Cocozza, Emidio; Fabbrini, Alessandro; Gisolo, Enrico; Gresti, Maurizio; Micucci, Giacinto

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Banking and Financial Sector in South-eastern Europe

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Banking and Financial Sector in the Countries of South Estern Europe

by Emidio Cocozza*, Alessandro Fabbrini**, Enrico Gisolo***, Maurizio Gresti**** and Giacinto Micucci**

Abstract

Notwithstanding considerable efforts on the legal and institutional fronts, financial markets in many transition countries countries are still fragile and too thin in order to fulfil their economic functions. The enforcement of rules, good practices and legal provisions – albeit formally stated – is often hampered by remaining deficiencies in the surveillance agencies and by the behaviour of agents which are not completely accustomed to market oriented mechanisms. This paper summarises the structure of the financial systems, particularly of the banking sector, in European south-eastern countries (Albania, Bosnia Herzegovina, Bulgaria, Croatia, Macedonia FYR, Romania, Yugoslavia FR) and Slovenia. Reforms and economic development in these countries are at a very different stage; however it could be of some interest to summarise some common regional features such as development patterns in the last decade, banking reforms, size and role of the financial system and banking crisis. This is done in the first part of this paper. Country specific profiles are presented in the second part.

* Banca d'Italia Bari (Italy), Economic Research Unit (cocozza.emidio@insedia.interbusiness.it)
** Banca d'Italia Ancona (Italy), Economic Research Unit (fabbrini.alessandro@insedia.interbusiness.it)
(micucci.giacinto@insedia.interbusiness.it)
*** Banca d'Italia Venezia (Italy), Economic Research Unit (gisolo.enrico@insedia.interbusiness.it)
**** Banca d'Italia Trieste (Italy), Economic Research Unit (gresti.maurizio@insedia.interbusiness.it)

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Country Profile

1. Summary and conclusions [1]

The paper analayzes the banking and financial sector in the Republics of former Yugoslavia (Bosnia and Herzegovina, Croatia, Macedonia FYR, Slovenia, Yugoslavia FR), Albania, Bulgaria and Romania which, except Slovenia, are commonly referred to as South-Eastern Europe (thereafter SEE-8). The countries in the region share the legacy of a centrally planned economy. Their transition paths and economic performances were marked, however, by initial conditions, political systems and economic structures which widely differed, ranging from extremely closed and predominantly rural Albania to the heavily industrialised Yugoslavia FR and the Western trade-oriented Slovenia. In the transition process SEE-8 countries are less advanced than Central European countries but ahead of other transition countries such as most of the former USSR republics. Following a deep recession in the early 1990s, growth recovered in all countries but only for few of them it was stable and sustainable; some countries were beset between 1996 and 1999 by a banking and financial crisis showing the fragility of the results achieved so far: privatisation, legal and institutional reforms were not enough. At the same time, the reform and reorganisation of the financial system proved to be particularly difficult. The persistence of a wide "grey area" in banks' corporate governance, management, credit practices, linkages to enterprises and government financing, left inefficiencies and structural weaknesses in the banking sector. Moreover, banking reform is a politically sensitive issue both for the social and the economic consequences of banks' failures and because banks are the main vehicle for the transmission of monetary and financial impulses to the economy and the main instrument for the implementation of stabilisation programs. On the other hand central banks often lack the expertise, the independence, sometimes even the structures and the authority to adequately perform the surveillance function entrusted to them. Financial and banking crises in the SEE-8 region mainly originated from the microeconomic mismanagement of single intermediaries often linked to the risky environment, lax surveillance rules and corruption. Sometimes, like in Croatia in 1998, macroeconomic imbalances and a tight monetary and fiscal stance exacerbated the banking crisis; in other cases, like in Albania, notwithstanding dramatic social consequences the financial crisis had only a marginal impact on banks and enterprises because the size of credit intermediation was relatively low. The extent of the domino effect generated by a single default was a function of the overall fragility and inefficiencies of the entire banking and financial system; the ability to contain this domino effect and manage the crisis depended also on the degree of political stability as the opposite cases of Croatia and Bulgaria testify.

The fragility of the banking and financial system in terms of structure, size, operations, management, corporate governance, markets and surveillance; the need to effectively enforce rules and Western-oriented legal frameworks; improved transparency in the judicial system; the need to develop capital markets in order to provide additional financial resources to the enterprise sector are, in our view,

[1] We wish to thank Giorgio Gomel, head of Bank of Italy International Relations Office, whose enthusiasm made this work possible and all the staff of his office for comments, discussions and technical support. We wish also to thank Prof. Riccardo Rovelli, University of Bologna, and Alberto Franco Pozzolo, Bank of Italy Research Department, for their useful comments.
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the issues to be addressed in order to increase the effectiveness of the reform effort before one can claim that the transition process is completed.

2. Economic performance and transition

The economic size of the entire SEE-8 region is small compared to any major EU country: in 2000 SEE-8 population stood at around 57 million people, roughly the same as, but its GDP around US$ 110 billion was equivalent to a mere 8 per cent of that of Italy. Economic standards are low: current per capita GNP is around US$ 1,655 (19,100 in Italy) while in terms of purchasing power parity it stands (1999) at US$ 4,300 (20,750 in Italy). The SEE-8 economic system is, on average, fragile: in 1999 growth in the area was almost null while in 2000 growth recovered at an average around 3 percent, unemployment was around 20 per cent, the central government deficit reached 5 per cent of GDP, the current account deficit 7 per cent, the stock of total external debt 50 per cent of GDP and total debt service around 13 per cent of exports. SEE-8 exports are mainly directed towards industrial countries (68 per cent) and, in particular, Western Europe (64 per cent); likewise, 67 per cent of imports comes from industrial countries (63 per cent from Western Europe). Among European countries, Italy and Germany are the main partners accounting each for 20 and 17 per cent of total SEE-8 exports and imports, respectively. Trade flows within the region are comparatively small: 11.5 per cent for exports and 7.5 per cent for imports. This could be due to political frictions persisting in the region and to similarities in the production structure.

Beyond the average picture, the SEE-8 region is characterised by fairly significant differences at the country level. Slovenia – which is part of the CEFTA-5 (Central Europe Free Trade Area, together with the Czech Republic, Hungary, Poland and Slovakia) – is the most advanced and stable economy and is a candidate for EU accession; with per capita GDP of US$ 9,200 (US$ 15,000 in PPP), Slovenia can be compared with European countries at intermediate stages of development. Croatia stands out in terms of economic size, stage of development and political institutions. In terms of per capita GDP, Croatia can be regarded as an upper-middle-income country. Bulgaria, Macedonia FYR and Romania, with per capita GDP in the range of US$ 1,400-1,700, are in the class of lower-middle-income countries while Albania, Bosnia and Herzegovina and Yugoslavia FR, ranging from US$ 700 to 900, are slightly better than low-income countries.

Main Economic Indicators for the SEE-8 Region

	Albania	Bosnia H.	Bulgaria	Croatia	Macedonia	Romania	Slovenia	Yugoslavia	SEE-8	Italy	EMU 1998
Population (1999, mil.) (a)	3.4	3.9	8.2	4.5	2.0	22.5	2.0	10.6	57.1	58	291
GNP p.c. (1999, Atlas) (a)	870	692	1,380	4,580	1,690	1,520	9,890	726	1,655	19,710	21,680

GNP p.c. PPP (1999, US$) (a)	2,892	n.a.	4,914	6,915	4,339	5,647	15,062	n.a.	4,328	20,751	20,990
GNP p.c. PPP (1989,US$) (b)	1,400	n.a.	5,000	6,171	3,394	3,470	9,200	n.a.	...	...	...
GDP (US$ bill.) (f)	3.7	5.4	12.1	19.8	3.3	37.9	18.3	7.7	108.1	1,077	5,756
GNP annual growth (f)	7.8	13.7	5.0	3.5	6.0	2.0	4.9	-19	3.0	2.9	3.4
Unemployment (% pop.) (c)	20	40	16	21	35	12	13	26.5	19.2	...	9.0
Central Gov bal. (%GDP) (d)	-8.5	-25	2.8	-1.3	-5	-3.9	-0.6	-30	-5.1	-0.3	-0.7
Current acc. bal. (% GDP) (d)	-1.8	-39.2	-0.5	-7.7	-8.5	-8.6	0.0	-18.5	-7.1	1.8	-0.4
Total debt stock (% GDP) (e)	28.6	36.1	90.3	40.5	72.4	27.0	29.0	144.6	49.2	...	...
Total debt serv. (% exports) (e)	4.5		22.1	8.9	13	23.5	7.7	2.0	13.5	...	...

Sources: (a) World Bank, World Development Indicators; (b) de Melo, Denizer, Gelb (1996); (c) Stiblar (1999); (d) World Bank, World Economic Report; (e) World Bank, Global Development Finance; (f) Current market price (IMF).

(1) Without Slovenia GNP p.c. in SEE-8 is US$ 1,360; (2) For Bosnia H., Macedonia FYR and Yugoslavia FR, source (c).

All countries experienced a sharp deterioration of economic fundamentals at the initial stages of the transition process. It could be of some interest to look at the evolution of GNP per capita in purchasing power parity from 1989 to 1999. In every country living standards improved: by 50 per cent in Albania, by 38 per cent in Slovenia and Romania, by 20 per cent in Macedonia FYR, by 10 per cent in Croatia. The only country that recorded a contraction (around 2 per cent) is Bulgaria.

Almost every country adopted comparable policy measures to regain economic stability: tight monetary and fiscal policies to reduce inflation and fiscal imbalances; control of capital account transactions and management of the exchange rate; privatisation, legal and fiscal reforms in the commercial and financial arena; rehabilitation and restructuring of the banking and the industrial sectors; reorientation of trade patterns toward more sophisticated products and Western partners.

The SEE-8 countries have adopted widely different monetary and exchange rate regimes. Bulgaria and Bosnia-Herzegovina are under a currency board arrangement, Albania and Yugoslavia have adopted independent floating, while Croatia, Macedonia and Slovenia have opted for a managed float, with a peg to the euro within a band; only Romania has associated a managed float with monetary targeting. In general, these countries have decided to pursue a rule-based monetary policy with euro as an anchor because they were experiencing both asset and currency substitution, hence high volatility of the velocity of money. In these circumstances monetary growth targets are an inefficient method for controlling inflation.

Exchange rate arrangements and anchors of monetary policy

Country	Exchange rate regime	Monetary policy framework
Albania	Independent float	Monetary targeting (M3)

Bosnia H.	Currency Board	Exchange rate anchor (euro)
Bulgaria	Currency Board	Exchange rate anchor (euro)
Croatia	Managed Float	Peg to the euro within a band
FYR Macedonia	Managed Float	Peg to the euro within a band
Romania	Managed Float	Monetary targeting (M3)
Slovenia	Managed Float	Peg to the euro within a band
Yugoslavia	Independent float	Monetary targeting (primary money)

Source: National Central Banks.

Varying degrees of deepness, speed and success of the reform process characterise each country's transition profile which, ultimately, is influenced by the country-specific initial conditions, the length and intensity of war and other external shocks, the social and political consensus on economic reforms. The Republics of ex-Yugoslavia had to sustain additional efforts: build new institutions and design new markets, overcome the spatial organisation of the former federate State with its strong regional economic specialisation and achieve a more balanced structure suited for an independent State. For some countries, such as Slovenia, Croatia and Albania, the worst phase of economic transition was already over in 1992-93; for countries which suffered from a longer and devastating war period, this phase lasted until 1995-96.

Transition recessions have sometimes been compared to Schumpeter's process of "creative destruction" since they are associated with the reallocation of resources from old, traditional and often inefficient industrial sectors to new and more efficient initiatives. However, transition recessions have proven to be dramatically deeper, faster and more pervasive than the "creative destruction". The overall fall of GDP has been contained at around 15 per cent in Slovenia, but elsewhere reached 60 per cent or more; e.g. in Albania, Bosnia H., Macedonia FYR and Yugoslavia FR. Following stabilisation, GDP growth recovered all over the SEE-8 region but conditions for sustained development were not there. Sometimes between 1996 and 1998 almost every country recorded a new GDP contraction, which was in some cases rather dramatic such as in Albania. Notable exemptions are Slovenia, Bosnia and, to some extent, Croatia. Since 1993 Slovenia registered a stable, albeit modest, growth in the 3-5 per cent range; since war ended in 1995, Bosnia had a cumulative GDP increase of around 30-35 per cent; in 1998 Croatia prospects became gloomy following a sharp deterioration in fundamentals and a deep banking crisis but recession was averted and growth recovered in 2000.

3. The financial sector: transition, structure, size, reforms

3.1 The legacy of centrally planned economies

Banks play a dominant role in the financial sector of all countries under review. Capital markets are practically limited to the equity markets and are, in general, quite fragile and underdeveloped. Other financial intermediaries, where in place, are mainly represented by insurance companies, pension funds and investment companies which are involved in the privatisation process acting as intermediaries between State agencies and private subscribers.

The legacy of planned economies in the banking and financial sector is well known. Under the former regime financial intermediaries, according to Western standards, were simply non existing. Banks were asked to extend credit according to the directives of the economic plan without any credit screening or control on borrowers' creditworthiness; they were simply agencies for the allocation of budget resources. Bad performing loans were kept in banks' portfolios; underestimated by weak accounting practices they greatly contributed to the quasi-fiscal deficit that emerged when the former regime collapsed. Partially eroded by the hyperinflation of the early 1990s bad loans were one of the main causes of the fragility of the banking sector.

The banking system in the former Yugoslavia had a somewhat different story than in other planned economies. Since 1971 Yugoslavia had a worker self-management system and in 1974 constitutional changes greatly enlarged the power of individual republics, provinces and local governments but the financial consequences of local mismanagement fell on the central government and the central bank. Enterprises were entitled to bank ownership; Yugoslav banks were, therefore, accustomed to commercial activities but they were a "service center" for credit and other financial facilities for enterprises.

During the 1980s an economic crisis erupted due to the overvalued exchange rate, poor trade performance, low productivity growth and accumulated fiscal deficits. Policy failures to address rising inflation and external shocks – such as the sharp increase in oil prices, the world-wide recession and the international debt crisis, exacerbated Yugoslavia's crisis. Stabilisation and reform plans aimed at financial restructuring of self-managed enterprises failed and in the mid-1980s their estimated losses were around 6-7 per cent of GDP while the quasi-fiscal deficit in the balance sheet of the National Bank of Yugoslavia reached 8-9 per cent of GDP. In 1989 the banking structure, operations, corporate governance and accounting practices were reshaped by a new banking law. In May 1990 the restructuring of illiquid banks began with the aim of reaching, if deemed necessary, an "exit" from the market but the declaration of independence by Croatia and Slovenia in 1991 and the outbreak of civil strife signed the collapse of the Federation.

There are at least four other aspects of the SEE-8 banking system worth mentioning: (1) the size of the banking sector and its importance in extending credit to the private sector; (2) the risk profile of loan portfolios; (3) the reform of the payment system; (4) the effective observance of international standards and codes.

1. An idea of the size of SEE-8 financial system and the role of banks in providing credit to the private sector can be offered by the following, albeit crude, indicators:

Monetary and Banking Intermediation Indicators for the SEE-8 Region
(per cent of GDP; end-1999)

	Albania	Bosnia H.	Bulgaria	Croatia	Macedon.	Romania	Slovenia	Yugosl.	**SEE-8** (1)	***EMU***
Money	20.2	13.7	13.5	9.6	10.2	5.5	9.7	n.a.	**8.4**	***2.6***
Quasi Money (2)	37.3	13.2	17.6	29.5	9.2	20.4	35.4	n.a.	**23.6**	***36.0***
Money plus quasi Money	57.5	26.9	31.1	39.1	19.5	25.9	45.1	n.a.	**32.0**	***68.6***
Domestic credit	32.7	34.6	19.1	45.9	21.2	18.8	41.8	n.a.	**28.1**	***134.1***
Credit to the Private Sector	3.6	30.7	14.9	36.9	22.5	8.5	34.7	n.a.	**20.1**	***102.2***

Source: IMF, International Financial Statistics Yearbook
(1) Data source for Bosnia H. is national authorities; Bosnia H. is therefore excluded from SEE-8 Total.
(2) Quasi Money = Time, savings and foreign currency deposits of residents other than Central Government.

The monetization of the economy is, on average, very far from the EU standards; only Albania and Slovenia, as far as the broad money indicator, can be regarded almost in line with the European average. Looking at domestic credit, and even more to the credit to the private sector, a striking difference emerges. Relative to GDP, the SEE-8 financial system provides only 1/5 of the credit provided by its European analogue. The ratio for credit to the private sector stands at only 20 per cent of GDP, against over 100 per cent in Europe, and in some countries, such as Albania and Romania, this indicator does not reach the two digit level.

2. During the 1990s all countries of the region have experienced problems arising from the very poor quality of banks' credit portfolio. Political pressure on banks to soften budget constraints on large loss-making enterprises, reluctance or inability of banking regulators to liquidate troubled banks, ineffective legal frameworks for creditors' rights have all contributed to widespread bad loan problems at the beginning of the transition process. Even though most countries have adopted measures to clean up banks' balance sheets few have succeeded in establishing an effective environment for safe banking activities. Comprehensive action for the resolution of bad debt problems was taken in Slovenia in the mid-1990s and since

then the banking system has shown a decline in non-performing loans which at mid-2000 accounted for 5.2 per cent of total assets, the lowest level in the region. The Bulgarian experience is different in that only after the deep financial turmoil of 1996 more severe criteria have been introduced leading banks to more conservative lending attitudes. This has led to an impressive improvement in portfolio quality even though operating in highly risky environment. Problems of credit quality are still huge in Romania owing to delays in the reform process.

3. An efficient payment system is one of the main strategic services that the banking system can offer to foster economic development. SEE-8 countries started from a structure of the payment system that was suited to the functioning of a planned economy. Usually all payment transactions were performed by a central agency and enterprises were obliged to keep an account with this agency in order to regulate international transactions. The transfer of these accounts from the central agency to commercial banks is the main step in reforming the payment system. This step requires substantial changes of the infrastructure related to the payment system and the acquisition of the necessary expertise by commercial banks. The standard prevailing in the European payment systems is the benchmark for the reform efforts. In the less developed SEE-8 countries cash is still widely used in many transactions given the limited circulation of credit cards and other cashless forms of payment. However, some reforms should be carried out by end-2001. These efforts are actively supported by Western central banks and IFIs with technical assistance programs.

4. It is still not easy to fully understand the actual compliance with the legal framework governing banking and financial activities. According to a EBRD survey conducted in 1998 among lawyers and other specialists working in Central and Eastern Europe and the CIS countries the legal setting of banking operations is quite advanced in those countries that experienced a banking crisis. However the enforcement of laws and regulations governing banking and capital markets lags far behind the extensiveness of these laws. This is partly due to ineffective legal institutions; problems in drafting rules and codes attached to these laws; lack of trained supervisory personnel; lack of sufficient funding. In this field, which has a direct bearing on the prevention of financial crisis, the World Bank and the Fund are engaged in an ongoing Financial Assessment Program. This program involves many national and international standard setting bodies, such as IOSCO and IAIS, and is aimed at assessing financial sector vulnerability.

3.2 Non-bank financial markets and intermediaries

Non-bank sectors play a marginal role in SEE-8 countries. In the most advanced economy under review, Slovenia, the total balance sheet of non-monetary financial institutions does not exceed half of that of credit institutions; in other countries this share is far smaller if not negligible. All SEE-8 countries have in place the basic laws, rules and infrastructures needed to run an equity market. The only exception is Bosnia and Herzegovina which, still at the beginning of the privatisation process, has not yet set up organised capital markets, a pre-requisite for a successful implementation of privatisation plans based on voucher schemes. However, both the Bosnia and Herzegovina Parliaments passed a set of capital market laws and a Securities Commission has been established. According to these laws, any issuer must submit a report of a completed private placement to the Securities Commission. By December 2000, ten issues had been reported.

Besides a fairly common legal framework, the deepness and performance of capital markets greatly differ among SEE-8 countries. In the Federal Republic of Yugoslavia, Macedonia and Albania trading is negligible in organised markets and the overwhelming activity is placed on OTC markets. The Tirana Stock Exchange, established as a department of the National Central Bank, quotes only treasury bills and government bonds; in Yugoslavia FR stockholding has been abandoned, owing to a virtually non-existent system of property rights. In Slovenia and in Croatia, at the end of 1999 total market capitalisation reached 25.3 and 13.4 per cent of GDP respectively. In Slovenia the share of official market in total capitalisation is larger than that of OTC market (69 against 31 per cent). Equity markets in the SEE-8 region suffer, in general, from imbalances between supply and demand which stem from privatisation procedures. These procedures, which focused on the primary distribution of shares to eligible groups of owners, are responsible for imbalances between few buyers and many sellers. Compared to other privatisation methods, voucher schemes are faster, simpler and politically appealing. In many circumstances voucher privatisation is the only feasible choice but has some drawbacks: it does not really contribute to modify households’ approach to saving and investment; it creates a dispersed ownership which prevents an effective control on management and radical shifts in corporate governance. On the demand side of equity markets, privatisation failed to play a catalytic role and household equity investments are still limited. Although basic standards in the institutional and regulatory settings are already in place, additional reform efforts are needed in some countries in order to improve the efficiency and to deepen capital markets. In particular priority should be given to the improvement of financial information, the strengthening of surveillance and monitoring activities, the enhancement of efficiency in order to lower costs and increase safety of transactions.

3.3 Privatisation in the banking system

In all countries of the region privatisation has mostly been concentrated on enterprises while bank privatisation has been held back until the end of the 1990s. Bank privatisation has long been delayed even though with sharp differences in terms of financial restructuring and stability of the banking sector. Slovenia adopted a centralised approach to banking reform but imposed early on hard budget constraints on State banks. The country's banking system has thus experienced a rather smooth transition without addressing the problem of excessive state ownership, which at the end of 1999 still accounted for 49 per cent of total banks' assets. Only recently the Government has adopted a plan for the gradual privatisation of Nova Ljubljanska Banka, the largest State bank.

Delays in privatisation have also characterised the reform of the banking industry in Bulgaria and Romania, hampering restructuring while State banks have long been a source of systemic instability. Both countries have only recently put privatisation on agenda for banking sector reform and major progress is expected by 2001.

Privatisation in Croatia occurred primarily in response to the two crises which have hit the banking system in the last decade. Following the first crisis of the mid-1990s the largest bank, Zagreb Banka, was privatised while the privatisation of the other State-owned banks was postponed, notwithstanding previous commitments. The privatisation process has made substantial progress in recent years as a part of a vast restructuring program adopted following the second banking crisis. At the end of 1999 a majority stake of Privredna Banka, the largest State-owned bank, has been sold to Banca Commerciale Italiana while Unicredito has acquired the control of the second largest, Splitska and a relevant participation in the Zagrebacka Group in 2000. With these operations Italian banks are controlling over 50 per cent of the Croatian banking system. Compared to other countries of the region bank privatisation in FYR Macedonia has proceeded quite rapidly even though the outcome in terms of financial restructuring and economic performance of the banking industry has been below expectations. Bank privatisation has followed the privatisation of the existing shareholders, mainly former socially owned enterprises and at the end of 1999 about 80 per cent of banking capital was privatised. However the distinctive feature in the privatizaton process, which has left unchanged ownership structures and management, has secured the perpetuation of previous lending patterns and links.

In Albania the process for the privatisation of the two dominant State banks, accounting for 82.4 per cent of total banking assets as of end June 1999, was initiated in 1998 and is still underway. In the first half of 2000 the authorities signed an agreement with foreign investors on the privatisation of the second largest bank, while the privatisation of the more economically significant Saving Bank in expected by end 2001.

4. Banking crises in the Balkans: determinants, resolutions and lessons

The credit system plays a central role in the transition process by virtue of its provision and allocation of funds to enterprises, possibly at a low cost.

Macroeconomic analysis generally focuses on the overall constraints represented by often large budget deficits in a context of low saving rates and restrictive monetary policy crowding out private investment, while micro-analysis points to the critical role of firm-level differences among countries: scarcity of production factors (human capital or equity), governance problems, weak property rights and information asymmetries. A different approach emphasizes the system dimension of the transition process in the banking sector, defined as the passage from a centralised state-supervised mechanism of resource allocation to a decentralised one whose function is characterised by tight microeconomic solvency constraints.

In recent years a few major episodes of banking and financial crisis beset the Balkans: the rise and fall of the pyramid scheme in Albania in 1996-97 and the banking crises in Bulgaria leading to two waves of bankruptcies, respectively in May and September 1996. Croatia also has recently experienced the crisis of single banks that spilled over to the overall financial system.

We further examine each of the episodes shading some light on the determinants of the crises, the solution adopted by the monetary authorities to solve them and the lessons that can be drawn from these episodes.

4.1 Albania: the crisis of the "pyramid" financial intermediaries

The "pyramid" scheme phenomenon in Albania was important because its scale relative to the size of the economy was unprecedented, and because the political and social consequences of the collapse of the pyramid scheme were deep. At their peak, the nominal value of the pyramid scheme liabilities amounted to almost half of the country's GDP. When the scheme collapsed, there was uncontained rioting, the government fell, and the country descended into anarchy and a near civil war in which some two thousand people were killed. Despite the tremendous political effect, however, the economic effects of the pyramid scheme phenomenon in Albania have been surprisingly limited.

Pyramid schemes have been prominent in transition economies in recent years (MMM in Russia, Caritas in Romania and smaller schemes in Bulgaria and Czech Republic), but they also exist in industrial countries. The reasons why they do not come to public attention are better law enforcement and maybe a great consciousness in distinguishing between a credible and an incredible rate of return. Some of the conditions that led to the success of a pyramid scheme in Albania are common to other parts of the world: an inadequate banking system, an unclear legal system, lack of governance, a population in poverty aware of, and attracted by, the behavior of wealthier countries (e.g. Italy), and so more vulnerable to the unlikely promise of pyramid scheme operators.

4.2 Bulgaria: the banking crisis in 1996

The banking crisis in Bulgaria had its antecedents and underpinnings in the fact that in the period 1990-95 practically no decisive transition to a market-oriented economy was achieved. State monopolies in the area of machine engineering, chemistry, the energy sector, transport and communications were not restructured, the privatization process was marginal, and the newly emerging private sector – insufficient and ineffective.

In mid-1995, 75 per cent of about 5,500 enterprises operating within the Bulgarian national economy officially reported a loss from their operations, and the loss approximated 20 per cent of GDP. It is particularly indicative that for 1,100 of them their proceeds could not cover their expenses for materials and energy consumption, while more than 2,000 of them were not able to provide the funds to cover their salary expenses. At the end of 1995, only one fifth of the enterprises reported a positive result of their operations. The genesis of the banking system after 1990, the forms and stages of introduction of prudential regulations, and the behaviour of the institutions inevitably paved the way to a deep banking crisis.

