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 MARCH 31, 2006

Sarajevo, May 2006

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 March 31, 2006) 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 by the Agency (off-site financial analysis).

I. INTRODUCTION

Positive trends, stabilization, further strengthening, growth, and development of the banking sector represent the characteristic of the first quarter of 2006, as well as continuity of positive changes from the past period. Aggregate balance sheet amounted to KM 9,7 billion, which represents an increase of KM 349 million or 4% in comparison to the end of 2005, and 72% of this increase or KM 253 million was gained by four largest banks in the system. Observed by balance sheet positions through sources, this growth was financed by deposit potential, which increased by KM 231 million or 3%, borrowings with growth rate of 4% or KM 48 million, while capital was increased by 3% or KM 36 million.

In the observed period, cash funds increased by KM 165 million or 5%, and loans increased by KM 213 million or 4%. A positive indicator is that in the first quarter of 2006 majority of banks' loans were originated to private companies and those placements increased by KM 118 million or 5% in comparison to the end of 2005, while loans originated to citizens increased by KM 98 million or 4%. At the same time, short-term loans increased by 4%, and long-term loans increased by 3%, which has resulted in better maturity adjustment of financial sources and placements.

Observing the structure through participation of balance sheet categories in assets and liabilities, we have noticed some minor changes, thus, in the sources, deposits still have the highest participation of 72,9%, although a slight trend of their decrease has continued. As a result and confirmation of further strengthening of confidence in the banking system, we have a continued growth of savings, which has reached the amount of KM 2,81 billion, representing an increase of 6% in comparison to the end of 2005.

In the first quarter, indicators of banks' performance are good. The profit gained on the system level amounted to KM 28,6 million, representing a significant increase of 93% in comparison to the same period last year. The profit in the amount of KM 31,5 million was gained by 17 banks, while seven banks reported loss in total amount of KM 2,9 million.

Two, the most significant indicators of profitability: ROAA (Return on Average Assets) and ROAE (Return on Average Equity) are considerably better than in the same period last year. At the end of first quarter of 2006, ROAA was 1,21%, and ROAE was 15,06%, which is better than the international feasible standards.

Although interest income increased by 23% in comparison to the same period last year, their participation in the structure of total income remained unchanged, which was 69%, while operating income with the growth rate of 22% also remained the same in its participation (31%) as at the end of the same period last year. On the side of the expenses, interest expenses increased by 30%, representing 29,3% of total expenses, and non-interest expenses represented 70,7% of total expenses.

In regard to the market shares and their reallocation, we could say that the first quarter did not have any significant changes, and the four banks with assets exceeding one billion KM «hold» 69,4% of total banking assets. On the other hand, market share of eight banks with the assets below KM 100 million is only 4,2%.

Capitalization rate and capital adequacy of banks are still one of key performance segments of the system, especially due to the fact that the largest banks in the system have capital adequacy rate slightly higher than the minimum prescribed by the Law (12%) from 1,7% to 3,1%. It is obvious that further capital strengthening of banks is high priority in future period, especially with largest banks, which is necessary, especially if banks want to keep developing their operations in line with the adopted strategic plans.

II. BUSINESS PERFORMANCE OF BANKS IN THE FEDERATION OF BIH

1. STRUCTURE OF THE BANKING SECTOR

1.1. Status, number and business network

As of 31.03.2006., there were 24 banks with the banking license issued in the Federation of BiH. Number of banks remained the same as of 31.12.2005.

As of 31.03.2006., there were five banks under provisional administration (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 the first quarter of 2006, banks tried to continue expanding the network of their organizational units. Banks in the Federation of BiH founded one new organizational unit in Republic Srpska. In comparison to 31.12.2005., when banks constituted of 480 organizational units, this represents an increase of 0,2%.

As of 31.03.2006., 11 banks from the Federation of BiH had 28 organizational units in Republic of Srpska and 11 in Brčko District. In comparison to 31.12.2005., number of organizational units from Republic Srpska in the Federation of BiH increased from 17 to 18, that is, three banks from Republic Srpska had 18 organizational units in the Federation of BiH.

The license for inter-bank-transactions in internal payment system was issued to all banks as of 31.03.2006. There were 15 banks with deposit insurance.

1.2. Ownership structure

As of 31.03.2006., ownership structure in banks[1] was assessed based on the available information and on-site visits to banks[2] as it follows:

- Private and majority private ownership 18 banks (75%)
- State and majority state ownership[3] 6 banks (25%)

Ownership structure can be observed from the aspect of financial results or by the value of total capital[4].

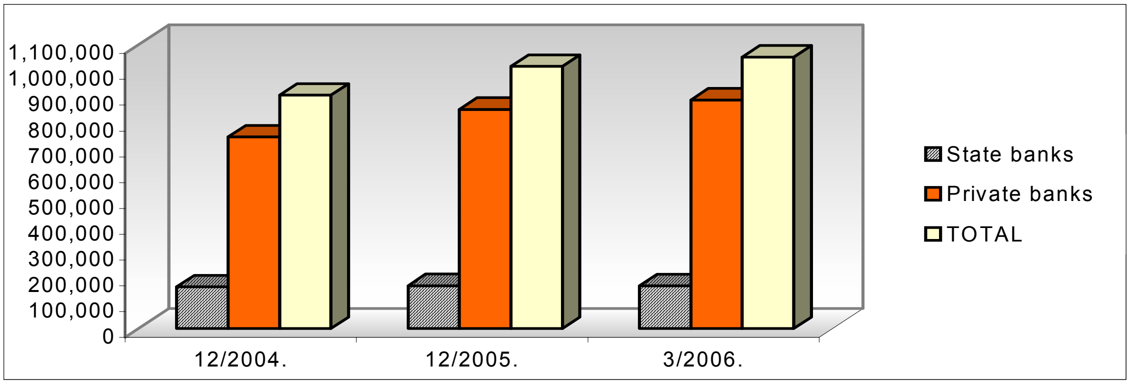
Table 1: *Ownership structure by total capital*

-in 000 KM-

BANKS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	161.915	18%	166.771	16%	166.039	16%	103	100
Private banks	743.495	82%	850.469	84%	886.482	84%	114	104
TOTAL	905.410	100%	1.017.240	100%	1.052.521	100%	112	104

[1] Classification criteria of banks by type of ownership is ownership over share capital of banks.
[2] General overview of ownership structure of banks in the F BiH as of 31.12.2005. resulted from received documentation, and registrations at authorized courts (changes in capital and shareholders structure).
[3] State ownership is defined based on domestic, state capital of BiH.
[4] Information from balance sheet - FBA schedule: shareholders capital, premium issue, undistributed profit and reserves, and other capital (financial results of current period).

Graph 1: *Review of ownership structure (total capital)*



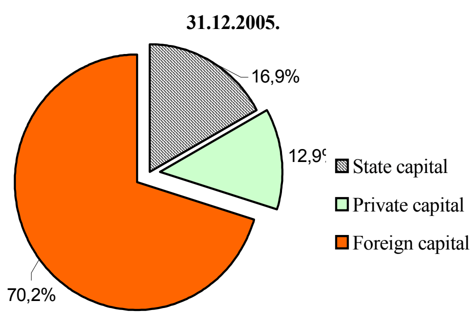
More detailed picture on ownership structure of banks in the Federation of BiH can be viewed from the analysis of participation of state, private and foreign capital in share capital of banks.

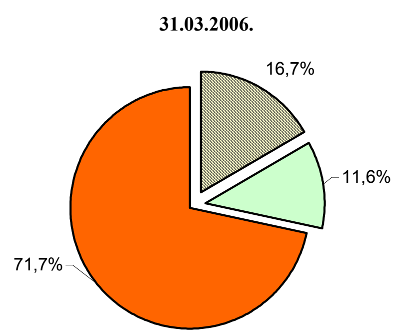
Table 2: *Ownership structure by participation of state, private and foreign capital*

- in 000 KM-

SHARE CAPITAL	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	5/3	7/5
1	3	4	5	6	7	8	9	10
State capital	135.350	17,8	135.344	16,9	135.321	16,7	100	100
Private capital (residents)	132.785	17,4	103.026	12,9	94.143	11,6	78	91
Foreign capital (nonresidents)	493.227	64,8	561.117	70,2	580.023	71,7	114	103
TOTAL	761.362	100,0	799.487	100,0	809.487	100,0	105	101

Graph 2: *Ownership structure (share capital)*





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

As of 31.03.2006., participation of state capital in total share capital of banks amounts to 16,7 % and it is less by 0,2% in comparison to 31.12.2005. Participation of remaining state capital in private banks is below 1%, that is, it amounts to KM 1,2 million.

If compared to 31.12.2005., participation of private capital (residents) in total capital of the banking sector decreased from 12,9% to 11,6%, and participation of foreign capital increased from 70,2% to 71,7%. Increase in the participation of foreign capital of 1,5% is a result of the following: additional capitalization of KM 10 million in one bank (of foreign ownership, one bank with majority domestic capital and one state owned bank), and sale of residents' shares (in four banks) to foreign buyers (nonresidents) in total value of approximately KM 9 million.

Changes in the ownership structure have also reflected through the participation, that is, market share and positioning of banks that grouped based on the criteria of majority ownership in share capital. Market share of banks with majority foreign ownership increased by 0,3%, and as of 31.03.2006., it was 89,3%. Market share of banks with majority domestic private capital was 6,4%, and trend of further decrease of share of state banks continued and it was only 4,3%.

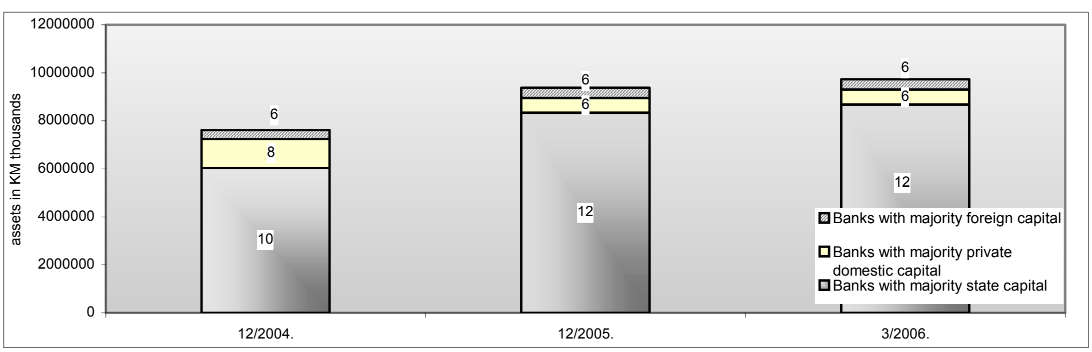
Integration process in the past periods has also been focused on stronger market positioning, which resulted in concentrations of the banking sector through growing of the largest banks, decreased number of banks, and intensified competition. There will be some changes in a near future, as a result of the current activities and related to the integration process of two banks.

Table 3: *Market share of banks by type of ownership*[5]

- in %-

BANKE	31.12.2004.			31.12.2005.			31.03.2006.		
	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. in total assets	No. of banks	Partic. in total capital	Partic. in total assets
1	2	2	3	7	5	6	10	8	9
Banks with majority state capital	6	17,9	4,9	6	16,4	4,5	6	15,8	4,3
Banks with majority private domestic capital	8	16,9	15,8	6	8,0	6,5	6	7,7	6,4
Banks with majority foreign capital	10	65,2	79,3	12	75,6	89,0	12	76,5	89,3
TOTAL	24	100,0	100,0	24	100,0	100,0	24	100,0	100,0

Graph 3: *Market share by type of ownership*



[5] According to majority owned capital (participation exceeding 50%).

