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Mr. President, Honorable Members of Parliament,

Allow me to present to you, on behalf of the Bank of Slovenia and its Governing Board, the annual business report and the annual financial statements for the year 1998, together with the opinion on the state of the Bank's affairs given by the authorized auditors PricewaterhouseCoopers AG, Zurich.

In spite of the difficulties the world economy faced last year, mainly due to financial crises in different parts of the world, the international terms of trade remained favorable for Slovenia and contributed significantly to the relatively good results of domestic entities. The favorable economic trends in the United States and in the European Union fostered Slovenian exports of goods and services; exports alone accounted for 55% of GDP. Very similar was the level of imports, so that the current account resulted in a negligible deficit of USD 4 million and was actually very close to balance.

Last year's decrease in the international commodity and oil prices of an average of 18% and 33% respectively was of significant importance and had a positive impact on Slovenian foreign trade. It actually rendered Slovenian exporters more competitive on international markets by 2.4%. In spite of the ongoing crisis, especially during the second half of 1998, some developments in the international financial and capital markets – namely further reductions of interest rates and consequent increase of capital gains - contributed to more favorable results of Slovenian economy. However, the crisis negatively affected the developing countries and the economies in transition to market economy: the demand for foreign capital by far exceeded the supply, the interest rate margins increased substantially.

In response to the Russian financial crisis a substantial volume of foreign capital fled, especially from portfolio investments in the countries in transition, which had previously positively affected their economic growth and foreign exchange liquidity. Due to the prudent policy as regards flows of foreign capital lead by the Bank of Slovenia since 1995, Slovenia did not record any substantial withdrawal of foreign capital. However, as a consequence of illiquidity of the Russian financial system the volume of its foreign trade with Russia shrank.

Inflation declined significantly, mainly due to moderate increases in free market prices. Their annual growth was reduced from 7.4% in 1997 to 5.7%, and to a seasonally adjusted 4.2% at the end of 1998. Controlled prices also contributed to the overall reduction of inflation: their growth slowed down from 14% in 1997 to 10.1%.

Volatility in financial markets of the three major world currencies, US Dollar, German Mark and the Japanese Yen, was considerable; the cross rate between the USD and the Yen alone changed by 25%. The Tolar exchange rate, on the other hand, remained relatively stable and appreciated – measured by the purchasing power - by about 3% against the DEM and 10% against the USD in one year. Such development of the Tolar was less favorable for Slovenian exporters on one side, but was a substantial contribution to further price stability in Slovenia on the other side.

Domestic interest rates declined substantially: the average real short-term borrowing rates 3.7 percentage points, the long-term rates by 3.5 percentage points. The reduction was triggered by lower inflow of foreign capital in form direct, portfolio investments and foreign loans. As a consequence, the credit activity of domestic banks increased in real terms by 15.4% in credits to the corporate sector and by 24.2% in credits to individuals.

In spite of such downward trend in domestic interest rates, the level of Tolar savings increased by 14.8% in real terms. It was for the first time that Tolar deposits in domestic banks exceeded those held in foreign currencies. It is, no doubt, a proof of sustained growth of confidence in domestic currency by individuals and other persons. The deposits are a valuable financial source of new investments necessary for further growth by the national economy.

Not only the credit activity of banks and the savings ratio increased last year: the balance sheet total of all banks increased by 9.2% in real terms (against 6.9% in 1997). Interest rate margins of domestic banks remained relatively high (about 4.5%) in comparison with the margins of their foreign competitors, and so did their operational costs against total bank assets (3.6%).

As evident from the relevant data, the Bank continued to conduct monetary policy oriented towards price stability and growing confidence in domestic banking system, and towards accession of Slovenia to the European Union. The Bank fully met the intermediate monetary policy target, the broad money aggregate growth (M3): the M3 growth resulted in 20.2%, i.e. only 2.2 percentage points above the lower level of the target band.

The global financial market conditions and the changes in development of domestic market affected the profit and loss accounts of the Bank to the effect that the projected loss of about SIT 1 billion resulted in profit of above 2 billion SIT (exchange rate differentials not taken into account in either case).

In view of the EU accession strategy adopted by the Parliament and in view of the fact that official negotiations between Slovenia and the European Union have actually started, the responsibility of each and all of us for sustainable economic growth and development and for the implementation of structural and social reforms has become even bigger. The globalization processes demand for higher degree of professionalism, for cost reduction and competitiveness. The Bank certainly aims to keep making an optimal contribution to such efforts with appropriate monetary policy, one of the key policies in the national economy. However, the Bank's efforts could fall short of the target without the appropriate support of the fiscal and incomes policies. Only a close coordination of the three policies and an effort made by each and every citizen can bring about good results and further increase in confidence in domestic currency.

I take this opportunity to thank all of you for your cooperation, support, understanding and confidence, and to express my wish and hope that such cooperation will continue and further develop in the future. I also find this a good opportunity to thank our board members for their efforts and their constructive contribution to the efficiency and success of monetary policy.

Finally, I thank all my associates and the Bank staff for their daily contribution to the Bank's efforts directed towards stability of the Tolar and success of national economy.

Dr.France Arhar
Governor

Ljubljana, March 22, 1999

1. ECONOMIC ENVIRONMENT

1.1. Global Economic Environment

The world economic growth in 1998 is estimated at 2.2%, which represents a slowdown by nearly 50% against 4.2% in 1997. Economy of the EU grew by 2.8% and that of the U.S.A. by 3.9%. The Japanese GDP declined by about 2.8%. The financial crises in emerging economies dominated in the global economic environment. (Box 1). It was most important for Slovenian economy that the spillover effects from the crises did not have a major impact on its main (European) economic partners – its export markets. Their economic growth remained relatively high (e.g. Germany 2.7%, France 3.0% and Italy a moderate 1.3%). Foreign demand, measured by real imports of the 8 most significant economic partners, without Croatia, remained on a favorable level of 6.5% (against 8% in 1997). The contribution of foreign demand to Slovenian growth was therefore of great significance.

World economic growth in 1998 only 2.2% due to crises…

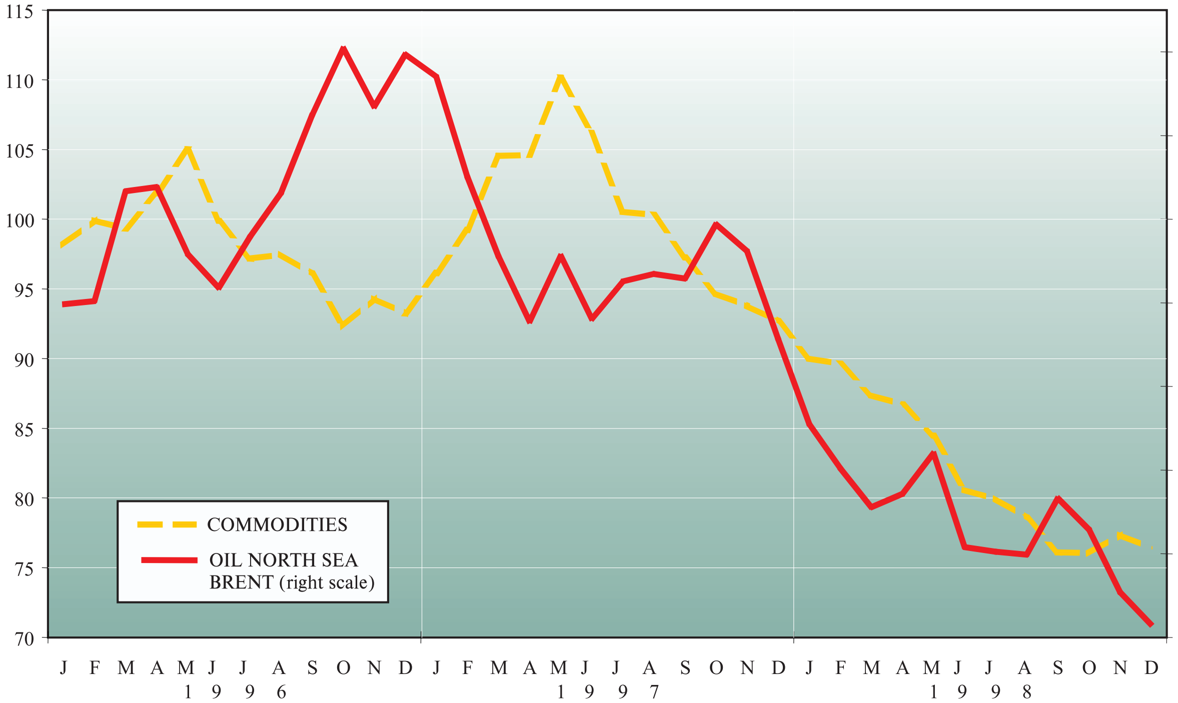
…and 2.8% growth of the less affected EU, the main Slovenian export market.

Slovenian terms of trade improved by 2.4%. Slovenian US Dollar export prices were lower by 0.3% and the import prices by 2.6% against the average of 1997. Such better terms of trade were due to the structure of foreign trade, while the reduction in Slovenian US Dollar denominated import prices is due to decline in the international commodity and oil prices: the former declined on average by 18%, the latter (North Sea Brent) by as much as 33 % (from the average of USD 19.2 in 1997 to the average of USD 12.8). The share of commodity imports

Terms of trade improved by 2.4% and prices in USD reduced…

…due to decline in international commodity and oil prices.

Figure 1: **Commodity** (1997=100) **and Oil Prices** (North Sea Brent in USD per barrel) **in International Markets**



Source: The Economist, London; OPEC Bulletin, Vienna.

Box 1: **World Financial Crises**

These started with the devaluation of the Thai Baht in July 1997 and culminated in the Russian crisis in August 1998. The uncertainty about the spillover effects dominated the global economic situation and the financial markets in 1998. There is more than one explanation to the world financial crises. The **first-generation** crises are due to fundamentals, such unsustainable fiscal policy and fixed exchange rate regime. The policy of budget deficit financing by the central bank and limited foreign exchange reserves used to support the fixed exchange rate can become unsustainable. With foreign exchange reserves reduced to a certain level, anticipated devaluation leads to speculative attacks on a domestic currency. The **second-generation** crises are known as capital account crises. Governments need to decide whether or not to protect domestic currency and are confronted with the decision in favor of short-term macroeconomic stability or in favor of long-term credibility. The crisis is triggered by higher opportunity costs (high interest rates) of the fixed exchange rate when the market anticipates devaluation. The speculative attacks on domestic currency follow when a negative turn in economic indicators is expected or when the anticipated devaluation happens.

The first analyses of the **Asian crisis** used the first generation crises models in spite of the fact that the Asian countries showed no budget deficit and there was no credit or money expansion perceived. The essence of the Asian financial crisis is to be found in the functioning of economies, in early nineties still called the Asian tigers, and of financial intermediaries, and cannot be described by means of economic models. The crisis was triggered by the relatively weak macroeconomic fundamentals, tight links between politics and economy (financial institutions), the deposit insurance scheme and weak supervision of financial sector. These circumstances led financial intermediaries into moral hazard and overinvestment in real estate. In the Asian case, there were no speculative attacks on domestic currencies, and no capital flight. What actually happened was as follows: financial institutions raised money abroad under state guarantee and placed the money into risky projects. As a consequence of high credit activity real estate prices shot up and real estate became overvalued. The financial position of real estate agencies seemed by far better than it really was. Since the real estate did not bring about any investment gains, repayment of loans became a problem. Supply in real estate markets exceeded the demand; prices collapsed and endangered the financial and banking system.

The **Russian crisis** was due to negative expectations of foreign investors, triggered by the Asian crisis and the instability of the Russian financial sector. Unlike in the Asian case, the Russian government failed to have budget revenues meet the high expenditure, mainly due to high public debt. The government exempted some enterprises from tax payment obligation and some big enterprises – especially those involved in production of and trade with oil derivatives – never paid the taxes. Russia had a well-developed market of treasury bonds with high yield. Foreign investors held about one third of the government debt and reinvested their funds into new bond issues; domestic banks even raised loans abroad to purchase government bonds in Russia. After the political crisis in the first half of 1998 and with the oil prices on the downturn foreign investors realized that the government would not be in position to meet its obligations and started withdrawing from their investments in government bonds. The Russian government ran short of funds (its obligations to foreign investors falling due from mid 1998 to May 1999 amounted to USD 1 billion per week on average) and was forced to expand the exchange rate band* ; Russia stopped meeting its foreign obligations and announced negotiations on restructuring of its external debt.

The contagion effect caused by the Asian and the Russian crises spread to other emerging markets due to **loss of confidence by foreign investors**. It resulted in a number of corrections of world economic growth projections, especially for Brazil and for Russia. The transition countries with relatively sound macroeconomic fundamentals did not suffer a major impact, among them Slovenia. Its 1998 exports of goods to Russia, by far more important trade partner than the Asian countries, amounted to USD 235 million (2.6% of total exports), i.e. 28% less than in 1997; after August 1998 Slovenian exports to Russia dropped by 66%. The share of Slovenian exports into crisis affected Asian countries was 0.2% of the total (against 0.3% in 1997). On the other hand, the balance of payments (BoP) capital account item Commercial Credit Extended grew rapidly (bigger amounts, extended total increased by USD 200 million). **Indirect impact of the crises** on the Slovenian economy was evident in early 1999 from decline in foreign demand, due to competitive export position of the countries, which had had their currencies, devalued.

* The band was first expanded from 5.3-7.1 Roubles for 1 USD to 6.0-9.5 Roubles for 1 USD; later on, the band was overdrawn, the exchange rate at the end of 1998 was 20.7 Roubles for 1 USD.

(group SITC 0-4) amounts to 17.2% of the total, the share of commodity exports to 6.7% of the total.

High cross rate fluctuation

Cross rate fluctuation of the major world currencies was high. The average US Dollar/DEM rate amounted to 1.76 DEM; USD appreciated against the DEM by 1.5% in 1998. The USD/DEM rate was very volatile during the year: the average rate in January was 1.82 DEM, and in December 1.67 DEM. This change and changes of cross rates of other currencies accounted for reduction of US Dollar export prices by 1.6% and US Dollar import prices by 1.8%.

Low interest rates in international markets

Interest rates in international financial markets were low and (for the major part) in decline since early 1998. The average 1998 3-months LIBOR for USD amounted to 5.56% (in December 5.23%), and for ECU 4.13% (in December 3.43%). The persistent decline in interest rates is due to a historical low in inflation (ECU (11 EU member countries) 0.8% in 1998) and to increasing capital market rates.

1.2. Gross Domestic Product, Employment and Labor Costs

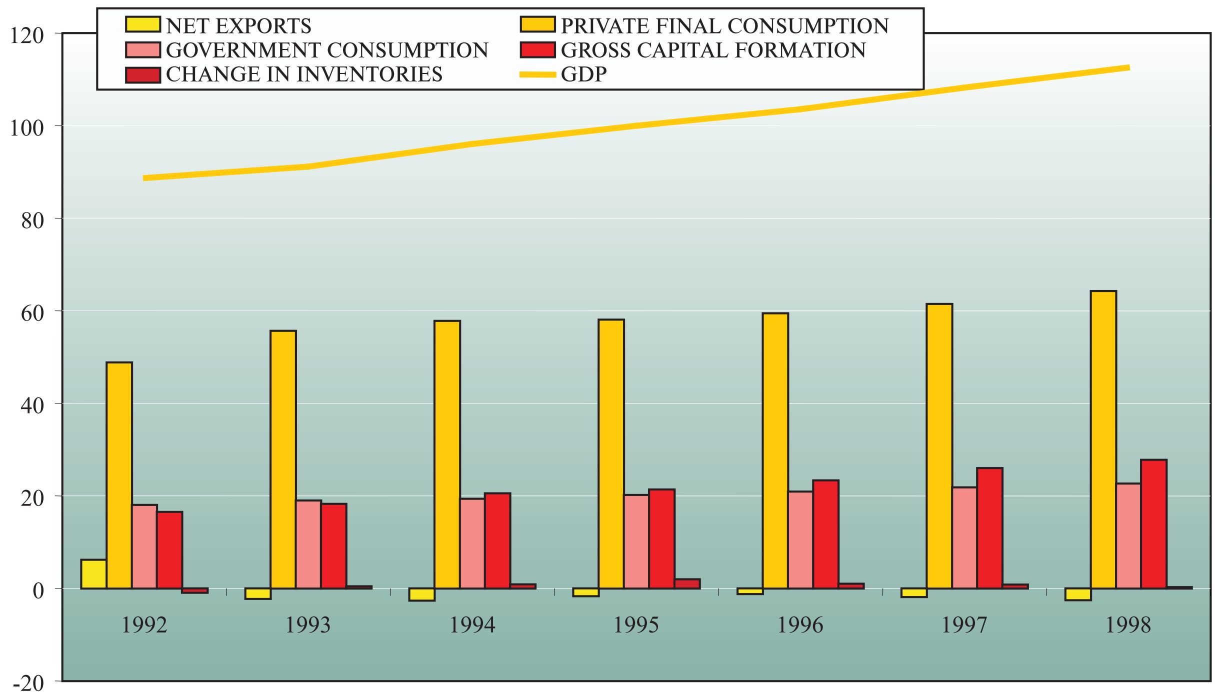
GDP growth 3,9 %.

GDP growth amounted to 3.9% in real terms and about equaled the average of last six years. In 1996 the growth amounted to 3.5%, and in 1997 4.6%.

Growth influenced by foreign demand, keeping the share of exports in GDP on a stable 55% level.

The contribution of foreign demand to growth exceeded that of domestic demand. Exports of goods and services grew by 5.6% (against 11.3% in 1997) and maintained the share of 55% in GDP recorded in the previous years. The share of imports fell to 6.4% (against 12.2% in 1997).

Figure 2: **GDP Structure** (1992-1998; GDP 1995=100)



Source: Statistical Office of RS and Institute of Macroeconomic Analysis and Development

Gross investments equal to gross domestic savings exceeded 24% of GDP already in 1997

Growth of domestic demand was moderate - 4% (against 4.4% in 1997). Expansion of investments recorded since 1993 held a major share (6.7% in 1998, and 11.1% in 1997). Already in 1997 investments in fixed assets exceeded 24% of GDP; investments in machines and equipment and in construction of buildings increased. Investments in railroad and telecommunication infrastructure increased above the average, those in road construction and postal services at a more moderate pace than before. Imports and production of investment goods were lively. With the BoP current account nearly in balance, the gross investments were equal to gross domestic savings.

Final consumption increased by 3.7%. Government consumption increased over the average and more than in the previous two years: by 4.6%.

Value added increased by 3.7%

The value added increased by 3.7% in real terms, approximately as much as in 1997 (3.8%). All industries but fisheries recorded an increase; after the decrease of 1997, even agriculture recorded an increase of 1%. As in previous years, the growth of value added was higher in services: it amounted to 4%. It amounted to

Table 1: **Some Economic Indicators**

	1992	1993	1994	1995	1996	1997	1998[1]
Real growth of gross domestic product[2] **in %**	-5.5	2.8	5.3	4.1	3.5	4.6	3.9
Gross domestic product in USD millions	12,523	12,673	14,386	18,744	18,878	18,206	19,626
Gross domestic product in USD per capita	6,275	6,366	7,233	9,431	9,481	9,163	9,899
Structure of Gross domestic product in % of GDP							
Agriculture, forestry and fishing	5.2	4.5	4.0	3.9	3.9	3.7	3.6
Industry and construction	35.9	33.4	34.4	32.6	32.7	33.6	33.4
- Manufacturing industry	28.4	25.9	26.2	24.6	24.1	24.8	24.7
Services	48.2	49.9	49.0	50.2	50.5	51.0	51.0
Added value - total	87.6	86.1	85.5	84.8	85.0	86.2	85.9
Compensation of employees	64.1	60.1	58.0	57.2	54.8	53.5	52.7
Taxes on production and imports, minus subsidies	12.3	13.9	14.2	14.8	15.3	14.9	15.3
Gross operating surplus and mixed income	23.5	26.0	27.8	27.9	29.9	31.6	32.1
- Exports of goods and services	63.1	58.8	60.0	55.2	55.6	57.1	55.2
- Imports of goods and services	56.2	57.7	57.8	56.8	56.5	58.3	56.5
Net exports	7.0	1.1	2.2	-1.6	-1.0	-1.2	-1.3
Private final consumption	55.1	58.5	56.7	58.1	57.3	56.5	56.5
Government consumption	20.3	21.1	20.2	20.2	20.2	20.5	20.5
Gross investment	17.6	19.3	20.9	23.4	23.5	24.2	24.3
Active population[3] **in thousands**	969	930	936	952	947	978	983
Employed and selfemployed	834	792	781	820	820	841	847
Unpaid family members and informal kind of jobs	55	53	70	62	57	65	60
Unemployed	80.0	85.0	85.0	70.0	69.0	72.0	75.0
Unemployment rate (% of unemployed in active population)	8.3	9.1	9.1	7.4	7.3	7.4	7.7
Real growth of gross wage per employed in %	-1.2	13.3	3.6	4.4	4.9	3.2	1.6
Real growth of labour productivity in %	-1.4	4.6	5	3.2	4.1	3.8	3.5

1 Data for 1998 (except for real GDP growth); estimate by Institute of Macroeconomic Analysis and Development.
2 Since 1995 in constant prices of 1995, prior to 1995 in constant prices of 1992.
3 Internationally comparable data by ILO methodology.
Source: Statistical office of RS and Institute of Macroeconomic Analysis and Development.

4% (and was lower than in the previous years) in civil construction services. The growth of value added in manufacturing slowed down to an estimated 3.5% (against 5.1% in 1997); its output, however, increased by 3.9% and that of industrial production by 3.7%.

Slight increase in total number of employed

Typically, employment was subject to seasonal oscillations, but the number of employed increased slightly. Unlike in the previous years, the number of employed in companies and organizations increased, and the number of self-employed decreased. The development differed from industry to industry. A decrease above the average was recorded in manufacturing (oil derivatives, furniture etc.), wooden products, paper and pulp production and in publishing. An increase, on the other hand, was recorded in rubber and plastic products, chemicals and chemical products, machines and equipment, electrical and optical devices, vehicles and vessels. The number of employed decreased in trade and catering, and increased in other services, especially in financial services.

Unemployment rate by ILO standards 7.7%

Relatively high structural unemployment

The internationally comparable active population increased by five thousand persons, out of which three thousand (4% of active population) unemployed. The unemployment rate increased from 7.4% to 7.7% after a three-year stagnation. According to not quite comparable data on registered unemployment the share of long-term structural unemployment is high or increasing in regions like the Drava, the Mura, the middle and the lower Sava regions. The unemployed are women above 40 and uneducated. The EU directives compliant employment policy is targeted to the following groups: the young (with unemployment rate of 18%), those above 40, the disabled, recipients of other remuneration, grants, aid and social allowance, workers from industries undergoing restructuring and permanently excessive workforce. The legal framework regulating employment has been changed in order to spur employment.

For the second consecutive year a moderate wage growth…

…it lead to further cost reduction and growth of operating surplus in economy.

Wages continued to grow moderately, owing, to a large extent, to the Minimum Wage and Wage Adjustment Act adopted in 1997. Such moderate growth resulted in lower social contributions for employers and in lower labor costs: in 1992 still representing 64.1% of BDP, in 1998 52.7% of BDP. Taxes on production and import taxes varied between 17% in 1995 and 1997 and 17.4% and 17.3% respectively in 1996 and 1998, due to lower customs and import duties and increase in some taxes (e.g. payroll tax). Under such circumstances, the operating surplus increased from 13.7% in 1992 to 21.3% of GDP in 1998.

Productivity increased at a moderate pace. It increased by 3.5% (against 4.1% in 1996 and 3.8% in 1997).

1.3. Public Finance

For the second time in a row budget deficit (0.6% of GDP).

Further reduction of customs tariffs.

The consolidated government sector ended up with a deficit, for the second time in a row. According to preliminary data the deficit amounted to about SIT 18 billion or 0.6% of GDP and was below that of 1997 (1.1% of GDP).

The deficit was lower due to growth at a slower pace of expenditure than of revenues. Growth in revenues (45.6% against 44.6% of GDP in 1997) ended the period of their reduction recorded since 1993 (47.0%). The upturn was due to a significant increase in non-tax revenues (4.6% against 3.6% in 1997); the share of other tax revenues remained almost unchanged against 1997 (40.5%). The lower share of customs tariffs (reduced by 0.6% to 1.4% of GDP) and of personal income tax (by 0.2%) was offset by an increase (by 0.1 to 0.2 percentage points of GDP) in air pollution tax, sales tax, tax on sales of immovable property, the new tax on bank assets and the one-time after-earthquake reconstruction contribution.

Linear expenditure cut in the budget.

Endeavors for pension reform go on…

The share of aggregate expenditure in GDP increased for the second time in a row in spite of the linear reduction in budget expenditure by about SIT 20 billion. Most significant was growth in investment; it reached, again, its highest share in GDP, realized in 1994 (2.8%). Subsidies and purchase of goods and services that increased by 0.2 percentage points each followed. The shares of transfers to households and of wages were lower than in 1997. The Government initiated the procedures for adoption of the new pension law, albeit the draft still not agreed to by trade unions.

…VAT to be introduced in July 1999.

As in the previous year, the sales tax revenue included that collected by January 15, 1999 (which amounted to SIT 22 billion against SIT 17 billion in 1997). The 1999 revenues will include the VAT collected by end of January 2000 due to the gap in revenue, which will occur at the time of its introduction. The Law on Value Added Tax and the Law on Excise Duties, adopted at the end of 1998, will become effective on July 1, 1999.

Repayment due and prepayment of the principal accounted for the main part of gross borrowing of 3.5% of GDP (against 2.4% in 1997).

Growth of governmental gross borrowing (1.8% of GDP in 1996, 2.2% in 1997, and 3.5% in 1998) is mainly due to the government policy aimed at a better currency, cost and maturity structure of the public debt, and not so much to financing of budget deficit itself. The total of capital amounts paid at maturity and of those prepaid amounted to 2.4% of GDP (SIT 46.5 billion to domestic and SIT 33.1 billion to foreign creditors); a substantial amount thereof is due to partial prepayment (USD 354 million) under the 1996 bond issue pertaining to the agreement on debt exchange (succession to a portion of debt of former SFR Yugoslavia) between the London Club and Slovenia.

External debt of the Republic of Slovenia amounted to 23.6% of GDP.

Domestic government bond issue amounted to SIT 15.5 billion under RS 09 and SIT 3 billion under RS 12. In addition, government took loans from domestic banks in amount of SIT 20.3 billion. Treasury bonds with a maturity of 3 months were first issued in May, and every month thereafter (SIT 2-3 billion per month). Foreign borrowing includes the Eurobond issue of ECU 500 million and syndicated loans of USD 194 million. According to preliminary data, the government cash and deposit accounts increased by SIT 15.5 billion. External debt of the Republic of Slovenia totaled SIT 771.3 billion or 23.6% of GDP at the end of 1998; the debt taken over under rehabilitation procedures and debt succeeded to of the former SFR Yugoslavia account for a major portion thereof.

1.4. Prices

Significant reduction of inflation (to 6.5% from 9% in the previous years)

Further significant reduction of inflation was achieved – from 9% in the previous three years to 6.5% (December/December). The system of retail price growth measured inflation was abolished and was replaced by CPI growth. Retail prices grew somewhat faster in the last two years; however, the cumulative growth of both price baskets reached the same level after 1992.

Free market prices increased by 5.7% (against 7.4% in 1997)

Free market prices increased by 5.7% (against 7.4% in 1997). Significantly lower than up to 1998 was the growth of food product prices (3.1% against 10.3% in 1997); on the other hand, growth of industrial production prices and prices of services remained on the level of 1997 (5.2%). Prices in manufacturing had been falling at a pace well beyond that of consumer or retail prices; their growth amounted to 3.6%.

During the previous years, the contribution to inflation by accelerated regulated price adjustments targeted towards regulation of price disequilibrium and to fiscal adjustments was substantial. The scope of adjustment was smaller in 1998 and resulted in 10.1% growth of regulated prices (against 14% in 1997). As a consequence of such smaller adjustment the share of regulated prices in the consumer price index amounted to 17% (against 20% to 25% in the previous years).

Growth of regulated prices 10.1% (against 14% in 1997)

Among the regulated prices, energy sector prices grew most (13.2% against 20.6% in 1997). Electricity price paid by households increased by 17.7% (i.e. more than in 1997), and prices of crude oil derivatives by 10.5% (against 23.3%) due to lower international market prices.

