth rate of the average number of natural persons - users of banking services equaled 26.1%, as opposed to the annual growth rate of the users - legal entities of 0.8%. Analyzed according to the type of services, the most widely used service was the investment in sight deposits, which was used by 65.6% of the total average number of users.

Table 7
Average number of users of banking services by individual bank as of December 31, 2006

No.	Description	Legal entities		Natural persons		Total		Growth rate since 31.12.2005
		Average number of users	%	Average number of users	%	Average number of users	%	
1	Credits, letters od credit, guarantees	1,481	17.6%	12,989	6.9%	14,470	7.3%	39.6%
2	Deposits	6,846	81.1%	122,532	64.9%	129,378	65.6%	14.1%
2a	- sight deposits	*6,802*	*80.6%*	*105,364*	*55.8%*	*112,166*	*56.9%*	*12.0%*
2b	-term deposits	*44*	*0.5%*	*17,168*	*9.1%*	*17,212*	*8.7%*	*29.5%*
3	Payment cards	111	1.3%	18,226	9.7%	18,337	9.3%	110.6%
4	Current accounts	0	0,0%	35,001	18.5%	35,001	17.8%	40.3%
	Total	**8,438**	**100.0%**	**188,748**	**100.0%**	**197,186**	**100.0%**	**25.2%**

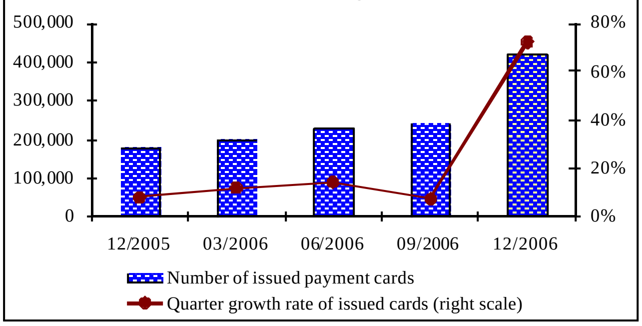
At the end of 2006, 65.4% of the total number of users at the level of the banking system belonged to the group of large banks, followed by the group of small banks with a share of 18.1% and the group of medium banks with a share of 16.5%. Apart from that, the group of large banks maintained its dominant share in the total number of natural persons - users of banking services at the level of the banking system with a share of 66.1%, which is an insignificant increment of 0.7 percentage points relative to December 31, 2005.

Figure 12
Structure of the supply of banking services by groups of banks at the end of2006



During 2006, banks significantly increased their operations in the area of payment cards. As of December 31, 2006, the total number of issued payment cards equaled 419,168 and compared with the end of 2005, it registered an increase of 240,935 payment cards, or 135.2%. Almost three quarters of the annual growth of

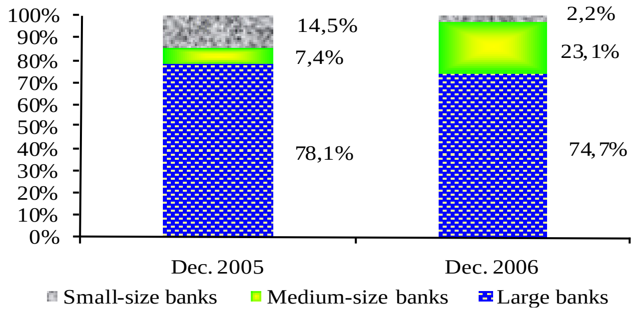
Figure 13
Number and growth rate of issued payment cards during 2006



the last quarter of 2006. At the same time, an increase in the use of payment cards was registered, which is evident from the annual rates of growth of the transactions with payment cards and their value, of 60.7% and 46.6%, respectively.

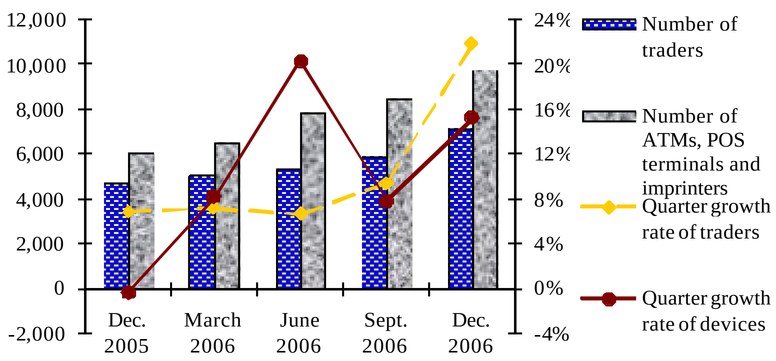
By December 31, 2006, twelve banks conducted activities related to payment cards. Dominant in the structure of payment cards was the group of large banks, which participated with 74.7% in the total number of issued cards, followed by the group of medium banks and the group of small banks, with respective shares of 23.1% and 2.2%.

Figure 14
Structure of issued payments cards by groups of banks



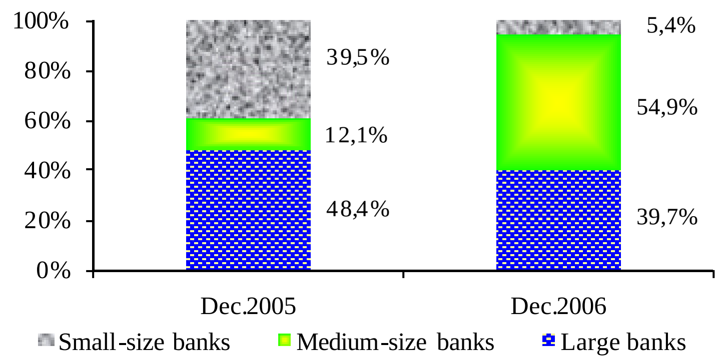
Along with the increased number of payment cards, an increase was registered in the number of devices in which payment cards are used (ATMs, imprinters, POS terminals), and in the number of traders who accept cards as payment instruments. Thus, as of December 31, 2006 the number of ATMs installed in the Republic of Macedonia was 297, which is by 140 more compared with December 31, 2005, while the number of devices at the selling points where payment cards are accepted equaled 9,546 and relative to the end of 2005, it went up by 3,632. As of December 31, 2006 the number of traders who accept payment cards equaled 7,196 which was by 2,481 more compared with December 31, 2005.

Figure 15
Number and growth rate of traders and devices that accept payment cards during 2006



It is realistic to expect that in the forthcoming period further increment will be registered both in the number of traders and in the number of devices that accept payment cards. At the end of 2006, the group of medium banks had the largest share of 54.9% in the structure of ATMs by group of banks, partially due to their larger expansion in the area of operations with payment cards and partially due to the transfer of few banks from the group of small to the group of medium banks.

Figure 16
Structure of ATMs by groups of banks



2. Banks' activities

The positive economic developments in the Republic of Macedonia, primarily the stable macroeconomic environment and the continuous trend of strengthening the confidence in the banking system, positively reflected on the increase in the deposit and in the total banks' potential in 2006. This increase was a sound base for further intensification of the support of the economic activity in the country, expressed through permanent increment in banks' lending activities. The increased volume of banks' activities simultaneously meant further deepening of the financial intermediation. In that sense, the degree of financial intermediation, as the main indicator of the relative meaning of the banks' activities in the total economic activity in the country maintained the upward trend typical for the past few years. At the end of 2006, the level of financial intermediation of the banking system, measured as a ratio of the total assets, gross credits and total deposits of non-financial entities on the one hand, to the gross domestic product (GDP)[12] on the other, equaled 57.4%, 29.6% and 41.3%, respectively. The group of large banks had the largest contribution to the financial intermediation, which reflects its dominant share in the total assets, gross credits and deposits. Thus, as of December 31, 2006, the degree of financial intermediation of the group of large banks, measured through the ratio of the total assets, gross credits and total deposits to GDP, equaled 38%, 20.5% and 29.8%, respectively.

Figure 17

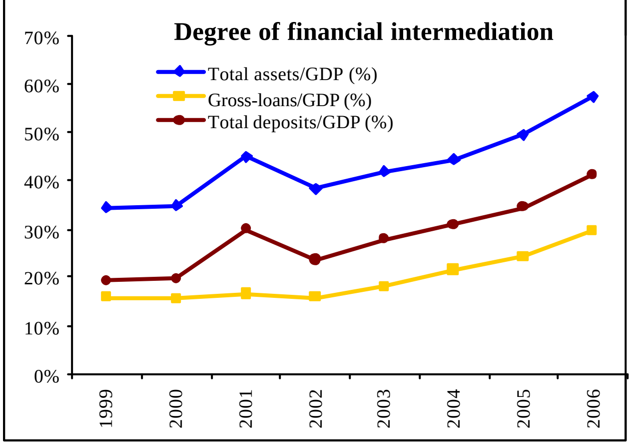


Table 8
Level of financial intermediation[13]

Country	Total assets/GDP	Gross-loans/GDP	Toal deposits/GDP	Loans/Deposits
Republic of Macedonia - 2006	57.4%	29.6%	41.3%	71.7%
Malta	604.7%	244.9%	249.6%	98.1%
Cyprus	449.9%	209.9%	281.9%	74.5%
Latvia	121.7%	77.4%	69.0%	112.2%
Estonia	112.2%	76.1%	57.6%	132.1%
Slovenia	109.8%	61.7%	59.9%	103.0%
Czech Republic	106.6%	41.6%	72.5%	57.4%
Slovakia	95.4%	38.7%	58.4%	66.3%
Bulgaria	86.0%	46.4%	na	na
Hungary	84.9%	51.8%	42.6%	121.5%
Lithuania	63.6%	42.8%	36.5%	117.0%
Poland	62.5%	31.9%	43.5%	73.4%
Romania	51.2%	30.1%	32.2%	93.6%
EU-25	303.9%	125.9%	103.7%	121.4%
EMU-12	283.3%	123.5%	102.1%	121.0%

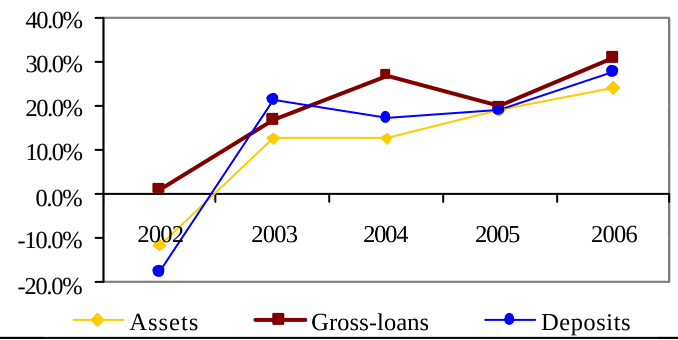
In spite of the continuous upward trend in the level of financial intermediation, it is significantly below the level of financial intermediation typical for the banking systems of the EU Member States and the average levels of financial intermediation in the EU (EU-25) and the Euro-zone (EMU-12). Only the banking system of Romania has a lower level of financial intermediation than the banking system of the Republic of Macedonia, measured as a ratio of total assets and total deposits to GDP. Still, it should be emphasized that in the past years a

[12] Estimated data of the State Statistical Office for 2006.
[13] Source: Report on the EU Banking Structures, (ECB), October 2006 and the web sites of the cenral banks of the respective countries. Data on all EU Memeber States are for 2005, except for Romania and Bulgaria for which data pertain to 2006.

trend has been present of convergence of the level of financial intermediation of the banking system of the Republic of Macedonia to the average levels in the EU (EU-25) and the Euro-zone (EMU-12).

2.1. Balance sheet of banks

Figure 18
Annual growth rates of the assets, gross-loans and deposits



As of December 31, 2006, the total banks' assets equaled Denar 174.117 million, which is an increase of 24.0% relative to December 31, 2005 (Annex 1- Balance sheet). The increase in the assets reflects the accelerated growth dynamics of the credit support to the non-financial entities and the significant interest of banks in investing in securities (mainly Treasury bills). Regarding the sources of funds for the banks, the increase was evident primarily in the expanded deposit potential of banks. The accelerated growth dynamics of the level of banks' assets, credits and deposits in 2006, led to relatively highest annual growth rates of these three categories, compared with the past few years.

Table 9
Structure of assets and liabilities

Balance sheet	Amount in millions of denars		Structure		Annual change 31.12.06/31.12.05			
	31.12.2006	31.12.2005	31.12.2006	31.12.2005	In absolute amounts	In percent	In the structure	Share in the increase
Cash and balances wih the NBRM	11,165	7,983	6.4%	5.7%	3,182	39.9%	0.7%	9.4%
Securities portfolio	24,264	17,845	13.9%	12.7%	6,419	36.0%	1.2%	19.1%
Placements to banks	47,194	43,158	27.1%	30.7%	4,036	9.4%	-3.6%	12.0%
Loans to non-financial entities (net)	79,627	58,908	45.7%	41.9%	20,719	35.2%	3.8%	61.5%
Accrued interest and other assets	5,060	6,178	2.9%	4.4%	-1,118	-18.1%	-1.5%	-3.3%
Fixed assets	6,880	6,476	4.0%	4.6%	404	6.2%	-0.7%	1.2%
Unallocated loan loss provisions	-74	-113	0.0%	-0.1%	39	-34.7%	0.0%	0.1%
Total assets	**174,117**	**140,435**	**100.0%**	**100.0%**	**33,682**	**24.0%**		**100.0%**
Bank deposits	3,902	2,717	2.2%	1.9%	1,185	43.6%	0.3%	3.5%
Deposits of non-financial entities	125,267	97,921	71.9%	69.7%	27,346	27.9%	2.2%	81.2%
Borrowings (short-term and long-term)	15,692	13,146	9.0%	9.4%	2,546	19.4%	-0.3%	7.6%
Other liabilities	5,421	3,676	3.1%	2.6%	1,745	47.5%	0.5%	5.2%
Provisions for off-balance sheet items	648	713	0.4%	0.5%	-65	-9.1%	-0.1%	-0.2%
Own funds	23,187	22,262	13.3%	15.9%	925	4.2%	-2.5%	2.7%
Total liabilities	**174,117**	**140,435**	**100.0%**	**100.0%**	**33,682**	**24.0%**		**100.0%**

The analysis of the structure of banks' assets as of December 31, 2006 indicates continuation in the downward trend of the low interest-bearing component of the assets, while the interest-bearing component increased, primarily net placements with non-financial entities and securities portfolio. Net credits to non-financial entities strengthened their dominant position and as of December 31, 2006, their share in the total assets equaled 45.7%, which is by 3.8 percentage points more relative to December 31, 2005. On annual level, they registered an increase of Denar 20,719 million or 35.2% and they were the main generator of the growth of the total assets (61.5% of the total annual growth of the assets). Placements with other banks, as the second largest structural component, continued the downward trend in the share in the total assets from 30.7% (December 31, 2005) to 27.1% (December 31, 2006). The securities portfolio remained to be the third largest category in the total assets, with a share of 13.9% (12.7% on December 31, 2005). Relative to December 31, 2005, it went up by Denar 6,419 million or 36.0%, whereby it contributed with 19.1% to the total growth of the assets. The remaining 13.3% of the assets pertain to components whose individual share in the total assets is relatively small and does not exceed 6.5%.

As of December 31, 2006, the structure of the banks' liabilities did not register significant changes relative to the preceding year. With a share of 71.9%, deposits of non-financial entities maintained their dominant position in the liabilities' structure, whereby they maintained the status of primary sources of funds for the banks. Relative to December 31, 2005, deposits of non-financial entities registered the largest growth in absolute amounts, of Denar 27,346 million, i.e. 27.9%, thus largely contributing to the increase in the total liabilities (81.2%). Banks' own funds had a share of 13.3%, which is a decline of 2.6 percentage points relative to December 31, 2005. Another more significant category of sources of funds as of December 31, 2006, were the loans from other banks, which, as on December 31, 2005, maintained the share of around 9% in the total banks' liabilities.

2.1.1. Structure of the total assets, credits and deposits by group of banks

Table 10
Market share and growth of the total assets, credits and deposits by group of banks

CATEGORIES	**Amount in millions of denars**		**Structure**		**Annual change 31.12.06/31.12.05**			
	31.12.2006	**31.12.2005**	**31.12.2006**	**31.12.2005**	**In absolute amounts**	**In percent**	**In the structure**	**Share in the increase**
Total assets	**174,117**	**140,436**	**100.0%**	**100.0%**	**33,681**	**24.0%**		**100.0%**
- Large banks	115,122	92,835	66.1%	66.1%	22,287	24.0%	0.0	66.2%
- Medium-size banks	41,368	17,245	23.8%	12.3%	24,123	139.9%	11.5	71.6%
Medium-size banks without the transferred banks	21,197		12.2%		3,952	22.9%	(0.1)	11.7%
- Small-size banks	17,627	30,356	10.1%	21.6%	(12,729)	-41.9%	(11.5)	-37.8%
Small-size banks with the transferred banks	37,798		21.7%		7,442	24.5%	0.1	22.1%
Credits to non-financial entities	**89,806**	**68,797**	**100.0%**	**100.0%**	**21,009**	**30.5%**		**100.0%**
- Large banks	62,143	47,627	69.2%	69.2%	14,516	30.5%	(0.0)	69.1%
- Medium-size banks	21,651	7,947	24.1%	11.6%	13,703	172.4%	12.6	65.2%
Medium-size banks without the transferred banks	10,179		11.3%		2,232	28.1%	(0.2)	10.6%
- Small-size banks	6,012	13,222	6.7%	19.2%	(7,210)	-54.5%	(12.5)	-34.3%
Small-size banks with the transferred banks	17,484		19.5%		4,261	32.2%	0.2	20.3%
Deposits of non-financial entities	**125,267**	**97,922**	**100.0%**	**100.0%**	**27,345**	**27.9%**		**100.0%**
- Large banks	90,507	71,540	72.3%	73.1%	18,967	26.5%	(0.8)	69.4%
- Medium-size banks	26,151	11,240	20.9%	11.5%	14,911	132.7%	9.4	54.5%
Medium-size banks without the transferred banks	13,943		11.1%		2,704	24.1%	(0.3)	9.9%
- Small-size banks	8,609	15,142	6.9%	15.5%	(6,533)	-43.1%	(8.6)	-23.9%
Small-size banks with the transferred banks	20,817		16.6%		5,675	37.5%	1.2	20.8%
Transferred banks								
Assets	20,171	14387	11.6%	10.2%	5,784	40.2%	1.3	17.2%
Credits	11,471	7,538	12.8%	11.0%	3,933	52.2%	1.8	18.7%
Deposits	12,208	8,015	9.7%	8.2%	4,192	52.3%	1.6	15.3%

The changes in the absolute amounts and in the assets structure, in gross credits and in the deposits of non-financial entities at the level of the banking system were caused by the group of large banks, having in mind its dominant share in all three categories. On the other hand, the change in the share of the group of medium banks and the group of small banks in the total assets, credits and deposits is mainly due to the structural change in these two groups of banks relative to December 31, 2005.

The banks which moved to the group of medium banks had a significant positive effect on the total increase in the assets, credits and deposits. In fact, the average growth rates of assets, credits and deposits in this group of banks exceed the average growth rates of these three categories at the level of the overall banking system. The fast pace of growth of the total activities of the group of medium banks is confirmed by the comparison analysis of the growth rates of credits and deposits by individual bank.

Figure 19
Growth rates of gross-credits to non-financial entities by individual bank

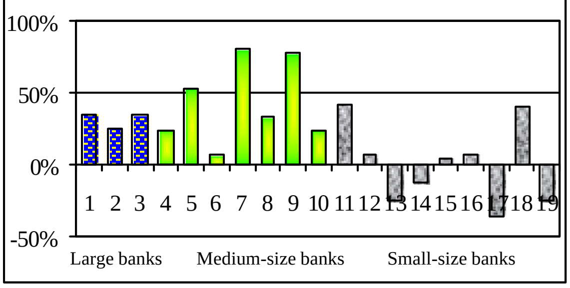
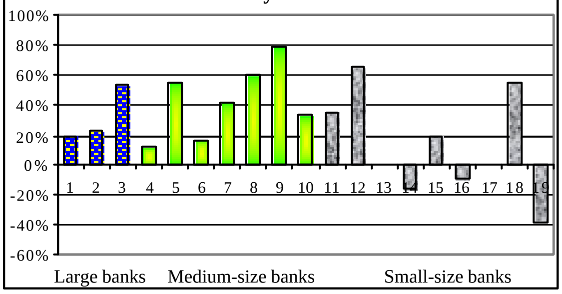


Figure 20
Growth rates of deposits of non-financial entities by individual bank



In spite of the dominance of the group of large banks, during 2006 there was a marked trend of strengthening of the position of the group of medium banks in performing financial intermediation. Contrary to the large and medium banks, most of the small banks register a trend of further deceleration of their role of financial intermediaries.

2.2. Credit activity of the banks - loans extended to non-financial entities

The positive trend in the banks' credit activity, recorded in the previous years, continued in 2006. Gross credits to non-financial entities picked up by Denar 21,009 million, or by 30.5% relative to December 31, 2005. The basis of the intensive credit activity was the increased deposit potential of the banks. The increased credit support of the banks was a result partially of the increased households' and enterprises' demand for credits, partially of the easing of lending terms, of the increased competition among banks, and of the positive perceptions about the total economic activity[14].

Bank Lending Survey

In July 2006, the National Bank started to conduct the Bank Lending Survey, based on the exa mple of the Survey of the European Central Bank. This Survey, which is conducted on a quarterly basis, should provide qualitative information about the banks' credit activity, i.e. about the terms of lending (general and individual terms), and about the demand for credits in individual quarters of the year, as well as about the banks' expectations regarding the following quarter.

The analysis of the terms of lending to enterprises and households points to their easing in most of the banks, during the whole period in which the Bank Lending Survey is conducted.

Most of the banks have explained that the terms of lending were eased by reducing the interest rate on credits. Smalest percentage of the banks reported easing of the terms of lending to enterprises, with respect to the maturity of the credits. Regarding the terms of lending to households, smallest percentage of the banks reported easing of the requirements for collateral for the credit. The easing of the terms of lending influenced the dynamics of the credit demand in both sectors. In all quarters of 2006, relatively larger number of the banks reported faster growth of the credit demand from the "households" sector (except the demand for housing loans in the last quarter of the year), relative to the demand for credits fro m the "corporate" sector. The increase in the credit demand in the "corporate" sector was especially evident in the last quarter of 2006, when it was registered in more than 60% of the banks (weighted average).

On the basis of the analysis of the banks' expectations about the future tendency for easing of the terms of lending, it may be concluded that the banks, in general, expect further easing of the terms of lending to both sectors, also in the beginning of 2007. Such a tendency should reflect positively on the supply of credits, i.e. it should provide for their better accessibility.

[14] In accordance with the results of the Bank Lending Survey for the last three quarters of 2006.

2.2.1. Structure of loans to non-financial entities (by sector, maturity and currency)

As of December 31, 2006, the **structure of the loans from the viewpoint of the various sectors** did not register significant changes relative to the end of 2005 (Annex 3 - Structure of the loans to non-financial entities). Loans to enterprises remained to be the dominant item, with a share of 64.9% (67.9% on December 31, 2005). On annual level, they increased by Denar 11,602 million or by 24.9%, having a contribution of 55.2% in the total increase of gross credits. The upward trend in the credit support of the households, which commenced in the preceding years, continued during 2006. These loans registered an annual increase of Denar 9,258 million, or 42.9%, contributing with 44.1% to the increase in the total gross credits. As a result of these movements, as of December 31, 2006, the share of the gross credits to households in the total gross credits reached the level of 34.4% (31.4% on December 31, 2005).

The analysis of the **maturity structure of gross credits** indicates further dominance and strengthening of long-term lending, which on December 31, 2006 covered 59.1% (54.8% on December 31, 2005) of the total gross credits. At the same time, long-term credits were the main driving force of the total credit growth in during 2006, with a contribution of 73%. The share of short-term lending and of due and non-performing loans equaled 28% and 12.9%, respectively. The dominance of the long-term lending was present in the loans to enterprises, with a share of 51.1%, and especially in the loans to households, with a share of 74.8%.

Table 11
Currency structure of loans by sector

Structure of loans as of 31.12.2006	Enterprises		Hoseholds		Total	
	in millions of denars	structure in %	in millions of denars	structure in %	in millions of denars	structure in %
Denar loans	25,402	43.1%	17,060	55.3%	42,462	47.4%
FX loans	21,917	37.2%	1,707	5.5%	23,624	26.3%
FX indexed loans	11,632	19.7%	12,087	39.2%	23,719	26.4%
Total	58,951	100.0%	30,854	100.0%	89,805	100.0%

Despite the decline in the share of Denar loans in the **currency structure of loans**, they are still dominant in the total gross credits with a share of 47.3% (52.5% as of December 31, 2005). At the expense of that, the share of foreign currency loans and loans with FX clause, which was almost identical as of December 31, 2006 and equaled 26.3% (25.4% on December 31, 2005), i.e. 26.4% (22.2% on December 31, 2005), registered an increase. During 2006, the most evident annual growth of 55.5% was registered in the Denar loans with FX clause, as opposed to the rise of 35.4% and 17.7% of the foreign currency loans and Denar loans, respectively. As a result of such growth, Denar loans with FX clause were the main generator of the total growth of the gross credits, with a share of 40.3%.

Regarding the lending activity with the households, it is evident that the banks were increasingly oriented towards extending Denar loans and Denar loans with FX clause, at the end of 2006. As opposed to this, foreign currency loans (including Denar loans with FX clause) are dominant in the currency structure of the loans to enterprises.

