BOSNIA AND HERZEGOVINA
FEDERATION OF BOSNIA AND HERZEGOVINA
BANKING AGENCY OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

I N F O R M A T I O N

ON BANKING SYSTEM
OF THE FEDERATION OF BOSNIA AND HERZEGOVINA
AS OF JUNE 30, 2005

Sarajevo, August-2005

Banking Agency of the Federation of BiH, as a regulatory authority performing bank supervision, prepared Information on banking system of the Federation of BiH (as of June 30, 2005) based on reports of banks, and other information and data submitted by banks. We also included findings and data resulting from on-site examinations and analysis performed in the Agency (off-site financial analysis).

I. INTRODUCTION

The banking sector in the Federation of BiH, even in the first half of 2005, continued positive changes, further stabilization, strengthening, growth, and development. Measured with the most significant quantitative and qualitative indicators, trend of improvement has been maintained in all segments of the performance.

After slow increase of entire 2% in the first quarter of 2005, banks increased assets in the first six months by 8% or KM 639 million, so the balance sheet total on the system level reached KM 8.25 billion. Such increase was financed through the two most significant balance sheet aggregates: deposits (increased by 7% or KM 365 million) and loans originated (increase rate of 19% or KM 161 million).

Savings had a strong increase of 15% or KM 310 million, and, as of 06-30-2005, amounted to KM 2.44 billion. This gives a confirmation of a retrieved and strengthened confidence of citizens to the safety of investments in our banks, which is especially important having in mind that saving deposits are the most important segment of deposit and financial potential of banks. As for banks, it is of significant importance that increase of long-term saving deposits continues. At the end of the observed period, they amounted to KM 936 million or 38.4% of total savings.

Along with increase of cash funds of 6%, participation of 36.6% and trend of further improvement in maturity adjustment among assets and liabilities items for the remaining maturity, liquidity of the banking sector is rated satisfactory.

In the first half of 2005, loans increased by 12% or KM 535 million, and so reached participation in the assets of 60%. Out of this, banks financed citizens in the amount of KM 291 million, and private enterprises of KM 271 million, while other segments reported decrease in the amount of loans.

Although both capitalization rate (13%) and capital adequacy rate (17.9%) are somewhat lower than at the end of 2004, capital strengthening of banks continues, especially of the larger ones in the system, which is important for safety and stability of the entire banking sector. At the same time, banks were strengthening their core and additional capital; core capital increased by KM 56.3 million, and additional capital increased by KM 13.6 million; and, in that way, they improved capital adequacy rate and provided for higher level of core capital to comply existing and future loan risk concentrations with the regulated limits.

Profitability at the system level is good; reported profit was KM 34 million, out of which 18 banks reported positive performance with the profit of 39 million, while six banks reported loss of six million. At the system level, ROAA (return on average assets) was 0.86%, and ROAE (return on average equity) was 8.88%, which is better in comparison to the same period last year, and is significantly worst than the international practice standards. Increase of loan risk and corresponding provisions for loan losses, decreasing trend of interest rates, as well as interest margin, increase of long-term loans and increase of their participation in total loans, and increase of interest expenses, are key determinants of profitability and financial result of our banks.

Finally, there were no significant changes in the segment of ownership structure and market share of banks. Banks with majority foreign capital have dominant market share of 79.2%, however, there is still significant asset concentration in four largest banks (67.9%).

II. BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF BANKING SECTOR

1.1. Status, Number and Business Network

As of 06-30-2005, there were 24 banks[1] with the banking license issued in the Federation of BiH. Number of banks remained the same as of 12-31-2004.

Provisional administrator was initiated in five banks as of 06-30-2005 (UNA bank d.d Bihać, Hercegovačka bank d.d. Mostar, Ljubljanska bank d.d. Sarajevo, Poštanska bank BiH d.d. Sarajevo and Privredna bank d.d. Sarajevo).

In first six months of 2005, banks tried to further expand their organizational network. Banks from the Federation of BiH have founded 27 new organizational parts, out of which three in Republic of Srpska. In comparison to 12-31-2004, when banks constituted of 439 organizational parts, this represents a growth of 6.2%.

As of 06-30-2005, 11 banks from the Federation of BiH had 24 organizational parts in Republic of Srpska and 10 in Brčko District. Number of organizational parts of banks from Republic of Srpska in the Federation of BiH remained unchanged in comparison to 12-31-2004, that is, three banks from Republic of Srpska had 11 organizational parts in the Federation of BiH.

License to perform inter-bank transactions in the internal payment system was granted to 24 banks as of 06-30-2005. There were 15 banks with deposit insurance.

1.2. Ownership Structure

As of 06-30-2005, ownership structure in banks[2] was rated upon available information and insight in banks[3], as follows:

- Private and predominately privately owned 18 banks (75%)
- State and predominately state owned 6 banks (25%).

Ownership structure can be observed from the aspect of financial indicators, which is, by the value of total capital[4].

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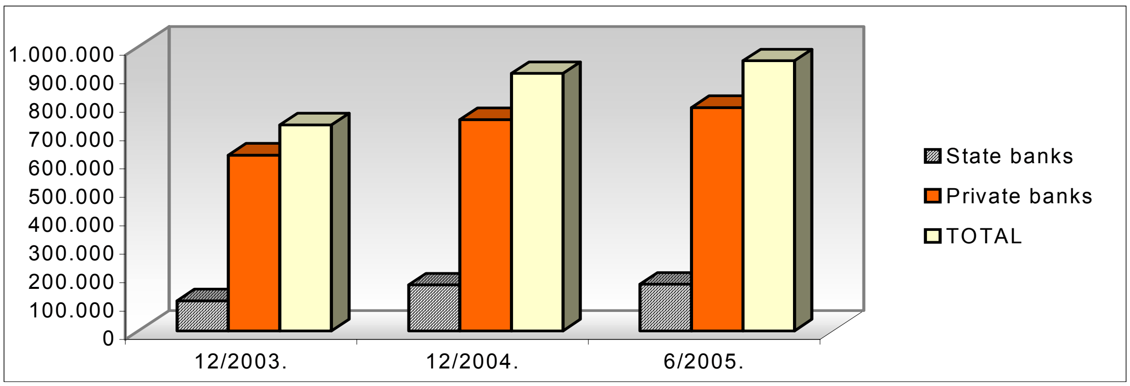
[1] Starting form 09/30/04, financial indicators include information from Hercegovačka Bank d.d. Mostar (in period from April 2001 when Provisional Administrator was instituted in Hercegovačka Bank until 09/30/04 information for the whole banking system did not include the data from this bank).
[2] Criteria for dividing banks by type of ownership are the ownership of shareholder capital in banks.
[3] General overview of ownership structure of banks in the F BiH as of 06/30/05 resulted from received reports, and registration in authorized courts (changes in capital and bank shareholders).
[4] Information from balance sheet - FBA schedule: share capital, value over the issue shares, undistributed profit and reserves and other capital (financial results from the current period).

Table 1: *Ownership structure by total capital* -In 000 KM-

BANKS	31.12.2003.		31.12.2004.[5]		30.06.2005.		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	106,105	15%	161,915	18%	164,291	17%	153	101
Private banks	607,430	85%	743,495	82%	786,133	83%	123	106
T O T A L	713,535	100%	905,410	100%	950,424	100%	127	105

Graph 1: *Ownership structure review (total capital)*



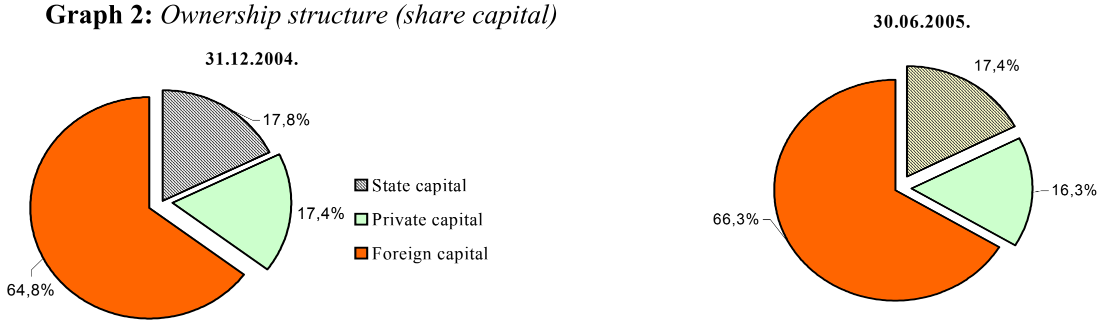
More detailed picture on capital ownership structure of banks in the Federation of BiH can be viewed by analysis of participation of state, private and foreign capital in share capital of banks.

Table 2: *Ownership structure by participation of state, private and foreign capital*

- In 000 KM-

SHARE CAPITAL	31.12.2003.		31.12.2004.		30.06.2005.		RATIO	
	Amount	Particp %	Amount	Particp %	Amount	Particp %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	75,636	12.6	135,350	17.8	135,350	17.4	179	100
Private capital (residents)	115,411	19.2	132,785	17.4	126,521	16.3	115	95
Foreign capital (nonresidents)	408,882	68.2	493,227	64.8	515,266	66.3	121	104
T O T A L	599,929	100.0	761,362	100.0	777,137	100.0	127	102

Graph 2: *Ownership structure (share capital)*



[5] All data in the Information related to 12-31-2004 come from the audited financial statements of banks (audit performed by external auditor).

Analysis of the ownership structure of banks, from the aspect of shareholder capital, most explicitly shows the changes and trends in the banking system of the FBiH, especially in the segment of ownership structure changes.

As of 06-30-2005, participation of state capital in total shareholder capital of banks was 17.4 % and it was lower by 0.4% in comparison to 12-31-2004. Participation of remaining state capital in private banks was below 1%, that is, it was KM 1.2 million.

In comparison to 12-31-2004, participation of private capital (resident) in total capital of the banking sector decreased from 17.4% to 16.3%, and participation of foreign capital increased from 64.8% to 66.3%. Increase of the foreign capital participation of 1.5% resulted from additional capitalization performed in the amount of KM 16 million in one bank with foreign ownership, and sale of shares of residents (in six banks) to foreign buyers (nonresidents) in total amount of approximately KM 6 million.

