

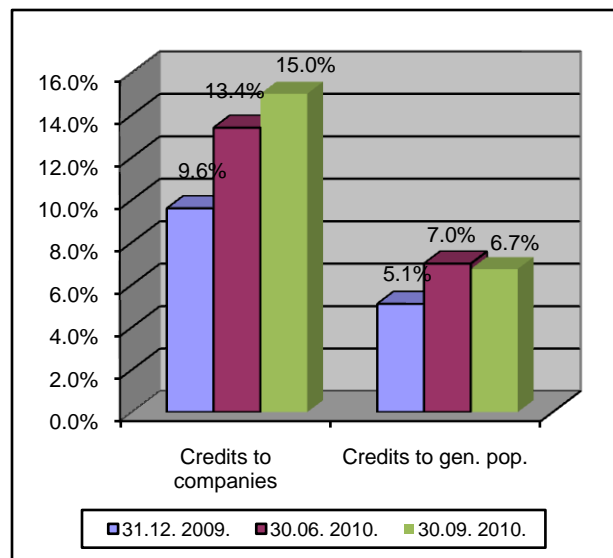
Banking sector still focuses on mere survival

Weakening of credit portfolio, decreased deposits and continued unfavorable investment climate in RS have made banks in RS preserve the existing credit exposure and safeguard remaining funds. Such credit policy, however, unless it does not last too long, can come back like a boomerang to the banking sector, because it makes the position of real economy sector significantly difficult. On the other hand, what is encouraging is the information on continued growth of deposits by population and on gradual economic recovery of the EU.

Credit portfolio continues to weaken

The first three quarters of 2010 were marked by a trend of weakening of abilities of domestic debtors to pay monthly payments for their credits to banks in RS. The percentage of bad credits (listed in several categories – C and D) in the number of all credits was growing constantly, from 7.7% at the beginning of 2010 to 11.7% at the end of the third quarter that year. This information tells us of still difficult situation that domestic economy has been in and of low liquidity ratio and confirms the rule that bad situation in economy must sooner or later reflect itself on the banking sector. What especially worries is the amount of bad credits in the sector of companies, which reached 15% at the end of the third quarter. Indicative is information that the amount of suspicious credits (category D) to companies was more than doubled in the first nine months of 2010, reaching the amount of 49 million

Participation of bad credits in credit payments of banks in RS



Source: Agency for Banking of RS

credits to companies were rescheduled, giving a full image of the difficult situation. Even though statistical data on trends in real economy sector show that gradual recovery of domestic economic activity has been occurring, it is apparent that more time has to elapse so this trend could turn into a more significant financial recovery of domestic companies. Therefore, in the forthcoming period additional deterioration of credit portfolio can be expected, before gradual recovery begins.

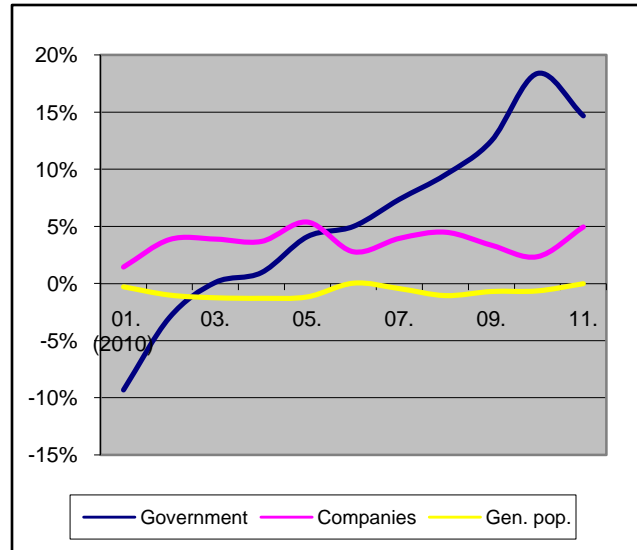
Participation of bad credits in credits to general population was somewhat lower and at the end of the third quarter it was 6.7%. Even though at first it appeared that negative trend had stopped in this segment, the main reason for this could have lied in writing-off of major part of debts in bad credits of general population on the account of reserves, due to classification to the worst risk category (18 million

BAM of debts were written-off in the case of one bank in RS in 2010, according to the Agency for Banking of RS).

