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Slovenska 35
1505 Ljubljana
Tel.: +386 1 47 19 000
Fax: +386 1 25 15 516

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Introduction

The year 2002 was one of major progress for the Bank of Slovenia in several areas. A new Bank of Slovenia Act came into force, compatible with European legislation and the requirements of the ECB. The migration of the payment system from the Agency for Payments to the commercial banks was completed. The first steps in the deindexation of financial instruments were taken. Meanwhile, the Bank's major attentions in 2002 continued to be focused on lowering inflation and maintaining stable conditions for financing and saving.

The new Bank of Slovenia Act came into effect in July 2002. It establishes price stability as the Bank's core aim. By ensuring price stability, the Bank of Slovenia supports general economic policy and promotes financial stability while adhering to the principles of an open market economy and free competition.

The Act emphasises the Bank's independence. The members of its decision-making bodies are independent and are not bound by decisions or views of state or other institutions in carrying out their work. The Bank continues to report to the National Assembly on its activities but no longer submits its financial plan and annual accounts for parliamentary approval. Another new measure is a prohibition of monetary financing, which prevents the Bank of Slovenia from approving overdrafts or other credit facilities to the Republic of Slovenia. The new Act also reduced the size of the Governing Board of the Bank of Slovenia from eleven members to nine. Henceforth, the Governing Board will comprise a governor, four vice-governors and four members.

The Bank of Slovenia conducts its monetary policy in the context of a managed floating exchange rate. Given this choice of exchange rate regime, the Bank pursues the core aim of monetary policy, namely price stability, by modifying the quantity of money in circulation. In order to maintain control over the money supply in the face of the free flow of capital, the Bank must simultaneously adjust interest rates and the exchange rate. The choice of exchange rate regime gives the Bank a certain flexibility in the conduct of monetary policy even in such conditions. The sterilisation of foreign exchange inflows remains an important aspect of this system.

Inflation last year fell more slowly than expected. At the end of the year it was still running at 7.2%, mainly because of inflationary pressures due to administered price and tax policy measures. Large capital inflows accompanying privatisations and corporate takeovers posed a further challenge to the conduct of monetary policy. In spite of major shocks – supply-side inflationary shocks and pressures on the money supply caused by capital inflows – the Bank of Slovenia succeeded in restraining inflation to a moderate level and preserving a high degree of stability within the economy. Importantly, while inflation did not come down in line with the forecasts, inflationary pressures on the demand side were not in evidence and there was no surge in consumption. By applying monetary policy and setting interest rates at an appropriate level, the Bank of Slovenia managed to ensure that the capital inflows were expressed mainly as a shift in asset holdings from capital assets to relatively long-term bank deposits, rather than as a credit expansion and a concomitant rise in consumer spending.

The Bank of Slovenia has been advocating tighter coordination of economic policy-making. A supply shock in the form of higher tax rates and administered price rises was the main cause of the rather high rate of price growth in the first half of the year. The Bank of Slovenia is conscious that economic policy coordination is crucial to the achievement of price stability and is therefore seeking to ensure that such supply shocks do not recur.

Last year also saw the completion after several years of the process of migrating the payment system from the Agency for Payments to the commercial banks. A Payment Transactions Act was passed in March 2002, splitting the Agency for Payments into Bureau for Governmental Payments and an Agency for Public Records and Services. Under the Act, the Bank of Slovenia has responsibility for authorising and monitoring payments, and for executing high-value transactions. The reform of the payment system was concluded on 30 June 2002 with the closure of all accounts held by legal persons with the Agency for Payments. This completed the transfer of responsibility for the conduct of payments to the banking sector. Simultaneously, a government single treasury account and accounts for members of the Central Securities Clearing Corporation were opened with the Bank of Slovenia.

Other areas in which the Bank of Slovenia was active included the completion in December 2002 of negotiations on Slovenia's entry to the EU. A transition period lasting to the end of 2004 was secured with regard to free movement of services, while the EU acquis for free movement of capital and for European and Monetary Union were adopted in their totality. Two commemorative coins were issued in 2002, marking the football World Cup in Korea and Japan and the 35th Chess Olympiad in the Slovenian town of Bled.

1. THE ECONOMIC ENVIRONMENT

1.1 International economic developments

Slow recovery in the global economy

World economic growth picked up in 2002 but remains relatively slow. Inflation was moderate in the first half of the year but began to creep up in the second half, owing mainly to growth in commodities prices.

Global growth increased gradually over the year and is estimated by the International Monetary Fund to have been 2.8% for 2002 as a whole. The US economy enjoyed a moderate recovery, while the European Union registered weak growth all year. Japan began to show signs of an end to recession in the second half of the year. According to provisional figures, economic growth in the US in 2002 was 2.4%, up strongly on 0.3% in 2001 but still below the level of the late 1990s. Growth in the European Union was slow all year and is provisionally put at 0.8%, less than the 1.5% of 2001. Japan's economy shrank by 0.3% but began to show faint signs of recovery in the second half of the year.

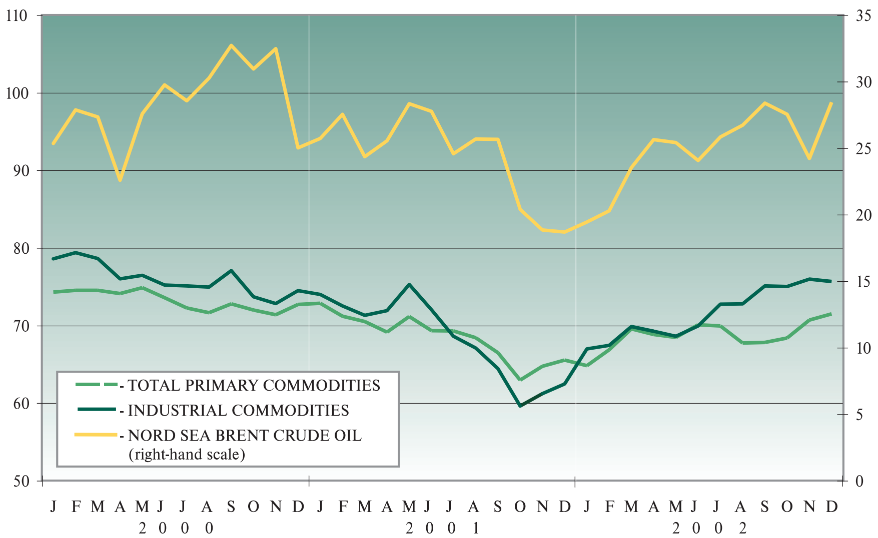
Slow economic growth among Slovenia's main trading partners

Economic growth among Slovenia's main trading partners in 2002 was modest. The slowest-growing economy of those in the European Union was Germany, which grew by around 0.3%, while Italy grew by 0.4%, Austria by 0.7% and France by 1.0%. Economic growth was higher than in 2001 in all of these except Austria, where it stayed at the same level. Among Slovenia's trading partners in eastern Europe, Russia and Croatia achieved growth exceeding 4.0%, while the Polish economy continued to struggle at around 1.2% growth.

Rising oil prices

Oil prices rose in 2002 and averaged USD 25 per barrel for the year. Political uncertainty in Venezuela and a one-month halt in oil production by Iraq caused a major rise in prices in spring 2002. In addition, a restriction on oil production quotas in the OPEC member countries was in force from January to October 2002. Further rises in oil prices in the second half of the year were caused by several factors, the most important being the restriction on OPEC output quotas, the approach of winter in the northern hemisphere and the associated increase in oil demand, the worsening political situation over Iraq, and unrest in Venezuela. The price increases eased

Figure 1: **Prices of commodities** (1999 = 100) **and oil** (North Sea Brent, USD per barrel) **on the world market**



Sources: The Economist, OPEC Bulletin.

temporarily in October when the OPEC countries lifted oil production quotas. By December 2002 the oil price had risen to USD 29 per barrel, having been at USD 20 per barrel in January. Dollar prices of other commodities besides oil also rose, and were up 5.0% on average on the previous year. Growth of food prices (7.8%) outstripped that of manufactured goods (1.2%).

Inflation increasing in the second half of the year

Inflation remained moderate up to the middle of 2002 but gathered momentum in the second half of the year, especially in the United States. The European Union recorded somewhat higher inflation than the US over the year as a whole, while Japan experienced deflation for a third successive year. Inflation for the year averaged 2.2% for the countries of EMU and 1.6% for the US. The average deflation rate in Japan was 0.9%. The moderate rate of inflation in the first half of the year was attributable mainly to the slow pace of economic recovery. A blip in inflation in the EMU countries at the start of the year was caused by one-off factors such as an increase in excise duty in some member states. According to the European Central Bank, the cash changeover to the euro in January 2002 had no significant impact on inflation. The rise in inflation in the second half of the year was due to the rise in oil prices and a lowering of interest rates.

Interest rate cuts by European and US central banks at the end of the year

The central banks of Europe and America cut interest rates at the end of the year. The Federal Reserve reduced the Fed Funds rate in November to 1.25%, below the rate of inflation. In December the European Central Bank likewise cut its interest rate on main refinancing operations, to 2.75%. Feeble economic growth lay behind both decisions. Short-term interest rates on international markets followed central bank rates down. Average LIBOR in 2002 was 1.79% for three-month US dollar deposits and 3.32% for three-month euro deposits.

Strengthening of the euro against the US dollar

Having been below parity with the dollar for about two years, the euro rose in value to above one dollar towards the end of 2002. The euro exchange rate against the dollar rose until mid-year, stood fairly still in the second half of the year, then rose again at year-end. On average for 2002 one euro was worth USD 0.942, a gain of 5% on 2001, when it was worth USD 0.895.

Falls on world stock markets

Stock market indices registered a decline in 2002. The Dow Jones fell 14% over the year and the Japanese Nikkei 16%. The falls reflected the overvaluation of the stock markets at the start of the year, which did not reflect business reality. On top of this, financial irregularities were uncovered at the start of the year among certain major US corporations.

1.2 Gross domestic product, employment and wages

Moderate economic growth in Slovenia

Slovenia's moderate economic growth of 2001 continued in 2002, in which real GDP grew by 3.2%. The biggest contributor to value added was once again manufacturing, which grew by 4.6%, followed by real estate and renting, which grew by 1.9%. Other major areas of economic growth were trade, public administration, financial intermediation and construction. Intensified motorway-building boosted value added in construction, which bounced back after a year of negative growth. Growth in manufacturing was driven largely by strong demand from the countries of the former Yugoslavia and Soviet Union. Domestic demand slowly began to pick up after two slack years. The largest component of domestic demand was household consumption (54.0%), which grew by 1.9%. Gross capital formation grew by 3.7%, mainly due to increased government investment spending, while government consumption grew by 2.7%. Net exports played a smaller part in driving economic growth in 2002 than the year before, growing by 0.6%.

Growth in industrial production similar to 2001

Growth in industrial production in 2002 was similar to that of the previous year and measured 2.4%. The biggest growth was in the output of capital goods (4.5%) and goods for intermediate consumption (3.9%). Production of consumption goods fell by 0.7%. Total goods inventories also fell, by 3.0%, the largest fall being in stocks of capital goods (21.7%).

Wage growth in line with growth in economic activity

Wages moved in line with growth in economic activity, with the result that gross wages in 2002 grew by 9.6%, or 2.0% in real terms. Wage growth was fairly similar in the tradable and non-tradable sectors. According to estimates by the Institute of Macroeconomic Analysis and Development, the share of compensation of employees in the cost composition of GDP consequently fell to 52.4% (from 52.7% in 2001), while that of taxes on goods and services grew to 17.2%. Gross operating surplus as a proportion of GDP in 2002 was the same as in 2001, or 32.2%, primarily reflecting worse conditions on international markets and consequent downward pressure on prices.

Standstill in total employment in the second half of the year

The slowdown in the growth of the number of people in employment observed in 2001 continued into 2002. The average rate of growth of the active population in 2002 remained positive at 0.6%. The number of employees stood still from September onward. This was due largely to workers being shed in the small enterprise sector (-1.5% growth), while employment growth in enterprises and institutions remained positive (0.7%). For the second year in a row employment grew fastest in real estate (9.9%), and employment growth was also strong in hotels and restaurants (3.5%)

Table 1: **Selected economic indicators**

	1996	1997	1998	1999	2000	2001	2002
Real growth of gross domestic product[1] (%)	3.5	4.6	3.8	5.2	...	2.9	3.2
Gross domestic product USD millions	18,878	18,208	19,585	20,071	18,962	19,530	21,996
Gross domestic product USD per capita	9,481	9,163	9,878	10,109	9,527	9,804	11,030
Composition of gross domestic product (%)							
Agriculture, forestry and fishing	3.8	3.7	3.6	3.2	3.7	3.6	3.5
Industry and construction	32.7	32.9	33.0	32.6	33.5	31.9	32.3
– Manufacturing	24.1	24.3	24.1	23.6	23.6	24.1	24.4
Services	48.4	49.5	49.2	49.5	53.8	54.2	54.1
Total value added	85.0	86.1	85.8	85.3	86.5	86.9	87.1
Compensation of employees	54.8	53.6	52.3	51.8	...	...	...
Taxes on production and imports less subsidies	15.3	14.9	15.4	16.1	...	...	...
Gross operating surplus and gross mixed income	29.9	31.5	32.4	32.1	...	...	...
– Exports of goods and services	55.8	57.4	56.6	52.5	56.5	58.5	60.1
– Imports of goods and services	56.8	58.3	58.2	56.9	60.1	60.2	61.1
Net exports	-1.0	-0.8	-1.5	-4.4	-3.6	-1.7	-1.0
Household final consumption expenditure	57.5	56.4	55.7	55.8	55.4	55.3	54.6
General government final consumption expenditure	20.1	20.4	20.3	20.2	20.0	20.2	20.1
Gross capital formation	23.4	24.1	25.6	28.4	27.0	25.0	25.1
Active population[2] thousands	942	978	978	959	968	979	971
Employed and self-employed	875	906	901	886	901	916	910
Unemployed	69	72	77	73	68	63	62
Unemployment rate (ILO)	7.3	7.4	7.9	7.6	7.0	6.4	6.4
Real growth in gross wages per employee (%)	5.1	2.4	1.6	3.3	1.6	3.2	2.0
Growth in labour productivity (%)	4.4	5.2	3.6	3.4	...	2.4	3.5

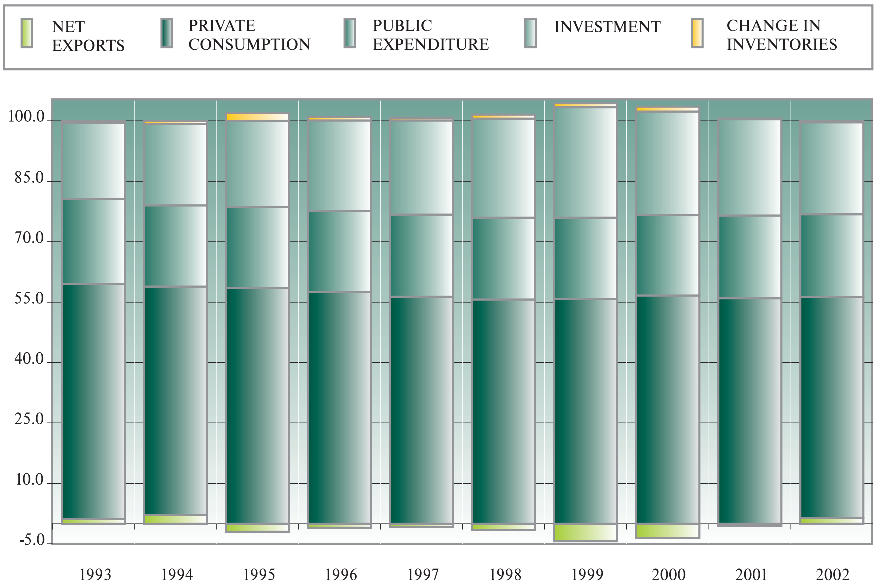
1 National accounts data from 2000 onwards are calculated according to the new methodology of the Statistical Office of the Republic of Slovenia and are given in constant 2000 prices.
2 Internationally comparable data compiled according to ILO methodology.
Sources: Statistical Office of the Republic of Slovenia and Institute of Macroeconomic Analysis and Development.

and transport (2.9%). Against a background of fairly buoyant manufacturing activity, manufacturing employment grew for the first time in several years, by 1.6% over the year. Trends in the number of employees in different branches of manufacturing varied widely, with sizeable falls in food, textiles and petroleum products being offset by strong employment growth in certain other sectors, particularly rubber products, furniture and electrical and optical equipment. The regional pattern of unemployment in 2002 was essentially unchanged, with rates of registered unemployment highest in the Podravska, Pomurska, Savinjska and Posavska regions and lowest in the Central Slovenian and Primorska regions.

Unemployment no longer falling

Total employment as measured by the International Labour Organisation (ILO) survey fell in 2002 by 6,000, while the unemployment total fell by 1,000. This put a halt to the decrease in the unemployment rate, which remained at 6.4%, the same as in 2001. The critical groups are the long-term unemployed, young people (mainly first-time job-seekers), the over-40s and those with a poor education. As part of the introduction of a modern four-pillar employment policy, priority is being given to active employment policy programmes for enhancing employability, followed by programmes for encouraging private enterprise, measures to enhance the flexibility of individuals and firms, and programmes to ensure equal opportunity. In the last few years there has been a marked fall in passive employment policy outlays, linked to the more stringent criteria of the 1998 Employment and Insurance in Case of Unemployment Act. After several years of negotiations among the social partners, a new Employment Relations Act was passed last year which came into effect on 1 January 2003, redefining in detail the relationship between employers and employees after 12 years. The Act, which is consistent with European legislation and ILO recommendations, contains a series of innovations including, most importantly, a new philosophy of employment relations in terms of a contractual relationship.

Figure 2: **Composition of gross domestic product** (%)



Sources: Statistical Office of the Republic of Slovenia, Institute of Macroeconomic Analysis and Development.

1.3 Prices

Consumer price inflation 7.2% at year-end

Consumer prices grew by 7.2% from December 2001 to December 2002 or by 7.5% if measured on the basis of the average for each year. Inflation was affected by both foreign and domestic factors. The world oil price and the US dollar exchange rate were the most influential foreign factors, while the major domestic ones were fiscal policy and administered price policy.

Inflationary impact of high world oil prices mitigated by a weakening US dollar

The year 2002 was characterised by strong growth in the oil price and a weak US dollar. Oil prices were pushed up in the first half of the year by the political crisis in Venezuela and in the final few months by speculation about an attack on Iraq. The impact of the high world oil price on prices of refined petroleum products in Slovenia was mitigated by the depreciation of the US dollar against the euro. The low exchange rate of the dollar had a benign effect on consumer prices in Slovenia by making imports cheaper.

Inflationary repercussions of fiscal policy

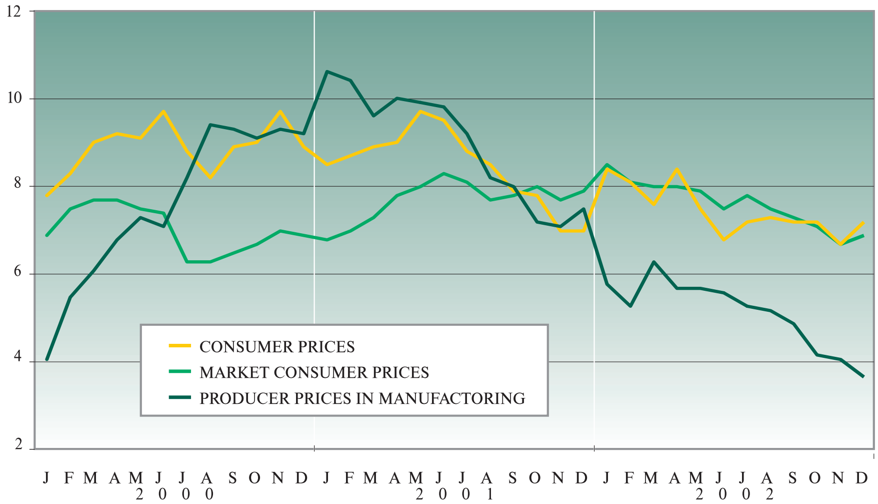
Inflationary pressure in the economy built up in the early part of the year because of fiscal policy and administered price policy. Fiscal policy affected growth in consumer prices through higher rates of value added tax, an increase in excise duty on tobacco and alcohol and the introduction of a tax on environmental discharges. Large hikes in administered prices, mainly in the first four months of the year, and the rising oil price on the world market were heavily reflected in administered price inflation, which came to 9.8% for year (compared with 3.6% in 2001). Administered prices excluding those of refined petroleum products rose by 9.5% (10.5% in 2001). Free market prices grew by 6.9% as against 7.9% in 2001.

Producer price inflation low

The slower rate of depreciation of the tolar against the euro helped ease growth of consumer and producer prices through its effect on import prices. Producer prices fell in every month except March. The jump in March was brought about by higher world oil prices coinciding with a strong dollar. As a result, producer price growth from December 2001 to December 2002 was 3.7%, 3.8 percentage points lower than a year previously, when it was 7.5%.

The Maastricht criterion for price growth in 2002, measured by the Harmonised Index of Consumer Prices, was 3.0%. Measured by the non-harmonised consumer price index, inflation in Slovenia was 7.5%.

Figure 3: **Prices** (annual percentage growth rates)



Sources: Statistical Office of the Republic of Slovenia, Bank of Slovenia.

1.4 Balance of payments

Large current account surplus due to favourable developments in trade in goods

In 2002 Slovenia had a surplus in current transactions with the rest of the world of USD 375 million, equivalent to 1.9% of GDP, the largest current surplus since 1994. The improvement in the current account over 2001, when the surplus was USD 31 million, was mainly thanks to favourable trends in trade in goods, and to a lesser extent to an expanded trade surplus in services. The surplus in current transfers also increased, while a deficit was recorded in the income account for the first time since 1993 because of increased outflows in the form of dividends and reinvested earnings.

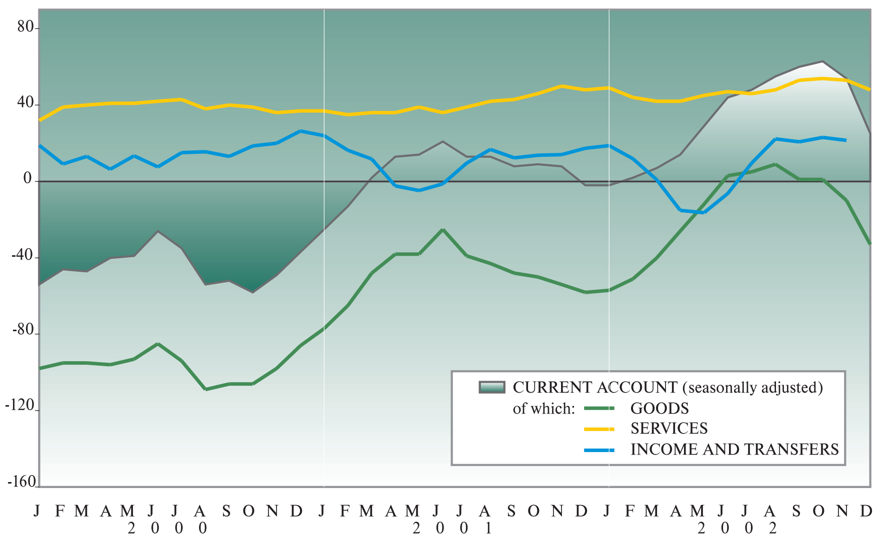
Goods exports growing faster than imports

Slovenia's goods trade deficit with the rest of the world has been shrinking since 1999, when it reached 7.7% of GDP. In 2002 it was worth USD 572 million or 2.9% of GDP, more than two percentage points less than in 2001. The country exported goods to the value of USD 10.4 billion, 11.9% more than in 2001. Goods imports grew less than exports in percentage terms and were worth USD 10.9 billion, 7.7% up on 2001. The faster rate of export growth caused import coverage by exports to rise by four percentage points to 95.9%. The improvement in export performance relative to imports reduced the goods trade deficit in 2002 and improved the current account balance correspondingly.

Share of US dollar export transactions down

In volume terms, exports and imports of goods in 2002 rose by less than implied by the figures expressed in US dollars. Dollar import and export prices are affected by changes in the currency composition of goods trade, in the exchange rate of the US dollar against other currencies, and in the price of goods in the original currency. The share of US dollar transactions in imports and exports has been shrinking since 1997. In 2002 it fell by 0.6 percentage points compared with the previous year to 9.7% on the exports side. On the imports side it fell more strongly, from 15.7% to 13.3%. The proportion of US dollar imports is rather more variable than that of exports, being subject to frequent and often large swings in the price of commodities and oil, which are quoted almost exclusively in US dollars on world markets. The major trading currency for goods is the euro, which accounts for 86.9% of exports and 82.8% of imports. Other convertible currencies besides the euro and the US dollar make up 4.0%. The US dollar climbed gently against the euro in the first three months of 2002 then fell rapidly from April onwards. Overall it lost 14.0% against the euro in the year to December. This weakening increased the dollar value of trade in goods, although the effect was proportionally larger on the exports side than on the imports side (3.9%

Figure 4: **Current account of the balance of payments**
(seasonally adjusted, USD millions)



Sources: Statistical Office of the Republic of Slovenia, Bank of Slovenia.

as against 2.6%) because of the larger proportion of euro export transactions. If the effect of exchange rate fluctuations is stripped out, prices of exports grew by 2.2% while those of imports grew by 1.7%, less than three-quarters as much as export prices. Real growth of goods exports rose in 2002 by 5.3% (compared with 5.1% in 2001), while that of imports rose by 3.2% (compared with 0.5%).

Improved terms of trade

Slovenia's terms of trade improved by 1.9% in 2002 compared with 2001. Without this improvement the goods trade deficit would have been around USD 200 million greater.

Rapid growth in imports of intermediate goods and exports of consumer goods

Trends in the makeup of domestic demand and demand for Slovenian goods from abroad affected the composition of imported goods by economic purpose. Compared with 2001 the share of capital goods fell from 15.4% to 15.2% and that of consumption goods from 25.3% to 24.8%. The share of intermediate goods imports has been increasing rapidly since 1999 and stood at 60.0% in 2002. On the exports side, consumption goods rose by more than the average (14.3%), capital goods grew more modestly (11.9%) and intermediate goods grew the least strongly (10.3%). Intermediate goods fell as a share of exports from 53.0% to 52.3%, while the share of capital goods was unchanged at 10.5% and that of consumption goods rose from 36.4% to 37.2%. The trade deficit widened by 3.0% in the case of intermediate goods and narrowed by the same percentage in the case of capital goods, while the trade surplus in consumer goods grew by 42.6% to USD 1.1 billion.

Table 2: **Geographical breakdown of trade in goods** (USD millions)

	EXPORTS			IMPORTS			TRADE BALANCE		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
European Union (15)	**5,580**	**5,758**	**6,138**	**6,856**	**6,865**	**7,430**	**-1,276**	**-1,108**	**-1,292**
Austria	656	692	730	833	845	903	-177	-152	-172
France	619	629	690	1043	1079	1118	-424	-450	-428
Italy	1,188	1,158	1,251	1,761	1,793	1,956	-574	-635	-705
Germany	2,376	2,428	2,561	1,918	1,949	2,094	457	479	467
CEFTA	**692**	**741**	**903**	**920**	**966**	**1034**	**-228**	**-226**	**-131**
Czech Republic	151	168	190	252	249	273	-101	-81	-83
Hungary	168	157	185	294	315	322	-125	-158	-137
Poland	226	242	288	138	144	159	89	98	129
EFTA	**125**	**120**	**195**	**213**	**172**	**191**	**-88**	**-53**	**4**
Non-European OECD members	**391**	**347**	**410**	**608**	**591**	**606**	**-217**	**-245**	**-196**
United States	270	244	283	299	297	313	-30	-54	-29
South Korea	13	11	16	73	63	72	-59	-52	-56
Countries of former Yugoslavia	**1,364**	**1,564**	**1,849**	**594**	**540**	**545**	**769**	**1024**	**1304**
Bosnia and Herzegovina	**374**	**398**	**466**	**58**	**62**	**65**	**316**	**335**	**401**
Croatia	688	799	902	448	404	397	240	395	505
FR Yugoslavia	143	236	330	41	47	58	102	188	271
Countries of former Soviet Union	**281**	**410**	**483**	**263**	**323**	**317**	**18**	**88**	**166**
Russian Federation	191	281	303	231	281	247	-40	0	56
Other countries	**300**	**313**	**378**	**662**	**689**	**805**	**-362**	**-376**	**-428**
TOTAL	**8,732**	**9,252**	**10,357**	**10,116**	**10,148**	**10,929**	**-1,384**	**-895**	**-572**

* Exports f.o.b. and imports c.i.f.
Source: Statistical Office of the Republic of Slovenia (external trade statistics); figures for 2002 provisional.

Increased market share of exports to top trading partners

Export competitiveness as measured by Slovenia's share of the European Union export market improved in 2002 for a second successive year. Preliminary figures suggest that it rose by over 5.0%. The rise in market share was above average in the French and Italian markets, around average in Germany and lowest in Austria. Slovenia's share of the Croatian export market has changed little in recent years and remains fairly high at around 9%. Its share of exports to the Czech Republic, Poland and Hungary grew faster than its share of exports to the European Union. The share of the market for exports to the Federal Republic of Yugoslavia has been rising by more than one percentage point in every year since 1999 and exceeded 5% in 2002. The share of the Russian export market fluctuates from year to year and fell in 2002, due mainly to reduced exports to that country.

Shift in geographical pattern of goods exports towards countries of former Yugoslavia and CEFTA

Changes in the geographical breakdown of Slovenia's trade in goods with the rest of the world occurred mainly on the side of exports, while imports went more or less unchanged. Exports to the markets of the former Yugoslavia and CEFTA, and to a lesser extent to the countries of the former Soviet Union, have been growing for the last three years. The proportion of exports to the European Union fell by 2.9 percentage points in 2002 to 59.3%, its lowest level since 1992. The proportion of imports originating from the European Union is fairly stable, rising from 67.7% in 2001 to 68.0% in 2002. The ranking of the EU countries who together account for over half Slovenia's external trade has been the same for several years. Germany has the largest share (24.7% of exports and 19.2% of imports), followed by Italy (12.1% and 17.9%), Austria (7.1% and 8.3%) and France (6.7% and 10.2%). The biggest change in recent years has been in the share of exports to Germany. After averaging around 30% up to 1999, it has fallen by 1.5 percentage points annually up to and including last year. The deficit with the European Union amounted to USD 1.3 billion, USD 184 million more than in 2001. For another year in succession the largest visible trade deficit was with Italy (USD 705 million), followed by France (USD 428 million) and Austria (USD 172 million). Slovenia again had a trade surplus with Germany as it has for several years, although this is fast narrowing as the share of exports to Germany declines. In 1999 the surplus was USD million 555, while in 2002 it was down to USD 467 million.

Large goods trade surplus with the countries of the former Yugoslavia

Exports to the countries of the former Yugoslavia increased as a proportion of total exports from 15.2% in 1999 to 17.9% in 2002, while corresponding imports fell from 5.7% to 5.0% of the total. The fastest growth was in exports to the Federal Republic of Yugoslavia, although annual growth has slowed from 68.0% in 2000 to 40.0% in 2002. Imports from the Federal Republic of Yugoslavia are growing two-and-a-half times more slowly than exports, causing the surplus in trade in goods to widen to USD 271 million in 2002. Slovenia's most important trading partner among the countries of the former Yugoslavia is still Croatia, which is the destination for more than half of all exports to this group of countries and the origin of around 73% of corresponding imports. The goods trade surplus with the countries of the former Yugoslavia has grown rapidly in the last two years. In 2002 it reached USD 1.3 billion, surpassing the goods trade deficit with the countries of the European Union.