Changes in the ownership structure reflected to the participation, that is, market share and positioning of banks grouped according to the criteria of majority ownership to shareholder capital. However, increase of foreign capital participation did not have any influence on market share of the banks with majority foreign ownership, because only banks with majority private capital experienced increase of market share of 0.4% as a result of higher increasing rate of assets of those banks (rate of 11%) than the banks with majority foreign capital (8%) in the first six months of 2005.

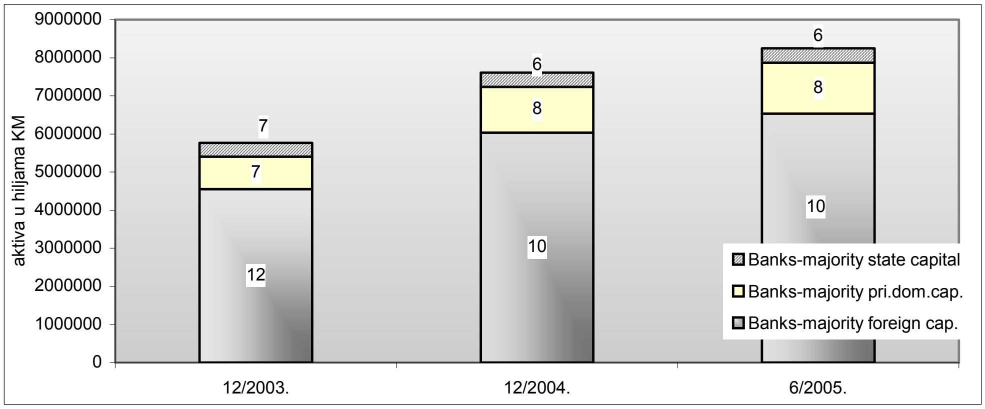
Integration processes in the earlier period were also in the function of stronger market positioning, which resulted in concentration in the banking sector through larger banks becoming even larger, decreased number of banks, and stronger competition. More significant changes will happen in future period, as a result of the on-going activities related to the changes in ownership structure with two banks.

Table 3: *Market share of banks by ownership type*[6] - In %-

BANKS	31.12.2003.			31.12.2004.			30.06.2005.		
	Partcp. in total capital	Partcp. in total assets	No. of banks	Partcp. in total capital	Partcp. in total assets	No. of banks	Partcp. in total capital	Partcp. in total assets	No. of banks
1	2	3	4	5	6	7	8	9	10
Banks with majority state capital	14.9	6.4	7	17.9	4.9	6	17.3	4.6	6
Banks with majority private domestic capital	19.7	14.7	7	16.9	15.8	8	16.4	16.2	8
Banks with majority foreign capital	65.4	78.9	12	65.2	79.3	10	66.3	79.2	10
T O T A L	100.0	100.0	26	100.0	100.0	24	100.0	100.0	24

[6] According to majority capital (participation over 50%).

Graph 3: *Market share of banks by ownership type*



1.3. Staff

As of 06-30-2005, there were total 5,809 employees in banks of the Federation BiH. Out of total number, 8% worked in banks with predominantly state capital and 92% in privately owned banks.

Table 4 : *Employees in banks of the FBiH*

BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2003.		31.12.2004.		30.06.2005.		3:2	4:3
1	2		3		4		5	6
State banks	549	10%	490	9%	481	8%	89	99
Private banks	4,845	90%	5,197	91%	5,328	92%	107	103
TOTAL	5,394	100%	5,687	100%	5,809	100%	105	102
Number of banks	26		24		24			

In the first six months of 2005, number of employees increased by 2% or 122 employees, which relates only to private banks.

Table 5 : *Education structure of the employees*

LEVEL OF EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	31.12.2003.	31.12.2004.	30.06.2005.	3:2	4:3
1	2	3	4	5	6
Graduate Degree	1,847	2,016	2,099	109	104
Under Graduate Degree	546	596	612	109	103
High School	2,825	2,962	2,999	105	101
Other	176	113	99	64	88
TOTAL	5,394	5,687	5,809	105	102

In 2005, banks continued their policy of hiring people with graduate degree and under graduate degree, although it did not significantly reflect to the changes in the educational structure, because the higher participation of 52% is still of the employees with high school education.

One of the indicators influencing rating of the performance of individual banks and the banking system is efficiency of employees, shown as ratio between assets and number of employees, that is, amount of assets per an employee. The higher ratio, the better efficiency of performance of both a bank and the system in whole.

Table 6 : *Assets per an employee*

BANKS	31.12.2003.			31.12.2004.			30.06.2005.		
	No. of empl.	Assets (000 KM)	Assets per emp.	No. of empl.	Assets (000 KM)	Assets per empl.	No. of empl.	Assets (000 KM)	Assets per empl.
State	549	369,974	674	490	373,064	766	481	384,654	800
Private	4,845	5,402,076	1,115	5,197	7,240,166	1,393	5,328	7,867,681	1,477
TOTAL	5,394	5,772,050	1,070	5,687	7,613,230	1,339	5,809	8,252,335	1,421

At the end of six months of 2005, for individual employee there was approximately KM 1.42 million of assets for the whole banking system. The indicator was much better in the private bank sector, which is to be expected since operations in state owned banks were stagnating or decreasing.

Table 7: *Assets per an employee by groups*

Aktiva (000 KM)	31.12.2003.	31.12.2004.	30.06.2005.
	Number of banks	Number of banks	Number of banks
Up to 500	9	7	7
500 to 1.000	5	5	5
1.000 to 1.500	9	4	3
1.500 to 2.000	3	7	7
Over 2.000	1	1	2
TOTAL	26	24	24

Analytical indicators for individual banks range from KM 157 thousand to KM 2.8 million of assets per an employee. Nine banks reported better indicator than the whole banking sector, and four largest banks in the system reported over KM 1.8 million. Other banks have significantly worst indicators, and seven banks had assets per an employee less than KM 500 thousand, which indicates excessive number of employees in comparison to their assets. Finally, we can say that the conditions under which banks service their customers have been improved, both for legal entities and individuals, as well as the conditions under which banks make placements to their customers.

2. FINANCIAL INDICATORS OF THE PERFORMANCE OF BANKS

Examination of banks through analysis of banks' reports is conducted by review of reports regulated by FBA and reports of other institutions. Those reports represent a database based on three sources:

1. Information on balance sheet for all banks submitted monthly, including quarterly attachments to balance sheet containing more detailed information on cash funds, loans, deposits and off-balance sheet items, and some basic statistical information,
2. Information on solvency of banks, information on capital and capital adequacy, asset classification, concentrations of various types of risk, liquidity position, exposure to foreign exchange risk, and based on the reports regulated by FBA (quarterly) and
3. Information on operating results of banks (income statement - FBA format) and reports on cash flows, submitted to FBA quarterly.

Aside from the mentioned standardized reports, the database includes information derived from additional reports requested by FBA in order to have the best quality monitoring and analysis of banks' operations in the Federation of BiH. Also, the database includes reports on audit of financial statements prepared by independent auditor, and all other information relevant to the assessment of operational results for banks individually and banking system in whole.

As it is regulated by the Law on Opening Balance Sheet of Banks, banks with predominantly state capital have to report to FBA based on "full" balance sheet, which would be divided into: passive, neutral and active sub-balance sheet. In order to have realistic indicators of operational indicators of the banks in Federation of BiH, all further analysis of banking system will be based on information from active sub-balance for banks with predominantly state capital[7].

2.1. Balance Sheet

Aggregated balance sheet totals of the banks in the Federation of BiH, according to the balance sheet submitted as of 06-30-2005, amounted to KM 8.25 million, which is by 8% or KM 639 million higher than as of 12-31-2004. Although, in the same period last year, the increase rate was 15%, we can say that a moderate and stable trend of growth of the banking system continues.

Table 8: *Balance sheet*

DESCRIPTION	AMOUNT (in 000 KM)			RATIO	
	31.12.2003.	31.12.2004.	30.06.2005.	3/2	4/3
1	2	3	4	5	6
ASSETS:					
Cash assets	2,059,285	2,859,489	3,019,918	139	106
Securities	25,017	19,430	23,038	78	119
Placements to other banks	36,369	81,624	55,979	224	69
Loans – net value	3,238,270	4,184,579	4,710,616	129	113
Premises and other fixed assets	304,680	299,189	295,842	98	99
Other assets	108,429	168,919	146,942	156	87
TOTAL ASSETS	**5,772,050**	**7,613,230**	**8,252,335**	**132**	**108**
LIABILITIES:					
PAYABLES					
Deposits	4,292,709	5,602,238	5,967,210	131	107
Borrowings from other banks	3,779	3,329	3,329	88	100
Loan payables	589,012	850,833	1,012,147	144	119
Other liabilities	173,015	251,420	319,225	145	127
CAPITAL					
Capital	713,535	905,410	950,424	127	105
TOTAL LIABILITIES (PAYABLES AND CAPITAL)	**5,772,050**	**7,613,230**	**8,252,335**	**132**	**108**

State banks increased their assets in the first six months of 2005 by only 3% or KM 12 million, while private banks reported increase of 9% or KM 627 million.

[7] Some state owned banks reported passive and neutral items in their "full" balance sheet, which will be taken over by the state upon the finalization of privatization process.

In the observed period, most of banks experienced increase of their assets, but only seven banks had the increase rate of 10%. In five banks (two private and three state owned), there was a small decrease in assets, and the rates were from 0.5% to 6.5%. Although the largest banks had a moderate increase of assets, with the rates in range from 4.3% to 8.5%, yet four banks in the system make 69% or KM 438 million of the total balance sheet growth of the banking sector.

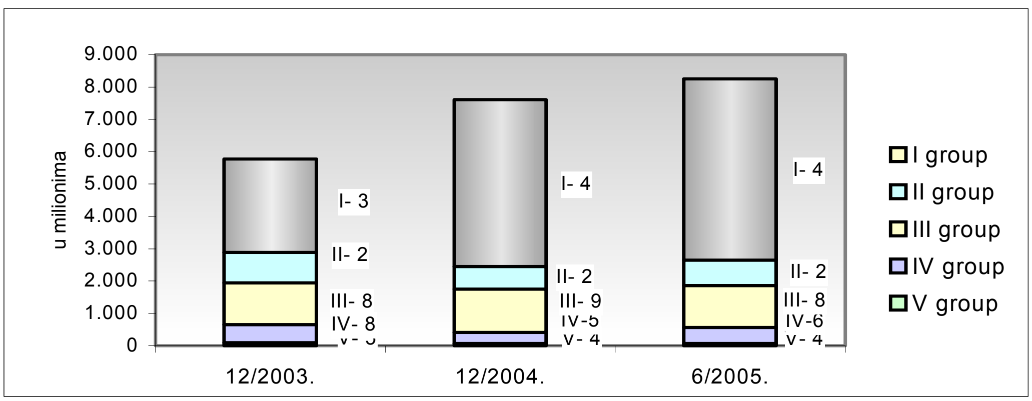
If the banking system is analyzed from the aspect of asset size and certain groups within that, we can determine minor changes in the participation and number of banks within the individual groups.