4.3 Croatia: the two waves of banking crisis (1996, 1998)

In the last decade the Croatian banking system experienced two crises. Compared to the ones described above, the Croatian crisis happened in a less turbulent way, and was confronted appropriately by national authorities, without a deep involvement of international financial institutions and within a favourable environment of political stability.

The first wave of the crisis happened in 1996, due to the misbehavior of the previous political regime and amplified by the weak supervisory legal framework and supervisory authorities' lack of expertise in timely recognizing the symptoms and adequately managing a banking crisis. The reforms in the banking system had been formal and had not changed incorrect business practices: several state-owned banks still received financial support, privatization often preserved the management unchanged while links between enterprises and banks were very profound. Four of the six largest banks were insolvent and needed to be recapitalised with an injection of public resources for an estimated social cost that amounted to 22 per cent of the 1997 GDP. The second crisis began in March 1998 and led to the insolvency of the fifth largest bank and the consequent failure of a number of small and medium-size institutions. The crises involved around 12 per cent of total bank assets, while the rehabilitation cost amounted to 5 per cent of GDP.

The costs of the financial rehabilitation of banks and the paying out of the insured deposits place Croatia amongst the countries with the highest outlays for solving bank problems (the total amount of public outlays for the rehabilitation of banks being estimated up to date at 31 per cent of GDP).

Until the mid-1980s, commercial banks in Croatia were under the control of their funding enterprises and their basic objective was to lend financial resources to their founders at the cheapest possible rate. From the beginning of the 1990s, a so called linear-rehabilitation process of reform of commercial banking was undertaken, even if it did not modify banks' attitude to lend money primarily to the respective founder enterprises. That fact led to a progressive deterioration of the banks' balance sheet that forced the government in 1996 to rehabilitate three large banks, transferring the bad bank credits to a special agency, recapitalizing the intermediaries and replacing shareholders and bank management. After this rehabilitation there was a large drop in interest rates that led, in 1998, to a new bank crisis that mainly hit new banks which had highly aggressive, and someway inappropriate, interest rate policies, exacerbated by external shocks. The intervention of the CNB has been speedy after the crisis began but probably not as prompt as it should have been. Although many banks failed, there are still many weaknesses, especially connected with currency and credit risks in many banks' balance sheets, bank involvement in enterprise shares, mismatch in asset and liability management, lack of full compliance with the best international practices in banking supervision.

4.4 Lessons from the crises

Based on the above analysis, we can draw a general conclusion: if we do not consider the political and social consequences (as in the case of Albania) and apart from the distributional effects and the high fiscal costs in terms of GDP that the rehabilitation of the concerned intermediaries have often implied, the banking crises in the Balkans did not have particularly heavy macroeconomic consequences, especially for growth. Some other tentative lessons can be drawn.

1. The lack or delay of reforms in the real economy allows a transfer of losses to the banking system, and consequently intensifies the decapitalization processes in it.
2. Measures that are uncoordinated and insufficient in scope and depth may alleviate only temporarily the pressures in the system, but not prevent the crisis.
3. The resolution of the crisis requires a strong political will and coordination between various centres of power and resources.
4. The period for recovering confidence in the banking system is long and during it the operations of Banking Supervision gain particular significance.
5. Very often bank and financial crises originate from an unstable political and economic situation and the recovery is highly conditioned by the timing and the pattern of the political stabilization process.

Some critical episodes, as the rise and fall of the pyramid schemes in Albania, suggest that to prevent negative consequences, there are some steps a government, as well as the international financial institutions, should follow.

A. National authorities should supervise both formal and informal financial markets. In Albania the latter was out of the control of public authorities: the National Bank began to take notice of it at the end of 1995, at about the time the escalation of the pyramid schemes began. The time delay between recognizing the potential danger of crisis and being prepared to put in place the required corrective actions is usually very long: an early awareness of the potential problems and the predisposition of the proper instruments of intervention are thus necessary.

B. International financial institutions should learn something from an episode like the Albanian crisis: they should have foreseen earlier the incoming crisis and warned the government more decisively, although we recognize the fact that their task is not to investigate the solvency of single intermediaries, especially when these intermediaries are suspected to pursue criminal activity, and they have no power of direct intervention in what can be considered an internal political matter.

COUNTRY PROFILE: ALBANIA *

1. Economic structure and transition process

During its transition to a market economy Albania has experienced wide swings in economic performance. As in many post-socialist countries, output sharply declined at the beginning of the transition with a cumulative contraction of GDP of nearly 40 per cent between 1989 and 1992 when a wide-ranging macroeconomic stabilisation and reform program was introduced with the assistance of the IMF and foreign financial aid. Tight fiscal and monetary policies helped to reduce the inflation rate from 211 per cent in 1992 to 6 per cent in 1995 while in the same years the general government deficit was cut from 21 per cent of GDP to 10.2 per cent. Price and quantitative trade controls were removed and in July 1992 the Lek was made convertible. Owing to rapid progress in the privatisation of agriculture, which still accounts for about half of the country GDP, the share of private sector to GDP rose to 50 per cent in 1994 from 5 per cent in 1991. A strong economic recovery started in 1993 and lasted until 1996, with real GDP growth averaging close to 10 per cent per year. Following the collapse of that “pyramid” scheme and the resulting civil unrest in the first half of 1997 the country plunged into a deep economic recession. Strong adjustment measures were adopted to restore economic stability and the economy rebounded in the second half of the year. The economic contraction for the full year amounted to 7 per cent while inflation increased to 42. In 1998 the authorities maintained a tight fiscal and monetary policy stance taming inflation, which fell to 9 per cent, and stabilising the exchange rate while growth accelerated markedly to 8 per cent. Growth remained too strong during 1999, despite the impact of the Kosovo crisis in the first half of the year; GDP increased to 7 per cent while inflation turned negative following a sharp appreciation of the Lek.

2. Institutional aspects

2.1 Legal framework of banking activities

A market-oriented legal framework was introduced in 1992 with the enactment of the law On the Bank of Albania and the law On Banking System which transformed the banking system from a centrally planned single tier into a two-level system. After the outbreak of the pyramid schemes the banking law was amended to strengthen prudential regulation, improve the supervisory powers of the Bank of Albania (BoA) and prevent the creation of pyramid schemes. The new Law On Banks enacted in July 1998 provides BoA with broad regulatory powers to set base capital and capital requirements and prudential rules concerning credit exposure to single debtors and related party lending. Following the enactment of the new Law BoA has thus set a prudential regulation broadly in line with Basle Core Principles, even though some Principles appear to be met in a rather formal way. Moreover significant weaknesses remain in effective supervision and regulatory enforcement.

2.2 The structure of the banking system and financial system

As of end-1999 the banking system consisted of 9 banks and 3 foreign bank branches. Considering the foreign branches, in 9 banks private shareholders held a majority stake even though the two largest banks were state owned. Eight banks were controlled by foreign investors, five of which were totally owned, one was a joint-venture between the state owned National Commercial Bank (NCB) and Banca di Roma with a minority participation of EBRD and another was a joint venture between NCB and a consortium of Arab banks holding a majority share. Both state banks were put under governance contract in 1998 in preparation for their privatisation. In the first half of 2000 the authorities signed an agreement with foreign investors on the privatisation of NCB while progress in the process of privatising the more economically significant Saving Bank has been limited. The Tirana stock Exchange was established in May 1996 as a department of BoA but since then trading has been negligible and limited to treasury bills and government bonds.

2.3 Monetary policy

* By Emidio Cocozza.

The main objective of the Bank of Albania is achieve price stability and, subordinate to the primary goal, to promote conditions conducive to balanced and sustained economic growth. BoA independence in formulating and implementing the monetary policy is enshrined in the Constitution. The BoA has opted for a monetary policy targeting and has largely relied on direct instruments of monetary control, mainly credit ceilings and floors on interest rates on deposits collected by state-owned banks. However the Bank is currently phasing out instruments of direct monetary control. Bank-by-bank credit ceilings were removed in November 1999 while minimum deposit rates will been maintained until the completion of state-owned banks privatisation.

3. The banking system structure and performance

3.1 Transition process in the banking system

The Albanian financial sector underwent a major crisis in 1997 with the collapse of the pyramid schemes. Since the beginning of transition an informal financial sector composed of companies taking deposits and making loans had flourished. These money-borrowing firms exploited loopholes in the legal framework and they had never been licensed to take deposit. Some of them begun early to run pyramid schemes, collecting deposits promising artificial high returns to customers which were paid out of newly attracted money. It is estimated that at their utmost, at the end of 1996, the pyramid schemes' liabilities amounted at 1.2 billions U.S. dollar, equivalent to 50 per cent of the annual gross domestic product. The outbreak of the pyramid schemes in early 1997 plunged the country into a deep crises, with civil unrest and riots while economic activities stalled and the Lek depreciated sharply. In July 1997 a special law for the winding up of the companies running the schemes was enacted and foreign administrator were appointed to liquidate them. The growth and collapse of the pyramid schemes had little impact on the banking system. A massive fall in deposits in the course 1997, owing to a partial seizure of the assets of the two largest schemes and withdrawals by owners, was reversed later in the year as confidence in the banking system was restored and individuals shift from cash holding to time deposit in Lek. Following the crisis the authorities adopted measures to strengthen the financial sector and to enhance the role of the private sector in the banking system. The operation of the smallest of the three state owned banks, the Rural Commercial Bank, were suspended at the end of 1997 and the bank was liquidated in 1998. The process for the privatisation of the remaining state banks was initiated and is still underway. Foreign administrators were appointed to streamline operations of the two banks which were also prohibited for prudential purposes from expanding net credit as the ratio of non-performing loans to total loans exceeded the legal limit of 20 per cent.

3.2 Development indicators and market structure

The banking system is fairly underdeveloped and inefficient and an informal financial sector still plays an important role. Even though domestic credit represented the 45.3 per cent of GDP at the end of 1999 credit provided by the banking system to the private sector is small reprensentig only the 3.3 per cent of GDP. The system is highly concentrated and dominated by the two state owned banks whose share in total banks' assets was 82.4 per cent as of end-June 1999, with the Saving Bank, the country's largest bank, owning 67.1 per cent of total assets. State banks have invested disproportionately in government bonds and having also being subject to strict prudential limits imposed on lending they have not performed an effective financial intermediation towards the private sector. At end-June 1999 the Saving Bank alone collected 75.6 per cent of total bank deposits and enjoyed a near monopoly position in the T-bill markets, with the share of 96.4 per cent of total banking system, while loans represented only the 11.5 per cent of its assets. On the other end private banks have so far showed a low propensity to extend credit to the private sector largely focusing on trade-financing and fees generating activities.

3.3 Risks and efficiency

Credit quality is poor. As of end-1999 54 per cent of total loans to public non financial enterprises and to private sector were classified as doubtful with a slight improvement from the 60 per cent at end-1998. Loan collection rates of the state-owned banks are very low. At end-December 1999 the weighted short-term (one year) lending rate was 25.8 per cent while weighted short- term deposit rate was 9.1 per cent. Despite nominal high interest margins the profitability is weak and at the end of 1999 the Return on Assets amounted to 1 per cent for the total the banking system and close to zero in the two state owned banks.

Albania: Main Economic Indicators

	1997	1998	1999
Population (mid-year estimation)(a)	3,324.3	3,354.3	3,387.8
Exchange rate (end of year)			
- Lek per 1 U.S. dollar	149.0	140.1	135.3
- Lek per 1 DM	83.8	84.0	69.9
Gross Domestic Product			
- current market price (million of Lek)(a)	341,716	460,631	506,205
- current market price (million of U.S. dollar)(a)	2,294	3,058	3,676
- growth rate (real Lek)(a)	-7.0	8.0	7.3
- per capita (in U.S. dollars)(a)	690.2	911.6	1.121.1
Current account			
- Current account balance - excluding official transfers (in percent of GDP)(a)	-14.4	-8.2	-9.3
Unemployment rate(a)	14.9	17.8	18.0
External debt (in percent of GDP)(a)	35.6	26.5	25.4
Reserves (in million of U.S. dollar)(a)	308.3	384.2	481.6
Consumer prices (annual average)(a)	42.1	8.7	-1.0
Overall Budget balance(in percent of GDP)(a)	-13.0	-10.4	-11.0
M1 (millions of Lek)(a)	91,667	83.728	103,004
- in percent of GDP(a)	26.8	18.2	20.3
M2 (million of Lek)(a)	162,221	199,263	239,662
- in percent of GDP(a)	47.5	43.3	47.3
M3 (million of Lek)(a)	198,547	239,526	292,871
- in percent of GDP(a)	58.1	52.0	57.9
Domestic credit (in million of Lek)	180,306	207,937	229,324
- in percent of GDP(a)	52.8	45.1	45.3
Credit to the private sector	12,955	13,485	16,841
- in percent of GDP(a)	3.8	2.9	3.3
Banks' Assets	180,936	207,708	246,798
- in percent of GDP(a)	52.9	45.1	48.8

Source: National Authorities (a) and IMF (b).

COUNTRY PROFILE: BOSNIA AND HERZEGOVINA *

1. The economic structure

1.1 Economic background (1995-98)

After the end of the war in Bosnia, the Dayton Agreement (December 1995) gave birth to Bosnia and Herzegovina (BH) as a highly decentralised state, consisting of two Entities: the Muslim-Croat "Federation of Bosnia and Herzegovina" (FBH) and the Serbian "Republika Srpska" (RS); the Federation itself is rather decentralised, consisting of ten "cantons". The war in Bosnia had lasted for three years, from 1992 to 1995. Human casualties, expulsions and flight have reduced the country's population by one quarter; the World Bank estimates that about 15 billions of USD worth of capital stock was destroyed during the war. The Central Bank of Bosnia and Herzegovina (CBBH) was founded in August 1997. The national currency, named "konvertibilna marka" (KM), was introduced in the summer of the following year. The KM is linked to the Deutsche Mark on the basis of a currency board arrangement. The fixed exchange rate is 1 KM for 1 DM.

In 1995 the GDP of BH had dropped to a quarter of its pre-war level. Between 1995 and 1998, the GDP average annual rate of growth was 33 per cent; the unemployment rate in the Federation fell from 70-80 per cent to under 40, while the RS achieved milder results. The monetary authorities appear to have subdued inflation: in 1999 the CPI in the Federation was equal to 0 (see Table 1), whereas in the RS the reduced circulation of the KM, in favour of Yugoslav dinar, hindered price control. In 1998 the consolidated (general government and Entities) budget deficit was at 3 per cent of GDP, and it was completely financed from abroad. Economic development in BH was fuelled by trade, construction and services, as well as large capital inflows. Trade deficits were covered by financial assistance, transfers, and accumulation of arrears.

1.2 Recent developments (1999-2000)

Notwithstanding the negative effects produced by the conflict over Kosovo (Yugoslavia is the major trading partner of BH), the Bosnian real GDP rose by 9 per cent in 1999, and it is estimated to have increased by 10 per cent in 2000, despite a severe drought which should have reduced output in agriculture by 15 per cent. In 2000, industrial production growth, which had slowed down in the previous year, has shown a substantial recovery in the RS and a slight deceleration in the FBH.

Both Entities have experienced great difficulties in implementing the approved budgets for 2000; these difficulties are the result of unexpected wage increases, larger transfers to the pension fund in RS, the effects on foreign debt service of the depreciation of KM against the USD, and higher spending on refugees. The financing gaps for 2000 reached 125 millions KM in the FBH (preliminary data available only for the federal authorities), and 53 millions KM in the RS; foreign donations reduced the gap in the FBH to 64 millions KM, and balanced the budget in the RS.

In 1999, broad money rose by 40 per cent, as a result of the marked increase in the demand for domestic currency at the expense of foreign currencies (Table 2). In 2000, the growth rate slowed down to 16 per cent, as this portfolio adjustment should have been neared completion. Private sector credit has grown less than the increase in nominal GDP, probably still reflecting weaknesses in the legal and institutional environment, and banks' difficulties to provide financial services.

Current account deficits have remained large (-4,351 millions KM in 2000), and foreign assistance is pivotal in supporting the balance of payments.

2. Institutional aspects

* By Alessandro Fabbrini

2.1 Legal framework of banking and financial activities

The central government of Bosnia and Herzegovina has got very limited powers: the State is in charge of foreign policy, foreign trade and customs policy, monetary and exchange rate policy, foreign debt, domestic and international communications. All duties not explicitly vested with the central government fall within the powers of the two Entities. Thus, the Entities are in charge of bank privatisation, bank supervision, and more in general of economic and development policies. The natural inclination of Serb and Croat ethnic groups to seek special ties with Serbia and Croatia respectively, has sometimes obliged authorities (first of all the High Representative [2]) to impose a uniform legislation, as economic and legislative integration between the two Entities is a key issue for the economic development of BH.

Pre-war banking structure of BH was the same as in the rest of Yugoslavia: banks were founded by enterprises, and banks lent heavily to their owners. They were, as a matter of fact, captive companies. The primary steps for a reform of the financial system have been: 1) the foundation of a banks' regulatory legislation; 2) the liquidation of insolvent banks and the privatisation of all other state-owned banks; 3) the enhancement of bank supervision; 4) the establishment of deposit insurance mechanisms; 5) the phased elimination of the Payments Bureaux.

Both Entities have issued their new *commercial bank laws*, defining the authority of the Entities Banking Supervision Agencies. These laws establish general operational requirements for banks, define permissible activities and prohibited transactions, include insolvency definitions, the conditions under which a provisional administrator may be appointed by the Agencies, his powers and duties, and a defined receivership role. They also permit deposit and investment banking, and establish a priority of claims in the liquidation process; finally, they establish general criteria for the disposition of banks' assets and liabilities, and for bank sales or mergers.

Banking, financial and payment systems supervision authorities are the Central Bank, the Banking Agencies, the Ministries of Finance, the Payments Bureaux, the Bank Privatisation Units, the Securities Commissions. The Banking Agencies have made progress in enforcing regular reporting of financial data by banks and in training staff to use off-site supervision. However, many important issues remain to be resolved: conservatorship powers, bank enforcement authority, off-site supervision capabilities, bank accounting standards, establishment of an integrated supervisory approach, licensing procedures, agency enforcement authority. In May, 2000, the High Representative simultaneously amended the banking laws in both Entities: they did not provide protection for bank supervisors, examiners and officials of the Banking Agencies from personal liabilities arising from the normal performance of their duties. Protection of this type of officials is both customary and necessary for strong and independent bank supervision, as stated by the Basle Committee.

Past financial history of BH has instilled a widespread reluctance to place deposits in banks[3]. A *deposit insurance* is needed. The Federation amended the Law on Deposit Insurance in April 2000, providing for the proper legal framework to set up a system for securing deposits. The Federation Deposit Insurance Agency has been formed, whereas a RS Agency has not yet been established. The RS Government withdrew the Proposals on Deposit Insurance and the Law on Payments Transactions from the Agenda of RS National Assembly Session, held on October 17th, 2000, and it is still expected to establish a system of deposit insurance.

In order to implement the *bank privatisation process*, each Entity established a Bank Privatisation Unit (BPU). The initial step was the issuance of the Laws on Opening Balance Sheets (OBS): they established the basis for determining banks' solvency, and determined which assets and liabilities would be removed. Banks whose OBS show a higher value of active assets than liabilities are considered solvent; they prepare privatisation plans and, after approval from the Entity government, they enter into the privatisation stage. Insolvent banks would be liquidated or merged. Both Entities have adopted laws on the sale or liquidation of commercial banks in public ownership. In 1998 the High Representative had issued the Framework Law on Privatisation of Enterprises and Banks in Bosnia and Herzegovina. This law had recognised the right of the

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[2] The Dayton peace agreement designated a High Representative to oversee the implementation of the civilian aspects of the peace agreement on behalf on the international community.

[3] Experts estimate that 450 millions of KM are lying "under the mattresses" in BH, reflecting the lack of trust in the banking system and the limited role that the banks are playing in economic revival.

Entities to privatise enterprises and banks and to dispose of the privatisation proceeds, and it had established the privatisation process principles of non-discrimination amongst beneficiaries of claims, transparency, and public accountability.

With the issuance of privatisation claims in the Federation and privatisation vouchers in the RS, mechanisms were required to allow citizens to transfer and trade their claims and vouchers through an *organised capital market*; a comprehensive set of capital market laws has been passed by parliaments in both Entities (Law on Securities; Law on Security Commissions; Law on Registrar of Securities; Law on Management Companies and Investment Funds).

The Federation Securities Commission is an independent institution established by the 1999 Law on Securities Commission; the Commission regulates, approves and supervises the issuance and trading of securities in the Federation. A minimal amount of registered capital is prescribed for professional intermediaries (brokerage and dealing houses). The Commission has defined the obligatory elements of the contracts between professional intermediaries and their customers, and the performance of broker business operations; take-overs and tender offers have also been regulated.

The process of dismantling and liquidating the *Payments Bureaux* is a key issue for the banking system development. It must be overseen by a Governing Board in both Entities. The new Law takes away the monopoly position of the Payment Bureaux over domestic payment transactions, and provides a legal basis for a governing board to guarantee transparency in the transformation process. A team of experts has developed a strategic plan for transfer of the functions of the Payments Bureaux to the appropriate governmental institutions and to the banking system. Commercial banks need to acquire licenses before they are allowed to perform payment transactions. The legal framework of the Payments Bureaux' transformation has been recently completed by the High Representative through the issuance of a set of laws and amendments; the new payment system began operations on January 5th, 2001.

2.2 Monetary policy

The Central Bank of Bosnia and Herzegovina is the sole authority for the issuing of currency and monetary policy implementation. The chief body of the Central Bank is the Governing Board, consisting of three members (two from the FBH, and one from the RS), and the Governor.

At the moment of establishment of CBBH, Bosnia and Herzegovina was experiencing both asset and currency substitution[4]. Since high currency and asset substitutions typically cause high volatility in the velocity of money supply, the monetary authorities decided to pursue a Currency Board Rule, tying the KM unit to one DM. Moreover, the Law on the Central Bank of Bosnia and Herzegovina requires that the aggregate amount of the monetary liabilities of Central Bank shall at no time exceed its net foreign exchange reserves, in order to increase its credibility.

So far, the CBBH has pursued two main results:

1) the maintenance of stability of the domestic currency (KM) has assured a full coverage of the CBBH monetary liabilities through its foreign assets (official foreign reserves); a stable value of the domestic currency and the adherence to the Currency Board have in this way a direct influence on inflation within Bosnia and Herzegovina;

2) the most significant result in 1999 was the removal of foreign currencies from the domestic non-cash payment system, as well as a reduction of their use for cash transactions. As a result, during 1999 the foreign reserves held within the CBBH and the commercial banks increased steeply, improving the credibility of the BH banking system abroad (Tables 3-4).

3. The financial system

3.1 The structure of the banking and financial systems

[4] Currency substitution occurs when assets denominated in foreign currency are used as means of payment, while asset substitution occurs when assets denominated in foreign currency serve as store of value. The ratios (in percent) of foreign currency deposits to M1 and M2 can be good indicators for currency and asset substitution rates, respectively.

Banks. On December 31st, 2000, 57 banks in BH had work permits; out of them, 38 banks were operational in the Federation, 18 banks and one postal savings bank in the RS.

Public confidence in the banking sector is low. Pre-war foreign exchange deposits have been frozen and replaced only partially with vouchers, therefore the major source of funds for banks are foreign credit lines. Banks derive over 50 per cent of their income from transfer fees (only abroad) and by leasing their premises. Despite considerable interest rate margins, low lending activities keep interest income low.

BH banks have very limited resources for new lending; savings were wiped out as a result of inflation and the freezing of foreign currency deposits (nominal claims of about 3 billion DM from depositors in Federation banks and about 1.2 billion DM from depositors in RS banks). There are additional reasons for public reluctance to place deposits in banks: first of all, the lack of services provided by most of them; the existence of the Payments Bureaux has been another factor stultifying the development of the banking industry. There remains a complete absence of long-term investment capital, despite the fact that capital demand is strong, and potential and profitable projects are numerous.

The banking market is still highly concentrated, despite the fact that several private banks have been set up after the war: 11 state owned banks control around three-quarters of total banking assets in the Federation, while in the RS the 4 largest public owned banks control two-thirds of all assets. A total of 17 banks (10 in the Federation, 7 in the RS) are mainly or entirely state-owned.

The RS has caught up with the Federation, as far as the privatisation process is concerned. All state owned banks have been declared solvent on the basis of their opening balance sheets, and five of them have been offered for sale. The fourth tender, published on August 21st, 2000, for the sale of state shares in Agroprom Bank has ended successfully, increasing the percentage of private capital in this bank to 51,2%. Negotiations are ongoing for the sale of the state-owned 90% in Privredna Banka, Doboj. There are several national and international bidders for the sale of Kristal Bank, published on October 23rd. However, the sales of the state capital in Privredna Banka, Srpsko Sarajevo, and in Banjaluca Banka, Banja Luka have been unsuccessful.

In the Federation, an agreement was reached in December, 2000, with the holder of the Czech creditor's position in the Privedna Banks related group: Privredna Banka Sarajevo, Central Profit Banka, Una Banka Bihac, Gospodarska Banka and Travnicka Banka Travnik. All or part of these banks will be tendered for privatisation; banks or portions not privatised by June 30th, 2001, are to go into liquidation. Two Privedna Banka Sarajevo-related banks that have already self-privatised need external investors in order to be competitive. Postbank BiH and Sipad Banka have been tendered, and a tender offer on Union Banka is projected.

At the end of 2000 total assets of BH commercial banks amounted to 4,358 million KM, averaging an annualised growth rate of 9.2 per cent from the end of 1997. In terms of GDP, however, in 1999 they fell from 48.8 to 47.5 per cent: foreign assets remained roughly constant (from 8.7 to 9 per cent), claims on government almost halved (from 1.7 to 0.9 per cent), whereas those on non financial enterprises and on private sector passed from 35.3 to 34.5 per cent. In 1999, the claims on households amounted to only 3.3 of GDP, those on industrial enterprises to 31.4 per cent. In recent years the share of short-term credits has equalled to 30-35 per cent; although the share of claims on household is just a fraction of those on enterprises, it is growing in importance (Figures 1-3).

Although a Turkish state owned bank has been operating since 1997, only now the foreign participation in the Bosnian banking sector is rapidly increasing. In August, 2000, the privately owned Market Banka was taken over by the Austrian Raiffeisen Zentralbank. In July 2000, another Austrian intermediary, Volksbank, was the first EU bank to open a subsidiary, the Volksbank Bosnia and Herzegovina; it was followed by the opening of branches of the Österreichische Volksbanken in the Federation, and the Lithuanian Balkan Investment Bank in the RS. The Zagrebacka Banka took a controlling share in Hrvatska Banka Mostar, which changed its name in Zagrebacka Banka BH Mostar; the Croat bank also bought a majority share in Universal Banka in January 2001, and it is entering into the RS banking market by taking over the assets and liabilities of the Komercijalna Banka Tuzla. The Slovenian Bank Domzale acquired a majority stake in the Commercial Bank Sahinpasic, renamed Commercebank. In November 2000 the Islamic Development Bank, the Dubai Islamic Bank and the Abu Dhabi Investment Bank founded the Bosnia Bank International Sarajevo.