Reduced goods trade deficit with CEFTA countries

Imports from CEFTA countries grew modestly by 7.0% while corresponding exports rose faster than average by 21.9%. As a result, the deficit was halved to USD 131 million. The deficit with Hungary fell to USD 31 million, while that with the Czech Republic was unchanged. Slovenia has run a surplus in trade with Poland for several years, which last year rose to USD 31 million.

Trade growth faster in services than in goods

Growth of trade in services again outstripped growth of trade in goods in 1992. Exports of services were up 16.9% on 2001 and imports up 19.1%. Services grew to 16.7% of total current account inflows, although this remains more than two percentage points lower than the proportion prior to 1998. The trade surplus in services was USD 556 million, USD 54 million more than in 2001.

Tourism surplus similar to 2001

Tourism receipts stood still in the first quarter of 2002 and only began to pick up after April. By the end of the year they had reached USD 1.1 billion, 8.2% up on the previous year. Tourism outgoings grew faster than this, by 16.2%, to stand at USD 614 million by the end of the year. The slower growth in tourist revenues occurred despite a 3.0% increase in numbers of foreign tourists and was due mainly to a 4.0% drop in overnight stays by visitors from Germany. The tourism surplus fell from USD 473 million in 2001 to USD 470 million in 2002.

Increased surplus in transportation services

Transportation receipts have been growing faster than outgoings since the second half of 2001, increasing the surplus by USD 51 million to USD 233 million in 2002. The trade surplus in construction services has risen by USD 10 million annually for the last three years. In 2002 it rose to USD 34 million, reflecting faster growth in exports (30.1%) and somewhat slower growth in imports (24.0%). Until 2001 Slovenia

Table 3: **Balance of payments** (USD millions, preliminary figures for 2002)

	1997	1998	1999	2000	2001	2002
A) CURRENT ACCOUNT	**51**	**-118**	**-698**	**-548**	**31**	**375**
– percentage of GDP	**0.3%**	**-0.6%**	**-3.5%**	**-3.0%**	**0.2%**	**1.9%**
1. Goods	-775	-792	-1,235	-1,139	-619	-243
2. Services	636	501	353	450	502	556
2.1 Transportation	96	128	141	139	182	233
2.2 Travel	663	528	416	449	473	470
– of which exports	1,181	1,088	958	961	1,001	1,083
2.3 Other	-123	-155	-203	-139	-153	-147
3. Income	75	56	64	26	19	-71
3.1 Compensation of employees	179	179	182	161	155	155
3.2 Investment income	-104	-123	-119	-135	-136	-226
4. Current transfers	114	117	120	115	129	134
B) NET FINANCIAL INFLOWS	**642**	**319**	**553**	**1,008**	**1,549**	**1,110**
– percentage of GDP	**3.7%**	**1.8%**	**3.2%**	**5.6%**	**8.2%**	**5.2%**
1. General government: bonds [1]	184	113	365	221	179	1
other (including loans)	-27	-20	-5	79	-28	-1
2. Bank of Slovenia	-9	-51	-51	12	-9	-44
3. Private sector:	419	215	202	655	1,355	1,121
3.1 Direct investment from rest of world [2]	294	215	107	136	503	1,865
3.2 Portfolio investment from rest of world [2]	92	6	-3	25	10	26
3.3 Trade credits	-351	-425	-316	-182	-203	-352
3.4 Loans from rest of world	356	294	752	864	445	514
– Banks1	-15	41	255	272	91	218
– Enterprises	371	254	497	592	354	296
3.5 Other (together with all outflows)						
– Households	149	86	-234	-10	696	-554
– Banks, enterprises	-120	38	-103	-178	-96	-378
4. Statistical discrepancy	74	61	42	42	53	33
C) FOREIGN EXCHANGE RESERVES (increase (-))	-692	-201	145	-461	-1,580	-1,485
1. Bank of Slovenia	-1,287	-112	126	-196	-1,282	-1,828
2. Banks	595	-89	19	-265	-298	344

[1] Excluding domestic bank transactions in central government bonds.
[2] Data for the period from September 1996 to February 1997 are estimated within the unchanged aggregate item direct and portfolio investment.
Source: Bank of Slovenia

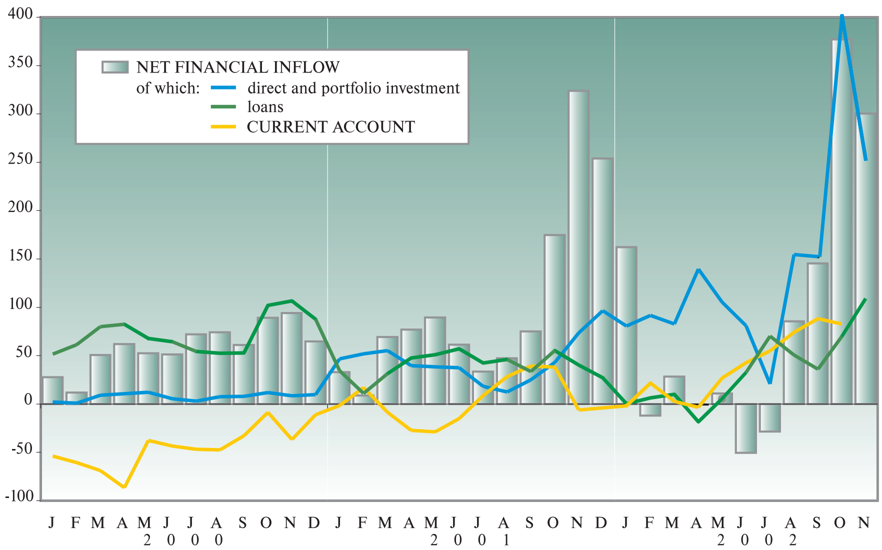
had a deficit on the financial services account averaging USD 15 million a year. Last year exports rose to USD 40 million from USD 11 million in 2001 while imports were only fractionally up at USD 29 million, yielding a surplus of USD 11 million. Trade in computer and information services was in balance. Among import-dominated services, exports grew faster than imports in communications services (170.0%) and other business services (129.3%), reducing the deficit in these accounts to the benefit of the overall services trade balance.

Income outflow

Net income was in decline up to 2001 due to falling labour income and a widening investment income deficit, but turned negative in 2002 to the tune of USD 71 million. Net labour income (compensation of employees) have levelled off in the last three years and were roughly the same in 2002 as in 2001 at USD 189 million. The deficit in investment income is growing and increased from USD 136 million in 2001 to USD 226 million in 2002. Foreign exchange reserves were almost equal to the stock of external debt by the end of the year. Both interest income and interest payments rose only little because of foreign interest rate cuts. Investment income excluding equity capital increased by 19 million USD or 7.0%. The increase in outward investment flows was smaller at USD 14 million or 3.5%. Most of the increase in the investment income deficit stemmed from an increase in outflows arising from foreign equity interests in domestic enterprises. Foreign investors' earnings in 2002 totalled USD 115 million, a rise of USD 94 million year-on-year. Dividends and distributed earnings accounted for somewhat less than 60% of this, while reinvested and undistributed earnings made up the other 40%.

In the current transfers account, transfers into Slovenia grew by less than transfers to the rest of the world in 2002 for the second year in a row. The former grew by 15.4% and the latter by 21.8%. As the process of accession to the European Union gathers pace, both inflows of official transfers into Slovenia and outflows to the rest of the world are accelerating. The deficit in official transfers nevertheless increased fractionally. The overall surplus was due to other transfers. Despite faster growth of current transfers to the rest of the world, the surplus grew from USD 129 million in 2001 to USD 134 million in 2002.

Figure 5: **Financing of the current account of the balance of payments**
(USD millions, 3-month moving average)



Source: Bank of Slovenia.

Net financial inflow lower than in 2001

Net financial inflow was lower in 2002 than in 2001 and was equivalent to 5.2% of GDP. There was an increase both in financial inflows (from 10.0% to 11.5% of GDP) and, more substantially, in financial outflows (from 1.8% to 6.3%). Financial inflows arose mainly from privatisation and other direct investment. Trade credits, the major form of financial outflow, were mainly related to the expansion of trade on the markets of the former Yugoslavia. Financial inflows roughly matched outflows until August but heavily outstripped them from September on, with the result that net financial inflows between September and December equalled as much as 16% of GDP.

Large inflows from direct investments

The largest financial inflows in 2002 were foreign direct investments. These were worth as much as USD 1.9 billion, more than three-quarters of total financial inflows and almost three times as much as in 2000 and 2001 put together. Two-thirds of these inflows resulted from the privatisation of Nova Ljubljanska Banka in September and the sale of Lek in November. Inflows due to increases in liabilities towards related enterprises, which are also included under direct investments and may also include debt transactions, rose strongly to USD 350 million 2002 from USD 174 million in 2001. These constitute a major source of finance for enterprises, roughly equalling foreign loans in 2002.

Surge in borrowing abroad in the last quarter

Borrowing abroad by banks and enterprises in 2002 totalled USD 514 million, a similar figure to 2001. Enterprises borrowed USD 296 million abroad and banks USD 218 million. Foreign borrowing by enterprises was lower than in 2001 while borrowing by banks was considerably higher. Borrowing by enterprises and banks was fairly modest until the final quarter, when USD 327 million was borrowed, almost two-thirds of the total. The rather high level of foreign borrowing in recent years can perhaps be explained by close links with foreign business partners who provide domestic enterprises with access to foreign credit on relatively favourable terms.

Heavy outflows in the form of household currency…

The largest category of outflow was household currency, which totalled as much USD 554 million. These outflows were fairly steady throughout the year and varied between USD 120 million and USD 170 million each quarter. The persistence and rather uniform distribution of these outflows over the year are evidence that they are not merely a restocking by the public of inventories of foreign currency deposited with the banking system at the end of 2001 at the changeover of EMU currencies to the euro. They were all the more surprising given the fairly slow and predictable depreciation of the tolar and the alleviation of uncertainty over entry to the EU.

Table 4: **Slovenian external debt and foreign exchange reserves**
(USD millions at year-end)

	1998	1999	2000	2001	2002
Total external debt	4,915	5,400	6,217	6,717	8,799
1. Short-term debt	110	117	99	126	119
as a percentage of total debt	2.2	2.2	1.6	1.9	1.4
2. Long-term debt:	4,805	5,283	6,118	6,591	8,680
- public and publicly guaranteed	2,326	2,451	2,665	2,710	3,238
- private non-guaranteed	2,479	2,832	3,453	3,881	5,442
External debt/GDP (%)	25.0	26.9	34.2	35.7	41.3
External debt/exports of goods and services (%)	42.5	49.3	55.9	57.0	66.3
Debt service/exports of goods and services (%)	13.3	7.7	9.3	14.1	13.8
Interest service/exports of goods and services (%)	2.1	2.3	2.7	3.1	2.8
3. Foreign exchange reserves	4,781	4,115	4,376	5,747	8,152
Foreign exchange reserves/exports of goods and services(months)	4.9	4.2	4.4	5.8	7.5
Foreign exchange reserves/external debt (%)	97.3	76.2	70.4	86.4	92.6

Source: Bank of Slovenia.

They may to some extent reflect a repayment of borrowing from the rest of the world that occurred when domestic consumption was high.

…and trade credits

Trade credits in 2002 increased due to weaker payments from the countries of the former Yugoslavia and the extension of payment deadlines in the EU. Trade credit outflows came to USD 352 million, almost twice their level in 2001. Virtually of it was short-term credit. According to data from enterprises, just under two-thirds of trade credits went to the countries of the former Yugoslavia and a quarter went to EU countries.

Lending by domestic banks and enterprises to the rest of the world increased strongly in 2002. These outflows totalled USD 215 million, as compared with a net inflow of USD 11 million in 2001.

Foreign exchange reserves increasing faster than external debt

Transactions with the rest of the world in 2002 increased the foreign exchange reserves of the Bank of Slovenia and commercial banks by USD 1.1 billion. The fact that the increase in reserves was larger than implied by transactions abroad was due mainly to the depreciation of the US dollar against the euro. At the end of the year foreign exchange reserves stood at USD 8.2 billion, a significant increase of USD 2.4 billion on 2001, and sufficient to cover more than seven months of imports of goods and services.

Being in the form of direct investments rather than constituting debt, a large proportion of inflows did not translate into additions to Slovenia's external debt. Net new borrowing pushed the latter up by USD 484 million to stand at 41.3% of GDP at the end of the year.

1.5 Public finances

Two-year budget introduced

In December 2001 the government carried through its intention of framing a two-year budget and passed a budget for 2002 and 2003. As part of the 2002 budget, the budget year was aligned with the calendar year, causing a one-off increase in the deficit of SIT 75.6 billion. In May, after the Institute of Macroeconomic Analysis and Development revised its forecasts for economic growth, imports and consumption, the government decided to rebalance the budget. This mainly involved reducing planned expenditures to keep the planned deficit unchanged. The government also introduced for the first time an automatic fiscal stabiliser, which allows the planned deficit to be exceeded by 0.3% of GDP in the event of an economic downturn. As part of its ongoing privatisation programme, the government sold a 34% stake in Nova Ljubljanska Banka for around SIT 113 billion to the Belgian bank KBC but postponed the sale of a 65% stake in Nova Kreditna Banka Maribor (NKBM) for one to two years. The revised budget for 2003 and the budget for 2004 were passed in December.

Public deficit provisionally SIT 157 billion or 3.1% of GDP

Provisional figures put the deficit in public finances, which covers four public treasuries, namely the national budget, the municipal budgets and the treasuries of the Institute of Pensions and Disability Insurance of Slovenia and the Health Insurance Institute of Slovenia, at SIT 157.5 billion or 3.1% of GDP. The municipal budgets and the Institute of Pensions and Disability Insurance ended the budget year in surplus, while the state budget and the Health Insurance Institute ended it in deficit.

Growth fastest in income and profit taxes among public revenues…

Total public revenue in 2002 was provisionally SIT 2,083 billion or about 40.8% of GDP, while public expenditure was SIT 2,241 billion or 43.9% of GDP. The fastest-growing of the major public revenue items in 2002 were personal and corporate income tax, which grew by around 2.7% in real terms to SIT 395 billion. Social security contributions grew more slowly, by around 2.1% in real terms, contributing SIT 682 billion to the public purse. Indirect taxes on goods and services, mainly value added tax (VAT) and excise duty, actually shrank in 2002 by 7.1% in real terms, bringing in only SIT 673 billion. The drop in these tax revenues was mainly due to the alignment of the budget year with the calendar year, which meant that January 2003 revenues were excluded.

…and in wages and transfers to households among public expenditures

Provisional figures for major public expenditures in 2002 attribute the fastest growth (5.0% in real terms) to wages, which totalled SIT 515 billion over the year. The government took measures to arrest the rapid growth in public sector pay in the middle of the year with the passage of a Public Servants' Wages Act and a Public Servants Act, designed to correct public sector wage differentials. Transfers to households grew more slowly, by 3.1%. They consist mainly of pensions, which grew by 2.6% in real terms to reach SIT 601 billion. Expenditure on goods in services grew by only 0.7% in real terms during 2002 to stand at SIT 418 billion by the end of the year.

The financial claims and investment account recorded net inflows of SIT 106 billion in 2002, almost wholly due to the sale of a 34% stake in Nova Ljubljanska Banka to KBC of Belgium.

Shift from foreign to domestic sources of finance

The financing account for all four public financial treasuries recorded net borrowing of around SIT 150 billion in 2002. The state borrowed SIT 171 billion net at home, SIT 160 billion in bonds and SIT 11 billion in loans, and repaid SIT 21 billion of debt to the rest of the world. An important development in the issuance of government bonds was the withdrawal of bank rehabilitation bonds (RS15 series G to T), which were mainly replaced by the four bonds RS44, RS45, RS46 and RS47 to a value of SIT 140.1 billion, while a smaller part, totalling SIT 21.4 billion, was redeemed early. In this way the government cut its debt servicing costs.

As at 30 September 2002, the external debt of the Republic of Slovenia stood at SIT 1,383 billion, of which roughly 57% was owed to the domestic sector and the remainder to the rest of the world. Loans made up only 16% of the debt, government securities making up the rest.

The Maastricht criterion for the budget deficit, calculated by the ESA95 method, is 3.0% of GDP, while the criterion for external debt is 60% of GDP. In 2002 Slovenia's budget deficit on the ESA95 basis was 1.8% of GDP, while the external debt is provisionally put at less than 30% of GDP.

2. MONETARY POLICY

2.1 The conduct of monetary policy

Price stability as the core aim of the Bank of Slovenia

The core aim of the Bank of Slovenia is price stability. By ensuring price stability, the Bank of Slovenia supports general economic policy and promotes financial stability while adhering to the principles of an open market economy and free competition. Pursuit of this aim is also mandated in the new Bank of Slovenia Act, which was passed in June 2002 and came into effect in the second half of July.

Complementary adjustment of interest and exchange rates under free flow of capital

Given the choice of exchange rate regime, the Bank pursues the core aim of monetary policy, namely price stability, by simultaneously modifying the quantity of money in circulation and the exchange rate. In order to maintain control over the money supply in the face of the free flow of capital, the Bank must adjust interest rates and the exchange rate interdependently.

The Bank of Slovenia conducts its monetary policy in the context of a managed floating exchange rate. This choice of exchange rate regime allows it a certain flexibility in the conduct of monetary policy even in conditions of free capital flow. The Bank's ability to sterilise the effects of net foreign exchange inflows by means of the instruments at its disposal is an important aspect of this arrangement. In view of the need to control growth in the money supply as a means of achieving price stability, controlled base money growth is thereby ensured.

In conducting its monetary policy, the Bank of Slovenia uses two levers to control the money supply, namely interest rates and the exchange rate. Exchange rate adjustments must eliminate differentials between domestic and foreign interest rates in order to prevent speculative, mainly short-term monetary inflows and outflows. Interest rates are meanwhile adjusted in line with the monetary stance and in accordance with inflation and inflation expectations. The Bank employs its instruments of intervention in the foreign exchange and money markets in order to achieve an appropriate supply of base money.

Agreement with commercial banks on cooperation on the foreign exchange market key to effective exchange rate intervention by the Bank of Slovenia

In conditions of the free flow of capital and large-scale capital inflow, foreign exchange interventions are an important mechanism for managing the exchange rate. This mechanism is based on an agreement between the Bank of Slovenia and the commercial banks regarding cooperation on the foreign exchange market which enables the Bank of Slovenia to steer the exchange rate, i.e. to set the range of rates at which the banks can deal with other parties. For their part, the banks who are party to the agreement enjoy a standing facility for the temporary sale of foreign currency to the Bank of Slovenia with compulsory repurchase after seven days (buy-sell swaps), and in some cases for the temporary sale of foreign currency with the option of outright sale after 270 days. By these means the Bank of Slovenia adjusts supply and demand on the foreign exchange market, while the resulting supply provides banks with a means of closing their foreign exchange positions and is their major source of liquidity. The Bank of Slovenia uses tolar-denominated central bank bills to sterilise any excess liquidity stemming from the large-scale monetisation of foreign exchange inflows.

Interest rate rises on Bank of Slovenia monetary policy instruments and securities

The Bank of Slovenia raised interest rates on its monetary policy instruments several times in 2002. In doing so it raised the differential between domestic and foreign rates, although not sufficiently to trigger additional financial inflows. The Bank only lowered its interest rate on monetary policy instruments in December, following the lead of the European Central Bank. Large-scale sterilisation increased the costs of monetary policy, but as yet these costs are not a constraint on its conduct.

Efforts at coordination of economic policy

Monetary policy in 2002 was affected by supply-side shocks to inflation, particularly higher tax rates and rises in administered prices. In order to avoid a recurrence of such shocks, the Bank of Slovenia advocated a tighter degree of coordination of economic policy, which is crucial to achieving the inflation target.

Adaptation of monetary policy instruments to those of European Central Bank

The Bank of Slovenia pressed on with the task of streamlining its range of monetary policy instruments and adapting them to those of the European Central Bank. In October it abolished overnight and emergency liquidity loans and adapted the lombard loan to serve the same purpose. At the same time it introduced a one-day loan for bridging banks' intraday liquidity needs. The Bank also modified the method for calculating compulsory reserves and abolished the discount rate, which under the new Bank of Slovenia Act it is no longer required to set.

Base money issued through foreign exchange swaps and absorbed through tolar bills

The Bank of Slovenia accomplished most of its issuance of base money in 2002 through foreign exchange transactions, specifically the foreign exchange buy-sell swap instrument. The Bank absorbed base money by issuing tolar-denominated bills, with which it sterilised 89% of the money issued through foreign exchange buy-sell swaps.

7.4% growth in monetary base

The monetary base, measured in terms of the average daily money stock by month, grew by SIT 18.1 billion or 7.4% in the year to December 2002. Most of this (85.6%) came from an increase in commercial banks' reserves, which grew by 16.0% over the year, while the rest came from a rise in currency in circulation, which grew by 5.9%. Measured on average for the year 2002 the monetary base grew by 16.7% with very similar growth in the two main components, currency in circulation (16.9%) and commercial banks' reserves (16.1%).

Significant growth in broader monetary aggregates due to financial inflows

Measured by the average daily level by month the M3 monetary aggregate grew in 2002 by SIT 657.6 billion, of which SIT 303.8 billion, or almost half, occurred in the last two months, reflecting one-off events, the privatisation of Nova Ljubljanska Banka and the sale of Lek. The monetisation of these financial inflows was reflected in a rise in M3 and M2, but did not affect M1 because of large-scale sterilisation. This indicates that there was a shift in asset holdings from forms of capital assets to relatively long-term bank deposits, so that there was no build-up of inflationary pressure despite the supply of broad money being increased.

Table 5: **Supply of base money** (SIT billions)

	As at 31 December			Quarterly changes during 2002				Total
	2000	**2001**	**2002**	**I**	**II**	**III**	**IV**	
1. Net foreign assets	742.0	1,122.2	1,580.2	79.2	59.6	145.4	173.9	458.0
2. Domestic liabilities in foreign currency	-394.0	-490.0	-581.1	-50.5	-29.8	-134.2	123.3	-91.2
– foreign currency bills	-358.3	-458.8	-551.1	-53.6	-32.6	-18.3	12.2	-92.4
– Budgetary foreign currency deposits	-35.7	-31.2	-30.0	3.2	2.8	-115.9	111.1	1.2
3. Net foreign currency assets (1+2)	**348.0**	**632.3**	**999.1**	**28.7**	**29.8**	**11.1**	**297.2**	**366.8**
4. Budgetary time deposits	**0.0**	**-19.9**	**-130.3**	**-0.1**	**14.9**	**-14.9**	**-110.4**	**-110.4**
5. Loans to banks	**6.8**	**0.5**	**1.3**	**1.7**	**0.2**	**1.2**	**-2.3**	**0.8**
6. Tolar bills	**-6.9**	**-161.3**	**-394.0**	**-38.4**	**-2.4**	**-14.4**	**-177.6**	**-232.7**
7. Other net liabilities	**-132.3**	**-190.6**	**-208.0**	**-10.8**	**2.1**	**-9.6**	**0.9**	**-17.4**
8. Net tolar assets	**-132.4**	**-371.3**	**-731.0**	**-47.6**	**14.9**	**-37.7**	**-289.4**	**-359.7**
9. Monetary base (3+8)	**215.6**	**261.0**	**268.1**	**-18.8**	**44.6**	**-26.5**	**7.8**	**7.1**
– banks' reserves	87.4	103.2	112.8	-10.1	29.1	-11.1	1.6	9.6
– other demand deposits	8.4	15.6	12.2	-2.6	5.4	-8.0	1.8	-3.4
– currency in circulation	119.8	142.1	143.1	-6.2	10.1	-7.4	4.4	0.9

Excluding accrued interest and discount.
Source: Bank of Slovenia.

On average for the year, M3 grew by 25.7%, M2 by 25.4% and M1 by 18.4%. The rate of annual growth of M3 slowed from the very beginning of the year and M1 growth slowed from the second half of the year, while M2, after slowing in the first ten months, grew faster again at the end of the year because of the conversion of financial inflows.

Increase in money multipliers

The money multiplier between M3 and the monetary base rose from 11.8 to 13.5 in 2002, the M2 multiplier rose from 8.3 to 9.7 and the M1 multiplier from 1.99 to 2.11.

Lengthening of maturity of tolar deposits

Looking at individual components, almost half of the growth in M3, or SIT 337.1 billion, was in the form of tolar savings and time deposits, among which the fastest growth was in longer-term deposits. Deposits with a term of over one year increased by SIT 181.2 billion, while demand deposits and deposits with a term of up to 30 days increased by SIT 125.5 billion. The average maturity of tolar deposits consequently rose from 118 days in December 2001 to 128 days in December 2002. Foreign currency deposits grew by SIT 127.6 billion and government time deposits at the Bank of Slovenia by SIT 125.5 billion. The slowest growth compared with 2001 was in foreign currency deposits, because of which the effect of tolar components on M3 growth increased and that of foreign currency components diminished.

M3 creation through net foreign assets and domestic credit

Creation of M3, or broad money, occurred through net foreign assets and bank credit. In the last quarter of 2002 M3 grew by twice as much as in the first nine months due to a rise in net foreign assets from large-scale financial inflows. In all months except two (September and November) the main source of M3 creation was domestic lending by banks, but as in 2001 net foreign assets contributed two-thirds of M3 growth overall.

Table 6: **Supply of M3: consolidated balance sheet of the monetary system**
(SIT billions)

	As at 31 December			Quarterly changes during 2002				Total
	2000	**2001**	**2002**	**I**	**II**	**III**	**IV**	
1. Net foreign assets	**811.2**	**1,225.7**	**1,478.9**	**26.3**	**-38.6**	**131.5**	**134.0**	**253.2**
2. Domestic assets	**2,047.8**	**2,404.8**	**2,755.2**	**113.2**	**68.2**	**90.6**	**78.3**	**350.3**
General government: bonds	326.5	388.1	463.2	60.0	21.2	9.3	-15.4	75.1
loans	152.5	160.1	229.0	25.6	9.4	25.6	8.3	68.9
Enterprises: debt securities	90.8	101.7	134.7	3.2	4.5	2.7	22.6	33.0
loans	983.0	1,219.1	1,349.7	17.5	22.9	34.3	55.9	130.6
Households: loans	495.0	535.8	578.5	7.0	10.2	18.6	6.9	42.7
3. Debt securities issued	**-79.2**	**-113.6**	**-184.2**	**-12.9**	**7.1**	**-13.2**	**-51.6**	**-70.6**
4. Budgetary foreign currency deposits	**-35.7**	**-31.2**	**-30.0**	**3.2**	**2.8**	**-115.9**	**111.1**	**1.2**
5. Other net liabilities	**-537.9**	**-608.3**	**-646.5**	**-36.5**	**15.3**	**-18.8**	**1.9**	**-38.2**
6. M3 (1 to 5)	**2,206.2**	**2,877.4**	**3,373.3**	**93.3**	**54.8**	**74.2**	**273.7**	**495.9**
– foreign currency deposits at banks	663.6	922.9	983.8	23.5	1.8	12.5	23.0	60.8
7. M2	**1,542.6**	**1,954.4**	**2,389.5**	**69.8**	**53.0**	**61.6**	**250.7**	**435.1**
– time deposits at banks	970.6	1,261.7	1,537.8	82.6	41.2	50.1	102.1	276.1
– time deposits at the BoS	0.0	19.9	130.3	0.1	-14.9	14.9	110.4	110.4
– savings deposits	148.0	170.7	156.7	4.1	-12.2	-3.8	-2.0	-13.9
8. M1	**424.0**	**502.2**	**564.8**	**-17.0**	**38.9**	**0.4**	**40.3**	**62.6**
– demand deposits at banks	295.8	344.5	409.5	-8.2	23.4	15.8	34.0	65.0
– demand deposits at BoS	8.4	15.6	12.2	-2.6	5.4	-8.0	1.8	-3.4
– currency in circulation	119.8	142.1	143.1	-6.2	10.1	-7.4	4.4	0.9

Source: Bank of Slovenia.

Increased credit to government

Monetary sector credit totalled SIT 353.5 billion, more than in 2001 because of large-scale lending in December. In terms of sectoral composition, credit to enterprises predominated with SIT 224.3 billion but was down by SIT 48.4 billion compared with 2001. Credit to the general government sector rose strongly by SIT 49.2 billion to SIT 139.6 billion, reflecting both increased borrowing and the restructuring of the government debt from foreign to domestic sources. Credit to the household sector stood at SIT 37.6 billion and was little changed from the previous year.

Lending mainly foreign currency-denominated

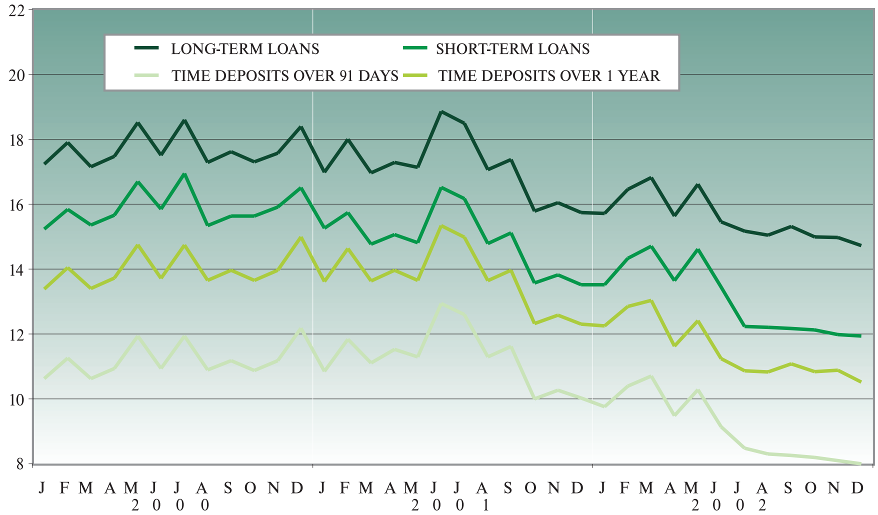
As well as the sectoral composition, the currency profile of credit also changed. Specifically, the proportion of foreign currency-denominated credit grew, because of an increase in foreign currency debt mainly of enterprises (SIT 135.9 billion), and to a lesser extent of the general government sector (SIT 15.4 billion). Except for December, net borrowing by enterprises at domestic banks in 2002 was exclusively in foreign currency, a fact that can be attributed to low foreign interest rates, a stable tolar exchange rate and strong foreign currency liquidity of banks. Enterprises additionally borrowed abroad to lower extent than in 2001, although the proportion of such borrowing in total new credit to enterprises increased.

2.2 Interest rates and money market

Banks' lending and deposit interest rates adjusted to inflation

The rise in inflation in the first four months of 2002 from 7.0% in December 2001 to 8.4% in April 2002 and its subsequent decline to 7.2% in the second half of the year had an effect on setting by banks of lending and deposit interest rates. The slower response of banks in adjusting interest rates on time deposits with the shortest maturities briefly caused the real interest rate on time deposits of up to one month to turn negative in January and April 2002. Changes in inflation were reflected with a lag in movements in the tolar indexation clause, which peaked in May at 8.56% but ended the year at 7.3%. Because of the movements in inflation and the method for calculating the tolar indexation clause, which has acted as a general inflation-indexing factor for interest rates since 1995, these fluctuations carried over to bank interest rates, particularly in the first half of the year. In July 2002 an Act Amending the Prescribed Penalty Interest Rate and Tolar Indexation Clause Act (Official Gazette of the Republic of Slovenia 109/01) became law, scrapping the indexation of short-term deposit and lending rates, which reduced their volatility.

Figure 6: **Average bank interest rates** (% per annum, monthly average)



Source: Bank of Slovenia.

Falls in lending rates…

The downward trend in inflation brought interest rates down in most segments of the financial market in 2002. Interest rates on short-term bank credit fell from 13.5% to 11.9% and those on long-term credit from 15.7% to 14.7%. Despite cutting their lending rates, however, banks met with subdued demand for both business and consumer credit.

