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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 of 2003 was one of major progress for the Bank of Slovenia in several areas. There was a significant fall in inflation, and in conjunction with the government the Bank of Slovenia approved and began to implement the joint programme for ERM II entry and adoption of the euro. The final phase of the transfer of responsibility for the conduct of payments to the banking sector was completed. Representatives of the Bank of Slovenia acquired observer status in ESCB bodies.

The fall in inflation in 2003 was in line with our expectations. Inflation decreased from 7.2% at the end of 2002 to 4.6% at the end of 2003 in a sustainable manner, all the important balances in the economy being maintained. Although the current account surplus was reduced in 2003, the slightly positive balance indicates that it remains in equilibrium. Slovenia's fiscal position also remains favourable, with the budget deficit within the limit set by the Maastricht criterion and government borrowing low.

An adequate policy mix played a key role in bringing inflation down. The Bank of Slovenia maintained a relatively restrictive monetary policy stance enabling inflationary pressures of a monetary nature to be avoided, while the Slovenian government kept administered price growth within the inflation target and restricted pressures on inflation through fiscal adjustments. At the same time it also adjusted excise duties using temporary measures in order to even out fluctuations in oil prices. More consistent implementation of administered price policy and a partial deindexation of public sector wages have enabled a decline in inflationary expectations.

Inflationary pressures were also lower because of a worsening of conditions in the domestic and foreign markets. The slowdown in economic activity, tougher labour market conditions and restrained domestic expenditures have made a clear contribution towards reducing inflationary pressures. Expectations of increased competition in the market for goods and services when Slovenia joins the European Union and ERM II have also resulted in a lowering of inflationary expectations and consequently of inflation. The absence of inflationary pressures from abroad, with a weak dollar compensating for high oil prices, also contributed to the reduction in inflation. Low inflation in the European Union and the United States had an indirect impact on domestic inflation.

The Bank of Slovenia's monetary strategy has remained unchanged and has operated under conditions of a managed floating exchange rate. The Bank of Slovenia has continued to pursue a monetary policy aimed at reducing inflation and creating the conditions for the earliest possible entry into ERM II and adoption of the euro. The fall in inflation and lowering of inflation expectations have enabled the Bank of Slovenia to gradually lower nominal interest rates and to reduce the rate of exchange rate growth. Balanced supply and demand in foreign exchange markets meant frequent exchange rate intervention was not required. The Bank of Slovenia has continued the process of bringing its monetary policy instruments into line with ECB standards, thereby preparing conditions for a smooth entry and participation in ERM II.

The Bank of Slovenia's strategic orientation of rapid adoption of the euro was supported in November 2003 by the Slovenian Government. In November 2003, in conjunction with the Government, the Bank of Slovenia approved the Programme for ERM II entry and adoption of the euro, in which the Bank of Slovenia and the Government committed Slovenia to entering ERM II by the end of 2004 and to creating the conditions for the earliest possible adoption of the euro. The Bank of Slovenia and the Government assess that it will be possible to adopt the euro at the beginning of 2007.

The process of monetary integration has already begun. With the signing of the accession agreement in April, Bank of Slovenia representatives acquired observer status at sessions of the ECB General Council and in the committees and working groups of the ESCB (the ECB and the central banks of EU member-states). The Governor of the Bank of Slovenia first attended an ECB General Council session as an observer in June 2003, and Bank of Slovenia representatives began attending ECSB committee and working group meetings. Cooperation with the acceding countries' central banks in preparations for the expansion of the ESCB was thus strengthened.

Effective banking supervision ensures financial stability. Inspectors and analysts from the Banking Supervision Department carried out on-site and indirect examinations of banks and savings banks in 2003. In addition to the standard areas of examination, they focused particularly on supervision of capital and capital adequacy, management of market risk and other risks, implementation of the Consumer Loans Act, implementation of the Prevention of Money Laundering Act, corporate payment systems and information technology. In 2003 there were 11 full-scope examinations and 25 partial examinations of banks, savings banks and savings and loan undertakings. There were also nine on-site examinations of companies suspected of engaging in unauthorised business activities.

The transfer of responsibility for the conduct of payments to the banking sector was completed in 2003. The last phase of the transfer was completed with the conversion of personal current accounts and certain savings deposits of private individuals into transaction accounts. Owing to a concurrent overhaul of the information support at one of the banks, not all personal current accounts were converted by the legal deadline. Because of problems in obtaining the tax numbers of private individuals, 1.5% of accounts remained unconverted at the end of 2003.

The Bank of Slovenia has established the National Counterfeits Centre and issued commemorative coins. The rising value of the counterfeits seized and the imminent EU entry and adoption of the euro are the most important reasons for establishing such a centre, which will help to identify and prevent the spread of counterfeits. As in previous years, commemorative coins were issued in 2003, this time to mark the European Year of the Disabled and the 60th anniversary of the assembly of the Slovenian nation's delegates in Kočevje.

1. THE ECONOMIC ENVIRONMENT

1.1 International economic developments

Economic growth in 2003 strengthened greatly in the USA and in Japan, but the economic recovery in the European Union lagged behind. Inflation remained moderate in both the USA and the EU at just over 2.0%. The euro rose strongly against the dollar last year.

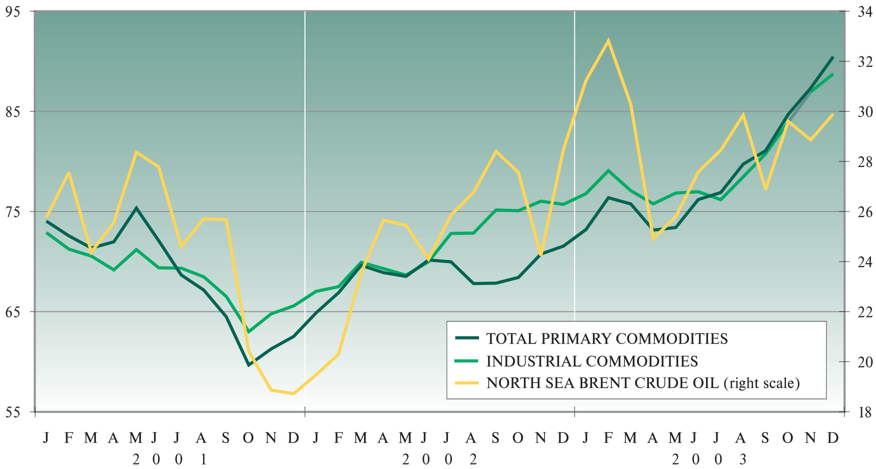
Recovery of EU economy behind USA and Japan

World economic growth improved in 2003, and according to the IMF the figure is expected to be 3.2%. The American and Japanese economies are most worthy of note. The American economy saw high growth in the second half of the year, while after two years of recession the Japanese economy is showing stronger signs of recovery. The recovery of the European Union economy is languishing behind, with weak growth over the whole year. According to preliminary estimates, economic growth in the USA in 2003 should be 3.1%, higher than in 2002, when it was 2.2%. According to preliminary estimates, economic growth in the European Union should be 0.5%, even lower than the figure of 0.9% seen in 2002. Japanese economic growth rose strongly in 2003, and the economy came out of recession. According to provisional estimates, economic growth in 2003 was 2.3%.

Moderate economic growth for Slovenia's main trading partners

In line with weak growth in the European Union, Slovenia's main trading partners also saw moderate growth. Among European Union partners Austria had the strongest growth with 0.8%, followed by Italy with 0.5% and France with 0.2%. All these countries, with the exception of Italy, are seeing a slowdown in economic growth in comparison with 2002. Better growth was seen in partners from eastern Europe. According to provisional estimates, economic growth strengthened in Russia (6.5%), and Poland (3.6%), while there was a slowdown from 2002 in Hungary (2.8%) and Croatia (4.5%).

Figure 1: **Prices of commodities and oil on the world market**



Note: Indices (1999=100), oil price (North Sea Brent in USD/barrel).
Sources: The Economist, London; OPEC Bulletin, Vienna.

Price of oil averaged USD 29 per barrel

The price of oil averaged around USD 29 per barrel in 2003, in comparison with an average of around USD 25 per barrel in 2002. The price in 2003 was strongly affected by the war in Iraq and the geopolitical tensions associated with this war, the record low stocks in the USA and the EU, and the crisis in Venezuela at the start of the year. In the first three months of the year the oil price was over USD 30 per barrel, but with the fall in the war premium at the end of hostilities in Iraq it fell by around 17%. Opec also responded to the major fluctuations in oil prices in 2003, first raising the pumping quota in January, then lowering it again after the war in Iraq in April and then September. Expectations connected with a revival of Iraq's oil production capacities were somewhat over-optimistic, as was subsequently seen: restoring its production took a significant time and the effect of the rising supply was not as significant as had been predicted before the conflict began. The oil price was on average above Opec's target corridor, which the cartel justified by the low dollar and the resulting lower earnings by oil exporters. In addition to oil, the dollar prices of other primary commodities rose by 11.3%, those of industrial goods by 14.9% and food prices by 8.9%.

Inflation in EU and USA just over 2.0%

Inflation in 2003 was moderate in both the USA and the EU at around a little over 2.0%. The faster economic growth in the USA does not seem to have been reflected in higher inflation, with inflation falling in the USA in the second half of the year (the peak annual rate was in 3.0% in March) to average 2.3% for the year. Inflation in the eurozone eased somewhat in the second half of the year, averaging 2.1% over the year, close to the target of the European Central Bank, which envisages inflation of 2.0%. In Japan, too, price movements were better than in previous years. After three years of deflation the rate fell somewhat, and averaged 0.2% over the year. Rises in food prices contributed most to inflation in the eurozone and the USA in the second half of the year.

Interest rate cut of 0.75 points by ECB and 0.25 points by Fed

In 2003 the European and American central banks made further cuts in interest rates. The ECB cut interest rates twice, a total of 0.75 percentage points, with the key ECB refinancing rate reaching 2.0% in June. The Fed cut interest rates by 0.25 points in June, taking the key rate to 1.0%. The central banks decided to cut interest rates because of the slower recovery in the two economies in the first half of the year and favourable movements in inflation. In line with the cut in central bank interest rates the short-term rates on international markets also fell. The Libor rate averaged 1.22% for three-month dollar deposits in 2003 and 2.33% for three-month euro deposits.

Euro rose 20% against dollar

The euro rose strongly against the dollar in 2003. The euro gained in value against the dollar throughout the year, its average rate against the dollar being USD 1.13 in 2003, a rise of 20% from 2002, when the euro averaged USD 0.94. The most notable reasons for the strong rise of the euro are the high budget deficit and trade deficit in the USA and the slow recovery of the American labour market.

Rise in market indices: Dow Jones (21%) Nikkei (22%) DAX (28%) FTSE (12%)

There was also evidence of the recoveries in the economies in 2003 in the rise in stock market indices. The faster economic growth in the USA had an effect on the financial markets, the Dow Jones rising by approximately 21% in 2003. The Nikkei rose by approximately 22%, and European markets also followed the rises on world financial markets. Germany's DAX rose by approximately 28% and the UK's FTSE by approximately 12%.

1.2 Gross domestic product, employment and labour costs

Economic growth in Slovenia just 2.3%

For the third year in a row economic growth was lower than the estimated potential growth, reaching just 2.3% in 2003. Value added grew most strongly in financial intermediation (5.7%), public administration (5.2%) and mining (5.1%), while it fell by 6.2% in agriculture and by 3.2% in the electricity, gas and water supply sector. This structure of growth shows the economy to have been under the influence of major changes on financial markets and relatively high employment growth in the public sector. Manufacturing exporters thus did not fully succeed in compensating for declining demand from traditional trading partners. In previous years they had plugged this gap with sales to former Yugoslav and Soviet republics and to other markets outside the EU.

Strengthening of domestic demand

Domestic demand gradually strengthened in 2003. Among the components of domestic consumption, gross fixed capital spending showed the largest rise (5.5%), primarily because of the relative strength of state infrastructure projects in the first part of the year and more residential building in the second half of the year, followed after several years of moderate growth by consumer spending (3.0%), while general government spending languished somewhat behind (2.8%), primarily because of a significant slowdown at the end of the year. Net foreign trade made a negative contribution to economic growth: following the positive contribution of 1.4 percentage points in 2002, the negative contribution in 2003 amounted to 1.8 percentage points. Given the relative balance in the current account, domestic saving in 2003 was sufficient to fully cover gross capital spending. Here in addition to greater investments there was a significant fall in private sector saving in 2003, which owing to the improved public finance position was more than half compensated for by state sector saving.

Table 1: **Selected economic indicators**

	1997	1998	1999	2000	2001	2002	2003
Real growth of gross domestic product [1] (%)	4.4	3.7	5.9	...	2.9	3.0	2.3
Gross domestic product EUR millions	16,991	18,374	19,831	20,594	21,823	23,362	24,073
Gross domestic product USD millions	19,193	20,604	21,121	18,960	19,534	22,000	27,216
Gross domestic product USD per capita	8,552	9,267	9,997	10,352	10,306	11,517	13,634
Composition of gross domestic product (%)							
Agriculture, forestry and fishing	3.7	3.6	3.2	3.7	3.6	3.5	2.6
Industry and construction	32.9	33.0	32.6	33.5	31.9	32.3	32.8
– Manufacturing	24.3	24.1	23.6	23.6	24.1	24.4	24.5
Services	49.5	49.2	49.5	53.8	54.2	54.1	54.9
Total value added	86.1	85.8	85.3	86.5	86.9	87.1	87.2
Compensation of employees	53.6	52.3	51.8	...	...	...	...
Taxes on production and imports less subsidies	14.9	15.4	16.1	...	...	...	...
Gross operating surplus and gross mixed income	31.5	32.4	32.1	...	...	...	...
– Exports of goods and services	54.4	53.8	49.8	56.5	57.9	57.9	57.3
– Imports of goods and services	55.2	55.3	54.0	60.1	58.5	56.5	57.3
Net exports	-0.8	-1.5	-4.2	-3.6	-0.6	1.4	0.0
Household final consumption expenditure	57.7	57.3	57.3	56.6	55.9	54.6	55.1
General government final consumption expenditure	19.7	19.6	19.5	20.0	20.6	20.5	20.7
Gross capital formation	23.4	24.6	27.4	27.0	24.2	23.5	24.2
Active population [2] thousands	978	978	959	968	979	971	959
Employed and self-employed	906	901	886	901	916	910	894
Unemployed	72	77	73	68	63	62	65
Unemployment rate (ILO)	7.4	7.9	7.6	7	6.4	6.4	6.8
Real growth in gross wages per employee (%)	2.4	1.6	3.2	1.6	3.3	2.1	1.9
Growth in labour productivity (%)	5.2	3.6	3.3	...	2.8	3.8	3.1

[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.

Industrial output up just 1.4%

In line with the relatively low growth in value added in manufacturing, the rise in industrial output in 2003 amounted to just 1.4%, with a considerable improvement in the second half of the year following weak growth in the first half. Over the whole year the output of capital goods showed the largest rise (5.0%), with the output of goods for intermediate consumption rising least (0.1%). After a fall in 2002 stocks grew again, up 4.8% from the previous year.

Wages grew by 1.9% in real terms in line with economic growth

Given the economic downturn, wages grew relatively slowly, thanks primarily to low wage growth in the public sector. Average year-on-year growth in gross wages was 7.6%, or 1.9% in real terms. Twelve-month average real gross wage growth in the tradable sector was 2.7%, just 0.5 percentage points below productivity growth. In the public sector the August wage increase in 2003 was replaced by the payment of a collective insurance premium, and an agreement relating to the adjustment of basic wages and bonuses for the 2004 to 2005 period was concluded under which the adjustment mechanism will take into account expected domestic inflation, inflationary expectations in the EU and the expected growth in the tolar/euro exchange rate. However, the social partners have yet to agree an adjustment mechanism for future wage setting in the private sector.

Cost composition of GDP unchanged

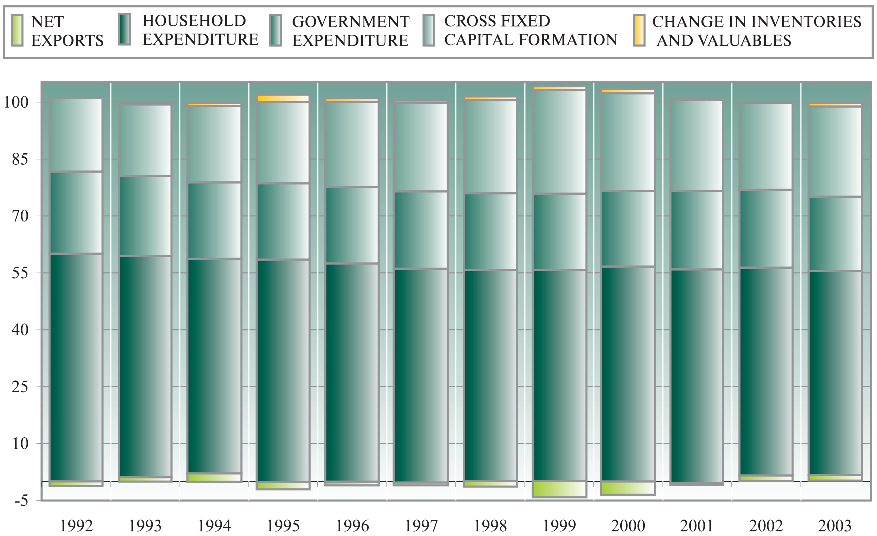
Compensation for employees equivalent to 52.8% of GDP

The cost composition of GDP in 2003 was very similar to that in 2002. Given the slowdown in wage rises and the fall in employment, compensation for employees is expected to be equivalent to 52.8% of GDP, and should thus remain almost unchanged from the previous year. Despite the gradual recovery of domestic demand, given the otherwise low level of economic activity the share of taxes on goods and services in the GDP cost composition should remain unchanged. Gross operating surplus as a proportion of GDP should fall by 0.2 percentage points in 2003 to 31.9%, primarily owing to low export demand and less favourable movements in the terms of trade than in 2002.

Employment trend slow

The employment trend in 2003 was rather slow-moving, or in line with the trend in economic activities. A gradual improvement at the end of the year followed a clear period of stagnation in the first six months. Nevertheless, even in the second half of the year the decline in employment continued, particularly in the labour intensive branches, with little prospect of an imminent turnaround. The average number of people in active employment fell by 0.9% in 2003. Employment in companies and institutions rose by 3.0%, but employment in the small business sector fell by 5.3%, not least as a result of the almost 20% drop in the number of farmers. The number of unemployed in 2003 was down 4.8% from 2002, with the unemployment rate reaching 11.0% in December, somewhat less than the yearly average (11.2%) and lower than in December 2002 (11.3%). For the third year in succession employment grew fastest in real estate (5.4%), while employment growth was slightly slower in public administration (4.5%).

Figure 2: **Composition of gross domestic product**



Sources: Statistical Office of the Republic of Slovenia.

The largest falls in employment were seen in mining at 5.6%, in agriculture at 4.0% and in the electricity, gas and water supply sector at 2.6%. Weak exports saw employment in manufacturing fall again (by 1.3% in one year) after more than two years of growth. Trends in the number of employees in different branches of manufacturing varied widely, with sizeable falls in some areas (food, textiles and paper) being partly offset by strong employment growth in certain other sectors (particularly chemicals, and the furniture and rubber industry). Employment growth in the service sector (1.0%) was again higher than that in industry, which saw a contraction (-1.4%). The difference between the trends in the two sectors thus increased further. The regional pattern of unemployment in 2003 was essentially unchanged, with rates of registered unemployment highest in the Podravska, Pomurska, Savinjska and Posavska regions. The rate at which unemployment is falling did change however, with the fastest falls seen in Dolenjska, Podravska and Savinjska.

Fall in active population and rise in unemployment

According to estimates the internationally comparable figure for active population fell by almost 12,000 in 2003, with the number of unemployed rising by almost 3,000. After falling to 6.4% in 2001 and 2002, the unemployment rate rose in 2003 to average 6.8%. The critical groups remain the long-term unemployed, young people (mainly first-time job-seekers), the over-40s and those with poor qualifications. Among the active employment policy programmes in line with EU guidelines, priority is still being given to programmes for enhancing employability, followed by programmes for encouraging private enterprise, measures to enhance the flexibility of individuals and companies, and programmes to ensure equal opportunities. 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 Against Unemployment Act. With EU entry international projects co-financed by the European Commission's Phare programme will also become increasingly important (these will aim to reduce regional differences on the labour market and to improve computer literacy among the unemployed), as will the EQUAL Community Initiative, which is co-financed by the European Social Fund and is devoted to equal employment opportunities for women.

1.3 Prices

Consumer price inflation 4.6% at year-end

Consumer prices rose by 4.6% in 2003 (December 2002 to December 2003), or by 5.6% 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 dollar exchange rate were the most influential foreign factors, while the major domestic factors were fiscal policy and administered price policy.

Inflationary impact of rising world oil prices mitigated by weakening dollar

The year of 2003 saw major fluctuations in world oil prices between USD 25 and USD 33 per barrel. In the first half of the year the oil price fell in the wake of the attack on Iraq, but stock renewals in the USA meant it remained at a high level. Opec's decision to cut the pumping quota caused the price to rise again in the second half of the year, reaching USD 30 per barrel by the end of the year. The impact of the high world oil price on prices of refined petroleum products in Slovenia was mitigated by the depreciation of the dollar against the tolar. Therefore, depreciation of the dollar had a favourable impact on import prices via lower commodity prices and thus on movements in imported inflation. The government made a major contribution in addition to this, using adjustments to the excise duties on refined petroleum products to prevent large fluctuations in their prices.

Government limited cost growth in administrated branches by using price control policy

Among the domestic factors having the most significant impact on lower inflation in 2003, prime position was taken by the coordinated action by the Bank of Slovenia and the Slovenian government. The latter consistently implemented a price control plan designed to contain cost growth in administrated branches. Administered prices thus rose by 4.4% in 2003, compared with 9.8% in 2002.

Nominal interest rates followed fall in inflationary expectations

The Bank of Slovenia pursued the goal of achieving a gradual and sustained reduction in inflation and conducting a monetary policy based on bringing nominal interest rates into line with inflationary expectations. An appropriate level of real interest rates, control of the quantity of money in circulation and gradual stabilisation of the exchange rate again helped to ensure that in 2003 there were no inflationary pressures of a monetary nature.

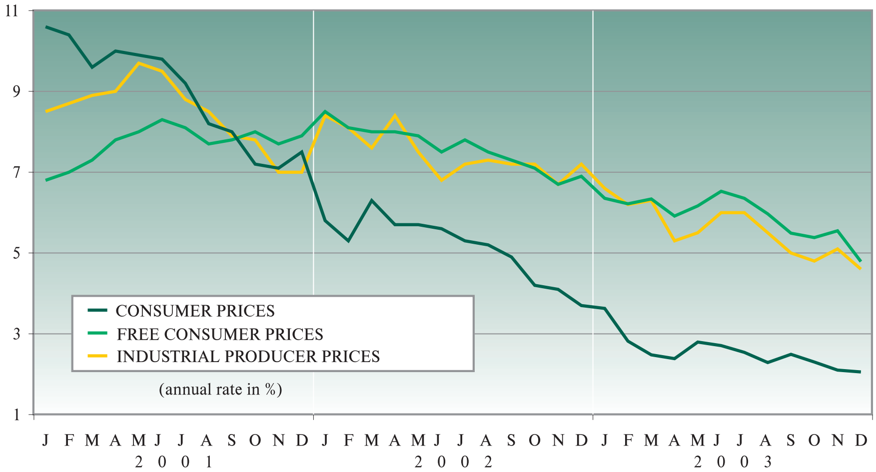
Core inflation of 3.4% at year-end

In addition to the published inflation figure, core inflation also fell to 3.4% in 2003, compared with 6.8% in 2002. The rise in industrial producer prices also eased by 1.6 percentage points to reach 2.1% by the end of the year. The largest rise from 2002 was seen among goods for intermediate consumption (2,5%) and consumption goods (2.4%), while capital goods prices fell by 1.1%.

Sustained fall in inflation made possible by slower growth in labour costs

The sustained fall in inflation was also made possible by slower growth in labour costs in 2003. The average gross wages real growth rate fell by 0.2 percentage points to 1.9% in December.

Figure 3: **Prices**



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

1.4 Balance of payments

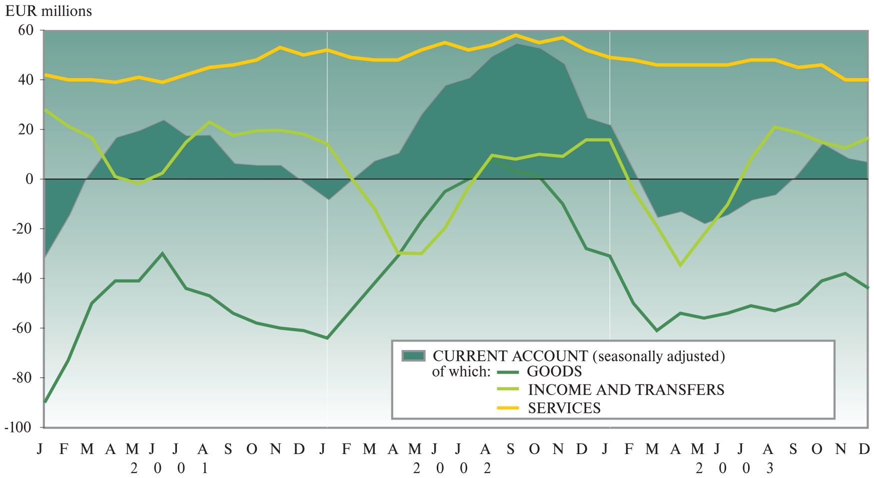
Current account surplus just EUR 17 million owing to unfavourable trends in trade of goods

In 2003 Slovenia had a current account surplus for the third year in a row, the surplus reaching EUR 17 million, or 0.1% of estimated GDP. The main factors influencing the reduction in the current account surplus compared with 2002, when it was EUR 330 million, were unfavourable trends in foreign goods trade in the context of higher domestic spending, and a fall in the surplus in trade in services. The surplus in current transfers decreased, while the fall of more than a third in net outward investment flows had a positive impact on the current account.

Growth in imports twice as fast as growth in exports

In 2003 Slovenia's trade deficit amounted to EUR 952 million or 3.9% of estimated GDP, and was 1.3 percentage points higher than in 2002, but more than 2 percentage points lower than the average deficit in 1996 to 2001. There were EUR 11,285 million of exports of goods, up 2.9% from 2002, while imports of goods rose twice as fast as exports, up 5.7% from 2002 to EUR 12,237 million. The faster growth in imports saw the coverage of imports by exports fall by 2.5 percentage points to 92.2%.

Figure 4: **Current account of balance of payments**



Sources: Statistical Office of the Republic of Slovenia; estimates by Analysis and Research Centre, Bank of Slovenia.

Negative contribution of balance of trade to GDP growth

Owing to the unfavourable trends in trade in goods and the more modest results in trade in services the balance of trade made a negative contribution to GDP growth in all quarters in 2003. It was 1.3 percentage points in the first quarter, just over 2 percentage points in the second and third quarters, and in the fourth quarter the negative contribution eased somewhat to 1.7 percentage points.

Imports and exports affected by exchange rates

Imports and exports of goods in 2003 grew more in volume terms than is implied by the figures in euros. The reason is that import and export prices in euros in 2003 fell in comparison to 2002. The most significant factor influencing the movement of import-export prices was changes in the dollar/euro exchange rate. The euro rose against the dollar for the second year in succession. The euro appreciated by 14% (December to December figure) in 2002 and by a further 20% in 2003. The euro's rise against the dollar reduces the nominal value of imports and exports of goods expressed in euros. The size of this reduction depends on the proportions of total imports and exports in euros and in dollars. In 2003 87.7% of exports were in euros and 9.4% in dollars. A similar breakdown is seen in imports, with 83.9% in euros and 12.9% in dollars, other currencies accounting for the remainder. Because of the smaller proportion of dollar exports, the nominal value of exports in euros fell less in relative terms (1.6%) than that of imports (2.1%). Ignoring the exchange rates, export prices rose by 1% and imports by 1.5%. The growth in exports of goods in real terms was 3.6% in 2003, less than in 2002 (5.3%), while import growth doubled from the rate in 2002 to 6.4%.

Terms of trade remained unchanged

The terms of trade, which show the overall effect of changes in exchange rates and import/export prices on the purchasing power of a unit of Slovenian exports were unchanged from 2002, and thus had no effect on the current account of the balance of payments. Given a similar improvement in the terms of trade to that in 2002, the current account surplus would have been more than EUR 200 million higher.

Imports of capital goods rose by 12%

More modest demand for Slovenian goods from abroad and trends in the make-up of domestic demand also affected the dynamics and composition of imported goods by economic purpose. On the import side the biggest rise in 2003 was in imports of capital goods (12%), while imports of consumption goods rose by half as much and the smallest increase (3.9%) was in imports of intermediate goods. The strong growth in imports of capital goods in 2003 reflected one-off imports of high-value items such as aircraft and helicopters, as well as imports associated with the periodic replacement of manufacturing equipment every four or five years. In addition to these factors, another reason why imports of equipment in 2003 were above average is Slovenia's impending entry into the EU, which is encouraging companies to invest in order to increase their competitiveness in the European market. Historically low interest rates making financing for equipment purchases relatively favourable are also an important factor. The composition of imports saw a rise in the share of capital goods from 17.9% in 2002 to 19%, while the share of consumption goods remained unchanged (23.2%) and the share of imports of intermediate goods fell by one percentage point to 57.9%. On the exports side, capital goods rose by more than the average (6%), intermediate goods grew more modestly (4.2%) and consumption goods showed the lowest rise (0.3%). In the context of these trends the share of exports accounted for by intermediate goods rose from 47.8% to 48.4%, the share of exports accounted for by capital goods rose from 14.1% to 14.5% and the share of exports accounted for by consumption goods fell from 38.1% to 37.1%.