Other financial intermediaries and the financial markets. An organised capital market does not yet exist in BH. As for the Federation of Bosnia and Herzegovina is concerned, a Contract on License with Lubljana Stock Exchange has been signed, prescribing the transfer of the Slovenian trading software system to the future Sarajevo Stock Exchange; the test trading system is already installed. The formation of the Steering Board of potential founders has been initiated. The establishment of the first brokerage and dealing houses is in process.

An effective, comprehensive and quick privatisation is the primary step for capital market's development. Management companies and investment funds are key actors in the public subscription of shares of enterprises subject to privatisation. In 2000 the Federation Securities Commission was occupied with several applications for the establishment of privatisation investment fund management companies and of privatisation investment funds. The minimum registered capital necessary for the establishment of a privatisation fund is 200 millions KM. The Commission has passed so far 12 resolutions on the issuance of licenses for the establishment of privatisation investment fund management companies, and 13 resolutions on the issuance of licenses for the establishment of privatisation investment funds. The total registered capital invested in these management companies is 12.3 millions KM, out of which the 27% is foreign capital. Five banks have been issued licenses to perform depository business operations for privatisation investment funds.

FBH legislation differs two methods of issuing securities, public offering and private placement. According to the Law on Securities, any issuer must report the private placement of shares to the Commission prior to the beginning of the subscription, and submit a report of the private placement after completion. By December 31st, 2000, ten issues were reported (20.1 millions KM of total value), out of which six issues were completed (6.9 millions KM) and three were being still in process. So far, there has not been requests by stock companies to perform sales of shares through public offering, with the exception of privatisation investment funds.

In BH there are too many insurance companies which are undercapitalised, do not apply international standards of risk management, and do not always fulfil their obligations; there are three types of insurance in BH: car, property, and life. The largest insurance companies are state-owned. The insurance industry lacks an effective supervisory body.

3.2 Efficiency and risks

At the end of 1998, bank capital for FBH commercial banks amounted to 784 million KM, but net bank capital was -4.5 billion KM, reflecting poor quality of on- and off-balance sheet assets held by large state owned banks. Poor assets (rated C-E) represented 63 per cent of all on- and off-balance sheet assets for FBH banks; the ratio was 22 per cent for private banks taken separately. In 1998, the return on assets was 0.21 per cent (0.49 per cent for private banks); the return on share capital amounted to 2.09 per cent (3.17 for private banks).

High risks in the credit market, market segmentation, and inadequate protection against borrowers' insolvency produce high lending interest rates and spreads. The interest rates imposed at annual level are between 5 and 60 per cent (between 2 and 25 per cent on long-term credits), and they are higher in the RS; on the other hand, rates on demand deposits are between 0.5 and 26 per cent, and between 1 and 34 per cent on time and savings deposits. Thus, in many banks the interest rate spread is of 20 percentage points, reaching sometimes 50; spreads tend to be higher in the RS. The credit interest rates imposed by the private banks are considerable higher than in the state owned banks, especially when compared with those in the developing banks established by the state.

RS Government has recently passed a decision, that sets a ceiling of 10 per cent on credit interest rates imposed by state-owned banks; some doubts have rightfully arisen about banks' capacity to implement such a decision without incurring in new losses.

The new foreign competition, however, is reducing interest rate margins, with rates on 3-5 years loans falling from 15-20 per cent or higher to around 12-13 per cent.

3.3 The payment system

In Yugoslavia, all public and private financial activities, including payment transactions, savings, tax collection, tax distribution, treasury functions, and public and private expenditures were controlled through a monopoly institution, the Payments Bureau (SDK). During the war, the SDK in Bosnia split into three separate organisations: the Sarajevo-based Bosniac organisation (ZPP), the West-Mostar-based Croat organisation (ZAP), and the Banja-Luka-based Serb organisation (SPP). Anyway, the Payments Bureaux's day to day activities had remained essentially unchanged from the pre-war era: they collected all taxes and tax returns, conducted all public and private payment transactions, held all public and private cash reserves, managed all governmental financial transactions, and collected all customs' duties. Banks were not allowed to conduct payment transactions, neither were they permitted to mediate consumer cash deposits. The SDK was designed as a control mechanism to support a centrally planned social economic system: at the end of each day, all businesses and banks were required to deposit daily their receipts at the Payments Bureau, robbing banks of their primary source of cash deposits, and lowering dramatically banking income. Payments Bureaux's monopoly on domestic non-cash payments was removed in 1999.

To perform a non cash transaction through a Payments Bureau, a payment order must be issued to move money from a commercial bank account to a Payments Bureau Giro account; Giro accounts, however, must have a zero balance at the beginning and at the end of each day. Payment orders are still the primary mode of performing non cash payments; cheques are not used by the public, and the use of plastic cards is possible only in a few hotels and restaurants.

A preliminary report completed by a team of experts on Payments Bureaux focused on the interrelation between functions that are performed by the Payments Bureaux, in order to identify the appropriate sequencing for transfer of the different components of these functions to government institutions (Ministry of Finance, Central Bank, Tax Administration) and to commercial banks. The team found that the Payments Bureaux provided very little accounting services and they contributed little to the tax collection process. The financial verification of the assets of the Payments Bureaux was completed in April, 2000. Neither the ZPP (Bosnian) nor the ZAP (Croat) have revealed large anomalies; some items recorded in the balance sheet of the SPP (Serb) would have to be written off. This verification was necessary for transfer of assets to the institutions which would take over the functions performed by the Payments Bureaux. A number of functions have already been transferred to public institutions such as Cantonal and Entity Treasuries, Tax and Custom Administrations, Statistical and Privatisation Agencies.

At the beginning of 2001 the Payment Bureaux have developed into agencies for financial, IT and agent services. The agencies signed temporary contracts with the CBBH for acceptance, storage and issuing of cash until the end of April. Thus the CBBH is allowed to use 12 individual vaults of these agencies.

The inter-bank market. In May, 2000, the Central Bank signed with Logica of London a contract relating to a new Real Time Gross Settlement System (RTGS), covering high value and priority payments, and operating on a gross settlement basis. In August, the Central Bank signed another contract with Logica and with Halcom of Ljubjana for computer equipment and software. These firms have also enabled a new bulk of clearinghouses for retail payments (20,000 KM or less) established by the CBBH, the Bulk Clearing System (BCS). The CBBH initially operates the clearinghouses in its Main Units of Banja Luka, Mostar and Sarajevo, but it may add other cities in the future if the volume of orders requires. As BCS provides clearance on a net basis, it imposes particularly stringent criteria. For needs of this system, a new banking network has been made, connecting all commercial banks through the Main Units of the CBBH into the Unified Gyro Clearing in the CBBH in Sarajevo. The CBBH has provided the necessary equipment and the rented line from the commercial banks to the relevant Main Unit of the CBBH.

In the period from January 5th to March 31st, 2001, a total of 2.3 million transactions were performed in gyro clearing and RTGS system, with a value of 3.2 billion KM. As expected, the large number of transactions of small value was performed through gyro clearing (2,123,203 transactions and 1,339 millions KM), and transactions of big value were performed through RTGS system (183,515 transactions and 2,098 millions KM). Although 43 banks participate to both systems, the 75% of transactions are concentrated in only 12 of them. Then next problem to be solved is the issue of the banks from one Entity wishing to perform transactions in the other Entity: banks are allowed to open branches in another Entity if registered in one, but the Law on Banks did not anticipate the technical issue of the performance of payment transactions in the other Entity.

Table 1

BOSNIA AND HERZEGOVINA: MAIN ECONOMIC INDICATORS

	1997	1998	1999 Prel.	2000 Prog.
Nominal GDP (millions of KM)	**6,116**	**7,141**	**8,043**	**9,075**
out of which: *Federation*	*4,748*	*5,407*	*5,833*	*6,434*
Republika Srpska	*1,368*	*1,734*	*2,210*	*2,641*
Industrial production (percent change)				
Federation	36	24	11	15
Republika Srpska	27	23	2	12
Federation employment (end-period, thousands) (1)	**288**	**336**	**356**	**360**
Wages (KM/month) (2)				
Federation	493	524	551	597
Republika Srpska (3)	138	...	...	392
			Percent change	
Real GDP (annual average)	**40**	**13**	**9**	**10**
CPI (12-month average)				
Federation (in KM terms)	14	5	0	2
Republika Srpska (in YUD terms)	3	38	....	....
Republika Srpska (DM/KM-based index) (4)	-7	2	14	10
		Change in percent of opening broad mone		
Money and credit (5)				
Broad money	52	31	40	13
Net foreign assets	-11	1	38	-3
Net domestic assets	63	30	2	16
			In percent of GDP	
Fiscal balances				
Federation				
Revenue	13	13	12	13
Expenditure	14	14	14	16
Balance (6)	-1	-2	-1	-3
Republika Srpska (7)				
Revenue	15	21	30	26
Expenditure	15	26	35	30
Balance (6)	0	-5	-5	-4
		in millions of USD, unless otherwise stated		
External current account balance (8)	**-1,482**	**-986**	**-1,058**	**-942**
Exports	575	697	649	732
Imports	2,333	2,656	2,502	2,338
External debt (9)				
in millions of USD	4,076	2,985	3,095	2,632
in percent of GDP	119	74	71	62

Source: IMF. Data refer to the entire country, unless otherwise indicated. (1) Excludes people formally employed but not working; data for 1997 and 1998 i personnel. (2) Average of monthly gross wages paid in the year (first eleven months of 1999). (3) For 1997, YUD wages converted into DM using the parall exchange rate. (4) Until mid-1998 prices converted from YUD into DM using the parallel market exchange rate. (5) In percent of beginning of year broad mo Before grants. (7) Excludes municipal government operations. (8) Excluding official transfer. Data for 1997-1999 are rough estimates for the whole territory Projected external debt and debt service for 1998 exclude debt relief.

Table 2

MONEY SUPPLY STRUCTURE (M2)

(millions of KM)

Items	31 Dec. 1997		31 Dec. 1998		31 Dec. 1999		31 Dec. 2000	
	amount	%	amount	%	amount	%	amount	%
Money (M1)	252	21.4	310	20.0	1,100	50.8	1,405	55.9
Cash outside banks	*113*	*9.6*	*162*	*10.5*	*515*	*23.8*	*652*	*26.0*
Demand deposits in domestic currency	*139*	*11.8*	*148*	*9.6*	*585*	*27.0*	*753*	*29.9*
Quasi money (QM)	926	78.6	1,237	80.0	1,065	49.2	1,109	44.1
Time and savings deposits in domestic currency	*9*	*8.0*	*8*	*0.5*	*23*	*1.1*	*76*	*3.0*
Total deposits in foreign currency	*917*	*77.8*	*1,229*	*79.4*	*1,042*	*48.1*	*1,033*	*41.1*
Money supply (M2)	**1,178**	**100.0**	**1,547**	**100.0**	**2,165**	**100,0**	**2,514**	**100,0**

Sources: Central Bank of Bosnia and Herzegovina Bullettin, n.4, Jan/Dec 2000.

Table 3

BALANCE SHEET OF CBBH

(millions of KM)

Items	31 Dec.1997	31 Dec.1998	31 Dec.1999	31 Dec. 2000
			Assets	
Foreign assets	144	283	866	1,044
Claims on Government	0	0	0	0
Claims on nonfinancial enterprises	0	0	0	0
Claims on private sector	0	0	0	0
Total	**144**	**283**	**866**	**1,044**
			Liabilities	
Reserve money	170	239	814	945
out of which: *cash outside banks*	*113*	*162*	*515*	*652*
Demand deposits in foreign currency	0	0	0	5
Time and savings deposits in domestic currency	0	0	0	0
Time and savings deposits in foreign currency	0	0	0	0
Money market instruments	0	0	0	0
Bonds	0	0	0	0
Restricted deposits	0	0	0	0
Foreign liabilities	0	0	0	1
General government deposits	0	7	9	10
Government credit funds	0	0	0	0
Funds counterparts	0	0	0	0
Capital accounts	1	30	34	59
Other items (net)	-27	7	9	24
Total	**144**	**283**	**866**	**1,044**

Source: Central Bank of Bosnia and Herzegovina Bullettin, n.4, Jan/Dec 2000.

Table 4

CONSOLIDATED BALANCE SHEET OF COMMERCIAL BANKS IN BH

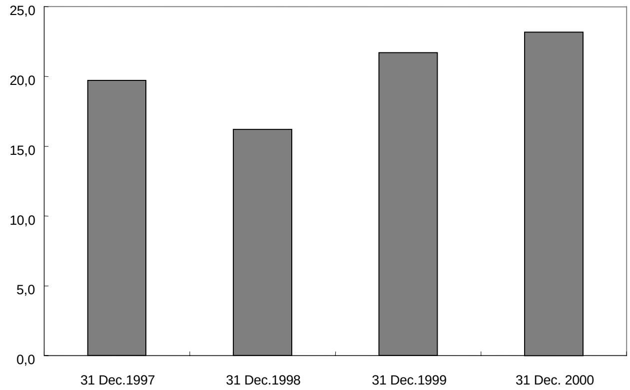
(millions of KM)

Items	31 Dec.1997	31 Dec.1998	31 Dec.1999	31 Dec. 2000
		Assets		
Reserves	239	207	276	289
Foreign assets	658	605	848	1,010
Claims on Government	134	113	37	35
Claims on nonfinancial enterprises	2,171	2,547	2,468	2,623
Claims on private sector	134	261	277	401
Total	**3,336**	**3,733**	**3,906**	**4,358**
		Liabilities		
General government deposits	234	222	170	144
Other demand deposits in domestic currency	139	147	584	753
Other demand deposits in foreign currency	448	638	465	553
Time and savings deposits in domestic currency	9	8	23	76
Time and savings deposits in foreign currency	363	467	577	475
Credits from CBBH	0	0	0	0
Money market instruments	0	0	0	0
Bonds	14	11	9	4
Restricted deposits	10	2	0	1
Foreign liabilities	1,514	1,606	1,519	1,585
Government credit funds	0	0	0	7
Funds counterparts	0	0	0	0
Capital accounts	1,043	1,305	1,257	1,140
Other items (net)	-438	-673	-698	-379
Total	**3,336**	**3,733**	**3,906**	**4,358**

Source: Central Bank of Bosnia and Herzegovina Bullettin, n.4, Jan/Dec 2000.

Figure 1

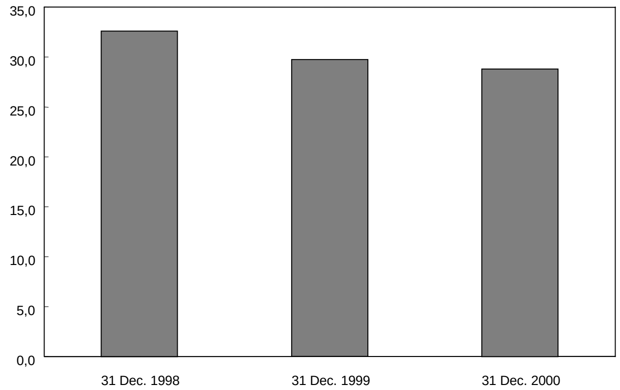
BH BANKS FOREIGN ASSETS
(percentage of total assets)



Source: Central Bank of Bosnia and Herzegovina.

Figure 2

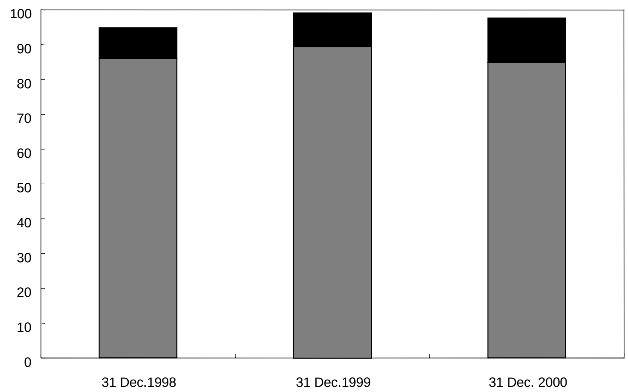
BH BANKS SHORT-TERM CREDITS
(percentage of total credits)



Source: Central Bank of Bosnia and Herzegovina.

Figure 3

BH BANKS CREDIT COMPOSITION
(percentage values)



Source: Central Bank of Bosnia and Herzegovina.

COUNTRY PROFILE: BULGARIA [*]

1. Transition process

The 1998 has been a year of transition after the deep crisis of 1997. Inflation has fallen to 1 per cent against 578 per cent in 1997. Industrial production has shown signs of recovery. The official unemployment rate has been 10.7 per cent of active population, although probably underestimated and bound to increase according to progress of the privatisation process.

The primary objective of the Government is that of privatisation and under this point of view Bulgaria is subject to a particular monitoring from the IMF that has linked any support to the realisation of the almost totality of planned privatisation within 2000.

Substantial improvement has been achieved in the liberalisation of the trade and foreign exchange regime as well as in price liberalisation. The trade tariff regime has been reduced and simplified, most export taxes has been eliminated and the number of products subjected to licensing requirements has been greatly reduced.

The currency board, introduced in July 1997 has been successful in pursuing its stabilisation goal, contributing to the dramatic decline in inflation, to a fall in interest rates and to the reduction of the fiscal deficit to sustainable levels. The external public debt is large but decreasing and has been restructured more favorably in terms of maturity.

Privatisation has been so far realised through several channels:

1) direct privatisation by the Privatisation Agency or Ministries;

2) two rounds of mass privatisation (the second one from January 1999);

3) privatisation under the coordination of advisors and consultants;

4) sale of shares on the national stock exchange (see below) – marginal so far.

By the middle of 2000, significant progress has been made in the privatisation of state owned enterprises, and several of the country largest enterprises were sold. The sale of the telecommunications operator is near completion: it will be the largest privatisation of the country up to now

2. Institutional aspects

Several attempts at economic reform in Bulgaria failed due to the fact that they were made under a non-democratic regime: the collapse of the Bulgarian banking system in Fall 1996 is one major indicator of financial sector distress.

In 1997, under pressure of the IMF, a currency board was introduced aimed at anchoring monetary policy and compressing inflation.

Improved banking supervision and stronger enforcement of prudential regulation have helped to strengthen the banking sector. Bank capital rose by 30 per cent in a year to June 1999 boosting capital adequacy ratio to 40 while the required 10 per cent risk-weighted capital adequacy ratio was met by all banks (the requirement has been raised to 12 per cent – with minimum capital of 7.7 million Euro – by the end of 1999).

Bank privatisation has been delayed by vested interests and political indecisiveness although the IMF suggested three amongst the largest banks to be privatised by the end of 1999. State saving banks became full-fledged commercial banks in 1998 with a government guarantee on deposits.

Authorities intended to liquidate 11 banks to which government is the main creditor. The draft law on bank bankruptcies has been adopted at the beginning of 2000 (deposit insurance funds will handle bank failures).

The privatisation of the five largest banks is planned for 2001. The banking regulatory power relies on the BNB, that pursues a policy of strictly adherence to international practices (EU directives on banking as well as Basle Committee).

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[*] By Enrico Gisolo.

The first half of 1999 saw draft amendments to the Law on Banks which came into force in June 1999. They helped to improve the legal framework by clarifying terms and expanding the scope of supervisory measures against banks, with a special view to accelerating bankruptcy proceedings. According to the new legal framework, commercial banks have to produce a monthly balance sheet and income statement. The BNB is introducing a risk assessment system CAMEL. As of now banks deemed to be in compliance with the newly introduced system are 22 out of 34, including 5 banks of systemic importance, and 15 medium and small-scale banks (including two subsidiaries of foreign banks).

3. The banking system

3.1 Market structure

The evolution of Bulgaria's banking sector may be characterised by three distinct phases: during the first one, covering the 1930s and 1940s, about 60 commercial banks were operating in a market-oriented economy. This period was concluded by the nationalisation of 1948. The second phase covers the period of the state-organised centrally planned economy, which featured a concentration of financial resources while the independent role of the central bank was eliminated. Until the mid-1980s there were only two other financial institutions in addition to the BNB – the State Savings Bank and the Bulgarian Foreign Trade Bank. Just before the changes of 1989, some financial institutions were established for the purpose of financing specific sectors of the economy – agriculture, metallurgy and machine engineering, chemistry and pharmaceutical industry, large infrastructure projects, construction. The third phase is still running and is directly related to the transition to a market economy. As of the end of 1999 the Bulgarian banking sector comprised 34 commercial banks.

3.2 Performance

During the first half of 1999, 12 banks reported losses. The average weighted interest spread between assets and liabilities (on a yearly basis) is 6.1 per cent . The ratio of off-balance-sheet credit substitutes to the volume of extended credits was, on average, in June 1999 of 24 per cent .

Amongst the 27 banks subject to capital adequacy regulations (i.e. excluding the branches of foreign banks), the value of the total capital adequacy indicator (capital base on risk-weighted assets) by bank varies from 15 to 284 per cent .

3.3 Risk-taking

As of June 1999, within the Bulgarian banking system, the share of standard exposures to financial and non-financial institutions was 83.1 per cent , and classified exposures in the two riskiest groups (doubtful and loss) amounted to 8.6 per cent .

Most banks adopt a conservative policy of lending and maintain mainly risk-free and low-income assets witch limits the potential for securing higher efficiency, but also limits credit risk.

The ratio of total banking system big credits to capital base was recently 1.13 times, far below the admissible eight times. At the same time, 13 banks reported big credit exposure exceeding the admissible 25 per cent of their capital base.

4. Money and financial markets

Trade in Government securities, i.e. bills (with a maturity of up to one year), notes (with a maturity of one to five years) and bonds (with a maturity of over five years), represents a major part of the government securities and money market.

The Ministry of Finance together with the BNB regulate both the primary and secondary markets for government securities and the Government Securities Depository settles the transactions.

The secondary market is an over-the-counter one, with transactions confirmed by telex on the basis of offers exchanged via Reuters.

Participants in the government securities and money market are all investment intermediaries, but only those which are authorised as primary dealers have access to the Government Security Depository. All other legal and physical persons may only participate in the primary and secondary markets through primary dealers.

The Bulgarian securities market can be divided into two segments, a market for debt instruments and an equity market. A common feature of these markets is that the traded securities are held in book-entry form: Bulgarian legislation allows the existence of equities in paper forms, but only book-entry equities may be offered publicly.

The equity market operates on the Bulgarian Stock Exchange (BSE). At present only equities are traded, but trading in corporate bonds and government securities is planned for the future.

The Bulgarian Stock Exchange has the following market segments:

1) the official market (divided into three sub-segments);

2) the free market.

Similarly to EU practice, the BSE has established minimum listing requirements, in terms of firm size, for each segment of the official market. The shares traded in the free market, usually belonging to firm involved in the mass privatisation program, do not meet the requirements to be admitted to quotation in the official market.

Only investment intermediaries (stockbrokers and banks, including the branches and subsidiaries of foreign banks) authorised by the Securities and Stock Exchange Commission are admitted to stock exchange and over-the-counter transactions, that requires the physical presence of the brokers on the trading area. Recently screen based trading (without the physical presence of the broker) have been admitted on the free market segment only, but the number of BSE members making use of this opportunity, even if growing, is still low.

To be admitted to trading activity an investment intermediary must be licensed by the Securities and Stock Exchange Commission (SSEC) and be member of the Stock Exchange.

To be licensed by SSEC an intermediary (with the exception of banks, whose BNB license is comprehensive of any security transaction) must meet requirements relative to the adequacy of capital and the structure of his balance sheet. To be member of the Stock Exchange there are some further specific access criteria: holding of shares of the BSE, employment contract with at least two licensed brokers, etc.

5. The payment system

5.1 Overview

The Bulgarian payment system undergone significant changes in the 1990s. The banking Integrated System for Electronic Payments, BISERA (Bulgaria's national settlement system) was introduced in 1992, The national operator BORICA, was established in 1995 to service card payments. BORICA Ltd. is totally owned by the BNB and is the operator of an ATM and POS network in Bulgaria: it administers ATM and POS transactions and is responsible for the maintenance of the terminals, performs on-line authorisation of card payments and is authorised by its members to act as a settlement agent for domestic debit cards.

Two securities settlement systems where also established, the Government Securities Depository (GSD) and the Central Depository AD (CDAD) in 1996.

All the settlements systems in the country are organised as gross systems. The level of computerisation varies: BISERA is fully computerised, while for the other two settlements systems there are some manual operations in use, which are going to be minimised through the implementation of several new projects. According to the Law on the Bulgarian National Bank, the central bank is responsible for the organisation, maintenance and development of the payment system.

Cash payments are still widely used in the country. However, the share of non-cash payments is increasing. Credit transfer is the dominant non-cash payment instrument in terms of value and volume. The growth of card payment is considerable.

During the 1999 bankrupt banks continued closing branches directly participating in the payment system and newly opened branches were included. As a result the number of direct participants in the payments system has increased by now to 622.

Between January and June 1999, 6.696.962 interbank settlements were cleared through the BISERA electronic interbank transfer system.

5.2 Payment media used by non-banks

Cash. The monetary unit of Bulgaria is the lev (BGL). It was redenominated on July 5, 1999 (when 1000 old levs were replaced by 1 new lev). One new lev is divisible in 100 stotinkas.

The BNB has the exclusive right to issue banknotes. Since 1998 they were printed abroad, but now they are printed internally by the BNB. The coins are produced at the Bulgarian Mint, which is a company totally owned by the central bank. The BNB distributes and collects banknotes and coins through its head office and its branches across the country.

Cash payments are widespread in Bulgaria, even if there is no reliable statistical data on the correspondent volume and value. However at the end of 1997 the banknotes and coins in circulation represented 57.4 per cent of the M1 Monetary aggregate and 7.68 of 1997 GDP.

The number of citizens holding accounts connected to debit cards has increased in recent years: however, most salaries are still paid in cash.

Debit cards are used almost exclusively at ATMs as cash dispensers: almost all retail transactions are made in cash, owing to the small number of POS terminals available.

Non cash. Non cash payments can be operated by a payer that holds a current account or a demand deposit. Each person my hold accounts in national or foreign currencies without limitations. Most banks offer account in Bulgarian levs, US Dollars, Deutsche Marks and Swiss Francs. However, in accordance with currency legislation, payments within the country can only be made in Bulgarian levs. Payments in foreign currency are allowed only for imports of goods and services, studies and medical treatment abroad, etc.

<u>Credit transfer</u> is the most widely used form of payment between entities in the corporate and the public sectors. It is also used for the payment of salaries, taxes, duties, subscription fees, etc. For most banks, credit transfers constitute over 95 per cent of all payments. Usually a transaction takes up to three working days (more for payments abroad operated by small banks with a limited number of foreign correspondents).

Only banks licensed to operate abroad are entitled to make cross-border credit transfers. For these services Bulgarian banks use correspondent accounts with foreign banks and the payments are executed through S.W.I.F.T.

