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Introduction

The Bank of Slovenia's monetary policy in 2004 was in line with the long-term guidelines adopted in November 2001 and the programme for ERM II entry and adoption of the euro (the joint programme) adopted by the Bank of Slovenia and the Slovenian government in November 2003. In the joint programme they committed themselves to entering the ERM II by the end of 2004 and establishing the conditions to allow the euro to be adopted at the beginning of 2007.

Policy coordination by the government and the Bank of Slovenia facilitated a reduction in the year-on-year inflation rate from 4.6% in December 2003 to 3.2% in December 2004. Excise duty policy played an important role in this, mitigating the effects that unfavourable movements in the foreign environment, high rises in oil prices in particular, had on domestic prices. The transmission of high oil prices to domestic prices did not have any secondary effects. The disinflation process was of a sustainable nature, as no macroeconomic imbalances arose. The fiscal indicators, the general government deficit and debt, are within the Maastricht criteria, as are long-term interest rates. There was a moderate current account deficit of 0.5% of GDP.

The sustained disinflation trends allowed the Bank of Slovenia to cut nominal interest rates while leaving real interest rates positive in the first half of the year. Prior to ERM II entry, in line with the need to maintain an appropriate difference between interest rates in Slovenia and those in the eurozone, cuts in nominal interest rates were accompanied by a reduction in the rate of tolar depreciation. After Slovenia entered the ERM II the Bank of Slovenia made no significant change to its key interest rates.

When it joined the EU on 1 May 2004 Slovenia became a member of the economic and monetary union, with a derogation regarding the introduction of the euro. This means that it did not adopt the euro immediately after joining the EU, but will do so when it meets the conditions. With Slovenia's entry into the EU, the Bank of Slovenia became a member of the ESCB, which comprises the ECB and all the national central banks of EU member-states. Bank of Slovenia representatives thus became members of the ECB's General Council, and the committees and working groups of the ESCB.

Slovenia entered the ERM II, one of the pre-requisites for adopting the euro, on 28 June 2004. The central rate was set at SIT 239.640 to the euro in agreement with the members of the eurosystem and the ECB. The nominal exchange rate is allowed to fluctuate within a standard band of ±15%. The Bank of Slovenia protects the tolar within this band, while at the boundaries the ECB also intervenes. Since ERM II entry, monetary policy has safeguarded the stability of the nominal tolar exchange rate, and the market exchange rates' deviations from the central rate have been negligible. When entering the ERM II Slovenia also committed itself in the statement by the ERM II committee to continuing to take measures to make a sustained reduction in inflation, to maintain competitiveness by controlling domestic costs, to give a decisive role in managing demand to fiscal policy and to implement structural reforms to strengthen the flexibility of the economy.

With the planned adoption of the euro in mind, the Bank of Slovenia continued to make monetary policy adjustments aimed at easing the transition to the conditions of business in the eurosystem. These adjustments relate to the offer of 270-day tolar bills, the minimum foreign currency liquidity within the framework of the liquidity ladder, the system of required reserves, and the level of swapped foreign exchange.

Effective supervision of banking guarantees financial stability. Given that credit risk is still for the moment the largest risk faced by banks and savings banks, the emphasis during examinations and reviews in 2004 was again primarily on the establishment of an appropriate lending system and the classification of balance-sheet and off-balance-sheet items. There was also appropriate focus in 2004 on consolidated supervision, i.e. verification of the financial statements of related parties, banks' policy to related parties, their asset quality, bank management and relations, and operating risk. In their direct examinations of banks and savings banks inspectors from the Banking Supervision Department devoted particular attention to overseeing the management of market risks, to supervising the implementation of the Consumer Credit Act and the Prevention of Money Laundering Act, and to information technology, in addition to the standard areas of examination.

EU membership and the planned introduction of the euro also require adjustments in payment systems. On 8 November 2004 the Bank of Slovenia became a direct participant in the STEP2 payment system, which allows the processing of cross-border low-value payments in euros. Eleven banks opted for indirect access to the system through the Bank of Slovenia, three banks participate in the system through selected indirect participants, and five banks participate in the system indirectly through foreign banks. In the management of payment systems at the Bank of Slovenia (the RTGS and Giro Clearing), work that was begun in 2003 on the risk management scheme was continued. The risk management scheme for the management of payment systems at the Bank of Slovenia is modelled on the scheme used by the ECB for its TARGET system.

By joining the ESCB the Bank of Slovenia assumed certain statistical obligations that must be completed prior to the euro adoption. In the first half of the year the Bank of Slovenia compiled its first annual financial accounts in accordance with the ESA95 methodology. The methodology of new reporting by monetary financial institutions is completely in line with ECB requirements. Monetary financial institutions began to report balance sheet figures and valuations in accordance with the aforementioned methodology at the end of the year, and in May 2005 will begin to report on interest rates.

1 THE ECONOMIC ENVIRONMENT

1.1 External economic factors

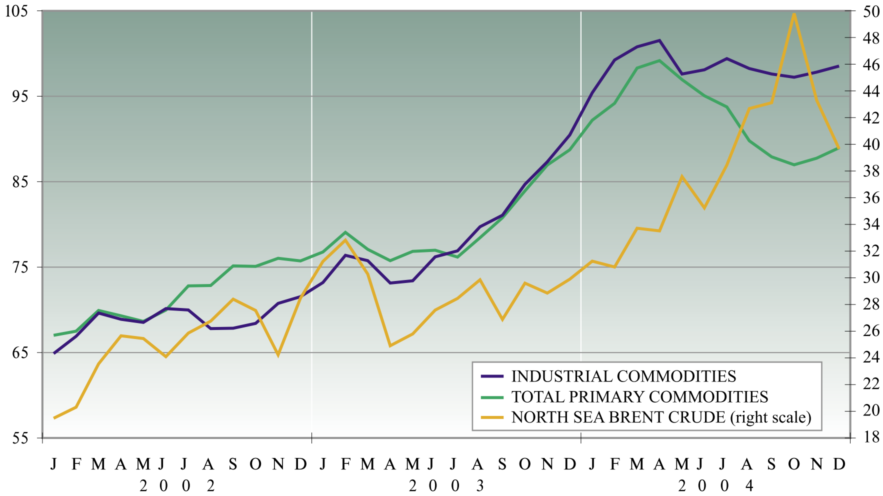
Economic growth in the USA and Japan strengthened, and also improved in the EU

Global economic growth rose in 2004. Growth in the eurozone was 2.0%, 1.5 percentage points higher than in 2003. It was up 1.4 percentage points in the EU25 at 2.3%. There was also faster economic growth in the USA, the relatively high level recorded all year taking the rate to 4.4% in 2004 from 3% in 2003. The Japanese economy recorded high growth for the second year in succession. Initial estimates are that the figure for economic growth in Japan in 2004 should be higher than that from the previous year at 2.6%.

Slovenia's trading partners also recorded higher economic growth

Slovenia's trading partners also saw increased economic growth. The fastest growth among EU15 partners was recorded by France (2.4%), followed by Austria (1.9%) and Germany (1.7%). Economic growth was higher than in 2003 in all the countries. Initial estimates are that east European countries also saw higher growth in 2004 than in the previous year, with the fastest rate being recorded by Poland (5.8%), followed by Hungary (3.9%) and the Czech Republic (3.8%). Only Croatia recorded slower economic growth in 2004. Initial estimates are that it fell 0.5 percentage points from 2003 to 3.8%.

Figure 1: **World market prices of commodities and oil**



Note: Index 1999 = 100; oil price is for North Sea Brent in USD per barrel.
Source: The Economist, London; Opec Bulletin, Vienna

2004 saw record levels in oil prices caused by

– uncertainty regarding sufficient supply

– increased demand for oil

The price of Brent crude rose in 2004 to average USD 38.3 per barrel, up almost one-third (33%) from 2003. The price was above USD 30 all year, and was above USD 40 in the second half of the year. In the middle of October it reached record levels of between USD 50 and USD 52 per barrel. The price had eased slightly by the end of the year, with the December average again falling below USD 40. Both geopolitical and economic factors were responsible for a rise of this magnitude. While the former hindered growth in supply, the latter dictated faster growth in demand. Supply was held back primarily by the uncertain situation in Venezuela, the crisis in Iraq, tension in Saudi Arabia, the uncertainty connected to the Yukos affair in Russia, weather in the Gulf of Mexico and Opec's unwillingness to significantly increase pumping. Demand was primarily strengthened by the gradual recovery of the world economy and faster growth in China, where Opec estimates demand to have risen by 13% in 2004. World demand for oil in 2004 was 82.4 million barrels per day, up 2.6 million barrels per day from the previous year.

Oil reserves have therefore reached a historically low level. Only the rise in interest rates, the forecast of a gradual slowing of rapid economic growth in China and the figures for higher reserves in the USA mitigated the rapid rise in oil prices in the final quarter of 2004.

Higher inflation in the USA, an end to deflation in Japan

Inflation in 2004 was just above 2% in the eurozone and close to 3% in the USA. In the first quarter the two economies recorded inflation below 2%, while over the rest of the year it ranged from 2% to 2.5% in the eurozone and from 2.3% to 3.5% in the USA. The peaks in inflation came in May in the eurozone (2.5%) and in October in the USA (3.5%). The average year-on-year inflation rate in the eurozone in 2004 remained at the level of 2.1% recorded in 2003, just above the ECB's medium-term target. In the USA the year-on-year consumer price index averaged 2.7%, up 0.4 percentage points from 2003. Inflation was negative in Japan in the first three quarters of 2004, while there was an average rise of 0.5% in prices during the final quarter. After several years of deflation, prices in Japan in 2004 remained unchanged from 2003.

Interest rates remained unchanged in the eurozone, but were gradually raised in the USA

The ECB made no changes to its interest rates in 2004. The ECB rate thus remains at the June 2003 level of 2.0%. The American central bank gradually raised its key interest rate by 1.25 percentage points during the second half of the year, with June 2004 bringing the first rise in American interest rates since January 2001. The Fed then raised the key interest rate on four further occasions, taking it to 2.25% in December. Moderate economic growth and improved conditions on the labour market were said to be factors of the rise in interest rates.

Exchange rates in the first half of the year were less beneficial than those at the end of the year

The gradual strengthening of the dollar against the euro in the first half of the year did nothing to mitigate the rise in oil prices. Through higher commodities prices exchange rates had an adverse effect on import prices, and thus on the movement of imported inflation. Only in the second half of the year, when the dollar again began to lose value against the euro, did movements in exchange rates turn round and have a beneficial effect on lower prices in imported goods, particularly commodities. The positive effects on the movement of imported inflation brought by exchange rates in the second half of the year were strengthened further by a fall in oil prices in the final quarter. The strengthening of the dollar at the beginning of the year was the result of signs of a gradual recovery in the American economy, the beginning of a gradual rise in interest rates in the USA and the consequent narrowing of the interest rate gap between the USA and eurozone. However the forecast of the USA's large trade deficit in the middle of the year shook the dollar, which lost 10% of its value against the euro in the second half of the year.

1.2 Gross domestic product, employment and labour costs

Increased economic growth

After being rather low for several years, economic growth in Slovenia was relatively high in 2004. At 4.6% annual growth exceeded growth in potential GDP for the first time in three years. The largest rises in added value were recorded by financial intermediation services (10.4%), in manufacturing (5.4%) and in the health sector (4.9%), while the largest declines were in fishing (-2.9%) and mining (-5.2%). This structure of economic growth indicates that activity was primarily under the influence of the high level of activity by financial intermediaries and the favourable economic climate abroad.

Domestic demand continued to strengthen

The gradual rise in domestic demand continued in 2004. Strong activity in the housebuilding sector and a substantial rise in stocks in particular saw investment spending record the fastest growth among the components of domestic spending (9.1%), followed by household spending (3.5%), while growth in general government spending was slightly slower (1.7%). After making a sizeable negative contribution of 2.2 percentage points to economic growth in 2003, net exports had an almost neutral effect over the whole of 2004 (-0.2 percentage points) following a significant improvement in the second half of the year. With the current account slightly in deficit in 2004, domestic saving was not sufficient to fully cover investment spending. Here there was an increase in both private sector saving and investments, while in the government sector saving declined slightly more than investments.

Private sector investments and saving rose in 2004

Table 1: **Selected economic indicators**

	1998	1999	2000	2001	2002	2003	2004
Real growth in gross domestic product[1] (%)	3.6	5.6	3.9	2.7	3.3	2.5	4.6
Gross domestic product (EUR millions)	18,602	20,011	20,740	21,925	23,492	24,592	25,919
Gross domestic product (USD millions)	20,856	21,317	19,096	19,616	22,121	27,749	32,182
Per capita gross domestic product (USD)	10,519	10,746	9,599	9,848	11,088	13,900	16,112
Composition of gross domestic product (%)							
Agriculture, forestry and fishing	3.9	3.3	2.8	2.4	2.7	2.2	2.4
Industry and construction	33.0	32.6	32.6	32.8	33.1	33.3	33.3
– Manufacturing	24.1	23.6	23.8	24.4	24.7	25.1	25.3
Services	49.2	49.5	53.6	54.4	54.3	54.8	54.6
Total value added	85.8	85.3	86.5	86.9	87.2	87.2	87.1
Compensation of employees	52.7	51.5	53.5	53.9	53.0	52.9	...
Taxes on production and imports less subsidies	12.9	13.3	12.0	12.7	12.9	13.1	...
Gross operating surplus and gross mixed income	34.4	35.2	34.0	33.4	34.1	34.0	...
– Exports of goods and services	53.8	49.8	56.1	57.6	57.6	56.5	59.9
– Imports of goods and services	55.3	54.0	59.7	58.3	56.1	56.5	60.5
Net exports	-1.5	-4.2	-3.5	-0.7	1.5	0.0	-0.6
Household spending	57.3	57.3	57.1	56.3	54.6	54.4	54.0
General government spending	19.6	19.5	19.8	20.5	20.2	20.3	19.8
Investment spending	24.6	27.4	26.7	23.9	23.8	25.3	26.8
Active population[2] **thousands**	978	959	968	979	971	962	1,007
Employed and self-employed	901	886	901	916	910	894	943
Unemployed	77	73	68	63	62	65	64
ILO unemployment rate (%)	7.9	7.6	7	6.4	6.4	6.8	6.3
Real growth in gross wages per employee (%)	1.6	3.2	1.6	3.3	2.1	1.9	2.0
Growth in labour productivity (%)	3.6	3.3	2.6	2.8	3.8	3.1	4.0

1 Since 2000 figures in the national accounts have been calculated using the new SORS methodology and are in fixed 2000 prices.
2 Internationally comparable figures under ILO methodology.
Source: Statistical Office of the Republic of Slovenia (SORS)

In line with the relatively high growth in added value in the manufacturing sector, there was growth in industrial output of 4.8% in 2004, although growth rates slowed slightly at the end of the year compared to the higher levels reached in the first part of the year. The largest increase over the whole year was recorded by production of capital goods (9.7%), while production of consumer goods fell by 1.1%. Total stocks in industry rose by 19.3% in 2004.

Industrial output rose by 4.8%

Low public sector wage growth was the primary factor in slow wage growth

In the context of the reasonably favourable economic outlook wage growth was relatively slow in 2004, primarily thanks to low public sector wage growth. Year-on-year growth in gross wages averaged 5.7% in 2004, or 2.0% in real terms. Real growth in gross wages in the tradable sector averaged 3.0% over the twelve months of the year, and was 1 percentage point lower than estimated productivity growth. The wage agreements for the 2004 to 2005 period were applied to the wage increases in the public and private sectors, with the projected rise in prices in Slovenia, the projected rise in prices in the EU and the projected rise in the euro exchange rate all being taken into consideration in the wage increase mechanism.

The cost composition of GDP was more favourable than in 2003

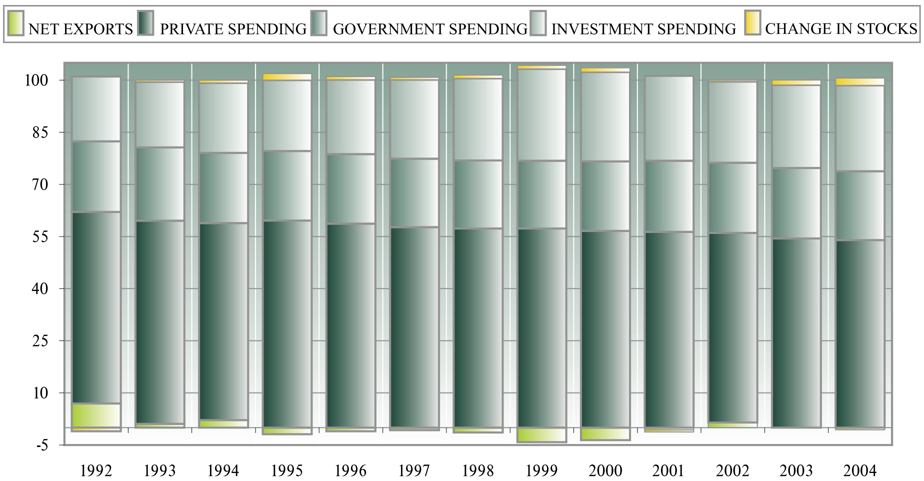
The cost composition of GDP is estimated to have shown a slight improvement in comparison with the previous year. In light of the slow wage growth and despite the rise in employment in 2004, employee compensation was equivalent to 52.1% of GDP in 2004, a decline of 0.8 percentage points from the previous year. Despite relatively high domestic demand and in light of the relatively high level of economic activity, the share of GDP cost composition accounted for by taxes on goods and services is estimated to have declined slightly. Thanks to favourable domestic demand and export demand and despite the adverse movements in the terms of trade, the share accounted for by gross operating surplus is estimated to have risen by 0.8 percentage points to 25.1% of GDP.

The employment trend was in line with economic activity

The number of unemployed in 2004 was down 5% from 2003

There was a favourable employment trend in 2004, in line with the trend in economic activity. There was an improvement in conditions on the labour market throughout the year, and only at the end of the year did a minor stalling in employment occur. Over the whole year, and particular in the second half, the decline in employment in labour-intensive sectors continued, with considerable pessimism in forecasts of any improvement. The number of people in active employment rose on average by 0.5% in 2004, with employment at companies and institutions rising by 0.6% and employment in the small-business sector falling by 0.6%. Given the favourable economic climate, the fall in employment in the small business sector had almost stopped by the end of the year. Unemployment was down 5.0% from 2003, with the unemployment rate reaching 10.4% in December, slightly lower than the average over the year (10.6%) and lower than in December 2003 (when it was 11.0%). For the fourth successive year employment rose most in real estate services (4.3%), while there was also a significant rise in employment in public administration (2.7%).

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



Source: Statistical Office of the Republic of Slovenia (SORS)

The rise in job figures in the service sector again outweighed that in industry

The largest falls in employment were recorded in mining (9.6%), agriculture (5.6%) and transport (2.3%). Despite significant export activity, employment in the manufacturing sector also fell in 2004 (by 0.9%). There was considerable variation in the movement of jobs figures in different areas of manufacturing, with a significant loss of jobs in some areas (foodstuffs, textiles and the leather industry), while other areas recorded rapid rises in employment (machinery production, the rubber industry and the car industry). As in the last few years the rise in the number of employees in the service sector (1.4%) again outweighed the change in employment in industry, which actually fell by 0.9%, widening the gap between the employment trends in the two sectors. The regional pattern of unemployment in 2004 was essentially unchanged, with rates of registered unemployment highest in the Podravska, Pomurska, Savinjska and Posavska regions. Unemployment rose most in the regions of Ljubljana, Dolenjska and Goriška, i.e. the regions where it is lowest, but fell most in Podravska, Pomurska, Savinjska and Posavska, the regions where it is above the average for Slovenia.

The ILO unemployment rate is 6.3%

According to estimates, the internationally comparable figure for the active population rose by almost 46,000 in 2004, with unemployment falling by a few thousand less. After rising in 2003 to 6.7%, the unemployment rate thus fell significantly in 2004 to average 6.3%. The long-term unemployed, young people (mainly first-time job-seekers), people over-40s and those with poor qualifications remain the critical unemployment groups. 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 Slovenia having joined the EU, international projects co-financed by the European Commission's Phare programme are also becoming 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.

EU programmes for reducing regional differences and discrimination against women

1.3 Prices

Continuation of the disinflation trend

The consumer price index stood at 3.2% as measured from December 2003 to December 2004, or 3.6% measured as the average for 2004 against the average for 2003. The disinflation trend thus continued in 2004, with the average annual inflation rate falling by 2 percentage points.

Price rises in the majority of sub-groups were similar to the overall rise in prices

Price rises in the majority of sub-groups were similar to the overall rise in prices. Only prices in housing (10.3%), education (8.0%) and catering and hospitality services (5.2%) rose faster than average. The prices of liquid fuels, municipal services and rents were prominent factors in the rise in housing prices. Price rises in the health sector (0.6%) were significantly slower than average, while there was a fall of 1.1% in prices of food and non-alcoholic beverages, primarily owing to cheaper food.

The sustained fall in inflation in 2004 was brought about mostly by domestic factors, namely structural factors connected with Slovenia joining the EU, and by appropriate macroeconomic policy that mitigated the effects of adverse trends in the foreign environment, high oil prices in particular.

High rises in oil prices on world markets and unfavourable exchange rates

Most prominent among the factors from the foreign environment in 2004 was the high rise oil prices on the world market, which went from USD 30 per barrel in January to around USD 40 per barrel at the end of December. In addition, exchange rates also had an adverse effect on import prices through high commodities prices, and thus on the movement of imported inflation.[1]

High rises in administered prices owing to high rises in the prices of refined petroleum products

Among the domestic factors having the most significant impact on lower inflation, prime position was taken by the coordinated action of the Bank of Slovenia and the Slovenian government. The latter used acyclic adjustments in excise duties to mitigate the transmission of high oil prices on the world market into domestic prices, and through its administered prices policy prevented the automatic transmission of costs into price formation. Administered prices (excluding prices of refined petroleum products) thus rose by 3.9% in 2004, compared with 4.7% in 2003. The most prominent changes were recorded by prices of textbooks (up 17.1%), prices of municipal services (up 7.1%), rail transport prices (up 5.8%) and the RTV licence fee, which unlike the others fell, by 6.5%. Despite the acyclic adjustment of excise duties, prices of refined petroleum products rose by 11.3% in 2004, contributing approximately 1.2 percentage points to the annual inflation rate of 3.2%. The relatively high effect of refined petroleum products is also a result of the greater weighting they are given in the basket compared to other countries. In making its adjustments the Government of the Republic of Slovenia was restricted by the EU directive on minimum excise duties, the minimum level being reached in the first half of the year.

The Bank of Slovenia pursued the goal of price stability

The Bank of Slovenia again pursued the goal of price stability in 2004. Prior to the tolar's inclusion in the ERM II, the Bank of Slovenia was able to affect the level of nominal interest rates, and through this bring about a gradual reduction in inflation. By maintaining an appropriate level of real interest rates and gradually stabilising the exchange rate it eased inflationary pressures of a monetary nature and aggregate demand pressures. The process of nominal convergence was supported by the balance of payments and the fiscal balance.

Core inflation fell to 2.2%, as did the rise in consumer prices excluding administered prices

In addition to headline inflation, core inflation fell in 2004 to 2.2%, having been 3.4% in 2003. There was a slowdown in the rise in consumer prices excluding administered prices, which amounted to 2.2%. The lower rate was primarily the result of certain structural changes connected with Slovenia joining the EU, the abolition of customs duties on specific products and increased competition on the domestic market. These factors were most powerfully felt by food products, which were on average 1.1% cheaper in 2004.

Growth in industrial producer prices stood at 4.9%

After several years of decline, year-on-year rates of growth in industrial producer prices rose again in 2004. Year-on-year growth in industrial producer prices stood at 4.9% at the end of the year, up 2.8 percentage points from December 2003. The fastest rise was recorded by intermediate goods at 6.9%, with prices of raw materials rising by 7.1% and fuel prices by 6.4%. There was similar movement in the year-on-year rates of growth in prices of capital goods, which rose sharply towards the middle of the year but slowed to 3.3% by the end of the year. Prices of consumer goods were more settled, rising by 3.0% in 2004. The rapid growth in prices of intermediate goods was primarily the result of the low basis from the previous year, and the rises in prices of oil and other raw materials. Apart from the low basis, another factor in the faster growth in prices of capital goods was the increased level of motorway construction, housebuilding, and other major investment projects.

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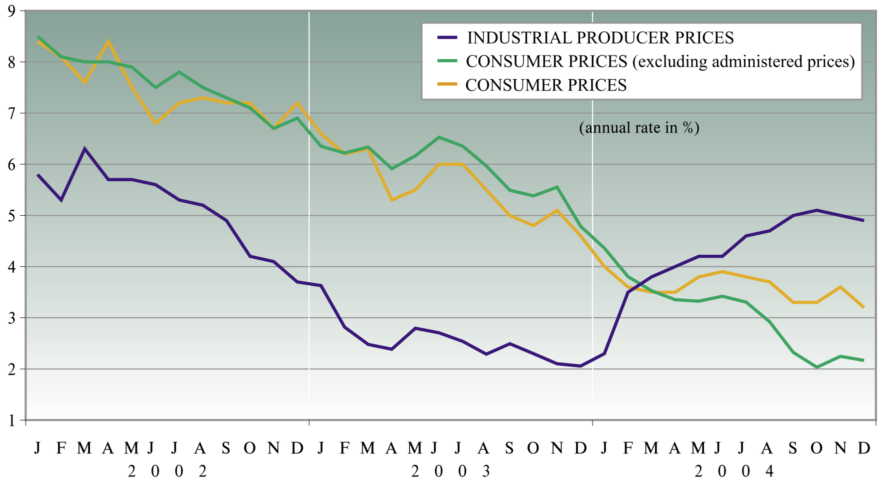
[1] The main reasons for the rise in oil prices are described in Section 1.1 (External economic factors).

Figure 3: **Prices**



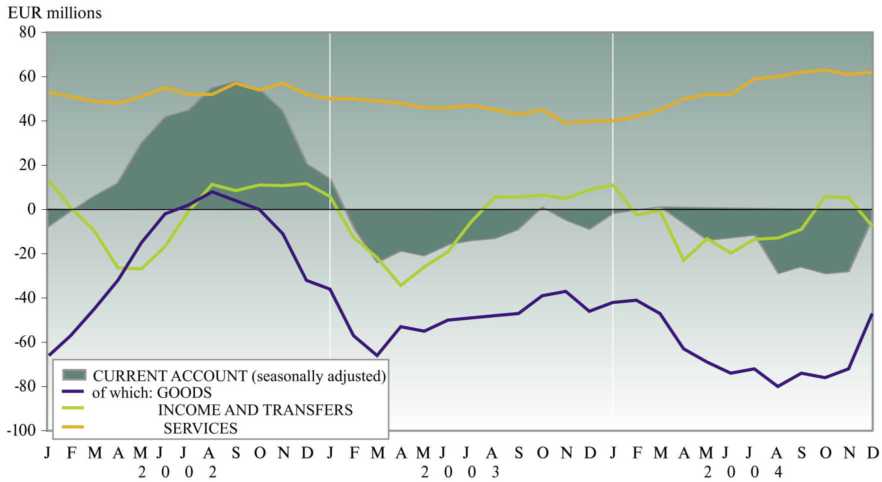
Source: SORS, Bank of Slovenia

1.4 Balance of payments

A moderate deficit in the current account

Slovenia recorded a current account deficit for the second successive year, the 2004 figure being EUR 238 million, or 0.9% of estimated GDP. The main factors in the widening of the current account deficit from 2003 were the trends in imports and exports in the context of slightly higher domestic demand and adverse price movements on the external market, and a decline in the surplus from transfers. The record high surplus recorded by services and the decline of more than 40% in net labour and capital outflows had a positive effect on the current account.