The following table shows a preview of amounts and participations of individual groups of banks[8] within the total assets through periods (amounts are presented in millions of KM):

Table 9: *Participation of individual groups of banks in total assets through periods*

ASSETS AMOUNT	31.12.2003.			31.12.2004.			30.06.2005.		
	Amount	Partc. %	No. of banks	Amount	Partc. %	No. of banks	Amount	Partc. %	No. of banks
I- Over 500	2,882	49.9	3	5,166	67.9	4	5,605	67.9	4
II- 300 to 500	945	16.4	2	701	9.2	2	783	9.5	2
III- 100 to 300	1,293	22.4	8	1,335	17.5	9	1,303	15.8	8
IV- 50 to 100	554	9.6	8	341	4.5	5	489	5.9	6
V- Below 50	98	1.7	5	70	0.9	4	72	0.9	4
TOTAL	5,772	100.0	26	7,613	100.0	24	8,252	100.0	24

Graph 4 : *Participation of individual groups of banks in total assets*



As mentioned, four banks in the system showed a moderate asset growth, so the group I shows average rate of growth of 8.5%; assets of the banks from the group II increased by average rate of 11.8%; while other groups, as in the earlier periods, show moderate asset growth.

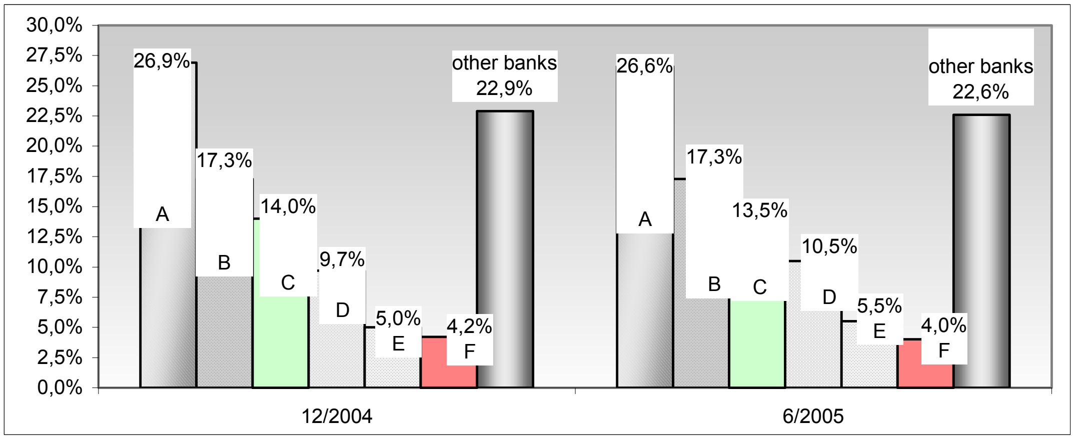
The only significant change in the observed period was shift of one bank from the group III to the group IV due to assets decreased, which reflected on the change in participation of those groups in total assets of the banking sector. Market share of the six largest banks (group I and group II) of 77.4% remained almost unchanged in comparison to the end of 2004, that is, it increased by only 0.3% in the segment of the group II.

[8] Banks are divided into five groups, depending on their asset size.

Based on the mentioned, we can conclude, as for market positioning, that there was some sort of stagnation and reaching the level of the planned share for most of the banks in the system. Further increase of participation should be expected based on new integration processes (mergers), especially of the banks in both entities of BIH, which have the same owner (mainly owned by foreign financial institutions), which will probably happen next year.

The following graph shows participation structure and trend of the six largest banks[9] in the banking system of the Federation of BiH:

Graph 5: *Participation of six largest banks in total assets*



Growth of the balance sheet total is a result of deposit growth (by 7% or KM 365 million), originated loans (by 19% or KM 161 million), subordinated debts (by 35% or KM 30 million) and capital (by 5% or KM 45 million).

On the assets side of banks, loans[10] increased by 12% or KM 535 million, which is by three percent less than the rate in the same period last year. Cash funds increased by 6% or KM 161 million.

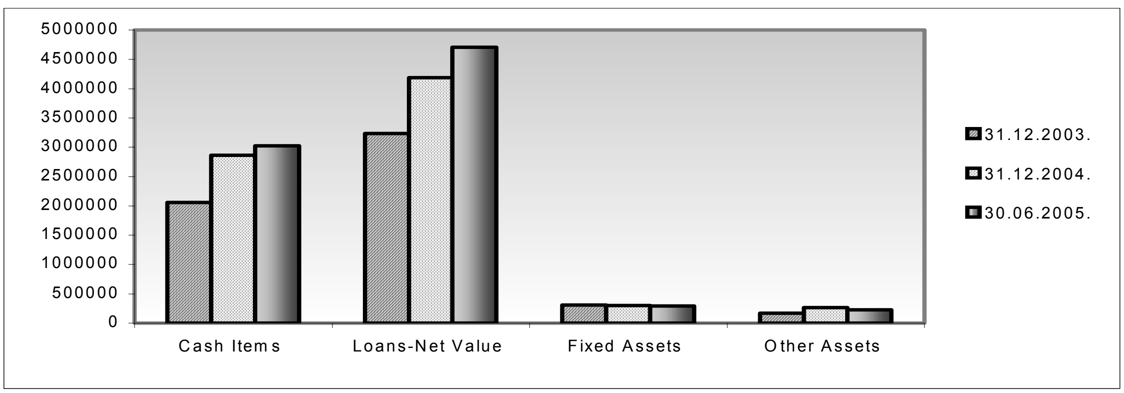
The following table and graphs show the structure of the most significant positions in the balance sheet assets and liabilities of banks through periods:

9 Banks are marked with letters from A to F.
10 Gross loans (data from balance sheet)

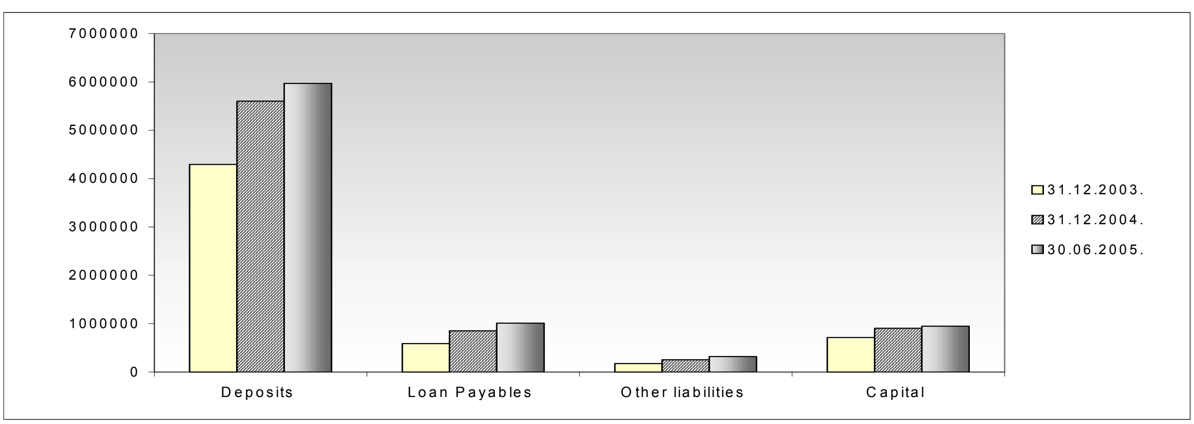
Table 10: *Balance sheet structure of banks* - In % -

DESCRIPTION	PARTICIPATION		
	31.12.2003.	**31.12.2004.**	**30.06.2005.**
ASSETS:			
Cash assets	35.7	37.6	36.6
Securities	0.4	0.2	0.3
Placements to other banks	0.6	1.1	0.7
Loans – net value	56.1	55.0	57.1
Premises and other fixed assets	5.3	3.9	3.6
Other assets	1.9	2.2	1.7
TOTAL ASSETS	100.0	100.0	100.0
LIABILITIES:			
PAYABLES			
Deposits	74.4	73.6	72.3
Borrowings from other banks	0.1	0.1	0.1
Loan payables	10.2	11.2	12.2
Other liabilities	2.9	3.2	3.9
CAPITAL			
Capital	12.4	11.9	11.5
TOTAL LIABILITIES (PAYABLES AND CAPITAL)	100.0	100.0	100.0

Graph 6: *Structure of balance sheet assets of banks*



Graph 7: *Structure of balance sheet liabilities of banks*



On the liabilities side of banks, from the aspect of participation of the most significant balance sheet categories in sources, the trend from earlier periods continued. Participation of deposits is still slowly decreasing, but with the rate of 72.3% it is still dominant. In the first six months of 2005, there was a significant increase of liabilities for originated loans, which resulted in increase of their participation from 11.2% to 12.2%.

There were some smaller changes in the asset structure. Although deposits had significant growth in the first six months of 2005, which resulted in increase of cash funds, still relative participation of cash funds decreased by one percent, and, at the same time, due to increase of new placements, participation of loans increased by 2.1%.

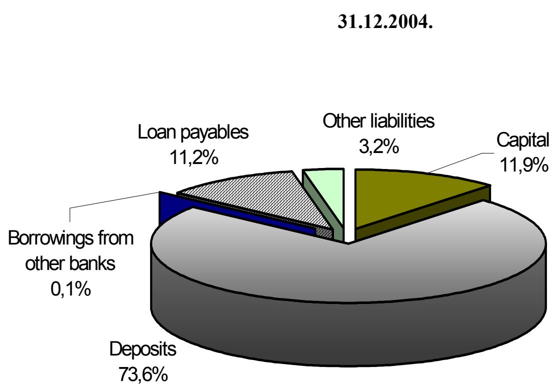
As of 06-30-2005, banks in the Federation of BiH maintained on their accounts with depository institutions abroad the amount of KM 1.62 billion (most of it in EUR) or 53.6% of their total cash funds, which is higher by 4.1% or KM 202 million than at the end of 2004. That is why there was decrease of cash funds on the reserve accounts with the Central Bank of BIH (from 41.2% to 37.6%), which as of 06-30-2005 amounted to KM 1.14 billion, which is less by 4% or KM 43 million than at the end of 2004. Banks held 7.3% or KM 220 million of their cash funds in vaults and tellers.