<u>Cheques</u> have never been widely used as a payment instrument in Bulgaria, mainly due to the risk associated: they represent a negligible percentage of all payments, their use being limited to counterparts which are well-acquainted one another.

<u>Direct debits</u> (indebtments of bank account with the permission of the holder) is increasingly used to pay providers of telephone, electricity, water and heating services as well in the securities settlement.

Credit cards are not yet widespread: several Bulgarian banks issue them under agreements with foreign counterparts (VISA, Eurocard/MasterCard and American Express circuits). On the contrary debit card (especially domestic one) are increasingly used. By the end of 1997 eight banks were issuing cards. All of them are members of the national card payments system BORICA.

Telecommunications companies and chains of petrol stations issue prepaid cards.

At the end of 1998 there was one ATM network in Bulgaria (operated by BORICA) and two POS networks (operated by BORICA and the Bulgarian Post Bank). The network of ATM and POS terminals is not very extensive at the moment but it is growing: the number of ATMs was 32 in 1995, 118 in 1997 and 180 in the second quarter of 1999. POS terminals was 100 in 1997 and increased to more than 510 in the second quarter of 1999.

The postal network is the largest branch network in Bulgaria. It is used for money transfer in small villages in which there are no bank branches, or if either the payer or the payee does not have a bank account. The total amounts of payments is currently negligible compared to the volume regulated through BISERA.

There is a significant interest in Bulgaria in making payments over the Internet, but, due to the limited number of credit cards, the total amounts of such payments remains low. Only one bank handles Internet transaction with cards, but it processes the transactions as mail orders (sophisticated systems complying with internationally set standards are not yet operative).

Furthermore a number of banks cooperates with Western Union in the execution of fast money transfers.

Some banks recently started offering home banking (or telebanking) services.

5.3 Interbank exchange and settlements system

Most of the non-cash payments in Bulgaria are settled through the national settlement system, BISERA (Banking Integrated System for Electronic tRAnsfer), which is a gross settlement system that has been operating since 1992. It has two basic functions:

a) the clearing of electronic messages comprising payments instruction of banks;

b) the settlement of payments.

BISERA operates at T+1 value date: nevertheless there is an option for some payments to be settled during the same working day directly by the BNB, on the basis of payments orders presented directly at the counters of the BNB. This express service (that settles a limited number of transaction of high value) is dedicated to bank-to-bank payments related to interbank money market operations, payments on the primary and secondary State security market, as well as some budget payments or payments initiated by or addressed to the BNB.

BISERA has been designed, programmed and implemented by Bankservice Joint Stock Company on behalf of the BNB. Bankservice is responsible for the development, maintenance and operation of the system. It also offers other telecommunications and banking automation services to banks. The major shareholder of the company is BNB (37 per cent of the capital). The remaining shares are distributed amongst commercial banks, according to quotas depending on the volume of bank activity as well of the number of branches belonging to the bank and the size of each bank's own capital.

Bankservice has a pyramid structure with a head office, five branches and 28 local offices, which are the access point to BISERA.

According to the current banking regulation, all licensed banks in Bulgaria are obliged to make all the interbank payments trough BISERA (bank whose license have been withdrawn are immediately excluded from the system). Also branches of banks that do not have an internal payment system can access directly to BISERA.

There are also two non-bank financial institution which also have direct access to BISERA: the Central Depository AD and BORICA. They respectively act as settlement agents in the payment related to securities transaction and interbank payments related to card transaction.

It is expected that the current system will be replaced by an RTGS system (BISERA4) in the next future.

COUNTRY PROFILE: CROAZIA *

1. The economic structure

1.1 Economic background (1992-97).

Independent since October 8 1991, Croatia economy went through a deep recession until late 1993 when a successful stabilisation plan was launched. Led by domestic demand, economic growth recovered from the first quarter of 1994 to the third quarter of 1998 with real GDP increasing around 6 per cent a year (Fig.1). After a period of hyperinflation, prices regained stability in 1995 when the increment of retail prices and of cost of living was around 3-4 per cent a year and nominal wages stabilised in 1996 (Fig.2). External imbalances widened because the bold increase of domestic demand – mainly private consumption – pushed import while export stagnated due to the loss of competitiveness triggered by wage increases greater then productivity gains: from a surplus of 5,5 per cent of GDP in 1993-94, the current account reached a unsustainable deficit of 23 per cent of GDP in the last quarter of 1997 (Fig.3 and 5). Deficits were mainly financed by capital inflows sustained by the repatriation of resident's foreign savings. Foreign exchange reserves at the Central bank, equalling only 1.6 month of goods' imports in 1993, doubled in 1996 reaching 3.2 month. A prudent fiscal policy kept the consolidated central government budget in balance with a surplus of 1.6 per cent of GDP in 1994 and a deficit of 1.3 per cent in 1997 (Fig.5). Deficits were domestically financed until 1996 when the share of external sources jumped over 40 per cent of the total debt (Fig.6). The middle solvency rating (BBB or Baa) given to Croatia by leading credit rating agencies, made easier to collect capital from international markets at interest rates below domestic rates. Domestic market for public debt remained underdeveloped and total Croatian external debt soared from 23 to 35 per cent of GDP (Fig.7). In 1996-97 short term debt stayed around 7 per cent of total debt; the share of public creditors decreased from 23 to 14 per cent while that of private creditors increased from 20 to 31 per cent.

1.2 Recent developments (1998-2000).

In 1997 economy showed signs of overheating and macroeconomic policies were tightened late that year, early 1998 and again in early 1999. Economic activities experienced a slowdown: in the last quarter of 1998 GDP fell by 4.4 per cent and did not resume growth until the last quarter of 1999. On average, 1999 recorded a 0.4 per cent fall in GDP; growth accelerated in 2000 reaching 4.5 per cent in the second quarter and 4.1 per cent at year-end. Policy interventions and economic downturn reduced the current account deficit to 7,5 per cent of GDP (2,5 per cent by end-2000) but structural imbalances were not properly addressed. Policy stances were constrained by the emergence of a banking crisis exacerbated by a loss of confidence in international markets (Croatia was downgraded to BB+). Failures in industrial restructuring led to growing domestic arrears of private and public enterprises. The unexpected large revenue from the introduction of VAT (January 1998) was accompanied by renewed spending pressures and a relaxation of fiscal stance. In 1999 Government expenditure equalled 50 per cent of GDP, 47 per cent in year 2000. External debt mounted to 49 per cent of GDP in 1999 and increased again in 2000 at 57,5 per cent; short term debt represented 4.6 and 6.5 per cent of the total in 1999 and 2000 while the share of private creditors remained around 42 per cent; the share of foreign financing of total Central Government debt has reached 64 (Fig.6). Since the second half of 1998 competitiveness improved due to exchange rate depreciation (Fig.9) and real wages modest increases. Nevertheless Croatian exports faced difficulties coming from either specific problems of quality and variety in the composition of goods and from a decreasing trend in the European demand. In March 1999 macroeconomic policies were tightened again following concerns about reserves, external financing and currency depreciation. Exchange rate remains fairly stable during 1999 showing a new depreciation trend thereafter. In 2000 prices went under pressure and retail prices increased by 7.4 per cent at year-end (6.2 on average). On July 17, 2000 Croatia became the 137th member of the WTO: on a 5-7 years transitional period, Croatia is committed to lower the average nominal tariff rate from 10 to 5.3 per cent (by 2005) on industrial products and from 33.7 to 16.4 (by 2007) for agriculture products and foodstuffs.

* By Maurizio Gresti

2. Institutional Aspects

2.1 Legal framework of banking and financial activities.

A market-oriented legal framework was introduced with the Law on the National Bank of Croatia (1992), the Law on Banks and Savings Banks (1993) and the Law on Bank Rehabilitation (1994). With this framework the banking system rapidly developed, either in the number of banks and in operational volumes, until end-1997. In 1998 a deep banking crisis erupted due to unsoundness of many banks structure and activities, weak supervision authority of the Croatian National Bank (CNB), adverse economic developments and monetary tightening. The New Banking Law passed at the end of 1998 and CNB's surveillance functions were strengthened. In line with international standards and BIS recommendations, the new legislation sets higher minimum initial capital requirements, strengthens maximum exposure levels and capital ratios, reinforces organisational structure, internal controls and auditing of banks; it improves financial discipline and procedures for bank exit, strengthens the reporting system to CNB and defines actions that can be taken to prevent and to address critical situations. The New Banking Law establishes the institution of temporary administrator in charge of the strategy of failing banks and it abolishes the category of savings banks, requiring these institutions to meet the characteristics of commercial banks by end-2001. Other relevant financial laws pertain to the issue and sales of securities (1995, amended in 1998), to the establishment of investment funds (1995, 1996) and to the take-over of joint-stock companies (1997). With the establishment of the Croatian Securities and Exchange Commission (1995) and the Central Depository Agency (1997), infrastructure and legal framework have made advances although they still need refinements. In April 2001 a new law on CNB was enacted; according to EU comments the new law is not completely in line with EU legislation perspective regarding the institutional, personal and financial independence of the central bank.

2.2 The structure of the banking and financial systems.

As of June 2001 there are 42 licensed banks and 25 savings and housing banks; all credit intermediaries are under CNB surveillance. There are six representative offices, one of which is the Italian Cassa di Risparmio di Udine e Pordenone. Seventeen banks and saving banks are under bankruptcy procedures; to other nine intermediearies, license has been revoked during 2000-01. Foreign banks control twelve Croatian banks, five of which at 100%. Recently, Italian participation in Croatian banks increased substantially: besides Cassa di Risparmio di Trieste, which founded and now holds 72 per cent of "C.R. Trieste d.d." in Zagreb, and Finanziaria per i Traffici Internazionali, which appears to have a 7 per cent in a Croatian bank, Gruppo Intesa (thorough Banca Commerciale Italiana) and Unicredito acquired majority stakes in former public Privredna (66.6 per cent) and Splitska Banka (63 per cent) respectively. Unicredito has also planned to acquire 70 per cent of voting shares in Zagrebacka banka. Commercial banks remain the cornerstone of the financial system, non-banking sectors playing a marginal role. Insurance sector is rapidly developing. At the end of 1999 there were 26 insurance companies in Croatia, four are controlled by foreign investors, other three companies have substantial foreign participation and two are state-owned, one of which is going to be privatised. Insurance market is highly concentrated but quite competitive; the new Insurance Act should improve competitiveness and soundness of this sector.

2.3 Monetary policy.

Price stability, liquidity and solvency of the banking system are the objectives of CNB's policies. Croatia has a managed floating exchange rate regime; exchange rate is the nominal anchor for monetary policy. Monetary policy's instruments are standard and include: Reserve requirements at 23.5 per cent reserve rate (22 per cent since July 2001) with 4.5 per cent remuneration on kuna deposits and international market rate for the foreign currency component; CNB bills in kuna and foreign currency; Repo auction for short-term bridging of liquidity on CNB and Treasury bills (banks offer the interest rate and the nominal amount of bills they want to sell); Lombard loans for credits up to 15 working days per month; Overnight loans (must be repaid the next working day); Short-term liquidity granted to troubled but not insolvent banks for liquidity problems with a final maturity within a year; Short term to the Government for bridging inflow and outflow discrepancies (credits must not exceed 5 per cent of the budget of the current year and must be repaid by the end of the current fiscal year). Foreign exchange management uses compulsory kuna deposit by banks with CNB for foreign financial credits; foreign currency auctions; foreign currency swaps; a compulsory ratio between forex claims and liabilities and a limited forex position exposure to currency risk position and capital. In September 2000 CNB decided to unify reserve requirements on kuna and foreign exchange deposit, causing an upsurge in liquidity which was sterlized by banks' investments in CNB bills. In year 2000 monetary aggregates showed a relatively high growth but high liquidity of the banking system and low interest rates did not trigger an increase of real sector lending and employment. For 2001 monetary policy is targeted to an inflation rate not exceeding 4.5 per cent; further reduction of interest rates is expected.

3. The Banking System

3.1 Development of the banking system.

In the last decade Croatian banking system underwent two crisis. The first one, rooted in the financial misbehaviour of the previous political regime, was not timely addressed. Banking system's unsoundness was exacerbated by lax requirements while inflationary growth and high liquidity – partly due to the repatriation of savings by residents – contributed to the rapid increase of the number of banks and their activities. Supervisory authorities had weak legal power, inadequate structures and expertise to address banking crisis. Reforms did not change business practices: several state-owned banks still enjoyed financial support; privatisation often left old management unchanged, ties between enterprises and banks survived, small and inefficient universal banks could be established. Four out of the six largest banks went insolvent and were recapitalized with an estimated cost of 22 per cent of the 1997 GDP. The second crisis began in March 1998 with the insolvency of the fifth largest bank followed by a number of small and medium-size bank failures. The crisis involved around 12 per cent of total bank assets; the rehabilitation cost around 5 per cent of GDP. In terms of GDP, total banks' assets picked at 69 per cent in 1997 dropping four points by end-1999. Since end-1994 foreign claims accounted for 8-10 per cent of GDP (12.5 per cent in 2000). Claims on domestic sector represented about 50 per cent of GDP: claims towards Government halved form 20 to 11 per cent while those towards private sectors increased from 32 to 39 per cent (Fig.10). Claims on banking and financial institution remained negligible. Total loans increased form 26 to 37.5 per cent of GDP (41 per cent of GDP in 1998); foreign currency loans dropped from 12 to 4.6 per cent of GDP (Fig.11). Loans to domestic enterprises were fairly stable around 20-22 per cent (26 per cent in 1998) but currency composition showed dramatic changes over the period; loans to households increased form 4 to 15 per cent (Fig.12). Croatian banking activities are founded over narrow basis and this reflects a low degree of economic development (Fig.13). Saving ratio recovered from end-1995 minimum (10 per cent of GDP) to 20 per cent in 2000. Financial depth – given by the ratio of intermediation volumes over GDP –increased at 63 per cent in 2000. Money multiplier – an indicator of banks' ability in creating deposit money – reached 3.2 in the first quarter 1998 and then decreased to 2.3 along with monetary policy tightening. The level of private sector credit decreased until 1996 reaching 2.6 times the base money; then increased at 3.2 at the end of 1998 and then decreased again to 2 by the last quarter of 2000. The share of foreign currency deposits is in the range of 37 (Apr. 1995) 45 (March 2001) per cent of total banks liabilities while forex deposits blocked for bankruptcy procedures decreased from 30 to 1.3 per cent of banks liabilities (Fig.14).

3.2 Market structure.

Official statistics divide banks in six groups according to the size of total assets. Out of the 45 reporting commercial banks at end-2000, eighteen have assets for over 1 billion kuna (130 million US$) of which only two exceeding 10 billion kuna; twenty-four banks have assets in the range 100-1.000 million kuna; three small bank have less then 100 million kuna assets. Saving and housing banks (29) represent a marginal share, slightly over 1 per cent, of total banking assets. For surveillance porpoises banks are divided in four main categories. At the end of 1998 non-problematic banks numbered 17 and represented 72 per cent of total banking assets; 26 were regional banks without operating problems (7.4 per cent of total assets); 9 banks (9.5 per cent of total assets) were experiencing operational difficulties while those under bankruptcy (7 banks for 7 per cent of total assets) were responsible of the bulk of banking sector losses equalling 215 million US$ (one per cent of GDP). In year 2000 the privatisation of the banking system drastically accelerated: the number of State-owned banks were reduced from ten to three, domestic private owned banks decreased from 30 to 21 while foreign investors control 20 banks (13 in 1999). In terms of total assets, State and State-participated banks account for only 6 per cent in 2000, down from 45 per cent in 1999; domestic private banks account for 10 per cent (14.5 per cent in 1999) while foreign owned banks represent almost 84 per cent of total (Fig 15). With recent acquisitions performed by Gruppo Intesa and Unicredito, Italian investors account for a substantial share of foreign banks in Croatia. The concentration of the Croatian banking system is high and stable: the biggest bank (Zagrbacka, privatised in middle-90s'), accounts for almost a quarter of total assets; the first two for 47 per cent and the top four banks for 61 per cent (Fig. 16).

3.3 Efficiency and risks.

Interest rates started to stabilise in the first quarter of 1994; from March 1994 to March 2001 average rates on local currency credits declined from 23.3 to 8.9 per cent and from 5.6 to 3.6 per cent on deposits. On average, in 2000 spread stood at 8.3 per cent (Fig.17) and decreased to 6.7 per cent in first quarter of 2001. Many are the reason for high interest rates in Croatia: risk premium for capital, currency and credit risk premium, inadequate credit policies and risk management by banks, expensive funding and financial markets inefficiency (segmentation, low competitiveness, poor supply of financial instruments). The high level of interest rates is reflected also in the structure of official rates (Fig.18). After the 1998 banking crisis, capital adequacy for the entire banking system fell at 12.7 per cent from 17,7 per cent of 1996; by official figure in year 2000 it stands at 21.4 per cent. Bad loans (categories C, D,E) reached 10.3 per cent of total portfolio in 1999 and decreased by one percentage point in year 2000 (Fig.19). It should be noted that according to IMF "*Bank's annual financial statements tend to understate the riskiness of their assets....leading to underprovisioning of bad assets and overstatement of capital adequacy ratios*" (IMF, March 2001, p.54).

4 Financial System

4.1 Other financial intermediaries.

Banks are by far the most important financial intermediaries, other intermediaries playing a marginal role. After 1994 liberalisation act, small private-owned insurance companies have began to flourish; international players are interested in Croatian insurance market after war's end in 1995. In 1998 a new Insurance Act improved financial soundness by raising capital requirements and strengthening operational and auditing procedures. The growth of the insurance sector could be reinforced by the privatisation of the biggest State-owned insurance company, by the inroad of European intermediaries (especially from Austria and Germany) financially assisted by EBRD, by the pension system's reform and by the diffusion of health insurance and of new financial-insurance instruments. In 1999 insurance market collected 4.3 billion kuna (567 million US$) gross premium, equal to 3 per cent of GDP and up 6.5 per cent from the year before. Non-life insurance accounts for 84 per cent and motor third-party liability for 34 per cent of total business. Croatia Insurance, first State-owned company, holds 54.6 per cent of the market; the second one, the private-owned Zagreb Insurance, has a share of 5.7 per cent. Financial market growth is expected to be spur by the ongoing pension system reform. Parallel to EC pension reforms, the Pension Insurance Law was passed in July 1998 and raised the age of retirement, lengthened the contribution period, reduced the benefit level and changed the funding system. The pension system will see the introduction of a compulsory and voluntary insurance schemes based on individual capitalised savings; private pensions schemes are expected to be launched in 2001. Meanwhile EBRD and IFC (World Bank Group) are involved in establishing pension fund management companies. Investment funds are regulated by the Investment Fund Act under the supervision of the Securities Commission (CROSEC). There are seven investment funds created through voucher privatisation of 471 formerly socially owned companies for a total nominal value of 2 billion US$ (1998). These funds will be converted to closed-end investment funds by 2004.

4.2 The equity market.

The Zagreb Stock Exchange (ZSE) is joint-stock company founded in 1991 by 25 banks and insurance companies (presently 40 members). ZSE has three segments: Quotation I and II (official market), where four companies' shares and four bonds are listed, and Quotation TN (Over-The-Counter) for 57 ordinary shares and 5 preferred shares. Another relevant OTC market is based in the city of Varazdin. ZSE activities expanded during 1997 following economic stabilisation, sovereign debt rating BBB, introduction of an exchange index (CROBEX) and privatisation of relevant firms (such as the pharmaceutical Pliva) and banks (Zagreb Bank). At end-1997 total turnover was 2.1 billion kuna (1.7 per cent of GDP) with a daily average of 10.4 million kuna, market capitalisation (26.8 bill. kuna) equalled 21.6 per cent of GDP. In 1998-99 ZSE was negatively influenced by the domestic economic environment and by the crisis of emerging markets. In 2000 ZSE indices regained some momentum: at year-end turnover and market capitalisation can be estimated around 1.3 and 14 per cent of GDP respectively, average daily turnover increased from 2.3 to 8.1 million kuna and CROBEX stands at 890 (952.5 at mid-June 2001) (Fig.20-21). The development of Croatian stock market is hampered by structural bottlenecks. On the supply side incentive for private-owned companies to be publicly traded are limited; market remains thin and highly concentrated (Pliva and Zagreb Bank represent over 60 per cent of market capitalisation). On the demand side privatisation failed to play a catalytic role and household equity investments are still underdeveloped, although the demand could be increased with the reform of the pension system by local institutional investors. Institutional and regulatory fragility must be addressed: financial information should be improved by reinforcing the Company Law and the Securities Law; stronger monitoring activities and authority by CROSEC are needed in order to lower costs and increase safety of transactions. Fixed-income securities market – which trades mainly Treasury and CNB bills – constitutes only a marginal source of financing for government and enterprises. Banks and, to some extent, insurance companies are the only players and secondary transactions are very limited. Usually banks hold debt instruments until maturity, liquidity being ensured by the transactions between banks and the CNB. Furthermore the development of capital markets require better clearing process and payment system.

4.3 The money market.

The Zagreb Monetary Market (ZMM) was set up in 1990 under the Money and Capital Market Law as a joint-stock company owned by 27 banks and 2 insurance companies. Money market operations are organised in three separate segments: the daily interbanking transactions; the overnight market which starts after the closing hour of the payment agency (ZAP); the daily direct bilateral transaction among major banks. In the first two segments ZMM is the sole broker. Sound banks are reluctant to deal with weaker ones on the money market and resource-surplus banks usually hold excess deposits with CNB or lend funds on the bilateral market whose participant are mainly strong and sound banks. With the 1998 crisis many banks withdrew from ZMM causing liquidity problems; in that occasion interest rates reached 17.5 per cent in June, up from 9.4 per cent at end-1997. Since the second quarter of 1999, with the stabilisation of the banking sector and the improvement of liquidity condition, interest rates started to decrease reaching historical minimum in March 2001 of 3.6 per cent on the daily market and of 2.7 per cent on the overnight (Fig.22). Given money market conditions, banks' liquidity is mainly ensured by CNB lending.

5. The Payment System

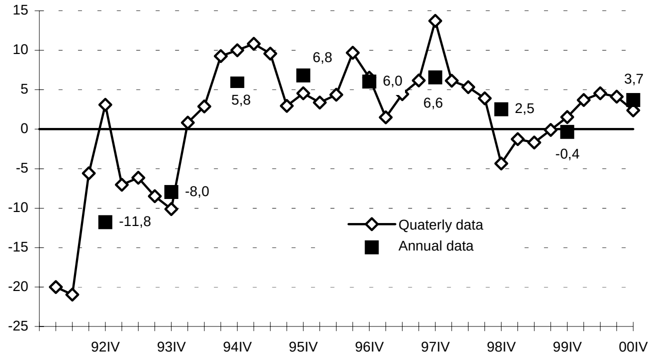
Croatia had a payment system similar to that of other ex-Yugoslavia countries where National Payment Agency (ZAP) played a central role in processing all payments through dedicate accounts. As similar reforms currently undertaken by neighbour countries, the functional role of ZAP will be passed to banks. In October 2000 a Join CNB-Ministry of Finance Committee was invested to draw a new Domestic Payment System Law which will replace the 1993 legislation. For large transaction in April 1999 the Croatian Large Value Payment System (CLVPS) was implemented. On February 5, 2001 the National Clearing System (NCS) was launched for small value payments transactions. With the NCS interbank payments are settled on net multilateral basis; the system is expected to process 300,000 transactions daily. Participants in the NCS are banks, saving banks, CNB, ZAP and third parties (institutions which executed payment transactions on a contractual basis on behalf and for the account of banks and savings banks). All cashless interbank payments are now settled through the CLVPS and the NCS; banks' daily transit account with ZAP are used only for cash payment transactions; CNB maintains the accounts of all banks and savings banks. The introduction of NCSentral Bankit is expected is is opreating On February 5 2001, a new National Clearing System (NCS) completes the infrastructure needed for the next step of payment system's reform: the transfer of customers accounts from the ZAP to commercial banks.