In the groups of large and medium banks Denar credits had a larger share. As opposed to that, despite the largest share of Denar loans in the total loans, the group of small banks registered relatively larger share of Denar loans with FX clause and an extremely small share of foreign currency loans.

Table 12
Structure of loans by group of banks

Structure of loans as of 31.12.2006	Sector structure				Maturity structure				Currency structure			
	Enterprises	Households	Other clients	Total	Short-term	Long-term	Due and non-performing	Total	Denar	FX	FX indexed	Total
Large banks	66.4%	32.7%	0.9%	100.0%	28.4%	57.0%	14.6%	100.0%	49.5%	28.9%	21.7%	100.0%
Medium-size banks	62.8%	36.9%	0.3%	100.0%	25.9%	68.0%	6.2%	100.0%	40.6%	24.5%	34.9%	100.0%
Small-size banks	57.1%	42.3%	0.6%	100.0%	31.2%	48.7%	20.2%	100.0%	48.8%	6.4%	44.7%	100.0%

The relative meaning of the long-term lending was especially emphasized in the group of medium banks, while lending to households had the largest relative share in the lending activity of the group of small banks.

2.2.2. Lending activity in foreign currency and in Denars with FX clause

In the past several years, the upward trend in the foreign currency component[15] of the lending activity of the banks in the Republic of Macedonia was evident. Such a development trend is present not only in the banking system of the Republic of Macedonia, but also in the banking systems of most of the new EU Member States[16], and it is evident both from the increase in the total loans with FX clause and from the increase in their relative share in establishing the total credit base of the banks. Thus, by the end of 2005, the share of loans with FX clause in the banks' total lending activity, by individual Member State, reached up to 76%. At the end of 2006, this indicator for the banking sector of RM equaled 52.7%, as opposed to the initial level of 39.3% at the end of 2002. At the end of 2005, in most of the analyzed countries there was a relatively larger share of the foreign currency component in the lending activity with enterprises, relative to the share of the lending with foreign currency component to the households.

Figure 21
Share of FX and FX indexed loans in total loans to non-financial entities

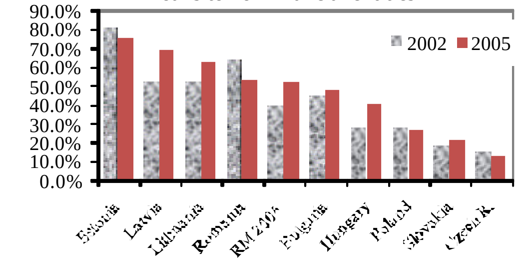
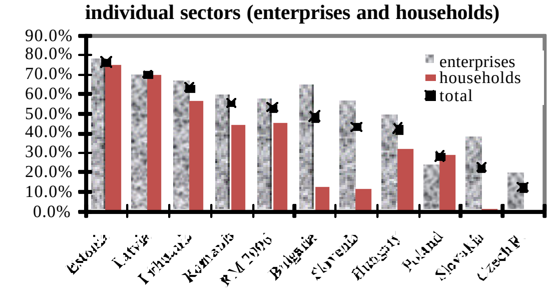
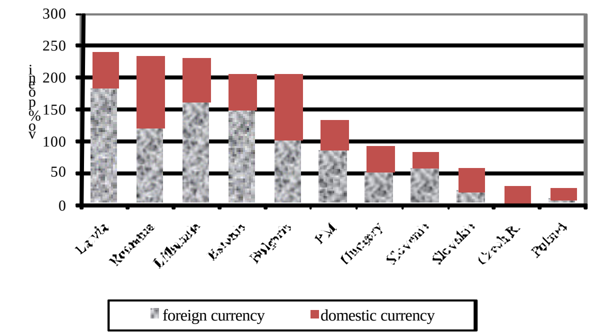


Figure 22
Share of FX indexed loans in total loans to individual sectors (enterprises and households)



The increasing trend in the loans with FX clause adequately reflects on the contribution of these loans to the total increase in gross credits, in the period 2002 - 2005. Almost in all countries, the foreign currency component of the banks' lending activity has a relatively larger contribution to the acceleration of the total lending activity of the banking systems of the respective countries.

Figure 23
Contribution of FX and FX indexed loans to the growth of total loans to private sector



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[15] For the needs of the analysis, lending activity with FX clause denotes loans in foreign currency and Denar loans with FX clause. Data on RM are as of December 31, 2006, while data on the EU Member States are as of December 31, 2005.

[16] Source: Report on the EU Banking Sector Stability, (ECB), November 2006.

The reasons behind such a development trend of the loans with FX clause are different in different countries. In general, most of the countries perceive the favorable interest rate on these loans as the main reason for their increased "popularity". In the Republic of Macedonia, the increasing orientation of the clients towards borrowing in foreign currency is primarily motivated by the lower interest rates that the banks offer for this type of loans.

Table 13
Main reasons for the "popularity" of the loans with FX clause

	Bulgaria	Estonia	Hungary	Lithuania	Latvia	Poland	Romania	Slovenia	Slovakia	RM
interest rate advantage	x	x	x	x		x	x	x		x
fixed exchange rate regime	x	x		x	x					x
expectation to join euro area soon		x		x	x			x		
lack of risk awareness			x			x	x			x
appreciation trend of local currency						x	x			
strong export orientation				x	x				x	
scarcity of domestic financing			x		x					

Source: EU Banking Sector Stability Report, ECB, November 2006. For RM assessment of NBRM.
Note: The data for the Czech Republic is not included due to the minor relevance of foreign currency loans in lending to private sector in this country.

2.3. Securities portfolio

During 2006, banks' increased interest in investing in securities, primarily debt securities, continued. That caused an increase of Denar 6,420 million of 36% in the securities portfolio, on annual basis. Such a dynamics led to an increase in the share of the securities portfolio from 12.7% (December 31, 2005) to 13.9% (December 31, 2006) in the total assets of the banks in the Republic of Macedonia.

Within the securities portfolio, debt securities had a dominant position with a share of 93.7% (Annex 4 - Structure of the securities portfolio). The structural analysis of the debt securities indicates a decline in the share of the CB bills (from 54.6% on December 31, 2005 to 41.6% on December 31, 2006), at the expense of the increase in the position of the government securities issued on various basis (from 44.1% on December 31, 2005 to 57.7% on December 31, 2006). Generator of such movements was the increase in the amount of underwritten Treasury bills. Such movements were to a large extent a result of the change in the monetary policy instruments of the National Bank[17]. As of December 31, 2006, the total amount of underwritten Treasury bills by the banks stood at Denar 7,103 million, which is an increase of Denar 6,313 million, or 799.2% relative to December 31, 2005. From the total amount of underwritten Treasury bills on December 31, 2006, 77.4% were for the banks, while 22.6% were for the clients.

Despite the increase of Denar 258 million, of 360% compared with December 31, 2005, the continuous Treasury bills still have an insignificant share of 2.5% in the overall securities portfolio.

As of December 31, 2006, 6.3% of the securities portfolio pertained to the equity instruments. Here, 55.2% of this item were investments in banks and other financial institutions in the country.

2.4. Deposit activity of banks - deposits of non-financial entities

The upward trend in the banks' deposit potential registered in the preceding years continued in 2006. Thus, as of December 31, 2006, deposits of non-financial entities stood at Denar 125,267 million, which is an increment of Denar 27,345 million, i.e. 27.9% relative to December 31, 2005.

[17] In March 2006, the National Bank, in cooperation with the Ministry of Finance, commenced the issuance of Treasury bills for monetary policy purposes.

2.4.1. Structure of deposits of non-financial entities (by sector, maturity and currency)

As of December 31, 2006, household deposits were still the main generator of the banks' total deposit potential, with a share of 57% (Annex 5 - Structure of deposits of non-financial entities). They registered the most significant increase in absolute amounts of Denar 13,839 million, which was the main driving force of the rise in the total deposits (share in the total growth of 49%) during 2006. The share of the corporate deposits in the total deposits was 36.5%. Compared with December 31, 2005, they went up by Denar 11,320 million, which was a contribution of 41.4% to the total growth of the deposit base. At the end of 2006, household deposits and corporate deposits registered annual growth rates of 24.0% and 32.9%, respectively.

Table 14
Structure of deposits by individual group of banks

Deposit structure as of 31.12.2006	Sectoral structure					Maturity structure				Currency structure		
	Enterprises	Households	Public sector	Other clients	Total	Sight deposits	Short-term deposits	Long-term deposits	Total	Denar deposits	Foreign currency deposits	Total
Large banks	35.6%	58.1%	1.0%	5.2%	100.0%	46.6%	51.5%	1.9%	100.0%	45.7%	54.3%	100.0%
Medium-size banks	41.9%	52.6%	1.3%	4.2%	100.0%	39.1%	50.8%	10.0%	100.0%	46.3%	53.7%	100.0%
Small-size banks	29.3%	58.8%	5.8%	6.2%	100.0%	55.4%	35.7%	8.9%	100.0%	68.7%	31.3%	100.0%

Regarding the **structure of deposits by sector** in each individual group of banks, the share of the deposits of the "household" sector was more significant in the groups of large and small banks, while in the group of medium banks there was a relatively equal distribution of the deposits between the "household" and "corporate" sectors.

The unfavorable **maturity structure** of the banks' deposit potential was maintained also at the end of 2006. Namely, 95.9% of the banks' deposits were with maturity of up to one year (of which 47.6% were sight deposits[18]), while only 4.1% were long-term deposits. However, it should be emphasized that also during 2006, a positive trend was registered towards increasing the maturity of bank's deposits. On annual basis, short-term and long-term deposits registered growth rates of 37.2% and 36.5%, respectively. In the same period, sight deposits registered a growth rate of 18.4%.

The analysis of the maturity structure of deposits at the level of each individual group of banks indicates relatively equal share of sight deposits and short-term deposits in the group of large banks, as opposed to the minor share of the long-term deposits. In the group of medium banks, short-term deposits were dominant, while in the group of small banks, largest was the share of sight deposits. In these two groups of banks, long-term deposits were relatively more significant in establishing the total deposit potential, compared with the group of large banks. In fact, the group of medium banks had a dominant share of 51.5% in the total long-term deposits at the level of the banking system.

As of December 31, 2006, the **currency of denomination structure of the banks' deposit base** was almost identical with that on December 31, 2005. Foreign currency deposits participated with 52.6%, and Denar deposits with 47.4% in the total deposit base. Of the total Denar deposits, 9% are Denar deposits with FX clause. During 2006, non-financial entities had stronger preference for saving in Denars, which is in correlation with the growth rate of the Denar deposits of 37%, as opposed to the increase in the foreign currency deposits of 20.7%.

Regarding the currency of denomination structure of deposits, in the group of large and in the group of medium banks larger share of foreign currency relative to the share of Denar deposits was registered. On the contrary, in the group of small banks, the share of the Denar deposits was dominant in their total deposit potential.

[18] The sight deposits include transaction deposits.

3. Risks in banks' operations

3.1. Credit risk

As of December 31, 2006, the total credit exposure[19] of the banking system amounted to Denar 179,188 million, which is by Denar 38,492 million, or 27.4% more compared with 31.12.2005. The transfer of four banks from the group of small to the group of medium banks caused the largest annual growth rate of the credit exposure (of 146.4%) with the group of medium banks, and at the same time a decline in the credit exposure (by 40%) in the group of small banks. This was primarily a result of the high rate of increase in the credit exposure of the banks which were transferred from the group of small to the group of medium banks (of 43.6%).

Table 15
Credit exposure and its increase by group of banks

Groups of banks	Credit exposure (in millions of Denars)		Structure of credit exposure (in %)		Annual change 31.12.2006/ 31.12.2005		
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	In absolute amounts	In percent	Share in the change
Large banks	98.437	124.108	70,0%	69,3%	25.671	26,1%	66,7%
Medium- size banks	15.945	39.283	11,3%	21,9%	23.338	146,4%	60,6%
- medium- size banks, excluding transferred banks from the group of small-size banks		*20.328*		*11,3%*	*4.383*	*27,5%*	*11,4%*
Small-size banks	26.314	15.797	18,7%	8,8%	-10.517	-40,0%	-27,3%
- small-size banks, including transferred banks to the group of medium-size banks		*34.752*		*19,4%*	*8.438*	*32,1%*	*21,9%*
Transferred banks	*13.197*	*18.955*	*9,4%*	*10,6%*	*5.758*	*46,6%*	*15,0%*
Total:	**140.696**	**179.188**	**100,0%**	**100,0%**	**38.492**	**27,4%**	**100,0%**

Regular credits were dominant in the structure of the credit exposure, with a share of 67.0%, and grew at an annual rate of 25.2%. Their share in the total increase of the credit exposure was 62.8%. During 2006, the downward trend in the non-performing loans continued, and they dropped by Denar 196 million, or 1.9%. As of December 31, 2006, their share in the total exposure at the level of the banking system equaled 5.8%, which is by 1.7 percentage points less compared with the end of December 31, 2005. Banks' off-balance sheet exposure registered the largest annual growth rate of 62.4% (primarily on the basis of approved credit limits on the basis of payment cards, permitted negative balances on current accounts and uncovered letters of guarantee, letters of credit and confirmed letters of credit), whereby its share in the total credit exposure picked up by 2.8 percentage points and equaled 12.6% on December 31, 2006.

Stress-test analysis for banks' resilience to credit risk

The stress-test analysis*, which is based on quantification of the maximum possible increase of the credit activity, without jeopardizing the banks' solvency, showed that as of December 31, 2006 the banks had sufficient capacity for increasing the lending volume. Gross credits at the level of the banking system could go up by 63.2%. The rate of credit growth in ten banks could exceed 100%, without reducing their capital adequacy ratio below the legally determined minimum level. Also, the analysis has shown that eleven banks could face with a shift of 25% of the regular credits into non-performing, without jeopardizing their solvency.

Such results are another indicator that the banking system of the Republic of Macedonia has a significant potential for further deepening of the financial intermediation.

* This stress-test analysis is based on the basic assumptions that the macroeconomic environment remains stable and that the same structure of the newly-extended credits, in terms of their risk level, is mainatined as in 2006.

[19] Besides credits, banks' total credit exposure also includes the claims on other basis (interest, commissions, advance payments, investments in equity instruments), as well as uncovered letters of guarantee, uncovered letters of credit and other potential claims of the banks which reflect certain level of credit risk.

3.2. Quality of the credit exposure

In spite of the intensive credit activity of the banks, during 2006 the quality of banks' credit exposure did not deteriorate significantly. Credit exposure classified in risk categories "A" and "B" registered an annual increase of Denar 40,238 million (the share of the credit exposure in risk category "A" in this increase equaled 86.5%), whereby their share in the total credit exposure went up by 3.3 percentage points and equaled 92.4% on December 31, 2006. As opposed to that, during the same period, credit exposure classified in risk categories "C", "D" and "E" dropped by Denar 1,746 million, whereby their share in the total credit exposure was reduced from 10.9% (on December 31, 2005) to 7.6% on December 31, 2006. During 2006, credit exposure classified in the risk category "E" went down by 1.5% and its share in the total credit exposure equaled 3.5% on December 31, 2006.

Figure 24
Movements of total absolute amount of credit exposure clasified in category of risks "C", "D" and "E"

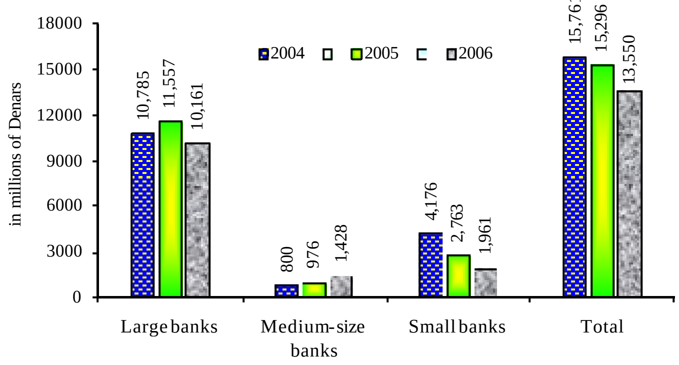


Table 16
Structure of credit exposure by risk category

Category of risk	Credit exposure				Change 31.12.2006/31.12.2005		
	31.12.2005		31.12.2006				
	Amount (in millions of Denars)	Structure (in %)	Amount (in millions of Denars)	Structure (in %)	In absolute amounts	In percent	Share in the change
A	108.913	77,4%	143.707	80,2%	34.794	31,9%	90,4%
B	16.488	11,7%	21.931	12,2%	5.443	33,0%	14,1%
C	4.473	3,2%	3.807	2,1%	-666	-14,9%	-1,7%
D	4.420	3,1%	3.435	1,9%	-985	-22,3%	-2,6%
E	6.403	4,6%	6.308	3,5%	-95	-1,5%	-0,2%
Total:	**140.697**	**100,0%**	**179.188**	**100,0%**	**38.491**	**27,4%**	**100,0%**

As a result of such developments, on December 31, 2006, the average risk level of the credit exposure at the level of the banking system equaled 6.6% (corresponds with the risk category "B"), which is by 1.8 percentage points less compared with December 31, 2005.

The improved quality of banks' credit exposure is evident also from the reduced share of the non-provisioned amount of credit exposure classified in risk categories "C", "D", and "E" (credit exposure reduced by the respective amount of allocated special reserve) in the guarantee capital from 26.1% (December 31, 2005) to 19.4% (December 31, 2006). This means that, under the assumption for complete non-collectibility of the credit exposure classified in risk categories "C", "D", and "E", it would take less than one-fifth of the banks' guarantee capital to cover the losses. In accordance with this, capital adequacy would reduce from 18.3% to 14.8%, which indicates that the solvency of the banking system of the Republic of Macedonia remains stable even under such an extreme scenario.

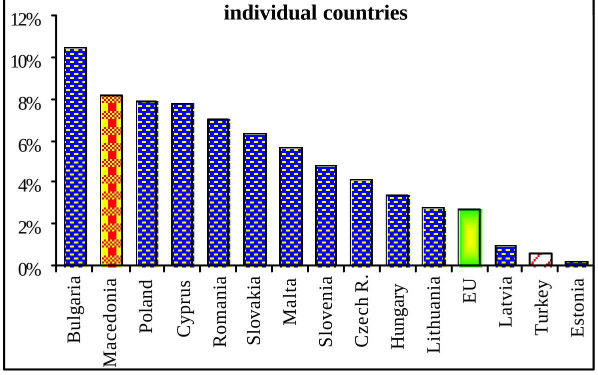
Table 17
Indicators of the credit exposure quality by individual group of banks

Groups of banks	% of „C“, „D“ and „E“ in total credit exposure		% of „C“, „D“ and „E“ in guarantee capital		% of net „C“, „D“ and „E“ in guarantee capital	
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	31.12.2005	31.12.2006
Large banks	11,7%	8,2%	123,5%	91,6%	43,8%	31,1%
Medium- size banks	6,1%	3,6%	36,7%	21,3%	20,8%	10,5%
- medium- size banks, excluding transferred banks from the group of small-size banks		*3,4%*		*21,5%*		*9,6%*
Small-size banks	10,5%	12,4%	29,8%	33,7%	9,8%	7,3%
- small-size banks, including transferred banks to the group of medium-size banks		*7,7%*		*29,1%*		*8,7%*
Transferred banks	*5,3%*	*3,8%*	*22,3%*	*21,1%*	*10,6%*	*11,2%*
At the level of banking system	**10,9%**	**7,6%**	**71,8%**	**57,4%**	**26,1%**	**19,4%**

The perception for improved quality of the credit exposure is confirmed also on the basis of individual groups of banks, although the level of improvement is not the same in all groups. In the group of small banks, all indicators of the credit exposure quality registered improvement relative to the end of 2005, while in the group of small banks part of these indicators deteriorated. Such unfavorable trends in the group of small banks are mainly a result of the transfer of four banks from the group of small to the group of medium banks. If the effect of the structural change in the groups of banks is excluded, the indicators of the quality of the credit exposure of all groups of banks registered a significant improvement.

The group of large banks plays the key role with respect to the quality of the credit exposure of the banking system. Thus, as of December 31, 2006, this group of banks took 75% of the credit exposure classified in the risk categories "C", "D" and "E", and 68.8% of the credit exposure in "A" and "B". At the same time, this group of banks had a share of 75.5% in the total amount of the allocated special reserve for covering of the potential losses at the level of the banking system.

Figure 25
Share of non-performing loans in total loans by individual countries



Despite the trend of improvement of the banking system's credit exposure quality, the analysis by individual European countries[20] shows that the indicator of the credit exposure quality - share of the non-performing loans in the total loans in the Republic of Macedonia is still relatively high. At the end of 2006, the share of the non-performing loans in the total loans at the level of the banking system of the Republic of Macedonia equaled 8.2%, while in the other analyzed countries this indicator ranged between 0.2% and 7.9% at the end of 2005. In the EU Member States the average share of the non-performing loans in the total loans was 2.7%. This indicator is higher only for the banking system of Bulgaria (10.4% as of December 31, 2005).

As of December 31, 2005, the indicator of the quality of the credit exposure for the EU Member States, calculated as a share of the credit exposure classified in "C", "D" and "E" in the total exposure equaled 2.8%. At the end of 2006, this indicator for the Republic of Macedonia equaled 7.6%.

[20] Source: Reports on the financial stability analysis of individual countires and of the European Central Bank.

3.2.1. Level of risk of the credit exposure regarding the currency of denomination structure

With respect to the currency structure of the credit exposure, as of December 31, 2006, Denar credit exposure had the largest share of 45.2%, and it was followed by the foreign currency credit exposure with 38.9%, and Denar credit exposure with FX clause, with a share of 15.9%. Hence, it is evident that the credit exposure with currency component is dominant with a share of 54.8% in the total credit exposure.

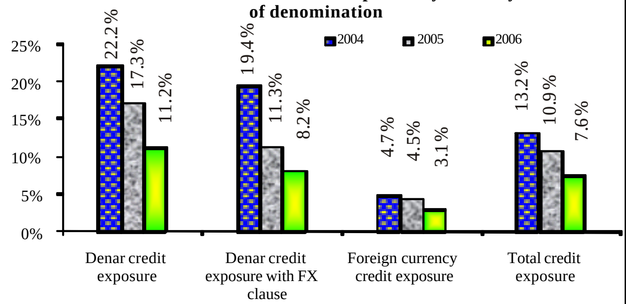
Table 18
Currency of denomination structure of the credit exposure

Type of credit exposure	Amount (in millions of Denars)		Growth 31.12.2006/31.12.2005		
	31.12.2005	31.12.2006	In absolute amounts	In percent	Share in the growth
Denar credit exposure	59,221	80,994	21,773	36.8%	56.6%
Denar credit exposure with FX clause	20,904	28,479	7,575	36.2%	19.7%
Foreign currency credit exposure	60,573	69,715	9,142	15.1%	23.8%
Total credit exposure	**140,698**	**179,188**	**38,490**	**27,4%**	**100,0%**

Denar credit exposure registered the fastest growth of Denar 21,773 million (or 36.8%) relative to the end of 2005, but the growth of the Denar credit exposure with FX clause of 36.2% is also noticeable.

Credit exposure quality, analyzed from the viewpoint of its currency of denomination structure, has also improved. Indicator of this is the continuous improvement of the indicators of the share of the credit exposure classified in risk categories "C", "D" and "E" in the total credit exposure by currency (domestic and foreign). Lowest risk is registered in the foreign currency credit exposure, which is partially a result of the fact that foreign currency lending to residents was liberalized in 2003, so it is a relatively "young" credit portfolio.

Figure 26
Share of credit exposure classified in categories of risk "C", "D" and "E" in total credit exposure by currency of denomination

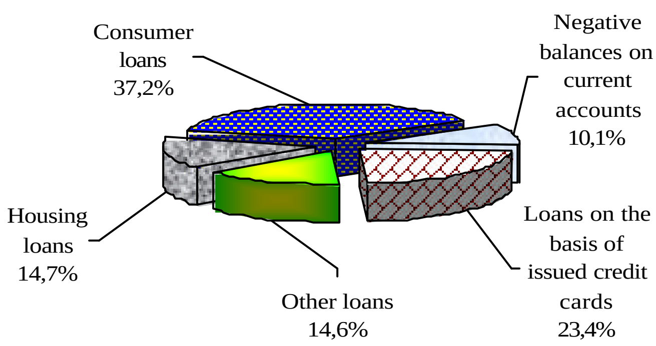


3.2.2. Level of risk of the credit exposure regarding the sector structure

As of December 31, 2006, the exposure to non-financial legal entities from various economic activities is dominant in the sector structure of the credit exposure, with 77.8%, while the remaining portion of 22.2% pertains to the exposure to the "households" sector. The trend of faster growth of the credit exposure to households compared with that to the other economic activities, continued in 2006. The annual growth rate of the credit exposure to households equaled 53.7%, as opposed to the annual growth rate of the credit exposure to the economic activities, which equaled 21.4%. As a result of the faster growth, credit exposure to households increased its share in the total credit exposure by 3.8 percentage points.