1.5. Balance of Payments

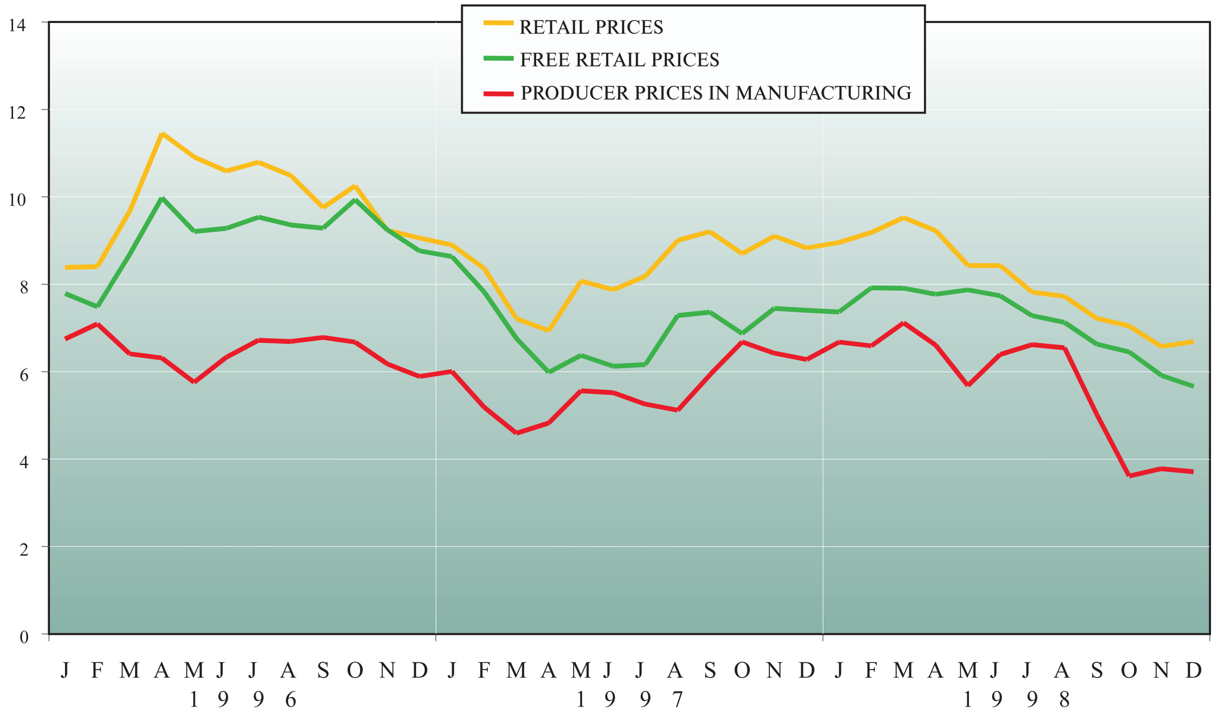
The year ended with current account in deficit of USD 4 million (equal to 0.02% of GDP), for the fourth time in a row close to an equilibrium. Capital inflow and growth of international reserves were moderate against 1997.

Moderate inflow of foreign capital and almost balanced current account for the fourth time in a row.

Foreign trade continued to grow. According to preliminary data, exports of goods (FOB), expressed in USD, amounted to USD 9.049 million and increased by 8.1% against 1997. Imports of goods (CIF) totaled USD 10.098 million and increased by 7.8% against 1997. The export – import ratio amounted to 89.6% (against 89.3% in 1997).

Exports in USD increased by 8.1%, imports by 7.8%.

Figure 3: **Prices** (annual growth rate from 1996 to 1998 in %)



Source: Statistical office of RS and Bank of Slovenia.

Exports increased by 8.2% and imports by 10.5% in real terms.

Growth of trade in goods in real terms exceeded that expressed in USD. The impact of changes in export and import prices (index 99.7 and 97.4 respectively) not taken into account, exports increased by 8.2% and imports by 10.5% in real terms.

According to balance of trade statistics trade deficit of 5.1% higher than in 1997...

... and on about the same level according to the balance of payments statistics.

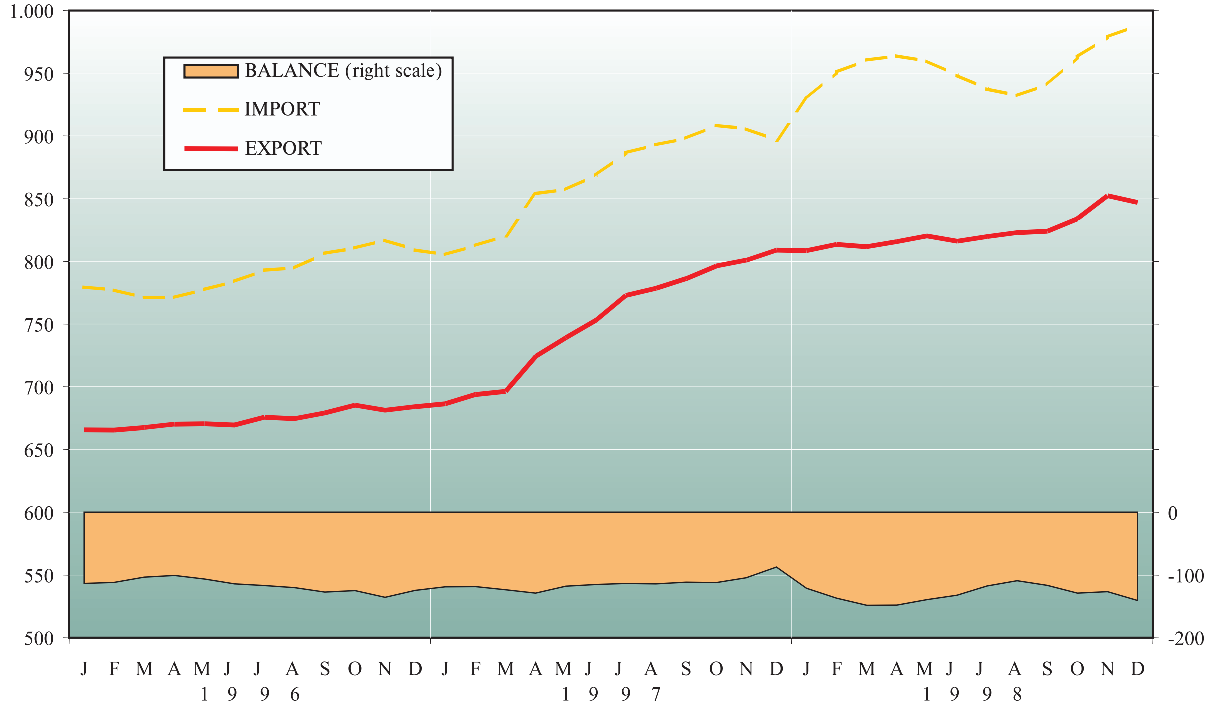
Trade deficit, measured in line with trade statistics (exports FOB, imports CIF) amounted to USD 1.049, and increased by USD 51 million or 5.1% against 1997. In real terms, the trade deficit measured by constant prices in 1995 increased by 14.5%; therefore, the real imports of goods grew at a higher pace than exports. Favorable terms of trade accounted for considerably lower growth of trade deficit expressed in USD. Trade deficit measured by the balance of payments statistics (which, unlike the balance of trade statistics, takes into account the adjustment of imports from CIF to FOB and some other adjustments), amounted to USD 775 million and about retained the 1997 level (USD 772 million).

Exports surged under favorable foreign demand

The contribution of foreign demand to economic growth was significant. Due to such favorable foreign demand, exports increased by as much as 8.2% in real terms. On one hand, the terms of trade became more favorable (by 2.4%), but on the other hand, the competitiveness of Slovenian economy measured by real effective exchange rate (of which the deflator is unit labor cost in comparison with export prices) deteriorated. According to this indicator Tolar appreciated on average by 2.3%.

Industrial production increased by 3.7% and spurred increase in imports of goods. Import prices for goods were reduced as of January 1, 1998 based on Association Agreement between Slovenia and the European Union. Higher foreign demand due to favorable economic conditions made the imports grow.

Figure 4: **Volume Exports and Imports** (in USD million) **and Merchandise Trade** (in constant prices 1995) (1996-1998; seasonally adjusted data)



Source: Bank of Slovenia.

The share of capital goods in exports and imports kept growing. Whereas the share of intermediate goods, capital goods and consumer goods in total exports changed only slightly, their share in total imports changed considerably. The share of imported capital goods increased by 1.7 percentage point (to 17.8%), mainly due to imports of intermediate goods (1.1 percentage point) and of consumer goods. The share of consumption goods has been on a downward track since 1996, among other things due to a more moderate increase of wages.

Share of capital goods in total imports amounted to as much as 17.8%

The regional structure of exports and imports remained basically unchanged. Trade with EU member countries increased above the average. With a share of 65.5% in exports and of 69.4% in imports European Union kept its position as Slovenia's main trading partner. Among the member countries, Germany kept the biggest share (exports 28.4%, imports 20.7%), and was followed by Italy (13% and 16.8%), France (8.3 and 12.5%), Austria (6.9 and 7.9%). Despite a USD 485 million surplus in trade with Germany, trade with EU countries ended

Trade with European Union predominated

Table 2: **Balance of Payments** (in million US Dollars; provisional data)

	1994	1995	1996	1997	1998
A. CURRENT ACCOUNT	**600**	**-23**	**39**	**37**	**-4**
- in % of GDP	***4.2 %***	***-0.1 %***	***0.2 %***	***0.2 %***	***0.0 %***
1. Goods	-338	-954	-882	-772	-772
2. Services	676	631	704	590	514
2.1. Transport	68	70	76	101	132
2.2. Travel	537	558	687	643	542
- of which: exports	911	1,082	1,230	1,188	1,117
2.3. Other	71	3	-59	-154	-161
3. Income	170	210	155	131	146
3.1. Labour income	201	210	210	208	208
3.2. Investment income	-31	0	-55	-77	-63
4. Current transfers	92	91	62	88	112
B. NET FINANCIAL INFLOWS	**450**	**513**	**868**	**645**	**204**
- in % of GDP	***3.1 %***	***2.7 %***	***4.6 %***	***3.5 %***	***1.0 %***
1. Commercial credits	-11	-4	-144	-250	-450
2. Governent: bonds [1]	-	-	163	186	104
other (including loans)	82	128	-73	-5	-19
Private sector:					
3.1. Direct investment from abroad [2]	128	176	120	281	165
3.2. Portfolio investment from abroad [2]	0	15	68	92	16
3.3. Loans from abroad	249	445	530	340	279
- Banks [1]	92	208	288	3	42
- Enterprises	157	237	243	337	237
3.4. Other (including all outflows)					
- Households	153	6	-103	74	-28
- Banks, enterprises	29	-39	171	-130	18
Bank of Slovenia	-103	-70	129	-9	-51
5. Statistical error	-77	-145	8	66	171
C. INTERNATIONAL RESERVES (increase (-))	-1,050	-490	-907	-681	-201
1. Bank of Slovenia	-645	-235	-587	-1,287	-112
2. Banks	-405	-254	-320	606	-89

1 Government bond issue of June 1996 (pertaining to succession to a portion of 1988 NFA debt) excluded. Trade of domestic banks with government bonds subtracted.

2 Data from September 1996 to February 1997 estimated within the unchanged aggregate di rect and indirect investment.

Source: Bank of Slovenia.

in a deficit of USD 1.085 million (whereof USD 442 million in trade with Italy, USD 510 million in trade with France and USD 180 million in trade with Austria). The market share of Slovenia in the EU countries increased.

Trade with CEFTA countries increased

Slovenia recorded a surplus in trade with successor countries to former SFR Yugoslavia (USD 805 million) and with the CIS countries (USD 114 million). Trade with the CIS countries increased substantially in 1997, but declined by more than 25% in 1998. CEFTA countries have gained importance in Slovenian foreign trade (with a share of 6.5% in exports and 7.2% in imports).

Higher deficit in trade of goods and services due to a lower surplus in services by USD 76 million…

The surplus in trade of services totaled USD 514 million; it was lower than in 1997 by USD 76 million. With the deficit in trade of goods almost on the level of 1997 (USD 775 million against USD 772 million in 1997), the trade deficit total increased to USD 261 million (from USD 182 million in 1997).

…with receipts from travel lower by USD 71 million…

Receipts from travel (measured in USD) totaled USD 1,117 million; they decreased for the second year in a row (a decrease by USD 71 million against 1997). A decrease in real terms was recorded, whereas that in 1997 was mainly due to intercurrency fluctuations. Receipts from daily tourism deteriorated most (a trend evident since mid 1996). Expenditure for travel abroad increased slightly; as a consequence, the surplus in travel decreased to USD 542 million (from USD 643 million in 1997).

… and in transport services higher by USD 31 million.

Exports of transport services totaled USD 537 million (an increase of 15% against 1997) and their imports USD 404 million (an increase of 11%). Transport

Table 3: **Regional Structure of Foreign Trade** (1996-1998, in million USD)

	EXPORT			IMPORT			BALANCE		
	1996	1997	1998	1996	1997	1998	1996	1997	1998
European union (15)	**5,367**	**5,320**	**5,927**	**6,360**	**6,312**	**7,012**	**-994**	**-993**	**-1,085**
Austria	551	565	621	835	789	801	-284	-223	-180
France	598	463	747	924	980	1,258	-326	-517	-510
Italy	1,103	1,248	1,255	1,593	1,558	1,696	-490	-310	-442
Germany	2,545	2,460	2,570	2,044	1,936	2,086	501	523	485
CEFTA	**473**	**504**	**588**	**641**	**705**	**725**	**-168**	**-201**	**-137**
EFTA	**83**	**87**	**98**	**249**	**194**	**207**	**-166**	**-107**	**-110**
Noneuropean OECD members	**349**	**350**	**381**	**676**	**631**	**736**	**-327**	**-281**	**-355**
Successor states to former SFRY	**1,385**	**1,387**	**1,397**	**709**	**594**	**593**	**676**	**793**	**805**
Croatia	855	837	815	590	466	431	265	371	384
CIS countries	**390**	**432**	**330**	**236**	**284**	**216**	**154**	**148**	**114**
Other countries	**263**	**290**	**327**	**550**	**646**	**608**	**-287**	**-356**	**-282**
TOTAL	**8,310**	**8,369**	**9,049**	**9,421**	**9,366**	**10,098**	**-1,112**	**-998**	**-1,049**

Source: Statistical Office of RS; provisional data for 1998.

services resulted in a surplus of USD 132 million (against USD 101 million in 1997). Other services resulted in a deficit of USD 161 million, somewhat higher than in 1997.

Net income receipts and current transfers contributed to equilibrium on current account

Since 1995 the surplus in trade of services has been insufficient to cover the deficit in trade of goods; however, the surplus in income receipts and in current transfers contributed to the equilibrium on the current account.

Net income receipts of USD 208 million remained on the level of the previous three years. Net outflow of investment income decreased slightly (USD 63 million against USD 77 million in 1997). Net increase by USD 42 million against 1997 of investment income receipts to USD 225 million was mainly due to increase in interest received and in international reserves. The investment income expenditures increased by USD 28 million to USD 288 million and reflected higher interest paid on foreign loans and government bonds.

Net inflow from current transfers amounted to USD 112 million, an increase by USD 24 million against 1997.

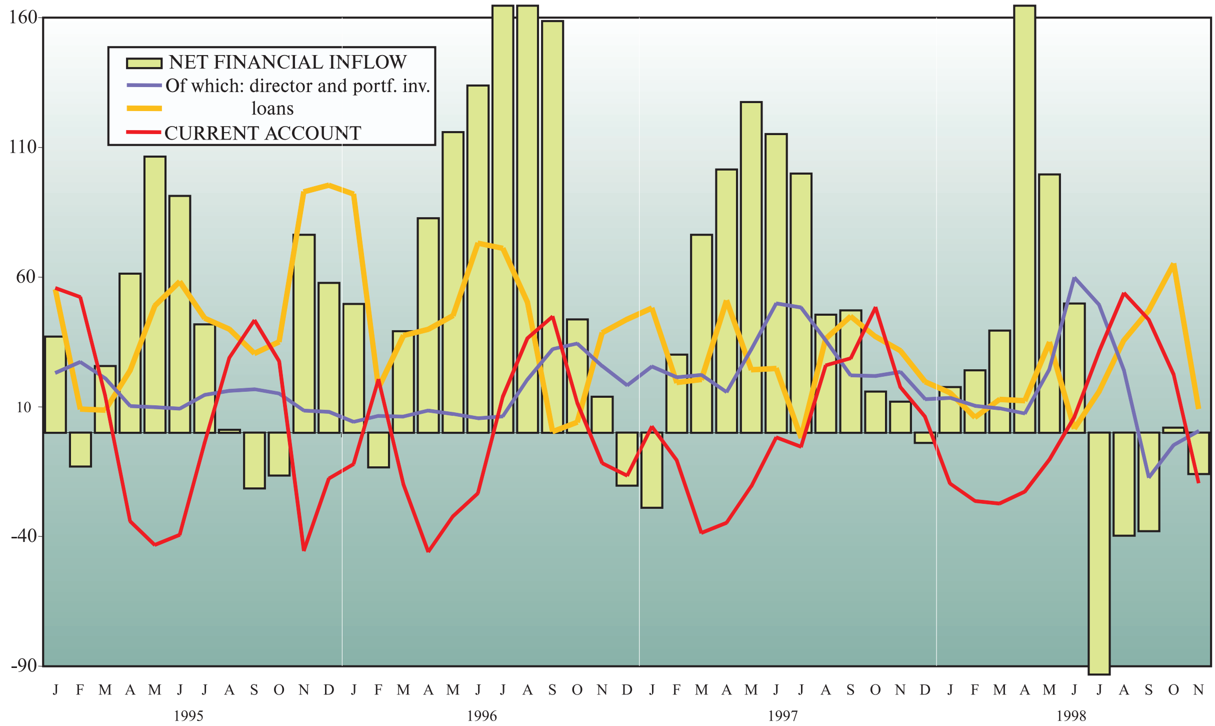
Net financial inflow the lowest in five years…

Net financial inflow amounted to USD 204 million or 1.1% of GDP and just about reached 1/3 of that in 1997; it was the lowest in five years.

…and net government sector debt down by half against 1997.

During the past three years, the government sector raised money by means of Eurobond issues and net repaid foreign loans. The government net raised USD 85 million in 1998 (bond issue of USD 104 million minus USD 19 million net repaid loans), about one half of the 1997 amount.

Figure 5: **Main Balance of Payments Aggregates** (in million of USD, moving average 3)



Source: Bank of Slovenia.

Net commercial loans given increased by USD 200 million.

Net financial inflow into the private sector amounted to USD 171 million against USD 473 million in 1997. The reduction was mainly due to net commercial loans given; these amounted to USD 450 million and exceeded the amount of such loans given in 1997 by USD 200 million.

Relatively low foreign direct...

Foreign direct investment totaled USD 165 million and was far below the peak level of 1997 (USD 281 million). Likewise, the Slovenian direct investment abroad did not reach the level of the previous year (USD 11 million against USD 25 million in 1997).

...and portfolio investment.

Foreign portfolio investment in private sector amounted to USD 16 million (against USD 92 million in 1996); during the first half of 1998 foreigners net purchased domestic securities (inflow of USD 40 million) and in the second half of the year withdrew (net sale of USD 23 million).

Liabilities of private sector under foreign loans increased by USD 279 million (against an increase of USD 340 million in 1997). Enterprises net borrowed USD 237 million, i.e. USD 100 million less than in 1997, and the least since 1995. Banks net borrowed USD 42 million abroad against only USD 3 million in 1997. At the same time, their claims under loans given increased by USD 31 million (against USD 72 million in 1997).

International reserves (comprising those held by the Bank of Slovenia and by commercial banks) increased by USD 390 million to USD 4,767 million. Financial transactions accounted for more than half of the increase (USD 204 million), current transactions, on the other hand, for a reduction (by USD 4 million), and the intercurrency fluctuations for the rest.

1.6. External Debt

94.3% of all new foreign loans taken were long-term

New credit arrangements concluded amounted to USD 1,914 million, an increase by 41.7% against 1997. Long-term credits prevailed with a share of 94.3%. New loans taken or guaranteed by the Republic of Slovenia increased by 139.9%. A major portion of the USD 586 million ECU-denominated bond issue was used for prepayment of the series DM-1 and USD-1 bonds issued by the Republic of Slovenia in June 1996 pursuant to the Law on Succession to Debt under the 1988 New Financing Agreement. Further amounts raised - USD 90 million in June and USD 104 million in November - were used for budget financing and for repayments due under foreign loans.

New loans taken by the private sector amounted to USD 1,005, an increase of 3.6% against 1997.

Average maturity of long-term loans 7 1/2 years

The average maturity of long-term loans increased and amounted to seven and a half years. Within the currency structure of new loans taken, German Marks predominated with a share of 61.7%; the currencies of all EU member countries had a share of 94.6%.

External debt total increased by 18.2% to USD 4,935 million

At December 31, 1998, the external debt total amounted to USD 4,935 million, an increase by 18.2% against 1997 (USD 4,176 million) due to increase of long-term debt. Long-term debt amounted to USD 4,824, short-term debt to USD 111 million (only 2.2% of total external debt). Nominal debt growth accounted for

67% of the long-term debt increase, the rest was due to intercurrency fluctuation and the lower share of US Dollar in the currency structure (it amounted to 18.1% against 49.0% share held by DEM, 19.1% held by ECU and 10.6% held by ATS).

Table 4: **External Debt of Slovenia** (at end of year 1992 – 1998 in million USD)

	31.12.1992	31.12.1993	31.12.1994	31.12.1995	31.12.1996	31.12.1997	31.12.1998
1. Longterm debt - total	1,659	1,744	2,172	2,916	3,960	4,041	4,824
1.1. Public and publicly guaranted *	1,203	1,206	1,331	1,437	2,025	2,067	2,370
1.1.1. International organizations	487	442	472	482	541	569	579
1.1.2. Governments and their agencies	320	281	277	220	229	142	161
1.1.3. Private creditors	396	483	582	735	1,255	1,356	1,630
1.2. Private nonguaranteed	456	538	841	1,479	1,935	1,974	2,454
2. Use of IMF credits	-	12	7	4	1	-	-
3. Shortterm debt	82	117	79	50	49	135	111
Total debt stocks	**1,741**	**1,873**	**2,258**	**2,970**	**4,010**	**4,176**	**4,935**
Undisbursed debt	200	382	579	431	562	440	536

* Increase in 1996 is due, to a great extent, to concluded agreements on succession to a portion of unallocated debt of former SFR Yugoslavia pursuant to 1988 New Financial Agreement and to bilateral agrements with the government of FR Germany.

Source: Bank of Slovenia.

2. MONETARY POLICY

2.1 Monetary Policy Objectives

No change in monetary policy objective

As in previous years, the Bank pursued a policy targeted at stability of domestic currency and at further lowering of inflation. The intermediate target of the Bank has been the growth of monetary aggregate. The Bank's interventions within the managed floating exchange rate regime were limited by the constraints of the monetary target set. The Bank's clear objective has been to bring inflation down to the European level within a few years' time.

M3 kept as intermediate target

Money market indicators important for current decisions

In 1997, the Bank publicly announced the implementation of a new monetary framework, which employed M3, the broad monetary aggregate, as intermediate target of its monetary policy. This money aggregate is to stay a medium-term orientation. The Bank took the more significant money market indicators (interest rates, realization of open tenders, excessive mandatory reserves) into account for its current decisions and measured the current monthly demand for transaction money (M1) and for base money.

Reduction of interest rates in 1998…

…encouraged by the Bank of Slovenia

Interest rates kept declining. Short-term borrowing rates were reduced to 12.3% (from 20.3% at end of 1997), those for term deposits to 7.7% (from 13.9%). The decline was due to both, reduction of indexation rate (Base Rate – hereafter BR) as well as real interest rate. Banks reduced the real rates in response to high borrowing of the corporate sector abroad and in view of the forthcoming liberalization of and opening up of Slovenian financial markets. The Bank of Slovenia encouraged such reduction of domestic borrowing rates, and served as forerunner and example with its own rates. This development resulted in an increase of domestic credit activity; according to preliminary data domestic banks accounted for as much as three quarters of corporate borrowing total.

Box 2: **Narrow Monetary Policy Target** (for 1998)

On March 24, 1998 the Governing Board of the Bank of Slovenia adopted the narrow monetary policy target for 1998. The M3 average of the last quarter of 1997 was projected to grow between 18% and 26% on yearly basis. The target was based on real annual GDP growth between 3.5% and 4.0%, on a budget deficit not exceeding 1% and on growth of regulated prices and of average wages by between 10.5% and 11.0%.

The realized M3 growth amounted to 20.2% and exceeded the lower error band level by only 2.2 percentage points. On January 22, 1999 the Governing Board determined that the monetary policy of 1998 was in line with the target set and considered no changes necessary. New M3 growth target was set.

The broad money aggregate M3 comprises nearly all liabilities of monetary system in domestic currency, and includes government deposits and foreign exchange deposits (mainly household) in banks. Beside capital and reserves, the bulk of such liabilities are securities issued by banks and by the Bank (4.3% of M3 at end of 1998); despite the development undergone, there is still only a limited number of other secure and liquid non-bank instruments available in the market.

Most of the 20.2% annual growth of M3 was due to the growth of (M2-M1), which comprises non-M1 Tolar deposits with banks and with the Bank. The growth of this aggregate alone amounted to 26.8%. Demand deposits with banks and with the Bank increased by 24.0%. Foreign exchange household deposits (aggregate M3-M2) increased by 6.1% only.

Government deficit and reduction of inflation key issues for monetary policy

Public finance ended in a slight deficit as the year before. However, the development of regulated prices was somewhat different. Within the framework of government program of price adjustments to European level, controlled prices for public utilities increased by 10.1% (electricity 17.7%, crude oil derivatives 10.5%) against the 14% increase of 1997. Free market prices increased by 5.7% (against 7.4% in 1997). This development resulted in a reduction of inflation to 6.5% against 8.8% in 1997.

Base money increased by 22.9%

Foreign exchange transactions employed to issue and Tolar transactions to withdraw base money

Foreign exchange market Interventions between June and September

The nominal increase of base money between December 1997 and December 1998 amounted to 22.9% (measured by monthly average) and 15.4% in real terms. The Bank issued 37.2 billion Tolars of base money through foreign exchange transactions and withdrew 8.9 billion Tolars through Tolar transactions. The net foreign assets of the Bank increased by SIT 34.7 billion; foreign exchange purchased by the Bank from banks amounted to SIT 48.3 billion, foreign exchange net sold to the budget SIT 16.3 billion, the volume of the Bank's foreign currency denominated bills outstanding decreased by SIT 6.8 billion. The Bank intervened on the foreign exchange market between June and September; this is when it purchased foreign exchange in countervalue of SIT 48.1 billion from banks at the intervention rate.

Loans to banks and deposits by the budget decreased

Loans to banks decreased by SIT 14.2 billion, deposits of Central Government by SIT 9 billion. Sale of Tolar bills accounted for a reduction by SIT 4.3 billion in base money. The volume of Tolar bills outstanding increased in the first and third quarters and decreased in the second and last quarters.