Deficit in goods trade widened by EUR 340 million

The deficit in goods trade widened by EUR 340 million in 2003. The biggest contributions to this were the rise in the deficit for capital goods of EUR 155 million, the rise in the deficit for intermediate goods by EUR 46 million and, for the first time in eight years, the narrowing of the surplus for consumption goods, by EUR 138 million to EUR 1,351 million.

Table 2: **Geographical breakdown of trade in goods**

	EXPORTS			IMPORTS			TRADE BALANCE		
EUR millions	2001	2002	2003	2001	2002	2003	2001	2002	2003
European Union (15)	**6,435**	**6,514**	**6,600**	**7,675**	**7,870**	**8,231**	**-1,239**	**-1,355**	**-1,631**
Austria	773	774	827	944	956	1,053	-170	-182	-226
France	702	734	638	1,205	1,190	1,230	-503	-455	-592
Italy	1,294	1,328	1,483	2,004	2,070	2,239	-710	-742	-756
Germany	2,715	2,714	2,610	2,178	2,216	2,357	536	499	253
CEFTA	**828**	**954**	**1,044**	**1,081**	**1,094**	**1,121**	**-252**	**-140**	**-77**
Czech Republic	188	201	205	278	288	308	-90	-87	-103
Hungary	175	196	223	352	341	352	-177	-145	-129
Poland	271	305	311	161	168	189	110	137	121
EFTA	**134**	**207**	**176**	**192**	**202**	**221**	**-59**	**5**	**-45**
Non-European OECD members	**400**	**447**	**586**	**732**	**715**	**761**	**-332**	**-268**	**-175**
United States	273	297	410	333	334	294	-60	-36	115
South Korea	12	16	19	70	72	82	-58	-56	-62
Countries of former Yugoslavia	**1,750**	**1,952**	**1,967**	**604**	**575**	**613**	**1,146**	**1,377**	**1,354**
Bosnia and Herzegovina	**445**	**492**	**471**	**70**	**69**	**78**	**375**	**423**	**393**
Croatia	894	954	1007	451	419	445	443	536	563
Serbia nad Montenegro	264	347	346	53	61	68	211	285	278
Countries of former Soviet Union	**417**	**455**	**498**	**355**	**336**	**374**	**61**	**119**	**124**
Russian Federation	315	320	347	315	269	311	1	51	36
Other countries	**382**	**432**	**414**	**706**	**782**	**916**	**-324**	**-350**	**-502**
TOTAL	**10,347**	**10,962**	**11,285**	**11,344**	**11,574**	**12,237**	**-998**	**-612**	**-952**

Note: Exports f.o.b. and imports c.i.f.
Sources: Statistical Office of the Republic of Slovenia, 2003 figures provisional.

Market share of Slovenian exporters in EU was 0.28%

Measured in terms of the market share of Slovenian exporters, export competitiveness improved in 2003. According to provisional estimates the market share should have risen by 0.28%. The rise in the market share was above-average on the Italian market (by 14%) and on the Austrian market (by 5%). The market share fell further on the

French market (by 11%) and on the German market (over 5%). Slovenian exporters' share in these markets fluctuates from year to year. The only exceptions are the share of the Austrian market, where there has been a rising trend, and the German market, where there has been a falling trend since 1995. Similarly, a falling trend has been observed in the Croatian market, where Slovenian exporters' share has dropped from a high of 16% in 1994 to 8.3% in 2003. The market share in Hungary, the Czech Republic and Poland as a whole remained unchanged last year. This aggregate position reflected a drop of 9% in the Czech market and rises of 11% in Hungary and just 0.1% in Poland. Although the market share of Slovenian exports in Russia fluctuates from year to year, in 2003 it rose by over 6% to reach 0.48% of total imports into Russia, the largest share since 1994. Last year also saw the biggest jump in Slovenia's share of exports to the United States, up by over 50% thanks to higher exports of pharmaceutical products, although at 0.035% the share of Slovenian exports on the American market is among the lowest.

Geographic make-up of trade in goods saw decline in EU export share

As much as 90% of Slovenia's goods trade is with European countries, and just 10% is with the rest of the world. Exports to Cefta countries, non-European members of the OECD and the countries of the former Soviet Union have been growing for the last three years, as were exports to other former Yugoslav republics until 2002. Goods exports to European Union countries have been declining as a percentage of total exports for a number of years: by 2.8 percentage points in 2002 and by a further percentage point in 2003 to 58.5%. The share of imports from the European Union is falling more slowly: from 68% in 2002 to 67.3% in 2003. Slovenia's four biggest trading partners in the EU, accounting for over half of Slovenia's foreign trade, again maintained the same order in 2003: Germany (exports: 23.1%, imports: 19.3%), Italy (exports: 13.1%, imports: 18.3%), Austria (exports: 7.3%, imports: 8.6%) and France (exports: 5.7%, imports: 10.1%). The biggest falls in export share over the last three years, with import share remaining virtually unchanged, have been in exports to Germany (over three percentage points) and France (one percentage point). With the export share to Austria remaining almost unchanged, that to Italy rose by a percentage point. The fall in exports to Germany and France was partly compensated for by rises in exports to Spain (by 42%), Ireland (by 26%), Greece (by 10%), Sweden, Denmark and the Netherlands. The deficit in goods trade with the European Union has been widening at an accelerated pace in recent years. In 2001 it was EUR 1,239 million, but by 2003 it had swollen to EUR 1,631 million. The largest deficits in 2003 were seen in trade with Italy (EUR 756 million), France (EUR 592 million) and Austria (EUR 226 million). Slovenia still has a trade surplus with Germany, but it has halved in comparison with previous years and in 2003 amounted to EUR 253 million. Among the non-European countries, the biggest change came in trade in goods with the USA, with its share of exports rising from 2.7% to 3.6% and its share of imports falling from 2.9% to 2.4%, which resulted in a surplus in trade in goods in the amount of EUR 115 million.

Decline in share of exports to former Yugoslav republics

The share of exports to the former Yugoslav republics slipped from a peak of 17.8% in 2002 to 17.4% in 2003 while the share of imports was unchanged at 5%. In particular there was a fall of 0.3 percentage points in the share of exports to Bosnia-Herzegovina to 4.2% and a fall in the share of exports to Serbia-Montenegro to 3.1%. The share of exports to Croatia, Slovenia's biggest trading partner in this group of countries, rose from 8.7% in 2002 to 8.9% in 2003. The surplus in goods trade with the countries of the former Yugoslavia fell only slightly to EUR 1,354 million.

Rise in exports to Cefta countries three times higher than rise in imports

Exports to Cefta countries rose by 9.4%, while there was a modest rise of 2.5% in imports. The rate of export growth in the last three years has been more than three times that of imports, which has contributed to the rapid narrowing of the deficit in trade in goods from EUR 252 million in 2001 to EUR 77 million in 2003. The deficits with Hungary, Slovakia and Romania are shrinking fastest, while that with the Czech

Republic is widening slightly. Slovenia has run a surplus in trade with Poland for several years, and last year it fell by EUR 16 million to EUR 121 million.

Growth of trade in services slower than growth in trade in goods

In unfavourable international economic conditions trade in services is contracting faster than trade in goods. In 2003 trade in services grew more slowly than goods trade. Exports of services were 0.6% higher than in 2002, and imports 5.6% higher. With exports of services growing more slowly than exports of goods the share of total exports of goods and services accounted for by services fell by 0.2 percentage points to 16.7%, while their share of imports remained unchanged at 13%. At EUR 541 million the surplus in trade in services was down EUR 85 million from 2002.

Tourism

For the fourth year in succession tourism revenues grew more slowly than tourism expenditures. With the rise in the standard of living in Slovenia, it is anticipated that this trend will continue in the years ahead. Tourism revenues were EUR 1,182 million in 2003, up 3.5% from 2002, while expenditures rose by 4.5% to EUR 667 million. The result of these trends was that the tourism surplus rose by just EUR 11 million to EUR 516 million.

Table 3: **Balance of payments**

EUR millions	1998	1999	2000	2001	2002	2003
A. CURRENT ACCOUNT	**-108**	**-664**	**-583**	**38**	**330**	**17**
(% of GDP)	***-0.6***	***-3.5***	***-2.8***	***0.2***	***1.4***	***0.1***
1. Goods	-708	-1,164	-1,227	-684	-265	-544
2. Services	447	330	489	536	627	541
2.1. Transport	115	132	149	203	250	259
2.2. Travel	470	389	489	504	505	516
- of which exports	971	900	1,045	1,105	1,143	1,182
2.3. Other	-138	-191	-149	-171	-128	-234
3. Income	49	58	29	43	-174	-73
3.1. Labour income	159	171	174	167	159	158
3.2. Investment income	-110	-113	-145	-124	-334	-231
4. Current transfers	104	112	125	144	142	93
B. NET FINANCIAL INFLOW	**291**	**521**	**1,089**	**1,724**	**1,149**	**92**
(% of GDP)	***1.6***	***2.6***	***5.3***	***7.9***	***4.9***	***0.4***
1. Private sector:	200	201	727	1,510	1,297	185
1.1. Claims	-304	-616	-423	287	-1535	-1602
Outward FDI	5	-45	-72	-161	-99	-269
Potrfolio investments	20	5	-24	-87	-144	-161
Net trade credits	-376	-294	-195	-249	-413	-235
Loans	-49	-39	-72	19	-238	-261
Households	80	-222	-13	797	-578	-591
1.2. Liabilities	503	817	1,150	1,223	2,832	1,787
Inward FDI	194	99	149	412	1,707	160
Potrfolio investments	7	-2	28	11	27	34
Loans	262	713	953	649	929	1,198
Deposits at banks	39	2	34	152	130	428
1.3. Other, net	17	-15	-61	-34	-25	-118
2. Government	82	326	307	114	-95	-126
3. Bank of Slovenia	-45	-46	13	-10	-50	-13
4. Net errors and omissions	55	40	41	110	-3	46
C. CHANGE IN RESERVES:	**-183**	**143**	**-506**	**-1,762**	**-1,479**	**-108**
1. BoS	-106	129	-206	-1,436	-1,876	-281
2. Banks	-77	13	-300	-326	397	173

[1] Excludes domestic bank transactions in government bonds.
Source: Bank of Slovenia.

Transport services

Financial services

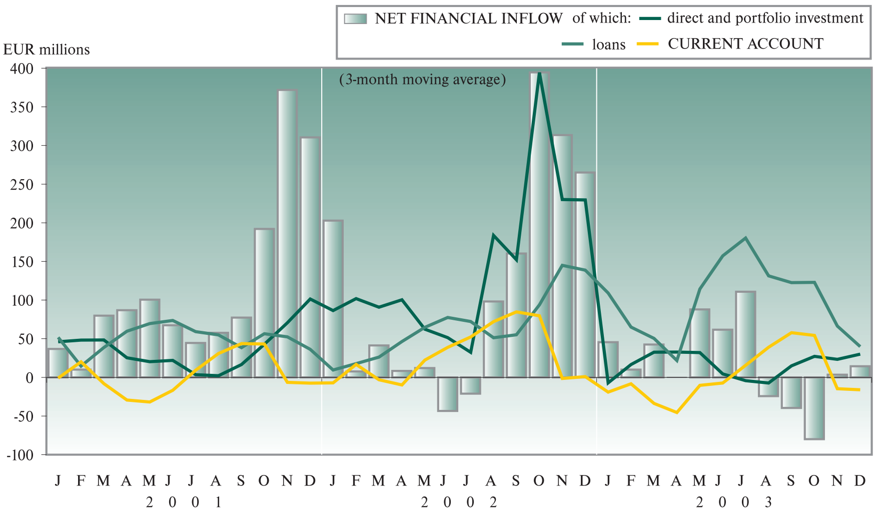
Computing and communications

Transport services are closely linked to trends in goods trade. Transport revenues grew more slowly than transport expenditures in the first half of 2003, and only when goods exports picked up in the second half of the year did they begin to grow more quickly than expenditures. The growth in revenues was 7% and the growth in expenditures was 9.1%. As a consequence, the surplus grew by just EUR 10 million to EUR 259 million. Heavy investment in the former Yugoslav republics saw the trade surplus in construction services rise in the period to 2002. In 2003 these activities abroad slowed, and because of lively investment at home expenditures rose faster than revenues. With revenues at EUR 70 million and expenditures at EUR 71 million, for the first time in three years there was a slight deficit (EUR 2 million). In 2002 Slovenia had a surplus in the financial services account of EUR 18 million, primarily because of a sharp rise of EUR 48 million in revenues, of which two-thirds was revenues from the privatisation of Slovenian companies and foreign direct investment. In 2003 investments by non-residents were relatively modest: with revenues of EUR 17 million and expenditures of EUR 28 million there was a deficit of EUR 12 million. The deficit in the predominantly outflow services of computing and communications rose by EUR 14 million to EUR 43 million. The biggest contribution to the deterioration in trade in services in 2003 came from a EUR 50 million increase in the deficit in other services.

Net income outflow of EUR 73 million

In 2003 income outflow was EUR 73 million more than income inflow. Net inflows of compensation of employees in 2003, totalling EUR 158 million, remained at approximately the same level as the year before. The investment income deficit fell by EUR 103 million from EUR 334 million in 2002 to EUR 231 million in 2003. The fall derives primarily from a change in the methodology for calculating reinvested profits on foreign direct investment in Slovenia. In 2002 they amounted to EUR 135 million, but in 2003 they were just EUR 39 million. Interest payments on investments in securities and other forms of capital rose by 2.3% to EUR 448 million. Given the increase in gross external debt of EUR 1,500 million, the rise could have been even sharper had interest rates on the world financial market not fallen this year. Among investment revenues, income on investments in securities rose by 22% from EUR 176 million to EUR 214 million. The management of the Bank of Slovenia's foreign exchange reserves also had a beneficial effect on this improvement. Income on investments in notes and bonds increased by EUR 51 million in 2003 to EUR 151 million.

Figure 5: **Financing of current account of balance of payments**



Sources: Bank of Slovenia.

Transfers to rest of world up 5.4%

Transfers to Slovenia are falling, while transfers to the rest of the world are rising. In 2003 the former rose fell by 6.6% and the latter rose by 5.4%. For a number of years the net deficit in official transfers has remained steady at around EUR 70 million. The main cause of the reduction in the net inflow of transfers from EUR 142 million in 2002 to EUR 93 million in 2003 was a 6.9% fall in private transfers to Slovenia and a rise of 12.1% in private transfers to the rest of the world.

Net financial inflows of EUR 92 million, significantly lower than previous year

Net financial inflows from the rest of the world amounted EUR 92 million or 0.4% of GDP in 2003, significantly less than in previous years. In the first half of the year inflows exceeded outflows, but in the second half of the year outflows exceeded inflows. Over the whole year outflows (or increase in claims) were approximately the same as in the previous year, while inflows (or increase in liabilities) were EUR 1 billion lower.

Claims on rest of world up (particularly households' foreign currency)

Total claims on the rest of the world (excluding foreign exchange reserves) in the whole of 2003 increased by EUR 1,602 million. Almost 40% of the increase in claims stemmed from the growth of households' foreign currency, which has continued uninterruptedly since the introduction of the euro notes and coins. Direct investment abroad increased significantly to become the second most important source of outflows last year. The growth trend in portfolio investments abroad also continued, although at a slower pace than in 2002. Loans made to non-residents are prominent among debt claims, while in 2003 trade credits, which in previous years were the most important source of net financial outflows, were only just over half of what they were in 2002.

Domestic direct investment abroad three times higher than in 2002

Domestic direct investment abroad amounted to EUR 269 million in 2003, almost three times what it was in the previous year. Last year Slovenian companies' investments were again mostly (63%) oriented towards the former Yugoslav republics, but they also invested in more distant markets, such as Luxembourg, with a share of 8%, and Bulgaria (7.5%). After an interruption in 2002, investments in Slovenian securities issued abroad (primarily eurobonds) rose strongly in 2003 to reach EUR 100 million.

Banks expand loans to rest of world

Having risen rapidly in 2002, private sector loans to non-residents remained at the same level last year, and in the case of banks there was even a rise. The largest portion of the loans came in the last four months. Companies lent EUR 136 million, and banks EUR 124 million. This does not include the 28% of loans made to subsidiaries abroad, of which the majority were made to companies in Croatia (28%), Serbia-Montenegro (21%), and Poland (just under 10%).

Increase in trade credits between affiliated enterprises

The flow of net trade credits fell to EUR 235 million in 2003 from EUR 413 million in 2002. More detailed figures from companies' survey show that, in terms of both claims and liabilities, trade credits issued by direct investors to their subsidiaries are increasing, particularly between Slovenian investors and companies abroad. The share of trade credits between affiliated companies grew from 40% in 2002 to 60% in 2003. In terms of regional composition, the largest part of the growth in trade credits went to European countries outside the European Union (increase by EUR 83 million), of which EUR 53 million went to former Yugoslav republics, with the USA also prominent with EUR 41 million more in liabilities to Slovenian exporters than at the end of 2002.

Direct investments by non-residents EUR 1.5 billion lower than in 2002

Total liabilities to non-residents grew by EUR 1,787 million, more than a billion less than in the previous year. The reason for the smaller inflow was low foreign direct investment in comparison to 2002, as the other inflows increased: direct investments inflow fell by more than EUR 1.5 billion, while foreign loans and bank deposits of non-residents rose by EUR 270 million and EUR 300 million respectively.

Portfolio investments by non-residents up just EUR 34 million

The flow of foreign direct investments in 2003 was just EUR 160 million. In this equity capital fell by EUR 109 million, while net liabilities to foreign investors rose by EUR 231 million. Foreign portfolio investments in Slovenia last year were also modest. While they rose by EUR 65 million in the first half of the year, primarily on the strength of investments by non-residents in treasury bills, in the second half of the year selling again outweighed buying. The net effect of these flows was a rise in portfolio investments of EUR 34 million.

Private sector borrowing abroad

The private sector increased its indebtedness abroad in 2003 in the form of loans. The banks almost doubled their net borrowings compared with 2002, to EUR 674 million. The borrowing was mostly long-term, with loans of up to one year accounting for just 8%. The average interest rate on loans raised by banks was a favourable 2.8%, one percentage point lower than in 2002. Companies raised loans of EUR 523 million abroad, lower than in 2002. The average borrowing rate for companies was 3.6%, also one percentage point lower than in 2002.

Government borrowing abroad cut

Government borrowing abroad fell for the second year in succession, with a net repayment of EUR 126 million of debt.

Net external debt positive

Gross external debt at the end of 2003 stood at EUR 12,995 million, EUR 1,512 million more than at the end of 2002. The increase in the debt was primarily due to foreign loans to the private sector (which grew by EUR 933 million) and growth in borrowing between affiliated companies (of EUR 242 million). Liabilities from trade credits fell by EUR 124 million, and consequently their share of the debt fell to 12%. The ratio of gross external debt to GDP rose by five percentage points in 2003 from 49% to 54%. The net external debt became positive again in December, meaning that the gross external debt exceeded the gross external assets in debt instruments, by some EUR 186 million.

Foreign exchange reserves exceed short-term debt by 69%

With modest financial inflows and the current account more or less in balance, only EUR 108 million was added to the foreign exchange reserves in 2003. At the end of the year the level of total foreign exchange reserves fell by EUR 142 million to EUR 7,700 million despite overall transactions with the rest of the world being positive over the year as a whole. Despite the fall, foreign exchange reserves still exceed short-term debt with a maturity of up to one year by 69%.

Table 4: **Slovenia's external debt and foreign exchange reserves**

EUR millions, year-end	1998	1999	2000	2001	2002	2003
Gross external debt (GED)	**6,459**	**8,012**	**9,491**	**10,403**	**11,483**	**12,995**
1. Long-term debt	3,725	4,812	5,895	7,349	8,140	9,290
(% of GED)	57.7	60.1	62.1	70.6	70.9	71.5
- of which: bonds and notes	1,094	1,494	1,748	1,934	1,935	1,947
loans	2,432	3,134	3,983	5,117	5,823	6,756
2. Short-term debt	1,839	2,155	2,283	2,222	2,319	2,439
(% of GED)	28.5	26.9	24.1	21.4	20.2	18.8
- of which: trade credite	1,432	1,659	1,834	1,690	1,696	1,572
currency and deposits	348	364	401	396	383	558
3. Liabilities to affilitated enterprises	895	1,045	1,312	831	1,024	1,266
(% of GED)	13.9	13.0	13.8	8.0	8.9	9.7
Short term debt by remaining maturity [1]	**…**	**3,374**	**4,382**	**4,569**	**4,448**	**4,555**
Net external debt [2]	**-657**	**315**	**791**	**-422**	**-1,101**	**186**
Foreign exchange reserves	4,080	4,104	4,705	6,513	7,842	7,700
Foreign exchange reserves/GDP (%)	22.2	20.7	22.9	29.9	33.6	31.8
Foreign exchange reserves/imports (months)	4.8	4.6	4.6	6.1	7.1	6.7
Gross debt/GDP (%)	35.2	40.4	46.1	47.7	49.3	53.6
Foreign exchange reserves/short-term debt by maturity (%)	**…**	**121.6**	**107.4**	**142.6**	**176.1**	**169.0**

1 Short–term debt by maturity includes all non-equity liabilities to non-residents due in next 12 months.
2 GED netted with non-equity claims on non-residents.
Source: Bank of Slovenia.

1.5 Public finance

Revision of state budget

The National Assembly passed the amended budget for 2003 and the budget for 2004 in December 2002. Owing to changes in macroeconomic circumstances the government decided in April to revise the state budget. Having assessed that the fiscal stabiliser in the amount of SIT 15 billion did not enable the implementation of the budget, the government responded to the projected fall in revenues with a combination of lower budget expenditures and a larger budget deficit. The National Assembly passed the revised budget in June. The amended budget for 2004 and the budget for 2005 were passed in December.

Preliminary figures for budget deficit of SIT 80 billion or 1.4% of GDP

Preliminary figures put the general government deficit, which covers operations of the state budget, the municipal budgets and the treasuries of the Pension and Disability Insurance Institute and the Health Insurance Institute (compulsory insurance alone), at SIT 80 billion or 1.4% of estimated GDP. The state budget, the municipal budgets and the Health Insurance Institute all showed a deficit, but the Pension and Disability Insurance Institute showed a surplus.

Corporate and personal income tax fastest growing revenues

According to preliminary figures general government revenue in 2003 was SIT 2,374 billion or approximately 41.9% of estimated GDP, while general government expenditure was SIT 2,454 billion or 43.4% of estimated GDP. The annual general government revenue and expenditure exceeded the government plan. The fastest growing of the major revenue items were personal and corporate income tax, which rose in real terms by more than a tenth to an inflow of SIT 461 billion in 2003. Worthy of particular note is the high growth in corporate income tax, which was significantly higher than forecast. Social security contributions grew more slowly, by 2.5% in real terms over the year and amounted to SIT 738 billion. Indirect taxes on goods and services, mainly VAT and excise duty, grew in real terms by approximately 2.7% in 2003, ignoring the effect of adjusting the fiscal year to the calendar year in 2002, to reach SIT 815 billion. Revenue from excise duties grew by less in real terms than revenue from VAT, while excise duties on tobacco products accounted for proportionately more.

Among expenditures varying growth for individual groups of transfers to public and high growth of investment expenditures

Preliminary figures for major general government expenditures in 2003 attribute the fastest growth to spending on certain types of current transfers and on investments. Current transfers rose by 3.2% in 2003 to SIT 1,097 billion. Of these the fastest growth was in spending on subsidies and on social security allowances. There was a smaller rise in spending on pensions of 0.9% in real terms over the year to SIT 640 billion. Investment spending, including transfers, amounted to SIT 233 billion, which was up by almost 7% in real terms from the previous year. Nevertheless fewer funds were earmarked for investments than had been projected. Expenditures on wages and salaries were up 3.2% in real terms from the previous year to SIT 561 billion. Total expenditures were somewhat lower than projected in the revised state budget, primarily because wages in the public sector were not increased in August as agreed, an agreement on collective supplementary pension insurance for public employees being concluded instead. Expenditures on goods and services grew 2.4% in real terms from the previous year and amounted to SIT 452 billion. They were higher than had been projected during the revision of the state budget.

Balance in general government lending and repayments account

The general government lending and repayment account recorded an approximate balance in 2003. The repayments of loans granted and sales of equities amounted to a total of SIT 10 billion, the same as the total of lending granted and acquisition of equities.

Domestic sources of financing still to fore

The core strategic policy in public debt management in 2003 remained borrowing on the domestic market. The general government financing account recorded net borrowing of approximately SIT 38 billion. The state borrowed SIT 50 billion net at home (SIT 53 billion in bonds and a net loan repayment of SIT 3 billion), and repaid SIT 21 billion of debt to the rest of the world. Thus in 2003 the share of external debt continued to fall and the share of domestic debt continued to rise. The government continued to issue three-year, five-year and ten-year bonds with a nominal fixed interest rate.

Republic of Slovenia debt 26.5% of GDP

As of 30 September 2003, the debt of the Republic of Slovenia stood at SIT 1,473 billion or 26.5% of estimated GDP, of which roughly 60% was owed to the domestic sectors and the remainder to the rest of the world. A significant part of the debt consists of government securities, mostly of a long-term nature. Debt guaranteed by the Republic of Slovenia accounted for an additional SIT 393 billion or approximately 7% of GDP.

Both Maastricht fiscal criteria met

In 2003 Slovenia met both Maastricht fiscal criteria. The general government deficit is restricted to 3.0% of GDP and public debt to 60% of GDP on the ESA95 basis. The Reporting of Government Deficits and Debt Levels on the ESA95 basis estimates Slovenia's general government deficit in 2003 at 1.8% of GDP, while the general government debt is estimated at less than 30% of GDP, both on the basis of preliminary figures.

2. MONETARY POLICY

2.1 The conduct of monetary policy

Price stability core aim of Bank of Slovenia

The core aim of the Bank of Slovenia is price stability. In 2003 the Bank of Slovenia conducted monetary policy in line with the long-term orientations that it adopted in November 2001. The Bank of Slovenia conducts its monetary policy in the context of a managed floating exchange rate, which allows it to pursue a relatively independent monetary policy even in conditions of free capital flows.

Monetary policy subordinated to ERM II entry

Monetary policy conduct was oriented towards lowering inflation and achieving the earliest possible entry into the exchange rate mechanism (ERM II) and adoption of the euro. In November 2003 the Bank of Slovenia and the Slovenian Government adopted a Programme for ERM II entry and adoption of the euro, in which they advocate entry into ERM II by the end of 2004 and creation of the conditions enabling the period within ERM II to be kept to a minimum and the euro to be adopted at the earliest opportunity. The Government and the Bank of Slovenia believe adoption of the euro will be possible at the beginning of 2007.

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

In conducting its monetary policy the Bank of Slovenia uses two instruments, namely interest rates and the exchange rate. The Bank of Slovenia adjusts interest rates and influences the euro/tolar exchange rate in accordance with the principle of uncovered interest parity, taking account of past inflation and inflationary expectations, ECB interest rates and the implicit risk premium. At the same time it closely monitors a range of monetary and economic indicators and takes account of the need to maintain the level of real interest rates, thereby ensuring a further reduction in inflation and the nominal convergence of interest rates necessary for ERM II and EMU.

Lower inflationary expectations enabled reduction in interest rates …

Modest domestic consumption, favourable balance of payments trends, lower inflationary expectations and the harmonisation of domestic economic policies allowed the Bank of Slovenia to lower the interest rates on its instruments several times, while maintaining real interest rates at a level that did not trigger an acceleration of domestic demand and consequently inflationary pressures.

… and rate of growth in tolar exchange rate

At the same time as lowering nominal interest rates the Bank of Slovenia also reduced the rate of growth in the tolar exchange rate. The exchange rate intervention mechanism is based on an agreement reached between the Bank of Slovenia and the commercial banks in 2000 on cooperation on the foreign exchange market. Under this agreement the commercial banks conclude deals on foreign exchange markets at an exchange rate signalled by the Bank of Slovenia, which provides the commercial banks with a standing facility for the temporary seven-day sale or purchase of foreign currency. In March 2003, with conditions on the foreign exchange market having stabilised, the Bank of Slovenia ended 18 months of uninterrupted exchange rate intervention. Since then the Bank of Slovenia has intervened in the market only occasionally, with the aim of signalling the desired rate of growth of the exchange rate.

Bank of Slovenia prevented speculative flows of foreign money

By following the principle of uncovered interest parity the Bank of Slovenia maintained an appropriate differential between domestic and foreign interest rates, reduced to take account of an implicit risk premium, which effectively prevented unwanted, mainly short-term and speculative flows of foreign money. Consequently, inflows of foreign money in 2003 were relatively modest, enabling the Bank of Slovenia to maintain effective control of the monetary aggregates and reducing the need for sterilisation of foreign exchange inflows.

Sterilisation papers

Along with currency swaps, sterilisation papers (60-day and 270-day tolar central bank bills) were the Bank of Slovenia's most important instruments, as the structural position of the money market was again in surplus last year. The Bank of Slovenia made only infrequent use of liquidity supply instruments (lombard loans, overnight loans and seven-day temporary purchase of central bank bills).

Adaptation of monetary policy instruments to those of ECB

As part of the process of preparing for EMU the Bank of Slovenia brought its monetary policy instruments into line with ECB instruments. In September 2003 the Bank continued the adjustment of its required reserve instrument, and in the context of preparing for ERM II it began a gradual reduction in the stock of outstanding buy-sell currency swaps with the purchase of EUR 300 million in foreign currency outright from banks. Also last year the Bank of Slovenia removed its last significant restriction on capital flows by allowing individuals to open bank accounts abroad (since February 2003). In October the Bank of Slovenia lifted all restrictions on foreign currency lending by banks.