1.3. Staff

As of 31.03.2006., there were total of 6.131 employees of banks in the Federation BiH. Out of total number, 8% worked in banks with majority state owned capital and 92% in private owned banks.

Table 4: *Employees of banks in the FBiH*

BANKS	NUMBER OF EMPLOYEES						RATIO	
	31.12.2004.		31.12.2005.		31.03.2006.		3:2	4:3
1	2		3		4		5	6
State banks	490	9%	476	8%	476	8%	97	100
Private banks	5.197	91%	5.540	92%	5.655	92%	107	102
TOTAL	5.687	100%	6.015	100%	6.131	100%	106	102
Number of banks	24		24		24			

In the first quarter of 2006, number of employees, in private banks only, increased by 2% or 116 employees.

Table 5: *Qualification structure of employees*

EDUCATION	NUMBER OF EMPLOYEES			RATIO	
	31.12.2004.	31.12.2005.	31.03.2006.	3:2	4:3
1	2	3	4	5	6
University qualifications	2.016	2.165	2.212	107	102
Two-year post secondary school qualifications	596	642	662	108	103
Secondary school qualifications	2.962	3.102	3.153	105	102
Other	113	106	104	94	98
TOTAL	5.687	6.015	6.131	106	102

One of the indicators influencing assessment of performance of respective banks and the banking system is effectiveness of employees, which is shown as ratio between assets and number of employees, that is, amount of assets per an employee. The higher ratio, the better effectiveness of performance, both of a bank and of the system.

Table 6: *Assets per an employee*

BANKS	31.12.2004.			31.12.2005.			31.03.2006.		
	No. of empl.	Assets (000 KM)	Assets per an empl.	No. of empl.	Assets (000 KM)	Assets per an empl.	No. of empl.	Assets (000 KM)	Assets per an empl.
State	490	373.064	766	475	423.349	891	476	422.786	888
Private	5.197	7.240.166	1.393	5.540	8.956.242	1.616	5.655	9.306.227	1.646
TOTAL	5.687	7.613.230	1.339	6.015	9.379.591	1.559	6.131	9.729.013	1.587

At the end of first quarter of 2006, there was KM 1,6 million of assets per an employee on the level of the banking system. This indicator is much better in the sector of private banks, which is to expect based on stagnation or decrease of business capacity of state banks and consequently excessive number of employees.

Table 7: *Assets per an employee by groups*

Assets (000 KM)	31.12.2004.	31.12.2005.	31.03.2006.
	Number of banks	Number of banks	Number of banks
Up to 500	7	5	5
500 to 1.000	5	7	7
1.000 to 1.500	4	3	4
1.500 to 2.000	7	3	1
Over 2.000	1	6	7
TOTAL	24	24	24

Analytical indicators of respective banks range from KM 164 thousand to KM 3,1 million of assets per employee. The indicator of eight banks is better than the one for the whole banking system, and the indicator of four largest banks of the system exceed the amount of KM 2,1 million. And finally, we could say that conditions under which banks service their customers, both legal entities and citizens, as well as conditions under which banks finance their customers, have improved.

2. FINANCIAL INDICATORS OF BANKS' PERFORMANCE

Examination of banks based on reports is performed in the way to use the reports prescribed by the FBA and the reports of other institutions, representing database of three groups of information:

1. Information on balance sheet for all banks submitted monthly, including quarterly attachments, containing more detailed information on funds, loans, deposits and off-balance sheet items, and some general statistic information,
2. Information on bank solvency, data on capital and capital adequacy, asset classification, concentrations of certain types of risks, liquidity position, foreign exchange exposure, based on the reports prescribed by the FBA (quarterly),
3. Information on performance results of banks (income statement – FBA format) and cash flow reports submitted to the FBA quarterly.

Aside from the mentioned standardized reports, the database includes the information obtained from additional reporting requirements prescribed by the FBA in order to have the best conditions for monitoring and analysis of banks' performance in the Federation of BiH. The database also includes audit reports of financial statements of banks prepared by independent auditor, as well as all other information relevant to the assessment of performances of individual banks and the entire banking system.

In accordance with the provisions of Law on Opening Balance Sheet of Banks, banks with majority state owned capital have to report to the FBA "full" balance sheet divided into: passive, neutral and active sub-balance sheet. In order to get realistic indicators of banks' performance in the Federation of BiH, all further analysis of the banking system will be based on the indicators from the active sub-balance sheet of banks with majority state owned capital[6].

[6] Some state banks in their "full balance sheet" report passive and neutral items, which will be taken over by the state upon finalization of the privatization process. As of 31.12.2005., these items amounted to KM 680 million.

2.1. Balance sheet

Aggregate balance sheet of banks in the Federation of BiH, according to the balance sheets submitted as of 31.03.2006., amounted to KM 9,7 billion, which is higher by 4% or KM 349 million in comparison to 31.122005. Growth rate realized in the same period last year was 2% or KM 155 million.

Table 8: *Balance sheet*

DESCRIPTION	AMOUNT (in 000 KM)			RATIO	
	31.12.2004.	31.12.2005.	31.03.2006.	3/2	4/3
1	2	3	4	5	6
ASSETS:					
Cash assets	2.859.489	3.533.700	3.698.548	124	105
Securities	19.430	20.010	23.933	103	120
Placements to other banks	81.624	68.811	57.432	84	83
Loans- net value	4.184.579	5.285.193	5.486.395	126	104
Business premises and other fixed assets	299.189	307.029	306.310	103	100
Other assets	168.919	164.848	156.395	98	95
TOTAL ASSETS	**7.613.230**	**9.379.591**	**9.729.013**	**123**	**104**
LIABILITIES:					
LIABILITIES					
Deposits	5.602.238	6.864.048	7.094.875	123	103
Borrowings from other banks	3.329	2.912	2.940	87	101
Liabilities for borrowings	850.833	1.152.910	1.201.151	136	104
Other liabilities	251.420	342.481	377.526	136	110
CAPITAL					
Capital	905.410	1.017.240	1.052.521	112	103
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	**7.613.230**	**9.379.591**	**9.729.013**	**123**	**104**

Table 9: *Assets of banks by ownership structure*

BANKS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
							3/2	4/3
1	2		3		4		5	6
State banks	373.064	5%	423.349	5%	422.786	4%	113	100
Private banks	7.240.657	95%	8.956.242	95%	9.306.227	96%	124	104
TOTAL	7.613.721	100%	9.379.591	100%	9.729.013	100%	123	104

Analytical indicators by banks show that during the observed period the assets of nine banks (three in provisional administration) decreased. Majority of banks (13) realized growth rate up to 10%, and only two banks that belong to the group of smaller banks (according to their assets level) experienced growth rate over 20%.

The four largest banks represent 72% or KM 253 million of total growth in the aggregate balance sheet of the banking sector.

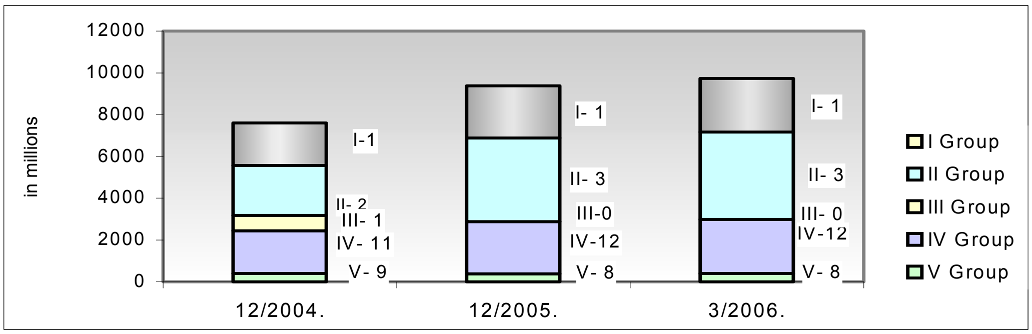
If the banking system is analyzed from the aspect of assets size and certain groups within this frame, changes in number of banks and participation of individual groups are the result of the assets growth of majority of banks.

The following table presents amounts and participations of individual groups of banks[7] in total assets in time line (amounts in million KM):

Table 10: *Participation of individual groups of banks in total assets through periods*

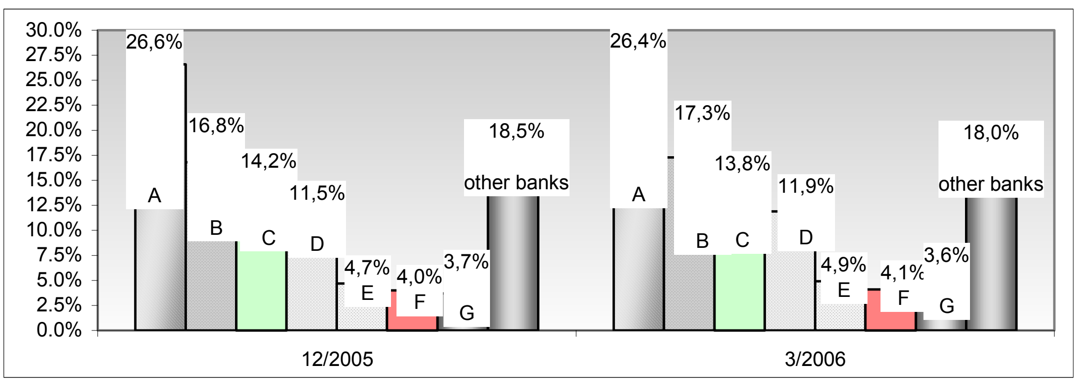
ASSETS	31.12.2004.			31.12.2005.			31.03.2006.		
	Amount	Partic. %	No.of banks	Amount	Partic. %	No.of banks	Amount	Partic. %	No.of banks
I- Over 2.000	2.043	26,9	1	2.495	26,6	1	2.564	26,4	1
II- 1000 to 2000	2.382	31,3	2	3.996	42,6	3	4.179	43,0	3
III- 500 to 1000	741	9,7	1	0	0,0	0	0	0,0	0
IV- 100 to 500	2.036	26,7	11	2.504	26,7	12	2.579	26,5	12
V- Below 100	411	5,4	9	384	4,1	8	407	4,2	8
TOTAL	7.613	100,0	24	9.380	100,0	24	9.729	100,0	24

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



The following graph shows structure and trend of participation of seven largest banks[8] in the banking system of the Federation of BiH:

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



Growth of the aggregate balance sheet in sources is a result of growth in deposits (by 3% or KM 231 million), borrowings (by 4% or KM 48 million) and capital (by 3% or KM 36 million).

In the assets of banks, loans[9] increased by 4% or KM 213 million and cash funds increased by 5% or KM 165 million.

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[7] Banks are divided into five groups, depending on the assets size.
[8] Banks are marked with letters from A to F.

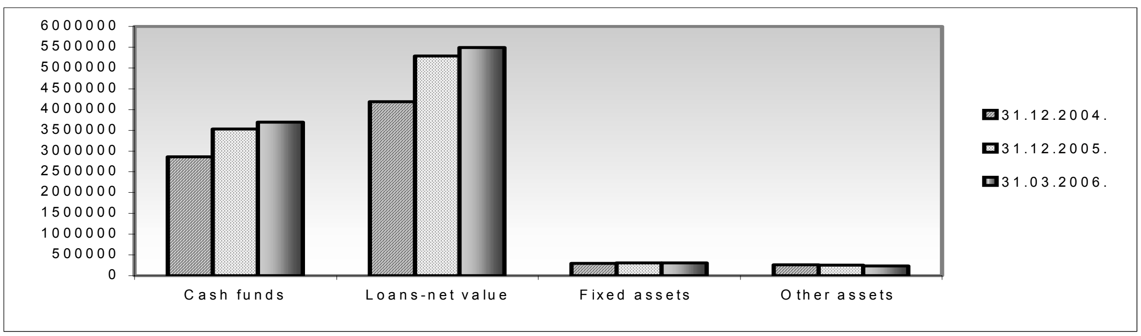
The following table and graphs present structure of the most significant balance sheet positions of banks.