…and deposit rates

Deposit rates came down more markedly than lending rates over the same period. However, the reduction was not the same across all maturities. The largest falls, of up to 2.4 percentage points, were in interest rates on time deposits of up to six months, while rates on long-term deposits fell by between 1.5 and 1.7 percentage points. The main reasons for this uneven reduction in deposit rates were the abolition of inflation-indexing for short-term interest rates in mid-2002 and a sustained narrowing of commercial banks' interest margins. The banks reduced deposit interest rates fairly rapidly in the first half of the year, while in the second half they primarily lowered rates that were not directly linked to fluctuations in the tolar indexation clause. The yield curve steepened in 2002 as banks stimulated savers to make longer-term deposits. The average bank rate in 2002 was 9.1% for three-month deposits and 10.8% for deposits with a maturity of one to two years, compared with 11.3% and 12.8% respectively in 2001.

Long-term deposit rates slower to fall

The Slovenian economy was subject to large capital inflows in 2002 due mainly to mergers and acquisitions and the part-privatisation of the country's largest bank. This encouraged lively growth in share prices, and the stock market index rose by 55.2%. The banks reacted primarily by holding up long-term deposit rates and offering a richer array of savings instruments.

Higher interest rates on Bank of Slovenia monetary policy instruments and securities

Higher inflation, mainly in the first half of the year, required the Bank of Slovenia to maintain its rather tight monetary stance, which involved successive increases in interest rates on most monetary policy instruments. Between the beginning of the year and mid-May the Bank raised interest rates on 60-day tolar bills four times, from 7.50% to 8.75%. In early April it raised the discount rate from 9.0% to 10.0%. Because of their favourable tolar liquidity position the banks did not respond to the open offer of monetary policy instruments, which caused the seven-day and two-month repo rates to go unchanged at 9.5%. Bank refinancing operations at the Bank of Slovenia were conducted by means of seven-day buy-sell swaps at an interest rate of 4.5%.

Table 7: **Bank of Slovenia and money market interest rates**
(% per annum, monthly average for 2002)

	Repurchase agreements		Lombard loan	Bank of Slovenia tolar bills		Money market	Treasury bills			Tolar indexation clause
	7 days	2 months	1 day	60 days	270 days	up to 30 days	3 months	6 months	12 months	
January	11.00	11.03	11.06	7.54	8.67	4.55	7.75	8.78	8.48	7.30
February	11.00	11.03	11.00	7.75	8.85	4.70	7.77	8.54	8.48	8.11
March	10.14	11.03	11.00	7.77	9.02	4.64	7.91	8.54	9.04	8.56
April	10.11	11.03	11.00	8.01	9.86	4.66	8.69	9.29	9.04	7.55
May	11.25	11.03	11.00	8.50	9.88	4.75	8.87	9.29	9.52	8.56
June	10.22	11.03	11.00	8.75	9.99	5.68	9.39	9.65	9.52	7.55
July	11.14	11.03	11.00	8.75	10.00	5.06	8.99	9.65	9.35	7.30
August	10.10	11.03	11.00	8.75	10.00	5.05	8.80	8.98	9.35	7.30
September	10.10	11.03	11.00	8.75	9.98	5.07	10.76	8.98	8.99	7.55
October	10.10	11.03	11.00	8.75	9.99	5.16	8.47	8.66	8.99	7.30
November	10.29	11.03	11.00	8.75	9.99	5.06	8.57	8.66	9.00	7.55
December	10.10	11.03	10.67	8.42	9.67	4.73	8.73	8.75	9.00	7.30

Source: Bank of Slovenia.

New instruments to neutralise heavy foreign exchange inflows at end of year

In November 2002, in order to stabilise the foreign currency market, the Bank of Slovenia extended additional 270-day foreign exchange buy-sell swaps to the signatory banks of the agreement on cooperation in foreign currency market intervention, at an interest rate of 4.5%. At the same time it enabled them to participate in auctions of 360-day tolar bills at a maximum interest rate two percentage points above the auction interest rate for 270-day tolar bills.

Rate cut by Bank of Slovenia at end of year

In December 2002 the Bank of Slovenia cut most of its interest rates following the 0.5 percentage point cut in the interest rate on main refinancing operations of the European Central Bank. On 9 December the Bank of Slovenia refinancing rate dropped to 7.25% and the lending rate to 5.25%. Also cut were the interest rates on foreign exchange repos, from 9.5% to 9.0%, and 60-day tolar bills, from 8.75% to 8.25%. At the same time, the maximum interest rate for auctions of 270-day tolar bills was reduced to 9.5% and that for 360-day tolar bills to 11.5%.

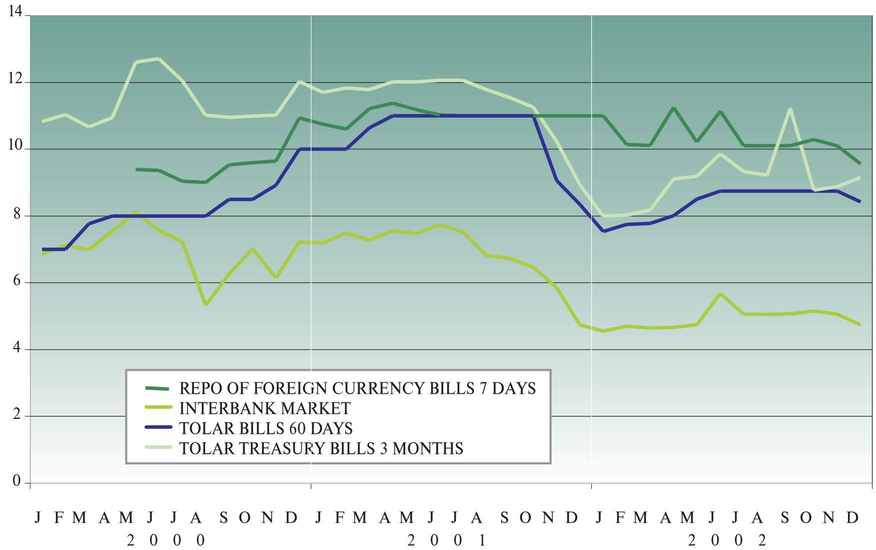
Interest rates on foreign currency bills set by reference to euro market

Throughout 2002 the Bank of Slovenia varied its interest rates on foreign currency bills according to fluctuations in rates on the euro market. The average interest rate on euro-denominated foreign currency bills with 60, 90 and 120-day maturities was between 3.16% and 3.17%, while that on US dollar bills with the same maturity was between 1.62% and 1.67%.

Interest rates on treasury bills falling in the second half of the year

Variations in money market interest rates also closely reflected fluctuations in Bank of Slovenia interest rates and trends in the liquidity of the banking system. Yields at auctions of one, two, six and twelve-month treasury bills, which had fallen sharply in the last quarter of 2001, climbed back up until the middle of 2002 before gradually falling again to the end of the year. The yield on three-month treasury bills on the primary market rose from 7.8% in January to 9.4% in June, then fell to 8.7% at the end of the year. Auctions of twelve-month treasury bills underwent a more muted rise and fall, going from 8.5% at the start of the year to 9.5% in June and 9.0% by year-end. Non-resident participation at primary treasury bill auctions became more frequent in the last quarter of 2002, which sped the decline in auction rates.

Figure 7: **Bank of Slovenia and money market interest rates**
(% per annum, monthly average)



Source: Bank of Slovenia.

Replacement of government bonds

At the end of 2002, RS15 government bonds with an interest rate between tolar indexation clause/DEM + 5.35% and tolar indexation clause/DEM + 6.50%, issued as part of the rehabilitation of state banks, were replaced by new RS44, RS45, RS46 and RS47 bonds. The interest rates on the first two of these were set respectively at 6.65% nominal for a ten-year maturity and at 8.2% nominal for a three-year maturity. Bonds RS46 and RS47 are for five and ten years respectively. Their principal is revalued according to movements in the tolar indexation clause and they bear interest at tolar indexation clause + 3% and tolar indexation clause + 3.25%.

The Maastricht criterion for long-term interest rates in 2002 was 6.86%. In line with European Central Bank criteria the interest rate on RS44 government bonds issued in November 2002 could be taken as the long-term interest rate for the purpose of meeting the Maastricht criterion. This rate is 6.65%.

2.3 Foreign exchange market and the exchange rate

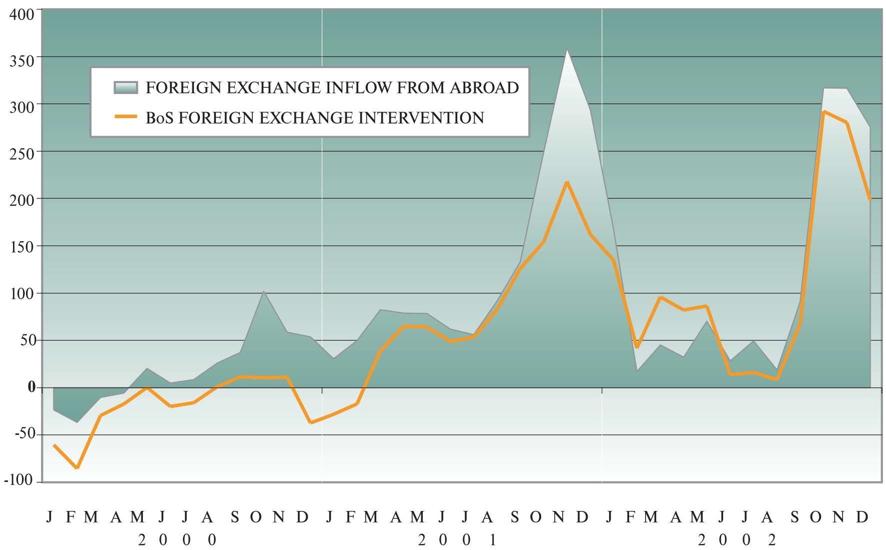
Major inflows in the balance of payments…

Supply and demand on the foreign exchange market is governed by movements in the balance of payments and the decisions of domestic economic agents as to the form in which they wish to hold their assets. Net financial inflows into Slovenia in 2002 totalled EUR 1.2 billion, equivalent to 5.2% of GDP, somewhat less than in 2001. The current account of the balance of payments recorded a substantial surplus of EUR 392 million or 1.9% of GDP. Foreign exchange reserves of commercial banks and the Bank of Slovenia thus grew by almost EUR 1.6 billion.

…creating excess supply of foreign currency on the foreign exchange market

Supply of foreign exchange in 2002 exceeded demand by EUR 919 million. On the currency spot market, demand exceeded supply by EUR 201 million. Only in the second quarter was a net inflow recorded. On the foreign exchange forward market, banks purchased EUR 1.4 billion more in foreign currency than they sold. The forward market recorded net purchases of EUR 377 million of foreign currency in the first quarter and net sales of EUR 32 million in the second quarter, while the second half of the year saw net purchases of EUR 1,064 million. The vast majority of this was

Figure 8: **Foreign exchange flows***
(USD millions per month, 3-month moving average)



* Inflows from abroad excluding direct flows to the Bank of Slovenia (in interest etc. and less net payments out of the Budgetary foreign exchange account).

Source: Bank of Slovenia.

traded in November when the sale of a large Slovenian enterprise to a foreign investor was completed. Over the year, exchange offices sold EUR 289 million worth of foreign currency more than they purchased.

Large-scale currency market intervention by the Bank of Slovenia

In 2002, in view of the goals and orientation set for monetary policy, the Bank of Slovenia continued to eliminate imbalances on the foreign exchange market and to support the growth of the exchange rate in order to bring about a progressive lowering of inflation and a narrowing of the differential between domestic and foreign interest rates. The Bank intervened on the foreign exchange market throughout the year by setting the base exchange rate, thereby slowing the rate of depreciation of the tolar. Month-on-month depreciation was running at an annualised 4% until May, at 3.75% from May to the end of July and at 3.5% thereafter. The Bank was a net purchaser of foreign currency in all months except January and July.

The Bank of Slovenia bought SIT 281 billion in foreign currency from the banks during the year as a whole. Because of developments on the foreign currency market the quantity purchased was largest in November, when it was as high as SIT 169 billion. For the bulk of its transactions the Bank employed 7-day buy-sell swaps, and also, from November on and with certain restrictions, 270-day swaps.

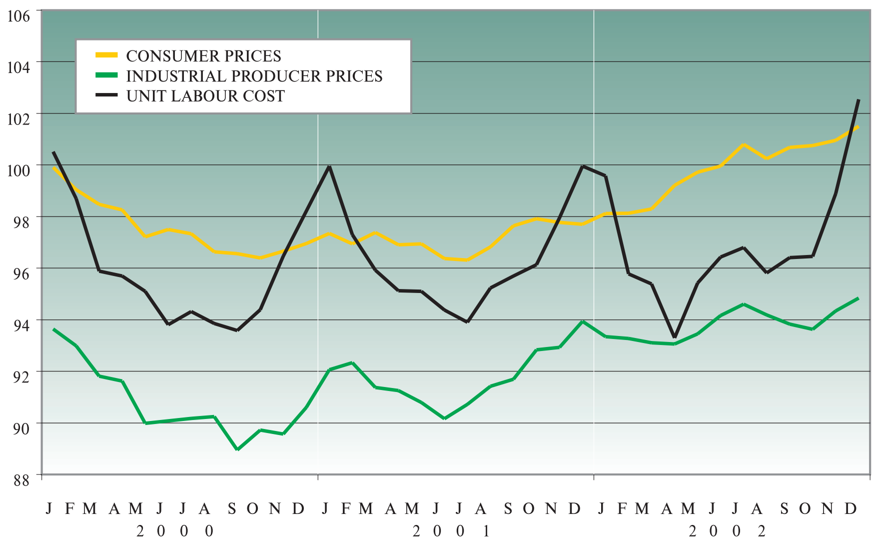
Slower depreciation of the tolar against the euro

Monthly growth in the euro exchange rate on the foreign exchange market gradually eased from 0.4% in January 2002 to 0.25% in December. Average monthly growth in the last three months of the year was below 0.3%. The Bank of Slovenia intervened on the foreign exchange market all year in order to forestall adverse shocks to the economy. The average growth in the euro exchange rate of below 0.3% in the last quarter kept overall depreciation of the tolar against the euro during 2002 down to 3.8%. Movements in the euro exchange rate at exchange offices mirrored those on the foreign exchange market, with annual growth likewise of 3.8%. The official exchange rate of the euro rose by 4.0% in 2002, while that of the US dollar fell by 11.9%. The nominal effective exchange rate (based on a trade-weighted basket of currencies) grew by 1.4%.

Real appreciation of the tolar

With a small exception in the second half of the year, the real effective exchange rate of the tolar rose all year. In the year to December 2002 the tolar appreciated in real terms by 3.9% measured by the ratio of foreign to domestic consumer prices, by 0.9% measured by relative unit labour costs, and by 1.1% measured in terms of producer prices.

Figure 9: **Real effective exchange rate of the tolar** (1995 = 100)



Source: Bank of Slovenia.

2.4 Use of instruments

Monetary and exchange rate policy instruments are surveyed on the basis of the structural position of the money market as defined for Slovenia. Accordingly we distinguish monetary policy instruments, exchange rate policy instruments and instruments of prudential control. Instruments for the purchase and sale of foreign currency are classified as exchange rate policy instruments despite the limited autonomy of foreign currency net assets. In addition to the exchange rate policy instruments appearing on the balance sheet of the Bank of Slovenia, a description is given of instruments that, while they do not appear on the balance sheet, nevertheless affect exchange rates or banks' credit activity. These are the steering of the exchange rate, the open foreign exchange position, the foreign currency minimum and the liquidity ladder.

Monetary policy instruments

The surplus in the structural position of the money market increased again in 2002 due to the monetisation of foreign exchange inflows through the capital account and also the current account of the balance of payments. These inflows were especially high in November and December, creating a corresponding need to neutralise their impact on the liquidity available to the banking system. During 2002 the Bank of Slovenia conducted most of its interventions under the agreement between it and twelve banks concerning cooperation in foreign exchange market interventions. In 2002 the “cooperating” banks included all banks with a main office in Slovenia

Table 8: **Use of monetary and exchange rate policy instruments**
(SIT millions)

	As at 31 December 2001	Daily average by quarter of 2002				As at 31 December 2002
		I.	II.	III.	IV.	
Monetary policy instruments						
Tolar bills	125,777	184,378	208,685	195,979	286,279	369,000
Overnight deposits	35,372	7,213	5,291	4,480	11,356	18,360
Loans to banks	75	245	658	326	205	18
Lombard	0	170	563	267	187	0
Liquidity	0	0	35	0	0	0
Other (*)	75	75	60	59	18	18
Repurchase agreements	0	458	379	92	382	1,148
Reserves of banks and savings banks		103,736	107,842	108,452	110,217	
Compulsory		101,975	105,806	106,294	107,891	
Excess		1,761	2,036	2,158	2,326	
Government time deposits	19,896	8,839	10,227	17,788	97,715	130,276
Exchange rate policy instruments						
7-day foreign exchange buy-sell swaps	262,012	261,226	313,942	326,941	422,640	507,527
270-day foreign exchange buy-sell swaps					23,941	35,565
7-day foreign exchange sell-buy swaps	0	27	216	0	0	0
Memo:						
Foreign currency bills	461,857	493,869	521,531	564,445	566,588	555,116

* Long-term selective loans granted before monetary independence.
Source: Bank of Slovenia; less interest and evaluation effects, at transaction rates.

except the Slovenian branch of Kärntner Sparkasse AG (see also the section on exchange rate policy instruments).

Large-scale issuance of tolar bills…

The most important instruments in 2002 were tolar bills. The Bank of Slovenia issued them for the purpose of absorbing the excess tolar liquidity arising from the increase in foreign exchange buy-sell swaps (see also the section on exchange rate policy instruments). The remainder of this section gives a brief overview of the use of the various monetary policy instruments.

…with 60, 270 and 360-day maturities

In the course of 2002 the Bank of Slovenia issued 60-day, 270-day and 360-day tolar bills. 60-day bills made were available to banks via open offers throughout the year. 270-day bills were offered to the cooperating banks at auctions. In June their frequency was increased from two to four per month because of the rather uniform distribution of the maturity of the large accumulated volume of bills. From early November to 12 January 2003 the cooperating banks were also able to subscribe for 360-day tolar bills aimed at absorbing the liquidity that had entered the money market as a result of the purchase of foreign currency in the takeover of Lek by the Swiss pharmaceuticals concern Novartis. The interest rate on these bills was two percentage points higher than on 270-day bills. The stock of outstanding tolar bills grew from SIT 125.8 billion to SIT 369.0 billion in the twelve months to December 2002.

In normal circumstances the interest rate on overnight deposits by banks and savings banks at the Bank of Slovenia is the lowest on the money market. The stock of overnight deposits increased temporarily during the period of increased foreign exchange inflow and later spilled over into an increase in tolar bills.

Marginal lending instruments maintained…

The Bank of Slovenia made liquidity loans of last resort, lombard loans and 7-day foreign currency bill repurchase agreements available to banks and (with the exception of the last of these) to savings banks on a daily basis. As in 2001, banks had an opportunity twice a month to acquire liquidity through two-month foreign currency bill repos. Within the range of monetary policy instruments, these three acted as the source of marginal financing to banks and savings banks.

…and one-day loans introduced

With the introduction of one-day loans at the end of October, the Bank of Slovenia abolished liquidity loans of last resort and reduced the required rate of central bank bill collateral on lombard loans from 2000% to 110%.

Changes in the calculation of compulsory reserve requirements…

The Bank of Slovenia twice changed the method for the calculation of compulsory reserves in 2002. The first occasion was in January, when it changed the treatment of repo transactions so that those based on short-term government securities are no longer included in the base for the calculation of compulsory reserves. The second change, which took effect as of the September compulsory reserve period, extended the compulsory reserve base to include banks' foreign currency-denominated liabilities as well as tolar-denominated liabilities and redefined the compulsory reserve ratios. A zero ratio was introduced for liabilities with a maturity of longer than two years and for repurchase agreements based on short-term government securities. Liabilities with a maturity of two years or less are divided into two classes, namely, on the one hand, foreign currency-denominated liabilities with a maturity of up to two years and tolar-denominated liabilities with a maturity of between 91 days and two years, both carrying a 2% ratio, and on the other, tolar-denominated liabilities with a maturity of 90 days or less, which are subject to a reserve ratio of 7%. Under the new method, National Housing Saving Scheme assets are included in the part of the base to which a zero ratio applies, which means that fulfilment of compulsory reserves by 60-day tolar bills, which was introduced in December 2000, is no longer possible as of September 2002.

Reserve base widened…

Before the change in the method of calculation, in other words until August 2002, the compulsory reserve base included only tolar-denominated liabilities with a maturity of up to one year (deposits, accepted loans and issued securities, held by non-banking sector agents), while the compulsory reserve ratio was determined according to their maturity: 12% for liabilities redeemable on demand or with an agreed maturity of up to 30 days, 6% for liabilities with a maturity of 31 to 90 days, 2% for maturities of 91 and 180 days and 1% for those of between 181 days and one year. Liabilities with a maturity over one year were not subject to compulsory reserves.

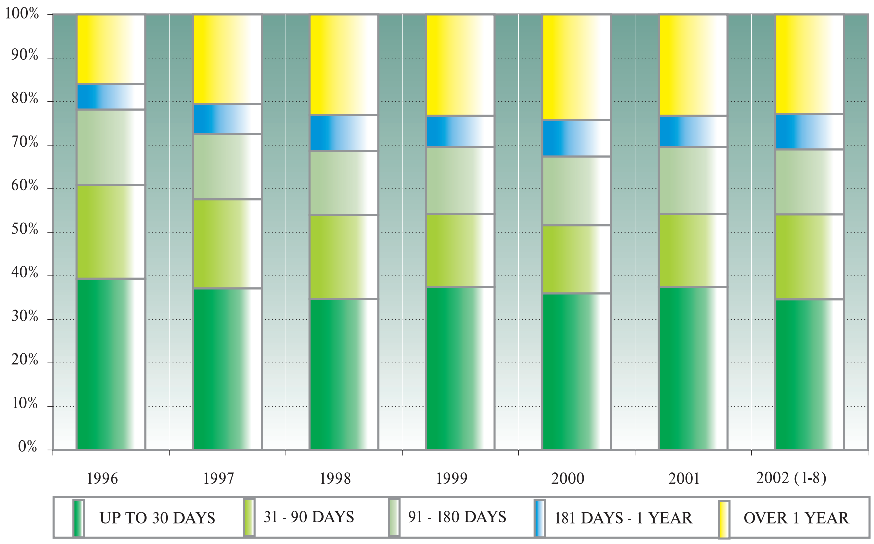
The base for the calculation of compulsory reserves is computed as the average daily accounting balance of the base items from the 22nd day of the previous month to the 21st day of the current month. The maintenance period is also one month but runs from the 27th of the previous month to the 26th of the current month. Direct participants in the Real Time Gross Settlement System (RTGS), namely the banks and the two savings banks, maintain their compulsory reserves by means of the balance on the settlement account and in treasury, while indirect participants do so by the balance of a special compulsory reserve account at the Bank of Slovenia and the stock of notes and coins in treasury. On any given day they are obliged to maintain 50% of reserves calculated from the previous month in the settlement or compulsory reserve account.

The compulsory reserve base increased by 12% between January and August (as compared with 25% in 2001). It grew by 67% in September because of the widening of the base, and by a further 7% to the end of the year. The base grew by SIT 1,911 billion to SIT 3,818 billion in nominal terms in the course of the year. As at December 2002 the proportion of liabilities to which a positive compulsory reserve ratio applied was 79%.

…but no change to the burden on banks

In setting the new compulsory reserve ratios, the Bank of Slovenia aimed to maintain compulsory reserves at approximately their existing level. In the year to December 2002, compulsory reserves grew by 15% to SIT 112.4 billion. The average compulsory reserve ratio in the period between January and August 2002 was 5.1% with respect to all tolar-denominated liabilities, or 6.9% with respect to liabilities of one year or less, which in both cases was 0.2 percentage points less than in 2001. Following the

Figure 10: **Average composition of tolar deposits**



Source: Bank of Slovenia.

revision, the average compulsory reserve ratio with respect to all tolar-denominated and foreign currency liabilities was 2.9%, while that on liabilities with a maturity of up to two years was 3.7%.

Actual reserves exceeded compulsory reserves by 2.0% on average (as against 2.8% in 2001). Banks maintained the lowest average excess reserves and savings and loan undertakings the highest.

Further issues of one-month treasury bills aimed at developing the money market

In 2001 the Ministry of Finance, in collaboration with the Bank of Slovenia, began to issue one-month treasury bills to assist the development of a secondary market in short-term government securities. In 2001 and 2002 the Ministry placed a portion of surplus proceeds with the Bank of Slovenia in the form of a one-month treasury deposit. In the first half of 2001 it did so only partially, but from July 2002 on its liquidity needs were satisfied to the extent that it was able to deposit the entire proceeds with the Bank. On 29 October 2002 the Ministry of Finance deposited several special tolar-denominated time deposits with maturities ranging between two months and one year. The funds originated from the sale of the Republic of Slovenia's equity holding in Nova Ljubljanska Banka. The Ministry also forged a smaller link with the Bank of Slovenia in early July at the transition to new arrangements for the management of funds of budget users (the introduction of a single treasury account).

Exchange rate policy instruments

The Bank of Slovenia employed a variety of instruments to influence the exchange rate. It bought and sold foreign currency in outright and reverse transactions, thereby altering supply and demand on the foreign exchange market. Under the agreement on cooperation in foreign exchange market intervention it steered the exchange rate, setting the range of rates at which the banks dealt with other parties.

Sale and purchase of foreign exchange

The sale and purchase of foreign exchange at the Bank of Slovenia was the most important source of liquidity for the banking system in 2002. With the exception of a small quantity of forward purchases of foreign currency from banks agreed in 2001, the Bank of Slovenia purchased foreign exchange from cooperating banks solely on a temporary swap basis. The most important instrument was the 7-day foreign exchange buy-sell swap. Until the end of October the term of the swap was 7 days; contracts were generally renewed at maturity. At the beginning of November the banks were also offered 270-day foreign exchange buy-sell swaps with the option of outright sale of the foreign exchange to the Bank of Slovenia at maturity.

Sale of foreign exchange to the Bank of Slovenia the most important source of liquidity for the banking system

The quantity of foreign exchange sold to the Bank of Slovenia under buy-sell swap contracts grew from SIT 262.0 billion at the start of 2002 to SIT 543.1 billion at the end of the year. The growth was especially rapid in the last two months of the year due to the monetisation of the proceeds of the sale of Lek.

In the course of 2002 the Bank of Slovenia sold the Ministry of Finance SIT 51.2 billion net in foreign exchange for the purpose of external payments.

Exchange rate steering

Continued foreign exchange market intervention

The Bank of Slovenia made use of the mechanism for steering the exchange rate available to it under the cooperation agreement with the banks concerning foreign exchange market intervention. By setting the exchange rate, the central bank sends signals to the wider financial and real sectors. The Bank of Slovenia responded to pressure to increase the value of the tolar in response to excess supply on the foreign exchange market by intervening to influence the path of exchange rate growth. Since mid-September 2001 it has intervened in the foreign exchange market by setting the base exchange rate and hence also the highest selling and lowest buying rates, thereby causing the interest differential between domestic and foreign interest rates to narrow.

2.5 Prudential control

Foreign currency bills

Foreign currency bills…

Banks were able to subscribe for euro and US dollar-denominated foreign currency bills with maturities of 60, 90 and 120 days. The Bank of Slovenia sold them via open offer and aligned their interest rates with those on the foreign money market.

…the most important collateral instrument on lending to banks

The Bank of Slovenia required adequate collateral on all monetary policy lending instruments, as well as one-day loans, taken up by banks. Foreign currency bills were the most important form of collateral. Besides these bills, banks and savings banks were able to pledge Bank of Slovenia tolar bills and Republic of Slovenia treasury bills as collateral.

The largest segment of demand for foreign currency bills, however, was created by the Regulation on the Minimum Level of Liquidity to be Maintained by Banks. This regulation requires that a bank's holdings of foreign currency bills be at least 45% of the value of its foreign currency liabilities with a remaining term to maturity of 180 days or less. The regulation replaced the previous Regulation on the Foreign Currency Minimum in February 2002.

Banks also subscribed for foreign currency bills for the purpose of fulfilling the liquidity ladder.

At the end of 2002 there was SIT 555.1 billion in outstanding euro and US dollar-denominated bills, 20.2% more than at the end of 2001.

Special liquidity loans granted with the participation of banks

A seventh agreement on willingness to participate was signed in 2002 between the Bank of Slovenia and 19 banks for the purpose of special liquidity loans granted with the participation of banks. The signatory banks were remunerated at a rate of 1.5% of the extent of their willingness to participate. In 2002, as has been the case in every year since the loan was introduced, the mechanism for the participation of signatory banks was not triggered.

Liquidity ladder

Simplified monitoring of tolar and foreign currency liquidity…

In October 2001 the Bank of Slovenia passed a Regulation on the Minimum Level of Liquidity to be Maintained by Banks, simplifying the monitoring of tolar and foreign currency liquidity. The regulation requires daily disclosure of banks' actual liquidity ratios with effect from 1 July 2002. This ensures daily monitoring within banks as well as regulation of all agreed monetary flows through calculation of the liquidity ratios. Liquidity ratios are calculated as the ratio of claims and liabilities by term to maturity, separated into a tolar and foreign currency portion within category one (0 to 30 days term to maturity) and category two (0 to 180 days term to maturity), and are set at 1.0. All flows are taken into account, both on and off-balance sheet.

…and prescription of minimum liquid foreign exchange assets

The regulation also prescribes a minimum volume of liquid foreign currency claims and compulsory subscription for Bank of Slovenia foreign currency bills. In category two (0-180 days) of the foreign exchange portion Banks are obliged to ensure that on any given day the sum of foreign currency claims on the Bank of Slovenia, the Republic of Slovenia, and foreign and domestic banks, foreign currency securities assets and foreign currency cash assets, is equal to at least 80% of balance sheet liabilities in category two of the foreign exchange portion as at the last working day of the previous month. Bank of Slovenia foreign currency bills must constitute at least 45% of foreign currency balance sheet liabilities in category two.

The Bank of Slovenia permitted the signatory banks of the special agreement on cooperation in foreign exchange market intervention to meet only the total liquidity ratio of categories one and two. As at 31 December 2002 the average liquidity ratio of all banks was 1.11 in category one and 1.09 in category two.

The new regulation superseded others that had previously been in force. The Regulation on the Foreign Exchange Liquidity Ladder and the Tolar Liquidity Ladder ceased effect as of 1 January 2002, while the Regulation on Fulfilment of the Minimum Quantity of Foreign Currency to be Maintained by Authorised Banks (the Foreign Currency Minimum) ceased effect as of 15 February 2002.

Open foreign exchange position of banks

Regulation on Unequalised Foreign Currency Claims and Liabilities of Banks superseded

In order to insure against foreign currency risk, banks undertaking operations involving foreign means of payment were obliged, in accordance with the Regulation on Unequalised Foreign Currency Claims and Liabilities of Banks, to perform daily calculations of their open foreign exchange position, which was not permitted to exceed 20% of each bank's capital, while the average monthly open foreign exchange position of each was not permitted to exceed 10% of capital. The Regulation on Unequalised Foreign Currency Claims and Liabilities of Banks ceased effect as of 30 June 2002.

The aggregate open foreign exchange position of banks as at 27 June 2002 was short. Foreign currency liabilities were SIT 9,953 million greater than claims, equivalent to 3.6% of banks' capital. Thirteen banks had a short open foreign exchange position, while eight had a long position.

Since the cancellation of the Regulation on Unequalised Foreign Currency Claims and Liabilities of Banks, insurance against foreign currency risk has been governed by the Regulation on the Capital Adequacy of Banks (see p. 48).

Oversight of monetary policy implementation

Six protocols were lodged in 2002 on the basis of findings made in the course of indirect oversight of banks with respect to minimum liquidity levels. In all six cases, the Bank of Slovenia issued rulings terminating proceedings once the non-compliance had been rectified. A further six rulings were made terminating proceedings pursuant to protocols lodged by the Bank in 2001.