2.2 Money and credit

Controlling quantity of money in circulation

In 2003 the Bank of Slovenia bought SIT 138.4 billion net of foreign exchange and issued a net total of SIT 96.7 billion of tolar central bank bills. The stock of tolar budgetary time deposits at the Bank of Slovenia fell by SIT 24.4 billion. The monetary base thus grew by SIT 11.5 billion, or 4.1%, in the year to December 2003. Among the components of base money, issued banknotes grew by SIT 14.0 billion (8.1%) and bank reserves by SIT 8.6 billion (10.6%).

Growth of broad money under influence of domestic bank lending

In 2003 M3 rose entirely on account of lending by domestic banks, as the contribution of flows with the rest of the world to M3 growth was negative. By contrast, in the previous two years net foreign assets were the principal component of M3 creation. Changes in M3 creation are primarily attributable to modest financial inflows from abroad and an increase in banks' liabilities to the rest of the world, and partly also to the somewhat larger volume of lending by banks than in 2001 and 2002.

Increased private sector borrowing

Although total bank lending in 2003 was only slightly higher than in 2002, the composition of that lending changed significantly, mainly on account of stronger private sector borrowing on the one hand and more modest government borrowing on the other. Borrowing by enterprises and households strengthened from the very beginning of the year, helped by lower bank interest rates, a gradual recovery in economic activity and an upturn in private consumption. Lending to enterprises accounted for three-quarters of all bank lending in 2003, compared with just over a half the year before. Lending to government fell during this period from one-third to 12%, while lending to households rose from 11% to 14%.

Table 5: **Base money supply**

	As at 31 December			Quarterly changes during 2003				
SIT billion	**2001**	**2002**	**2003**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	1,122.2	1,580.2	1,644.7	-10.3	75.4	14.8	-15.4	64.5
2. Domestic liabilities in foreign currency	-490.0	-581.1	-592.3	11.9	-11.2	-11.0	-0.9	-11.2
– foreign currency bills	-458.8	-551.1	-555.3	10.1	-4.5	-9.4	-0.3	-4.1
– budgetary foreign currency deposits	-31.2	-30.0	-37.1	1.8	-6.7	-1.6	-0.6	-7.0
3. Net foreign currency assets (1+2)	**632.3**	**999.1**	**1,052.4**	**1.6**	**64.2**	**3.8**	**-16.3**	**53.3**
4. Budgetary time deposits	**-19.9**	**-130.3**	**-105.8**	**31.1**	**-1.6**	**0.0**	**-5.1**	**24.4**
5. Loans to banks	**0.5**	**1.3**	**0.1**	**0.3**	**-1.4**	**2.4**	**-2.4**	**-1.2**
6. Tolar bills	**-125.9**	**-375.6**	**-472.3**	**-59.9**	**-17.9**	**-17.7**	**-1.3**	**-96.7**
7. Other net liabilities	**-194.7**	**-214.8**	**-183.1**	**1.9**	**-0.8**	**-4.5**	**35.1**	**31.7**
8. Net tolar assets	**-340.0**	**-719.4**	**-761.2**	**-26.6**	**-21.6**	**-19.8**	**26.2**	**-41.8**
9. Monetary base (3+8)	**292.3**	**279.7**	**291.2**	**-25.0**	**42.6**	**-16.0**	**9.9**	**11.5**
– notes issue	165.8	172.1	186.0	-6.6	13.1	-2.8	10.3	14.0
– bank settlement accounts	78.6	82.4	91.1	1.0	24.9	-8.9	-8.4	8.6
– overnight deposits	35.4	18.4	8.2	-17.5	3.9	-4.7	8.2	-10.2
– other deposits at BoS	12.6	6.8	5.9	-1.9	0.7	0.5	-0.2	-0.9

Source: Bank of Slovenia; accrued interest not included.

Enterprises borrowed twice as much

Strengtehning of household borrowing

Slower growth of government borrowing

Enterprises borrowed SIT 259.3 billion domestically in 2003, twice as much as the previous year. Borrowing by enterprises through the issue of securities, which has traditionally been weak, fell further in 2003 to SIT 15.1 billion, half the level of the previous year. Household borrowing began to pick up in 2003. Households borrowed a total of SIT 62.4 billion from domestic banks, mostly in long-term loans, around half as much again as the previous year. Last year the government sector borrowed SIT 47.3 billion from domestic banks, raising SIT 16.3 billion in loans and issuing SIT 31.0 billion in bonds. Government borrowing from domestic banks in 2003 was just one-third the level in 2002, when it was boosted by a restructuring from foreign to domestic sources.

Enterprises borrowed mainly in foreign currency

In 2003, for the second year in succession, the currency composition of enterprises' borrowing was dominated by foreign currency loans, although their share declined. Foreign currency loans accounted for almost three-quarters (72%) of the total credit raised by enterprises with domestic banks. With the exception of December, borrowing by enterprises in 2002 was exclusively in foreign currency. Enterprises borrowed in foreign currency not only from domestic banks but also abroad. Foreign borrowing remained an important source of finance for enterprises in 2003, although the proportion of foreign loans in total credit to enterprises declined compared with 2002. While enterprises' foreign borrowing was up by a quarter in 2003 compared to 2002, foreign borrowing fell as a proportion of total borrowing by enterprises from 53% in 2002 to 43% last year. The last quarter also saw a slight strengthening of foreign currency borrowing by households following a decision by the Bank of Slovenia in October to lift all restrictions on foreign currency credit transactions between banks and residents.

Slower growth of monetary aggregates

The growth of monetary aggregates slowed in 2003. M3 grew at an average annual rate of 12.0%, but the growth rates were lowest at the end of the year. This can be attributed mostly to the high base at the end of 2002 arising from the privatisation of NLB and the sale of Lek. On average, M2 grew by 16.8% and M1 by 11.6%. Compared with 2002 the biggest decline in the rate of growth was recorded by broad money.

Money multipliers remain unchanged

In 2003 the money multipliers remained similar to 2002. The money multiplier between M3 and the monetary base was 13.0 (12.9 in 2002), between M2 and the monetary base it was 9.3 (9.2 in 2002) and between M1 and the monetary base 2.7 (2.6 in 2002).

Table 6: **Supply of M3: consolidated balance sheet of the monetary system**

	As at 31 December			Quarterly changes during 2003				Total
SIT billions	2001	2002	2003	I	II	III	IV	
1. Net foreign assets	**1,225.7**	**1,461.6**	**1,280.6**	**-31.9**	**-12.8**	**-41.2**	**-95.2**	**-181.1**
2. Domestic assets	**2,404.8**	**2,745.0**	**3,129.1**	**29.5**	**136.5**	**86.6**	**131.6**	**384.2**
General government: bonds	388.1	463.4	494.5	7.7	15.3	12.1	-4.1	31.0
loans	93.9	141.7	158.0	0.2	11.9	-2.7	7.0	16.3
Enterprises: debt securities	101.7	136.2	151.3	-16.0	6.4	1.1	23.7	15.1
loans	1,285.3	1,426.2	1,685.5	30.5	86.6	53.7	88.5	259.3
Households: loans	535.8	577.4	639.9	7.1	16.4	22.5	16.4	62.4
3. Other net liabilities	**-589.9**	**-605.9**	**-631.9**	**-19.4**	**-23.4**	**-3.9**	**20.8**	**-26.0**
4. M3 (1 to 3)	**3,040.6**	**3,600.7**	**3,777.8**	**-21.8**	**100.3**	**41.4**	**57.1**	**177.1**
– foreign currency deposits at banks and BoS	962.6	1,020.8	1,062.3	-0.2	-1.2	37.6	5.3	41.5
– securities in foreign currency	17.5	3.1	3.7	2.9	-2.1	1.3	-1.5	0.6
5. M2	**2,060.4**	**2,576.8**	**2,711.8**	**-24.5**	**103.6**	**2.5**	**53.4**	**135.0**
– time deposits at banks	1,296.4	1,545.3	1,591.6	1.9	27.1	4.4	12.9	46.3
– time deposits at BoS	19.9	130.3	105.8	-31.1	1.6	0.0	5.1	-24.4
– tolar securities	96.1	181.1	217.7	18.7	6.4	3.7	7.7	36.6
6. M1	**648.1**	**720.1**	**796.7**	**-14.0**	**68.5**	**-5.6**	**27.7**	**76.6**
– demand deposits at banks	490.3	564.5	626.5	-9.5	55.8	-6.6	22.4	62.0
– demand deposits at BoS	15.6	12.6	14.1	-3.4	1.5	3.1	0.4	1.6
– currency in circulation	142.1	143.1	156.0	-1.0	11.2	-2.1	4.9	13.0

Source: Bank of Slovenia.

Increased share of deposits with shorter maturities

The main contribution to M3 growth came from demand deposits at banks, with smaller contributions coming from time deposits at banks and foreign currency deposits. The lowering of nominal interest rates on tolar deposits led to a restructuring of time deposits towards shorter maturities. A reduction in the share of deposits with agreed maturity of over one year (from 32% to 28%) was matched by an increase in the share of deposits with agreed maturity of one to three months (from 23% to 27%). Foreign currency deposits began to increase more appreciably in the second half of the year, partly as a result of the accelerated convergence of tolar nominal interest rates with euro area interest rates. But because foreign currency deposits and tolar time deposits grew at similar rates the proportion of all bank deposits accounted for by foreign currency deposits remained unchanged at approximately one-third.

2.3 Interest rates and the money market

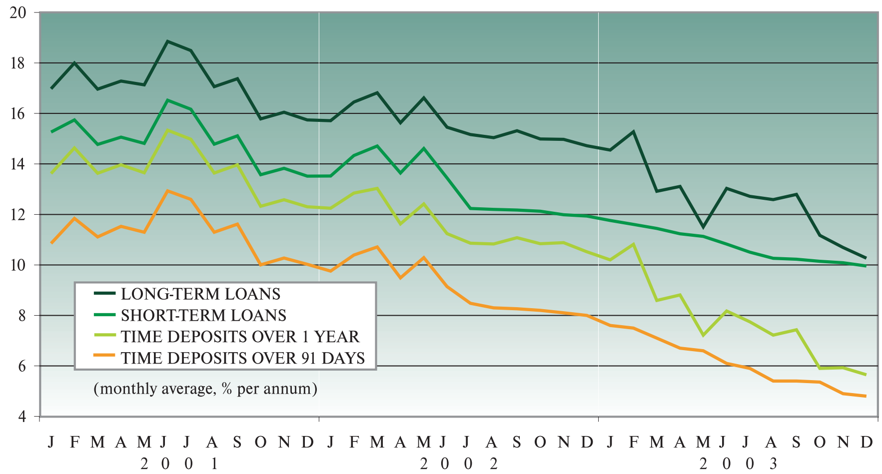
Deposit rates fell faster than lending rates

The fall in the inflation rate from 7.2% at the end of 2002 to 4.6% at the end of 2003 was followed by cuts in bank lending and deposit rates. The banks reduced deposit rates faster than lending rates. The rapid reduction of short-term deposit rates in 2003 caused negative real interest rates throughout the year on time deposits of up to 30 days, and in some months also on time deposits of up to 90 days. The fall in the inflation rate also affected movements in the tolar indexation clause, which fell by 2.5 percentage points in 2003 to 4.8%. The average value of the tolar indexation clause was 5.98%, while average year-on-year inflation was 5.6%. At a monthly level the tolar indexation clause fell from 0.6% in January 2003 to 0.4% in December 2003.

Deposit rate cuts

Bank interest rates fell at an accelerated pace throughout 2003. The banks reduced deposit rates faster than lending rates. Interest rates on long-term time deposits fell the most. Nominal interest rates on deposits with a maturity of over five years were 5.2 percentage points lower in December 2003 than in December 2002, on deposits with a maturity of two to three years they were 4.8 percentage points lower, and on deposits with a maturity of one to two years they were 4.3 percentage points lower. Reductions in interest rates on short-term deposits were smaller: 0.4 percentage points on deposits with a maturity of up to one month and from 2.8 to 3.7 percentage points for maturities of up to one year. Interest rates on foreign currency time deposits fell by 0.7 percentage points, and on foreign currency demand deposits by 0.4 percentage points. Interest rates above the tolar indexation clause also came down: in the short-term segment by 0.3 to 1.1 percentage points and in the long-term segment from 1.7 to 2.5 percentage points.

Figure 6: **Average bank interest rates**



Source: Bank of Slovenia.

Table 7: **Bank of Slovenia and money market interest rates**

	Repurchase agreements	Lombard loans	Bank of Slovenia tolar bills		Interbank market	Treasury bills			Tolar indexation clause
	7 days	1 day	60 days	270 days	up to 30 days	3 months	6 months	12 months	
January	9.58	10.50	8.25	9.68	5.15	8.30	8.75	8.27	7.30
February	9.85	10.50	8.25	9.38	6.10	8.30	8.29	8.27	8.11
March	9.85	10.01	7.76	9.03	6.07	7.90	8.29	7.33	6.05
April	8.71	9.75	7.50	8.51	6.37	7.28	7.22	7.33	6.26
May	8.32	9.31	7.35	8.00	6.08	6.90	7.22	6.49	4.81
June	7.31	8.49	6.74	7.11	5.78	6.08	6.01	6.49	6.26
July	7.01	8.25	6.50	6.63	4.94	5.95	6.01	5.95	6.05
August	7.57	8.25	6.50	6.70	5.36	5.98	5.92	5.95	6.05
September	7.29	8.25	6.50	6.71	6.18	5.98	5.92	5.85	6.26
October	7.29	8.02	6.27	6.78	5.27	5.49	5.64	5.85	4.81
November	7.29	7.60	6.05	6.82	4.96	5.13	5.64	5.10	4.98
December	9.83	7.28	6.00	6.77	4.69	5.11	5.12	5.10	4.81

Note: Monthly averages for 2003; % per annum.
Source: Bank of Slovenia.

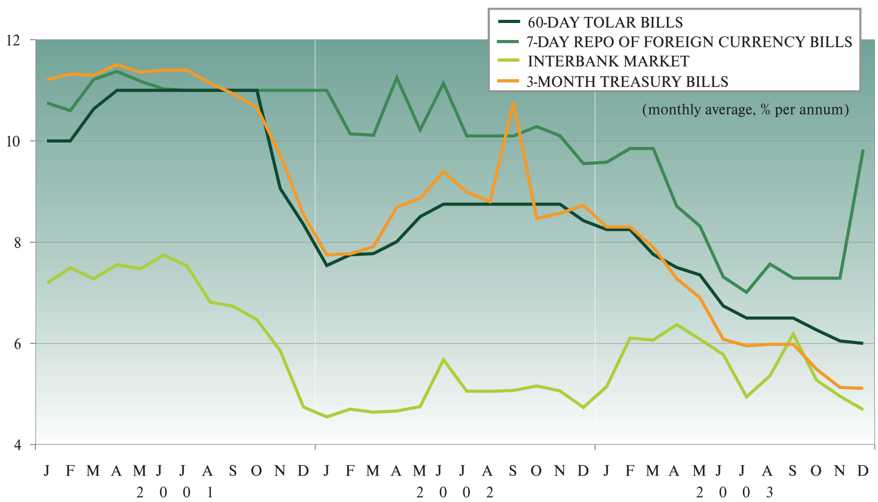
Growth of bank deposits falling

The curve of the time structure of deposit rates fell most in December 2003 compared with December 2002 at the longest maturities. The slower growth in bank deposits, across all categories, resulted from the rapid fall in deposit rates. Savers probably transferred at least part of their assets to the securities market, where the Slovenian stock market index grew by 17.7% last year.

Reduction in lending rates

On the lending side, the biggest fall in interest rates in 2003 was in long-term business loans, which came down by 4.4 percentage points. The average nominal interest rate on long-term loans in December 2003 was 10.3%, or 5.2% above the tolar indexation clause. Nominal interest rates on consumer loans fell by 2 percentage points to reach an average of 9.6% at the end of the year. The smallest fall was in nominal interest rates on short-term business lending, which fell by 1.9 percentage points to reach an average of 9.9% at the end of 2003. Interest rates on housing construction loans were down 4.3 percentage points to an average of 9% in December 2003, or 4% above the tolar indexation clause. Compared with interest rate levels in the euro area the smallest gap was in consumer credit (2.0 percentage points in December 2003), while the gap was largest for short-term business lending (5.9 percentage points in December 2003).

Figure 7: **Bank of Slovenia and money market interest rates**



Source: Bank of Slovenia.

Replacement of SMOM with SITIBOR for interbank interest rates

Slovenian interbank interest rates (SMOM) were first calculated at the start of 2001 based on the interest rates of selected banks for deposits received from other banks at nine standard maturities. On the basis of an agreement concerning the formulation of Slovenian interbank interest rates the SMOM was calculated from the rates of the eight biggest Slovenian banks in terms of total assets, while the next two banks in size were quoted for information purposes only. The method used to calculate the SMOM was modelled on the EURIBOR, so that the SMOM was calculated using the arithmetic mean of the middle two quarters of the rates received. A weakness in this system was that the rates submitted by the individual banks were not binding, nor did the banks even publish them. And because the SMOM was only for deposits received, not deposits placed, it was not possible to monitor the interest gap.

Following a six-month trial period, in mid-July 2003 a new agreement concerning the formulation of Slovenian interbank interest rates was adopted which introduces a number of changes into the quoting of interbank rates that have improved the credibility of the data. The most significant of these changes is that the interest rates quoted by the selected banks now have to be identical to the rates at which the banks are actually prepared to conclude transactions. The selected banks' rates are published in the media. The banks quote both interest rates for offered deposits (SITIBOR) as well as interest rates for received deposits (SITIBID). This reveals the interest gap, which is an important indicator of the development of the market.

Under the terms of the agreement the SITIBOR and SITIBID are calculated and published for interbank deposits offered or received at standard maturities: overnight, one week, one month, two months, three months, six months, nine months and one year. The deadline for cash settlement of a concluded deal is the same day for overnight deposits (T+0), while for other categories it is the second working day after the concluding of the deal (T+2).

Gradual achievement of Maastricht criteria

Favourable inflation trends in 2003 allowed the Bank of Slovenia to gradually lower interest rates on all the key monetary policy instruments. Bank of Slovenia nominal interest rates came down by between 2.5 and 3 percentage points in 2003, enabling the gradual achievement of the Maastricht criteria and at the same time preserving an appropriate level of real interest rates.

Reduction in Bank of Slovenia nominal interest rates

In the first half of 2003 the Bank of Slovenia cut interest rates three times. In March and May the Bank cut the rates on its instruments by between 0.25 and 0.75 percentage points, and took a similar measure at the beginning of June, following a cut in the refinancing rate of the European Central Bank, when it lowered interest rates on all the key monetary policy instruments, mostly by 0.75 percentage points. The Bank of Slovenia left interest rates unchanged during the summer but the rate cuts continued in the autumn. Between October and December it cut interest rates a further three times, by 0.25 percentage points on each occasion. On the assets side the interest rate on lombard loans was cut by 3.25 percentage points, while on the liabilities side the interest rate on 60-day tolar bills was cut by 2.25 percentage points and on 270-day tolar bills by 2.75 percentage points. The Bank of Slovenia foreign exchange buy-sell swap rate fell by 1.5 percentage points, while the refinancing rate at the Bank of Slovenia came down by 2.25 percentage points.

Interest rate on interbank market between 6.4% and 4.7%

On the interbank market the interest rate on deposits fixed for up to 30 days in 2003 varied between 6.4% and 4.7%. In the first half of the year they rose from 5.1% in January to 6.4% in April before sliding back 1.5 percentage points to reach 4.9% in July. In September they climbed back to 6.2% before again falling 1.5 percentage points to reach 4.7% on average in December.

Surplus demand for 270-day tolar bills …

Surplus demand dominated auctions of 270-day tolar bills throughout the year. The Bank of Slovenia adapted its quotas to market conditions. During the first half of the year the average bid rate fell from 9.5% to 6.5%, after which it remained at a level between 6.4% and 6.9% until the end of the year.

… and treasury bills

Auctions of one-month, three-month, six-month and twelve-month treasury bills were also constantly dominated by excess demand in 2003. The interest rates on these instruments responded both to Bank of Slovenia rates and to liquidity movements in the banking system. The yield to maturity rates at auctions fell throughout the year, with the single exception of the February auctions when interest rates rose slightly for a brief period. The average bid rate for one-month treasury bills fell from 8.2% in January to 5% at the end of the year. A similar trend was observed at auctions of three-month, six-month and twelve-month treasury bills. The average bid rate on three-month treasury bills fell by 3.2 percentage points in 2003, on six-month treasury bills by 3.6 percentage points and on twelve-month treasury bills by 3.2 percentage points.

2.4 Foreign exchange market and the exchange rate

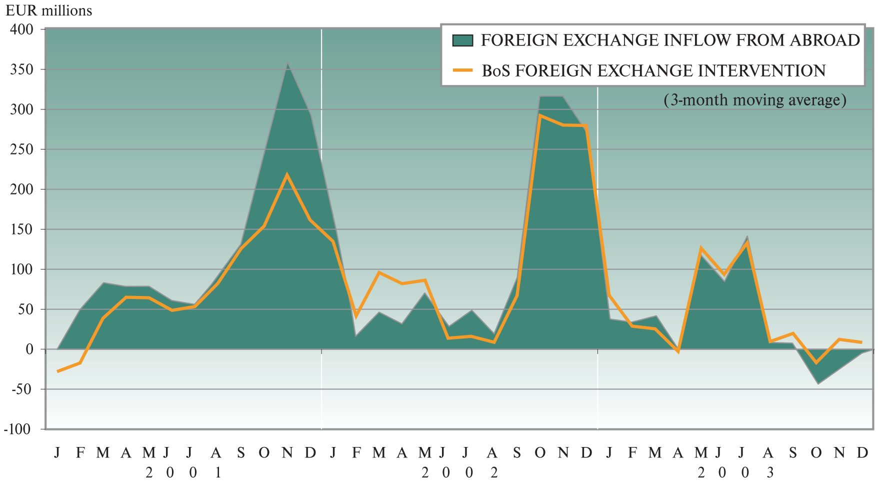
Modest balance of payments inflows

Supply and demand on foreign exchange markets are determined by balance of payments movements and the investment decisions of domestic agents. In 2003 net financial inflows into Slovenia totalled EUR 92 million, or 0.4% of estimated GDP, and much less than in 2002, when the net financial flow totalled EUR 1,149 million. A current account surplus of EUR 17 million was recorded. Foreign exchange reserves thus grew by EUR 108 million.

Supply exceeded demand on foreign exchange markets

Supply exceeded demand on the foreign exchange market in 2003 by EUR 218.5 million. On the currency spot market supply exceeded demand throughout the year, but particularly in the second and third quarters, when the average net monthly inflow of foreign exchange was EUR 370 million. On the forward market banks sold EUR 2,294 million more in foreign exchange than they purchased. With the exception of February, banks were net sellers of foreign exchange throughout the year, at an average of EUR 209 million a month. In 2003 exchange offices sold EUR 336 million worth of foreign currency more than they purchased.

Figure 8: **Foreign currency flows**



Note: 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.

Bank of Slovenia was net purchaser of foreign currency in first half of year, and net seller in second half of year

The Bank of Slovenia again bought and sold foreign currency in 2003. In the first half of the year the Bank was a net purchaser of foreign currency, and a net seller in the second half of the year. In the first six months of the year it bought SIT 106 billion net, and in the second six months sold SIT 144 billion net. For the bulk of its foreign currency purchase transactions the Bank employed buy-sell swaps and outright purchase of foreign currency.

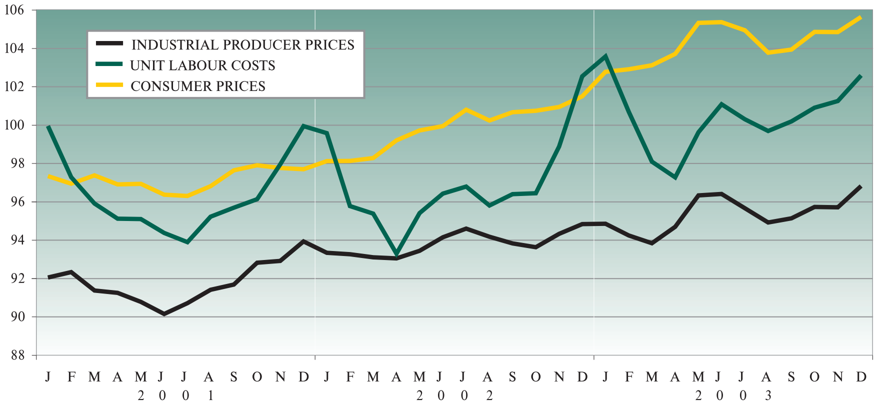
Average monthly growth in euro exchange rate was 0.23%, or 2.8% at annual level

The average monthly growth in the euro exchange rate on the foreign exchange market in 2003 was 0.23%. The growth rate was somewhat higher in January (0.33%) and July (0.27%) and below average in September, when the exchange rate grew by just 0.11%. Growth in the euro exchange rate on the foreign exchange market over the course of last year was 2.8%. With an annual growth of 2.7%, movements in the euro exchange rate in exchange offices did not differ significantly from exchange rate movements on the foreign exchange market. The official exchange rate of the euro rose by 2.8% in 2003, while the official exchange rate of the US dollar fell by 14.3%. The nominal effective exchange rate (based on a trade-weighted basket of currencies) grew by 0.8% in 2003.

Effective exchange rate of tolar grew by 0.8% in nominal terms, and in real terms (based on the CPI) by 4.1%

With the exception of the summer months, the real effective exchange rate of the tolar increased all year. In 2003 the tolar appreciated in real terms by 4.1% measured by the ratio of foreign to domestic consumer prices, and by 2% measured in terms of producer prices. There was no significant change in the real effective exchange rate of the tolar measured by relative unit labour costs.

Figure 9: **Real effective tolar exchange rate**



Note: Indices with fixed base 1995 = 100.
Source: Bank of Slovenia.

2.5 Use of instruments

This section describes the monetary policy instruments, exchange rate policy instruments and instruments of prudential control used in 2003. 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 or signalling of the exchange rate, the open foreign exchange position, the foreign currency minimum and the liquidity ladder.

2.5.1 Monetary policy instruments

Surplus in structural position of money market

The surplus in the structural position of the money market resulting from the purchase of foreign exchange surpluses was strong in 2003, creating a need to neutralise its impact on the liquidity available to the banking system (sterilisation). During 2003 the Bank of Slovenia conducted most of its interventions under an agreement between it and so-called "cooperating banks" concerning cooperation in foreign exchange market intervention.

Liquidity absorption instruments …

… 60-day and 270-day tolar bills

The Bank of Slovenia used tolar bills in 2003 as an instrument to absorb the excess tolar liquidity arising from the growth in temporary sale of foreign exchange to the Bank of Slovenia by the commercial banks (see also the section on exchange rate policy instruments). In the course of 2003 the Bank of Slovenia issued 60-day and 270-day tolar bills. Sixty-day bills were made available to banks via standing facility throughout the year. The Bank of Slovenia offered 270-day bills to all banks at regular weekly auctions, and when the 360-day tolar bills matured at the end of the year also via a closed offer to the "cooperating banks".

In the twelve months to 31 December 2003 the stock of outstanding tolar bills grew from SIT 369.0 billion to SIT 472.3 billion.

Table 8: **Use of monetary and exchange rate policy instruments**

	As at	Daily average by quarter of 2003				As at
SIT millions	31-Dec-02	I.	II.	III.	IV.	31-Dec-03
Monetary policy instruments						
Tolar bills	369,000	438,051	432,815	479,370	485,268	472,330
Overnight deposits	18,360	2,841	1,806	1,581	2,905	8,170
Loans to banks	18	529	140	201	18	9
Lombard	0	511	127	188	9	0
Other (*)	18	18	13	13	9	9
Repurchase agreements	1,148	2,568	1,603	589	206	0
Reserves of banks and savings banks		114,463	116,029	111,441	93,762	
Compulsory		112,724	114,102	109,736	93,194	
Excess		1,739	1,927	1,705	568	
Government time deposits (**)	130,276	112,681	100,436	100,713	102,065	105,847
Exchange rate policy instruments						
7-day foreign exchange buy-sell swaps	507,527	494,754	481,234	548,373	528,537	503,698
270-day foreign exchange buy-sell swaps	35,565	75,820	104,627	87,651	26,517	
7-day foreign currency sell-buy swaps	0	0	0	0	0	0
Memo:						
Foreign currency bills	555,116	542,274	545,190	557,900	551,548	557,878

* Long-term selective loans granted before monetary independence.
** Including one-month treasury deposit.
Less interest and evaluation effects; foreign currency bills at nominal value. At transaction rates.
Source: Bank of Slovenia.

Liquidity instruments …

… lombard loans

… 7-day temporary purchase of foreign currency bills

As well as using sterilisation instruments the Bank of Slovenia also made available two standing facilities to banks and savings banks on a daily basis. At their own initiative, banks and savings banks were able to deposit money overnight through overnight deposit facility or borrow money overnight through a lombard loan facility. The interest rates at which banks and savings banks can deposit money overnight with the Bank of Slovenia or borrow money overnight from the Bank of Slovenia represent the lower and upper limits of the band within which interest rates vary for overnight money on the interbank money market in normal circumstances. The interest rates on these two facilities are the lowest and highest rates, respectively, offered by the Bank of Slovenia. In addition to lombard loans, banks also had the opportunity to obtain liquidity through 7-day temporary purchase of foreign currency bills.

Ministry of Finance tolar time deposits at the Bank of Slovenia

In certain periods the activities carried out by the Bank of Slovenia on behalf of the Ministry of Finance can have a significant impact on liquidity in the banking system. When the tolar time deposits placed by the Ministry of Finance with the Bank of

Slovenia at the end of October 2002 arising from the sale of the government's stake in NLB d.d. matured in 2003, the Ministry used part of the funds to reduce the public debt and retained the remainder in the form of a time deposit with the Bank of Slovenia. During the course of 2003 the Bank of Slovenia sold the Ministry of Finance an equivalent SIT 70.2 billion net in foreign exchange for the purpose of external payments and debt service.