Table 11: *Structure of balance sheet of banks*

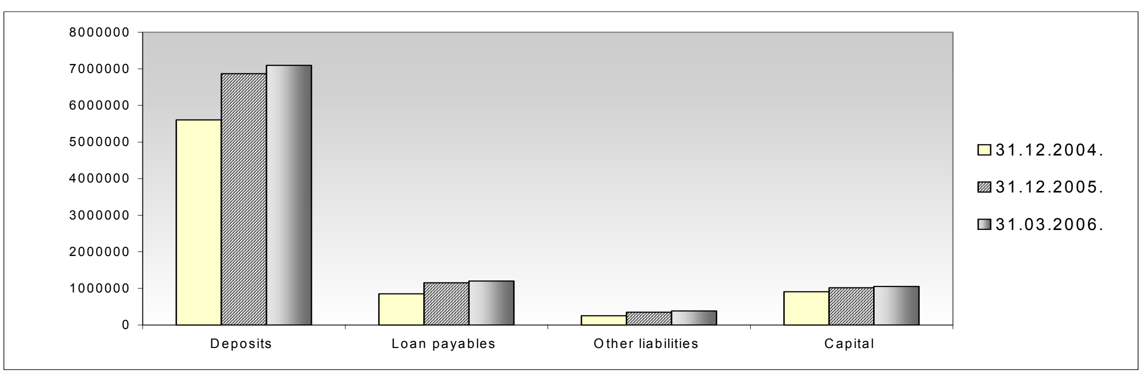
- in % -

DESCRIPTION	PARTICIPATION		
	31.12.2004.	**31.12.2005.**	**31.03.2006.**
ASSETS:			
Cash assets	37,6	37,7	38,0
Securities	0,2	0,2	0,2
Placements to other banks	1,1	0,7	0,7
Loans- net value	55,0	56,3	56,4
Business premises and other fixed assets	3,9	3,3	3,1
Other assets	2,2	1,8	1,6
TOTAL ASSETS	100,0	100,0	100,0
LIABILITIES:			
LIABILITIES			
Deposits	73,6	73,2	72,9
Borrowings from other banks	0,1	0,0	0,0
Liabilities for borrowings	11,2	12,3	12,3
Other liabilities	3,2	3,7	4,0
CAPITAL			
Capital	11,9	10,8	10,8
TOTAL LIABILITIES (LIABILITIES AND CAPITAL)	100,0	100,0	100,0

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



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



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[9] Gross loans (balance sheet data): short term, long term, past due claims, paid-called guarantees and claims from leasing operations.

Changes in the structure of balance sheet liabilities of banks from the aspect of participation of the most significant balance sheet categories in sources continued following the trend from previous periods. Participation of deposits keeps slightly decreasing, but the rate of 72,9% is still dominant. Participation of loan payables (12,3%) and capital (10,8%) is the same as at the end of 2005.

The most significant change in the assets structure is increase of participation of cash funds from 37,7% to 38%, while participation of loans increased by only 0,1% in comparison to the end of 2005.

Table 12: *Cash funds of banks*

CASH FUNDS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Cash	215.543	7,5	231.874	6,6	208.812	5,6	108	90
Reserve accounts with CBBiH	1.177.935	41,2	1.679.194	47,5	1.806.240	48,8	143	108
Accounts with deposit institutions in BiH	47.798	1,7	24.241	0,7	23.299	0,6	51	96
Accounts with deposit institutions abroad	1.416.779	49,5	1.596.932	45,2	1.659.084	44,9	113	104
Cash assets in collection process	1.434	0,1	1.459	0,0	1.113	0,0	102	76
TOTAL	2.859.489	100,0	3.533.700	100,0	3.698.548	100,0	139	105

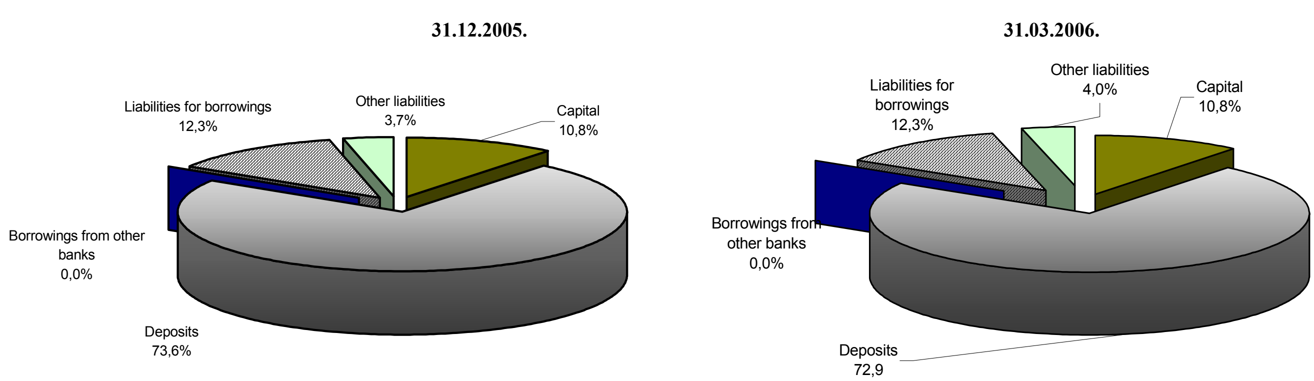
At the end of first quarter of 2006, banks in the Federation of BiH maintained on the accounts of deposit institutions abroad the amount of KM 1,7 billion (most of it in EURO) or 44,9% of total cash funds, which is less by 0,3% than at the end of 2005, although the funds are nominally higher by 4% or KM 62 million. On the reserve accounts with the Central Bank of BiH, there was KM 1,8 billion or 48,8% of total cash funds, which is higher by 1,3% in comparison to the end of 2005. Banks held cash in vault and tellers of 5,6% or KM 209 million of cash funds.

From the aspect of structure of the cash funds, trend of increase in participation of funds in domestic currency has continued (from 52% to 53,2%), along with decrease in participation of funds in foreign currencies (from 48% to 46,8%).

2. 1. 1. Liabilities

Structure of liabilities (liabilities and capital) in the balance sheet of banks as of 31.03.2006. is presented in the following graph:

Graph 8: *Liabilities structure of banks*



Structure of liabilities slightly changed in comparison to the end of 2005. Deposits, as primary source of financing, still have the highest participation of 72,9%, while participation of liabilities for borrowings of 12,3% and capital of 10,8% remained unchanged.

Although participation of loan payables did not change, banks have continued borrowing abroad during 2006, which has reached growth of 4% or KM 48 million. Five major creditors with 65% of total borrowings were: Raiffeisen Zentralbank Osterreich A.G. (RZB), Bank Polska OPIEKI, Kreditanstalt fur Wiederaufbau (KfW), OEWAG Wien, and European Bank for Reconstruction and Development (EBRD).

In the first quarter of 2006, deposits increased by 3% or KM 231 million. The same as earlier, the increase primarily comes from the private bank sector.

Based on the information reported by banks, out of total deposits as of 31.03.2006. only 4% were deposits collected by organizational units of the banks from the Federation of BiH operating in Republic Srpska and Brcko District.

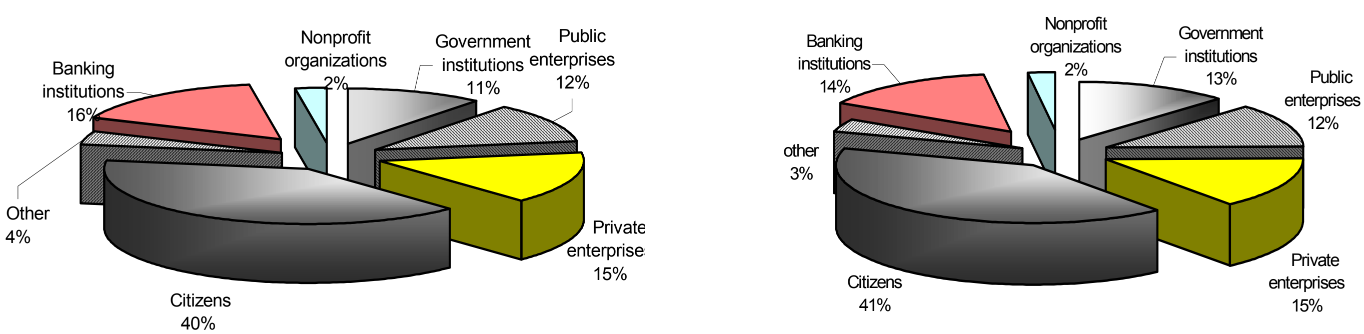
Table 13: *Deposit structure by sectors* [10]

- in 000 KM-

SECTORS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Governmental institutions	599.060	10,7	733.881	10,7	893.453	12,6	123	122
Public enterprises	783.655	14,0	806.321	11,7	857.432	12,1	103	106
Private enterprises and assoc.	876.831	15,7	1.066.022	15,5	1.032.395	14,6	122	97
Non-profit. organizations	180.705	3,2	169.005	2,5	166.583	2,3	94	99
Banking institutions	808.112	14,4	1.102.161	16,1	1.027.269	14,5	136	93
Citizens	2.173.228	38,8	2.717.081	39,6	2.872.433	40,5	125	106
Other	180.647	3,2	269.577	3,9	245.310	3,4	149	91
TOTAL	5.602.238	100,0	6.864.048	100,0	7.094.875	100,0	123	103

Graph 9: *Deposit structure by sectors*

31.12.2005. **31.03.2006.**



Analysis by sectors, in the first quarter of 2006, indicates the highest rate of growth of 22% or KM 159 million in the deposits of government institutions. The same rate of growth of 6% was observed in citizens and public enterprises deposits with nominal increase of KM 155 million,

[10] Information from attached form BS-D submitted by banks each quarter with balance sheet - FBA format.

that is, KM 51 million. As a result of this, there was increase in participation of these three sectors, although the highest participation of 40,5% still belongs to citizen deposits. Due to downfall of 7% or KM 75 million, participation of banking institutions deposits decreased by 1,6%.

Currency structure of deposits remained the same as at the end of 2005. Out of total amount of deposits, 41,9% or KM 2.972 million were deposits in domestic currency, and 58,1% or KM 4.123 million were deposits in foreign currency, with dominant participation of EURO.