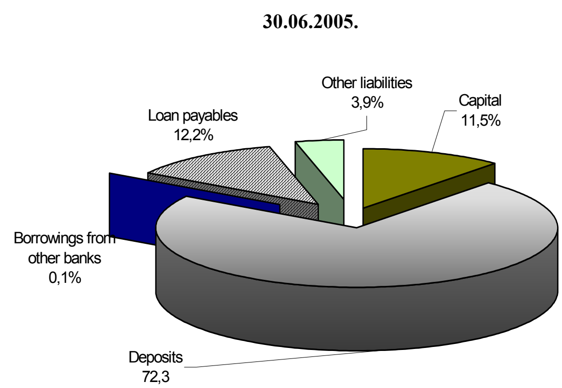
The mentioned changes resulted in change of currency structure of cash funds and increase of participation of funds in foreign currencies from 54% to 57.4%, that is, decrease of participation of funds in domestic currency from 46% to 42.6%.

2. 1. 1. Liabilities

Structure of liabilities (payables and capital) in the balance sheet of banks as of 06-30-2005 is presented in the following graph:

Graph 8 : *Liabilities Structure of Banks*





Trend of changes in the structure of liabilities from the earlier period continued in the first six months of 2005. Participation of deposits decreased from 1.3% and amounted to 72.3%. At the same time, further growth of loans resulted in increase of their participation from 11.2% to 12.2%, while participation of capital decreased from 0.4% and it was 11.5%.

In 2005, banks continued borrowing abroad. Long-term credit lines resulted in improved maturity structure of funding sources, and at the same time, banks ensured new long-term funds for financing their customers. Analytical data by banks showed approximately 50% of the funds were borrowed by banks' owners (banks shareholders), and remaining funds were provided by borrowing from international financial market and by using credit lines financed by foreign and domestic financial institutions. Four major creditors, with 60% out of total borrowings were: Raiffeisen Zentralbank Osterreich A.G. (RZB), European Bank for Reconstruction and Development (EBRD), Bank Polska OPIEKI, and Kreditanstalt fur Wiederaufbau (KfW).

In the reporting period, deposits increased by 7% or KM 365 million. This growth was recorded in the second quarter of 2005. The increase almost entirely relates to private bank sector (growth rate of 6% or KM 355 million), while in state banks deposits increased by 7% or KM 10 million.

Participation of deposits in liabilities with private banks was 74% and with state banks 39%.

Based on information reported by banks, out of total deposits 4.4% were deposits accepted in the organizational parts of banks from the Federation of BiH operating in Republic Srpska and Brcko District as of 06-30-2005.

There were some smaller changes in maturity structure of deposits within two basic groups divided by their maturity. Increase in demand deposits of 9% resulted in increase of their participation by 2.4%, and, viewed on the level of the sector, the higher participation of 37.5% is by demand deposits from citizens. In short-term deposits, deposits with term over three months increased by 15%, which resulted in increase of their participation by 1.1%, with the highest participation of citizen deposits (54.2%) within this group.

Although long-term deposits increased by 4%, their participation decreased by 0.9%. It should be emphasized that citizen deposits make 58.2% of term deposits up to three years, and funds of banking institutions sector participate with 66.6% with term deposits over three years.

Table 11: *Maturity structure of deposits* - In 000 KM-

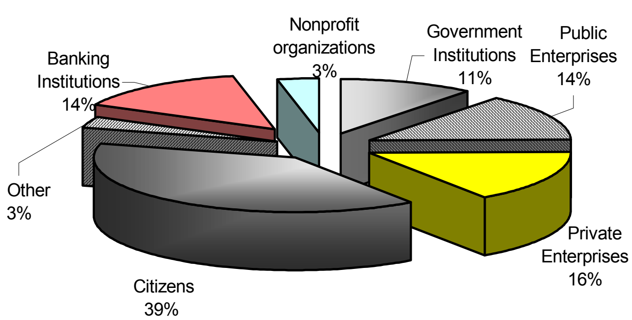
DEPOSITS	31.12.2003.		31.12.2004.		30.06.2005.		RATIO	
	Amount	Particp %	Amount	Particp %	Amount	Particp %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	2,215,925	51.6	2,663,053	47.5	2,915,334	48.9	120	109
Up to 3 months	303,203	7.1	389,395	7.0	352,688	5.9	128	91
Up to 1 year	447,952	10.4	490,685	8.8	564,046	9.5	110	115
1. Total short term	2,967,080	69.1	3,543,133	63.3	3,832,068	64.2	119	108
Up to 3 years	715,648	16.7	1,367,882	24.4	1,420,959	23.8	191	104
Over 3 years	609,981	14.2	691,223	12.3	744,183	12.0	113	103
2. Total long term	1,325,629	30.9	2,059,105	36.7	2,135,142	35.8	155	104
TOTAL (1 + 2)	4,292,709	100.0	5,602,238	100.0	5,967,210	100.0	131	107

Table 12: *Deposit structure by industries*[11] - In 000 KM-

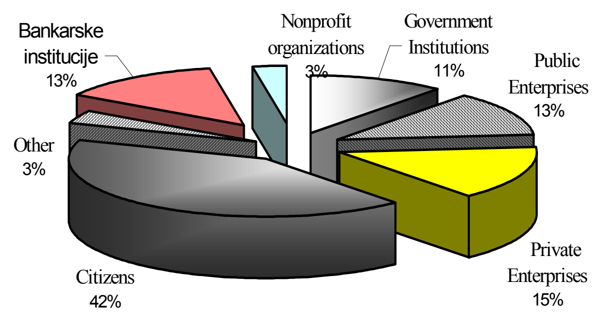
INDUSTRY AREA	31.12.2003. Amount	31.12.2003. Particp %	31.12.2004. Amount	31.12.2004. Particp %	30.06.2005. Amount	30.06.2005. Particp %	RATIO 4/2	RATIO 6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	498,132	11.6	599,060	10.7	657,096	11.0	120	110
Public enterprises	567,677	13.2	783,655	14.0	751,728	12.6	138	96
Private enterprises and associations	607,046	14.1	876,831	15.7	890,449	14.9	145	102
Non-profit organizations	147,606	3.5	180,705	3.2	168,647	2.8	122	93
Banking institutions	557,166	13.0	808,112	14.4	791,331	13.3	145	98
Citizens	1,737,238	40.5	2,173,228	38.8	2,494,620	41.9	125	115
Other	177,844	4.1	180,647	3.2	213,339	3.5	102	118
TOTAL	4,292,709	100.0	5,602,238	100.0	5,967,210	100.0	131	107

Graph 9: *Industrial deposit structure*

31.12.2004.



30.06.2005.



Analyzed by sectors, in the first six months of 2005, there was increase of citizen deposits of 15% or KM 322 million, along with increase of participation by 3.1%, so they reached the highest participation so far of 41.9%. Deposits of government institutions also increased by 10% or KM 58 million, and of private enterprises only by 2% or KM 13 million, and deposits of other sectors (without sector «other») decreased both nominally and relatively through participation in total deposits.

Out of total deposits, 41% or KM 2,459 million were in domestic currency and 59 or KM 3,508 million were in foreign currencies, which changed by only one percent in favor of deposits in foreign currency in comparison to the end of 2004.

Saving deposits, as the most significant segment of deposit and financial potential of banks, continued maintaining moderate and stable growth in 2005. After increase of 6% or KM 130 million in the first quarter, new inflow of saving deposits of KM 180 KM in the second quarter resulted in growth rate of 15% in the first six months of 2005. Only two banks had minor decrease of saving deposits, and other banks recorded increase of saving deposits. In seven banks, growth ratio was higher than 20%; in ten banks between 10% and 20%; and in five banks less than 10%. Out of total growth of saving deposits, 76% or KM 232 million refers to four largest banks in the system.

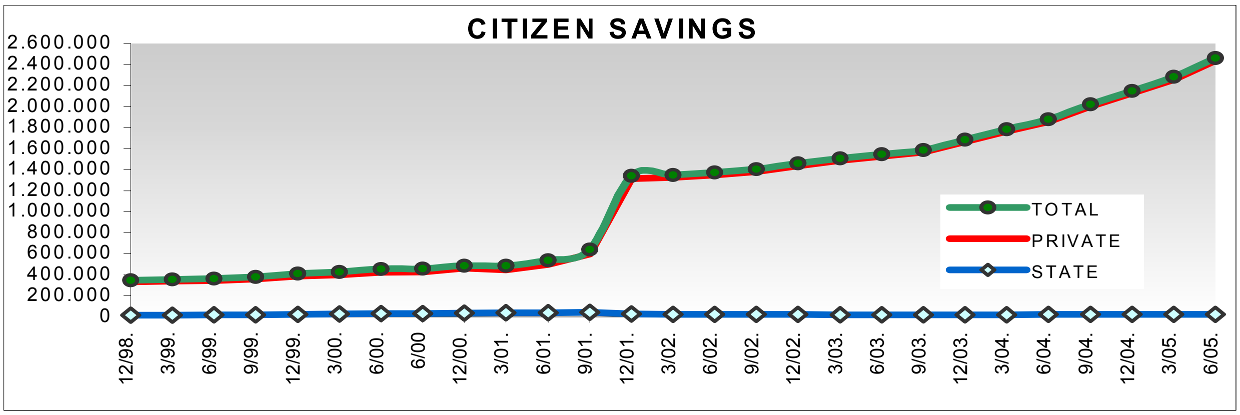
[11] Data from supporting form BS-D submitted by banks quarterly attached to balance sheet in FBA format.

Viewed by sectors, almost all savings are held with private banks, that is, only 1.1%, out of total savings, is held on the accounts of five state banks.

Table 13: *New citizen savings by periods* - In 000 KM-

BANKS	AMOUNT (IN 000 KM)			RATIO	
	31.12.2003.	31.12.2004.	30.06.2005.	3/2	4/3
1	3	3	4	5	6
State	20,758	22,342	25,679	108	115
Private	1,645,991	2,105,167	2,411,934	128	115
TOTAL	1,666,749	2,127,509	2,437,613	128	115

Graph 10: *New citizen savings by periods*



As in other segments, there is obvious existence of strong concentration of savings in larger banks, because 77% of total savings is held with four largest banks.