3.2.2.1. Structure and quality of the credit exposure to households

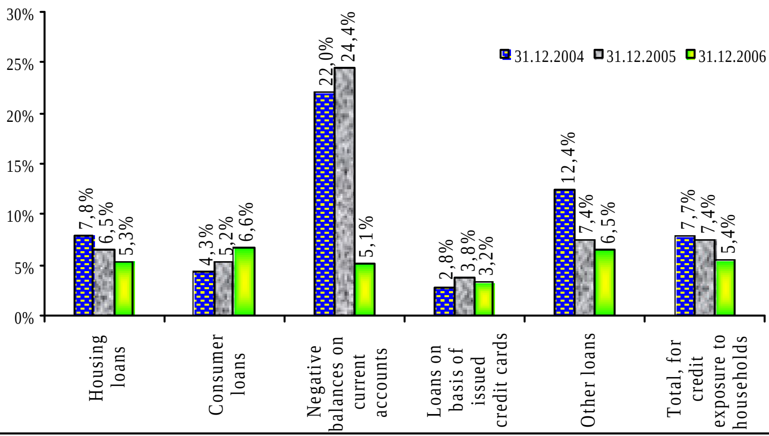
Figure 27
Structure of credit exposure to households as of 31.12.2006



Note: The category "other loans" also includes micro credits for business purposes. Starting at 31.03.2007 banks will report to NBRM more detailed about the structure of these loans according to their purposes.

Consumer credits were dominant in the structure of the credit exposure to the "household" sector, with a share of 37.2%. Relative to December 31, 2005, this share dropped by 8.2 percentage points, while the share of the credit exposure on the basis of issued credit cards increased (from 16% on December 31, 2005, to 23.4% on December 31, 2006). The other types of credit exposure to households did not register significant changes during 2006.

Figure 28
Share of credit exposure classified in categories of risk "C", "D" and "E" in total credit exposure to households



The general trend of improvement of the banks' credit exposure quality was present in the part of the credit exposure to households. Thus, as of December 31, 2006, the share of the credit exposure to households classified in risk categories "C", "D" and "E" in the total credit exposure to this sector, equaled 5.4%, which is by 2 percentage points less relative to December 31, 2005.

At the end of 2006, the average classification of the credit exposure, measured as a ratio of the determined potential losses to the credit exposure to the households sector, equaled 4.6%, which corresponds with the risk category "A" and registers a decline of 0.8 percentage points relative to December 31, 2005.

3.2.2.2. Sector structure of credit exposure to non-financial legal entities and risk level

The financial intermediation dominates in the structure of the total credit exposure of the banking system, making up 37.2%. Most of the credit exposure to this activity arises from the banks' exposure to the National Bank (based on placements in CB bills), and from the exposure in the form of deposits with foreign and domestic banks. Compared to December 31, 2005, the share of financial intermediation in the total exposure by activity went down by 4.7 percentage points, owing to the acceleration of the credit activity and the higher demand for government securities by the banks over the past period. Hence, compared to December 30, 2005, the highest growth rate was registered in the credit exposure to the public administration, defense and compulsory social protection, as a result of the accelerated activity of the banks on the primary government securities market (treasury bills and continuous government bonds)[21].

Table 19
Annual dynamics of credit exposure by activity

Activity	Credit exposure by activities (31.12.2005)		Credit exposure by activities (31.12.2006)		Annual growth 31.12.2006/31.12.2005		
	Amount (in millions of Denars)	Structure (in%)	Amount (in millions of Denars)	Structure (in%)	In absolute amounts	In percent	Share in the growth
Financial intermediation	48.106	41.9%	51.887	37.2%	3.781	7.9%	15.4%
Industry	24.357	21.2%	30.706	22.0%	6.349	26.1%	25.8%
Wholesale and retail trade	17.647	15.4%	22.329	16.0%	4.682	26.5%	19.0%
Public administration and defense; compulsory social	7.866	6,8%	13.566	9,7%	5.700	72,5%	23,2%
Construction	5.967	5,2%	6.975	5,0%	1.008	16,9%	4,1%
Transport, storage and communication	3.215	2,8%	4.772	3,4%	1.557	48,4%	6,3%
Agriculture, hunting and forestry	2.069	1,8%	2.842	2,0%	773	37,4%	3,1%
Other activities*	5.613	4.9%	6.372	4.6%	759	13.5%	3.1%
Total:	**114.839**	**100.0%**	**139.450**	**100.0%**	**24.611**	**21.4%**	**100.0%**

*The annual growth of credit exposure to other activities resulted from the Denar 639 million, or 40.5% higher credit exposure to the activity hotels and restaurants Thus, this activity generates more than 84% of the growth in the total exposure to the other activities.

On December 31, 2006, 43% of the banks' credit exposure was concentrated in three activities (industry[22], wholesales and retail sales and construction). The banks' credit exposure to the industry constituted 22% of the total credit exposure and registered an annual growth of 26.1%. It was an impetus for the 3.6% cumulative growth of the industrial output for 2006. Within this activity, the credit exposure to the electricity, gas and water supply sector also registered considerable annual growth of 191.1%, primarily resulting from the higher exposure to two clients.

Fast growth in the exposure of 48.4% was also registered in the sector of transport, storage and communications. More than half of the growth in the credit exposure to this sector was concentrated in three legal entities.

The credit exposure to the wholesales and retail sales registered an annual growth of Denar 4,682 million, i.e. 26.5%. Considering that the growth in the total wholesales and retail sales in 2006 amounted to Denar 4,155 million, one could conclude that the trade growth was largely consistent with the banks' credit support.

The credit exposure to the construction went up by 16.9% on annual basis, which corresponds to the 5.7% higher value of contractual construction works in 2006, compared to 2005.

The permanent trend of improving the credit exposure quality of the banking system over the past period, also led to lower average risk level[23] of the exposure to each activity, and also lower share of credit exposure classified in C, D and E risk categories in the total credit exposure to each activity. These indicators refer to five

[21] As of December 31, 2006, the banks accounted for 77.4% of the ownership structure of the issued treasury bills, making up 97.0% of the credit exposure of the banking system to the public administration.
[22] The industry includes the sectors of manufacturing industry, mining and quarrying and electricity, gas and water supply.
[23] The average risk level of the credit exposure for a specific activity is a ratio of the identified potential credit risk losses to the total credit exposure across the banking system, which relate to the specific activity.

activities[24], jointly making up 48.5% of the total credit exposure of the banking system as of December 31, 2006, and approximately 58.4% of the GDP structure in 2006, generating roughly 69.9% of the total GDP growth in the same period[25]. The differences in the risk profile of the activities under observations were also evident. The lowest risk was registered in the credit exposure to the transport, storage and communications, and the highest risk was registered in the banks' credit exposure to the agriculture, hunting and forestry. Although the values of these indicators were still relatively high, they registered a downward trend in all analyzed activities. Compared to the end of 2005, the industry and the agriculture, hunting and forestry registered the fastest decrease in the average risk level of 6.4, i.e. 5.9 percentage points, respectively. Also, the share of the credit exposure of the agriculture, hunting and forestry classified in C, D and E risk categories registered the fastest decrease of 15.8 percentage points in the total credit exposure to this activity.

Table 20
Indicators for the credit exposure quality by economic activity

Indicators for credit portfolio quality	Date	Industry	Agriculture, hunting and forestry	Construction	Wholesale and retail trade	Transport, storage and communication
Average level of risk of credit exposure to selected economic activities	*31.12.2004*	21,9%	29,5%	11,1%	18,3%	11,7%
	31.12.2005	21,5%	25,2%	9,7%	14,3%	10,7%
	31.12.2006	15,1%	19,3%	8,5%	11,4%	8,2%
Share of credit exposure classified in "C", "D" and "E" in total credit exposure to selected economic activities	*31.12.2004*	32,1%	43,8%	24,4%	20,3%	13,2%
	31.12.2005	28,8%	36,5%	23,8%	14,8%	11,5%
	31.12.2006	18,3%	20,7%	14,9%	11,9%	6,9%

Although, at the end of 2006, the average risk category of the credit exposure to the non-financial legal entities remained unchanged compared to the end of 2005 (B), there is an improvement in the potential loss-to-credit exposure ratio by 4 percentage points.

Based on the transitional matrix for natural persons[26] and on non-financial legal entities[27], for the December 31, 2005 - December 31, 2006 period (Annex 7 - Transitional Matrix for Clients - natural persons and Transitional Matrix for Clients - non-financial legal entities), an attempt was made to assess the credit exposure quality developments as of December 31, 2005 and December 31, 2006, abstracting the effect of the newly extended credits in 2006. It could be also ascertained that in 2006, the existing credit exposure of the natural persons deteriorated, measured through the share of C, D and E in the total credit exposure to the households (this indicator increased from 5.9% at the end of 2005, to 9.1% at the end of 2006). On the other hand, the existing credit exposure to non-financial legal entities deteriorated, measured through the same indicator (from 15.2% on December 31, 2005, to 16.5%

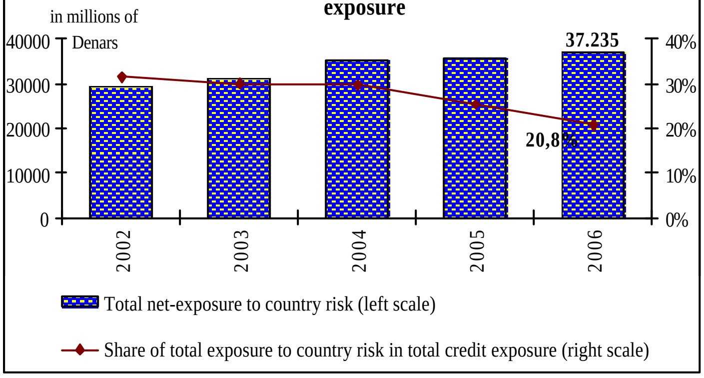
[24] The activities the banks are mostly exposed to, except for the financial intermediation and public administration and defense, such as industry, wholesales and retail sales, construction, transport, storage and communications and agriculture hunting and forestry are subject to analysis.
[25] Source: Announcement on short-term macroeconomic indicators, State Statistical Office, dated March 30, 2007.
[26] The transitional matrix for natural persons includes only natural persons - residents with exposure of over 150.000, the banks are required to report to the Credit Registry as defined by the Decision on the Contents and the Method of Operating the Credit Registry.
[27] The transitional matrix for clients - non-financial legal entities (enterprises) includes only non-financial legal entities - residents the banks are required to report individually to the Credit Registry as defined by the Decision on the Contents and the Method of Operating the Credit Registry. More precisely, in the compilation of the transitional matrix, the credit exposure of banks to other domestic banks, to legal entities - non-residents (including foreign banks) and to legal entities with a total credit exposure below Denar 500,000 were not taken into account.

on December 31, 2006). If these results are compared with the credit exposure quality as of December 31, 2006 (the share of C, D and E in the total credit exposure to the natural persons and to non-financial legal entities equaled 5.4% and 14.6%, respectively), it could be concluded that the newly extended credits, primarily classified in a lower risk level, had a greater effect on the credit exposure quality to the households, rather than to the non-financial legal entities.

3.3. Country risk

On December 31, 2006, the total exposure of the banking system to the country risk stood at Denar 37,648 million. Compared to the end of 2005, the total exposure to country risk went up by Denar 1,249 million, i.e. by 3.5%, and its share in the total credit exposure went down by 4.6 percentage points, reducing to 21% on December 31, 2006.

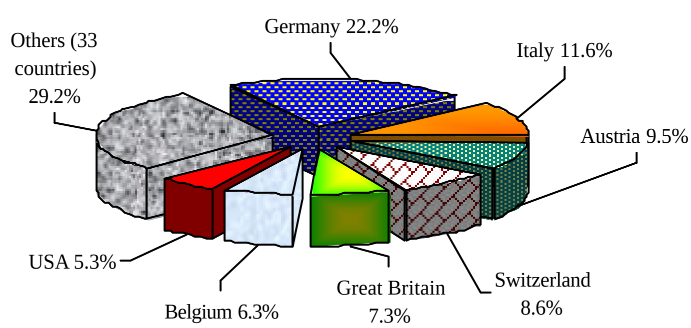
Figure 29
Exposure to country risk and its share in total credit exposure



Most of the banks' exposure to country risk (98.9%) arose from the deposits placed with foreign banks. On December 31, 2006, the total potential losses on the country risk amounted to Denar 45 million, i.e. only 0.4% of the total potential losses as of December 31, 2006. Also, 91.6% of the total potential losses on the country risk stemmed from the banks' exposure to two countries, and 61.8% was exposure of one bank to one client.

The banks' exposure to country risk arose from the credit exposure to clients from 33 countries. The country-by-country analysis shows the highest exposure to the EU member-states (Germany, Italy, Austria, Great Britain, Belgium, etc.), and to other countries such as Switzerland and the USA. Analyzing by groups of banks, the group of large banks dominate in the total net-exposure to the country risk, constituting 73.1%. On December 31, 2006, the groups of medium- and small-size banks made up 20.9% and 5.9%, respectively of the total net-exposure to the country risk.

Figure 30
Structure of net-credit exposure to country risk by countries



3.4. Liquidity risk

In 2006, the banks in the Republic of Macedonia preserved satisfactory liquidity level, analyzed through the level and the structure of the sources of financing, availability of highly liquid and liquid assets and through the maturity match of the banks' assets and liabilities. Particularly positive is the increase in the maturity of the banks' deposit potential, especially as a result of the faster growth in the time deposits, compared to the growth in the sight deposits. Yet, this trend is not sufficient to overcome the contractual residual maturity mismatch of the banks' assets and liabilities, since the credit maturity period exceeded the average maturity period of the deposit potential. On the other hand, the residual maturity of the expected inflows and outflows of the banks indicates high degree of matching, primarily due to the high stability of the sight deposits, determined on the basis of the experience in the recent years.

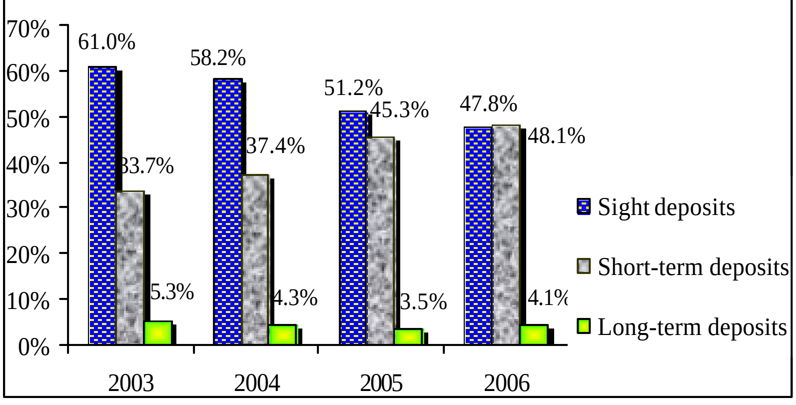
The stress-test analysis of the banking system of the Republic of Macedonia, as of December 31, 2006, that rely upon several stress-test scenarios, indicates a relatively high level of resilience of the banking system to liquidity risk.

3.4.1. Primary sources of financing (deposits of non-financial entities)

The permanent increase in the deposits of the non-financial entities, registered in the preceding years, continued in 2006. In 2006, the average monthly amount[28] of deposits of non-financial entities, as primary sources of financing climbed to Denar 109,556 million which by 21.2% more compared to 2005. On the other hand, in the preceding year, the average share of primary sources of financing in the total average sources of financing and in the total third party's sources of financing of the banks reached 71% and 84.3%, respectively (in 2005, these shares equaled 69.6% and 84.1%, respectively).

The trend of constant increase in the maturity of the primary sources of financing kept on in 2006. The sight deposits accounted for 47.8%, on average, of the total deposit base, losing the privilege of a major category of primary sources of financing. On the other hand, the time deposits with maturity

Figure 31
Maturity structure of primary sources of funds

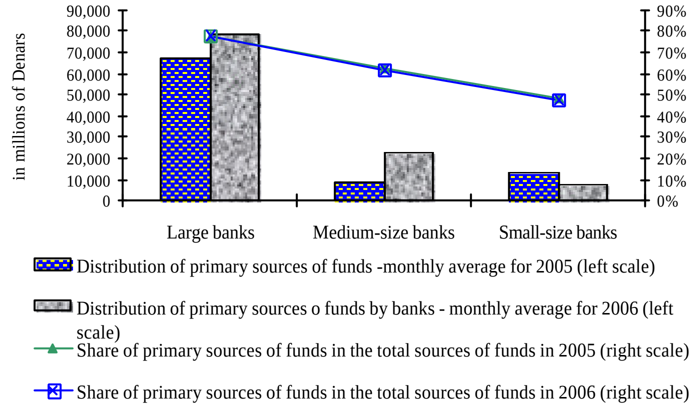


[28] For the purposes of this report, "average monthly amount" denotes a balance average at the end of each month over the period under observation.

of up to one year became dominant in the primary sources of financing, with an average monthly share of 48.1%. The average monthly share of the long-term deposits remained low, and equaled 4.1% in 2006.

In 2006, the deposit structure by group of banks was almost identical as in 2005. In 2006, the highest growth rate of the average amount of primary sources of financing of 145.0% was registered in the group of medium-size banks, followed by the group of large banks with an average annual growth rate of 16.5%. Only the group of small-size banks registered by 39.9% lower average amount of primary sources of financing in 2006, largely due to the structural development of this group of banks. With an exception of two banks, all other banks in the Republic of Macedonia registered an increase in the primary sources of financing in 2006.

Figure 32
Distribution of primary sources of funds by groups of banks

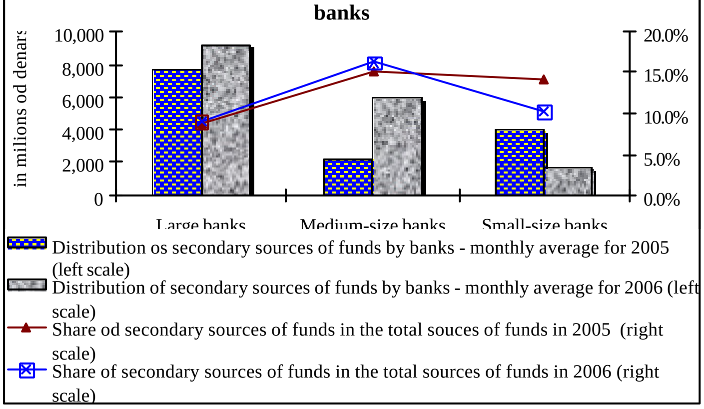


3.4.2. Secondary sources of financing

In 2006, the average share of secondary sources of financing (banks' deposits and short-term and long-term borrowings) constituted 10.9% of the total sources of financing (10.7% in 2005). Their average share in the total banks' liabilities remained unchanged relative to 2005, accounting for 12.9% in 2006. Most of the secondary sources of financing (79.6%) are long-term credit lines withdrawn from foreign banks and placed in the form of long-term credits. Analyzing the comparative balance sheet data, in 2006, compared to 2005, the long-term borrowings from foreign banks dropped by 1.5%. The above drop resulted from the reversals book entry in the banks' balance sheets made upon suggestion of the NBRM. Disregarding the reversal book entry, the long-term borrowings from foreign banks would further register an uptrend of 11.2%, compared to the preceding year, primarily due to the increase in the long-term borrowings by the groups of large and small-size banks.

In 2006, most of the secondary sources of financing (54.6%) still belonged to the group of large banks. Compared to 2005, the share of the secondary sources of financing in the total sources of financing of the group of medium-size banks went up, whereas such share of the group of small-size banks went down. Such

Figure 33
Distribution of secondary sources of funds by groups of banks



developments resulted primarily from the structural changes of these two groups and from the increase in the deposits of other banks with the group of medium-size banks.

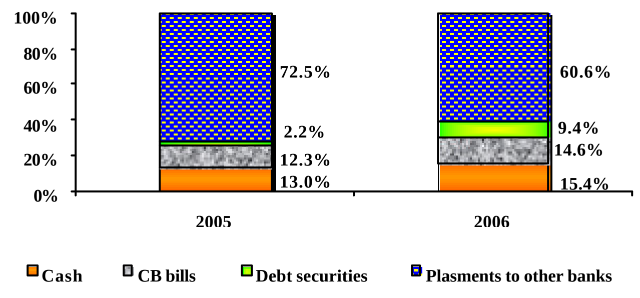
In the period under observation, the groups of large, medium- and small-size banks financed 9.1%, 16.3% and 10.2%, respectively, of their business through the secondary sources of financing. The comparable analysis shows that in 2005, these ratios equaled 8.3%, 14.8% and 14.0% for the groups of large, medium- and small-size banks, respectively. These ratios show that the dependence of the group of small-size banks from the secondary sources of financing slows down, unlike the groups of large and medium-size banks. This is due to the high share of own funds in the total sources of financing and the lower share of primary sources of financing in the total sources of financing of the group of small-size banks, compared to the groups of large and medium-size banks.

In 2006, 28.9% of the total average amount of secondary sources of financing across the banking system belonged to the banks in majority ownership of foreign banks, originating from their parent banks and other members of the parent bank groups. Also, 81.7% of the total secondary sources of financing of these banks originate from their parent bank groups. The long-term credits and deposits had the highest share in the structure of these funds (63.6%).

3.4.3. Liquid assets and highly liquid assets

In 2006, the average amount of banks' liquid assets, defined in broader terms[29], amounted to Denar 56,491 million. Its share of 36.6% in the total assets of the banks was by inconsiderable 0.8 percentage points lower compared to 2005.

Figure 34
Structure of liquid asstes



The liquid assets registered certain structural changes over the analyzed period. The placements to other banks dominated, making up 60.6% of the total liquid assets of the banks, which is notably lower compared to the share of the preceding year (72.5%). Most of these assets (90.7%) were short-term time deposits with foreign banks. The other liquid assets of the banks, in 2006, were in the form of cash (15.4%), CB bills (14.6%) and debt securities (9.4%).

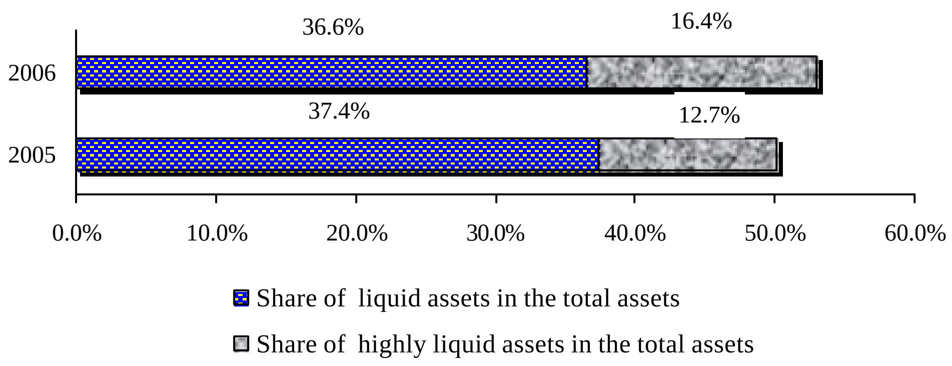
In 2006, the average amount of highly liquid assets[30] equaled Denar 25.349 million, constituting 16.4% of the total assets of the banks in the Republic of Macedonia. The share of highly liquid assets in the total assets surged by 3.8 percentage points compared to 2005. Such level of highly liquid assets in the total assets provides 48.4% coverage of the sight deposit and 19.5% coverage of the total

[29] Liquid assets, in broader terms cover highly liquid assets (defined in the next footnote), short-term placements to foreign banks and placements in other short-term debt securities.
[30] Highly liquid assets includes cash and balances with NBRM; securities with NBRM rediscount; short-term placements in securities issued by the government and correspondent accounts with foreign banks.

banks' liabilities. The above indicates improved liquidity of the banks compared to the preceding year, when the average rate of coverage of the sight deposits and the total liabilities with highly liquid assets equaled 35.6% and 15.3%, respectively.

Figure 35

Share of liquid and highly liquid assets in the total assets



Analyzing by group of banks, the group of small-size banks registered the highest share of highly liquid assets in the total assets, of 24.8% (19.9% for 2005[31]), followed by the group of medium-size banks with a share of 23.3% (22.2% for 2005), and the group of large banks registering the lowest share of 12.6% (8.8% for 2005). The higher shares of highly liquid assets, and the greater domination of the own funds in the total sources of funds with the small-size banks made this group of banks have the highest coverage ratio of the sight deposits with highly liquid assets (94.2%), followed by the group of medium-size banks (86.9%) and the group of large banks (33.3%).

Stress- test analysis of the banks' resilience to liquidity shocks - as of December 31, 2006

The banking system of the Republic of Macedonia could be regarded as significantly resilient to liquidity risk, demonstrated by the results of the simulations of liquidity shocks and the consequences thereof. Applying a simulation of hypothetical one-time withdrawal of 20% of the total households' deposits from the banking system, the total liquid assets and the highly liquid assets of the banking system would reduce by 22.4% and 47.0% respectively on December 31, 2006. This leads to the conclusion that with such liquidity, i.e. assets structure, the banks could endure substantial outflow of households' deposits. Applying this simulation, the coverage ratio of the total liabilities with liquid assets would reduce from 42.6% to 36.5%.

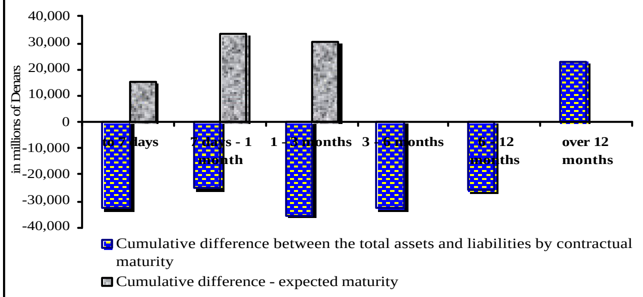
In general, banks hold sufficient liquidity potential for covering the potential withdrawal of deposits of the 20 largest depositors of each bank of the banking system. The share of deposits of the 20 largest depositors in the deposit base of each bank ranges from 12.8% to 75.7%. When simulating such liquidity shock, the reduction of the liquid assets of each bank would range from 0.1% to 113.5%.