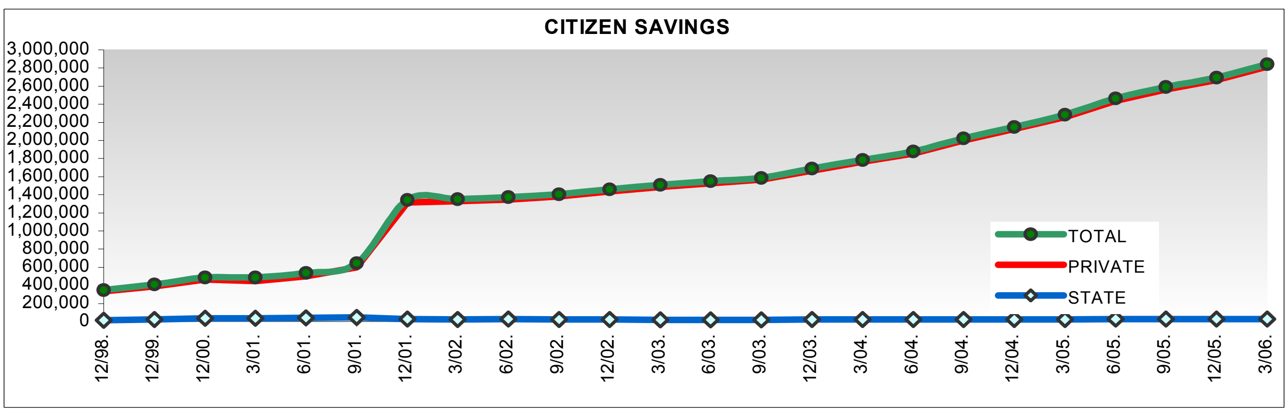
In the observed period of 2006, saving deposits, as the most significant segment of both deposit and financial potential of banks, have continued growing in a moderate and stable way, reaching the rate of 6% or KM 148 million. Only two banks showed that saving deposits slightly decreased, while remaining banks recorded increase of saving deposits. Out of total increase reported, 70% or KM 104 million refers to the four largest banks in the system.

Table 14: *New citizen savings by periods*

- in 000 KM-

BANKS	AMOUNT (in 000 KM)			RATIO	
	31.12.2004.	31.12.2005.	31.03.2006.	3/2	4/3
1	3	3	4	5	6
State	22.342	26.886	28.070	120	104
Private	2.105.167	2.638.391	2.785.145	125	106
TOTAL	2.127.509	2.665.277	2.813.215	125	106

Graph 10: *New citizen savings by periods*



As in other segments, there is an obvious strong concentration of savings in larger banks, since the four largest banks hold 76% of total savings.

Out of total savings, 29% are savings deposits in domestic currency, and 71% are savings in foreign currency. .

Table 15: *Maturity structure of citizen savings deposits by periods*

BANKS	AMOUNT (in 000 KM)						RATIO	
	31.12.2004.		31.12.2005.		31.03.2006.		3/2	4/3
1	3		3		4		5	6
Short-term savings deposits	1.360.285	63,9%	1.567.617	58,8%	1.613.718	57,4%	115	103
Long-term savings deposits	767.224	36,1%	1.097.660	41,2%	1.199.497	42,6%	143	109
TOTAL	2.127.509	100,0%	2.665.277	100,0%	2.813.215	100,0%	125	106

Maturity structure of saving deposits, as well as of total deposits, showed a positive trend of changes, mainly due to a continuing improvement of the entire banking sector and strengthening of trust in banks, which resulted in faster growth of long term savings deposits. We should especially emphasize the stability and high level of growth rate in long term savings deposits, which consequently resulted that their participation already exceeded two fifth of total deposits.

Aside from activities initiated by FBA, growth of savings in banks of the FBiH resulted from deposit insurance system, which was founded 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 for BiH was founded. There was total of 15 banks from the Federation of BiH that became part of the deposit insurance program and received certificate on deposit insurance. Analytical data on level of deposits by banks indicate that in those banks there 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. Out of remaining nine banks, eight cannot apply for deposit insurance certificate, since they are not meeting the criteria prescribed by Deposits Insurance Agency: a reason for six state owned banks is ownership structure, and two private banks are under provisional administration. Safety of deposits is a guaranty and incentive for further growth of savings, not only in those banks, but also in all other banks.

2.1.2. Capital – strength and adequacy

As of 31.03.2006., capital[11] of banks in the FBiH amounted to KM 1.235 million.

Table 16: *Regulatory capital*

-in 000 KM-

DESCRIPTION	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
							3/2	4/3
1	2		3		4		5	6
STATE BANKS								
1. Core capital before reduction	163.061		166.737		167.791		102	101
2. Offsetting items	2.607		3.923		5.032		150	128
a) Core capital (1-2)	160.454	98%	162.814	96%	162.759	96%	102	100
b) Additional capital	3.639	2%	7.107	4%	6.580	4 %	195	93
c) **Capital (a + b)**	164.093	100%	169.921	100%	169.339	100%	104	100
PRIVATE BANKS								
Core capital before reduction	744.519		828.196		914.113		111	110
Offsetting items	88.598		98.341		98.726		111	100
a) Core capital (1-2)	655.921	75%	729.855	72%	815.387	77%	111	112
b) Additional capital	217.639	25%	286.672	28%	249.834	23%	132	87
c) Capital (a + b)	873.560	100%	1.016.527	100%	1.065.221	100%	116	105
Total								
1. Core capital before reduction	907.580		994.933		1.081.904		110	109
2. Offsetting items	91.205		102.264		103.758		112	101
a) Core capital (1-2)	816.375	79%	892.669	75%	978.146	79%	109	110
b) Additional capital	221.278	21%	293.779	25%	256.414	21%	133	87
c) Capital (a + b)	1.037.653	100%	1.186.448	100%	1.234.560	100%	114	104

In the first quarter of 2006, capital[12] increased by 4% or KM 48,1 million in comparison to the end of 2005, which was the result of increase of core capital by KM 85,5 million, and decrease of additional capital by KM 37,4 million.

[11] Regulatory capital is defined by Article 8 and 9 in the Decision on Minimum Standards for Managing Capital

[12] Data source is quarterly Report on Capital Positions in Banks (Form 1-Schedule A) regulated by the Decision on Minimum Standards for Managing Capital in Banks.

Growth of core capital is mainly caused by allocation of profit from 2005 to retained undistributed profit in the amount of KM 55,5 million, allocation to reserves of KM 21,5 million, and based on additional capitalization of one bank by KM 10 million.

Offsetting items (causing decrease of core capital) increased by KM 1,5 million based on the increase of uncovered losses from earlier years by KM 0,3 million, increase of current losses of KM 2,9 million (in seven banks), and decrease of intangible assets by KM 1,7 million.

Decrease of additional capital by KM 37,4 million is primarily result of allocation of profit from 2005 in the amount of KM 39 million to core capital and increase of general reserves for loan losses in the amount of KM 1,7 million.

The mentioned changes influenced the structure of regulatory capital in the way that the participation of core capital was increased from 75% to 79%, and additional capital was decreased from 25% to 21%.

Growth of regulatory capital of 4% was positively reflected on net capital that in the first quarter of 2006 increased by 4% or KM 48,1 million, which amounted to KM 1.217 million as of 31.03.2006. (private banks – KM 1.048 million and state banks – KM 169 million).

Capitalization rate of banks, viewed as ratio between capital and assets, was 12,3% as of 31.03.2006., which was the same as at the end of 2005 due to proportional growth of both capital and assets.

One of the most significant indicators of capital strength and adequacy[13] of banks is capital adequacy ratio calculated as ratio between net capital and risk weighted assets. As of 31.03.2006., this ratio was 17,7% for the whole system, which is higher by 0,2% in comparison to the end of 2005.

Observed on the sector level of state banks at the end of 2005, the ratio was decreased from 57,2% to 55,2%, and increased in private banks from 15,7% to 16%.

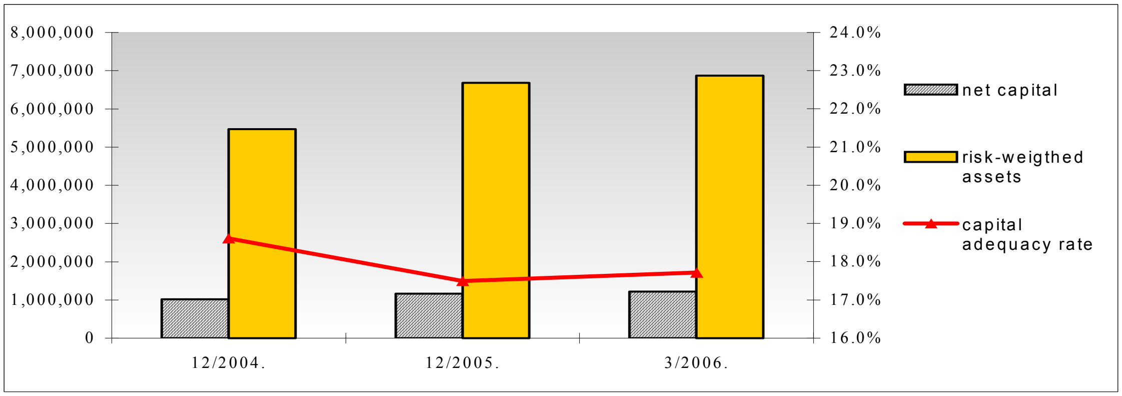
While conducting supervision of operations and financial positions of banks in the F BiH as regulated by the Law, the FBA issued orders to banks to undertake actions for strengthening of capital base and provision of adequate capital in order to strengthen safety in banks individually and in the entire banking system, according to the level and profile of existing and potential exposure to all risks relevant to the banking operation.

Table 17: *Net capital, risk weighted assets and capital adequacy rate*

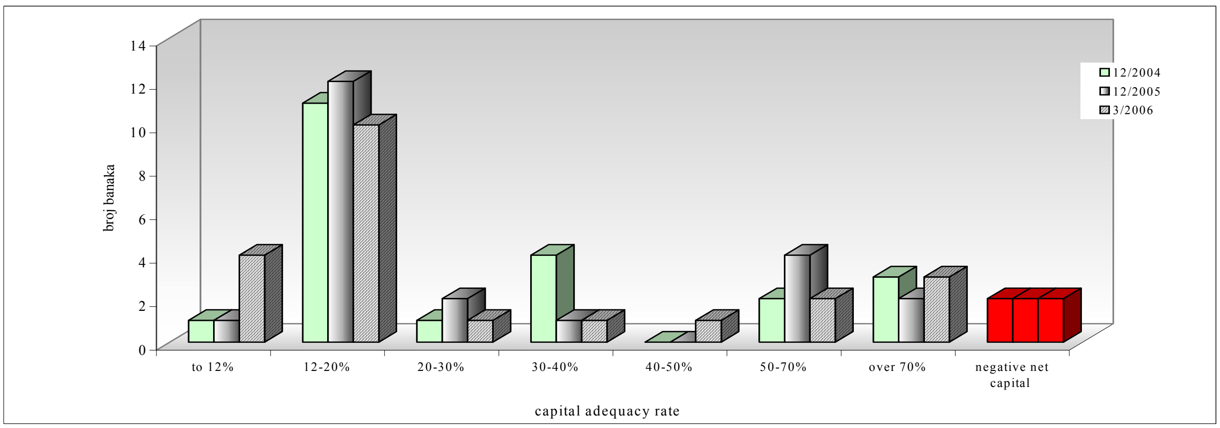
DESCRIPTION	31.12.2004.	31.12.2005.	31.03.2006.	RATIO	
				3/2	4/3
1	2	3	4	5	6
NET CAPITAL	1.018.626	1.169.213	1.217.324	115	104
RISK WEIGTHED ASSETS AND CREDIT EQUIVALENTS	5.472.154	6.682.394	6.869.678	122	103
NET CAPITAL RATE (CAPITAL ADEQUACY)	18,6%	17,5%	17,7%	94	101

[13] The Law prescribes minimum capital adequacy rate of 12%.

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



Graph 12: *Capital adequacy rate of banks*



There were 18 banks out of total of 24 banks in the FBiH, as of 31.03.2006., with capital adequacy rate higher than minimum requirement of 12%. Four banks (three under provisional administration) had capital adequacy ratio below 12%, while two banks under provisional administration had negative capital adequacy rate.