Table 5: **Supply of Base Money** (in billion SIT)

	December 31st			Change in quarter 1998				
	1996	**1997**	**1998**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	329.6	559.2	593.9	2.1	63.1	-22.9	-7.6	34.7
2. Domestic liabilities in foreign currency	-181.1	-301	-298.6	-3	-25.8	26.2	5	2.5
- foreign currency bills	-162.1	-289.2	-282.4	-3	-21.4	32.2	-1	6.8
- foreign currency deposits of the budget	-19	-11.8	-16.2	0.1	-4.4	-6	6	-4.3
3. Net foreign currency assets (1+2)	**148.5**	**258.2**	**295.4**	**-0.9**	**37.3**	**3.4**	**-2.6**	**37.2**
4. Time deposits of the budget	**0**	**-9.0**	**0.0**	**9**	**-5**	**5**	**0**	**9.0**
5. Loans to the banks	**15.7**	**18.1**	**3.9**	**1.7**	**-6**	**-0.8**	**-9.1**	**-14.2**
- liquidity	1.3	0	0.0	0	1.6	-1.1	-0.5	0
- repurchase	13.6	13.7	3.5	5.7	-9.7	2.3	-8.6	-10.2
- other loans	0.8	4.4	0.5	-4	2.1	-2.0	0	-3.9
6. Tolar bills	**-16.3**	**-75.8**	**-80.1**	**-9.4**	**1**	**-24.6**	**28.7**	**-4.3**
- 60 days	-2.9	-24.6	-20.1	14.6	-2.2	-18.3	10.5	4.6
- 270 days	-	-23.8	-33.1	-13.7	-0.6	10.7	-5.7	-9.3
- bills with warrants	-9	-17.4	-11.7	-15.2	7.3	0.0	13.6	5.7
- other bills	-4.5	-10	-15.3	4.9	-3.4	-17	10.3	-5.2
7. Other items net	**-28**	**-45.8**	**-45.2**	**-1.4**	**-12.9**	**23.1**	**-8.2**	**0.6**
8. Net tolar assets (4 to 7)	**-28.6**	**-112.6**	**-121.4**	**-0.1**	**-22.9**	**2.7**	**11.4**	**-8.9**
9. Base money (3+8)	**119.9**	**145.6**	**173.9**	**-1**	**14.4**	**6.1**	**8.8**	**28.3**
- bank reserves	48.1	63.1	74.4	1.2	1.8	2.9	5.5	11.4
- other sight deposits	4.9	4.4	5.9	1.6	1.6	-0.7	-1.1	1.4
- currency	66.8	78.1	93.7	-3.8	10.9	4	4.4	15.5

Source: Bank of Slovenia; accrued interest and discount not included.

Money aggregate M3 increased due to substantial increase in loans to non-banking sectors, and during the first six months also due to inflow of foreign exchange. M3 increased by 20.9% in nominal (December to December, measured by monthly average) and by 13.5% in real terms.

M3 growth due to increase in loans of banks to non-banking sectors…

Domestic assets increased by SIT 275.6 billion (of which loans by banks amounted to SIT 244.8 billion). Loans to enterprises and households increased substantially - by 20.4%. Due to reduction in domestic interest rates and due to external factors (financial crises) enterprises replaced foreign loans with domestic loans. Loans to government sector increased by 38.9%, most notably in the second and last quarters. Bank portfolios of corporate securities increased by SIT 25.2 billion, those of government bonds by SIT 5.6 billion.

…20.4% increase in loans to enterprises and households…

…and 38.9% increase in loans to government sector.

Net foreign assets of the monetary system increased by SIT 41.9 billion. Monetization of SIT 37 billion took place in foreign currency exchange offices, that of SIT 3.2 billion in foreign exchange market; the Bank net purchased SIT 16.3 billion from government sector. Foreign loans accounted for a substantial inflow in balance of payments, foreign direct and portfolio investments much less; commercial credits accounted for substantial outflow during the second half of 1998.

Table 6: **M 3 Supply: Consolidated Balance Sheet of Monetary System** (in billion SIT)

	Volume per December 31			Change in quarter 1998				
	1996	**1997**	**1998**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	**488.4**	**669.2**	**711.1**	**10.9**	**29.2**	**2.8**	**-1.1**	**41.9**
2. Domestic assets	**994.9**	**1,142.9**	**1,418.5**	**45**	**86.5**	**51.9**	**92.2**	**275.6**
General Government: bonds*	228.1	249.6	255.2	16.4	-2.3	9.1	-17.6	5.6
loans	40.7	69.9	114.2	-7.9	27.5	-1.6	26.4	44.4
Enterprises : securities	40.9	40.7	65.9	1.4	4.6	4.7	14.5	25.2
loans	478	541.8	680.0	24.2	39.1	20.8	54.1	138.2
Households: loans	207.2	240.9	303.1	10.9	17.6	18.9	14.8	62.2
3. Securities issued	-52.2	-66.8	-73.2	-0.8	2.3	-5.5	-2.4	-6.4
4. Foreign currency deposits of the budget	-19	-11.8	-16.2	0.1	-4.4	-6	6	-4.3
5. Other items net	-276.9	-322.1	-350.7	-21.4	-24.2	17.2	-0.2	-28.6
6. M3 (1 to 5)	**1,135.3**	**1,411.3**	**1,689.5**	**33.8**	**89.4**	**60.5**	**94.5**	**278.2**
- foreign currency deposits at banks	384.4	404.7	427.3	4.3	-0.6	4.4	14.5	22.7
7. M2	**750.9**	**1,006.7**	**1,262.2**	**29.5**	**90**	**56.1**	**79.9**	**255.5**
- time deposits in banks	450.6	648.1	829.7	40.3	43.6	42.3	55.4	181.6
- time deposits in Bank of Slovenia	0	9.0	0.0	-9	5	-5	0	-9.0
- saving deposits	65.2	79.1	99.8	6.6	10.6	4.4	-0.8	20.8
8. M1	**235.1**	**270.5**	**332.7**	**-8.3**	**30.8**	**14.4**	**25.3**	**62.2**
- sight deposits at banks	163.3	187.9	233.2	-6.2	18.2	11.2	22	45.2
- sight deposits at Bank of Slovenia	4.9	4.4	5.9	1.6	1.6	-0.7	-1.1	1.4
- currency in circulation	66.8	78.1	93.7	-3.8	10.9	4	4.4	15.5

* Net of 'other foreign exchange liabilities' of banks to general government (external liabilities of banks taken over by the government in 1996).

Source: Bank of Slovenia.

2.2. Interest Rates

Real interest rates declined

Real interest rates defined as the real component above the indexation rate (Base Rate - BR, in Slovenian TOM), kept decreasing during the year, mainly due to the changes adopted in the interbank agreement on deposit rate ceiling, and partly due to higher credit activity of banks.

Indexation rate – a stable average of 12-month inflation -…

Nominal interest rates declined even more due to lower inflation. The indexation rate (base rate, BR; twelve-month average of CP growth) declined from 9.84% in January to 6.05% in December.

…declined.

Deindexation: The Bank did not change the method for calculation of BR; the reference period was kept at 12 months. The stable monthly base rate (since October at 0.5%) contributed to stability of nominal interest rates.

In September the Bank first issued a parallel 270-day bill at a nominal rate equal to the indexed interest rate for the same instrument, and abolished the 270-day instrument at an indexed rate of interest as of January 1, 1999. The government Treasury followed the example and issued the first bonds at a nominal interest rate.

The Bank's Discount (10%) and Lombard (11%) rates were kept on the level of 1997. They were only changed in January 1999, to 8% and 9% respectively.

Interest rate on all instruments of monetary policy reduced…

The Bank undertook reduction of interest rates in line with the declining inflation during the year on all of its monetary policy instruments. However, the implicit interest rate on foreign currency repo and on 28-day Tolar bills remained subject to daily and weekly auctions.

Table 7: **Interest Rates of Bank of Slovenia and Money Market Rates** (monthly average of 1998 in % p.a.)

	Nominal interest rates					TOM	Interest rate over tolar revaluation clause TOM*			
	Repurchase	Tolar bills		Interbank	Treasury		Repurchase	Tolar bills		Interbank
		60 days	270 days	market	bills			60 days	270 days	market
January	12.71	12.74	15.33	9.43		9.84	2.61	2.64	5.00	-0.37
February	12.28	12.28	16.01	9.08		10.95	1.20	1.20	4.56	-1.68
March	12.02	12.00	14.23	8.83		9.84	1.99	1.97	4.00	-0.92
April	12.06	12.00	15.98	10.03		11.52	0.49	0.43	4.00	-1.34
May	11.91	11.43	14.23	8.59	13.32	9.84	1.89	1.45	4.00	-1.14
June	11.22	11.12	12.66	7.25	13.09	8.86	2.16	2.08	3.49	-1.48
July	11.05	11.00	11.82	6.90	12.02	8.56	2.30	2.25	3.00	-1.53
August	10.20	10.06	10.52	6.12	10.69	7.3	2.71	2.57	3.00	-1.10
September	9.91	9.84	10.78	6.42	10.37	7.55	2.20	2.13	3.00	-1.06
October	7.87	7.95	9.23	5.48	9.11	6.05	1.72	1.79	3.00	-0.54
November	7.89	7.80	9.45	5.72	8.57	6.26	1.53	1.45	3.00	-0.51
December	8.55	7.80	9.23	5.58	8.57	6.05	2.36	1.65	3.00	-0.44

* Calculation based on all nominal interest rates of the Bank of Slovenia except for the 270-day Tolar bill.

Source: Bank of Slovenia.

Foreign currency bill repo was the most significant Tolar instrument used by the Bank to issue base money; the interest rate applied to it is subject to auction and is dependent on the rate for 60-day Tolar bills. The implicit average nominal interest rate on 28-day repo kept declining, from 12.7% in January to 7.9% in December. So did utilization of base money made available by the repo (from 14% in January, over 81% in May to 20% of the quota made available in December).

…as well as on foreign currency repo – the instrument used to issue base money.

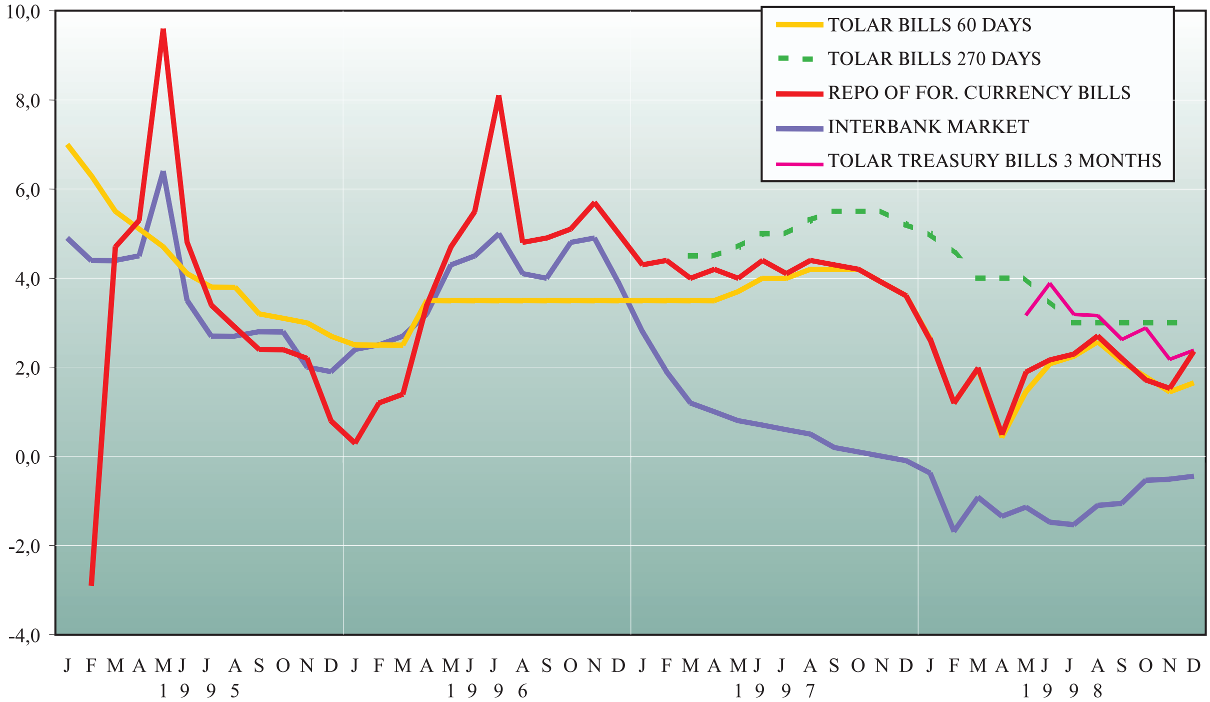
To a smaller extent, banks occasionally made use of the three- and five-day loans against pledge of 12- and 30-day Tolar bills, the interest rate on which decreased at a slower pace than the implicit repo rate, set by the Bank in dependence of Tolar bill rate development. Interest on 3-day liquidity loans decreased from 7% to 5.7% and that on 5-day loans from 10% to 9.4%. The interest rate on liquidity loan of last resort developed in line with that charged for overdue obligations and was reduced from 27.8% to 20.5%.

In line with the general trend, reduction of interest rate on liquidity loans…

The Bank reduced liquidity of the banking system, which increased due to interventions on the foreign exchange market, by means of Tolar bills. Nominal Tolar bill rates and interest rate above the base rate for the 270-day Tolar bill were reduced in line with inflation rate development and with the need for regulation of quantity of money in circulation (sterilization). The changes in interest rate undertaken by the Bank varied in relation to Tolar bill maturity; interest rate reductions for 270- and 60-day Tolar bills were more substantial. Most of the Tolar bill nominal interest rate reductions took place in the first and third quarters, except for that on the 30-day bill, which was increased by 2 percentage points in June. The last substantial reduction of Tolar bill rates for all maturities took place in early October. At end of December 1998 the Tolar bill rates were

…and on Tolar bills as instruments used for withdrawal of base money.

Figure 6: **Bank of Slovenia and Money Market Interest Rates** (monthly average above BR in % p.a.)



Source: Bank of Slovenia.

as follows: 2-day bills 1.7% (against 2.5% in January 1998), 12-day bills 3.2% (against 5% in January), 30-day bills 6.4% (against 8% in January), 60-day bills 7.8% (against 13% in January) and 270-day bills 3% above BR (against 5% above BR in January).

A new 28-day Tolar bill was introduced in September, interest rate subject to auction; the volume made available each time amounted to SIT 3 billion. The average weighted interest rate on the 28-day bill was reduced from 9.21% to 7.76% by the end of the year. As a rule, it was higher than that on 30-day bill rate, which makes banks eligible for liquidity loans.

Money market rates followed declining trend.

Money market interest rates: the nominal short-term money market interest rate changed in relation to the Bank rates; it was reduced from 9.21% in January to 7.76% in the last quarter. The rate above BR, a better indicator of liquidity of the banking sector, reached its lowest level in summer (1.5 percentage points below BR) and increased slowly to 0.5 percentage points below BR by the end of the year.

Treasury bill issued by Ministry of Finance to spur development of money market

3-month Treasury bills were issued on regular monthly basis to spur further money market development. The average monthly volume issued after May was between SIT 2 and 3 billion. With the growing volume of such bills subscribed – between SIT 1.9 and 7.8 billion (in November SIT 8.3 billion) – the compound prime market interest rate came down from 13.2% to 8.6%. Treasury bills were not traded on the secondary market.

2.3. Exchange Rate

Weak inflow of foreign exchange in foreign exchange reserves

The inflow total of foreign exchange in foreign exchange reserves of banks and of the Bank amounted to USD 201 million. After the high inflow in the previous two years (foreign exchange reserves increased by USD 681 in 1997, and even more in 1996), the inflow almost ceased in the first quarter of 1998. Transactions on the government foreign exchange account not taken into account, the inflow in the second and third quarters was a steady USD 30 million per month (with exception in June - USD 99 million), and the net outflow in the last quarter USD 61 million. The main source of foreign exchange for banks was foreign exchange offices; they net purchased USD 219 million from residents and non-residents. The second source was enterprises on the foreign exchange market; they net sold only USD 19 million.

Foreign exchange intervention of the Bank equal to net inflow total of foreign exchange last year

The inflow derived from the capital and not from current transactions; the current account was in balance. The foreign exchange intervention total of the Bank about equaled the aggregate net inflow of foreign exchange. The Bank withdrew any market surplus of foreign exchange by means of temporary purchase from banks; it definitively purchased the surplus in June and in July at intervention rate. Demand by banks in the market became higher in October and November due to stricter requirements on open foreign exchange position; this led to the Bank's intervention in November, when it sold USD 32 million to Banks to stop depreciation. The market was balanced at the end of the year given the Tolar exchange rate at that time.

The DEM market exchange rate increased from 94.30 SIT at end of December 1997 to 94.60 SIT in early February and stayed at 94.50 SIT until the second decade in February; it decreased at a quick pace afterwards and reached 93.20 SIT in mid-April. The Bank intervened between end of May through first decade of July; as a consequence, the rate of exchange first increased to 93.90 and then to 94.40 SIT/DEM. The rate of exchange remained on this level throughout summer and until the Bank's second intervention on September 14. This intervention period lasted one week; the exchange rate reached 94.70 SIT/DEM. The rate kept increasing even after the Bank stopped intervening on the foreign exchange market due to changed regulations on foreign exchange position of banks; it increased to 96.50 SIT/DEM by the end of November, and decreased to 96.40 SIT/DEM by the end of 1998.

DEM at 94.3 SIT early in the year…

…at 93.2 SIT in April…

…and at 96.4 SIT by the end of 1998.

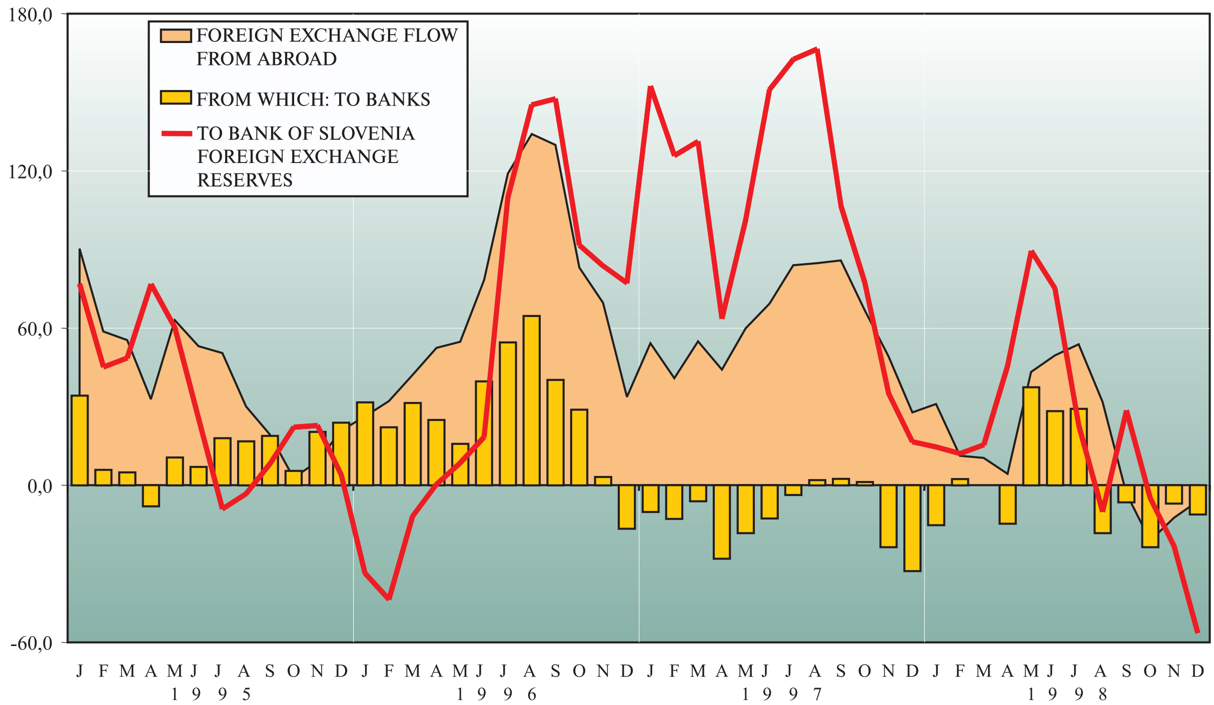
The DEM exchange rate growth amounted to 2.2% (against 3.6% in 1997). As a rule, the foreign currency exchange offices' DEM rate lagged behind that of the foreign exchange market, except during a period of a few days earlier in the year; the highest difference of 0.8 SIT was recorded at the end of April. After the intervention by the Bank, the difference became smaller but stayed until the second decade of November. After that, the average DEM rate in foreign currency exchange offices exceeded that of the foreign exchange market. It increased to 96.54 SIT/DEM (by 2.4%) at the end of the year.

DEM exchange rate growth slowed down

The nominal effective exchange rate weighted by the currency basket of Slovenian exports increased by 1%, i.e. by over 50% less than that of the DEM alone, among others also due to depreciation of USD in the second half of the year.

The nominal effective exchange rate increased by 1%

Figure 7: **Foreign Exchange Inflow*** (in million USD monthly; moving average 3)



* Inflow of foreign exchange without direct inflow to Bank of Slovenia (interest etc., reduced for net payments to the debit of foreign exchange account of the budget).

Source: Bank of Slovenia.

The real appreciation of Tolar between 3.5% and 4.4%

The real effective rate. Tolar appreciated by 3.6% in real terms when measured by the ratio between the change in exchange rate and the growth in foreign against domestic producer prices (December/December), and by 4.4% when compared to consumer price growth. It only appreciated by 3.5% when measured by the relative unit labor cost.

2.4. Monetary Policy Instruments

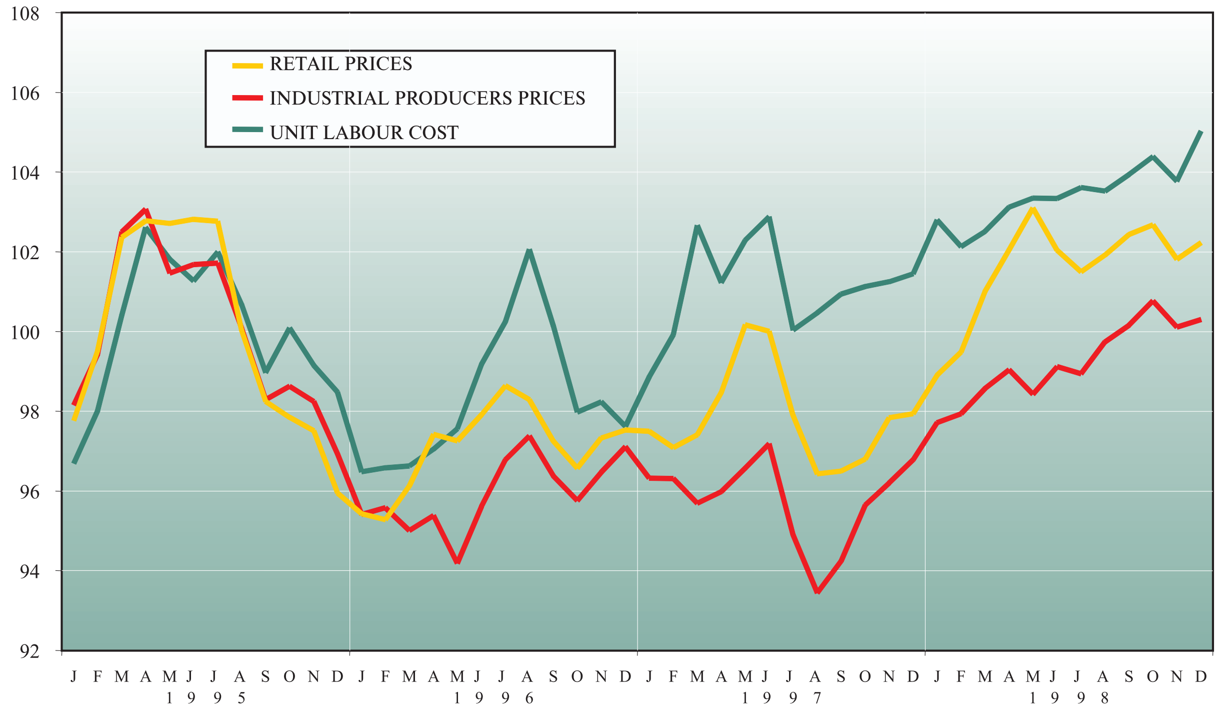
Volume of base money increased by 26%.

The average volume of base money amounted to SIT 159.6 billion (calculated as the average book balance on the last day in a month), and was well over 26% higher than in 1997. The average balance of the Bank liabilities (deposits of Central Government and of other domestic non-bank entities and capital), together with base money an indicator of activity of the Bank as the institution conducting monetary policy, amounted to SIT 243.7 billion. Loans to banks accounted for only 6%, claims to Republic of Slovenia pertaining to succession issues and other claims for 6%, and deposits abroad for as much as 88% of this amount.

Securities issued by the Bank with the purpose to manage the exchange rate equaled 12% of GDP and were entirely covered by foreign assets.

Securities issued by the Bank with the purpose to manage the exchange rate, amounted to an average of USD 385.3 billion (increase by 32% against 1997) and equaled 12% of (the estimated) GDP. They were entirely covered by foreign assets of the Bank. For the major part (SIT 293.0 billion or 76% of all) these securities were foreign-currency denominated; banks subscribed to SIT 218.0 billion under the foreign exchange minimum requirement.

Figure 8: **Real Effective Tolar Exchange Rate** (1995=100)



Source: Bank of Slovenia.

Net claims of residents to the Bank amounted to 16% of GDP

Net liabilities of the Bank to residents (mainly banks) amounted to SIT 539.1 billion or 16% of GDP. They are calculated as the difference between the average claims of the Bank to residents (banks and Central Government) on one side, and the base money, Central Government and other non-bank deposits and securities issued on the other side. The Tolar liabilities of the Bank to domestic persons alone amounted to SIT 223.2 billion or 7% of GDP.

The following monetary policy instruments had a major impact on the volume of base money and on the exchange rate:

- **Loans** accounted for net withdrawal of SIT 4 billion, whereby the net base money issued does not include the interest paid and received respectively. The decrease in base money is entirely due to repayments of supplementary short-term loans, drawn in 1997. The daily average of loans outstanding amounted to SIT 1.1 billion (against 4.5 billion in 1997).

- **Repurchase agreements under foreign currency bills** accounted for withdrawal of SIT 1.7 billion. Not included in this amount are the differentials between the buying and selling rates (interest).

- Withdrawals under time **deposits of Central Government** made in 1997 accounted for an increase by SIT 9 billion. The Ministry of Finance made no time deposit in the second half of 1998.

- **Tolar bills** accounted for net withdrawal of SIT 5.9 billion. The average volume of bills outstanding amounted to SIT 93.7 billion (against 43.5 billion in 1997).

Table 8: **Monetary Policy Instruments** (in million SIT)

	Stock	Average daily stock per quarter 1997				Stock
	Dec. 31st 1997	I.	II.	III.	IV.	Dec. 31st 1997
Loans to banks	3,968	2,386	1,230	453	476	0
- Lombard loans	0	167	364	107	125	0
- Short-term loans	**3,968**	**1,784**	**560**	**8**	**0**	**0**
- Liquidity loans	**0**	**435**	**306**	**338**	**351**	**0**
Repurchase of bills	5,179	3,739	8,004	3,541	2,810	3,454
Repurchase of foreign exchange	8,473	10,317	12,248	7,532	1,684	0
Bank of Slovenia bills	**369,313**	**377,075**	**393,046**	**398,807**	**390,221**	**366,441**
- Tolar bills -banks and savings banks	58,388	62,102	56,566	70,698	78,954	66,749
- Twin bills	51	1,292	108	2,442	2,307	3,259
- Bills with warrants	17,349	23,469	31,342	25,273	20,374	11,661
- Foreign exchange bills	293,525	290,212	305,031	300,394	288,586	284,773
Central government deposits	**9,000**	**5,303**	**1,570**	**54**	**0**	**0**
Required reserves of banks and saving banks	54,589	56,292	59,913	64,119	67,932	69,949
Foreign exchange minimum of banks	352,254	359,248	364,118	364,472	365,329	362,440
Purchase of foreign exchange		6,066	27,550	27,445	5,195	
Sale of foreign exchange		9,521	5,847	2,747	16,224	

Source: Bank of Slovenia; accrued interest and discount not included.

- **Temporary purchase of foreign exchange** accounted for withdrawal of SIT 8.5 billion.

- **Final purchase of foreign exchange from banks** accounted for an increase of SIT 31.9 billion, mostly as the Bank's intervention on foreign exchange markets at intervention rate.

The Bank also regulated supply and demand for foreign exchange on the foreign exchange market by means of prescribed mandatory reserves in foreign exchange (foreign exchange minimum), by obliging banks to balance their foreign exchange assets with foreign exchange liabilities, by limiting the open foreign exchange position and by means of non-interest-bearing Tolar deposit required on non-trade related loans taken abroad.

Loans to banks

The average daily volume of loans to banks outstanding amounted to SIT 1.1 billion (against 4.5 billion in 1997)

The bank issued base money by means of Lombard, short-term and liquidity loans. Due to the level of supplementary short-term loans outstanding at the beginning of the year, the share of these loans was the highest. The volume of liquidity loans outstanding increased also due to loans extended against pledge of Tolar bills.
The daily average of loans outstanding amounted to SIT 1.1 billion (against SIT 4.5 billion in 1997), with a peak in January (3.1 billion) and a low in September (67 million).