Out of total amount of savings, 29.6% relates to saving deposits in domestic currency, and 70.4% in foreign currency.

Table 14: *Maturity structure of citizen savings by periods*

BANKS	AMOUNT (IN 000 KM)						RATIO	
	31.12.2003.		31.12.2004.		30.06.2005.		3/2	4/3
1	3		3		4		5	6
Short-term saving deposits	1,228,261	73.7%	1,360,285	63.9%	1,501,769	61.6%	111	110
Long-term saving deposits	438,489	26.3%	767,224	36.1%	935,844	38.4%	175	122
TOTAL	1,666,749	100.0%	2,127,509	100.0%	2,437,613	100.0%	128	115

Maturity structure of saving deposits, as well as of total deposits, has a positive trend of changes, mainly due to constant improvement of the condition of the banking sector and strengthening of confidence in banks, which resulted in faster growth of long-term saving deposits. Special emphasis should be given to stability and high level of growth rates in long-term saving deposits, which is a positive indicator for future time.

Aside from the activities implemented by FBA, growth of savings in banks of the FBiH resulted from deposit insurance system, which was implemented in January 2001, immediately after the inception of the Deposit Insurance Agency of F BiH. The Law on Deposit Insurance in Banks of BiH was passed in August 2002 and shortly after that the Deposit Insurance Agency of BiH was founded. Total of 15 banks from the Federation of BiH became part of the deposit insurance program and received certificate on deposit insurance. Analytical data showed that participation of deposits in those banks, out of total deposits, was 94% of total deposits and 97% of total savings. The admission of banks in the deposit insurance system for the Federation of BiH is entering the closing phase, because within nine remaining banks, which don't have certificate, six are state banks and they cannot apply for certificate (they do not have appropriate ownership structure), because of regulations set up by the Deposit Insurance Agency. Safety of deposits is guaranty and incentive for further growth of savings, not only in those banks, but all other banks.

2.1.2. Capital - Strength and Adequacy

Capital[12] of banks in the FBiH, as of 06-30-2005, amounted to KM 1,108 million.

Table 15: *Regulatory capital* -In 000 KM-

DESCRIPTION	31.12.2003.		31.12.2004.		30.06.2005.		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
1.Core capital before deduction	122,937		163,061		163,841		133	100
2. Off-setting items	17,687		2,607		2,863		15	110
a) Core capital (1-2)	105,250	97%	160,454	98%	160,978	98%	152	100
b) Additional capital	3,061	3%	3,639	2%	3,561	2%	119	98
c) Total capital (a + b)	108,311	100%	164,093	100%	164,539	100%	152	100
PRIVATE BANKS								
1. Core capital before deduction	584,221		744,519		796,135		127	107
2. Of-setting items	34,311		88,598		84,426		258	95
a) Core capital (1-2)	549,910	75%	655,921	75%	711,709	75%	119	109
b) Additional Capital	183,681	25%	217,639	25%	231,300	25%	118	106
c) Total capital (a + b)	733,591	100%	873,560	100%	943,009	100%	119	108
Total								
1. Core capital before deduction	707,158		907,580		959,976		128	106
2. Off-setting items	51,998		91,205		87,289		175	96
a) Core capital (1-2)	655,160	78%	816,375	79%	872,687	79%	125	107
b) Additional Capital	186,742	22%	221,278	21%	234,861	21%	118	106
c) Capital (a + b)	841,902	100%	1,037,653	100%	1,107,548	100%	123	107

Core and net capital are reported more realistically based on new methodology for capital accrual that became effective as of 12-31-2003[13], which is especially important from the aspect of computing exposure of bank to risks, primarily to loan risk concentrations.

In first six months of 2005, capital[14] was increased by 7% or KM 69.9 million in comparison to the end of 2004, out of which the increase of core capital was KM 56.3 million, and additional capital was KM 13.62 million.

Increase of core capital was primarily influenced by additional capitalization, that is, an increase of shareholder capital in one bank by KM 16 million, and then allocation of profit for to retained undistributed profit of KM 16.6 million and reserves of KM 20 million.

Off-setting items (which decreased core capital) were decreased by KM 3.9 million, and the most important changes were the following: coverage of uncovered losses from previous years by KM 10 million KM (in three banks), increase of current loss of KM 5.9 million, and increase of intangible assets by KM 0.4 million.

[12] Regulatory capital defined under Articles 8 and 9 of Decision on Minimum Standards for Bank Capital Management.
[13] Decision on Changes and Amendments to the Decision on Minimum Standards fpr Bank Capital Management ("Official Gazette of the FBiH", No. 18/03).
[14] Data source is quarterly Report on Bank Capital Balance (Form 1-Table A), regulated by the Decision on Minimum Standards for Bank Capital Management.

Increase of additional capital by KM 13.6 million is primarily result of an increase of subordinated debts of KM 29.6 million in two banks, including audited current profit in one banks of KM 14 million and increase of general reserves of loan losses of KM 12 million, along with decrease of KM 42 million due to distribution of profit from 2004 to core capital.

The mentioned changes did not influence the structure of regulatory capital, so participation of core capital is still 79%, and additional 21%.

Growth of regulatory capital of 7% positively influenced net capital, which in first six months of 2005 had the same growth rate of 7% or KM 70 million, so, as of 06-30-2005, it amounted to KM 1.1 billion (in private banks it was KM 924 million, and in state banks it was KM 164 million).

As of 06-30-2005, ratio of capital and assets, that is, capitalization rate of banks was 13% and in comparison to 2004 (13.2%) slightly changed due to proportional growth both in capital and assets.

One of the most important indicators of strength and adequacy of capital[15] in banks is capital adequacy ratio calculated as relationship between net capital and risk-weighted assets. As of 06-30-2005, calculated on the level of banking sector, this ratio was 17%, which is by 0.7 percent less than at the end of 2004.

Decrease of the ration on the system level is a result of drop in the ratio in state banks from 59.1% (2004) to 54.8% and continuous slight drop in the ratio in private banks from 16.5% (2004) to 16%.

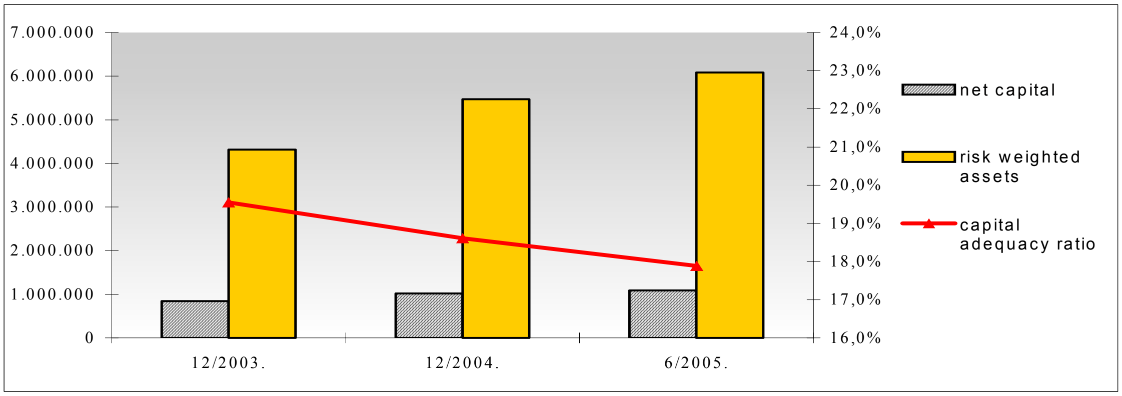
While performing supervision of performance and financial condition of banks in the F BiH, according to the authority prescribed by the Law, FBA ordered banks to take proper actions for strengthening of capital base and providing for adequate capital up to the level and profile of existing and potential exposures to all risks immanent to any banking activity.

Table 16: *Net capital, risk-weighted assets, and capital adequacy rate*

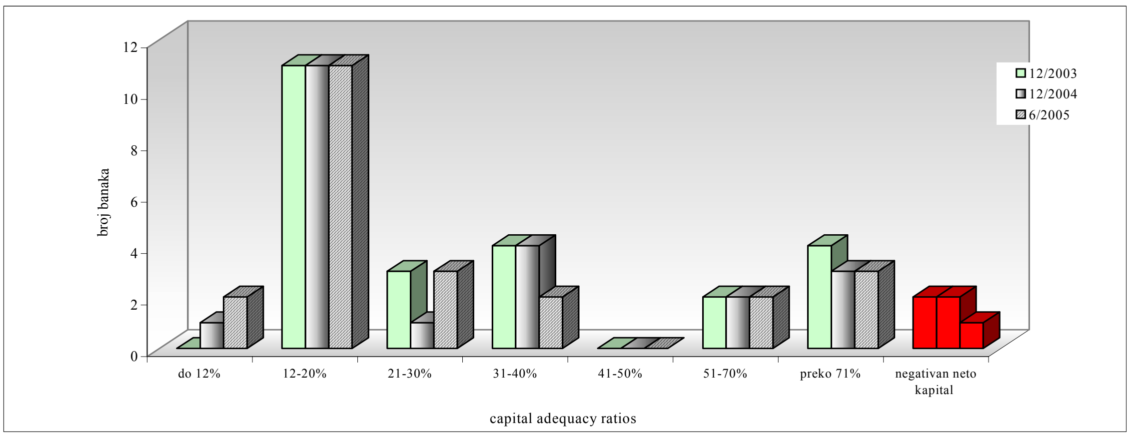
DESCRIPTION	31.12.2003.	31.12.2004.	30.06.2005.	RATIO	
				3/2	4/3
1	2	3	4	5	6
NET CAPITAL	840,605	1,018,626	1,088,521	121	107
RISK WEIGHTED ASSETS AND CREDIT EQUIVALENTS	4,306,774	5,472,154	6,084,785	127	111
NET CAPITAL RATE (CAPITAL ADEQUACY)	19.5%	18.6%	17.9%	95	96

Graph 11: Net capital, risk weighted assets, and capital adequacy rate

[15] Minimum capital adequacy rate of 12% prescribed by the Law.