In the area of foreign exchange dealing, the Bank of Slovenia conducted 34 investigations of licensed bureaux de change in 2002. On the basis of these investigations and the protocols of investigations of licensed banks, three proposals for the institution of infringement proceedings were submitted to the National Foreign Exchange Inspectorate, two licences for foreign exchange dealing were conditionally withdrawn and two decisions revoking licences for foreign exchange dealing were issued.

3. BANKING SECTOR

Introduction of new accounting standards, changes in ownership structure and further consolidation of the banking sector

The year 2002 witnessed the introduction of new Slovenian Accounting Standards, further consolidation of the banking sector and changes in banks' ownership structure. The introduction of the new Slovenian Accounting Standards (2001), in use since 1 January 2002, affected banks' financial statements for 2002, particularly the income statement. The most important change brought in by the new Slovenian Accounting Standards is the scrapping of inflation-indexed revaluation. The introduction of the new standards necessitated revisions to a number of Bank of Slovenia regulations concerning banking supervision. Consolidation of the banking sector in 2002 was not as intense as in 2001, although the merger of a minor with a major bank expanded the latter's market share, lifting it from fourth to third place by total assets. The ownership structure of banks in Slovenia was considerably altered in 2002 by the acquisition of shareholdings in Slovenian banks by foreign banks, which doubled the proportion of foreign equity between the end of 2001 and the end of 2002. Another factor in the rising share of foreign ownership in Slovenia's banks was the privatisation of the largest bank in Slovenia, Nova Ljubljanska Banka, in the summer of 2002.

3.1 Composition of the banking sector

Slovenia's banking sector is dominated by banks. At the end of 2002 these formed 98.6% of the market by unconsolidated total assets, with savings banks and savings and loan undertakings making up the rest. Savings banks formed 0.3% of the market and savings and loan undertakings 1.1%.

20 banks…

In 2002 there were 21 banks operating in Slovenia (including the branch office of a foreign bank), although on the last day of the year Banka Vipa of Nova Gorica merged with Abanka of Ljubljana. The merger left 20 banks operating in Slovenia as at 31 December 2002, including five subsidiaries and one branch office of a foreign bank. This was the only change of incorporation among banks in 2002 and caused the merged entity Abanka Vipa to leapfrog SKB Banka of Ljubljana into third place among Slovenian banks by total assets. SKB Banka had been the third largest bank in terms of total assets for the previous four-and-a-half years.

…2 savings banks…

One change of incorporation occurred among savings banks in 2002. In the middle of the year LLT Hranilnica in Posojilnica of Murska Sobota merged with Nova Kreditna Banka Maribor, leaving only two savings banks in operation as at 31 December 2002.

…and 25 savings and loan undertakings at end of 2002

In addition to the 20 banks and two savings banks, there were also 25 savings and loan undertakings operating at the end of the year. The number of savings and loan undertakings has declined heavily since the Regulation on the Conformity of Savings and Loan Undertakings with the Banking Act became law in 2000. Since then a large number savings and loan undertakings have amalgamated with the Association of Savings and Loan Undertakings. There have also been some takeovers of savings and loan undertakings by banks, three voluntary liquidations and three bankruptcies.

Table 9: **Ownership of banking sector** (% of equity capital as at 31 December)

	31-Dec-00	31-Dec-01	31-Dec-02
Non-residents	12.0%	16.0%	32.5%
Central government	36.8%	37.0%	20.3%
Other domestic entities	51.2%	47.0%	47.2%

Source: Bank of Slovenia.

The reason for the decline in the number of savings and loan undertakings has been the requirements of compliance with the Banking Act.

Increased non-resident share and decreased government share of bank ownership

In addition to consolidation, the banking sector also underwent changes to its ownership structure. Slovenia's banks are characterised by being mostly privately owned, while its savings banks are wholly so. The majority of private owners of banks, and all owners of savings banks, are also residents. With the privatisation of Nova Ljubljanska Banka of Ljubljana, the share of state ownership in that bank and in the overall banking system decreased. The sale of 39% of the government share in Nova Ljubljanska Banka in summer of 2002 turned the government from the majority owner into a minority one. The country's second-largest bank, Nova Kreditna Banka Maribor, and Poštna Banka Slovenije remain in majority state ownership. Meanwhile, the share of foreign equity more than doubled in 2002 to stand at 32.5% as at 31 December. This strong rise was caused mainly by an increase in foreign equity in Banka Koper, the acquisition of Krekova Banka by an Austrian bank and the purchase of 39% of Nova Ljubljanska Banka by a Belgian bank and the European Bank for Reconstruction and Development. At the end of 2002, of the 20 banks in operation, six were in majority foreign ownership (including one branch of a foreign bank), six more were wholly domestically owned, and the remaining eight were in majority domestic ownership. Of the last group, half had less than 1% foreign equity.

Table 10: **Average total assets and GDP**

SIT millions	2000	2001	2002[2]
Average total assets of banks and savings banks[1]	2,925,937	3,505,317	4,216,394
GDP at current prices	4,222,400	4,740,995	5,284,501
Average total assets/GDP (%)	69.3	73.9	79.8

[1] Including savings and loan undertakings.
[2] Excluding the branch of Nova Ljubljanska Banka in Italy.
Source: Bank of Slovenia.

Total assets of banks and savings banks (including savings and loan undertakings) are growing annually as a proportion of GDP.

The issuing of authorisations to banks and savings banks is one of the Bank of Slovenia's most important responsibilities. As well as authorisations to provide banking services and other financial services, the Bank of Slovenia issues authorisations for acquiring a qualifying shareholding, undertaking a merger, establishing a branch abroad, establishing a branch of a foreign bank in the Republic of Slovenia, establishing a representative office of a foreign bank, and serving as a member of a bank's management board. The decision to grant or refuse an authorisation is taken by the Governing Board of the Bank of Slovenia on the basis of an opinion of an expert committee, except in the case of authorisations to serve as a member of a management board, where the decision is based on an opinion by a special committee of the Governing Board.

Table 11: **Number of authorisations granted and refused to banks and savings banks**

	Type of authorisation	2001		2002	
		granted	rejected	granted	rejected
1.	Authorisation to provide banking services	0	0	0	0
2.	Authorisation to provide other financial services	10	1	4	2
3.	Authorisation to a foreign bank to establish a branch	0	0	0	0
4.	Authorisation for a merger of banks or savings banks	4	0	1	0
5.	Authorisation to a foreign bank to establish a representative office	2	0	0	0
6.	Authorisation to acquire a qualifying holding	6	1	3	2
7.	Authorisation to serve as a member of a management board	7	0	20	0
	Total	29	2	28	4

Source: Bank of Slovenia.

3.2 Financial performance of banks

Since savings banks and savings and loan undertakings have only a 1.4% combined market share in terms of total assets, this section on financial performance of the banking sector in 2002 focuses exclusively on banks.

Income statement

In reporting their income statements for 2002, banks restated their 2001 figures in accordance with the new Slovenian Accounting Standards. Accordingly, the various categories of income and expense for 2001 (such as net interest income and foreign exchange gains and losses) have been supplemented by appropriate items for revaluation gains and losses, which under the old accounting standards were shown under net inflation-indexed revaluation income. The residual difference from net revaluation income in 2001 is shown as a net amount under extraordinary expense arising from capital revaluation adjustment. This enhances the comprehensibility and comparability of the various types of income and expense in the income statement for 2002.

The new accounting standards do not require specific provisioning for equity investments or investments in securities. Such investments are instead valued in accordance with the new standards. Expense arising from the revaluation of such investments due to impairment is shown as financial revaluation expense under losses arising from financial transactions.

The statement conventions and criteria for the suspension of income have also been altered. The income statement must recognise accrued income from claims on counterparties classified in categories A or B, provided the claim has not been classified within category B on the basis of real estate collateral. Thus, only income accounted on non-performing claims on counterparties classified in categories C, D and E is suspended.

Improved financial results of banks…

Banks performed better in 2002 than in past years, ending the financial year with pre-tax profits of SIT 46.1 billion. Only three banks posted a loss. The results were up by SIT 30.6 billion on 2001 before taking into account SIT 19.5 billion in losses by a major bank. The improved performance of banks in 2002 was partly due to changes brought in by the Slovenian Accounting Standards, which no longer require compulsory inflation-indexed revaluation of capital. Under the new rules, general capital revaluation is undertaken only if appreciation of the euro against the tolar in the preceding financial year exceeds 5.5%. In 2001 this appreciation was only 4.7%.

The banks' month-on-month results during 2002 were variable. Four banks traded temporarily at a loss (mainly because of higher additional provisions), while one minor bank recorded poor results all year due to lower net income from fees and commissions and financial transactions, and registered a more sizeable loss at the end of the year due to additional provisions made in December.

…due mainly to higher gross profits

Banks earned SIT 143.0 billion in net interest income during 2002. This represented real growth compared with 2001 of 14.8%[1] or SIT 27.0 billion, thanks to faster growth of interest income than of interest expense (interest and similar income, which includes interest on Bank of Slovenia and government securities, grew by 7.1% in real terms while interest expense grew by 2.2%). Net fees and commissions grew even faster, by 20.5% in real terms to SIT 53.8 billion. The strongest growth was in

[1] Real growth of items in the income statement is calculated on the basis of average annual inflation for 2002 of 7.5%.

commissions on payments to government, intermediation and brokerage, while commissions on administrative services were also high. Net income from financial transactions was down on 2001 by 5.2% in real terms, mainly due to the newly included item foreign exchange gains and losses, which recorded a net loss, although on the side of gains from financial transactions, income from the sale of shares increased. Other net income[2] was negative in 2001 (SIT 5.1 billion) due to SIT 20.6 billion in extraordinary expense arising from capital revaluation adjustments, to which residual inflation-indexed revaluation losses were booked, while in 2002 other net income was up by SIT 10.8 billion to SIT 5.8 billion thanks to the absence of extraordinary restatements of residual gains and losses from inflation-indexed revaluation.

Gross profit of banks in 2002 came to SIT 223.8 billion, of which somewhat more than half (59.7%) was absorbed by operating costs and around one-fifth by net provisions (19.7%), leaving 20.6% in pre-tax profits.

Operating costs up

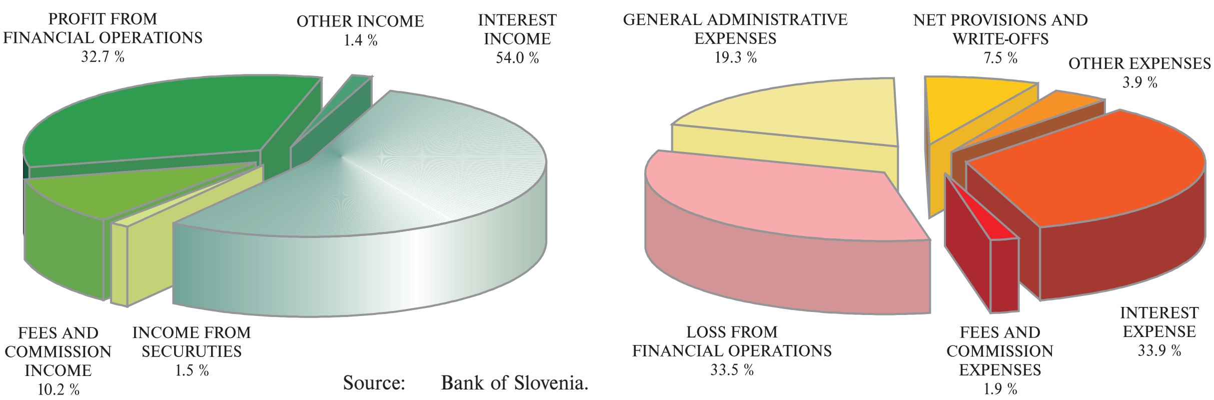
Operating costs grew by 9.9% in real terms in 2002, a substantial jump that was due mainly to staff costs, which grew by 15.3% over the period. The ratio of staff costs to average assets grew fractionally, from 1.55% in 2001 to 1.59% in 2002, as did the

Table 12: **Income statement of the banking sector, principal items**

	SIT millions		Share in %		Nominal growth in %	
	2001	2002*	2001	2002	2001/2000	2002/2001
Net interests	115,930	143,019	66.9	63.9	-8.1	23.4
Net fees and commissions	41,523	53,794	24.0	24.0	9.7	29.6
Net financial transactions	20,805	21,196	12.0	9.5	44.1	1.9
Net other	-5,080	5,789	-2.9	2.6	-38.0	-214.0
Gross income	**173,179**	**223,798**	**100.0**	**100.0**	**1.7**	**29.2**
Operating expenses	112,949	133,494	65.2	59.6	12.5	18.2
– labour (staff) expenses	53,181	65,951	30.7	29.5	9.2	24.0
Net income	**60,230**	**90,304**	**34.8**	**40.4**	**-13.7**	**49.9**
Net provisions and net write-offs	-44,783	-44,183	-25.9	-19.7	20.3	-1.3
Profit/loss before tax	**15,447**	**46,121**	**8.9**	**20.6**	**-52.6**	**198.6**
Profit/loss after tax	**1,926**	**29,606**	**1.1**	**13.2**	**-90.3**	**1,437.6**

* Excluding the branch of Nova Ljubljanska Banka in Italy.
Source: Bank of Slovenia.

Figure 11: **Breakdown of banks` income and expense**



Source: Bank of Slovenia.

2 Other net income covers other operating income, extraordinary income, other operating expenses and extraordinary expenses.

staff costs as a proportion of total expense, from 10.0% to 11.2%. Services costs also rose sharply. Despite the significant rise in operating costs, net profits in 2002 were up 39.5% in real terms on the previous year. In 2002 the banks made SIT 44.2 billion in net provisions, a very similar total to 2001.

Improved profitability ratios…

Profitability ratios were more favourable in 2002 than in 2001 thanks to higher profits. The most significant improvement was in return on equity, which rose partly because of increased profits and partly also because of slower equity growth as a result of the absence in 2002 of general capital revaluation.

…but interest margin unchanged

Banks' interest margin, expressed as the ratio of net interest income to average gross interest-bearing assets, was similar to 2001. The only difference was slightly faster growth of net interest income (23.4%) than of average gross interest-bearing assets (21.4%), causing a small rise in the interest margin in 2002. In 2001 net interest income was actually lower than in 2000, while gross interest-bearing assets grew by 19.8%.

Table 13: **Selected banking sector profitability ratios** (%)

	1999	2000	2001	2002
Gross income/average total assets	5.4	5.9	5.0	5.4
Return on average assets	0.8	1.1	0.5	1.1
Return on average equity	7.8	11.4	4.8	13.3
Net interest margin	4.1	4.7	3.6	3.7
Operating expenses/average total assets	3.6	3.5	3.3	3.2

Source: Bank of Slovenia.

Balance sheet

Changes to Slovenian Accounting Standards

The change in the Slovenian Accounting Standards entailed various alterations in the structure and content of banks' balance sheets. Suspended income is no longer recorded within liabilities under accruals and deferred income, but enters the assets side of the balance sheet as part of value adjustments for impairment of bad and doubtful investments and claims. Investments in securities, equity, own shares and bills of exchange are valued as laid down in the Slovenian Accounting Standards and expressed at fair value. The effects of asset enhancement are recognised as specific capital value adjustments, while impairment expenses are shown as financial value adjustments and reduce income. The new accounting standards do away with inflation-indexed revaluation, and the inflation-indexed capital revaluation adjustment for the year 2001 has therefore been transferred to the general capital value adjustment as part of the transition to the new standards.

The restatement of the figures for 2001 to accord with the new accounting standards caused a 2.2% reduction in total assets, mainly because of the altered accounting treatment of suspended income.

Total assets up by 17.4%

Total assets of the banking system in Slovenia grew in 2002, albeit more modestly than in 2001, which was exceptional because of the introduction of the euro currency. At the end of the year, total assets stood at SIT 4537.2 billion (excluding the branch of Nova Ljubljanska Banka in Italy), representing 17.1% nominal growth (9.1% real)[1]. Nominal total asset growth of individual banks varied between –13.5% and 60.0%. Two banks ended the year with lower total assets than at the end of 2001.

Market share of leading bank little changed

The market share of Slovenia's largest bank at the end of 2002, measured in terms of unconsolidated total assets, was 35.3%, or 39.1% including its three subsidiaries, roughly the same as a year previously. The market share of the three largest banks shrank compared with the end of 2001 due to the reduced market share of SKB Banka of Ljubljana, which even the rise in market share of Abanka Vipa due to its takeover of Banka Vipa of Nova Gorica could not counteract. On the other hand, the market share of the seven largest banks grew due to an expanded market share of the fifth, sixth and seventh largest banks.

Reduced growth in amounts owed to non-bank customers

Amounts owed to non-bank customers grew by 14.0% in 2002 (6.3% in real terms), a much lower rate of growth than in 2001. Real growth was more in line with the period from 1998 to 2000, in which there were no increased foreign exchange inflows due to the introduction of the euro currency. Strong growth of deposits from enterprises continued in 2002, although more so in the foreign exchange segment than the tolar segment, reflecting inflows from abroad. Household deposits grew more moderately last year after growing strongly in 2000 and 2001, reflecting the impact of alternative forms of saving, especially mutual investment funds.

Increase in amounts owed to foreign banks

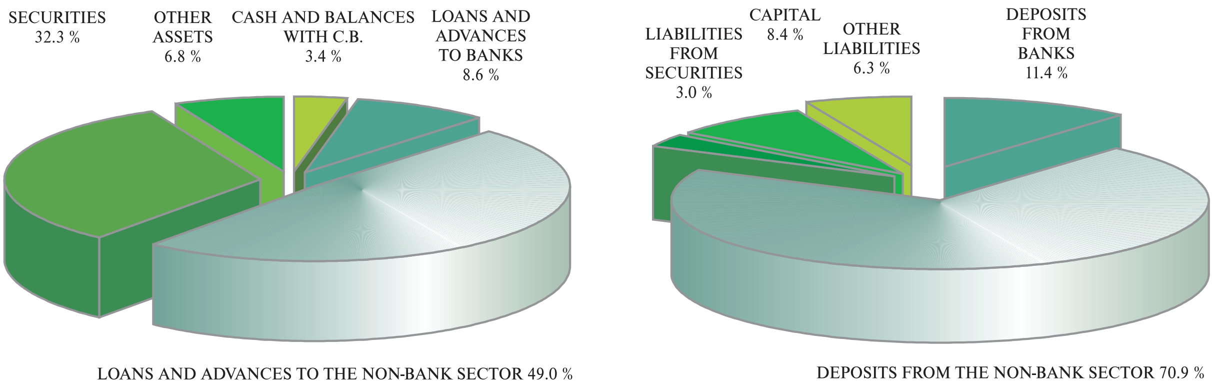
Amounts owed to banks grew by 25.2% in 2002. There was a continuation in the upward trend in the proportion of amounts owed to foreign banks, which stood at 79.2% of all amounts owed to banks, compared with 72.5% in 2001. Amounts owed to the Bank of Slovenia also grew in 2002, increasing more than fifteen-fold from a mere SIT 75 million at the end of 2001, while amounts owed to domestic banks fell by 6%. In 2002 banks focused on issuing long-term securities, unlike 2001 when the emphasis was on short-term securities.

Table 14: **Total assets and market share of largest banks**

Bank	Total assets (SIT millions)		Nominal growth (%)		Market share (%)	
	31-Dec-01	31-Dec-02	2001/2000	2002/2001	31-Dec-01	31-Dec-02
NLB *	1,376,656	1,600,150	50.2	16.2	35.5	35.3
NKBM	447,175	517,538	26.1	15.7	11.5	11.4
Abanka	253,996	389,273	35.8	53.3	6.6	8.6
SKB banka	365,616	360,095	19.2	-1.5	9.4	7.9
Banka Koper	233,960	282,116	23.5	20.6	6.0	6.2
Banka Celje	224,270	275,658	22.2	22.9	5.8	6.1
Gorenjska banka	189,445	227,130	29.6	19.9	4.9	5.0
Largest 7 banks	3,091,118	3,651,961	35.3	18.1	79.7	80.5
All banks	3,876,768	4,537,784	24.0	17.1	100.0	100.0

* Excluding the branch of Nova Ljubljanska Banka in Italy.
Source: Bank of Slovenia.

Figure 12: **Breakdown of banks' assets and liabilities as at 31 December 2002**



Source: Bank of Slovenia.

[3] Real growth of balance sheet items is calculated on the basis of annual inflation for 2002 of 7.2%.

Banks' total capital grew by 11.2% in nominal terms in 2002, or by 4.4% in real terms. Under the new Slovenian Accounting Standards, total capital includes a new item, termed specific capital value adjustment, which reflects the effect of revaluation on the fair value of assets and liabilities. The specific capital value adjustment plays a transitional role as an adjustment to the value of the categories on the balance sheet to reflect the change in their fair value. Inclusion of this item, which in fact represents as yet unrealised income, caused a 5.9% nominal increase in total capital. Ignoring the specific capital value adjustment, total capital grew by 5.3% in nominal terms (and declined by 1.8% in real terms). No general capital revaluation was performed in 2002 as provided for in the new accounting standards, since the appreciation of the euro exchange rate against the tolar in 2001 was below the 5.5% threshold.

Little growth in credit to customers…

Loans to non-bank customers rose by 13.3% in 2002 (5.7% in real terms), a lower annual rate of growth in real terms than in any year from 1999 to 2001. Loans to enterprises, having grown strongly in 2001, grew by only 9.7% in 2002. The expansion in credit to the enterprise sector of recent years came to an end. The decline in household credit began after the introduction of value added tax in 1999. Growth of credit in 2002 was greater than in 2001, although at 0.8% in real terms it represents no more than the maintenance of the value of the portfolio. The volume of banks' loans to government was greatly increased in 2002 as a result of the restructuring of the government debt from foreign to domestic sources, and partly also to payments of the 4th and 15th issues of Republic of Slovenia bonds. Loans to non-residents, in which the downward trend of 2000 and 2001 was reversed by strong growth of 113.3%, resulted from the encouragement of exports, especially to the former Yugoslavia, the Czech Republic in the United States, and loans to subsidiaries of resident enterprises.

Table 15: **Balance sheet of the banking sector, principal items**

	SIT millions		Share		Nominal growth in %		Real growth in %
	31-Dec-01	31-Dec-02*	31-Dec-01	31-Dec-02*	2001/ 2000	2002/ 2001*	2002/ 2001*
Deposits with central bank	206,225	143,308	5.3	3.2	109.1	-30.5	-35.2
Loans and advances to the banking sector	396,245	373,390	10.2	8.2	8.7	-5.8	-12.1
Loans and advances to the non-bank sectors	1,913,914	2,168,068	49.4	47.8	17.0	13.3	5.7
– Loans and advances to non-financial institute.	1,167,066	1,280,631	30.1	28.2	24.4	9.7	2.4
– Loans and advances to households	521,135	562,862	13.4	12.4	7.7	8.0	0.8
– Loans and advances to government	159,075	215,992	4.1	4.8	5.4	35.8	26.7
– Loans and advances to others	66,638	108,583	1.7	2.4	7.1	62.9	52.0
Securities	1,109,316	1,546,902	28.6	34.1	39.9	39.4	30.1
Other assets	251,067	306,116	6.5	6.7	7.4	21.9	13.7
Total assets	**3,876,768**	**4,537,784**	**100.0**	**100.0**	**24.1**	**17.1**	**9.2**
Liabilities to the banking sector	452,765	567,014	11.7	12.5	13.6	25.2	16.8
Liabilities to the non-bank sectors	2,761,651	3,148,492	71.2	69.4	28.0	14.0	6.4
– Liabilities to non-financial institutions	517,744	604,050	13.4	13.3	17.2	16.7	8.8
– Liabilities to households	1,756,177	1,978,294	45.3	43.6	35.8	12.6	5.1
– Liabilities to government	151,533	207,533	3.9	4.6	-11.5	37.0	27.8
– Liabilities to others	331,197	358,615	8.5	7.9	32.1	8.3	1.0
Liabilities arising from securities	110,996	176,483	2.9	3.9	59.9	59.0	48.3
Other liabilities	209,329	265,324	5.4	5.8	14.4	26.7	18.2
Capital	342,028	380,470	8.8	8.4	8.0	11.2	3.8
Total liabilities	**3,876,768**	**4,537,784**	**100.0**	**100.0**	**24.1**	**17.1**	**9.2**

* Figures for 31 December 2002 exclude the branch of Nova Ljubljanska Banka in Italy.
Source: Bank of Slovenia.

…and increased investment in Bank of Slovenia bills

Banks invested spare resources in securities. The pattern of growth from 2001 continued in 2002. Due to the absorption of excess liquidity by the Bank of Slovenia, the biggest increase (of 57.5%) was in investments in Bank of Slovenia bills, especially tolar bills. Investments in government securities grew by 19.7% while investments in other securities (shares, bonds, foreign-issued securities, foreign government securities etc.) grew by 18.6%. The strongest growth was in shares and domestic securities.

Increase in amounts owed to customers…

Within the average composition of liabilities during 2002, amounts owed to non-bank customers grew by one percentage point as a share of the total compared with 2001, due mainly to an increase of two percentage points in household deposits coupled with a reduction of one percentage point in government deposits and 0.3 percentage points in deposits by enterprises. Total capital decreased as a proportion of the total by 1.1 percentage points compared with 2001.

…and in the proportion of securities

Major shifts occurred in the average makeup of assets in 2002. Investments in securities increased as a proportion of total assets by 4.9 percentage points as loans to banks fell by 2.2 percentage points and loans to non-bank customers fell by 2.4 percentage points. In the face of reduced demand from the non-banking sector, banks put their spare resources into securities, and securities also registered the effect of the sterilisation of monetary inflows arising from the acquisition of Lek by a foreign corporation. At the end of 2002, Bank of Slovenia securities represented the largest proportion, while the proportions of government and other securities were smaller than in 2001.

Table 16: **Maturity of deposits from/loans to non-bank customers** (%)

	31-Dec-01	31-Dec-02	31-Jun-02	31-Sep-02	31-Dec-02
Demand deposits of non-banking sector	34.3	32.4	33.2	32.7	32.1
Short-term deposits of non-banking sector	58.0	59.6	58.3	58.2	58.4
Long-term deposits of non-banking sector	7.7	8.1	8.4	9.1	9.6
Total deposits of non-banking sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Short-term loans to non-banking sector	57.1	56.9	55.3	55.3	53.8
Long-term loans to non-banking sector	42.8	43.0	44.6	44.6	46.1
Claims arising from guarantees	0.1	0.1	0.1	0.1	0.1
Total loans to non-banking sector	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Slovenia.

Table 17: **Currency breakdown of principal balance sheet items** (%)

	Share at 31-Dec-01		Share at 31-Dec-02	
	in domestic currency	in foreign currency	in domestic currency	in foreign currency
Deposits with central bank	3.5	1.8	2.9	0.3
Loans and advances to the banking sector	1.7	8.5	1.7	6.6
Loans and advances to the non-banking sector	40.2	9.2	36.4	11.4
Securities	14.6	14.1	20.2	13.9
Other assets	5.7	0.8	6.3	0.5
Total assets	**65.6**	**34.4**	**67.4**	**32.6**
Liabilities to the banking sector	3.4	8.3	3.5	9.1
Liabilities to the non-banking sector	45.6	25.7	46.1	23.3
Liabilities arising from securities	2.9	0.9	3.8	0.1
Other liabilities	4.1	0.4	4.7	1.2
Capital	8.8	0.0	8.4	0.0
Total liabilities	**64.7**	**35.3**	**66.4**	**33.6**

Source: Bank of Slovenia.

Increases in long-term deposits…

Within the maturity breakdown of deposits of non-bank customers, the proportion of long-term deposits is increasing, due mainly to strong growth of deposits of enterprises, households and other financial institutions. Demand deposits for each individual segment grew, but not as strongly as time deposits. The growth of short-term deposits was driven mainly by an increase in deposits with a maturity of between 90 days and one year, while deposits of 90 days or less decreased relative last year.

…and long-term foreign currency loans

The maturity breakdown of loans to non-bank customers has shifted in favour of long-term credit in recent years. In 2002 this shift was especially marked. In 1995 the ratio of short to long-term loans at year-end was 59:41, compared with 57:43 in 2001 and 54:46 in 2002. Short-term loans grew by 6.8% and long-term loans by 22.0%. Foreign currency loans to non-bank customers grew by 44.3%, the highest rate of growth in the last four years, while tolar-denominated loans grew by only 6.2%. The strong growth in foreign currency loans was attributable to the slower, steady depreciation of the tolar against the euro.

Changes in the currency breakdown of both assets and liabilities were brought about by the fact that the tolar depreciated more slowly than the tolar indexation clause rose, which gave non-banking customers especially incentives to borrow in foreign currency and save in the domestic currency. A further reason for the growth in the share of securities denominated in the domestic currency was the absorption of excess liquidity by the Bank of Slovenia.

Foreign currency liabilities down by more than assets

The year-on-year changes in the currency breakdown were also reflected in the average currency breakdown. Average foreign currency liabilities as a proportion of total liabilities continued on a downward trend, ending the year at 34.4% (as against 34.7% in 2001). The average proportion of foreign currency assets within total assets was 33.7% (compared with 33.8% in 2001). At the end of 2002 banks thus had 2.1% more in foreign currency liabilities than in assets.

Tolar lending and borrowing rates for the non-banking sector

Loans reduced as a proportion of total assets

Income from non-banking sector loans and deposits is affected by the structure of banks' balance sheets. As a result of increased investment in securities in 2002, loans to non-bank customers represented a declining proportion of banks' total assets, having fallen from 49.4% at the end of 2001 to 47.7% at the end of 2002. Slow growth was noted in tolar loans, which form the bulk (76.2%) of loans to non-bank customers, while foreign currency lending grew more briskly.

Rise in short-term credit…

Despite the decline in tolar-denominated lending to non-banks, income from this source was similar in 2002 and 2001. The main change in the maturity breakdown of

Table 18: **Tolar lending and deposit interest rates for non-banking sector**

in % (annual)	I/01	II/01	III/01	IV/01	I/02	II/02	III/02	IV/02
1. LENDING INTEREST RATES	**14.6**	**14.6**	**14.3**	**12.7**	**13.3**	**13.1**	**12.2**	**12.2**
a) short term loans	13.9	14.0	13.8	12.2	12.7	12.6	11.9	11.8
b) long term loans	15.1	15.0	14.6	13.1	13.7	13.4	12.7	12.4
2. DEPOSIT INTEREST RATES	**8.4**	**8.7**	**8.9**	**7.8**	**8.3**	**7.9**	**7.4**	**7.1**
a) demand deposits	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1
b) short term deposits (maturity to 30 days)	4.9	5.2	5.4	5.3	4.8	4.5	4.6	4.8
c) short term deposits (maturity over 30 days)	11.2	11.7	11.9	10.2	10.7	10.2	9.3	8.8
d) long term deposits	13.4	13.6	13.6	11.8	12.5	12.0	11.5	11.3
INTEREST MARGIN (1-2)	6.2	5.9	5.4	4.9	5.0	5.2	5.0	5.1

Source: Bank of Slovenia.

…and short-term tolar deposits with a nominal interest rate

such lending was the decline in the proportion of short-term credit bearing interest at a rate linked to inflation via the tolar indexation clause and an increase in the proportion of credit subject to a nominal interest rate[4], on which the rate of interest earned is somewhat higher. In the last quarter of 2002 as much as 26% of tolar-denominated credit to non-banks was remunerated at a nominal rate of interest (as opposed to 2.3% in the corresponding period of the previous year), 63% was linked to inflation through the tolar indexation clause (of which 11.8% was short-term and 51.2% long-term credit) and 11% was linked to the foreign currency clause.