Figure 4: **Current account**



Source: SORS, ARC estimates, Bank of Slovenia

Imports of goods grew faster than exports in 2004

Slovenia's trade deficit in 2004 was EUR 1,291 million, or 5.0% of estimated GDP, up 1 percentage point from 2003, but down 1 percentage point from the average over the 1996 to 2002 period. Exports of goods amounted to EUR 12,587 million, up 11.5% from 2003. Imports of goods rose slightly faster, by 13.4% from 2003, to reach EUR 13,878 million. With import growth faster than export growth, the coverage of imports by exports declined by 1.5 percentage points to 90.7%.

The balance of trade first made a negative then a positive contribution to GDP growth

Owing to the adverse movements in the balance of trade, particularly in the period leading up to EU membership, the contribution made to GDP growth by the balance of trade was negative in the first two quarters of 2004, although at 0.7 percentage points in the first quarter and 1.1 percentage points in the second quarter it was less than half the level recorded in the second half of 2003. Then results in the trade of goods and services improved in the third and fourth quarters of the year, the balance of trade contributing 0.4 percentage points to GDP growth.

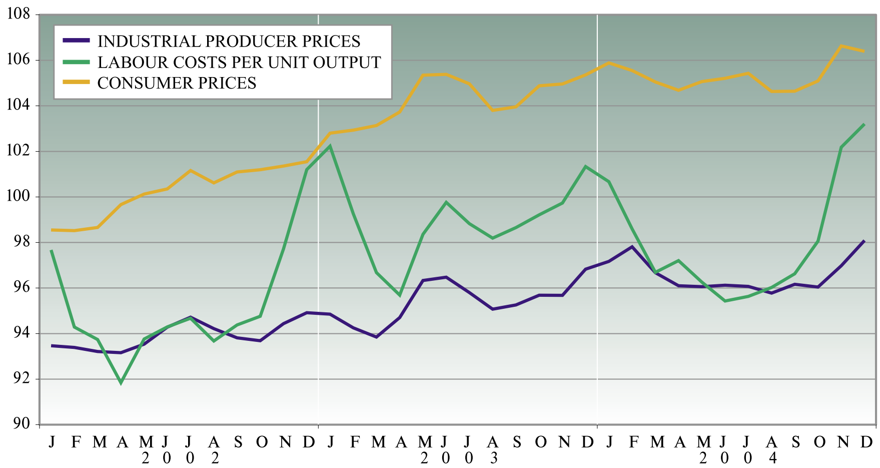
Growth in imports and exports in volume terms

Growth in imports and exports of goods in volume terms was slightly lower in 2004 than indicated by the figures expressed in euros. The reason for the difference is that the import and export prices of goods expressed in euros rose in 2004 in comparison with 2003. There were two distinct periods of movement in import and export prices in 2004. During the first, between January and April, prices declined in year-on-year terms, with import prices declining more than export prices, which brought an improvement in the terms of trade of Slovenian exporters. From May onwards there was positive year-on-year growth in import and export prices. During this period growth in import prices exceeded growth in export prices, with the gap ranging from 1 to 3 percentage points in the individual months. The strong factors in the faster growth in import prices were rises in oil prices on world markets and rises in the prices of industrial metals quoted in dollars on world exchanges. The reason for the faster growth in euro import prices seen from April onwards was that the dollar prices of certain commodities, industrial metals and, in particular, oil began to rise faster than the euro did against the dollar. Although food prices and commodities prices, which have declined since August, were of less significance, the prices of oil and industrial metals remained relatively high until the end of the year. Oil prices were 39% higher in the final quarter of 2004 than in the same period the previous year, while prices of industrial metals were up 19%.

Real growth in exports of goods doubled, while imports were up by one-half

In 2004 euro export prices rose by 1.4% year-on-year, and euro import prices by 1.5%. Real growth in exports of goods in 2004 more than doubled from the rate recorded in 2003 to 9.5%, while growth in imports of goods was up by more than one-half at 10.3%. The terms of trade, which indicate the difference between import and export prices, deteriorated by 1.2% from the previous year. Were the terms of trade the same as they had been in 2003, the deficit in trade in goods in 2004 would be more than EUR 150 million narrower than the actual figure.

Figure 5: **Real effective tolar exchange rate**



Note: Fixed index 1995 = 100.
Source: Bank of Slovenia

The real effective tolar exchange rate appreciated in 2004

The real effective tolar exchange rate appreciated in 2004, but much less than in the previous two years given the faster current rate of fall in domestic prices than in prices abroad. The real effective tolar exchange rate as measured by relative labour costs per unit output depreciated by 1% on average over 2004, despite appreciating in November and December, owing to high wage growth and modest output.

Slovenia's membership of the EU and the economic recovery in the EU benefited trade in goods

There were two important factors affecting the trade in goods in 2004. The first was the recovery of economic activity in the countries of the EU, which began in the final quarter of 2003, while the second was Slovenia joining the European Union on 1 May 2004. When Slovenia joined the organisation, the acquis communautaire replaced the favourable bilateral agreements with countries of the former Yugoslavia and Soviet Union, which had brought a powerful increase in exports to and imports from these countries in the months leading up to EU membership. After 1 May exports to and imports from EU member-states also rose.

The largest rises in exports were recorded by intermediate goods and capital goods

Increased demand from abroad and changes in the structure of domestic spending also affected the dynamics and structure of imports and exports of goods in the different economic categories. The largest rise in exports in 2004 was recorded by intermediate goods at 13.9%, with exports of capital goods rising by a little less (12.1%), and exports of consumer goods rising by half this level (7.1%). In addition to greater foreign demand, another factor in the high growth in exports of intermediate goods and capital goods was higher direct investment by Slovenian companies, particularly in the countries of the former Yugoslavia and Soviet Union. The more modest demand for Slovenian consumer goods is an indication of the vastly increased level of competition faced by domestic consumer goods manufacturers on foreign markets. This is particularly prominent in certain labour-intensive sectors, such as the textile industry and footwear industry, which are facing competition from countries with a cheap labour force. The foodstuffs industry and beverage producers have also faced fierce competition since Slovenia joined the EU.

The largest rises on the import side were recorded by intermediate goods and consumer goods

The largest rise on the import side was also recorded by intermediate goods at 14.4%. Given the level to which the Slovenian economy is integrated into the EU economies, the movement in imports and exports of intermediate goods are closely linked. These are imports that after processing or manufacture are exported and used to manufacture final products for sale at home or abroad. The smallest rise came in imports of capital goods at 3.5%, which indicates that the period of strong investment by companies in order to increase their competitiveness prior to EU membership has come to an end. Under the influence of higher consumer spending, the rise in imports of consumer goods doubled in 2004 to 12.7%.

The deficit in trade in goods was EUR 337 million wider

The changes in the current rates of growth in imports and exports of goods also brought changes in the structure in terms of economic category. The proportion of exports accounted for by intermediate goods rose from 48.4% to 49.6% in 2004, while the proportion accounted for by capital goods remained unchanged at 14.6% and the proportion accounted for by consumer goods fell by 1.3 percentage points. Similarly for imports, the proportion accounted for by intermediate goods rose most, from 57.8% to 59.1%, while the proportion accounted for by consumer goods rose from 23.2% to 23.4% and the proportion accounted for by capital goods fell from 19% to 17.5%. The deficit in trade in goods widened by EUR 337 million, the main factors being a widening of the deficit in trade in intermediate goods by EUR 260 million, of which more than EUR 150 million was the rise in the value of oil imports in comparison with 2003. For the second year in succession there was a negative effect on the deficit caused by a decline in the surplus in trade in consumer goods, which fell by EUR 65 million in 2004. The contraction of EUR 116 million in the deficit in trade in capital goods had a positive effect.

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

	EXPORTS[1]			IMPORTS[1]			TRADE BALANCE		
EUR millions	2002	2003	2004[2]	2002	2003	2004[2]	2002	2003	2004[2]
European Union (25)	**7,407**	**7,556**	**8,270**	**8,838**	**9,256**	**10,867**	**-1,431**	**-1,700**	**-2,598**
Austria	774	827	931	956	1,052	1,587	-182	-225	-657
France	734	638	802	1,190	1,230	1,175	-455	-591	-373
Italy	1,328	1,483	1,619	2,070	2,240	2,540	-742	-757	-921
Germany	2,714	2,611	2,676	2,216	2,359	2,688	499	252	-12
New member-states	**892**	**956**	**1,039**	**968**	**1,023**	**1,206**	**-76**	**-67**	**-167**
Czech Republic	201	205	238	288	308	333	-87	-103	-95
Hungary	196	223	242	341	352	480	-145	-129	-238
Poland	305	311	334	168	189	196	137	121	138
Slovakia	132	162	169	162	163	171	-31	-1	-2
Efta	**207**	**176**	**165**	**202**	**221**	**219**	**5**	**-45**	**-55**
Non-European OECD members	**447**	**586**	**632**	**715**	**761**	**593**	**-268**	**-175**	**38**
United States	297	410	399	334	294	223	-36	116	176
Canada	28	21	20	36	46	40	-9	-25	-20
South Korea	16	19	13	72	82	73	-56	-62	-60
Countries of former Yugoslavia	**1,952**	**1,967**	**2,247**	**575**	**613**	**797**	**1,377**	**1,354**	**1,450**
Bosnia-Herzegovina	492	471	489	69	78	150	423	393	339
Croatia	954	1,007	1,164	419	444	508	536	562	656
Serbia-Montenegro	347	346	454	61	68	112	285	278	342
Macedonia	159	143	139	26	22	27	133	121	112
Countries of former Soviet Union	**455**	**498**	**603**	**336**	**374**	**384**	**119**	**124**	**219**
Russia	320	348	419	269	311	316	51	36	103
Other countries	**494**	**502**	**621**	**908**	**1,014**	**839**	**-414**	**-512**	**-217**
TOTAL	**10,962**	**11,285**	**12,587**	**11,574**	**12,239**	**13,878**	**-612**	**-954**	**-1,291**

1 Exports f.o.b. and imports c.i.f.
2 Figures 2004 are provisional.
Source: Statistical Office of RS

Exports to countries of the former Soviet Union and Yugoslavia recorded faster than average growth

The regional structure of Slovenia's foreign trade has remained unchanged for a long time. European countries account for more than 90%, with just 10% of trade being with the rest of the world. In 2004 there was an above-average increase in exports to the countries of the former Soviet Union and the former Yugoslavia, an approximately average increase in exports to non-European OECD countries, and a decline in exports to Efta nations. The proportion of exports accounted for by EU member-states has long been declining, with a fall of more than 3 percentage points in the period between 2001 and 2003, and a further fall of 1 percentage point in 2004 to 66%. The proportion of imports accounted for by the EU averaged around 76% in the period to 2003, but with imports growing at twice the rate of exports in 2004 it rose by more than 3 percentage points to 79%.

Germany, Italy, Austria and France remain the most important trading partners

The ranking of the countries that account for just under one-half of Slovenia's total exports and 60% of its imports remained unchanged in 2004, with Germany, Italy, Austria and France accounting for the largest proportions. With a small increase in its share of imports, last year the trend of a decline in exports of goods to Germany continued, the fall of just under 2 percentage points last year taking the fall in the last five years to 5 percentage points. There was a smaller decline of 0.2 percentage points in Italy's share of exports. In both countries the recovery in economic activity in the last year and a half has been slower than the EU average. With Austria's share of imports remaining stable, France's share of exports rose by 0.7% last year, having fallen for the three previous years. The proportion of exports accounted for by countries that joined the EU together with Slovenia on 1 May 2004 was 8.4%, slightly less than in 2003, while the proportion of imports they account for rose to 8.7%. Poland's export share remains the largest among the new member-states at 2.7%, followed by Hungary and the Czech Republic with 2.0% and Slovakia with 1.3%. Slovenian exporters have compensated for the slowdown in exports to the most important trading partners inside the EU in the last two years by expanding exports to other EU member-states. The most notable growth was recorded by exports to Greece (56%), Belgium (48%), Denmark (22%), Spain (16%) and certain other countries with which trade in goods had been relatively modest in the past.

There was a rise in exports to Greece, Belgium, Denmark and Spain

The deficit in the balance of trade with the EU has doubled in the last four years, widening most in 2004. In 2001 it stood at EUR 1,244 million, but had reached EUR 2,598 million by the end of 2004. The largest deficits in 2004 were recorded in trade with Italy, Austria and France. One of the major factors in the rapid widening of the deficit with EU member-states is the accelerating decline of the surplus in trade in goods with Germany. In 2001 the surplus stood at EUR 522 million, but in 2004 there was a deficit of EUR 12 million. The largest volume of trade in goods with a country outside Europe is with the USA. Its share of imports and exports fell last year, probably as a result of the fall in the dollar against the euro. However the surplus increased by 50% to EUR 176 million.

The deficit in the balance of trade with the EU has doubled in the last four years

After stalling in 2003, the former Yugoslav republics' share of exports rose to 17.9% in 2004, while the share of imports rose to 5.8%. In the last three years there has been a decline in exports of goods to Bosnia-Herzegovina and Macedonia. The largest rise has been in Croatia's share, by 0.4 percentage points to 9.3%, caused partly by major exports of electricity. There was a slightly smaller rise of 0.4 percentage points in the share of exports to Serbia-Montenegro. Exports to the countries of the former Soviet Union rose at twice the rate of exports overall, and their share of total exports rose to 4.8%. Just two countries account for approximately 90% of these exports: Russia (70%) and Ukraine (just under 20%).

The former Yugoslav republics' share of exports rose to 17.9% in 2004, and the share of imports to 5.8%

Movements on world foreign exchange and oil markets are increasing the risks to further growth in Slovenia's exports. The dollar's decline against the euro and the rise in oil prices are having a significant adverse effect on the competitiveness of EU member-states, particularly the eurozone, and are adversely affecting the conditions for economic growth. As these countries include Slovenia's most important trading partners, a slowdown in the recovery of economic activity in these countries could have negative consequences on Slovenia's exports and economic growth.

Risks on foreign exchange and oil markets could threaten growth in Slovenia's exports

Since the second quarter of 2004 the improvement of economic activity abroad has also accelerated growth in the services balance. Exports of services were up 13% from 2003, while imports were up 9.9%. With exports rising faster than imports, the surplus in trade in services reached EUR 672 million, up EUR 134 million from 2003 and the highest figure since 1996.

Exports of services rose by 13% in 2004, while imports rose by 10%

For the first time in four years revenues from tourism rose faster than expenditure. Growth in the number of arrivals by foreign tourists doubled in 2004 to 9%, while the rise in the number of overnight stays by foreign guests was more modest at 4%. The different dynamics point to an increase in the number of tourists visiting

Tourism revenues grew faster than expenditure

Slovenia for a shorter period. The rise in the number of tourists from the most important trading partners, Austria and Germany, was above-average, while there was an average rise in the number from Italy. The largest rise was recorded by the number of foreign tourists from other members of the EU, in particular the United Kingdom and France, which rose by 50% on average. Tourism revenues amounted to EUR 1,312 million in 2004, up 10.6%, while tourism expenditure rose more slowly (up 9.9%) to reach EUR 732 million by the end of the year. In the light of these movements the tourism surplus rose by EUR 60 million to EUR 580 million.

Since 1996 transport services have been the fastest-growing service activity

Transport services are closely linked to movements in trade in goods and the increase in passenger transport to and from the rest of the world. Since 1996 transport services in foreign trade have been the fastest-growing service activity. Revenues from export transport have doubled in the last eight years, while expenditures have risen by just over one-half, and the surplus is five times bigger. Revenues rose by 18.8% in 2004 and expenditures by 16.1%. In line with these dynamics the surplus rose by EUR 60 million to EUR 321 million. Expenditures for construction and assembly work in Slovenia rose by more than one-third from 2003. With revenues of EUR 78 million and expenditures in the amount of EUR 49 million, there was a surplus of EUR 29 million generated. The results in the financial intermediation sector also deteriorated, owing to modest investments by non-residents. With revenues of EUR 14 million and expenditures of EUR 33 million, there was a deficit of EUR 19 million. In outflow-oriented service sectors, e.g. communications and computing, the deficit narrowed by EUR 3 million to EUR 41 million. In the last four years expenditures on patents, licences and copyrights have doubled. They rose by more than one-third in 2004, or by EUR 99 million. With regard to other services, in the context of revenue growth that is faster than growth in expenditures, the deficit of EUR 68 million remained at the prevous year level.

In the last four years expenditures on patents, licences and copyrights have doubled

Net income was negative in 2004

Net income in the balance of payments was negative in 2004 in the amount of EUR 101 million. Net inflows from labour income fell by EUR 9 million from the previous year to EUR 156 million. The deficit in capital income fell by EUR 86 million from EUR 342 million in 2003 to EUR 256 million in 2004. Dividends paid and profit distributed to non-residents rose by 50% last year. With the external debt rising by EUR 1.6 billion, interest payments to the rest of the world rose by 16%. Capital revenues rose by 11%, with income from investments in securities rising by 31% from EUR 193 million to EUR 253 million. Income from bonds and notes rose by EUR 23 million to EUR 189 million in 2004.

A decline in the contribution to the current account made by transfers

The contribution made to the current account by net transfers has been falling rapidly in the last three years. In 2002 it stood at EUR 142 million, but in 2004 it was less than one-quarter of this at EUR 31 million. The main reason for the decline in net transfers was a rise last year of EUR 53 million in other net transfers and a EUR 12 million rise in official transfers to the rest of the world.

Table 3: **Balance of payments**

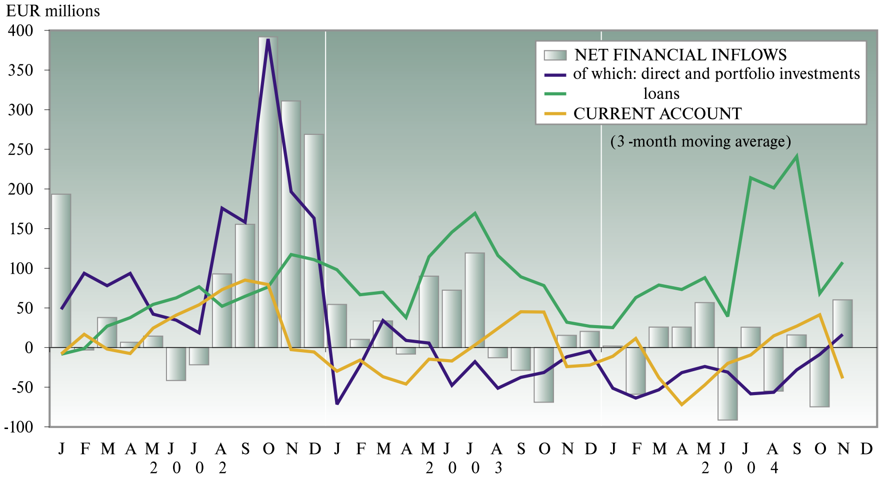
EUR millions	1999	2000	2001	2002	2003	2004
A. CURRENT ACCOUNT	**-664**	**-583**	**38**	**335**	**-91**	**-238**
- as % of GDP	*-3.5*	*-2.8*	*0.2*	*1.4*	*-0.4*	*-0.9*
1. Goods	-1,164	-1,227	-684	-269	-546	-840
2. Services	330	489	536	616	538	672
2.1. Transport	132	149	203	249	261	322
2.2. Travel	389	489	504	508	520	579
- of which exports	900	1,045	1,105	1,143	1,186	1,312
2.3. Other	-191	-149	-171	-141	-243	-229
3. Income	58	29	43	-154	-178	-101
3.1. Labour income	171	174	167	169	164	155
3.2. Capital income	-113	-145	-124	-323	-342	-256
4. Current transfers	112	125	144	142	94	31
B. NET FINANCIAL INFLOW	**521**	**1,089**	**1,724**	**1,107**	**159**	**105**
- as % of GDP	*2.6*	*5.3*	*7.9*	*4.7*	*0.6*	*0.4*
1. Private sector:	201	727	1,510	1,438	244	282
1.1. Claims	-616	-403	296	-1,594	-1,861	-2,524
Capital transfers	-	-	-	-237	-245	-276
Outward FDI	-45	-72	-161	-168	-414	-401
Investments in securities	5	-24	-87	-144	-160	-483
Trade credits[1]	-294	-194	-249	-136	-119	-236
Loans	-39	-72	19	-250	-242	-292
Households	-222	-13	797	-592	-590	-710
1.2. Liabilities	817	1,130	1,213	3,032	2,105	2,807
Capital transfers	-	-	-	74	81	87
Inward FDI	99	149	412	1,750	299	422
Investments in securities	-2	28	11	27	34	148
Trade credits[2]	-	-	-	94	64	200
Loans	713	953	649	917	1,230	1,682
Bank deposits	2	34	152	130	428	236
1.3. Other, net	-15	-61	-34	-27	-123	-95
2. Government	326	307	114	-86	-126	-161
3. Bank of Slovenia	-46	13	-10	-51	-24	114
4. Net errors and omissions	40	41	110	-193	65	-130
C. FOREIGN EXCHANGE RESERVES (change):	**143**	**-506**	**-1,762**	**-1,443**	**-68**	**133**
1. Bank of Slovenia	129	-206	-1,436	-1,840	-241	239
2. Banks	13	-300	-326	397	173	-106

[1] Before 2002 trade credits are recored as net trade credits (claims minus liabilities).
[2] 'Minus domestic banks' transactions in government bonds.
Source: Bank of Slovenia

Net financial outflows in 2004

Slovenia's financial account had net inflows in the amount of 0.4% of GDP in 2004. The majority of financial transactions with the rest of the world again proceeded through the private sector, which received a net financial inflow of EUR 282 million. By contrast, for the third year in succession the government had a net outflow in financial transactions. In 2004 it made a net repayment of EUR 161 million of its external debt. In June the eurobonds issued in 1997 matured in the amount of EUR 205 million (DM 400 million at issue), although the government's payment to non-residents was lower at EUR 154 million, as some of the bonds were held by domestic banks.

Figure 6: **Financing of the current account**



Source: Bank of Slovenia

The private sector expanded its financial transactions with the rest of the world

In 2004 the private sector expanded its financial transactions with the rest of the world in terms of both borrowing and lending. Gross financial transactions with the rest of the world amounted to 20% of GDP, with financial inflows equivalent to 10.8% of GDP (up 2.2 percentage points in comparison with 2003), and financial outflows equivalent to 9.2% (up 1.6 percentage points).

An increase in the private sector's financial outflows

The private sector's financial outflows reached EUR 2,524 million in 2004, up 36% from 2003. The rise derives mainly from a large increase in portfolio investments abroad, while other types of investment connected to export support and the business of Slovenian companies abroad also continued to grow.

The proportion of financial outflows accounted for by investments in foreign securities doubled

Investments in foreign securities amounted to EUR 483 million in 2004, and the proportion of financial outflows that they account for have more than doubled to 19%. They are equivalent to almost 2% of GDP. This rapid increase in portfolio investments abroad is in particular the result of changes in the structure of the domestic financial market, primarily the boom in mutual funds, which in just under two years have more than tripled their investor numbers and assets value.

After growing rapidly in 2003, the flow of direct investment abroad was somewhat lower in 2004 at EUR 401 million, down 3% from the previous year. The investments were almost entirely of an equity nature, while in previous years a significant proportion of the investments were debt claims against affiliated companies.

An expansion of trade credits for foreign partners with the high growth in exports to less wealthy regions

In 2004 Slovenian companies expanded their financing of foreign trade partners abroad through trade credits in the total amount of EUR 236 million. The expansion of trade credits is linked to the above-average growth in exports to less wealthy European countries. The amount of subsequently agreed discounts on exported goods rose to reach EUR 276 million at year-end, up 13% from 2003. There was also a rise in the financing of foreign trade partners through loans, which reached EUR 292 million, up 21%. In contrast to previous years, when financial loans to foreign trade partners were approved by companies, in 2004 the burden of lending to foreign trade partners was primarily assumed by banks (EUR 199 million from banks, EUR 93 million from companies).

Financial inflows to the private sector rose slightly more than outflows in 2004, by 33% to EUR 2,807 million. The largest rise in inflows came from the increase in borrowing abroad by banks, while inflows from direct and portfolio investments and trade credits received from foreign partners also strengthened.

Direct investments by non-residents amounted to EUR 422 million in 2004, up EUR 103 million from the previous year. The majority of the investments were in the form of equity investments, unlike 2003 when investments by non-residents were exclusively in the form of debt relationships between foreign investors and subsidiaries in Slovenia, and reinvested earnings. In the last months of the year non-residents again began to appear primarily as portfolio investors, while the banking sector secured an additional source of financing at the end of the year by issuing bonds abroad. Portfolio investments by non-residents in Slovenia' private sector totalled EUR 148 million in 2004 (compared with just EUR 34 million in 2003).

Direct investments by non-residents were higher than in 2003

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

Balance at end of period (EUR millions)	1999	2000	2001	2002	2003	2004
Gross external debt (GED)	**8,012**	**9,491**	**10,403**	**11,455**	**13,305**	**15,397**
1. Long-term debt	4,812	5,895	7,349	8,147	9,737	11,498
as % of GED	60.1	62.1	70.6	71.1	73.2	74.7
- of which: bonds and notes	1,494	1,748	1,934	1,935	2,145	2,180
loans	3,134	3,983	5,117	5,832	7,003	8,491
2. Short-term debt	2,155	2,283	2,222	2,305	2,447	2,823
as % of GED	26.9	24.1	21.4	20.1	18.4	18.3
- of which: trade credits	1,659	1,834	1,690	1,692	1,656	1,853
deposits	364	401	396	383	558	550
3. Intercompany lending	1,045	1,312	831	1,002	1,120	1,076
as % of GED	13.0	13.8	8.0	8.8	8.4	7.0
Short-term debt by remaining maturity	**3,374**	**4,382**	**4,569**	**4,448**	**4,555**	**5,322**
Net external debt	**315**	**791**	**-422**	**-1,125**	**456**	**2,004**
Foreign exchange reserves	4,104	4,705	6,513	7,842	7,703	7,477
FX reserves/GDP (%)	20.7	22.9	29.7	33.4	31.3	28.9
FX reserves/imports (months)	4.6	4.6	6.1	7.1	6.7	5.8
GED/GDP (%)	40.4	46.1	47.7	48.8	54.1	59.3
FX reserves/short-term debt by maturity (%)	**121.6**	**107.4**	**142.6**	**176.4**	**169.1**	**140.5**

[1] Short-term debt by remaining maturity consists of non-equity debt to the rest of the world that falls due within 12 months.
[2] GED netted with non-equity claims against the rest of the world.
Source: Bank of Slovenia

Banks and companies increased their borrowing abroad in 2004. The private sector had net borrowing of EUR 1,682 million in foreign loans. Banks' net borrowing amounted to EUR 943 million (up 43%), which gave them an additional source for financing their investments at home, primarily by making foreign currency loans to companies. In order to finance their expanded economic activities in 2004, there was a strong increase in companies' demand for loans from domestic banks, and also in the demand for foreign loans. The latter rose by 27% from 2003 to reach EUR 739 million. In raising loans abroad in 2004, banks achieved an average interest rate of 2.4%, down 0.4 percentage points from the average in 2003. An even larger reduction was achieved by companies, whose average interest rate of 2.7% was down 0.8 percentage points from the previous year. The fall in the average annual interest rates came from the reduction of rates during 2003, while in 2004 they were more or less unchanged.