Maintaining the existing credit exposure

Credit payments in RS, as well as in entire B&H, have not shown signs of more significant growth for the second consecutive year. In the first three quarters, banks in RS realized minimal credit growth of 2%. Such situation was predictable, having in mind mentioned deterioration of credit portfolio, more rigorous crediting policy and decreased level of investment activities in private sector. More significant growth in the first three quarters of 2010 in RS was realized only in the sector of Government and Government's institutions (+12%), as a response to difficult fiscal position, which was a continuation of the last year's trend. According to the Agency for Banking of RS, most of the new debt within this sector in 2010 was related to local communities, so one can hope that those funds were used for

Credits payments made per major sectors in B&H (change in comparison with December 31, 2009)



Source: Agency for Banking of RS

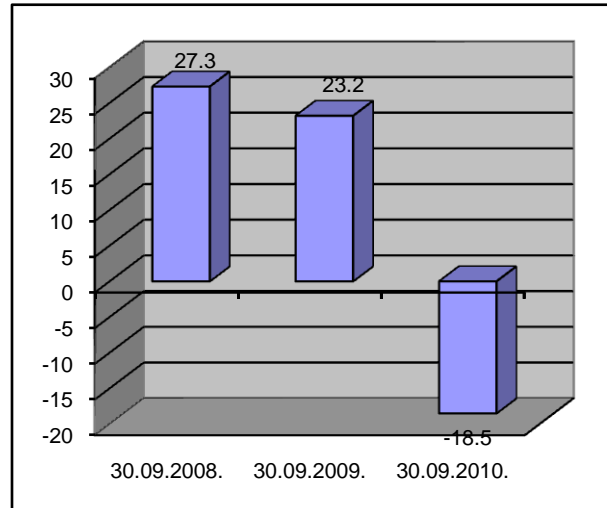
investment projects, and not current expenditure. As for the credits to general population, their level at the end of the third quarter of 2010 was equal to the level from the end of 2009, while the number of credits to companies increased by 2% over the same period.

It is important to mention that domestic demand, and therefore economic growth, will not be able to fully recover without the continuation of crediting activity of banks, since domestic consumption over the previous period was largely financed by credit indebtedness. The appearance of growth trend in credit payments will also pose a strong signal of a more complete departure from economic crisis.

Banks losing profit

The banking sector of RS did business negatively in the first three quarters of 2010 realizing negative financial result in the amount of 18.5 million BAM. This result was an unexpected consequence of decreased banks' crediting activity, which affected the decrease of this most important source of profit, and of the weakening of credit portfolio, which brought to significant increase of reserving costs for crediting and other losses of banks. Six banks in RS did business positively in the first three quarters, with realized total profit, before taxation, of 20.4 million BAM, while four banks had loss of 36.2 million BAM. In the next period, unless there is a more significant recovery in crediting activity, banks will be forced to reconstruct their costs in a more aggressive way. This is primarily related to the costs of operation, which participate with 39% in total costs and are in major part related to wages and premises rent. At the end of the third quarter these costs increased by 5% in comparison to the year before, suggesting that banks still have not reached for this measure.

Realized nett profit of banks in RS

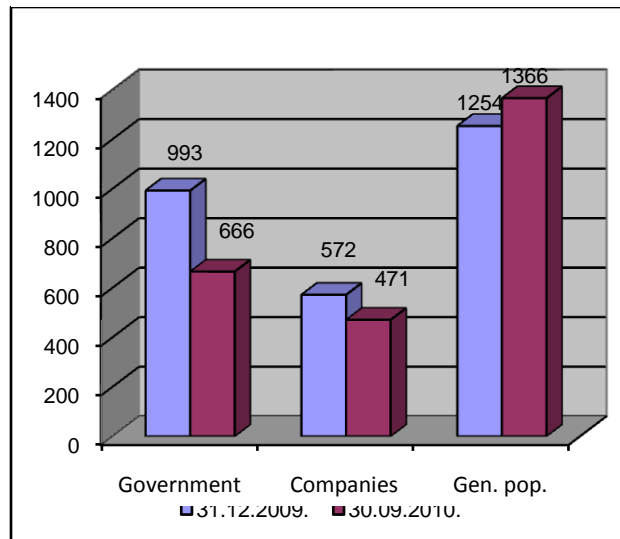


Source: Agency for Banking of RS

Deposits decrease

In the first three quarters of 2010 bank deposits in RS decreased by 5%, by which the fall trend from the previous year was continued (in 2009 deposits fell by 12%). The decrease of deposits negatively affected the already low readiness of banks to pay grant new credits, and it also reflected on their liquidity. The biggest decrease of deposits in the first three quarters of 2010 occurred in the sector of the Government and Government's institutions (-33%), which portrayed the continuation of withdrawal of funds available from the privatization. The decrease of deposits by private companies of 18% portrayed the chronic problem of liquidity in that sector and it went hand in hand with registered increase of delayed credit settlements. Sector of public and state-owned

Movements of deposits per selected sectors



Source: Agency for Banking of RS

companies, however, realized an increase of even 42%, but this occurrence was mostly caused by increased deposits by the Power Utility of RS ("Elektroprivreda RS"). Actual positive trend appeared in the area of deposits by general population with a growth of 9% in the first three quarters of 2010. Deposits by banking institutions maintained very important participation in total bank deposits in RS of 21% and were amounting to 822 million BAM. Such a significant participation of deposits by banking institutions pointed to a high level of dependability of domestic banking system on foreign mother banks and to possible jeopardized liquidity of some banks in an event of a sudden withdrawal of these deposits. Therefore, it is of utmost importance to monitor the nature of these relationships and financial state of mother banks by domestic control bodies.