Graph 12: *Capital adequacy ratios in banks*



As of 06-30-2005, out of 24 banks in the FBiH, 21 banks had capital adequacy ratio higher than minimum of 12% prescribed by the Law, while one bank (under provisional administration) had negative adequacy ratio.

Two banks (under provisional administration) had adequacy ratio below 12%. Certain number of banks (11) in the second, the largest group (ratio between 12% and 20%), for quite some time, did not have any changes, while five banks had the ratio between 21% and 40%. With the remaining banks, the ratio ranged from 50% to 83%. However, although three banks largest by the size of assets had the capital adequacy ratio higher than minimum prescribed by the Law (between 14% and 14.9%), we should emphasize that two banks experienced improvement at the end of 2004 as a result of capital strengthening based on additional capitalization and/or growth of additional capital-subordinated debt.

Any further growth of risk assets will necessarily require adequate growth of capital, and, in that sense, banks are obliged to prepare program for capital management and continuously monitor its implementation in order to assure and maintain capital quantities and qualities at least on the level of minimum standards prescribed by the Law.

Further strengthening of capital base should be priority task for most of banks, especially after the new capital accrual methodology becoming effective, focusing the largest banks in the system, which is necessary for stability and safety of banks and entire banking system. FBA will be taking proper measures and issuing decisions based on which banks will strengthen their capital base which will guarantee their stability and safety.

2.1.3. Assets and Asset Quality

Decision on Minimum Standards for Bank Loan Risk Management and Asset Classification (Decision) determines the criteria for assessing bank's exposure to loan risk by rating their asset quality and adequacy of reserves for loan and other losses depending on risk of placements and balance sheet assets items and off-balance sheet items.

As of 06-30-2005, gross assets[16] from the balance sheet of banks in the FBiH amounted to KM 8.5 billion, which is by 8% or KM 647 million higher than at the end of 2004. Off-balance sheet risk items amounted to KM 1,211 million and have been increased by 16% or KM 165 million.
Total assets with off-balance sheet items (assets)[17] amounted to KM 9.7 billion and are by 9% higher than at the end of 2004.

Table 17: *Assets, off-balance sheet items, and potential loan losses* -In 000 KM-

DESCRITION	AMOUNT (in 000 KM)						RATIO	
	31.12.2003.	Struct. %	31.12.2004.	Struct. %	30.06.2005.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	3,272,569	54.5	4,208,295	53.5	4,714,662	55.3	129	112
Interests	26,395	0.4	29,856	0.4	33,509	0.4	113	112
Past due receivables	171,821	2.9	209,218	2.7	238,904	2.8	122	114
Receivables on paid guarantees	5,353	0.1	5,026	0.1	4,750	0.1	94	95
Other placements	50,906	0.9	40,811	0.4	33,310	0.4	80	82
Other assets	2,468,073	41.2	3,378,320	42.9	3,493,778	41.0	137	103
TOTAL ASSETS	5,995,117	100.0	7,871,526	100.0	8,518,913	100.0	131	108
OFF BALANCE SHEET	749,382		1,046,809		1,211,498		140	116
BALANCE SHEET AND OFF BALANCE SHEET	6,744,499		8,918,335		9,730,411		132	109
General credit risk and potential loan losses	247,369		282,412		297,111		114	105
Allocated general and special reserves for loan losses	247,411		285,090		297,256		115	104

Out of total assets with off-balance sheet items, non-risk items represent KM 3.3 billion or 34%, which is by one percent less than at the end of 2004.

Growth of loan placements (12%) resulted in changes of the structure of risk assets and increase of participation of loan placements from 58.1% to 60.1%, along with decrease in participation of cash funds from 37.6% to 36.6%. It should be emphasized that past-due receivables increased by 14%, which resulted in increase of their participation by 0.2 percent.

Analytical indicators by banks show that five banks (three under provisional administration) had decrease in their loan placements. Three banks had growth rate higher than 30%, 12 banks had growth rate from 6% to 18%, while other banks had growth rate ranged from 2% to 3%. Three largest banks in the F BiH increased their loan placements by KM 274 million, which is 51% of total increase on the level of banking sector.

[16] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.
[17] Assets defined under Article 2 of Decision on Minimum Standards for Bank Loan Risk Management and Asset Classification.

Based on the analysis of loan structure by sectors, we can conclude that most of the increase of KM 291 million or 13.6% was in placements originated to citizens, which is why their participation in total loan structure by sectors increased from 48.4% to 49%. There was significant growth (KM 271 million or 14%) in placements originated to private enterprises and associations, along with increase of participation from 43.7% to 44.5 %. The increase of placements occurred both in nonprofit and banking institutions (KM 5.6 million), while decrease of loan placements occurred mostly in public enterprises, government institutions and other sectors (KM 26.4 million).

Change in participation of individual sectors in total loan structure is presented in the following table:

Table 18: *Industrial Structure of Loans* -In 000 KM-

INDUSTRY AREA	31.12.2003.		31.12.2004.		30.06.2005.		RATIO	
	Amount	Particip %	Amount	Particip %	Amount	Particip %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	24,526	0.7	31,810	0.7	30,264	0.6	130	95
Public enterprises	217,587	6.3	203,698	4.6	179,212	3.6	94	88
Private enterprises and assoc.	1,439,009	41.7	1,933,595	43.7	2,204,606	44.5	134	114
Nonprofit organizations	3,015	0.1	3,619	0.1	6,773	0.2	120	187
Banking institutions	33,281	1.0	34,082	0.8	36,572	0.7	102	107
Citizens	1,676,325	48.6	2,139,699	48.4	2,430,915	49.0	128	114
Other	55,999	1.6	76,036	1.7	69,974	1.4	136	92
TOTAL	3,449,742	100.0	4,422,539	100.0	4,958,316	100.0	128	112

As for maturity of loans, we should emphasize that, in the first six months of 2005, there was faster growth of long-term loans (growth rate of 13%), while short-term loans increased by 8%, which influenced growth of participation of long-term loans in total loans from 72.8% to 73.4%. Analysis by sectors shows that participation of long-term loans in total loans originated to citizens is 90%, and to private enterprises 58%.

Table 19: *Maturity structure of loans* -In 000 KM-

LOANS	31.12.2003.		31.12.2004.		30.06.2005.		RATIO	
	Amount	Particip %	Amount	Particip %	Amount	Particip %	4/2	6/4
1	2	3	4	5	6	7	8	9
Pastdue receivables and paid off-balance sheet liabilities	177,174	5.1	214,244	4.8	243,654	4.9	121	114
Short-term loans	776,014	22.5	991,183	22.4	1,073,498	21.7	128	108
Long-term loans	2,496,554	72.4	3,217,112	72.8	3,641,164	73.4	129	113
TOTAL LOANS	3,449,742	100.0	4,422,539	100.0	4,958,316	100.0	128	112

Since the placements, that is, loans represent part of the assets holding most of risk, their quality is one of the most significant determinations of stability and success of their performance. Asset quality rating is actually rating of exposure of bank's placement to loan risk, that is, identification of potential loan losses that are recognized as provisions for loan losses.

Asset quality and off-balance sheet risk items, general loan risk, potential loan losses by classification categories[18] and off-balance sheet items are presented in the following table:

Table 20: *Classification of Assets, General Credit Risk (GCR), and Potential Loan Losses (PLL) and Off-Balance Sheet Items (assets charged off and suspended interest)*

Classification category	AMOUNT (in 000 KM) AND PARTICIPATION (in %)									RATIO	
	31.12.2003.			31.12.2004.			30.06.2005.				
	Asset classific.	Particip. %	GCR PLL	Asset classific.	Particip. %	GCR PLL	Asset classific.	Particip. %	GCR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	5,881,803	87.2	70,974	7,880,830	88.4	94,501	8,628,323	88.7	106,500	134	109
B	563,498	8.4	46,657	730,737	8.2	53,633	797,218	8.2	58,858	130	109
C	152,581	2.3	44,593	143,586	1.6	42,104	143,672	1.5	40,584	94	100
D	139,311	2.0	77,839	162,299	1.8	91,294	160,831	1.6	90,805	117	99
E	7,306	0.1	7,306	883	0.0	880	367	0.0	364	12	42
TOTAL	6,744,499	100.0	247,369	8,918,335	100.0	282,412	9,730,411	100.0	297,111	132	109
OFF-BALANCE SHEET ITEMS											
E	341,166	79.8		343,472	83.3		373,053	85.5		101	109
Suspended interest	86,205	20.2		68,680	16.7		63,456	14.5		80	92
TOTAL	427,371	100.0		412,152	100.0		436,509	100.0		96	106

If we analyze asset quality with off-balance sheet risk items, we will notice increase of classified assets (B-E) by 6% or KM 65 million, along with decrease in poor quality assets by 1% or KM two million. However, based on analysis of analytical data, we can see that poor quality assets related to legal entities have decreasing trend, while poor quality assets related to placements originated to citizens have increasing trend, whish is to expect, since after loan expansion in 2002 and years after, lending to citizens has been intensified. It is obvious that part of loans from this portfolio in some banks is becoming a problem and goes from the category of good assets to worst classification categories. Poor quality assets related to citizens in total originated loans is 2.5% or KM 60 million, and is experiencing growth of 21% or KM 10.4 million in comparison to 12-31-2004. Although we talk in absolute figures that are not high, taking into account the trend shown, in future we will divert our attention to rating and changes in quality of those loans, as well as activities of banks to minimize adverse effects in this segment of loan portfolio and improve management practices.

In the first six months of 2005, banks written off from balance sheet to off-balance sheet, that is, charged off receivables of KM 48 million and suspended interest of KM five million. In the same period, there was permanent charge off of assets items performed in the amount of KM seven million, while permanent charge off of suspended interest amounted to KM two million. In the same period, banks were able to collect previously charged off assets of KM 16 million. And suspended interest of KM five million, which was positively reflected on their profitability.

As of 06-30-2005, balance of charged off assets amounted to KM 373 million and it was higher by 9% than at the end of 2004, while balance of suspended interest amounted to KM 63 million.