Tolar deposits by the non-banking sector rose throughout 2002 and grew by 10.2% in real terms to make up 46% of total liabilities by the end of the year. This was accompanied by a more moderate rise in expenses arising from tolar deposits of non-bank customers of 4% in real terms compared with 2001. As on the lending side, the abolition of inflation-indexed revaluation on short-term deposits of less than one year caused the average level of short-term deposits of more than 30 days to decline substantially in favour of deposits bearing interest at a nominal rate, although nominal interest rates were somewhat lower in this segment. In the last quarter of 2002, 64% of tolar deposits of non-bank customers were earning purely nominal interest, as compared with 32.6% in the same quarter of 2001, while 33% was linked to inflation via the tolar indexation clause (of which 23.2% was long-term and 9.8% short-term deposits) and 3% was linked to the foreign currency clause.

Average lending and deposit rates down

The downward trend in average effective[1] interest rates on loans and deposits continued last year. Effective rates for non-bank customer loans and deposits were below the level of past years throughout 2002.

Closer analysis of effective interest rates within different value-indexed categories in 2002 reveals that effective rates for long-term credit, deposits of more than 30 days and long-term deposits linked to the tolar indexation clause[2] were higher than those of similar maturity linked to the foreign currency clause or else not linked to any value index. An exception to the pattern were effective nominal interest rates on short-term loans, which rose in the first half of the year and actually overtook interest rates on short-term credit linked to the tolar indexation clause in the second half of the year.

Table 19: **Classification of on- and off-balance sheet items of banks, value adjustments and provisions**

	31-Dec–01				31-Dec–02			
	Aggregate exposure		Value adj., provisions		Aggregate exposure		Value adj., provisions	
	SIT millions	%	SIT millions	%	SIT millions	%	SIT millions	%
A	2,755,349	82.6	28,991	13.7	2,946,199	80.3	32,128	14.1
B	348,333	10.4	38,014	18.0	466,603	12.7	51,447	22.5
C	91,012	2.7	24,181	11.4	113,399	3.1	30,138	13.2
D	62,188	1.9	37,005	17.5	63,355	1.7	35,389	15.5
E	78,947	2.4	83,485	39.4	79,478	2.2	79,159	34.7
Total	3,335,829	100.0	211,676	100.0	3,669,033	100.0	228,262	100.0

4 As of 1 July 2002 domestic currency liabilities and claims with a maturity of less than one year are no longer revalued by inflation using the tolar indexation clause.

5 Effective interest rates are calculated on the basis of financial reports as the ratio of interest income/expense to the average level of loans to/deposits of non-bank customers by quarter.

6 Movements in the effective interest rate for the non-bank sector are still influenced by the tolar indexation clause because of the large proportion of loans (63.1%) and the smaller but still substantial proportion of deposits (33%) that are inflation-indexed. The three-month rate on the tolar indexation clause fell in 2002, from 7.93% in the first quarter to 7.84% in the second, 7.33% in the third and 7.33% in the fourth.

Source: Bank of Slovenia.

Interest rate spread unchanged at 5 percentage points

The interest rate spread, expressed as the difference between the lending and deposit interest rate, remained around 5 percentage points in 2002 as lending and deposit rates fell largely in parallel.

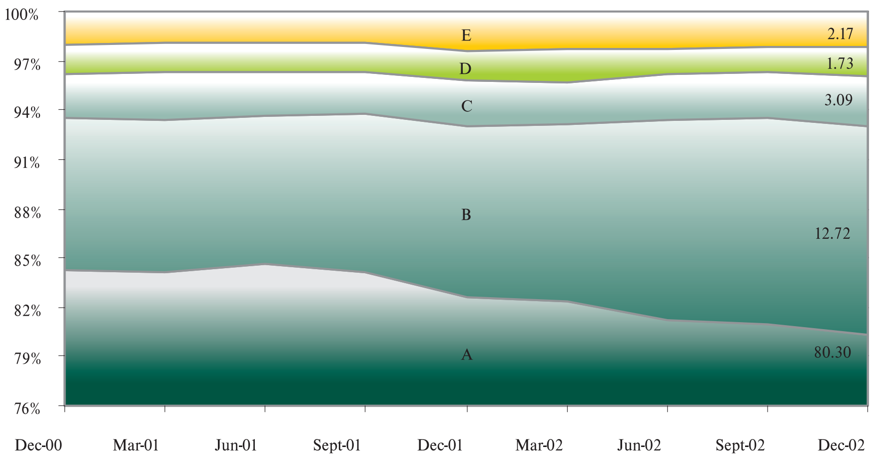
Asset quality

The new Slovenian Accounting Standards had a direct impact on the classification of balance sheet items, provisioning and the suspension of income, necessitating amendments to the Regulation on the Financial Reports and Accounts of Banks and Savings Banks, the Regulation on the Classification of On-Balance Sheet and Off-Balance Sheet Assets and the Regulation on Specific Provisioning, which came into effect on 1 May 2002. A major change under the Slovenian Accounting Standards is that investments in securities and equity are valued at fair value and therefore are not classified, while all other assets are classified into categories A to E. For these assets, expected losses are identified and provisions made for credit risk. In order to facilitate comparison, data on classified assets have been calculated retrospectively, although these should be treated only as indicative, which prevents firm conclusions from being drawn with regard to changes in the credit risk of classified assets between 2001 and 2002.

Credit risk management

Avoiding excessive concentration of credit exposure to individual entities, groups of associated undertakings, other entities in the group and entities with a special relationship with the bank is a key element of credit risk management. The number of large exposures declined in 2002, as did their total value, which stood at 195.3% of capital at the end of 2002 (compared with a limit of 800%).

Figure 13: **Classification of aggregate exposure of banks**



Source: Bank of Slovenia.

Table 20: **Banks' exposure by sector and average risk by sector**

	31-Dec-00		31-Dec-01		31-Dec-02	
	Share	Average risk	Share	Average risk	Share	Average risk
A. Industry	19.9	7.5	19.6	7.8	18.5	7.4
B. Services	55.0	4.2	55.4	5.0	58.9	5.6
C. Households	14.0	4.6	14.9	4.5	13.6	4.5
D. Non-residents	11.1	6.1	10.1	7.3	9.0	6.1
Total	100.0	5.3	100.0	5.8	100.0	5.9

Source: Bank of Slovenia.

Fall in average exposure to individual counterparties

Total exposure of banks as at 31 December 2002 stood at SIT 5,415.0 billion (SIT 4514.6 billion in on-balance sheet and SIT 900.4 billion in off-balance sheet assets). Average exposure to individual counterparties fell by 12.1% to SIT 120.5 million. While banks' total exposure grew by 17.6%, the volume of classified assets grew by 10.0%. Demand for credit among enterprises and households remains subdued, forcing banks to turn to less risky but lower-yielding investments in government securities and Bank of Slovenia bills, which are not classified. The quality of banks' classified assets also changed. Specifically, the proportion falling into category A fell by 2.3 percentage points[7], primarily in favour of an increase in the proportion of category B assets.

Reduction in non-performing assets

The trend in non-performing assets (those classified in categories C to E) was favourable in 2002 in as much as the proportion remained unchanged at 7%. The change in the composition was also reflected in a change in average default risk of assets[8] in the banking system, which deteriorated slightly from 5.8% at the end of 2001 to 5.9% at the end of 2002.

Exposure to service sectors growing

The composition of banks' exposures by sector reveals that the largest proportion, which is still growing, is exposures to services. The service sector is also relatively low-risk, although its level of risk is increasing. Among individual services, exposures to the financial intermediation industry, which includes the Bank of Slovenia, are the largest category, followed by exposures to government, in the form of securities, and to commerce. Exposure to the industrial sector is slowly diminishing as a proportion of the total and represented 18.5% at the end of the year, with average default risk at 7.4% and on an upward trend. Exposure to the household sector was lower than in past years, at 13.6%.

Foreign exposure down

In terms of the composition of exposures by country groupings, despite a reduction in exposures to non-residents from 10.1% to 8.9% of the total, as much as 73.3% of foreign exposures are to the EU, or 81.7% if the countries of EFTA are added. The majority of these exposures are investments in banks, which are generally of prime, low-risk grade.

Capital adequacy

Deterioration of capital adequacy halted

The downward trend in the capital adequacy of the banking system that had lasted since 1996 halted in the second half of 2002. At 31 December 2002 banks' capital adequacy was the same as twelve months earlier.

Table 21: **Exposure to country groupings** (SIT millions, %)

	31-Dec-00		31-Dec-01		31-Dec-02	
	Amount	Share	Amount	Share	Amount	Share
EU	319,238	75.8	338,903	73.1	369,721	76.4
EFTA	22,897	5.4	26,387	5.7	25,586	5.3
Former Yugoslav republics	19,393	4.6	24,509	5.3	37,748	7.8
CEFTA	1,239	0.3	5,379	1.2	9,549	2.0
Others	58,304	13.8	68,302	14.7	41,407	8.5
Total	421,071	100.0	463,480	100.0	484,011	100.0
Share of non-residents	11.10%		10.10%		8.90%	

7 Because of the non-inclusion of securities and equity investments among graded assets. Asset quality is not considered to have altered materially.
8 Average default risk of assets refers to expected losses as a percentage of value. It is calculated as the value of assets in grades A to E weighted by the required provisioning rate for each grade (A 1%, B 10%, C 25%, D 50% and E 100%).
Source: Bank of Slovenia.

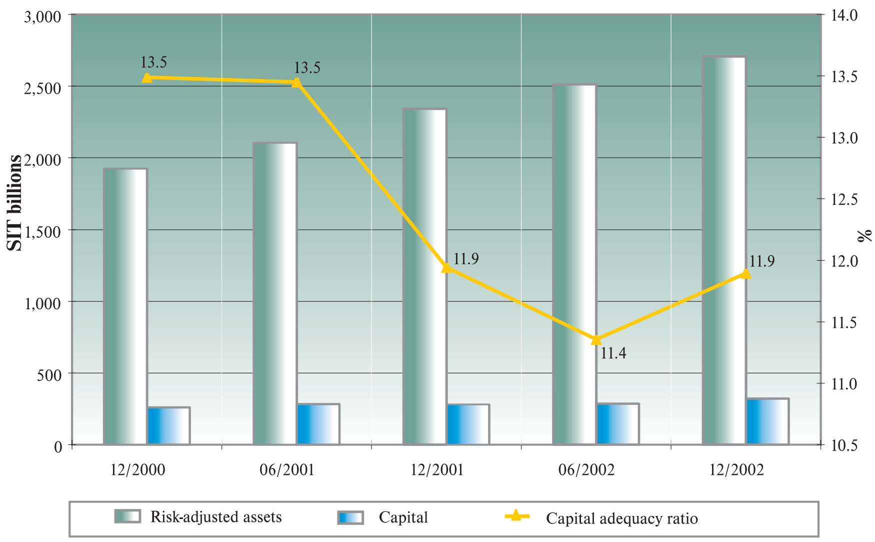
Banks' capital at the end of the year, calculated in accordance with the Regulation on the Capital Adequacy of Banks and Savings Banks, stood at SIT 321.4 billion, representing a capital ratio of 11.9% on risk-weighted assets of SIT 2,706.9.

Banks' capital increased by SIT 41.7 billion in 2002, with the largest increase occurring within supplementary capital as subordinated debt. The increase in supplementary capital caused the proportion of primary capital to contract from 94.8% at the end of 2001 to 83.5% at the end of 2002.

Regulation on Capital Adequacy harmonised with European directives

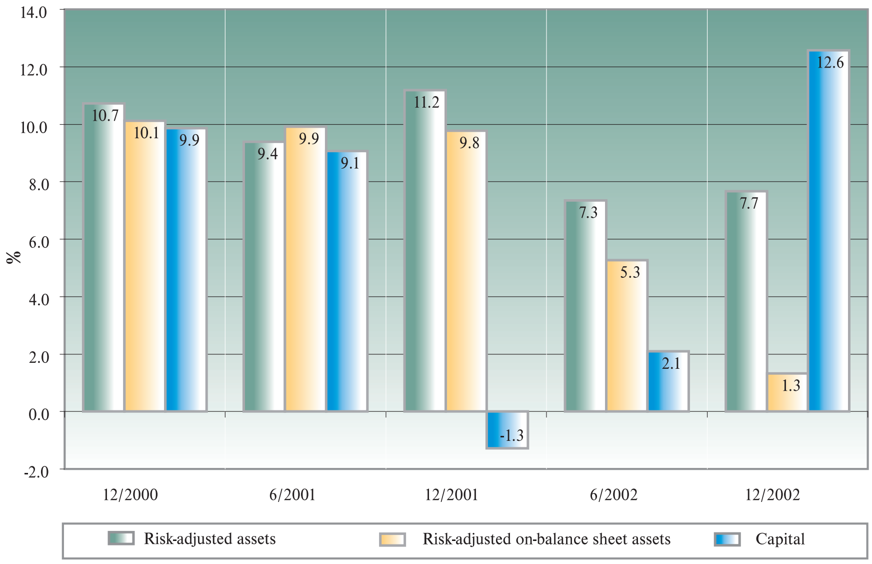
During 2002 a regulation on capital adequacy was changed. The Regulation on Capital Adequacy was revised in order to improve harmonisation with EU directives and take account of the new Slovenian Accounting Standards. In addition a new method for calculating the total net foreign currency position and new capital requirements for market risk were introduced. These changes entailed an increase in capital requirements and led to a lower level of capital adequacy of the banking system than would have been the case under the previous rules.

Figure 14: **Risk-adjusted assets, capital and capital adequacy ratio**



Source: Bank of Slovenia.

Figure 15: **Changes of risk-adjusted assets and capital of banks**



Source: Bank of Slovenia.

3.3 Banking supervision

Ongoing supervision…

Ongoing supervision of banks and savings banks is provided for through regular submission of reports for off-site verification and through on-site surveillance. Supervision is based on the "four-eyes" principle, whereby off-site analysts and on-site inspectors are jointly responsible for supervising each bank.

…in various spheres of banking activity

Analysts continuously monitor the operating results of banks and savings banks on the basis of returns of data and information, monitor compliance with prudential regulations for safe and sound banking, are involved in preparing documentation for the issue or variation of authorisations for different types of activity, evaluate proposed new systemic solutions, advise on the implementation of standards of safe and sound banking, are involved in preparations for inspections in banks and savings banks and in discussions with the management of banks, savings banks and other institutions, compile various written documents for bodies of the Bank of Slovenia, and so on. On discovering a departure from the normal activity of a bank or savings bank, analysts immediately notify the inspectors and management of the Banking Supervision Department, who may accordingly decide to launch a direct examination of the institution concerned.

On discovering an irregularity in the conduct of a bank or savings bank, both analysts and inspectors take appropriate action and monitor the remedial steps taken.

The Banking Supervision Department's strategic plan for the period 2000-2003 envisages between seven and nine full-scope examinations of banking institutions and around 30 examinations of particular areas of operation (including IT) each year. A bank or savings bank may be examined more than once in a given year. The scope of the examination is determined on the basis of prior information and analysis of the institution's activities, initiated by the management of the Bank of Slovenia or by external bodies. Risk assessments in the area of IT constitute a special area of examination. The examinations permit an in-depth investigation of areas of heightened risk or areas in which the Bank of Slovenia lacks adequate information or verification.

In view of the fact that the most significant source of risk in banks and savings banks is credit risk, the emphasis in an examination is on the appropriate grading of on and off-balance sheet assets. Special attention is given to consolidated supervision – the examination of a bank and its associated undertakings. Bank of Slovenia inspectors check the accounting statements of associated undertakings, the bank's policy (current and future) towards them, the quality of their assets, their governance and relationship towards the bank and the riskiness of their activities. On this basis the inspectors assess inter alia whether the provisions and value adjustments for the bank's exposure to the associated undertakings are adequate.

In direct examinations of banks and savings banks during 2002, inspectors from the Banking Supervision Department, in addition to the standard areas of examination, focused particularly on supervision of capital and capital adequacy, management of market risk, implementation of the Consumer Loans Act, implementation of the Prevention of Money Laundering Act, payment systems, card operations etc.

The number of on-site examinations by the Banking Supervision Department during 2002 was on plan.

12 full-scope examinations, 24 partial examinations and 39 examinations in the area of IT

In addition to 12 full-scope examinations (six banks, one savings bank and five savings and loan undertakings), a further 24 partial examinations of banking institutions and other companies were undertaken in relation to specific areas of activity, excluding examinations of IT systems. A total of 39 IT examinations were undertaken, either as part of full-scope examinations or as specific partial examinations.

The most frequently irregularities in banks and savings banks were the following:

- inadequate control of credit risk (classification of counterparties and required provisioning),
- incorrect calculation of capital and capital adequacy,
- inadequate control of foreign exchange or market risk,
- dealings inconsistent with internal regulations,
- ineffective internal audit and internal control procedures,
- deficiencies in IT support for banking transactions (absence of a comprehensive risk analysis with a corresponding risk management process, lack of defined and implemented comprehensive security policy, lack of contingency plans for continued operation of business functions, inadequate virus protection),
- organisational shortcomings with regard to security and control of business operations etc.

The most frequently irregularities in savings and loan undertakings were the following:

- failure to observe capital requirements and principles of safe and sound banking,
- inappropriate classification of counterparties and provisioning,
- inappropriate accounting procedures,
- inadequate IT support for business operations with regard to security etc.

16 orders for correction of irregularities issued

Using its legal powers, in 2002 the Bank of Slovenia issued 16 orders for the correction of operating irregularities and a series of recommendations for operating improvements. Seven orders relating to IT were issued in the course of the year.

In 2002 the Banking Supervision Department instituted bankruptcy proceedings against three savings and loan undertakings and issued two orders for the commencement of involuntary liquidation of one savings and loan undertaking and one company undertaking banking services in contravention of the Banking Act. One order for the conditional withdrawal of authorisation with the possibility of commencement of liquidation proceedings was also issued, while in one case a referral was made to the misdemeanours judge for the institution of proceedings for unauthorised carrying-on of banking services and a prosecution launched against a savings and loan undertaking.

Also issued were 11 decisions in relation to appeals against orders (five upheld and six overturned), and 30 decisions and decrees terminating examination procedures owing to correction of irregularities.

The Bank of Slovenia's supervisory powers extend to other entities in the case of suspected carrying-on of banking services without authorisation from the Bank of Slovenia. In 2002, on the basis of referrals from relevant government institutions (mainly the Ministry of the Economy and the Market Inspectorate of the Republic of Slovenia) or at the instigation of members of the Governing Board of the Bank of Slovenia, Bank of Slovenia inspectors undertook five direct examinations of companies suspected of engaging in unauthorised business activities. In two cases an order was issued for the immediate cessation of banking activities, and in one of the cases a decision and request for the commencement of liquidation proceedings and a referral to the misdemeanours judge were also issued.

In line with the Core Principles for Effective Banking Supervision, the Banking Supervision Department of the Bank of Slovenia maintains regular contact with the management of banks and savings banks, through channels including regular annual meetings held at the completion of full-scope examinations or specially. These meetings are primarily devoted to assessing the operating results and position of the bank or savings bank in question and learning about its strategy for future development. The exchange of views and information between supervisors and the management of banking institutions is also a prerequisite for timely and appropriate action in the event of operating difficulties.

Besides working with the Market Inspectorate of the Republic of Slovenia and the Office for Money Laundering Prevention, the Banking Supervision Department collaborates with the two financial market supervisory authorities – the Securities Market Agency and the Agency for Insurance Supervision. During 2002, apart from the exchange of data and documentation, joint examinations were conducted of specific areas of operation in two banks.

During 2002, on the basis of memoranda of understanding with authorities in other countries, three examinations were undertaken of the dealings of banking subsidiaries and a financial corporation of Nova Ljubljanska Banka on foreign territory (in Switzerland, Macedonia and Bosnia and Herzegovina) in collaboration with local supervisors or independently. In the case of irregularities uncovered in the course of the examination of banks in Macedonia and Bosnia and in other countries, further action is the responsibility of local supervisory authorities.

4. FINANCIAL MARKETS

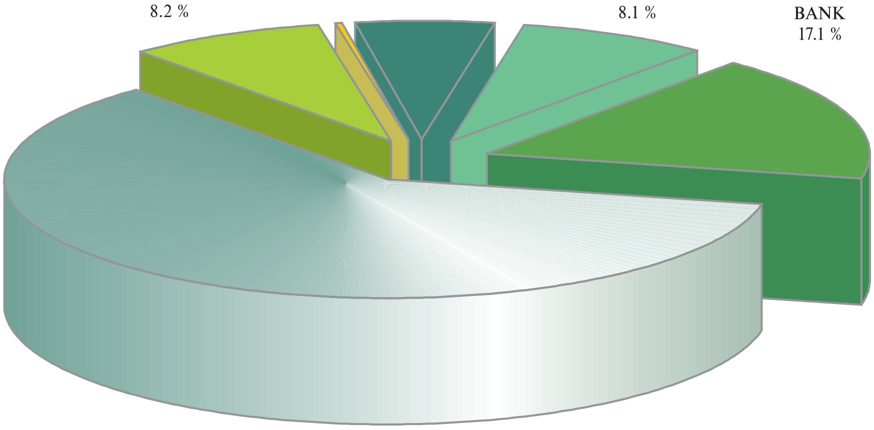
Financial market dominated by monetary financial institutions

The Slovenian financial market is dominated by monetary financial institutions. Non-monetary financial institutions account for 22.4% of total assets of the Slovenian financial system. At the end of 2002, non-monetary financial institutions included 35 investment companies (including 31 authorised investment companies), 18 mutual funds and 13 insurance companies (11 classic insurance companies and 2 reinsurance companies). At the end of 2002 pension providers comprised seven mutual pension funds, six pensions companies and three insurance companies. Authorised securities market participants included 11 banks and 17 stockbroking companies.

Non-monetary financial institutions predominantly investment companies…

Investment companies had total assets of SIT 466.5 billion at the end of 2002, 15% less than at the end of 2001. In 2002 the Slovenian Development Corporation transferred to authorised investment companies the last portion of assets allocated to them by the government in order to fill the privatisation gap. By the end of 2002 authorised investment companies therefore no longer possessed unused ownership certificates (privatisation vouchers). The total value of mutual funds' investments at the end of 2002 stood at SIT 55.4 billion, up 377% on a year earlier.

Figure 16: **Financial intermediaries by total assets** (at the end of 2001)



Source: Bank of Slovenia.

Table 22: **Composition of the Slovenian financial system** (SIT millions)

Total assets	1999		2000		2001	
	SIT millions	%	SIT millions	%	SIT millions	%
Central bank	**677,177**	**14.4**	**769,100**	**14.3**	**1,141,031**	**17.1**
Commercial banks	**2,763,260**	**58.9**	**3,286,058**	**61.1**	**4,041,363**	**60.5**
Non-monetary financial intermediaries	**1,250,461**	**26.7**	**1,324,247**	**24.6**	**1,493,096**	**22.4**
Authorised investment companies	599,165	12.8	566,937	10.5	548,096	8.2
Mutual funds	8,821	0.2	10,737	0.2	14,686	0.2
Insurance companies	264,558	5.6	321,823	6.0	391,088	5.9
Other	377,917	8.1	424,749	7.9	539,226	8.1
Total	**4,690,898**	**100.0**	**5,379,405**	**100.0**	**6,675,490**	**100.0**

Source: Bank of Slovenia.

...and insurance companies

Insurance companies are the second largest group of non-monetary financial institutions after investment companies. Gross effective premiums of insurance companies at the end of 2002 stood at SIT 284.2 billion and gross claims at SIT 178.4 billion, representing a claims-to-premiums ratio of 0.63. At the end of the year insurance companies had SIT 369.4 billion in investments in the financial market, predominantly in banks and government securities.

The importance of authorised securities market participants for the Slovenian financial market is evident in the value of the investments that come via these institutions. The total value of these investments at the end of 2002 stood at SIT 1606.8 billion and represented a rise of 50% on twelve months previously.

Primary securities market still underdeveloped

The primary securities market in Slovenia remains rather underdeveloped. In 2002 only one bank bond (of SIT 3 billion) was offered, while the Republic of Slovenia issued 21 bonds with a total value of SIT 394.3 billion on the domestic market.

Share issues dominated by non-financial corporations, bond issues by government

At the end of December 2002 1,032 securities of 870 issuers were registered at the Central Securities Clearing Corporation, of which 910 were shares and 122 were bonds. The market or book value of shares registered at the Central Securities Clearing Corporation at year-end was SIT 3,369.8 billion (66.1% of GDP). By far the dominant share issuers (excluding insurance companies) were non-financial corporations (81% of the total value). These were followed by banks (11%) and other financial intermediaries (8%). The largest group of holders of shares were consumers (25%), followed by non-financial corporations (20%), other financial intermediaries (18%), government (18%), the rest of the world (13%) and banks (4%). The value of bonds registered at the Central Securities Clearing Corporation, by market or nominal value, stood at SIT 967.3 billion at year-end (19% of GDP). The most important bond issuer was the government sector (87% of the total by value), followed by banks (9%) and non-financial corporations (3%). The main holders of bonds were banks (43%), then insurance companies (20%), consumers (16%), government (10%), non-financial corporations (5%), other financial intermediaries (5%) and the rest of the world (1%).

SBI20 share index up 55.2% and PIX investment company index up 71.9%

At the end of December 2002 264 securities of 197 issuers were being traded on the Ljubljana Stock Exchange, of which 172 were shares and 92 were bonds. Total market capitalisation stood at SIT 2,174.2 billion, equivalent to 42.7% of gross domestic product. Turnover during the year was SIT 481 billion, an increase of 38% on 2001. Just under half of turnover was in block trades. The largest volume of transactions was in shares (58%), followed by bonds (23%) and investment companies (18.9%). The most heavily traded shares during 2002 were Krka, Lek, Petrol, Gorenje and Pivovarna Laško. The Slovenian Stock Market Index (SBI20) rose by 55.2% and the Authorised Investment Company Index (PIX) by 71.9% over the year. Among the sector indices, the biggest rise was in chemicals (81%), followed by pharmaceuticals (74.2%), oil and gas (68.9%), trade (37.1%), food and beverages (35.8%) and transport (33.1%). The concentration of ownership of joint stock companies through mergers and acquisitions continued. The highest-profile were in pharmaceuticals (the takeover of Lek) and brewing (the takeover of Pivovarna Union).

Strong rise in investments in domestic securities by non-residents

Investments by non-residents in Slovenian securities were worth SIT 325.2 billion in 2002, almost five times as much as in 2001. The biggest investments were in shares in Nova Ljubljanska Banka and Lek. In September, SIT 114 billion worth of shares in Nova Ljubljanska Banka were sold by the government to the Belgian banking and insurance group KBC and the EBRD. In November Lek was taken over by Novartis of Switzerland in a deal worth SIT 201 billion and with a net value of SIT 161 billion.

Investments by residents in securities issued abroad

At the end of December 2002 residents held SIT 88.6 billion in investments in securities issued abroad by non-residents (72% of it in bonds) and SIT 60.1 billion in investments in securities issued abroad by residents. The Republic of Slovenia had EUR 2.31 billion or SIT 532.7 billion in outstanding eurobonds at year-end.

5. OTHER ACTIVITIES

5.1 Management of foreign exchange reserves

The reserves of the Bank of Slovenia are defined as:

- cash in foreign currency and foreign exchange holdings abroad,
- prime securities of foreign issuers,
- monetary gold,
- holdings of special drawing rights (SDRs) and the reserve tranche at the International Monetary Fund.

Bank of Slovenia foreign exchange reserves up from USD 4.4 billion to USD 7.1 billion

In 2002 the Bank of Slovenia' reserves grew from USD 4,397.1 million to USD 7,063.5 million. The rise was mainly accounted for by 7-day foreign exchange swaps, which rose from USD 1,039.7 million to USD 2,308.5 million, and to a lesser extent by the introduction of 270-day foreign exchange swaps (USD 161.3 million) and the sale of government assets to foreign investors and subsequent purchase from the government of the associated sums of foreign exchange. The increase was also aided by the steep fall in the value of the US dollar over the year. The portion of foreign exchange reserves for which the Bank of Slovenia has liabilities towards the domestic sector on the basis of subscribed foreign currency bills and foreign currency accounts of banks and the government at the Bank of Slovenia rose in 2002 from USD 1,952.4 million to USD 2,628.8 million. Meanwhile the other portion of the reserves, own assets without foreign exchange liabilities, rose from USD 2,444.7 million to USD 4,434.7 million. The value of Slovenia's monetary gold grew due to an increase in the dollar price of gold. Besides official foreign exchange reserves and holdings at the IMF, the total claims of the Bank of Slovenia on the rest of the world include certain other assets such as the fiduciary accounts in Luxembourg at Dresdner Bank and Société Générale, worth a total of USD 66.0 million at year-end.

For the needs of short-term financing the Bank of Slovenia maintained the two lines of credit opened in 2001 at Commerzbank AG, Frankfurt, worth EUR 100 million, and Bayerische Landesbank, worth EUR 50 million. As in 2001, these lines of credit were not drawn on in 2002.

Table 23: **Reserves and foreign exchange reserves of the banking system**
(at year-end, USD millions)

	BANK OF SLOVENIA							BANKS
	RESERVES							
	Gold	SDRs balances	Reserve position with the IMF	Foreign exchange	Total	Including counter value of liabilities in foreign currency	Other foreign assets	Foreign exchange reserves of commercial banks
1992	0.1	-	-	715.5	715.5	465.1	1.4	448.1
1993	0.1	0.0	17.6	770.1	787.7	425.2	1.1	796.5
1994	0.1	0.1	18.8	1,480.1	1,499.0	868.5	103.3	1,283.1
1995	0.1	0.1	19.1	1,801.6	1,820.8	1,259.2	170.1	1,624.1
1996	0.1	0.1	18.5	2,278.7	2,297.4	1,280.0	33.7	1,845.4
1997	0.1	0.1	17.4	3,297.2	3,314.7	1,779.3	41.3	1,079.7
1998	0.1	0.2	65.4	3,572.9	3,638.5	1,852.1	46.8	1,208.6
1999	0.1	1.6	107.6	3,058.8	3,168.1	1,699.1	52.0	1,056.4
2000	0.1	3.7	82.3	3,110.0	3,196.1	1,732.8	58.1	1,266.2
2001	67.2	5.0	80.6	4,244.3	4,397.1	1,952.4	76.1	1,502.5
2002	83.2	7.0	120.7	6,852.6	7,063.5	2,628.8	84.7	1,299.2

* Subscribed foreign currency bills and foreign exchange accounts of banks and government at the Bank of Slovenia.

Source: Bank of Slovenia.

Slovenia's reserve tranche position at the IMF stood at USD 120.7 million at year-end, arising from Slovenia's quota under IMF rules and Slovenia's participation in IMF loans under the Financial Transactions Plan.

The Governing Board of the Bank of Slovenia lays down basic rules on a quarterly basis for the management of the Bank's portfolio of foreign exchange reserves, namely the currency mix, the average maturity or interest rate sensitivity of foreign exchange deposits and investments in securities, and the selection of banks. Under the criteria currently in effect for managing the foreign exchange reserves, the latter may be invested in financial instruments with supranational, national and banking risk, in connection with which there exists a list of partner banks of acceptable banking risk and limits for each bank based on its credit rating. The existing rules deal with currency risk, stipulating that the amount of each currency within the portion of foreign exchange assets for which there are corresponding foreign exchange liabilities must correspond to a minimum proportion of the liabilities in that currency, while the currency mix of Bank of Slovenia own funds (whose liability counterpart is not denominated in foreign currency) and the permitted range of variation are specified in detail. The rules also govern the average modified duration of capital market instruments and specify the average maturity of money market instruments.

Increased deposit assets

In view of the fact that in 2002 the Bank of Slovenia's foreign exchange reserves increased mainly on account of short-term swap transactions with banks, the proportion of deposits in the foreign exchange reserves was increased in order to keep liquidity risk at an appropriate level. Because of the desire to maintain limits on the one hand and the lowering of banks' credit ratings on the other, the list of partner banks was widened so that the proportion of investments in banks with a still acceptable credit rating was enlarged. The proportion of investments in government securities meanwhile remained at the same level as at the end of 2001.