Lombard loan: a five-day loan made available on permanent basis at one percentage point above the discount rate, i.e. at 11% p.a. since April 1995. Banks can draw on 2.5% of Bank of Slovenia foreign currency bills or Treasury bills pledged. The amount drawn under this loan amounted to SIT 14.1 billion (against 25.6 billion in 1997), of which 6.6 billion in May. All such loans were repaid before end of 1998, so that the impact of the principal on base money was neutral.

Short-term loan: the Bank first offered the loan in 1994 as an instrument for regulation of intra-month liquidity; the Bank first introduced supplementary short-term loans in September 1995 to neutralize the effect of the transfer of budgetary liquidity surplus from banks to the Bank.

Supplementary short-term loan is given to banks in dependence of and in amounts equal to or exceeding time deposits received from the Ministry of Finance for a period equal to the term of such deposit, but not exceeding three months. The share of an individual bank in the total volume made available is determined by the proportion of its share in the foreign exchange position total of banks. The interest rate applied exceeded that on time deposits, which, in turn, is in line with that on the Tolar bills with comparative (next shorter) maturity, by six percentage points.

Supplementary short-term loans given only during first half of the year

In total supplementary loans were made available to banks 16 times, all during the first six months. On average, the volume of supplementary loans extended reached 34% of time deposits received; the average maturity of such loans was 10 days. The average amount of loans outstanding was SIT 588 (against SIT 4 billion in 1997), with a peak in January (SIT 2.5 billion).

Liquidity loans serve to regulate Tolar liquidity of the banking system, during short periods of time also to regulate the quantity of base money. In 1998 banks mostly drew on loans against pledge of Tolar bills and a few times under liquidity loans of last resort. Overnight liquidity loans were not made available; likewise the special liquidity facility for banks under rehabilitation was not available after completion of bank rehabilitation process in mid 1997.

Daily drawings of liquidity loans amounted to SIT 357 billion

The daily average of liquidity loans drawn amounted to SIT 357 million (against SIT 166 million in 1997).

Liquidity loan against pledge of Bank Tolar bills can be drawn for a maximum of three and five days against pledge of 12 and 30-day Tolar bills in the amount up to the nominal value of bills pledged. Liquidity loans against pledge of 12-day bills prevailed in the first half, and those against pledge of 30-day bills in the second half of the year. Drawings on such loans (amounting to SIT 343 million on average) represented 96% of all liquidity loans drawn. Banks drew on the loan throughout the year (except in March), with a peak in November (SIT 9.5 billion).

96 % of all liquidity loans drawn against the bledge of tolar bills.

The interest rate applied is that of the respective Tolar bill increased by a margin. The interest rate for the loan against pledge of 12-day bills amounted to 7% p.a. until October, and was reduced to 5.7% p.a. after that; that for loans against pledge of 30-day bills increased from 10% to 12% in June and was reduced to 11% p.a. in August and to 9.4% p.a. in October.

Overnight liquidity loan is offered to banks, which are not net creditors on the interbank market. The Bank makes such loans available on the evening interbank market when the supply of loans is scarce in spite of good liquidity of the system or when the Bank wants to influence the market lending rates. Banks can draw on amounts in dependence of the volume of collateral available. In 1998 the Bank abstained from such intervention in the evening interbank market.

Three banks needed liquidity loan of last resort

Liquidity loan of last resort is always available to any bank facing unexpected liquidity problems, i.e. for payment of due obligations and for fulfillment of mandatory reserves requirement, against pledge of collateral equal to nominal amount of the loan. The interest rate charged is that for overdue obligations. Three banks made use of the facility in the total amount of SIT 4.7 billion.

Special liquidity loan with participation of banks is available to banks facing liquidity problems, which are unexpectedly not able to attract new depositors or borrow on the interbank market, and are not eligible for the Bank's loans due to non-availability of appropriate securities. Any such bank can obtain a liquidity loan from the Bank with one or more banks participating. The participating bank is obliged to pledge to the Bank securities issued by the Bank or the Republic of Slovenia; the lending bank pledges other first-class securities or grade A claims to participating bank in return.

Special liquidity loan with participation of banks available (and not used) for the third consecutive year

The Bank concluded the third consecutive yearly agreement with 20 banks on their availability for participation in loans to banks with liquidity problems against compensation of 1.5% (3% in 1997) p.a. of the amount made available. No loan with participation of banks has been used since conclusion of the first agreement.

Temporary purchase of Bank of Slovenia bills

The Bank offers on a daily basis to temporarily purchase its foreign currency denominated bills from banks, obliging them to repurchase the bills after four weeks. The Bank purchased the bills at the Bank's buying rate for the relevant currency on the day of the purchase. The selling bank repurchases the bills at the rate of exchange, which is subject to auction. The selling bank is obliged to purchase foreign exchange receivables from non-bank legal persons up to a predetermined percentage of the bills temporarily sold in the first week following the temporary sale.

Temporary purchase totaled DEM 627 million

The Bank temporarily purchased bills of up to DEM 8 million per day. The response of banks exceeded the Bank's offer in May only; on average, the response equaled 38% of the Bank's offer. The Bank's temporary purchase totaled DEM 627 million (SIT 58.9 billion). The amount of bills repurchased exceeded that by SIT 2.2 billion (interest included). This instrument served to net withdraw base money.

The average annual nominal interest rate applied was calculated based on the ratio between the predetermined minimum rate for obligatory repurchase of foreign currency denominated bills and the buying rate of the Bank on the day of repurchase; it varied from 12.7% in January and 7.9% in October and exceeded the interbank rate throughout the year (on average by 3.2 percentage points). The average real interest rate above the monthly revaluation rate amounted to 1.9%.

The obligatory purchase of foreign exchange from enterprises was set at 120% of bills temporarily sold to the Bank and did not change during the year.

Bank of Slovenia Bills

New 270-day Tolar bill issued at nominal interest rate

The variety of Bank issued bills was similar to that of the previous years. The Bank issued a new 270-day Tolar bill in September at nominal interest rate. The Bank also started weekly auctions of 28-day Tolar bills in the same month. The conditions varied in line with the monetary policy and exchange rate targets, and in line with fluctuations of interest rates on international and on domestic money markets.

Tolar bills subscribed totaled SIT 695.5 billion…

The volume of securities subscribed increased. Tolar bills subscribed amounted to SIT 695.5 (against SIT 465.5 billion), their redemption to SIT 691.0 billion plus DEM 26 million under twin bills. Purchase of foreign currency denominated bills amounted to DEM 8.9 billion and USD 1.2 billion, their redemption to DEM 9 billion and USD 1.2 billion.

Tolar bills are short-term registered securities in book-entry form of various maturities offered to banks (2, 12, 30, 60 or 270 days) and savings bank (7, 14, 60 or 270 days). Except for bills with maturities of 60 and 270 days, they are not issued in series. The 28-day Tolar bill sold at a discount was made available on regular weekly basis since September. In the same month Bank also made available the 270-day Tolar bill at a nominal interest rate to banks and savings banks. The Bank abolished sale of the 270-day Tolar bill at an indexed interest rate towards the end of the year. By early 1999 only 270-day Tolar bills at a nominal interest rate were available.

The 28-, 60- and 270-day bills are issued in series, the rest as non-series securities. Securities purchased by banks and savings banks are registered on a special deposit account with the Bank against issue of respective certificate. The interest rate applied by the Bank changed from tender to tender, depending on domestic market rates and monetary policy target.

…whereof SIT 628.4 billion were purchased by banks and savings banks.

Banks and savings banks purchased Tolar bills in total value of SIT 628.4 billion, and received redemptions thereunder of SIT 620.2 billion; the instrument served to net withdraw SIT 8.2 billion of base money. The average daily volume of Tolar bills outstanding amounted to SIT 67.1 billion (against 24.5 billion in 1997); it varied between SIT 50.3 billion in May and SIT 82.8 billion in October. 270-day bills held the biggest share (50%), and were followed by 60-day bills (33%) and 30-day bills (9%).

Twin bills are short-term transferable securities issued to the bearer in hard copy. They comprise a Tolar and foreign currency part, are bought in Tolars at a discount and are redeemed half in Tolars and half in German marks. The two parts can be traded separately. They are available to banks and through them to households and enterprises. Revaluation clause applies to the Tolar part.

Twin bills of series issued in 1997 and two new series were made available in 1998. The value of twin bills purchased amounted to SIT 8.2 billion (against 8.4 billion in 1997), that of redemptions thereunder SIT 2.6 billion and DEM 26 million (against SIT 4.9 billion and DEM 48 million in 1997). The instrument served to net withdraw SIT 5.6 billion of base money.

Bills with warrants are transferable securities issued to the bearer in hard copy up to including series nine and as registered securities in book-entry form afterwards. They are issued at a face value of half a million Tolars. They are bought at discount in Tolars and bear a nominal annual interest rate. A warrant (consisting of several parts) attached to the security acts as a hedge against higher inflation and smaller devaluation of SIT against DEM and USD respectively than projected. Holders of warrants are able to buy new Tolar bills (without warrants) or foreign currency bills at a discount depending on the number and value of warrants of a single series presented, and on the increase in consumer prices and the Bank's middle exchange rates compared to official projections for inflation. The bills are issued twice a year, each time with maturity of six months; the due date of the first issue coincides with the issue date of the next. The interest rate is determined separately for each issue, and so is the number of warrants attached. Bills with warrants are sold at auctions.

In 1998 two new issues (number nine and ten) and redemptions under issue eight and nine took place. The interest on tenth issue was reduced from 9% to 7% (based on expected lower consumer price growth than projected – 4.8% instead of 6%), and so was the number of warrants attached (from five to three) and the number of warrants accepted for purchase of foreign currency bills at a discount limited.

A total of 123,979 lots of bills of the eighth, ninth and tenth issues were sold at a discounted total amount of SIT 58.9 billion and a total of 263,475 warrants under ninth and 72,450 warrants under tenth issue attached (validity of the latter expire at the end of May 1999). Redemptions under issues 8 and 9 totaled SIT 68.2 billion.

Discount realized under foreign currency bills totaled DEM 12.8 million and USD 5.2 million, that under Tolar bills with the nominal value of SIT 500,000 SIT 1,053.1 million. At end of December 252,384 warrant parts under ninth issue and 72,450 parts under tenth issue remained unemployed. Their validity expires at the end of May 1999.

Foreign currency bills are transferable, registered non-series securities issued since January 1992 with maturity between two months and one year in book-entry form. They are available to banks and through them to other legal entities. They are purchased at a discount in DEM or USD. Those with maturity of 180 days or more can be purchased at a discount based on warrants. The actual discount depends on the number of warrants of a respective series presented, and on the difference between the Bank's DEM middle exchange rate and the official inflation projections. The interest rate applied reflects the relevant changes in international markets. Interest rate for DEM was changed 16 times, that for USD 18 times.

Foreign currency bills make banks eligible for almost any loan of the Bank – for Lombard, liquidity and short-term loans; they can also be temporarily sold to the Bank. Claims under foreign currency bills can serve as collateral. Foreign currency bills with maturity of up to 120 days serve to comply with the Bank's requirement on foreign exchange minimum.

Sale of DEM denominated bills decreased by 4.1%…

DEM-denominated bills of DEM 2,626 million were purchased early in the year. The volume of DEM-denominated bills outstanding reached its peak at the end of June (DEM 2,830 million, an increase by 7.8% against the level outstanding at the beginning of the year) and its low at the end of the year (DEM 2,519 million, a decrease by 11% against the peak or 4.1% against the beginning of the year). Like in 1997, 120-day bills held a major share in the structure of total foreign exchange bills outstanding (on average 51%).

…and that of USD denominated bills increased by 16.7%.

USD-denominated bills of USD 270 million were purchased in early 1998. The volume of such bills outstanding decreased by 8.5% in the course of January and increased afterwards to reach its peak in June (USD 315 million, an increase by 16.7% against the volume at the beginning of the year). During the subsequent months redemptions exceeded subscriptions; the USD bills outstanding reached a low of USD 261 million at the end of the year (3.4% below the level at December 1997). Within the structure of 120 day bills, USD bills held the biggest share of 39% (even though by 7 percentage points smaller than in 1997).

Deposits by Central Government

Deposits by the budget amounted to SIT 63.6 billion

Bank of Slovenia provides banking services to the Central Government pursuant to the respective decree-based agreement concluded. Central Government made 16 time deposits of 13 days each in the first half of the year, totaling SIT 63.6 billion, with deposit amount average of SIT 1.7 billion. The impact of transfer of these deposits (budget liquidity surplus) from banks to the Bank was neutralized by the Bank's supplementary loans made available to banks (SIT 63.6 billion was made available, 45% thereof actually drawn by banks).

A credit facility was made available to the Central Government (account 630) in December 1997 for drawings necessary for the execution of the budget, in dependence of the overall balance of deposits held with the Bank. The Bank determined the monthly level of such credit facility at between SIT 4.4 billion Tolars in April and SIT 5.3 billion in July. Central Government did not make use of the facility in 1998.

The credit facility not drawn by the budget

Reserve requirement for banks and savings banks

Banks, savings banks and savings co-operatives are obliged to have minimum reserve holdings with the Bank. The requirement applies against Tolar deposits, loans received and bank issued securities held by non-banking sectors. The minimum reserves requirement was 12% for sight deposits and time deposits with maturity of up to 30 days, 6% for deposits with maturity between 31 days and up to three months, 2% for deposits with maturity between three and six months and 1% for deposits with maturity between six months and one year. The special minimum reserves account is remunerated at 1% p.a., but remuneration applies to the amount of calculated reserves only.

Tolar deposits increased at a monthly average of 2.1% (against 2.4% in 1997). They increased from SIT 933.1 billion to SIT 1,203.2 billion (29%). Time deposits with maturity of up to one year increased at a monthly average of 2.0%, and those with maturity of over one year at a monthly average of 2.7%. The share of the latter in the Tolar deposits total increased by 2.5 to 22.8%. The structure of Tolar deposits has changed since 1995 (when minimum reserves requirement was changed) in favor of long-term deposits.

The **calculated reserves** grew on average at a pace of 2.1% per month (against 1.6% p.m. in 1997). They increased by SIT 15.4 billion and reached SIT 69.9 billion at December 1998. The average calculated requirement for deposits with maturity of up to one year varied between 7.2% and 7.6%, and amounted, on average, to 7.4% (a decrease by 0.2 percentage points against 1997). The average calculated reserve requirement for all Tolar deposits amounted to 5.7% (against 6.1% 1997). The actual reserve holdings (on giro accounts, in cash and on special minimum reserves accounts) exceeded the calculated requirement on average by 4.1% (against 5% in 1997).

The calculated minimum reserves on Tolar deposits 5.7%

Banks and savings banks may utilize their **minimum reserves in case of liquidity constraints**. A daily average equal to half of the mandatory reserves for the previous month must be kept on a special account and may be used for such purpose over night. Interest rate equal to that for overdue obligations is applied.

On December 1, 1998 the Bank abolished the special reserves accounts for banks participating in the real time gross settlement system (RTGS) obliging them to hold the minimum reserves on the new settlement account with the Bank. Balances on the settlement account may be utilized for regulation of their intraday liquidity. The end-of-day balance on such account must not go below 50% of the calculated reserve requirement for the previous month. There was no change for RTGS non-participant banks.

Between January and November, the minimum reserve holdings on the special account amounted to an average of SIT 33.1 billion (against SIT 25.4 billion in 1997). Compensations paid to the Bank for utilization of such holdings amounted to SIT 1 billion (against SIT 1.8 billion in 1997).

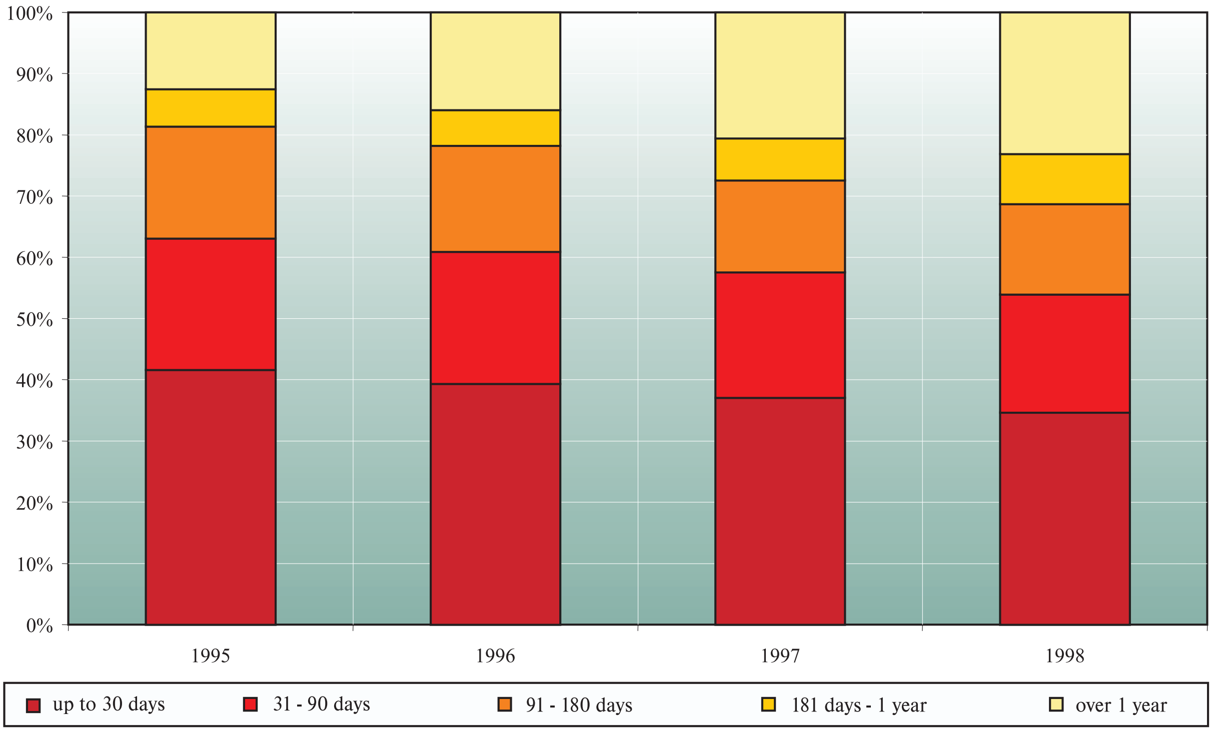
Regulation of supply and demand in foreign exchange market

Foreign exchange minimum (the required minimum foreign exchange reserves) is the instrument to ensure general liquidity in cross-border payments and fulfillment of obligations deriving from foreign currency deposits of residents and non-residents in domestic banks. Banks are obliged to hold at least such minimum foreign exchange assets as prescribed on a daily basis. The 1998 monthly requirement was determined based on the volume of a bank's cross-border payments (35% of last 3-months' average), and on foreign currency deposits of residents and non-residents (100% of sight deposits, 75% of time deposits with maturity of up to three months, 35% of time deposits with maturity between three months and one year, 5% of time deposits with maturity of over one year). The calculation methodology remained basically unchanged, except that as of March, the Tolar time deposits based on sale of foreign currency at maturity was included in the calculation base.

The calculated mandatory foreign exchange minimum equaled 80%, and the actual foreign exchange minimum holdings 99% of foreign currency deposits total.

Banks complied with the requirement with appropriate balances on accounts with foreign first-class banks, with foreign cash in hand and checks, with foreign currency claims on domestic and foreign banks and the Bank, with the Bank's foreign currency bills (with maturities of up to 120 days), with first-class domestic and foreign securities. The prescribed minimum holdings of the Bank's foreign currency bills were 60% of the required foreign exchange reserves.

Figure 9: **Average Structure of Tolar Deposits** (1995 – 1998)



Source: Bank of Slovenia.

The minimum reserves of banks in foreign currencies increased by 3% from SIT 352.3 billion (end of 1997) to SIT 362.4 billion. Foreign currency deposits of households and cross-border payment transactions accounted for most of this increase. Household foreign currency deposits increased at a high pace – time deposits with maturity of 3 months increased by 9% and those with maturity beyond one year by 31%. Actual foreign exchange minimum exceeded that prescribed by 9% in March and by as much as 23% at the end of the year.

Foreign exchange minimum increased by 3%

In addition, the Bank prescribes to banks the so-called net daily foreign exchange position (the difference between foreign exchange assets and short-term domestic and external debt) which is equal to at least 75% of the foreign exchange minimum.

Governing Board of the Bank adopted new methodology for calculation of foreign exchange minimum from January 1999. The calculation base comprises household foreign currency deposits, household Tolar deposits with the foreign exchange withdrawal option and non-resident foreign currency deposits (100% of demand deposits, 95% of deposits up to 3 months, 75% of deposits between 3 months and 1 year, 35% of deposits over one year).

New methodology for calculation of foreign exchange minimum adopted for 1999

Balancing requirement for increase in liabilities to foreign persons. In 1996 the Bank prescribed to banks an obligation to balance any additional liability beyond their position at July 31, 1996 with corresponding assets. The requirement remained in force in 1998. Such liabilities comprise any Tolar and foreign currency liabilities to non-residents, and liabilities under foreign financial loans taken by domestic legal persons, majority-owned by banks.

In 1997 the Bank deliberated that custody accounts of non-residents held by domestic authorized banks were made part of such balancing obligation of banks. Exempt from the balancing requirement in 1998 were foreign portfolio investments pledged for seven years unless they were sold to another non-resident (in which case the seven-year period was calculated from the date of such sale).

Open foreign exchange position. With the purpose to protect banks against foreign exchange risk, the Bank prescribed to banks involved in dealings with foreign currencies the daily (short or long) open foreign exchange position which is not to exceed 20% of regulatory capital. The transition period (allowing for gradual compliance) expired on October 1, 1998; full compliance of banks was requested after that date.

In order to prevent larger oscillations in foreign exchange assets and liabilities of banks, the Bank additionaly required (as of November 1998) the average monthly foreign exchange position of banks not to exceed 10% of regulatory capital.

At December 31, 1998 the aggregate open foreign exchange position of banks was short; foreign exchange liabilities of banks exceeded the assets by SIT 10,233 billion. A total of 16 banks ended up in open short foreign exchange position, 8 banks with an open long foreign exchange position.

Open foreign exchange position of banks short at end of December 1998

Purchase and sales of foreign exchange

The Bank purchased more foreign exchange from banks even if through fewer transactions than in the previous year. Purchase and sales were based on offers made to all banks, or on the needs of Central Government for payments abroad, and were also based on agreements concluded with banks on their participation in foreign exchange market interventions; proposals for such participation were made to all banks, but some chose not to participate. The Bank purchased a total of DEM 701.6 million and sold DEM 360.2 million. The most significant instrument of Bank intervention on the foreign exchange market was the purchase of foreign exchange from banks at the Bank's intervention rate.

The volume of transactions under temporary purchase of foreign exchange increased substantially. The Bank purchased a total of DEM 1,128.1 million (against DEM 223 million in 1997) and sold DEM 1,218.1 million. Temporary purchase from banks obliging these to repurchase the foreign exchange after two weeks accounted for the largest portion thereof.

Agreement concluded with banks on their participation in foreign exchange market interventions

The Bank proposed to banks conclusion of an agreement on their participation in foreign exchange market interventions. The agreement specified the rights and obligations of banks and of the Bank in three types of interventions on the foreign exchange market:

- **Intervention at intervention purchase rate**: the participating banks purchase foreign exchange and foreign cash at an intervention rate determined by the Bank. The participating bank can sell any excess foreign exchange to the Bank until five days after the conclusion of intervention period. The Bank determines the latter and the intervention rate in line with the monetary policy objective. The participating banks are the banks which have signed

Box 3: **Deregulation of Capital Account Transactions**

The Association Agreement between Slovenia and the European Union came into effect on February 1, 1999. The Agreement obliges Slovenia to liberalize capital flows related to foreign direct investment and to foreign loans to businesses and services, and those related to foreign financial loans. Liberalization of portfolio transactions is to take place after the transition period of four years.

The Agreement also gives Slovenia the right to impose capital account controls for a period of six months when the capital flows interfere or threaten to interfere with the monetary or exchange rate policies.

The Governing Board of the Bank deliberated the following deregulation of capital flows as of February 1, 1999:

a) Credit arrangements:

- Banks are allowed to take short-term loans abroad;
- The obligation of banks to balance the net increase in foreign exchange liabilities with for eign exchange assets is abolished, and
- The non-interest bearing Tolar deposit on foreign financial loans is abolished.

The Governing Board deliberated that the Bank has the right to require payment of such Tolar deposit of up to 30% on foreign financial loans for a period of two years if and when the capital inflow interferes or threatens to interfere with monetary and exchange rate policies.

b) Foreign Direct and Portfolio Investment:

- Foreign direct investment (FDI) means a stake of more than 10% (formerly 50%) in the capital or more than 10% of voting rights;
- Foreign portfolio investment for a period of more than 4 years (formerly 7 years) is categorized as FDI in case the investor abstains from disposal of such portfolio during such period;
- Foreign portfolio investors open custody accounts with the authorized banks in Slovenia. Banks are obliged to purchase options at a premium in the amount equal to the balance on such custody accounts (the premium equaled 2.5% in the first quarter of 1998). The options can be exercised only in case of foreign exchange outflow from such custody accounts.

the agreement with the Bank and the auction bids of which were successful (subject of the auction was the difference between the buying rate for foreign exchange and foreign currencies of banks and the selling rate for sales of such foreign exchange to the Bank).

- **Intervention at intervention selling rate**. During the intervention period, the participating banks sell foreign exchange at an intervention rate. Any deficit can be covered by purchase from the Bank. Banks qualify as participating banks in the same way they do in case of the foregoing instrument. The intervention rate and intervention period are determined in the same way as above.

- **Determination of margin between the selling and the buying rate**. The Bank may prescribe to participating banks the margin between the selling and the buying rate for a period of up to 3 months. The margin should not be lower than 0.3%.

12 banks participated…

12 banks (with a market share total of 70%) signed the agreement with the Bank.

…in two interventions (between May and July, and in September).

Two interventions of the Bank at the intervention rate took place in 1998: the first in the period between end of May and beginning of July (at intervention rate between 93.90 SIT/DEM and 94.10 SIT/DEM), the second in September (at the intervention rate of 94.70 SIT/DEM. The foreign exchange total purchased amounted to DEM 508.8 million (SIT 48.1 billion).

Between June and November 1997 the **Bank offered to banks to purchase foreign exchange from them and give them the right to sell further amounts to the Bank and to purchase foreign currency bills** on monthly basis. Banks could sell foreign exchange to the Bank without limitation and purchased 360-day foreign currency bills in percentage equal to their bid for sales of foreign exchange to the Bank. The banks sold foreign exchange at the preset minimum exchange rate increased by any increase in the market exchange rate of the previous month. A bank would sell foreign exchange to the Bank at the selling rate so determined and would purchase foreign exchange from enterprises and cash in its foreign currency exchange offices at the same rate. Any such sale of foreign exchange to the Bank would give the bank the right to sell another such total amount to the Bank during the subsequent 5 months (1/5 per month).

The total amount of foreign exchange purchased by the Bank during the first half of 1998 based on such rights of banks amounted to DEM 55.6 million at the exchange rate of 94.50 SIT/DEM.

Throughout the year, **banks** were able to **buy foreign exchange from the Bank** (at the selling rate increased by certain percentage points) but **were obliged to purchase the Bank's 120-day foreign currency bills in the same nominal value.** Banks purchased a total of DEM 52.8 million (SIT 5.1 billion) and purchased 1,068 lots of 120-day DEM-denominated bills.

As **banker of the Central Government pursuant to Law and the respective agreement concluded**, the Bank purchased a total of DEM 137.2 million (SIT 12.9 billion) and sold DEM 307.4 million (SIT 29.2 billion). The Ministry of Finance had the right to sell to the Bank additional DEM 170.3 million on account of the extended budgetary year, but did not make use of such right.

Three types of purchase of foreign exchange by the Bank

The Bank offered to **buy foreign exchange for a limited time** under three different instruments. The Bank bought most of it between January and April when it offered to purchase foreign exchange from banks, obliging banks to repurchase the amount sold after two weeks. Banks sold the foreign exchange at the buying rate of the Bank and repurchased it at the selling rate of the Bank on the day of transaction. The Bank bought DEM 823.1 million (SIT 77.4 billion) on such temporary basis.