Required reserves fall as result of changes in method of calculation

As part of the process of gradually bringing its required reserves instrument into line with ECB arrangements, in September 2003 the Bank of Slovenia modified the method for calculating required reserves. The required reserves ratio for tolar-denominated liabilities with a maturity of up to 90 days was reduced from 7% to 4.5%, the possibility of meeting the required reserves using vault cash was withdrawn, and repo transactions based on all government securities were included in the zero ratio group (which previously only included repos of short-term government securities). The change had virtually no impact on liquidity in the banking system as a result of the counter effects of the reduction in the ratio and the withdrawal of the possibility of using vault cash to meet the required reserves requirement.

For all tolar-denominated liabilities with a maturity of up to 90 days the required reserve ratio is 4.5%, for tolar-denominated liabilities with a maturity of 91 days to two years and foreign currency liabilities with a maturity of up to two years the ratio is 2%, and for all liabilities with a maturity of over two years the required reserve ratio is 0%. Banks, savings banks and savings and loan undertakings fulfil the required reserve requirement with funds in an account at the Bank of Slovenia.

Required reserves base increased

In the twelve months to December 2003 the required reserves base rose from SIT 3,819 billion to SIT 4,297 billion. However, the changes to the calculation method meant that actual required reserves fell from SIT 112.4 billion to SIT 94.6 billion over the same period. The average required reserve ratio thus fell from 2.9% in December 2002 to 2.2% in December 2003.

2.5.2 Exchange rate policy instruments

The Bank of Slovenia influenced the exchange rate by buying and selling foreign currency, 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.

Purchase and sale of foreign exchange

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

Selling foreign exchange to the Bank of Slovenia was the most important source of liquidity for the banking system in 2003. The most important instrument was the 7-day foreign exchange buy-sell swap, with contracts generally being renewed at maturity. In 2003 the 270-day swap matured in full, but the banks mostly took advantage of the possibility of selling outright the foreign currency released on the maturity of this instrument to the Bank of Slovenia. In addition, in the last quarter of 2003 the Bank of Slovenia bought a further EUR 285 million outright from the banks.

The amount of buy-sell swap outstanding fell from SIT 543.1 billion at the start of 2003 to SIT 503.7 billion at the end of the year.

Exchange rate steering

Occasional intervention in foreign exchange market by setting base exchange rate

The Bank of Slovenia made use of mechanisms for steering exchange rates 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 occasional pressures on the exchange rate in 2003 by intervening to influence the rate of exchange rate growth. The Bank intervened five times in the foreign exchange market by setting the base exchange rate (see section 7.3.1. Monetary policy measures).

2.5.3 Prudential control instruments

Foreign currency bills

Foreign currency bills …

In 2003 the Bank of Slovenia made no changes to foreign currency bills standing facility. Banks were able to subscribe for euro- and dollar-denominated foreign currency bills with maturities of 60, 90 and 120 days.

Demand for foreign currency bills arises primarily from the requirements of the decision on the minimum level of liquidity to be maintained by banks, which regulates the liquidity risk associated with the banks' foreign currency liabilities. This decision 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. Banks also subscribed for foreign currency bills for the purpose of fulfilling the liquidity ladder.

… most important collateral instrument for loans to banks

The Bank of Slovenia required adequate collateral on all monetary policy lending instruments, as well as intraday loans, taken up by banks. Foreign currency bills were the most important form of collateral again in 2003. Besides these bills, banks and savings banks were able to pledge central bank tolar bills and Republic of Slovenia treasury bills as collateral for obtaining loans from the Bank of Slovenia.

The balance of euro- and dollar-denominated bills outstanding grew from SIT 555.1 billion at the start of 2003 to SIT 557.9 billion at the end of the year.

Special liquidity loans granted with the participation of banks

In 2003 the Bank of Slovenia continued to conclude one-year agreements with banks on willingness to participate in liquidity lending, the purpose of which was to prevent a systemic risk caused by a sudden lack of bank liquidity. The agreement with the Bank of Slovenia (the eighth in succession) was signed by 16 banks. In 2003, as has been the case 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 (and later amended) a decision on the minimum level of liquidity to be maintained by banks, unifying the monitoring of tolar and foreign currency liquidity. The decision requires daily disclosure of banks' actual liquidity ratios with effect from 1 July 2002. This ensures daily monitoring as well as regulation of all agreed monetary flows through calculation of the liquidity ratios in banks. Liquidity ratios are calculated as the ratio of claims and liabilities by term to maturity, separated into a tolar and foreign exchange 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 items are taken into account, both on and off-balance sheet.

…and prescription of minimum liquid foreign exchange assets

The decision 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 the monthly average of balance sheet liabilities in category two of the foreign exchange portion in the previous calendar month. In July 2003 an amendment to the decision came into force enabling banks, in the event of a long foreign currency position in achieving the minimum volume of liquid foreign currency claims, to additionally take account of claims arising on the basis of foreign currency credit extended to residents, except to the Republic of Slovenia and other banks, irrespective of maturity. The banks can also include these foreign currency credits in the calculation of liquidity ratios in categories one and two of the foreign exchange portion, but only those with a maturity of more than 180 days. 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 2003 the average liquidity ratio of all banks was 1.14 in category one and 1.11 in category two.

2.5.4 Oversight of implementation of instruments

Five cases of failure to fulfil prescribed obligations

Fourteen protocols were lodged in 2003 on the basis of findings made in the course of direct and indirect oversight of banks with respect to implementation of liquidity ladder provisions. In nine cases the Bank of Slovenia issued rulings terminating proceedings once the non-compliance had been rectified, and in five cases it issued decisions on the basis of which the bank concerned had to pay penalty interest on amounts by which the prescribed obligations were not met.

Indirect oversight of implementation of required reserves instrument

In the case of indirect oversight of the implementation of the required reserves instrument, one decision was issued to a bank and 14 to savings and loan undertakings for non-fulfilment of required reserves requirements, and in each case the measure imposed was a payment of a charge for the unfulfilled required reserves. Six banks were also subject to direct oversight of the implementation of the decision on required reserves and the decision on submission of certain data by banks and savings banks. In the case of five banks the oversight procedure was concluded with a ruling terminating proceedings, and one bank was issued with a decision imposing payment of a charge for the unfulfilled reserves for infringing the decision on required reserves. No direct oversight of savings banks or savings and loan undertakings was carried out in 2003.

46 investigations of licensed exchange offices

In the area of foreign exchange dealing the Bank of Slovenia conducted 46 investigations of licensed exchange offices in 2003. On the basis of these investigations and the protocols of investigations of licensed banks, two proposals for the institution of infringement proceedings were submitted to the National Foreign Exchange Inspectorate, one decision revoking a licence for foreign exchange dealing was issued on the basis of unilateral cancellation of the contract by the licensed bank, and 14 decisions on agreed termination of a contract were issued thereby revoking the licence for foreign exchange dealing.

3. BANKING SECTOR

3.1. Composition of the banking sector

Composition of banking sector

Slovenia's banking sector is dominated by banks. At the end of 2003 they formed 98.7% of the market as measured by total assets (up from 98.6% at the end of 2002), with savings banks and savings and loan undertakings making up the remainder. Savings banks formed 0.4% of the market (0.3% at the end of 2002), and savings and loan undertakings 0.9% (1.1% at the end of 2002).

Twenty banks

In 2003 there were 20 banks operating in Slovenia, the same as on 31 December 2002. Of the 20, five were subsidiaries of foreign banks and one was a branch office of a foreign bank. In addition to the six banks under majority foreign ownership, there were seven wholly domestically owned and seven more under majority domestic ownership (of the seven under majority domestic ownership, three had less than 1% foreign equity capital).

Two savings banks

Neither were there any changes to the savings banks in 2003. At the end of the year, as in 2002, there were two savings banks in operation. The number of savings and loan undertakings continued to fall, the reason being the need to bring their operations into line with the Banking Act. There were 25 savings and loan undertakings in operation at the end of 2002, but just eight at the end of 2003. During the last two years a large number of savings and loan undertakings amalgamated with the Association of Savings and Loan Undertakings, and to a lesser degree savings and loan undertakings were taken over by banks or underwent voluntary liquidation and bankruptcy.

Minor changes in ownership structure

There were few changes in ownership structure in 2003. There was a change in the equity capital shares at eight banks (increases at five and decreases at three), but the changes were mostly of less than one percentage point (only at one bank did the equity capital share rise by almost 5 percentage points). The share of foreign equity amounted to 33.7% at the end of 2003, compared with 32.5% the previous year. The country's second-largest bank (as measured by total assets), Nova Kreditna banka Maribor d.d., and the 11th-largest bank, Poštna banka Slovenije d.d., remain under majority state ownership.

Table 9: **Ownership of banking sector**

% of equity capital	31-Dec-00	31-Dec-01	31-Dec-02	31-Dec-03
Non-residents	12.0%	16.0%	32.5%	33.7%
Central Government	36.8%	37.0%	20.3%	19.6%
Other domestic entities	51.2%	47.0%	47.2%	46.7%

Source: Bank of Slovenia.

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

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

SIT millions	2001	2002	2003[2]
Average total assets of banks and savings banks[1]	3,505,317	4,216,394	4,839,673
GDP at current prices	4,740,995	5,284,501	5,546,700[3]
Average total assets (% GDP)	73.9	79.8	87.3

[1] Including savings and loan undertakings.
[2] Figures exclude Nova Ljubljanska banka branch in Italy.
[3] Estimate for 2003.
Source: Bank of Slovenia.

Issue of authorisations to banks and savings banks

Issuing 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 or an acquisation, 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. Decisions to grant or refuse an authorisation were taken in 2003 by the Governing Board of the Bank of Slovenia on the basis of an opinion by Banking Supervision Department personnel, 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 commission of the Governing Board.

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

		2002		2003	
	Type of authorisation	granted	rejected	granted	rejected
1.	Authorisation to provide banking services	0	0	0	0
2.	Authorisation to provide other financial services	4	2	13	0
3.	Authorisation to a foreign bank to establish a branch	0	0	0	0
4.	Authorisation for a merger of banks or savings banks	1	0	0	0
5.	Consent/authorisation to a foreign bank to establish a representative office	0	0	0	1
6.	Authorisation to acquire a qualifying shareholding	3	2	6	2
7.	Authorisation to serve as a member of a management board	20	0	4	0
	Total	28	4	23	3

Source: Bank of Slovenia.

3.2 Financial performance of banks

3.2.1 Income statement

Moderate growth in total assets

Banks saw moderate growth in their total assets during 2003. The proportion of banks' original assets fell, while borrowing at foreign banks rose. Banks also acquired their assets by issuing debt securities and through subordinated debt. Bank credit activity was lively in 2003, with banks lending more to non-financial companies and other financial institutions, and significantly less to the state. The faster fall in lending rates brought about a squeeze in interest margins and as a consequence lower earnings for banks from net interest.

Pre-tax profits of SIT 48.1 billion

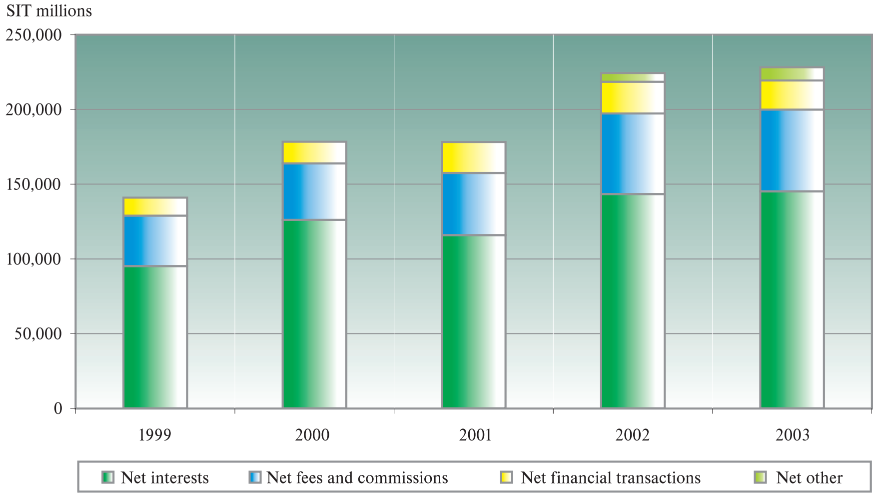
Banks ended the 2003 financial year with pre-tax profits of SIT 48.1 billion, and after-tax profits of SIT 31.8 billion. The operating result generated by banks (pre-tax) was nominally higher in comparison with that of previous years, and was up SIT 2.1 billion or 4.6% from 2002. This moderate growth indicates a slowdown in performance in comparison with 2002, when there was a substantial increase in banks' operating results as a result of changes in the Slovenian Accounting Standards. Ignoring the bank that recorded major losses in previous years, the system's profits in 2003 were down 0.9%, which entailed a real fall of 6.1%.

Two banks end year with loss

With the exception of two banks who ended 2003 with a loss, the remainder recorded positive operating results. Five banks recorded lower profits in 2003 than in 2002: one because of lower revenues from net interest and net fees and commissions, one because of lower revenues from equity investments owing to the final sell-off of equity investments in 2002, and the remaining three because of the net creation of provisions and increases in operating costs. The banks' month-on-month results during 2003 were variable, with monthly rises of between SIT 2.7 billion (in May and October) and

SIT 7.5 billion (in January), while the December result was SIT 1.8 billion lower than the November result. One bank operated at a loss throughout 2003, and was joined by another bank in the second half of the year, while two banks saw occasional losses.

Figure 10: **Gross income**



Source: Bank of Slovenia.

Net interest in 2003 amounted to SIT 145.3 billion, down 4.0% in real terms from 2002.[1] Despite the rise in commissions received on payment transactions, on credit operations and for administrative services, net commissions are falling in real terms. In 2003 they fell by 4.0% to SIT 54.7 billion. Net income from financial transactions fell by 12.9% in real terms, with banks recording lower revenues from the sale of shares and other securities but slightly higher financial revaluation expenses on equity investments in other companies and companies in the same group. At SIT 8.8 billion, other net income[2] was SIT 3 billion higher than in 2002 owing to the higher extraordinary expenses realised then.

Net interest of SIT 145.3 billion

Net commissions of SIT 54.7 billion

The fall in net interest, net commissions and net financial transactions led to a fall in gross income. After rising in 2002, banks' gross income fell again in 2003 (by 3.6% in real terms) to SIT 228 billion. The make-up of banks' gross income was almost unchanged from 2002, with net interest accounting for 63.6%, net commissions 23.9%, net financial transactions 8.5% and other net income 3.9%.

Gross income down 3.6% in real terms

The make-up of the spending of banks' gross income changed. In 2003 banks spent 62.5% of gross income on covering operating costs and 16.4% on net provisions, while the remaining 21.1% represented banks' pre-tax profits. Given the fall in gross income in real terms, operating costs accounted for a greater proportion of the spending of gross income in 2003 than in the previous year, with the proportion accounted for by net provisions declining and that accounted for by profit rising. Banks spent more of their gross income on covering operating costs, less on net provisions and more on profit.

Operating costs higher as proportion of gross income at 62.5%

Banks' operating costs remained at the same level in real terms, primarily because of labour costs, which grew by 2.6% in real terms, with the proportion of total expenses accounted for by labour costs rising over the period in question from 11.2% to 12.4%. Operating costs as a proportion of average assets continue to fall (from 3.2% to 3.0%).

Labour costs grew by 2.6%

1 Applying a consumer price index of 5.6% in 2003.

2 Other net income consists of other operating revenues, extraordinary revenues, other operating expenses and extraordinary expenses.

Net provisions of SIT 37.5 billion

In 2003 banks created net provisions of SIT 37.5 billion, a consequence of both the rise in credit exposure and changes in average default risk. The amount of provisions created in 2003 was SIT 6.9 billion or 15.5% lower than in 2002, with the level of provisions created being lower at 11 banks. Of these, seven showed a significant fall in net provisions, primarily a result of the banks having created abnormally high provisions in 2002 for various reasons (a conservative classification policy, the write-off of claims on the state for payment of corporate income tax in previous years, the creation of additional provisions by order of the Bank of Slovenia because of standardisation of client classification during takeovers, and others). The lower level of provisions created at the other banks was a result of factors in 2003: slower credit growth, improvements in portfolio quality, lower levels of provisions created for general banking risks and the use of lower but still allowable percentages for provisions within individual groups).

Table 12: **Principal items in income statement**

	SIT millions		Share (%)		Nominal growth (%)	
	2002	2003*	2002	2003	2002/2001	2003/2002
Net interests	143,407	145,282	63.9	63.6	23.7	1.3
Net fees and commissions	53,962	54,671	24.0	23.9	30.0	1.3
Net financial transactions	21,205	19,503	9.5	8.5	1.9	-8.0
Other income	5,808	8,860	2.6	3.9	-214.3	52.5
Gross income	**224,382**	**228,316**	**100.0**	**100.0**	**29.6**	**1.8**
Operating expenses	133,914	142,621	59.7	62.5	18.6	6.5
– of which: labour costs	66,169	71,733	29.5	31.4	24.4	8.4
Net income	**90,467**	**85,695**	**40.3**	**37.5**	**50.2**	**-5.3**
Net provisions and net write-offs	-44,450	-37,546	-19.8	-16.4	-0.7	-15.5
Profit/loss before tax	**46,017**	**48,149**	**20.5**	**21.1**	**197.9**	**4.6**
Profit/loss after tax	**29,501**	**31,763**	**13.1**	**13.9**	**1,432.1**	**7.7**

* Figures exclude NLB branch in Italy.
Source: Bank of Slovenia.

Banking sector profitability ratios lower than in previous years

With average assets growing more slowly (9.1% in real terms), the real fall in **gross income** (-3.6%) led to a fall in gross income per total assets, which at 4.8% in 2003 was the lowest to date.

The **return on average assets** was 1.0% in 2003, slightly lower than in 2002 (1.1%). After rising in 2002 (because of slower equity growth as a result of the absence of a general equity capital revaluation in 2002), the return on equity was somewhat lower in 2003 at 12.6%.

The **interest margin** (expressed as the ratio of net interest income to average gross interest-bearing assets) was 3.2% in 2003, and is continuing to fall because of the real decline in net interest. It was 0.5 percentage points lower than in 2002.

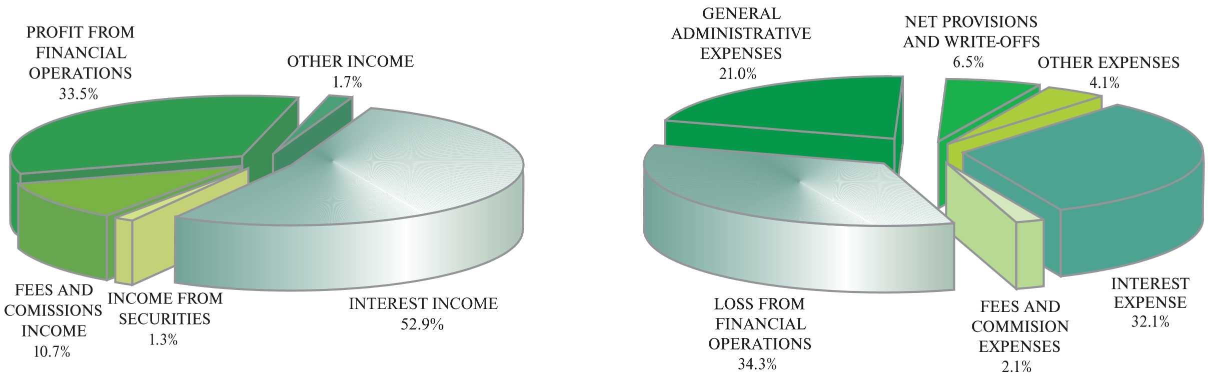
Table 13: **Selected banking sector profitability ratios**

(%)	1999	2000	2001	2002	2003
Gross income/average total assets	5.4	5.9	5.0	5.4	4.8
Return on average assets	0.8	1.1	0.5	1.1	1.0
Return on average equity	7.8	11.4	4.8	13.3	12.6
Net interest margin	4.1	4.7	3.6	3.7	3.2
Operating expenses/average total assets	3.6	3.5	3.3	3.2	3.0

Source: Bank of Slovenia.

With average assets growing in real terms and operating costs remaining at the same level, **operating costs per total assets** fell in 2003 from 3.2% to 3.0%.

Figure 11: **Breakdown of banks' income and expenses**



Source: Bank of Slovenia.

3.2.2 Balance sheet

Total assets under majority foreign ownership up over 30%

The **total assets** of the banking system grew in 2003, but at a slower rate of 10.5% in nominal terms or just 5.6% in real terms.[3] At year-end, according to unaudited figures, total assets stood at SIT 5,033.8 billion (excluding the NLB branch in Italy). Nominal total asset growth of individual banks ranged from -40.5% to 53.7%, with the general meeting of the bank whose total assets fell passing a decision on the ordinary liquidation of the bank at the end of the year. There was notably high growth in the total assets of the banks under majority foreign ownership, which with one exception had nominal growth in excess of 30%, and low growth in the total assets of the largest banks.

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

	Total assets (SIT millions)		Nominal growth (%)		Market share (%)	
Bank	31-Dec-02	31-Dec-03	2002/2001	2003/2002	31-Dec-02	31-Dec-03
NLB *	1,619,165	1,693,190	17.6	4.6	35.5	33.6
NKBM	517,538	544,035	15.7	5.1	11.4	10.8
Abanka	389,273	432,426	53.3	11.1	8.5	8.6
SKB banka	360,095	391,675	-1.5	8.8	7.9	7.8
Banka Koper	275,658	324,648	20.6	17.8	6.0	6.4
Banka Celje	282,116	305,985	22.9	8.5	6.2	6.1
Gorenjska banka	227,130	245,749	19.9	8.2	5.0	4.9
Largest 7 banks	3,670,976	3,937,708	18.8	7.3	80.6	78.2
All banks	4,556,637	5,033,805	17.5	10.5	100.0	100.0

* Figures for 2003 exclude NLB branch in Italy.
Source: Bank of Slovenia.

Market share of three largest banks down 2.3 percentage points

The **market share** of Slovenia's largest bank at the end of 2003, measured in terms of total assets, was 33.6%, or 37.3% including its three subsidiaries. The group's market share fell by 1.97 percentage points primarily as a result of a significant decline in the parent bank's market share (1.90 percentage points, the largest decline in the banking system), and a proportionate decline in the market shares of the subsidiaries. The market share of the three largest banks fell by 2.3 percentage points. Within the group of the seven largest banks, only one saw its market share strengthen significantly, while the group as a whole saw a significant decline. The eighth bank saw its market share improve by 0.69 percentage points in 2003 to 4.6%, bringing it close to the group of the largest banks.

3 This is the lowest real growth in total assets in the period since 1999. The real growth in balance sheet items was calculated on the basis of an annual inflation rate in 2003 of 4.6%.

Liabilities to banks up 33% in real terms

In comparison with the low growth in total assets, **liabilities to banks** rose by 39.1% in nominal terms (33.0% in real terms) in 2003, and by 3.4 percentage points to 16.2% as a proportion of total assets. It was banks under foreign ownership and the faster-growing domestic banks in particular that acquired assets from foreign banks, which was reflected in the rise of 46.7% in liabilities to foreign banks. The trend of the rising proportion of liabilities to foreign banks has continued since 1998, and they now account for 84.1% of liabilities to banks.

Liabilities to non-banking sector unchanged in real terms

In 2003 **liabilities to non-bank customers** saw growth of just 4.6% in nominal terms, and in real terms maintained their level from 2002.[1] The most significant factor was the fall in government deposits by SIT 49.7 billion or 24%, most obviously at the largest bank. Deposits of businesses showed low nominal growth, but fell in real terms, while household deposits grew by 3.3% in real terms, thus continuing to account for the largest proportion, albeit falling, of all sources of bank assets.

Additional sources through issue of debt securities

In contrast to the low growth in deposits of the non-banking sector, banks acquired additional assets by issuing **debt securities**. Liabilities from these grew by 22.6%[2] in nominal terms in 2003, leading to an increase in the proportion of total assets accounted for by debt securities (4.3% at the end of the year). In terms of maturity, in contrast to 2002 the amount of short-term securities rose and the amount of long-term securities fell.

Table 15: **Principal items in banking sector balance sheet**

	SIT millions		Share (%)		Nominal growth (%)		Real growth (%)
	31-Dec-02	31-Dec-03[1]	31-Dec-02	31-Dec-03	2002/2001	2003/2002	2003/2002
Deposits with central bank	143,311	141,464	3.1	2.8	-30.5	-1.3	-5.6
Loans and advances to the banking sector	381,208	338,523	8.4	6.7	-3.8	-11.2	-15.1
Loans and advances to the non-bank sectors [2]	2,182,147	2,517,354	47.9	50.0	14.0	15.4	10.3
– Loans and advances to non-financial institute.	1,282,846	1,592,893	28.2	31.6	9.9	24.2	18.7
– Loans and advances to households	562,845	629,192	12.4	12.5	8.0	11.8	6.9
– Loans and advances to government	215,992	141,946	4.7	2.8	35.8	-34.3	-37.2
– Loans and advances to others [3]	120,464	153,323	2.6	3.0	80.8	27.3	21.7
Securities	1,547,139	1,719,574	34.0	34.2	39.5	11.1	6.3
Other assets	302,832	316,889	6.6	6.3	20.6	4.6	0.0
Total assets	**4,556,637**	**5,033,805**	**100.0**	**100.0**	**17.5**	**10.5**	**5.6**
Liabilities to the banking sector	584,723	813,634	12.8	16.2	29.1	39.1	33.0
Liabilities to the non-bank sectors	3,149,394	3,293,089	69.1	65.4	14.0	4.6	0.0
– Liabilities to non-financial institutions	604,952	618,223	13.3	12.3	16.8	2.2	-2.3
– Liabilities to households	1,978,294	2,138,537	43.4	42.5	12.6	8.1	3.3
– Liabilities to government	207,533	157,859	4.6	3.1	37.0	-23.9	-27.3
– Liabilities to others	358,615	378,471	7.9	7.5	6.7	5.5	0.9
Liabilities arising from securities	176,483	216,366	3.9	4.3	59.0	22.6	17.2
Other liabilities	265,693	289,656	5.8	5.7	26.9	9.0	4.2
Capital	380,345	421,060	8.3	8.4	11.2	10.7	5.8
Total liabilities	**4,556,637**	**5,033,805**	**100.0**	**100.0**	**17.5**	**10.5**	**5.6**

[1] Excluding the branch of Nova Ljubljanska Banka in Italy.
[2] Credits to DARS were at the end of 2003 included in government, but at the end of 2003 in non-financial institutions.
[3] Others: other financial institutions, non-profit institutions serving households, non-residents.
Source: Bank of Slovenia.

Rise in book capital SIT 40.7 billion or 10.7%

In 2003 five banks underwent a recapitalisation, of which two have not yet made the arrangements with the register of companies, which means that the paid-up capital has not yet been entered in the capital item. Book capital rose by SIT 40.7 billion in 2003, a rise of 10.7% in nominal terms from 2002. The increase in capital was tracked by the rise in total assets.

[4] Between 1999 and 2002 the lowest rate of real growth was 3.2% in 1999
[5] The rate was lower than in the 2000 to 2002 period, when the annual rates exceeded 50%

The book capital includes the profit generated in the financial year, which was SIT 31.8 billion after tax. In line with legal provisions banks have already transferred SIT 12.1 billion to profit reserves, while SIT 19.6 billion of profit remains undistributed. The further distribution of this profit will be decided on at the individual banks' general meetings.

After-tax profits of SIT 31.8 billion generated by banking sector in 2003

In 2003 banks made no general capital revaluation adjustments, as the new Slovenian Accounting Standards only require such general adjustments if the euro exchange rate rises by more than 5.5% in the financial year just ended.

No need for banks to make general capital revaluation adjustment

Banks compensated for the low growth in share capital from new capital contributions with subordinated liabilities, thus ensuring capital adequacy. Six banks increased their subordinated liabilities, leading to a total rise of 40.2% or SIT 27.5 billion.

Subordinate liabilities used to ensure capital adequacy

In 2003 there was a rise of 15.4% in **loans and advances to non-bank customers**. Although the nominal growth was the lowest in the 1999 to 2003 period, because of low inflation the real growth rate of 10.3% was the highest since 1999, which saw the introduction of VAT.[6] The biggest factor in the rise in loans to the non-banking sector was the increase in lending to non-financial companies of 24.2% in nominal terms (18.8% in real terms), the highest real growth in the last five years following real growth of just 2.5% in 2002. The amount of lending to non-financial companies rose all year. The largest absolute growths were attained by the major domestic banks, while the highest relative growths were attained principally by the foreign banks and subsidiaries of the largest bank. Lending to households in 2003 saw the largest growth since 1999, with almost half of the nominal growth being generated by foreign banks, while four banks saw their lending to households fall. The increase in lending to other sectors is a result of lending to other financial institutions. Taking the methodology changes into consideratio[7] , lending to the government was modest in 2003, with the government borrowing more by issuing securities.

Real rise of 10.2% in loans to non-banking sector

In addition to balance sheet investments, banks also increased **off-balance-sheet items**, with the amount of guarantees issued rising by 5.4% in real terms, the highest real rise in the last five years.

Real rise of 5.4% in guarantees issued

With a nominal rate of 11.1%, the growth in investments in **securities** was behind the growth in lending to the non-banking sector. In particular banks invested less in government and Bank of Slovenia securities, a result of smaller foreign exchange inflows than in 2002 and thus less need for Bank of Slovenia sterilisation. At 20.5% the growth in investments in the securities of other issuers was higher than in 2002 (18.8%).