5.2 Operations for the government sector

Payment transactions with the rest of the world

On the basis of the Foreign Exchange Act the Bank of Slovenia performs payment transactions with the rest of the world and other foreign currency transactions for the Republic of Slovenia. A Ministry of Finance Order on the Method and Procedure for the Management of Accounts of Direct and Indirect Users of the National and Municipal Budgets Held at the Bureau for Governmental Payments of the Republic of Slovenia stipulates that budget users who, at the end of the payments system reform, still had open transactions accounts or other accounts for foreign exchange transactions at commercial banks, should continue to conduct payment transactions with the rest of the world through such accounts.

In 2002 the Bank of Slovenia performed EUR 410.9 million worth of payments to the rest of the world and paid out EUR 6.6 million in cash. There was EUR 638.8 million in inflows from abroad, EUR 6.3 million in inflows of domestic commercial banks and EUR 1.4 million in foreign currency remittances. A total of EUR 307.4 million in foreign currency was sold to budget users and EUR 530.6 million in foreign currency was purchased from them (including monetisation of EUR 496.2 million). Analysis of the currency composition of inflows and outflows shows that 99.4% of inflows were in euros and a mere 0.6% were in other currencies, while 62.6% of outflows were in euros, 32.3% were in US dollars and 5.1% were in other currencies.

Management of tolar accounts

In the first half of 2002, until the conclusion of the reform of the payments system, the Bank of Slovenia managed the government transactions account and 192 municipality transactions accounts. Inflows of SIT 196.1 billion and the same level of outflows passed through the government transactions account, primarily from treasury bill transactions. Inflows of SIT 352.6 billion and outflows of SIT 351.0 billion passed through the municipality transactions accounts in the first half of the year.

Creation of single treasury account…

On 30 June 2002 the Agency for Payments of the Republic of Slovenia ceased performing payment services. In accordance with the objective of the project to create a single treasury system in Slovenia, the government transactions account was converted into a government single treasury account and each of the 192 municipality transactions accounts were converted into municipal single treasury accounts, which can be run in different currencies. The accounts of direct and indirect users of the national and municipal budgets, the Health Insurance Institute of Slovenia and the Institute of Pensions and Disability Insurance of Slovenia, which are included in the single treasury account system as laid down in the Public Finances Act, were opened as sub-accounts of the government or municipal treasury accounts. With the establishment of a single treasury system in Slovenia, the foreign exchange assets of the government held at the Bank of Slovenia were also transferred, depending on their purpose, either to the government single treasury account or to over 60 newly opened special government foreign currency accounts at the Bank of Slovenia.

…and its subaccounts

The sub-accounts of the government and municipal treasury accounts are run by the Bureau for Governmental Payments of Republic of Slovenia, to which direct and indirect users of the national and municipal budgets present payment instructions and from which they receive the full set of return information regarding payment transactions performed.

In the second half of 2002 SIT 3,166.1 billion in inflows and the same in outflows were conducted through the government single treasury account and SIT 1,752.5 billion in inflows and SIT 1,751.4 billion in outflows through the municipal treasury accounts.

Fiscal stamps, securities certificates and notes and coins

The Bank of Slovenia undertook the preparation, issue, distribution and storage of commemorative coins and coins for circulation, fiscal stamps and tobacco stamps for the Republic of Slovenia.

Two new commemorative coins issued

The Bank of Slovenia issued 500,000 copies of a new bimetallic circulation-standard commemorative 500 SIT coin. By the end of 2002 402 million coins had been issued since 1993 (compared with 372 million at the end of 2001), worth SIT 1,375 billion (SIT 988 billion to the end of 2001). The quantity of coins in circulation rose by 8% in 2002. In 2002 gold, silver and circulation-standard commemorative coins were issued to mark the football World Cup (Korea-Japan 2002) and gold and silver coins were issued to mark the 35th Chess Olympiad (Bled 2002). In total, 7,984 commemorative coins were issued at the Bank of Slovenia treasury and via commissioners (banks), comprising 2,116 gold and 5,868 silver coins.

In 2002, administrative and judicial duty stamps worth SIT 2.7 billion were issued, compared with SIT 4.9 billion in 2001. Expert and technical work in connection with tobacco stamps consisted of ensuring a sufficient quantity and an adequate range of tobacco stamps and issuing them to producers and importers of tobacco products. A total of 235.8 million tobacco stamps were issued (compared with 225 million in 2001). Under a contract with the Ministry of Finance, the Public Revenues Administration took over operations regarding administrative and judicial stamps as of 30 June 2002 and operations regarding tobacco stamps as of 20 December 2002.

The Bank of Slovenia also undertook tasks with regard to the acceptance and processing of redeemed bonds and mature coupons. During 2002, 525 coupons and 9,686 blocks of RS02 were accepted.

A total of 4,140 treasury receipts and outlays of tolar cash and 16,463 inward and outward payments of foreign currency for travel expenses and other needs of government bodies were undertaken (compared with 3,139 treasury receipts and outlays of tolar cash and 14,675 inward and outward payments of foreign currency in 2001).

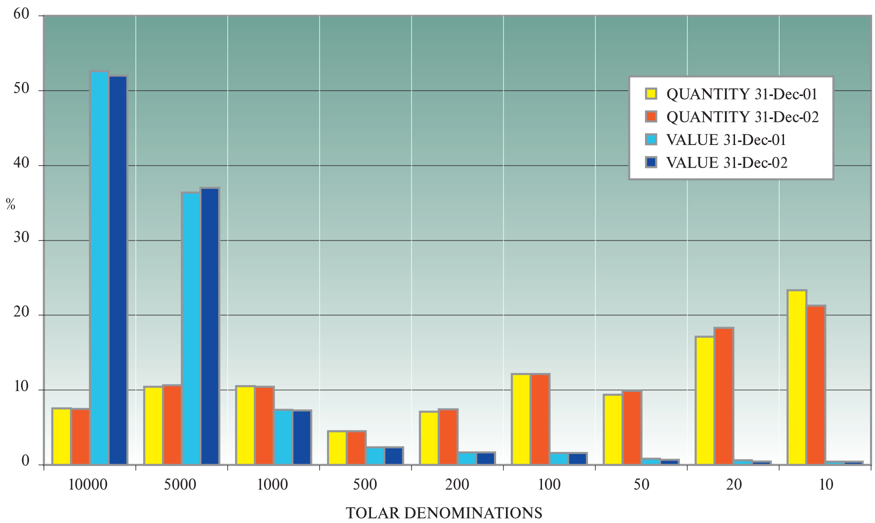
5.3 Cash operations

The Bank of Slovenia has a statutory remit to ensure a smooth supply of tolar banknotes to government.

SIT 172 billion in banknotes circulating at year-end

As at 31 December 2002 there were 119.7 million banknotes in circulation with a total value of SIT 172 billion (including cash at banks). Both the volume and value of banknotes in circulation had risen by 4% on a year before. An overview of cash in circulation in the last seven years is presented in Table 24. At the end of 2002 banknotes represented 99.2% of cash in circulation by value and 22.9% by volume. The main denominations used for cash transactions were the SIT 10,000 note (representing 52.0% of the value of banknotes in circulation, compared with 52.6% in 2001), which has the largest denomination, and the SIT 5000 note (representing 37.0% by value, as against 36.4% in 2001). The SIT 1000 note is steadily losing significance in both volume and value terms (representing 7.3% of the value of banknotes in circulation, as in 2001). A comparison of 2002 and 2001 in terms of the composition by value and volume of banknotes in circulation is shown in Figure 17.

Figure 17: **Analysis of banknotes in circulation by volume and denomination** (year-end 2001 and 2002, %)



Source: Bank of Slovenia.

SIT 50.0 million counted by money counting unit

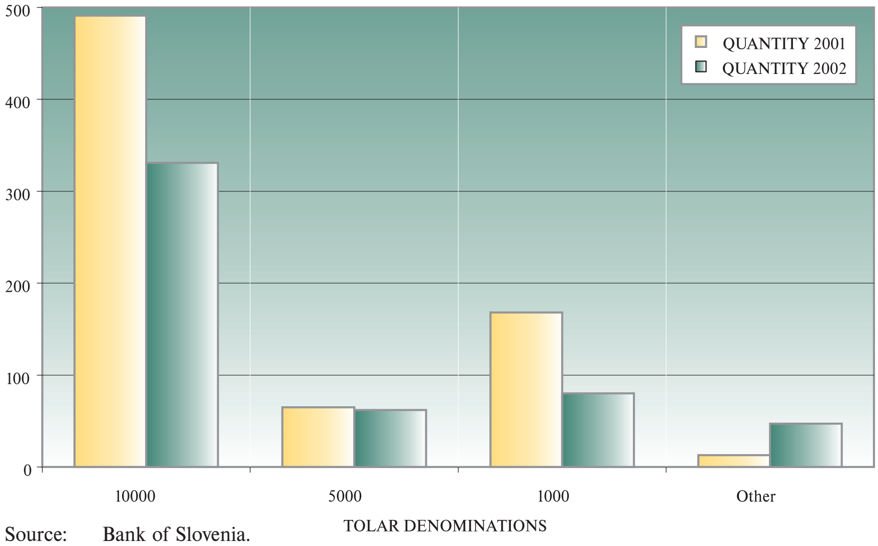
The Bank of Slovenia's money counting unit counted 50.0 million banknotes, of which 39.3 million were also sorted. A total of 24.3 million banknotes (compared with 13.9 in 2001), of which the largest group was 5.1 million SIT 1000 notes, were taken out of circulation and destroyed in order to maintain an appropriate quality of banknotes in use.

Table 24: **Cash in circulation** (1996–2002) SIT billions

At year-end	Banknotes in circulation	Coins in circulation	Cash in circulation total
1996	71.4	0.4	71.9
1997	85.7	0.5	86.1
1998	104.7	0.6	105.2
1999	142.5	0.6	143.1
2000	139.6	0.8	140.4
2001	165.8	1.0	166.8
2002	172.1	1.4	173.4

Source: Bank of Slovenia.

Figure 18: **Tolar counterfeits examined in 2001 and 2002**



Source: Bank of Slovenia.

Box: **Supply of cash**

The supply of banknotes to government is operated through eight Bank of Slovenia banknote depots and five commercial banks who act as depositaries, while the supply of coins is operated through the central coin stock.

As a temporary means of streamlining operations, lasting until 30 June 2002 when the organisational units of the Agency for Payments ceased to operate, each Bank of Slovenia banknote depot obtained banknotes from the regional branch of the Agency for Payments. After 30 June 2002 the banknote depots obtained cash largely through the ordinary operations of the banks and savings banks who use their services.

Direct users of a depot have a contract with the depositaries for the use of the depot's services, while other banks manage their need for banknotes by buying and selling at the depositary banks (the retail banknote market).

With the gradual migration of legal persons' accounts to the banks and the winding-down of the cash activity of Agency for Payments, which was concluded in 2002 with the termination of operations of the Agency, the banks take in and pay out all cash to legal persons. The banks obtain cash from their customers, with the result that the provision of banknotes at central bank distribution points (Bank of Slovenia banknote depots) functions as a means of dealing with surpluses or shortages of cash arising from ordinary operations.

Tolar cash was supplied to government through the Bank of Slovenia's banknote depots and, until 30 June 2002, through organisational units of the Agency for Payments, for which the Bank of Slovenia set a quarterly treasury maximum and checked their operations on a daily basis. No irregularities in their operations were discovered during 2002.

In the first half of the year 15 million SIT 5000 banknotes with enhanced security features were printed in response to an increased need for this denomination and to replace soiled and damaged notes.

The Bank of Slovenia, jointly with the Bank Association of Slovenia, the commercial banks and other relevant institutions, coordinated and directed activities under the euro cash project. Two additions to the currency catalogue were issued, the first of which contained information on the euro currency.

At the Bank of Slovenia 520 counterfeit tolar banknotes discovered and confiscated on the territory of the Republic of Slovenia were examined (compared with 789 in 2001). The Bank worked jointly with the Ministry of the Interior, Interpol and Europol on these cases.

The number of counterfeit notes discovered puts Slovenia in the middle rank of European countries

The value of counterfeit Slovenian tolars declined in 2002 after growing between 1994 and 2001. It is negligible by comparison with the total value of cash in circulation (rising from 0.0010‰ in 1994 to 0.0352‰ in 2001 and falling to 0.0214‰ in 2002). The total value of confiscated Slovenian banknotes last year was SIT 3,709,700 (compared with SIT 5,878,050 in 2001). The Ministry of the Interior passed the following counterfeit banknotes to the Bank of Slovenia for examination: 331 SIT 10,000 notes, 62 SIT 5000 notes, 80 SIT 1000 notes and 47 notes in other denominations. Compared with 2001 the number of counterfeit SIT 10,000 notes fell by 38.2%, SIT 5000 notes by 10.1% and SIT 1000 notes by 52.9%. The quality of the counterfeits was poor, with the majority being photocopied or scanned on computer and printed on office paper. There were 4.3 counterfeit notes discovered for every one million notes in circulation, which puts Slovenia in the middle rank of European countries. A comparison of examined counterfeit tolar banknotes in 2001 and 2002 is given in Figure 18.

Handling tasks related to the issue of Bank of Slovenia bills consisted of the custody, distribution and acceptance of redeemed bills. During 2002, 35 Bank of Slovenia bills were processed at redemption.

5.4 Reform of payment systems

The Payment Transactions Act

Payment Transactions Act adopted

On 20 March 2002 the National Assembly of the Republic of Slovenia passed a Payment Transactions Act (Official Gazette of the Republic of Slovenia, No. 30/02) regulating the conduct of payments in Slovenia. In defining payment services and the conditions for their conduct, the Act augments the section of the Banking Act that deals with other financial services that may be performed by banks and savings banks on obtaining relevant authorisation from the Bank of Slovenia.

The first part of the Act resolves institutional, substantive and operational issues connected with the conduct of payment services. Under the Act the Bank of Slovenia is responsible for issuing authorisations to all legal persons wishing to perform payment services and who meet the conditions. In connection with this role the Bank of Slovenia issued a regulatory decree (Regulation on the Criteria and Requirements to be Met by An Authorised Provider of Payment Services, Official Gazette of the Republic of Slovenia, No. 57/02) defining payment services and the conditions to be met by a potential payment provider in order to obtain authorisation from the Bank of Slovenia.

Under the Act the Bank of Slovenia is responsible for issuing authorisations for performing payment services

The Act goes on to regulate the area of payments systems and settlements between payment services providers. It establishes the Bank of Slovenia as responsible for operating the payment system for high-value payments, while payment systems for low-value transactions may be operated by private entities under authorisation from the Bank of Slovenia. The Act lays down the basic conditions for the grant of authorisation, in addition to which the Bank of Slovenia issued a regulatory decree (Regulation on Settlements Between Providers of Payment Services, official Gazette of the Republic of Slovenia 07/03) setting out detailed requirements for obtaining authorisation.

Bank of Slovenia responsible for operating high-value payment system

Under the Act, the Bank of Slovenia is also responsible for supervision of the conduct of payment services and for supervision and oversight of the operation of payments systems.

Another major area regulated by the Act is that of the issuance of electronic money, in relation to which the Act pays close attention to the regulation of electronic money issuers and the services they can provide. The Act's provisions are harmonised with European Directive 2000/46/EC on the pursuit and supervision of the business of electronic money.

Bank of Slovenia charged with supervision of conduct of payment services

The second part of the Act covered the closure of the Agency for Payments and the creation of a Bureau for Governmental Payments within the Ministry of Finance and an Agency of the Republic of Slovenia for Public Records and Services, enabling completion of the payment system reform process.

Creation of Bureau for Governmental Payments and Agency for Public Records and Services

Completion of payment system reform

The reform of payment systems was concluded on 30 June 2002, when the Agency for Payments ceased undertaking payment transactions for legal persons. The reform process began in 1994, when the foundations of the project were put in place and the project was taken on by the Bank of Slovenia. After the foundations of the project had been set out in a document entitled Needs for Change in the Slovenian Payment System (September 1994), strategic decisions were adopted at the start of 1995 with regard to the institution of a reformed payment system. In 1996 an operational plan for the transition to the new payment system was drawn up.

Completion of payment systems reform…

Practical implementation of the reform began with the transfer of the compulsory reserve accounts of banks, savings banks and savings and loan undertakings to the Bank of Slovenia in March 1997. This was followed in 1998 by the opening of settlement accounts for banks at the Bank of Slovenia and the establishment of a Real Time Gross Settlement System (April 1998) and a Giro Clearing System (October 1998). While the strategic decisions focused on infrastructural payment systems, special emphasis in defining the distinct phases of execution was put on the process of migrating the accounts of legal persons to the banking sector. The accounts of legal persons were gradually transferred from the Agency for Payments to the banks, while the accounts of budget users and municipalities, accounts for the paying-in of public revenues and accounts of members of the Central Securities Clearing Corporation were transferred to the Bank of Slovenia. The process of transferring the accounts of legal persons commenced on 11 September 2000 and was concluded on 30 June 2002, as envisaged in the Payment Transactions Act.

…begun in earnest in 1997

Closure of giro accounts of legal persons at the Agency for Payments completed…

At the end of June 2002 the Agency for Payments also closed the giro accounts of legal persons who, during the migration process, had not by themselves transferred their accounts to banks or were prevented from doing so by their accounts being blocked. There were 7,788 such cases. Funds to the value of SIT 2.3 billion from these closed giro accounts were transferred by the Agency for Payments to a collection account at the Bank of Slovenia, which credited them to temporary accounts at the banks at which the legal persons concerned were registered customers. The banks began the transfer of these funds from the temporary accounts to transactions accounts of the legal persons concerned at the grounded request of the latter on 1 July 2002. Under the Payment Transactions Act, any remaining funds from this process will be transferred to the national budget in 30 June 2004.

…opening of single treasury account…

In keeping with the objective of the project for the establishment of a single treasury system the Bank of Slovenia opened a government single treasury account and 192 municipal treasury accounts. Accounts of budget users, the Health Insurance Institute and the Institute of Pensions and Disability Insurance were opened as sub-accounts of the single treasury account, managed by the Bureau for Governmental Payments. As of 1 July 2002 budget users manage the funds in their sub-accounts through the Bureau for Governmental Payments, to which they also submit payment instructions.

…and accounts of Central Securities Clearing Corporation members at Bank of Slovenia

At the end of June 2002 the Bank of Slovenia also opened accounts for members of the Central Securities Clearing Corporation who are at the same time members of the payments and transfers system. In accordance with Article 151 of the Securities Market Act, which states that funds of customers of stockbroking companies must be managed in a separate cash account, and with the Payment Transactions Act and Regulation on Keeping Accounts with the Bank of Slovenia, members of the Central Securities Clearing Corporation opened transactions accounts for customer funds and clearing accounts at the Bank of Slovenia in June 2002. Stockbroking companies transferred their own funds from accounts at the Agency for Payments to transactions accounts at commercial banks, while banks authorised to carry on stockbroking activity already had settlement accounts opened at the Bank of Slovenia. Since 20 June 2002 settlement of the cash leg of securities transactions is thus accomplished via clearing accounts at the Bank of Slovenia in central bank money.

Oversight of payment systems

On the basis of the new Bank of Slovenia Act (Official Gazette of the Republic of Slovenia, No. 58/02) and the Payment Transactions Act, the Bank of Slovenia also formally took charge of payment systems oversight. The Bank of Slovenia Act gives the Bank general authority for oversight of the legality and correctness of the country's payment systems, while the Payment Transactions Act sets out its specific powers.

Objective: effectiveness and safety of the payment systems

The Bank of Slovenia oversees the operation of payments systems with the aim of ensuring their effectiveness and safety, particularly through preventing the possibility of a spread of financial problems on the part of one participant in the system to others or to the system as a whole (systemic risk or the domino effect). The Bank performs its role in accordance with internationally accepted principles for the oversight of payment systems (Core Principles for Systemically Important Payments Systems).

The payment systems oversight function must be distinguished from that of banking supervision. Supervision involves responsibility for regulating individual financial organisations, including their involvement in payment systems, while oversight of payment systems concentrates on the payment system itself.

In performing its oversight function the Bank of Slovenia is concerned with the adequacy of the legal basis of payment systems, the effectiveness of operational and financial risk management in such systems, the transparency of the operating rules and management of systems, and the safety and effectiveness of the technical design of systems and their operating procedures.

Assessment by the European Central Bank

As part of the process of EU enlargement the European Commission was required to provide an assurance to the European Council that no critical deficiencies are present in the candidate countries in the area of payment systems and securities clearing and settlement systems that could impede the accession process. To this end the European Central Bank (ECB), on the basis of a request and authorisation from the European Commission and in conjunction with the central banks in the European System of Central Banks (ESCB) and candidate countries, undertook in May and June an assessment of payments systems and securities clearing and settlement systems and the related oversight functions in the candidate countries.

For the purpose of the assessment the ECB drew up an extensive questionnaire which central banks of the candidate countries were required to complete in collaboration with other relevant domestic institutions and payment systems operators. The completed questionnaire constituted a self-assessment by the domestic central bank. Following the self-assessment, all candidate countries were visited by an ECB commission, which formed its own assessment based on discussions with representatives of relevant institutions and with participants in the systems concerned, and the self-assessment provided.

The commission visited Slovenia in June, and conducted discussions with representatives of key institutions concerned with the secure functioning of payments systems and securities clearing and settlement systems (the Bank of Slovenia and Securities Market Agency), with certain participants in these systems and with the Central Securities Clearing Corporation as the operator of the securities clearing and settlement system.

In September, having carried out assessments in all candidate countries, the ECB prepared a combined summary report on the results of the inspections, containing general findings and recommendations to the candidate countries, and individual country assessments. The ECB's general finding was that the payments systems and securities clearing and settlement systems in the candidate countries are not deficient in respects that will impede their accession to the EU. The assessment of Slovenia's payment systems and securities clearing and settlement systems was also very favourable, which bears out the strategic decisions at the start of the payments system reform and the success of their implementation. The Bank of Slovenia has also proceeded to implement the recommendations for further improvement of the payment and settlement infrastructure set out by the ECB on the basis of its assessment.

Integrated system for low-value payments

The plan to establish an integrated system for low-value payments, which was drawn up in concrete detail in late 2000, envisaged as key objectives for the future development of payment systems in Slovenia an integral communications infrastructure, integral standards and use of payment instruments at the level of the banking system as a whole, the development of new kinds of payment services and payment instruments, more rapid and lower-cost execution of payment transactions, greater transparency and more effective risk management.

Memorandum of understanding with regard to low-value payments between banks, savings banks and Bank Association of Slovenia

The strategic directions for the project emphasised the vital importance of ensuring interbank cooperation in order for the set aims to be realised. To this end a memorandum of understanding with regard to the processing of low-value payments was signed in May 2002 by the banks, the savings banks and the Bank Association of Slovenia, setting out the areas and manner of their cooperation. The memorandum of understanding formalises the cooperation that is necessary and reasonable across all areas in which the banks have a common interest and where competition would be less effective and more costly.

The memorandum of understanding was submitted for scrutiny by the Office of the Republic of Slovenia for the Protection of Competition, which confirmed that cooperation among the banks and savings banks in integrating systems of low-value payments would not directly affect their market position and impede, prevent or distort competition. This ruling confirmed the validity of the memorandum of understanding and enabled the setting-up of a Payment Services Committee with authority for strategic decisions-making in the area of payments systems. The composition of the Committee (eight representatives of banks and savings banks and a representative of the Bank of Slovenia, who also chairs the Committee) promotes active cooperation among all banks, while the role of the Bank of Slovenia consists mainly in steering initiatives and seeking agreement for decisions that will foster the realisation of the Committee's set aims.

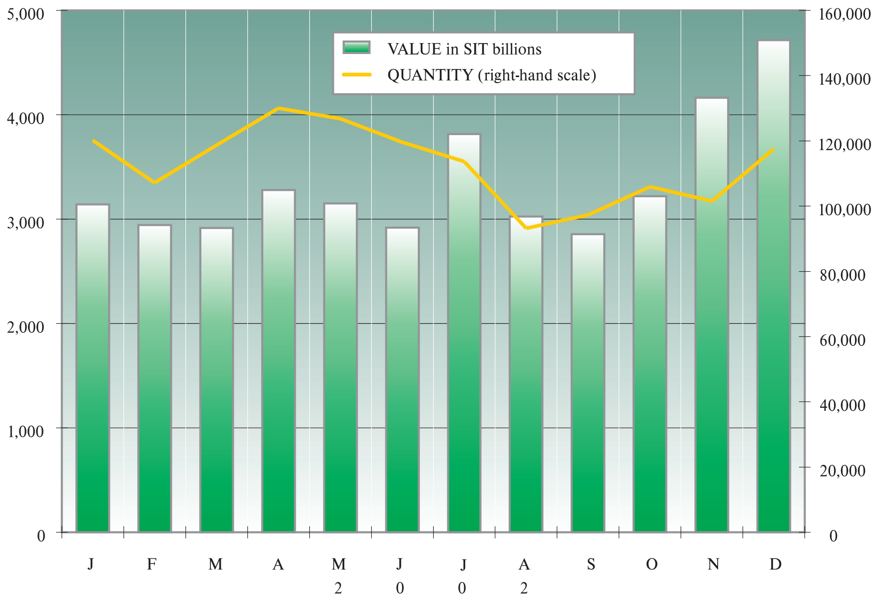
The first regular meeting of the Committee was held at the end of October 2002 and was devoted to the constitution of the Committee and discussion of substantive issues, in line with its role as an interbank body for strategic decision-making. For the workstream relating to the integration of low-value payment systems, the Committee is expected to be joined in 2003 at a second level of organisation by a working or project group that will be responsible at an operational level for drawing up specific functional requirements to be met by a future integrated system for low-value payments.

Activity in the area of standardisation and electronic transactions

In 2002 the Bank of Slovenia kept abreast of ongoing activity within the Slovenian e-business project "e-slog", being led by the Slovenian Chamber of Commerce. The first phase of the project, involving the preparation of documentation for a standardised billing scheme under the EANCOM and XML standards, was completed in June. In connection with the work on standardised billing, the entire process of technological interoperability and security of transactions was verified.

In September as part of the "e-slog" project, a working group for payment standards was set up, whose members are drawn from the Bank of Slovenia, the Bank Association of Slovenia, selected firms and the Ministry of Finance. The core aim of

Figure 19: **Payment transactions through the RTGS in 2002**



Source: Bank of Slovenia.

the working group is the standardisation of payment transactions between legal persons, banks and state institutions. The standardisation effort involves a description of business processes and documents and, in collaboration with other "e-slog" project working groups, the preparation of technical solutions and the integration of single digital verification for providing identification and electronic signature of business documents. The standardised documents will encompass the full range of communications between business entities in this area (payment instructions, cancellation of a payment instructions and all appropriate notifications in either direction during the fulfilment of payment services). The standardised documents will be prepared in EANCOM and XML form.

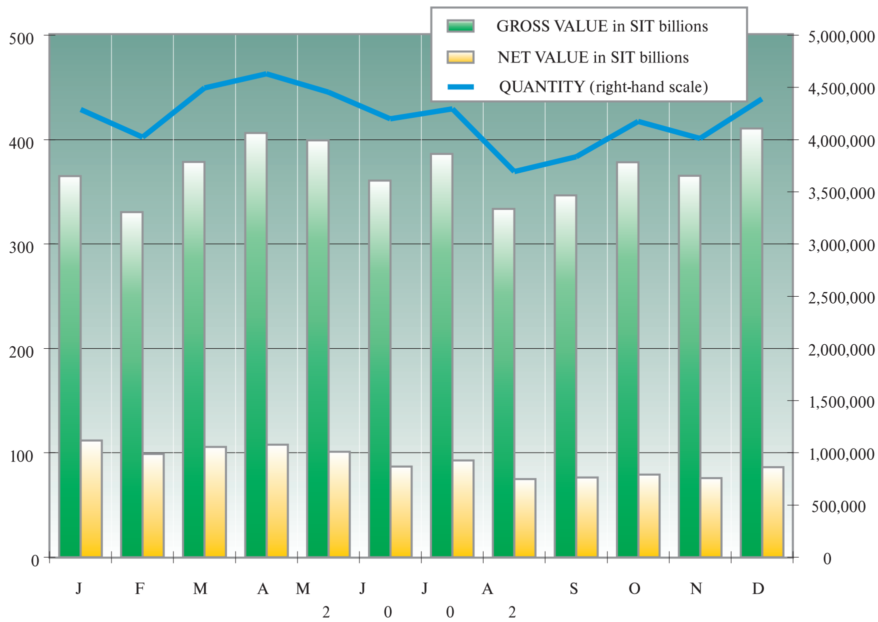
Payment systems statistics

In 2002 1,351,429 transactions with a total value of SIT 40,138 billion were settled through the Real Time Gross Settlement System, a 6.5% reduction in volume but a 37.7% increase in value compared with 2001. An average of 5,427 transactions were settled each day, with an average value of SIT 29.7 million per transaction.

The Giro Clearing net settlement system, the second most important interbank payment system, which handles non-urgent payments worth less than SIT 2 million, processed 50,486,456 transactions in 2002 with a total value of SIT 4,462 billion, a 4.8% rise in volume and 17.6% rise in value compared with 2001. The value of net settlements of these payments in central bank money via the RTGS was SIT 1,098 billion or 24.6% of the gross value of transactions, implying netting ratio as high as 75.4%. On average 202,757 transactions were processed daily, with an average value of SIT 88,372.

The total number of transactions settled through both systems in 2002 was 51,837,885, of which 2.6% were processed through the RTGS and 97.4% through the Giro Clearing system (compared with 2.9% and 97.1% respectively in 2001). The total value of transactions through the two systems in 2002 was SIT 44,599 billion, of which the RTGS accounted for 90.0% and the Giro Clearing system 10.0% (compared with 88.5% and 11.5% respectively in 2001).

Figure 20: **Payment transactions through the Giro Clearing system in 2002**



Source: Bank of Slovenia.

5.5 Statistical system

Bank of Slovenia among the institutions responsible in law for the national statistical research programme

Under the National Statistics Act the Bank of Slovenia is among the institutions responsible for carrying out the statistical research programme, which is defined in general terms for the medium term and in detail at an annual level. In 2002 a new medium-term programme for the period 2003-2007, which was shaped partly by major economic and information-related changes, and especially also by developments in connection with entry to European Union.

The task of the Bank of Slovenia's statistical system is to keep a domestic and foreign audience informed about financial and macroeconomic developments in Slovenia. It also supports the Bank of Slovenia's monetary policy and assists in cooperation with international organisations, principally the IMF, Eurostat and the ECB, in the field of statistics.

Responsibility for monetary and balance of payments statistics…

The Bank of Slovenia is responsible for producing a rigorous set of financial accounts and monetary and balance of payments statistics. These statistics are based mainly on data from direct and indirect reports from banks and corporations and on merchandise trade data prepared by the Statistical Office of the Republic of Slovenia on the basis of customs declarations. The Bank of Slovenia also collects, compiles and publishes statistics on modern payment instruments, financial markets etc.

…and financial accounting statistics

The financial accounts are still in the development phase. In 2002 preliminary studies and proposed templates for the first round of reporting in 2003 were created in cooperation with the Agency for Public Records and Services, the Ministry of Finance and the Statistical Office. In the area of monetary statistics, the monetary aggregates according to ECB methodology were built and a project was commenced to bring bank data into line with the statistical requirements of Slovenia's future membership of European Monetary Union.

The methodological basis for these statistics are the standards of the IMF and increasingly, with the purpose of adapting to the legal framework of the European Union, the ECB and Eurostat.

Statistical data disseminated via the Internet…

The Bank releases data on its website in accordance with the IMF's Special Statistical Data Dissemination Standards for Slovenia. The data are prepared jointly with the Statistical Office and the Ministry of Finance. The standards require the regular publication of methodologically sound key macroeconomic figures according to an advance release calendar. Observance of these standards enhances macroeconomic accountability, permitting early identification of financial problems, and is therefore important in gaining access to international financial markets.