[31] The liquid and highly liquid assets for 2005 were impaired as a result of the application of the new methodology underlying their calculation, according to the methodology for analyzing financial stability.

3.4.4. Maturity structure of assets and liabilities

On December 31, 2006, notwithstanding the high level of liquid assets in the total assets, there was contractual[32] residual maturity mismatch between the banks' assets and liabilities. The cumulative contractual residual maturity mismatch between the assets and liabilities could be overcome in the maturity ladder of over 12 months.

Figure 36
Cumulative difference between the total assets and liabilities by contractual and expected maturity - as of 31.12.2006



Analyzing the groups of banks, the largest influence on the contractual residual maturity mismatch, across the banking system was exerted by the group of large banks, which is expected having in mind the dominant share of this group of banks in the total sight deposits (73.8%), which are the most relevant balance sheet category that influence the contractual maturity mismatch. In the group of small-size banks, the cumulative contractual residual maturity mismatch between the assets and liabilities could be overcome in the maturity ladder from one to three months, in the medium-size banks this period is 6 to 12 months, and in the group of large banks it is over 12 months.

The overall picture of the banks' liquidity position would be completely different, if the analysis takes into account the residual maturity structure of the assets and liabilities, anticipated (expected[33]) by the banks. As of December 31, 2006, in all maturity ladders there was a full coverage of the expected outflows with the expected inflows in all groups of banks.

Figure 37
Percent of stable deposits

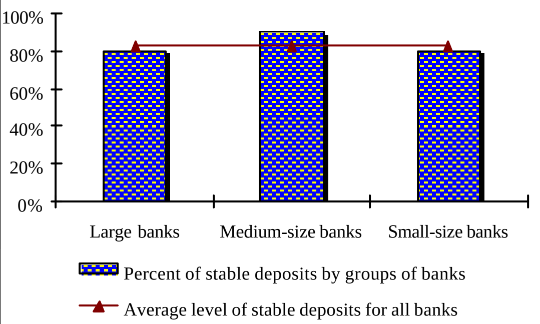
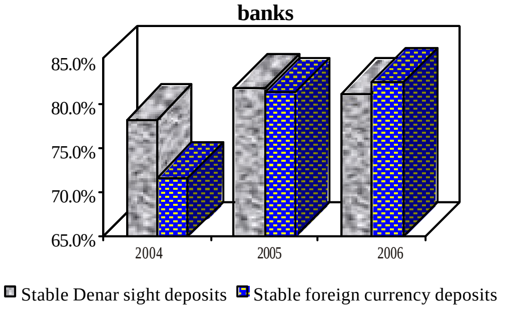


Figure 38
Movements of stable sight deposits for all banks



The experience of the banks shows high level of stability of the sight deposits. On December 31, 2006, the average level of stable sight deposits for all banks equaled 81.8% (81.5% on December 31, 2005), whereas according to the banks' expectations, only 11.6% of the total deposits could be withdrawn within seven days. The level of

[32] The contractual residual maturity of each assets and liabilities items is the residual period from the end of the reporting period to their contractual maturity, i.e. the maturity specified in the agreement concluded between the bank and its client.

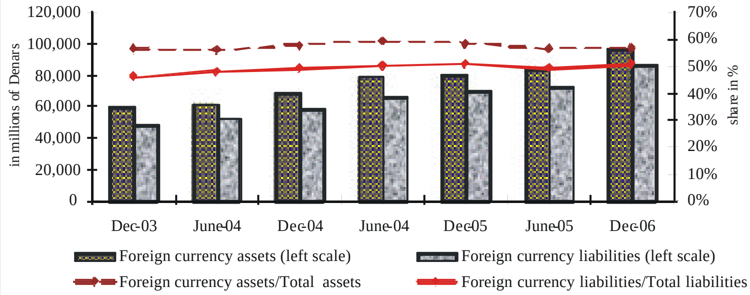
[33] The expected residual maturity of each assets and liabilities items is the residual period from the end of the reporting period to their expected maturity, i.e. period within which the bank considers that there will be inflows and outflows of funds based on its claims and liabilities.

stable Denar sight deposits remained unchanged relative to 2005 (81.8%), and the level of foreign currency deposits mounted to 82.5% (81.2% on December 31, 2005).

3.5. Foreign exchange risk - risk of exchange rate

The increase in both foreign currency credits and foreign currency-indexed credits, and the increase in the foreign assets of foreign persons and the foreign currency-indexed deposits were the major driving force of the increase in the foreign currency component of the balance sheet of the banking system. On December 31, 2006, the total foreign assets of the banking system stood at Denar 96,285 million, and the foreign liabilities totaled Denar 85,885 million. Compared to the end of 2005, the growth rates of the foreign assets and liabilities of the banks equaled 21.3% and 23.6%, respectively.

Figure 39
Trend and share of foreign currency assets and foreign currency liabilities in the total assets and total liabilities



These developments resulted in share of the foreign assets, i.e. liabilities, in the total assets across the banking system of 56.7%, i.e. 50.6%, respectively. Observing by group of banks, the group of large banks had the highest share of the foreign currency components in the assets and the liabilities of 60.1% and 53.0%, respectively. Even though it registered certain reduction, the share of the group of large banks was the highest, making up 71.8% of the total foreign assets and 71.1% of the total foreign liabilities of the banking system.

Figure 40
Share of foreign currency assets and foreign currency liabilities in the total assets of each group of banks as of 31.12.2006

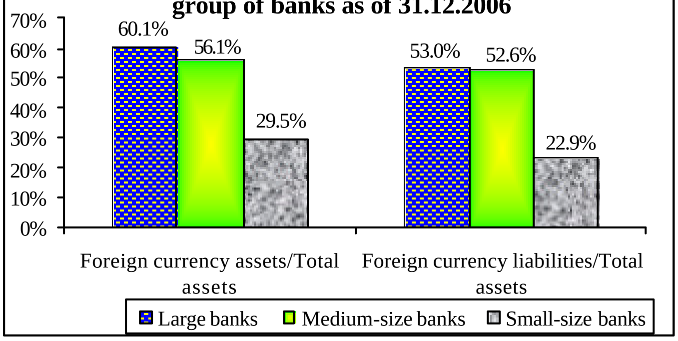


Figure 41
Distribution of foreign currency assets by groups of banks

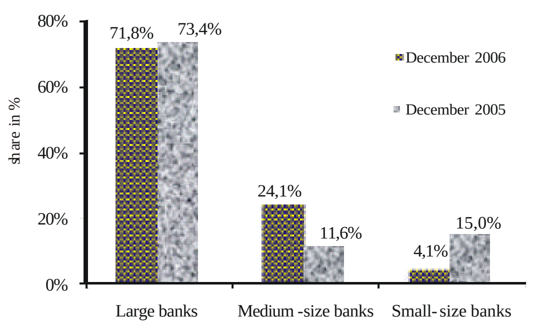
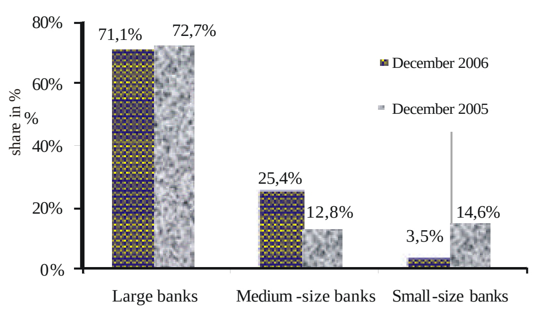


Figure 42
Distribution of foreign currency liabilities by groups of banks



Same as in the previous years, in 2006, the Euro dominated in the currency structure of the assets and liabilities. This results from the relatively high degree of currency substitution in the Macedonian economy and from the foreign trade structure dominated by the Euro-zone countries. The second most used currency in the Macedonian banks is the US Dollar, the share of which in the foreign assets and liabilities has remained stable over the recent years. The share of the remaining currencies (British sterling, Swiss franc, Australian Dollar, Danish crown, etc.) in the foreign assets and liabilities in the banking system was marginal.

Table 21
Currency structure of the foreign assets and liabilities

Currency	Dec.04		Dec.05		Dec.06	
	Foreign currency assets	Foreign currency liabilities	Foreign currency assets	Foreign currency liabilities	Foreign currency assets	Foreign currency liabilities
Euro	84,0%	83,3%	82,9%	82,6%	84,7%	85,0%
Dollar	11,5%	13,3%	12,6%	14,2%	10,3%	11,4%
Others	4,5%	3,4%	4,5%	3,2%	5,0%	3,6%
Total	**100,0%**	**100,0%**	**100,0**	**100,0%**	**100,0%**	**100,0%**

The annual increase in the foreign currency and foreign currency-indexed claims of 35.8% and 28.8%, respectively, which is a result of the accelerated growth in the foreign currency and foreign currency-indexed credits, in 2006, led to certain structural developments in the banks' foreign assets (Annex 10 - Structure of foreign assets as of December 31, 2006, in the banking system). The assets placed with foreign banks were no longer dominant (45.6% on December 31, 2006; 51.6% on December 31, 2005), at the expense of the increase in the share of claims based on foreign currency credits and foreign currency-indexed credits. The foreign currency-indexed assets constituted 29.1% of the foreign currency component of the assets, (26% in 2005), relative to the "pure" foreign assets that constituted 70.9% (74% for 2005).

As of December 31, 2006, no considerable structural developments were registered in the foreign liabilities compared to December 31, 2005 (Annex 10 - Structure of foreign liabilities as of December 31, 2006, in the banking system). Although 2006 registered faster increase in the foreign currency deposits of legal entities (annual growth rate of 31.5%), relative to the foreign currency deposits of the households (annual growth rate of 14.2%), the foreign currency deposits of the households remained a dominant category (52.3%) within the foreign currency liabilities of the banking system.

The share of the foreign currency-indexed liabilities is low, making up 6.2% of the total foreign currency component of the liabilities, but special attention should be paid to their upward trend (3.9% as of December 31, 2005).

The relatively high degree of currency substitution in the Macedonian economy is demonstrated by the comparative analysis of the share of the foreign assets and the foreign liabilities in the total assets, i.e. the total liabilities in the banking system of certain East and Central European countries[34]. With a share of 56.7% of the foreign assets in the total assets of the banking system, the Republic of Macedonia immediately followed Latvia and Estonia (68.8% and 73.8%, respectively). Lithuania (54.4%), Bulgaria (51.6%) and Romania (47.4%) follow right after Macedonia.

[34] Source: "BSCEE Review 2005".

Figure 43
Share of total foreign currency assets in the total assets in the countries of Central and Eastern Europe

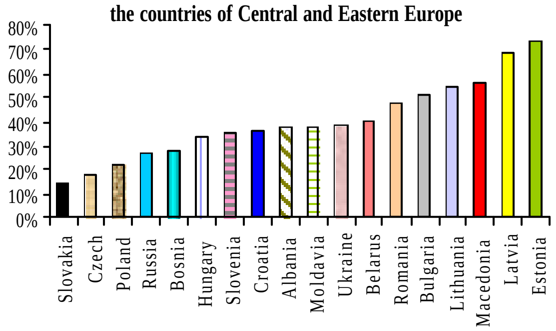
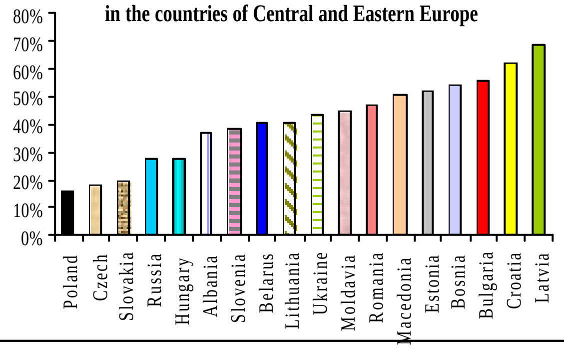


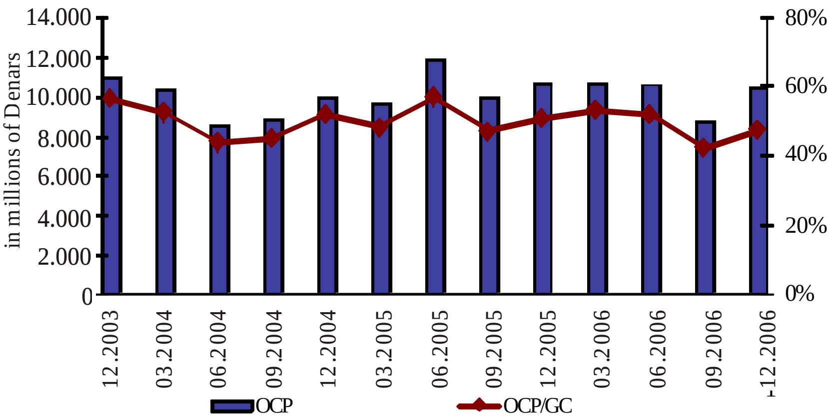
Figure 44
Share of total foreign currency liabilities in the total liabilities in the countries of Central and Eastern Europe



Observing the share of the total foreign liabilities in the total liabilities in the banking system of 50.6%, the Republic of Macedonia is ranked at the bottom of the list, behind Estonia (52.1%), Bosnia and Herzegovina (54.2%), Bulgaria (56%), Croatia (61.9%) and Latvia (68.6%).

On December 31, 2006, the open currency position[35], aggregated on a level of the banking system, totaled Denar 10,400 million or 47.1% to the guarantee capital.

Figure 45
Movement of open currency position relative to the guarantee capital at the level of the banking system



The open currency position in Euro generated 82.4% of the total amount of open currency position in the banking system. The US Dollar, although second most used currency in the banks' operations, constitutes only 0.7% of the open foreign position of the banking system.

As of December 31, 2006, only one bank had liability (short) open currency position, and the remaining banks had assets (long) open currency position. The banks managed with the foreign exchange risk within the prudential limits specified by the National Bank. On December 31, 2006, only one bank failed to observe these limits.

35 In the analysis of the foreign exchange risk, since December 2005, two banks have been excluded from the banking system. According to the Law on Amending the Law on Establishment of Macedonian Bank for Development Promotion ("Official Gazette of the Republic of Macedonia" no. 109/05), MBPR AD Skopje is not subjected to the regulations governing the open currency position. In addition, one bank is not required to report on the open currency position, since its foreign assets, i.e. foreign liabilities is below 20% of the guarantee capital of that bank.

3.6. Capital adequacy / Insolvency risk

3.6.1. Capital

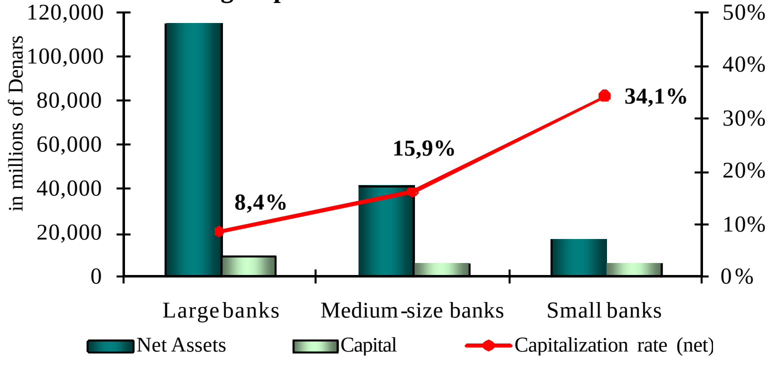
On December 31, 2006, the capital of the banks in the Republic of Macedonia, as defined by the methodology of the National Bank equaled Denar 22,257 million, and compared to the end of 2005, it surged by Denar 587 million, i.e. by 2.7%. Such increased resulted from the increase in the reserve fund of the banks and the lower amount of unallocated loan loss provisions.

Observing by group of banks, the group of medium-size banks was the major contributor to the capital growth. Following the pace of increase in their overall activities, the capital of this group went up by Denar 650 million, or by 11%[36]. The growth in the capital of the large banks of Denar 234 million (2.5%), was sufficient to offset the adverse effect of the decrease in the capital of the group of small-size banks of Denar 296 million (4.7%), caused by the loss of two banks within their preparatory activities related to their merger. Such capital and structural developments of each group of banks induced changes in the distribution of the capital base of each group of banks. On December 31, 2006, the share of the group of small-size banks was the lowest, equaling 27%, compared to the end of 2005, when the share of this group of banks was the highest, constituting 44.1% of the total banks' capital. On the other hand, the group of medium-size banks, the share of which was the lowest at the end of 2005, increased its share to 29.5%. The share of the group of large banks was the highest, accounting for 43.5% of the total banks' capital, which is almost identical with the share as of December 31, 2005.

On December 31, 2006, the capital of the banks ranged from Denar 231 million to Denar 3,729 million. The analysis of the capital distribution by banks indicates further widening of the gap between the bank with highest capital and the bank with lowest capital. The widening of the gap resulted, on the one hand, from the non-profitable operating and the decrease in the capital of the bank that has the lowest capital, and from the profitable operating and reinvestment of a part of the profit of the bank with highest capital, on the other.

The downward trend of capitalization rate of the banking system, which is a capital-to-net-assets ratio, carried on in 2006. At the end of 2006, the capitalization rate equaled 12.8%, which is by 2.6 percentage points lower compared to the end

Figure 46
Level of net-assets, capital and capitalization rate by group of banks as of 31.12.2006



[36] In the calculation of the capital growth rate, the effect of the change in the structure of the group of medium-size banks has been eliminated.

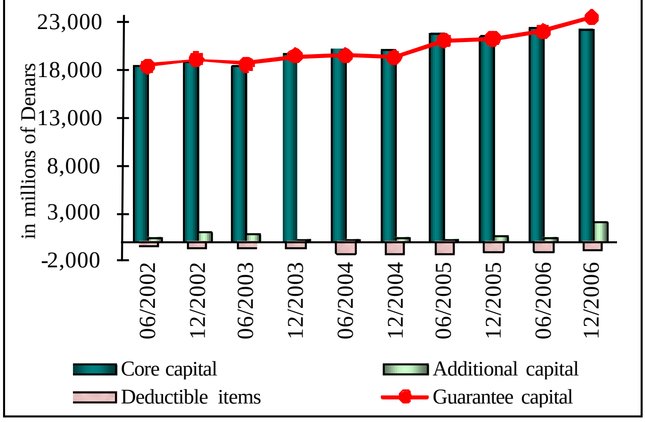
of 2005, as a result of the faster relative assets growth, compared to the relative capital growth in the last year.

Observing each bank group, only the group of large banks registered decrease in the capitalization rate (from 10.2%, on December 31, 2005, to 8.4%, on December 31, 2006). The level of capitalization of the group of medium-size banks remained almost unchanged compared to the preceding year, due to the identical pace of growth in the capital and the assets of this bank group. The structural change, i.e. the admission of four small-size banks with evident intermediation function to the group of medium-sized banks contributed to further increase in the capitalization rate of the group of small-size banks and its further departure from the average of the overall banking system, which is also an indicator for the decreasing role of the group of small-size banks in the financial intermediation.

3.6.2. Banks' capital adequacy ratio

On December 31, 2006, the guarantee capital in the banking system stood at Denar 23,604 million, registering an annual growth rate of 10.9%. Same as in the preceding periods, the core capital played the major role in the formation of the guarantee capital[37]. At the end of 2006, in spite of the still low share in the formation of the guarantee capital, the influence of the additional capital was significant[38], which registered an annual increase of 210.6%. Such increase was only a result of the subordinated liabilities in the structure of the banks' sources of financing that occurred in 2006. On December 31, 2006, this type of sources of financing was present in three banks. The group of large banks had a dominant share in the total subordinated liabilities of 91%.

Figure 47
Dynamics and structure of guarantee capital



Observing by group of banks, the group of large banks had the highest share of 47.0% in the formation of the guarantee capital in the banking system, followed by the group of medium-size banks with a share of 28.4% and the group of small-size banks with 24.6%.

At the end of 2006, the risk weighted assets (RWA) equaled Denar 118,479 million, registering an annual growth of 33.1%. Such increase resulted from the permanent uptrend of the overall banks' activities, and the change in the structure of such activities, and consequently in the risk weighted assets structure. This meant that

[37] Core capital, as specified by the National Bank's Decision on the Methodology for Determining the Guarantee Capital, consists of the book value of the issued common and preference shares (except for cumulative preference shares), the bank's reserves, the retained unappropriated profit which is not encumbered with liabilities and losses and is confirmed by the management body, the current gain discounted by 50%, less the amount of uncovered loss from the previous years, the amount of current loss and the goodwill.

[38] Additional capital, as defined by the Decision of the National Bank on the methodology for determining the guarantee capital, consists of book value of the issued cumulative preference shares, revaluation reserves, hybrid capital instruments and subordinated liabilities. On December 31, 2005, the banks had no hybrid capital instruments and subordinated capital forms in the additional capital.

the banks' lending activity accelerated (100% weight activity, in the calculations of the balance sheet risk weighted assets) and the banks off-balance sheet activities enhanced, at the expense of the lower share of accounts with other banks (20% weight item, in the calculations of the balance sheet risk weighted assets). The analysis of the off-balance sheet risk weighted assets shows higher share of 100% weight items, as a result of the acceleration of the banks' activity related to issuing credit cards, particularly in 2006. The balance sheet risk-weighted assets, was still a dominant item in the formation of the total risk-weighted assets (share of 85%), in spite of the increase in the off-balance sheet activities of the banks.

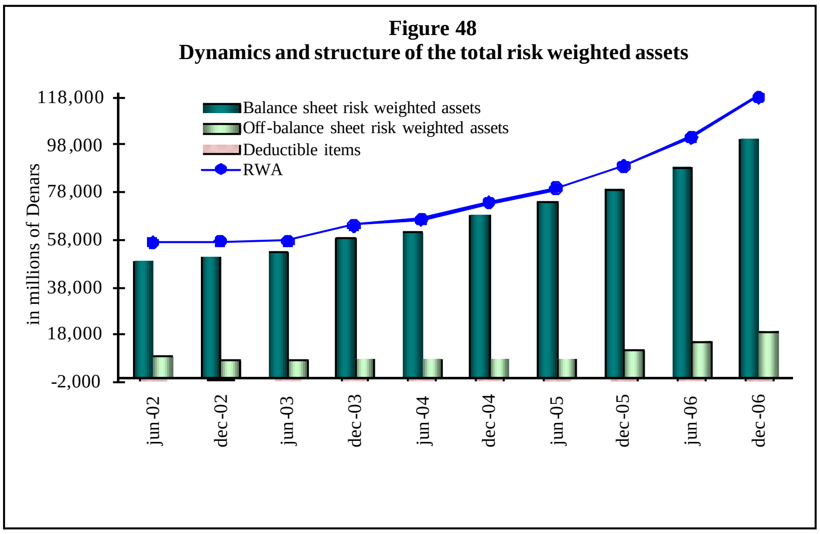


Figure 48
Dynamics and structure of the total risk weighted assets

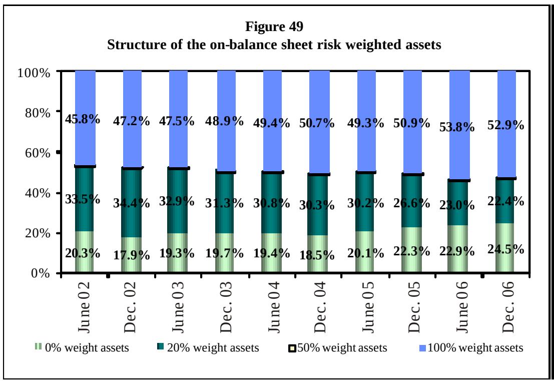


Figure 49
Structure of the on-balance sheet risk weighted assets

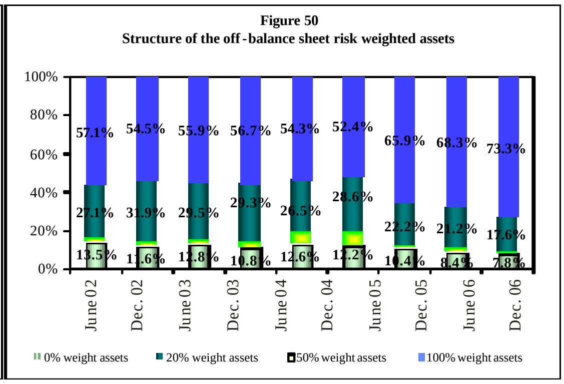


Figure 50
Structure of the off-balance sheet risk weighted assets

On December 31, 2006, the aggregate open currency position equaled Denar 10,452 million, plunging by 3.2% on annual basis.