Borrowing abroad by banks and companies

The gross external debt stood at EUR 15,397 million at the end of 2004, up EUR 2,092 million from the end of 2003. The largest rise in the level of external debt was on the part of the banking sector, its debt rising by EUR 1,369 million to EUR 4,784 million. The non-financial sector's debt rose by EUR 929 million to EUR 7,189 million. Just under 30% of the latter is in the form of short-term debt, almost

An increase in the gross external debt

all trade credits received, while trade credits account for 12% of the total external debt, with a falling trend.

The financial account only partly covered the deficit in the current account

Claims against the rest of the world rose more slowly in 2004 than the gross external debt, and were up EUR 519 million to EUR 13,393 million, which increased the net external debt to EUR 2 billion at the end of the year.

The financial account only partly covered the deficit in the current account. The difference of EUR 133 million was covered by total foreign exchange reserves, which fell to EUR 7,477 million by the end of the year. The level of reserves is sufficient to cover 5.8 months of imports of goods and services, and exceeds the external debt falling due for payment within one year by 41%.

1.5 Public finances

An amendment to the national budget

The National Assembly adopted the revised 2004 budget and the 2005 budget in December 2003. In 2004 there were important changes in the area of public finances connected with EU membership. Flows between the Slovenian budget and the European Union budget were established, while the consequences of membership were also reflected in a (one-off) liquidity loss in VAT and in lower Slovenian budget revenues from customs duties and fees.

Provisional figures put the general government deficit at 1.4% of GDP

The general government deficit, which covers the four general government treasuries – the state budget, municipal budgets, the Pension and Disability Insurance Institute and the Health Insurance Institute (compulsory insurance only with regard to the latter two) – amounted to SIT 85 billion or 1.4% of GDP in 2004 according to provisional figures. The state budget and the Health Insurance Institute recorded a deficit, while the municipal budgets and the Pension and Disability Insurance Institute recorded a surplus.

Taxes on income and profit were the fastest-growing revenues

According to the provisional figures, general government revenues amounted to SIT 2,584 billion in 2004, equivalent to approximately 41.7% of GDP, while general government expenditures amounted to SIT 2,669 billion, equivalent to 43.1% of GDP. The year-end general government revenues and expenditures were lower than had been forecast. The fastest growing of the major general government revenues were taxes on income and profit, which rose by 6.3% in real terms in 2004 and generated revenues of SIT 507 billion. There was particularly high growth in revenues from corporate income tax, which were higher than forecast at close to 2% of GDP. Social security contributions grew more slowly, by approximately 4.8% in real terms over the year, and they generated revenues of SIT 801 billion. Taxes on goods and services, the largest proportion of which is accounted for by VAT and excise duties, rose by 1.6% in real terms in 2004, with revenues amounting to SIT 857 billion. While there was a fall of 0.6% year-on-year in VAT revenues, the movement in excise duty revenues was more favourable. Excise duties rose by more than 6% in real terms over the year, with the structure continuing to change as duties on tobacco products account for an increasing proportion.

Certain types of current transfer were the fastest-growing expenditures

Provisional figures show the fastest-growing of the major general government expenditures in 2004 to be expenditures on certain types of current transfer. Current transfers amounted to SIT 1,250 billion in 2004, with expenditures on subsidies and social security transfers growing the fastest. There was a smaller rise in expenditures on pensions, which were up 2.2% in real terms over the year to reach SIT 678 billion. The number of pensioners rose by 1.2%, with the number of old age pensioners up 2%. There were two pension increases, in February and December. Investment expenditures, which also include transfers, amounted to SIT 244 billion in 2004, up more than 1% in real terms from the previous year. Less money was earmarked for investment over the whole year than had been forecast. Expenditures for public sector wages were higher in real terms than in the previous year at SIT 589 billion. The expenditures benefited from the adoption of the public sector wage policy agreement, which brought a real decline in the average wage in the public sector. However in 2004 there was again an increase in employment in the public sector, which was up more than 2% over the year. Premium payments for collective supplementary pension insurance for public employees during the year amounted to SIT 13 billion. Expenditures on goods and services amounted to SIT 430 billion in 2004.

A deficit in the general government lending and repayment account of SIT 8 billion

The general government lending and repayment account recorded a deficit in the amount of SIT 8 billion in 2004. The received repayments of loans granted and sales of capital shares amounted to a total of SIT 6 billion, while loans granted and increases in capital shares totalled SIT 14 billion.

The proportion of external debt continued to fall, and the proportion of internal debt continued to rise

The public debt in 2004 rose by SIT 109 billion or 7.3%. The core strategic policy in managing the public debt was again borrowing on the domestic market in 2004. The financing account for all four general government treasuries recorded net borrowing of SIT 89 billion during the year. The government borrowed SIT 140 billion net domestically – net borrowing of SIT 137 billion through bonds, and net borrowing of SIT 3 billion through loans – while it reduced its debt to the rest of the world by SIT 51 billion. Thus in 2004 the proportion of external debt fell (by 5 percentage points to September) and the proportion of internal debt rose. In 2004 the government continued to issue 3-year, 5-year and 10-year bonds with a fixed nominal interest rate.

The debt of the Republic of Slovenia amounted to 25.8% of GDP

As at 31 December 2004, the debt of the Republic of Slovenia stood at SIT 1,600 billion, or 25.8% of GDP, of which approximately two-thirds was owed to the domestic sector 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. Republic of Slovenia debt guarantees accounted for an additional SIT 527 billion, or approximately 8.5% of GDP.

Both Maastricht fiscal criteria met

In 2004 Slovenia met both Maastricht fiscal criteria. The general government deficit is limited to 3.0% of GDP and the general government debt to 60% of GDP on the ESA95 basis. The March 2005 Reporting of Government Deficit and Debt Levels put Slovenia's general government deficit in 2004 at 1.9% of GDP on the basis of provisional figures, while the general government debt was estimated to be 29.5% of GDP at the end of 2004, the same level as the previous year.

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2 MONETARY POLICY

2.1 The conduct of monetary policy

Price stability and adopting the euro at the beginning of 2007 are the Bank of Slovenia's core aims

The main objective of monetary policy is price stability. The Bank of Slovenia conducted its monetary policy in 2004 in line with the Bank of Slovenia Monetary Policy Guidelines of November 2001, and the Programme for ERM II Entry and Adoption of the Euro (the joint programme), which was adopted by the Bank of Slovenia and Slovenian government in November 2003. In the joint programme they committed themselves to entering the ERM II by the end of 2004 and to creating the conditions to allow the euro to be adopted at the beginning of 2007.

Slovenia entered the ERM II on 28 June 2004

Slovenia entered the ERM II, one of the prerequisites for introducing the euro, on 28 June 2004. The central rate was set at SIT 239.640 to the euro in agreement with the relevant European institutions. The nominal exchange rate is allowed to fluctuate within a standard band of ±15%.

Since entry into the ERM II, the Bank of Slovenia has maintained the stability of the exchange rate. The discrepancies between the central rate and the market rate during the participation to date in the ERM II have been negligible. The average deviation of the exchange rate on the spot market[2] between the day of entry and the end of 2004 was 0.08%, with a maximum deviation upwards of 0.24% and a maximum deviation downwards of 0.18%. The volatility of the exchange rate on the exchange office market was even lower. The two exchange rates were above the central rate. The tolar/euro exchange rate published by certain banks and taken by the ECB as the reference tolar exchange rate against the euro was also above the central rate, and showed less volatility than the exchange rate on the spot market.

Since ERM II entry interest rate policy has been subordinate to maintaining the stability of the tolar

Maintaining a stable exchange rate makes the Bank of Slovenia' interest rate policy subordinate to factors that are independent of the bank. The most important of these are:

- interest rates in the eurozone, which are in essence shaped on the basis of the ECB's monetary policy
- the risk premium, which is shaped on the basis of foreign investors' perception of the country risk, and currency and liquidity risk

The sustained disinflation trends allowed the Bank of Slovenia to cut nominal interest rates while leaving real interest rates positive in the first half of the year. Prior to ERM II entry, in line with the need to maintain an appropriate difference between interest rates in Slovenia and those in the eurozone, cuts in nominal interest rates were accompanied by a reduction in the rate of tolar depreciation. The interest rate on 60-day tolar bills was cut from 6.0% in December 2003 to 4.0% in June 2004, while the year-on-year inflation rate fell from 4.6% to 3.9%. During the same period the current annual rate of tolar depreciation against the euro fell from 2.5% to 1.0%. Under this policy the gap between domestic and foreign interest rates was reduced to a level that allowed the stabilisation of the exchange rate when the ERM II was joined.

[2] The spot market is intended for concluding transactions to be settled within two working days of the contract being concluded. All bank transactions in euros with companies, households and non-residents and all transactions between banks are considered when the rate is calculated. The figures are published in Table 2.13.2 of the Bank of Slovenia Bulletin.

The Bank of Slovenia has made no change in its key interest rates since ERM II entry. Interest rates in the eurozone have remained unchanged since the middle of 2003, with the ECB refinancing rate at 2.0%. Neither is there any indication that Slovenia's risk premium has changed since it entered the ERM II. Developments on the money market allowed tolar interest rates to be maintained at the level reached at ERM II entry.

The approach of the introduction of the euro encouraged structural changes

With the planned adoption of the euro in mind, the Bank of Slovenia made certain structural adjustments aimed at easing the transition to the conditions of operation in the eurosystem. These adjustments relate to the replacement of 270-day tolar bills with long-term deposits, the gradual relaxation of minimum foreign currency liquidity within the framework of the liquidity ladder, the system of required reserves and the level of swapped foreign exchange.

New offer of tolar deposits

The Bank of Slovenia issued 270-day tolar bills with the aim of sterilising excess liquidity from the purchase of foreign currency that arrived on the foreign exchange market when Novartis took over Lek. When these matured the Bank of Slovenia offered the opportunity to take up long-term tolar deposits with a maturity period that extends into the period after the planned adoption of the euro. The interest rate offered on the long-term tolar deposits is 0.2 percentage points higher than the interest rate on 60-day tolar bills. Banks used 55% of the possible subscription, and there were SIT 156.7 billion of long-term tolar deposits at the end of the year.

Relaxation of minimum foreign currency liquidity

The Bank of Slovenia relaxed the minimum foreign currency liquidity for banks within the framework of the liquidity ladder. In 2004 the Bank of Slovenia reduced the minimum level of liquid assets in foreign currency from 80% to 70% of short-term liabilities in foreign currency and the level of required subscription to foreign currency bills from 45% to 35% of liquid assets in foreign currency.

Statement of ERM II committee upon Slovenia's entry into ERM II

At the request of the Slovenian authorities, the ministers of the euro area member-states of the European Union, the president of the European Central Bank and the ministers and the central bank governors of Denmark and Slovenia have decided, by mutual agreement, following a common procedure involving the European Commission and after consultation of the Economic and Financial Committee, to include the Slovenian tolar in the ERM II. The central rate of the Slovenian tolar is set at SIT 239.640 to the euro. The standard fluctuation band of plus or minus 15% will be observed around the central rate of the tolar. The agreement on the participation of the tolar in the ERM II is based on a firm commitment by the Slovenian authorities to continue to take the necessary measures to lower inflation in a sustainable way: these include most notably measures aimed at further liberalising administered prices and advancing further with de-indexation, in particular of the wage and certain social transfer setting mechanisms. Continued vigilance will be needed so that domestic cost developments, in particular wages, are in line with productivity growth. The authorities, together with the responsible EU bodies, will closely monitor macroeconomic developments. Fiscal policy will have to play a central role in controlling demand-induced inflationary pressures and financial supervision will assist in containing domestic credit growth. Structural reforms aimed at further enhancing the economy's flexibility and adaptability will be implemented in a timely fashion so as to strengthen domestic adjustment mechanisms and to maintain the overall competitiveness of the economy. The compulsory intervention points in the mechanism will be communicated by the ECB and the Bank of Slovenia, in time for the opening of the foreign exchange markets on 28 June 2004.

The Bank of Slovenia continued its gradual adjustment of the required reserve instrument to the standards of the ECB. In January it changed the period for maintaining the required reserves. In addition the Bank of Slovenia now charges interest on the average balance in the accounts of those obliged to maintain required reserves, and no longer on the daily balance. It continued to make adjustments to the standards of the ECB in September, when it:

- included companies issuing electronic money among those obliged to maintain required reserves
- abolished the mandatory 50% daily maintenance of required reserves
- regulated the obligation to maintain required reserves in the event of bankruptcy
- set a 0% level of required reserves for repo transactions

A reduction in the amount of swapped foreign exchange from the past

ERM II entry, the maintenance of exchange rate stability and the structural adjustments to the Bank of Slovenia instruments demand greater flexibility for banks in operating on foreign exchange markets. The cumulative amount of foreign exchange swapped with the Bank of Slovenia affects this flexibility, and the Bank of Slovenia therefore offered banks the opportunity of a final sale of foreign exchange from cumulative Bank of Slovenia reverse swaps. In seven offers banks were offered a total of EUR 1,718 million of reverse-swapped foreign exchange to convert to a final purchase, and banks accepted EUR 1,391 million of foreign exchange for final purchase.

2.2 Money and credit

6.8% growth in base money

Between December 2003 and December 2004 base money rose by SIT 6.3 billion, with average year-on-year growth in base money of 6.8%. Among the components of base money, there was an increase in issued banknotes and banks' settlement accounts, while overnight and other deposits fell.

In line with the movement of supply and demand on the foreign exchange market, the Bank of Slovenia was a net seller of foreign currency in the first half of the year, and a net purchaser in the second half of the year. Between January and July it sold SIT 92.1 billion net, and between August and December it purchased SIT 71.2 billion net. Over the year it withdrew SIT 20.9 billion net of base money through net sales of foreign currency. Net sales of foreign currency to EU institutions and valuation effects additionally contributed to the reduction in net foreign currency assets. Net foreign currency assets thus fell by SIT 33.3 billion in 2004.

Table 5: **Supply of base money**

	As at 31 December			Quarterly changes during 2004				
SIT billions	**2002**	**2003**	**2004**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	1,580.2	1,644.7	1,582.8	8.1	-76.3	34.6	-28.3	-61.9
2. Domestic liabilities in foreign currency	-581.1	-592.3	-563.8	-18.7	43.6	-12.6	16.3	28.6
– foreign currency bills	-551.1	-555.3	-500.8	-16.6	47.9	-3.4	26.6	54.5
– budget foreign currency deposits	-30.0	-37.1	-63.0	-2.1	-4.3	-9.2	-10.3	-25.9
3. Net foreign currency assets (1+2)	**999.1**	**1,052.4**	**1,019.1**	**-10.6**	**-32.8**	**22.1**	**-12.0**	**-33.3**
4. Budget time deposits	**-130.3**	**-105.8**	**-125.1**	**-5.0**	**-0.0**	**-0.3**	**-13.9**	**-19.2**
5. Loans to banks	**1.3**	**0.1**	**0.1**	**25.3**	**-2.2**	**-21.0**	**-2.1**	**0.0**
6. Tolar bills	**-375.6**	**-472.3**	**-266.6**	**-3.2**	**40.9**	**168.2**	**-0.2**	**205.7**
7. Long-term deposits	**0.0**	**0.0**	**-156.7**	**0.0**	**0.0**	**-136.7**	**-20.0**	**-156.7**
8. Other net liabilities	**-214.8**	**-183.1**	**-173.2**	**-20.9**	**15.5**	**-29.8**	**45.1**	**9.8**
9. Net tolar assets (4 to 8)	**-719.4**	**-761.2**	**-721.6**	**-3.8**	**54.2**	**-19.6**	**8.8**	**39.6**
10. Base money (3+9)	**279.7**	**291.2**	**297.5**	**-14.4**	**21.4**	**2.5**	**-3.2**	**6.3**
– banknotes issued	172.1	186.0	195.4	-12.1	12.6	-2.3	11.1	9.3
– banks' settlement accounts	82.4	91.1	94.0	6.6	8.5	6.0	-18.2	2.9
– overnight placements	18.4	8.2	4.8	-8.2	0.0	0.0	4.8	-3.4
– other deposits at Bank of Slovenia	6.8	5.9	3.3	-0.7	0.2	-1.2	-0.9	-2.6

Note: Accrued interest not included.
Source: Bank of Slovenia

In 2004 the Bank of Slovenia issued SIT 205.7 billion net of base money through tolar bills, and withdrew SIT 156.7 billion net of base money through long-term tolar deposits. The level of budget time tolar deposits rose by SIT 19.2 billion, while other flows contributed SIT 9.8 billion to the increase in base money. The net effect of loans on base money was neutral. The Bank of Slovenia thus issued SIT 39.6 billion net of base money through tolar instruments in 2004.

Slow growth in the broad money aggregates

Growth in the broad money aggregates was slow in 2004. The average rate of growth in M2 was 2.8%, while that of M3 was 5.2%. Growth in M1 was significantly higher, its average year-on-year rate standing at 22.5%. The rapid growth in M1 was primarily the result of the recovery of economic activity and the fall in interest rates on tolar time deposits, and thus increased investment in other forms of saving, mutual funds in particular.

Rapid growth in demand deposits and foreign currency deposits

Demand deposits and foreign currency deposits were prevalent in the structure of M3, with demand deposits accounting for more than three-quarters of the growth in M3 of SIT 256.0 billion. The increase in foreign currency deposits was slightly higher than the decrease in tolar time deposits. Growth in foreign currency deposits was particularly strong in the first half of the year, and was connected to the uncertainty in the lead-up to ERM II entry and the ongoing continuation of the trend of the gradual decline in interest rates on tolar time deposits. The gradual decline in tolar interest rates was also a factor in the structure of time deposits moving towards shorter-maturity deposits. The proportion of M2 accounted for by long-term tolar time deposits thus fell from 17.1% in December 2003 to 11.2% in December 2004.

The money multipliers remain unchanged

In 2004 the money multipliers remained similar to 2003. The money multiplier between M3 and base money was 13.3 (compared with 13.5 in 2003), between M2 and base money it was 9.3 (compared with 9.7 in 2003), and between M1 and base money it was 3.0 (compared with 2.7 in 2003).

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

	As at 31 December			Quarterly changes during 2004				
(SIT billions)	**2002**	**2003**	**2004**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	**1,461.6**	**1,264.6**	**936.6**	**-51.8**	**-148.2**	**-70.3**	**-57.7**	**-328.0**
2. Domestic assets	**2,745.0**	**3,123.3**	**3,733.4**	**119.5**	**190.6**	**160.9**	**139.1**	**610.1**
General government: bonds	463.4	494.5	600.9	28.4	50.7	18.7	8.7	106.4
loans	141.7	143.5	143.9	11.7	27.0	4.3	-42.5	0.4
Companies: securities	136.2	152.9	166.4	-23.2	-1.6	15.1	23.2	13.6
loans	1,426.2	1,688.6	2,042.3	81.4	82.6	73.0	116.6	353.7
Households: loans	577.4	643.8	779.8	21.1	31.9	49.8	33.2	136.0
3. Other net liabilities	**-605.9**	**-607.8**	**-634.0**	**-55.8**	**20.9**	**-27.4**	**36.2**	**-26.2**
4. M3 (1 to 3)	**3,600.7**	**3,780.1**	**4,036.0**	**11.8**	**63.3**	**63.1**	**117.7**	**256.0**
– foreign currency deposits at banks and Bank of Slovenia	1.020.8	1.064.4	1.214.7	33.2	74.9	36.4	5.8	150.3
– foreign currency securities	3.1	3.7	2.1	-0.7	0.0	0.4	-1.4	-1.7
5. M2	**2,576.8**	**2,711.9**	**2,819.2**	**-20.6**	**-11.6**	**26.3**	**113.2**	**107.3**
– time deposits at banks	1,545.3	1,591.2	1,471.7	-0.8	-89.5	-4.7	-24.5	-119.5
– time deposits at Bank of Slovenia	130.3	105.8	125.1	5.0	0.0	0.3	13.9	19.2
– tolar securities	181.1	217.7	203.6	-23.5	-10.1	5.5	14.0	-14.1
6. M1	**720.1**	**797.2**	**1,018.9**	**-1.3**	**88.0**	**25.2**	**109.8**	**221.7**
– demand deposits at banks	564.5	627.0	838.1	6.1	76.8	25.6	102.7	211.2
– demand deposits at Bank of Slovenia	12.6	14.1	12.8	-3.9	0.5	2.2	0.0	-1.3
– currency in circulation	143.1	156.0	167.9	-3.5	10.8	-2.6	7.2	11.9

Source: Bank of Slovenia

It was investments by domestic banks that exclusively contributed to the creation of M3 in 2004, as there was a negative contribution to M3 growth made by flows with the rest of the world. The net foreign assets (NFA) figure, which shows the contribution of balance of payments flows to growth in M3, fell by SIT 328.0 billion. Bank investments rose by SIT 610.1 billion, of which the corporate sector accounted for SIT 367.2 billion, the general government sector for SIT 106.9 billion and households for SIT 136.0 billion.

The rise in total bank investments in 2004 was 61.2% more than the rise in 2003. Year-on-year growth in total bank investments thus rose from 13.8% in December 2003 to 19.5% in December 2004. In terms of sector, there was a significant rise in general government borrowing and in corporate and household borrowing.

A strengthening of corporate and household borrowing

The rise in domestic investments in companies was one-third higher than that in 2003, with year-on-year growth rising from 17.9% in December 2003 to 19.9% in December 2004. Household borrowing was strong, almost twice in excess of the level recorded in 2003. The strengthening of corporate and household borrowing was primarily connected to the fall in interest rates at banks and the strengthening of economic activity and private spending. The government borrowed SIT 106.9 billion from domestic banks in 2004, of which SIT 0.4 billion was in the form of loans and SIT 106.4 billion was through bond issues. The increase in general government borrowing was primarily the result of the restructuring of general government borrowing from foreign to domestic sources.

Companies raised foreign currency loans

Foreign currency loans were prevalent in the currency structure of borrowing in 2004. In 2003 they accounted for just over one-half of new lending, but in 2004 this proportion rose to almost 60%. Foreign currency loans accounted for more than four-fifths of all loans raised by companies at domestic banks. Companies borrowed in foreign currency both at domestic banks and abroad. Borrowing abroad was again an important source of financing for companies in 2004. Foreign loans accounted for approximately one-third of all loans raised by companies. Foreign currency borrowing by households also strengthened slightly, with more than one-tenth of the total household borrowing during the year being in foreign currency.

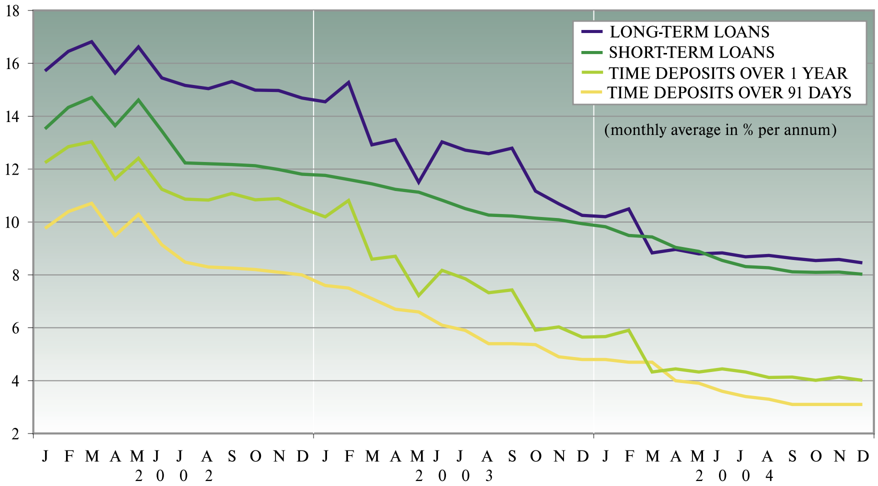
2.3 Interest rates and the money market

A faster decline in lending rates than deposit rates

With inflation falling, the decline in nominal lending and deposit interest rates at banks continued in 2004. The rate of decline in interest rates was lower than 2003. Unlike the previous year, in 2004 banks made more rapid cuts in lending rates than in deposit rates. The gradual abandonment of tolar indexation clauses on long-term interest rates contributed to a decrease in the variability of nominal interest rates. Indexation was still used on long-term personal loans, although even in this area there is a move to nominal interest rates.

Deposit rates on time deposits fell by between 1.6 and 1.7 percentage points in 2004. There was a slightly larger fall of 1.9 percentage points in rates on deposits of more than five years. The interest rates on time deposits at the end of year ranged from 3.1% on the shortest deposits to 4.1% on deposits of more than five years. After six years without any change in the interest charged on demand deposits, banks gradually cut these interest rates, from 1.0% in December 2003 to 0.5% at the end of 2004. There was a change in interest rates on time deposits with a foreign currency clause, with those on deposits of up to one year falling by between 0.1 and 0.3 percentage points and those on longer deposits rising by 0.4 percentage points. The average interest rate on foreign currency clause deposits ranged from 1.7% to 2.3% at the end of 2004. Despite the smaller fall in interest rates, owing to the stabilisation of the tolar/euro exchange rate after Slovenia joined the ERM II, the return on foreign currency bank deposits fell more than the return on tolar bank deposits.

Figure 7: **Average bank interest rates**



Source: Bank of Slovenia

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

	Lombard loan	Bank of Slovenia tolar bills		Interbank market	Treasury bills			Tolat indexation clause
	1 day	60-day	270-day	up to 30-day	3-month	6-month	12-month	
January	7.06	5.81	6.06	5.33	5.03	5.12	5.20	4.83
February	6.79	5.54	5.33	5.71	5.39	5.28	5.20	5.17
March	6.75	5.39	5.53	5.46	5.10	5.28	4.87	3.60
April	6.27	4.77	5.02	4.92	4.40	4.30	4.87	3.72
May	5.84	4.55	4.80	4.72	4.10	4.30	3.99	3.60
June	5.28	4.16	4.41	4.41	3.87	3.83	3.99	3.72
July	5.00	4.00	4.23	3.93	3.82	3.83	3.70	3.60
August	5.00	4.00	4.20	3.70	3.73	3.67	3.70	3.60
September	5.00	4.00	4.20	3.77	3.68	3.67	3.70	3.72
October	5.00	4.00	4.20	3.76	3.63	3.71	3.70	3.60
November	5.00	4.00	4.20	3.67	3.68	3.71	3.60	3.72
December	5.00	4.00	4.20	3.38	3.55	3.55	3.60	3.60

Note: Monthly average for 2004 (% per annum).
Source: Bank of Slovenia

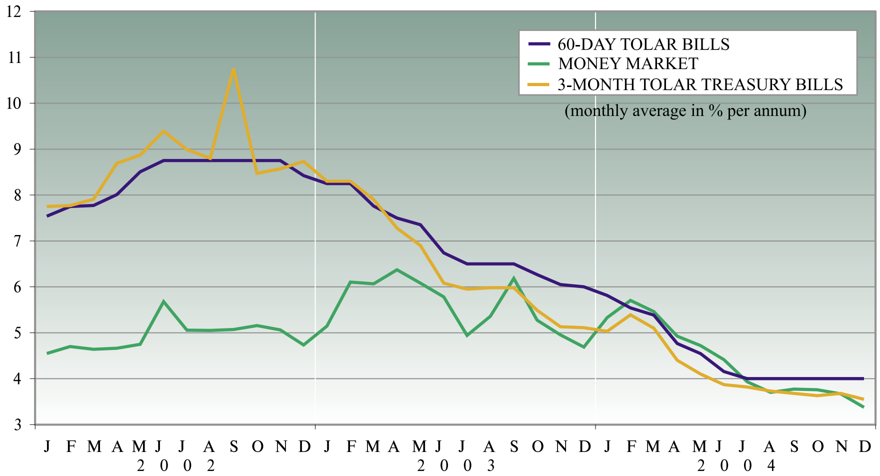
Interest rates on housing loans fell by 2 percentage points

The biggest decline in lending rates in 2004 was recorded by interest rates on housing loans, with a fall of 2 percentage points. The average nominal interest rate of housing loans stood at 7% in December 2004. The smallest decline was recorded by interest rates on consumer loans, which fell 1.7 percentage points to 7.9%. The interest rate on short-term corporate loans at the end of the year was 8%, down 1.9 percentage points from one year before, while the interest rate on long-term corporate loans was down 1.8 percentage points at 8.5%.