Croatia: Main Economic Indicators

	1997	1998	1999	2000
Population (mid year estimation)	4,572,000	4,501,000	4,554,000	4,535,000
Exchange rate (mid-point end-year)				
- Kuna per 1 US$	6.303	6.248	7.648	8.155
- Kuna per 1 Euro	6.947	7.329	7.679	7.598
Gross Domestic Product				
- current market price (billion Kuna)	124	138	144	158
- current market price (million US$)	20,107	21,751	20,177	18,908
- growth rate (real Kuna)	6.8	2.5	-0.3	3.7
- per capita (US$)	4,371	4,663	4,431	4,169
Current account				
- Trade Balance (million US$)	-5,196	-4,147	-3,299	-3,237
- Current account balance (mill.US$)	-2,325	-1,530	-1,523	-531
- Current account balance (% GDP)	-11.4	-7.1	-7.5	-2.5

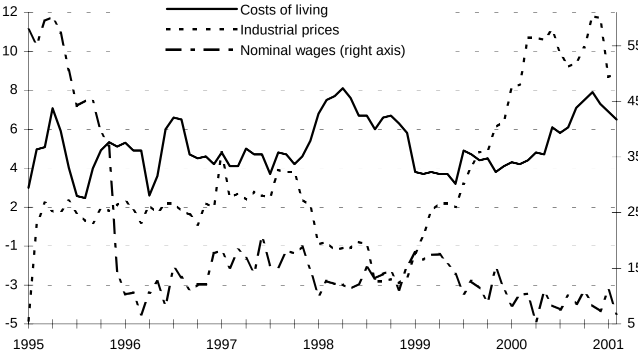
Unemployment rate (annual average)				
- Statistical survey	17.5	17.2	19.1	22.9
- ILO definition	9.9	11.4	13.6	15.1
External debt				
- million US$	7,452	9,586	9,872	10,876
- % GDP	37.1	44.3	49.2	57.5
- Tot. Ext. Debt / Export G&S (%)	90.6	111.9	121.6	125.7
Inflation rate (annual average)				
- Retail price	3.6	5.7	4.1	6.2
Reserves (million US$)				
- CNB international reserves	2,539	2,816	3,025	3,525
- Banks foreign exchange	2,333	1,949	1,069	2,456
Overall Budget Balance				
- million Kuna	-1,587	882	-2,802	-7,697
- % GDP	-1.3	0.6	-2.0	-4.9
M1 (billion Kuna)	14	14	14	18
- % GDP	11.1	9.8	9.7	11.7
M4 (billion Kuna)	51	57	57	73
- % GDP	40.9	41.7	39.7	46.6
Banks' Assets (billion Kuna)	85	93	93	110
Banks' Loans (billion Kuna)	45	56	54	59
- National currency	36	47	46	52
- Foreign currency	9	10	7	7
- to enterprises	31	37	31	32
- to households	13	18	19	24
Interbank interest rate (end period)				
- daily market	9.3	15.5	12.4	4.5
- overnight	8.1	10.0	10.0	3.3
Banks' rates (average on Kuna)				
- Credit rate	14.5	16.9	11.7	10.9
- Deposit rate	4.4	4.1	4.3	3.6
CNB's rates				
- Discount rate	5.9	5.9	7.9	5.9
- Lombard rate	9.5	12.0	13.0	12.0
Zagreb Stock Exchange				
- Market capitalisation (million Kuna)	26,760	18,276	19,225	22,179
- Market capitalisation (% GDP)	21.6	13.2	13.4	14.1
- Turnover (million Kuna)	2,095	929	549	1,990
- Turnover (% GDP)	1.7	0.7	0.4	1.3
- CROBEX	1002	712	715	890

Fig. 1 GDP Real Growth
(Quarterly and annual data - Year-on-year change)



Source: Croatian National Bank

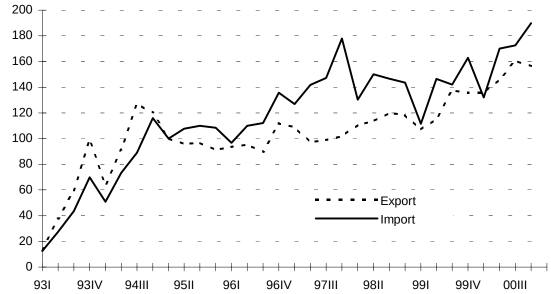
Fig. 2 Prices and Wages Developments
(Monthly data - Percent year-on-year)



Source: Croatian National Bank

Fig. 3 Import and Export of Goods

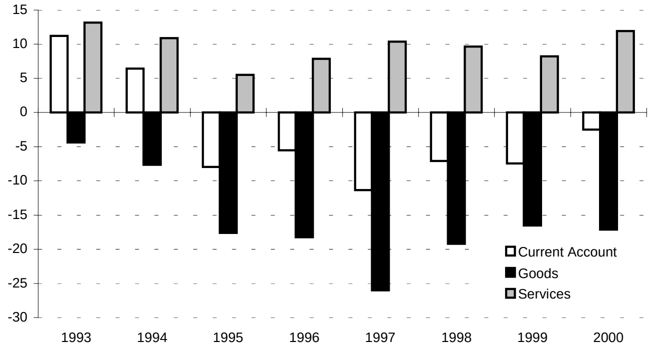
(Index: 1st Quarter 1995 = 100)



Source: Croatian National Bank

Fig. 4 Balance of Payments Development

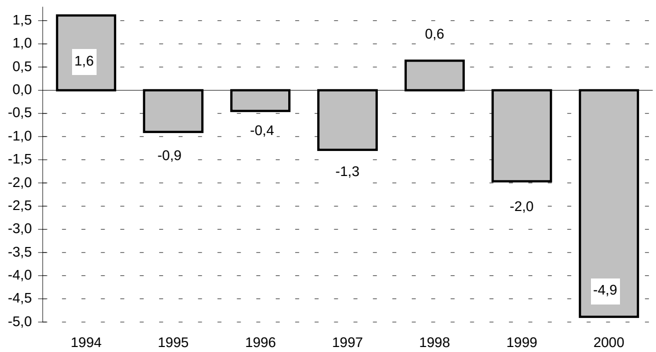
(Percentage on GDP)



Source: Croatian National Bank

Fig. 5 Consolidated Central Gov. Budget

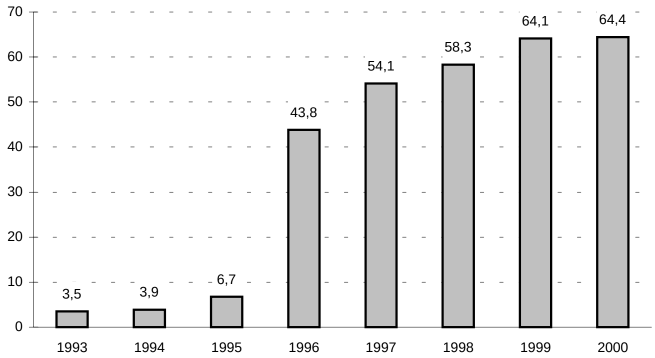
(Surplus/Deficit in percentage of GDP)



Source: Croatian National Bank

Fig. 6 Central Gov. Budget: external financing

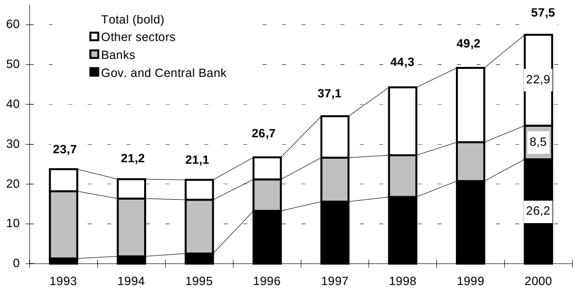
(Percentage of total financing)



Source: Croatian National Bank

Fig. 7 External Debt by Domestic Sector

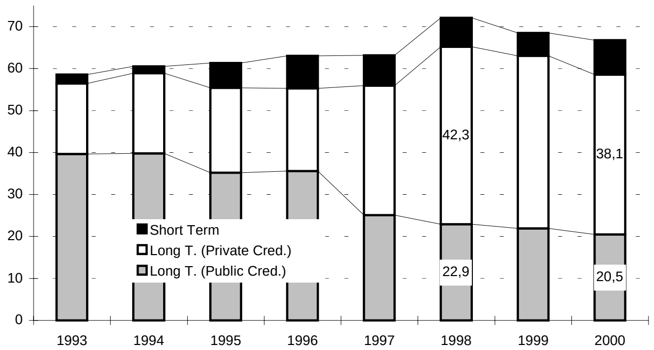
(Percentage on GDP)



Source: Croatian National Bank

Fig. 8 External Debt by Domestic Creditors

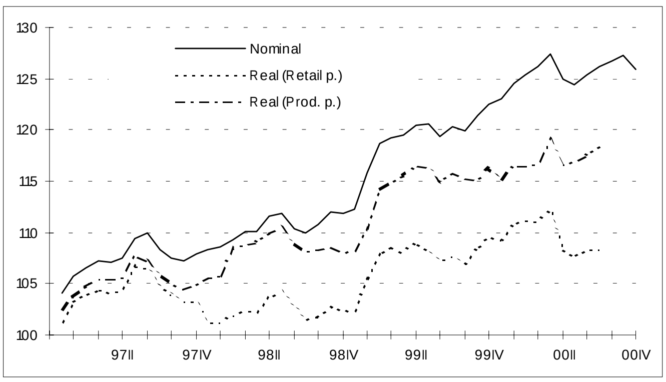
(Percentage composition)



Source: Croatian National Bank

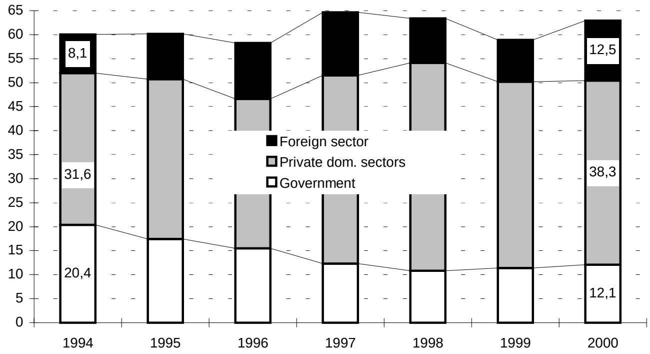
Fig. 9 Exchange Rate Developments

(Index: 1995=100; Increase indicates depreciation)



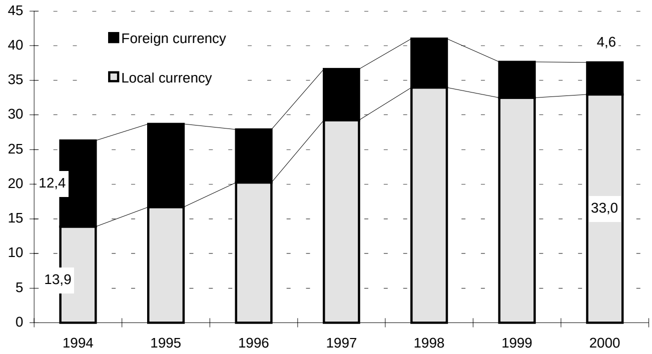
Source: Croatian National Bank

Fig. 10 Banking Assets
(Year-end percentage on GDP)



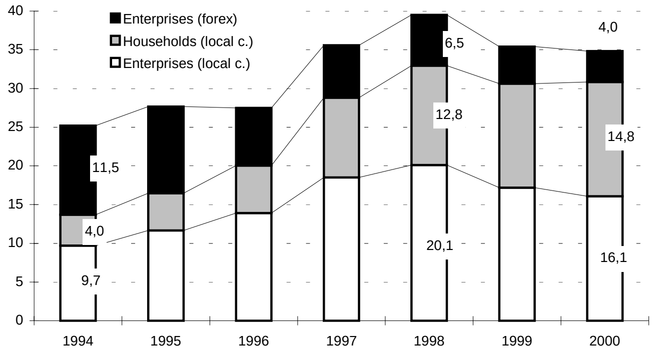
Source: Croatian National Bank

Fig. 11 Loans Developments
(Year-end percentage on GDP)



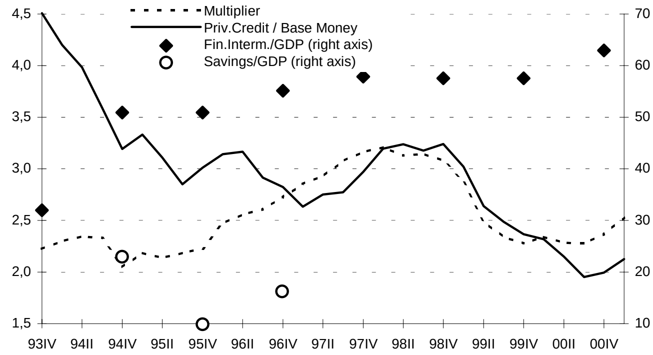
Source: Croatian National Bank

Fig. 12 Loans to Private Domestic Sectors
(Year-end percentage on GDP)



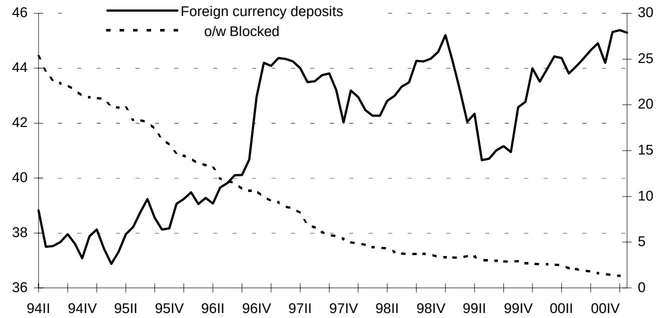
Source: Croatian National Bank

Fig. 13 Indices of Banking Sector Development



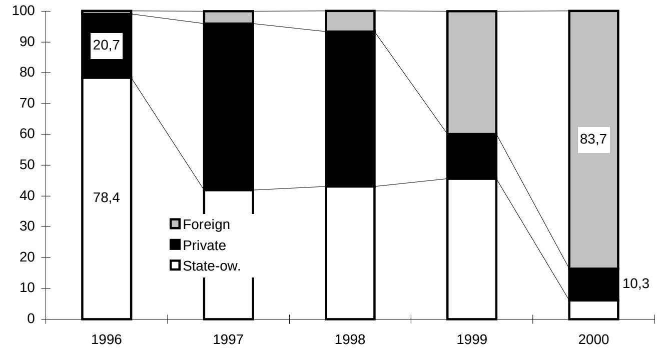
Source: Croatian National Bank; IMF

Fig. 14 Foreign Currency Deposit
(Percent on total banks liabilities)



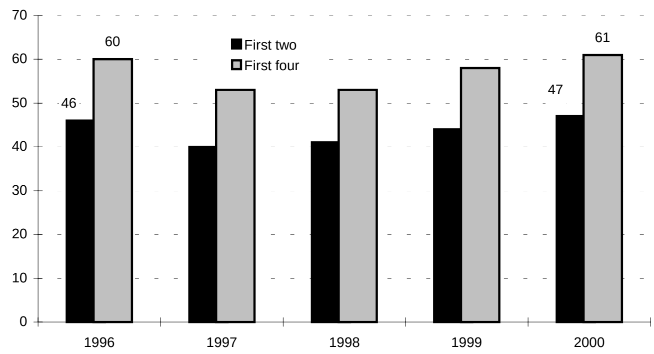
Source: Croatian National Bank

Fig. 15 Banking Ownership Structure
(Percent on total assets)



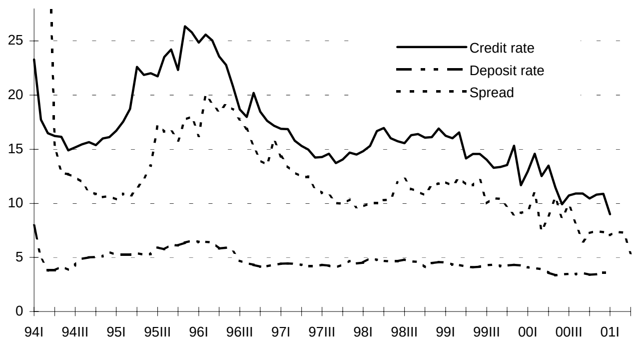
Source: Croatian National Bank

Fig. 16 Assets of Top Banks
(Percent on total assets)



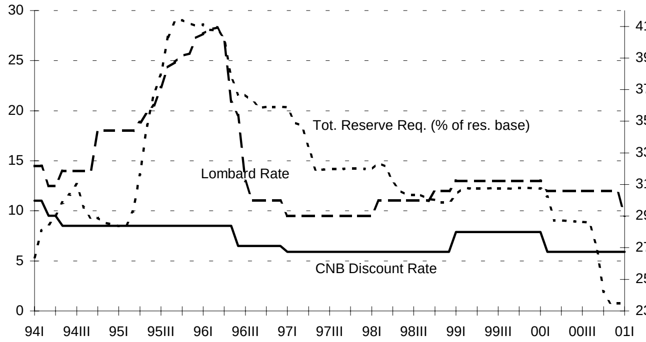
Source: Croatian National Bank

Fig. 17 Average Interest Rates
(Percent on year basis)



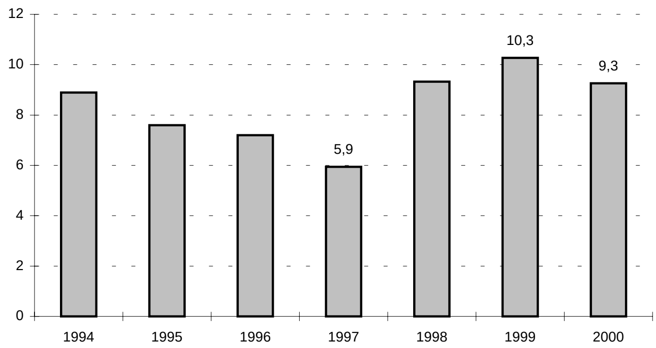
Source: Croatian National Bank

Fig. 18 Official Rates and Reserve Requirement
(Percent)



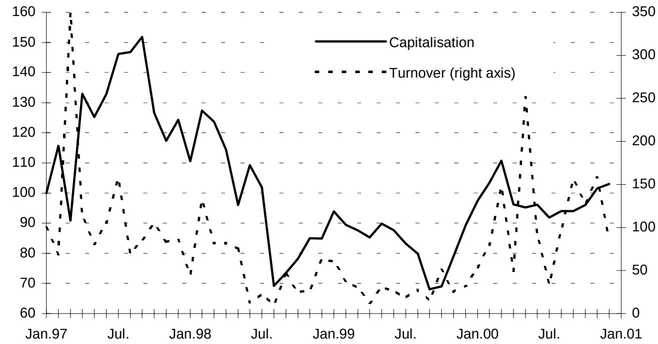
Source: Croatian National Bank

Fig. 19 Bad Loans of Croatian Banks (*)
(Year-end; percent of total loan portfolio)



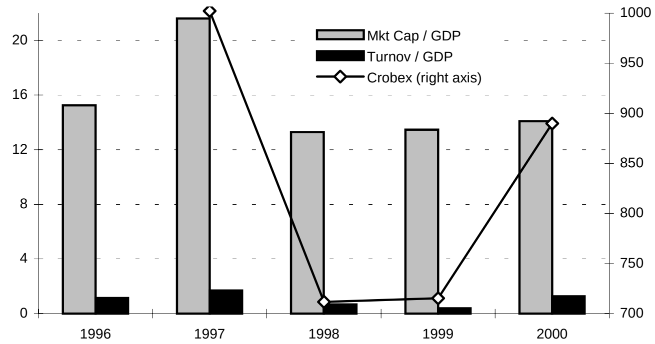
Source: Croatian National Bank; (*) Categories C,D,E

Fig. 20 Stock Exchange: Indices
(Capitalisation and Turnover: Index Jan 1997=100)



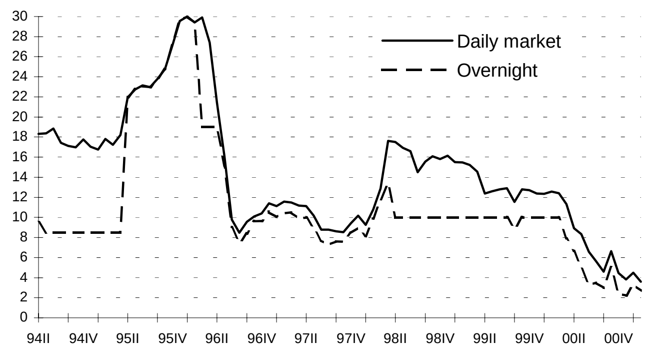
Source: Zagreb Stock Exchange; *Monthly Reports*

Fig. 21 Stock Exchange
(Percent of GDP and Index)



Source: Zagreb Stock Exchange; *Monthly Reports*

Fig. 22 Money Market Interest Rates
(Percent)



Source: Croatian National Bank; Zagreb Money Market

COUNTRY PROFILE: FORMER YUGOSLAV REPUBLIC OF MACEDONIA [*]

1. Economic structure and transition process

The Former Yugoslav Republic of Macedonia (FYR Macedonia) was the least developed of the six republics that constituted the Socialist Federal Republic of Yugoslavia (SFRY), producing less than 5 per cent of total output. The economy relied on sizable transfers from the Federation, accounting for 6 per cent of the country's GDP, and was fairly industrialised though it inherited from the system of central planning a core of inefficient large scale manufacturing plants designed to provide inputs to factories in other parts of the Federation. After independence in 1991 FYR Macedonia experienced a sharp decline in output as a result of the loss of subsidies from the Federation, the impact of UN sanctions against Federal Republic of Yugoslavia, which cut off the country from traditional markets and transit routes to Central and West Europe, and the imposition of a blockade by Greece. In 1995, when output reached the lowest level, real GDP was about 36 per cent lower than 1991.

In 1994-95 the authorities launched a macroeconomic stabilisation program with the support of international financial institutions. An exchange-rate targeted monetary policy strategy was pursued, choosing the Deutsche Mark as an anchor. The strategy proved successful in restoring price stability and inflation was brought down to one of the lowest levels of all transition countries. A tight fiscal stance helped reduce the budget deficit to only 0.5 per cent of GDP by the end of 1996. As a part of its transition towards a market economy the country undertook a vast program for restructuring and privatisation of socially owned enterprises enacting in mid-1993 the Law on Transformation of the Enterprises with Social Capital, even though privatisation did not gain momentum until late 1994.

Following stabilisation and the suspension of the Greek trade embargo and international sanctions against Yugoslavia, the Macedonian economy started to recover but growth in 1996-97 was slow partly owing to the impact of the collapse of neighboring economies of Bulgaria and Albania. In 1996 the authorities liberalised the trade system by dismantling the import quotas and reducing tariffs. In response to the liberalisation of trade and increased economic activities import growth picked up in 1997 while exports stagnated due to the erosion of competitiveness. The country's external position came under increasing pressure and in July the exchange rate was devalued by 14 per cent against DM. The inflationary impact of the devaluation was neutralised through a six months wage freeze and a tight fiscal policy. Economic growth accelerated to 2.9 per cent in 1998, the highest growth since independence. In the first half of 1999 the economy suffered the impact of the Kosovo crisis, but with the end of the conflict economic activity picked up sharply and GDP was slightly lower than the previous years (2.7 per cent).

In the second half of 1990s progress was made in implementing the privatisation program even though the outcome in terms of enterprises restructuring and financial performance was below expectations. As of November 2000 1,604 enterprises have been privatised, mostly through management and employee buyouts, leaving 123 enterprises still awaiting privatisation. Enterprises sold to private outside investors accounted for about 18 per cent of the privatisation undertaken as of November 2000, of which about 10 percentage point went to foreigner investors. Most of the enterprises privatised are SMEs while only initial steps have been made for restructuring and privatisation of state-owned utilities and largest lossmakers. Lack of financial discipline and adequate corporate governance arrangement, partly owing to the predominance of insider privatisation, have resulted in widespread enterprise losses and a build-up of inter-enterprises arrears and non-performing loans in the banking system. Delays in reforming the legislative framework for creditors' rights have also undermined the imposition of hard budget constraint limiting the ability of creditors to enforce their claims.

2. Institutional aspects

2.1 Legal framework of banking activities

FYR Macedonia became an independent currency area at the end of April 1992. In 1993 the Banks and Saving Houses Act was enacted which introduced the basic rules for establishing banks and set base capital requirements for conducting banking activities. The law regulated two types of deposit institutions: banks, operating in a broad range of activities other than performing the traditional function of collecting

[*] By Emidio Cocozza.

deposits and extending credit, and saving houses with scope of activities mainly limited to households. Minimum capital requirements were raised in the 1996 amendment to the Act which also introduced tighter prudential regulations concerning credit exposure to single debtors and related party lending. To strengthen depositors' confidence in the banking system the amendment provided also for the establishment of a Deposit Insurance Fund which was set up in January 1997 as a joint stock company owned by all banks and saving houses allowed to accept personal deposits. During the first half of 2000 the legislation in the banking area has undergone considerable changes. A new Banking law aimed at harmonising the legal framework with European Directives as well as achieving higher compliance with the Basle Core Principles for Effective Banking Supervision was enacted. The new Law sets the minimum capital requirement for conducting banking activities at 3.5 million Euro, raised to 9 million Euro to perform payment or credit activities with non resident or trading in securities, foreign currency and financial derivatives. The new Law contains also provisions aimed at strengthening corporate governance, risk management and internal auditing in banks and provides the National Bank of Republic of Macedonia (NBRM) with a wide variety of corrective actions to enable early intervention and resolution of failing banks. To strengthen monitoring and enforcement activities the NBRM has recently reorganised the Supervision Department establishing two separate units for off-site monitoring and handling problem banks. The Law on the Deposit Insurance Fund enacted in 2000 provided that the current bank-owned and operated system is to be replaced by mid-2001 with a government-backed insurance scheme.

In 1997 was enacted the Law on Issuance and Trading of Securities which laid down the basic regulatory framework for the securities market and provided the regulatory body, the Securities and Exchange Commission, with broad regulatory and supervisory authority. The securities regulation has been extensively revised in the first half of 2000 with the enactment of a new Law on Securities and the Law on Investment Funds.

2.2 The structure of the banking system and financial system

Banks have a central position in the country's financial system as other segments are still at the starting phase of their development. The banking system comprises 21 banks, 1 foreign bank branch and 19 saving houses. Of the total number of banks 15 and the foreign bank branch have a full license allowing for both domestic and foreign operations. The structural relations between the two segments of the banking system shows that banks, with a share of 98.9 per cent of the total assets, play a dominant role in the process of intermediation relative to saving houses. Bank privatisation has proceeded gradually over 1990s mainly trough the privatisation of existing shareholders and as of June 2000 80.4 per cent of banking capital was privatised. During the first half of 2000 the presence of foreign investors has significantly increased owing to the acquisition of 85 per cent of share capital of Stopanska Banka, the country's largest bank with a share of 36.5 per cent of total banks' assets, by National Bank of Greece in consortium with IFC and EBRD. As of June 2000 the share of foreign capital in total bank capital was 33.3 per cent, 14 percentage point higher than the end of 1999.

The Macedonian Stock Exchange (MSE) was founded in 1995 and commenced trading in 1996. Trading on MSE is conducted on three markets, the first two officials while the third has features of an OTC market. In 1999 there were 114 securities traded but only two companies were listed on the official market while most activities took place on the third market. Clearings for trades on all three tiers is undertaken by MSE while settlement of transactions in listed companies is carried out by the PBO. In the third market the settlement is delivery versus payment organised bilaterally between brokers. According to the Law on Securities December 2003 all transaction in securities not listed on the official market have to be executed on the MSE third market. The total turnover in 1999 was denar 1.5 billion or roughly DM 50 million. A money and short-term securities market has been active since November 1997.

2.3 Monetary policy

The NBRM is responsible for designing and conducting the monetary policy on the basis of the targets and objectives set annually by the Parliament. The main monetary policy objective is the maintenance of price stability which since the mid-1990s has been pursued by pegging the Denar exchange rate against the Deutsche Mark. From April 2000 the NBRM has moved from direct credit ceilings to a system of monetary control based mainly on the use of indirect instruments, in the form of open market auctions of central bank bills.

3. The banking system structure and performance

3.1 Transition process in the banking system

At independence the Macedonian banking system comprised 5 banks, with the largest accounting for 65 per cent of total bank’s asset. In order to change market structure and foster competition, the NBRM set low minimum capital requirements, thus supporting the establishment of 13 new banks by the end of 1993. The shocks associated with the break-up of the former SFRY and weak financial discipline in the enterprise sector had a severe impact on banking soundness, leading to the accumulation of a high amount of non-performing loans, whose share of credit portfolios reached an estimated level of 80 per cent in 1994. In order to address the problem of banking system soundness in 1995 the Government adopted an extensive program for the rehabilitation and restructuring of the sector with a total cost equivalent to 12.1 per cent of GDP. This comprised the cleaning of banks’ balance sheets with the transfer of non-performing foreign currency debts of socially and state-owned enterprises to the Bank Rehabilitation Agency, the liquidation of four banks and a first round of financial restructuring of Stopanska Banka, with the replacement of non performing denar-denominated loans with Government Bonds and, in order to create greater competition in the system, the reduction of the size of the bank trough spinning off the five major branches which were transformed into independent commercial banks. The restructuring of the mid-1990s has not prevented the recurrence of new banking problems owing in part to shortcomings in supervision. In 1997-98 saving houses were closed including TAT, the country’s largest saving houses, which was running a pyramid scheme and was found to have about DM 100 million in unreported deposits, equivalent to 12 per cent of total deposits in the banking system. In the second half of 1998 Stopanska Banka’s liquidity position began to deteriorate and in 1999 the bank became technically insolvent, repeatedly failing to meet the minimum reserve requirement. After the replacement of bad debts equivalent to 3.5 per cent of GDP with Government Bonds, in 2000 Stopanska Banka has been sold to a consortium of foreigner investors

3.2 Development indicators and market structure

The level of financial intermediation of the banking system of FYR of Macedonia is relatively low compared to some of the leading countries in transition economies. At the end of 1999 total assets represented 37 per cent of GDP, with an increase of 9.5 percentage point if compared to the end of 1997. The amount of deposits of the non-banking institutions and individuals in term of GDP was 20.9 per cent at the end of 1999. Lending to private sector has been crippled by the low level of intermediation, lack of financial discipline and poor allocation of credit. The ratio of credit to social and private sector to GDP at the end of 1999 equalled 18 per cent. Notwithstanding several efforts of the authorities to foster competition, the banking system is highly concentrated and the indicators of market concentration showed a slight growth in the first half of 2000. At end-June 2000, the first three largest banks accounted for 64.5 per cent of total balance sheet and off-balance sheet activities and the share of the largest banks was 38.8 per cent. The share of the off-balance sheet activities was 17 per cent of the total scope of banking operation and the largest bank had a share of 50.1 per cent in the total volume of off-balance sheet activities.