Growth in investments in non-banking sector securities slower owing to smaller foreign exchange inflows

There was a significant increase of 17.2% in nominal terms in equity investments in the banking sector in 2003, representing new investments in subsidiary and associated financial institutions and transfers from equity securities to equity investments.

Equity investments up 17.2%

Within the **average composition of liabilities**, the unfavourable trend in deposits of the non-banking sector in 2003 was reflected in a fall in the average liabilities to non-banking customers of 3.7 percentage points, whereby despite nominal growth the largest fall was in the average proportion accounted for by household deposits

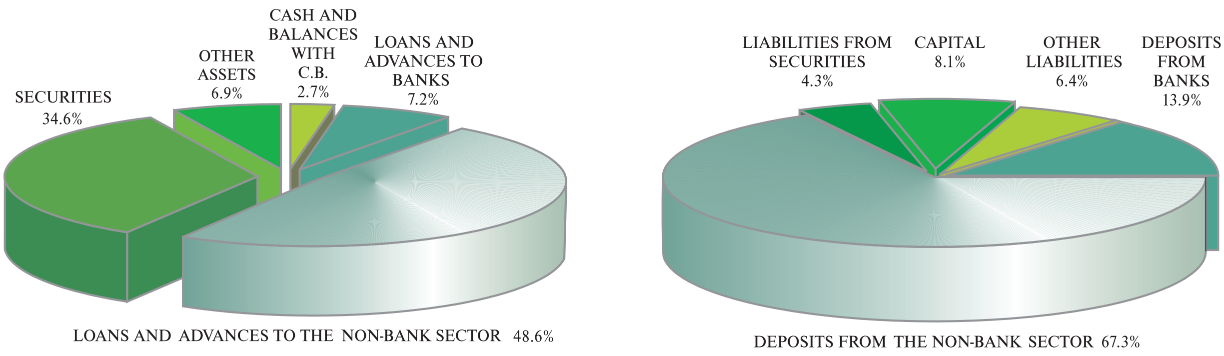
Liabilities to banking sector and new issues of securities compensated for fall in deposits from non-banking sector

6 Real growth was 16.0% in 1999, 8.2% in 2000, 9.4% in 2001 and 6.4% in 2002.

7 The rise in lending to non-financial companies was also partly the result of a change in the methodology for administering loans to DARS, which in 2002 were administered as part of the government sector, but in 2003 were transferred to the non-financial companies sector. Ignoring this change, the non-financial companies sector would have attained nominal growth of 18.2% (13.0% in real terms), and the government sector nominal growth of 1.7% (a decline of 2.8% in real terms).

(1.5 percentage points). In terms of the sources from which banks acquired new assets, there was a significant increase in the proportion accounted for by average liabilities to the banking sector (2.5 percentage points) and average liabilities arising from securities issued (1.3 percentage points). The proportion of capital fell by 0.3 percentage points from 2002.

Figure 12: **Average composition of banking sector sources of assets and investments in 2003**



Source: Bank of Slovenia.

Proportion of loans to non-banking sector down 0.4 percentage points

Within the **average composition of assets**, the proportion of average loans to the non-banking sector fell by 0.4 percentage points from 2002, whereby the proportion of loans to non-financial companies rose by 1.2 percentage points and the proportion of loans to households fell by 0.7 percentage points. There was a significant increase in the proportion of average investments in securities (2.3 percentage points).

Non-banking sector diverted long-term deposits to short-term and demand deposits

Within the maturity breakdown of deposits of non-bank customers, in contrast to 2002 there was a significant rise in the proportion of demand deposits (1.7 percentage points). Demand deposits of the non-banking sector rose by 10.1% in nominal terms in 2003, with the rate of growth in demand deposits outstripping that of short-term and long-term deposits for non-financial companies, households and other sectors. The amount of short-term deposits rose by 2.6% in 2003, but the proportion they account for fell by 1.1 percentage points. In contrast to the last five years, when the amount of long-term deposits increased, in 2003 it fell by 2.4%, with the biggest fall in the non-financial companies sector (24.6%), while long-term deposits of other financial institutions and non-residents increased. In line with all this the proportion accounted for by long-term deposits fell by 0.6 percentage points.

Table 16: **Maturity of deposits of and loans to non-bank customers**

(%)	31-Dec-01	30-Jun-02	31-Dec-02	30-Jun-03	31-Dec-03
Demand deposits of non-banking sector	34.3	33.2	32.1	33.7	33.8
Short-term deposits of non-banking sector	58.0	58.3	58.4	56.1	57.3
Long-term deposits of non-banking sector	7.7	8.4	9.5	10.3	8.9
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	55.3	54.1	53.8	52.4
Long-term loans to non-banking sector	42.8	44.6	45.9	46.1	47.5
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.

Banks replacing non-banking sector with longer-term sources

The average deposits of the non-banking sector accounted for 67.3% of the average total liabilities in 2003, this proportion having fallen by 3.7 percentage points from the previous year owing to the acquisition of other sources. The sources that banks are using to replace deposits of the non-banking sector are primarily long-term. Taking the long-term liabilities to banks, long-term deposits, long-term securities issued and long-term subordinated liabilities into consideration, at the end of 2003 average long-term liabilities accounted for 22.4% of average interest-bearing liabilities. This proportion rose all year, and finished up 4.2 percentage points from 2002.[8]

In terms of bank investments, non-banking sector raised more long-term than short-term loans

In contrast to deposits of the non-banking sector, the trend of faster growth in long-term loans continued for loans to non-bank customers. In 2003 long-term loans rose by 19.6% and short-term loans by 11.8%, the faster growth in long-term loans being seen in all sectors. This was also reflected in the composition, with the proportion accounted for by long-term loans rising by 1.6 percentage points in 2003.

Table 17: **Currency breakdown of principal balance sheet items**

(%)	Share at 31-Dec-02		Share at 31-Dec-03	
	in SIT	in foreign currency	in SIT	in foreign currency
Deposits with central bank	2.9	0.3	2.6	0.2
Loans and advances to the banking sector	1.7	6.7	1.3	5.5
Loans and advances to the non-bank sectors	36.3	11.6	35.9	14.1
Securities	20.1	13.8	21.4	12.8
Other assets	6.2	0.5	5.8	0.5
Total assets	**67.0**	**33.0**	**67.0**	**33.0**
Liabilities to the banking sector	3.4	9.4	4.9	11.3
Liabilities to the non-bank sectors	45.9	23.2	43.7	21.8
Liabilities arising from securities	3.8	0.1	4.2	0.1
Other liabilities	4.7	1.2	4.6	1.1
Capital	8.4	0.0	8.4	0.0
Total liabilities	**66.1**	**33.9**	**65.7**	**34.3**

Source: Bank of Slovenia.

Proportion of liabilities in foreign currency up 0.4 percentage points

In 2003 liabilities in foreign currency rose by 11.6% while those in domestic currency rose by 9.9%, which was reflected by an increase in the proportion of liabilities accounted for by foreign currency of 0.4 percentage points. The low growth in deposits of the non-banking sector resulted in a fall in the proportion of average assets they account for in both domestic currency (2.2 percentage points) and foreign currency (1.4 percentage points). The larger fall in the proportion accounted for by deposits in domestic currency is the result of the acquisition of assets through the issue of securities and subordinated liabilities, which was reflected in the rise of 0.4 percentage points in the proportion they account for.

Proportions of assets in domestic and foreign currencies unchanged

The domestic/foreign currency breakdown of investments in 2003 was similar to that of the previous year, but there were changes in individual currencies. As a result of the lack of change in investments in Bank of Slovenia securities in foreign currency and the growth in investments in securities in domestic currency, the proportion of investments in domestic currency rose (by 1.3 percentage points). The higher growth in lending to the non-banking sector in foreign currency in comparison to that in domestic currency was reflected in the rise of 2.5 percentage points in the proportion of such loans in foreign currency and the decline of 0.4 percentage points in the

[8] Average long-term liabilities as proportion of average interest-bearing liabilities for last four years: 15.3% in 1999, 16.5% in 2000, 17.1% in 2001, 18.2% in 2002.

proportion in domestic currency. To a considerable degree this is the result of a change in regulations[9] at the end of October, which relaxed the restrictions on the purpose of foreign currency loans and was reflected in particular in the larger amount of lending to non-financial companies in foreign currency.[10]

3.2.3 Tolar lending and deposit rates for the non-banking sector

Effective tolar lending rate fell more than effective deposit rate

The downward trend in average effective[11] interest rates on loans and deposits continued in 2003. Effective rates for non-bank customer loans and deposits were below the level in previous years. The interest rate spread, expressed as the difference between the effective lending and deposit interest rate fell by half a percentage point in 2003 to 4.5 percentage points, as the fall in effective lending rates was sharper than that in effective deposit rates.

Structure of banks' balance sheets affected income from loans and deposits

Income from non-banking sector loans and deposits is to a considerable degree affected by the structure of banks' balance sheets. Owing to the rise in loans in foreign currency, investments in loans to the non-banking sector again strengthened to half of assets (49.9%) in 2003. Loans to non-banks in domestic currency also showed higher growth than in 2002,[12] owing to which the proportion of assets they account for stalled at 35.9%. The ratio of loans to the non-banking sector in domestic and foreign currency is 72%:28%.

Proportion of loans with nominal interest rate rose to 40% and loans with foreign currency clause to 15%

The low rate of real growth in tolar lending to the non-banking sector and the fall in interest rates resulted in revenues in 2003 in this segment falling in nominal terms from 2002. In particular there was a fall in the proportion of tolar lending to the non-banking sector accounted for by loans at an index-linked interest rate and a corresponding rise in the proportion accounted for by loans with a nominal interest rate or foreign currency clause. In the last quarter of 2003, 40% of tolar loans to the non-banking sector were earning a nominal interest rate,[13] 45% were earning an index-linked interest rate and 15% had a foreign currency clause.

Proportion of tolar deposits earning nominal interest rate rose to 72%

Tolar deposits of the non-banking sector remained at the same level in real terms in 2003, while foreign currency deposits of the non-banking sector fell by 2.1% in real terms. The ratio of deposits of the non-banking sector in domestic and foreign currency is 67%:33%. Tolar deposits of the non-banking sector fell as a proportion to 43.7% of liabilities. Expenses arising from tolar deposits fell in nominal terms from 2002. In the last quarter of 2003, 72% of tolar deposits of the non-banking sector were earning a nominal interest rate,[14] 26% were earning an index-linked interest rate and 2% had a foreign currency clause.

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9 Decision on the conditions of entering into foreign currency credit transactions between residents.

10 Loans in foreign currency rose by 40.7% or SIT 171.0 billion in 2003, while those in domestic currency rose by 16.1% or SIT 139.1 billion.

11 Effective interest rates from financial reports are calculated from interest revenues/expenses and the average level of investments/assets for the non-banking sector by quarter.

12 Tolar lending to the non-banking sector rose by 6.1% in 2002 but by 9.5% in 2003 (in nominal terms).

13 In 2002, 26% of tolar loans to the non-banking sector were earning a nominal interest rate, 63% were earning an index-linked interest rate and 11% had a foreign currency clause.

14 In 2002, 64% of tolar deposits of the non-banking sector were earning a nominal interest rate, 33% were earning an index-linked interest rate and 3% had a foreign currency clause.

Table 18: **Effective tolar lending and deposit interest rates for the non-banking sector**

(% per annum)	I/02	II/02	III/02	IV/02	I/03	II/03	III/03	IV/03
1. LENDING INTEREST RATES	**13.3**	**13.1**	**12.4**	**12.2**	**11.8**	**10.8**	**10.4**	**9.3**
a) short-term loans	12.7	12.6	11.9	11.8	11.6	11.1	10.4	9.5
b) long-term loans	13.7	13.4	12.7	12.4	11.9	10.6	10.5	9.2
2. DEPOSIT INTEREST RATES	**8.3**	**7.9**	**7.4**	**7.1**	**6.7**	**6.0**	**5.5**	**4.8**
a) demand deposits	1.0	1.1	1.1	1.1	1.0	1.0	1.0	1.1
b) short-term deposits (maturity to 30 days)	4.8	4.5	4.6	4.8	4.8	4.8	4.3	4.2
c) short-term deposits (maturity over 30 days)	10.7	10.2	9.3	8.8	8.3	7.5	6.7	5.9
d) long-term deposits	12.5	12.0	11.5	11.3	10.5	9.0	8.9	7.7
INTEREST MARGIN (1-2)	5.0	5.2	5.0	5.1	5.1	4.8	4.9	4.5

Note: Total nominal interest rates, including tolar indexation clause and foreign currency clause.
Source: Bank of Slovenia.

3.2.4 Quality of assets

Credit risk management – banks not exceeding exposure limits

Avoiding excessive concentration of credit exposure to individual persons, groups of related parties, other persons in the group and persons with a special relationship with the bank is a key element of credit risk management. As at 31 December 2003, at no bank were the limits on the maximum allowable exposure to individual persons (25% of capital), to groups of related parties (25% of capital), to other persons in the group (20% of capital) or to persons with a special relationship with the bank (20% of capital) exceeded.

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

	31-Dec-02				31-Dec-03			
	Aggregate exposure		Value adj., provisions		Aggregate exposure		Value adj., provisions	
	SIT millions	%	SIT millions	%	SIT millions	%	SIT millions	%
A	2,943,971	80.3	32,114	14.1	3,364,116	80.9	35,919	14.7
B	467,919	12.8	51,579	22.6	523,209	12.6	53,574	21.9
C	113,470	3.1	30,146	13.2	119,373	2.9	32,306	13.2
D	63,434	1.7	35,429	15.5	70,103	1.7	40,745	16.7
E	79,483	2.2	79,165	34.7	81,669	2.0	81,660	33.4
Total	3,668,276	100.0	228,432	100.0	4,158,470	100.0	244,203	100.0

Source: Bank of Slovenia.

Average exposure to individual person of SIT 120.9 million

The number of large exposures or large total exposures (a bank's exposure to an individual person calculated according to the decision on large exposures that reaches or exceeds 10% of the bank's capital) as at 31 December 2003 was somewhat higher (272) than at the end of the previous year, as was the ratio of the sum of large exposures to capital, which in the entire system was 212.8% at the end of 2003. At no bank did the sum of large exposures exceed the limit of 800% of the bank's capital. Throughout the system there was a rise in the number of counterparties (excluding small businesspersons and members of the public) to 42,588 and also a rise in the total exposure, while the average exposure amounted to SIT 120.9 million and was at the same level as in 2002.

Faster growth in classified assets

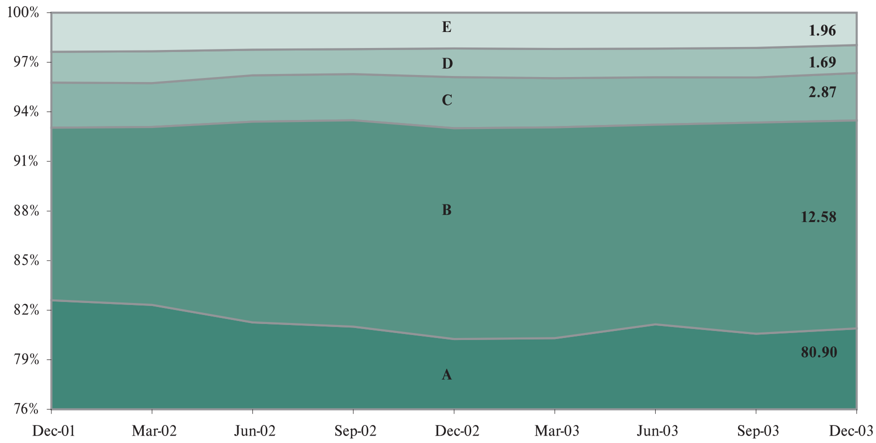
As at 31 December 2003, banks' total exposure was SIT 6,089 billion (of which SIT 5,028 billion was in balance sheet liabilities and SIT 1,056 billion was in off-balance-sheet liabilities), while the volume of classified assets was SIT 4,158 billion or 68.3% of total exposure. In 2003 there was again faster growth in classified assets (13.3%)

than in total exposure (12.3%). In 2002 the total exposure rose by 17.5% while classified assets fell by 18.8%.

Credit risk composition of aggregate exposure improved

The credit risk composition of the aggregate exposure improved in 2003. The proportion of assets in Category A rose by 0.6 percentage points, while there was a reduction in assets classified as Categories B, C and E. As a result the trend of assets classified into Categories C, D and E was also favourable in this period. The proportion of assets in Categories C, D and E fell by 0.4 percentage points to 6.6%. The change in the composition was also reflected in a change in the average default risk of assets[15] in the banking system, which fell from 5.88% to 5.59% over the period in question.

Figure 13: **Composition of aggregate exposure of all banks**



Source: Bank of Slovenia.

Within the composition of classified assets by activities and sector, the proportion accounted for by services, which is also the sector with a relatively low level of risk, rose further in 2003 having already been predominant. Trade continues to have the highest profile among services, its average risk falling to 7.36. The proportion accounted for by industry continues to rise, and the relatively high average risk in this sector also fell somewhat. In 2003 the proportion accounted for by households and non-residents fell, and the average risk of these two sectors (otherwise low) fell further.

Table 20: **Proportion of classified assets by sector and average credit risk of sector**

	31-Dec-01		31-Dec-02		31-Dec-03	
	Share %	Average risk	Share %	Average risk	Share %	Average risk
A. Industry	24.4	7.8	25.1	7.4	25.8	7.3
B. Services	44.0	5.0	43.8	5.6	44.7	5.3
C. Households	20.1	4.5	19.7	4.5	18.9	4.1
D. Non-residents	11.5	7.3	11.4	6.1	10.6	5.2
Total	100.0	5.9	100.0	5.9	100.0	5.6

Source: Bank of Slovenia.

[15] The average risk of assets means the size of the potential loss per 100 units of asset. It is calculated from the classification of assets in Categories A to E and is weighted with the percentage of provisions required for each category (A 1%, B 10%, C 25%, D 50% and E 100%).

Table 21: **Exposure to individual country groupings**

	31-Dec-01		31-Dec-02		31-Dec-03	
	SIT millions	%	SIT millions	%	SIT millions	%
EU	338,903	73.1	369,721	76.4	350,114	68.6
EFTA	26,387	5.7	25,586	5.3	30,927	6.1
Former Yugoslav republics	24,509	5.3	37,748	7.8	58,477	11.5
CEFTA	5,379	1.2	9,549	2.0	12,292	2.4
Others	68,302	14.7	41,407	8.6	58,872	11.5
Total	463,480	100.0	484,011	100.0	510,682	100.0
Share of non-residents	11.50%		11.40%		10.60%	

Source: Bank of Slovenia.

Exposure to non-residents 10.6% of total exposure

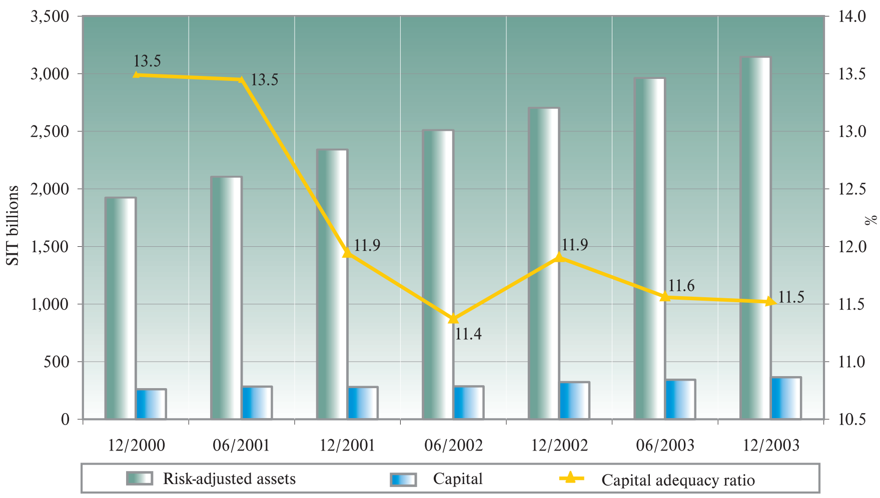
At the end of 2003 exposure to non-residents accounted for 10.6% of total exposure. EU member-states predominate in the composition of exposure to non-residents, accounting for 68.6% of total foreign exposure. There was a significant trend of decline in the proportion accounted for by exposure to EU member-states and an increase in the proportion accounted for by exposure to former Yugoslav republics and other countries (investments in the USA account for 45.8% of the exposure to other countries, while exposure to banks in Russia made a contribution to this increase in 2003).

3.2.5 Capital and capital adequacy ratio

Faster growth in risk-weighted assets than capital reducing capital adequacy ratio

Banks' capital as at 31 December 2003, calculated in accordance with the Regulation on capital adequacy of banks and savings banks, stood at SIT 364.3 billion, and represented a capital adequacy ratio of 11.5% on risk-adjusted assets of SIT 3,195.4 billion. Having risen for the first time in recent years to 11.9% in September 2002 and remained at this value until the end of December 2002, the capital adequacy ratio of the banking system as a whole again showed a steady fall in 2003, finishing the year 0.4 percentage points lower. The trend of a falling capital adequacy ratio is a result of faster growth in risk-adjusted assets than in capital. At the end of 2003 three banks declared a capital adequacy ratio of less than 10%, of which one failed to meet the prescribed ratio of 8%. An order to rectify the breach was issued to the bank, in line with which the bank must attain the required capital adequacy ratio by the end of April 2004.

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



Source: Bank of Slovenia.

Structure of capital remains stable

The structure of capital in 2003 was stable. The proportion of core capital remained at 84.5% of total capital at the end of the 2003 (and additional capital at 33.4%). Banks' capital rose by SIT 42.4 billion or 13.2% in 2003, with core capital rising by SIT 38.9 billion and additional capital rising by SIT 18.1 billion as subordinated debt and subordinated debt II (for covering capital requirements for market risk). The rise in core capital is the result of a rise in both share capital and capital reserves, and in the inclusion of profit reserves and the creation of provisions for general banking risks. The considerable reduction in deduction items (coverage of loss from previous years at one of the banks) also had a positive effect on the increase in core capital.

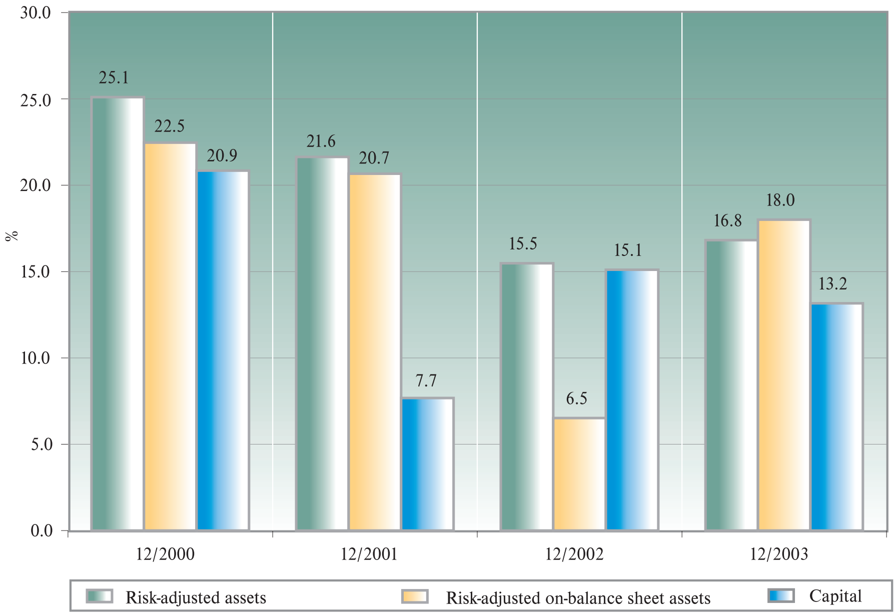
Deduction items 17.9% of capital

At the end of 2003 deduction items in the calculation of capital represented 17.9% of capital (compared with 15.7% in December 2002), having risen by SIT 14.7 billion or 29.0% during 2003.

Risk-adjusted assets grew by 16.8%

At the end of 2003 total risk-adjusted assets were SIT 3,195.4 billion, having risen by SIT 454.9 billion or 16.8% during the year. The increases in credit-risk-adjusted assets (SIT 349 billion or 14.8%), in currency-risk-adjusted items (SIT 46.7 billion or 28.1%) and in market-risk-adjusted assets (SIT 59.1 billion or 33.1%) were the largest contributions to this rise. The majority of the increase in credit-risk-adjusted assets of SIT 349 billion or 14.8% consisted of an increase in risk-adjusted assets (SIT 345.6 billion or 18%). At the end of the year the capital requirements for market risks had to be met by 15 banks for whom trading transactions were an average of 13.5% of all transactions. Trading items consist primarily of transactions in debt and equity securities (54.5%), while derivatives also account for a significant proportion of trading items (45.1%).

Figure 15: **Year-on-year changes in risk-adjusted assets and capital of banks**



Source: Bank of Slovenia.

Banking system used 69.4% of capital to cover capital requirements

At the end of 2003 the banking system used 69.4% of its capital to cover all capital requirements (compared with 67.2% in December 2002), but there were considerable differences between the individual banks. The earmarking of less than 50% of capital to cover all capital requirements was seen at just three banks.

3.3 Banking supervision

Ongoing supervision …

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

… in various areas of banking

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 amendment 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, and compile various written documents for bodies of the Bank of Slovenia. 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 an on-site examination of the bank or saving bank 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.

Strategic plan for supervising banking

The Banking Supervision Department's strategic plan for the 2000 to 2003 period envisages between seven and nine full-scope examinations of banking institutions and around 30 targeted examinations (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 other departments at 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 data.

Special attention given to consolidated supervision

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

On-site examinations of banks and savings banks…

In on-site examinations of banks and savings banks during 2003, 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 and other risks, implementation of the Consumer Loans Act, implementation of the Prevention of Money Laundering Act, corporate payment systems and information technology. In the first half of 2003 Bank of Slovenia inspectors also supervised banks' readiness to convert personal accounts into transaction accounts.

… 11 full-scope examinations and 25 partial examinations

In addition to 11 full-scope examinations (seven banks, one savings bank, and three savings and loan undertakings), there were 25 partial examinations undertaken on banks and savings banks (including savings and loan undertakings) and other companies in relation to specific areas of activity, excluding examinations of IT systems. Examinations of IT systems were included in full-scope examinations or were undertaken as independent examinations.

Most frequent irregularities at banks and savings banks

The most frequently identified irregularities at banks and savings banks were the following:

- nadequate 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 department,
- inadequate internal controls,
- failure to provide integral data on claims on and liabilities to an individual counterparty,
- inappropriate maintenance of accounts,
- deficiencies in IT support for banking transactions (ineffective management of projects to upgrade information systems, deficient IT staffing, 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, lack of reserve locations for computer centres for operation in states of emergency, inadequate virus protection),
- organisational shortcomings with regard to security and control of business operations,
- operational risks.

Most frequent irregularities at savings and loan undertakings

The most frequent irregularities at 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 maintenance of accounts,
- inadequate IT support for business operations with regard to security,
- excessive (concentrated) exposure to founders of savings and loan undertakings and to individual counterparties.

Twelve orders for correction of operating irregularities issued

The Bank of Slovenia used its legal powers to issue 12 orders for the correction of operating irregularities in 2003. There were also 12 orders issued in the area of IT.

Information passed on for initiation of criminal proceedings

In 2003 information was passed to prosecutors for the initiation of criminal proceedings against one savings and loan undertaking for fraud and deliberate bankruptcy, and one order was issued to a savings and loan undertaking in which the Bank of Slovenia required that it adopt a programme to rehabilitate its financial position.

Bank of Slovenia measures against Slovenska investicijska banka d.d.

In the first half of 2003 Bank of Slovenia inspectors focused much attention on the smallest Slovenian bank: Slovenska investicijska banka d.d. During a regular examination in November and December 2002 the inspectors again found considerable irregularities, and so on 14 January 2003 the Bank of Slovenia issued two orders setting the bank deadlines for rectifying the irregularities. Among the things required by the order was that the bank's supervisory board and management board convene a general meeting and propose a recapitalisation, as owing to inadequate provisioning the bank failed to meet the minimum capital adequacy ratio of 8% (Article 69 of the Banking Act) as at 30 September 2002. The bank's shareholders did not vote in favour of the recapitalisation at the general meeting on 27 February 2003.

In February 2003 the Bank of Slovenia issued two supplementary orders appointing its agents, and they maintained a constant physical presence at the bank between 20 February and 19 May, supervising its operations on a daily basis.

In parallel with the presence of the Bank of Slovenia agents at Slovenska investicijska banka, the sale of the majority interest of 78.8% in the bank, owned by Javno podjetje Energetika, was also carried out. The aforementioned company appointed a bank sale commission, and appointed auditors KPMG Ljubljana as the financial advisor for the sale. An appraisal of the bank's value was made by auditors Ernst & Young Ljubljana.

In April the banks that had submitted non-binding bids for purchasing the interest of 78.8% in Slovenska investicijska banka from Javno podjetje Energetika (namely NLB, NKBM, Abanka and Unicredito) had the opportunity to conduct their due diligence. Only one binding bid was received by the deadline for such bids of 9 May 2003. Javno podjetje Energetika sold its interest in Slovenska investicijska banka to NLB, to whom the Bank of Slovenia issued an authorisation for acquiring a qualifying shareholding. NLB also issued a letter of comfort guaranteeing that it would settle all of Slovenska investicijska banka's due liabilities itself should the latter be unable to.

A resolution on the voluntary liquidation of Slovenska investicijska banka d.d. was adopted on 29 December 2003. An order restricting the authorisation to provide banking and other financial services was issued to the bank.