The gaps between interest rates in Slovenia and interest rates in the eurozone narrowed

By the end of 2004 banks' tolar interest rates on consumer loans had equalised with the interest rates in the eurozone, while interest rates on housing loans and corporate loans were 3 and 2.4 percentage points above them respectively. With regard to deposit rates, the gap between interest rates in Slovenia and interest rates in the eurozone is slightly larger on long-term deposits (1.8 percentage points) than on deposits of up to one year (1.2 percentage points).

Figure 8: **Bank of Slovenia and money market interest rates**



Source: Bank of Slovenia

Favourable inflation trends allowed the Bank of Slovenia to gradually cut nominal interest rates

The favourable fall in inflation allowed the Bank of Slovenia to continue the gradual reduction of its nominal lending and deposit rates in the first half of 2004. It thus cut the foreign exchange swap rate from 3.0% at the end of December 2003 to 1.0% at the end of June. While the ECB refinancing rate remained unchanged (at 2.0%), the refinancing rate at the Bank of Slovenia was cut from 5.0% to 3.0%. During the same period the Bank of Slovenia cut the interest rate on 60-day tolar bills by 2.0 percentage points and the lombard loan rate by 2.25 percentage points, the rates being 4.0% and 5.0% respectively at the end of June.

After ERM II entry the Bank of Slovenia made no change to interest rates

After Slovenia joined the ERM II at the end of June, the Bank of Slovenia made no significant change to its lending and deposit rates. The interest rate on the long-term deposits introduced in July was set at 0.2 percentage points above the interest rate on 60-day tolar bills, and thus stood at 4.2%. In December the Bank of Slovenia raised the foreign exchange swap rate and thus the refinancing rate by 0.25 percentage points, aiming to ensure continuing stability on the money market with this structural adjustment.

The interest rate on the interbank market fell to 3.4%

The interest rate on the interbank market fell by 1.3 percentage points during the year, from 4.7% at the end of 2003 to 3.4% at the end of 2004. In the first two months of the year there was a rise in the interest rate on interbank deposits of up to 30 days to 5.7%, followed by a rapid decline to 3.7% in August, after which the rate fluctuated at this level for the next three months. In December it fell further to 3.4%.

Surplus demand was a constant feature at the treasury bill auctions in 2004. This allowed the government to borrow more cheaply in the short term. There was only a slight rise in the interest rates in the January and February auctions, and then they declined throughout the remainder of the year. The rate of decline was similar to that on the interbank money market, with significantly slower movement from the half-year point onwards. The average bid rate at auctions of 1-month treasury bills rose in 2004 to 5.4% in February, and then declined to 3.6% at the end of the year, down 1.5 percentage points from the end of 2003. There was a similar trend at the auctions of 3-month, 6-month and 12-month treasury bills. All the interest rates were formulated at around 3.6% (3.55% for the 3-month and 6-month bills and 3.60% and 3.61% for the 12-month and 1-month bills).

Slovenia meets the Maastricht criterion for interest rates

The gradual fall in domestic interest rates also narrowed the gap between domestic and foreign interest rates. Slovenia meets the Maastricht criterion for long-term interest rates. In December the interest rate on long-term government securities stood at 4.68%, while the Maastricht criterion was 6.28%.

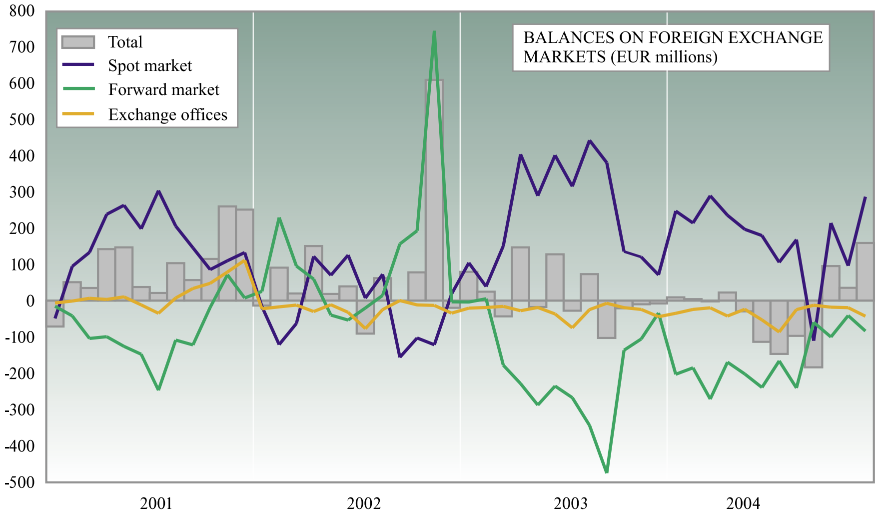
2.4 Foreign exchange market and the exchange rate

Supply and demand on foreign exchange markets are determined by balance of payments movements and the investment decisions of domestic agents. In 2004 the current account deficit was 0.9% of GDP, while the net financial inflow was insignificant.

Demand for foreign currency on the foreign exchange markets exceeded supply

In 2004 demand for foreign currency on the foreign exchange markets exceeded supply by EUR 251 million. Between January and April supply of foreign exchange slightly exceeded demand (by EUR 33 million). Between May and September demand exceeded supply by EUR 573 million, and then from October to December supply exceeded demand by EUR 289 million.

Figure 9: **Foreign currency flows**



Source: Bank of Slovenia

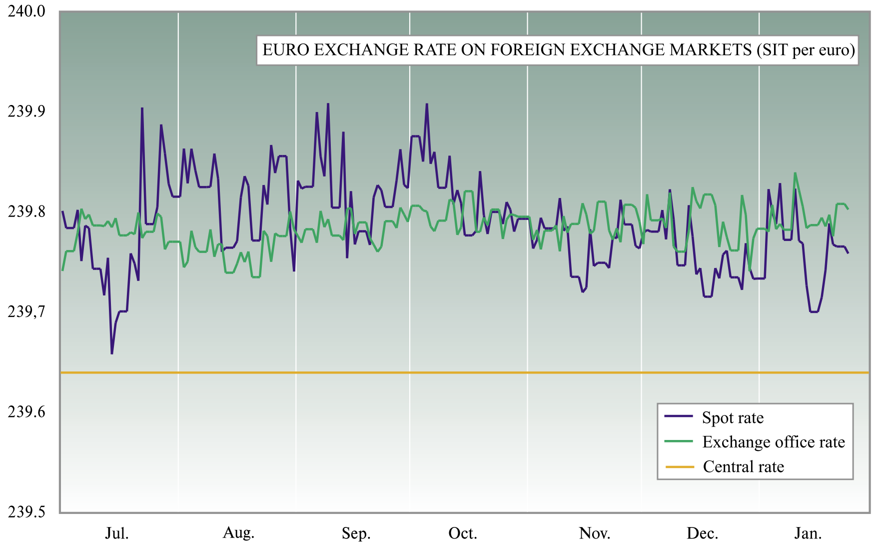
Supply of foreign currency exceeded demand on the spot market

Supply of foreign currency exceeded demand on the spot market in all months except September. Of the net supply of foreign currency in the amount of EUR 2,118 million, non-residents accounted for 93%, companies for 6% and private individuals for just 1%. On the forward market banks sold foreign currency throughout the year, a total of EUR 1,964 million being sold, of which EUR 1,907 million was to non-residents. The net supply of foreign currency on the foreign exchange markets by non-residents was relatively small at EUR 56 million, compared with EUR 448 million in 2003 and EUR 724 million in 2002. The net sale of foreign currency at exchange offices has been increasing since 2001. In 2004 it was up by more than one-third from 2003 at EUR 405 million.

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

Transactions between banks and the Bank of Slovenia increased the potential supply of foreign currency on the foreign exchange market. In 2004 the Bank of Slovenia made a net final purchase from banks of EUR 1,361 million of foreign currency, while reducing the net balance of swapped foreign currency (forward swaps) by EUR 1,191 million and the balance of foreign currency bills by EUR 258 million. In total the net potential supply of foreign currency on the foreign exchange market was increased by just under EUR 90 million.

Figure 10: **Euro exchange rate on foreign exchange markets**



Source: Bank of Slovenia

With tolar interest rates declining, there was a slowdown in the depreciation of the tolar against the euro and stabilisation of the exchange rate for ERM II entry

In line with the reduction in tolar interest rates the Bank of Slovenia continued its policy of reducing the level of tolar depreciation against the euro in the first half of 2004. In January the rate was 0.23% per month, but in May it was just 0.13%. When Slovenia joined the ERM II on 28 June the central rate was set at SIT 239.64 to the euro. The euro exchange rate on the foreign exchange market was 0.08% off the central rate between July and October. In the last two months of the year there was a nominal appreciation, and the exchange rate averaged SIT 239.76 in December, 0.05% off the central rate. Year-on-year growth in the average monthly euro exchange rate on the foreign exchange market in December 2004 was 1.5 percentage points lower than in the previous year at 1.3%. The nominal effective tolar exchange rate as measured by a trade-weighted basket of currencies appreciated by 0.2% year-on-year in the year to December, 0.6 percentage points less than in the same period in 2003.

2.5 Use of instruments

In 2004 the structural surplus on the money market narrowed

In 2004 the surplus in the structural position of the money market narrowed. For most of the year the Bank of Slovenia allowed banks to access liquidity at the Bank of Slovenia or to make investments with the Bank of Slovenia if they had excess liquidity on the basis of standing facilities. Decisions were made on these in line with the change in the structural position on the money market.

2.5.1 Monetary policy instruments

The Bank of Slovenia made constant use of 60-day tolar bills in the form of standing facilities, but from the middle of 2004 replaced 270-day tolar bills when they matured with occasional limited-quantity offers of long-term deposits.[3] At the end of 2004, 60-day tolar bills accounted for 50% of all instruments for absorbing liquidity, 270-day tolar bills for 12% and long-term deposits for 37%.

[3] The long-term deposits mature at the beginning of 2007; the interest rate is variable and equal to the current interest rate on 60-day tolar bills plus 20 base points.

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

	As at 31-Dec.-03	Quarterly in 2004 I.	II.	III.	IV.	As at 31-Dec.-04
Monetary policy instruments						
Tolar bills	472,330	490,800	470,283	366,990	284,335	266,588
Long-term deposits				65,125	148,871	156,730
Overnight placements	8,170	629	453	514	777	4,800
Lombard loan	0	82	0	10	11	0
7-day temporary purchase of securities	0	2,425	23,297	21,145	1,184	0
Reserves of credit institutions		96,716	98,938	102,325	103,360	
Required		96,206	98,375	101,692	102,726	
Excess		510	563	633	634	
Exchange rate policy instruments						
Foreign exchange swap	503,698	463,500	313,172	298,966	276,922	225,716
Reverse foreign exchange swap	0	54	0	28,250	7,336	479
Memo:						
Final purchase of foreign currency from banks (flow)		118,939	114,949	0	97,892	
Foreign currency bills	557,878	570,703	558,536	522,366	519,715	503,324
Government time deposits *	105,847	107,986	110,337	107,717	108,472	124,725

* [1] Includes 1-month treasury deposit.
[2] Excluding valuation and interest effects; at transaction prices; foreign currency bills at nominal value.
Source: Bank of Slovenia

The repo standing facilities eased the fluctuation of the interest rate on the interbank market

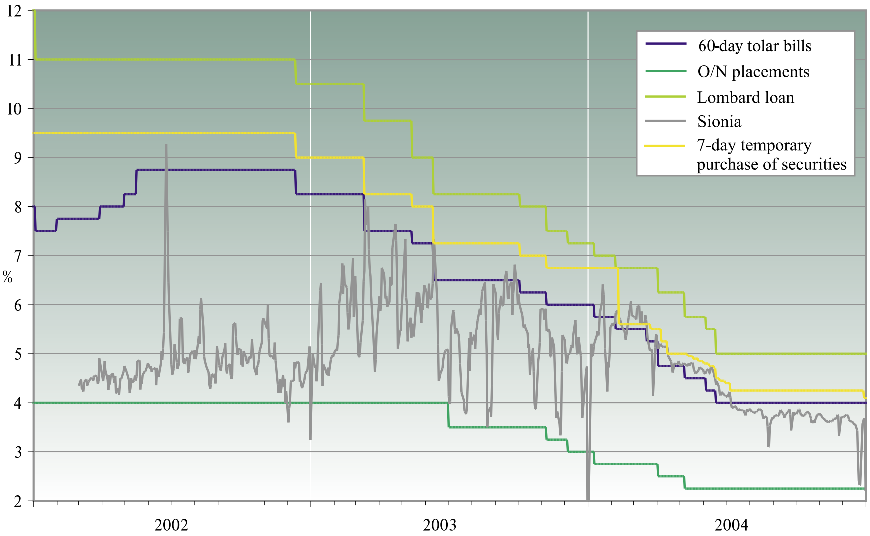
The interest rates on the lombard loan and the overnight placements are the limits for the fluctuation of the market overnight interest rate. Within these limits the Bank of Slovenia made changes to the offer of 7-day temporary purchase of securities in 2004 to ease fluctuation in the Sionia.[4]

A change in the required reserve system

As part of the gradual adaptation of the required reserve instrument to ECB arrangements, the Bank of Slovenia twice made changes to the required reserve instrument in 2004. Since 27 January 2004 the requirement has been calculated on the basis of the average required reserves base between the 22nd of the month before the previous month and the 21st of the previous month, while the reserves have been maintained on average between the 27th of the previous month and the 26th of the current month. The daily obligation to maintain at least half of the requirement in the settlement account at the Bank of Slovenia was abolished in the November maintenance period.

[4] See Section 7.6 (Glossary).

Figure 11: **Price of monetary policy instruments**



Source: Bank of Slovenia

2.5.2 Exchange rate policy instruments

The Bank of Slovenia exerted an influence on the exchange rate in 2004 in line with the agreement on cooperation in foreign exchange market intervention with commercial banks. In line with the policy of maintaining an appropriate gap between interest rates in Slovenia and in the eurozone during the reduction of tolar interest rates, in the first half of the year it periodically signalled the exchange rate at which banks concluded transactions with other customers. When Slovenia joined the ERM II on 28 June 2004, the operational objective of exchange rate policy changed. After this date the Bank of Slovenia left the formulation of the tolar exchange rate to participants on the foreign exchange market, and no longer used the possibility of exerting the direct influence on it that it had under the agreement.

Purchase and sale of foreign exchange

The reverse foreign exchange swap is the most important source of liquidity for the banking system

Banks were able to swap or reverse swap foreign exchange for seven days on the basis of standing facilities, with the contracts generally being renewed when they mature, except when the Bank of Slovenia offered banks the limited-quantity final purchase of swapped foreign exchange. In seven instances in total the Bank of Slovenia made a final purchase of SIT 331.8 billion of foreign exchange from banks, this realisation being 81% of the amount offered.

The Bank of Slovenia made a net sale of SIT 67.9 billion of foreign exchange to the government in 2004.

Foreign exchange intervention by the Bank of Slovenia

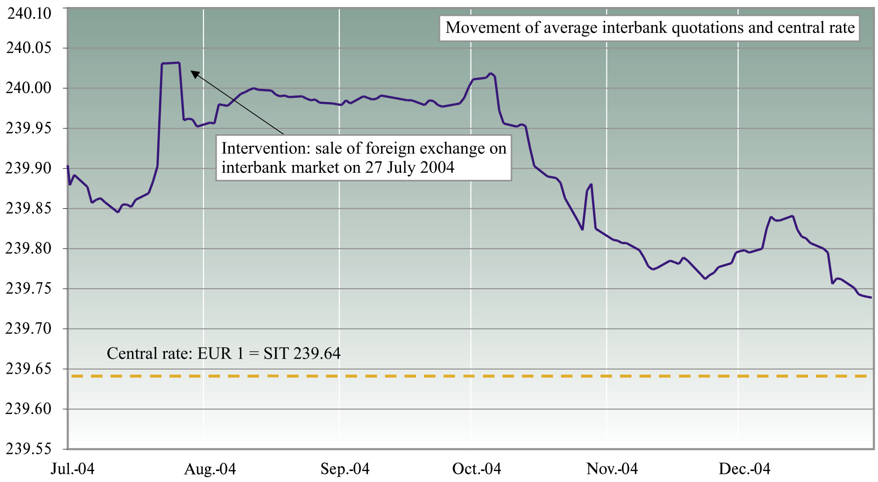
ERM II entry brought the end of indirect foreign exchange intervention

In the period prior to and during entry into the ERM II, the Bank of Slovenia used indirect intervention by steering exchange rates under the agreement on cooperation in foreign exchange market intervention. By periodically setting exchange rates the central bank transmitted its signals to the financial sector and the real sector. The Bank of Slovenia responded by setting the current rate of growth in the exchange rate six times in the first half of the year, the final occasion being when Slovenia joined the ERM II.[5] The total period of indirect intervention prior to and during ERM II entry lasted 16 days.

After ERM II entry the Bank of Slovenia directly intervened only once

When Slovenia joined the ERM II the issue of the euro/tolar exchange rate became of decisive importance, and the possibility of directly intervening on the interbank foreign exchange market by selling or purchasing foreign currency was therefore included among the Bank of Slovenia's instruments. Under the ERM II rules the ECB must come to the defence of the tolar by purchasing or selling at the upper or lower exchange rate limits,[6] while the Bank of Slovenia may also intervene within the limits set at entry in line with the objective of exchange rate policy. The Bank of Slovenia only intervened once in 2004 by selling foreign currency, on 27 July, when during a re-emergence of the inertia in the movement of the exchange rate from the period prior to ERM II entry it sent a clear signal to banks that this period was irrevocably over.

Figure 12: **Movement of average interbank quotations and central parity**



Source: Bank of Slovenia

2.5.3 Prudential control instruments

Liquidity ladder

In October 2001 the Bank of Slovenia passed (and later amended) a decision on the minimum 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 and the regulation of all plannedfinancial flows through the calculation of the liquidity ratios. Liquidity ratios are calculated as the ratio of investments to liabilities by term to maturity, separated for 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.

The decision also prescribes a minimum level of liquid foreign currency investments and mandatory subscription of Bank of Slovenia foreign currency bills. In 2004 the minimum level of liquid investments in foreign currency was reduced from 80% to 70%, and the level of mandatory subscription of foreign currency bills

5 For details, see Section 7.3.1 (Monetary policy measures).
6 Fluctuations of ± 15% around the central rate of SIT 239.64 are allowed.

from 45% to 35%. With the mitigation of the requirements for the minimum level of liquid foreign currency investments and the level of mandatory subscription to Bank of Slovenia foreign currency bills, the restrictions placed on banks in their investment policies were relaxed. The average excess over the required minimum liquid investments by all banks rose from 25.8% at the end of 2003 to 30.9% at the end of 2004. There was a similar move in the excess over the subscription to Bank of Slovenia foreign currency bills by all banks, which rose from 10.4% at the end of 2003 to 13.8% at the end of 2004.

The average excess over the required minimum liquid investments rose from 25.8% to 30.9%

In 2004 savings banks with the Bank of Slovenia's authorisation to undertake operations in foreign means of payment were also classified among those obliged to meet the requirements of the decision. Securities with a Republic of Slovenia guarantee were additionally placed directly into categories one and two of the liquidity ladder, irrespective of their term to maturity, as well as foreign currency loans granted to residents (except for the Republic of Slovenia and other banks) with the remaining maturity of more than 180 days in the amount of no more than 120% of the average sum of the Bank of Slovenia's 7-day FX swaps in August 2004.

Forward transactions were also added to balance sheet items in the calculation of the open foreign exchange position in 2004, which enabled banks longer open foreign exchange positions calculated in accordance with the decision.

The Bank of Slovenia allowed banks that signed the agreement on cooperation in foreign exchange market intervention to meet a single liquidity ratio for categories one and two. Banks that have not signed the agreement must meet the liquidity ratios for tolars and for foreign currency separately (two banks only).

The average liquidity ratio of all banks stood at 1.14 in category one and 1.11 in category two at the end of 2003. By the end of 2004 the ratios were 1.10 in categories one and two.

The average liquidity ratio

Foreign currency bills

In 2004 the Bank of Slovenia made no changes to its offer of foreign currency bills. Banks were able to subscribe to bills of three different maturity periods, 60, 90 and 120 days, denominated in two different currencies, euros and dollars.

Demand for foreign currency bills arises primarily from the requirements of the regulation on the minimum liquidity to be maintained by banks, which regulates the liquidity risk associated with the banks' foreign currency liabilities.

The Bank of Slovenia required adequate collateral on all loans made to banks. Foreign currency bills were the most frequent form of collateral in 2004. In addition to these bills, banks and savings banks were able to pledge Bank of Slovenia tolar bills, long-term deposits at the Bank of Slovenia and government treasury bills as collateral for obtaining loans from the Bank of Slovenia.

Foreign currency bills are the most frequent form of collateral

Special liquidity loans granted with the participation of banks

In 2004 the Bank of Slovenia continued to conclude one-year agreements with commercial banks regarding their 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 ninth in succession) was signed by 15 banks. Yet again in 2004 the mechanism for the participation of signatory banks was not triggered.

2.5.4 Oversight of implementation of instruments

There were three cases of failure to maintain required reserves

In the case of indirect oversight of the implementation of the required reserve instrument, one ruling was issued against a bank and two against savings and loan undertakings for the failure to maintain required reserves. In each case the ruling included the payment of a charge for the shortfall in required reserves and an additional 15-day ban on subscription to tolar bills. Two savings banks and two savings and loan undertakings were also subject to direct oversight of the implementation of the decision on required reserves. In all cases the oversight procedure was concluded with a decision terminating the procedure. One bank had to pay interest on arrears for reason of its failure to pay bill subscription charges on time. No banks were subject to direct oversight procedures during 2004.

Direct and indirect oversight of liquidity

In 2004 there were five protocols sent to banks on the basis of findings made during direct and indirect oversight of banks in the implementation of the liquidity ladder. In two cases the Bank of Slovenia issued a decision terminating the procedure, and in three it issued a ruling based on which the bank had to pay interest on arrears for the amount of the shortfall in the prescribed obligations.

Oversight of exchange office operations

In the area of exchange office operations, the Bank of Slovenia conducted 70 examinations of licensed exchange offices and seven examinations of bank exchange office counters in 2004. On the basis of these examinations by the Bank of Slovenia and the protocols of examinations of licensed banks, one proposal for the initiation of misdemeanour proceedings was submitted to the National Foreign Exchange Inspectorate.

The Bank of Slovenia issued 11 decisions revoking the licence for foreign exchange dealings on the basis of the agreed termination of a contract between a licensed bank and a licensed exchange office.

3 BANKING SECTOR

3.1 Composition of the banking sector

Banks dominate the banking sector

Slovenia's banking sector comprises banks, savings banks, and savings and loan undertakings, with banks having the dominant position. At the end of 2004 banks accounted for 99.4% of the market as measured by total assets (compared with 98.7% at the end of 2003), with savings banks and savings and loan undertakings sharing the remainder. Savings banks held a 0.5% market share (compared with 0.4% at the end of 2003), while savings and loan undertakings held a market share of 0.1% (compared with 0.9% at the end of 2003).

There are 18 banks and two branches of foreign banks in Slovenia

As at 31 December 2004 there were 18 banks and two branches of foreign banks operating in Slovenia. The number of banks is down one from the end of the previous year, with an order initiating ordinary liquidation proceedings against Slovenska investicijska banka d.d. having been entered in the companies register on 5 January 2004. However on 15 October 2004 the second branch of a foreign bank in Slovenia was entered in the companies register, namely Bank für Kärnten und Steiermark AG, bančna podružnica.

Two savings banks remain

There was no change in the number of savings banks in 2004 (with two still in operation), although the number of savings and loan undertakings continues 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, eight at the end of 2003, but just two at the end of 2004. In recent years a large number of savings and loan undertakings amalgamated with the Association of Savings and Loan Undertakings, while to a lesser extent savings and loan undertakings were taken over by banks or underwent voluntary liquidation and bankruptcy. On 1 July 2004 the Association of Savings and Loan Undertakings transferred its operations to Slovenska zadružna kmetijska banka d.d., Ljubljana, which was renamed Deželna banka Slovenije d.d. on the same day.

Minor changes in ownership structure

There were no major changes in ownership structure in 2004. Apart from the five subsidiary banks and two branches that were under majority foreign ownership, there were five banks under full domestic ownership, and eight banks under majority domestic ownership (of these eight banks, three had less than 1% foreign capital). The proportion of equity capital under the ownership of non-residents was the same at the end of 2004 as at the end of 2003, at 32.4% (of which 16.5% was held by non-residents that hold more than 50% of the voting rights). The proportion held by non-residents as measured by total assets was 3.8 percentage points more than the proportion held by non-residents as measured by equity as at 31 December 2004. The country's second-largest bank (as measured by total assets), Nova Kreditna banka Maribor d.d., and the 12th-largest bank Poštna banka Slovenije d.d. remain under majority state ownership.

Table 9: **Ownership structure of banking sector (in terms of equity)**

(% of equity capital)	**31-Dec.-02**	**31-Dec.-03**	**31-Dec.04**
Non-residents (more than 50% of management rights)	15.7%	16.6%	16.5%
Non-residents (less than 50% of management rights)	16.8%	15.8%	15.9%
Government in narrower sense	20.3%	19.4%	19.1%
Other domestic persons	47.2%	48.2%	48.6%

Source: Bank of Slovenia

Table 10: **Ownership structure of banking sector (in terms of total assets)**

% in total assets	31-Dec.-02	31-Dec.-03	31-Dec.-04
Non-residents (more than 50% of management rights)	16.8%	18.7%	19.1%
Non-residents (less than 50% of management rights)	17.9%	17.3%	17.1%
Government in narrower sense	24.9%	23.8%	23.5%
Other domestic persons	40.4%	40.2%	40.4%

Source: Bank of Slovenia

The ratio of the total assets of banks and savings banks (including savings and loan undertakings) to GDP is rising from year to year.