In the intervention period between April and June the Bank bought foreign exchange in countervalue of SIT 15.9 billion.

In the period between April and June the Bank offered each week to buy foreign exchange from participating banks, obliging them to repurchase such foreign exchange after two months. The Bank bought such foreign exchange at the buying rate and sold it to banks at the buying rate increased by a margin equal to interest rate of 12% p.a. The bank bought a total of DEM 170 million (SIT 15.9 billion).

The Bank bought foreign exchange in countervalue of SIT 12.8 billion under July intervention

In July the Bank offered to buy foreign exchange from banks, obliging them to repurchase such foreign exchange after two months. The Bank bought such foreign exchange at the last intervention buying rate increased by the margin, which was subject to auction, and sold it to banks at this same rate increased by a margin which corresponds to the interest rate on 60-day Tolar bills increased by a half percentage point. The participating bank is obliged to purchase foreign exchange from enterprises and foreign currency in the foreign currency exchange offices at the last intervention's buying rate in the time between the temporary sale to the Bank and repurchase from the Bank. The foreign exchange temporarily purchased by the Bank totaled DEM 135 million (SIT 12.8 billion).

Table 9: **Purchase and Sale of Foreign Exchange**

	1997		1998	
	millions of DEM	millions of SIT	millions of DEM	millions of SIT
Purchase	**1,072.5**	**99.6**	**701.6**	**66.3**
Purchase with right to sell and subscription of bills	1045.8	97.2	55.6	5.3
Purchase at intervention purchase exchange rate			508.8	48.1
Payments for the government	26.7	2.5	137.2	12.9
Sale	**102.3**	**10.1**	**360.2**	**34.3**
From right to sell	38.3	4.2		
For purchase of foreign currency bills	2.0	0.2	52.8	5.1
Payments for the government	62.0	5.7	307.4	29.2
Temporary purchase	**223.0**	**21.0**	**1,128.1**	**106.1**
Triple offer (swap)	33.0	3.1		
Temporary purchase (auctions)	190.0	17.9	993.1	93.3
Temporary purchase (open tender)			135.0	12.8
Repurchase of foreign exchange	**133.0**	**12.6**	**1,218.1**	**115.6**
Triple offer	33.0	3.1		
Temporary purchase (auctions)	100.0	9.5	1083.1	102.6
Temporary purchase (open tender)			135.0	13.0

Source: Bank of Slovenia.

Surveillance of implementation of monetary policy measures

The Bank surveys the implementation of its monetary policy measures and compliance with the conditions and rules governing its market interventions by means of indirect control and direct examination in banks and savings banks.

Indirect control is a continuous process, carried out via regular control of reports and other documentation delivered by banks and savings banks to the Bank. In addition, the Bank occasionally also carries out on-site examinations of books and other documentation in banks and savings banks.

23 cases of non-compliance

The Bank established a total of 23 cases of non-compliance in 2 banks, 3 savings banks and 18 savings co-operatives (against 7 cases in 1997). Non-compliance was established in mandatory reserves requirement and in compliance with conditions and rules governing the Bank's market interventions.

The Bank issued penalty decrees in 21 case, the measures taken depending on the nature and extent of non-compliance established. Among such measures was temporary prohibition to purchase the Bank's bills, temporary suspension from participation in the Bank's interventions and in two cases proposal for suspension of chief executive officer. In cases of minor non-compliance the bank issued warnings and requests for due orderliness.

The Bank carried out 53 controls of foreign currency exchange operations, out of which 35 on site-examinations (2 in authorized banks, 33 in contractual foreign currency exchange offices), and off-site controls of 7 foreign currency exchange offices and 11 banks. The Bank notified the district attorney accordingly of 11 such cases, the judiciary authority in charge of one case and the state Foreign Exchange Inspectorate of the Republic of Slovenia of two cases; the Bank requested termination of two contracts between a bank and foreign currency exchange offices, temporarily suspended the right of one bank to purchase securities and to conclude contracts with foreign currency exchange offices, and issued 13 decrees on termination of legal procedures against contractual foreign currency exchange offices.

The Bank carried out 10 examinations of banks in the area of foreign exchange operations; based on non-compliance established, the Bank issued 7 penalty decrees. Penalties included limitations in access to the Bank's long-term bills.

3. BANKING SECTOR

Further consolidation of banking sector in view of pending changes in legislation

Some progress was made in consolidation of the banking sector, among others also in view of and due to the following milestones: the new Banking Law was adopted in early 1999 (see Box 4); the Association Agreement between Slovenia and the European Union came into effect on February 1, 1999; the validity of the interbank agreement on maximum deposit interest rates expired and the agreement was eliminated as of March 1, 1999.

3.1. Structure of Banking Sector

Three bank mergers and one liquidation.

Consolidation of the banking sector has taken place since late 1994; the most significant step was the establishment of four banking groups in 1997. Three bank mergers (out of these two acquisitions by controlling bank within banking groups) and one liquidation took place in the last four months of 1998. By the end of 1998 there were only two banking groups left.

At end of December 1998 there were 24 banks in Slovenia…

At December 31, 1998 there were 24 banks (in addition to the two banks established pursuant to the Constitutional Law), 6 savings banks and 70 credit co-operatives. The reduction in the number of banks (28 in 1997) is due to acquisition of Hmezad Banka d.d., Žalec by Banka Celje d.d., the merger between Banka Creditanstalt d.d. and Bank Austria d.d. Ljubljana and acquisition of UBK Univezalna banka d.d. Ljubljana by SKB Banka d.d. Ljubljana, and to the liquidation of Hipotekarna banka d.d. Brežice. The number of savings banks and savings co-operatives remained the same as in 1997. In addition, there were seven representative offices of foreign banks.

The market share (measured by balance sheet total) of the savings banks and savings co-operatives remained small – 2.2% (whereof savings banks 0.4% and credit co-operatives 1.8%) against 2.0 in 1997 and 1.8% in 1996. Due to such low share the report covers banks only.

…11 fully owned by domestic entities and 3 fully owned or controlled by foreign owners.

Out of the 24 banks, 11 were fully owned by domestic entities (against 13 in 1997) and 3 fully owned or controlled by foreign owners. The remaining 10 were majority owned by domestic entities (the share of foreign owners in five of these was lower than 1%).

Shareholders in most banks are local or private firms and individuals. The two largest banks (Nova Ljubljanska banka and Nova Kreditna banka Maribor, together holding a market share of 40%) were still directly and Poštna banka Slovenije indirectly state owned. Savings banks were fully owned by domestic private entities.

As regards banking licenses, 14 banks (against 15 in 1997) held an unlimited banking license (8 thereof for commercial and investment banking, 5 for commercial banking only, and 1 for commercial banking and limited investment banking).

Licenses and approvals issued by the Bank

The Bank issued one new banking license and approved of establishment of one new representative office of a foreign bank. The Bank approved of three bank mergers. Approval was given to 15 foreign persons for an ownership share in domestic banks (against 8 such approvals in 1997). Approval was given to 2 domestic entities for an ownership share in domestic banks exceeding 15% (against

Box 4: **New Banking Law**

The new Banking Law (Official Gazette of RS No. 7/99) came into effect on February 20, 1999. With the new law, Slovenia's banking legislation introduced all Stage One and to a big extent Stage Two measures of the EU in this area (aimed at providing the overall legal framework and at addressing fundamental principles and procedures governing the sector). This means that the banking legislation is now fully harmonized with the First Council Directive, the Own Funds Directive, the Solvency Ratio Directive, the Directive on Deposit-Guarantee Schemes (effective as of January 1, 2001), the Directive on Money Laundering and to a big extent the 25 Core Principles for Efficient Banking Supervision adopted by the Basle Committee on Banking Supervision in 1997. The principal novelties introduced are the following:

1. Establishment of a bank and definition of financial services in line with EU directives. The law defines taking of deposits from natural and legal persons and giving credits based on such deposits by a bank in its own name and for its own account as banking services in addition to all other services which, pursuant to other laws, are to be provided by banks only. Limited banking licenses are abolished and minimum capital required set at SIT 1 billion.

2. Common standards for banking license. It is up to the Bank to determine the terms and conditions as regards the management, organization and technical support.

3. In line with the Second Banking Directive the board of management shall have at least two members who have demonstrated to be fit, proper and experienced; they will be held accountable for compliance of the bank operation with prudential rules and other stipulations of the law. Accountability of the management is specified in detail.

4. Foreign banks can establish branches in Slovenia subject to the Bank's license, and are not allowed to provide banking and other financial services directly until Slovenia has become full member of the EU. The Bank may require endowment capital in form of a deposit or other guarantee for settlement of any liabilities of such branch deriving from its operations in Slovenia. Branches of foreign banks shall be subject to supervision of the Bank. In the transition period and until Slovenia has become full member of the EU the stipulations concerning branches of foreign banks shall apply also to banks of EU member countries. After Slovenia has become full member of EU, banks licensed for banking operations by the respective home (member) country authorities will be allowed to provide banking services in Slovenia either directly or through branches; their operation in Slovenia will be subject to supervision of the Bank of Slovenia to the extent determined by the Second Banking Directive.

5. The difference in treatment of domestic and of foreign investors acquiring an ownership share in domestic banks is abolished. Under the old law, approval of the Bank was necessary for domestic persons acquiring an ownership share exceeding 15% of voting rights, and for foreign persons acquiring any stake (percentage) in a domestic bank. The new law stipulates that approval of the Bank is needed for acquisition of a "qualified participation" (meaning direct or indirect holding of 10% of voting rights or of the capital). Approval of the Bank is needed for any further acquisition of shares of the same bank if such acquisition results in a 20%, 33% or an ownership share of 50% of voting rights or of the capital and in a controlling position of such investor.

6. Prudent and sound operation of banks is safeguarded by appropriate capital (in the old law regulatory capital) scaled to the scope and type of operations performed by a bank, and by management of risks in compliance with the law. The minimum capital requirement and the capital adequacy ratio of at least 8% are in line with the "capital directives" (Council Directive on Own Funds of Credit Institutions – 89/299/EEC) and the Council Directive on Solvency Ratio for Credit Institutions – 89/647/EEC) and have remained basically unchanged against the old law.

11 such approvals in 1997). No approvals were issued to existing institutions to perform additional bank operations (against 4 such approvals in 1997). One new license for securities business was issued (against three such licenses withdrawn in 1997). Six approvals for appointment of presidents and members of the board of management were issued.

Box 4 Continued

7. Identification, measurement and management of credit risk and provisioning for bad assets are in line with international rules and standards. New are non-mandatory reserves for general banking risks aimed at cover of any losses resulting from risks deriving from all banking operations.

8. The stipulations on large exposure to a single borrower or to a group of related persons, on maximum single exposure (25% of the bank capital) and on maximum large exposure (800% of the bank capital) are in line with the Large Exposure Directive (92/191/EEC). The law introduces the definition of related persons and enables supervision of credit institutions on a consolidated basis.

9. The stipulations on management of liquidity risk, interest rate risk, currency risk and other market risks mean partial implementation of the CAD Directive; in line with the Second Banking Directive they limit investment of banks in equity and in real property.

10. Supervision of banks on a consolidated basis enables supervision of risk management activities of a whole banking group. The new definition of a banking group is broader and comprises other financial intermediaries, financial holdings and companies active in ancillary banking services. One of the features of the banking group is direct or indirect majority ownership participation of at least 20% (against 40% in the old law) of voting rights or capital (controlling stake and prevailing influence). The stipulations on consolidated supervision are in line with the EU Directive 92/30/EEC on consolidated supervision of credit institutions.

11. Off-site control and on-site examination in line with international supervisory standards. The new law enables the Bank to supervise legal persons related to a bank if deemed necessary for thorough supervision of a bank or in case the Bank reasonably suspects that such legal persons conduct banking activities without having obtained the Bank's license. The new law brings all credit institutions providing banking services under the jurisdiction of the Bank. Accordingly, the credit co-operatives have become subject to the Bank's supervision and are obliged to fully comply with provisions of this new law after a transition period of 5 years. The minimum capital required for savings banks is set at exceptional SIT 186 million.

12. The Bank shall cooperate with other domestic and foreign supervisory authorities by means of exchange of information and in direct examinations. According to the Post BCCI Directive, confidentiality and protection of confidential data and of business secrets are preconditions for such cooperation.

13. In line with the EU directive 94/19/EC aimed at protection of small depositors and through that at stability of financial systems, a new deposit insurance scheme is to be implemented as of January 1, 2001. The scheme shall cover deposits of natural and of legal persons, with a deposits by individual depositor limited to SIT 3,700,000. Exemptions from such general deposit scheme are listed in Article 153. In case of bankruptcy proceedings in a bank, other banks shall be made liable to depositors and shall meet their obligation; to that end banks shall have invested the amount prescribed by the Bank into first class securities (issued by the Treasury and by the Bank).

14. The Bank plays a key role in case of bank bankruptcy proceedings. Unlike under the old law, there is no rehabilitation, and the so-called special administration envisaged in case that a bank fails to comply with the requirement on regulatory capital and the Bank considers that further operation of the bank could endanger its liquidity and solvency. The special administration is envisaged for a period not exceeding one year.

The Bank shall prepare and adopt the implementing rules and regulations for the new law within three months after coming into force of the law.

3.2. Banking Operations

Balance sheet total increased by 9.2% in real terms

According to unaudited data, the **balance sheet total** of all Slovenian banks amounted to SIT 2,351.2 billion at December 31, 1998, an increase by 16.3% in nominal and 9.2% in real terms (against the increase by 16.9% in nominal terms and 6.9% in real terms in 1997). While the balance sheet total of all banks increased in nominal terms, that of three banks decreased in real terms. The growth rates vary from bank to bank between 5.2% and 67.4% (the latter is due to the merger between Creditanstalt d.d. and Bank Austria d.d. Ljubljana).

Market shares of the biggest banks fairly stable since 1994

Market shares (measured by the unconsolidated balance sheet totals – see Table 10) of the seven largest banks have been fairly stable. The market share of the three largest banks has varied between 51% and 53% since 1994, that of the largest five between 62% and 63%, that of the seven largest banks between 71% and 73%, and that of the ten largest banks between 80% and 82%.

Balance sheet total of the largest bank SIT 649 billion, that of the seventh largest SIT 108 billion and that of the smallest bank SIT 11 billion

In terms of their balance sheet total the differences among the seven largest banks are substantial: at end of 1998, the balance sheet total of the largest bank amounted to SIT 649 billion and that of the seventh largest bank only SIT 108 billion. The market share of each of the largest three banks exceeded 10%, market shares of the next 16 were between 1% and 6% each, and those of the five smallest less than 1% each. The balance sheet total of the smallest bank amounted to about SIT 11 billion.

Out of initial 4 only two banking groups left after completed mergers

At December 31, 1998, the balance sheet totals of the two remaining banking groups were as follows:

- Nova Ljubljanska banka (NLB) banking group: SIT 830,384 million, market share 35.3% (a slight increase against 1997);

- Banka Koper banking group, SIT 151,417 million, market share 6.4% (a slight decrease against 1997).

The **average structure of bank liabilities** shows an increase in non-bank deposits and a decline in deposits of banks. Liabilities to banks decreased from 10.7% at

Table 10: **Balance Sheet Totals and Market Share of the Largest Banks**

Bank	Balance sheet total in million SIT			Market share in %		
	Dec. 31st 1996	Dec. 31st 1997	Dec. 31st 1998	Dec. 31st 1996	Dec. 31st 1997	Dec. 31st 1998
NLB (Milano branch included)	490,299	549,225	649,435	28.4	27.2	27.6
NKBM	197,201	237,654	285,029	11.4	11.8	12.1
SKB banka	206,584	241,010	281,184	11.9	11.9	12.0
Banka Koper	99,251	120,299	137,190	5.7	5.9	5.8
Banka Celje	89,504	109,246	135,094	5.2	5.4	5.7
Abanka	88,348	103,055	123,151	5.1	5.1	5.2
Gorenjska banka	71,833	90,706	108,041	4.2	4.5	4.6
Total - top 7 banks	1,243,020.00	1,451,195.00	1,719,125	71.9	71.8	73.0
Total - all banks	1,729,083.00	2,022,037.00	2,351,210	100.0	100.0	100.0

Source: Bank of Slovenia.

end of 1997 to 9.1% at end of 1998. In the same period the liabilities to non-banking sector increased from 67.6% to 70.0% (liabilities to households from 36.1% to 38.0% and those to enterprises from 16.6% to 16.7% of liabilities total).

The share of bank liabilities based on securities issued remained almost unchanged: 2.4% against 2.3% in 1997. Capital accounted for a share of 10.7% (against 11.0% in 1997), other liabilities for 7.8% (a decrease by 0.6% percentage point against 1997).

The average structure of bank assets shows a decrease in loans and advances to banks (from 12.8% in 1997 to 9.3%) and an increase in loans to customers other than banks (from 41.4% in 1997 to 44.2%). Investments in securities kept growing (an increase from 32.3% in 1997 to 33.5%). Cash in hand and accounts with the Bank have accounted for about 3% in the last few years. Other assets have continued on their downward trend of the last few years and accounted for about 10%.

As evident from Figure 10 and Table 11, non-bank deposits – the bulk came from private individuals – prevailed among liabilities, and loans to customers other than banks – the bulk to enterprises – among the bank assets.

Tolar household deposits increased

In the composition of household deposits, the share of Tolar deposits increased to 54.3% (against 48.9% in 1997), and that of foreign exchange deposits declined. The share of foreign exchange deposits amounted to 57.6% (against 55% in 1997) of the banks' foreign exchange liability total.

Liabilities to banks increased by 4.1% (after a decline in two consecutive years), and even more so did loans and advances to banks – by 4.6% (against a decline in 1997 by 30.7%). Foreign exchange time deposits accounted for 83.2% of the loans and advances to banks total, demand deposits for 8.2%, and Tolar deposits for the rest.

Investments in (short-term) securities increased

Banks invested more funds in securities (mainly short-term). In the composition of such assets, the Bank issued bills prevailed, followed by the bank rehabilitation bonds, bonds issued for paid and unpaid foreign exchange deposits of private individuals, bonds issued for rehabilitation of Slovenian Steel-Works and other bonds issued by the Republic of Slovenia.

Whereas the share of investment in securities in the average composition of bank assets increased in 1997 to 29.4% (from 24.6% in 1996), it declined in 1998 by 0.3 percentage points against 1997 (from SIT 628.1 billion to SIT 615.9 billion). The decline was mainly due to lower investment in long-term securities (bonds of the Republic of Slovenia and foreign-currency denominated bonds of foreign issuers). However, in the last two years banks still managed to form additional liquidity reserves and to comply with the requirement to balance the maturity structure of foreign assets and liabilities and with that on open foreign exchange position.

The share of securities held for trading purposes in the average composition of bank assets has been increasing since 1996 and accounted for 4.4% of total bank assets in 1998 (it amounted to SIT 98.5 billion against SIT 61.6 billion at the end of 1997).

Secondary liquidity of banks increased

Bank of Slovenia bills accounted for almost half of the securities portfolio of banks, followed by securities issued by the Republic of Slovenia and securities issued by other public entities and others. **Secondary liquidity** of banks kept rowing and increased to SIT 363.3 billion (against SIT 353.3 billion at the end of 1997) or 15.5% of the balance sheet total.

The share of **foreign exchange liability average of banks in the average bank liabilities total** declined from 35.8% in 1997 to 31.5% at December 31, 1998. Likewise, the share of **average foreign exchange assets** in the **average foreign assets total** declined from 32.8% to 30.2% in the same period, mainly owed to decline in investments in foreign-currency denominated securities issued by the Republic of Slovenia and Bank of Slovenia.

15.3% real increase in profit before tax.

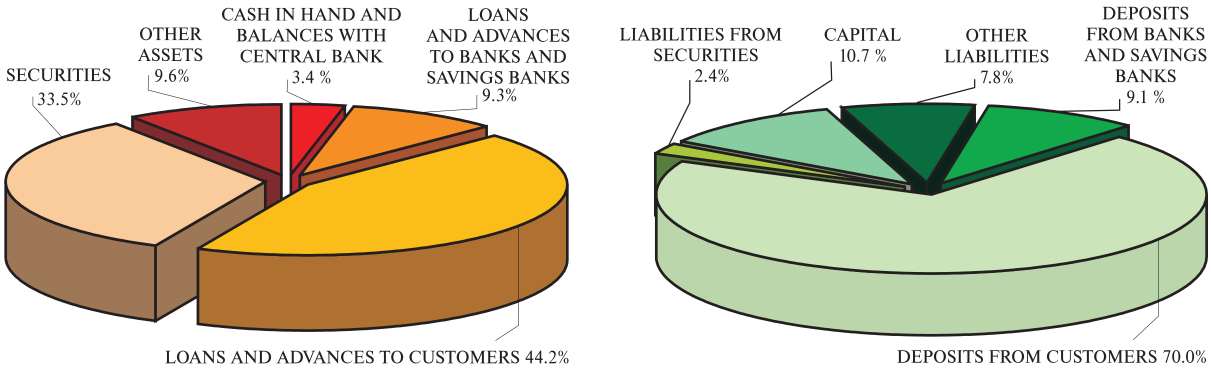
Profit of banks before tax increased by 22.8% in nominal terms (against 15.0% in 1997) and by 15.3% in real terms (against 5.1% in 1997); it amounted to SIT 25.9

Table 11: **Basic Composition of Balance Sheet of Banks** (December 31, 1997 and December 31, 1998 and nominal growth)

	Amount in million SIT		Nominal growth in %	
	Dec. 31st 1997	Dec. 31st 1998*	Dec. 31st 97/ Dec. 31st 96	Dec. 31st 98/ Dec. 31st 97
Cash in hand and balances with central bank	73,888	84,695	26.4	14.6
Loans and advances to banks and savings banks	214,874	224,681	-30.7	4.6
Loans and advances to customers	862,406	1,097,887	18.9	27.3
Securities	689,622	714,424	44.1	3.6
Other assets	181,247	217,682	15.8	20.1
Total assets	**2,022,037**	**2,339,369**	**16.9**	**15.7**
Capital	228,360	257,784	15.3	12.9
Deposits from banks and savings banks	204,085	212,375	-4.6	4.1
Deposits from customers	1,412,196	1,666,938	20.8	18.0
Liabilities from securities	52,418	57,649	41.4	10.0
Other liabilities	124,978	144,623	13.0	15.7
Total liabilities	**2,022,037**	**2,339,369**	**16.9**	**15.7**

* Data of NLB Milano branch, Italy not included
Source: Bank of Slovenia.

Figure 10: **Average Composition of Bank Assets and Liabilities** at December 31, 1998



Source: Bank of Slovenia.

billion (of which revaluation balance accounted for 91% or SIT 23.5 billion). Two banks (against 4 in 1997 and two in 1996) reported losses.

Net interest income earned by banks increased in nominal terms (and remained on the level of 1997 in real terms). Net fees and commissions receivable increased in real terms. Due to general reduction in interest rates the interest expenses declined more than did interest receivable and other income.

Net interest income amounted to almost SIT 90 billion.

The net interest income amounted to SIT 89.7 billion (out of which SIT 32.4 billion owed to revaluation interest); its share in bank income total has been stable at about 80% during the last few years (80.4% in 1996, 80.5% in 1997 and 80.0% in 1998).

Net fees and commissions increased by 5.1% in real terms.

Net fees and commissions earned by banks increased in real terms. Fees and commissions receivable increased more than did fees and commissions payable. Net earnings due to fees and commissions receivable increased by 11.9% in nominal and 5.1% in real terms, deriving mainly from domestic payment operations, administrative services rendered and from credit transactions. The share of fees and commissions receivable in the banks' income has been increasing (from 8.7% in 1996 to 10.4% in 1998).

Net financial operations (profit reduced by loss in financial operations) declined in nominal terms by 11.1% against 1997.

Net provisions allocated and net write-offs by banks amounted to SIT 18.6 billion, i.e. SIT 3.7 billion less than in 1997.

Taking into account the gross profit of banks of SIT 25.9 billion (against SIT 21.1 billion in 1997), net provisions and write-offs of SIT 18.6 billion (against SIT 22.2 billion), the bank accumulation amounted to SIT 44.5 billion (against SIT 43.3 billion in 1997) and was equal to 12.7% of the bank revenue total (against 11.9% in 1997). The bank revenue total amounted to SIT 350.1 billion (against SIT 365.2 billion in 1997).

Table 12: **Average Composition of Bank Assets and Liabilities by Sector** (in % of total assets and nominal growth)

	1997		1998*	
	Average structure	Growth	Average structure	Growth
Assets				
Enterprises	26.0	12.9	27.2	24.5
Household sector	11.7	15.8	12.2	26.6
Central Government	0.3	334.9	1.0	216.2
Other General Government	2.4	53.3	2.5	18.8
Liabilities				
Enterprises	16.6	16.8	16.7	11.9
Household sector	36.1	21.3	38.0	20.0
Central Government	3.6	25.0	3.2	1.1
Other General Government	5.0	9.7	5.2	31.6

* Data of NLB Milano branch, Italy not included
Source: Bank of Slovenia.

Interest expense declined.

Interest payable accounted for the largest share of bank expenditure, even if its share declined against 1997 (from 60.7% in 1997 to 58.7%).

In the composition of higher general administrative expenses in real terms…

…material costs accounted for the largest portion.

In the composition of bank expenditure, general administration expenses accounted for the second largest share; they increased by 3.3 percentage points and reached 20.2%. General administration expenses increased by 12.7% in nominal terms (5.8% in real terms, i.e. somewhat less than in 1997), out of which material costs increased most and accounted for 12.4% of total administrative expenses (due to substantial increase in cost of maintenance of equipment). Services received accounted for 29.3% of general administrative expenses (due to higher cost of advisory, auditing, accounting and other services, rental and lease) and came second in terms of increase. Labor costs followed (especially contributions paid based salaries) and accounted for the more than half of general administrative expenses. Other operating expenses accounted for less than 6% of general administrative expenses and declined in real terms.

Higher return on average assets and on average equity

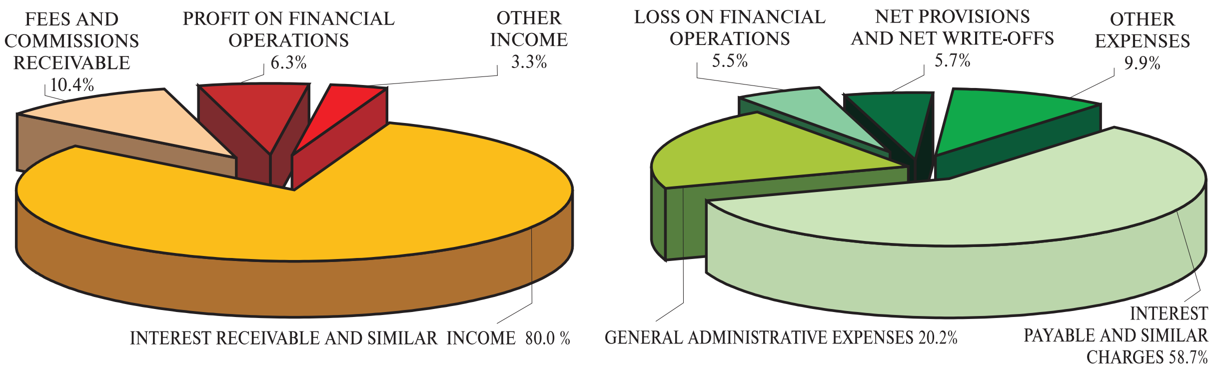
Owing to such good operating results, the **return on average assets and on average equity increased.**

Table 13: **Main Items in Profit and Loss Account of Banks** (1997-1998)

	Amount in million SIT		Share in %		Nominal growth in %	
	1997	1998*	1997	1998	97/96	98/97
Net interest income	84,512	89,737	75.0	73.0	2.2	6.2
Net fees and commissions	26,923	30,130	24.0	25.0	14.0	11.9
Net financial operations	7,462	6,631	7.0	5.0	-942	-11.1
Net other	-6,725	-3,788	-6.0	-3.0	48.6	-43.8
Gross income	112,173	122,709	100.0	100.0	11.2	9.4
Operating expenses	68,846	78,229	61.0	64.0	-16.5	13.6
Net provisions and net write-offs	-22,240	-18,585	20.0	15.0	-5.3	-16.4
Profit before tax	21,087	25,896	19.0	21.0	15.0	22.8

* Data of NLB Milano branch, Italy not included
Source: Bank of Slovenia.

Figure 11: **Composition of Bank Income and Expenses** (in 1998)



Source: Bank of Slovenia.