The banking sector as a whole relatively stable after all

Basic indicators of the security of the banking sector of RS were, despite everything, at a relatively satisfying level. Capital adequacy rate did not decrease more significantly even despite a 10% growth of pondered risk in the first three quarters of 2010. The reason for that was the fact that most of the profit realized in 2009 had been distributed to the item of capital (83.4%), while only a minor part had been paid through dividend (16.6%). According to the Agency for Banking of RS, only one bank in RS made dividend payment in 2009. One can conclude from this that banks were expecting additional losses and costs in 2010

Capital Adequacy

Capital adequacy rate of banks in RS, which represents the measure of nett capital in relation to total risks of business operation, on September 30, 2010, amounted to 15.1%, which represented a decrease in comparison to December 31, 2009, when it had been 15.8%. Defined minimal capital

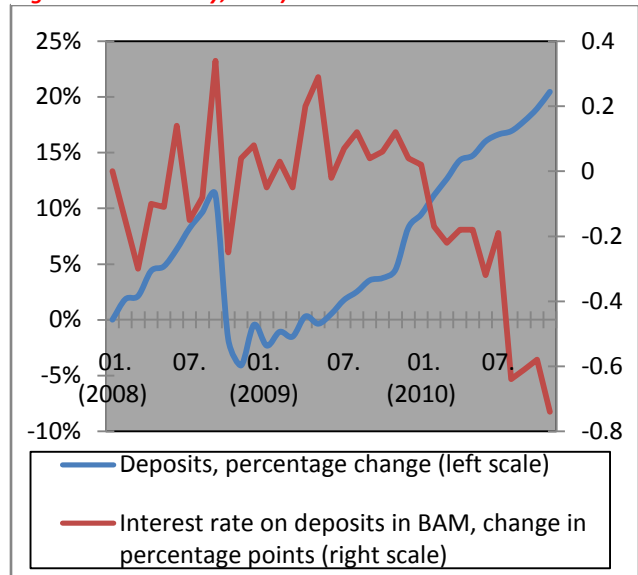
and that this was one of the ways to keep business parameters on a satisfying level. However, since one can expect further deterioration of credit portfolio and increase of total pondered risk in the forthcoming period, additional recapitalization will probably be necessary for a number of banks. Recapitalization needs probably will not be equal for all banks and they will depend on the range of crediting losses and tendencies and structure of pondered risk with certain banks.

Liquidity of the banking sector of RS, even though having been mildly weakened, was preserved, having in mind that the amount of funds owned by banks significantly surpassed the defined minimum of liquidity. Still, the amount of funds decreased by 15% in the first three months of 2010 in comparison to the end of 2009, primarily thanks to the decrease of deposits. It was interesting to witness that on September 30, 2010, banks in RS held 446 million BAM or 35% of all their funds on accounts abroad. This information pointed to banks' caution regarding their liquidity and limited development level of domestic interbank market of money and potential lack of sufficiently attractive domestic projects in light of increased aversion towards risk.

Deposit interest rates fall

Interest rates on total bank deposits in RS kept falling during 2010. It appears that the trend of increase of deposits was having encouraging effect on banks, which were gradually decreasing passive interest rates. Since deposits by general population participating with 35% represented the biggest sector in total deposits, one is not surprised by the effect of movements of the level of these deposits onto bank passive interest rates. By monitoring comparative movements of deposits by general population and interest rates on deposits by general population, it can be seen that these two variables had pretty precise inverted movement over the last three years. Besides the amount of deposits by general population onto the level of passive interest rates, other factors had influence as well, such as: movement of the level of other deposits, level of referent interest rates at European interbank market, availability of other sources of financing, current levels of liquidity of banks and expectations for period to come. Level of liquidity of some banks, and thereby their need for money, was significantly different, which was confirmed by the information on significantly different levels of offered interest rates on deposits.

Ratio of amount of deposits by general population and interest rates on deposits by general population in B&H (changes in regards with January, 2008)



Source: Central Bank of B&H