In majority of banks, we have noticed a continuous trend of slight decrease of capital adequacy ratio. In the first group of banks (rate up to 12%), number of banks increased from one to four, while in the second, the largest group (rate between 12% and 20%), number of banks decreased from 12 to 10. Three banks have the rate between 21% and 50%. In the group of banks (rate between 51% and 70%) there was decrease of banks from four to two, while in the group (rate over 70%), there was increase of number of banks from two to three, as a result of significant improvement of the adequacy rate in one bank based on additional capitalization, which influenced increase of the rate on the level of the banking system by 0,2% in comparison to 2005. However, four largest banks by assets size (participating with 69,3% in total assets of the banking system) have capital adequacy rate somewhat higher than the minimum requirement (between 13,7% and 15,1%).

Any further increase of risk assets, and especially of credit placements, will necessarily require adequate capital growth, therefore banks are obliged to adopt program for capital management and continuous monitoring of 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 will be priority task in most of banks, especially in the largest banks of the system, which is necessary to strengthen stability and safety of both banks and the banking system. Based on the expansion of banks, the FBA orders banks to strengthen their capital base and to perform additional capitalization, and compliance with the orders is monitored through follow-up procedure.

2.1.3. Assets and asset quality

Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks (the Decision) determines criteria for evaluation of bank's exposure to loan risk based on evaluation of their assets quality and adequacy of reserves for loan and other losses according to the risk of placements and balance sheet and off-balance sheet items.

Gross assets[14] of the balance sheet of banks in the FBiH, as of 31.12.2005., amounted to KM 10 billion, which is higher by 4% or KM 354 million than at the end of 2005. Off-balance sheet risk items amounted to KM 1,4 billion and in the first quarter of 2006 they decreased by 2% or KM 22 million.

Total assets with off-balance sheet items (assets)[15] amounted to KM 11 billion, which is higher by 3% than at the end of 2005.

Table 18: *Assets, off-balance sheet items and potential loan losses*

-in 000 KM-

DESCRIPTION	AMOUNT (in 000 KM)						RATIO	
	31.12.2004.	Struct. %	31.12.2005.	Struct. %	31.03.2006.	Struct. %	4:2	6:4
1.	2	3	4	5	6	7	8	9
Loans	4.208.295	53,5	5.326.900	55,0	5.507.753	55,0	127	103
Interests	29.856	0,4	37.537	0,4	33.623	0,3	126	90
Past due claims	209.218	2,7	214.274	2,3	246.503	2,5	102	115
Claims for paid guarantees	5.026	0,1	4.132	0,0	4.292	0,0	82	104
Other placements	40.811	0,4	23.950	0,2	26.616	0,3	59	111
Other assets	3.378.320	42,9	4.051.255	42,1	4.193.255	41,9	120	104
TOTAL ASSETS	7.871.526	100,0	9.658.048	100,0	10.012.042	100,0	123	104
OFF-BALANCE SHEET	1.046.809		1.391.183		1.368.989		133	98
ASSETS AND OFF-BALANCE SHEET	8.918.335		11.049.231		11.381.031		124	103
General loan risk and Potential loan losses	282.412		313.851		318.643		111	102
General and Special loan loss reserves already established	285.090		314.133		319.062		110	102

The amount of non-risk items, out of total assets with off-balance sheet items, was KM 4,1 billion or 35,9%, which represents a slight increase of 0.1% in comparison to the end of 2005, which is primarily the result of increase of cash assets by 16,2% or KM 281 million.
Growth of credit placements of 4% or KM 213 million had almost no influence to the changes in the structure of risk assets (increase of participation of credit placements from 59,1% to 59,2%), while participation of cash assets increased from 37,7% to 38%. Past due claims increased by 15%, while their participation in the assets structure increased from 2,3% to 2,6%.

Analytical data by banks indicate that five banks (four under provisional administration) reported decrease of credit placements. Most of banks (nine) had rate of growth in credit placements between 4% and 9%, and two banks reported increase of loans higher than 9%.

[14] Data source: Report on classification of balance sheet assets and off-balance sheet items of banks.
[15] Assets defined by Article 2 of Decision on Minimum Standards for Loan Risk Management and Assets Classification of Banks.

Although the four largest banks in the FBiH increased their credit placements by KM 151 million, which represented 71% of total increase on the level of the banking sector, their participation in total loans remained the same as at the end of 2005 (70,5%).
Based on the analysis of loan structure by sectors, we can see that the highest increase of KM 118 million or 5% was recorded in placements to private companies, which is why their participation increased from 44,1% to 44,5%. Placements to citizens increased by 4% or 98 million. However, their participation in the overall structure by sectors decreased from 50,2% to 50%. According to the data submitted by banks as of 03/31/2006, from the aspect of citizen loan structure by purpose, the highest participation of approximately 73% had loans for financing consumer goods[16], 23% had housing loans, and remaining 4% had loans for SMEs and agriculture.

Other sectors recorded smaller changes in both nominal and relative amount.

The four largest banks in the system originated loans to citizens of 73% of total loans originated to this sector, while the same indicator for the sector of private enterprises was 70, which represented an increase of 2% in comparison to the end of 2005.

Changes in participation of individual sectors in the overall structure of loans is presented in the following table:

Table 19: *Structure of loans by sectors*

-in 000 KM-

SECTORS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Government institutions	31.810	0,7	35.513	0,6	34.256	0,6	112	96
Public enterprises	203.698	4,6	188.143	3,4	180.262	3,1	92	96
Private enterprises and assoc.	1.933.595	43,7	2.446.591	44.1	2.564.355	44,5	127	105
Non-profit organizations	3.619	0,1	9.272	0,2	11.143	0,2	256	120
Banking institutions	34.082	0,8	33.123	0,5	32.062	0,6	97	97
Citizens	2.139.699	48,4	2.784.053	50,2	2.881.686	50,0	130	104
Other	76.036	1,7	48.611	1,0	54.784	1,0	64	113
TOTAL	4.422.539	100,0	5.545.306	100,0	5.758.548	100,0	125	104

Since placements, that is, loans represent the most risky portion of banks' assets, their quality represents one of the most significant elements of stability and successful performance. Evaluation of assets quality is actually evaluation of exposure to loan risk of banks' placements, that is, identification of potential loan losses that are recognized as loan loss provisioning.

Quality of assets and off-balance sheet risk items, general loan risk, potential loan losses by classification categories[17] and off-balance sheet items are presented in the following table:

[16] Including card based operations.
[17] As it is regulated in the Article 22 of the Decision on Minimum Standards for Managing Credit Risk and Assets Classification in Banks, banks have to allocate and maintain reserves for general and special loan losses in percentages according to classification categories: A 2%, B 5% to 15%, C 16% to 40%, D 41% to 60% and E 100%.

Table 20: *Assets classification, general loan risk (GLR), potential loan losses (PLL) and off-balance sheet items (assets charged off and suspended interest)*

Classification categories	AMOUNT (in 000 KM) AND PARTICIPATION (in %)									RATIO	
	31.12.2004.			31.12.2005.			31.03.2006.				
	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	Assets classif.	Partic. %	GLR PLL	5/2	8/5
1	2	3	4	5	6	7	8	9	10	11	12
A	7.880.830	88,4	94.501	9.901.365	89,6	118.884	10.151.531	89,2	121.389	126	103
B	730.737	8,2	53.633	831.166	7,5	62.517	931.418	8,2	72.607	114	112
C	143.586	1,6	42.104	157.515	1,4	41.954	143.881	1,2	37.612	110	91
D	162.299	1,8	91.294	159.151	1,5	90.465	154.174	1,4	87.011	98	97
E	883	0,0	880	34	0,0	31	27	0,0	24	4	87
TOTAL	8.918.335	100,0	282.412	11.049.231	100,0	313.851	11.381.031	100,0	318.643	124	103
OFF-BALANCE SHEET ITEMS											
E	343.472	83,3		385.366	87,6		385.616	87,0		112	100
Susp. Interest	68.680	16,7		54.420	12,4		57.574	13,0		79	106
TOTAL	412.152	100,0		439.786	100,0		443.190	100,0		107	101

If we analyze quality of assets with off-balance sheet risk items, we see that there is increase of classified assets (B-E) by 7% or KM 84 million, with simultaneous increase of poor quality assets (C-E) by 6% or KM 19 million. Further analysis of analytical data by sectors is based on the indicators of loan quality originated to two, the most significant sectors: citizens and private enterprises. During the observed period, poor quality assets related to the placements originated to the sector of citizens have decreased by 3% and amounted to KM 75 million, which represents 2,6% of total loans originated to citizens. Poor quality assets related to legal entities have also decreased by 5% and amounted to KM 220 million or 7,6% of total loans originated to legal entities.

In the first quarter of 2006, banks charged off from balance sheet to off-balance sheet, that is, they charged off claims of KM 13,5 million and suspended interest of KM 9,9 million. In the same period, there was permanent charge off of assets items of KM 3,2 million and suspended interest of KM 2,8 million. Banks succeeded in the same period to collect earlier charged off assets of KM 10,3 million and suspended interest of KM 3,8 million, which was positively reflected on their profitability.

At the end of the first quarter of 2006, balance of charged off assets was KM 386 million, which was almost the same amount as at the end of 2005, while balance of suspended interest was KM 58 million, which is higher by 6% or KM 3 million in comparison to the end of 2005.

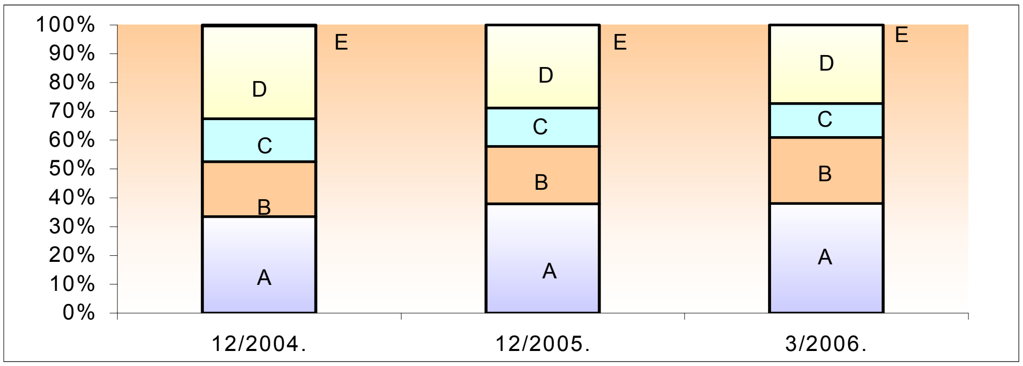
Out of total assets charged off, assets charged off based on loans originated to citizens were KM 42 million or 11%, and suspended interest was KM 6,1 million or 10,6%.

Level of general loan risk and potential loan losses by classification categories, as determined in accordance with the criteria and methodology prescribed by the FBA's Decisions, their trend and structure on the level of banking sector is presented in the following table and graph.

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

Classification category	AMOUNT (in 000 KM) AND STRUCTURE (in%)						RATIO	
	31.12.2004.		31.12.2005.		31.03.2006.		4/2	6/4
1	2	3	4	5	6	7	8	9
A	94.501	33,5	118.884	37,9	121.389	38,1	126	102
B	53.633	19,0	62.517	19,9	72.607	22,8	117	116
C	42.104	14,9	41.954	13,4	37.612	11,8	100	90
D	91.294	32,3	90.465	28,8	87.011	27,3	99	96
E	880	0,3	31	0,0	24	0,0	4	77
TOTAL	282.412	100,0	313.851	100,0	318.643	100,0	111	102

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



As reported in the statements, banks established loan loss reserves in accordance with the regulations and level of evaluated loan risk.

According to the analysis of established reserves in total amount and by classification categories, if compared to the end of 2005, reserves for general loan risk and potential loan losses are higher by 2% and they amounted to KM 319 million, that is, 2,8 % of total assets with off-balance sheet items. At the end of first quarter of 2006, banks in average allocated reserves for category B of 7,8%, for category C of 26,1%, for category D of 57% and category E 100%, which can be rated satisfactory.