On December 31, 2006, as a result of the development of the guarantee capital, the risk-weighted assets and the aggregate open currency position, the capital adequacy ratio of the banking system equaled 18.3%, which is by 3 percentage points less compared to December 31, 2005. Analyzing by group of banks, the capital adequacy ratio ranged from 12.4% in the group of large banks, 23.8% in the group of medium-size banks, to 49.8% in the group of group of small-

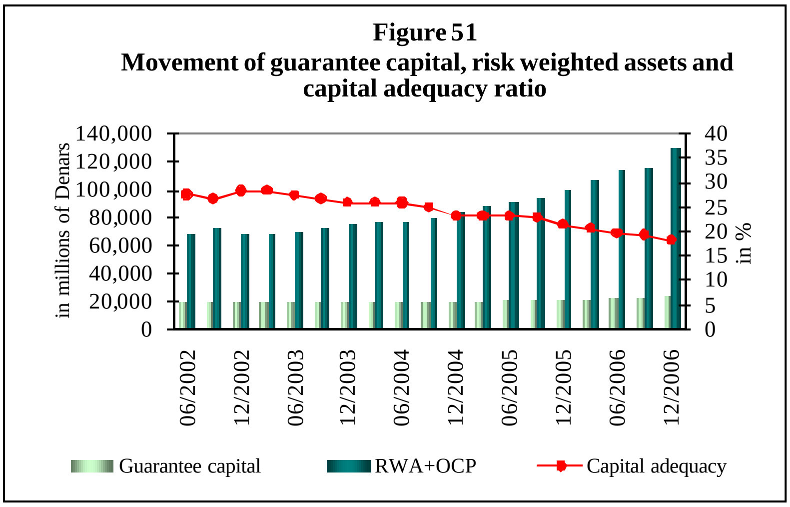
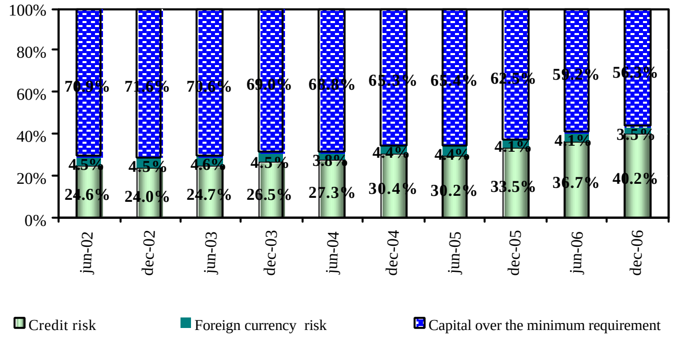


Figure 51
Movement of guarantee capital, risk weighted assets and capital adequacy ratio

size banks. The capital adequacy ratio increased only in the group of small-size banks, as a result of the aforementioned structural change in the bank groups and the further marginalizing of the role of the group of small-size banks in the financial intermediation.

Over the last several years, the part of the guarantee capital required for covering the credit risk registered an upward trend, resulting in a decrease in the part of the guarantee capital over the minimum requirement of 8% relative to the risk-weighted assets. Such tendency is a reasonable consequence of the accelerated banks' lending activity, i.e. the improved assets structure with respect of performing financial intermediation in the same period.

Figure 52
Distribution of banks' guarantee capital by types of risk



Stress-test analysis of the banking system resilience to hypothetical shocks

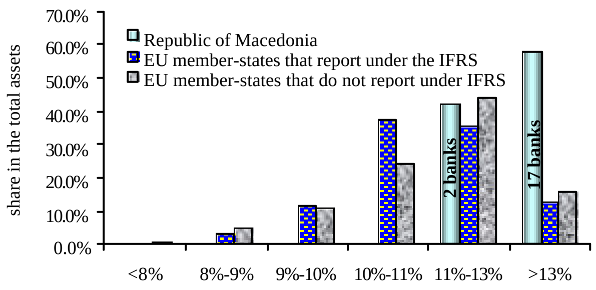
The relatively high capital adequacy ratio of the banking system ensured its greater stability, proved through the stress-test analysis of the banking system sensitivity to various hypothetical shocks. Recently, there has been a trend of permanent improvement of the results of the stress-test analyses, with respect to increasing the banks' resilience to various hypothetical shocks.

The results of the stress-test analyses at the end of 2006 showed satisfactory resilience of the banks to insulated shock, on the side of the credit risk. Thus, the presumption of increasing the credit exposure classified in C, D and E by 10%, 30% or 50%, would reduce the capital adequacy ratio in the banking system, from the initial 18.3%, to 17.7%, 16.6% and 15.4%, respectively.

The banking system of the Republic of Macedonia could also be considered relatively stable from the aspect of combination of two or more various hypothetical shocks. Combination of a shock on the side of the credit risk (30% increase in the credit exposure in C, D and E risk categories) and interest rate shock (increase in the domestic interest rates by 5 percentage points), would result in capital adequacy ratio of 16.3%, i.e. reduction of 2 percentage points. The combination of shock on the side of the credit risk (50% increase in the credit exposure in C, D and E risk categories) and foreign exchange risk (20% depreciation of the Denar relative to the Euro and the US Dollar) would reduce the capital adequacy ratio of the banking system to 16.6%, i.e. by 1.7 percentage points. The effect resulting from the combination of credit and foreign exchange shock is more favorable than the effect of insulated credit shock, as a result of the banks' open currency assets position. In most extreme scenario including a combination of all hypothetical shocks (50% increase in the credit exposure in the C, D and E risk categories, 5 percentage points higher domestic interest rates and 20% depreciation of the Denar relative to the Euro and the US Dollar), the capital adequacy ratio of the banking system would be 16.3%.

As of December 31, 2006, none of the banks registered a capital adequacy ratio below the minimum requirement of 8%. Notwithstanding the permanent downtrend of the capital adequacy ratio of the banking system in the Republic of Macedonia and its approximation to the level of the EU member-states, it still dwells above the average capital adequacy ratio of the EU banks. On December 31, 2005, in the EU member-states, that report under the International Financial Reporting Standards (IFRS), the average capital adequacy ratio was 11.6%, and in those countries that do not report under these standards, this ratio was 12.6%. Additionally, the distribution of the capital adequacy ratio by banks does not correspond to the conditions and trends in the EU. On December 31, 2005, capital adequacy ratio of over 13%[39] was registered only in 12.6% of all banks in the EU member-states that report under IFRS, i.e. 15.7% of the banks of the EU member-states that do not report under IFRS. On the other hand, the capital adequacy ratio of most of the banks in the Republic of Macedonia (17 banks), making up 57.9% of the total assets of the banking system, was above 13%. The capital adequacy ratios of the banking systems of the EU member-state ranged from 9.8% to 20.5%, which is below the level in the Republic of Macedonia.

Figure 53
Distribution of the banks by capital adequacy ratio



The constant downtrend of the capital adequacy ratio of the banks in the Republic of Macedonia and its steady approximation to the level of the EU banking sector is closely related to the strengthening the role of the banks as financial intermediaries over the recent years. In spite of the positive opinion on this trend, it should be noted that it has to be accompanied with strengthening of the risk management and corporate governance systems in the banks.

3.7. Profitability

The favorable macroeconomic environment, accompanied with the permanent enhancement in the volume of banking activities and reduction in the overall risk profile of the banks ensured further improvement of the efficiency and profitability of the banks in the Republic of Macedonia in 2006. Thus, on December 31, 2006, the banks registered an operating profit of Denar 2,800 million, which is by 76.0% more compared to the end of 2005. Only two banks showed a loss, having a total market share (share in the total assets of the banking system) of 1.4%, at the end of 2006.

In 2006, all bank groups generated operating profit. The aggregated financial result of the banking system still depends on the performances of the group of large banks, which constitutes 66.1% of the total financial potential of the banking system and which generates 68.1% of the total profit of the banking system.

[39] Source of data: EU Banking Sector Stability Report (ECB), November 2006.

The future perspectives of the banks, with respect to their profitability, are primarily contingent upon the successfulness in the reallocation of the low interest-bearing liquid assets of the banks to high interest-bearing assets. The greater competitiveness in the banking sector could result in launching new bank products and services, which in turn, could be an additional source of increasing the banks' profitability.

3.7.1. Income Statement Structure

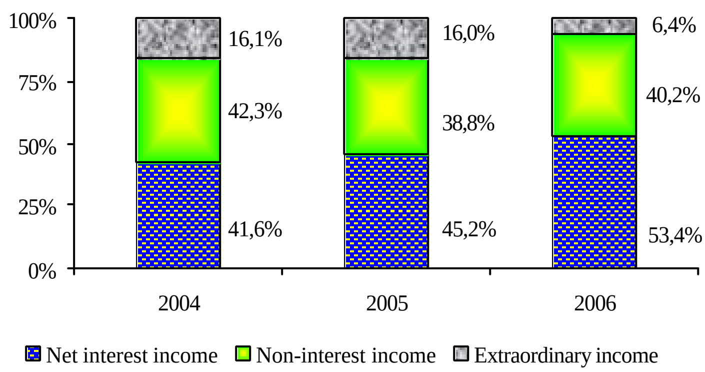
The structural analysis of the aggregated income statement for 2006, in the banking system (Annex 2 - Income Statement), proves the ascertainment that the profitability of the banks in the Republic of Macedonia improved.

Table 22
Restructured banks' income statement

No.	Item	Amount (in millions of Denars)			Structural share in total income			Annual change (in %)	
		2006	2005	2004	2006	2005	2004	2006/2005	2005/2004
	Interest income	9,553	7,670	5,920	87.3%	82.2%	75.0%	24.6%	29.6%
	Interest expenditures	-3,311	-2,653	-2,004	30.3%	28.4%	25.4%	24.8%	32.4%
1	**Net interest income**	6,242	5,017	3,916	57.1%	53.8%	49.6%	24.4%	28.1%
	Fees and commissions income	3,444	3,047	2,627	31.5%	32.7%	33.3%	13.0%	16.0%
	Other net-financial income	744	679	652	6.8%	7.3%	8.3%	9.6%	4.1%
	Other income	509	584	696	4.7%	6.3%	8.8%	-12.8%	-16.1%
2	**Non-interest income**	4,697	4,310	3,975	42.9%	46.2%	50.4%	9.0%	8.4%
3	**Total regular income (1+2)**	10,939	9,327	7,891	100.0%	100.0%	100.0%	17.3%	18.2%
	Fees and commissions expenses	-470	-422	-359	4.3%	4.5%	4.5%	11.4%	17.5%
	Staff expenses	-2,861	-2,675	-2,487	26.2%	28.7%	31.5%	7.0%	7.6%
	Other expenses	-3,626	-3,251	-3,120	33.1%	34.9%	39.5%	11.5%	4.2%
4	**Non-interest expenditures**	-6,957	-6,348	-5,966	63.6%	68.1%	75.6%	9.6%	6.4%
5	**Net loan provisions (including nonallocated provisions)**	-1,623	-2,548	-2,613	14.8%	27.3%	33.1%	-36.3%	-2.5%
6	**Gross income before extraordinary items and taxes (3+4+5)**	2,359	431	-688	21.6%	4.6%	8.7%	447.3%	-162.6%
	Extraordinary income	747	1,771	1,513	6.8%	19.0%	19.2%	-57.8%	17.1%
	Extraordinary expenses	-14	-363	-25	0.1%	3.9%	0.3%	-96.1%	1352.0%
	Income tax	-292	-248	-186	2.7%	2.7%	2.4%	17.7%	33.3%
7	**Net- income after tax**	2,800	1,591	614	25.6%	17.1%	7.8%	76.0%	159.1%

The profit generated in 2006, was mostly a result of the regular operating income. At the end of 2006, the extraordinary income generated 6.4% of the total income, which is by 9.6 percentage points less compared to 2005. On the other hand, the net interest income accounted for 53.4% of the total banks' income in 2006, thus being a key component in the formation of the banks' profit.

Figure 54
Structure of total regular and extraordinary income



Major driver of the positive developments related to the banks' profitability, same as in the recent years was the **interest income**, which registered an annual growth of 24.6% (December 31, 2005 - December 31, 2006). Comparing to the end of 2005, the interest expenditure registered almost identical growth of 24.8%. Such developments in the components constituting the net interest income are closely correlated with the increase in the volume of lending activity of the banks, and also with the growth in both the deposit base and the government securities portfolio over the recent years.

Figure 55
Movements of net interest income and annual growth rates of loans and deposits

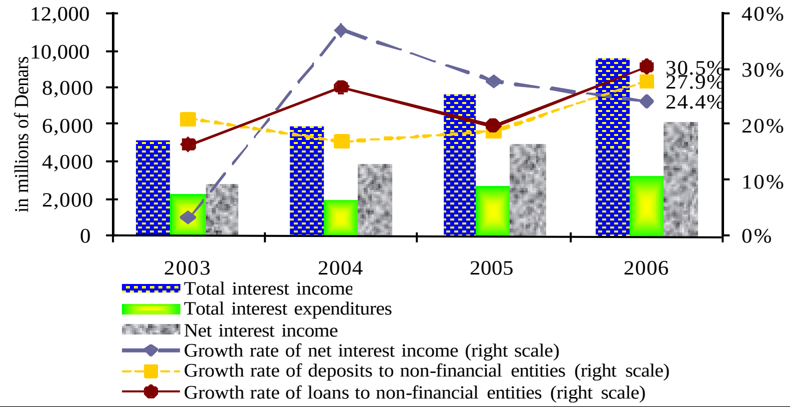
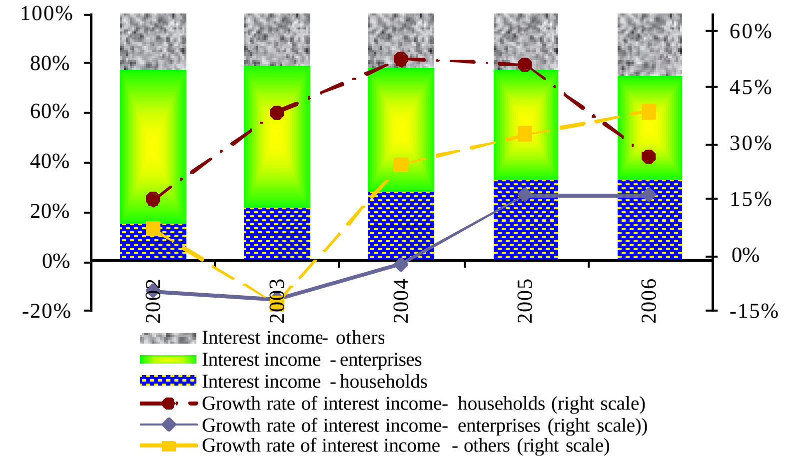


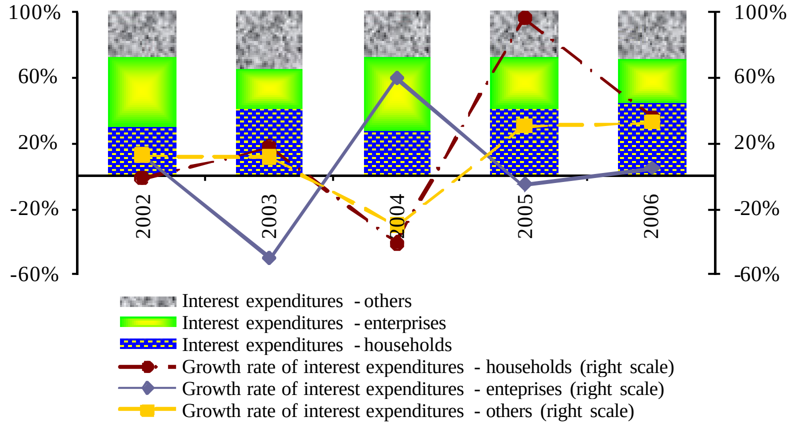
Figure 56
Structure of interest income and growth rates of interest income's components



At the end of 2006, the interest income from corporations had a dominant position in the interest income structure, which absorbed 41.2% of the total banks' interest income, followed by the interest income from households that accounted for 33.2%. Also, the structural share of the interest income from enterprises registered a downtrend, whereas the share of the interest income from the households registered an uptrend. On the other hand, in 2006, the highest annual growth rate was registered in the interest income generated from other sectors (banks and financial institutions, public sector), as a result of the fast increase in the treasury bills held by the banks in 2006. The interest income generated from the households went up by 26.1%, in 2006, which is substantially faster than the growth in the interest income generated from the corporate sector, which equaled 16.1% in the same period. Comparing with the growth rates in 2005, the interest income generated from the corporate sector in 2006 registered an identical growth rate, whereas the growth rate of the interest income generated from the households was by 25 percentage points lower than the growth rate in 2005. Having annual increase of 42.9% in the credits to the household, in 2006, such development of the growth rate of the interest income from the households is primarily due to the cut in the interest rates on the banks' credit products intended for the households.

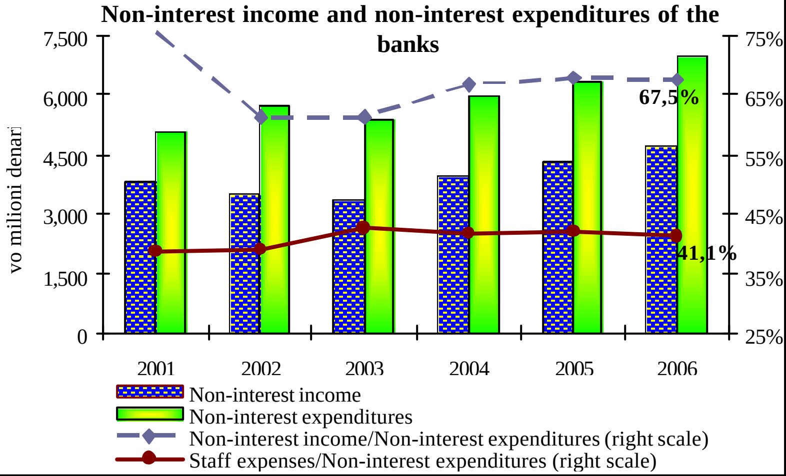
Observing the structure of the **interest expenditures**, the expenditures from interests to households still dominated at the end of 2006, accounting for 44.3%, which is an increase of 3.6 percentage points compared to the end of 2005. On the other hand, the trend of reducing the share of the expenditures from interests to enterprises continued, and at the end of 2006, they constituted 26.4% of the total interest expenditures (31.6%, at the end of 2005). The sector-by-sector analysis showed considerably larger fluctuation of the annual growth rate of each interest expenditure components, compared to the counteritems in the interest income. In the period under observation (2002-2006), the highest annual growth rates of the expenditures from interests to the households and interests to the corporate sector were achieved in 2004 and in 2005 (96.2% and 59.1%, respectively).

Figure 57
Structure of interest expenditures and growth rates of interest expenditures' components



The **fee and commission income** for provided bank services remained the second key source of income for the banks in 2006, generating 31.5% of the total regular income. Also, the fees and commissions income constituted 73.3% of the non-interest income the banks generated in 2006. On the other hand, **the non-interest income** of the banks was the largest expense component in the income statement of the banks, and in 2006, registered a growth rate of 9.6%. The staff expenses (wages and contributions) still represented the major expense item of the non-interest expenditures, making up 41.1%. Also, the share of these expenses in the total non-interest expenditures over the recent years was distinguished by its stable development. At the end of 2006, the non-interest income of the banks covered 67.5% of the non-interest expenditures, which is almost identical to the end of 2005.

Figure 58
Non-interest income and non-interest expenditures of the banks



The expansion of the credit portfolio, accompanied by the constant alleviation of its average risk brought about annual reduction in the **net loan loss provisions** of 36.3%. Thus, in 2006, the banks generated income from the credit portfolio, sufficient for full financing of the interest expenditures and the loan loss provisions. The rate of coverage of the loan loss provisions with the generated net interest income reached almost 3.8 times (2 times in 2005).

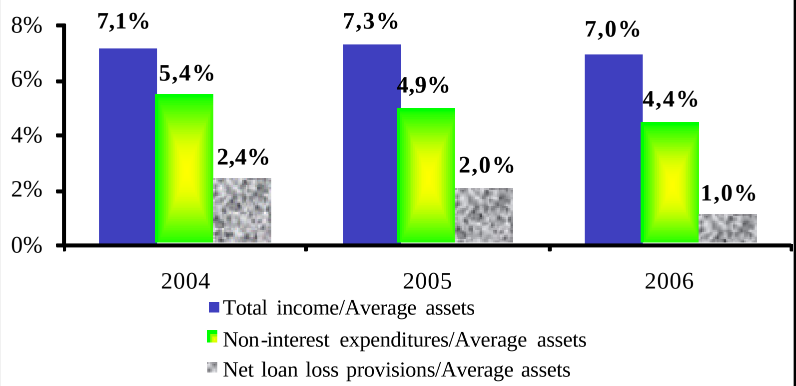
3.7.2. Banks' profitability and efficiency indicators

The positive trends of the basic income and expense categories of the aggregate income statement of the banking system in the Republic of Macedonia brought about significant improvement in the banks' performances in 2006, compared to the end of 2005. All banks' profitability and efficiency indicators registered an uptrend, compared to 2005.

Table 23
Banks' profitability and efficiency indicators

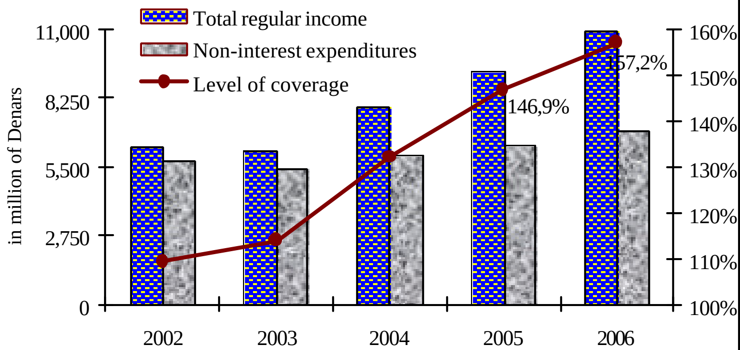
Indicator	2004	2005	2006
Rate of return on average assets (ROAA)	0,6%	1,2%	1,8%
Rate of return on average equity (ROAE)	3,1%	7,5%	12,3%
Non-interest expenditures/Total regular income (Cost to income ratio)	75,6%	68,1%	63,6%
Wage expenses/Total regular income	31,5%	28,7%	26,2%
Loan loss provisions/Net-interest income	66,7%	50,8%	26,0%
Net-interest income/Average assets	3,5%	3,9%	4,0%
Net-interest income/Total regular income	49,6%	53,8%	57,1%
Net-interest income/Non-interest expenditures	65,6%	79,0%	89,7%
Financial result/Total regular income	7,8%	17,1%	25,6%
Number of employees	4.635	4.633	5.010
Assets per employee (in millions of Denars)	25,46	30,31	34,75
Financial result per employee (in millions of Denars)	0,13	0,34	0,56

Figure 59
Total income, non-interest expenditures and net loan loss provisions in average assets



The trend of increasing the expense efficiency of the banks in the Republic of Macedonia continued in 2006. The non-interest expenditures and the banks' net provisions, as major components of the expense structure of the banks, went down in the past three years, although the banks' overall activities increased. These developments improved the indicators measuring the expense efficiency.

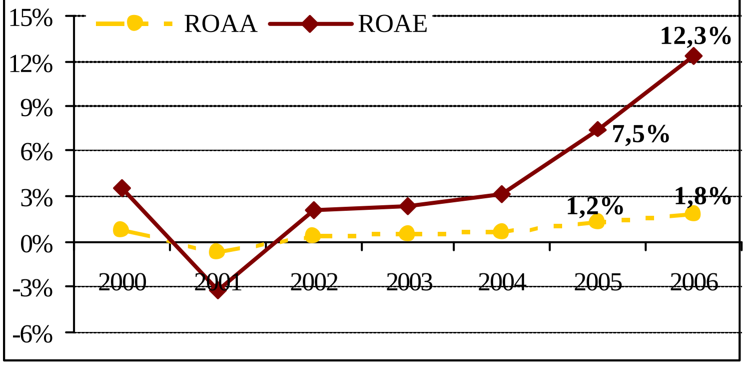
Figure 60
Movements in level of coverage of non-interest expenditures with total regular income



In 2006, the positive developments on the income side of the income statement brought about higher rate of coverage of the banks' non-interest expenditures with the total regular operations income. Thus, at the end of 2006, the rate of coverage of the non-interest expenditures with the total regular income equaled 157.2%, and compared to the end of 2005, it surged by 10.3 percentage points. Also, this is the highest level registered over the past several years, which is yet another demonstration of the improvement of the operating efficiency of the banks in the Republic of Macedonia.

The upward trend of the rate of return on average assets (ROAA) and the rate of return on average equity (ROAE) in the entire banking system continued in 2006. On December 31, 2006, they equaled 1.8% and 12.3%, respectively. Compared to the end of 2005, these indicators went up by 0.6 and 4.8 percentage points, respectively.

Figure 61
Movements of the ROAA and ROAE indicators



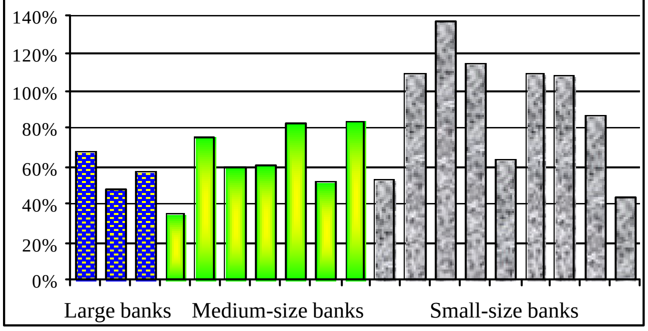
The analysis of the profitability and efficiency indicators by group of banks shows remarkable improvement in the group of large banks. All indicators for this group of banks improved compared to the end of 2005. Also, the indicators for the group of large banks are better than the average of the entire banking system and, except for the indicator for the rate of return on average assets (ROAA), they are also better compared to the other two groups of banks. The deterioration of the indicators for the groups of medium- and small-size banks is a result of the structural movement of four banks from the one to the other group, which, on average, have worse profitability and efficiency indicators compared to the existing medium-size banks, and better than those of the other small-size banks. These four banks registered fast growth in their financial activities in 2006, so that it is reasonable to expect positive effects on the profitability and efficiency in the next period. Besides, most indicators for these banks for 2006 are better than the average of the overall banking system.