3.3 Risks and efficiency

Following the restructuring program in 1995, loan collection rates have improved but low credit quality still remains a major problem in the banking sector. The total amount of claims and off-balance sheets items classified in Substandard, Doubtful and Loss categories , which represented 44 per cent of banks’ total credit exposure at the end of December 1995, dropped at 33 per cent at the end of 1998, but during 1999 the quality of loan portfolio deteriorated again and at the end of December non-performing loans accounted for 41 per cent of credit portfolio. In the first half of 2000 the quality of loan portfolios slightly improved and as of end-June non-performing loans represented 39 per cent of total credit exposure and Doubtful and Loss debt alone accounted for 24 per cent of credit portfolio. Net of loan loss provisions, non-performing claims represented 18 per cent of total credit portfolio and 59 per cent of the guaranteed capital of banks. Low level of intermediation, high concentration of the market and low quality of loan portfolio have resulted in very high interest rates. The average weighted nominal lending rate in the first half of 2000 was 18.8 per cent while the weighted deposit rate equaled 11.3 per cent. The spread between lending and deposits rates was thus 7.5 percentage points but has remained high at about 8-10 per cent in recent years. Despite high nominal interest rate margins, profitability in the banking system has been weak and declining in recent years. In 1999 the rate of Return on Assets was 0.8 per cent and 1.2 percentage point lower than the previous year. Net interest income after provisions was negative, reflecting an implicit subsidy to outstanding non performing debtors. The ratio between loan loss provision and net interest income amounted in 1999 to 1.59. In the first half of 2000 the profitability has slightly improved and the Return on Assets equaled 1.3 per cent.

4. The payment system

Cash payments are very widely used. At the end of 1999 banknotes and coins represented about the 41 per cent of M1 monetary aggregate and 4.1 of GDP. Most pensions are paid in cash and there is a wide practice of paying wages in cash, both in the private and public sector. Almost all retail transaction are also made in cash owing to the insufficient development of non-cash payment instrument such as credit and debit card and the small number of POS.

As in other former SFRY countries the payment non cash payments involving legal entities are processed trough a Bureau for Payment Operation (ZPP).The existing BPO payment arrangement is expected to be replaced by the end of 2001 with an RTGS system operated by the NBRM and a clearing house for small value payment owned and operated by commercial banks.

FYR Macedonia: Main Indicators

	1997	1998	1999
Population (thousands persons, mid- year estimation)	1996.9	2007.5	2020.0
Exchange rate (average annual rates**)**			
- Denar per 1 U.S. dollar	49.83	54.45	56.90
- Denar per 1 DM	28.70	30.95	30.99
Gross Domestic Product			
- current price (millions of denars) (a)	184,982	190,827	195,284
- current price (billions of U.S. dollars) (b)	3,707	3,469	3,566
- constant price (millions of denar - at constant 1995 market prices) (a)	174,000	179,120	183,908
- growth rate (real denar)(a)	1.4	2.9	2.7
- per capita (in U.S. dollars)(b)	1,693	1,574	1,608
Current account			
- Trade balance (in millions of U.S. dollars) (a)	-386	-418	-409
- Current account balance (in millions of U.S. dollars) (a)	-286	-307	-136
- Current account balance –excluding grants (in millions of U.S. dollars) (a)	-283	-335	-201
- Current account balance (in percent of GDP)(a)	-7.4	-8.8	-4.0
- Current account balance – excluding grants(in percent of GDP)(a)	-7.6	-9.6	-5.9
Unemployment rate (b)	36.0	34.5	32.4
External debt			
- in percent of GDP (a)	31.6	41.1	43.3
- Debt service ratio (Debt service due as a percentage of exports of goods and services (a)	8.7	10.1	13.0
Consumer prices (annual average)(**a)**	2.6	-0.1	-0.7
General government balance (in percent of GDP)(a)	-0.4	-1.8	-0.1
M1 (million of Denar) (a)	13,985	15,178	19,694
- in percent of GDP (a)	7.6	8.0	10.1
M2 (million of Denar)(a)	22,010	25,375	32,837
- in percent of GDP (a)	11,9	13,3	16,8
M3 (million of Denar)(a)	25,778	29,461	38,103
- in percent of GDP(a)	13.9	15.4	19.5
Banks' assets	50,912	58,260	72,279
- in percent of GDP(a)	27.5	30.5	37.0
Macedonia Stock Exchange			
- Turnover (millions of denars) (a)	1,101	4,476	1,552.8
- Turnover (in percent of GDP) (a)	0.6	2.4	0.8

Sources: National Authorities (a) and IFM (b).

COUNTRY PROFILE: ROMANIA [*]

1. Transition process

In 1998 the macroeconomic performance of Romania has been the worst amongst the countries that applied for the accession into the EU. After a steady growth during 1993-96, GDP has sharply decreased. This fact, jointly with the precarious political situation, impelled the IMF to suspend the third tranche of the loan granted in 1997, while international rating agencies downgraded the country.

At present, the priorities of the Government are the reduction of inflation, privatisation and reduction of the budget deficit.

All quantitative restrictions on exports were eliminated by 1998 and replaced with licensing requirements for monitoring purposes. However, the Government introduced a temporary import surcharge by the end of 1998 that has been progressively reduced and finally eliminated. Capital inflows are as of now without restrictions, while outflow by residents requires prior approval of the NBR.

Sustainable stabilisation, after the turbulence of 1998, strongly depends on tightening public finances (whose bad performance was the major cause of economic default). Amongst required measures there is the confiscation of state-owned bank balances, the closure of public loss-making enterprises and a throughout reform of tax system that will fill the gap determined by the lack of personal income tax (the actual fiscal regime relies excessively on indirect taxation). Some recent Government initiatives, to be submitted to the Parliament in the next future, move towards this end.

Both small-scale and large-scale privatisation accelerated during 1998 and 1999. Moreover the new privatisation law approved by Parliament in June 1999, allows explicitly for the use of investment banks as share sales agent, admits share sales at market value (eliminating the minimum sale prices linked to book value imposed by the former legal framework) and contains provisions for debt workouts.

2. Institutional aspects

The National Bank of Romania (NBR) is an independent Central Bank whose main goal is to ensure the stability of the domestic currency in order to fight inflation. It has also licensing and supervisory powers on the banking system.

The legal framework for the banking sector was significantly strengthened in 1998 with the adoption of three laws: on banking activity, on the Statute of the NBR and on bank bankruptcy. A law on money laundering has also been established in late 1998.

Moreover, due to the cited turbulence of the financial sector, in June 2000 the two budget-finance Commissions of the Parliament decided to set up a sub-commission (composed by seven members of the Parliament) to review the legislation which governs the capital market in Romania. According to his mandate the commission should present in September proposals for improving capital market legislation.

Romania is amongst the three south-eastern European economies (with Albania and Yugoslavia FYR) that opted for a monetary policy rule based on money growth target to maintain price stability (this implies a floating exchange rate regime).

3. The banking system

3.1 Market structure

In 1998 in Romania was registered 47 commercial banks (36 of which national entities were registred). Eleven were branches of foreign banks. Among the remaining, seven banks were state-owned, five were constituted with private domestic capital, eight were founded with private foreign capital and 16 were totally private (with foreign and/or domestic capital).

As of now there are 35 authorised banks in Romania and seven branches of foreign banks, out of which 33 are covered in the assessment and classification system of the NBR, the exception being the

[*] By Enrico Gisolo.

Investment and Development Bank that has been authorised but has not started his activity yet, and the Agricultural Bank which has been recently privatised after a series of unsuccessful attempts (at the last deadline for the submission of offers, September 2000, a bid has been finally been received: the consortium made up of the Agricultural Bank of Greece, Rabobank and the Romanian-American Enterprise Fund, which had previously stated its intention to buy the 56.5 per cent , submitted a formal offer). The privatisation of the Agricultural Bank is one of the conditions the Government undertook to fulfill within the IMF stand-by agreement. A special role is played by CEC, a saving bank which is organised as a public limited company and regulated by a special law: it operates now on a extended range of banking activity with a large degree of independence with respect to NBR supervision and control.

Since 1996 other institutions, the so-called credit cooperatives, can provide banking services. Nevertheless it was well known the need to proceed to regulate their activity, the Credit Cooperatives have operated outside the authority control of the NBR since June, 2000. In May, 2000, the largest mutual fund, the National Investment Fund (FNI) collapsed due to a fraud. The subsequent turbulence on domestic financial markets and the declining trust and withdrawals forced the largest credit cooperative (Banca Populara Romana) to announce in June the suspension of payments for at least six months.

Since 1990 the number of banks has increased by almost ten times, even if the quantity and quality of banking products and services still remains low compared to industrialised countries. This is explained by several factors:

1) although the number of banks rapidly increased and some of the state-owned banks where privatised at the end of 1998, the Romanian banking system still has an high degree of concentration and segmentation;
2) the weakness of some state-owned banks and the hesitation of the authorities to let them fail created an excellent profit-making opportunity for lending to banks with chronic liquidity problems;
3) the great amount of Treasury Bills issued by the Government at high interest rates (mainly after 1996), has ensured a further low-risk profit opportunity for the banks;
4) Romanian financial markets are thin, banks are not significantly involved either in the insurance market or in the capital market, and even now there is no mortgage market.

As a consequence the banking activity is generally not customer-oriented, even if recently some commercial bank has made headway by introducing some modern instrument, such as Internet banking. Nevertheless, card-based payment schemes are not yet widespread. Moreover, there are no interbank networks or service providers for ATMs that have only cash dispenser functions.

As regards concentration four state-owned banks (Bancorex, Romanian Commercial Bank, Romanian Bank for Development and Agriculture Bank) and the saving bank CEC dominate the market: the four banks account for 62 per cent of the market and CEC 10 per cent (in terms of total assets).

There are three main segments of banking activity:

1) big state-owned banks engaged in the financing of state-owned companies and the public sector;
2) foreign banks especially devoted to serve the major foreign companies operating in Romania;
3) small banks with foreign and/or domestic capital more oriented towards lending to private companies.

It is likely that, due to recent developments, the situation is going to evolve towards a more competitive environment, although no evidence is yet available to confirm it.

3.2 Performance

The scale of banking (in terms of both broad money and total domestic credit to the private sector) is significantly lower than in most advanced economies of central and Western Europe. Bank lending in Romania is more short-term oriented: evidence shows that banks have achieved only modest progress in expanding the maturity of their lending.

The profitability of Romanian banks, measured as the ratio of net profits before taxes to total assets, for the 1991-98 period has been, on average, of 4.4 per cent , far above the 2.6 of banks in transition economies in the years 1993-97 and 0.7 per cent in the OECD countries for the years 1993-95.

The net interest margin scaled by total assets has shown over time a slow decline from 6.3 per cent in 1994 to -2.2 per cent in 1998 (the latter figure due to the liquidity problems of two state-owned banks (Bancorex and Banca Agricola), that had borrowed significantly from the interbank market.

The financial soundness of Romanian banks, measured by the ratio of equity to total assets, has fluctuated widely: starting from a 6.5 per cent in 1991, it reached a peak of 12 per cent in 1995 and fell down in the following years to 7.6 per cent in 1998. By comparison, for the years 1993-97, the average ratio in transition countries was 9.6 per cent and, in general, over time across transition countries there was an upward trend. Therefore Romania is an exception among transition economies.

Customer orientation remains low due to the dominance of state-owned banks and the moral hazard arising from a regulatory legislation that appears too permissive. An improvement of customer care appear necessary to solve the under-provision problems shown by the system.

In August 2000 the interest rate for bank lending to the non banking sector went down on average to 50 per cent on an annual basis from 62 per cent in December, 1999, while the June 2000 deposit rates stood close to 30 per cent .

Consequently the gap between lending and deposit rates went down. In June 2000 the average interest rate on Treasury Bills stood in the primary market at 44 per cent , down from 72 per cent in December 1999.

4. Money and financial markets

In accordance with its Statute, the NBR acts as the agent of the State Treasury. Accordingly, the NBR can sell Treasury bills or other negotiable papers issued by the State. The BNR performs the registry and depository functions for these securities. At present the NBR and Ministry of Finance are working on a project to create a secondary market for Government securities, in order to provide the banks with a facility enabling them to have access to liquidity based on market conditions and to allow the central bank to pursue monetary policy objectives through open market operations. However it is not yet clear if these securities will be traded on one of the two existing security markets (see below), or on a third market created *ad hoc*.

In 1994 the Parliament approved the new Securities and Stock Exchanges Act, the legal framework required to establish a modern capital market. The Bucharest Stock Exchange was set up by the decision of the National Securities Commission. Although a public entity, the market is effectively managed by its members, initially 24 securities companies that formed the Stock Exchange association.

The Exchange can adopt rules and regulations regarding registration of members, listing standards, trading mechanisms, transfer and clearing activities and registry activities according to the delegation of powers extended by the National Securities Commission.

Currently, there are 96 members, out of which 12 were set up as securities subsidiaries of commercial banks. According to the Securities Act, Banks cannot engage directly in securities business but can set up securities subsidiaries. However, the Exchange is an open institution, therefore membership is not restricted to a limited number of participants.

Foreign securities companies can act in the Romanian market only through a subsidiary subject to Romanian law. Foreign banks will be subject to the same requirements provided they already have or set up a securities subsidiary.

Subsequently to the mass privatisation program and the investment opportunities deriving from it, at the end of 1996 another stock market was inaugurated, the RASDAQ (Romanian Association of Security Dealers Automated Quotation) built after the model of the American over-the-counter NASDAQ. The aim of the new authorities was to offer a possibility to acquire great or majority stakes, in order to increase the interest of strategic investors looking for the control of the companies whose shares was traded on the markets. The number of traded companies has rapidly increased to over 2000.

No discrimination exists againts foreign investors in the securities market: only repatriation of profits requires a clearing authorisation from the NBR. At the present there is no capital gain tax.

5. The payment system

5.1 Overview

Since 1995 the payment system in Romania has undergone a broad process of modernisation, improvement and diversification, developed in accordance with the fundamental changes in the Romanian financial and banking system that have occurred during this period and in accordance with the implementation of monetary policy goals. One result has been a gradual shift in the relative importance of the various payment services and instruments in the Romanian banking industry. The current Romanian payment system is the result of the enforcement between 1992 and 1998 of a homogeneous legal framework, based on the new banking laws. This new law gives commercial banks and the State Treasury the right to issue and manage the payment media and explicitly designate the NBR as the regulatory authority of the payment system, with the aim of increase competition and thus improve the quality of banking payment services as well as risk monitoring features. As a result from April 1995 in Romania operates an interbank payment system, denominated DECONT-BNR which is fully owned and managed by the central bank. All commercial banks licensed by the NBR as well as other financial institutions that provide banking intermediation are participants with equal rights and obligations.

5.2 Payment media used by non-banks

Cash. The monetary unit in Romania is the ROL. The NBR, through a network of 41 branches, distributes and collect banknotes that, together with coins, are the most widely used retail payment media in Romania (61 per cent of M1 as at the end of August 1998).

Non cash. Subsequently to the establishment of DECONT-NBR the volume of non-cash payments has been constantly increasing during recent years.

<u>Credit transfers.</u> The payment order is the most commonly used cashless payment instrument. According to NBR disposals a credit transfer may be performed either in paper-based form or electronically. At the present all interbank payments are paper-based and only 1 per cent of intrabank payments is electronically performed. At present all paper-based retail payment orders (value less than ROL 500 millions) are cleared and settled in one of the 42 NBR clearing houses (within a time that averaged in 3.67 days). All money wholesale orders with a higher value, mainly issued by enterprises, are settled through the NBR network on the day of issuance.

<u>Cheques</u> are less used in interbank payments than payment orders (in 1997 were settled, on average, 9.157 interbank cheques each day). All crossed cheques (with the exception of those for which the drawee bank is the NBR) are cleared on a multilateral basis. The cheques for which the drawee bank is the NBR are bilaterally netted and settled in the current accounts of the commercial bank held by the central bank. Due to the higher risk, and higher administrative costs in order to prevent fraud and losses, the time it takes the bank to credit funds is higher than for credit transfer (on average 5.16 days). Direct debits, although regulated by NBR, are still not widely used by national banks (some branches of foreign banks offers their customer services based on this mean of payment.

<u>Payment cards</u>. From 1992 six Romanian commercial banks became VISA members and started accepting transaction made by using cards issued in foreign countries. Since 1997 currency-denominated card are issued by a small number of commercial bank under the VISA or Europay logo.
At the present there are only debit cards usually with the only function of cash withdrawal and, in some cases, of debit function at POS.

All transactions, transmitted electronically by banks or ROMCARD, are cleared by VISA or Europay processing centers (ROMCARD is a joint stock company established by five of the most important banks specialised in transmitting these transaction). On the basis of agreements signed both with VISA and Europay, the NBR is the final settlement agent. In Romania there are no interbank networks for ATMs and POS. ATMs have only cash dispenser function and they are managed by the issuing bank. The Romanian Post administers (only for cash transfer because it does not hold accounts for customers) the postal money order, recently offered with the new option of instant (real-time) transfer. Accepted, but negligible, means of payments are also bills of exchange and promissory notes.

5.3 Interbank exchange and settlement systems

At present the NBR is the only interbank payment operator and it provides the final settlements for nearly all the interbank cashless payments in Romania through its payment system, DECONT-NBR. The architecture of DECONT-NBR comprises three interbank exchange and settlement subsystems running intraday. All commercial bank are allowed to take part directly in the operations of the interbank exchange and settlement subsystems, while indirect participation (sub-participation) in DECONT-NBR is not permitted at present. A comprehensive scheme of the actual Romanian payment system (taken from the ECB Blue Book on Payments systems of countries that have applied for membership of the EU) has been reported above. The gross settlement subsystem was created in December 1995 and since then has undergone several changes according to evolution of banking system in Romania. At present the direct participants in this subsystem are the following: 46 bank headquarters and the State Treasury, at the NBR headquarters as well as 541 bank branches and 47 State Treasury branches, at the local branches of the NBR. As of now the gross settlement subsystem processes on daily basis the following categories of payments:

1) State Treasury large-values (more than ROL 500 millions) transfers;
2) interbank large-value (more than ROL 500 millions) transfers ordered by the customers of the banks;
3) interbank transfers related to the treasury bills primary markets, money and foreign exchange markets.

The gross settlement subsystem operates on an end-of-day gross settlements basis because the payment orders are processed one by one throughout the day, while final settlement is performed on a gross basis at the end of the day (there is no credit or liquidity risks involved because the payment orders are settled only if sufficient funds are available on the current account of the senders). The NBR is looking for implement S.W.I.F.T. standards to process the real time gross settlements of cross-border credit transfers. The net settlement subsystem consists of three components:

1) multilateral clearing with net settlement of interbank payments;
2) bilateral clearing with net settlement of low-value transactions related to State Treasury or the NBR;
3) multilateral clearing of interbank payments with net settlement performed by clearing houses other than those owned by the NBR.

In April 1995 the NBR started to operate its own clearing network consisting of 41 district interbank clearing houses (one in each NBR branch) and one interbank clearing house located at the NBR headquarters. All the commercial banks, including the CEC, participate directly in the clearing procedures with no more than one of their branches in each district of the country (541 commercial banks branches currently participate in the clearing and settlement project).At present the net settlement subsystem also provide final settlements and multilateral clearing operations in the RASDAQ.

There is also a special settlement subsystem designed to carry out daily, on a gross basis, all the fund transfers related to insolvent banks. This subsystem functions on the basis of regulations issued by the NBR on a case-by-case basis, according to the decision taken by the NBR board regarding the particular banks being subjected to a legal insolvency procedure or a special supervision procedure of the central bank.

COUNTRY PROFILE: SLOVENIA *

1. The economic structure
***1.1** Economic background (1992-97)*

After independence (June 1991) Slovenia recorded a fairly balanced economic growth with real GDP increasing in the range of 5.3 (1994) and 3.5 (1996) per cent (Fig.1). The main goals of monetary policy, price and exchange rate stability, were reached in 1993-95 (Fig.2). Trade flows were redirected away from other FYR and the already high degree of integration into the European economic system increased. Notwithstanding trade deficits, current account showed surplus in 1994 and remained balanced until 1998 (Fig.3-4). Monetary policy was extremely prudent while fiscal policy was moderately expansive and income policy almost neutral. In 1997 central government budget started to show deficits but external financing was gradually reduced (Fig.5-6). In 1994-97 total external debt increased to 23 per cent of GDP and to 38 per cent of exports of goods and services; external debt service represented 8.5 per cent of goods and services' exports while total foreign exchange reserves declined, equalling external debt in 1997 (Fig.7-8). In terms of imports of goods, foreign exchange reserves at the Central bank were equal to 1.8 month of imports in 1993 and increased to 4.4 months in 1998. Economic growth slowed in 1995-96 either for the weakening of external demand and for domestic bottlenecks caused by the slow implementation of structural reforms, privatisation programs and financial restructuring in the industrial sector.

1.2 Recent developments (1998-2000)

In 1998 economic growth was fuelled by domestic investment and external demand. Low interest rates, strong corporate retained earnings and productivity gains fuelled domestic investment while exports were helped by the strong demand of trading partners and by the real depreciation of the tolar (Fig.9). By end-1998 real GDP growth was at 3.9 per cent. In the first half of 1999 exports were affected by the slowdown of Western economies, crisis in Croatia and Russia and, to a limited extend, by the Kosovo war. In advance of the introduction of VAT (July 1999), imports recorded an upsurge as well as domestic investment and consumption demand. Coupled with the recovery of external demand, at year-end the real GDP growth was slightly above 5 per cent but external imbalances emerged: a wide trade deficit and a small service surplus led to a current account deficit equal to 2.9 per cent of GDP. Inflation rate continued declining until mid-1999 when introduction of VAT and world energy prices increases generated new pressures until mid-2000: at December 2000 CPI increased by 8.9. In 1999 Government budget deficit was reduced to 0.6 per cent of GDP but it increased again in year 2000 (1.4 per cent of GDP). In year 2000 GDP recorded a growth of 4.8 per cent; average inflation rate was around 11 per cent; current account deficit expanded at 3.3 per cent of GDP. External debt increased at 6,2 billion US$ (31 per cent of GDP) 66 per cent covered by foreign exchange reserves. In 2001-02 GDP growth is expected to be around 4.5 per cent, current account imbalances should remain above 3 per cent of GDP, unemployment rate should be around 7 per cent (it was 7.9 and 7.2 per cent in 1999 and 2000 respectively). Inflation rate should decrease at 8 per cent in 2001 and 5 per cent in 2002; general government deficit should decrease at 1.3 per cent of GDP.

2. Institutional Aspects
2.1 Legal framework of banking and financial activities.

With the enforcement of the Europe Association Agreement (February 1999) Slovenia committed, within a transitional period, to liberalise the movements of goods, labour force, capital and services and to open the property market. With the new Banking Law (20.2.1999) legal framework is substantially harmonised with most of the EU banking and financial directives especially those concerning with the rules of establishment, prudential regulations and supervision. For some requirements – such as the acquisition of bank's shares, capital investment in non-financial institution, large exposure and deposit guarantees – there is an up to three years adjustment period; for other requirement – such as single license, home country control and cross-border provision of services – the are phased-in provisions which will be valid until Slovenia's accession to the EU. Competition in the banking sector should be fostered by the liberalisation of foreign

* By Maurizio Gresti.

banks' branches and the set up of banks by foreign legal entities and natural persons. Bank of Slovenia (BoS), established in June 1991, is a non-governmental independent institution; it is obliged to report before the Parliament twice a year. Central bank's primary task is the stability of domestic currency and to ensure the liquidity of payments within the country and with foreign countries; it is also in charge of the supervision of banks but not of other non-banks financial intermediaries. For insurance activities the Europe Association Agreement envisaged a transition period and therefore the basic 1994 Law on Insurance Companies has not changed yet. This law imposes some restriction on foreign entities: insurance companies can be founded only with domestic capital participation and if a company is controlled by foreign capital it can only operate in some segment of the insurance market. In the area of capital movement, a new Foreign Exchange Law was enforced in September 1999, subsequently revised on February and May 2000. Under the new regime, restrictions on foreign direct investment applies only in few sectors (armaments, health and pension insurance, auditing and media); free movement of capital applies also to profits, to investment results, to loans for commercial transactions and to the provision of services and financial loans. BoS implemented new regulations easing restrictions on capital flows.

2.2 The structure of the banking and financial systems

Banks are the main sources of credit, other segments of the Slovenian financial system are relatively under-developed. As of end-1999 there were 25 banks, six saving banks and 68 credit and loan undertakings. By the first half of 2000 the number of banks has increased by one with the establishment of a foreign bank's branch. The market shares of the savings banks (0.4 per cent) and credit and loans undertakings (1.7 per cent) are structurally small. Foreign presence, from Austria and Germany, represents a small portion of the market. The banking sector is highly concentrated and is dominated by State-owned intermediaries. The Ljubljana Stock Exchange (LSE) was founded in December 1989 and it is currently under the Law on Securities Market. The structure of LSE and trading procedures resemble the Anglo-Saxon model of capital market; OTC market was opened in 1995; futures trading started in 1996. Mass privatisation procedures – mainly focused on primary distribution of shares to eligible groups of owners – caused imbalances in the capital markets with few buyers and many sellers. In 1994-97 period there were few cash public offerings with newly issued securities subscribed mostly by banks. Moreover capital market development suffered from BoS's cautious stance regarding foreign currency inflow aimed at exchange rate and price stability. The insurance market is substantially sheltered from international competition. At end-1999 there were 12 insurance companies and three reinsurance companies; the presence of foreign capital is negligible. As the banking sector, even insurance market is highly concentrated –the top four companies cover 88 per cent of the market – with a strong public participation. Two State funds provide voluntary health and pension insurance; the Slovenian Export Corporation provides insurance for export activities. Other financial intermediaries include 46 Authorised Investment Companies managed by 22 management companies – collecting ownership certificate and issuing shares sold by the Slovenian Development Corporation (the national agency for privatisation) – and two investment funds: the Slovenian Development Capital Fund, the first equity fund operating since June 1995, which provides long-term financing to private, medium-size enterprises and the Horizont Fund, sponsored by an Austrian-American venture management group, which provides venture capital and management assistance to small and medium-size private companies with high growth and export potential.