Nine on-site examinations of companies suspected of engaging in activities without appropriate Bank of Slovenia authorisation

The Bank of Slovenia's supervisory powers extend to other persons suspected of providing banking services without authorisation from the Bank of Slovenia. In 2003, on the basis of referrals from relevant government institutions (primarily 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 nine on-site examinations of companies suspected of engaging in business activities without the appropriate Bank of Slovenia authorisation. The Bank of Slovenia reported one company to a misdemeanours judge.

Regular contact with management of banks and savings banks

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.

Cooperation with domestic regulatory institutions

The way in which the Bank of Slovenia works with the Securities Market Agency and the Insurance Supervision Agency is set out by Regulation on cooperation between regulatory authorities. On the basis of this Regulation a coordinating body has been established under the leadership of the Ministry of Finance, with the involvement of the Governor of the Bank of Slovenia, the president of the Securities Market Agency and, since September 2000, the president of the Insurance supervision Agency. The conclusion of memoranda of understanding between the regulatory authorities having been envisaged by the rules, memoranda of understanding between the Bank of Slovenia and the Securities Market Agency and between the Bank of Slovenia and the Office for Insurance Supervision at the Ministry of Finance were concluded in

November 1999. Because the Office for Insurance Supervision ceased to function, a new memorandum of understanding between the Bank of Slovenia and the Insurance supervision Agency was concluded in November 2000, and in February 2001 a further memorandum between the Securities Market Agency and the Insurance supervision Agency was concluded.

The memoranda set out the details of cooperation between the institutions and the way in which information is exchanged. The commission on cooperation between regulatory authorities, which meets once every three months, is responsible for implementing the memoranda between the regulatory authorities and the tasks adopted by the coordinating body. The commission consists of the Deputy-Governor of the Bank of Slovenia, the director of the Bank of Slovenia's Banking Supervision Department, the director of the Securities Market Agency and the director of the Insurance supervision Agency. In the majority of cases the regulatory authorities conduct their supervision independently, but they also work with the other two institutions by exchanging figures and information when preparing for an examination or when establishing the findings of an examination, all in line with the Regulation and the bilateral memoranda of understanding between regulatory authorities.

A prerequisite for the exchange of information is a commitment by supervisors to safeguard confidential information and to maintain commercial confidentiality as required by the Banking Act. The regulatory authorities are obliged to notify the other regulatory authorities of any irregularities they identify that concern the others' fields.

Among the important subjects discussed by the commission on mutual cooperation between regulatory authorities, in addition to ordinary supervisory and regulatory activities, was the possibility of establishing a single supervisory agency. A working group consisting of members of all three regulatory institutions was set up to this end, but its work was suspended because of recommendations by the IMF and the World Bank.

Cooperation with foreign regulatory agencies

To date the Bank of Slovenia has concluded memoranda of understanding with the following regulatory institutions:

- January 2000: the State of New York Banking Department (because LBS, a subsidiary of the largest bank in Slovenia, is no longer owned by the bank, the memorandum is no longer required),
- January 2001: Austria's Bundesministerium für Finanzen (the Austrian Federal Ministry of Finance, which on 1 April 2002 merged with other financial sector regulators to form the Austrian Financial Market Authority or Finanzmarktaufsicht),
- April 2001: Germany's Bundesaufsichtsamt fur das Kreditwesen (the Federal Banking Supervisory Office, which on 1 May 2002 merged with other financial sector regulators to form the German Financial Supervisory Authority or Bundesanstalt für Finanzdienstleistungsaufsicht),
- June 2001: the National Bank of the Republic of Macedonia,
- November 2001: Bosnia-Herzegovina's Banking Agency (a Bosnian Federation and Republika Srpska authority) and the Central Bank of Bosnia-Herzegovina,
- November 2001: the Bank of Italy,
- October 2002: France's Commission Bancaire (the French Banking Commission),
- August 2003: Belgium's Commission Bancaire et Financiere (the Banking and Finance Commission),
- October 2003: the Central Bank of Montenegro,
- December 2003: the Bulgarian National Bank.

A memorandum with the Serbian central bank is expected to be signed shortly.

On the basis of memoranda of understanding with foreign regulatory authorities an on-site examination was conducted at one of Nova Ljubljanska banka's foreign subsidiaries (LHB Internationale Handelsbank Aktiengesellschaft, Frankfurt am Main). Two interviews with representatives of foreign supervisors were also conducted as part of the on-site examination.

On-site examination primarily encompassed the control and governance mechanisms established between NLB and the subsidiary bank and between the subsidiary bank and its affiliated companies, the subsidiary bank's system of reporting to NLB for the purpose of drawing up reports in line with the Regulation on the supervision of banks and savings banks on a consolidated basis, lending, the creation of provisions and success in collecting bad assets, and briefings on other areas such as capital, internal audit, profitability and treasury operations.

4. FINANCIAL MARKETS

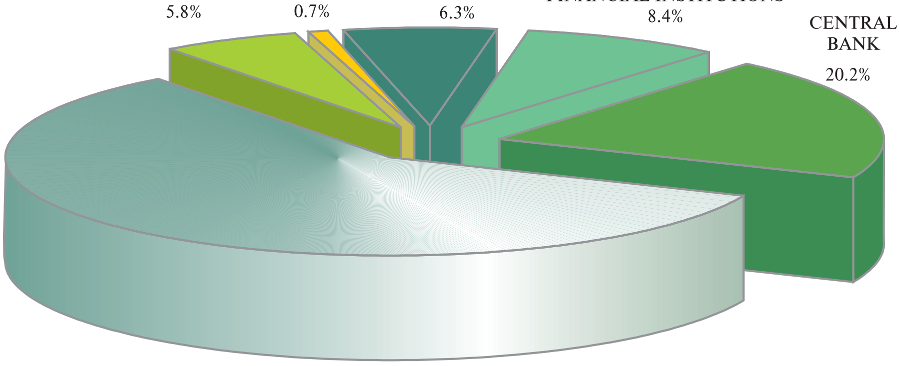
The Slovenian financial market is dominated by monetary financial institutions. **Non-monetary financial institutions** account for 21.3% of the total assets of the Slovenian financial system. At the end of 2003, the non-monetary financial institutions included 26 investment companies (including 18 privatisation funds), 20 mutual funds and 14 insurance companies (12 insurance agencies and 2 reinsurance companies). At the end of 2003 the pension providers included five mutual pension funds, four pension companies and three insurance agencies. Authorised securities market participants included ten banks and 17 investment firms.

Financial markets dominated by monetary financial institutions

Investment companies had total assets of SIT 346.1 billion at the end of 2003, down 26% from the end of 2002. In line with the Act Amending the First Pension Fund of the Republic of Slovenia and Transformation of Authorised Investment Corporations Act (the ZPSPID-A), privatisation funds had to convert into investment companies and/or ordinary public limited companies by the end of 2003. Those that failed to do so were placed under the administration of a management company, which had between six and 12 months to convert them. The total value of **mutual funds**' investments stood at SIT 93.1 billion at the end of 2003, up 68% from the end of 2002.

Prevalent among non-monetary financial institutions are investment companies…

Figure 16: **Financial intermediaries by total assets**



Note: Situation as at end of 2002.
Source: Bank of Slovenia.

Table 22: **Composition of Slovenia's financial system**

Total assets	2000 SIT millions	2000 %	2001 SIT millions	2001 %	2002 SIT millions	2002 %
Central bank	**768,889**	**14.6**	**1,141,031**	**17.4**	**1,601,506**	**20.2**
Monetary financial institutions	**3,195,182**	**60.7**	**3,954,031**	**60.4**	**4,623,220**	**58.4**
Non-monetary financial institutions	**1,299,075**	**24.7**	**1,454,685**	**22.2**	**1,686,306**	**21.3**
Authorised investment companies	566,937	10.8	548,096	8.4	462,552	5.8
Mutual funds	10,737	0.2	14,686	0.2	55,422	0.7
Insurance companies	321,823	6.1	391,088	6.0	501,683	6.3
Pension funds	-	-	8,123	0.1	22,526	0.3
Brokerage firms	23,177	0.4	19,936	0.3	22,826	0.3
Other	376,401	7.2	472,756	7.2	621,297	7.9
Total	**5,263,146**	**100.0**	**6,549,747**	**100.0**	**7,911,032**	**100.0**

Source: Bank of Slovenia.

… and insurance companies

Insurance companies are the largest group of non-monetary financial institutions. Gross effective premiums of insurance companies at the end of 2003 stood at SIT 314.7 billion and gross claims at SIT 196.9 billion, representing a claims-to-premiums ratio of 0.63. At the end of the year insurance companies had SIT 481.1 billion in investments in the financial market, predominantly in government securities and other debt securities.

209,000 persons already covered by voluntary supplementary pension insurance

There were 209,000 persons covered by **voluntary supplementary pension insurance** at the end of 2003 (62% via pension companies). In 2003 the pension companies and insurance agencies collected a total of SIT 17.1 billion in premiums from voluntary supplementary pension insurance, 38% more than in the previous year. The pension providers opted for a conservative investment policy. At the end of year 55% of their assets were invested in government securities and 18% in bank deposits.

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 2003 stood at SIT 1,926.1 billion and represented a rise of 20% on twelve months previously.

Primary securities market still relatively undeveloped

The **primary securities market** in Slovenia remains rather underdeveloped. In 2003 only one bank bond (of SIT 4 billion) was offered, while the Republic of Slovenia issued seven bonds with a total value of SIT 161 billion on the domestic market.

Largest groups of securities registered with KDD were…

… shares in non-financial companies (78%)

… and government bonds (83%)

At the end of December 2003 there were 1,033 securities of 869 issuers registered at the **Central Securities Clearing Corporation**, of which 913 were shares and 120 were bonds. The market value of shares registered at the Central Securities Clearing Corporation at year-end was SIT 3,829 billion (68% of GDP). By far the dominant share issuers were non-financial companies (78% of the total value), followed by banks (10%), other financial intermediaries (9%) and insurance agencies (3%). The largest group of shareholders were non-financial companies (29%), followed by consumers (20%), the government (18%), other financial intermediaries (18%), the rest of the world (13%), banks (4%) and insurance agencies (2%). The value of bonds registered at the Central Securities Clearing Corporation, by market or nominal value, stood at SIT 1,115 billion at year-end (20% of GDP). The most important bond issuer was the government (83% of the total by value), followed by banks (13%), non-financial companies (3%) and insurance agencies (1%). The main holders of bonds were banks (43%), then insurance agencies (25%), consumers (13%), the government (6%), non-financial companies (5%), other financial intermediaries (5%) and the rest of the world (3%).

Rise of 17.7% in SBI 20 and 23.5% in PIX

At the end of December 2003 there were 254 securities of 185 issuers being traded on the **Ljubljana Stock Exchange**, of which 162 were shares and 92 were bonds. Total market capitalisation rose by 12% in 2003 to SIT 2,442 billion, equivalent to 43% of GDP. Turnover during the year was SIT 340 billion, down 29% from 2002. Just over half of turnover was in block trades. The largest volume of transactions was in shares (44%), followed by bonds (38%) and investment companies (18%). The most heavily traded shares during 2003 were Krka, Petrol, Mercator, Gorenje and Pivovarna Laško. The SBI20, Slovenia's stock market index, rose by 17.7% and the privatisation fund index (the PIX) rose by 23.5% over the year. Among the sector indices, the biggest rise was in oil and gas (35%), followed by transport (33%), pharmaceuticals (23%), trade (19%), food and beverages (13%) and chemicals (8%).

Investments by non-residents in Slovenian securities

Investments by non-residents in Slovenian securities, primarily in treasury bills and bonds, totalled SIT 53 billion in 2003, but taking the fall in treasury bills into consideration the net inflow was just SIT 21 billion.

Investments by residents in foreign securities

Investments by residents in securities issued abroad: at the end of December 2003 residents held SIT 143 billion in investments in securities issued abroad by non-residents (60% of it in bonds) and SIT 57 billion in investments in securities issued abroad by residents. Residents held SIT 531 billion of debt securities issued on foreign markets, with the Republic of Slovenia having SIT 522 billion in outstanding eurobonds at year-end.

5. OTHER ACTIVITIES

5.1 Management of 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's reserves grew from EUR 6,781.4 million to EUR 6,879.0 million

In 2003 the Bank of Slovenia's reserves grew from EUR 6,781.4 million to EUR 6,879.0 million. 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 fell from EUR 2,523.8 million to EUR 2,502.5 million in 2003. Meanwhile the other portion of the reserves, own assets without foreign exchange liabilities, grew from EUR 4,186.3 million to EUR 4359.4 million. The rise was mainly accounted for by the outright purchase of currency from the temporary sale of foreign currency swaps. 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 EUR 53.0 million as at 31 December 2003.

Table 23: **Reserves and foreign exchange reserves of the banking system**

	BANK OF SLOVENIA							BANKS
	RESERVES					Including counter value of liabilities in foreign currency to residents*	Other foreign assets	Foreign exchange reserves of commercial banks
year-end EUR millions	Gold	SDR balances	Reserve position with at IMF	Foreign exchange	Total			
1994	0.1	0.1	15.3	1,206.5	1,222.0	708.0	84.2	1,046.0
1995	0.1	0.0	14.9	1,405.9	1,420.9	982.6	132.8	1,297.6
1996	0.1	0.1	14.9	1,837.9	1,853.0	1,032.4	27.2	1,488.4
1997	0.1	0.1	15.7	2,987.3	3,003.1	1,612.1	37.4	978.2
1998	0.1	0.2	55.8	3,048.5	3,104.6	1,580.3	40.0	1,031.2
1999	0.1	1.6	107.3	3,050.3	3,159.3	1,694.4	51.8	1,053.5
2000	0.1	4.0	88.5	3,343.3	3,435.9	1,862.8	62.4	1,361.2
2001	76.2	5.7	91.3	4,810.5	4,983.7	2,212.9	86.2	1,703.0
2002	79.9	6.7	115.9	6,578.9	6,781.4	2,523.8	81.3	1,263.2
2003	80.9	7.3	115.7	6,675.0	6,879.0	2,502.5	69.8	1,024.8

* Subscribed foreign currency bills and foreign currency accounts of banks and government at Bank of Slovenia.
Source: Bank of Slovenia.

Rules for managing reserves prescribed by Governing Board

The Governing Board of the Bank of Slovenia lays down basic rules on a quarterly basis for the management of the bank's reserves, separately for each type of risk. Under the criteria for managing credit risk, foreign exchange reserves 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 criterion for managing currency risk stipulates that all Bank of Slovenia liabilities in foreign currencies must be covered in full by claims in the same currencies. For the portion of reserves that do no have currency counter-items among the liabilities (the so-called net reserves), the currency mix and the permitted range of variation are precisely prescribed. The criterion for interest rate risk stipulates the average modified duration of foreign exchange reserves and prescribes the maximum allowable modified duration of an individual financial instrument. The criterion for managing liquidity risk divides foreign exchange reserves into segments according to their projected remaining maturity and prescribes a minimum level of liquid assets. The basic rules for managing the reserves also lay down the conditions for foreign currency operations, bond lending and other activities.

Change in rules allowed shift from eurodeposits to securities market

In 2003 there was a change in the direction of increasing liquidity, which resulted in a shift of investments from eurodeposits to the securities market. In the second half of the year there were also shifts in the currency mix of the net reserves, in the direction of greater diversification and a larger proportion of currencies that bring (with regard to the euro) less currency risk than the dollar, but also give a greater return than investments denominated in euros.

5.2 Payment transactions of Bank of Slovenia counterparties

5.2.1 Operations for government sector

Management of tolar accounts

Single treasury accounts

The Bank of Slovenia manages a government single treasury account and 193 municipal treasury accounts open in various currencies. The accounts of direct and indirect users of the state and municipal budgets, the Health Insurance Institute of Slovenia and the Institute of Pension and Disability Insurance of Slovenia, which are included in the single treasury account system as laid down in the Public Finance Act, are open as sub-accounts of the government or municipal treasury accounts. The sub-accounts are managed by the Public Payments Administration of the Republic of Slovenia, to which direct and indirect users of the state and municipal budgets present payment instructions and from which they receive the full set of return information regarding payment transactions performed.

In 2003 SIT 5,836.2 billion in inflows and the same in outflows were conducted through the government single treasury account and SIT 3,950.9 billion in inflows and SIT 3,951.6 billion in outflows through the municipal treasury accounts.

Special foreign currency accounts

In addition to the single treasury accounts the Bank of Slovenia also manages more than 110 special foreign currency accounts for the government and other budget users.

Portion of deposits from sale of share in NLB used to reduce Slovenia's external debt

Since October 2002 the Ministry of Finance has held tied assets at the Bank of Slovenia from the sale of the state's interest in NLB d.d. The ministry used a portion of these assets to reduce the external debt of the Republic of Slovenia, and kept the remainder as time deposits at the Bank of Slovenia.

Bank of Slovenia and Ministry of Finance contract on joint action on money market

The Bank of Slovenia and the Ministry of Finance have a signed contract on joint action on the money market. The purpose of the contract is to further develop the money market based on one-month treasury bills. Under this contract the ministry deposits the revenue from selling one-month treasury bills at the Bank of Slovenia and can use it to manage the liquidity of the budget. One-month treasury bills are sold at weekly auctions, and the total quantity of bills issued is SIT 20 billion.

Payment transactions with rest of world

Bank of Slovenia conducts payment transactions with rest of world and other foreign currency transactions for Slovenia

On the basis of the Foreign Exchange Act the Bank of Slovenia conducts 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 Managing Accounts of Direct and Indirect Users of the State and Municipal Budgets at the Public Payments Administration of the Republic of Slovenia stipulates that direct and indirect budget users who still had open transactions accounts or other accounts for foreign exchange transactions at commercial banks when the payment system reform was completed should continue to conduct payment transactions with the rest of the world through such accounts.

In 2003 the Bank of Slovenia made EUR 378.9 million worth of payments to the rest of the world and paid out EUR 6.7 million in cash. There was EUR 103.0 million in inflows from abroad, EUR 5.2 million in inflows of domestic commercial banks and EUR 1.7 million in foreign currency remittances. A total of EUR 327.0 million in foreign currency was sold to budget users and EUR 27.4 million in foreign currency was purchased from them. Analysis of the currency composition of inflows and outflows shows that 77.1% of inflows were in euros, 21.9% were in dollars and just 1.0% were in other currencies, while 84.2% of outflows were in euros, 11.0% were in dollars and 4.8% were in other currencies.

Fiscal stamps, securities certificates, notes and coins

The Bank of Slovenia undertook the preparation, issue, distribution and storage of commemorative coins and coins for circulation for the state.

New 500 tolar commemorative coin for European Year of the Disabled

The Bank of Slovenia issued 200,000 copies of a new bimetallic circulation-standard commemorative 500 tolar coin to mark the European Year of the Disabled. By the end of 2003, 442.7 million coins had been issued since 1993 (compared with 401.3 million at the end of 2002), worth SIT 1.9 billion (SIT 1.4 billion to the end of 2002). The quantity of coins in circulation rose by 10.3% in 2003, while coins account for 1.0% of the total value of cash in circulation (compared with an EMU average of 3.0%).

4,787 commemorative coins sold

In 2003 commemorative coins to mark the European Year of the Disabled (gold, silver and circulation-standard) and the 60th anniversary of the assembly of the Slovenian nation’s delegates in Kočevje (gold and silver) were issued. In total, 4,787 commemorative coins were sold at the Bank of Slovenia treasury and via commissioners (banks) last year, comprising 1,222 gold and 3,565 silver coins.

3,704 blocks of RS02 accepted

The Bank of Slovenia also undertook tasks with regard to the acceptance and processing of redeemed bonds and mature coupons. During 2003, 3,704 blocks of RS02 were accepted.

A total of 4,767 treasury receipts and outlays of tolar cash and 21,066 inward and outward payments of foreign currency for travel expenses and other needs of government bodies were undertaken (compared with 4,140 treasury receipts and outlays of tolar cash and 16,463 inward and outward payments of foreign currency in 2002).

5.2.2 Management of accounts for Central Securities Clearing Corporation

Cash leg of securities transactions in transaction accounts at Bank of Slovenia

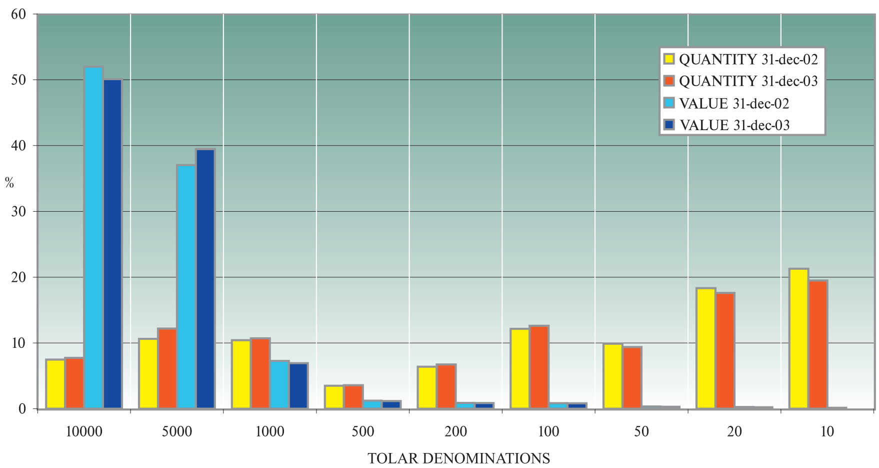
Settlement of the cash leg of securities transactions is accomplished via transaction accounts for customer funds and clearing accounts of members of the Central Securities Clearing Corporation (KDD), who are at the same time members of the payments and transfers system. At the end of 2003, 29 members of KDD, 11 commercial banks and 18 investment firms, had the aforementioned accounts open at the Bank of Slovenia. There were inflows of SIT 660.9 billion and outflows of SIT 658.0 billion via them in 2003.

5.3 Cash operations

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

As at 31 December 2003 there were 120.2 million banknotes in circulation with a total value of SIT 185.6 billion (including cash at banks). The value of banknotes in circulation rose by 8.1% from 2002 and the quantity in circulation by 0.5%. An overview of cash in circulation in the last seven years is presented in Table 24. At the end of 2003 banknotes represented 99.0% of cash in circulation by value and 21.4% by quantity. The most important denomination in terms of value is the 10,000 tolar note (representing 50.1% of the value of banknotes in circulation, compared with 52.0% in 2002), which together with the 5,000 tolar note (representing 39.5% by value, as against 37.0% in 2002) forms the backbone of cash transactions. The 1,000 tolar note is steadily losing significance in terms of both value and quantity (representing 6.9% of the value of banknotes in circulation, compared with 7.3% in 2002). A comparison of 2003 and 2002 in terms of the composition by value and quantity of banknotes in circulation is shown in Figure 17.

Figure 17: **Quantity and value of banknotes in circulation**



Source: Bank of Slovenia.

Counting unit handled 60.5 million banknotes

The Bank of Slovenia's money counting unit counted 60.5 million banknotes, of which 36.4 million were also sorted. A total of 36.0 million banknotes (compared with 24.3 million in 2002), of which the largest group was 9.0 million 1,000 tolar notes, were taken out of circulation and destroyed in order to maintain an appropriate quality of banknotes in use.

Cash supplied to country via Bank of Slovenia banknote depots

Tolar cash is supplied to the country through the Bank of Slovenia's banknote depots at five commercial banks, for whom the Bank of Slovenia sets a quarterly treasury maximum, checking their operations on a daily basis. Last year all the depots observed the rules of operation, and no irregularities were found.

Banknote prints

In 2003 there were 7 million 10,000 tolar notes, 10 million 1,000 tolar notes and 10 million 100 tolar notes printed because of higher demand for banknotes in cash circulation and to replace soiled and damaged notes.

Cash Supply

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.

The Bank of Slovenia banknote depots supplied cash largely through the ordinary cash 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 migration of legal persons' accounts to the banks, the banks take in and pay out all cash to legal persons. The banks receive cash from counterparties, 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.

1,189 counterfeit tolar banknotes examined by experts

At the Bank of Slovenia 1,189 examples of counterfeit tolar banknotes discovered and confiscated in Slovenian territory were examined by experts, compared with 520 in 2002. In this process the Bank of Slovenia worked with the Ministry of the Interior, the ECB, the EU, Interpol and Europol.

Table 24: **Cash in circulation**

SIT billions	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
2003	185.6	1.9	187.5

Note: Figures refer to situation as at 31 December.
Source: Bank of Slovenia.

Value of counterfeits confiscated rising

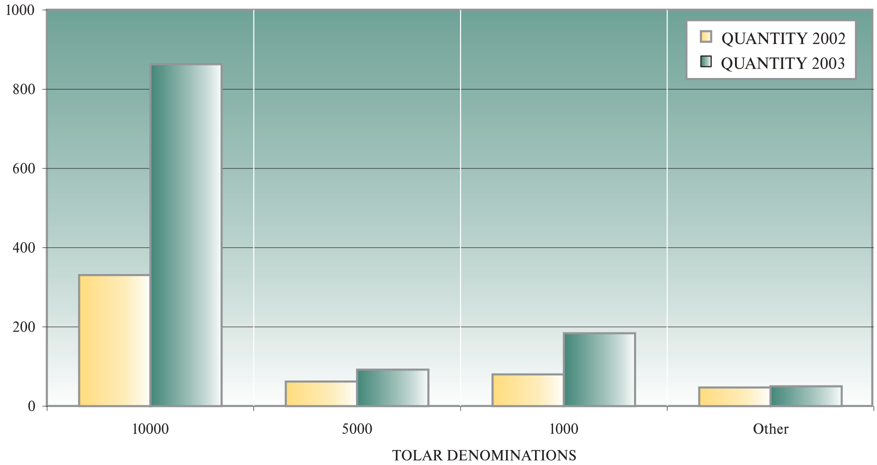
Between 1994 and 2003 the value of counterfeit Slovenian tolars confiscated rose (with the exception of 2002). The value of the counterfeits was negligible compared with the value of cash in circulation (0.0010‰ in 1994 to 0.0352‰ in 2001, 0.0214‰ in 2002, and a rise to 0.0495‰ in 2003). The total value of counterfeit Slovenian banknotes confiscated in 2003 was SIT 9.3 million (compared with SIT 3.7 million in 2002). The Ministry of the Interior sent the following to the Bank of Slovenia for examination: 863 examples of 10,000 tolar notes, 92 examples of 5,000 tolar notes, 184 examples of 1,000 tolar notes and 50 examples of other denominations. In comparison with the previous year the number of counterfeit 10,000 tolar notes rose by 160.7%, the number of 5,000 tolar notes by 48.4% and the number of 1,000 tolar notes by 130%. The quality of the tolar counterfeits in 2003 did not differ significantly from those found in 2002. Most common were counterfeits made using computer technology (scanners, computers, printers) or colour photocopying. The counterfeits were printed on commercial paper and in the majority of cases lacked the security features (watermark, colour fibres, security strip, fluorescent features). There were 9.89 counterfeits per one million notes in circulation (compared with a European average of 60), which places Slovenia in the middle group of European countries in this regard. A comparison of counterfeit tolar banknotes examined in 2002 and 2003 is given in Figure 18.

Most common counterfeits made using computer technology or colour photocopying

National Counterfeits Centre established

The National Counterfeit Centre was established at the Bank of Slovenia on 30 October 2003 as part of the Banknote Department.

Figure 18**: Tolar counterfeits handled in 2002 and 2003**



Source: Bank of Slovenia.

5.4 Payment systems

Completion of opening of personal TRRs

After the completion of the migration of the corporate payments to banks and the conversion of personal giro accounts into transaction accounts (TRRs), in the second half of 2002 the conversion of current accounts and savings deposits with the nature of personal inflow accounts into transaction accounts began. The legal deadline for the conversion of accounts was 30 June 2003.

Purpose of converting current accounts into single structure TRRs

The purpose of converting personal current accounts into standard TRRs was to prepare a standard platform for managing the accounts of all customers, irrespective of their status, and to integrate tolar and foreign currency payments, which together with the designation of an IBAN allows all customers to conduct domestic and international payments in a faster and more efficient manner.

Possibility of conversion without new contracts

Given the large volume of accounts it was necessary to convert, in order to ease the conversion of the accounts the Bank of Slovenia issued a resolution on payments via personal transaction accounts giving banks the possibility of converting the old accounts into transaction accounts without concluding new contracts.

Approximately 30,000 accounts remained unconverted because of difficulties

Despite the majority of banks upholding the aforementioned resolution, for a variety of reasons not all current accounts were converted by the legal deadline. Apart from a concurrent overhaul of applications support to allow integral customer handling, other reasons included an inability to obtain customers' tax numbers, which under current regulations are a compulsory item of data in the opening of transaction accounts at banks and the entry of accounts in the transaction accounts register at the Bank of Slovenia. Because of difficulties in obtaining tax numbers around 30,000 accounts remained unconverted at the end of 2003, which represents 1.5% of the total number of accounts subject to the conversion.

Oversight of payment systems

On the basis of the new Bank of Slovenia Act and the Payment Transactions Act (the ZPlaP), the Bank of Slovenia is responsible for payment systems oversight. The Bank of Slovenia Act gives it 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.

Aim: efficiency and security of payment system

The aim of oversight of the payment system is first to protect the financial system from the potential systemic consequences of one or more participants in the payment system facing financial difficulties, and second to ensure operational security and efficiency in the operation of the payment system. Oversight of the payment system focuses on the system itself and not individual participants in it.

Core principles…

In the majority of countries the central banks (including the ESCB) apply the uniform standards drawn up by a working group at the Bank for International Settlements in the oversight of the payment system, namely the Core Principles for Systemically Important Payment Systems. The Core Principles stipulate the minimum requirements to be fulfilled by all systemically important payment systems in a country, whereby the central bank rules on the (systemic) importance of a particular payment system. The Core Principles represent a guideline for carrying out oversight of the payment system, and in addition to requirements regarding the security and efficiency of the operation of the payment system the responsibilities of central banks for implementing the Core Principles are also given.