Table 24
Profitability and efficiency indicators by group of banks

Indicator	Large banks		Medium-size banks		Small-size banks		Transferred banks from small-size banks to medium-size banks	
	2005	2006	2005	2006	2005	2006	2005	2006
Rate of return on average assets (ROAA)	1,1%	1,8%	2,8%	2,2%	0,8%	0,4%	1,3%	2,0%
Rate of return on average equity (ROAE)	10,4%	19,6%	16,0%	12,9%	2,5%	1,1%	5,1%	9,4%
Non-interest expenditures/Total regular income (Cost to income ratio)	64,1%	58,5%	62,5%	65,4%	82,0%	87,9%	66,4%	61,6%
Wage expenses/Total regular income	27,3%	24,6%	27,4%	26,8%	33,0%	33,5%	26,5%	23,9%
Loan loss provisions/Net-interest income	66,1%	32,4%	9,0%	11,7%	41,5%	27,8%	21,5%	27,7%
Net-interest income/Average assets	3,5%	3,7%	5,5%	4,9%	4,3%	3,4%	4,7%	4,2%
Net-interest income/Total regular income	50,2%	56,4%	69,6%	63,1%	55,0%	46,5%	56,5%	56,1%
Net-interest income/Non-interest expenditures	78,3%	96,4%	111,4%	96,5%	67,1%	52,9%	85,1%	90,9%
Financial result/Total regular income	15,8%	27,7%	35,2%	28,9%	10,6%	5,9%	16,2%	26,9%
Number of employees	2.654	2.726	635	1.413	1.344	871	494	577
Assets per employee (in millions of Denars)	34,98	42,23	27,16	29,28	22,59	20,24	29,12	28,58
Financial result per employee (in millions of Denars)	0,35	0,70	0,66	0,58	0,17	0,08	0,33	0,51

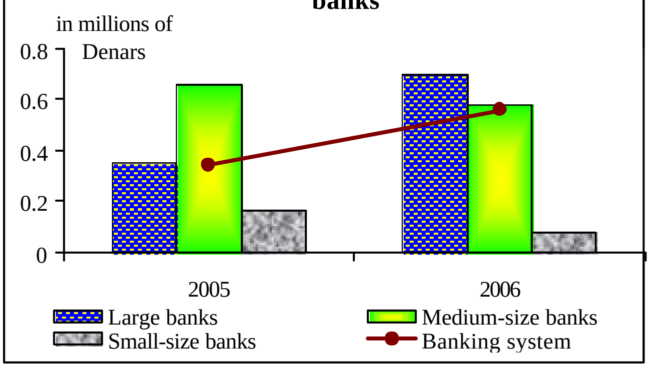
On December 31, 2006, the banks' efficiency indicator, with respect to the cost to income ratio, improved by 2.5 percentage points compared to 2005. On annual basis, this indicator for the groups of large and medium-size banks improved, whereas it deteriorated by 5.9 percentage points in the group of small-size banks. Also, in 2006, the indicators for the group of small-size banks registered higher values, proving the relatively low operating efficiency of this group of banks, compared to the other two.

Figure 62
Non-interest expenditures/Total regular income (cost to income ratio) by individual banks



The assets and profit growth of the banks in the Republic of Macedonia also improved the productivity indicators in the banking system. On December 31, 2006, the assets per employee in the banking system equaled Denar 34.8 million, which is by Denar 4.44 million more compared to December 31, 2005. The net-profit by employee in the banking system at the end of 2006, totaled Denar 0.56 million, registering an annual growth of 64.7%. This growth was ensured by the group of large banks, where the amount of profit per employee at the end of 2006, was as twice as higher than that at the end of 2005.

Figure 63
Financial result per employee by groups of banks



The comparative country-by-country analysis of the profitability and efficiency indicators shows certain approximation of the banking system of the Republic of Macedonia to the level of operating efficiency of the banking system of the European countries. The values of the profitability and efficiency indicators of the banking system of the Republic of Macedonia are relatively higher. This primarily results from the lower assets of the banking system of the Republic of Macedonia relative to the assets of the banking systems of the European countries, illustrating the lower financial intermediation, but also an existence of considerable room for its further deepening and for improving the banks' performances, including their profitable potential. On the other hand, the high banks' capitalization rate and the low level of financial intermediation led to relatively lower return on equity generated by the banks in the Republic of Macedonia compared to the banks of other countries included in this analysis. The relatively lower operating efficiency of the banks in the Republic of Macedonia, compared to the EU banks, is particularly evident in the analysis of the indicator for the share of the non-interest expenditures in the total regular operating income.

Table 25
Comparable profitability and efficiency indicators for the banking systems of the Republic of Macedonia and some EU member-states[40]

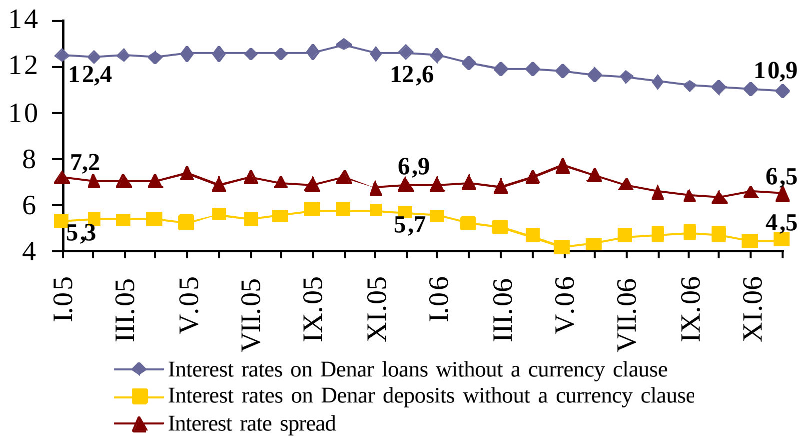
Country	Net-interest income/Total assets	Net interest income / Total regular income	ROA	ROE	Cost to income ratio
Czech Republic	2,26%	56,66%	1,29%	24,13%	56,87%
Poland	3,18%	57,80%	1,58%	20,14%	61,42%
Estonia	1,50%	58,47%	0,83%	17,04%	55,52%
Lithuania	1,99%	66,85%	0,87%	17,19%	58,98%
Latvia	2,46%	56,08%	1,69%	27,29%	53,19%
Slovakia	2,12%	70,06%	0,99%	17,46%	65,82%
Greece	2,68%	69,14%	0,94%	15,82%	57,11%
Hungary	4,23%	72,81%	1,80%	24,75%	55,18%
Slovenia	2,29%	57,67%	0,68%	13,42%	60,84%
Macedonia	3,58%	57,06%	1,78%	12,32%	63,60%

The indicators on Republic of Macedonia presented in this table relate to 2006, whereas the indicators on EU-countries relate to 2005. All EU-countries (with the exception of Hungary and Slovenia) have already had implemented the International Financial Report Standards in 2005.

3.7.3. Lending and deposit interest rates and interest rate spread

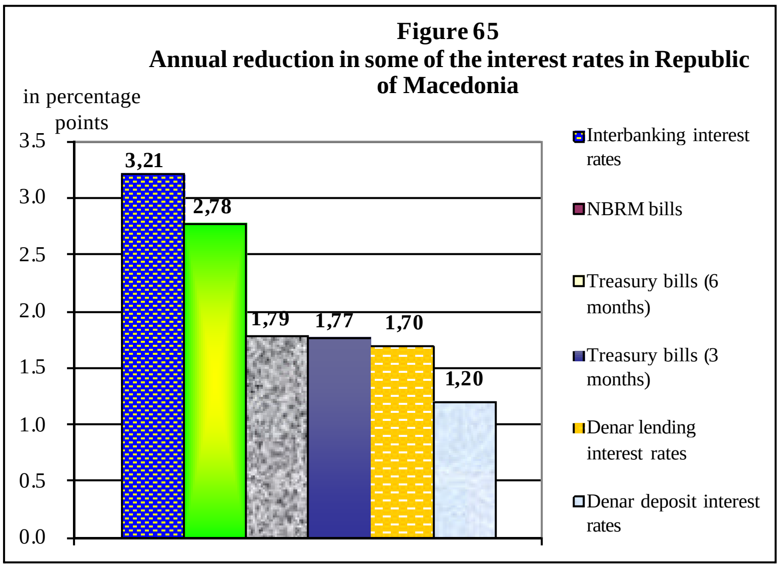
In 2006, the interest rate spread between the weighted lending and deposit Denar interest rates[41] registered divergent movements. In the first half of 2006, the interest rate spread was widening, and in the second half of 2006, it was narrowing. Over the entire 2006, the weighted Denar lending interest rates registered a downtrend, and in December 2006, they were by 1.7 percentage points lower compared to December 2005. The cut in the Denar lending interest rates might be interpreted as a result of the banks' responsiveness to the decrease in the interest rates on CB bills and the process of convergence with the interest rates on treasury bills, as an alternative investment opportunity for the non-banking entities. The reduction in the Denar lending interest rates was also a result of the accelerated lending activity of the banks, particularly to the household sector, and the positive economic expectations of the banks. However, the pace of cutting the lending interest rates of the bank is far slower that that on the CB bills and on the interbank market. The increase in the interest rate spread of the Denar credits and deposits in the first half 2006, resulted from the faster reduction in the Denar deposit

Figure 64
Interest rate spread of the Denar loans and deposits

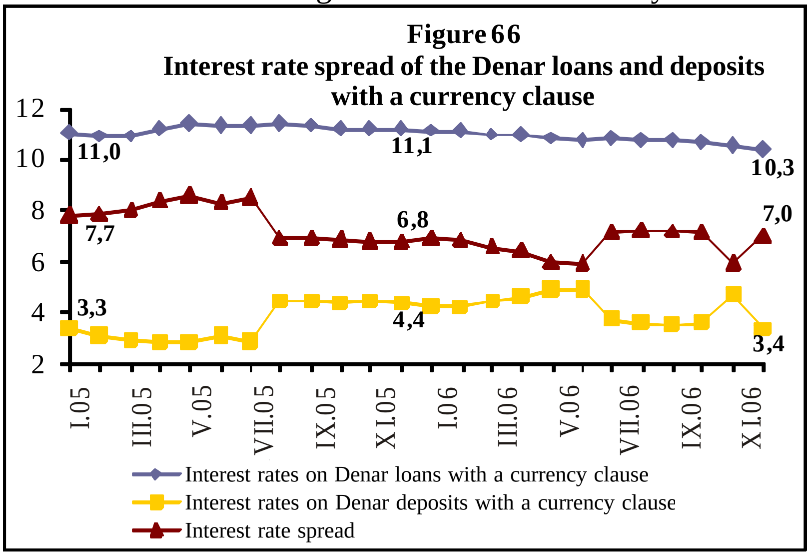


[40] Source of data: European Central Bank and EU Banking Sector Stability Report (ECB), November 2006.
[41] Weighted lending Denar interest rate is the average interest rate on non-foreign currency indexed Denar credits for all sectors and maturities, and weighted deposit Denar interest rate is the average interest rate on non-foreign currency indexed Denar deposits for all sectors and maturities.

interest rates, compared to the reduction in the Denar lending interest rates. On the other hand, in the second half of 2006, there was a switch in the development of the Denar deposit interest rates which started going up, unlike the Denar lending interest rates that kept on decreasing. As a result of these developments, in December 2006, the interest rate spread was by 0.2 percentage points lower, compared to December 2005.



In December 2006, the interest rate spread between the weighted lending and deposit foreign currency-indexed interest rates[42] was by 0.2 percentage points higher compared to December 2005, in environment of faster reduction in the deposit interest rate, compared to the reduction in the lending interest rates. This is yet another illustration that the banks, in environment of lowering the interest rates on CB bills and treasury bills, reduce the deposit interest rates in a faster pace, compared to the reduction of the lending interest rates. Thus, at the end of 2006, the foreign currency-indexed interest rates registered the highest interest rate spread, which, having a share of the foreign currency-indexed credits of 26.4% in the total credits and a share of the foreign currency-indexed deposits of 4.3% in the total deposits, generated the highest income potential for the banks. Furthermore, the lending foreign currency-indexed interest rates, opposite of the expectations, were closer to the non-foreign currency indexed Denar interest rates, rather than to the foreign currency interest rates.



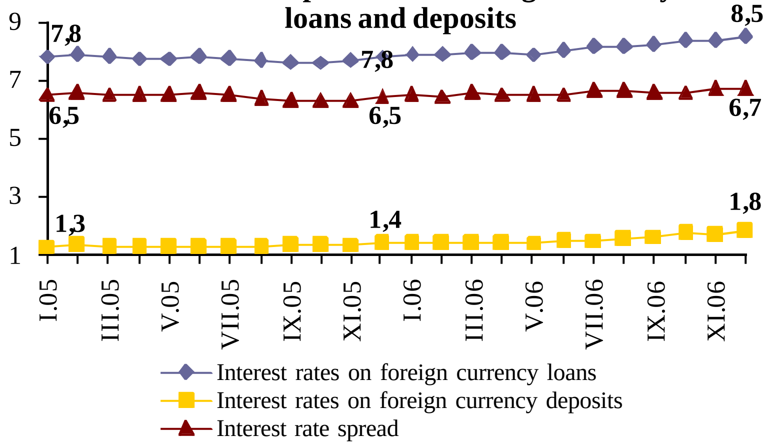
The interest rate spread between the weighted lending and deposit foreign currency interest rates[43] was the most stabile in its development. Thus, over the last several months of 2006, the foreign currency interest rates registered an uptrend,

[42] Weighted lending foreign currency-indexed interest rate is the average interest rate on foreign currency-indexed credits for all sectors and maturities, and weighted deposit foreign currency-indexed interest rate is the average interest rate on foreign currency-indexed deposits for all sectors and maturities.
[43] Weighted lending foreign currency interest rate is the average interest rate on foreign currency credits for all sectors and maturities, and weighted deposit foreign currency interest rate is the average interest rate on foreign currency deposits for all sectors and maturities.

owing to the increase in the interest rates on the international financial markets. Therefore, in December 2006, the interest rate spread of the foreign currency credits and deposits equaled 6.7 percentage points, which is by 0.2 higher compared to the end of 2005.

Figure 67

Interest rate spread of the foreign currency loans and deposits



II. BANK SUPERVISION IN 2006

1. Regulatory framework of the bank supervision

An adequate regulatory framework for the banks' operations and for the conduct of bank supervision is one of the major prerequisites for creating a sound, stable and safe banking system. In 2006, the National Bank was primarily focused on:

- further strengthening of the regulatory requirements for prudential credit risk management,
- completion of the regulatory framework for full implementation of the Basel Capital Accord -BASEL I,
- improvement of the methodology for identifying the net-debtors of the banks,
- prescribing methodology for provisioning the loss on foreclosures,
- completion of the regulations concerning the determination and publishing the effective lending and deposit interest rate.

1.1. Strengthening of the regulatory requirements for credit risk management

In environment of increasing lending activity of the banks, particularly to natural persons, the amendments to the **Decision on determining the methodology for classifying the balance sheet and off-balance sheet assets items of the banks by their risk degree,** introduced the concept of retail portfolio classification, i.e. classification of group of akin credits (consumer credits, housing credits, credits based on credit cards, etc.). Considering that these are lower-value credits and are numerous, the amendments to this decision allows for their monitoring and classification of their risk on a group basis (instead on individually). The classification of the retail credit portfolio rests on three basic criteria: timely settlement of the due liabilities of the client to the bank; collateral quality and degree of covering the credit exposure with regular inflows.

Additional preventive measure the National Bank undertook in conditions of accelerating credit activities of the bank is the introduction of a requirement for the banks to make minimum 1% provisioning for losses arising from credit exposure classified in A risk category.

On the other hand, the acceleration of the banks' foreign currency-indexed and foreign currency lending activity[44] created the need of tightening the criteria and terms under which a bank may extend foreign currency and foreign currency-indexed credits to resident.

For this purpose, in 2006, the National Bank adopted a **Decision on the terms and the method of extending foreign currency and foreign currency-indexed credits between residents**, aimed at providing greater protection for the banks from so-called indirect credit risk, i.e. risk of diminishing the creditworthiness of the borrower, as a result of their exposure to foreign exchange risk. This risk is equally present in both foreign currency and foreign currency-indexed credit. Hence, this decision specifies identical terms and criteria for extending such types of credits. Therefore, the banks are required to develop policies and procedures for identification,

[44]Foreign currency-indexed loan denotes loan disbursed and payable in Denar equivalent of certain foreign currency (predominantly Euro).

measuring and monitoring the so-called indirect credit risk, which, inter alia, includes requirement for conducting stress-test analyses of the effect of the Denar exchange rate fluctuations, if any, on the value of the foreign currency and foreign currency-indexed credit portfolio of the banks; defining the quantitative limits on the value of the foreign currency and foreign currency-indexed credit portfolio of the banks, etc. Furthermore, the Decision specifies stricter criteria for extending foreign currency and foreign currency-indexed loans to residents (these credits can be extended only if the borrower is classified in A and B risk categories, the National Bank and if they provided a first-class collateral instrument).

1.2. Completion of the regulatory framework for full implementation of the Basel Capital Accord - BASEL I

At the end of 2006, the National Bank adopted a new **Decision on the methodology for capital adequacy,** which introduced explicit requirement for the banks to hold capital required for covering not only the credit risk, but for hedging the various types of market risks, (interest rate risk, risk of price changes in the acquired trading securities, foreign exchange risk, commodity risk, settlement/delivery risk, counterparty risk). Although the credit risk is mostly present in the banks' operations, the growing interest of the banks to trade in government securities, in particular, i.e. the increasing participation of the banks in the trade in securities on the capital market created the need of such regulation. In addition, the adoption of this decision fully implemented the Basel Capital Accord (BASEL I), i.e. the amendments to the 1996 Basel Capital Accord, based on which the market risks are included in the calculation of the banks' capital adequacy.

1.3. Improvement of the methodology for identifying net-debtors of the banks

The new **Decision on identifying net-debtors of the banks** allows for closer identification of the banks' net-debtors, who, as specified by the Banking Law, may not be members of a Board of Directors of a bank. According to this Decision, a net-debtor is a natural person, whose average annual liabilities to the bank exceed their average annual claims on and investments in the bank, and natural person who is representative, or otherwise connected to a legal entity the bank is exposed to with more than 1% of its guarantee capital. With the new decision, the existing methodology, which uses the quarterly average in the calculations of the average annual claims and liabilities of each client of the banks, was replaced by a new one which allows for the use of monthly average in the calculations of the annual claims and liabilities of each client. It also allows for the bank to determine the average annual liabilities, claims and investments on the basis of the daily average of these categories in one calendar year.

1.4. Determining methodology for provisioning the loss on foreclosures

The Decision on the methodology for provisioning the loss on foreclosures introduced the requirement for the banks and the savings houses to make provisioning for the losses on foreclosures.

The need of adopting this decision arose from the market and economic conditions in the Republic of Macedonia, where the banks often suffer difficulties in the sale of the foreclosures, thus increasing their non-cash and non-interest bearing assets and its deferred and difficult sale. The introduction of the requirement for foreclosure provisioning ensures more realistic presentation of the balance sheet items and the results from the banks operations. Furthermore, the Decision includes a requirement for appraising the foreclosed assets by an authorized appraiser, at least once a year, and during the foreclosure.

1.5. Completion of the regulation for calculating and publishing effective lending and deposit interest rate

The adoption of the **Instructions for enforcing the Decision on calculating and publishing the effective lending and deposit interest rate, in the first half of 2006,** completed the part of the regulatory package concerning the consumer right protection. These instructions defines the methodology for calculating and publishing effective lending and deposit interest rate, as a major indicator for the consumers - natural persons, in particular, in the selection of most favorable terms when using bank credits, i.e. when depositing in the banks.

2. Activities of the bank supervision

The supervisory function of the National Bank is carried out through the following:

- licensing i.e. issuing licenses and approvals to banks and savings houses,
- supervision of the operations of the banks and the savings houses,
- undertaking corrective actions.

2.1. Licensing i.e. issuing licenses and approvals to banks and savings houses

Tables on the number of issued, i.e. non-issued licenses and approvals and revoked applications for issuing licenses and approvals by banks and savings houses in 2006, compared to 2005, are given below.

Table 26
Types and number of issued, i.e. non-issued licenses and approvals

Type of license	Banks						Savings houses					
	January - December 2005			January - December 2006			January - December 2005			January - December 2006		
	Issued	Refused	Withdrawn	Issued	Refused	Withdrawn	Issued	Refused	Withdrawn	Issued	Refused	Withdrawn
Status changes	1			1						1	1	
Acquiring 5%, 10%, 20%, 33%, 50% and 75% of voting shares	1	2	1	3		1	2					1
Statute	26			14			3		1	8		
Executive body	25		4	18	2	1	2	1		3	1	2
Change in the title, main office and address	3	1		4								
Capital investment	2	1										
Insight in report	10	1		8						1		
Amendment to the Decision on issuing lincense of a bank				1								
Policy for information system security				2								
Total	**68**	**5**	**5**	**51**	**2**	**2**	**7**	**1**	**1**	**13**	**2**	**3**

In the licensing process, the National Bank examines the source of financing the purchase of shares and parts in the banks and savings houses. In 2006, the National Bank processed fifty two notifications on change in the ownership structure of voting shares, as follows: twenty eight notifications (for eight banks and five savings houses) were given positive opinion on the evidence for the source of financing, twenty one notification (for six banks) were given negative opinion on the evidence for the source of financing, and three notifications (for two banks) were not decided upon, since they became unnecessary in the course of the procedure.

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

Thirty one examinations of the operations of the banks and the savings houses in the Republic of Macedonia were conducted in 2006. Eleven of them were full-scope examinations of seven banks and four savings houses, and twenty were targeted examinations. The established practice for performing targeted examination of all savings houses with respect to the update of the lists of savings deposits once a month, continued in 2006.

The assets quality analysis, i.e. the credit risk assessment and quantification, as a dominant risk the banks and the savings houses are exposed to remained the most important component of the supervisory examinations of the banks and the savings houses. Relevant segment of the examinations also was the evaluation of the design and functioning of the internal control and audit systems, the anti-money laundering systems and the design and the functioning of the corporate governance. The risk assessment, besides the credit risk, was particularly focused on the assessment of the liquidity risk and the so-called indirect credit risk that arises from the exposure of the borrowers to foreign exchange risk.

The positive developments in the banking system, illustrated primarily through the improved banks' risk profile and the improved corporate governance systems, are also proved by the ascertainment and the observations from the on-site supervisory examinations, and from the permanent off-site supervision of the banks and the savings houses. The average weighted composite rating[45] for the banks for 2006 was 2.18[46], compared to 2005, when it equaled 2.34. The average weighted composite rating for the savings houses for 2006, equaled 1.95[47], compared to 2005, when it was 1.97. Nevertheless, some banks showed weaknesses in the risk management, demonstrated mainly through the non-adherence to the prudential credit exposure limits, unsatisfactory information security system, inadequate shareholder structure and weaknesses in the corporate governance.

Pursuant to Article 24 and 32 of the Law on the National Bank of the Republic of Macedonia, in 2006, 29 examinations were conducted *analyzing the aspect of regulation enforcement.* Fourteen examinations were full-scope, three were targeted (concerning the international payment operations, collection of cash foreign currency

[45] The composite rating of the banks' operations is determined according to the CAMELS rating system, covering analysis and assessment of the capital, assets quality, assets and liabilities management, risk monitoring, earnings and the overall corporate governance process of the banks. The composite rating shows the level of supervisory interest in each bank and savings house and it is only intended for the purposes of performing the supervisory function of the National Bank.
[46] Average of the ratings for each bank weighted by its assets.
[47] Average of the ratings for each savings house weighted by its assets.

by residents, etc.), and eleven were examinations of savings houses (concerning the currency exchange operations, meeting the reserve requirement, etc.).

2.3. Undertaken corrective actions against banks and savings houses

Within their legal authorizations, and in order to preserve and stability and safety of some banking institutions and the banking system as a whole, the National Bank undertook corrective actions against banks and savings houses that showed irregularities and incorrectness in their operations. In 2006, the National Bank adopted 27 decisions with corrective actions against ten banks and seven savings houses, filed 25 requests for initiation of misdemeanor procedure against 13 banks, 5 savings houses and 1 legal entity and their responsible persons and pressed one criminal charge against a person with special rights and responsibilities in a bank.

In 2006, the founding and operating license of the savings house Kiro Kucuk DOO Veles was revoked, identifying that the requirements for introducing liquidation in this savings houses were met. Furthermore, on request of the founders of the Money and Short-Term Securities Market AD Skopje, the National Bank revoked the operating license.

The actions undertaken in 2006, and the number of banks and savings houses concerned, are given below.