2.3 Monetary policy

The BoS policies are aimed at lowering inflation and maintaining price stability; its intermediate target is the growth of M3. After an initial liberalisation, during 1995-98 BoS restored heavy restrictions on foreign capital inflows in order to control exchange rate level and volatility. The efficiency of BoS monetary policy was hindered by the poor performance of the interbank market and the small size of the money market. Given the limited competition among banks, interest rates on the interbank market are driven by liquidity needs of few big players; the lack of short-term government debt securities limited the development of the money market. Moreover there was a cartel agreement among banks imposing a ceiling on deposit interest rates. In 1999 monetary policy operations improved with the abolishment of the cartel agreement and most controls on capital flows and the issue of Treasury bill with short and medium-term maturities. Besides imposing administrative controls, the BoS can manage forex exchange either issuing forex bills and intervening directly on the market with short-term repurchase operations. The growth of M3 is controlled by the issue of domestic currency (tolar) bills with different maturities, by imposing different reserve requirements on tolar and foreign currency and by using a range of lending facilities (Lombard, short-term and liquidity loans). BoS is currently implementing a program of de-indexation of monetary medium-term instruments: a 270-day bill at nominal interest rate was issued on September 1999; three-month Treasury bill are now de-indexed; a 6-month de-indexed bill was issued in October 1999.

3. The Banking System

3.1 Development of the banking system.

At the end of 2000 total assets of the Slovenian banking sector equalled 3,3 billion tolar (14,4 billion US$); since 1996 the annual rate of growth has been around 14-19 per cent. During 1994-2000 period, total assets in terms of GDP grew from 67 to 81 per cent; the share of foreign assets and that of claims on government decreased, reaching 12 per cent of GDP, and that of domestic private sector increased form 22.5 to 33 per cent (Fig.10). In particular at end-1999 claims on enterprises represented 23 per cent of GDP, on households 12 per cent. At 2000-end total loans to domestic sectors equalled 1,6 billion tolar (7 billion US$); the share of national currency loans increased up to 90 per cent of total loans in 1997 and then declined to 85 per cent. Total loans represent 40 per cent of GDP, of which 6 percentage points are those denominated in foreign currency (mainly to private enterprises). Loans to private sectors accounts for 35 per cent of GDP: 23 per cent to enterprises and non-profit institutions and 12 per cent to households (Fig.11 and 12). The economic environment for financial and banking intermediation is relatively comfortable. The national gross saving ratio stood at 21 per cent of GDP at end-1993, increased to 25 per cent at the end of 2000. In the same period financial intermediation increased from 48 to 68 per cent of GDP. Since 1993 money multiplier – an indicator of banks' ability in creating deposit money – remained between average values of 8-11 per cent; the level of private sector credit stood around 7 times the base money (Fig.13). In percentage of total banks' liabilities, foreign exchange deposit share decreased from 23 (June 1993) to 17.6 per cent per cent in the first quarter of 1999 and then increased again reaching 20.8 per cent at end-2000 (Fig.14).

3.2 Market structure

At the end of 1999 there were 579 branches and agencies (650 at end-1998). On average there were 3,433 inhabitants per branch (3,044 in 1998). Total employees in the banking sector stood at 10,386, almost unchanged in these last years. Out of the 25 operational banks in 1999, three are State-owned, five are State-controlled, 13 are private owned by domestic entities and four are controlled by non-residents. Since end-1997 market shares remained almost unchanged. State-owned banks account for 41 per cent of total assets; including all banks with significant State participation (the Group Nova Ljubljanska Banka) the share increases to 49 per cent. Private banks has a 46 per cent share while foreign-owned banks represent 4,8 per cent. In the past three years, assets shares changed little (Fig.15). Banking groups have been reduced by M&A and liquidation from four in 1997 to one since 1999. The concentration of banking system is high and constant: the first seven banks account for almost 74 per cent of total assets (72 per cent at end-1996); the first three – two of which are State-owned – for 51 per cent (Fig.16). With the first phase of gradual privatisation, launched during 2000, the overall State-owned equity stake should be reduced by 30 per cent.

3.3 Efficiency and risks

Interest rates declined substantially until the third quarter of 1999. Since then the effective average rate on loans lies between 6 and 5.5 per cent while the range for time deposit (over 1 year) is 5-4,5 per cent. Effective interest rates on loans declined faster than rates on deposits especially during 1998. Between the end-1997 and the first quarter of 1999 the spread on interest rates decreased from 2.5 to one percentage point (Fig.17). The official discount rate, 25 per cent until April 1993, was gradually reduced to 8 per cent in May 2000 before increasing to 9 and the to 10 per cent before year-end.. The Lombard rate stands always one percentage point above the discount rate. Interbank market rates started to stabilise in 1995. On average rates stood around 12-14 per cent in 1995-96 and decreased to 7 per cent in 1999-2000 (Fig. 18). At December 1998 capital adequacy was on average equal to 16 per cent. When the Banking Law introduced new rules (June 1999) for determining the ratio, capital adequacy fell, reaching an average of 13.6 in June 2000. Individual banks' capital ratios vary from 8 to 35 per cent; three banks had capital adequacy ratio below 10 per cent; nine banks between 11 and 15 per cent, twelve banks up to 30 per cent and one bank over 30 per cent. In 1994-97 problem assets (categories B-E) decreased from 14 to 10 per cent of total assets; in 1999, partially influenced by a new accounting methodology, the share increased to 11.5 per cent (11.8 per cent by June 2000). Non performing assets (substandard, doubtful and loss; categories C, D,E) show a constant decline from 8.2 per cent in 1994 to 5.2 per cent in June 2000 (Fig.19).

4. Financial System

4.1 Other financial intermediaries.

At end-1999, non-monetary financial intermediaries included 46 Authorised Investment Companies, 15 mutual funds and 13 insurance companies and 80 leasing companies. Total balanced sheet of non-monetary financial institution does not exceed half of credit institutions. Authorised Investment Companies hold a share of 57 per cent of the balance sheet of non-bank financial intermediaries. Insurance and reinsurance companies are about half of the size of Authorised Investment Companies. In 2000 gross premiums of Slovene insurance sector, including mutual insurance companies, stands around 1 billion US$ (4,7 per cent of GDP), up 30 per cent on the previous year; non-life premiums (840 million US$) increased by 35 per cent; life premiums climbed 17 per cent but they stand at the modest level of 160 million US$. The only foreign presence is that of the German Merkur Insurance and of the joint venture between the Austrian EA-Generali AG and SKB Bank. Furthermore, it is highly concentrated: the first company (Triglav) has a market share of 54 per cent. To satisfy the EU's harmonisation schedule, in January 2000 a privatisation law was finally passed. A substantial public stake in Triglav was to be sold to foreign strategic partner but private shareholders, namely the important pharmaceutical company Lek, opposed this plan. A legal procedure was open in order to determine the constitutionality of the entire law and since May 2000 the Constitutional Court suspended its implementation.

4.2 The equity market.

Under the former FRY regional equity markets were not allowed; the Ljubljana Stock Exchange (LJSE) reopened in 1990. Total market capitalisation reached 1,138 billion tolar at the end of 2000, 27.8 per cent of GDP; turnover was equal to 270 billion tolar, 6.6 per cent of GDP (Fig.20-21). The performance of LJSE, as measured by the market index (SBI=1000 in January 1994), has been particularly satisfactory in 1997-98 when SBI recorded a 18.7 and 21.4 per cent increments at year-end; at the end of 2000 SBI closed at 1808, almost unchanged from 1999. In 2000 LJSE activities were fuelled by M&A in the industrial sectors (those announced in the banking sector did not take place) but, in general, were negatively influenced by uncertainty and unfulfilled expectations about the privatisation process and the further opening up of the Slovenian capital market. Rules regarding portfolio foreign investment were eased in March 1999 but the share of foreign ownership did not responded as expected: in Febraury 2001 it stands at 7.88 per cent of market capitalisation against the highest share (12.2 per cent) recorded in May 1998.

4.3 The money market.

According to IMF (March 2000 and May 2001) Slovenian monetary policies can suffer from the weaknesses of the interest rate transmission mechanism. Lack of a competitive domestic financial market structure – few banks dominate both interbank and lending markets – is the basic reason for these inefficiencies but they are also the results of past BoS's policies (high-yield sterilisation instruments, agreement on a deposit rate ceiling, capital controls) which limited competition and reduced interbank market to an overnight lending facility. Recently BoS and Treasury started to implement measures aimed at deepen the money market and improve the interest rate transmission mechanism such as the expansion of monetary instruments' menu and the de-indexation of private financial contracts.

5. The Payment System

5.1 Payments by non-banks

All payments by legal entities – other than credit institutions – are processed by the Agency for Payments (APP); funds on accounts of commercial banks' clients are cleared through settlements accounts of credit institutions with the BoS. In 1999 APP processed 84 million payment orders, 63.8 per cent of which cashless (in 1997 orders were 87.5 million). Payment transactions are carried out by APP through giro and other accounts held by legal entities (at end-1999 APP managed around 75,000 giro and other accounts). Since 1994 the payment system has been reformed – both in the small and large value transactions – in order to reach European standard. In 1998 (October) Giro Cleaning – for low value, non-urgent payments not exceeding 3 million tolar – was implemented. BoS is the clearing and settlement agency for the Giro Cleaning participants operating on a net basis. The next reform step is the Integrated Small Value Payment

System which will integrate the existing clearing mechanisms for settlement through Real Time Gross Settlement (RTGS) and will incorporate all payment services (Giro Cleaning, ATM and POS, cheque and direct debit systems). At the end of 2000 the number of credit cards issued in Slovenia was over 840,000; debit cards numbered over one million (Fig.22). Credit cards issued by banks represent 62 per cent of the total, down from 73 per cent at end-1996. In 2000 there has been almost 56 million payments with credit cards, for a total value of 337 billion tolar (in 1996 payments were numbered 24 million for 106 billion tolar value). Between March 1996 and December 2000 the number of ATMs increased from 334 to 865; that of EFT/POS from 2,319 to 21,723 (Fig.23).

5.2 Interbank payment system.

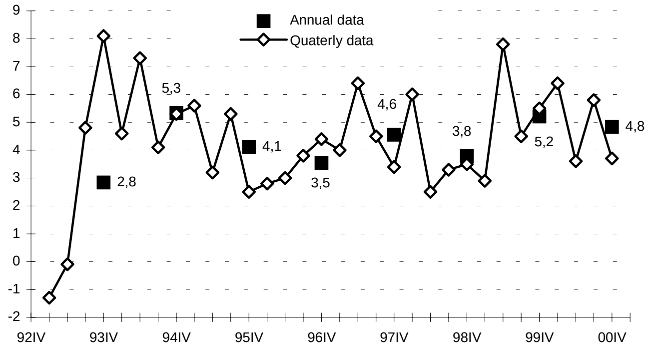
In March 1997 reserve accounts of all banks were transferred from APP to BoS; in April 1998 also giro accounts of commercial banks were transferred to BoS and the RTGS system for interbank payments was initiated. RTGS handles pure interbank payments pursued through the standard and via the SWIFT network; the system links 30 domestic banks and BoS and is sized to cope with more than 2,000 transaction per day. The next step, which started to be implemented during 1999, is that of moving the accounts of all legal entities to the banking system. According to the reform's schedule, accounts' transfer will end by 2001; in the meantime banks will be proving their capacity to perform domestic and international payments for their clients. APP will cease to operate in the last quarter of 2001.

Slovenia: Main Economic Indicators

	1997	1998	1999	2000
Population (mid-year estimation)	1,984,923	1,978,334	1,987,756	1,990,094
Exchange rate (end-year)				
- Tolar per 1 US$	169.18	161.20	196.77	227.38
- Tolar per 1 Euro	186.73	188.93	197.32	211.51
Gross Domestic Product				
- current market price (billion Tolar)	2,907	3,254	3,648	4,046
- real growth rate	4.6	3.8	4.9	4.8
- per capita (US$)	9,163	9,878	10,109	9,128
Current account				
- Trade Balance (million US$)	-776	-789	-1,245	-1,081
- Current account balance (mill.US$)	11	-147	-783	-594
- Current account balance (% GDP)	0.1	-0,8	-3.9	-3.3
Unemployment rate (annual average)				
- Stat. Office definition	14.4	14.5	13.6	12.2
- Annual survey (ILO definition)	7.4	7.9	7.6	7.0
External debt				
- million US$	4,176	4,959	5,491	6,217
- Tot. Ext. Debt / Exports G&S (%)	39.5	44.1	51.1	58.9
- Tot. Debt Service / Exports G&S	8.8	13.8	8.0	9.8
Inflation rate (annual average)				
- Consumer Price Index	8.4	8.0	6.2	8.9
Reserves (million US$)				
- BoS international reserves	3,297	3,573	3,059	2,859
- Banks foreign exchange	1,080	1,209	1,056	1,124
Overall Budget Balance				
- million Tolar	-34,081	-25,591	-23,267	55,520
- % GDP	-1.2	-0.8	-0.6	-1.4
M1 (billion Tolar)	266	327	392	419
- % GDP	9.1	10.0	10.7	10.4
M3 (billion Tolar)	1,386	1,676	1,951	2,284
- % GDP	47.7	51.5	53.5	56.5
Banks' Assets (billion Tolar)	2,094	2,413	2,763	3,268
Banks' Loans (billion Tolar)	853	1,100	1,366	1,619
- National currency	759	961	1,188	1,369
- Foreign currency	93	138	179	250
- to enterprises	532	675	772	933
- to households	241	303	439	495
Interbank interest rate (end period)				
- daily market	9.8	5.6	6.8	6.2
- overnight	9.8	5.6	6.9	5.8
Banks' rates (average on Tolar)				
- Credit rate (short-term)	9.0	5.9	5.1	4.5
- Deposit rate (one year)	4.5	2.0	2.0	2.0
BoS's rates				
- Discount rate	10.0	10.0	8.0	10.0
- Lombard rate	11.0	11.0	9.0	11.0
Lubljana Stock Exchange				
- Market capitalisation (billion Tolar)	399	710	920	1,138
- Market capitalisation (% GDP)	13.7	21.8	25.3	28.1
- Turnover (billion Tolar)	108	173	266	270
- Turnover (% GDP)	3.7	5.3	7.3	6.7
- SBI	1,405	1,706	1,806	1,808

Fig. 1 GDP Real Growth

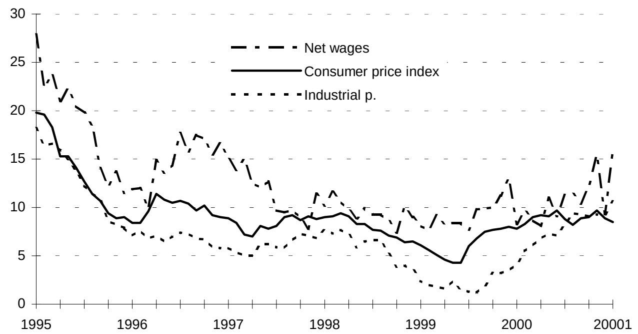
(Quarterly and annual data - Year-on-year perc. change)



Source: Bank of Slovenia

Fig. 2 Prices and Wages Developments

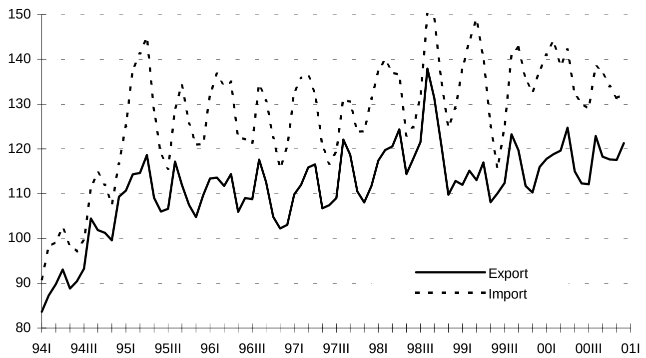
(Monthly data - Year-on-year perc. change)



Source: Bank of Slovenia

Fig. 3 Import and Export of Goods

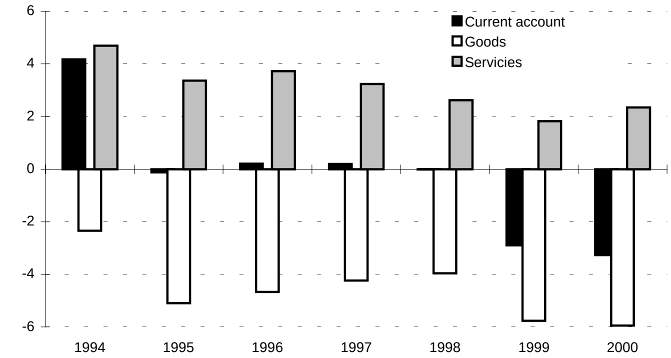
(Index: Jan. 1995 = 100)



Source: Bank of Slovenia

Fig. 4 Balance of Payments Development

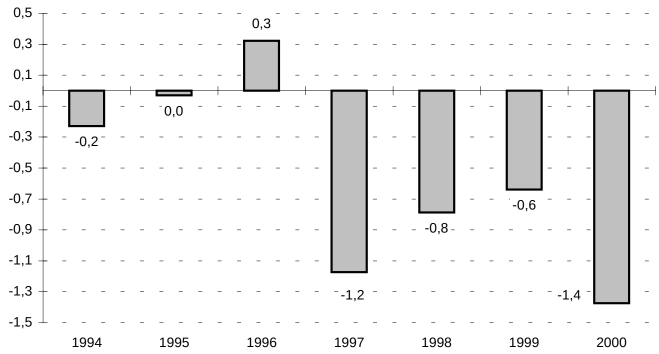
(Percentage on GDP)



Source: Bank of Slovenia (*) Estimated

Fig. 5 Consolidated Central Government Budget

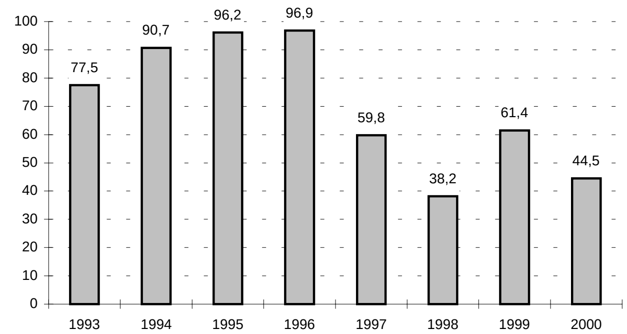
(Surplus/Deficit in percentage of GDP)



Source: Bank of Slovenia; Budget for year 2000; (*) Estimated.

Fig. 6 Central Gov. Budget: External financing

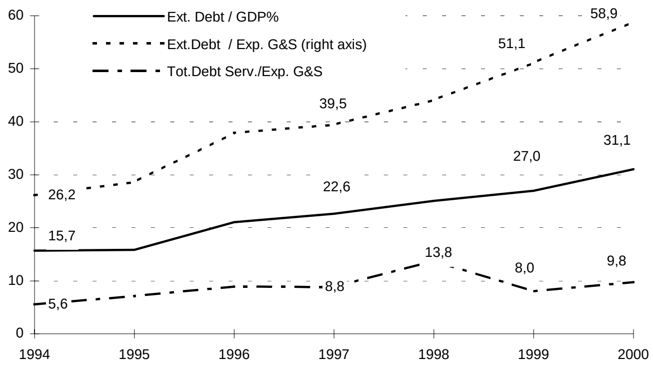
(Percentage of total financing)



Source: Bank of Slovenia

Fig. 7 External Debt

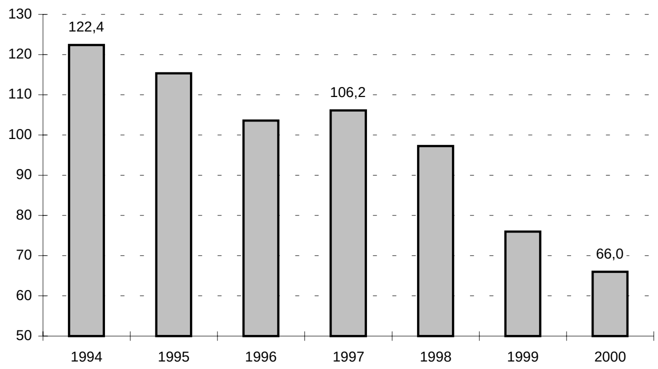
(Percentage on GDP and Export of G&S)



Source: Bank of Slovenia; (*) Estimated

Fig. 8 Foreign Exchange Reserves

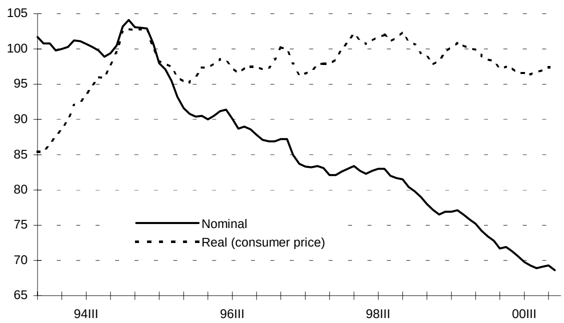
(Percentage over External debt)



Source: Bank of Slovenia

Fig. 9 Exchange Rate Developments

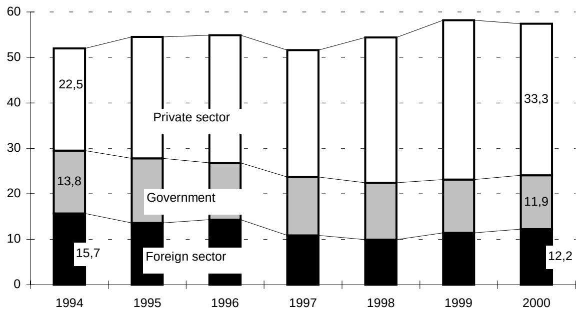
(Index: 1995=100; Increase indicates depreciation)



Source: Bank of Slovenia

Fig. 10 Banks' Assets Development

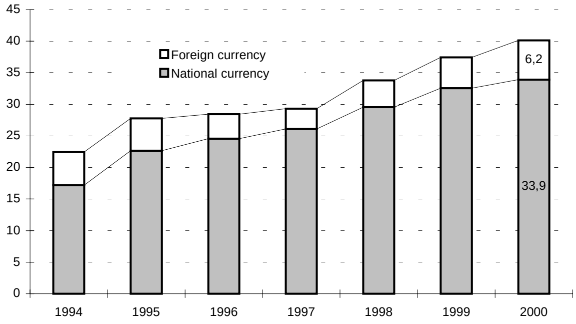
(Percentage on GDP)



Source: Bank of Slovenia

Fig. 11 Loans Developments

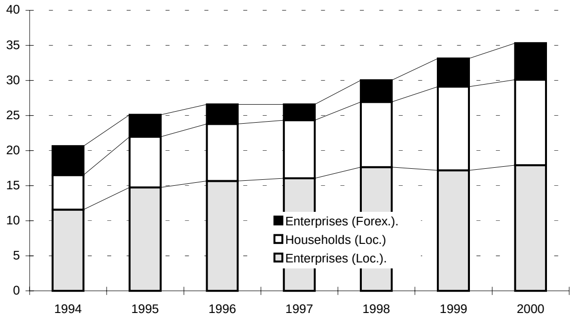
(Percentage on GDP)



Source: Bank of Slovenia

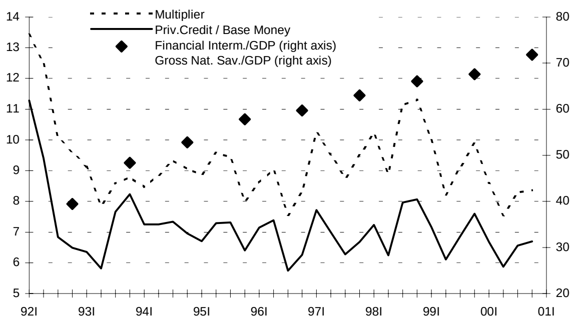
Fig. 12 Loans to Private Domestic Sectors

(Percentage on GDP)



Source: Bank of Slovenia

Fig. 13 Indices of Banking Sector Development



Source: Bank of Slovenia; Slovenia Statistical Office; IMAD

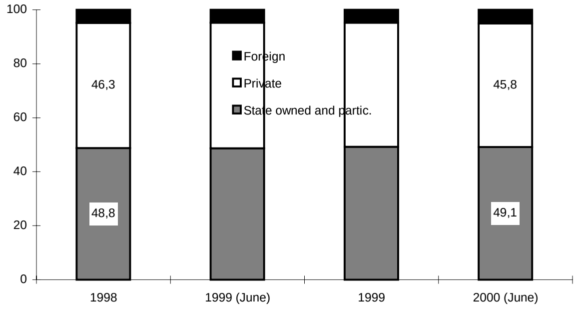
Fig. 14 Foreign Currency Deposit

(Percent on total banks liabilities)

Source: Bank of Slovenia

Fig. 15 Banking Ownership Structure

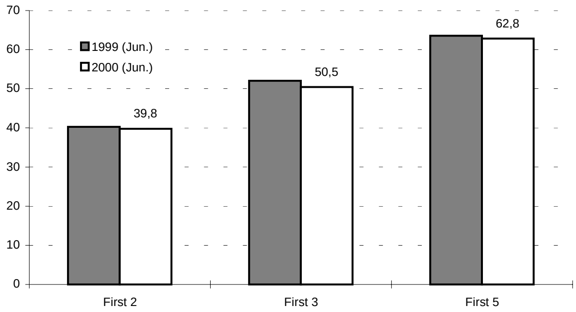
(Percent on total assets)



Source: Bank of Slovenia;

Fig. 16 Assets of Top Banks

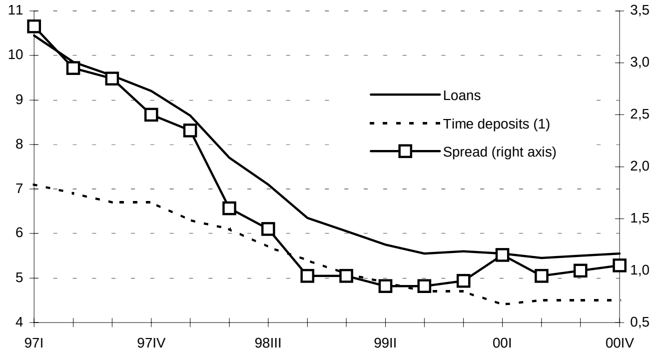
(Percent of total assets)



Source: Bank of Slovenia.