…in print and at press conferences

The main financial and macroeconomic data for Slovenia appear in a Monthly Bulletin. Other publications are Financial Markets (quarterly) and Direct Investment (annual). All publications, along with information on the balance of payments, extended time series of data from the Monthly Bulletin and certain other important data categories, are published on the Bank of Slovenia website. The Bank also sends statistical data to the IMF, the ECB and Eurostat. In 2001 it began to release balance of payments figures at monthly press conferences in addition to the other channels.

In addition to regular meetings in working groups and at seminars of Eurostat and the ECB, Bank of Slovenia representatives also attend plenary sessions of the Committee on Monetary, Financial and Balance of Payments Statistics, the main body for coordinating strategic issues concerning European financial statistics.

5.6 International cooperation

International Monetary Fund

Slovenia's quota at the International Monetary Fund (IMF) was unchanged at SDR 231.7 million, which translates to 0.12% of the voting power of all IMF members.

Since 1998 Slovenia has been among the member countries of the IMF that finance loans under the Financial Transactions Plan (FTP). In 2002 Slovenia contributed SDR 35.2 million to the FTP for Turkey and received a total of SDR 10.6 million in repayments on IMF loans to the Philippines, Jordan, Uruguay, Russia and Moldavia made under the FTP for past years. At the end of December 2002 Slovenia's reserve tranche position at the IMF stood at SDR 88.8 million.

The 2002 report for Slovenia on consultations under Article IV of the Articles of Agreement of the IMF was published in early April after discussion at the IMF Executive Board in March, and a Report on the Observance of Standards and Codes for Slovenia was published in June. In December an IMF mission visited Slovenia as part of the Article IV consultations for 2003.

European Central Bank

Strengthening of ties with the ECB

In 2002 the ECB further strengthened its bilateral and multilateral ties with the central banks of the candidate countries for EU entry. The Bank of Slovenia intensified its cooperation in relevant areas of central banking, legislation regarding Economic and Monetary Union, statistics and payments systems.

Seminars for future ESCB committee members

In September 2002 the ECB informed the Bank of Slovenia that Bank of Slovenia representatives would be given observer status on the committees of the European System of Central Banks (comprising the ECB and the national central banks of the EU member states) upon signature of Slovenia's treaty of accession to the European Union. In preparation, the ECB began holding a series of seminars on particular topics, attended by representatives of the central banks of the candidate countries who will attend the ESCB committees. Permanent members of these committees also participate in these seminars.

Central bank seminar on the EU accession process

The fourth annual central bank seminar on the EU accession process took place in December 2002. It was attended by representatives of the ECB, the national central banks of the EU member states which introduced the euro, and representatives of the candidate countries for EU entry. The seminar was devoted to exchanging views on important central banking issues ahead of accession to the EU.

ECB report on status of legal preparation of accession countries

In 2002 the ECB updated its report, first produced in 2000, on the state of legal preparation accession countries in the areas of Community law which are of concern to the eurosystem (the ECB and the national central banks of the EU member states which introduced the euro). The report analyses the adoption and implementation of the EU acquis, primarily concerning central bank independence, other legislation with regard to the monetary field, and legislation on the banking sector and financial markets.

Public information campaign regarding the introduction of euro notes and coins

Early in 2002 the Bank of Slovenia continued its cooperation with the ECB on increasing public awareness about the introduction of euro banknotes and coins in twelve of the EU member states on 1 January 2001. The public information campaign in Slovenia regarding the euro currency has been run in conjunction with the Bank Association of Slovenia and the European Commission delegation to Slovenia.

European Union

EU acquis for the free movement of capital and Economic and Monetary Union adopted

The Bank of Slovenia continued to cooperate in the review of the harmonisation of Slovenian law with the EU acquis and the preparation of further negotiating positions with regard to the freedom to provide sevices, the free movement of capital, Economic and Monetary Union, and institutions. Negotiations on Slovenia's entry to the EU were concluded in December 2002. With regard to free movement of services, a transition period lasting until 31 December 2004 was secured for the application to savings and loan undertakings established before 20 February 1999 of the capital and other requirements of safe and sound banking that are the subject of the Second Banking Directive 89/646/EEC and Directives 86/635/EEC, 89/299/EEC, 89/647/EEC, 92/121/EEC and 94/19/EC. During this period the latter cannot benefit from the "European passport" for operating in the single market. A transitional period until 31 December 2005 was also secured for protection of the level and scope of the domestic deposit-guarantee scheme at banks, and the protection of the level and scope of the domestic investor-compensation scheme for the funds of investors with an investment firm (export ban). Slovenia adopted the EU acquis for free flow of capital and Economic and Monetary Union. On accession to the EU Slovenia will participate in Economic and Monetary Union, although it will have a derogation with regard to the introduction of the euro under the Treaty establishing the European Community. After accession, Slovenia will be required to act in accordance with the ultimate goal of introducing the euro. The following will apply to institutional provisions: on Slovenia's accession to the EU the Bank of Slovenia will become part of the ESCB and the governor of the Bank of Slovenia will become a member of the ECB General Council, while upon the introduction of the euro in Slovenia, the Bank of Slovenia will become part of the Eurosystem and the governor of the Bank of Slovenia will become a member of the ECB Governing Council.

The Bank of Slovenia participated in the drafting of the annual Report on Slovenia's Progress towards Accession and amendments to the Republic of Slovenia's National Programme for the Adoption of the Acquis by the end of 2002.

The Bank of Slovenia also took an active part in the Subcommittee on the Internal Market and the Subcommittee on Economic and Monetary Affairs.

Other

In 2002 the Bank of Slovenia continued to participate in the process of negotiations over succession to the Socialist Federal Republic of Yugoslavia.

6. 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.

Report of the Auditors

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 2002 and 2001 and the related statements of income and expenditure, of changes in equity and of cash flows for the years then ended as set out on pages 71 to 89 (“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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 2002 and 2001, and the results of its operations and its cash flows for the years then ended in accordance with International Financial Reporting Standards and Slovenian Law.

PricewaterhouseCoopers AG
A. Schönenberger
Authorised Auditors

K. Morscher

Zürich, 25 March 2003

Statement of income and expenditure

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

	Notes	2002	2001
Operating income:			
Interest income	4	**61,677**	44,583
Interest expenses	5	**42,321**	25,529
Net interest income		**19,356**	19,053
Net foreign exchange gain/loss		**-8,588**	22,397
Gain (loss) from unrealized price revaluation of securities		**9,365**	3,972
Loss from unrealized gold revaluation		**1,550**	-63
Net investment income		**21,684**	45,360
Fee and commission income		**1,793**	1,123
Fee and commission expense		**406**	356
Net fee and commission income		**1,387**	768
Other operating income		**382**	289
Total operating income		**23,452**	46,417
Operating expenses	6	**4,396**	3,930
Provisions and write-offs	7	**498**	7,690
Operating surplus available for appropriation		**18,558**	34,798
Appropriations:			
Transfer/Release to special reserves for foreign exchange differences		**-8,588**	22,397
Transfer/Release to special reserves price risks		**10,915**	3,972
Financial results after the appropriation of net foreign exchange gain/loss and gain (loss) from unrealized price revaluation		**16,231**	8,428
Transfer to general reserves		**12,173**	6,321
Total transfer to reserves	13	**14,500**	32,691
Provision for transfer of surplus to the budget of RS		**4,058**	2,107
Total appropriations		**18,558**	34,798

The notes on pages 75 to 89 form an integral part of the financial statements.

Balance sheet

at 31 December (in millions of tolars)

	Notes	31.12.2002	31.12.2001
Assets			
Financial assets			
Foreign currency assets			
Gold and gold receivables	8	**18,403**	16,869
Cash and deposits		**592,862**	492,109
Derivative financial instruments	9	**328**	21
Investment securities available for sale	16	**927,375**	580,193
Receivables from the Republic of Slovenia		**7,668**	8,509
International Monetary Fund		**28,221**	21,479
Accrued interest and other assets		**13,605**	11,978
Total		**1,588,462**	1,131,158
Domestic currency assets			
Due from banks		**18**	438
Reverse – repo agreements		**1,148**	-
Accrued interest and other assets		**2,089**	2,290
Total		**3,255**	2,728
Fixed assets	10	**3,094**	2,608
Total assets		**1,594,812**	1,136,494
Liabilities and reserves			
Serviced liabilities			
Foreign currency liabilities			
Current accounts and deposits to banks		**30,545**	31,842
Bank of Slovenia bills		**552,952**	460,837
IMF and other international financial organisations		**7**	5
SDR allocation	11	**7,643**	8,013
Accrued interest and other liabilities		**131**	191
Total		**591,278**	500,889
Domestic currency liabilities			
Current accounts and deposits		**89,804**	85,557
Overnight deposits		**18,360**	35,372
Bank of Slovenia bills		**375,636**	125,912
Republic of Slovenia deposits		**134,793**	28,837
Accrued interest and other liabilities		**8,915**	6,629
Total		**627,508**	282,308
Banknotes in circulation	12	**172,056**	165,778
Provision for transfer of surplus to the budget of RS		**4,058**	2,107
Total liabilities		**1,394,900**	951,082
Capital and Reserves	13	**199,912**	185,411
Total liabilities and reserves		**1,594,812**	1,136,494

The notes on pages 75 to 89 form an integral part of the financial statements.

Statement of changes in equity

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

	Capital of the BoS	General reserve	Special Reserve	Operating surplus/ deficit	Total equity
Balance at 31 December 2000	**-**	**21,914**	**109,768**	**-**	**131,682**
Increase by transfer (BIS)	-	21,039	-	-	21,039
Operating surplus	-	-	-	34,798	34,798
FX gains/losses	-	-	22,397	-22,397	-
Operating surplus retained in general reserve	-	10,293	-	-10,293	-
Provisions for transfer to RS	-	-	-	-2,107	-2,107
Total movement	-	31,332	22,397	-	53,729
Balance at 31 December 2001	**-**	**53,246**	**132,165**	**-**	**185,411**
Arising in the period					
Adoption of the new Bank of Slovenia Act	2,000	-9,537	7,537	-	-
Operating surplus	-	-	-	18,558	18,558
FX gains/losses	-	-	-8,588	8,588	-
Transfer to special reserves -price risk	-	-	10,915	-10,915	-
Operating surplus retained in general reserve	-	12,173	-	-12,173	-
Provisions for transfer to RS	-	-	-	-4,058	-4,058
Total movement	2,000	2,636	9,865	-	14,500
Balance at 31 December 2002	**2,000**	**55,882**	**142,030**	**-**	**199,912**

An analysis of the movements in each category within 'Reserves' is presented in Note 13.

The notes on pages 75 to 89 form an integral part of the financial statements.

Statement of cash flow

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

	Notes	**2002**	2001
Cash flows from operating activities			
Interest received		**60,319**	41,534
Interest paid		**-35,886**	-25,569
Other		**-1,992**	-169
Net cash flow from operating activities		**22,441**	15,797
Cash flows from investing activities			
Purchase of securities		**-1,248,148**	-624,042
Proceeds from sale of securities		**911,919**	553,917
Purchase of time deposits		**-14,695,325**	-10,114,544
Proceeds from redemption of time deposits		**14,588,360**	9,854,193
Loans and reverse repo to domestic banks		**-332,175**	-57,553
Repayment from domestic banks		**331,447**	63,848
Purchase of fixed assets		**-806**	-189
Proceeds from sale of fixed assets		**63**	3
Net cash flow from investing activities		**-444,664**	-324,366
Cash flows from financing activities			
Issue of banknotes in circulation		**6,278**	26,331
Issue of Bank of Slovenia bills	17	**5,619,908**	4,023,304
Repayment of Bank of Slovenia bills	17	**-5,295,401**	-3,824,130
Republic of Slovenia deposit		**114,041**	19,896
General reserves increase by transfer		**-**	21,039
Other, net		**-1,808**	-2,744
Net cash flow from financing activities		**443,018**	263,696
Exchange rate effect		**459**	1,223
Net cash flow from all activities		**21,254**	-43,650
Cash and cash equivalents at beginning of year		**-135,599**	-91,949
Cash and cash equivalents at end of year	18	**-114,345**	-135,599
Increase (decrease) in cash and cash equivalents		**21,254**	-43,650

The notes on pages 75 to 89 form an integral part of the financial statements.

These financial statements were approved by the Governing Board on 25 March 2003 and were signed on its behalf by:

Mitja Gaspari
President of the Governing Board and
Governor of the Bank of Slovenia

In accordance with Article 49 of the Bank of Slovenia Act. The Bank of Slovenia shall inform the National Assembly of the Republic of Slovenia of these annual financial statements.

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 25 June 1991. In 2002 a new Bank of Slovenia Act (Official Gazette of the Republic of Slovenia No. 58/02) was adopted. The Bank is a legal person, governed by public law, which independently disposes of its own property. The Bank is wholly owned by the state and is autonomous as regards its finances and administration. The Bank is supervised by Parliament. The Bank shall take care of the stability of domestic prices and of general liquidity of financial system.

2 Accounting standards and conventions

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Committee under the historical cost convention as modified by the revaluation of available for sale securities, financial assets and liabilities held for trading, and all derivative contracts. These were adopted by the Governing Board at the 90th meeting on 9 May 1995.

3 Specific accounting policies

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.

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. Fee and commission income is recognised in the statement of income and expenditure as it accrues.

Financial assets and liabilities

All financial assets are initially recognised at cost in the balance sheet on a settlement date basis. The settlement date is the date that an asset is delivered to or by an enterprise. Financial liabilities are recognised in the balance sheet when the Bank becomes a party to the contractual provisions of the instrument.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

Gold and gold receivables

The Bank's gold holdings are valued on the basis of the dollar market price per fine ounce of gold. The revaluation gain or loss due to movements in the price per fine ounce and the dollar exchange rate is reported in the income statement as a gain (loss) from gold revaluation. The net unrealised gain or loss is taken to special reserves according to a decision of the Governing Board.

Investment securities

The Bank invests in marketable securities as a part of its management of international reserves. The Bank does not hold a trading securities portfolio or held to maturity securities. All investment securities are classified as available for sale and are carried at market value. When the securities are disposed of, the related accumulated fair value adjustment is included in the income statement as a gain less losses from investment securities. The effect of securities price changes appears in the Statement of Income and Expenditure under the item Gain (loss) from unrealised price revaluation of investment securities. The net unrealised gain (loss) is taken to special reserves according to a decision of the Governing Board.

Derivative financial instruments

The bank does not use derivative financial instruments except foreign exchange swap arrangements with domestic banks and forwards for the purposes of implementing monetary policy and managing loans to banks. Both are recognised on the balance sheet at their fair value. Gains are accrued over the life of the swap and reported in the Income Statement as swap gains. The market value is derived from the difference between the forward price and the market price of the underlying item.

Hedging

The Bank did not designate any transactions as hedges during the year.

Reverse – Repurchase Transactions

Securities purchased under agreements are recorded to resell (reverse repos) in the Balance sheet and reported within "Domestic currency assets". The difference between the purchase price and the sale price represents interest income. It is accrued over the life of the repo agreement.

Originated loans and provisions for loan impairment

Loans are carried at amortised cost and are recognised when drawn down. When there is evidence that the loans may not be repaid in full with respect to the original contract, a loan-loss provision is established. When a loan is deemed uncollectable, it is written off against the corresponding provision for impairments. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flow, including amounts recoverable from guarantees and collateral discounted on the basis of the interest rate at inception.

Current accounts and deposits

Borrowings are recognised initially at cost. Subsequently, borrowings are stated at amortised cost.

Bank of Slovenia bills

Bank of Slovenia bills comprises bills in domestic currency and bills in either EUR or USD. Tolars bills are issued with maturities of sixty, two hundred and seventy and three hundred and sixty days. Foreign currency bills are issued with maturities from two to four months. Both kinds of Bank of Slovenia bills are carried at amortized cost.

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. The last revaluation was performed in 1999. 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.

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.

Cash flows

Cash and cash equivalents 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 on a gross basis.

Taxation

The Bank is not subject to Slovenian profit taxes.

Appropriations

In accordance with the Bank of Slovenia Act, net profit is allocated to special reserves, general reserves and the budget of the Republic of Slovenia. Unrealized income deriving from exchange rate and price changes is allocated in its entirety to special reserves. These may only be used to cover a shortfall deriving from unrealized expenses deriving from exchange rate and price changes. After the allocation of funds to special reserves, 25% of net income is allocated to the budget of the Republic of Slovenia, while the rest is allocated to general reserves.

A net loss of the Bank of Slovenia is covered from general reserves. Any net loss which cannot be covered from general reserves is covered by the budget of the Republic of Slovenia.

Changes in accounting policies

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

4 Interest income

	2002 SIT millions	2001 SIT millions
Interest income from foreign currency		
Income on gold assets	**64**	64
Interest on deposits	**17,707**	13,036
Income on investment securities	**27,935**	27,337
Interest on International Monetary Fund deposits	**538**	597
Total	**46,243**	41,033
Interest income from domestic currency		
Interest on loans to banks	**88**	1,249
Interests from Reverse – repo agreements	**31**	413
Swap gains	**15,315**	1,888
Total	**15,434**	3,550
Total interest income	**61,677**	44,583

Income on investment securities consists of the following:

	2002 SIT millions	2001 SIT millions
Interest income	**26,485**	26,528
Gains less losses from investment securities on sale	**1,449**	809
Total investment income on marketable securities, net	**27,935**	27,337

5 Interest expenses

	2002 SIT millions	2001 SIT millions
Interest expenses on foreign currency		
Interest on current accounts and deposits	**843**	1,693
Interest on Bank of Slovenia bills	**16,594**	17,818
Total	**17,437**	19,511
Interest expenses on domestic currency		
Interest on current accounts and deposits	**815**	701
Interest on overnight deposits	**288**	120
Interest on Republic of Slovenia deposits	**3,083**	455
Interest on Bank of Slovenia bills	**20,697**	4,743
Total	**24,884**	6,019
Total interest expenses	**42,321**	25,529

6 Operating expenses

	2002 SIT millions	2001 SIT millions
Staff costs	**2,582**	2,221
Administration costs	**1,519**	1,456
Printing and minting costs	**184**	106
Other	**111**	146
Total operating expenses	**4,396**	3,930

The Bank employed 391 employees on 31 December 2002 (2001: 387 employees).

7 Provisions and write-offs

	2002 SIT millions	2001 SIT millions
Receivables from Succession Fund	**-**	8,650
Due to finances institutions	**-2**	-1,010
Off-balance sheet items	**500**	50
Total provisions	**498**	7,690

8 Gold and gold receivables

	2002 SIT millions	2001 SIT millions
Gold	**40**	174
Gold deposits	**18,363**	16,694
Total gold and gold receivables	**18,403**	16,869

9 Derivative financial instruments

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements in 2002 and in 2001 which require the Bank to buy EUR for SIT and/or to sell EUR for SIT. The value of derivative instruments and currency forwards are as follows at 31 December:

	2002		2001	
	Fair value	**Notional amount**	Fair value	Notional amount
	SIT millions			
Foreign exchange swaps				
- to be received forward against EUR	**328**	**542,233**	21	260,909
Currency forward				
- to be given forward against EUR	**-**	**-**	-	3,919
Total derivative financial instruments	**328**	**542,233**	21	264,828

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and therefore do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms.

10 Fixed assets

	Land and buildings	Computers & equipment	Total
		SIT millions	
Cost or valuation			
At 1 January 2001	2,682	2,229	4,912
Additions	50	140	190
Disposals	-	-73	-73
At 1 January 2002	2,732	2,297	5,029
Additions	136	687	823
Disposals	-	-256	-256
At 31 December 2002	**2,869**	**2,727**	**5,596**
Depreciation			
At 1 January 2001	576	1,559	2,134
Disposals	-	-68	-68
Charge for the year	20	335	355
At 1 January 2002	596	1,825	2,421
Disposals	-	-243	-243
Charge for the year	21	302	323
At 31 December 2002	**617**	**1,884**	**2,501**
Net book value			
At 31 December 2002	**2,251**	**843**	**3,094**
At 31 December 2001	2,136	471	2,608

Included in land and buildings at 31 December 2002 and 2001 is an amount of SIT 1,115 million relating to investment properties in Austria.

Amounts included in income statement:

	2002 SIT millions	2001 SIT millions
Rental income from investment properties	**182**	177
Direct operating expenses	**130**	135
Total income from investment properties	**52**	42

11 SDR allocation

	2002 SIT millions	2001 SIT millions
SDR allocation	**7,643**	8,013
Total SDR allocation	**7,643**	8,013

The SDR allocation liability carried an interest rate of 1.91% at 31 December 2002 (2001: 2.23%). Interest paid by the Bank is recharged directly to the Republic of Slovenia, thereby giving a nil effective interest rate.

Receivables from the Republic of Slovenia have a carrying value equal to principal and are mostly funded by Special Drawing Rights allocations.

12 Banknotes in circulation

Value of banknotes in circulation by denomination:

		2002 SIT millions	2001 SIT millions
SIT	10	**255**	269
SIT	20	**439**	395
SIT	50	**591**	542
SIT	100	**1,454**	1,401
SIT	200	**1,527**	1,411
SIT	500	**2,087**	2,001
SIT	1,000	**12,480**	12,137
SIT	5,000	**63,562**	60,197
SIT	10,000	**89,255**	87,019
Total		**171,651**	165,372
Tolar coupons		**405**	406
Total		**172,056**	165,778

13 Reserves

	2002 SIT millions	2001 SIT millions
Balance at 1 January	**185,411**	131,682
Increase of general reserve – BIS	**-**	21,039
Transfer from general reserve	**-2,000**	-
Constitution of initial capital of the Bank of Slovenia	**2,000**	-
Transfer/Release to special reserve for foreign exchange differences	**-8,588**	22,397
Transfer to special reserve – price risk	**10,915**	3,972
Transfer to general reserve	**12,173**	6,321
Balance at 31 December	**199,912**	185,411
Represented by		
Initial capital of the Bank of Slovenia	**2,000**	-
Special reserve for foreign exchange differences	**123,578**	132,165
Special reserve – price risk	**18,452**	7,537
General reserve	**54,767**	44,594
Investment properties revaluation	**1,115**	1,115
Total reserves	**199,912**	185,411

Article 5 of the Bank of Slovenia Act (Official Gazette of the Republic of Slovenia, No. 58/02)provides as follows: “The initial capital of the Bank of Slovenia constituted from a portion of the general reserves of the Bank of Slovenia shall amount to SIT 2 billion on entry into force of this act”. The Bank of Slovenia Act became effective on 19 July 2002. On that day SIT 2 billion was transferred from general reserves to the initial capital.

The reserves of the Bank of Slovenia are composed of general reserves and special reserves. General reserves serve to cover general risks associated with the operations of the Bank of Slovenia. Special reserves serve to cover exchange rate and price risks. Special reserves are equal to the amount of unrealized income deriving from exchange rate and price changes.

According to the new Bank of Slovenia Act, the amount of SIT 7,537 million was transferred from general reserves (General reserve – price risk) to special reserves (Special reserve – price risk). This amount represents the amount of unrealized gains from previous years’ price changes.

In 1996, the Act on the Membership of the Bank of Slovenia in the Bank for International Settlements came into force. With this Act, the Republic of Slovenia permitted the Bank of Slovenia to join the BIS. Five years later, in 2001, an agreement between successor states regarding proportional shares was reached and the Republic transferred the proportional share of capital and of the other bank balances of the former National Bank of Yugoslavia at the BIS to the Bank of Slovenia. The Republic of Slovenia’s share of 16.39% of the assets of the former NBY assets in BIS amounts to USD 82 million. Transferred assets that were booked to the Bank of Slovenia per the BIS assembly of 13 June 2001 consisted of gold (SIT 16.9 billion), deposits (SIT 1.1 billion) and BIS shares (SIT 2.9 billion).

14 Commitments and off-balance sheet instruments

Letters of Credit

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

	2002 SIT millions	2001 SIT millions
Foreign currency letters of credit	-	13

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements and currency forwards in 2002 and in 2001 which require the Bank to buy EUR for SIT and to sell EUR for SIT. The notional amounts of these instruments are shown in Note 9.

Litigation and other provisions

There are certain legal claims pending or threatened involving the Bank, which have not yet been settled. The claims relate mainly to disputes about wages in the early 1990s. The Governing Board believes that sufficient provision has been made in the accounts for any expected loss from future settlement. Detailed information in accordance with IFRS 37 "Provisions, Contingent Liabilities and Contingent Assets" has not been given as this is considered by the Governing Board to be prejudicial to the Bank of Slovenia's position in these cases.

15 Fair value of financial assets and liabilities

The following table summarises carrying amounts and fair values of those financial assets and liabilities not presented on the Bank of Slovenia balance sheet at their fair value. The estimated fair values of fixed interest bearing deposits and of Bank of Slovenia bills are based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.

	Carrying value		**Fair value**	
	2002	2001	**2002**	2001
	SIT millions			
Assets				
Cash and deposits	**592,862**	492,109	**593,439**	492,673
Due to the banks	**18**	438	**18**	453
Reverse repo agreements	**1,148**	-	**1,148**	-
Liabilities				
Bank of Slovenia bills in foreign currency	**552,952**	460,837	**552,951**	460,817
Bank of Slovenia bills in domestic currency	**375,636**	125,912	**387,629**	126,355

The fair values of deposits approximate their carrying amounts as they are payable on demand or of very short maturity.

Due to the specific role of IMF holdings and the SDR allocation, fair values of both do not differ from their carrying amounts.

The fair value of currency in circulation is considered to be its face value.

16 Risk management

Credit risk

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-. Credit rating represents the average of credit ratings graded by Fitch, Moody's and Standard & Poor's. The maximum credit risk exposure at 31 December 2002 in the event that 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 and the Republic of Slovenia. The Governing Board believes that there is no significant concentration of credit risk.

Concentrations of securities by currency and type of counterparty are as follows at 31 December 2002:

	EUR	USD	Other	Total
		%		
Sovereign bonds	**25.66**	**9.37**	**0.08**	**35.11**
Supranational securities	**0.70**	**3.00**	**0.59**	**4.30**
Foreign banks securities	**56.47**	**2.82**	**1.31**	**60.60**
December 31, 2002	**82.83**	**15.19**	**1.98**	**100.00**
Sovereign bonds	49.70	15.27	0.44	65.40
Supranational securities	1.27	6.01	0.65	7.93
Foreign banks securities	20.50	4.02	2.14	26.66
December 31, 2001	71.47	25.30	3.23	100.00

Interest rate risk

Average effective interest rates:

	2002				2001
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
	%				
Assets					
Foreign currency assets					
Gold and gold receivables	0.32	0.31	-	0.32	0.62
Cash and deposits	2.81	-	-	2.81	3.29
Derivative financial instruments	1.00	1.00	-	1.00	0.50
Investment securities available for sale	3.04	2.97	2.93	2.97	3.76
International Monetary Fund	1.74	-	-	1.74	1.96
Domestic currency assets					
Due from banks	-	-	10.00	10.00	11.28
Reverse – repo agreements	9.01	-	-	9.01	-
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	2.00	-	-	2.00	1.99
Bank of Slovenia bills	2.84	2.58	-	2.80	3.24
Domestic currency liabilities					
Current accounts and deposits	0.94	-	-	0.94	0.92
Overnight deposits	4.00	-	-	4.00	3.92
Bank of Slovenia bills	8.97	11.03	-	10.48	9.04
Republic of Slovenia deposits	7.83	-	10.00	9.12	5.20

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

Interest sensitivity of assets and liabilities

	2002			
	Repricing period			
	3 months or less	3 months to 1 year	Over 1 year	Total
	SIT millions			
Assets				
Foreign currency assets				
Gold and gold receivables	12,326	6,077	-	**18,403**
Cash and deposits	592,862	-	-	**592,862**
Derivative financial instruments	92	236	-	**328**
Investment securities available for sale	309,106	126,536	491,733	**927,375**
Receivables from the RS	25	-	7,643	**7,668**
International Monetary Fund	28,221	-	-	**28,221**
Domestic currency assets				
Due from banks	-	-	18	**18**
Reverse – repo agreements	1,148	-	-	**1,148**
Total assets	**943,781**	**132,848**	**499,394**	**1,576,023**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	30,545	-	-	**30,545**
Bank of Slovenia bills	464,939	88,013	-	**552,952**
IMF and other IFO	-	-	7	**7**
SDR allocation	-	-	7,643	**7,643**
Domestic currency liabilities				
Current accounts and deposits	89,804	-	-	**89,804**
Overnight deposits	18,360	-	-	**18,360**
Bank of Slovenia bills	100,351	275,285	-	**375,636**
Republic of Slovenia deposits	54,793	-	80,000	**134,793**
Total liabilities	**758,792**	**363,298**	**87,649**	**1,209,740**
Net interest sensitivity gap	**184,988**	**-230,450**	**411,744**	**366,283**
December 31, 2001				
Total assets	561,759	119,494	438,365	1,119,618
Total liabilities	683,106	85,252	8,018	776,377
Net interest sensitivity gap	-121,347	34,242	430,347	343,241

Currency risk

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 2002

	SIT	EUR	USD	Other	Total
			SIT millions		
Assets					
Foreign currency assets					
Gold and gold receivables	-	-	-	18,403	**18,403**
Cash and deposits	-	529,863	62,327	673	**592,862**
Derivative financial instruments	-	328	-	-	**328**
Investment securities available for sale	-	768,149	140,876	18,350	**927,375**
Receivables from the RS	-	-	-	7,668	**7,668**
International Monetary Fund	-	-	-	28,221	**28,221**
Accrued interest and other assets	-	7,661	2,211	3,733	**13,605**
Domestic currency assets	3,255	-	-	-	**3,255**
Total assets	**3,255**	**1,306,000**	**205,414**	**77,048**	**1,591,717**
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	-	12,897	17,447	201	**30,545**
Bank of Slovenia bills	-	500,165	52,788	-	**552,952**
IMF and other IFO	-	-	-	7	**7**
SDR allocation	-	-	-	7,643	**7,643**
Accrued interest and other liabilities		108	21	1	**131**
Domestic currency liabilities	627,508	-	-	-	**627,508**
Total liabilities	**627,508**	**513,170**	**70,256**	**7,852**	**1,218,786**
Net balance sheet position	**-624,253**	**792,830**	**135,158**	**69,196**	**372,931**
Off-balance sheet net position	**9,740**	**-542,233**	**-**	**-**	**-532,493**
December 31, 2001					
Total assets	2,728	872,312	188,948	69,898	1,133,886
Total liabilities	282,308	421,089	71,571	8,229	783,197
Net balance sheet position	-279,580	451,223	117,377	61,669	350,689
Off-balance sheet net position	3,912	-260,909	-	-	-256,997

Maturities of assets and liabilities

	Remaining period to the contractual maturity date			
	3 months or less	3 months to 1 year	Over 1 year	2002 Total
	SIT millions			
Assets				
Foreign currency assets				
Gold and gold receivables	-	-	18,403	**18,403**
Cash and deposits	592,862	-	-	**592,862**
Derivative financial instruments	92	236	-	**328**
Investment securities available for sale	309,106	126,536	491,733	**927,375**
Receivables from the RS	25	-	7,643	**7,668**
International Monetary Fund	1,543	-	26,679	**28,221**
Accrued interest and other assets	6,975	3,284	3,347	**13,605**
Domestic currency assets				
Due from banks	-	-	18	**18**
Reverse – repo agreements	1,148	-	-	**1,148**
Accrued interest and other assets	1,786	28	276	**2,089**
Total assets	**913,536**	**130,083**	**548,098**	**1,591,717**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	30,545	-	-	**30,545**
Bank of Slovenia bills	464,939	88,013	-	**552,952**
IMF and other IFO	-	-	7	**7**
SDR allocation	-	-	7,643	**7,643**
Accrued interest and other liabilities	131	-	-	**131**
Domestic currency liabilities				
Current accounts and deposits	89,804	-	-	**89,804**
Overnight deposits	18,360	-	-	**18,360**
Bank of Slovenia bills	100,351	275,285	-	**375,636**
Republic of Slovenia deposits	54,793	80,000	-	**134,793**
Accrued interest and other liabilities	2,647	2033	4,235	**8,915**
Total liabilities	**761,571**	**445,331**	**11,885**	**1,218,786**
December 31, 2001				
Total assets	532,700	122,320	478,866	1,133,886
Total liabilities	684,995	85,955	12,247	783,197

Liquidity risk is the risk that a company will face inability in raising funds at short notice to meet its immediate liabilities associated with financial instruments. Liquidity risk is also the risk of selling a financial asset quickly at significantly lower value than its fair value.