Table 11: **Comparison of average total assets and GDP**

(SIT millions)	2001	2002	2003	2004
Average total assets of banks and savings banks[1]	3,505,317	4,217,835	4,841,493	5,364,886
GDP at current prices	4,761,815	5,314,494	5,747,168	6,191,161
Average total assets/GDP (%)	73.6	79.4	84.2	86.7

[1] Including savings and loan undertakings.
Source: Bank of Slovenia

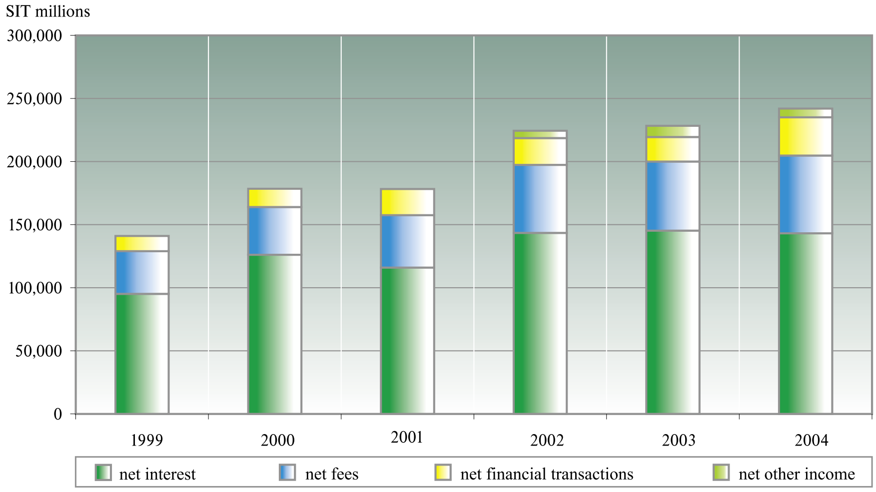
In 2004 the Bank of Slovenia issued a total of 22 authorisations for banking and other financial services, for acquiring qualifying holdings and for holding office as a member of the management board. One application for acquiring a qualifying holding was rejected.

3.2 Income statement

Banks and bank branches recorded a profit SIT 8.3 billion higher than in 2003

The operating result[7] of the banks and the two branches of banks of member-states (the banking system's pre-tax profit) amounted to SIT 56.1 billion in 2004, higher than the figures recorded in previous years. The 2004 profit was up SIT 8.3 billion from that in 2003, a real[8] rise of 13.3%. The rise in profit is the result of higher earnings from net fees and net financial transactions, while earnings from net interest continued to decline last year, despite noteworthy lending to non-financial companies and households.[9]

Figure 13: **Gross income**



Source: Bank of Slovenia

[7] All 2004 figures are unaudited.
[8] Allowing for a consumer price index of 3.6% between 2003 and 2004.
[9] All figures in the income statement and balance sheet exclude the NLB branches abroad.

Net interest amounted to SIT 143 billion in 2004, a real decline of 5.1% from 2003. Net fees in the amount of SIT 61.6 billion rose by 8.3% in real terms, while the highest real growth of 49.9% was recorded by net financial transactions, which during 2004 amounted to SIT 30.2 billion. Net other income[10] in the amount of SIT 6.9 billion was down SIT 1.9 billion owing to a decline in other operating revenues and a rise in other operating expenses.

Net interest amounted to SIT 143 billion, and net fees to SIT 61.6 billion

Banks' gross income in 2004 amounted to SIT 242 billion, up SIT 13.1 billion from 2003, or 2% in real terms.

Banks' gross income amounted to SIT 242 billion, up SIT 13.1 billion

In 2004 banks created SIT 38.7 billion of net provisions, approximately the same as in 2003 (SIT 38 billion).

Table 12: **Principal items of adjusted income statement**

	Amount (SIT millions)		Proportion (%)		Nominal growth (%)	
	2003	2004	2003	2004	2003/2002	2004/2003
Net interest	145,678	143,176	63.6	59.2	1.6	-1.7
Net fees	54,907	61,619	24.0	25.5	1.8	12.2
Net financial transactions	19,490	30,263	8.5	12.5	-8.1	55.3
Net other income	8,862	6,931	3.9	2.9	52.6	-21.8
Gross income	**228,937**	**241,989**	**100.0**	**100.0**	**2.0**	**5.7**
Operating expenses	143,169	147,152	62.5	60.8	6.9	2.8
– of which labour costs	72,015	76,643	31.5	31.7	8.8	6.4
Net income	**85,768**	**94,836**	**37.5**	**39.2**	**-5.2**	**10.6**
Net provisions and net write-downs	-38,006	-38,760	-16.6	-16.0	-14.5	2.0
Pre-tax profit/loss	**47,762**	**56,076**	**20.9**	**23.2**	**3.8**	**17.4**
Net profit/loss	**31,345**	**36,753**	**13.7**	**15.2**	**6.3**	**17.3**

Source: Bank of Slovenia

3.2.1 Net interest income

Net interest in 2004 in the amount of SIT 143 billion was down SIT 2.5 billion from 2003. There was a sharper decline in interest income than interest expenses over the year.

Net interest was down SIT 2.5 billion

In addition to the more pronounced fall in lending rates than deposit rates, another factor in the decline in interest income in 2004 was the change in the structure of interest-bearing assets. The lower interest rates on foreign currency loans and advances meant that the growth in lending to non-financial companies, and partly also foreign currency household lending, resulted in a decline in interest income. The fall in the proportion of investments in Bank of Slovenia tolar bills in the second half of the year caused a significant decline in interest income from these securities, while interest income from government bonds remained unchanged. The rise in banks' investments in government securities tracked the rise in lending to non-bank sectors.

Interest income declined by SIT 44.2 billion, and income from bonds by SIT 1.7 billion

The factors affecting the amount of interest expenses in 2004 were the decline in deposits by non-financial companies, the fall in deposit rates and the shortening of average maturity periods. The small range in the deposit rates offered with regard

Interest expenses were down SIT 43.4 billion

10 Net other income includes other operating revenues, extraordinary revenues, other operating expenses and extraordinary expenses.

to maturity period and the pace of economic growth dictated that non-financial companies would opt for shorter-maturity time deposits. With less resources being sought through securities issues, interest expenses on issued securities also declined. The expansion of borrowing from foreign banks brought a rise in interest expenses for loans and advances received in foreign currency.

The real level of net interest was primarily maintained in 2004 by small banks, with a total market share of 13.3%.[11] They achieved above-average levels of growth in lending to non-financial companies and households, with the majority favouring domestic currency for their lending and maintaining lower expenses on long-term time deposits, while individual banks also recorded higher revenues from government bonds. With other banks failing to maintain the real level of net interest from 2003, the proportion of banks' gross income accounted for by net interest declined to 59.2%.

3.2.2 Net non-interest income

Net fees rose

Net fees in the amount of SIT 61.6 billion recorded a rise of SIT 6.7 billion in 2004, or 8.3% in real terms. The proportions of fees received accounted for by fees for administrative services, fees for payment transactions in Slovenia and fees for credit transactions rose. There was no rise in the proportions accounted for by fees for payment transactions with the rest of the world and fees for guarantees. Net fees continue to be equivalent to a stable 1.2% of average assets.

Net financial transactions were up 49.9% in real terms

Net financial transactions in the amount of SIT 30.3 billion recorded significant growth in 2004 (SIT 10.7 billion), and were up 49.9% in real terms, as a result of higher revenues from shares sold, revenues from capital investments in subsidiary other financial organisations, lower expenses in derivatives trading and lower exchange rate losses. Revenues from securities trading continue to account for the largest proportion of net revenues from financial transactions, followed by revenues from capital investments and revenues from foreign exchange trading. The proportion of banks' gross income accounted for by net financial transactions rose from 8.5% to 12.5%, and real growth in net financial transactions was recorded by 13 banks with a total market share of 86.2%.

3.2.3 Banks' operating expenses

Operating costs fell 0.8% in real terms

After a slowdown in growth in previous years, operating costs in 2004 fell below the level of operating costs recorded in 2003, with a decline of 0.8% in real terms. The largest factor in this was more effective cost management at large banks. Banks made fundamental cuts in their expenditure on material costs, costs of other services and costs of consulting, auditing and accounting services in particular. A real decline in operating costs was recorded by ten banks with a total market share of 73.3%. Banks already cover two-thirds (67.1%) of their operating costs with non-interest income, while this proportion is even higher at banks that are more active in seeking earnings from non-interest income.

Labour costs rose by 2.7% in real terms

Labour costs maintained their real level (a rise of 2.7% in real terms), but primarily as a result of other labour costs (severance pay for early retirement, other employee expenses under employment contracts), while gross wages only grew moderately (1.25% in real terms).

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[11] In 2003 there were 11 banks and one branch with a total market share of 40.1% that maintained the real level of net interest.

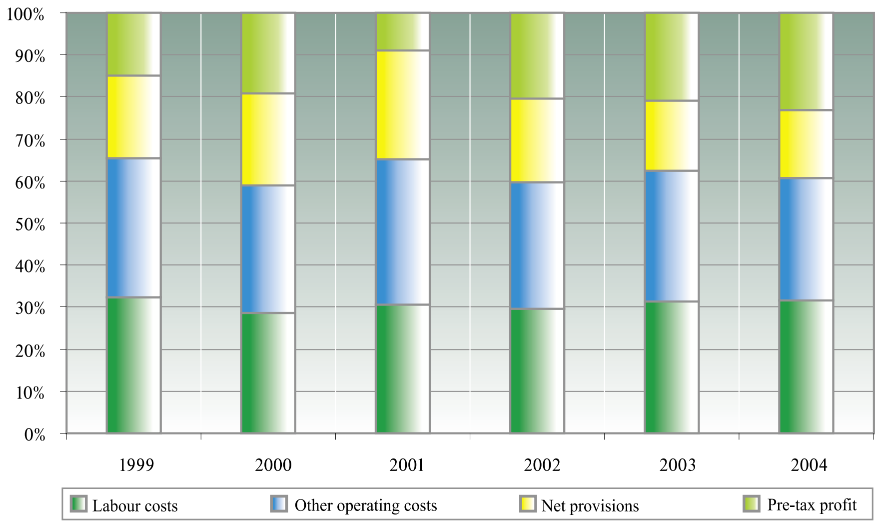
3.2.4 Net provisions

Banks created net provisions of SIT 38.8 billion, up SIT 0.7 billion from 2003

In 2004 banks created net provisions of SIT 38.8 billion, which was SIT 0.7 billion more than in 2003. It is worth noting that the net provisions created in all months of 2004 were higher than those created by banks in the corresponding months of 2003, although at individual banks the net provisions in December often fluctuate owing to regulation of the amount of profit (payment of tax). In December 2004 alone, net provisions rose by a further SIT 4.9 billion.

Despite the lively growth in lending, it is estimated that there was no deterioration in asset quality. As at 31 December 2004 the proportion of assets graded as Category A had risen to 81.7%.

Figure 14: **Composition of disposal of banks' gross income (in %)**



Source: Bank of Slovenia

Banks used 60.8% of their gross income to cover operating costs

In 2004 banks used 60.8% of their gross income to cover operating costs and 16% for net provisions, while 23.2% of the gross income represented pre-tax profit. In the last three years the proportion of gross income disposal accounted for by net provisions has declined significantly in favour of a rise in the proportion of operating profit.

3.2.5 Bank performance indicators

Average return on assets is stable

The average return on assets has been stable in the last three years, with banks compensating for the decline in interest income with non-interest income and lower operating costs. The number and market share of banks that generate an above-average return on assets remained the same, while the number and market share of banks that generate an above-average return on equity fell slightly. The number of banks that achieve an above-average interest margin, expressed as the ratio of net interest to average gross interest-bearing assets, is also falling. With the interest margin narrowing, the non-interest margin, expressed as the ratio of net non-interest income to average assets, is strengthening.

Table 13: **Selected bank performance indicators**

(%)	1999	2000	2001	2002	2003	2004
Gross income / average total assets	5.4	5.9	5.0	5.4	4.8	4.6
Average return on assets	0.8	1.1	0.5	1.1	1.0	1.1
Average return on equity	7.8	11.4	4.8	13.3	12.5	13.3
Interest margin	4.1	4.7	3.6	3.7	3.2	2.8
Non-interest margin	1.59	1.54	1.67	1.95	1.74	1.86
Operating costs / average total asset	3.6	3.5	3.3	3.2	3.0	2.8

Source: Bank of Slovenia

Gross income per average assets fell to 4.55%

With year-on-year growth in average total assets (7.4% in real terms) higher than growth in gross income (2% in real terms), there was a further fall in the gross income per average assets indicator from 4.79% to 4.55%. The average return on assets was unchanged for the third year in succession.

Return on equity rose to 13.3%

The average return on equity improved. After rising in 2002 (owing to slower growth in capital as a result of the abolition of general equity capital revaluation), it first fell slightly in 2003, then rose to 13.3% in 2004 thanks to profit growing faster than capital.

The interest margin continues to show a falling trend, as banks' earnings from net interest are falling despite real growth in gross interest-bearing assets.

The non-interest margin is increasingly important

The non-interest margin is of increasing importance, and is strengthening significantly in the context of real growth in net fees and net financial transactions.

Cost-effectiveness continues to improve

The cost-effectiveness indicator (operating costs per average assets) continued to improve, owing to the slowdown in labour costs and other operating costs.

3.3 Interest rates and interest rate spread

The proportion of interest-bearing liabilities accounted for by deposits by non-bank sectors fell to 72.9%

In the composition of interest-bearing liabilities, there was a decline in the proportion of average interest-bearing liabilities accounted for by deposits by non-bank sectors from 77.2% at the end of 2003 to 72.9% at the end of 2004. With borrowing from foreign banks more prominent, the proportion of average interest-bearing liabilities accounted for by bank deposits rose (from 15.9% to 20.5%), while there was also a slight rise in the proportion accounted for by liabilities from subordinated liabilities (from 1.9% to 2.3%).

The proportion accounted for by lending to non-bank sectors rose to 58.3%

In the composition of interest-bearing assets, the expansion of foreign currency lending to non-financial companies and household lending brought an increase in the proportion accounted for by lending to non-bank sectors (from 55.1% to 58.3% of interest-bearing assets) at the expense of a decline in the proportion of investments in securities (from 35.2% to 32.1% of interest-bearing assets).

The effective interest rates are given below, i.e. a comparison of the level of interest income/expenses with the relevant interest-bearing assets/liabilities. It is clear that the trend of a decline in effective lending and deposit rates and a contraction of the interest rate spread continued in 2004 (lending rates are declining faster than deposit rates). There was a fall of 1.71 percentage points in lending rates last year, and a decline of 1.40 percentage points in deposit rates.

Table 14: **Effective lending and deposit interest rates**

% per annum	1999	2000	2001	2002	2003	2004
Average lending rate	8.84	10.61	9.30	8.85	7.34	5.63
Average deposit rate	5.26	6.54	6.24	5.60	4.45	3.05
Interest rate spread	3.58	4.07	3.06	3.25	2.89	2.58

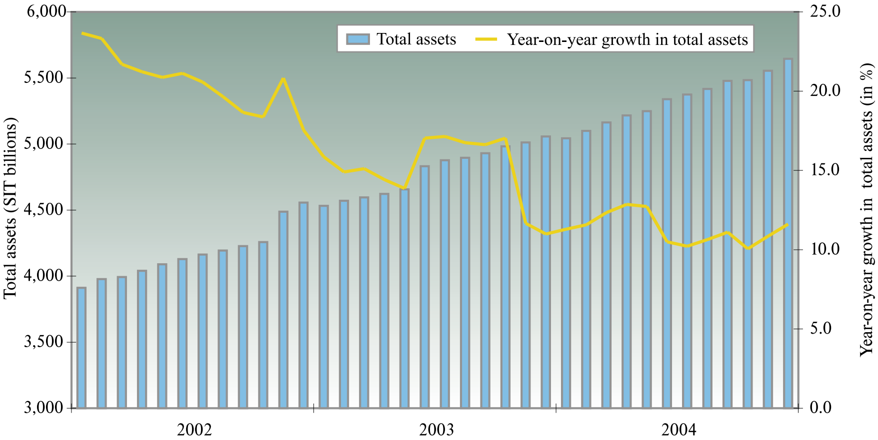
Source: Bank of Slovenia

3.4 Balance sheet

Total assets grew by 11.6% in nominal terms and 8.2% in real terms

Total assets grew in nominal and real terms in 2004, particularly banks under majority foreign ownership continuing to record rapid growth. At the end of 2004 the total assets of the banking system amounted to SIT 5,644.7 billion, and were up 11.6% in nominal terms and 8.2% in real terms[12] from the previous year (compared with growth of 11.0% in nominal terms and 6.1% in real terms in 2003). Year-on-year growth in total assets ranged from 10.1% to 12.9% last year. The trend of a decline in year-on-year growth that began in December 2001 ended in June 2004, and at the end of the year growth was strengthening slightly. The nominal growth in banks' total assets ranged from −1.1% to 55.5%. Again last year there was a continuation of the above-average growth in the total assets of banks under majority foreign ownership, while small banks under domestic ownership also recorded above-average growth.

Figure 15: **Nominal and year-on-year growth in total assets**



Source: Bank of Slovenia

The market share of the six largest banks declined by 2.7 percentage points

A feature of 2004 was a fall in the market share of the large banks. Over the year the market share of the six largest banks in terms of total assets fell by 2.7 percentage points. Only the seventh-largest bank saw its market share increase, and this by 0.8 percentage points, the largest increase in the banking system. The market share of Slovenia's largest bank has been falling since 2002, and had reached 32.4% by the end of 2004, with its fall of 1.6 percentage points last year standing out prominently from the minor fluctuations of 0.01 to 0.9 percentage points in the market shares of the other banks. The fall in the parent bank's market share was also reflected in a lower market share for the banking group of 36.1%.

12 Allowing for inflation of 3.2%.

Table 15: **Total assets and market shares of largest banks**

	Total assets (SIT millions)		Nominal growth (%)		Market share (%)	
Bank	31-Dec.-03	31-Dec.-04	2003/2002	2004/2003	31-Dec.-03	31-Dec.-04
NLB	1,717,258	1,831,022	6.1	6.6	34.0	32.4
NKBM	544,035	602,948	5.1	10.8	10.8	10.7
Abanka Vipa	432,426	481,845	11.1	11.4	8.6	8.5
SKB banka	391,675	387,325	8.8	-1.1	7.7	6.9
Banka Celje	324,648	361,317	17.8	11.3	6.4	6.4
Banka Koper	305,985	333,280	8.5	8.9	6.1	5.9
Bank Austria	229,214	299,414	30.2	30.6	4.5	5.3
Gorenjska banka	245,749	279,688	8.2	13.8	4.9	5.0
Largest 8 banks	**4,190,990**	**4,576,839**	**8.9**	**9.2**	**82.9**	**81.1**
All banks	5,057,459	5,644,744	11.0	11.6	100.0	100.0

Source: Bank of Slovenia

The market share of the three largest banks fell by 2.3 percentage points

As in the previous two years the principal source of financing in 2004 was borrowing at foreign banks. Liabilities to foreign banks rose by 39.2%, and banks used this money to finance 47.2% of the increase in total assets. Liabilities to foreign banks account for 17.4% of total liabilities (compared with 14.0% in 2003). In the past domestic banks found it harder to acquire foreign resources at favourable terms, but after Slovenia joined the European Union access to these resources became easier and cheaper, and growth in resources acquired from foreign banks was therefore much stronger at smaller domestic banks. At banks under majority foreign ownership, resources from foreign banks accounted for 70% of the growth in total assets in 2004.

Liabilities to non-bank sectors grew more slowly than total assets

Liabilities to non-bank sectors grew slower than total assets in 2004, and totalled SIT 3,524.2 billion at the end of the year. The largest rise was in household deposits (9.5%), with growth more rapid in foreign currency deposits than in tolar deposits. Deposits by non-bank sectors account for the largest source of assets, even though as a proportion of total assets they have been declining since 2001, when the figure was 71.2%, reaching 62.4% at the end of 2004. The decline can be seen at all banks, but varies greatly in its depth. Deposits by non-bank sectors rose by SIT 229.7 billion or 7.0% last year, a rate of growth 4.6 percentage points behind that of total assets. The largest contribution to this rise came from household deposits, which rose by SIT 202.7 billion, and rose particularly strongly in December, when one-half of the annual growth was recorded. For the second year in succession deposits by non-financial companies recorded low growth (2.3%, compared with 2.4% in 2003), and government deposits fell.

Significantly lower growth in securities issues than in previous years

In 2004 banks increased the volume of securities issued by just 4.0%, significantly less than in previous years, when the annual rate of growth ranged from 22% to almost 60%. The slower growth was primarily the result of non-renewals of securities issues at individual banks.

Table 16: **Principal items in banking sector balance sheet**

	Amount (SIT millions)		Proportion (%)		Nominal growth (%)		Real growth (%)
	31-Dec.-03	31-Dec.-04	31-Dec.-03	31-Dec.-04	2003/2002	2004/2003	2004/2003
Deposits with central bank	141,493	141,088	2.8	2.5	-1.3	-0.3	-3.4
Loans and advances to banking sector	345,170	500,160	6.8	8.9	-9.5	44.9	40.4
Loans and advances to non-bank sectors[1]	2,538,083	3,041,342	50.2	53.9	16.3	19.8	16.1
– Loans and advances to companies	1,596,856	1,930,301	31.6	34.2	24.5	20.9	17.1
– Loans and advances to households	629,128	763,608	12.4	13.5	11.8	21.4	17.6
– Loans and advances to government	141,946	142,928	2.8	2.5	-34.3	0.7	-2.4
– Loans and advances to others[2]	170,153	204,506	3.4	3.6	41.2	20.2	16.5
Securities	1,719,681	1,642,153	34.0	29.1	11.2	-4.5	-7.5
Other assets	313,032	320,001	6.2	5.7	3.4	2.2	-0.9
Total assets	**5,057,459**	**5,644,744**	**100.0**	**100.0**	**11.0**	**11.6**	**8.2**
Liabilities to banking sector	835,640	1,086,883	16.5	19.3	42.9	30.1	26.0
Liabilities to non-bank sectors	3,294,452	3,524,170	65.1	62.4	4.6	7.0	3.7
– Liabilities to companies	619,582	633,885	12.3	11.2	2.4	2.3	-0.9
– Liabilities to households	2,138,537	2,341,252	42.3	41.5	8.1	9.5	6.1
– Liabilities to government	157,859	135,356	3.1	2.4	-23.9	-14.3	-16.9
– Liabilities to others[2]	378,474	413,677	7.5	7.3	5.5	9.3	5.9
Debt securities	216,366	224,938	4.3	4.0	22.6	4.0	0.7
Other liabilities	290,363	347,977	5.7	6.2	9.3	19.8	16.1
Capital	420,638	460,775	8.3	8.2	10.6	9.5	6.1
Total liabilities	**5,057,459**	**5,644,744**	**100.0**	**100.0**	**11.0**	**11.6**	**8.2**

1 Owing to a change in methodology at the beginning of 2003, loans and advances to DARS, which as at 31 December 2002 were included among loans and advances to government, were included among loans and advances to companies as at 31 December 2003.

2 Others: other finanical organisations, non-profit household service providers, non-residents.

Source: Bank of Slovenia

Book capital rose by 9.5%

Book capital as at 31 December 2004 amounted to SIT 460.8 billion. The increase in capital of 9.5% was lower than growth in total assets. The increase includes that part of profit transferred to the reserves in accordance with the Companies Act. In 2004 seven banks underwent a recapitalisation, with the subscribed capital rising by a total of SIT 7.8 billion. Banks made no general equity capital revaluation in 2004, as the Slovenian accounting standards only prescribe a general revaluation when the euro has appreciated against the tolar by more than 5.5% in the previous year.

Capital adequacy was maintained by a rise in subordinated liabilities

With growth in capital from new capital contributions so low, banks maintained capital adequacy by increasing subordinated liabilities. These rose at 11 banks in a total amount of SIT 47.6 billion, or by 49.7%, to reach SIT 143.5 billion at the end of 2004. The introduction of tax on interest and the additional tax liabilities associated with this will also have a bearing on the subsequent decisions to increase subordinated debt or recapitalise, from the point of view of banks and potential subscribers to subordinated debt.[13]

13 The estimated interest income and the costs of paying tax on interest for subordinated debt (long-term time deposits, with a premium included in the interest rate for the subordination to other bank liabilities) in comparison with capital gains from dividends, and the taxation and liquidity thereof, according to the new Corporate Income Tax Act.

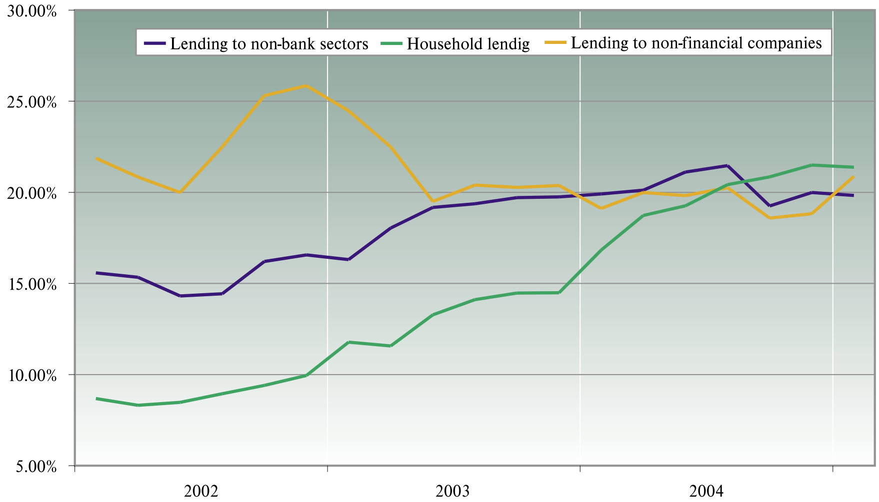
Banks directed the majority of the increase in total assets to lending to non-bank sectors, in particular to non-financial companies and households. Owing to the Bank of Slovenia's new offer of subscription to long-term deposits, individual banks recorded a rise in investments in banks at the expense of a decline in investments in securities, which was also reflected in the investment structure.

Lending to non-bank sectors rose by 19.8% in real terms

Growth in lending to non-bank sectors in 2004 strengthened further to 19.8% from the previous year (when it was 16.3%). Investments in non-bank sectors amounted to SIT 3,041.3 billion at the end of the year, having risen by SIT 503.3 billion over the year. In lending too, banks under foreign ownership are recording relatively high growth, although the majority of the nominal rise in lending (63.7%) in 2004 was generated by domestic banks. Growth in lending was influenced by the fall in interest rates and the decline in the level of depreciation of the tolar. In addition, the cycle of repayments of consumer loans raised prior to the introduction of VAT in 1999 is coming to an end, and the first disbursements from the national housing saving scheme are bringing an expansion of housing lending. These factors were reflected in a rise of SIT 134.5 billion or 21.4% in personal lending. As a result of these factors, and stronger economic activity, lending to non-financial companies also strengthened significantly, rising by SIT 333.4 billion or 20.9%.[14]

In contrast to the significant growth in lending to non-bank sectors, the potential liabilities of banks rose by only 1.2%, which is the lowest rate of growth in the last five years. Within the banking system there was a decline in guarantees given at certain banks, while other banks continued to record growth in this item.