… as basis for overseeing payment systems

In line with the above the Governing Board of the Bank of Slovenia adopted a resolution in May confirming the Core Principles as the basis for the specialist staff at the Bank of Slovenia for overseeing the payment system. It also adopted a resolution stating that the RTGS system alone is recognised in Slovenia as a systemically important payment system, and will thus have to fulfil all the Core Principles, and that as the manager of the Giro Clearing system the Bank of Slovenia will have to ensure that all the principles are also fulfilled in this system. The Bank of Slovenia will ensure that all other interbank payment systems are in line with the guidelines of the Core Principles, and in so doing the requirements regarding fulfilment of the Core Principles will be adapted to the features and characteristics of the individual payment systems.

Adaptation of existing payment systems in Slovenia to requirements of legal basis

Harmonisation with legal basis by end of March 2004

On the basis of the ZPlaP and in line with the decision on settlements between providers of payment services (the settlements decision), managers of existing payment systems are obliged to harmonise with the requirements of the aforementioned legal basis by the end of March 2004.

The intermediate deadlines for harmonising with the requirements are given in the settlements decision itself, and thus managers of payment systems were obliged to produce documentation of the existing way in which settlements between providers of payment services are carried out in the payment system by the end of March 2003, and to produce documentation harmonised with the ZPlaP and the settlements decision by the end of June 2003.

On this basis and on the basis of an informational examination of the managers, the Bank of Slovenia issued requirements to the managers by the end of October for organisational and technical adaptations of the payment systems that referred in part to the formal conditions regarding documentation and the formulation of rules for the payment system, and in particular to the management of financial and operational risk. The managers of payment systems must constantly update the Bank of Slovenia regarding their progress in fulfilling the individual recommendations until the end of March 2004 or until full harmonisation with the requirements.

Integrated system for low-value payments

Integration of low-value payment systems

The Payment Services Committee, set up in October 2002 on the basis of the memorandum of understanding with regard to the processing of low-value payments, continued its work in 2003 in the integration of low-value payment systems in Slovenia.

Two possibilities of integration:
- upgrade to existing system (Bankart)
- creation of new entity

In this context a concept was drawn up in June for the creation of a clearing house, raising two possibilities, namely an upgrade to the existing system (Bankart), or the formation of a new legal person. In order to study the two possibilities in detail, particularly in terms of time feasibility and costs, the Bank of Slovenia published a call for bids, sending an invitation to draw up a study of the creation of a clearing house to two potential bidders. The Payment Services Committee discussed the studies at its October session together with a report on the existing payment systems and payment schemes in Slovenia.

More attention to upgrade of existing payments schemes (Bankart)

Subsequently attention was focused on analysing the possibility of upgrading the existing payment schemes within the framework of the collection centre (Bankart) into payment systems. The details were presented at the Payment Services Committee session in December, and activities proceeding from this and partly also within the process of harmonising existing payment systems on the basis of the settlements decision will continue in 2004.

In 2003 the Payment Services Committee also discussed information regarding activities in the area of setting up a single payments area for payments in euros (SEPA – the Single Euro Payments Area), particularly in relation to the connection of Slovenia to the pan-European payment systems TARGET (for high-value payments) and STEP2 (for low-value payments).

Pan-European payment systems (TARGET and STEP2)

Connection to TARGET and STEP2 system dependent on banks' interest and on Slovenia's entry into EMU

From the point of view of Slovenia's imminent entry into the European Union, in 2003 the Bank of Slovenia commenced preparation of the guidelines for connection to the pan-European payment systems TARGET and STEP2. The decision on how and when Slovenia is connected to the TARGET and STEP2 systems also depends on the interest of banks in participating in these systems and on Slovenia's date of entry into EMU.

TARGET – system for interbank settlement of cross-border payments in EU in real time

TARGET (Trans-European Automated Real-Time Gross Settlement Express Transfer System) is the system for interbank settlement of cross-border payments in euros in the EU in real time, and began operating on 1 January 1999. The TARGET system consists of 15 national systems for real-time gross settlement (RTGS) and the ECB system, which are linked to allow cross-border payments to be executed. The objective of the system is to provide support for the implementation of monetary policy in the Eurosystem and to ensure that payments are executed securely, reliably and efficiently, with the fundamental aim of contributing to integration and the stability of the euro money market.

System participants are banks of EU member-states

Banks from EU member-states participate in the TARGET system. Banks that participate in individual national RTGS systems send domestic payments (payments where the sending bank is from the same country as the receiving bank) and cross-border payments (payments where the sending bank is from one country and the receiving bank is from another, but both countries are members of the TARGET system) into the system. Domestic payments are settled within the individual national RTGS system, while cross-border payments are settled between the systems connected to TARGET.

When they join the EU, connection to the TARGET system will become a pressing issue for all the acceding countries, Slovenia included. Here it should be emphasised that when they join the EU these countries acquire the right, but not the obligation, to participate in the system, but they must become members of the TARGET system when they join EMU. The ESCB has begun preparations for setting up the next generation of the TARGET system (TARGET2), which should allow the new countries to join smoothly.

Countries joining EU acquire right, not obligation, to participate in TARGET system

The Regulation on Cross-Border Payments in Euro (2560/2001/EC), which requires the cost of services of executing domestic and cross-border low-value payments in euros to be equalised (it currently applies to payments of up to EUR 12,500, but later will apply to payments of up to EUR 50,000), has also dictated changes in the European payments infrastructure for low-value payments.

With entry into EMU participation becomes obligatory

It was in this context that the EBA (Euro Banking Association), which since 1999 has gradually been developing and managing the pan-European payment systems for payments in euros (EURO1 for high-value payments and STEP1 for low-value payments), set up the STEP2 system. This system, which also represents a first step to establishing a pan-European clearing house, allows mass low-value payments in euros to be processed automatically, and thus allows the costs of cross-border payments in euros to be reduced or equalised with the cost of domestic payments.

STEP2 – low-value payment system

The system is also important for banks in Slovenia, as the ECB requires all banks from acceding countries to allow the receipt of payments and thus to be accessible via this system by the end of 2004. The subject was discussed in December by the Payment Services Committee. Having taken the projected low volume of payments and the relatively high costs of direct participation in the system into consideration, the banks favoured setting up common entry points to allow neutral access to the system for all banks.

By the end of 2004 all banks must be accessible via this system

Assessment of securities settlement systems against the ECB standards for use in ESCB credit operations

In 2003 the central banks of the EU acceding countries, in conjunction with the ECB, conducted an assessment of securities settlement systems in the acceding countries compared to the Standards for the Use of EU Securities Settlement Systems in ESCB Credit Operations, which set out framework for risk management in the settlement of domestic and cross-border securities transactions. All securities settlement systems in which assets (securities) suitable for securing ESCB credit operations are booked must be harmonised with these standards.

The final objective of the assessment was to ensure that these systems are suitable for use in ESCB credit operations.

Objective: systems suitable for use in ESCB credit operations

The ECB's general finding is that there are no deficiencies in the majority of securities settlement systems in the acceding countries that would present a serious obstacle to their entry into EMU. The assessment given to the two Slovenian securities settlement systems (the Central Securities Clearing Corporation system and the system for settling transactions in central bank bills in foreign currency at the Bank of Slovenia) is positive, so after the implementation of the ECB recommendations the two systems will be suitable for carrying out ESCB operations.

No deficiencies in acceding countries

New features in payment systems managed by Bank of Slovenia

In 2003 a new method for the Bank of Slovenia to access the SWIFT network, which is used for communication in the RTGS system, was introduced. The introduction of

New services in upgraded SWIFT network

the new method was requested by SWIFT (the network manager), and the main reason for the request was the upgrade of the entire network currently being carried out by the company. Even though the SWIFT request was of a purely technological nature, when introducing the new method the Bank of Slovenia also set up infrastructure that allows the use of the new services already offered by SWIFT on the upgraded SWIFT network. SWIFT is offering new services in the area of secure access to remote databases, particularly in the area of low-value payment systems.

Software and hardware upgrade for RTGS system…

… to allow simultaneous operation at reserve location

Activities related with ensuring and maintaining the secure operation of payment systems took place in 2003. In January 2003 the RTGS system was upgraded with new version software, and the hardware was also upgraded in line with this. The upgrade changed the basis for the operation of the RTGS system to allow a RTGS back-up system to operate simultaneously at a reserve location. In addition the hardware is duplicated at the primary and reserve locations, which allows functions and operations to be transferred quickly in the event of technical problems in any of the components. The essence of the upgrade was that each transaction in the RTGS system is also recorded at the reserve location. In the event of any major problems at the primary location, it will therefore be simpler and quicker to establish the operation of the RTGS system at the reserve location, and the risk of data loss will be significantly lower. The hardware in the Giro Clearing system was similarly upgraded to allow operation at the reserve location to be established simply and quickly in the event of problems at the primary location.

Reserve centre reduces risk

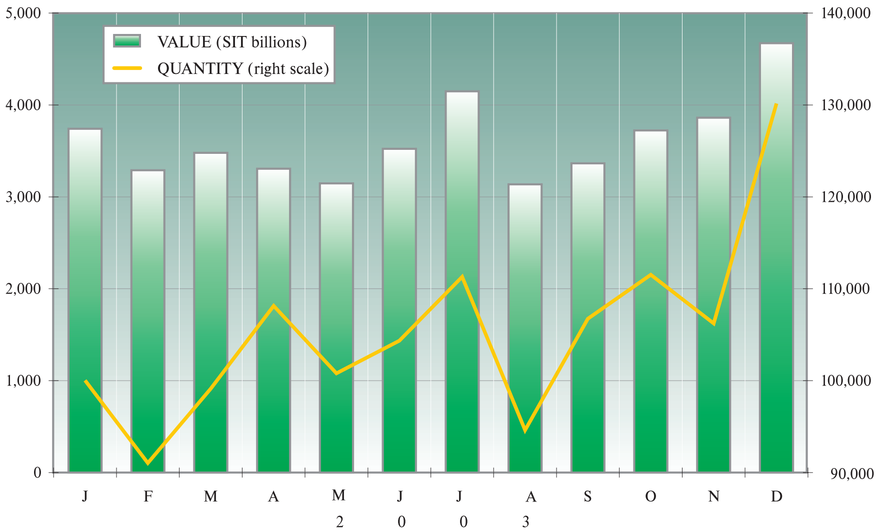
By setting up the reserve centre the Bank of Slovenia has reduced operational risk for business processes in the management of payment systems and is ensuring that international BS 7799 security standard is met.

Payment systems statistics

RTGS system settled more than 1.26 million transactions

In 2003 there were 1,264,074 transactions settled via the RTGS system in a total amount of SIT 43,391.2 billion, a fall of 6.5% in the volume of transactions but a rise of 8.1% in value from 2002. An average of 5,036 transactions were settled each day, with an average value of SIT 34.3 million per transaction.

Figure 19: **Payment transactions in the RTGS system in 2003**



Source: Bank of Slovenia.

Giro Clearing second most important payment system

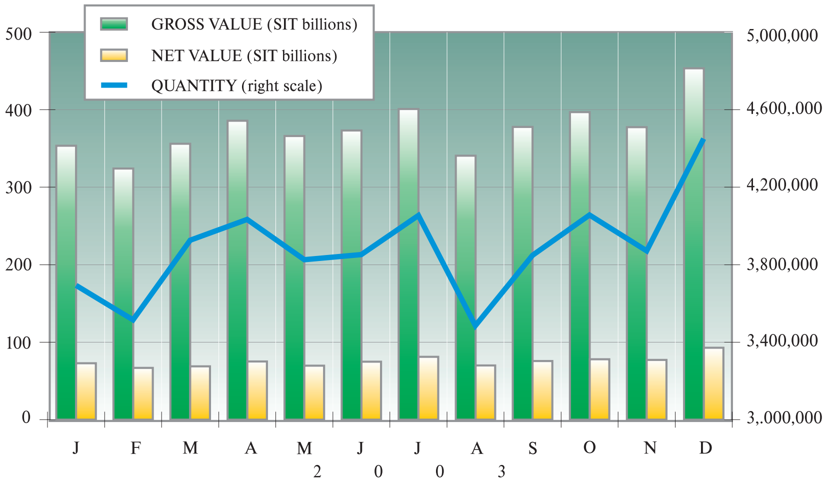
As the second most important interbank payment system, the Giro Clearing system (intended for payments of up to SIT 2 million) handled 46,613,463 transactions in 2003, in a total value of SIT 4,505.7 billion, a fall of 7.7% in volume and a rise of 1.0%

in value from 2002. The value of net settlements of these payments in central bank money via the RTGS system was SIT 902.5 billion or 20.0% of the gross value of transactions, implying a netting ratio as high as 80.0%. On average 185,711 transactions were processed daily, SIT 96,661.45 being the average value.

Two systems settled almost 48 million transactions in total

The total number of transactions settled through the two systems in 2003 was 47,877,537, of which 2.64% were processed through the RTGS system and 97.36% through the Giro Clearing system (compared with 2.61% and 97.39% respectively in 2002). The total value of transactions through the two systems in 2003 was SIT 47,896.9 billion, of which the RTGS system accounted for 90.59% and the Giro Clearing system 9.41% (compared with 90.00% and 10.00% respectively in 2002).

Figure 20: **Payment transactions in the Giro Clearing system in 2003**



Source: Bank of Slovenia.

5.5 Statistical system

Bank of Slovenia among institutions responsible for statistical research

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. Statistical work in 2003 was shaped partly by major economic and information-related changes, and in particular by changes in connection with entry to the 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 statistics, 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 companies 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 accounts statistics

The Bank of Slovenia issued secondary legislation in the field of financial accounts statistics in 2003, based on which the first direct annual reporting of data for these purposes was carried out in the autumn. All domestic institutional units were included in the reporting, with the exception of units in sector S14 (households) and S15 (not-for-profit household service providers) according to the Standard Classification of Institutional Sectors. The reports for financial accounting statistics were gathered by the Agency for Public Records and Services, which also provided for the relevant application solutions and the technical instructions for reporting. The Ministry of Finance, the Slovenian Institute of Auditors and the Insurance supervision Agency also participated in the design of special substantive instructions, and these are published on the Bank of Slovenia's website. The data from direct reporting will serve as a source for compiling the first annual financial accounts for 2002 in accordance with ESA95, which is the methodological basis for compiling national accounts, of which financial accounts form part. On the basis of its experience in compiling annual financial accounts the Bank of Slovenia will begin planning and upgrading the compilation of the quarterly financial accounts required by the ECB by introducing direct quarterly reporting of data for the purposes of financial accounting statistics.

In the area of monetary statistics, the calculation of Slovenia's monetary aggregates was adjusted to ECB methodology, and the project to bring bank data into line with the statistical requirements of Slovenia's future membership of the European Monetary Union was continued. In 2003 the Bank of Slovenia also began publishing data on the external debt according to the new international standard.

The methodological basis for these statistics are the standards of the IMF and increasingly, with the aim of adapting to the acquis communautaire, the methodology employed by the ECB and Eurostat.

Release of statistical data on website …

The Bank releases data on its website in accordance with the IMF's Special Statistical Data Dissemination Standards for Slovenia. The data is prepared in conjunction 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. Upholding these standards enhances macroeconomic accountability, permitting early identification of financial problems, and is therefore important in gaining access to international financial markets.

… in publications and at press conferences

The main financial and macroeconomic data for Slovenia appears 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. Since 2001 it has released balance of payments figures at monthly press conferences in addition to the other channels. The Bank also sends statistical data to the IMF, the ECB and Eurostat, with the package of data for the ECB gradually becoming the most important in terms of size and complexity.

Participation in Eurostat and ECB working groups and seminars

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

IMF quota remains SDR 231.7 million

Slovenia's quota at the 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 2003 Slovenia contributed

SDR 7.5 million to the FTP for Bolivia, SDR 16.5 million for Uruguay and SDR 1.9 million for Indonesia, and received a total of SDR 16.7 million in repayments on IMF loans to Romania, Uzbekistan, Papua New Guinea, Jordan and Turkey made under the FTP for past years. At the end of December 2003 Slovenia's reserve tranche position at the IMF stood at SDR 97.3 million (EUR 114.5 million).

The 2003 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 the same month.

European Central Bank

Strengthening of ties with ECB

In 2003 the ECB further strengthened its bilateral and multilateral ties with the central banks of the acceding countries. The Bank of Slovenia co-operated with the ECB in relevant areas of central banking, legislation in connection with economic and monetary union, statistics and payment systems.

Bank of Slovenia representatives acquire observer status at meetings of the:
- General Council of the ECB
- ESCB committees and working groups

With the signing of the Accession Treaty in April, Bank of Slovenia representatives acquired observer status at meetings of the General Council of the ECB and of the committees and working groups of the ESCB (the ECB and the national central banks of EU Member-States). The Governor of the Bank of Slovenia first attended the meeting of the General Council of the ECB as an observer in June 2003, while Bank of Slovenia representatives began attending ESCB committee and working group meetings. Cooperation with the acceding countries' central banks in preparations for the enlargement of the ESCB was thus strengthened. Bank of Slovenia representatives also attended seminars and workshops organised by the ECB.

ECB report on the status of legal preparation of acceding countries

In 2003 the ECB again updated its report, first produced in 2000, on the status of the legal preparation of the acceding 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 that have introduced the euro). The report analyses the adoption and implementation of the acquis communautaire, primarily concerning central bank independence, other legislation with regard to the monetary field, and legislation on the banking sector and financial markets.

Acceding countries' exchange rate policy as a matter of common interest after EU entry

In December 2003 the ECB published the policy position of the Governing Council of the ECB on exchange rate issues relating to the acceding countries. After joining the EU the new Member-States are required to treat their exchange rate policy as a matter of common interest. New Member-States will join the EU with a derogation regarding the introduction of the euro, which means that they will not immediately adopt the euro after joining the EU, but must work towards final adoption of the euro when all the convergence criteria for the introduction of the euro are met.

European Union

Transitional periods …

… for free movement of services

… for protection of scope of deposit-guarantee scheme at banks

The Bank of Slovenia continued to cooperate in the review of the harmonisation of Slovenian law with the acquis communautaire and the preparation of additional negotiating positions with regard to the free movement of services, the free movement of capital, economic and monetary union, and institutions. Although negotiations on Slovenia's accession to the EU were concluded in December 2002, it was necessary to prepare a review of the harmonisation of Slovenian law with the acquis communautaire that was adopted after the negotiations were concluded. With regard to free movement of services, a transitional 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 has adopted the acquis communautaire for the free movement of capital and economic and monetary union. When it joins 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 General Council of the ECB, 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 Governing Council of the ECB.

… and for investment compensation scheme at investment firms

Introduction of euro as ultimate goal

The Bank of Slovenia participated in the drafting of the final annual report on Slovenia's progress towards accession and in the preparation of the Pre-Accession Economic Programme for 2003.

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

With the signing of the Accession Treaty in April, Bank of Slovenia representatives were invited as observers to meetings of committees, working groups and other bodies that function within the framework of EU institutions. They attended some meetings of the Economic and Financial Committee and its subcommittees, meetings of the Bank Advisory Committee and its working groups, and meetings of working groups within the European Financial Conglomerates Committee.

Others

In 2003 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 financial statements (statement of income and expenditure, balance sheet, statement of changes in equity, statement of cash flows and notes to the financial statements) of Bank of Slovenia for the year ended December 31, 2003, as set out on pages 77 to 95 ("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 audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with standards promulgated by the Swiss profession and with the International Standards on Auditing, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS).

PricewaterhouseCoopers Ltd

A. Schönenberger K. Morscher

Zürich, 1. April 2004

Statement of income and expenditure

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

	Notes	2003	2002
Operating income:			
Interest income	4	**74,978**	61,677
Interest expenses	5	**67,841**	42,321
Net interest income		**7,137**	19,356
Net foreign exchange gain/loss		**-16,593**	-8,588
Gain (loss) from unrealized price revaluation of securities		**-8,996**	9,365
Gain from unrealized gold revaluation		**740**	1,550
Net investment income		**-17,712**	21,684
Fee and commission income		**1,660**	1,793
Fee and commission expense		**426**	406
Net fee and commission income		**1,234**	1,387
Other operating income		**322**	382
Total operating income		**-16,156**	23,452
Operating expenses	6	**4,971**	4,396
Provisions and write-offs	7	**704**	498
Operating surplus available for appropriation		**-21,830**	18,558
Appropriations:			
Transfer/Release to special reserves for foreign exchange differences		**-16,593**	-8,588
Transfer/Release to special reserves – price risks		**-8,256**	10,915
Financial results after the appropriation of net foreign exchange gain/loss and gain (loss) from unrealized price revaluation		**3,019**	16,231
Transfer to general reserves		**2,264**	12,173
Total transfer to reserves	13	**-22,585**	14,500
Provision for transfer of surplus to the budget of RS		**755**	4,058
Total appropriations		**-21,830**	18,558

The notes on pages 81 to 95 form an integral part of the financial statements.

Balance sheet

at 31 December (in millions of tolars)

	Notes	**31.12.2003**	31.12.2002
Assets			
Financial assets			
Foreign currency assets			
Gold and gold receivables	8	**19,143**	18,403
Cash and deposits		**400,209**	592,862
Derivative financial instruments	9	**48**	328
Investment securities available for sale		**1,190,216**	927,375
Receivables from the Republic of Slovenia		**7,175**	7,668
International Monetary Fund		**29,130**	28,221
Accrued interest and other assets		**23,554**	13,605
Total		**1,669,475**	1,588,462
Domestic currency assets			
Due from banks		**9**	18
Reverse – repo agreements		**-**	1,148
Accrued interest and other assets		**1,254**	2,089
Total		**1,263**	3,255
Fixed assets	10	**3,106**	3,094
Total assets		**1,673,844**	1,594,812
Liabilities and reserves			
Serviced liabilities			
Foreign currency liabilities			
Current accounts and deposits to banks		**41,059**	30,545
Bank of Slovenia bills		**555,260**	552,952
IMF and other international financial organisations		**5**	7
SDR allocation	11	**7,156**	7,643
Accrued interest and other liabilities		**1,278**	131
Total		**604,758**	591,278
Domestic currency liabilities			
Current accounts and deposits		**100,818**	89,804
Overnight deposits		**8,170**	18,360
Bank of Slovenia bills		**472,330**	375,636
Republic of Slovenia deposits		**109,674**	134,793
Accrued interest and other liabilities		**13,971**	8,915
Total		**704,963**	627,508
Banknotes in circulation	12	**186,042**	172,056
Provision for transfer of surplus to the budget of RS		**755**	4,058
Total liabilities		**1,496,517**	1,394,900
Capital and reserves	13	**177,327**	199,912
Total liabilities and reserves		**1,673,844**	1,594,812

The notes on pages 81 to 95 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 2001	**-**	**53,246**	**132,165**	**-**	**185,411**
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**
Arising in the period					
Operating surplus	-	-	-	-21,830	-21,830
FX gains/losses	-	-	-16,593	16,593	-
Transfer/Release to special reserves -price risk	-	-	-8,256	8,256	-
Operating surplus retained in general reserve	-	2,264	-	-2,264	-
Provisions for transfer to RS	-	-	-	-755	-755
Total movement	-	2,264	-24,849	-	-22,585
Balance at 31 December 2003	**2,000**	**58,145**	**117,181**	**-**	**177,327**

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

The notes on pages 81 to 95 form an integral part of the financial statements.

Statement of cash flow

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

	Notes	**2003**	2002
Cash flows from operating activities			
Interest received		**66,077**	60,319
Interest paid		**-69,124**	-35,886
Other		**-3,055**	-1,992
Net cash flow from operating activities		**-6,101**	22,441
Cash flows from investing activities			
Purchase of securities		**-1,200,709**	-1,248,148
Proceeds from sale of securities		**913,496**	911,919
Purchase of time deposits		**-16,193,578**	-14,695,325
Proceeds from redemption of time deposits		**16,388,715**	14,588,360
Loans and reverse repo to domestic banks		**-62,909**	-332,175
Repayment from domestic banks		**64,066**	331,447
Purchase of fixed assets		**-287**	-806
Proceeds from sale of fixed assets		**18**	63
Net cash flow from investing activities		**-91,188**	-444,664
Cash flows from financing activities			
Issue of banknotes in circulation		**13,985**	6,278
Issue of Bank of Slovenia bills	17	**5,819,155**	5,619,908
Repayment of Bank of Slovenia bills	17	**-5,720,375**	-5,295,401
Republic of Slovenia deposit		**-11,573**	114,041
Other, net		**-4,528**	-1,808
Net cash flow from financing activities		**96,664**	443,018
Exchange rate effect		**52**	459
Net cash flow from all activities		**-574**	21,254
Cash and cash equivalents at beginning of year		**-114,345**	-135,599
Cash and cash equivalents at end of year	18	**-114,919**	-114,345
Increase (decrease) in cash and cash equivalents		**-574**	21,254

The notes on pages 81 to 95 form an integral part of the financial statements.

These financial statements were approved by the Governing Board on 1. April 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 to resell (reverse repos) are recorded 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 future cash flow, including amounts recoverable from guarantees and collateral discounted on the basis of the effective 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 comprise bills in domestic currency and bills in either EUR or USD. Tolar 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 indipendent 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 are 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.

4 Interest income

	2003 SIT millions	2002 SIT millions
Interest income from foreign currency		
Income on gold assets	**40**	64
Interest on deposits	**11,257**	17,707
Income on investment securities	**40,278**	27,935
Interest on International Monetary Fund deposits	**414**	538
Total	**51,989**	46,243
Interest income from domestic currency		
Interest on loans to banks	**55**	88
Interests from Reverse – repo agreements	**107**	31
Swap gains	**22,827**	15,315
Total	**22,989**	15,434
Total interest income	**74,978**	61,677

Income on investment securities consists of the following:

	2003 SIT millions	2002 SIT millions
Interest income	**39,812**	26,485
Gains less losses from investment securities on sale	**466**	1,449
Total investment income on marketable securities, net	**40,278**	27,935

5 Interest expenses

	2003 SIT millions	2002 SIT millions
Interest expenses on foreign currency		
Interest on current accounts and deposits	**302**	843
Interest on Bank of Slovenia bills	**12,158**	16,594
Total	**12,460**	17,437
Interest expenses on domestic currency		
Interest on current accounts and deposits	**897**	815
Interest on overnight deposits	**81**	288
Interest on Republic of Slovenia deposits	**9,241**	3,083
Interest on Bank of Slovenia bills	**45,162**	20,697
Total	**55,382**	24,884
Total interest expenses	**67,841**	42,321

6 Operating expenses

	2003 SIT millions	2002 SIT millions
Staff costs	**2,937**	2,582
Administration costs	**1,535**	1,519
Printing and minting costs	**289**	184
Other	**209**	111
Total operating expenses	**4,971**	4,396

The Bank employed 394 employees on 31 December 2003 (2002: 391 employees).

In accordance with the contract between the Bank and Trade union from March 2002 Bank employees have been included into Voluntary supplementary pension insurance with their participation, which is defined as a contribution plan. Staff costs include contribution of the Bank for Voluntary supplementary pension insurance of SIT 58 million (2002: SIT 39 million).

In 2003 the remuneration of the Governing board members of the Bank were of SIT 127 million (2002: SIT 129 million)

7 Provisions and write-offs

	2003 SIT millions	2002 SIT millions
Due to financial institutions	**4**	-2
Contingent liabilities	**700**	500
Total provisions	**704**	498

8 Gold and gold receivables

	2003 SIT millions	2002 SIT millions
Gold	**42**	40
Gold deposits	**19,101**	18,363
Total gold and gold receivables	**19,143**	18,403

9 Derivative financial instruments

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements in 2002 and in 2003 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:

	2003		2002	
	Fair value	**Notional amount**	Fair value	Notional amount
	SIT millions			
Foreign exchange swaps to be received forward against EUR	**48**	**503,748**	328	542,233
Total derivative financial instruments	**48**	**503,748**	328	542,233

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 2002	2,732	2,297	5,029
Additions	136	687	823
Disposals	-	-256	-256
At 1 January 2003	2,869	2,727	5,596
Additions	46	314	360
Disposals	-	-249	-249
At 31 December 2003	**2,915**	**2,792**	**5,707**
Depreciation			
At 1 January 2002	596	1,825	2,421
Disposals	-	-243	-243
Charge for the year	21	302	323
At 1 January 2003	617	1,884	2,501
Disposals	-	-248	-248
Charge for the year	22	326	348
At 31 December 2003	**640**	**1,962**	**2,602**
Net book value			
At 31 December 2003	**2,275**	**830**	**3,106**
At 31 December 2002	2,251	843	3,094

Included in land and buildings at 31 December 2003 and 2002 is an amount of SIT 1,115 million relating to investment properties in Austria.

Amounts included in income statement:

	2003 SIT millions	2002 SIT millions
Rental income from investment properties	**190**	182
Direct operating expenses	**139**	130
Total income from investment properties	**51**	52

11 SDR allocation

	2003 SIT millions	2002 SIT millions
SDR allocation	**7,156**	7,643
Total SDR allocation	**7,156**	7,643

The SDR allocation liability carried an interest rate of 1.57% at 31 December 2003 (2002: 1.91%). 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:

		2003 SIT millions	2002 SIT millions
SIT	10	**234**	255
SIT	20	**423**	439
SIT	50	**563**	591
SIT	100	**1,516**	1,454
SIT	200	**1,619**	1,527
SIT	500	**2,151**	2,087
SIT	1,000	**12,871**	12,480
SIT	5,000	**73,253**	63,562
SIT	10,000	**93,005**	89,255
Total		**185,636**	171,651
Tolar coupons		**405**	405
Total		**186,042**	172,056

13 Reserves

	2003 SIT millions	2002 SIT millions
Balance at 1 January	**199,912**	185,411
Transfer from general reserve	**-**	-2,000
Constitution the initial capital of the Bank of Slovenia	**-**	2,000
Transfer/Release to special reserve for foreign exchange differences	**-16,593**	-8,588
Transfer/Release to special reserve – price risk	**-8,256**	10,915
Transfer to general reserve	**2,264**	12,173
Balance at 31 December	**177,327**	199,912
Represented by		
Initial capital of the Bank of Slovenia	**2,000**	2,000
Special reserve for foreign exchange differences	**106,985**	123,578
Special reserve – price risk	**10,196**	18,452
General reserve	**57,031**	54,767
Investment properties revaluation	**1,115**	1,115
Total reserves	**177,327**	199,912

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.