The matching and controlled mismatching of the maturities is a key criterion in determining and managing the Bank's foreign currency assets and liabilities. This is reflected in appropriate maturities of foreign assets additionally taking into account potential needs for intervention. The Bank has set controls that encounter different liquidity ratios for different instruments. These limits as well as currency and credit risk exposures are monitored daily. Additionally, the Bank has standby credit facility arrangements.

One of the Bank's primary task is to ensure liquidity of payments within the country. The nature of these activities are such that the Bank is not subject to the liquidity constraints that impact on other entities.

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

	2002 SIT millions	2001 SIT millions
Source		
Foreign currency bills	**79,684**	80,343
Tolar bills	**244,823**	118,832
Total	**324,507**	199,174
Total net source	**324,507**	199,174

18 Supplemental cash flow information: cash and cash equivalents

	2002 SIT millions	2001 SIT millions
Foreign currency assets		
Cash	**3,203**	3,136
Total assets	**3,203**	3,136
Foreign currency liabilities		
Demand deposits	**-4,868**	-8,864
Domestic currency liabilities		
Commercial banks demand deposits	**-82,437**	-78,594
Overnight deposits	**-18,360**	-35,372
Non-bank deposits	**-11,883**	-15,905
Total liabilities	**-117,548**	-138,735
Cash and cash equivalents	**-114,345**	-135,599

Foreign currency cash assets include IMF balances of SIT 1,543 million (2001: SIT 1,261 million) and do not include time deposits of SIT 575,841 million (2001: SIT 474,537 million) or other assets of SIT 15,361 million (2001: SIT 15,697 million).

Foreign currency demand deposits do not include restricted deposits of SIT 25,677 million (2001: SIT 22,978 million).

Domestic currency liabilities include Republic of Slovenia deposits of SIT 4,515 million (2001: SIT 8,942 million).

7. APPENDICES

7.1 Statutory basis and tasks

The Bank of Slovenia is the central bank of the Republic of Slovenia and was established by the Bank of Slovenia Act of 25 June 1991 on the basis of the Enabling Statute for the Implementation of the Basic Constitutional Charter on the Independence and Sovereignty of the Republic of Slovenia. With the introduction of the Slovenian currency, the tolar, on 8 October 1991 the Bank of Slovenia assumed all functions of a monetary authority.

Article 152 of the Constitution of the Republic of Slovenia guarantees the independence of the Bank of Slovenia and makes it directly accountable to the National Assembly.

On 17 July 2002 a new Bank of Slovenia Act came into effect, introducing several changes. Under the new Act the Bank's decision-making powers are vested, as before, in the Governor and the Governing Board, but the latter is reduced from eleven members to nine. The Governing Board now consists of the Governor, four Vice-governors and four Members. All are appointed by the National Assembly at the nomination of the President of the Republic for a term of six years with the possibility of reappointment. The Governing Board decides by a two-thirds majority of all its members on all matters that are within its authority under the Bank of Slovenia Act and other legislation.

The Act establishes the core aim of the Bank of Slovenia as price stability. While ensuring price stability, the Bank of Slovenia also supports general economic policy and promotes financial stability while adhering to the principles of an open market economy and free competition. The main tasks of the Bank of Slovenia in relation to the implementation of monetary policy are:

1. to define and implement monetary policy,
2. to define and implement monetary control,
3. to be responsible for the general liquidity of the banking system,
4. to conduct operations on the foreign exchange and financial markets,
5. to accept deposits of banks and savings banks,
6. to open accounts for banks and savings banks,
7. to regulate payments systems.

In addition to the above, the Bank of Slovenia undertakes tasks such as managing foreign exchange assets and other assets entrusted to it, acting as a payments and/or fiscal agent of government and representing the country in international financial organisations as provided for in law, opening accounts for government institutions and public entities, other money market participants and other financial institutions, designing, promulgating and monitoring compliance with rules for the safe and sound operation of banks and savings banks, and maintaining an information system for the smooth conduct of all its functions.

The Bank of Slovenia and the members of its decision-making bodies are independent and are not bound by the decisions, views or instructions of government or other institutions in carrying out their tasks, nor may they seek their guidance or direction. The Bank's independence is reinforced by the fact that it is now only required to report to the National Assembly on its activities; the National Assembly no longer approves the Banks' financial plan and annual accounts. However, until the introduction of the euro as the monetary unit of the Republic of Slovenia, a committee of the National Assembly appoints an independent external auditor for a three-year period to audit the Bank's financial statements.

Another new measure is a prohibition of monetary financing, which prevents the Bank of Slovenia from approving overdrafts or other credit facilities to bodies of the Republic of Slovenia, the European Union or member states of the European Union or their regional or local bodies, or other public undertakings. In addition, the Bank of Slovenia may not issue guarantees for liabilities of these entities or purchase debt instruments from them. The Act allows exceptions to the prohibition which are applicable to banks, savings banks and other financial institutions in public ownership if they are obliged to fulfil the same conditions as other banks, savings banks and financial institutions, financing of liabilities of the Republic of Slovenia to the International Monetary Fund, operations related to the issue of coins not exceeding 10% of the value of coins in circulation, and the intra-day bridging loans granted to the public sector provided there is no renewal option.

7.2 Income statement and balance sheet

Five-year income statement

for the period 1 January to 31 December (SIT millions)

	1998	1999	2000	2001	2002
			SIT millions		
Operating income:					
Interest income	29,188	29,724	35,010	44,583	61,677
Interest expenses	24,701	16,885	18,580	25,529	42,321
Net interest income	**4,487**	**12,839**	**16,430**	**19,053**	**19,356**
Net foreign exchange gain/loss	-4,753	38,399	28,642	22,397	-8,588
Gain (loss) from unrealized price revaluation of securities	-	-8,292	3,557	3,972	9,365
Loss from unrealized gold revaluation	-	-	-	-63	1,550
Net investment income	**-266**	**42,946**	**48,630**	**45,360**	**21,684**
Fee and commission income	1,054	699	914	1,123	1,793
Fee and commission expense	286	408	332	356	406
Net fee and commission income	**768**	**291**	**582**	**768**	1,387
Other operating income	245	253	225	289	382
Total operating income	**747**	**43,490**	**49,436**	**46,417**	**23,452**
Operating expenses	2,923	3,298	3,685	3,930	4,396
Provisions and write-offs	312	-	308	7,690	498
Operating surplus available for appropriation	**-2,489**	**40,192**	**45,443**	**34,798**	**18,558**
Appropriations:					
Transfer/Relese to special reserves for exchange differences	-4,753	38,399	28,642	22,397	-8,588
Transfer to special reserves – price risks	-	-	3,557	3,972	10,915
Financial results after the appropriation of net foreign exchange gain/loss and gain from unrealized price revaluation	2,264	1,793	13,244	8,428	16,231
Transfer to general reserves	1,457	1,554	9,933	6,321	12,173
Total transfer to reserves	-3,297	39,952	42,132	32,691	14,500
Provision for transfer of surplus to the budget of RS	807	240	3,311	2,107	4,058
Total appropriations	**-2,489**	**40,192**	**45,443**	**34,798**	**18,558**

Five-year balance sheet

as at 31 December (SIT millions)

	1998	1999	2000	2001	2002
			SIT millions		
Assets					
Financial assets					
Foreign currency assets	**600,916**	**640,950**	**748,154**	**1,131,158**	**1,588,462**
Gold and gold receivables	15	18	20	16,869	18,403
Cash and deposits	260,545	181,102	237,070	492,109	592,862
Derivative financial instruments	-	-	-	21	328
Investment securities available for sale	314,660	423,983	475,274	580,193	927,375
Receivables from the Republic of Slovenia	6,781	7,260	8,180	8,509	7,668
International Monetary Fund	10,582	21,490	19,557	21,479	28,221
Accrued interest and other assets	8,333	7,097	8,052	11,978	13,605
Domestic currency assets	**13,124**	**31,456**	**16,441**	**2,728**	**3,255**
Receivables from Succession Fund	8,650	8,650	8,650	-	-
Due from banks	697	3,630	566	438	18
Reverse – repo agreements	3,454	18,550	6,299	-	1,148
Accrued interest and other assets	323	626	926	2,290	2,089
Fixed assets	2,372	2,914	2,777	2,608	3,094
Total assets	**616,412**	**675,320**	**767,372**	**1,136,494**	**1,594,812**
Liabilities and reserves					
Serviced liabilities					
Foreign currency liabilities	**307,081**	**343,047**	**404,736**	**500,889**	**591,278**
Current accounts and deposits to banks	16,356	23,990	35,997	31,842	30,545
Derivative financial instruments	-	-	9	-	-
Bank of Slovenia bills	284,865	312,009	361,168	460,837	552,952
IMF and other international financial organisations	59	58	5	5	7
SDR allocation	5,772	6,868	7,534	8,013	7,643
Accrued interest and other liabilities	29	122	23	191	131
Domestic currency liabilities	**154,982**	**100,058**	**87,990**	**282,308**	**627,508**
Current accounts and deposits	66,515	65,167	71,835	85,557	89,804
Overnight deposits	-	-	-	35,372	18,360
Bank of Slovenia bills	79,904	27,101	6,946	125,912	375,636
Republic of Slovenia deposits	2,317	2,303	3,411	28,837	134,793
Accrued interest and other liabilities	6,246	5,487	5,797	6,629	8,915
Banknotes in circulation	104,667	142,489	139,644	165,778	172,056
Provision for transfer of surplus to the budget of RS	807	240	3,311	2,107	4,058
Total liabilities	**567,538**	**585,833**	**635,681**	**951,082**	**1,394,900**
Capital and Reserves	48,874	89,484	131,691	185,411	199,912
Total liabilities and reserves	**616,412**	**675,317**	**767,372**	**1,136,494**	**1,594,812**

7.3 Important measures taken in 2002

7.3.1 Monetary policy measures

January	With effect from 1 January **interest is calculated linearly** on all monetary policy instruments. On 1 January the **discount rate** was **cut** from 11.0% to 9.0%. On 3 January the following **interest rates** were **lowered**: the lombard rate from 12.0% to 11.0% and the interest rate on 60-day tolar bills from 8.0% to 7.5%. On 31 January the interest rate on the latter was raised to 7.75%. The auction interest rate on 270-day bills at the auction on 14 January was reduced from 11.0% to 9.0%.
March	The **auction interest rate** on 270-day bills at the auction on 28 March was **raised** to 10.0%. On 29 March the interest rate on 60-day bills was raised from 7.75% to 8.0%.
April	On 1 April the **discount rate** was **raised** to 10.0%. On 30 April the **interest rate** on 60-day bills was **raised** to 8.25%.
May	On 16 May the **interest rate** on 60-day bills was **raised** to 8.75%.
June	The **frequency of auctions** of 270-day bills was **increased** from two to four per month.
August	With effect from 1 August access to the **lombard loan** facility was extended from banks to **savings banks** authorised under the Banking Act. Lombard loans can also be obtained against tolar bills pledged as collateral.
October	On 29 October the Bank of Slovenia made an outright purchase from the government of foreign currency arising from the **proceeds from the sale of Nova Ljubljanska Banka** in the amount of SIT 113.6 billion (EUR 497 million). On the same day the Ministry of Finance deposited the entire amount with the Bank of Slovenia in three deposits of 15, 272 and 360 days respectively.
November	In early November, for the purpose of **monetisation of the proceeds from the sale of Lek**, the Bank of Slovenia offered cooperating banks the possibility of entering into 270-day foreign exchange buy-sell swaps with the option of outright sale at maturity. The price was set at the same level as the price of 7-day foreign exchange buy-sell swaps (4.5%). As of 4 November the Bank of Slovenia began to issue 360-day tolar bills with the purpose of **sterilisation of the proceeds from the sale of Lek**. Subscription to these bills is open only to banks who have entered foreign exchange buy-sell swaps with the Bank of Slovenia under the agreement on cooperation in foreign exchange market intervention. Banks were entitled to subscribe for the bills up to a limit equal to the average quarterly amount of outstanding swaps with the Bank of Slovenia. The interest rate was set at 12% (the interest rate on 270-day bills plus two percentage points).
December	On 2 December, as a result of the reduction in the weighted average interest rate in the auction of 270-day tolar bills at the end of November, the **interest rate** on 360-day tolar bills was **lowered** from 12% to 11.91%.

The Bank of Slovenia followed the 0.5 percentage point cut in interest rates by the European Central Bank on 6 December. With effect from 12 December the following **interest rates** were **lowered**: the lombard rate from 11.0% to 10.5%, the auction interest rate on 7-day and 2-month tolar bills repos from 9.5% to 9% and the interest rate on 60-day tolar bills from 8.75% to 8.25%. The auction interest rate on 270-day tolar bills was reduced from 10.0% to 9.5% at the auction of 12 December. Consequently the interest rate on 360-day tolar bills was reduced to 11.5% on 13 December.	**December**

7.3.2 Adaptations in advance of entry to the ESCB

Repurchase agreements based on short-term government securities were excluded from the base for the calculation of **compulsory reserves**.	**January**
A new Regulation on **Compulsory Reserves** came into effect on 22 August, introducing the following changes: the base for the calculation of compulsory reserves was widened with respect to maturity and currency (domestic and foreign currency liabilities), three ratios (0%, 2% and 7%) are applied in the calculation of compulsory reserves, and the fulfilment of compulsory reserves by means of 60-day Bank of Slovenia tolar bills was abolished.	**August**
With effect from 29 October the Bank of Slovenia offers banks and savings banks an interest-free **one-day loan** as an instrument for ensuring the stability of payments. The level of collateral for the loan was set at 110% of the amount borrowed. The interest rate on the lombard loan into which a one-day loan is converted if not repaid by the end of the day was set at the ordinary lombard rate plus 4 percentage points, or 15%. On the same day the level of collateral required on ordinary lombard loans was reduced to 110% of the amount borrowed (which was previously limited to 5% of collateral). With effect from 29 October the Bank of Slovenia **abolished overnight liquidity loans** and liquidity loans of last resort.	**October**
With effect from 20 November the Bank of Slovenia **abolished short-term credit** to banks.	**November**

7.3.3 Banking supervision measures

Regulation on the Financial Reports and Accounts of Banks and Savings Banks Regulation on the Classification of On-Balance Sheet and Off-Balance Sheet Assets of Banks and Savings Banks Regulation on Large Exposures of Banks and Savings Banks Regulation on Specific Provisioning of Banks and Savings Banks Regulation on the Minimum Scope and Content of Audits and Auditors' Reports Regulation on the Capital Adequacy of Banks and Savings Banks	**March**
Regulation Amending the Regulation on the Financial Reports and Accounts of Banks and Savings Banks Revised Guidelines on the Implementation of the Regulation on the Financial Reports and Accounts of Banks and Savings Banks (method of compilation of the balance sheet and income statement) Guidelines on the Implementation of the Regulation on the Financial Reports and Accounts of Banks and Savings Banks (method of calculation of indicators)	**June**

October	Regulation Amending the Regulation on the Determination and Reporting of the Value of Investments of Banks and Savings Banks in Equity of Non-financial Organisations and in Tangible Fixed Assets Regulation Amending the Regulation on the Classification of On-Balance Sheet and Off-Balance Sheet Assets of Banks and Savings Banks Regulation Amending the Regulation on the Detailed Method of Calculating Liabilities, Claims and Investments in Determining Net Indebtedness Regulation Amending the Regulation on the Capital Adequacy of Banks and Savings Banks Regulation on Electronic Money Issuing Companies
November	Regulation on the Granting of Special Liquidity Loans with the Cooperation of Banks
December	Regulation Amending the Regulation on the Financial Reports and Accounts of Banks and Savings Banks

7.3.4 Payment systems

June

The **migration of accounts of budget users** from the Agency for Payments to the Bank of Slovenia at the end of June was carried out as part of the establishment of a government single treasury system designed to allow central government and municipal funds to be administered through a system of single treasury accounts. Spare funds in the government single treasury accounts were managed by the Ministry of Finance, which at the end of the day placed them overnight in banks according to an allocation scheme. Spare funds in the municipal single treasury accounts were managed by the municipalities on the basis of a contract with the Bank on the management of surplus liquid funds.

The **reform of payments systems** was completed on 30 June when the Agency for Payments ceased to perform payment transactions for legal persons. This completed the migration of accounts from the Agency for Payments to the banking sector.

7.3.5 Operations for the government sector

On 22 July the Bank of Slovenia paid the Ministry of Finance a proportion of the **surplus of the Bank of Slovenia** for 2001 in the amount of SIT 2,107 million.

7.4 Governance and organisation

7.4.1 Changes in the composition of the Governing Board of the Bank of Slovenia in 2002

There were no changes in the composition of the Governing Board of the Bank of Slovenia in 2002.

7.4.2 Composition of the Governing Board of the Bank of Slovenia as at 31 December 2002

President of the Governing Board of the Bank of Slovenia

Mitja Gaspari
(Governor of the Bank of Slovenia)

Members of the Governing Board of the Bank of Slovenia

Samo Nučič
(Deputy Governor of the Bank of Slovenia)

Darko Bohnec
(Vice Governor of the Bank of Slovenia)

Janez Košak, M.Sc.
(Vice Governor of the Bank of Slovenia)

Andrej Rant
(Vice Governor of the Bank of Slovenia)

Tatjana Fink
(Trimo, Trebnje)

Bine Kordež, M.Sc.
(Merkur, Kranj)

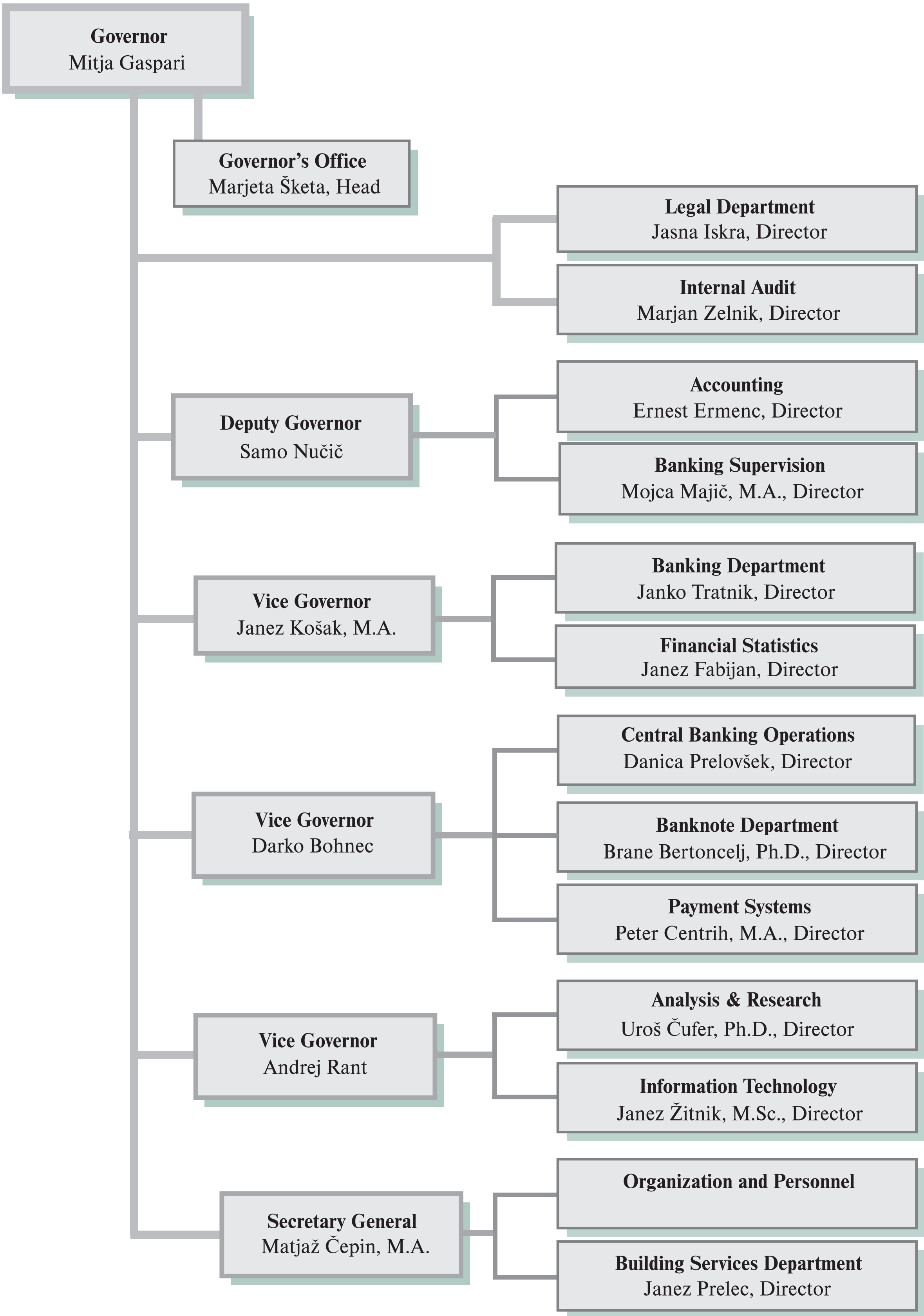
Vladimir Lavrač, M.Sc.
(Institute of Economic Research, Ljubljana)

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

Ivan Ribnikar, Ph.D.
(Faculty of Economics, Ljubljana)

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

7.4.3. Organisation of the Bank of Slovenia as at 31 December 2002



7.5 Publications and website

Content	Title and basic information
Macroeconomic statistics with an emphasis on monetary statistics, exchange rates and economic relations with the rest of the world. Review of current developments in charts; methodological appendix; review of Slovenian banks, calendar of data releases.	**Monthly Bulletin** · Monthly · in Slovenian · English translation
Report of the Bank of Slovenia to the National Assembly of the Republic of Slovenia. Description of economic developments, monetary policy, operations of banks and the Bank of Slovenia and other activity of the Bank of Slovenia.	**Annual Report** · annual (published in spring) · in Slovenian · English translation
Report of the Banking Supervision department to the National Assembly of the Republic of Slovenia on the operations of banks, the development of statutory foundations for supervision, and banking supervision.	**Report on Supervision of Banking Operations** · annual (published in autumn) · in Slovenian · English translation
Statistical review of direct and portfolio investment in the rest of the world, Slovenian investment abroad and foreign investment in Slovenia (at an annual level).	**Direct Investment** · Annual · bilingual in Slovenian and English
Speeches by the governor of the Bank of Slovenia at the National Assembly, analytical and methodological presentations in monetary, balance of payments and related areas.	**Figures and analysis** · quarterly · in Slovenian
Statistical review of non-monetary financial intermediaries, the securities market and interest rates.	**Financial markets** · quarterly · in Slovenian
Analysis of current macroeconomic trends with a detailed breakdown of monetary and balance of payments developments.	**Monetary Review** · monthly · in Slovenian
Current and envisaged monetary policy actions, inflation trends and projections of key macroeconomic indicators for Slovenia for the next two years.	**Monetary Policy Implementation Report** · semi-annual · in Slovenian and English
Collection of articles on all topics of professional and operational relevance for central banking. Content of articles may be analytical or informative.	**Analysis and Research Department working papers**
Web pages of the Bank of Slovenia with presentations about the institution, Slovenian banknotes and coins, laws and regulations governing the work of the central bank, and other useful information. Current data on exchange rates, interest rates and Bank of Slovenia securities and major publications available for download in electronic form.	**Website** · index of Slovenian pages http://www.bsi.si/... **.../html/kazalo.html** · index of English pages http://www.bsi.si/... **.../eng/index.html**

7.6 Glossary of selected terms

Capital (accounting) – Subscribed share capital, capital reserves, profit transferred to reserves, net profit or loss carried over from past years, capital value adjustments and net profit or loss not yet appropriated and security deposit.

Capital (regulatory) – An amount calculated on the basis of core and supplementary capital which banks can use to cover their capital requirements under the Regulation on the Capital Adequacy of Banks and Savings Banks (Official Gazette of the Republic of Slovenia, Nos. 24/02 and 85/02).

Capital adequacy ratio – The ratio of capital to total risk-adjusted assets and other risk-adjusted items.

Classification of assets – Banks and savings banks grade assets into categories A to E based on the estimated ability of the counterparty to meet its liabilities to the bank when they fall due.

<u>Category A comprises:</u>
- claims on the Bank of Slovenia and the Republic of Slovenia, claims on the European Communities, governments and central banks of EEA countries and comparable OECD countries;
- claims on debtors who are expected to be able to pay their liabilities without difficulties and who pay their liabilities when they fall due or exceptionally up to 15 days in arrears;
- claims secured on prime collateral.

<u>Category B comprises:</u>
- claims on debtors whose cashflows are estimated to be sufficient for the regular settlement of due liabilities, but whose financial position is currently weak, and where there are no grounds to believe that it will deteriorate significantly in the future;
- claims on debtors who frequently pay their liabilities up to 30 days in arrears and occasionally 31 to 90 days in arrears.

<u>Category C comprises:</u>
- claims on debtors whose cashflows are estimated to be insufficient for the regular settlement of due liabilities;
- claims on debtors who are substantially undercapitalised;
- claims on debtors who lack sufficient long-term sources of funds to finance long-term investments;
- claims on debtors who do not currently provide the bank with satisfactory information or appropriate documentation regarding claims, guarantees and sources for the repayment of claims;
- claims on debtors who frequently pay their liabilities 31 to 90 days in arrears and occasionally 91 to 180 days in arrears.

<u>Category D comprises:</u>
- claims on debtors who are highly likely to default;
- claims on debtors who are illiquid and insolvent;
- claims on debtors in respect of whom a proposal for the commencement of involuntary settlement or bankruptcy proceedings has been made to a competent court;

- claims on debtors who are subject to rehabilitation or involuntary settlement proceedings;
- claims on debtors who are subject to bankruptcy proceedings;
- claims on debtors who frequently pay their liabilities 91 to 180 days in arrears and occasionally 181 do 365;

but where a reasonable expectation exists that the claims will partly be covered.

Category E comprises:

- claims on debtors which are not expected to be paid;
- claims on debtors whose legal status is in dispute.

Compulsory reserves – The prescribed amount of assets, commonly computed as a percentage of banks' deposits and other liabilities, that banks are obliged to keep in their settlement accounts or special compulsory reserve accounts with the Bank of Slovenia as well as cash balances.

Financial institutions – In the official sector classification based on ESA95, the financial institutions sector is divided into five subsectors: the central bank, other monetary financial institutions, other financial intermediaries except insurance corporations and pension funds, ancillary financial institutions, and insurance corporations and pension funds. **Monetary financial institutions** include the central bank and other monetary financial institutions engaged in financial intermediation. **Non-monetary financial institutions** comprise other financial intermediaries except insurance corporations and pension funds, ancillary financial institutions, and insurance corporations and pension funds.

Foreign currency bills – Short-term securities issued by the Bank of Slovenia, which are subscribed for and paid in foreign currency.

Foreign currency minimum – The minimum permitted amount of foreign currency assets of a bank.

Interest margin (net) – The ratio of net interest income (interest income less interest expense) to average gross interest-bearing assets.

Interest spread (nominal) – The difference between the average nominal interest rate the bank earns on its assets and average nominal interest rate the bank pays on its liabilities of the same maturity.

Large exposure – An exposure of a bank to a counterparty equalling or exceeding 10% of the bank's capital.

Monetary aggregates (M1, M2 and M3) – Measures of the national money supply of differing liquidity. The most liquid measure, **M1**, includes cash in circulation and tolar demand deposits at banks and the Bank of Slovenia. **M2** comprises M1 plus savings and time deposits at banks and the Bank of Slovenia. **M3** consists of M2 plus households' foreign currency bank deposits and, since September 1999, foreign currency bank deposits of all non-monetary sectors.

Monetary base (base money) – Cash in circulation, banks' reserves and demand deposits at the Bank of Slovenia.

Monetary sector – The monetary sector comprises the Bank of Slovenia and the commercial banks. Savings banks and savings and loan undertakings, which together account for 1.5% of total assets of monetary financial institutions (as defined by the ECB), are not included. This practice is consistent with ECB rules, which permit minor institutions representing less than 5% of total assets of national monetary financial institutions to be excluded from the definition of the monetary sector.

Monetisation – Conversion of assets purchased by the central bank and commercial banks into money. It involves the purchase of (financial) assets, i.e. claims, or the grant of loans, using newly created or issued money.

Money market – The interbank financial market on which prime short-term securities are traded.

Net provisions – The difference between write-offs of uncollectable loans and claims, expenses for long-term provisioning, expenses for specific provisioning and expenses for provisions for general banking risks, and income from loans and claims previously written off, income from released long-term provisions and income from released provisions for general banking risks from the income statement.

Nominal interest rate – The total interest rate, comprising the part which compensates the lender or investor for inflation and the real part.

Open (foreign exchange) position – Unequalised foreign currency items on the balance sheet of a bank. It may consist of multiple assets or multiple liabilities.

Operating expenses – Staff, materials and services expenses, depreciation and operating expenses for revaluation on intangible long-term assets and tangible fixed assets, taxes and subscriptions.

Other assets – Equity investments in companies in the same group (subsidiary, related or jointly controlled) and other companies, intangible long-term assets, tangible fixed assets, own shares, subscribed but not paid up shares, deferred expenses and accrued income, and other assets such as cheques, inventories, claims arising from interest, fees and commissions etc.

Other liabilities – Liabilities arising from interest and fees and commissions, accrued expenses and deferred income, long-term provisions for liabilities and expenses, and provisions for general banking risk, and other liabilities.

Other risk-adjusted items – Equal to the sum of the capital requirements for currency and market risk, multiplied by conversion factors corresponding to the required minimum capital adequacy ratio (e.g. 12.5 for a capital adequacy ratio of 8%).

Persons in a special relationship with a bank – Major shareholders of a bank and members of a bank's bodies, and persons associated with them.

Provisions – These comprise general provisions against unknown losses and specific provisions for potential losses arising from on and off-balance sheet items, for country risk and for other known risks.

Repurchase agreement (repo) – The sale (or purchase) of securities and their simultaneous purchase (or sale) on a specified date in the future or on demand. In repos between the Bank of Slovenia and banks, the securities are retained by the seller, but the buyer acquires a lien on them.

Secondary liquidity – The amount of Bank of Slovenia bills denominated in domestic and foreign currency and Republic of Slovenia bills and bonds (investments in Bank of Slovenia and Republic of Slovenia securities denominated in domestic and foreign currency, Bank of Slovenia and Republic of Slovenia bills, and short-term Republic of Slovenia bonds).

Sterilisation – Generally, the sale of short-term government securities by the central bank intended to offset the effect of its purchases of foreign currency on the monetary base. In Slovenia sterilisation means the sale of tolar bills by the Bank of Slovenia intended to offset the effect of its purchases of foreign currency on the monetary base.

Swap – spot purchase (or sale) of a currency and its simultaneous forward sale (or purchase). In a swap transaction the foreign currency is transferred from the seller's to the buyer's account.

Tolar indexation clause – Officially determined indexation rate for claims and liabilities computed as average monthly inflation (since January 1998, growth in the retail price index, previously growth in the cost of living index) for the most recent month or the most recent few months (currently 12 months).

Total assets – The sum of all asset or liability items on the balance sheet (of a bank).

Tolar bills – Short-term debt securities issued by the Bank of Slovenia denominated in tolars.