Figure 16: **Year-on-year growth in lending to non-bank sectors**



Source: Bank of Slovenia

The proportion accounted for by investments in banks rose to 8.9% in 2004

As a result of the Bank of Slovenia's offer of subscription to long-term deposits, investments in banks began to strengthen in July, recording growth of 44.9% by the end of the year. Bank deposits rose by SIT 155.0 billion to SIT 500.2 billion. Consequently investments in banks advanced by 2.1 percentage points in the investment structure to 8.9%. The option to subscribe to the deposits was taken up by 15 banks.

[14] The rise in lending to non-financial companies of 24.5% in 2003 includes the transfer of investments in DARS from the government sector to the non-financial companies item.

Investments in Bank of Slovenia securities declined

The opportunities for more favourable investment of assets were reflected in a decline of 25.6% or SIT 260.8 billion in investments in Bank of Slovenia securities to SIT 766.4 billion, which also brought about a significant decline of 4.9 percentage points in the proportion of total assets accounted for by securities. The decline in this proportion was mitigated by the increases of 21.7% in investments in government securities to SIT 600.9 billion, and of 38.4% in investment in other[15] securities to SIT 274.9 billion.

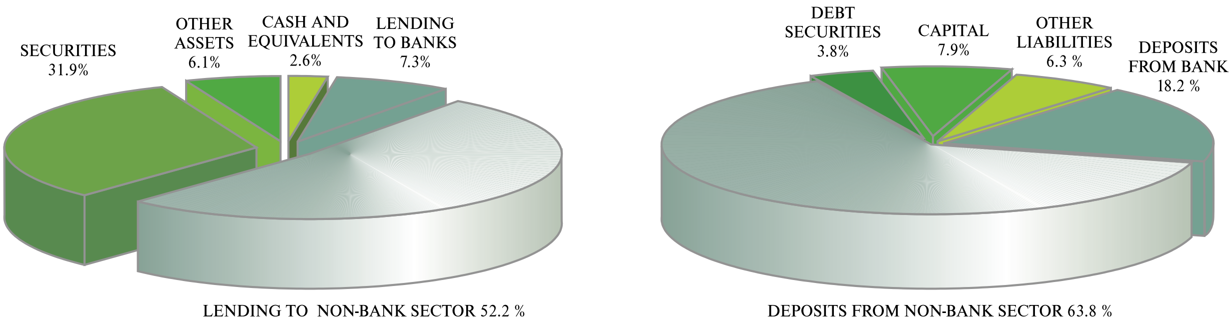
A change in the average liabilities structure

The changes in banks' sources of assets were also reflected in the average liabilities structure in 2004. Owing to borrowing at foreign banks, the proportion accounted for by liabilities to banks rose by 4.3 percentage points from 13.9% to 18.2%. The proportion accounted for by liabilities to non-bank sectors fell significantly for the second year in succession, from 67.3% in 2003 to 63.8% in 2004.[16]

The proportion accounted for by lending to non-bank sectors rose by 3.6 percentage points

In the average assets structure there was a significant rise of 3.6 percentage points in the proportion accounted for by lending to non-bank sectors to 52.2%, primarily at the expense of a decline of 3.5 percentage points in the proportion accounted for by securities to 13.9%. Investments in Bank of Slovenia long-term deposits have not yet brought any change to the average assets structure.

Figure 17: **Average structure of bank sources of assets and investments in 2004**



Source: Bank of Slovenia

The decline in long-term deposits by non-bank sectors is continuing

In the maturity structure of deposits by non-bank sectors, the trend of a decline in long-term deposits is continuing, with the figure down 8.2% from the previous year, while demand deposits are recording the highest growth. The largest proportion of deposits by non-bank sectors is accounted for by short-term time deposits (57.6%), while the proportion accounted for by long-term deposits is just 7.7%. In contrast to sources of assets, on the investments side long-term investments in non-bank sectors grew more quickly in nominal and relative terms than short-term investments for the third year in succession, having risen by SIT 321.5 billion or 26.8% in 2004 (compared with SIT 181.8 billion or 13.6% for short-term investments).

Banks are replacing deposits by non-bank sectors with longer-term resources

The principal source of banks' financing remains deposits by non-bank sectors, but the proportion of average interest-bearing liabilities that they account for has been showing a falling trend for several years.[17] In 2004 it fell by 4.3 percentage points to 72.9%. By contrast the proportion of average interest-bearing liabilities accounted for by average liabilities to banks rose by 4.6 percentage points in 2004 to 20.5%. Longer maturity periods are a feature of resources acquired from banks, and therefore despite the shortening of the average maturity period of deposits by non-bank sectors the proportion of average interest-bearing liabilities accounted for by long-term debts is rising, and stood at 24.5% in 2004 (compared with 22.4% in 2003).

15 Securities not issued by the government or the Bank of Slovenia.
16 70.9% in 2002.
17 The proportion fell by 10.8 percentage points between 2000 and 2004.

Table 17: **Maturity structure of deposits by and lending to non-bank sectors**

(%)	31-Dec.-01	30-Jun.-02	31-Dec.-02	30-Jun.-03	31-Dec.-03	30-Jun.-04	31-Dec.-04
Demand deposits by non-bank sectors	34.3	33.2	32.1	33.7	33.8	37.5	34.8
Short-term deposits by non-bank sectors	58.0	58.3	58.4	56.1	57.3	54.5	57.6
Long-term deposits by non-bank sectors	7.7	8.4	9.5	10.3	8.9	8.0	7.7
Total deposits by non-bank sectors	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Short-term lending to non-bank sectors	57.1	55.3	54.1	53.8	52.8	52.9	50.0
Long-term lending to non-bank sectors	42.8	44.6	45.9	46.1	47.2	47.1	50.0
Claims arising from guarantees	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Total lending to non-bank sectors	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Slovenia

Growth in foreign currency deposits by non-bank sectors was significantly faster than growth in tolar deposits

The growth in foreign currency deposits by non-bank sectors of 11% recorded in 2004 was significantly faster than that in tolar deposits (4.9%), although in December the contribution to growth in total assets was almost equal, primarily thanks to tolar household deposits (52.6% foreign currency deposits, 46.9% tolar deposits). This was also a factor in the decline of 1.3 percentage points in the proportion accounted for by tolar deposits to 65.4%. After the final relaxation of restrictions on foreign currency lending in 2003, foreign currency lending to non-bank sectors expanded strongly in 2004, by 42.6% or SIT 310.8 billion, while tolar lending rose by 10.6% or SIT 192.4 billion. The majority of this lending, 82.3% or SIT 255.7 billion, was approved for non-financial companies, meaning that 76.7% of the increase in investments in non-financial companies was realised in foreign currency. Growth in foreign currency lending to households was also recorded but at a significantly lower level. The proportion of investments in non-bank sectors accounted for by foreign currency stood at 34.2% at the end of 2004, and had thus risen by 5.6 percentage points.

Table 18: **Currency structure of principal balance sheet items**

	Proportion as at 31-Dec.-03		Proportion as at 31-Dec.-04	
(%)	tolars	foreign currency	tolars	foreigncurrency
Deposits with central bank	2.6	0.2	2.3	0.2
Loans and advances to banking sector	1.3	5.6	3.5	5.4
Loans and advances to non-bank sectors	35.8	14.4	35.4	18.4
Securities	21.3	12.7	18.2	10.9
Other assets	5.7	0.5	5.2	0.5
Total assets	**66.6**	**33.4**	**64.5**	**35.5**
Liabilities to banking sector	4.8	11.7	4.7	14.5
Liabilities to non-bank sectors	43.5	21.7	40.9	21.6
Debt securities	4.2	0.1	3.9	0.1
Other liabilities	4.6	1.1	4.4	1.7
Capital	8.3	0.0	8.2	0.0
Total liabilities	**65.4**	**34.6**	**62.1**	**37.9**

Source: Bank of Slovenia

3.5 Asset quality

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 2004, 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 and off-balance-sheet bank assets, adjustments and provisions**

	31-Dec.-03				31-Dec.-04			
	Classified assets (SIT millions)	%	Value adjustments, provisions (SIT millions)	%	Classified assets (SIT millions)	%	Value adjustments, provisions (SIT millions)	%
A	3,363,863	80.9	36,226	14.8	4,001,552	81.7	40,170	15.7
B	522,938	12.6	53,547	21.9	624,126	12.7	63,448	24.9
C	119,360	2.9	32,303	13.2	121,050	2.5	32,367	12.7
D	70,428	1.7	40,926	16.7	69,614	1.4	40,051	15.7
E	81,870	2.0	81,861	33.4	79,059	1.6	79,060	31.0
Total	**4,158,459**	**100.0**	**244,862**	**100.0**	**4,895,401**	**100.0**	**255,096**	**100.0**

Source: Bank of Slovenia

The total of large exposures in the banking system fell below 200% of capital

The total of large exposures (a bank's exposure to an individual person calculated according to the regulation on large exposures that reaches or exceeds 10% of the bank's capital) in the banking system fell during 2004 to reach 196% of capital at the end of the year. The total number of large exposures was down 43 from the end of 2003. Three banks recorded a large exposure total of more than 300% of their capital.

Table 20: **Bank exposure with regard to capital**

	2001	2002	2003	Sep.-04	Dec.-04
Total large exposures / capital (%)	209	195	214	201	196
Number of large exposures	280	256	296	238	253
Number of banks with large exposure of more than 300% of capital	5	4	4	1	3

Source: Bank of Slovenia

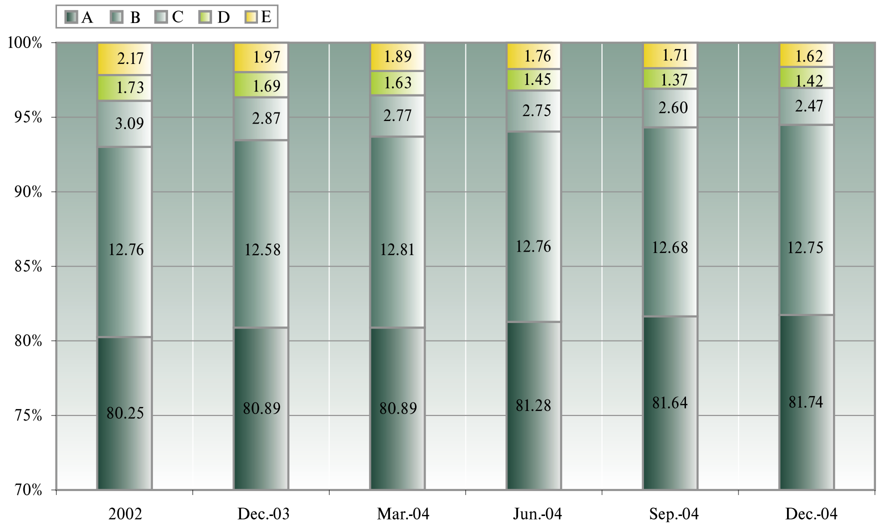
Balance-sheet and off-balance-sheet claims rose by 12.1%

The total exposure of banks as at 31 December 2004 amounted to SIT 6,817 billion (of which SIT 5,653 billion was claims on the balance sheet and SIT 1,164 billion was off-balance-sheet claims), while classified assets amounted to SIT 4,895 billion or 71.8% of total exposure. Total exposure rose by 12.1% in 2004, while classified balance-sheet and off-balance-sheet assets rose by 17.7%. In 2003 total exposure rose by 12.3%, while classified assets rose by 13.3%.

The credit risk composition of assets did not deteriorate during 2004

Despite the expansion in banks' lending activity and the potential for banks to approve lending to weaker customers given the level of competition, the credit risk composition of classified assets did not deteriorate last year. Analysis of the credit portfolio of the entire banking system shows that the proportion of claims graded as Category A rose by 0.85 percentage points and the proportion graded as Category B rose by 0.17 percentage points from 2003, with a corresponding decline in those graded as Categories C to E (a total decline of 1.02 percentage points, of which Category C accounted for 0.40 percentage points, D for 0.27 percentage points and E for 0.35 percentage points).

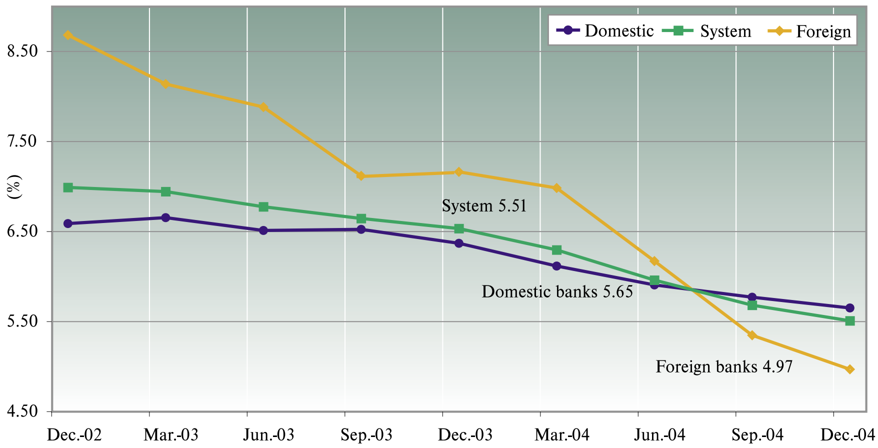
Figure 18: **Composition of banking sector credit portfolio (in %)**



Source: Bank of Slovenia

Banks under majority foreign ownership made a particular contribution to the quality of the portfolio, with the proportion of their claims graded as Category A being above-average at 91.2%.

Figure 19: **Proportion of claims in Categories C to E, by groups of banks and for banking system**



Source: Bank of Slovenia

Favourable movement in non-performing claims

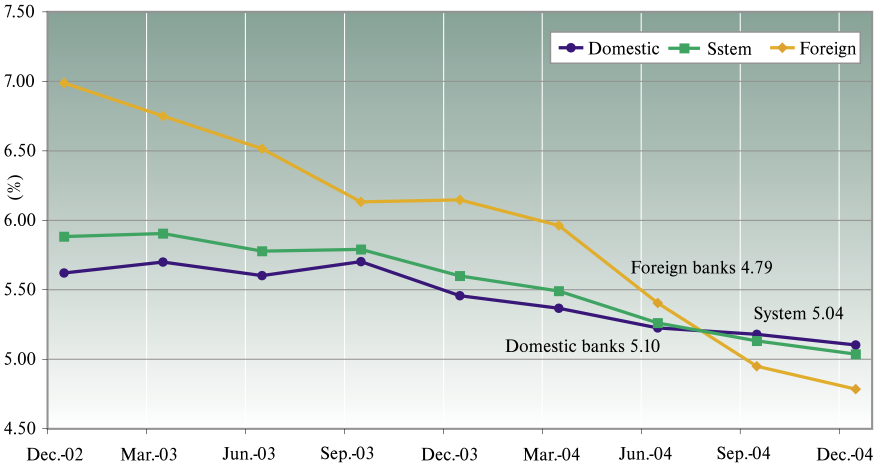
There was favourable movement in non-performing claims (claims graded as Category C, D or E) in 2004, with the total proportion that they account for continuing to decline. A comparison of domestic and foreign banks shows that this proportion is declining more sharply at the foreign banks, with the figure of 4.97% at the end of the year already significantly below the average for the banking system (5.51%). Domestic banks are also recording a decline in the proportion of non-performing assets, but the decline is less sharp and the figure of 5.65% at the end of 2004 was above the system average.

The average default risk fell

A decline in the average default risk,[18] and a consequent improvement in the credit risk composition, was recorded by both groups of banks. The average default risk of assets in the banking system fell from 5.60% at the end of 2003 to 5.04% at the end of 2004, with the decline slightly more pronounced at foreign banks, where the figure had fallen below the average to reach 4.79% by the end of the year.

[18] The average default risk means the size of the potential loss per 100 units of assets. It is calculated from the volume of classified assets in Categories A to E, weighted by the percentage of provisions required for each group(A 1%, B 10%, C 25%, D 50% and E 100%).

Figure 20: **Average default risk, by groups of banks and for banking system**



Source: Bank of Slovenia

Banks were most exposed to customers in the service sector

In 2004 banks were most exposed to customers in the service sector, who accounted for more than one-half of total exposure (57.5%) as at 31 December 2004. Within the service sector banks were most exposed to financial intermediation (20.3%) and the government (10.5%), although the proportions that they account for are declining. Another feature of these two sectors is their low level of risk. The financial intermediation figure also includes exposure to the Bank of Slovenia, whose proportion fell in 2004 to settle at 14.1% at the end of the year. The proportion accounted for by government securities, which are included among exposure to the government, is relatively stable (8.9%). Exposure to industry, which is characterised by an above-average level of risk,[19] rose in 2004 to reach 19.3%. Within this sector the fastest-growing exposures were those to the metal and machinery industry and to construction. Exposure to the household sector, which is less risky than other sectors, rose by just under 0.5 percentage points last year (to 13.6%), while exposure to non-residents, which is more risky, rose by 1 percentage point (to 9.6%).

Table 21: **Composition of classified assets by sector and average credit risk of sector**

	31-Dec.-03		30-Jun.-04		30-Sep.-04		31-Dec.-04	
	proportion %	average risk	proportion %	average risk	proportion %	average risk	proportion %	average risk
A. Industry	**18.6**	**7.3**	**18.8**	**6.8**	**19.2**	**6.8**	**19.3**	**6.6**
- metals and machinery	3.8	5.6	4.1	5.1	4.1	5.0	4.1	4.4
- chemicals	2.5	7.3	2.5	6.4	2.6	6.1	2.6	6.3
- foodstuffs	1.9	5.6	2.0	5.5	2.0	5.7	2.0	5.8
- construction	3.5	8.2	3.6	7.4	3.7	7.1	3.9	6.7
- energy supply	1.3	4.4	1.1	4.2	1.1	4.1	1.0	3.7
B. Services	**59.7**	**5.3**	**58.8**	**4.9**	**57.7**	**4.6**	**57.5**	**4.6**
- vehicle trade and repair	9.8	7.3	9.8	7.1	10.2	7.1	10.3	6.8
- transport, warehousing	4.0	5.8	3.8	4.6	3.6	3.4	3.6	3.4
- financial intermediation	24.5	2.2	22.0	2.3	20.8	2.0	20.3	2.1
- Bank of Slovenia	17.1		15.0		14.2		14.1	
- real estate, leasing	6.9	5.6	7.3	5.5	7.3	5.4	9.8	4.4
- public admin, defence, social security	11.8	1.4	12.8	1.4	12.7	1.4	10.5	1.7
- government securities	8.1		8.9		9.0		8.9	
C. Households	**13.2**	**4.1**	**13.3**	**3.9**	**13.8**	**3.9**	**13.6**	**3.9**
D. Non-residents	**8.5**	**5.2**	**9.1**	**5.1**	**9.2**	**5.2**	**9.6**	**5.3**
Total	**100.0**	**5.6**	**100.0**	**5.2**	**100.0**	**5.1**	**100.0**	**5.0**

Source: Bank of Slovenia

19 Expensive raw materials, and competition from eastern markets.

EU member-states were prevalent within the composition of exposures to particular groups of countries at the end of 2004, accounting for 65.4% of the total (69.7% including the Efta countries), although this proportion has fallen in the last two years. Worthy of note is the increase in exposure to countries of the former Yugoslavia, with the proportion that they account for rising by 2.7 percentage points from the end of 2003 to 15.4%. Investments in the USA account for 39% of those itemised as others. Investments in foreign countries, the EU and Efta in particular, almost entirely constitute investments in banks, and are therefore less risky.

Table 22: **Exposure to particular groups of countries**

	31-Dec.-01		31-Dec.-02		31-Dec.-03		31-Dec.-04	
(SIT millions)	Amount (%)	Proportion	Amount (%)	Proportion	Amount (%)	Proportion	Amount (%)	Proportion
EU(15)	338,903	73.1	369,721	76.4	350,114	67.6	423,564	65.4
Efta	26,387	5.7	25,586	5.3	30,927	6.0	28,149	4.3
Countries of former Yugoslavia	24,509	5.3	37,748	7.8	65,930	12.7	99,517	15.4
Cefta	5,379	1.2	9,549	2.0	12,292	2.4	23,849	3.7
Others	68,302	14.7	41,407	8.6	58,872	11.4	72,084	11.1
Total	**463,480**	**100.0**	**484,011**	**100.0**	**518,135**	**100.0**	**647,163**	**100.0**
Proportion of classified assets accounted for by non-residents	11.5%		11.4%		10.6%		10.6%	

Source: Bank of Slovenia

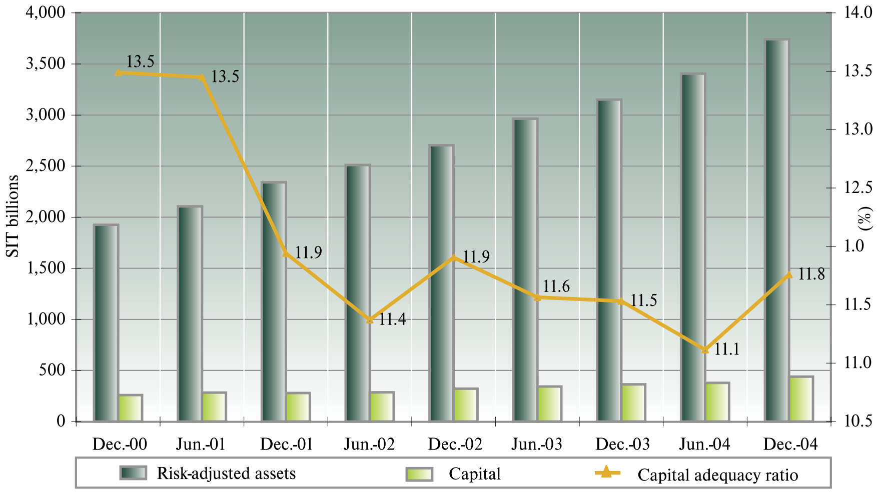
3.6 Capital and capital adequacy ratio

The decline in capital adequacy ceased

After declining sharply in 2001, capital adequacy fluctuated between 11% and 12% in the following years. Although fluctuating, it never dropped below 11%, and it reached a low of 11.04% in September 2004, owing to the rising growth in bank lending and the increase in currency-risk-adjusted items in the context of slower growth in capital. In the final quarter of 2004, with capital growing more rapidly, capital adequacy recovered by 0.72 percentage points.

The capital adequacy ratio of the banking system stood at 11.76% as at 31 December 2004 (compared with 11.53% one year earlier), having risen slightly over the year (0.23 percentage points).

Figure 21: **Risk-weighted assets, capital and capital adequacy ratio**



Source: Bank of Slovenia

At the end of 2004 the banking system's capital amounted to SIT 440 billion, up SIT 76.5 billion or 21% from the end of 2003, mostly as a result of supplementary capital (an increase of SIT 50.8 billion), and to a lesser extent from primary capital (SIT 30.5 billion). The ratio of primary capital to supplementary capital moved further towards supplementary capital in 2004, with the breakdown being 66.3% primary capital versus 33.7% supplementary capital at the end of the year. The increase in supplementary capital in 2004 was primarily the result of an increase in hybrid instruments (SIT 30.8 billion) and subordinated debt (SIT 20 billion from bond issues). The increase in primary capital was primarily the result of an increase of SIT 17.4 billion in profit reserves, an increase of SIT 8.3 billion in additional provisions for general banking risk and an increase of SIT 6.5 billion in share capital and capital reserves, while other items of primary capital declined. Five banks recorded an increase in share capital. Capital investments, which represent a capital deduction item, rose by SIT 4.8 billion in 2004 to SIT 70.2 billion, the proportion of capital that they account for declining by 2 percentage points from 17.9% at the end of 2003 to 15.9% at the end of 2004.

The banking system's capital rose by 21% in 2004

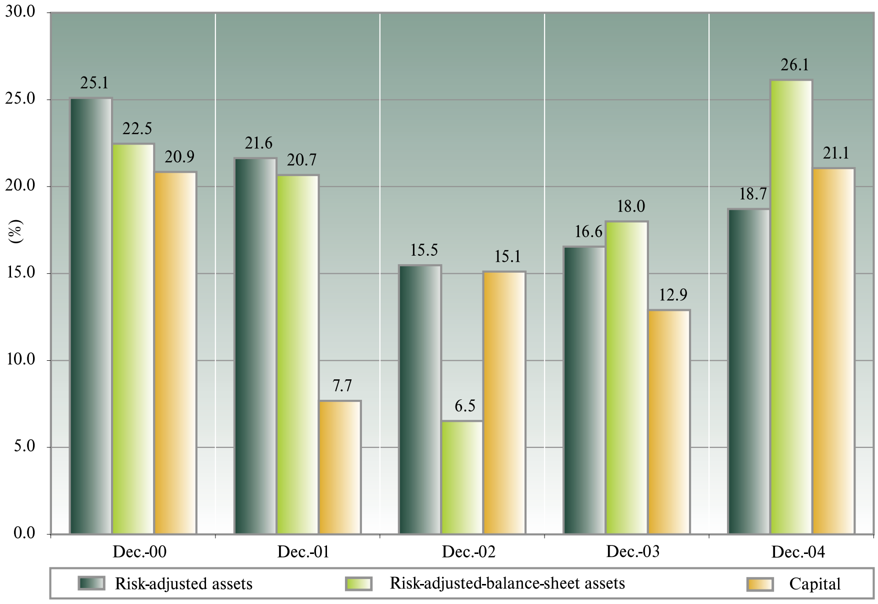
Risk-adjusted assets totalled SIT 3,742 billion at the end of 2004, up SIT 589.8 billion or 18.7% from the end of 2003. The largest factor in the increase was the increase of SIT 489.7 billion or 18.1% in credit-risk-adjusted assets. Currency-risk-adjusted assets increased by SIT 29.7 billion or 14%, with significant variation at individual banks, while market-risk-adjusted assets increased by SIT 70.4 billion or 29.6%.

Risk-adjusted assets were up 18.7% from 2003

Within the credit-risk-adjusted assets there was a large increase of SIT 591.8 billion or 26.1% in risk-adjusted balance-sheet assets, and also a decline of SIT 102.6 billion or 23.5% in risk-adjusted off-balance-sheet-assets. The capital requirements for market risk were met by 16 banks at the end of 2004 (compared with 15 banks at the end of 2003), with their average trading turnover accounting for 14.7% of total turnover (compared with 13.5% at the end of 2003). Transactions in debt and equity securities accounted for 48.5% of trading turnover, and derivatives and other financial instruments for 50.9%.