Fig. 17 Average Interest Rates

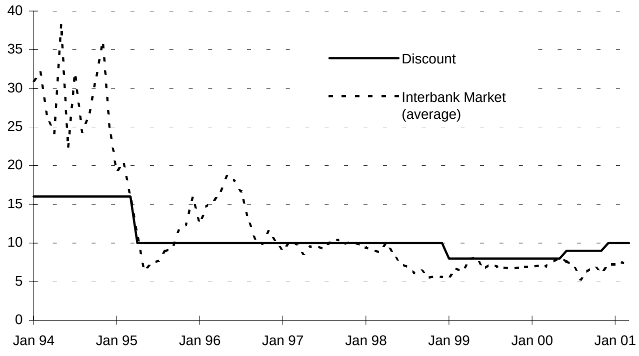
(Percent)



Source: Bank of Slovenia. (1) Over one year

Fig. 18 Official Rates and Interbank Rates

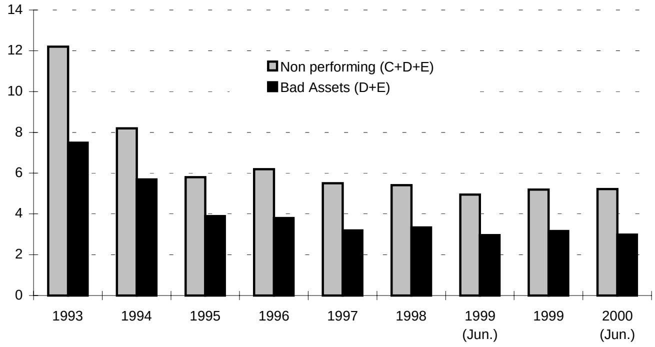
(Percent)



Source: Bank of Slovenia.

Fig. 19 Bad Loans of Slovenian Banks

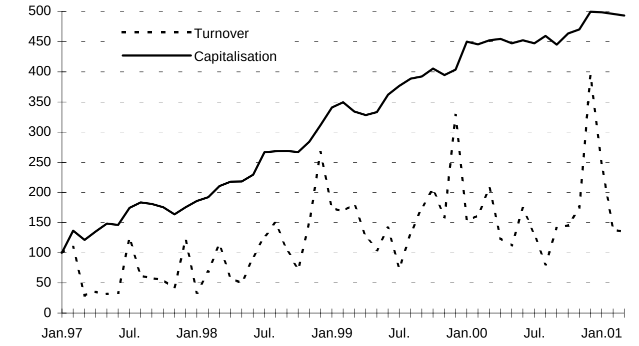
(Percent of total loan portfolio; end of period)



Source: Bank of Slovenia *Report on Supervision of Banking Op.*

Fig. 20 Stock Exchange: Indices

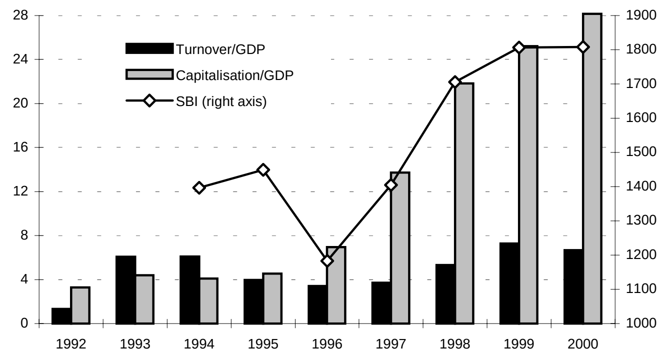
(Capitalisation and Turnover: Index Jan 1997=100)



Source: Bank of Slovenia; Ljubljana Stock Exchange

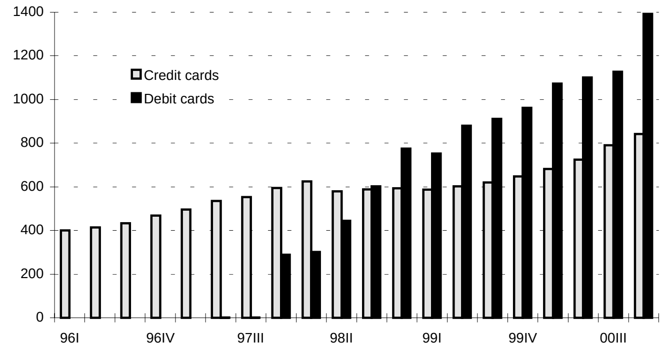
Fig. 21 Stock Exchange

(Percent of GDP and Index)



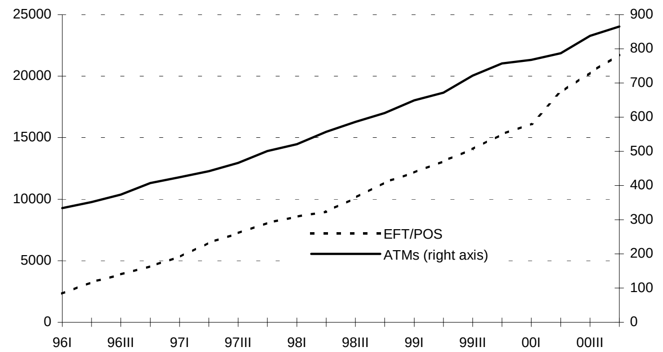
Source: Bank of Slovenia; Ljubljana Stock Exchange

Fig. 22 Number of Credit and Debit Cards
(Thousand)



Source: Bank of Slovenia

Fig. 23 Number of ATMs and EFT/POS



Source: Bank of Slovenia

COUNTRY PROFILE: FEDERAL REPUBLIC OF YUGOSLAVIA [*]

1. The economic structure

1.1 Economic background (1990-99)

The Federal Republic of Yugoslavia (FRY) was constituted in April 1992, as a federation of the Republics of Serbia and Montenegro. FRY was subject to sanctions and international isolation from its foundation until recently; owing to war, the country lost markets and trade relationships between 1991 and 1993. In 1993 the government kept real spending constant, increasing the nominal fiscal deficit to almost a third of GDP; as a result, by January 1994 the monthly inflation rate was more than 300 per cent, while industrial production was less than one third of its January 1991 value.

A stricter macroeconomic policy succeeded in achieving some output growth in 1994-98; over this period, annual output growth and inflation averaged 6.5 per cent and 43 per cent respectively. The success of the government stabilisation program was helped by the large foreign exchange receipts from the sale of Serbian Telecom in 1997-98.

The Kosovo crisis and the spring NATO air campaign, however, reduced 1999 real GDP by 20 per cent. Authorities' measures to keep inflation under control (price controls, rationing, special taxes, confiscation) were unable to offset the impact of the external imbalances. The shortage of foreign currencies was reflected in the growing spreads between the official and the parallel market exchange rates.

In summary, the Yugoslav 1990-99 average annual growth rate of GDP was -7 per cent; the industrial production followed a similar pattern, losing importance in GDP formation in favour of agriculture. In the first years of the 1990s, Yugoslavia experienced two hyperinflations, stemmed from both exogenous and endogenous causes (state disintegration, prolonged war, sanctions, monetisation of the deficits); the second hyperinflation was stopped for a few months by a stricter macroeconomic conduct, but the lack of consistency in the government financial discipline and the absence of structural changes and privatisation programs caused old problems to emerge again. The accumulation of foreign debt proceeded through the whole decade, up to 12 billion USD in 2000 (Table 1); trade deficits have been until now the rule (Tables 2 and 3).

1.2 Recent developments

Output has only partially recovered from the bombing devastation, and it is now at less than a half of its 1989 level; unemployment, including workers on involuntary leave, is about one half of the labour force. The increase of the ratio of external debt to GDP to 140 per cent without debt servicing is the main signal of macroeconomic fragility.

GDP is estimated to have risen by 5 per cent in 2000, but the severe drought has sharply reduced agricultural output: the economic effects of the Kosovo war will be recovered only partially this year. The 12-month retail price inflation rose in December to 113 per cent, following the price liberalisation introduced by the government; average wages and pensions dropped in August 2000 to 90 DM per month and 68 DM per month, respectively.

The output decline in 1999 and the decision to stimulate economic activity in 2000 have compressed government revenues in real terms by a cumulative 40 per cent in the last two years. The need to keep public deficits low (0.9 per cent of GDP in 2000) has led to a severe compression of spending, with the exception of defence; nevertheless, the fiscal deficit on accrual basis is at least 3 per cent of GDP, without considering the debt service, that is over 100 per cent of GDP. The Montenegro[5] general government deficit is estimated to run at about 8 per cent of GDP, and will be entirely financed by US and EU grants. The economic separation of Montenegro from Serbia is the result of political strife: the exchange of goods is at the lowest level ever registered, and payments have been halted. Nevertheless, the Montenegrin economy is still dependent on

[*] By Alessandro Fabbrini

[5] After Montenegro has stopped contributing to the federal budget and the federal budget has stopped contributing to the Montenegrin pension funds, the Montenegro public finances are actually separated from the rest of the Federation.

Serbia: in 1995 the average dependency ratio of Montenegrin enterprises from Serbian exports and imports was 68 per cent; the search for new markets induced by trade difficulties reduced the ratio to 42 per cent in 1999, but the balance of payments deficit has increased.

High inflation together with reduced aggregate supply is explained by large monetary financing: the National Bank of Yugoslavia and the rest of the banking system have been used until recently to finance state owned enterprises and the agricultural sector. During the run-up to the elections of September 2000, as the last subsidising economic policy measure, the 12-month growth rate of currency in circulation rose from 32 per cent (June) to 58 per cent (see Table 4).

2. The financial system

2.1 Monetary policy

With amendments to the Law on the National Bank of Yugoslavia, the Bank's governor is now independent from other state bodies and has got full authority to quantify domestic money and to supervise commercial banks. The government has lost its right to set the dinar's exchange rate; now it only establishes the regime of the exchange rate, opting for hard currency exchange rates on the basis of market principles. There will be no "currency board", nor the direct use of foreign currency, as in Montenegro and in Kossovo. The ban on the use of foreign currencies in transactions and the penalties for those who do not respect it have been maintained.

Governor Dinkic announced his monetary goals for 2001. He did not give any anticipation of money supply trends, but he stated the future amounts of the NBY's net domestic assets or "primary money", which includes cash, as well as deposits of banks and state accounts in the central bank. The Governor has committed himself to not increase primary money in the first quarter of the year by more than 500 million dinars, and, more in general, to set strict monetary conditions, aiming to abate the growth rate of average retail prices by one per cent per month. The emitted surplus dinars are to be annulled by the sale of the NBY's securities, but the near non-existence of bond markets makes open market operations extremely difficult. An expanded use of interest rates in the dinar's quantitative regulation has been announced. Also projected is the co-ordination of the discount rate with market rates.

2.2 The structure of the banking and financial systems

Yugoslavia has a highly concentrated banking system: although there are 79 banks, three of them (Beogradska Bank, Vojvodina Bank and Yugo Bank) centralise almost all the bank assets in the country. There are also small and medium sized banks: some of them have been established by profitable firms to manage their own finances in the absence of reliable intermediaries. Anyway, these small private banks have got limited capacity to provide loans in any significant volume relative to the needs of the economy.

The balance sheet of the three largest banks has decreased from a total of 22 billion USD in 1989 to 9.5 billion USD in 1999; in the same time, the share in dinars has decreased form 17.5 billion USD to 0.4 billion USD. Around 75% of the liabilities are foreign currency loans, both from abroad and old foreign currency savings. Domestic currency deposits amount to around 6 billion dinars, and liquidity is estimated to be around 600 million YUD, meaning that banks can only offer basic services, such as transfers, letters of credit, or guarantees. Some foreign banks have already been granted a license, and several others have shown some interest in entering into the Yugoslav market. The insurance sector is based on motor, third party, fire and theft, with little life insurance business; the market is controlled by two large state owned companies. Payment transaction are mainly cash. Payments with giro money are burdened by fees which total to 0.6 per cent of each payment, and banks usually pay no interest on sight deposits, making cash more profitable than giro money as mean of payment.

2.3 Efficiency and risks

Although the 1988 Banking Act aimed to ensure that banks respect internationally accepted prudential standards and auditing procedures, only a handful of the smaller banks are thought to be able to respect it. A strict implementation of the Banking Act would lead the majority of the intermediaries to declare bankruptcy, including the National Bank of Yugoslavia. The three major banks are thought to have bad debts of between 80-90% of total loans; main debtors are state enterprises.

The government has not yet planned a strategy for a recovery process of banks', although advisors to the National Bank of Yugoslavia are preparing an audit of individual banks. In the Serbian banking sector, a 50 per cent of the loan portfolio is estimated to be non-performing. Moreover, reported capital is probably overstated, owing to the practice of reporting accrued interest of non-performing loans as income. Banks also need an improved system for the protection of deposits, as the deposit insurance scheme in force has been impossible to implement.

Confidence in the banking sector is extremely low, as a result from the freezing of the foreign currency deposits and pyramid scheme scandals in 1992-93. Moreover, hyperinflation in 1989 and 1992-93 wiped out domestic currency saving accounts.

2.4 The situation in Montenegro

In the past three years, Montenegro has come to operate as a separate state from Serbia, taking control over the main instruments of economic policy. After the introduction of the Deutsche Mark as a parallel currency with the Dinar (November 1999), a "Monetary Council of the National Bank of Montenegro" was set up to foresee monetary and foreign currency policy. In November 2000, the DM became the sole legal tender, and a law on Montenegro's central bank was passed.

The National Bank of Yugoslavia has recently moved to re-establish a payment system in DM between Serbia and Montenegro; the electronic payments between the two republics had been severed by Belgrade in 1999, as a consequence of Montenegrin introduction of a foreign currency as mean of payment. Two years of severe negative shocks (1998 and 1999) have affected the budget of Montenegro, which had been until then approximately balanced. The cash deficit of the consolidated budget is financed through commercial banks' credits, partly explaining their difficult situation, and draining 2% of the central budget expenditure for the payment of interests on these loans.

In March, 2000, 5 branch offices of Yugoslav banks and 10 local banks were operating in Montenegro; 5 Montenegrin banks have developed from the transformation of the former Investiciona Banka Titograd in 1990. Out of the 5 major banks, only two (Mortgage Bank and Montenegro Commercial Bank) hold considerable shares of private capital. Competition in the banking system is limited: interest rates, although not legally regulated, are ruled by a codex of the Association of Banks.

The Montenegrin banking system shows a strict relationship between shareholders and borrowers through connected lending: these shareholders and large borrowers gain power over the bank's business policy as members of the managing board. Loans are mostly financed by shareholders' funds, deposits of legal entities and borrowing from public agencies: due to the public loss of confidence in the banking system, induced by the Yugoslav seizure of foreign exchange deposits and by the unpaid government bonds, household savings are in practice non-existent in banks, and cannot be used for financial intermediation. A so-called Middle Authorisation is needed to conduct foreign exchange transactions; non-authorised banks operate via Montenegro Bank.

Two thirds of the assets in the Montenegrin banking system's balance sheet are in foreign currency or gold, held mainly for international transactions. The loan portfolio is only 10% of total assets: three quarters of it have a maturity below one year (commercial papers, claims to the National Bank of Yugoslavia, and accrued interest and fees), whereas the long-term positions are almost completely FRY's bonds. Liabilities, both in foreign currency (60% of the total) and in YUD are predominantly short-term; the major part of deposits are giro accounts of legal entities. Determination of bad loans is still extremely difficult, evaluation of collateral nearly impossible. Even if loans are sometimes covered up to three times by mortgages, the value of the mortgages is often unrealistic, because of a highly illiquid market in real estate, long bankruptcy procedures, and difficulties in defining ownership in real estate. The payment system is highly centralised: the clearing and settlement agency ZOP holds a monopoly position over the system, even after the introduction of the DM.

2.5 The financial market organisation

The regulatory framework in financial markets is based on the authorities' discretionary powers, and is related to rent-seeking behaviours: legal and economic regulations do not correspond to economic needs, or they are not implemented. Property rights and contracts have no adequate protection. As a result, the capital, foreign currency and money markets exist, at the best, only as a matter of form, or they have been transferred to the black market.

Some financial institutions already exist (for example, the commission for securities, the stock market, and the brokers), but the decision-making process actually takes place outside the institutional structure. Stockholding has been almost completely abandoned, due to the lack of ownership rights' protection; trade in stocks is nearly non-existent (Table 6). On February 19^{th}, 2001, the Belgrade Stock Exchange signed an Agreement on Co-operation with the Athens Stock Exchange: the program includes several aspects of the financial market and infrastructure, from training, software and hardware packages, up to the maintenance and development of the whole system.

FEDERAL REPUBLIC OF YUGOSLAVIA (SERBIA/MONTENEGRO): SELECTED ECONOMIC AND FINANCIAL INDICATORS, 1997/2001 (1)

	1997	1998	1999	2000 Prel.
Real economy (change in percent)				
Real GDP	10.1	1.9	-15.7	5.0
Industrial production	9.5	3.6	-22.5	10.9
Retail prices (annual average)	18.5	29.8	42.4	71.8
Unemployment rate (in percent) (2)	25.8	25.1	26.5	27.3
Average wage (DM)	206	169	109	99
General government finances (percent of GDP) (3)				
Revenue (4)	….	….	….	38.8
Expenditure	….	….	….	39.7
Cash balance	….	….	….	-0.9
Commitment balance (5)	….	….	….	-3.0
Money supply (end of period, percent change)				
M1 (6)	66.5	17.1	47.3	85.1
M2 (6) (7)	23.9	69.4	67.6	61.4
Balance of payments (in billions of USD)				
Merchandise exports	2.4	3.0	1.7	1.9
Merchandise imports	4.8	4.8	3.3	3.8
Trade balance	-2.4	-1.9	-1.6	-1.8
Current account balance	-1.8	-1.2	-1.3	-1.0
Foreign debt (8)	….	….	….	11.7
Gross official reserves (in months of imports of goods and services)	….	….	0.3 (1.1)	0.5 (1.5)
Black market exchange rate (din/DM) (9)	….	6.7	12.6	30.0

Sources: International Monetary Fund and G17.
(1) With the exception of money supply and foreign debt, data for 1999 and 2001 exclude Kosovo. GDP excludes Kosovo throughout. (2) Excluding worke holiday" (about 20-25 percent of the labor force in recent years). (3) Fiscal operations of all levels of government, except for Montenegro where it exclude governments. (4) Excludes foreign grants. (5) Excludes arrears of local governments and most interest payments on foreign debt due but not paid. (6) Fro excludes Montenegro. (7) Frozen foreign currency deposits are excluded and other other foreign currency deposits are valued at parallel market rates unt and at YUD 30 per DM thereafter. (8) Includes arrears on unpaid imports of fuel and gas. (9) From 2000 onwards exchange rate is the official rate determ

FEDERAL REPUBLIC OF YUGOSLAVIA:
EXPORTS AND IMPORTS BY MAIN PARTNERS
(cif-fob, millions of USD)

Countries	1996	1997	1998	1999 (1)
		Exports		
Bosnia-Herzegovina	328.2	458.8	614.9	304.1
Macedonia	211.7	221.6	247.5	176.7
Germany	204.0	337.8	332.7	165.1
Italy	202.0	317.7	309.9	156.4
Switzerland	99.4	189.1	246.0	105.7
Other countries	972.7	1,152.0	1,107.0	589.6
Total exports	**2,018.0**	**2,677.0**	**2,858.0**	**1,497.06**
		Imports		
Germany	524.7	650.6	603.9	404.8
Italy	437.1	488.1	516.9	331.5
Russia	225.4	438.4	527.1	274.3
Bosnia-Herzegovina	186.8	288.6	251.2	187.8
Bulgaria	220.2	124.5	79.4	151.6
Greece	147.3	181.1	179.5	146.9
Macedonia	215.5	292.1	246.2	122.4
Austria	123.4	158.1	154.8	113.9
Romania	123.4	102.0	98.1	108.6
Hungary	128.4	127.8	116.6	101.8
Other countries	1,786.8	1,974.7	2,075.3	1,352.1
Total imports	**4,119.0**	**4,826.0**	**4,849.0**	**3,295.7**
Trade balance	**-2,101.0**	**-2,149.0**	**-1,991.0**	**-1,798.1**

Source: V. Gligorov, *Yugoslavia: Political change,* The Vienna Institute for International Economic Studies.

(1) Excluding Kosovo and Metohia.

Table 3

FEDERAL REPUBLIC OF YUGOSLAVIA:
EXPORTS AND IMPORTS BY COMMODITY GROUPS
(cif-fob, millions of USD)

Commodity groups	1996	1997	1998	1999 (1)
		Exports		
Food and live animals	407.9	280.8	346.8	293.9
Beverages and tobacco	102.4	75.2	41.2	22.0
Crude materials, inedible, except fuel	86.7	129.1	127.4	82.0
Mineral fuels, lubricants, etc.	47.9	55.5	69.9	36.2
Animal and vegetable oils, fats, waxes	9.1	20.6	23.1	8.1
Chemicals and related products, n.e.s.	169.0	322.0	278.4	144.0
Manufactured goods class. by materials	641.5	911.0	855.1	465.9
Machinery and transport equipment	226.2	239.3	290.3	184.6
Miscellaneous manufactured articles	294.0	419.8	378.1	218.8
Commodities not classified by kind	33.4	223.7	447.7	42.1
Total exports	**2,018.0**	**2,677.0**	**2,858.0**	**1,497.6**
		Imports		
Food and live animals	503.3	586.8	490.3	277.9
Beverages and tobacco	36.6	83.8	50.2	41.1
Crude materials, inedible, except fuel	428.3	401.5	303.6	230.2
Mineral fuels, lubricants, etc.	573.6	754.7	743.2	592.3
Animal and vegetable oils, fats, waxes	11.1	8.6	10.0	7.8
Chemicals and related products, n.e.s.	587.0	640.2	686.1	519.9
Manufactured goods class. by materials	816.7	1,004.3	1,039.9	674.6
Machinery and transport equipment	799.2	868.1	1,013.6	713.6
Miscellaneous manufactured articles	327.4	374.5	391.9	211.3
Commodities not classified by kind	35.8	103.6	120.2	27.0
Total imports	**4,119.0**	**4,826.0**	**4,849.0**	**3,295.7**
Trade balance	**-2,101.0**	**-2,149.0**	**-1,991.0**	**-1,798.1**

Source: V. Gligorov, *Yugoslavia: Political change,* The Vienna Institute for International Economic Studies.
(1) Excluding Kosovo and Metohia.

Table 4

FEDERAL REPUBLIC OF YUGOSLAVIA: BALANCE SHEET OF THE NATIONAL BANK OF YUGOSLAVIA AND PROGRAM TARGETS, 1999/2001

(in millions of dinars; end of period)

Items	1999	2000				2001
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.
Net foreign reserves (1)	**4,589.2**	**3,641.5**	**9,108.7**	**13,652.4**	**13,652.4**	**13,652.4**
Gross foreign reserves (2)	11,940.6	11,723.0	17,404.3	24,491.1	....	....
Gross reserve liabilities (3)	-7,351.4	-8,081.5	-8,295.6	-10,838.7	....	....
Net domestic assets (4)	**4,010.3**	**5,449.6**	**669,8**	**-1,446.4**	**-1,446.4**	**-946.4**
Domestic credit	22,410.4	24,159.7	24,958.1	26,524.6	26,524.6	27,024.6
Net claims on government	1,758.3	3,078.4	2,793.2	3,347.3	3,347.3	3,847.3
Claims	*2,610.8*	*3,888.8*	*4,247.6*	*4,385.1*	....	....
Liabilities	*-852.5*	*-810.4*	*-1,454.4*	*-1,037.8*	....	....
Net claims on banks	22,655.6	22,979.0	23,460.7	23,845.6	23,845.6	23,845.6
Claims	*31,460.4*	*31,963.0*	*32,221.1*	*33,546.3*	....	....
Liabilities	*-8,804.8*	*-8.984.0*	*-8,760.4*	*-9,700.7*	....	....
Net claims on the rest of the economy	-2,003.5	1,897.7	-1,295.8	-668.3	-668.3	-668.3
Claims	*2,697.6*	*2,994.0*	*3,000.6*	*4,020.0*	....	....
Liabilities	*-4,701.1*	*-4,891.7*	*-4,296.4*	*-4,688.3*	....	....
Other assets (net) (5)	-18,400.1	-18,710.1	-24,288.3	-27,971.0	-27,971.0	-27,971.0
Reserve money	**8,599.5**	**9,091.1**	**9,778.5**	**12,206.0**	....	....
Currency in circulation	6,688.3	6,202.5	7,159.4	9,026.4	....	....
Reserve deposits	1,911.2	2,888.6	2,619.1	3,179.6	....	....
Required reserves	1,215.3	1,657.2	1,670.9	2,074.0	....	....
Excess reserves (6)	695.9	1,231.4	948.2	1,105.6	....	....

Source: International Monetary Fund.

(1) Dec. 2000 and Mar. 2001: program floor. (2) Defined as monetary gold, holding of SDRs, any reserve position in the IMF, holdings of foreign exchange in convertible currencies by the NBY, and any short-term foreign exchange accounts held abroad. Excludes frozen assets of the FRY, undivided assets of the SFRY, long-term assets, NBY redeposits with the domestic commercial banks, any assets in nonconvertible currencies, encumbered reserve assets, reserve assets pledged as collateral for foreign loans, reserve assets pledged through forward contracts, and precious metals other than gold. (3) Gross reserve liabilities are subject to revision. They are defined as any loan, deposit, swap (including any portion of the NBY gold that is collateralized), and forward liabilities of the NBY in convertible currencies to residents and nonresidents; IMF purchases; borrowing from international capital markets; and bridge loans from the BIS, foreign banks, foreign governments, or other financial institutions, irrespective of their maturity. Excludes long-term liabilities and any foreign liabilities not being serviced as of September 30, 2000. (4) Dec. 2000 and Mar. 2001: program ceiling. (5) Given the definition of net foreign reserves, gross foreign assets and liabilities excluded from net foreign reserves are captured in other assets (net). For end-September 2000, the items excluded represented net foreign liabilities totaling dinars 21,758.3 million. (6) Comprises balances in giro accounts and cash in commercial bank vaults.

Table 5

KEY DATA FOR THE FIVE MAJOR BANKS IN THE MONTENEGRIN BANKING SYSTEM

(units and millions of DM)

Item	Sep. 1999	in % of all banks
Number of employees	893	....
Capital and Reserves	62	74
Loans in YUD	21	54
Short term liabilities in foreign currency	276	93
Long term liabilities in foreign currency	1229	96

Source: D. Gros and N. Whyte (ed.), *Notes on the economy of Montenegro,* CEPS Working Document 142.

Table 6

BELGRADE STOCK EXCHANGE TURNOVER

(millions of dinars)

	1998	1999	2000
Total turnover	**6,004**	**6,160**	**8,925**
out of which: *Shares*	*125*	*310*	*301*
NBY bonds	*2,713*	*364*	*0*
FRY bonds	*1,465*	*2,900*	*613*
Commercial notes of companies	*1,489*	*1,053*	*6,878*

Source: Belgrade Stock Exchange.

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