Operating costs (composed of general administrative expenses- equal to 84% of operating costs total, depreciation, tax, contributions, membership-fees etc.) **over average bank assets decreased to 3.6%** (a reduction by 0.1 percentage point against 1997) and exceeded the international standards.

Interest rates declined owing to interbank agreement on deposit rates.

Deposit and lending rates declined even more than they did in 1997, mainly due to the interbank agreement on maximum deposit rates. The agreement was amended in March and in July 1998 and expired as of March 1, 1999. In line with the amendments interest rate for short-term (by 1.5 percentage point) and long-term (by 1.0 percentage point) deposits were reduced most.

The average lending rate above BR (Base Rate, in Slovenian TOM) declined during the year from 9.3% in January to 5.9% in December for short-term loans, and from 10.7% to 7.2% for long-term loans. Similar was the development of deposit rates above BR: they declined from 3.6% to 0.9% for deposits with maturity between 31 and 90 days, and from 6.0% to 4.2% for deposits with maturity over one year.

Higher credit activity of banks accounted for further reduction in lending rates

Higher credit activity of banks (especially noted in December) contributed, among others, to further reduction in lending rates. Foreign currency loans to corporate clients (by SIT 29.2 billion against a decline by SIT 4.6 billion in 1997) and short-term loans in domestic currency (by SIT 63.4 billion against an increase by SIT 27.8 billion in 1997) increased most, long-term loans in domestic currency a little less (by SIT 45.8 billion).

Due to such credit activity of banks and the reduction of the indexation rate (BR), nominal interest rates p.a. declined substantially: short-term lending rates from 20.1% to 12.3%, long-term lending rates from 21.6% to 13.7%, deposit rates for maturities between 31 and 90 days from 13.8% to 7.0%, deposit rates for maturities above one year from 16.5% to 10.5%, with annual inflation at 6.5%.

Net interest margin reduced…

The net interest margin declined (after an increase from 3.7% in 1994 to 5.6% in 1996) since 1997 to 4.5% in December 1998. It varied from bank to bank between 2.6% and 8.1%.

…and so was the interest spread.

The **interest spread** as the difference between the average nominal lending rate and the nominal deposit rate for clients other than banks declined from 7.5 percentage points in the first quarter (against 8.3 percentage points in the same period of 1997), to 6.2% in the last quarter. In the same period and for the same clients, the interest spread for the real interest rate declined from 4.5 percentage points (against 5.5 % in the first quarter of 1997) to 3.7 percentage points.

Capital adequacy reduced…

Capital adequacy of the banking system increased up to including 1995, mainly due to the requirement for higher regulatory capital imposed by the Bank. It increased from 20.5% in 1994 to 21.5% in 1995. It declined to 19.7% in 1996, to 19.0% in 1997 and to 16.0% at December 31, 1998.

The decline of 1997 against 1996 was due to higher growth of risk weighted assets (by 15.8%) than of regulatory capital (by 11.4%). The pattern continued in 1998 – by the end of the first six months, the weighted risk assets increased by 12.2% and the regulatory capital by 2.2%.

…but remained fairly high.

The capital adequacy of Slovenian banks remains fairly high and enables banks to better manage new risks with their own regulatory capital. It increases the safety net against existing and potential non-performing assets and enables banks to support a considerable growth in risk assets.

At December 31, 1998 no bank's capital adequacy was lower than 9.6% and the highest amounted to 49.9%.

Credit risk criteria tightened gradually

By way of importance, credit risk comes next after the operational risk in Slovenian banks. It is assessed based on criteria set out in the Decree on Classification of Balance and Off Balance-Sheet Items of Banks and Savings Banks (Official Gazette Nos. 78/96, 49/98). The methodology in place between 1993 and 1996 was based on assessment of creditworthiness of the customer, but allowed, under certain circumstances, for classification of a loan, secured by a lien, both on real estate and movable property, as lending in group A, irrespective of the actual credit-standing of that particular borrower. Since January 1997, however, the loan secured by a lien could be graded one higher class than the credit standing of a particular borrower allowed for.

In order to prevent deterioration of the bank credit portfolio due to more stringent criteria, banks were allowed to gradually comply with the requirement for additional allocation of provisions by the end of 1997.

Despite expectations, the bank credit portfolio did not deteriorate by the end of 1997. Many banks had classified loans exclusively on the basis of the credit-standing of the borrower even prior to introduction of the new criteria; besides, banks purchased more securities issued by the Bank (classified group A).

Performing assets accounted for 94.6% of the total.

Slight increase of bad and doubtful assets.

Performing assets (balance sheet claims and off balance-sheet receivables, classified in groups A and B) amounted to 94.6% of the total (a slight increase against 1997). Likewise, the share of bad assets (groups D and E) increased slightly (from 3.2% in 1997 to 3.3%). On the other hand, the share of non-performing assets declined.

Exposure to credit risk increased by 11.8% in real terms.

At December 31, 1998 the aggregate exposure (balance and off-balance) of banks to credit risk amounted to SIT 2,731.4 billion – an increase by 19.1% in nominal and by 11.8% in real terms against 1997. Claims to group B increased most (by 36.8%), and were followed by claims to groups D (increase by 24.7%), E (24.3%) and A (18.3%). The share of B graded claims increased by 6.3% in nominal terms, but decreased in real terms. Value adjustments and provisions made increased by 14.7% and exceeded the minimum required.

Table 14: **Indicators of Bank Efficiency**

	Dec. 31st 1996	Dec. 31st 1997	Dec. 31st 1998
Return on average assets	1.1	1.1	1.2
Return on average equity	10.2	10.3	11.2
Net interest margin	5.6	4.9	4.5
Labour cost/Average assets	1.9	1.9	1.7
Other operating expenses/Average assets	1.7	1.8	1.8

Source: Bank of Slovenia.

Bad and doubtful claims covered to a high degree.

The share of bad and doubtful claims in the gross assets total increased to from 9.4% in 1997 to 10.8%, and so did the share of value adjustments and provisions in gross assets total – from 5.2% to 5.6%. At December 31, 1998, value adjustments of bad and doubtful assets made amounted to 51.7% of the total and were by 3.9 percentage points lower than in the same period of 1997; still, the bank claims of lower grade were provisioned at a high degree, which contributed to the degree of safety and soundness bank of bank operations.

The volume of bad and doubtful balance-sheet assets increased at a faster pace than did the balance sheet total (by 33.3% against 16.3%)

13.4% of all loans to manufacturing

At December 31, 1998, the composition of bank lending was as follows: loans to financial intermediaries 18%, loans to public administration, defense and social security 13.4%, loans to manufacturing 13.4% (primarily to chemical, metal processing and production of machines and equipment).

Loans to trade and motor vehicles' repair businesses accounted for 10%, loans to real estate businesses, leasing companies and business services for about 5% and loans to other businesses for less than 4% each.

Table 15: **Classification of Balance and Off-Balance Sheet Assets of Banks**

Category	Dec. 31st 1996	Dec. 31st 1997	Dec. 31st 1998
A	89.5	90.1	89.6
B	4.2	4.4	5.0
C	2.4	2.3	2.1
D	2.2	1.8	1.8
E	1.6	1.4	1.5

Source: Bank of Slovenia.

3.3. Supervision of Banks and Savings Banks

Up to15 full-scope and 20 examinations of selected areas in banks and savings banks per year.

Supervision and surveillance of banks and savings banks is a continuous process based on regular reports submitted by banks to the Bank, on analyses and control of such reports by the Bank and on on-site examinations. Each year full scope on-site examinations are carried out in up to 15 banks and savings banks in addition to up to 20 examinations of selected areas (target examinations). In line with the banking supervision strategy adopted by the Bank full scope examinations are to be carried out every two years, and targeted examinations every year. Special examinations are carried out to assess the information technology risk. Regular annual meetings take place with the management of banks and savings banks to assess the operating results, the bank standing and their strategic development plans. High importance is attributed to such exchange of views and information between the management and the supervisory authority. Implementation of measures prescribed for elimination of non-compliance and irregularities established is monitored and additional measures taken by the Bank in case of a need on a timely basis.

The 4-eye principle used in supervision.

Analysts and examiners are jointly in charge of surveillance and supervision of banks and savings banks; this means that supervisory activities of the Bank are governed by the four-eye principle.

Analysts assess operating results of banks and savings banks, they participate in licensing procedures, evaluate proposals for new systemic solutions, advise on implementation of principles of prudent, safe and sound banking, monitor compliance of banks and savings banks with respective measures, monitor bank operations based on data and information submitted at least once per month, take measures, if necessary, for elimination of irregularities and monitor their implementation, participate in preparatory actions for on-site examinations, participate in meetings held with banks and savings banks, prepare documents for committees and other bodies of the Bank, etc. Upon detection of non-compliance or irregularity, analysts advise examiners accordingly; based on such information examiners can take an on-site examination into consideration.

Table 16: **Exposure of Banks by Category and Value Adjustments and Provisions Made** (in million SIT)

Category	Dec. 31st 1996		Dec. 31st 1997		Dec. 31st 1998	
	Aggregate exposure	Adjustments, provisions	Aggregate exposure	Adjustments, provisions	Aggregate exposure	Adjustments, provisions
A	1,776,331	158	2,067,463	1,325	2,446,781	683
B	83,785	9,898	100,241	11,772	137,094	15,613
C	47,365	14,926	53,040	17,386	56,363	16,644
D	44,544	30,313	40,352	27,925	50,155	30,774
E	32,558	32,592	32,885	32,877	40,996	41,002
Total	1,984,583	87,887	2,293,981	91,285	2,731,389	104,716

Source: Bank of Slovenia.

30 on-site examinations in 1998

In 1998, as many as 30 on-site examinations (26 in banks, 4 in savings banks) were carried out in banks and savings banks, 14 full-scope (4 in savings banks) and 16 target examinations. For the first time the Bank's examiners carried out an examination in a branch of a domestic bank abroad (Italy). A target examination (mainly IT) was carried out in the Slovenian Export Corporation on its own request.

Control of Y2K compliance

Target examinations of information technology were carried out with special emphasis on the year 2000 compliance.

Liquidation of a bank took place in the second half of 1998 since conditions for its further operation were not met.

The full-scope examinations focused primarily on:

- credit and securities portfolio,
- capital adequacy compliance,
- risk management compliance,
- profitability,
- bank liquidity and deposits of customers,
- adequacy and efficiency of internal control,
- equity investments and fixed assets,
- management of the bank and internal audit,
- information technology with special emphasis on Y2K compliance etc.

Target examinations focused primarily on:

- loans to corporations,
- loans to individuals and individual entrepreneurs,
- securities portfolio,
- correctness of accounting data disclosed,
- information technology etc.

4. OTHER FUNCTIONS

4.1. Management of International Reserves

International reserves of the Bank comprise
- foreign cash and balances on accounts abroad,
- first-class foreign securities purchased,
- monetary gold,
- reserve tranche with the International Monetary Fund,
- SDR holdings with the International Monetary Fund.

At December 31, 1998 foreign exchange reserves of the Bank amounted to USD 3,639 million…

International reserves of the Bank increased from USD 3,315 to USD 3,639 million. The portion of foreign exchange reserves of the Bank (foreign cash, deposits abroad and foreign securities purchased) with a counter-claim of domestic sectors (based on foreign currency denominated Bank bills and foreign exchange accounts of banks and of the Central Government with the Bank) increased from USD 1,779 to USD 1,878 million. The Bank's own foreign exchange reserves (not offset by any counterclaim) increased from USD 1,459 million to USD 1,732 million. Other foreign currency assets of the Bank in addition to such foreign exchange reserves and holdings with the IMF include the balance of the fiduciary account in Luxembourg. Due to its participation in the Operational Budget of the IMF (in lending operations to Indonesia, Sierra Leone and Korea in particular) the holdings with the IMF increased from USD 17 to USD 65 million.

…out of which USD 1,732 million without counter-claim.

The Governing Board sets the guidelines for management of foreign exchange reserves of the Bank and revises them on a quarterly basis. The guidelines include but are not limited to the currency structure, the average maturity of deposits and securities, selection of foreign partner banks (deposits are allowed

Table 17: **International Reserves and Foreign Exchange Reserves of the Banking System** (in million USD)

	BANK OF SLOVENIA						BANKS	TOTAL
	International monetary reserves					Other foreign assets	Foreign exchange reserves	FOREIGN EXCHANGE
	Gold	SDRs	Reserve position in IMF	Foreign exchange	Total			
Dec. 31 1997	**0.1**	**0.1**	**17.4**	**3,297.2**	**3,314.8**	**41.3**	**1,079.7**	**4,394.5**
Jan. 31 1998	0.1	0.5	17.3	3,243.6	3,261.5	46.5	1,035.6	4,297.1
Feb. 28 1998	0.1	0.1	17.4	3,281.7	3,299.3	46.7	1,054.9	4,354.2
Mar. 31 1998	0.1	0.1	17.2	3,268.8	3,286.2	46.9	1,004.0	4,290.2
April 30 1998	0.1	0.4	17.3	3,332.4	3,350.2	47.1	1,028.9	4,379.1
May 31 1998	0.1	0.1	17.2	4,037.2	4,054.6	47.4	928.1	4,982.7
June 30 1998	0.1	0.1	17.1	3,639.1	3,656.4	46.4	941.3	4,597.7
July 31 1998	0.1	0.3	17.2	3,550.7	3,568.3	46.5	1,024.0	4,592.3
Aug. 31 1998	0.1	0.0	39.7	3,530.4	3,570.2	46.5	1,034.6	4,604.8
Sep. 30 1998	0.1	0.0	41.0	3,780.8	3,821.9	46.6	1,107.3	4,929.2
Oct. 31 1998	0.1	0.4	42.1	3,810.4	3,853.0	46.7	1,023.2	4,876.2
Nov. 30 1998	0.1	0.2	46.9	3,684.4	3,731.6	46.6	1,120.9	4,852.5
Dec. 31 1998	**0.1**	**0.2**	**65.4**	**3,572.9**	**3,638.6**	**47.2**	**1,193.7**	**4,832.3**

Source: Bank of Slovenia.

The Bank invested more foreign exchange reserves in securities

only with banks with the highest long-term rating). In line with the strategy of the Governing Board, the Bank increased the portion of foreign exchange reserves invested in securities (primarily issued by sovereign borrowers) and by doing so, increased liquidity and minimized the credit risk.

4.2. Banking Services to Central Government

Cross-border Payments

Pursuant to the Law on the Bank of Slovenia, the Bank clears cross-border payments and performs any other transactions in foreign currencies for the account of the Central Government. The Bank cleared outgoing payments of DEM 1,748 million, incoming payments of DEM 1,457 million, met obligations under letters of credit of DEM 25.9 million, processed DEM 12.1 million of outgoing cash payments and DEM 2.6 million of cash repayments. The Bank sold a total of DEM 307.5 million to, and purchased DEM 137.2 million from the Central Government. Drawings on foreign loans and donations from abroad account for the difference between the two amounts.

The Republic of Slovenia issued eurobonds on international market in amount of ECU 500 million. The bonds were sold in May. In April the Republic concluded a short-term loan agreement of DEM 150 million with foreign creditors (to be utilized on rollover basis up to DEM 230 million) to bridge temporary liquidity constraints of the budget. Further DEM 174.5 million were raised based on bond issue in November.

Slovenia repaid foreign debt of USD 849 million (principal and interest), whereof USD 446 prior to due date

The Republic of Slovenia duly met all its obligations under foreign loans; total repayments amounted to USD 849 million (principal and interest), out of which USD 446 million were paid under bonds issued in 1996 prior to due date. Payments to fiduciary account with Dresdner Bank Luxembourg of obligations (roughly 60% of the total) succeeded to under the 1975 and 1983 Osimo and Rome Treaties respectively, concluded between the former SFR Yugoslavia and Italy totaled USD 5.1 million. At December 31, 1998 the balance on this account totaled USD 35.6 million (interest not included).

Securities Services (Fiscal Stamps and Government Bonds)

Pursuant to the respective agreement, the Bank prepared the issue and distribution of, and took custody of fiscal stamps on behalf of and for the account of the Ministry of Finance.

Administrative and fiscal stamps issued totaled SIT 3.4 billion, and comprised 211,180,000 various tobacco stamps bearing safety features.

The Bank also processed 729,821 coupons redeemed of government bonds RS 01, and 45,191 coupons redeemed of government bonds RS 02.

Cash-processing transactions totaled in 3,195 Tolar and 14,845 foreign currency transactions.

4.3. Processing and Distribution of Cash

The Bank processed and duly distributed Tolar notes within the country. The new cash processing-machine and contributed to better quality of banknotes in circulation by duly sorting out and destroying the worn-out notes.

Nominal value of banknotes in circulation at December 31, 1999 totaled SIT 104.2 billion

At December 31, 1999 94.3 million banknotes of nominal value of SIT 104.2 billion were in circulation (approximately 47 banknotes per citizen; Figure 12; without cash in banks). The volume of banknotes in circulation increased by 9.8%, their value by 19.7% against 1997. The volume increased most with denominations of SIT 10,000 (by 34%) and SIT 200 (by 50%).

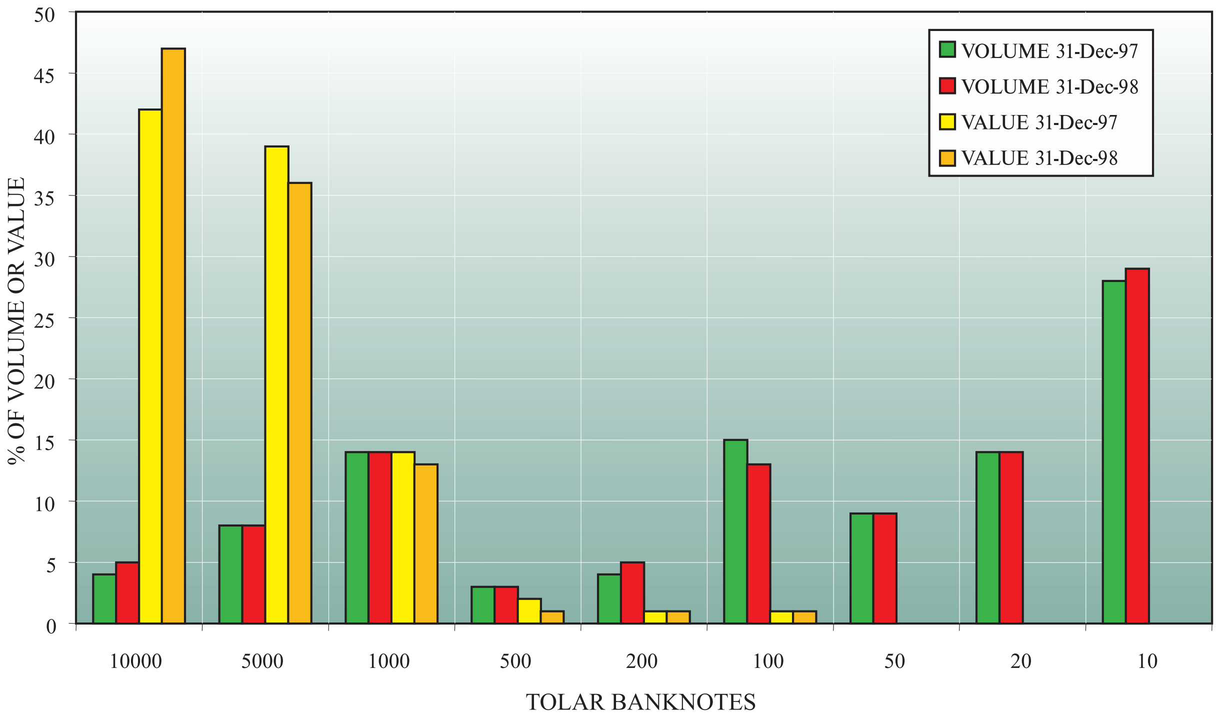
At the beginning of 1998 the Bank had additional quantities of 10 million and 4.5 million pieces of SIT 200 and 5.000 denominations respectively printed to ensure orderly and smooth cash operations.

30.6 million worn-out banknotes destroyed.

The Bank processed 51.7 million banknotes and duly sorted out and destroyed the worn-out and damaged banknotes. 30.6 million banknotes were destroyed (composition by denomination: 4.1 million of SIT 5,000, 10.5 million of SIT 1,000, 4.8 million of SIT 100, 11.2 million of other denominations).

The Bank determined the three months maximum of cash in hand to be kept by regional units of Agency for Payments Processing (APP). The Bank controlled their compliance and their operations on monthly basis. No irregularities were established last year.

Figure 12: **Quantity and Denomination Structure of Bank Notes in Circulation** (end of 1997 and 1998 in %)



Source: Bank of Slovenia.

At December 31, 1998 263 million coins in circulation…

…with nominal value SIT 551 million.

Coins with face value of SIT 5, 2 and 1 in total nominal value of SIT 30.5 million were put in circulation in 1998. Together with coins put in circulation since 1993, a total of 263 million coins were in circulation (on average 131 coins per citizen), an increase by 13% (or 15 coins per citizen) against 1997. Their nominal value amounted to SIT 551 million.

2,978 memorial coins were sold, of which 1,054 golden and 1,924 silver coins. The Bank had three designs for new memorial coins prepared to commemorate selected historical events. No memorial coin was issued in 1998.

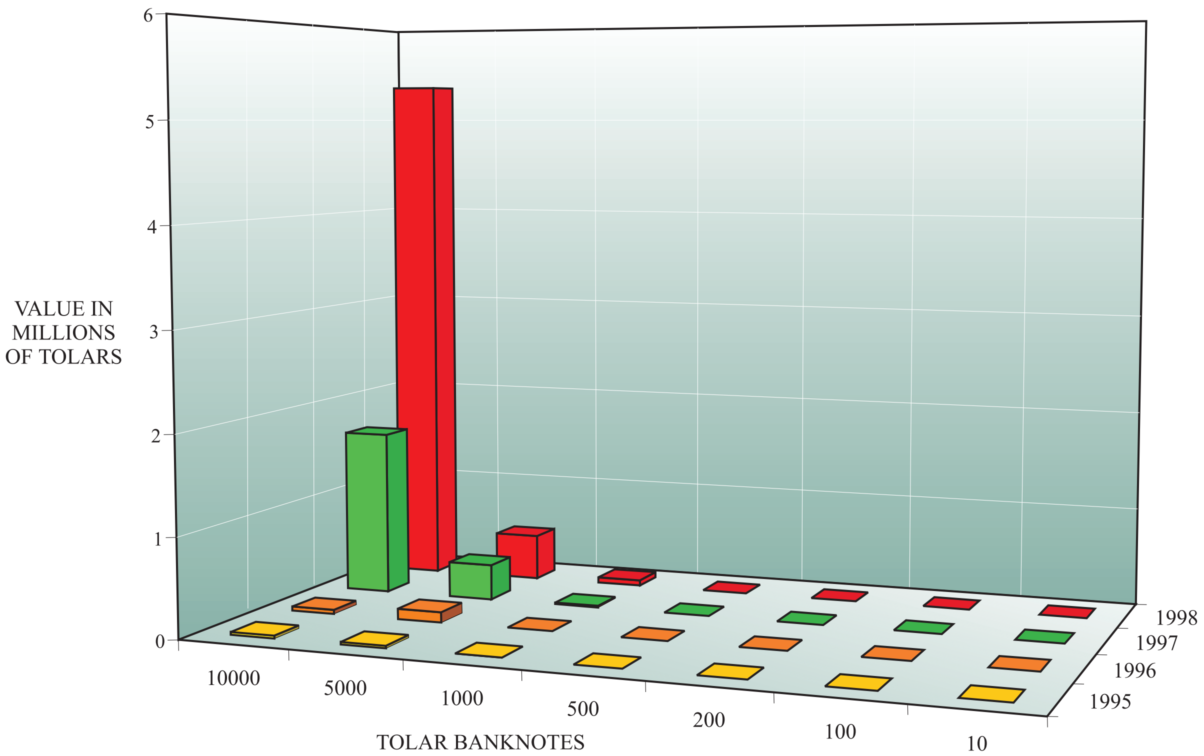
11,960 foreign counterfeit notes discovered

The Bank examined 12,661 counterfeit banknotes discovered and seized on the territory of Slovenia. Most of them were foreign banknotes (11,960) – Italian Lira (an increase by 121% against 1997), German Mark (an increase by 98%) and US Dollar (an increase by 33.3% against 1997).

The volume of Tolar counterfeit notes increased

There were more attempts to cash in Tolar counterfeit notes (color reproductions). The nominal value of Tolar counterfeit notes seized amounted to SIT 5,873,510.00 and is, compared to that of banknote in circulation total, not significant. The Ministry of the Interior requested examinations of 535 counterfeit SIT 10,000 denominations, 93 counterfeit SIT 5,000 denominations, and 56 counterfeit SIT 1,000 and 17 other counterfeit denominations. Compared to 1997, the volume of counterfeit notes increased most in the following denominations: SIT 10,000 (by 218%), SIT 5,000 (by 29%) and SIT 1,000 (by 229%).

Figure 13: **Tolar Counterfeit Notes by Value of Denomination**



Source: Bank of Slovenia.

The activities of Cash Distribution Department comprise storage, distribution and redemption of bills issued by the Bank. The department processed 98,526 bills with warrants, 179,501 coupons and 131,995 renewal coupons, as well as 17,876 twin bills issued and 30,496 twin bills redeemed.

4.4. Payment Systems Reform

Payment systems reform continued

Payment systems reform continued. In addition to the Bank, the following institutions are involved: the Ministry of Finance, Agency for Payments Processing of the Republic of Slovenia, domestic banks, Bankers' Association and Central Statistical Office. After the implementation of Stage I (transfer of mandatory reserves' accounts of banks, savings banks and savings cooperatives to the Bank) in 1997, Stage II was implemented in 1998.

Giro accounts of banks and savings banks transferred to the Bank and to banks…

On April 6, 1998 giro accounts of 28 banks and 1 savings bank were transferred from APP to the Bank and were designated settlement accounts; balances on accounts of remaining savings banks and credit cooperatives were transferred from APP to transaction accounts in banks. As a consequence, the accounts in APP designated 620 (of banks) and 625 (of savings banks and savings cooperatives) had an intra-day function only (balances on these accounts served to settle operations with customers during the day). At close of business balances on these accounts were transferred to settlement and transaction accounts with the Bank and with banks respectively. Real time gross settlement was introduced at the same time.

…and real time gross settlement – RTGS introduced.

The transfer of bank accounts and introduction of real time gross settlement resulted in transfer of interbank payments to the Bank; banks, savings banks and savings cooperatives became direct or indirect participants of the RTGS system.

The number of active (direct) bank participants was reduced to 24 and three additional savings banks opened settlement accounts with the Bank by the end of the year. The Bank itself has had such settlement account opened since the beginning. APP has also had a special "clearing account" opened to serve as the link between the payments operations in APP and the RTGS system in the Bank. The Bank adopted rules and regulations for RTGS and determined contingency procedures in case of system problems in the Bank or in direct participant banks, and in case of any other problems or delays.

The system was available during 189 days in 1998, which corresponded to 99.76% of envisaged availability. 224,270 transactions in total value of SIT 15,216.80 billion were settled (on average, 1,187 transactions of average total value of SIT 67.85 million per day).

Giro clearing (low value payments system) introduced in October

Giro clearing – low value (SIT 3 million and below) non-urgent payments clearing system - was implemented on October 22, 1998, a pilot version of ISVPS, based on respective Decree adopted by the Bank. It is based on multilateral net settlement of processed batch credit orders through RTGS. The role of the Bank is that of clearing and settlement agent. Payments by and to natural persons and by and to banks have been included in the system. Giro clearing reduces cost for participants and encourages banks to introduce electronic data processing at the point of entry.

171,527 credit orders of average value of SIT 99,169 (and total value SIT 17.01 billion) were processed within the 50 days of giro clearing system availability; the net settlement amounted to SIT 4.18 billion or 29.59%. With the threshold amount introduced, the number of credit orders processed through Giro Clearing increased on one hand and the number of transactions settled in RTGS decreased. However, more than 66% of all transactions settled through RTGS in December were still below the threshold.

Respective designated working groups have also done preparatory work for further implementation stages of the reform.

Balances on mandatory reserve accounts transferred to settlement accounts

On December 1, 1998 the balances on mandatory reserve accounts of direct participants in RTGS were transferred to their settlement accounts. The special mandatory reserve accounts have been kept for indirect participants.