Analysis of assets quality, that is, loan portfolio of individual banks, and based on on-site examinations of banks, indicates that loan risk is still a dominant risk in majority of banks, that is, existence of problem loans originated to legal entities (enterprises).
In banks with poor quality assets, the FBA ordered correction measures in regard to preparation of operating programs which have to include action plan aimed to improve existing loan risk management practices, that is assets quality, decrease existing concentrations, and resolve issues of poor quality assets and prevent their further deterioration. The FBA continuously monitors implementations of the orders through follow up procedures based on reports and other documentation submitted by banks, as well as through checks and controls during on-site examinations.

Transactions with related entities

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

In accordance with the Basle Standards, the FBA has established certain prudential principles and requirements related to transactions with related entities of banks[18], which is regulated in Decision on Minimum Standards for Bank's Operations with Related Entities, prescribing requirements and method of operations with related entities. The Decision and Law on Banks regulate the duty of Supervisory Board of a bank, which has to adopt, upon the proposal of the General Manager, special policies regulating operations with related entities and to monitor their implementation.

The FBA Decisions prescribe a special set of reports, which include transactions with one segment of related entities, such as loans and potential and undertaken off-balance sheet liabilities (guarantees, letters of credit, undertaken loan commitments) as the most frequent and the most riskiest form of transactions between a bank and related entities. The set of prescribed reports include data on loans originated to the following categories of related entities:

- Bank's shareholders over 5% of voting rights,
- Supervisory Board members and bank senior management and
- Subsidiaries and other enterprises related to a bank through capital

Table 22: *Transactions with related entities*

-000 KM-

Description	LOANS ORIGINATED			RATIO	
	31.12.2004.	31.12.2005.	31.03.2006.	3/2	4/3
1	2	3	4	5	6
Shareholders over 5% of voting rights, subsidiaries and other enterprises related to a bank through capital	40.084	28.520	29.024	71	102
Supervisory Board members	141	101	55	72	54
Bank Management and employees	2.392	2.663	2.372	111	89
TOTAL	42.617	31.284	31.451	73	101
Potential and undertaken off-balance sheet liabilities	3.235	911	1.301	28	143

These are the reasons why the FBA is emphasizing (in on-site examinations) bank's operations with related entities. The FBA on-site examiners issue orders for elimination of determined weaknesses within certain deadlines and initiate violation procedures, and part of the activity is also to monitor and supervise implementation of the issued orders. This has had a positive influence on this segment of operations, since the level of transactions with related entities has a decreasing trend, causing decrease in risk exposure to those entities.

2.2. Profitability

According to the non-audited data of income statements of banks in the first quarter of 2006, banks in the Federation of BiH reported positive financial result – profit of KM 28,6 million, which is higher by 93% than in the same period of 2005 on the system level. Trend of increase in profitability is mainly a result of growth in profit, although the loss has been significantly decreased.

Positive financial result of KM 31,5 million was gained by 17 banks, which is higher by 55,5% or KM 11,2 million than in the same period of 2005. At the same time, seven banks reported loss in their performance of KM 2,9 million (four state banks and three private banks), which represents a decrease of 46,6% or KM 2,5 million in comparison to the same period last year.

More detailed information is presented in the following table.

[18] Article 39, Paragraph 2 of Law on Changes and Amendments to the Law on Banks defines term "entities related to a bank", excluding employees from this list.

Table 23: *Financial result reported: profit/loss*

-000 KM-

Date/Description	Banking system		Private banks		State banks	
	Amount	No.of banks	Amount	No.of banks	Amount	No.of banks
31.03.2004.						
Loss	-5.261	9	-4.884	5	-377	4
Profit	15.541	17	13.895	14	1.646	3
Total	10.280	26	9.011	19	1.269	7
31.03.2005.						
Loss	-5.426	9	-4.725	5	-701	4
Profit	20.247	15	19.519	13	728	2
Total	14.821	24	14.794	18	27	6
31.03.2006.						
Loss	-2.898	7	-2.025	3	-873	4
Profit	31.487	17	31.070	15	417	2
Total	28.589	24	29.045	18	-456	6

Based on analytical data, as well as parameters for evaluation of profitability quality (level of realized financial result – profit / loss and ratios used for evaluation of profitability, productivity and effectiveness of performance, and other parameters related to evaluation of performance), we can conclude that improvement of the general profitability of the system comes from individual profitability of smaller number of large private banks. Financial result of state banks does not have any significant influence on general profitability of the banking system.

Out of total profit, only four large banks (assets of 69,3% of the banking system assets) reported profit of KM 24 million, which represents 83,8% of total profit of the banking system.

Out of total loss reported, one private bank reported KM 1,6 million or 53,6%.

Total income on the system level was KM 154,5 million; rate of growth was 21% or KM 26,5 million, which represents increase of 7 index points in comparison to the same period last year. Total non-interest bearing expenses were KM 125,9 million with rate of growth of 11% or KM 12,7 million, which represents the same rate of growth as in the first quarter of last year.

Total interest income increased by 23%. However, due to faster increase of interest expenses of 30%, there was somewhat slower increase of net interest income of 20%, which is by one index point less if compared to the same period in 2005.

Increase of interest income on loans of 22% in comparison to the same period of 2005 is slower by 2% than the increase of credit placements, which is a result of fall in interest rates and implementation of the provision of IAS 18 in majority of banks in 2006.

Significant growth of 37% in comparison to previous year is realized on the basis of interests on deposit accounts with depository institutions.

If compared to the same period last year, there has been significant growth of long-term interest-bearing sources (used for financing of growth in credit placements which were primarily used by banks to reach maturity adjustment) that caused faster growth of interest expenses with the rate of 30% and slower growth of net interest-bearing income with the rate of 20%.
Based on the mentioned, quality of structure of banks' total income did not improve, since total interest income was neutralized by increased participation of interest-bearing expenses in the structure of total income, which resulted by decrease of participation of net interest-bearing income in the structure of net income from 59,2% to 58,7%.

Operating income recorded faster growth than net interest income, and it increased by 22%, and their participation in structure of total income increased from 40,8% to 41,3% in comparison to the same period last year, although their participation decreased as a result of changes in the accounting policy in the segment of methodology of treatment and recognition of income based on fees related to loans[19] (applied in majority of banks).

Non-interest bearing expenses recorded slower growth with the rate of 11% in comparison to total income (growth of 21%) in comparison to the same period last year. Within the same category, loan loss provisions decreased by 4%, salary and contribution expenses increased by 13%, fixed assets expenses increased by 14% and other operating income increased by 21%.

Slower growth of non-interest bearing expenses was positively reflected through their participation in the structure of total income which decreased from 88,4% to 81,5% if compared to the same period last year, and the most significant decrease was in participation of loan loss provisions from 23,8% to 19,0% (as a result of assets quality of banks, that is, high participation of good assets classified in category A) and salary and contribution expenses from 29,7% to 27,8%.

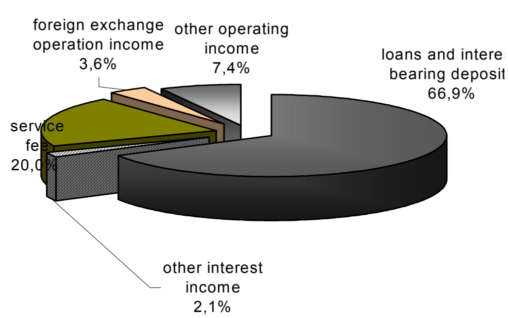
Trend and structure of total income and expenses is presented in the following tables and graphs:

Table 24: *Structure of total income*

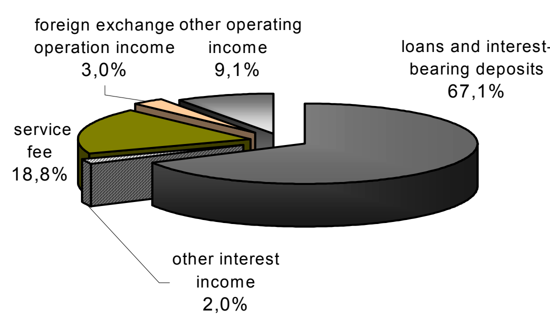
- in 000 KM-

Structure of total income	31.03.2004.		31.03.2005.		31.03.2006.		RATIO	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest income and similar type of income								
Interest bearing deposit accounts with depository institutions	6.119	4,3	9.806	5,8	13.413	6,5	160	137
Loans and leasing	83.119	58,4	102.689	61,1	125.311	60,6	124	122
Other interest income	3.330	2,3	3.494	2,1	4.172	2,0	105	119
TOTAL	92.568	65,0	115.989	69,0	142.896	69,1	125	123
II Operating income								
Service fees	29.591	20,9	33.643	20,0	38.866	18,8	114	116
Foreign exchange income	5.417	3,8	6.092	3,6	6.265	3,0	112	103
Other operating income	14.734	10,3	12.419	7,4	18.702	9,1	84	151
TOTAL	49.742	35,0	52.154	31,0	63.833	30,9	105	122
TOTAL INCOME (I + II)	142.310	100,0	168.143	100,0	206.729	100,0	118	123

Graph 14: *Sructure of total income*



31.03.2005.



31.03.2006.

[19]Implementation of IAS 18-Income and IAS 39-Financial instrument: recognition and measurement.

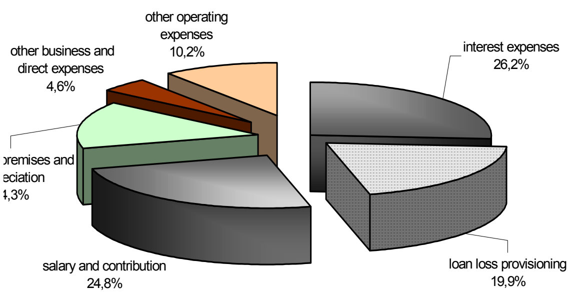
Table 25: *Structure of total expenses*

- in 000 KM-

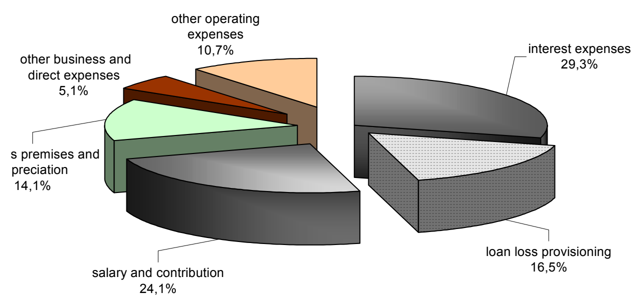
Structure of total expenses	31.03.2004.		31.03.2005.		31.03.2006.		INDEKS	
	Amount	%	Amount	%	Amount	%	4/2	6/4
1	2	3	4	5	6	7	8	9
I Interest expenses and similar expenses								
Deposits	24.186	18,3	31.500	20,5	39.657	22,3	130	126
Liabilities for borrowings	4.971	3,8	7.872	5,2	11.242	6,3	158	143
Other interest expenses	651	0,5	799	0,5	1.350	0,7	123	169
TOTAL	29.808	22,6	40.171	26,2	52.249	29,3	135	130
II Total non-interest bearing expenses								
General loan risk and potential loan losses provisioning	28.487	21,6	30.526	19,9	29.382	16,5	107	96
Salary expenses	33.754	25,6	37.940	24,8	42.960	24,1	112	113
Business premises and depreciation expenses	18.527	14,0	21.973	14,3	25.073	14,1	119	114
Other business and direct expenses	7.169	5,4	7.027	4,6	9.477	5,3	98	135
Other operating expenses	14.285	10,8	15.685	10,2	18.999	10,7	110	121
TOTAL	102.222	77,4	113.151	73,8	125.891	70,7	111	111
TOTAL EXPENSES (I + II)	132.030	100,0	153.322	100,0	178.140	100,0	116	116

Graph 15: *Sructure of total expenses*

31.03.2005.