Risk-adjusted balance-sheet assets increased, while risk-adjusted off-balance-sheet assets declined

Figure 22: **Year-on-year change in risk-weighted assets and bank capital**



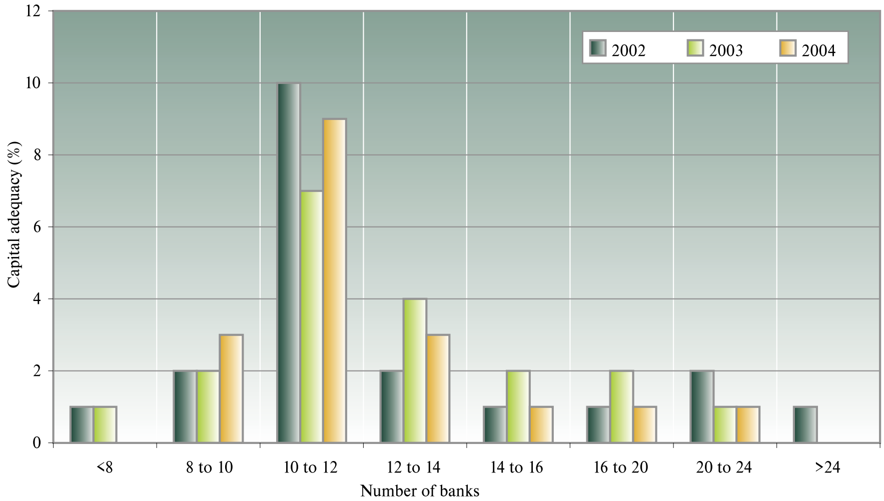
Source: Bank of Slovenia

At the end of 2004 some 73% of capital was used for covering all capital requirements in the banking system, down 1.2 percentage points from the figure of 74.2% at the end of 2003. All the banks had sufficient capital to cover their capital requirements, but there were some significant differences between them. Only two banks needed less than 50% of their capital for covering the capital requirements.

All the banks met the minimuim capital adequacy requirement

All the banks met the minimum capital adequacy requirement as at 31 December 2004. In comparison with 2003 there was a significant shift towards the 8% to 10% interval (from two to three) and the 10% to 12% interval (from seven to nine) at the expense of a decline in the number of banks in other intervals with higher capital adequacy.

Figure 23: **Distribution of capital adequacy ratio**



Source: Bank of Slovenia

4 FINANCIAL MARKETS

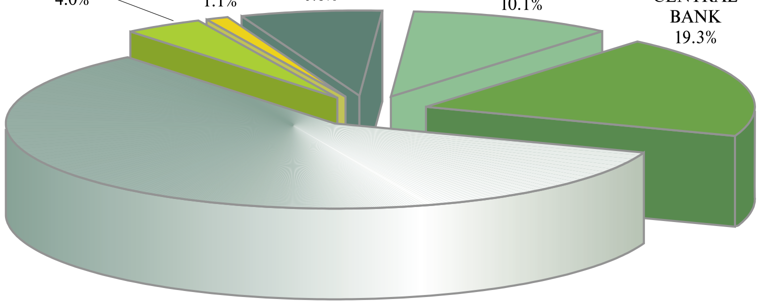
Monetary financial institutions dominate the financial markets

The Slovenian financial market is dominated by monetary financial institutions. Non-monetary financial institutions account for 22% of the total assets of the Slovenian financial system. At the end of 2004 the non-monetary financial institutions comprised 11 investment companies, 34 mutual funds and 15 insurance companies (13 insurers and two reinsurance companies), while the pension providers comprised seven mutual pension funds, four pension companies and two insurers. There were 18 brokerage houses and ten banks among the authorised securities market participants.

Prevailent non-monetary financial institutions are investment companies and insurance companies

Investment companies held total assets of SIT 289.8 billion at the end of 2004, down 16% from the end of 2003. The last remaining privatisation funds underwent conversion in 2004, mostly into ordinary public limited companies. The total value of investments by mutual funds amounted to SIT 210.1 billion at the end of the year 2004, up 126% from the end of 2003.

Figure 24: **Financial intermediaries in terms of total assets**



Note: Situation as at end of 2003.
Source: Bank of Slovenia

Table 23: **Composition of Slovenia's financial system**

	2001		2002		2003	
Total assets	(SIT millions)	%	(SIT millions)	%	(SIT millions)	%
Central bank	**1,141,031**	**17.3**	**1,601,506**	**20.2**	**1,677,978**	**19.3**
Monetary financial institutions	**3,954,031**	**60.0**	**4,623,220**	**58.2**	**5,099,010**	**58.7**
Non-monetary financial institutions	**1,492,179**	**22.7**	**1,719,321**	**21.6**	**1,907,068**	**22.0**
Investment companies (privatisation funds)	548,096	8.3	462,552	5.8	346,063	4.0
Mutual funds	14,686	0.2	55,422	0.7	93,118	1.1
Insurers and reinsurance agencies	391,088	5.9	501,683	6.3	588,978	6.8
Pension funds	45,617	0.7	55,541	0.7	80,164	0.9
Brokerage houses	19,936	0.3	22,826	0.3	21,459	0.2
Others	472,756	7.2	621,297	7.8	777,286	9.0
Total	**6,587,242**	**100.0**	**7,944,046**	**100.0**	**8,684,056**	**100.0**

Source: Bank of Slovenia

Insurance companies form the largest group among non-monetary financial institutions. Their gross effective premiums amounted to SIT 353.9 billion, and gross claims of SIT 223.8 billion resulted in a claims-to-premium ratio of 0.63 last year. Insurance companies held investments of SIT 553.1 billion in the financial market at the end of 2004, predominantly in government securities and other debt securities.

There are already 450,000 people covered by voluntary supplementary pension insurance

There were 450,000 persons covered by voluntary supplementary pension insurance at the end of 2004 (56% through mutual pension funds). In 2004 mutual pension funds, pension companies and insurers collected a total of SIT 42.8 billion in premiums from voluntary supplementary pension insurance, 90% more than in the previous year. The total value of investments held by pension providers at the end of 2004 was SIT 131.7 billion. The majority of their assets were invested in government securities and other securities, with equity securities prevalent among these.

The importance of authorised securities market participants for the Slovenian financial market is evident in the value of the investments that are made through these institutions. The total value of these investments at the end of 2004 stood at SIT 2,199.4 billion, a rise of 14% on the standing at the end of 2003.

The primary securities market is still relatively undeveloped

There were no public offers of securities on the primary market in 2004, while the government issued bonds in a total amount of SIT 180 billion on the domestic market.

Non-financial companies accounted for most shares registered with the Central Securities Clearing Corporsation (78%), and the government for most bonds (81%)

At the end of December 2004 there were 1,030 securities of 853 issuers registered at the Central Securities Clearing Corporation, of which 897 were shares and 133 were bonds. The market or book value of shares registered at the Central Securities Clearing Corporation at year-end was SIT 4,406 billion (equivalent to 72% of GDP). By far the most prominent share issuers were non-financial companies (78% of the total value), followed by banks (11%), other financial intermediaries (8%) and insurers (3%). The largest group of shareholders were non-financial companies (25%), followed by the general public (22%), other financial intermediaries (18%), the government (17%), the rest of the world (12%), banks (4%) and insurers (3%). The value of bonds registered at the Central Securities Clearing Corporation, by market or nominal value, stood at SIT 1,363 billion at year-end (equivalent to 22% of GDP). The most important bond issuer was the government (81% of the total value), followed by banks (14%), non-financial companies (4%) and insurers (1%). The main holders of bonds were banks (45%), followed by insurers (24%), the general public (12%), non-financial companies (6%), other financial intermediaries (6%), the government (4%) and the rest of the world (3%).

The SBI 20 rose by 24.7% and the PIX by 33.8%

At the end of 2004 there were 254 securities of 173 issuers being traded on the Ljubljana Stock Exchange, of which 153 were shares and 101 were bonds. Total market capitalisation rose by 25% in 2004 to SIT 3,050 billion, equivalent to 50% of GDP. The volume of trading during the year was SIT 397 billion, up 17% from 2003. Just under one-half of the volume was in block trades. The largest volume was in shares (56%), followed by bonds (29%) and investment companies (15%). The most heavily traded shares during 2004 were Krka, Mercator, Petrol, Intereuropa and Gorenje. The SBI20, Slovenia's stock market index, rose by 24.7% over the year, while the investment fund index (the PIX) rose by 33.8%. Among the sector share indices, the biggest rise was in pharmaceuticals (62%), followed by transport (39%), chemicals (28%), trade (23%), oil and gas (9%) and food and beverages (-0.4%).

Non-residents' investments in Slovenian securities

Investments by non-residents in Slovenian securities totalled SIT 32.8 billion in 2004, but taking the maturity of treasury bills into consideration the net inflow was just SIT 22.2 billion.

Resident's investments in foreign securities

At the end of 2004 residents held SIT 313.5 billion in investments in securities issued abroad by non-residents (61% of it in bonds), and SIT 58.2 billion in investments in securities issued abroad by residents (92% in Slovenian government eurobonds). Outstanding amount of debt securities issued by residents on foreign markets was SIT 539.9 billion at year-end, of which SIT 484.7 billion was issued by the government.

5 OTHER ACTIVITIES

5.1 Management of foreign exchange reserves

The reserves of the Bank of Slovenia are defined as:

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

Fall in the Bank of Slovenia's international reserves

In 2004 the Bank of Slovenia's foreign currency reserves fell from EUR 6,879.0 million to EUR 6,541.8 million. The portion of the foreign currency 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 held at the Bank of Slovenia by banks and the Government – fell in 2004 by EUR 151 million, from EUR 2,502.5 million to EUR 2,351.5 million. Other reserves, representing net assets without foreign exchange reserves, fell in 2004 from EUR 4,376.5 million to EUR 4,190.2 million. The value of Slovenia's monetary gold decreased due to a fall in the tolar price of gold. The Bank of Slovenia's total claims abroad include official currency reserves and holdings at the IMF and a number of other holdings.

Table 24: **International monetary reserves and foreign exchange reserves of the banking system**

	BANK OF SLOVENIA							BANKS
	International monetary reserves					Including counter-value of liabilities in foreign currency* to residents	Claims against reest of world	Foreign exchange reserves of commercial banks
	Gold	SDR balances	Reserve position with 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	0.1	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
2004	77.8	8.2	87.9	6,367.9	6,541.8	2,351.5	67.4	1,116.4

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

Governing Board lays down rules for managing the Bank of Slovenia's foreign reserves

The Governing Board of the Bank of Slovenia lays down basic rules on a quarterly basis for the management of the bank's reserves, and does so separately for each type of risk. Under the present criteria for managing credit risk, foreign exchange reserves may be invested in financial instruments with supranational, national and banking risk for 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. The currency mix and the permitted range of variation are prescribed in detail for the portion of reserves that do not have currency counter-items in the liabilities (net reserves). 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 securities lending and other activities.

It should be mentioned in the context of efforts in 2004 to increase the yield of foreign currency reserves while retaining the same level of risk that the decision was taken to continue the transfer from eurodeposits to the securities market. There were no major shifts in the rest of the foreign currency reserves. The financial statements give a more detailed breakdown of the foreign exchange reserves at 31 December 2004.

5.2 Payment transactions by Bank of Slovenia counterparties

5.2.1 Operations for the government sector

Contract for joint action on the 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 28 billion.

Management of budget user accounts

Single treasury account

The Bank of Slovenia manages Government's 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 subaccounts 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 2004 a total of SIT 5,477.5 billion in inflows and the same in outflows were conducted through the Government's single treasury account, and SIT 4,575.3 billion in inflows and SIT 4,576.4 billion in outflows through the municipal treasury accounts.

Special foreign currency accounts

In addition to the single treasury accounts the Bank of Slovenia manages over 100 special foreign currency accounts for the government and other budget users.

Payment transactions with the rest of the world

Bank of Slovenia conducts Slovenia's government's foreign payment transactions and other currency transactions

The Bank of Slovenia conducts payment transactions and other transactions for the Republic of Slovenia, on the basis of the Payment Transactions Act. 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 stipulated that direct and indirect budget users that 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 2004 the Bank of Slovenia made EUR 774.4 million worth of payments abroad, and paid out EUR 7.4 million in cash. Inflows from abroad were worth EUR 430.7 million, inflows from domestic commercial banks were worth EUR 4.9 million and there was EUR 1.9 million in foreign currency remittances. A total of EUR 315.8 million in foreign currency was sold to budget users, while EUR 36.0 million was purchased from them. An analysis of the currency composition of inflows and outflows reveals that 81.6% of inflows were in euros, 8.0% in US dollars, 10.2% in tolars and only 0.2% in other currencies, while 68.6% of outflows were in euros, 4.2% in US dollars, 24.8% in tolars and 2.4% in other currencies.

In 2004 the Bank of Slovenia made EUR 774.4 million worth of payments abroad, and paid out EUR 7.4 million in cash

Management of accounts for foreign financial institutions and EU institutions

In 2004 the Bank of Slovenia opened tolar and foreign currency accounts for foreign financial institutions and EU institutions though which EUR 168.0 million was sold, and transactions worth EUR 105.0 million were made.

Fiscal stamps, securities certificates, notes and coins

The Bank of Slovenia prepared, issued, distributed and organised the storage of commemorative coins and coins for circulation for the state.

It issued a new bimetallic circulation-standard commemorative 500 tolar coin to mark the 250th anniversary of the birth of Jurij Vega, with a mintage of 200,000. From 1993 to the end of 2004 a total of 480.8 million coins had been issued (cf. 442.7 million up to the end of 2003), worth SIT 2.8 billion (SIT 1.9 billion by the end of 2003). The quantity of coins in circulation rose by 8.6% in 2004, with coins accounting for 1.4% of the total value of cash in circulation, compared with an eurozone average of 3.1 per cent.

New 500-tolar coin to mark 250th anniversary of Jurij Vega's birth

In addition to the commemorative coins issued to mark the 250th anniversary of the birth of Jurij Vega (gold, silver and circulation-standard), gold and silver commemorative coins were issued to mark the 1000th anniversary of the first written record of Bled. In total, 8,650 commemorative coins were sold at the Bank of Slovenia treasury and via commissioners (banks) last year (cf. 4,787 in 2003), of which 1,891 gold coins (1,222 in 2003) and 6,759 silver coins (3,565 in 2003).

8,650 commemorative coins sold

The Bank of Slovenia also worked on the acceptance and processing of redeemed bonds and mature coupons. In 2004 no RS 02 blocks were accepted (cf. 3,704 in 2003). The fall in RS 02 transactions was due to the maturity of the coupons and RS 02 bond blocks in 1998 and 2000.

No RS 02 blocks were accepted in 2004

There was a total of 5,187 treasury receipts and outlays of tolar cash, and 23,562 inward and outward payments of foreign currency for travel expenses and other requirements of state bodies (in 2003 there were 4,767 treasury receipts and outlays of tolar cash and 21,066 inward and outward payments of foreign currency).

5.2.2 Management of accounts for the Central Securities Clearing Corporation

Securities transactions settled from accounts at the 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 members), who are at the same time members of the payments and transfers system. At the end of 2004, 31 KDD members – 12 commercial banks and 19 investment firms – had accounts open at the Bank of Slovenia, which recorded inflows of SIT 984.4 billion and outflows of SIT 982.9 billion in 2004.

5.3 Cash operations

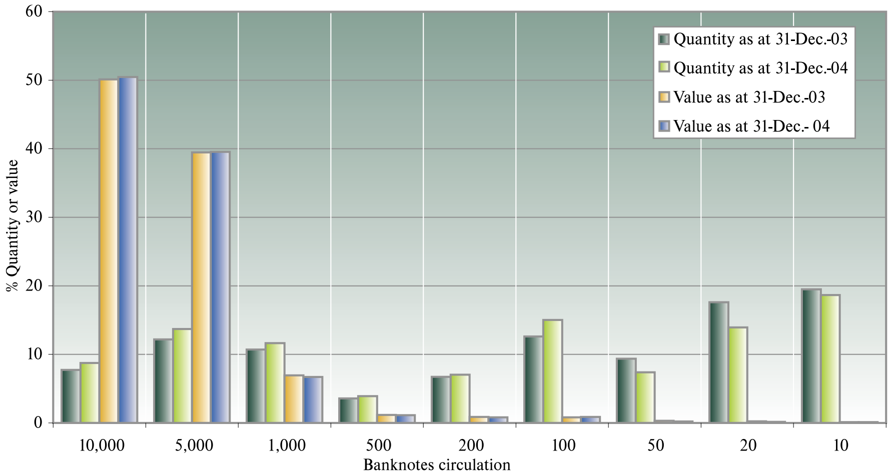
The Bank of Slovenia has a statutory remit to ensure a smooth supply of tolar banknotes to government.

5,000 and 10,000 tolars notes are principal denominations for cash transactions

10, 20 and 50 tolar notes replaced by coins of same denomination

On 31 December 2004 there were 112.5 million banknotes in circulation worth SIT 194.9 billion (including cash at banks). Compared to 2003 there was a 5.0% increase in the value of banknotes in circulation, while the number of banknotes decreased by 6.4%[20]. At the end of 2004 banknotes represented 98.6% of cash in circulation, and 19.0% by quantity. The highest denomination banknote in circulation is the 10,000 tolar note (which represents 50.5% of banknotes in circulation by value compared to 50.1% in 2003). The 5,000 tolar banknote represents 39.5% of banknote value, the same level as in 2003, and together these two notes are the principal denominations for cash transactions. The 1,000 tolar note is steadily losing its position in terms of value and quantity (now representing 6.7% of banknotes in circulation by value compared to 6.9% in 2003). The average overall value and quantity of 10, 20, 50 and 200 tolar banknotes has also fallen. This is largely due to the appearance of coins of the same denomination, except in the case of the 200 tolar note[21].

Figure 25: Cash in circulation



Source: Bank of Slovenia

Counting unit deals with 56.3 million banknotes

The Bank of Slovenia's money counting unit counted 56.3 million banknotes (60.5 million in 2003), of which 37.2 million were also sorted (36.4 million in 2003). A total of 27.3 million banknotes (compared with 36.0 million in 2003), were taken

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20 An overview of cash in circulation over the last nine years is presented in Table 24.

21 Figure 20 gives a comparison of the value and quantity of banknotes in circulation in 2003 and 2004.

out of circulation and destroyed in order to maintain the quality of banknotes in circulation. The largest group was the 20 tolar note, with 5.7 million withdrawn and destroyed.

Tolar cash supply to the country through the Bank of Slovenia's 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 reissues

In 2004 a total of ten million 5,000 tolar notes, five million 1,000 tolar notes and five million 200 tolar notes were printed because of higher demand for banknotes in cash circulation and to replace soiled and damaged notes.

1,238 counterfeit tolar banknotes
645 counterfeit foreign banknotes examined

Bank of Slovenia experts examined 1,238 examples of counterfeit tolar banknotes discovered and confiscated in Slovenia, compared to 1,189 in 2003 (Index 104). The Bank of Slovenia collaborated in these operations with the Ministry of the Interior – MoI (NAC and CNAC - national analysis centre and coin national analysis centre), ECB, EU, Interpol and Europol. According to the data submitted to the Bank of Slovenia by the MoI's Forensic Research Centre, the centre examined 645 examples of counterfeit foreign currency, compared to 445 in 2003 (index 145).

Table 25: **Cash in circulation**

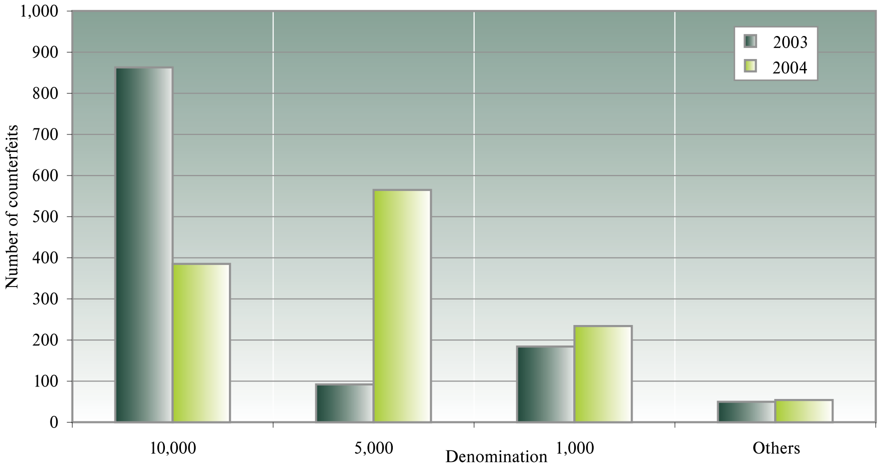
(SIT billions)	Banknotes in circulation	Coins in circulation	Total cash in circulation
1996	71.4	0.4	71.9
1997	85.7	0.5	86.1
1998	104.7	0.6	105.2
1999	142.5	0.6	143.1
2000	139.6	0.8	140.4
2001	165.8	1.0	166.8
2002	172.1	1.4	173.4
2003	185.6*	1.9	187.5
2004	194.9*	2.8	197.7

Note: Figures as at 31 Dec.
* Figures for 2003 and 2004 do not include vouchers issued.
Source: Bank of Slovenia

Decrease in the value of confiscated forgeries

The value of tolar coins and banknotes confiscated has grown every year since 1994, apart from 2002 and 2004. The total value of tolar banknotes confiscated in 2004 was down on previous year (SIT 9.3 million) to SIT 6.9 million. The MoI sent the following counterfeit notes to the Bank of Slovenia for examination: 385 examples of 10,000 tolar notes, 565 examples of 5,000 tolar notes, 234 examples of 1,000 tolar notes and 54 examples of other denominations.

Figure 26: **Five-year balance sheet as at 31 December**



Source: Bank of Slovenia

In comparison with the previous year the number of counterfeit 10,000 tolar notes fell by 55.4% (cf. an increase of 160.7% in 2003 on the previous year), the number of 5,000 tolar notes increased by 514.1% compared to 2003 (cf. an increase of 48.4% in 2003 on the previous year), and the number of 1,000 tolar notes increased by 27.2% (cf. increase of 130% in 2003).

Most common forgeries were made using computer technology or colour photocopying

The quality of the tolar counterfeits in 2004 did not differ significantly from those found in 2003. The only improvements in quality were found in forgeries of foreign notes, which were printed using offset printing techniques with fake ultra-violet security features and holograms. The most common forgeries were made using computer technology (scanners, computers, printers) or colour photocopying. The counterfeits were printed on commercial paper in most cases without any security features (watermark, colour fibres, security strip, and fluorescent features)[22].

Cash supply

Up until 30 October 2004 the supply of banknotes to government was operated through eight Bank of Slovenia banknote depots and five commercial banks who act as depositaries, while the supply of coins was operated through the central coin stock. From 1 November 2004 three depots that had functioned within two commercial banks ceased operations in accordance with a Governing Board decision.

The Bank of Slovenia banknote depots generally supply cash through the ordinary cash operations of the banks and savings banks who use their services.

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

With the migration of business accounts to the banks, the banks take in and pay out all cash to businesses. 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 arising in cash operations.

[22] Figure 21 gives a comparison of counterfeit tolar banknotes in 2003 and 2004.

5.4 Payment systems

Joining the TARGET system

TARGET - the interbank cross-border settlement system

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 has been operating since 1 January 1999. The TARGET system consists of 15 national systems for real-time gross settlement (RTGS) managed by the EU-15 central banks, and the ECB system, which are linked to allow the execution of cross-border payments. 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 main aim being to contribute to integration and the stability of the euro money market. The TARGET system participants are banks from the European Union.

Having now joined the European Union, connection to the TARGET system is a pressing issue for all the new member states, including Slovenia. On EU entry these countries acquired the right, without obligation, to participate in the system, but membership of the TARGET system is obligatory when they adopt the euro.

TARGET2 to start 1 January 2007

Slovenia could enter the system directly when it adopts the euro

The ECB Governing Council has already passed a decision on strategic guidelines for the further development of the TARGET system (TARGET2), which will lead to greater harmonisation of services and cost efficiency. TARGET2 should be available on 1 January 2007, which means that if Slovenia's adoption of the euro goes to plan, the Bank of Slovenia and Slovenian banks could enter that system directly, on the day the obligation to join comes into force (on adoption of the euro), i.e. without the need to join the existing TARGET system. However, the project's complexity means there is no guarantee that the system can realistically be brought online on time. To meet this contingency, the Bank of Slovenia has taken into account ECB advice and prepared a plan to join the system even if TARGET2 is not yet established when Slovenia adopts the euro.

Bank of Slovenia joins TARGET via the German central bank

The Bank of Slovenia's project decision has primarily taken into account the obligation to meet the ECB security and other formal requirements, as well as being cost efficient. The Governing Board of the Bank of Slovenia therefore decided in October that the Bank of Slovenia and Slovenian banks will join the TARGET system – if that becomes obligatory before the TARGET2 system starts to operate – as a remote direct participant in the Deutsche Bundesbank system ($RTGS^{plus}$), which is part of the TARGET system. It is therefore in favour of banks having remote access to the $RTGS^{plus}$/TARGET system before euro adoption, as this will provide all the benefits of immediate settlement in central bank money.

Remote participation to the TARGET system

Remote participation means the direct participation of an institution in an EEA country in the RTGS system of another country (host country). Remote participation offers immediate settlement of payments in central bank money, but does not represent formal membership of TARGET or meet the ECB requirements for adopting the euro. The Bank of Slovenia's objective in using remote participation is to create the same base for entry and settlement in pan-European payment systems as in the complementary STEP2 system (for low-value payments only).

Fallback solution
This will involve the new EU member states joining the current TARGET system on the day they adopt the euro. The Bank of Slovenia and other Slovenian banks will participate in TARGET via the German central bank's RTGSplus system, which is part of TARGET. The day fallback solution is activated, the Slovenian RTGS system will cease to function, and banks will direct large-value domestic payments via TARGET.

Migration to the TARGET2 system
The TARGET2 system is set to be operational on 1 January 2007, but this date is not yet certain, given the great complexity of the project. This means that the Bank of Slovenia and Slovenian banks will enter the TARGET2 environment by migrating from the fallback solution. During this phase the Bank of Slovenia and other Slovenian banks will be participants in the German component of the TARGET system, and will migrate to TARGET2 at the same time as banks in Germany.

Joining the STEP2 system

STEP2 – system for low-value payments in euros

On joining the European Union, Slovenian banks also had the opportunity to join the STEP2 payment system, which is managed by the Euro Banking Association (EBA). This is a system for processing low-value cross-border payments in euros (up to EUR 12,500), with bilateral gross settlement between participants via another system that is also managed by the EBA.
In March the Slovenian interbank Payment Services Committee proposed that Slovenian banks should join the STEP2 system via the Bank of Slovenia, which then went before the Bank of Slovenia's Governing Board. It supported the initiative once it has discussed it in April, and in May gave approval given the majority of banks in favour of joining STEP2 via the Bank of Slovenia. This decision was then backed by the Supervisory Board of the Bank Association of Slovenia at its May session.

Bank of Slovenia becomes direct STEP2 participant

On 8 November 2004 the Bank of Slovenia became a direct participant in the STEP2 system, with the banks participating via the Bank of Slovenia having indirect participant status. Eleven banks decided on indirect access to STEP2, while three banks participate via a selected indirect participant. The remaining five banks decided to participate in the STEP2 system indirectly via foreign banks.

From the date of entry to the STEP2 system the Bank of Slovenia became the Entry Point for Slovenia, which means that all payment services providers in Slovenia are accesible (as payment recipients) via the STEP2 system.

Between 8 November and 31 December, 44,083 payments were sent via the STEP2 system with a total value of EUR 135.52 million, making a daily average of 1,130 payments worth EUR 3.47 million. Over the same period 13,325 payments were received from the STEP2 system with a total value of EUR 48.79 million, which means a daily average of 342 payments worth EUR 1.25 million. The average payment value was therefore EUR 3,074 on the outflow side and EUR 3,662 on the inflow side.