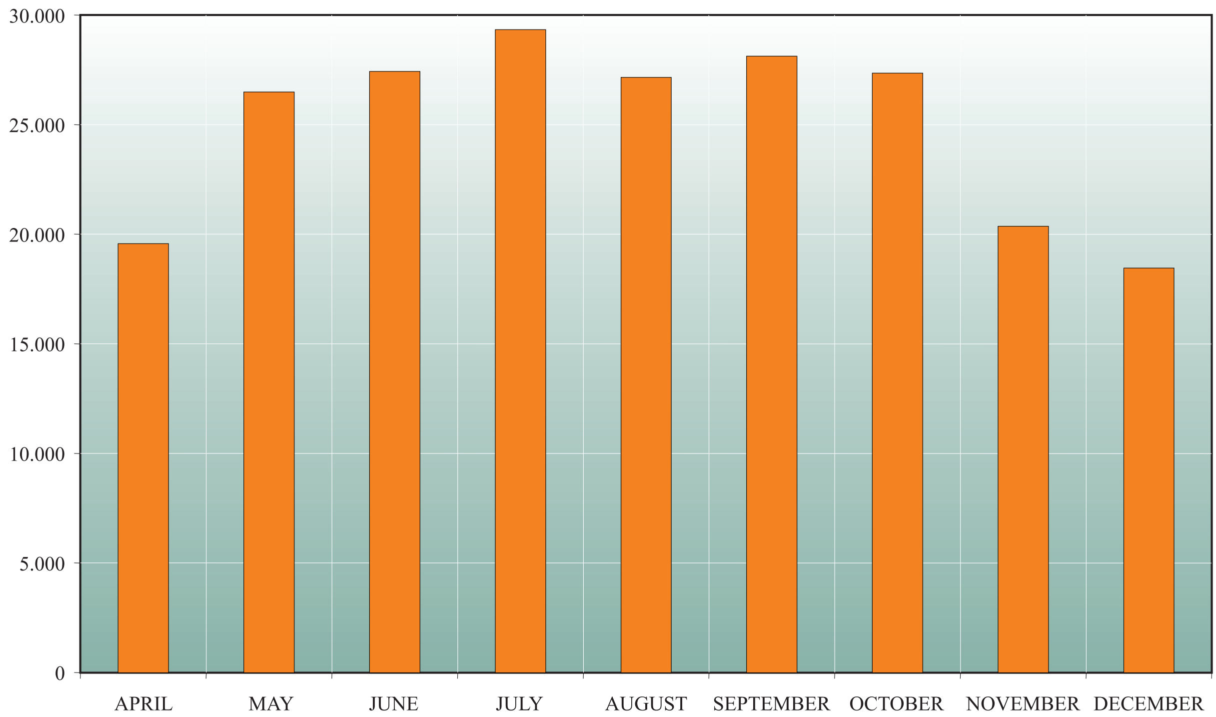
Upon introduction of RTGS, overdrafts of participants' accounts with APP were allowed equal to one quarter of mandatory reserves to enable morning supply of cash needed. Possibility of overdrafts was abolished as of December 2, 1998.

RTGS and Giro Clearing as basic infrastructure of payment systems reform

Transfer of accounts of legal persons from APP to banks is pending.

Implementation of RTGS and of Giro Clearing means establishment of the basic infrastructure necessary for implementation of payment systems reform. Migration from APP to banks of accounts of legal persons will come next. A pilot migration project has been in place to that end. Extensive preparatory work has been done for establishment of central register, for implementation of integral small value payment system (ISVPS), a link to the existing systems, and for reform of cash distribution.

Figure 14: **RTGS Cleared Transactions per Month in 1998**



Source: Bank of Slovenia.

Cash Distribution Reform

Payment systems reform includes migration of cash distribution from APP

Pursuant to respective agreement concluded between the Bank and APP, the Bank has distributed cash through the regional units of APP. Payment systems reform includes migration of cash distribution from APP to banks. Preparatory actions for such migration have taken place.

Contractual depots of banknotes to be located in banks…

The Governing Board of the Bank adopted the guidelines for the new banknote distribution system. The Bank will distribute cash through a system of contractual depots in participating banks. Respective draft agreements and rules and regulations for the participating banks have been prepared.

…and just one depot for coins.

Likewise, the Board adopted rules and regulations for distribution of coins. These are to be held in one single depot.

Initially and in the scope of preparatory work for migration of cash distribution the Governing Board of the Bank adopted an operational plan for collection of cash from legal persons by a selected group of banks; any other bank was able to join the group later on. Banks were invited to participate in the tender for depositary. Their bids were evaluated in line with criteria adopted. Final selection was not completed by the end of the year.

4.5. Financial Statistics

Pursuant to the National Program of Statistical Research the Bank is obliged to collect and publish data on banking and monetary statistics, balance of payments, international investment position and interest rate statistics.

Main macroeconomic data are published in the Monthly Bulletin, which is available in hard copy and on the Bank's Internet home page (Slovenian and in English versions). Data on Slovenian investment position are published in the Bank's annual Investment Report (the next issue is expected to be published in the first half of 1999). The quarterly publication on domestic financial market (in Slovenian only) was first issued in 1998.

Data are also regularly directly conveyed to domestic and foreign users and various international organizations, especially to the International Monetary Fund and Eurostat.

Basic economic and financial data for Slovenia published on the web site in line with IMF Special Dissemination Standards

The Bank is national coordinator (and cooperates with the Central Statistical Office, the Ministry of Finance and the Institute of Macroeconomic Analyses and Development) in the IMF project aiming at introduction and implementation of special data dissemination standards (Dissemination Standards Bulletin Board). The Bank assured – within the flexibility limits stipulated - integrity, consistency, transparency of data, timeliness of publication (in line with the publication calendar) and ready access to such web site by the end of transition period December 31, 1998. The basic economic and financial data are available on the web under http://www.bsi.si/imf/, the duly updated data in Rapid Reports.

The Bank collected data from banks (based on their reports) for the needs of money and balance of payments statistics. In addition 2,600 enterprises provided data on their cross-border transactions with related persons, additional 4,000 enterprises reported on their short-term credit relations (commercial credits taken and given) with non-residents and 1,000 enterprises on transactions and balances on their accounts held abroad.

4.6. International Relations and Cooperation

Cooperation of the Bank with central banks of developed…

The Bank cooperates on regular basis with central banks - members of the Bank for International Settlements (BIS), other central banks and international institutions. The Governor has participated in monthly meetings of governors of the central banks members of the BIS in Basle. The Bank has hosted quite a few foreign central bank officials; on the other hand, short study visits have been made possible to its officials and staff by foreign central banks. Equally beneficial was the active participation of the Bank's officials in specialized seminars, international conferences and roundtables organized by foreign central banks and international institutions and by regional and other associations; they added to better understanding of accomplished transition processes in the Slovenian financial and banking sector by the international financial community and by foreign investors.

… and with those of countries in transition.

On the other hand, the Bank has gladly shared information and its own know-how and experience with central banks of other countries in transition and EU candidate countries. The Bank officials also participated in different regional conferences and fora; the Bank is to host of the regional group conference of bank supervisors in September 1999.

Active participation in negotiations for EU accession…

The Bank officials have played an active role in bilateral negotiations between the European Commission and the six out of 11 candidate countries initiated after April 1998. They participated in bilateral screenings of legislation and in preparatory work for negotiations concerning financial services, capital transactions and economic and monetary union. The Bank participated in preparation of respective documents. Its officials and staff participated in working groups and delegations.

…and in endeavors for comprehensive solution of succession to former central bank of former SFRY in BIS, Basle

The Bank continued to pursue a comprehensive settlement of succession to and division of the assets of the former central bank of the former SFR Yugoslavia held in the books of the Bank for International Settlements and the shares registered in the name of that central bank. Likewise, the Bank officials participated in negotiations on succession to the former SFR Yugoslavia pursuant to the Dayton Accord.

Slovenia participated in the IMF operational budget, the first country in transition ever.

The Executive Board of the International Monetary Fund (IMF) included Slovenia - the very first country in transition - on the list of members considered sufficiently strong as to participate in the Operational Budget of the IMF; its effective participation amounted to SDR 33.6 million.

Slovenia endorsed the increase in quotas of IMF members under Eleventh General Review…

Slovenia endorsed the quota increase pursuant to the Board of Governors Resolution No. 53-2 on 45% increase in Quotas of Fund Members under Eleventh General Review. When the increase becomes effective, its quota will increase from SDR 150.5 million (at December 31, 1998, whereof the reserve tranche SDR 46.5 million) to SDR 231.7 million, its share from 0,0103% to 0,109% of voting rights total.

…and fourth amendment of IMF Articles of Agreement.

Slovenia also endorsed the proposed fourth amendment of the Articles of Agreement of the IMF on new SDR allocation; when the Amendment will have entered in force, Additional SDR 18.7 million will be allocated to Slovenia.

5. FINANCIAL STATEMENTS

Statement of responsibilities of the Governing Board

The Law on the Bank of Slovenia (the Bank) and the Statutes of the Bank require the Governing Board to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the surplus or deficit of the Bank for that period. In preparing those financial statements the Governing Board is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Governing Board has a general responsibility for taking such steps as are reasonably open to it to safeguard the assets of the Bank.

To the Governing Board

of the Bank of Slovenia

We have audited the balance sheet of the Bank of Slovenia ("the Bank") as of 31 December 1998 and 1997 and the related statement of income and expenditure and of cash flows for the years then ended as set out on pages 71 to 84 ("the financial statements"). These financial statements are the responsibility of the Bank's Governing Board. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing as promulgated by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respect, the financial position of the Bank as of 31 December 1998 and 1997, and of the results of its operations and its cash flows for the years then ended in accordance with International Accounting Standards and Slovenian law.

PricewaterhouseCoopers AG
A. Schönenberger
Authorised Auditors

K. Morscher

Zürich, 30 March 1999

Statement of income and expenditure

for the year ended 31 December (in thousands of tolars)

	Notes	1998	1997
Operating income:			
Income from financial assets		**29,188,477**	19,475,274
Net foreign exchange gain/loss		**-4,753,204**	16,797,269
Total income from financial assets	4	**24,435,273**	36,272,543
Expenses on serviced liabilities	5	**24,701,239**	17,726,605
Net investment income		**-265,966**	18,545,938
Other income	6	**1,298,867**	381,215
Total operating income		**1,032,900**	18,927,152
Operating expenses	7	**3,209,483**	3,346,753
Provisions		**312,459**	718,260
Operating surplus/deficit available for appropriation		**-2,489,042**	14,862,139
Appropriations:			
Transfer/Release to foreign exchange reserves		**-4,753,204**	16,797,269
Financial results after the appropriation of net foreign exchange gain/loss		**2,264,162**	-1,935,130
Transfer/Release to general reserves		**1,456,669**	-1,935,130
Total transfer/release to reserves	12	**-3,296,535**	14,862,139
Provision for transfer of surplus to the budget of RS		**807,493**	
Total appropriations		**-2,489,042**	14,862,139

Balance sheet

at 31 December (in thousands of tolars)

	Notes	1998	1997
Assets			
Financial assets	8	**614,040,090**	593,440,585
Fixed assets	9	**2,371,916**	2,071,656
Total assets		**616,412,006**	595,512,242
Liabilities and reserves			
Serviced liabilities	10	**462,063,001**	457,733,748
Banknotes in circulation	11	**104,667,380**	85,652,534
Provision for transfer of surplus to the budget of RS		**807,493**	
Total liabilities		**567,537,875**	543,386,282
Reserves	12	**48,874,131**	52,125,959
Total liabilities and reserves		**616,412,006**	595,512,242

The notes on pages 73 to 84 form an integral part of the financial statements.

Statement of cash flows

for the year ended 31 December (in thousands of tolars)

	Notes	**1998**	1997
Cash flows from operating activities			
Interest received		**28,824,135**	16,284,942
Interest paid		**-24,549,041**	-18,415,650
Other		**-2,099,338**	-3,234,318
Net cash flow from operating activities	13	**2,175,756**	-2,130,708
Cash flows from investing activities			
Disbursements		**-21,435,755**	-195,779,958
Increase in foreign deposits		**-18,078,989**	-200,162,610
Increase in fixed assets		**-621,801**	-581,501
Other		**-2,734,964**	4,964,153
Net cash flow from investing activities		**-21,435,755**	-195,779,958
Cash flows from financing activities			
Issue of circulating currency		**19,094,420**	13,715,657
Bank of Slovenia bills, net	14	**-6,231,496**	170,231,887
Other, net		**-5,504,370**	15,427,471
Net cash flow from financing activities		**7,358,554**	199,375,014
Exchange rate effect		**-428,180**	-1,828,847
Net cash flow from all activities		**-12,329,625**	-364,499
Opening cash balance		**-62,011,438**	-61,646,939
Closing cash balance	15	**-74,341,064**	-62,011,438
Increase (decrease) in cash balance		**-12,329,625**	-364,499

The notes on pages 73 to 84 form an integral part of the financial statements.

These financial statements were approved by the Governing Board on 30 March 1999 and were signed on its behalf by:

Dr. France Arhar
President of the Governing Board and
Governor of the Bank of Slovenia

In accordance with Article 82 of the Law on the Bank of Slovenia these financial statements have still to be approved by the Parliament of the Republic of Slovenia.

Notes to the financial statements

1 Constitution

The Bank of Slovenia (the Bank) is the central bank of the Republic of Slovenia. It was constituted by the Law on the Bank of Slovenia dated June 25, 1991. The Bank is self governing and is an independent institution with its own distinct legal personality. The Republic of Slovenia guarantees the obligations of the Bank which is supervised by Parliament. The Bank is responsible for the stability of the national currency and for the liquidity of the Slovenian banking system.

2 Accounting standards and conventions

These financial statements have been prepared in accordance with International Accounting Standards (IAS) as promulgated by the International Accounting Standards Committee under the historical cost convention, except as detailed below. These were adopted by the Governing Board at the 90th meeting on 9 May 1995.

3 Specific accounting policies

Income recognition

Interest income is recognised in the statement of income and expenditure as it accrues, other than interest of doubtful collectibility which is credited to a suspense account and excluded from interest income. The closing balance of the suspense account is netted in the balance sheet against accrued interest receivable. Suspended interest is written off when there is no longer any realistic prospect of it being recovered.

Fees and commissions receivable mainly arise from payment and settlement services, supervisory and regulatory functions and the distribution of fiscal stamps on behalf of the state.

Foreign currencies

Foreign currency financial assets and liabilities have been translated into Tolars (SIT) using the middle exchange rates of the Bank of Slovenia applying at the balance sheet date. Transactions in foreign currencies have been translated into SIT using exchange rates applying on the settlement dates of those transactions.

Marketable securities

The Bank invests in marketable securities as a part of its management of international reserves. Marketable securities are carried at the lower of amortized cost and market value.

Bills with warrants

The discount and coupon on bills with warrants, which are included in serviced liabilities, are amortised over the total period over which the bills and any related financing are outstanding, in proportion to the value of the related indebtedness. Future potential discount costs inherent in the warrants outstanding on bills in issue is estimated by the Bank and the amortisation related to the current year is accrued in the accounts as an expense and liability. Amounts are adjusted in future periods as the actual utilisation and value of warrants presented is determined.

Derivative financial instruments

The bank does not use derivative financial instruments except foreign exchange swap arrangements with domestic banks for purposes of implementing monetary policy and managing loans to banks. The amounts related to foreign exchange swap agreements are not recognised in the balance sheet until the settlement date.

Banknotes in circulation

Banknotes issued by the Bank represent a charge on the Bank in favour of the holder and are recognised as a liability at face value.

Fixed assets

Investment properties located in Austria are carried at fair value and are not depreciated. The Bank's policy is to obtain an outside appraisal and revaluation of these properties once every 5 years. All other fixed assets are stated at cost and net of depreciation except for land, which is not depreciated. Property revaluations are taken to reserves.

Depreciation is provided on a straight line basis so as to write off the cost of the assets over their estimated useful lives at the following annual percentage rates:

Buildings	1.3 – 1.8 %
Computers	20 – 33 %
Other equipment	10 – 25 %

Gains and losses on disposal of fixed assets are determined as the difference between net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the statement of income and expenditure.

Reserves

In accordance with the Law on the Bank of Slovenia, net foreign exchange gains are transferred to foreign exchange reserves. Foreign exchange reserves can only be used for covering the realised foreign exchange loss. Any remaining surplus after transfer to the general reserves is appropriated by the Republic of Slovenia. A loss is covered from the Bank's general reserves; if these prove insufficient, the loss shall be covered from the budget of the Republic of Slovenia.

Taxation

The Bank is not subject to Slovenian profit taxes.

Cash flows

Cash is defined as net freely transferable cash in convertible currency and demand deposits.

Cash flows from investing activities comprise cash movements in Bank portfolios, arising from the performance of the functions of the central bank. Also included are cash flows arising from movements in IMF Special Drawing Rights and fixed assets. Cash flows from financing activities are those arising from the issue of currency, the issue of Bank of Slovenia bills and movements in

Republic of Slovenia deposits. Operating activities include income and expenditure cash flows not included as investing or financing activities.

Cash movements in portfolios have been presented net.

Changes in accounting policies

There have been no changes in accounting policies since the previous year.

4 Income from financial assets

	1998	1997
	SIT 000's	SIT 000's
Income from foreign currency assets		
Interest on deposits	**14,220,406**	13,406,427
Investment income on marketable securities, net	**13,075,654**	4,199,909
Interest on International Monetary Fund deposits	**97,361**	38,792
Net foreign exchange gain/loss	**-4,753,204**	16,797,269
Total	**22,640,216**	34,442,396
Income from domestic currency assets		
Interest on loans to banks	**1,795,057**	1,829,888
Interest on loans to the Republic of Slovenia	**-**	259
Total	**1,795,057**	1,830,147
Total income from financial assets	**24,435,273**	36,272,543

Investment income on marketable securities consists of the following:

	1998	1997
	SIT 000's	SIT 000's
Interest income	**13,438,635**	5,696,788
Gains/loss on sale of securities, net	**1,502,599**	-209,976
Unrealised loss upon revaluation	**1,865,580**	1,286,903
Total investment income on marketable securities, net	**13,075,654**	4,199,909

5 Expenses on serviced liabilities

	1998	1997
	SIT 000's	SIT 000's
Expenses on foreign currency liabilities		
Interest on current accounts and deposits	**398,810**	481,289
Interest on Bank of Slovenia bills	**13,027,670**	11,132,978
Total	**13,426,480**	11,614,267
Expenses on domestic currency liabilities		
Interest on current accounts and deposits	**352,156**	253,206
Interest on Republic of Slovenia deposits	**100,722**	322,768
Interest on Bank of Slovenia bills	**10,821,881**	5,536,364
Total	**11,274,759**	6,112,338
Total expenses on serviced liabilities	**24,701,239**	17,726,605

6 Other income

	1998 SIT 000's	1997 SIT 000's
Fees and commissions receivable	**1,053,882**	191,544
Other income	**244,984**	189,671
Total other income	**1,298,867**	381,214

7 Operating expenses

	1998 SIT 000's	1997 SIT 000's
Staff costs	**1,697,726**	1,575,259
Commissions and fees for banking services	**286,227**	676,430
Administration costs	**1,052,596**	931,008
Printing and minting costs	**69,662**	56,062
Other	**103,272**	107,994
Total	**3,209,483**	3,346,753

8 Financial assets

	1998				1997
	Repricing period				
	Up to 3 months	3 to 12 months	Over 1 year	Total	Total
	SIT 000's				
Foreign currency assets					
Cash and deposits	**254,419,937**	**6,124,696**	**-**	**260,544,633**	374,859,599
Marketable securities	**79,522,505**	**93,573,355**	**141,563,750**	**314,659,610**	182,213,240
Receivables from the Republic of Slovenia	**-**	**1,007,821**	**5,773,576**	**6,781,396**	6,482,555
International Monetary Fund	**10,582,039**	**-**	**-**	**10,582,039**	2,951,443
Accrued interest and other	**2,953,389**	**1,876,809**	**3,518,126**	**8,348,325**	7,773,160
Total	**347,477,870**	**102,582,681**	**150,855,452**	**600,916,003**	574,279,997
Domestic currency assets					
Receivables from Succession Fund of the RS	**-**	**-**	**8,649,807**	**8,649,807**	8,649,807
Loans to banks	**3,868,937**	**107,744**	**174,412**	**4,151,094**	10,140,444
Accrued interest and other	**113,188**	**20,879**	**189,119**	**323,187**	370,337
Total	**3,982,125**	**128,623**	**9,013,338**	**13,124,087**	19,160,588
Total financial assets	**351,459,995**	**102,711,304**	**159,868,790**	**614,040,090**	593,440,585

Average effective interest rates on financial assets.

	1998				1997
	Repricing period				
	Up to 3 months	**3 to 12 months**	**Over 1 year**	**Total**	Total
			%		
Foreign currency assets					
Cash and deposits	**4.02**	**3.09**	**-**	**4.00**	3.84
Marketable securities	**3.75**	**4.64**	**4.90**	**4.53**	4.41
Receivables from the Republic of Slovenia	**-**	**-**	**-**	**-**	-
International Monetary Fund	**2.98**	**-**	**-**	**2.98**	1.53
Domestic currency assets					
Receivables from Succession Fund of the RS	**-**	**-**	**-**	**-**	-
Loans to banks	**7.97**	**8.70**	**8.00**	**7.99**	14.07

Deposits with other banks and loans to other banks have a carrying amount equal to the principal less specific provisions (1998: SIT 891 million; 1997: SIT 579 million). Interest is paid on maturity.

Market value of marketable securities is SIT 316.973 million (1997: SIT 182.319 million) and it exceeds the book value for SIT 2.313 million (1997: SIT 106 million). Marketable securities pay interest mostly semi-annually.

The deposits with the International Monetary Fund represent the Reserve Tranche Position and Special Drawing Rights (SDR) and pay interest on a quarterly basis.

Receivables from the Republic of Slovenia have a carrying value equal to principal and are mostly funded by Special Drawing Rights allocations. Interest borne on the funding is recharged directly to the Republic.

The Succession Fund of the Republic of Slovenia was established in February 1993 (Official Gazette of the Republic of Slovenia 10/93) as an intermediary in the process of the division of assets and liabilities of former Yugoslavia. It assumed, on behalf of the Republic of Slovenia, all the claims on and the obligations to the former National Bank of Yugoslavia which included SIT 8,650 million due to the Bank. This amount will be repaid after the settlement of claims and liabilities of the Republic of Slovenia and the states of the former SFR Yugoslavia. The amount is not interest bearing and has no fixed repayment term and therefore the fair value of this asset is less than the carrying value. Due to the uncertainty relating to the likely repayment term of this asset, no estimation of the fair value has been provided. However, the Governing Board considers that the carrying value of this asset fairly represents the amount which will be recovered.

The Governing Board considers that the fair value of financial assets, except as mentioned above, is not materially different from the carrying value.

The effective interest rates shown represent average interest at the end of the reporting period.

Currency concentration and maturity analysis

The nature and manner in which the Bank conducts its operations, principally in relation to monetary policy management and foreign currency reserve management, give rise to currency concentrations in the financial assets. This primarily arises from country and counterparty concentration of exposures.

Basic guidelines for the management of the Bank's international reserves are set by the Governing Board of the Bank and revised on a quarterly basis; the guidelines prescribe the currency structure, average term of deposits and of investments in foreign securities, as well as selection of foreign banks.

These concentrations of risk by currency and type of counterparty are as follows at 31 December 1998.

	SIT	DEM	USD	Other	Total
	%	%	%	%	%
Sovereign issuers	**1.45**	**24.79**	**17.40**	**10.16**	**53.80**
Domestic banks	**0.69**	**-**	**-**	**-**	**0.69**
Foreign banks	**-**	**32.91**	**5.97**	**6.63**	**45.51**
31-Dec-98	**2.14**	**57.70**	**23.37**	**16.79**	**100.00**
31-Dec-97	4.66	63.20	23.89	8.25	100.00

Financial assets at 31 December 1998 will mature within the following periods analysed by currency (in SIT 000's):

	SIT	DEM	USD	Other	Total
Up to 1 month	**3,790,008**	**127,583,954**	**38,161,792**	**33,619,655**	**203,155,409**
1 to 3 months	**192,118**	**117,346,862**	**8,245,842**	**11,975,637**	**137,760,459**
3 to 12 months	**128,623**	**56,125,731**	**29,987,043**	**16,469,907**	**102,711,305**
1 year and over	**9,013,339**	**53,244,051**	**67,130,139**	**41,025,389**	**170,412,918**
31-Dec-98	**13,124,087**	**354,300,598**	**143,524,816**	**103,090,589**	**614,040,090**
31-Dec-97	27,656,839	375,048,073	141,781,780	48,953,894	593,440,585

Credit Risk Concentration

All marketable securities are interest bearing bonds. All marketable securities and deposits are held with foreign banks.

All foreign banks in which the Bank places funds have a credit rating of at least AA- as graded by Fitch IBCA. The maximum credit risk exposure at 31 December 1998 in the event other parties fail to perform their obligations is the amount recorded in the financial statements as financial assets. Sovereign issuers' exposure consists of OECD countries, the Republic of Slovenia and the Succession Fund of the Republic of Slovenia. Loans to domestic banks are collateralized. The Governing Board believes that there is no significant concentration of credit risk.

9 Fixed assets

	Land and buildings SIT 000's	Computers & equipment SIT 000's	Total SIT 000's
Cost or valuation			
At 1 January 1997	1,608,763	1,154,892	2,763,655
Additions	204,386	469,536	673,922
Disposals	-26,367	-21,605	-47,972
At 1 January 1998	1,786,782	1,602,823	3,389,605
Additions	159,998	493,282	653,280
Disposals	0	-92,511	-92,511
At 31 December 1998	**1,946,780**	**2,003,594**	**3,950,374**
Depreciation			
At 1 January 1997	516,647	589,615	1,106,262
Disposals	-8,973	-20,291	-29,263
Charge for the year	14,011	226,939	240,950
At 1 January 1998	521,685	796,263	1,317,949
Disposals	0	-91,464	-91,464
Charge for the year	15,904	336,071	351,975
At 31 December 1998	**537,589**	**1,040,870**	**1,578,459**
Net book value			
At 31 December 1998	**1,409,191**	**962,724**	**2,371,916**
At 31 December 1997	1,265,097	806,560	2,071,656

Included in land and buildings at 31 December 1998 and 1997 is an amount of SIT 500 million relating to investment properties in Austria. These properties are valued on the basis of outside appraisals received in 1995 as approved by the Governing Board. The basis of the appraisal was a multiple of rental earnings and the price at which property transfers were taking place in the same neighbourhood.

10 Serviced liabilities

	1998				1997
	Repricing period				
	Up to 3 months	3 to 12 months	Over 1 year	Total	Total
	SIT 000's				
Foreign currency liabilities					
Current accounts and deposits	**16,355,582**	**-**	**-**	**16,355,582**	12,693,522
SDR allocation	**5,772,178**	**-**	**-**	**5,772,178**	5,804,986
IMF and other international financial organisations	**-**	**-**	**58,551**	**58,551**	39,978
Bank of Slovenia bills	**231,998,860**	**52,866,255**	**-**	**284,865,115**	291,862,902
Accrued interest and other liabilities	**23,201**	**5,511**	**-**	**28,712**	40,256
Total	**254,149,821**	**52,871,766**	**58,551**	**307,080,137**	310,441,644
Domestic currency liabilities					
Current accounts and deposits	**66,515,431**	**-**	**-**	**66,515,431**	57,258,570
Bank of Slovenia bills	**45,437,035**	**34,467,279**	**-**	**79,904,314**	75,674,220
Republic of Slovenia deposits	**2,316,795**	**-**	**-**	**2,316,795**	11,278,732
Accrued interest and other liabilities	**1,488,264**	**500,222**	**4,257,837**	**6,246,323**	3,080,583
Total	**115,757,525**	**34,967,501**	**4,257,837**	**154,982,864**	147,292,104
Total serviced liabilities	**369,907,346**	**87,839,267**	**4,316,388**	**462,063,001**	457,733,748

Average effective interest rates on serviced liabilities.