Table 27
Types and number of undertaken actions

Type of measure	Number of banks and savings houses
Appointing conservator	one bank
Recapitalization	one savings house
Ban on performing all bank activities, other than claim collection	three savings houses
Ban on extending credits and other types of credit exposure to clients classified in C, D and E risk categories	one bank
Ban on extending credits and other types of credit exposure, other that placements in securities, issued by the Republic of Macedonia and the National Bank, with maturity of up to 90 days, and financing allowed current account overdraft to the amount of one regular monthly inflow, per current account user	one bank
Ban on extending credits and other types of credit exposure to the group of inside persons and persons connected thereto	one bank
Ban on acquiring capital holdings in financial and non-financial institutions, increasing the existing capital holdings and on expanding the network	one bank
Ban on payment of dividend from net-profit and requirement for it to be reinvested in capital	one bank

Ban on amending concluded agreement on earmarked deposits between a bank and a shareholder, and on making payments based on the agreement, without obtaining prior approval by the National Bank	one bank
Ban on using bank deposits as collateral for credits extended in favor of third parties	one bank
Revocation of issued approval for appointing an executive body	one bank
Verification of orders by authorized officers from the National Bank	two banks two savings houses
Restriction on the off-balance exposure based on issued guarantees, backing guarantees, unused current account overdrafts to 30% of the guarantee capital	one bank
Restriction on approved overdraft on current accounts and credit cards to amount not exceeding the double amount of the regular monthly income of the accountholder	one bank
Restriction on the total amount of foreign assets kept by bank with first-class banks	one bank
Requirement for filing an application for obtaining prior approval from the National Bank for appointing an executive body	one bank one savings house
Requirement for collective signing of all domestic and international payments from the foreign currency accounts by the members of the executive body	one bank
Requirement for maintaining liquid assets with maturity of up to 90 days, in an amount exceeding 40% of the total deposits	one bank
Requirement for permanent maintaining of liquid assets in an amount ensuring 90% liabilities coverage	one bank
Requirement for regular reporting to the National Bank on the amount of the total liabilities and the total liquid assets for the preceding day	one bank
Requirement for reducing the share of a shareholder below 10% of the voting shares	one bank
Requirement for reducing the credit exposure to an individual and to the persons connected thereto, to 10% of the guarantee capital	one savings house
Requirement for reducing the credit	one bank

exposure to an individual entity to 25% of the guarantee capital	
Requirement for reducing the credit exposure to an inside person to 3% of the guarantee capital	one bank
Requirement for complying with the capital investments limit of a bank (Article 39 paragraph 1 of the Banking Law)	two banks
Requirement for reclassification of claims on clients according to the findings of the on-site examination	three banks two savings houses
Requirement for undertaking enhanced activities for sale of assumed tangible and fixed assets, and for collection of due claims	one bank
Requirement for the President of the Board of Directors and the President of the Risk Management Committee, to take legal actions related to claim collection	one bank
Requirement for organizing Internal Audit Department	four savings houses
Requirement for staffing of the Internal Audit Department	one bank
Requirement for observing the protocol concluded with the National Bank	one bank
Requirement for implementing a plan of measures and activities for overcoming the identified shortcomings	one bank
Requirement for the Meeting of Shareholders to dismiss members of the Board of Directors who are net-debtors	one bank
Requirement for the Board of Directors to adopt a detailed plan of activities including a monthly timetable for collection of non-performing claims	one bank
Requirement for preparation of a business plan of activities	one bank
Requirement for regular reporting to the National Bank on undertaken activities related to the imposed corrective actions	one bank
Requirement for reconciliation of the number of issued check with the current account overdraft limit	one bank
Requirement for establishing adequate credit risk monitoring system	one bank
Requirement for revising the method of analyzing the foreign exchange risk the clients are exposed to	two banks
Requirement for establishing adequate accounting systems	one bank

Requirement for establishing system for monitoring and identification of money laundering transactions	one bank
Requirement for establishing an adequate system for identification and monitoring of connected entities	two banks one savings house
Requirement for observing the supervisory standards for recording non-performing credits	one bank
Requirement for establishing a records system to ensure adherence to the supervisory standards that regulate the overdue claims	one bank one savings house
Requirement for observing the banks' information security standards	one bank
Requirement for adherence to the accounting standards and principles	two savings houses
Requirement for revising the internal credit procedures	one bank
Requirement for undertaking activities for addressing the identified weaknesses in the internal client classification systems	one bank one savings house
Requirement for concluding loan agreements specifying the interest rate underlying the calculation of the interest in the repayment schedule	one savings house
Requirement for harmonizing a text of a statute with the changes in the shareholding structure	one savings house

Within the corrective actions undertaken by the National Bank, in 2006, the right to vote was restricted in three cases of acquiring shares in a bank, due to which the National Bank did not grant prior approval.

3. Strengthening the institutional capacity of the National Bank in the performance of the regulatory and supervisory function

3.1. Promotion of the accounting framework for the banks

Based on the Memorandum of Understanding, signed at the end of 2005 between the National Bank and the Netherlands Financial Sector Development Exchange (NFX), and based on the donation provided by the Ministry of Development of the Netherlands, the Project on Introducing the International Financial Reporting Standards (IFRS) and the International Accounting Standards (IAS) in the banking system of the Republic of Macedonia was launched in November 2006. The successful implementation of this project, delivered in cooperation with a recognized foreign consulting firm, implies development of a new chart of accounts for the banks, methodology for accounting and financial reporting for the banks and definition of the format of the financial statements under the IFRS. The overall accounting regulation is expected to be completed to September 2007, inclusive.

3.2. Promotion of the Credit Registry

The promotion of the Credit Registry of the National Bank is one of the elements of the Business Environment Reform and Institutional Strengthening Project (BERIS), aimed at facilitating the access to information in the Republic of Macedonia. Therefore, the existing Credit Registry was advanced in 2006, by creation of new reporting forms for the needs of the National Bank and creation of preconditions for expanding its database. For that purpose, the National Bank signed an Agreement with the Central Registry AD Skopje for using a part of its data, only for the internal purposes of the National Bank. This facilitated the compilation of a file for almost all legal entities - borrowers, including data on their financial condition, ownership and management structure, their total credit exposure to the banking system, the average risk level, etc.

Along with these activities, the National Bank performed a series of preparatory activities for establishment of a new Credit Registry with modern technical features, containing a wide range of data and ensuring more frequent updating. For that purpose, procurement of new IT infrastructure of the National Bank is underway, as a prerequisite for the procurement of new hardware and software for the needs of the new Credit Registry.

3. 3. Improvement of the bank supervision

In early 2006, the National Bank adopted a Supervision Development Plan aimed at facilitating the transition to risk-based supervision.

The plan is expected to be implemented by the end of 2009.

3.4. Improvement of the financial stability analysis in the Republic of Macedonia

Within the activities related to the improvement of the financial stability analysis, a Methodology on Financial Stability Analysis was adopted in late 2006, which provides a summary of the techniques and methods of collecting, processing and disclosing data that underlie the assessment of the financial stability of the country. Also, last year, the National Bank took an initiative to establish interdepartmental financial stability body, the members of which are representatives of all regulatory and supervisory bodies in the country. The purpose of this body is to monitor the developments, on an informal and expert basis, in each segment of the financial system, to initiate amendments to laws relevant for the functioning of the financial system, to initiate greater consistence of the regulations and coordination of the activities of each regulatory and supervisory authorities, etc.

ANNEX

Annex 1

Balance sheet

in millions of denars

ASSETS	31.12.2006				31.12.2005			
	Group of large banks	Group of medium-size banks	Group of small-size banks	Total	Group of large banks	Group of medium-size banks	Group of small-size banks	Total
CASH AND BALANCES WITH NBRM	***7,341***	***2,348***	***1,476***	***11,165***	***4,561***	***1,366***	***2,056***	***7,982***
Denar cash	5,765	1,735	1,305	8,805	3,499	875	1,665	6,039
Foreign currency cash	1,576	612	170	2,358	1,062	490	389	1,941
Precious metals and other cash	0	2	1	3	0	0	2	3
CB BILLS	***6,069***	***2,204***	***1,183***	***9,457***	***4,072***	***2,379***	***2,483***	***8,934***
DEBT SECURITIES	***8,072***	***3,579***	***1,629***	***13,281***	***6,516***	***447***	***409***	***7,372***
Checks and bills of exchange	42	56	35	134	45	47	41	134
Denar-nominated Government securities	5,612	39	43	5,694	6,167	47	145	6,359
Other debt securities	2,417	3,484	1,551	7,453	305	352	223	880
PLACEMENTS TO OTHER BANKS	***32,337***	***9,850***	***5,008***	***47,194***	***30,337***	***4,676***	***8,146***	***43,158***
Accounts with domestic banks	4,702	1,610	583	6,895	4,040	596	1,087	5,723
Accounts with foreign banks	27,041	7,657	2,111	36,810	26,081	3,999	5,141	35,221
Short-trem loans and other claims on domestic banks and other financial organizations	57	168	164	389	77	2	173	252
Short-trem loans and other claims on foreign banks and other financial organizations	165	412	329	906	76	76	278	430
Past due loans and claims on banks	0	0	0	0	0	0	0	0
Long-term loans and other claims on domestic banks and other financial organizations	294	3	824	1,120	62	3	419	484
Long-term loans and other claims on foreign banks and other financial organizations	0	0	823	823	0	0	867	867
Non-performing loans from banks	77	1	174	252	0	1	182	183
LOANS TO CLIENTS	***54,355***	***20,502***	***4,770***	***79,627***	***39,964***	***7,367***	***11,577***	***58,908***
Loans to enterprises	34,413	12,954	2,602	49,969	25,553	5,674	6,681	37,908
Loans to other clients	400	61	1	461	181	43	157	381
Loans to households	19,183	7,753	2,341	29,277	13,364	1,955	4,869	20,189
Non-performing loans to clients	8,147	883	1,069	10,099	8,529	275	1,515	10,319
Special loan reserve	-7,788	-1,149	-1,243	-10,179	-7,663	-580	-1,645	-9,889
ACCRUED INTEREST AND OTHER ASSETS	***2,713***	***962***	***1,385***	***5,060***	***3,249***	***319***	***2,611***	***6,178***
Interest claims	493	204	90	788	359	80	154	593
Suspended interest and other claims	3,643	172	454	4,269	4,373	125	573	5,071
Special interest reserve	-3,648	-182	-459	-4,288	-4,394	-130	-579	-5,103
Other claims	125	176	266	568	972	1	250	1,223
Foreclosures	2,034	542	1,084	3,660	1,831	224	2,292	4,348
Net commisssion relations	-27	-1	-97	-125	-26	0	-152	-177
Net internal relations	*0*	*0*	*0*	0	0	0	0	0
Other assets	93	49	47	190	134	19	72	225
PLACEMENTS IN SECURITIES	***624***	***262***	***641***	***1,527***	***581***	***79***	***879***	***1,539***
Securities available for sale in foreign currencies	154	2	74	230	152	0	59	210
Securities in foreign currency held to maturity	0	0	0	0	0	0	0	0
Investments in domestic equity securities	470	260	565	1,295	429	79	820	1,328
Special reserve for repurchased owm securities	0	0	2	2	0	0	0	0
FIXED ASSETS	***3,610***	***1,684***	***1,586***	***6,880***	***3,557***	***615***	***2,304***	***6,476***
Buildings	3,193	1,239	1,534	5,966	3,158	471	1,834	5,463
Equipment	2,479	739	691	3,909	2,288	312	920	3,520
Intangible investments	235	140	50	425	275	41	86	402
Other means of operation	88	14	15	117	60	4	50	114
Means of operation in preparation	171	156	27	355	80	33	355	469
Correction of value of fixed assets	-2,556	-605	-731	-3,892	-2,304	-246	-941	-3,491
UNLOCATED LOAN LOSS PROVISIONS	***0***	***-24***	***-50***	***-74***	***0***	***-3***	***-109***	***-113***
TOTAL ASSETS	***115,122***	***41,368***	***17,627***	***174,117***	***92,835***	***17,245***	***30,356***	***140,436***

Annex 1

Balance sheet

in millions of denars

LIABILITIES	31.12.2006				31.12.2005			
	Group of large banks	**Group of medium-size banks**	**Group of small-size banks**	**Total**	**Group of large banks**	**Group of medium-size banks**	**Group of small-size banks**	**Total**
BANK DEPOSITS	**1,763**	**1,852**	**286**	**3,902**	**1,247**	**333**	**1,137**	**2,717**
Denar sight deposits	155	3	31	189	200	14	11	224
Foreign currencies sight deposits of domestic banks	303	114	4	421	135	48	83	266
Foreign currencies sight deposits of foreign banks	223	278	0	500	226	0	254	479
Short-term time Denar deposits	718	586	113	1,417	499	163	249	911
Short-term time foreign currency deposits	364	871	0	1,235	188	108	403	699
Long-term time Denar deposits	0	1	139	140	0	0	138	138
Long-term time foreign currencies deposits	0	0	0	0	0	0	0	0
SIGHT DEPOSITS	**42,158**	**10,233**	**4,766**	**57,157**	**35,160**	**5,268**	**7,841**	**48,269**
Denar sight deposits of enterprises	9,382	2,581	911	12,874	7,242	952	1,972	10,166
Denar sight deposits of public sector	468	169	454	1,091	346	222	281	849
Denar sight deposits of other clients	1,428	335	266	2,029	1,260	130	343	1,734
Denar sight deposits of households	7,539	1,500	1,334	10,374	6,116	759	1,697	8,572
Restricted Denar deposits	342	165	19	527	278	62	100	439
Foreign currency sight deposits of legal entities	6,012	1,525	568	8,105	4,213	748	1,235	6,195
Foreign currency sight deposits of households	16,401	3,812	1,189	21,402	15,423	2,320	2,037	19,780
Restricted foreign currency deposits	586	145	25	756	283	75	177	535
SHORT-TERM DEPOSITS UP TO 1 YEAR	**46,642**	**13,296**	**3,076**	**63,015**	**35,039**	**5,152**	**5,729**	**45,920**
Denar short-term deposits of enterprises	10,122	3,603	909	14,633	7,250	1,847	955	10,051
Denar short-term deposits of public sector	415	5	40	460	472	85	167	723
Denar short-term deposits of other clients	812	71	67	950	504	14	144	662
Denar short-term deposits of households	10,047	2,561	1,273	13,880	5,981	643	1,258	7,882
Foreign currency short-term deposits of legal entities	5,607	2,864	19	8,490	4,616	767	1,117	6,500
Foreign currency short-term deposits of other clients	2,223	487	21	2,731	1,148	98	275	1,521
Foreign currency short-term deposits of households	17,416	3,707	748	21,870	15,067	1,699	1,815	18,581
SHORT-TERM BORROWINGS UP TO 1 YEAR	**76**	**40**	**114**	**230**	**201**	**0**	**18**	**219**
Short-term Denar borrowings from domestic banks	76	30	114	221	121	0	8	129
Short-term Denar borrowings from foreign banks	0	10	0	10	80	0	10	89
Short-term Denar borrowings from others	0	0	0	0	0	0	0	0
OTHER LIABILITIES	**1,616**	**633**	**246**	**2,495**	**1,988**	**713**	**975**	**3,676**
Payable interest	329	155	40	524	299	63	65	426
Other Denar liabilities	680	295	140	1,114	1,317	582	808	2,707
Other foreign currency liabilities	322	75	17	415	245	18	63	326
Other differed expences	285	108	50	442	127	51	39	217
LONG-TERM DEPOSITS OVER 1 YEAR	**1,707**	**2,622**	**767**	**5,096**	**1,341**	**820**	**1,571**	**3,732**
Denar long-term deposits of enterprises	235	169	74	478	325	0	311	635
Denar long-term deposits of public sector	0	49	0	49	0	48	0	48
Denar long-term deposits of other clients	32	195	175	402	17	76	187	280
Denar long-term deposits of households	544	715	390	1,649	507	355	456	1,318
Foreign currency long-term deposits of legal entities	0	6	0	7	0	0	0	0
Foreign currency long-term deposits of other clients	248	17	1	266	1	0	2	3
Foreign currency long-term deposits of households	648	1,470	127	2,245	490	341	616	1,448
LONG-TERM BORROWING OVER 1 YEAR	**8,836**	**5,085**	**1,540**	**15,461**	**7,611**	**2,211**	**3,106**	**12,927**
Long-term borrowings from NBRM	1,404	874	23	2,301	158	750	29	937
Long-term Denar borrowings from domestic banks	635	117	234	986	331	59	157	546
Long-term foreign currency borrowings from domestic banks	320	1,020	34	1,373	11	262	697	970
Long-term borrowings from foreign banks	4,505	1,909	1,143	7,557	6,602	835	1,887	9,324
Long-term borrowings from others	435	553	89	1,078	508	0	305	813
Long-term borrowings from non-financial legal entities	0	459	0	459	0	0	27	27
Long-term foreign currency borrowings from others	0	0	17	17	0	306	0	306
Assumed long-term foreign currency liabilities	1,538	153	0	1,690	0	0	4	4
PROVISIONS FOR OFF-BALANCE SHEET ITEMS	**576**	**50**	**22**	**648**	**637**	**36**	**40**	**713**
OWN FUNDS	**9,839**	**6,735**	**6,613**	**23,187**	**9,612**	**2,712**	**9,937**	**22,262**
Equity capital	7,641	5,856	5,899	19,396	7,626	2,467	9,418	19,510
Reserve fund	2,037	1,275	333	3,645	1,886	232	1,165	3,284
Revaluation reserves	130	4	202	335	132	0	272	404
Unallocated gain from previous year	30	151	13	194	29	53	51	133
Other funds	1	8	399	408	1	0	88	90
Loss	0	-558	-108	-666	-62	-36	-653	-751
Unallocated loan loss provissions	0	0	0	0	0	-3	-109	-113
Current loss	0	0	-125	-125	0	0	-295	-295
NET GAIN AFTER TAXATION	***1,907***	***821***	***197***	***2,925***	***0***	***0***	***0***	***0****
TOTAL LIABILITIES	**115,122**	**41,368**	**17,627**	**174,117**	**92,835**	**17,245**	**30,356**	**140,436**

* Net gain after taxation on 31.12.2005 is included in other liabilities.

Annex 2

INCOME STATEMENT

in millions of denars

Income statement	*31.12.2006*				*31.12.2005*			
	Large banks	*Medium-size banks*	*Small-size banks*	*Total*	*Large banks*	*Medium-size banks*	*Small-size banks*	*Total*
ITEREST INCOME	***6.114***	***2.099***	***1.340***	***9.553***	***4.834***	***1.140***	***1.696***	***7.670***
banks	547	326	180	1.053	419	239	325	983
enterprises	2.502	1.023	415	3.940	2.123	591	681	3.395
households	1.986	575	606	3.167	1.624	286	601	2.511
others	1.207	231	177	1.615	787	45	148	981
cancelled income	-128	-56	-38	-222	-119	-22	-58	-199
INTEREST EXPENDITURE	***-2.236***	***-699***	***-376***	***-3.311***	***-1.837***	***-307***	***-508***	***-2.652***
banks	-494	-140	-32	-666	-362	-42	-82	-486
enterprises	-625	-204	-44	-873	-618	-107	-114	-839
households	-1.025	-274	-169	-1.468	-769	-114	-198	-1.081
others	-92	-81	-131	-304	-88	-44	-114	-246
NET INTEREST INCOME	***3.878***	***1.400***	***964***	***6.242***	***2.997***	***833***	***1.188***	***5.018***
NET PROVISIONS	***-1.255***	***-115***	***-253***	***-1.623***	***-1979***	***-75***	***-493***	***-2.549***
Provisions	-1.765	-211	-258	-2.234	-2.386	-105	-533	-3.024
Provisons recovery	510	120	55	685	407	33	149	588
Unallocated provisions	0	-24	-50	-74	0	-3	-110	-113
NET INTEREST INCOME AFTER PROVISIONING	***2.623***	***1.285***	***711***	***4.619***	***1.018***	***758***	***694***	***2.471***
NET FEES AND COMMISSONS INCOME	***2.015***	***550***	***409***	***2.974***	***1.805***	***237***	***583***	***2.625***
Fees and commissions income	2.228	695	521	3.444	2.013	283	751	3.047
Fees and commissions expences	-213	-145	-112	-470	-209	-46	-168	-423
DIVIDENDS	***4***	***15***	***7***	***26***	***2***	***3***	***7***	***12***
NET INCOME FROM SECURITIES	***17***	***3***	***16***	***36***	***39***	***0***	***2***	***41***
NET CAPITAL INCOME	***130***	***11***	***49***	***190***	***58***	***1***	***-59***	***0***
NET EXCHANGE RATE DIFFERENTIALS	***321***	***133***	***38***	***492***	***425***	***68***	***133***	***626***
OTHER INCOME	***780***	***227***	***249***	***1.256***	***1.347***	***118***	***890***	***2.356***
Other income	297	83	130	510	437	8	139	584
Extsraordinary income	483	144	119	746	910	110	751	1.771
GENERAL AND ADMINISTRATIVE EXPENSES	***-3.567***	***-1219***	***-1239***	***-6025***	***-3.394***	***-661***	***-1.491***	***-5.546***
Salary	-1.690	-602	-569	-2.861	-1.633	-328	-714	-2.675
Depreciation	-494	-122	-129	-745	-497	-62	-189	-748
Tangible expences	-219	-87	-89	-395	-182	-53	-108	-343
Service expences	-621	-260	-331	-1212	-607	-134	-360	-1102
Business trip expences	-35	-16	-16	-99	-31	-10	-21	-62
Representation expences	-177	-62	-68	-307	-166	-38	-52	-255
Deposite insurance premium	-331	-69	-37	-437	-279	-35	-47	-360
OTHER EXPENSES	***-248***	***-90***	***-138***	***-476***	***-251***	***-42***	***-451***	***-743***
Other expences	-243	-84	-135	-462	-227	-40	-114	-381
Exstraordinary expences	-5	-6	-3	-14	-24	-2	-337	-363
GROSS INCOME/ LOSS	***2.075***	***914***	***103***	***3.092***	***1.049***	***482***	***310***	***1.841***
INCOME TAX	-168	-95	-29	-292	-106	-61	-81	-249
NET INCOME AFTER TAXATION / LOSS	***1.907***	***819***	***74***	***2.800***	***943***	***421***	***228***	***1.592***

Annex 3

Structure of loans to non-financial entities

in millions of denars

Date	Description	Total	Total		Enterprises		Households		Other clients	
			Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency
31.12.2005	Past due loans	1,551	945	606	749	592	193	12	3	3
	Short-term loans	19,237	16,485	2,752	12,895	2,714	3,535	29	55	9
	Long-term loans	37,690	24,838	12,852	9,031	11,928	15,745	676	62	248
	Non-performing loans	10,319	9,077	1,242	7,657	1,119	1,382	25	38	98
	Total gross loans	**68,797**	**51,344**	**17,452**	**30,332**	**16,352**	**20,854**	**742**	**159**	**359**
	Loan loss provisions	-9,889								
	Total net loans	**58,908**								
31.12.2006	Past due loans	1,521	1,024	497	703	481	321	15	0	1
	Short-term loans	25,153	20,996	4,157	14,902	4,122	5,830	25	264	10
	Long-term loans	53,034	35,311	17,723	13,824	15,937	21,450	1,636	37	150
	Non-performing loans	10,098	8,850	1,248	7,197	1,120	1,545	32	108	96
	Total gross loans	**89,806**	**66,181**	**23,625**	**36,626**	**21,660**	**29,146**	**1,708**	**409**	**257**
	Loan loss provisions	-10,179								
	Total net loans	**79,627**								
Growth 31.12.06/ 31.12.05	**Absolute gross loan growth**	21,009	14,837	6,173	6,294	5,308	8,292	966	250	-102
	In %	30.5%	28.9%	35.4%	20.8%	32.5%	39.8%	130.2%	157.2%	-28.4%
	Participation in growth	100.0%	70.6%	29.4%	30.0%	25.3%	39.5%	4.6%	1.2%	-0.5%

Annex 4

Structure of the securities portfolio

Securities portfolio	Amount in millions of denars		Structure		Annual growth 31.12.06/31.12.05		
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	Absolute growth	In percents	Participation in growth
Debt securities	**16,365**	**22,738**	**91.7%**	**93.7%**	**6,373**	**38.9%**	**99.3%**
CB Bills	8,934	9,457	54.6%	41.6%	523	5.9%	8.2%
Government securities	7,221	13,127	44.1%	57.7%	5,907	81.8%	92.7%
-Bond for privatization of Stopanska Banka AD Skopje	4,992	4,332	69.1%	33.0%	-660	-13.2%	-11.2%
- Bonds for rehabilitation of Stopanska Banka AD Skopje (large bond) issued by the Bank Rehabilitation Agency	93	76	1.3%	0.6%	-17	-18.2%	-0.3%
- Bonds for old foreign curency savings and denationalization	1,273	1,287	17.6%	9.8%	13	1.0%	0.2%
- Treasury bills	790	7,103	10.9%	54.1%	6,313	799.2%	106.9%
- Continuous Government securities	72	330	1.0%	2.5%	258	360.0%	4.4%
Other Securities	211	154	1.3%	0.7%	-57	-27.1%	-0.9%
Equity securities	**1,480**	**1,527**	**8.3%**	**6.3%**	**47**	**3.1%**	**0.7%**
Investments in securities with management right in domestic non-financial legal entities	356	360	24.1%	23.6%	4	1.1%	8.3%
Investments in banks and other financial organizations in the contry	887	842	59.9%	55.2%	-45	-5.1%	-96.6%
Other equity securities	237	324	16.0%	21.2%	87.53	37.0%	187.9%
Total securities portfolio	**17,845**	**24,264**	**100.0%**	**100.0%**	**6,420**	**36.0%**	**100.0%**