14 Commitments and off-balance sheet instruments

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements and currency forwards in 2002 and in 2003 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**	
	2003	2002	**2003**	2002
	SIT millions	SIT millions	**SIT millions**	SIT millions
Assets				
Cash and deposits	**400,209**	592,862	**400,303**	593,439
Due to the banks	**9**	18	**9**	18
Reverse repo agreements	**-**	1,148	**-**	1,148
Liabilities				
Current accounts and deposits to banks	**41,059**	30,545	**41,091**	30,544
Bank of Slovenia bills in foreign currency	**555,260**	552,952	**556,356**	552,951
Bank of Slovenia bills in domestic currency	**472,330**	375,636	**481,964**	387,629
Republic of Slovenia deposits	**109,674**	134,793	**113,188**	137,313

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 2003 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 2003:

	EUR %	**USD** %	**Other** %	**Total** %
Sovereign bonds	**48.84**	**8.02**	**0.73**	**57.59**
Supranational securities	**3.82**	**2.12**	**0.29**	**6.23**
Foreign banks securities	**33.51**	**1.65**	**1.02**	**36.18**
December 31, 2003	**86.17**	**11.80**	**2.04**	**100.00**
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

Interest rate risk

Average effective interest rates:

	2003				2002
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
			%		
Assets					
Foreign currency assets					
Gold and gold receivables	-	0.27	-	0.27	0.32
Cash and deposits	2.19	-	-	2.19	2.81
Derivative financial instruments	0.05	-	-	0.50	1.00
Investment securities available for sale	2.44	2.15	2.91	2.81	2.97
International Monetary Fund	1.44	-	-	1.44	1.74
Domestic currency assets					
Due from banks	-	-	6.25	6.25	10.00
Reverse – repo agreements	-	-	-	-	9.01
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	1.23	1.19	-	1.22	2.00
Bank of Slovenia bills	1,91	1.91	-	1.91	2.80
Domestic currency liabilities					
Current accounts and deposits	0.92	-	-	0.92	0.94
Overnight deposits	3.00	-	-	3.00	4.00
Bank of Slovenia bills	6.95	6.79	-	6.82	10.48
Republic of Slovenia deposits	3.96	7.07	-	6.31	9.12

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

Interest sensitivity of assets and liabilities

	2003			
	Repricing period			
	3 months or less	3 months to 1 year	Over 1 year	Total
	SIT million			
Assets				
Foreign currency assets				
Gold and gold receivables	42	19,101	-	**19,143**
Cash and deposits	400,209	-	-	**400,209**
Derivative financial instruments	48	-	-	**48**
Investment securities available for sale	53,055	121,738	1,015,423	**1,190,216**
Receivables from the RS	19	-	7,156	**7,175**
International Monetary Fund	29,130	-	-	**29,130**
Domestic currency assets				
Due from banks	-	-	9	**9**
Total assets	**482,504**	**140,838**	**1,022,587**	**1,645,930**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	33,845	7,215	-	**41,059**
Bank of Slovenia bills	482,666	72,594	-	**555,260**
IMF and other IFO	-	-	5	**5**
SDR allocation	-	-	7,156	**7,156**
Domestic currency liabilities				
Current accounts and deposits	100,818	-	-	**100,818**
Overnight deposits	8,170	-	-	**8,170**
Bank of Slovenia bills	76,922	395,408	-	**472,330**
Republic of Slovenia deposits	26,760	82,914	-	**109,674**
Total liabilities	**729,180**	**558,131**	**7,161**	**1,294,473**
Net interest sensitivity gap	**-246,676**	**-417,293**	**1,015,426**	**351,457**
December 31, 2002				
Total assets	943,781	132,848	499,394	1,576,023
Total liabilities	758,792	363,298	87,649	1,209,740
Net interest sensitivity gap	184,988	-230,450	411,744	366,283

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 2003:

	SIT	EUR	USD	Other	Total
			SIT millions		
Assets					
Foreign currency assets					
Gold and gold receivables	-	-	-	19,143	**19,143**
Cash and deposits	-	300,130	55,391	44,689	**400,209**
Derivative financial instruments	-	48	-	-	**48**
Investment securities available for sale	-	1,025,565	140,426	24,225	**1,190,216**
Receivables from the RS	-	-	-	7,175	**7,175**
International Monetary Fund	-	-	-	29,130	**29,130**
Accrued interest and other assets	-	17,934	1,650	3,969	**23,554**
Domestic currency assets	1,263	-	-	-	**1,263**
Total assets	**1,263**	**1,343,677**	**197,467**	**128,331**	**1,670,738**
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	-	17,929	22,903	227	**41,059**
Bank of Slovenia bills	-	513,516	41,744	-	**555,260**
IMF and other IFO	-	-	-	5	**5**
SDR allocation	-	-	-	7,156	**7,156**
Accrued interest and other liabilities		1,159	99	20	**1,278**
Domestic currency liabilities	704,963	-	-	-	**704,963**
Total liabilities	**704,963**	**532,603**	**64,746**	**7,409**	**1,309,721**
Net balance sheet position	**-703,700**	**811,074**	**132,721**	**120,923**	**361,017**
Off-balance sheet net position	**-**	**-503,748**	**-**	**-**	**-503,748**
December 31, 2002					
Total assets	3,255	1,306,000	205,414	77,048	1,591,717
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

Maturities of assets and liabilities

	Remaining period to the contractual maturity date			
	3 months or less	3 months to 1 year	Over 1 year	2003 Total
	SIT millions			
Assets				
Foreign currency assets				
Gold and gold receivables	-	-	19,143	**19,143**
Cash and deposits	400,209	-	-	**400,209**
Derivative financial instruments	48	-	-	**48**
Investment securities available for sale	53,055	121,738	1,015,423	**1,190,216**
Receivables from the RS	19	-	7,156	**7,175**
International Monetary Fund	1,738	-	27,392	**29,130**
Accrued interest and other assets	11,065	9,286	3,203	**23,554**
Domestic currency assets				
Due from banks	-	-	9	**9**
Accrued interest and other assets	872	117	265	**1,254**
Total assets	**467,008**	**131,140**	**1,072,590**	**1,670,738**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	33,845	7,215	-	**41,059**
Bank of Slovenia bills	482,666	72,594	-	**555,260**
IMF and other IFO	-	-	5	**5**
SDR allocation	-	-	7,156	**7,156**
Accrued interest and other liabilities	1,185	92	-	**1,278**
Domestic currency liabilities				
Current accounts and deposits	100,818	-	-	**100,818**
Overnight deposits	8,170	-	-	**8,170**
Bank of Slovenia bills	249,635	222,695	-	**472,330**
Republic of Slovenia deposits	26,760	82,914	-	**109,674**
Accrued interest and other liabilities	5,160	8,802	9	**13,971**
Total liabilities	**908,238**	**394,312**	**7,170**	**1,309,721**
Maturity gap	**-441,231**	**-263,172**	**1,065,419**	**361,017**
December 31, 2002				
Total assets	913,536	130,083	548,098	1,591,717
Total liabilities	761,571	445,331	11,885	1,218,786
Maturity gap	151,966	-315,248	536,213	372,931

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

	2003 SIT millions	2002 SIT millions
Source		
Foreign currency bills	**-**	79,684
Tolar bills	**101,730**	244,823
Total	**101,730**	324,507
Disbursment		
Foreign currency bills	**-2,950**	-
Total net source	**98,780**	324,507

18 Supplemental cash flow information: cash and cash equivalents

	2003 SIT millions	2002 SIT millions
Foreign currency assets		
Cash	**3,326**	3,203
Total assets	**3,326**	3,203
Foreign currency liabilities		
Demand deposits	**-5,432**	-4,868
Domestic currency liabilities		
Commercial banks' demand deposits	**-91,087**	-82,437
Overnight deposits	**-8,170**	-18,360
Non-bank deposits	**-13,557**	-11,883
Total liabilities	**-118,245**	-117,548
Cash and cash equivalents	**-114,919**	-114,345

Foreign currency cash assets include IMF balances of SIT 1,738 million (2002: SIT 1,543 million) and do not include time deposits of SIT 385,337 million (2002: SIT 575,841 million) or other assets of SIT 13,284 million (2002: SIT 15,361 million).

Foreign currency demand deposits do not include restricted deposits of SIT 35,627 million (2002: SIT 25,677 million).

Domestic currency liabilities include Republic of Slovenia deposits of SIT 3,825 million (2002: SIT 4,515 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)

	1999	2000	2001	2002	2003
			SIT millions		
Operating income:					
Interest income	29,724	35,010	44,583	61,677	74,978
Interest expenses	16,885	18,580	25,529	42,321	67,841
Net interest income	**12,839**	**16,430**	**19,053**	**19,356**	**7,137**
Net foreign exchange gain/loss	38,399	28,642	22,397	-8,588	-16,593
Gain (loss) from unrealized price revaluation of securities	-8,292	3,557	3,972	9,365	-8,996
Gain (loss) from unrealized gold revaluation	-	-	-63	1,550	740
Net investment income	**42,946**	**48,630**	**45,360**	**21,684**	**-17,712**
Fee and commission income	699	914	1,123	1,793	1,660
Fee and commission expense	408	332	356	406	426
Net fee and commission income	**291**	**582**	**768**	**1,387**	**1,234**
Other operating income	253	225	289	382	322
Total operating income	**43,490**	**49,436**	**46,417**	**23,452**	**-16,156**
Operating expenses	3,298	3,685	3,930	4,396	4,971
Provisions and write-offs	-	308	7,690	498	704
Operating surplus available for appropriation	**40,192**	**45,443**	**34,798**	**18,558**	**-21,830**
Appropriations:					
Transfer/Relese to special reserves for exchange differences	38,399	28,642	22,397	-8,588	-16,593
Transfer/Relese to special reserves – price risks	-	3,557	3,972	10,915	-8,256
Financial results after the appropriation of net foreign exchange gain/loss and gain/loss from unrealized price revaluation	**1,793**	**13,244**	**8,428**	**16,231**	**3,019**
Transfer to general reserves	1,554	9,933	6,321	12,173	2,264
Total transfer/Relese to reserves	**39,952**	**42,132**	**32,691**	**14,500**	**-22,585**
Provision for transfer of surplus to the budget of RS	240	3,311	2,107	4,058	755
Total appropriations	**40,192**	**45,443**	**34,798**	**18,558**	**-21,830**

Five-year balance sheet

as at 31 December (SIT millions)

	1999	2000	2001	2002	2003
			SIT millions		
Assets					
Financial assets					
Foreign currency assets	**640,948**	**748,153**	**1,131,158**	**1,588,462**	**1,669,475**
Gold and gold receivables	18	20	16,869	18,403	19,143
Cash and deposits	181,102	237,070	492,109	592,862	400,209
Derivative financial instruments	-	-	21	328	48
Investment securities available for sale	423,983	475,274	580,193	927,375	1,190,216
Receivables from the Republic of Slovenia	7,260	8,180	8,509	7,668	7,175
International Monetary Fund	21,490	19,557	21,479	28,221	29,130
Accrued interest and other assets	7,096	8,052	11,978	13,605	23,554
Domestic currency assets	**31,456**	**16,441**	**2,728**	**3,255**	**1,263**
Receivables from Succession Fund	8,650	8,650	-	-	-
Due from banks	3,630	566	438	18	9
Reverse – repo agreements	18,550	6,299	-	1,148	-
Accrued interest and other assets	626	926	2,290	2,089	1,254
Fixed assets	2,914	2,777	2,608	3,094	3,106
Total assets	**675,318**	**767,371**	**1,136,494**	**1,594,812**	**1,673,844**
Liabilities and reserves					
Serviced liabilities					
Foreign currency liabilities	**343,047**	**404,736**	**500,889**	**591,278**	**604,758**
Current accounts and deposits to banks	23,990	35,997	31,842	30,545	41,059
Derivative financial instruments	-	9	-	-	-
Bank of Slovenia bills	312,009	361,168	460,837	552,952	555,260
IMF and other international financial organisations	58	5	5	7	5
SDR allocation	6,868	7,534	8,013	7,643	7,156
Accrued interest and other liabilities	122	23	191	131	1,278
Domestic currency liabilities	**100,058**	**87,990**	**282,308**	**627,508**	**704,963**
Current accounts and deposits	65,167	71,835	85,557	89,804	100,818
Overnight deposits	-	-	35,372	18,360	8,170
Bank of Slovenia bills	27,101	6,946	125,912	375,636	472,330
Republic of Slovenia deposits	2,303	3,411	28,837	134,793	109,674
Accrued interest and other liabilities	5,487	5,797	6,629	8,915	13,971
Banknotes in circulation	142,489	139,644	165,778	172,056	186,042
Provision for transfer of surplus to the budget of RS	240	3,311	2,107	4,058	755
Total liabilities	**585,834**	**635,681**	**951,082**	**1,394,900**	**1,496,517**
Capital and reserves	89,484	131,691	185,411	199,912	177,327
Total liabilities and reserves	**675,318**	**767,371**	**1,136,494**	**1,594,812**	**1,673,844**

7.3 Important measures taken in 2003

7.3.1 Monetary policy and exchange rate policy measures

January	1 Jan: The Bank of Slovenia general discount rate is abolished. 13 Jan: Decision on cessation of sales of 360-day tolar bills adopted. 29 Jan: The offer of temporary purchase of central bank bills in foreign currency with compulsory repurchase after two months is withdrawn.
March	12 Mar: The Bank of Slovenia lowers the spot/1-week buy/sell FX swap rate from 4.5% to 4.0% and the spot/1-week sell/buy FX swap from 2.5% to 2.0%. Owing to this and the cut in ECB interest rates the Bank of Slovenia refinancing rate is cut from 7.25% to 6.5%. The interest rate for 60-day tolar bills is cut from 8.25% to 7.5%, the interest rate for 270-day tolar bills is cut from 9.5% to 8.75%, the minimum bid rate for 7-day temporary purchase of foreign currency bills is cut to 8.25% and the lombard rate is cut to 9.75%. 25 Mar: The Bank of Slovenia ends its intervention in the foreign exchange market through the setting of the rate of growth of the intervention exchange rate. It had set it continuously since 13 September 2001.
April	3 Apr: The Bank of Slovenia again intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 7 April 2003.
May	14 May: The Bank of Slovenia lowers the interest rates on certain monetary policy instruments: for 60-day tolar bills from 7.5% to 7.25%, the maximum bid rate for 270-day tolar bills from 8.75% to 8.25%, for lombard loans from 9.75% to 9.0% and the minimum bid rate for 1-week buy/sell-back of FX bills from 8.25% to 8.0%.
June	11 Jun: The Bank of Slovenia lowers the interest rates on the majority of monetary policy instruments: for 60-day tolar bills from 7.25% to 6.5%, the maximum bid rate for 270-day tolar bills from 8.25% to 7.5%, for lombard loans from 9.0% to 8.25%, the minimum bid rate for b 7-day temporary purchase of foreign currency bills from 8.0% to 7.25% and the spot/1-week buy/sell FX swap rate from 4.0% to 3.5%. Owing to a cut in ECB interest rates and the spot/1-week buy/sell FX swap rate the Bank of Slovenia refinancing rate is cut from 6.5% to 5.5%.
July	1 Jul: The Bank of Slovenia lowers the interest rate on overnight deposits from 4.0% to 3.5%. 9 Jul: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 23 July 2003.
August	26 Aug: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 28 August 2003. In the September maintenance period (beginning 27 August) the Bank of Slovenia changes the system of required reserves: the reserve ratio for tolar deposits of up to 90 days is cut from 7.0% to 4.5%, and vault cash can no longer be used to fulfil the required reserves.

3 Oct: The Bank of Slovenia lowers the interest rates on certain monetary policy instruments: for 60-day tolar bills from 6.5% to 6.25%, the maximum bid rate for 270-day tolar bills from 7.5% to 7.25%, for lombard loans from 8.25% to 8.0% and the minimum bid rate for 7-day temporary purchase of foreign currency bills from 7.25% to 7.0%. 24 Oct: The Bank of Slovenia lowers the spot/1-week buy/sell FX swap rate by 0.25 percentage points to 3.25% and the spot/1-week sell/buy FX swap rate to 1.75%. The refinancing rate is cut to 5.25% as a result.	**October**
7 Nov: The Bank of Slovenia lowers interest rates for all instruments of monetary policy and exchange rate policy, mostly by 0.25 percentage points: for 60-day tolar bills from 6.25% to 6.0%, the maximum bid rate for 270-day tolar bills from 7.25% to 7.0%, for lombard loans from 8.0% to 7.5%, for overnight deposits from 3.5% to 3.25%, and the minimum bid rate for 7-day temporary purchase of foreign currency bills from 7.0% to 6.75%. The spot/1-week buy/sell FX swap rate is cut from 3.25% to 3.0% and the spot/1-week sell/buy FX swap rate from 1.75% to 1.5%. The refinancing rate is cut to 5.0% as a result. 10 Nov: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 11 November 2003.	**November**
5 Dec: The Bank of Slovenia lowers the interest rates on certain monetary policy instruments, all by 0.25 percentage points: the maximum bid rate for 270-day tolar bills from 7.0% to 6.75%, for lombard loans from 7.5% to 7.25% and for overnight deposits from 3.25% to 3.0%.	**December**

7.3.2 Banking supervision measures

Regulation amending the regulation on the minimum level of liquidity to be maintained by banks	**January**
Regulation amending the regulation on the minimum level of liquidity to be maintained by banks	**February**
Regulation amending the regulation on capital adequacy of banks and savings banks Regulation amending the regulation on large exposures of banks and savings banks	**March**
Regulation on the granting of special liquidity loans with the cooperation of banks Regulation on the reporting of effective interest rates	**April**
Instructions on the implementation of the decision on the reporting of effective interest rates	**May**
Regulation amending the regulation on the deposit guarantee scheme Regulation amending the regulation on the minimum level of liquidity to be maintained by banks Regulation amending the regulation on large exposures of banks and savings banks	**June**
Regulation amending the Regulation on the deposit guarantee scheme Regulation amending the Regulation on the minimum level of liquidity to be maintained by banks Regulation amending the Regulation on large exposures of banks and savings banks	**July**
Instructions on the implementation of the regulation on the classification of balance sheet and off-balance-sheet assets and the regulation on specific provisioning by banks and savings banks	**August**

September	Regulation amending the regulation on the detailed content of reports specified in Article 127 of the Banking Act Regulation on the detailed method of calculating liabilities, claims and investments in determining net indebtedness and net exposure
December	Regulation amending the regulation stipulating the conditions to be fulfilled by banks and savings banks for providing banking and other financial services and stipulating the documentation based on which it is possible to establish whether a company is capable of pursuing the activities to which the request for the authorisation refers

7.3.3 Other important measures

Februar	An amendment to the Regulation on the liquidity ladder allows banks that are in a swap with the Bank of Slovenia and have a long foreign exchange position to take the swap with the Bank of Slovenia into consideration in the fulfilment of claims in foreign currency, but in the maximum amount of 10%.
Julij	An amendment to the Regulation on the liquidity ladder allows banks that have a long foreign exchange position to take loans approved for residents into consideration in the fulfilment of the coefficients, but in the maximum amount of the value of the swap.
September	The Regulation on foreign exchange dealing is amended in order to harmonise with an amendment to the foreign exchange act in the section relating to foreign exchange dealing.
Oktober	On the basis of an amendment to the Regulation on the conditions for concluding credit operations in foreign currency between residents, authorised banks may approve credit in foreign currency for residents without restrictions. An amendment to the Regulation on the conditions and method for conducting payments with the rest of the world means the ordering party is no longer obliged to append to the payment order a document that makes the payment basis clear.

7.4 Governance and organisation

7.4.1 Changes in the composition of the Governing Board in 2003

On 10 September 2003 five members of the Governing Board of the Bank of Slovenia saw their terms of office end:

- 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)

Because the new Bank of Slovenia Act has reduced the number of members sitting on the Governing Board from eleven to nine, the National Assembly confirmed just three new members in office, these being:

- Ivan Ribnikar, Ph.D. (Faculty of Economics, Ljubljana)
- Božo Jašovič, M.Sc. (Bank of Slovenia, Ljubljana)
- Boštjan Jazbec, Ph.D. (Faculty of Economics, Ljubljana)

In accordance with Article 38 of the Bank of Slovenia Act, Božo Jašovič, M.Sc. has concluded a full-time employment contract with the Bank of Slovenia, while as university lecturers Ivan Ribnikar, Ph.D., Dušan Zbašnik, Ph.D. and Boštjan Jazbec, Ph.D. are employed for one-third of full-time working hours.

7.4.2 Composition of the Governing Board of the Bank of Slovenia as at 31 December 2003

President of the Governing Board of the Bank of Slovenia

Mitja Gaspari
(Governor of the Bank of Slovenia)

Other 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)

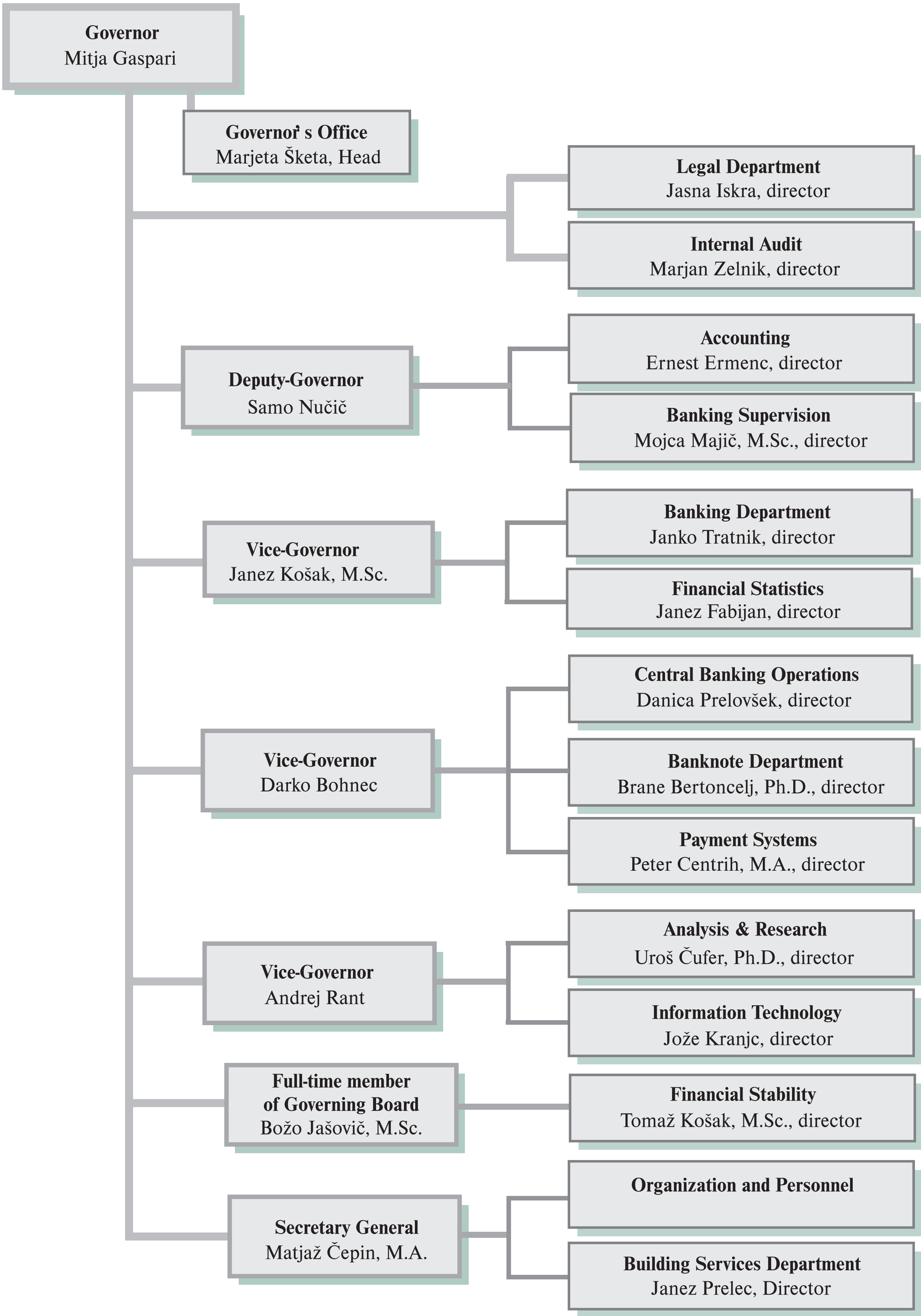
Božo Jašovič, M.Sc.
(Member of the Governing Board of the Bank of Slovenia)

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

Boštjan Jazbec, 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



7.4.4 Governing Board commissions and committees as at 31 December 2003

- Liquidity Commission (president: Darko Bohnec)

- Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions in Connection with Procedures for Ruling on the Issue of Authorisations for Providing Banking Services and Acquiring a Qualifying Shareholding and Other Authorisations, Approvals and Opinions Pursuant to the Banking Act (president: Samo Nučič)

- Commission of the Governing Board of the Bank of Slovenia for the Preparation of Opinions for the Issue of Authorisations for Serving as a Member of a Bank's Management Board (president: Ivan Ribnikar, Ph.D.)

- Research Commission (president: Ivan Ribnikar, Ph.D.)

7.5 Publications and website

Title and basic information	Content
Monthly Bulletin • monthly • in Slovene • English translation	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.
Annual Report • annual (released in spring)) • in Slovene • English translation	Report by 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 activities of the Bank of Slovenia.
Report on Supervision of Banking Operations • annual (released in autumn) • English translation	Report by the Banking Supervision Department to the National Assembly of the Republic of Slovenia on the operations of banks, the development of legal foundations for supervision, and banking supervision.
Direct Investment • annual • bilingual publication in Slovene and English	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).
Figures and Analysis • quarterly • in Slovene	Speeches by the Governor of the Bank of Slovenia at the National Assembly, analytical and methodological presentations in monetary field, balance of payments field and related areas.
Financial Markets • quarterly • in Slovene	Statistical review of non-monetary financial intermediaries, the securities market and interest rates.
Monetary Review • monthly • in Slovene	Analysis of current macroeconomic trends with a detailed breakdown of monetary and balance of payments developments.
Monetary Policy Implementation Report • half-yearly • in Slovene and English	Current and envisaged monetary policies, inflation trends and projections of key macroeconomic indicators for Slovenia for the next two years.
ARC Working Papers	Collection of articles on all topics of professional and operational relevance for central banking. Content of articles may be analytical, or merely informative.
Website • Slovene URL http://www.bsi.si/... .../html/kazalo.html • English URL http://www.bsi.si/... .../eng/index.html	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.

7.6 Glossary of selected terms

Capital (in accounting sense) – Subscribed capital, capital reserves, profit reserves, retained earnings and net losses from previous years, equity capital revaluation adjustment, net profit not yet distributed, net loss not yet covered and security deposi.t

Capital (in regulatory sense) – An amount calculated on the basis of core and supplementary capital that banks can use to cover their capital requirements under the decision on 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 debtor to meet the liabilities to the bank when they fall due.

Category A comprises:
- 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.

Category B comprises:
- 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.

Category C comprises:
- 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.

Category D comprises:
- 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 motion for the initiation of composition or bankruptcy proceedings has been filed with a competent court,
- claims on debtors who are the subject of rehabilitation or composition proceedings
- claims on debtors who are the subject of bankruptcy proceedings,
- claims on debtors who frequently pay their liabilities 91 to 180 days in arrears and occasionally 181 do 365 days; but where a reasonable expectation exists that the claims will partly be covered.

Category E comprises:

- claims on debtors that are not expected to be repaid,
- claims on debtors whose legal status is in dispute.

Financial institutions – In the official sector classification based on ESA95, the financial institutions sector is divided into five sub-sectors: the central bank, other monetary financial institutions, other financial intermediaries excluding insurance agencies and pension funds, ancillary financial institutions, and insurance agencies 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 excluding insurance agencies and pension funds, ancillary financial institutions, and insurance agencies and pension funds.

Foreign currency bills – Short-term securities issued by the Bank of Slovenia, subscribed for and paid in foreign currency (euros or dollars).

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 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 market on which participants gather and invest short-term assets and trade them via instruments with an original maturity of up to one year.

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 that 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 – Labour costs, costs of materials and services, depreciation, amortisation and revaluation operating expenses on intangible fixed assets and tangible fixed assets, taxes and subscriptions.

Other assets – Equity investments in customers in the same group (subsidiaries, associates and jointly controlled companies) and other customers, intangible fixed assets, tangible fixed assets, treasury stock, uncalled capital, deferred expenses and accrued income, and other assets such as cheques, inventories, and claims arising from interest, fees and commissions.

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 in a bank and members of a bank's bodies, and parties related to them.

Provisions – These comprise general provisions against unknown losses and specific provisions for potential losses arising from balance sheet items 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 (the bank), but the buyer (the Bank of Slovenia) acquires a lien on them.

Required reserves – The minimum prescribed amount of assets, commonly computed as a percentage of obliged persons' deposits and other liabilities, that obliged persons (banks, savings banks and savings and loan undertakings) are obliged to keep in their settlement accounts or special required reserve accounts with the Bank of Slovenia.

Reserve money – Cash in circulation, banks' reserves and demand deposits at the Bank of Slovenia.

Secondary liquidity – Investments in financial instruments that are highly liquid and can be sold quickly.

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 account 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).

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

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