31.03.2006.



The following tables present the most significant ratios[20] for evaluation of profitability, productivity and effectiveness of banks:

Table 26: *Ratios of profitability, productivity and effectiveness by periods*

-in %-

RATIOS	31.03.2004.	31.03.2005.	31.03.2006.
Return on Average Assets	0,72	0,77	1,21
Return on Average Total Capital	5,75	6,46	11,46
Return on Average Equity	6,89	7,79	15,06
Net Interest Income/Average Assets	4,08	3,93	3,84
Fee Income/Average Assets	3,43	2,71	2,70
Total Income/Average Assets	7,51	6,64	6,54
Operating and Direct Expanses21/Average Assets	2,20	1,95	1,64
Operating Expenses/Average Assets	4,55	3,92	3,68
Total Non-interest Expanses/Average Assets	6,76	5,87	5,33

[20] The ratios are calculated on annual basis.
21 Expenses include provisions for potential loan losses.

Table 27: *Ratios of profitability, productivity and effectiveness as of 03/31/ 2006*

-in %-

RATIOS	31.03. 2006. STATE BANKS	PRIVATE BANKS	AVERAGE IN THE FBiH
Return on Average Assets	-0,43	1,29	1,21
Return on Average Total Capital	-1,09	13,98	11,46
Return on Average Equity	-1,25	18,92	15,06
Net Interest Income/Average Assets	3,29	3,86	3,84
Fee Income/Average Assets	4,28	2,63	2,70
Total Income/Average Assets	7,57	6,49	6,54
Operating and Direct Expanses/Average Assets	3,59	1,55	1,64
Operating Expenses/Average Assets	4,41	3,65	3,68
Total Non-interest Expanses/Average Assets	8,00	5,20	5,33

Based on the analysis of general parameters for evaluation of profitability quality, we come to the two most important indicators of profitability: ROAA (Return on Average Assets) of 1,21% and ROAE (Return on Average Equity) of 15,06%, which are significantly better than in 2005.

Productivity of banks, measured by ration between total income and average assets (6,54%), as well as realized net interest and operating income per average assets, deteriorated, which was caused by further growth of average assets (23%) to growth of net interest income (20%), then trend of decrease of interest rates, faster growth of long term loans and increase of their participation in total loans, faster growth of interest expenses, on one side, and slower growth of average interest-bearing assets than average total assets.

Profitability of banks in the following period will still depend on assets quality, that is, exposure of banks to credit risk, and effective operating expenses management. That is why, the key factor of effectiveness and profitability of each bank is management quality and business policy the management is following, since this is the most direct way to influence its performance.

In addition, under the new market conditions, banks are more willing to adopt new concept of business policy aimed to market oriented banking in order to gain more profit, providing for bank stability and adequate management and control of all risks a bank is exposed to, and primarily to credit risk. However, by entering international financial operations and market, banks will in future be more exposed to market risks: interest rate risk, foreign exchange and price risk, as well as indebtness risk, which will require further strengthening of capital base, not only from internal sources through increase of retained income from profit, but from external sources, which is at the same time a precondition for further expansion and growth of banks.

2.3. Liquidity

Liquidity risk management, along with credit risk, is one of the most compound and most important segments of banking operation. Maintaining liquidity in market economy is a permanent task of a bank and main precondition for its sustainability in financial market. This is also one of the key preconditions for establishment and maintenance of trust in banking system of any country.

Decision on Minimum Standards for Liquidity Risk Management prescribes minimum standards a bank has to establish and maintain in the process of managing this risk, that is, minimum standards to create and implement liquidity policy, which assures bank's ability to fully and immediately performs its liabilities as they become due.

In general, the mentioned regulation represents a framework for liquidity risk management and qualitative and quantitative provisions and requirements towards banks. It prescribes limits banks have to meet in regard to average ten-day minimum and daily minimum of cash assets in relation to short-term sources, as well as minimum limits of maturity adjustment of the instruments of financial assets and liabilities up to 180 days. In addition, it sets requirement by which the reports on liquidity position and maturity adjustment have to be submitted to the FBA[22].

Analysis of liquidity risk exposure and liquidity position of banks individually and of the entire banking system is based on the submitted set of reports related to the segment of liquidity, including all other relevant data from other reports, as well examination performed by on-site examiners of bank's liquidity position adequacy and practices in management of sources in relation to its risk.

For the last three years, banks in the Federation of BiH, upon orders issued by the FBA, have implemented intensive activities in order to improve their maturity adjustment of financial assets and liabilities, which was significantly undermined in the preceding period due to credit expansion of primarily long term loans financed from the sources (deposits mostly) that did not have adequate maturity. The implemented activities and measures had positive effect on decrease of imbalance in maturity profiles of assets and liabilities, and the result was adjustment within prescribed limits.

In the structure of financing sources of banks in the Federation of BiH, deposits have the highest participation of 72,9%, while for the last three years participation of borrowings has also increased (as of 31.03.2006., it was 12,3%), which have longer maturity and represent good quality source for long term placements, and have significantly contributed to the maturity adjustment of assets and liabilities.

On the other hand, maturity structure of deposits is much worst, although we have trend of improvement for longer period of time. Liquidity risk is closely correlated with other risks, and in this case, it has adverse effect to the profitability of banks.

Table 28: *Maturity structure of deposits*

- in 000 KM-

DEPOSITS	31.12.2004.		31.12.2005.		31.03.2006.		RATIO	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Savings and demand deposits	2.663.053	47,5	3.264.937	47,5	3.379.406	47,6	123	104
Up to 3 months	389.395	7,0	408.679	6,0	445.522	6,3	105	109
Up to 1 year	490.685	8,8	541.832	7,9	544.526	7,7	110	100
1. Total S-T	3.543.133	63,3	4.215.448	61,4	4.369.454	61,6	119	104
Up to 3 years	1.367.882	24,4	1.709.665	24,9	1.831.789	25,8	125	107
Over 3 years	691.223	12,3	938.935	13,7	893.632	12,6	136	95
2. Total L-T	2.059.105	36,7	2.648.600	38,6	2.725.421	38,4	129	103
TOTAL (1 + 2)	5.602.238	100,0	6.864.048	100,0	7.094.875	100,0	123	103

In maturity structure of deposits, there have been smaller changes within two main groups of maturity. Demand deposits recorded the highest nominal growth of 4% (rate of growth of 4%) within short-term deposits. Observed on the sector level, government institutions deposits recorded the highest nominal growth of KM 184 million or 32% out of all term deposits. Term

[22] Report on liquidity position is submitted per decade, and Report on maturity adjustment of financial assets and liabilities and List of 15 largest sources of bank is submitted quarterly.

deposits up to three months increased by 9% or KM 37 million, while term deposits over three months up to one year recorded minimum increase of approximately three million KM.

Growth realized in long-term deposits (3%) that was lower than in short-term deposits (4%) influenced their participation which was decreased from 38,6% to 38,4%. We should emphasize that there is a dominant participation of long term deposits in two sectors: citizens of 44,2% and banking institutions of 31,6%, where citizen deposits make 57,4% of term deposits up to three years, and, in term deposits over three years, the funds of banking institutions participate with 64%.

In the function of planning necessary level of liquid resources, banks have to plan for sources and structure of adequate liquidity potential, along with planning of credit policy. Maturity of placements, that is, credit portfolio is determined by maturity of sources. Since maturity transformation of assets in banks is inherently connected to the functional characteristics of banking performance, banks continuously control and maintain maturity imbalance between sources and placements within prescribed minimum limits.

Table 29: *Maturity structure of loans*

-in 000 KM-

LOANS	31.12.2004.		31.12.2005.		31.03.2006.		INDEX	
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	4/2	6/4
1	2	3	4	5	6	7	8	9
Pastdue claims and paid off-balance sheet liabilities	214.244	4,8	218.406	3,9	250.795	4,3	102	115
Short term loans	991.183	22,4	1.134.850	20,5	1.206.456	21,0	115	106
Long term loans	3.217.112	72,8	4.192.050	75,6	4.301.297	74,7	130	103
TOTAL LOANS	4.422.539	100,0	5.545.306	100,0	5.758.548	100,0	125	104

In the first quarter of 2006, there was faster growth of short-term loans (growth rate of 6%), than long-term loans (3%), which resulted by decrease in participation of long-term loans in total loans from 75,6% to 74,7%. Analysis of the sector by maturity indicates that participation of long-term loans in total loans originated to citizens is 89%, and to private enterprises is 60%.

Although loans, as the most significant assets category, recorded growth of 4% during the observed period, and reached participation of 59,2%, cash assets had almost the same rate of growth (5%), but their participation increased from 37,7% to 38%.

In 2005, banks were regularly meeting required reserves with the Central Bank of BiH. At the end of 2005, the regulation changed and required reserves increased. The effective date of the change was December 1, 2005, when the required reserve increased from 10% to 15%. In BiH, under the environment of Currency Board and relatively financially underdeveloped market, required reserve as the most significant instrument of monetary policy is used to meet a primary monetary purpose, that is, monetary control, in sense of stopping fast credit growth from the past years and decrease multiplications. On the other hand, implementation of regulation on foreign exchange risk and maintenance of currency adjustment within prescribed limits also significantly influence the amount of funds banks keep on the reserve account with the Central Bank in domestic currency, which provides for high liquidity of individual banks and the banking sector.

In liquidity analysis, we use several ratios, and list of the most significant is presented in the following table:

Table 30: *Liquidity ratios*

- in % -

Ratios	31.12.2004.	31.12.2005.	31.03.2006.
1	2	3	4
Liquid assets[23] / Total assets	37,3	37,8	38,1
Liquid assets / Short term financial liabilities	60,5	63,9	62,9
Short term financial liabilities / Total financial liabilities	70,4	66,9	68,5
Loans / Deposits and borrowings[24]	68,5	69,2	69,4

All the mentioned indicators of liquidity indicate that liquidity position of the banking system in the Federation of BiH is good, with satisfactory participation of liquid assets in total assets and coverage of short-term liabilities by liquid assets. Maturity structure of sources, primarily deposits, as well as realized higher increase of short-term financial liabilities (deposits) caused some slight deterioration of structural indicators for participation of short-term liabilities in total financial liabilities, although this is just conditional, since more relative indicator is the ration of short-term liabilities and short-term financial assets based on the criteria of remaining maturity. The last indicator expressed as ratio between loans and financing sources (deposits and borrowings) is also very good and it meets the level of feasible standard, although it has decreased (by 0,2%) in comparison to 2005.

Regulatory requirements prescribed towards banks are quite restrictive, which resulted in good liquidity of banks individually and the entire banking system. All banks continuously meet prescribed minimum over the average, requirement of ten-day average of 20% in relation to short-term sources, and daily minimum of 10% according to the same basis, which is presented in the following table.