	1998				1997
	Repricing period				
	Up to 3 months	3 to 12 months	Over 1 year	Total	Total
	%				
Foreign currency liabilities					
Current accounts and deposits	**4.02**	**-**	**-**	**4.02**	4.80
SDR allocation	**-**	**-**	**-**	**-**	-
IMF and other international financial	**-**	**-**	**-**	**-**	-
Bank of Slovenia bills	**3.81**	**3.91**	**-**	**3.83**	4.45
Domestic currency liabilities					
Current accounts and deposits	**0.97**	**-**	**-**	**0.97**	0.49
Bank of Slovenia bills	**7.60**	**8.63**	**-**	**8.04**	12.20
Republic of Slovenia deposits	**1.00**	**-**	**-**	**1.00**	3.08

The interest rates shown represent average interest at the end of the reporting period.

The SDR allocation liability carried an interest rate of 3,64% at 31 December 1998, (1997: 4,19%). Interest paid by the Bank is recharged directly to the Republic of Slovenia, thereby giving a nil effective interest rate.

Bank of Slovenia bills

Bank of Slovenia bills are comprised of the following at 31 December:

	1998	1997
	SIT 000's	SIT 000's
Foreign currency bills	**283,214,286**	291,836,953
Tolar bills	**66,769,502**	58,387,691
Bills with warrants	**11,469,694**	17,259,789
Twin bills	**3,315,947**	52,689
Total Bank of Slovenia bills	**364,769,429**	367,537,122

Tolar bills are issued with maturities from two to two hundred and seventy days. Foreign currency bills are issued at a discount in either USD or DEM with maturities from two to twelve months. Twin bills are short-term securities issued in bearer form which are comprised of a Tolar and a foreign currency part. They can be bought in Tolars at a discount with redemption in Tolars and in DEM. Bills with warrants are short-term securities issued in bearer form in Tolars. Warrants attached to the bills enable the holder to buy new Tolar bills (without additional warrant) or foreign currency bills at a discount.

Currency concentration and maturity analysis

Financial liabilities at 31 December 1998 will mature within the following periods analysed by currency (in SIT 000's):

	SIT	DEM	USD	Other	Total
Up to 1 months	**106,678,686**	**77,290,762**	**17,624,343**	**2,094,117**	**203,687,907**
1 to 3 months	**9,078,841**	**133,330,808**	**18,037,583**	**30**	**160,447,261**
3 to 12 months	**34,967,501**	**38,975,983**	**13,890,272**	**5,511**	**87,839,267**
1 year and over	**4,257,837**	**-**	**58,009**	**5,772,719**	**10,088,566**
31-Dec-98	**154,982,864**	**249,597,554**	**49,610,206**	**7,872,377**	**462,063,001**
31-Dec-97	147,292,104	248,881,704	54,296,856	7,263,084	457,733,748

11 Banknotes in circulation

Value of banknotes in circulation by denomination:

		1998	1997
		SIT 000's	SIT 000's
SIT	10	**270,228**	240,023
SIT	20	**268,695**	240,762
SIT	50	**411,192**	371,772
SIT	100	**1,211,213**	1,276,551
SIT	200	**955,190**	623,498
SIT	500	**1,557,116**	1,429,500
SIT	1,000	**13,164,648**	11,959,871
SIT	5,000	**37,090,325**	32,877,515
SIT	10,000	**49,332,600**	36,225,710
Total		**104,261,207**	85,245,202
Tolar coupons		**406,173**	407,332
Total		**104,667,380**	**85,652,534**

12 Reserves

	1998 SIT 000's	1997 SIT 000's
Balance at 1 January	**52,125,959**	37,211,943
Contributions to the welfare fund	**44,707**	51,877
Transfer/Release of foreign exchange reserve	**-4,753,204**	16,797,269
Transfer/Release of general reserve	**1,456,669**	-1,935,130
Balance at 31 December	**48,874,131**	52,125,959
Represented by		
General reserve	**5,072,420**	3,615,749
Welfare fund	**574,681**	529,975
Investment properties revaluation	**500,000**	500,000
Foreign exchange reserve	**42,727,030**	47,480,235
Total reserves	**48,874,131**	52,125,959

The general reserve has been established in recognition of the economic and other risks inherent in the discharge of the Bank's responsibilities, and its portfolio of financial assets.

The foreign exchange reserve relates to cumulative net foreign exchange gains which by law are only available to offset any future net foreign exchange losses and are not distributable.

The welfare fund has been established to provide recreational and other facilities for the staff of the Bank. The assets representing the fund are included in the Bank's balance sheet and any movement in asset values is taken directly to reserves.

13 Reconciliation of operating cash flows with reported operating surplus

	1998 SIT 000's	1997 SIT 000's
Reported operating surplus	**-2,489,042**	14,862,139
Non-cash items		
Net foreign exchange gain/loss	**4,495,062**	-16,797,269
Depreciation	**349,485**	238,774
Total	**4,844,547**	-16,558,494
Movements in other working capital items		
Changes in interest receivable	**-360,893**	-3,179,450
Changes in interest payable	**163,654**	2,554,286
Changes in other accruals	**17,490**	190,811
Total	**-179,749**	-434,353
Net cash flow from operating activities	**2,175,756**	-2,130,708

14 Supplemental cash flow information: cash flows from Bank of Slovenia bills

	1998	1997
	SIT 000's	SIT 000's
Source		
Tolar bills	**8,360,998**	51,466,574
Foreign currency bills	**-**	114,017,134
Bills with warrants	**-**	5,649,722
Twin bills	**3,200,784**	-
Total	**11,561,782**	171,133,430
Disbursements		
Foreign currency bills	**-12,075,647**	-
Bills with warrants	**-5,717,632**	-
Twin bills	**-**	-901,543
Total	**-17,793,278**	-901,543
Total net source	**-6,231,496**	170,231,887

15 Supplemental cash flow information: cash balance

	1998	1997
	SIT 000's	SIT 000's
Foreign currency assets		
Cash	**324,646**	295,984
Total assets	**324,646**	295,984
Foreign currency liabilities		
Demand deposits	**-5,833,429**	-2,769,823
Domestic currency liabilities		
Commercial banks demand deposits	**-62,863,305**	-55,067,421
Non-bank deposits	**-5,968,975**	-4,470,178
Total liabilities	**-74,665,709**	-62,307,422
Cash balance	**-74,341,064**	-62,011,438

Foreign currency cash assets do not include time deposits of SIT 252.863 million.

Foreign currency demand deposits do not include restricted deposits of SIT 10.522 million.

16 Commitments and off balance sheet instruments

Letters of Credit

The aggregate amounts of outstanding letters of credit at the year end were:

	1998	1997
	SIT 000's	SIT 000's
Foreign currency letters of credit	**1,528,370**	3,909,277

Foreign exchange swaps

The Bank entered into certain foreign exchange swap agreements in 1997 which require the Bank to sell DEM for SIT in 1998 in the total nominal value of SIT 8.5 billion. At 31 December 1998 there were no foreign exchange swaps.

	1998	1997
	SIT 000's	SIT 000's
Amounts to be received forward against DEM	-	8,496,251

Because of the short term nature of these transactions, the fair value does not differ materially.

Bills with warrants

The Bank issued SIT 62 billion of bills during 1998 with 335.925 warrants attached. Each bill has a maximum of five (9. issue) or three (10. issue) warrants attached. The warrants represent a contractual obligation by the Bank to sell SIT, DEM or USD bills, with maturities of 180 days to 360 days, at an additional discount based on the value of the warrant. The value of the warrant is calculated by the Bank on a monthly basis and represents the difference between the actual inflation and projected inflation for additional discount on SIT bills and between projected inflation and actual devaluation of SIT against DEM and USD for DEM or USD bills respectively. The warrants have a maturity of 6 months from the date of issue. At 31 December 1998, there were 324.834 issued but unexercised warrants. The future potential discount costs of these warrants are estimated by the Bank and amortised over the total period during which the bills with warrants and the newly issued bills (resulting from the presentation of warrants) are outstanding. The provision for the amortisation estimated for unexercised warrants which relates to the year ending 31 December 1998 is recorded as a liability and expense in the accounts. Amounts are adjusted in future periods as the actual utilisation and value of warrants presented is determined.

Litigation and other provisions

The Bank made a provision in 1997 of SIT 556 mio for deposit liabilities, which arose from the difference on Payment Agency (APP) clearing accounts. According to the findings of both institutions, this difference arose at the monetary independance in 1991. Bank has already in 1992 covered a difference of 135 mio tolars resulting from conversion of dinar balances to tolars, according to the Government of Republic of Slovenia decree (Ur.l.RS št. 8/92). Due to the similar nature of differences Bank will use this provision to cover the clearing account difference.

There are certain legal claims pending or threatened, where the Bank is involved which have not yet been settled. The Governing Board believes that sufficient provision has been made in the accounts for any expected loss from future settlement.

6. ANNEXES

6.1. Legal Status and Tasks

The Bank of Slovenia ("the Bank) was established on June 25, 1991 pursuant to the Law on the Bank of Slovenia and based upon the Constitutional Law on Implementation of the Basic Constitutional Charter on Independence of the Republic of Slovenia. The Bank actually became monetary authority upon introduction of Slovenian legal tender (Tolar), on October 8, 1998.

By Constitution Bank of Slovenia is independent and responsible to Parliament…

Pursuant to Article 152 of Constitution of the Republic of Slovenia, the Bank is independent and directly responsible to Parliament.

The Governing Board of the Bank and the Governor manage the Bank. The Governing Board consists of eleven members: the Governor (Chairman of the Governing Board), Deputy Governor, three Vice-Governors and six external members – independent experts. Parliament appoints the Governor and the six external members upon proposal of the President of State. Parliament appoints the Deputy Governor and the Vice-Governors upon proposal of the Governor. All members of the Board are appointed for a term of six years. The Board takes all decisions by two-third majority.

…and in charge of stability of Slovenian currency and of general liquidity in domestic and cross-border payments.

Pursuant to the law, the main responsibility of the Bank is to maintain stability of the domestic currency and general liquidity of payments within the country and of cross-border payments. To this end, the Bank

- regulates the quantity of money in circulation,
- ensures general liquidity of banks and savings banks and of cross-border payments,
- supervises and surveys banks and savings banks,
- issues banknotes and puts those and coins in circulation,
- prescribes reporting and information systems,
- prescribes rules for implementation of deposit guarantee scheme,
- provides banking services to Central Government.

The Bank has other tasks and responsibilities pursuant to the Law on Banks and Savings Banks, Foreign Exchange Law and Law on Pre-Rehabilitation, Rehabilitation, Bankruptcy and Liquidation of Banks and Savings Banks.

The Bank is independent in adopting and implementing monetary policy and in performing other tasks and responsibilities. The Governing Board and the Governor are accountable to Parliament. The Bank reports to Parliament twice a year, and has its Annual Financial Statements and the financial plan for the current year adopted by Parliament.

Pursuant to the law, the Bank is only allowed to give short-term credit to Republic of Slovenia; the volume of such credit is limited to a maximum of 5% of the budget and of one fifth of the anticipated budget deficit respectively.

6.2. Important Decision and Measures Taken

6.2.1. Monetary Policy Measures

January

Tolar bills
The Bank reduced interest rate on all Tolar bills with maturity between 2 and 60 days.

March

In addition to DEM, the Bank offered to temporarily purchase from banks ATS, ITL, FF and USD; the Bank also offered to net set off such amounts purchased with a new sale by the bank in the same amount and currency at maturity.

Interbank agreement on maximum deposit interest rates
Banks concluded a new agreement to reduce the maximum deposit interest rates for some maturities; it was enforced on March 1, 1998.

April

Amendment to Decree on mandatory reserves of banks and savings banks
With introduction of RTGS compliance related to settlement accounts with the Bank and no longer on giro accounts of banks with APP.

Temporary purchase of foreign exchange from banks by the Bank with obligatory repurchase after 60 days
The Bank first made this instrument available to banks on April 15, 1998.

May

Intervention on foreign exchange markets
The Bank intervened on May 29, 1998 on foreign exchange markets for the first time with its intervention buying rate of 93.90 SIT/DEM. The intervention period ended on July 8.

Special liquidity loan with participation of banks
On May 28, 1998 new agreement was concluded between the Bank and banks on their participation in special liquidity loans during one year. The interest margin which participating banks were allowed to charge to the borrowing banks was raised to 2 percentage points (against former 1.5 percentage points), and compensation rates paid by the Bank to participating banks reduced.

June

Intervention on foreign exchange markets
The Bank set new intervention rate on June 16, 1998 at 94.10 SIT/DEM.

Temporary purchase of foreign exchange from banks by the Bank with obligatory repurchase after 60 days
The Bank made the instrument available to banks for the last time in early June.

July

Interbank agreement on maximum deposit interest rates
Amendment to the agreement came in effect on July 1; accordingly, deposit interest rates were further reduced for some maturities (most for deposits with maturity from 31 to 90 days) and nominal interest rate introduced for deposits up to one month.

Intervention on foreign exchange markets
The Bank set new intervention rate on July 2 at 94.40SIT/DEM; the intervention period expired on July 8.

Temporary purchase of foreign exchange from banks by the Bank with obligatory repurchase after two months — **July**
The Bank made the instrument available to banks at the intervention rate for the first time.

Decree on terms and conditions for purchase of foreign exchange from banks and the right of banks to repurchase it — **August**
The last bank's right to repurchase foreign exchange from the Bank at the Bank's selling rate expired on August 5.

Intervention on foreign exchange markets — **September**
The Bank intervened on foreign exchange markets at intervention rate 94.70 SIT/DEM between September 14 and 21.

270 day Tolar bill with nominal interest rate
The Bank first made the new bill available to banks and savings banks on September 15 at nominal interest rate of 10.78% (corresponding to BR+3%).

28 day Tolar bill
The Bank made the new instrument first available on September 21, and afterwards on regular weekly auctions (every Monday); banks make their bids for the price in percent of nominal value of the bill (this is SIT 10 million). The minimum price set by the Bank usually corresponded to interest rate applied on 60-day bills.

Amendment to Decree on non-balanced foreign exchange claims and liabilities of banks (Decree on open foreign exchange position of banks) — **October**
The transition period originally determined for adjustment and compliance of banks with the Decree adopted in 1997 is abolished.
Banks are obliged to comply with requirement not to have their open foreign exchange position exceed 20% of regulatory capital upon effectiveness of the amendment.

Amendment to Decree on non-balanced foreign exchange claims with foreign exchange liabilities of banks (Decree on open foreign exchange position of banks) — **November**
Open foreign exchange position allowed is reduced to 10% of regulatory capital.

Temporary purchase of foreign exchange from banks by the Bank with obligatory repurchase after two months
The Bank changed the intervention rate three times: on November 3 to 95.39 SIT/DEM, on November 13 to 95.73 SIT/DEM and on November 25 to 96.13 SIT/DEM.

270 day Tolar bill with indexed interest rate
The Bank issued the last series of this bill in mid November and limited its availability to end of 1998.

Amendment to Decree on mandatory reserves of banks and savings banks — **December**
The special reserves account was abolished for direct participants in RTGS (but not for indirect participants). Direct participants complied with the requirement on their settlement accounts with the Bank; in addition, the Bank limited remuneration of such mandatory reserves to the calculated mandatory reserves of the month prior to enforcement of amendment.

December **Temporary purchase of foreign exchange from banks by the Bank with obligatory repurchase after two months**
The Bank changed the intervention rate three times: on December 4 to 96.36 SIT/DEM, on December 15 to 96.38 SIT/DEM and on December 23 to 96.36 SIT/DEM.

Bills with warrants
The Bank issued the 10th issue of such bill, for the fist time not in paper form. The holder of warrants can exercise his right for discount on purchase of foreign currency bills not later than six months from date of issue.

6.2.2. Supervisory Measures

January **Amendment to Instructions for preparation of monthly reports on effective proportion between claims graded first, second and third class**

Amendment to Decree on amount and method of provisioning against potential losses in banks and savings banks
The amendments were necessary in line with amendments to the chart of accounts prescribed to banks and savings banks in force as of December 31,1997.

April **Amendment to Decree on chart of accounts for banks and savings banks**

Amendment to Decree on financial accounts of banks and savings banks

Amendment to Instructions for implementation of Decree on financial accounts of banks and savings banks

Amendments were necessary due to introduction of client transaction accounts in banks and to other changes: e.g. abolishment of giro accounts of banks with APP and introduction of settlement accounts with the Bank.

May **Amendment to Decree on special liquidity loans with participation of banks**

July **Amendment to Decree on amount and method of provisioning against potential losses in banks and savings banks**
Pursuant to this amendment banks are obliged to make general provisions irrespective of capital adequacy ratio until December 31, 2000 at the latest.

Amendment to Decree on classification of balance and off balance sheet items

Amendment to Instructions on implementation of Decree on classification of balance and off balance sheet items

The amendments were due to some exceptions to requirement for value adjustment and provisioning against country risk.

December **Amendment to Decree on chart of accounts of banks and savings banks**

Amendment to Instructions for implementation of Decree on financial accounts of banks and savings banks

December

Amendments were needed due to introduction of international financial standards.

Decree on integrity of data on claims and liabilities of banks and savings banks to a single customer
Introduction of new deposit insurance scheme (effective as of January 1, 2001) pursuant to the new Banking Law necessitated such decree.

Amendment to Decree on detailed determination of terms and conditions and procedures for a banking license and
Amendment to Decree on terms and conditions for a banking license.
The decrees introduce payment of a warranty deposit (at least equal to the minimum capital required) or guarantee of the parent company for establishment of foreign bank branches, determines the scope of liability of such branches, stipulates protection of domestic deposit insurance scheme and the procedures and terms and conditions for the license to CEO of foreign bank branches, defines reciprocity and conclusion of cooperation agreement between the Bank and the supervisory authority in its home country.

Amendment to Decree on supervision of banks and savings banks.
The amendment gives the Bank the authority to supervise branches of EU member countries' banks and stipulates the possibility for division of supervisory tasks based on a respective agreement between the Bank and supervisory authorities of EU member countries.

6.3. Governing Board and Organizational Structure

6.3.1. Changes in Governing Board

Mr. Darko Bohnec was appointed Vice Governor of the Bank for a term of six years by the Parliament on March 4, 1998.

6.3.2. Members of Governing Board at December 31, 1998:

Chairman of Governing Board

Dr. France Arhar
(Governor of the Bank)

Members of Governing Board

Samo Nučič
(Deputy Governor)

Darko Bohnec
(Vice Governor)

Mag. Janez Košak
(Vice Governor)

Andrej Rant
(Vice Governor)

Tatjana Fink
(Trimo, Trebnje)

Mag. Bine Kordež
(Merkur, Kranj)

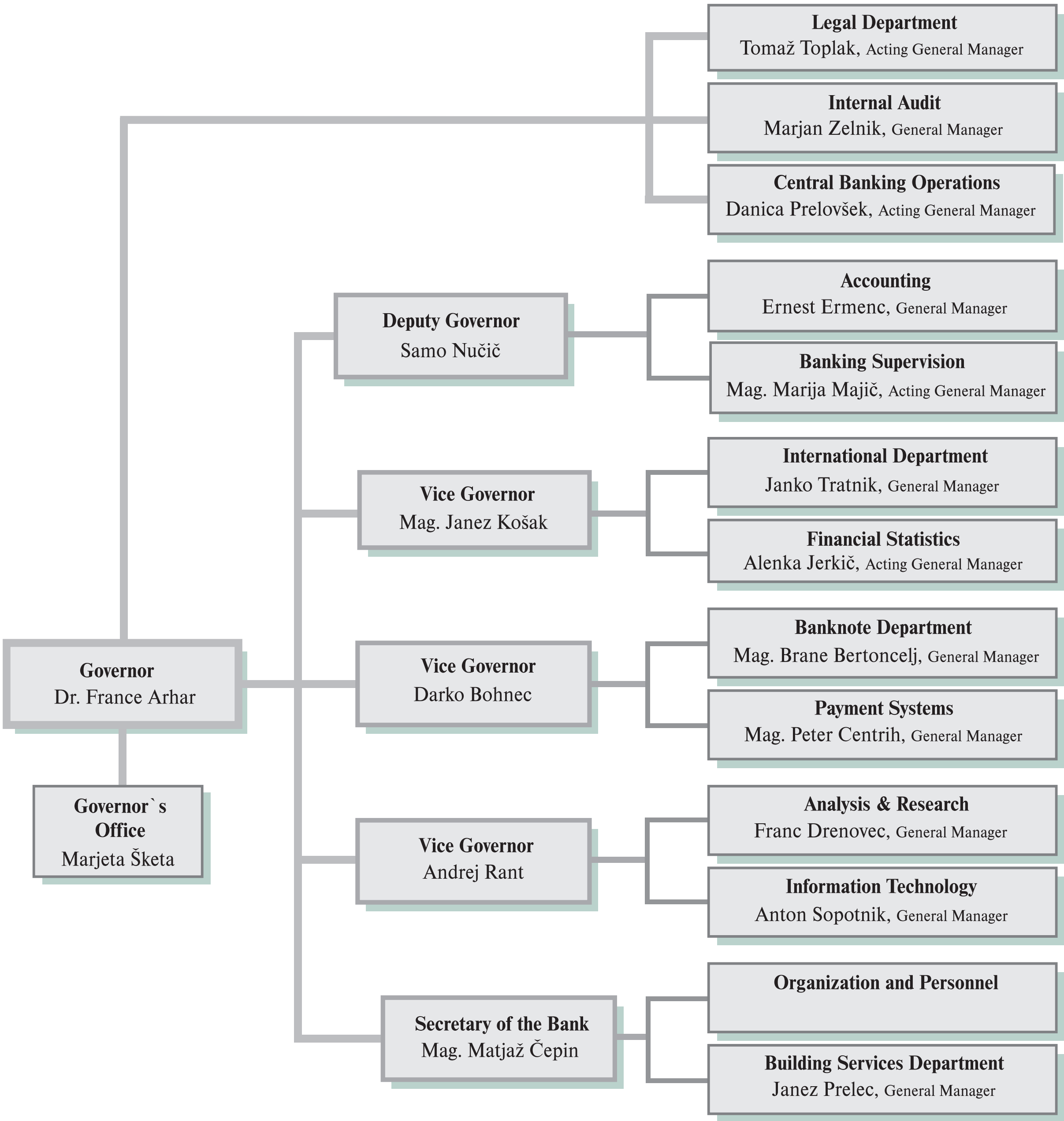
Mag. Vladimir Lavrač
(Institute of Economic Research, University Ljubljana)

Dr. Leon Repovž
(Faculty of Business Administration and Economics, Maribor)

Dr. Ivan Ribnikar
(Faculty of Economics, University of Ljubljana)

Dr. Dušan Zbašnik
(Faculty of Business Administration and Economics, Maribor)

6.3.3. Organization Chart of the Bank of Slovenia at December 31, 1998:



6.4. Publications and Web Site

Title, frequency of issue, language	Content
Monthly Bulletin • Monthly • Slovenian, English	Macroeconomic statistical data; monetary statistics, exchange rates, data on economic relations with foreign countries. Current development in figures; notes on methodology; list of banks holding the Bank's license.
Annual Report • Annual • Slovenian, English	Annual Report as prepared for the Parliament of the Republic of Slovenia. Report on economic development, monetary policy, operation of banks and the Bank, and on other tasks of the Bank.
Report on Supervision of Banking Operations • Annual (first issued in December 1997) • Slovenian, English	Report on operation of banks, on supervision of bank operation, on development of legal supervisory framework as prepared for the Parliament of the Republic of Slovenia.
Direct Investment • Annual (first issued in June 1997) • Slovenian, English	Statistical survey of Slovenian direct investment abroad and of foreign direct investment in Slovenia on annual basis
Surveys and Analyses • Quarterly • Slovenian	Speeches held by the Governor in Parliament, analytical and methodological survey of monetary, balance of payments and other issues.
Financial Markets • Quarterly • Slovenian	Statistical survey of other financial intermediaries, of securities market and interest rates.
Monetary survey • Monthly • Slovenian	Analytical survey of current macroeconomic situation with detailed breakdown/ analyses of monetary and balance of payments development
Web site **Home page index:** **http://www.bsi.si/…** **…/html/eng/index.html**	Presentation of the Bank, presentation of Slovenian banknotes and coins, legal framework concerning activities of the Bank, etc. Up-to-date rates of exchange, interest rates, securities issued by the Bank. Publications.

6.5. Glossary

Balance sheet total: the aggregate amount of bank assets or liabilities.

Foreign currency (denominated) bill (FCB): short-term security issued by the Bank of Slovenia, subscribed and redeemed in foreign currency.

Monetary aggregates (M1, M2 and M3): monetary aggregates with differentiated liquidity grade. **M1** is of highest liquidity grade and comprises banknotes and coins in circulation and sight Tolar deposits with domestic banks and with the Bank of Slovenia. **M2** comprises M1, Tolar savings accounts and time deposits in domestic banks and with the Bank of Slovenia. **M3** comprises M2 and household foreign currency deposits in domestic banks.

Money market: Interbank financial market where first class short-term securities are traded.

Foreign exchange minimum: The minimum amount of foreign exchange reserves or assets that banks are required to hold.

Other assets: Equity investments in related (dependent) and unrelated (independent) parties, tangible fixed assets, intangible long-term assets, capital subscribed but not paid and own shares, prepayments and accrued income and other assets like checks, interest rate claims, commissions etc.

Other liabilities: Accruals and deferred income, long-term and general provisions and other liabilities.

Regulatory capital: The sum total of core (tier 1) and supplementary (tier 2) capital, reduced by direct and indirect capital investments, loans and other equity investments in banks, savings banks and other legal persons fully or majority owned directly or indirectly by the bank, of claims and liabilities (without a first class collateral) to legal persons and individual entrepreneurs owned by bank employees, members of the Board of Management and of the Supervisory Board and by members of their families respectively, and of claims and off-balance sheet items guaranteed by hybrid and debt instruments up to the amount not exceeding that included in the supplementary capital.

Withdrawal of money from circulation: operation opposite to issue or creation of money.

Capital: The sum total of subscribed capital and foundation capital of savings banks, of share premium account, reserves, capital revaluation adjustments, net profit or loss brought forward from the previous period and net profit or loss for the financial year.

Capital adequacy: Ratio between the regulatory capital and risk-weighted assets total.

Monetization: A change in financial assets that banks and the Bank buy, into money; they namely buy such (financial) assets, i.e. claims, (or extend credits) with newly issued or newly created money.

(Net) interest margin: The ratio between net interest income (difference between real and revaluation interest income and expenses) and average gross interest bearing assets.

Nominal interest rate: the interest rate total composed of indexation (revaluation) part (based on inflation) and of the real interest rate.

(Nominal) interest rate differential: The difference between the average nominal interest rate earned on assets and the average nominal interest rate paid on liabilities.

Mandatory reserves: The amount of assets, usually set as percentage of deposits and other bank liabilities, that banks are required to hold on a special account with the Bank and as cash in hand.

Purchase with right: Offer made by the Bank to banks to purchase foreign exchange from them giving them the right to sell additional quantities to the Bank in the future.

Open (foreign exchange) position: Foreign exchange assets in excess of foreign exchange liabilities of a bank (long position) or vice versa (short position).

Operating expenses: General administrative expenses (labor cost and other expenses), depreciation and taxes.

Base or high powered money: Currency in circulation, bank reserves and sight deposit money with the Bank.

Revaluation (indexation) rate: Part of the nominal Tolar lending and deposit rates intended as compensation for the current inflation rate to the lender and depositor respectively.

Provisions: General provisions against contingent risks and special provisions against potential losses deriving from balance and off-balance-sheet items and against country risk. Banks are obliged to make general provisions equal to 1 % of assets classified into grade A (claims on Bank of Slovenia and the Republic of Slovenia excluded) irrespective of their capital adequacy ratio until December 31, 2001. **Net provisions:** The difference between the total of claims written off and value adjustment of doubtful claims, expenses from long-term provisions made, income from provisions cancelled and expenses from long-term provisions.

Secondary liquidity: (Assets comprising) Tolar and foreign currency denominated bills issued by the Bank and bonds issued by the Republic of Slovenia.

Sterilization: In general, sale of short-term Government bonds (Treasury Bills) by the central bank to offset the impact of foreign exchange purchased from banks on the quantity of base money. In Slovenia, sterilization means sale of foreign currency denominated and Tolar bills by the Bank to neutralize the impact of foreign exchange purchased from banks on the quantity of base money.

Base rate (BR, in Slovenian TOM): Officially established indexation rate for claims and liabilities calculated as average inflation rate (until end of 1997 based on retail price index, since then on consumer price index) of the last month or of the last few months (since May 1997 of the last 12 months).

Tolar bills (TB): Short-term Tolar securities issued by the Bank.