Annex 5

Structure of deposits of non-financial entities

in millions of denars

Date	Descrption	Total	Total		Enterprises		Households		Public sector		Other clients	
			Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency	Denar	Foreign currency	Denarski	Foreign currency
31.12.2005	Sight deposits	47,295	21,320	25,975	10,166	6,195	8,572	19,780	849	-	1,734	-
	Restricted deposits	974	439	535	303	535	-	-	128	-	8	-
	Short-term time deposits up to 1 year	45,920	19,318	26,602	10,051	6,500	7,882	18,581	723	-	662	1,521
	Short-term time deposits over 1 year	3,732	2,281	1,451	635	-	1,318	1,448	48	-	280	3
	Total	**97,922**	**43,359**	**54,563**	**21,155**	**13,230**	**17,772**	**39,809**	**1,748**	**-**	**2,684**	**1,524**
31.12.2006	Sight deposits	55,875	26,367	29,507	12,874	8,105	10,374	21,402	1,091	-	2,029	-
	Restricted deposits	1,282	527	756	362	756	-	-	162	-	3	-
	Short-term time deposits up to 1 year	63,015	29,924	33,091	14,633	8,490	13,880	21,870	460	-	950	2,731
	Short-term time deposits over 1 year	5,096	2,578	2,518	478	7	1,649	2,245	49	-	402	266
	Total	**125,267**	**59,396**	**65,871**	**28,348**	**17,357**	**25,903**	**45,517**	**1,762**	**-**	**3,383**	**2,997**
Annual growth 31.12.06/ 31.12.05	**Absolute deposite growth**	27,345	16,037	11,308	7,193	4,127	8,131	5,708	14	-	699	1,474
	In %	27.9%	37.0%	20.7%	34.0%	31.2%	45.7%	14.3%	0.8%		26.0%	96.7%
	Participation in growth	100.0%	58.6%	41.4%	26.3%	15.1%	29.7%	20.9%	0.1%		2.6%	5.4%

Annex 6

Indicators for the credit portfolio quality

in millions of denars

Items	31.12.2001	31.12.2002	31.12.2003	31.12.2004	31.12.2005	31.12.2006
A	23,303	67,337	77,686	91,394	108,913	143,707
B	11,844	11,018	10,871	12,025	16,487	21,931
C	7,891	6,269	4,602	4,826	4,473	3,807
D	7,740	6,497	5,735	4,191	4,420	3,435
E	2,260	2,094	5,413	6,744	6,403	6,308
Total credit exposure	53,040	93,214	104,306	119,179	140,696	179,188
Potential losses	9,609	8,166	10,719	11,591	11,753	11,762
total C, D, E	17,892	14,860	15,749	15,761	15,296	13,550
total C, D, E	10,001	8,591	11,148	10,935	10,823	9,743
total C and D	15,632	12,766	10,336	9,017	8,893	7,242
% of C, D, E in the total credit exposure	33.7	15.9	15.1	13.2	10.8	7.6
% of D, E in the total credit exposure	18.9	9.2	10.7	9.2	7.7	5.4
% of C, D in the total credit exposure	29.5	13.7	9.9	7.6	6.3	4.0
% of D in the total credit exposure	14.6	7.0	5.5	3.5	3.1	1.9
% of E in the total credit exposure	4.3	2.3	5.2	5.7	4.6	3.5
% of C in the total credit exposure	14.9	6.7	4.4	4.1	3.2	2.2
% of risk (potential loss/total exposure)	18.1	8.8	10.3	9.7	8.4	6.6
Net positions in C, D, E (less adequate provisions)	9,789	7,950	6,318	5,715	5,565	4,573
Guarantee capital	18,699	19,122	19,441	19,397	21,292	23,604
% of C, D, E in the guarantee capital	95.7	77.7	81.0	81.3	71.8	57.4
% of D, E in the guarantee capital	53.5	44.9	57.3	56.4	50.8	41.3
% of C, D in the guarantee capital	83.6	66.8	53.2	46.5	41.8	30.7
% of D in the guarantee capital	41.4	34.0	29.5	21.6	20.8	14.6
% of E in the guarantee capital	12.1	11.0	27.8	34.8	30.1	26.7
% of C in the guarantee capital	42.2	32.8	23.7	24.9	21.0	16.1
% of net C, D, E in the guarantee capital	52.4	41.6	32.5	29.5	26.1	19.4
Capital adequacy	35.3	28.1	25.8	23.0	21.3	18.3
Total country risk exposure (net)		29,438	31,195	35,278	35,589	37,235
Potential country risk losses		8	12	13	42	45
% of potential country risk losses/total country risk exposure		0.03	0.04	0.04	0.1	0.1

Annex 7

Transition matrix for clients - natural persons

Risk category 31.12.2005	Number of clients			Risk category on 31.12.2006					
	31.12.2005	Settled and written off	31.12.2006*	A	B	C	D	E	Total
A	17,565	6,561	11,004	87.9%	7.7%	3.7%	0.5%	0.2%	100.0%
B	3,589	1,224	2,365	14.8%	71.8%	10.4%	2.5%	0.5%	100.0%
C	643	214	429	15.9%	17.2%	43.8%	19.3%	3.7%	100.0%
D	385	166	219	11.0%	7.3%	11.4%	26.5%	43.8%	100.0%
E	533	250	283	3.5%	0.7%	2.1%	7.1%	86.6%	100.0%
Total	**22,715**	**8,415**	**14,300**	**70.8%**	**18.4%**	**6.1%**	**1.9%**	**2.8%**	**100.0%**
Risk category 31.12.2005	**Amount of credit exposure**			**Risk category on 31.12.2006**					
	31.12.2005	**Settled and written off**	**31.12.2006***	**A**	**B**	**C**	**D**	**E**	**Total**
A	8,310,435	1,508,958	6,801,477	89.2%	7.4%	2.6%	0.6%	0.2%	100.0%
B	1,921,109	131,537	1,789,572	11.7%	77.7%	8.8%	1.5%	0.4%	100.0%
C	329,013	37,245	291,769	14.9%	19.8%	46.8%	15.2%	3.3%	100.0%
D	149,417	10,403	139,014	14.5%	7.0%	14.6%	31.4%	32.6%	100.0%
E	195,502	87,557	107,945	2.0%	1.9%	1.2%	5.8%	89.1%	100.0%
Total	**10,905,476**	**1,775,700**	**9,129,777**	**69.4%**	**21.5%**	**5.4%**	**1.8%**	**1.9%**	**100.0%**

Transition matrix for clients - non-financial legal entities

Risk category 31.12.2005	Number of clients			Risk category on 31.12.2006					
	31.12.2005	Settled and written off	31.12.2006*	A	B	C	D	E	Total
A	4,930	883	4,047	89.4%	7.0%	2.8%	0.4%	0.4%	100.0%
B	1,520	315	1,205	16.9%	72.9%	5.5%	3.7%	1.0%	100.0%
C	258	49	209	18.7%	7.2%	51.7%	13.4%	9.1%	100.0%
D	238	52	186	2.2%	2.7%	4.8%	54.3%	36.0%	100.0%
E	443	75	368	0.5%	0.3%	1.1%	1.6%	96.5%	100.0%
Total	**7,389**	**1,374**	**6,015**	**64.3%**	**19.7%**	**5.0%**	**3.3%**	**7.8%**	**100.0%**
Risk category 31.12.2005	**Amount of credit exposure**			**Risk category on 31.12.2006**					
	31.12.2005	**Settled and written off**	**31.12.2006***	**A**	**B**	**C**	**D**	**E**	**Total**
A	51,201,406	1,991,193	49,210,213	90.6%	7.7%	1.2%	0.4%	0.1%	100.0%
B	13,515,194	262,816	13,252,377	14.9%	76.7%	6.7%	1.4%	0.2%	100.0%
C	3,807,078	136,272	3,670,806	3.7%	21.6%	62.2%	7.3%	5.2%	100.0%
D	3,386,449	355,891	3,030,558	0.1%	0.2%	0.9%	51.7%	47.1%	100.0%
E	5,506,220	1,017,465	4,488,754	0.2%	1.4%	0.1%	1.0%	97.3%	100.0%
Total	**77,416,347**	**3,763,638**	**73,652,709**	**63.4%**	**20.1%**	**5.2%**	**3.1%**	**8.2%**	**100.0%**

* This column includes the clients the banks were exposed to on December 31, 2005 and the clients the banks are still exposed to on December 31, 2006 as well as the total amount of credit exposure of those clients. The column does not include those new clients to which the banks in the meantime established credit exposure and the amount of that exposure.

Annex 8

Contractual maturity structure of the assets and the liabilities as of December 31, 2006

in thousands of denars

Ref. no.	Description	to 7 days	from 7 days to 1 month	from 1 month to 3 months	3 - 6 months	6 - 12 months	over 12 months	Total
1	Cash and balances with NBRM	9,967,337	1,674	2,581	283	445	7,498,560	17,470,880
2	Securities of NBRM and Repubic of Macedonia	3,465,981	8,644,824	3,200,854	1,182,194	780,364	5,156,503	22,430,720
3	Debt securities and other payment instruments	86,391	44,128	14,193	7,765	1,092	73,916	227,485
4	Placements to other banks	17,401,307	17,644,518	2,119,003	1,167,355	325,704	2,256,309	40,914,196
5	Placements to clients	3,252,139	4,154,952	8,407,810	10,403,130	17,841,181	45,745,547	89,804,759
6	Accrued interest	448,899	180,367	168,754	7,705	1,067	4,240,687	5,047,479
7	Other assets	613,728	311,024	404,981	80,888	192,052	192,305	1,794,978
8	Placements in equity securities and capital investments	121,652	0	0	0	264,858	1,203,663	1,590,173
9	**Total assets(1+2+3+4+5+6+7+8)**	**35,357,434**	**30,981,487**	**14,318,176**	**12,849,320**	**19,406,763**	**66,367,490**	**179,280,670**
10	Bank deposits	1,567,996	622,491	1,150,013	155,214	275,469	145,751	3,916,934
11	Sight deposits	56,216,637	479,479	25,973	10,206	86,970	307,453	57,126,718
12	Short-term deposits up to 1 year	6,579,143	19,847,695	19,496,974	8,051,523	7,501,769	6,950	61,484,054
13	Short-term borrowings up to 1 year	130,028	12,235	25,081	0	61,174	0	228,518
14	Issued debt securities	0	0	0	0	0	316	316
15	Other liabilities	1,129,311	704,764	348,916	14,874	97,709	40,005	2,335,579
16	Long-term deposits over 1 year	130,637	159,465	232,945	291,394	818,427	5,154,802	6,787,670
17	Long-term borrowings over 1 year	1,883	200,432	1,753,129	402,223	1,447,088	9,979,138	13,783,893
18	Off-balance sheet items	2,045,101	1,631,707	1,671,991	1,509,270	1,662,376	2,231,225	10,751,670
19	**liabilities(10+11+12+13+14+15+16+17+18)**	**67,800,736**	**23,658,268**	**24,705,022**	**10,434,704**	**11,950,982**	**17,865,640**	**156,415,352**
20	Difference (9-19)	-32,443,302	7,323,219	-10,386,846	2,414,616	7,455,781	48,501,850	22,865,318
21	Cumulative difference	-32,443,302	-25,120,083	-35,506,929	-33,092,313	-25,636,532	22,865,318	-128,933,841

Annex 9

Expected maturity structure of the assets and the liabilities as of December 31, 2006

in thousands of denars

Ref. no.	Description	to 7 days	from 7 days to 1 month	from 1 month to 3 months	Total
1	Cash and balances with NBRM	9,400,346	17,799	2,500	9,420,645
2	Securities of NBRM and Repubic of Macedonia	3,451,138	8,254,695	2,630,970	14,336,803
3	Debt securities and other payment instruments	86,134	43,975	13,806	143,915
4	Placements to other banks	15,584,527	18,117,875	2,082,077	35,784,479
5	Placements to clients	2,105,712	3,665,213	6,839,916	12,610,841
6	Accrued interest	361,401	187,381	288,090	836,872
7	Other assets	536,128	237,484	444,359	1,217,971
8	Placements in equity securities and capital investments	121,652	0	0	121,652
9	**Total assets (1+2+3+4+5+6+7+8)**	**31,647,038**	**30,524,422**	**12,301,718**	**74,473,178**
10	Bank deposits	1,142,442	577,846	864,815	2,585,103
11	Sight deposits	10,223,245	2,515,901	1,383,517	14,122,663
12	Short-term deposits up to 1 year	3,534,616	7,891,504	10,487,522	21,913,642
13	Short-term borrowings up to 1 year	130,028	12,235	21,294	163,557
14	Issued debt securrities	0	0	0	0
15	Other liabilities	860,226	731,176	349,195	1,940,597
16	Long-term deposits over 1 year	18,641	88,345	134,924	241,910
17	Long-term borrowings over 1 year	1,883	187,916	1,749,397	1,939,196
18	Off-balance sheet items	413,481	348,695	405,659	1,167,835
19	**Total liabilities(10+11+12+13+14+15+16+17+18)**	**16,324,562**	**12,353,618**	**15,396,323**	**44,074,503**
20	Difference (9-19)	15,322,476	18,170,804	-3,094,605	30,398,675
21	Cumulative difference	15,322,476	33,493,280	30,398,675	79,214,431

Annex 10

Structure of foreign assets and foreign liabilities

Foreign assets	Amount (in millions of denars)		Participation in assets		Change rate
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	
Cash and checks and debt market securities	2026	2,439	2.6%	2.5%	20.4%
Assets in foreign and domestic banks	40,984	43,949	51.6%	45.6%	7.2%
Foreign currency claims	17,532	23,813	22.1%	24.7%	35.8%
Foreign currency indexed claims in Denars	21,712	27,975	27.3%	29.1%	28.8%
Value correction	-2,262	-2396	-2.8%	-2.5%	5.9%
Securities for sale	59	74	0.1%	0.1%	25.4%
Other assets - other accounts	1,434	432	1.8%	0.4%	-69.9%
Total foreign assets	**79,400**	**96,285**	**100.0%**	**100.0%**	**21.3%**

Foreign liabilities	Amount (in millions of denars)		Participation in liabilities		Change rate
	31.12.2005	31.12.2006	31.12.2005	31.12.2006	
Foreign currency deposits of banks	1,437	2,147	2.1%	2.5%	49.4%
Foreign currency deposits of households	39,305	44,905	56.6%	52.3%	14.2%
Foreign currency deposits of enterprises, public sector and other clients	11,688	15,373	16.8%	17.9%	31.5%
Foreign assets of foreign entities	3,881	7,752	5.6%	9.0%	99.7%
Foreign currency indexed deposits in Denars	2,731	5,333	3.9%	6.2%	95.3%
Foreign curency loans of banks	10,065	9,825	14.5%	11.4%	-2.4%
Other liabilities - other accounts	389	551	0.6%	0.6%	41.6%
Total foreign liabilities	**69,488**	**85,885**	**100.0%**	**100.0%**	**23.6%**

Annex 11

Guarantee capital

in millions of denars

Ref. no.	Description	Total
A	**CORE CAPITAL**	
1	Issued common and preference shares or immediately paid in funds	19.286
2	Reserves	3.644
3	Reatined undistributed income	194
4	Income according to interim financial statement discounted by 50%	
5	Uncovered loss from previous years	-743
6	Current loss	
7	Goodwil	
8	**CORE CAPITAL**	**22.381**
B	**ADDITIONAL CAPITAL**	
9	Issued cumulative preference shares	108
10	Revaluation reserves	335
11	Hibrid capital instruments	0
12	Subordinated liabilities	1.691
13	**TOTAL ADDITIONAL CAPITAL**	**2.134**
14	Additional capital included in the guarantee capital	**2.134**
V	**GUARANTEE CAPITAL**	
15	**Gross guarantee capital**	**24.515**
16	Capital investments in banking and non-banking financial institutions	-837
17	Unallocated special loan loss provisions and country risk losses	-74
17.1	Unallocated non-performing interest	-2
17.2	Unallocated special loan loss provisions	-72
	GUARANTEE CAPITAL	**23.604**

Decomposition of the rate of return on average own funds at the level of the banking system

ROAE=Net income/ Average own funds

2004	0,031
2005	0,075
2006	0,123

h

ROAA=Net income/ Average assets

2004	0,006
2005	0,012
2006	0,018

Average assets/ Average own funds

2004	5,527
2005	6,123
2006	6,921

Profit margin = Net income/ Total regular income = 1+(Expenditures/Total regular income)

2004	0,078
2005	0,170
2006	0,256

	2004	*2005*	*2006*
Net provisions/ Total regular income	-0,331	-0,273	-0,148
Non-interest expenditures/ Total regular income	-0,756	-0,681	-0,636
Net extraordinary items and tax/ Total regular income	0,165	0,124	0,040

h

Total regular income/ Average assets

2004	0,071
2005	0,073
2006	0,070

	2004	*2005*	*2006*
Net interest income/Average assets	0,035	0,039	0,040

+

	2004	*2005*	*2006*
Non-interest income/Average assets	0,036	0,034	0,030

Annex 13

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, 40/2004, 61/2005 and 129/2006);
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. 24/1998 and 6/2000);
4. Law on Microfinancing Banks ("Official Gazette of the Republic of Macedonia" no. 61/2002).

Decisions:

5. Decision on the methodology for determining the bank guarantee capital ("Official Gazette of the Republic of Macedonia" no. 77/2000)
6. 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)
7. 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)
8. Decision on the methodology for determining risk weighted assets of the banks ("Official Gazette of the Republic of Macedonia" no. 50/2001)
9. Decision on determining and calculating the banks' foreign exchange positions ("Official Gazette of the Republic of Macedonia" no. 103/2001 - revised text)
10. 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)
11. 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. 65/1996, 16/2001 and 85/2001)
12. Decision on determining the methodology for classification of the on-balance and off-balance sheet assets items of according to their risk level ("Official Gazette of the Republic of Macedonia" no. 21/2002 - revised text and 80/2006)
13. Decision on the manner of conducting surveillance of the application of the regulations governing the foreign exchange and undertaking measures against banks ("Official Gazette of the Republic of Macedonia" no. 44/2002 and 80/2002)
14. Decision on the supervisory standards for regulating the banks over due claims ("Official Gazette of the Republic of Macedonia" no. 19/2003)
15. Decision on the methodology for determining the banks' capital ("Official Gazette of the Republic of Macedonia" no. 66/2003)
16. 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)
17. Decision on defining the standards for ensuring the banks' information security ("Official Gazette of the Republic of Macedonia" no. 77/2003)
18. Decision on consolidated supervision of banks ("Official Gazette of the Republic of Macedonia" no. 84/2003)

19. Decision on identifying, assessing and managing the banks' liquidity risk ("Official Gazette of the Republic of Macedonia" no. 84/2003)
20. Decision on the credit exposure limits of bank ("Official Gazette of the Republic of Macedonia" no. 1/2004 - revised text)
21. Decision on the contents and the manner of functioning of credit registry ("Official Gazette of the Republic of Macedonia" no. 61/2004)
22. Decision on the documentation necessary for granting approvals and submitting notification on the change in the ownership structure of the voting shares ("Official Gazette of the Republic of Macedonia" no. 85/2004);
23. Decision on calculating and publishing the effective interest rate on credits and deposits ("Official Gazette of the Republic of Macedonia" no. 117/2005)
24. Decision on the methodology for determining net bank debtors ("Official Gazette of the Republic of Macedonia" no. 41/2006)
25. Decision on conditions and manner of concluding foreign currency indexed loans in Denars and in foreign currencies between residents ("Official Gazette of the Republic of Macedonia" no. 41/2006)
26. Decision on methodology for allocating special loss provisions of assumed assets based on non-repaid claims ("Official Gazette of the Republic of Macedonia" no. 80/2006)
27. Decision on the dynamics of reconciliation between savings houses founding capital and the regulations of the Law on Banks and Savings Houses ("Official Gazette of the Republic of Macedonia" no. 49/1998)
28. Decision on determining the volume and manner of savings houses operating ("Official Gazette of the Republic of Macedonia" no. 111/2000, 80/2002 and 66/2003)
29. Decision on the methodology for determining capital adequacy ("Official Gazette of the Republic of Macedonia" no. 5/2007)

Annex 14

Review by group of banks*

	Group of large banks (assets exceeding Denar 15 billion)		Group of medium-size banks (assets from Denar 4,5 to 15 billion)		Group of small-size banks (assets below Denar 4,5 billion)
1	Komercijalna Banka AD Skopje	1	Alfa Banka AD Skopje	1	Eurostandard Banka AD Skopje
2	NLB Tutunska Banka AD Skopje	2	Investbanka AD Skopje	2	Internacionalna Privatna Banka AD Skopje
3	Stopanska Banka AD Skopje	3	Export and Credit Bank AD Skopje	3	Komercijalno Investiciona Banka AD Kumanovo
4		4	Ohridska Banka AD Ohrid	4	Makedonska Banka AD Skopje
5		5	ProCredit Banka AD Skopje	5	Macedonian Bank for Development Promotion AD Skopje
6		6	Stopanska Banka AD Bitola	6	Postenska Banka AD Skopje
7		7	UNI Banka ADSkopje	7	Sileks Banka AD Skopje
8		8		8	TTK Banka AD Skopje
9		9		9	T.X. Ziraat Bankasi - subsidiary Skopje

* By alphabetical order.

Annex 15

Banks and savings houses in the Republic of Macedonia as of December 31, 2006

I. Banks

Banks licenced to perform financial activities stipulated under articles 45 and 46 of the Banking Law

Alfa Banka a.d. Skopje
Dame Gruev, 1
1000 Skopje
fax: 02 3116 830; 02 3135 206
tel: 02 3116 433

UNI Banka a.d. Skopje
Maksim Gorki, 6
1000 Skopje
fax: 02 3130 448; 02 3286 000
tel: 02 3286 100

Eurostandard Banka a.d. Skopje
27 Mart, b.b. (mal ring)
1000 Skopje
fax: 02 3249 430
tel: 02 3249 400

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

Izvozna i Kreditna Banka a.d. Skopje
Partizanski odredi, 3 blok 11
1000 Skopje
fax: 02 3240 872
tel: 02 3240 800

Komercijalna Banka a.d. Skopje
Dimitar Vlahov, 4
1000 Skopje
fax: 02 3113 494
tel: 02 3107 107; 02 3111 133

Ohridska Banka a.d. Ohrid
Makedonski prosvetiteli, 19
6000 Ohrid
fax: 046 254 130; 046 254 133
tel: 046 206-600; 046 265-330

ProKredit Banka a.d. Skopje
Jane Sandanski, 109/a
1000 Skopje
fax: 02 3219 901
tel: 02 3219 900; 02 3219 948

Stopanska Banka a.d. Bitola
Dobrivoe Radosavlevic, 21
7000 Bitola
fax: 047 207 515; 047 207 541; 047 207 513
tel: 047 207 500

Sileks Banka a.d. Skopje
Gradski stadion, b.b.
1000 Skopje
fax: 02 3249 303
tel: 02 3249 300

Stopanska Banka a.d. Skopje
11 Oktomvri, 7
1000 Skopje
fax: 02 3114 503
tel: 02 3295 295

TTK Banka a.d. Skopje
Naroden front, 19/a
1000 Skopje
fax: 02 3236 444
tel: 02 3236 400

NLB Tutunska Banka a.d. Skopje
12-ta makedonska brigada, 20
1000 Skopje
fax: 02 3105 630; 02 3105 681
tel: 02 3105 601; 02 3105 606;
02 3105 649

Makedonska Banka a.d. Skopje
Bul. VMRO, 3-12/2
1000 Skopje
fax: 02 3117 191
tel: 02 3117 111

T.X.Ziraat Bankasi - podruznica- Skopje
Zeleznicka, 8
1000 Skopje
fax: 02 3110 013
tel: 02 3111 337

Makedonska Banka za poddrska na razvojot a.d. Skopje
Veljko Vlahovic, 26
1000 Skopje
fax: 02 3239 688
tel: 02 3114 840; 02 3115 844

Banks licenced to perform financial activities stipulated under article 45 of the Banking Law

Komercijalno Investiciona Banka a.d. Kumanovo
Plostad Nova Jugoslavija, b.b.
1300 Kumanovo
fax: 031 420 061
tel: 031 475 100; 031 426 455

Postenska banka a.d. Skopje
27 Mart, b.b. (mal ring)
1000 Skopje
fax: 02 3163 054; 02 3103 216
tel: 02 3103 200

Internacionalna Privatna Banka a.d. Skopje
27 Mart, 1
1000 Skopje
fax: 02 3112 830; 02 3134 060
tel: 02 3119 191; 02 3124 288

II. Savings houses

AL KOSA a.d. Stip
Vanco Prke, b.b.
2000 Stip
fax: 032 393 163
tel: 032 392 960

AM d.o.o. Skopje
Orce Nikolov, 70
1000 Skopje
fax: 02 3223 770
tel: 02 3223 770

Bavag d.o.o. Skopje
Koco Racin, 32/1-1
1000 Skopje
fax: 02 3135 328
tel: 02 3134 362

Fersped d.o.o. Skopje
Marsal Tito, 11a
1000 Skopje
fax: 02 3149 350
tel: 02 3149 325; 02 3149 336

Graganska Stedilnica d.o.o. Skopje
Dame Gruev, 10
1000 Skopje
fax: 02 3118 585
tel: 02 3118 585

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

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

Interfalko d.o.o. Skopje
Bul. Partizanski odredi, 123
1000 Skopje
fax: 02 3062 546
tel: 02 3062 546

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

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

Mak - BS d.o.o. Skopje
Dame Gruev, blok 1
1000 Skopje
fax: 02 3166 466
tel: 02 3131 190

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

III. Foreign bank representative offices

Bank AustriaCreditanstalt AG -
representative office - Skopje
Makedonija, 53-4
1000 Skopje
fax: 02 3215 140
tel: 02 3215 130