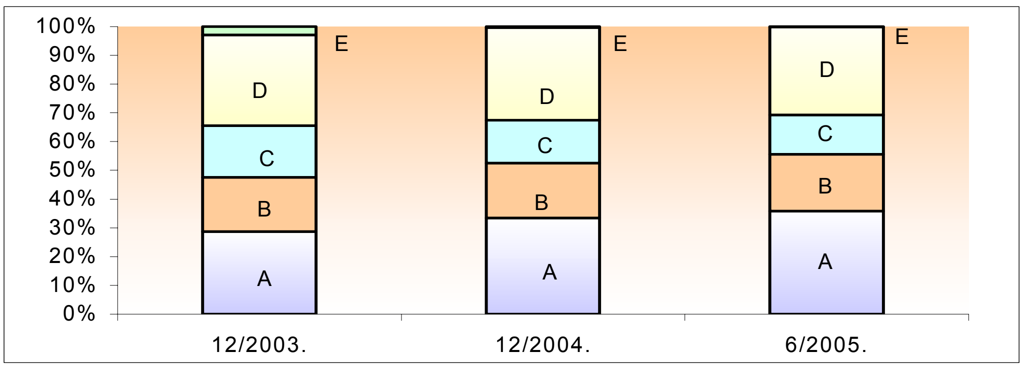
[18] In accordance to Article 22 of Decision on Minimum Standards for Loan Risk Management and Asset Classification, banks are obliged to establish and continiously maintain reserves for GCR and SLL in following percentiges by categories: A 2%, B 5% do 15%, C 16% do 40%, D 41% do 60% and E 100%.

Level of general credit risk and estimated losses by classification categories, determined in accordance with the criteria and methodology prescribed in FBA's decisions, their trend and structure on the level of the banking sector is presented in the following table and graph:

Table 21: *Structure and trend of general credit risk and potential loan losses*

Classification category	AMOUNT (in 000 KM) AND STRUCTURE (in %)						RATIO	
	31.12.2003.		31.12.2004.		30.06.2005.		4/2	6/4
1	2	3	4	5	6	7	8	9
A	70,974	28.7	94,501	33.5	106,500	35.8	133	113
B	46,657	18.9	53,633	19.0	58,858	19.8	115	110
C	44,593	18.0	42,104	14.9	40,584	13.7	94	96
D	77,839	31.5	91,294	32.3	90,805	30.6	117	99
E	7,306	2.9	880	0.3	364	0.1	12	41
TOTAL	247,369	100.0	282,412	100.0	297,111	100.0	114	105

Graph 13 : *Structure and trend of general credit risk and potential loan losses*



According to the reports, banks established reserves for loan losses in accordance to the regulations and up to the amount of estimated loan risk.
Analyzing the level of established reserves in total and by classification categories, in comparison to 2004, reserves for general credit risk and potential loan losses were higher by 4% and amounted to KM 297 million, that is, 3.1 % of total assets with off-balance sheet. In the first six months of 2005, banks allocated reserves for category B in average of 7.4%, for category C 28.3%, category D 56.5% and E 100%, which can be rated satisfactory.

Analysis of asset quality, that is, loan portfolio of individual banks, as well as of on-site examinations in banks, indicates that key risk in most of banks is still loan risk, that is, existence of problem loans originated to legal entities (enterprises).

FBA issued orders to banks with poor quality assets to implement corrective measures in sense of preparation of operating programs containing action plan to improve existing management practices for loan risk, that is, asset quality, decrease existing concentrations, and solve issue of poor quality assets and prevent further deterioration. Performance of FBA's orders is continuously monitored in follow up procedures based on reports and other records submitted by banks, as well as in on-site examinations.

Transactions with Related Entities

While operating, banks are exposed to different types of risk, but the most significant is risk related to transactions with related entities.

In accordance with the Basle Principles, FBA established certain prudential principles and requirements related to transactions with related entities[19], which is regulated by Decision on Minimum Standards for Bank's Operations with Related Entities, regulating conditions and ways of operations with related entities. Based on the Decision and Law on Banks, Supervisory Board of bank, upon proposal of General Manager, is obliged to adopt special policies regulating operations with related entities and to monitor their implementation.

FBA Decisions determine a special set of reports containing transactions with one part of related entities, including loans and potential and accepted off-balance sheet liabilities (guarantees, letters of credit, accepted loan payables), since those represent the most frequent and the riskiest types of transactions between banks and their related entities. The set of reports includes information on loans approved to the following categories of related entities:

- Shareholders with more than 5% of voting rights,
- Members of Supervisory Board and senior management of bank and
- Subsidiaries and other enterprises related to bank through capital

Table 22: Transactions with related entities -000 KM-

Description	LOANS ORIGINATED			RATIO	
	31.12.2003.	31.12.2004.	30.06.2005.	3/2	4/3
1	2	3	4	5	6
Shareholders with over then 5% of voting shares, subsidiaries and other enterprises related to the bank through capital	37,050	40,084	33,977	108	85
Members of Supervisory Board	388	141	146	36	104
Management and employees of bank	1,670	2,392	2,150	139	96
TOTAL	39,108	42,617	36,273	109	85
POTENTIAL AND ACCEPTED OFF-BALANCE SHEET LIABILITIES	8,689	3,235	2,228	37	69

From the same reasons, FBA directs special attention (during on-site examinations) to banking operations with related entities. FBA examiners issue on-site orders for elimination of found oversights, determine deadlines and initiate legal procedures. Part of those activities is monitoring and follow-up supervision.

2.2. Profitability

According to the income statements, for first six months of 2005, banks in the Federation of BiH reported positive financial result – profit of KM 33.9 million, which is higher by 20% than the same period in 2004 or 75% of the reported profit in 2004.

Positive financial result was reported by 18 banks of total KM 39.8 million, which is more by 14.3 % or KM 5.0 million in comparison to same period 2004. At the same time, six banks

[19] Article 39, item 2 of the Law on Changes and Amendments to the Law on Banks defines term “entities related to bank”, excluding bank´s employees.

reported operating loss (three state and three private) of KM 5.9 million, which is decrease by 11.5% or KM 0.7 million in comparison to same period last year.

More detailed information is presented in the following schedule:

Table 23: *Financial result realized: profit/loss* -000 KM-

Date/Description	Banking system		Private banks		State banks	
	Amount	Number of banks	Amount	Number of banks	Amount	Number of banks
30.06.2003.						
Loss	-8,615	9	-67,365	5	-1,879	4
Profit	34,520	17	32,498	14	2,022	3
Total	25,905	26	25,762	19	- 143	7
30.06.2004.						
Loss	-6,710	8	-6,137	5	-573	3
Profit	34, 840	18	31,335	14	3,505	4
Total	28,130	26	25,198	19	2,932	7
30.06.2005.						
Loss	-5,936	6	-5,500	3	-436	3
Profit	39,830	18	36,969	15	2,861	3
Total	33,894	24	31,469	18	2,425	6

As in other segments, this one is characterized by concentrations: out of total profit (KM 39.8 million), 65.8% or KM 26.2 million was with four largest banks in the system. It is the same with total loss (KM 5.4. million) since two banks reported 72.4% or KM 3.9 million. Remaining state owned banks did not influence significantly the total profitability, and four banks under provisional administration operated with loss.

Individual analytical information from banks, as well as indicators for quality rating lead to conclusion that general profitability of the system is improving due to general improving trend and stabilization of banking sector, and fewer large banks hold the concentration (owner by foreign investors).

In the structure of total income, net interest income still has growing trend and it participates with 59.1% of total income (in the same period in 2004 it was 55.8%), while participation of operational income decreased from 44.2% to 40.9%.

Total interest income for this period in comparison to the same period last year was increased by 25.7% and amounted to KM 241.8 million, while at the same time interest expenses increased significantly faster by 34.1% and amounted to KM 83.6 million, so net interest income on the level of banking system for the six months of 2005 had slightly lower growth rate (21.8%) and amounted to KM 158.1 million.

At the same time, lower growth of net interest income rate in comparison to growth rate of average interest bearing assets (22.2%) and average amount of loan (24.7%) are the result of continuous decreasing trend of interest rates, and consequently interest margin, then further growth of long-term loans (26.5%) and increase of their participation in total loans, as well as deterioration in loan portfolio quality (poor quality loans increased by 3.5%, and past due receivables classified as poor quality assets increased by 16%). On the other hand, interest bearing financing in 2005 significantly increased (average interest bearing deposits increased by 21.8%, and interest bearing liabilities increased by 26.5%) due to which interest expenses increased by 33.8%.

Operating income increased by 6% in comparison to the same period last year, but their participation in the structure of total income decreased by 3.8% primarily as a result of drop in other operating income where the largest item is income from decrease in provisioning, but also the result of changes in accounting policy in the segment of methodology and recognition of fee income tied to loans[20] (applied in several banks).

Total non interest bearing expenses increased by 14% or KM 30 million in comparison to the same period last year, which is primarily result of significant increase of provisions for loan losses of 25.3% or KM 13.4 million, along with increase of their participation in total income from 21.8% to 23.8%, which represented a significant influence on profitability of banks. Increase of loan risk and prudential standards require from banks, regardless of adverse influence on financial result, to continue performing realistic assessment of asset quality and through expenses establish and maintain adequate reserves for loan losses, as absorber of future losses, in order to protect capital.

Operating expenses increased by rate of 11% and are higher by approximately KM 16 million, but their structure did not essentially change and in comparison to the same period last year they increased in average by 11%.