Table 31: *Liquidity position –ten-day average and daily minimum*

Description	31.12.2004.	31.12.2005.	31.03.2006.	RATIO	
	Amount	Amount	Amount	3/2	4/3
1	2	3	4	5	6
1. Average daily balance of cash assets	2.502.469	2.687.043	2.817.824	107	105
2. Minimum total daily balance of cash assets	2.305.200	2.371.336	2.380.621	103	100
3. Short term sources (accrual basis)	3.598.348	4.165.268	4.255.318	116	102
4.Liabilities:					
4.1. ten-day average 20% of Item 3	719.670	833.054	851.064	116	102
4.2. daily minimum 10% of Item 3	359.835	416.527	425.532	116	102
5.Meeting requirement: ten-day average Surplus = Item 1 – Item 4.1.	1.782.799	1.853.989	1.966.760	104	106
6. Meeting requirement: daily minimum Surplus = Item.2 – Item 4.2.	1.945.365	1.954.809	1.955.089	100	100

Apart from the mentioned prescribed minimum standards, monitoring of remaining maturity of financial assets and liabilities according to the time scale is of crucial significance for the liquidity position analysis. The time scale is, from the aspect of prescribed minimum limits, created based on time horizon up to 180 days.

[23] Liquidity assets in the narrow sense: cash and deposits and other financial assets with maturity below three months, except inter-banking deposits.
[24] Feasible standards: below 70%-very sound, 71%-75%-satisfactory, 76%-80%-marginal to satisfactory, 81%-85%-insufficient, over 85%-critical.

Table 32: *Maturity adjustment of financial assets and liabilities up to 180 days*

Description	31.12.2004. Amount	31.12.2005. Amount	31.03.2006. Amount	RATIO 3/2	RATIO 4/3
1	2	3	4	5	6
I. 1- 30 days					
1. Financial assets	3.357.819	4.051.257	4.286.541	121	106
2. Financial liabilities	3.121.488	3.668.868	3.860.409	118	105
3. Difference (+ or -) = 1-2	236.331	382.389	426.132	162	111
Accrual of requirement in %					
a) Performed %= Item 1 / Item 2	107,6%	110,4%	111,0%		
b) Required minimum %	100,0%	100,0%	100,0%		
Surplus (+) or shortage (-) = a – b	7,6%	10,4%	11,0%		
II. 1-90 days					
1. Financial assets	3.723.961	4.559.015	4.760.901	123	104
2. Financial liabilities	3.496.272	4.150.956	4.368.659	119	105
3. Difference (+ or -) = 1-2	227.689	408.059	392.242	179	96
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	106,5%	109,8%	109,0%		
b) Required minimum %	100,0%	100,0%	100,0%		
Surplus (+) or shortage (-) = a – b	6,5%	9,8%	9,0%		
II. 1-180 days					
1. Financial assets	4.188.159	5.091.381	5.268.677	122	103
2. Financial liabilities	3.877.037	4.598.836	4.875.437	119	106
3. Difference (+ or -) = 1-2	311.122	492.545	393.240	158	80
Accrual of requirement in %					
a) Performed %= Item 1 / Item.2	108,0%	110,7%	108,1%		
b) Required minimum %	95,0%	95,0%	95,0%		
Surplus (+) or shortage (-) = a – b	13,0%	15,7%	13,1%		

Minimum limits prescribed for maturity adjustment of assets and liabilities represent minimum standards that banks have to include in their policies. Each bank has to create and implement its own internal models for liquidity management and liquidity strategy, as composite part of its liquidity risk management program. This means a continuous measuring and monitoring of net financing source needs in order to identify in advance a possibility of having net deficit of liquid assets and to take timely activities to provide for additional funds.

Banks are also required to adopt contingency plans with clear definition of action strategy to implement in case liquidity position is undermined. This is especially important for banks in the Federation of BiH, having in mind that the Central Bank of BiH does not have a role of «lender of last resort», but on the other hand, taking into account ownership structure of our banks, majority of banks have access to financial funds and support from their founders-owners.

Liquidity of the banking system of the Federation of BiH, based on the presented indicators, is high, which is a result of existing restrictive regulation. Since this segment of performance and level of liquidity risk exposure is in correlation with credit risk, and having in mind increasing trend and level of credit risk, banks will in future have to pay more attention to liquidity risk management through establishment and implementation of liquidity policies, which will make sure that all matured liabilities of banks are timely realized, based on continuous planning of future liquidity needs and taking into account changes in operating, economic, regulatory and other segments of business environment of banks. The FBA will both through reports and on-site examination in banks monitor how banks manage this risk and if they acted in accordance with the adopted policies and programs.

2.4. Foreign exchange risk – foreign currency adjustment of balance sheet and off-balance sheet assets and liabilities

While operating, banks are exposed to significant risks coming from potential losses in balance sheet and off-balance sheet items created as a result of price changes in the market. One of those risks is foreign exchange risk (FX) created as a result of changes of exchange rates and/or imbalance in assets, liabilities and off-balance sheet items of the same currency – individual foreign currency position or all currencies together used by a bank in its operations – total foreign currency position of bank.

In order to enable implementation of prudential principles in foreign exchange activities of banks and to decrease influence of foreign exchange risk to their profitability, liquidity and capital, the FBA issued Decision on Minimum Standards for Foreign Exchange Risk Management in Banks that regulates minimum standards for adoption and implementation of programs, policies and procedures for undertaking, monitoring, control and management of foreign exchange risk.

Imbalance (difference) between the items relating to individual foreign currency in assets and liabilities of balance sheet and off-balance sheet represents an open foreign currency position (long or short), which can vary only within the minimum limits prescribed and calculated in relation to the amount of bank's core capital.[25]

Banks daily report to the FBA as part of the monitoring of prescribed limits.

Based on examination, monitoring and analysis of submitted reports on foreign currency position of banks, we can conclude that banks meet prescribe limits and perform their FX activities within those limits. FX risk management in each bank is based on adopted program that includes detailed policies for FX risk management and procedures for monitoring, implementation, measuring and control of FX risk.

Since the Central Bank functions as Currency Board and EURO is anchor currency of the Currency Board, in practice banks are not exposed to foreign exchange risk in case of the most significant currency EURO. However, during the past two years, based on the order issued by the FBA, banks have started taking significant activities to comply to the prescribed limits and to eliminate huge currency imbalances and incompliance, most of them in EURO. Method of compliance, then maintaining of foreign currency position in accordance with prescribed limits, was specific to individual bank and mostly determined by balance sheet and currency structure of balance sheet assets and liabilities.

As of 31.03.2006., currency structure of banks' assets on the level of banking system recorded participation of items in foreign currencies of 26% or KM 2,5 billion (the same at the end of 2005). On the other hand, currency structure of liabilities is significantly different, since participation of liabilities in foreign currency is 55% or KM 5,4 billion (at the end of 2005, it was 56% or KM 5,2 billion).

Furthermore, if we analyze structure of foreign currencies, we will see a dominant participation of EURO in financial assets[26] of 80% or KM 2 billion (at the end of 2005, it was 77% or KM

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[25] Article 8 of Decision on Minimum Standards for Capital Management of Banks determines limits for individual foreign currency position in EURO up to 30% of core capital, for other currencies up to 20% and foreign currency of bank up to 30%.

[26] Form 5-Foreign currency position: portion of financial assets (foreign currencies denominated in KM). According to prescribed methodology, financial assets are expressed per net principle (loan loss reserves deducted).

1,9 billion), and in liabilities of 90% or KM 4,9 billion (at the end of 2005, it was 89% or KM 4,7 billion).

However, the accrual of FX risk exposure include amount of indexed assets items (loans) and liabilities[27], especially significant in assets[28] with participation of 57% or KM 3,3 billion, while participation of other items in EURO was 34% or KM 2 billion, and in other currencies 8,6% (at the end of 2005, indexed loans participated with 56% or KM 3,2 billion, and items in EURO with 34% or KM 1.9 billion).

On the other side, structure of financial liabilities restricts and determines structure of financial assets for individual currencies. Items in EURO (deposits mostly) have the highest participation in liabilities of 87% or KM 4,8 billion, while participation and amount of indexed liabilities is at minimum of 3,6% or KM 210 thousand (at the end of 2005, liabilities in EURO participated with 86% or KM 4,7 billion, and indexed liabilities with 3,5% or KM 190 thousand).

The following table presents structure and trend of financial assets and liabilities and foreign currency position for EURO as the most significant currency[29] and total:

Table 33: *Foreign currency adjustment of financial assets and liabilities (EURO and total)*

-in million KM-

Description	31.12.2005.				31.03.2006.				RATIO	
	EURO		TOTAL		EURO		UKUPNO		EURO	TOTAL
	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	Amount	Partic. %	6/2	8/4
1	2	3	4	5	6	7	8	9	10	11
I. Financial assets										
1. Cash assets	1.217	23,8	1.706	30,0	1.299	24,4	1.739	29,9	107	102
2. Loans	598	11,7	653	11,5	611	11,5	655	11,3	102	100
3.Loans with currency clause	3.198	62,5	3.203	56,3	3.327	62,6	3.333	57,3	104	104
4. Other	105	2,0	124	2,2	79	1,5	93	1,6	75	75
Total (1+2+3+4)	5.118	100,0	5.686	100,0	5.316	100,0	5.820	100,0	104	102
II. Financial liabilities										
1. Deposits	3.447	70,9	3.956	73,1	3.565	70,95	4.062	72,6	103	103
2. Borrowings	1.052	21,7	1.093	20,1	1.102	21,8	1.142	20,4	105	104
3.Deposits and loans with currency clause	190	3,9	190	3,5	201	4,0	201	3,6	106	106
4.Other	170	3,5	176	3,3	187	3,7	189	3,4	110	107
Total (1+2+3+4)	4.859	100,0	5.415	100,0	5.055	100,0	5.594	100,0	104	103
III. Off-balance sheet										
1.Assets	11		13		10		52			
2.Liabilities	196		197		239		240			
IV.Position										
Long (amount)	74		86		33		39			
%	8,2%		9,6%		3,5%		4,2%			
Short										
%										
Limit	30%		30%		30%		30%			
Below limit	21,8%		20,4%		26,5%		25,8%			

[27] As headging instrument for exchange rate changes, banks contract certain assets items (loans) and liabilities with currency clause – they are almost all tied to EURO (regulation allows only two-way currency clause).

[28] Financial assets, which include items in foreign currency, denominated in KM and loans with currency clause.

[29] Source: Form 5-Foreign currency position.

Observed by banks and total on the level of the banking system of the FBiH, we can conclude that banks are exposed to FX risk within prescribed limits.

As of 31.03.2006., there were 13 banks with long foreign currency position, and 11 banks with short position, so on the system level long foreign currency position represented 4,2% of core capital of banks, which was less by 25,8% than the limit. Individual foreign currency position for EUR was 3,5%, where financial assets items were higher than financial liabilities (long position).

Although in the environment of the Currency Board banks are not exposed to foreign exchange risk in the most significant currency EUR, they are still required to operate within prescribed limits for individual currencies and for total foreign currency position, and to daily manage this risk in accordance with adopted programs, policies, procedures and plans.

III. CONCLUSION

Consolidation and stabilization of the banking sector of the Federation of BiH have 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 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 area of whole Bosnia and Herzegovina;
- Continuously build legal regulation for banking system and financial system based on 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, leasing companies, 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 the upcoming period, the Banking Agency of the Federation of BiH shall:

- Proceed with a continues supervision of banks through on-site and off-site examinations, emphasizing targeted examination of dominant risk segments of banking operations, which will make supervision more frequent and effective;
- Finalize remaining provisional administrations based on the Conclusion of the FBA's Management Board of 29.03.2006. and accelerate liquidation processes;
- Insist on strengthening of capital in banks, especially those that have recorded rapid growth in assets;
- 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 of becoming part of European Union;
- 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;
- Continuous operational development of the new IT 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;
- Organize counseling and provide advising about implementation 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 assets quality;
- Strengthen internal control systems and establish internal audits, which will be fully independent in their work;
- 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;
- Staff training and professional development;
- Maintaining prevention of money laundering and terrorism financing by implementation of adopted policies and procedures;
- Consider potential implications of the 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.