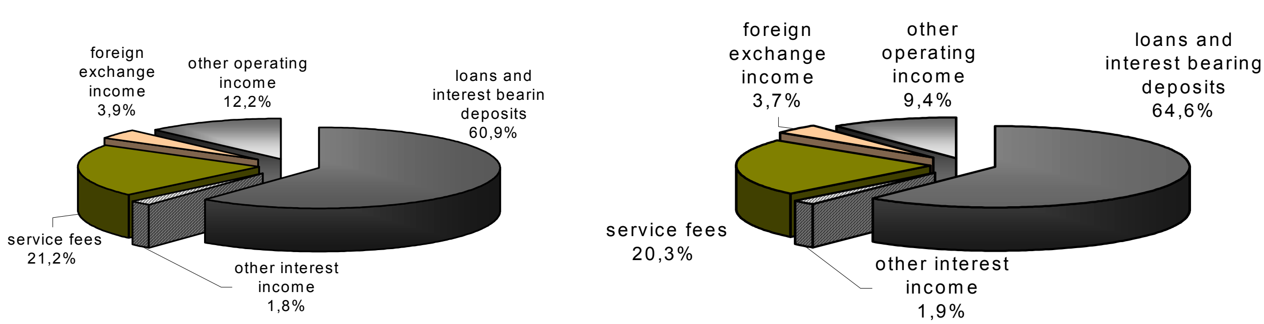
Trend and structure of total income and expenses is presented in the following tables and graphs:

Table 24: *Structure of total income* - In 000 KM-

Structure of total income	30.06.2003.		30.06.2004.		30.06.2005.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar types of income								
Interest bearing deposit accounts with depository institutions	13,278	5.1	13,838	4.5	20,426	5.6	104	148
Loans and lease financing	140,522	54.1	172,971	56.4	214,601	59.0	123	124
Other interest income	2,422	0.9	5,607	1.8	6,787	1.9	232	121
TOTAL	156,222	60.1	192,416	62.7	241,814	66.5	123	126
II Operating income								
Service Fees	59,644	22.9	64,894	21.2	73,699	20.3	109	114
Foreign Exchange Income	14,192	5.5	12,031	3.9	13,680	3.8	85	114
Other operating income	29,892	11.5	37,457	12.2	34,349	9.4	125	92
TOTAL	103,728	39.9	114,382	37.3	121,728	33.5	110	106
TOTAL INCOME(I + II)	259,950	100.0	306,798	100.0	363,542	100.0	118	118

Graph 14: *Sructure of total income*

30.06.2004. **30.06.2005.**

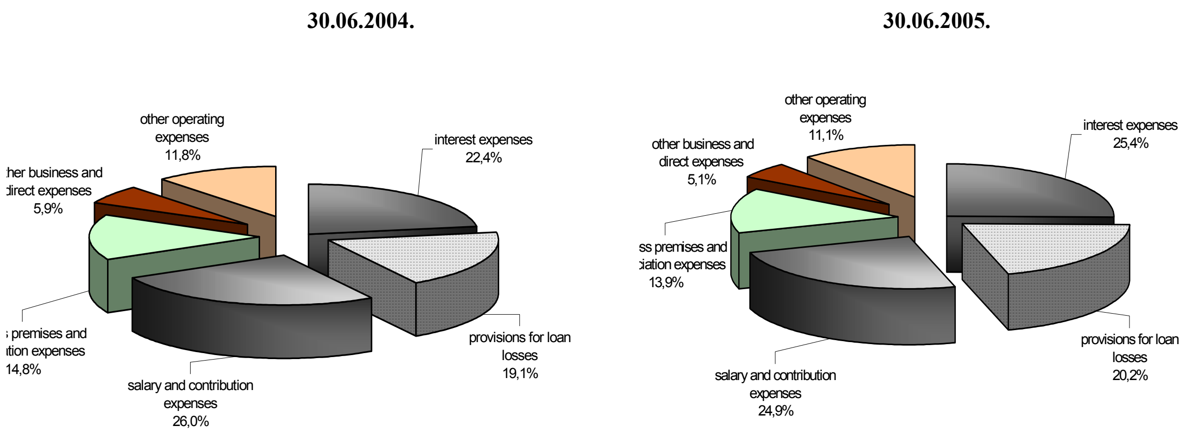


[20] Application of IAS 18-Income and IAS 39-Financial instruments: recognition and measurement.

Table 25: *Structure of total expenses* - In 000 KM-

Structure of total expenses	30.06.2003.		30.06.2004.		30.06.2005.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and other similar expenses								
Deposits	36,648	15.7	49,979	17.9	63,839	19.4	136	128
Liabilities for loans and other borrowings	4,628	2.0	11,781	4,2	17,241	5.2	255	146
Other interest income	1,683	0.7	745	0.3	2,554	0.8	44	343
TOTAL	42,959	18.4	62,505	22.4	83,634	25.4	145	134
II Total noninterest bearing expenses								
Provisions for general credit risk and potential loan losses	52,349	22.4	53,147	19.1	66,585	20.2	102	125
Salary and contribution expenses	63,559	27.2	72,360	26.0	80,154	24.3	114	111
Business premises and depreciation expenses	36,347	15.5	41,358	14.8	45,882	13.9	114	111
Other business and direct expenses	10,539	4.5	16,491	5.9	16,654	5.1	156	101
Other operating expenses	28,291	12.1	32,807	11.8	36,739	11.1	116	112
TOTAL	191,085	81.6	216,163	77.6	246,014	74.6	113	114
TOTAL EXPENSES (I + II)	234,044	100.0	278,668	100.0	329,648	100.0	119	118

Graph 15: *Sructure of total expenses*



The following tables present the most significant ratios to rate profitability, productivity and efficiency of banks:

Table 26: *Profitability, Productivity, and Efficiency Ratios by Periods* -In %-

RATIOS	31.12.2003.	31.12.2004.	30.06.2005.[21]
Return on Average Assets	0.88	0.69	0.86
Return on Average Total Capital	6.75	5.57	7.29
Return on Average Share Capital	8.16	6.61	8.88
Net Interest Income/Average Assets	4.60	4.08	4.00
Fee Income/Average Assets	4.27	3.41	3.08
Total Income/Average Assets	8.88	7.49	7.09
Operating and Direct Expanses22/Average Assets	2.79	2.20	2.11
Operating Expenses/Average Assets	5.17	4.57	4.12
Total Non-interest Expanses/Average Assets	7.95	6.76	6.23

Table 27: *Profitability, Productivity, and Efficiency Ratios as of 30.06. 2005.* -In %-

RATIOS	30.06. 2005.		
	STATE BANKS	PRIVATE BANKS	AVERAGE IN FbiH
Return on Average Assets	1.28	0.84	0.86
Return on Average Total Capital	2.97	8.21	7.29
Return on Average Share Capital	3.39	10.14	8.88
Net Interest Income/Average Assets	3.47	4.03	4.00
Fee Income/Average Assets	7.61	2.85	3.08
Total Income/Average Assets	11.08	6.88	7.09
Operating and Direct Expanses[23]/Average Assets	4.83	1.97	2.11
Operating Expenses/Average Assets	4.98	4.08	4.12
Total Non-interest Expanses/Average Assets	9.80	6.05	6.23

Analysis of basic rating parameters for profitability quality shows that, apart from other things, the amount of reported profit was higher in comparison to the same period last year with ROAA (return on average assets) of 0.86% and ROAE (return on average equity) of 8.88%, although productivity of banks measured with ratio of total income and average assets (7.09%), and reported net interest and operating income per unit of average assets deteriorated, because of further significantly faster growth of average assets against total income (net interest and operating income) and significant participation of non-earning assets.

All key indicators of profitability, analyzed by the criteria of ownership in banks, show that private banks operate in more cost-effective, productive and efficient way, which is an advantage for them in competition with state banks, which indicates a necessity to finalize privatization in remaining state banks.

Profitability of banks in future period will still mostly depend on asset quality, that is, exposure of banks to loan risk, including efficient operating expense management. This means that the key factor of efficiency and profitability for any bank is quality of management and business policy, because that is how one can most directly influence its performances.

[21] Ratios as of 06-30-2005 recalculated on annual level.
22 Expenses include reserves for potential credit losses.
[23] Expenses include reserves for potential credit losses.

In addition, under new market conditions, banks will have to adopt some new concepts of business policies complied with market oriented banking striving for maximum profit, providing stability and adequate management and control of all risks to which bank is exposed to in its performance, and primarily to credit risk. However, taking place in international financial business and market, banks will, in future, be more exposed to market risks: interest rate risk, foreign exchange risk and price risk, which will require further strengthening of capital base, not only from their internal sources through increase of retained income from realized profit, but through external sources, which is at the same time a precondition for further expansion and growth of banks.

III. CONCLUSION

Consolidation and stabilization of banking sector of the Federation of BiH has reached an enviable level and upcoming activities should provide further progress and development of the system. This implies a continuous engagement of all parts of the system, legislative and executive authorities in order to provide for the most favorable environment in economy, which would be stimulating to banks and to the economy.

In other to meet such goals, it is necessary to have further involvement of authorized institutions and bodies in Bosnia and Herzegovina and the Federation of BiH in order to:

- Support and accelerate consolidation and establishment of banking supervision on state level;
- Finalize privatization process of state banks, that is, define resolution of their status;
- Improve environment for banks to operate in the whole area of Bosnia and Herzegovina;
- Continuously build legal regulation for banking system and financial system starting from Basle Principles and European Banking Directives;
- Define and build on regulation for financial sector related to the activity and status of microcredit organization, BOR and Investment Bank of the Federation of BiH d.d. Sarajevo, etc.;
- Accelerate implementation of economic reform in the real sector in order to reach the level of monetary and banking sector;
- Accelerate establishment of special court division for economy;
- Establish more efficient process for realization of pledges
- Pass laws for protection of creditors and more and concrete responsibility of debtors

In future, the Banking Agency of the Federation of BiH will:

- Proceed with continues supervision of banks through on-site and off-site examinations;
- Accelerate finalization of remaining provisional administrations and liquidation processes;
- Insist on strengthening of capital in banks, especially those that have recorded growth in assets above average;
- In order to protect depositors, implement special supervision in banks with high concentration of saving and other deposits;
- Work on further development of regulations under authority of the Agency starting from Basle Principles and incorporating European Directives, as part of preparation process for becoming part of European Union;
- Initiate additional education of members in Supervisory Boards of banks;
- Work on continuous education and training of its own staff;
- Maintain continuity in payment system examinations;

- Continue effective monitoring of banks activities for prevention of money laundering and terrorism financing, and improve cooperation with other supervisory and examination institutions;
- Provide effective operation of new informational system for early warning and prevention of weaknesses in banks;
- Improve cooperation with Bankers Association;
- Establish and expand cooperation with home country supervisors of the investors present in the banking sector of the FBiH
- take active part in preparation for passing law on banks on state level
- organize counseling and provide advising on application of regulations passed by the FBA, etc

Banks, as the most important part of the system, have to concentrate their actions to:

- Further strengthen capital in correlation with growth of assets and risks;
- Improve asset quality;
- Adopt and implement new business policies and procedures complied with competitive market conditions;
- Strengthen internal control systems and establish internal audits, and provision of their independence;
- Further development of credit/debit card operations and electronic banking, and introduction of other, new products and services;
- Development of procedures for control and improvement of IT;
- Training and staff improvement;
- Maintaining prevention of money laundering and terrorism financing by implementation of adopted policies and procedures;
- Consider potential implications of Law on Value Added Tax;
- Improve work of Bankers Association;
- Establish unified registry of irregular debtors – legal entities and individuals on the level of the Federation of BiH through Bankers Association which will provide for data to banks in order to decrease loan risk, etc.