The amended Payment Transactions Act and entry into force of Regulation 2560/2001 on cross-border payments in euro

At its 35th regular session, the National Assembly held a special session to pass the amended Payment Transactions Act (official Slovenian abbreviation: ZPlaP-B) to harmonise Slovenian legislation with the Directive on Cross-Border Credit Transfers (97/5/EC) and the Directive on Settlement Finality in Payment and Securities Settlement Systems (98/26/EC).

Implementing the Cross-Border Credit Transfers Directived

The new act implements the cross-border credit transfers directive by regulating the issue of minimal reciprocal rights and obligations for institutions executing payment transactions and for counterparties to cross-border payments within the European Union in any of the EU member state currencies. The provisions implementing the settlement finality directive regulate the issue of reciprocal relations between participants in a payment system with respect to the settlement of obligations and participation in the system at the start of bankruptcy proceedings against a system participant. In this sense the provisions of the new Payment Transactions Act exclude the provisions of general bankruptcy legislation that make a debtor's payment orders invalid, if not executed (settlement finality) on the day bankruptcy proceedings commence.

Transaction account register

The provisions of the new Payment Transactions Act also covers a range of other areas. It includes provisions to make account holders' names from the transaction account register public via the Bank of Slovenia website even for accounts held by natural persons, however, the Ministry of Justice found in a procedure on the grounds for disclosing the personal data account holders from the register that the act does not clearly define the purpose of making this data public. Based on decisions from the Personal Data Protection Inspectorate and the Ministry of Justice, the Bank of Slovenia withdrew the account data from their website, for individuals not registered as sole traders.

Another new feature of the Payment Transactions Act is its prohibition on the opening of new accounts by entities with unpaid liabilities due to insufficient funds in accounts they already have open. Other provisions of the Payment Transactions Act are intended to address some unclear issues and deficiencies that have appeared during the application of the act due to problems with its wording.

Regulation on Cross-Border Payments in Euros

On Slovenia's EU entry, Regulation 2560/2001 on Cross-Border Payments in Euros also came into force in the payment transactions field. The Regulation applies directly to all EU member states and defines the duties of institutions executing payments in euros to ensure that if a payment order is suitable for straight through processing then the charges for cross-border payments in euros must be the same as charges levied for payments in euros within that country. This only applies to payments worth less than EUR 12,500, but after 1 January 2006 that will be extended to all payments below EUR 50,000. In addition to these basic duties the Regulation requires institutions executing payments to transparently inform users of the conditions for executing cross-border payments in euros and the data that is compulsory for the automatic processing of a payment order for cross-border and domestic payments. The Regulation also requires member states to lift the obligation on institutions executing cross-border payments relating to statistical reporting on cross-border payments below EUR 12,500.

Oversight of payment system and adapting existing Slovenian payment systems to meet legal requirements

Bank of Slovenia responsible for payment systems oversight

Pursuant to the Bank of Slovenia Act and the Payment Transactions Act, the Bank of Slovenia is responsible for the oversight of payment systems. The purpose of payment system oversight 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.

As part of its normal functions in 2004 the Bank of Slovenia performed two inspections of private payment system operators, taking into account the legal requirements (from the Payment Transactions Act and the Decision on Settlements between Payment Transaction Institutions) and the Core Principles for Systemically Important Payment Systems,[23] which is the Bank of Slovenia-approved basis for payment system oversight. On the basis of the inspections, the Bank of Slovenia issued payment system operators with recommendations intended to bring these systems into compliance with the legal bases and core principles. The two payment system operators prepared action plans based on the recommendations that set out activities and deadlines for their implementation, and now report on a monthly basis on their progress in implementing individual recommendations.

In accordance with the Core Principles that require the central bank to ensure that the payment systems it manages respect the Core Principles, in November and December the Bank of Slovenia also inspected the RTGS system it runs itself. It used a methodology based on the ECB methodology for TARGET system oversight.

ESCB-CESR Standards for Securities Clearing and Settlement in the European Union

In October the ECB Governing Council and the Committee of European Securities Regulators (CESR) confirmed the Standards for Securities Clearing and Settlement in the European Union.

19 standards adapted to European needs

The document sets out 19 standards based on the CPSS[24]-IOSCO[25] Recommendations for Securities Settlement Systems issued in 2001, but harmonised to suit the European environment. The purpose of the standards is to create a sound basis for supervision, oversight and regulation, to ensure reliable trading in securities, protect the interests of investors, manage systemic risk, facilitate the integration of financial markets within the EU and to strengthen the security and efficiency of clearing and settlement systems.

After a suitable method for assessing compliance assessment has been approved, these standards will be used during the oversight of securities clearing and settlement systems in the European Union. The ECB Governing Council and Committee of European Securities Regulators plan to approve a methodology by the end of 2005.

Risk management

Risk management based on ECB model

In 2004 the Bank of Slovenia continued the work on a risk management scheme started in 2003 for payment systems within the Bank of Slovenia (RTGS and Giro clearing system). The risk management scheme for managing Bank of Slovenia payment systems are based on a scheme used by the ECB for the TARGET system.

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23 The Core Principles for Systemically Important Payment Systems were issued in 2001 by the Bank for International Settlements.

24 The G10 Committee on Payment and Settlement Systems, which operates within the Bank for International Settlements.

25 The International Organization of Securities Commissions.

Plan to test emergency procedures

After a fully functional back-up location was established in 2003, with critical technological components for the RTGS and Giro clearing payment systems installed and integrated with the main location, in 2004 the Bank of Slovenia first systematically started the planning and regular training for operators on contingency procedures. A testing plan for contingency procedures was passed for 2004. The plan including testing the Bank of Slovenia's conduct as the administrator and banks as system participants in the case of an integral infrastructure failure at the primary location and the failure of individual infrastructural components. Contingency procedures for every anticipated emergency situation were tested at least once, while the full testing plan should be completed next year.

New instructions on emergency procedures

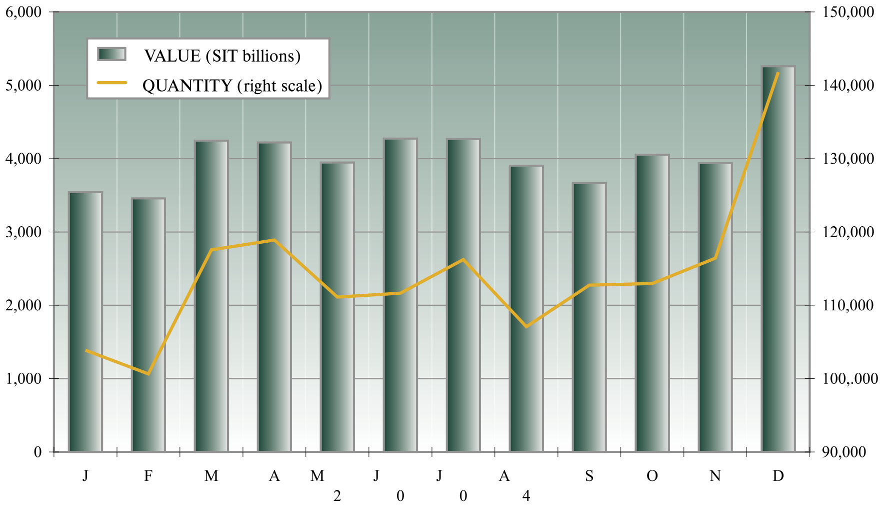
In 2004 participants in the two systems were sent instructions on the contingency activities for both the operator and participants, if both systems cease to function. Contingency procedures were also designed for new operating processes in the Bank of Slovenia with inclusion in the Europe-wide TARGET and STEP2 payment systems.

Payment systems statistics

RTGS system deals with over 1.37 million transactions

In 2004 there were 1,370,990 transactions settled via the RTGS system with a total amount of SIT 48,774.41 billion, an increase of 8.46% in the volume of transactions and a rise of 12.41% in value from 2003. An average of 5,355 transactions were settled each day, with an average value of SIT 35.58 million per transaction.

Figure 27: **Payment transactions through the RTGS in 2004**



Source: Bank of Slovenia

Giro clearing second most important interbank payment system

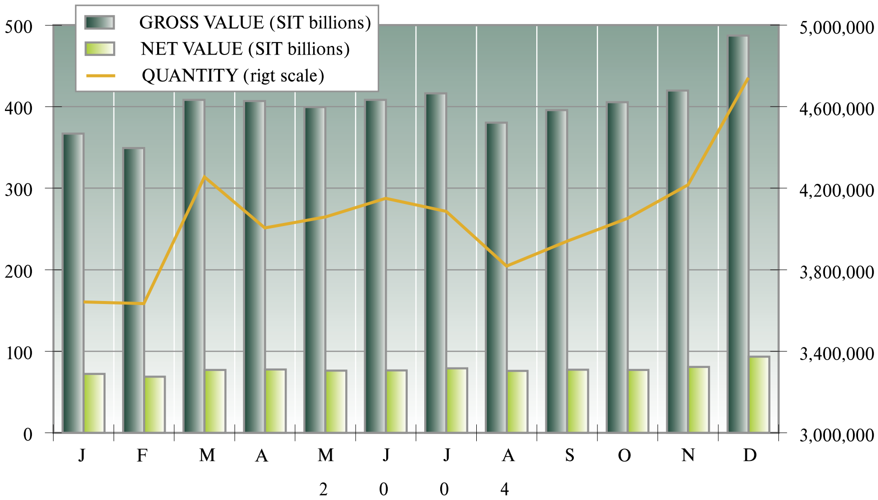
As the second most important interbank payment system, the Giro Clearing system (intended for non-urgent payments of up to SIT 2 million) handled 48,598,219 transactions in 2004, with a total value of SIT 4,844.19 billion, an increase of 4.26% in volume and an increase of 7.51% in value compared to 2003. The value of net settlements of these payments in central bank money via the RTGS system was SIT 932.38 billion or 19.25% of the gross value of transactions, indicating a netting ratio of 80.75%. On average 189,837 transactions were processed daily, with an average value of SIT 99,678.37.

Almost 50 million transactions settled via the 2 systems

The total number of transactions settled through the two systems in 2004 was 49,862,293, of which 2.54% were processed through the RTGS system and 97.46% through the Giro Clearing system (compared with 2.64% and 97.36% respectively in 2003). The total value of transactions through the two systems in 2004 was

SIT 48,235.39 billion, of which the RTGS system accounted for 89.96% and the Giro Clearing system 10.04% (compared with 90.59% and 90.59% respectively in 2003).

Figure 28: **Payment transactions through the Giro clearing system in 2004**



Source: Bank of Slovenia

5.5 Statistical system

Following Slovenia's EU entry in May 2004 and in accordance with the Bank of Slovenia Act – specifically Article 55 of that act – the Bank of Slovenia is bound by Article 5 of the Statute of the ESCB. Under the National Statistics Act the Bank of Slovenia is among the institutions responsible for carrying out Slovenia's statistical research programme, which is defined in general terms for the medium term and in detail at an annual level with sources and obligations to submit required data.

Focus on monetary, financial and balance of payment statistics

The Bank of Slovenia's main statistical work covers monetary, financial and balance of payment statistics. The statistical process is increasingly being extended to include public finances and general economic statistics.

The task of the Bank of Slovenia's statistical system is to keep domestic and foreign audiences informed about financial and macroeconomic developments in Slovenia. It also supports the Bank of Slovenia's monetary policy and the national economic policy, and cooperates with international organisations in the field of statistics principally the IMF. The European System of Central Banks, which now includes the Bank of Slovenia, places particular emphasis on the obligation to harmonise statistics in order to adopt the euro and cooperate to the Eurostat within the European statistical system.

New statistics obligations on joining the ESCB

In 2004 the implementation of regular statistical work saw an increasing number of changes implemented due to European Union entry and as part of preparations for economic and monetary union (EMU). On joining the ESCB (European System of Central Banks), the Bank of Slovenia assumed statistical obligations that it must meet before the country joins the EMU. According to the ECB and ESCB Statutes, member states must implement at the national level all the necessary measures on the collection of statistical data to meet the ECB's statistical reporting requirements. Every six months, the ECB reviews the progress of new member states in meeting the statistical requirements that will be compulsory when these countries adopt the euro.

Agreement on cooperation in macroeconomic and financial statistics signed with MF and SURS

The similar and increasing demands of the EU statistical system, regardless of the size and available resources of individual members, and the allocation of competence and responsibilities in meeting the ECB and Eurostat statistical requirements led to the Bank of Slovenia, Ministry of Finance and Statistical Office of the Republic of Slovenia signing an Agreement on Cooperation in Macroeconomic and Financial Statistics in 2004. The agreement is based on an agreement of understanding and cooperation between the ECB and Eurostat.

The agreement defined the responsibilities of the individual signatories and the allocation of responsibilities and method of cooperation between them in providing the European Commission, Eurostat, Ecofin and ECB with Slovenia's macroeconomic and financial statistics.

The agreement also covered cooperation in maintaining the Standard Classification of Institutional Sectors, given its importance to macroeconomic and financial statistics. The Agency for Public Records and Services manages the standard classification as part of the Business Register of Slovenia.

Vital statistics

The Bank of Slovenia is responsible for producing a demanding 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 trade data. The inputted Intrastat statistics, based on customs declarations are prepared by the Statistical Office of the Republic of Slovenia in cooperation with the Customs Administration of the Republic of Slovenia. The Bank of Slovenia also collects, compiles and publishes statistics on modern payment instruments, financial markets etc.

Slovenia's first annual financial reports complied

In the first half of 2004 the Bank of Slovenia compiled the first annual financial reports for Slovenia in line with European system of accounts methodology (ESA95), with consolidated and non-consolidated balance sheet data for 2001 and 2002 and transactions for 2002.

Annual financial accounts calculated for 2001, 2002 and 2003

The basic source for compilation of the first ESA95 financial accounts was annual data based on direct reporting by all non-financial and financial companies and government sector units in accordance with the Decision on the Reporting of Data for the Purposes of Financial Accounts Statistics Official Gazette of the Republic of Slovenia, 66/2003), which took place in November and December 2003. The Agency for Public Records and Services (AJPES) gathers the reports for the Bank of Slovenia.

The data from the first annual financial accounts were first submitted to the Governing Board of the Bank of Slovenia in June 2004 and were then submitted to the ECB and Eurostat in July 2004, in line with the prescribed requirements (Council Regulation 2223/96).

The compilation of financial accounts for 2003 took place in the second half of 2004 using balance sheet and transaction data on the basis of the second direct reporting of annual data, which took place in May and June 2004. The annual financial account data for 2003 were submitted to the Governing Board of the Bank of Slovenia in December 2004, and then sent to the ECB and Eurostat.

A reporting threshold for the non-financial corporation sector (S11) was introduced for the next reporting of data for financial account statistics (annual reporting for 2004), by means of a decision amending the Decision on the Reporting of Data for the Purposes of Financial Accounts Statistics Official Gazette of the Republic of Slovenia, no. 122/2004). All non-financial corporations are required to report unless their balance sheet total is less than SIT 200 million for at the end of the calendar year before the reporting period.

The amendments to the instructions for the Decision on the Reporting of Data for the Purposes of Financial Accounts Statistics (Official Gazette of the Republic of Slovenia, 140/2004) included data on changes in value in addition to balance sheet and transaction data. Including data on value changes in the report is intended to improve the quality of reporting on transaction data.

Bank of Slovenia to introduce quarterly financial account reporting in 2005

In 2005 the Bank of Slovenia is planning to introduce quarterly reporting on financial account statistics in accordance with the requirements of Regulation ECB/2002/7. The preparation and acceptance of Slovenian instructions on quarterly reporting are planned for the first half of 2005. The first quarterly reports are planned for the second half of 2005.

MFI reports conform with ECB requirements on money and banking statistics

In July 2004 the Governing Board of the Bank of Slovenia passed the Decision and Instructions to Implement the Decision on Reporting by Monetary Financial Institutions (Official Gazette of the Republic of Slovenia, 77/04), which formalised the harmonisation of reporting sector data for monetary financial institutions or MFIs (classification nos. S121 and S122) with the requirements of harmonised money and financial instruments set out in Regulation ECB/2001/13 and ECB/2001/18 and the relevant section of Guideline ECB/2003/2. The methodology for new reporting is fully harmonised with ECB requirements.

These implementing acts ushered in the reporting of MFI data, which is then used in compilation of the aggregate harmonised money and banking statistics in accordance with the more stringent ECB requirements the new member states must now meet. The ECB expects the new member states to provide all the harmonised money and banking statistics in 2005, and to gradually meet the requisite quality.

MFI balance sheet reporting starts November 2004

In Slovenia all the monetary financial institutions on an ECB list are required to report to the Bank of Slovenia. The list includes credit institutions operating in Slovenia and foreign bank branches. The reports were first submitted in November 2004, in accordance with the instructions, providing data on balance sheets one month later revaluation data, wile interest rate reporting starts in May 2005.

The aggregate data from reporting institutions will, in tandem with Bank of Slovenia data, enable the exchange of statistical data, monetary aggregates and balance sheet counter-items that comply with the ECB's harmonised money and banking statistics created on the basis of the partly adapted reporting system in 2003.

Agreement with banks on reporting methods until euro is adopted

The Bank of Slovenia is working on a new concept of direct reporting for participants in transactions with non-residents for its balance of payment statistics. The regulation covering cross-border payment in euros within the European Union requires balance of payment reporting to be discontinued below a threshold level. The application of this regulation and the need for consistency between balance of payment statistics during the ERM2 phase has led the Bank of Slovenia to reach a special agreement with banks on the way of reporting during the interim period before euro adoption. The Bank of Slovenia has also separated balance of payment data into intra-statistics (transactions between Slovenia and other EU members) and extra-statistics (transactions between Slovenia and non-EU countries) to meet ESCB requirements. The same separation applies in relation to members of the eurozone.

The Bank of Slovenia must submit other data to the ECB, including public finance and general economic statistics. The most important of these are the data on the

Maastricht criteria, long-term interest rates, government deficit, government debt, and the harmonised consumer price index, which is prepared by the Statistical Office of the Republic of Slovenia.

The technical side of the Bank of Slovenia's inclusion in the ECB statistics system was successfully completed and special data exchange standards were introduced.

Slovenia meets SDDS standards

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. Fulfilment of these standards enhances macroeconomic accountability, permitting the early identification of financial problems, and is therefore vital to accessing international financial markets.

Having published external debt data in line with the new international standard since 2003, the Bank of Slovenia has ensured that Slovenia fully complies with all requirements of the IMF's Special Statistical Data Dissemination Standards.

New methods based on Commission and ECB guidelines

The Bank of Slovenia's statistics, previously based predominantly on IMF standards, are moving closer to the ECB and Eurostat methodologies defined in regulations and European Commission and ECB guidelines.

Publication of statistics

The main financial and macroeconomic data for Slovenia appear in a Monthly Bulletin. Other publications include the quarterly, Financial Markets, and Direct Investment (issued annually). All these 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 also available on the Bank of Slovenia website. 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.

5.6 International cooperation

International Monetary Fund

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.

Financial Transactions Plan

Since 1998 Slovenia has been among one of the IMF members financing loans under the Financial Transactions Plan (FTP). Slovenia did not contribute to the FTP in 2004, but did receive a total of SDR 20.1 million in repayments on IMF loans from Algeria, Azerbaijan, Gabon, Jamaica, Jordan, New Guinea and the Russian Federation. At the end of December 2004 Slovenia's reserve tranche position at the IMF stood at SDR 77.3 million.

The 2004 report for Slovenia on consultations under Article IV of the IMF Articles of Agreement, prepared every year by the IMF mission was discussed by the IMF Executive Board in the May 2004, and published at the end of the same month. The visit by IMF representatives relating to those consultations took place in January 2004.

European Central Bank and the European System of Central Banks

Bank of Slovenia joins the ESCB

On EU entry representatives of the Bank of Slovenia also joined, the ECB General Council, and the ESCB committees and working groups

On Slovenia's entry to the European Union on 1 May 2004, the Bank of Slovenia became part of the European System of Central Banks (ESCB), which comprises the ECB and the national central banks of the EU member states. The Governor of the Bank of Slovenia became a member of the General Council of the ECB. The General Council is the ECB's third decision making body after the Governing Council and the Executive Board, and will function as long as there are EU member states that have not adopted the euro. The General Council members are the ECB president and vice-president and the governors of every EU national central bank. The governor of the Bank of Slovenia has been participating as a full member of the General Council since May 2004.

Bank of Slovenia experts also gained membership of the committees and working groups whenever they meet in ESCB composition, i.e. with all the EU national central banks. The Bank of Slovenia's governor and experts had previously participated in the General Council and its committees as observers.

Bank of Slovenia share in key for subscription to ECB capital set at 0.3345%

Slovenia's share in the key for subscription of ECB capital is 0.3345%. In line with the Statue of ESCB and ECB, the percentage shares of the national central banks in the ECB capital key are weighted according to the member state's relative share in the overall EU population and overall EU GDP. The national central banks shall be the sole subscribers to and holders of the capital of the ECB. The national central banks of EU member states that have adopted the euro have paid up the full share into the ECB capital. The national central banks of EU members without the euro have only paid 7% of the share they would have to pay if they adopted the euro. The present total of paid up subscribed ECB capital for all national central banks is EUR 4,089.3 million. On joining the European Union, the Bank of Slovenia paid up its minimum percentage of ECB subscribed capital worth EUR 1.3 million, as its contribution to ECB operational costs.

Slovenia participates in EMU as a member state with derogation

Slovenia's EU entry has led to it participating in the economic and monetary union as a member state with derogation regarding the euro adoption. This means that it did not immediately adopt the euro on EU entry, but will work towards finally adopting it by meeting all the convergence criteria for the euro adoption. In October 2004 the ECB issued the 2004 Convergence Report in accordance with the Treaty establishing the European Community. This report covers progress by EU members outside the eurozone towards meeting their obligations regarding the achievement of economic and monetary union. The report provides key facts and figures and results from the assessment of Slovenia's economic and legal convergence, as well as for the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Sweden.

The European Union

Harmonising Slovenian legislation with the acquis

The Bank of Slovenia continued to cooperate in reviewing the harmonisation of Slovenian law with the sections of the acquis communautaire that cover economic and monetary union, the free movement of services, and the free movement of capital.

EU committees

On EU entry Bank of Slovenia experts became members of the committees, working groups and other working bodies for financial and monetary affairs that function within EU institutions. This participation included meetings of the Economic and Financial Committee (EFC) and its sub-committees, the Committee of European Banking Supervisors (CEBS) and its working groups, meetings of the Committee on Monetary, Financial and Balance of Payment Statistics, meetings of the working groups of the European Financial Conglomerates Committee (EFCC) and other working groups within the European Commission and the Council of the European Union.

The European Commission also published a Convergence Report in October 2004 on fulfilment of euro adoption criteria.

Others

In July 2004 the Agreement on Succession Issues came into force. The Bank of Slovenia has continued to cooperate in negotiations on matters relating to the succession of the former Yugoslavia.

6 APPENDICES

6.1 Legal status and tasks

The Bank of Slovenia is the central bank of the Republic of Slovenia and was established on 25 June 1991 by the Bank of Slovenia Act 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 Slovenia's parliament, the National Assembly.

On 17 July 2002 a new Bank of Slovenia Act entered into force, introducing a number of changes. Under the new law 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 other members. All are appointed by the National Assembly at the nomination of the president 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 jurisdiction under the Bank of Slovenia Act and other legislation.

The law 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 upholding 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:

- to define and implement monetary policy
- to define and implement monetary control
- to be responsible for the general liquidity of the banking system
- to conduct operations on the foreign exchange and financial markets
- to accept deposits of banks and savings banks
- to open accounts for banks and savings banks
- 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 persons of public law, other money market participants and other financial institutions, designing, promulgating and monitoring the system of 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. Neither 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 bank's financial plan and annual accounts. However, until the introduction of the euro as the monetary unit of Slovenia, a committee of the

National Assembly appoints an independent international auditor for a three-year period to audit the Bank's financial statements.

Another new measure is a prohibition of public sector lending and 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 persons of public law. In addition the Bank of Slovenia may not issue guarantees for liabilities of these entities or purchase debt instruments from them. The law allows exceptions to the prohibition that are applicable to banks, savings banks and other financial institutions under public ownership if they are obliged to fulfil the same conditions as other banks, savings banks and financial institutions, the financing of Slovenia's liabilities to the IMF, operations related to the issue of coins not exceeding 10% of the value of coins in circulation, and intra-day bridging loans granted to the public sector provided there is no renewal option.

In its operations the Bank of Slovenia applies Article 43 of the Statute of the European System of Central Banks and the European Central Bank, which applies to European Union member-states with a derogation. In line with the statute of the ESCB and ECB, the Bank of Slovenia cooperates with the ECB in recording, collating, processing and declaring figures and information in order to carry out its functions.

6.2 Income statement and balance sheet

Table 26: **Five-year income statement for 1 January to 31 December (SIT millions)**

	2000	2001	2002	2003	2004
Operating income					
Interest income	35,010	44,583	61,677	74,978	60,662
Interest expenses	18,580	25,529	42,321	67,841	44,975
Net interest income (expenses)	**16,430**	**19,053**	**19,356**	**7,137**	**15,688**
Net exchange rate gains/losses	28,642	22,397	-8,588	-16,593	-5,312
Gain (loss) from unrealised price revaluation of securities	3,557	3,972	9,365	-8,996	-409
Gain (loss) from unrealised gold revaluation	-	-63	1,550	740	-498
Net income from financial assets	**48,630**	**45,360**	**21,684**	**-17,712**	**9,469**
Fee and commission income	914	1,123	1,793	1,660	1,682
Fee and commission expenses	332	356	406	426	486
Net fees and commission	**582**	**768**	1,387	1,234	1,196
Other income	225	289	382	322	367
Total operating income	**49,436**	**46,417**	**23,452**	**-16,156**	**11,032**
Operating expenses	3,685	3,930	4,396	4,971	5,524
Provisions and write-downs	308	7,690	498	704	398
Operating surplus for appropriation	**45,443**	**34,798**	**18,558**	**-21,830**	**5,110**
Appropriation of surplus:					
Transfer to / release of special reserves for exchange rate gains/losses	28,642	22,397	-8,588	-16,593	-5,312
Transfer to / release of special reserves for price risks	3,557	3,972	10,915	-8,256	-906
Financial result after coverage/distribution of net foreign exchange gains/losses and net gains from unrealised price revaluation	13,244	8,428	16,231	3,019	11,329
Transfer to general reserves	9,933	6,321	12,173	2,264	8,497
Total transfer to / release of reserves	**42,132**	**32,691**	**14,500**	**-22,585**	**2,278**
Funds for Republic of Slovenia budget	3,311	2,107	4,058	755	2,832
Total appropriations	**45,443**	**34,798**	**18,558**	**-21,830**	**5,110**

Source: Bank of Slovenia

Table 27: **Five-year balance sheet as at 31 December (SIT millions)**

	2000	2001	2002	2003	2004
Assets					
Financial assets					
Foreign currency financial assets	**748,153**	**1,131,158**	**1,588,462**	**1,669,475**	**1,612,953**
Gold and gold receivables	20	16,869	18,403	19,143	18,646
Cash and deposits	237,070	492,109	592,862	400,209	178,046
Derivatives	-	21	328	48	39
Investment securities available for sale	475,274	580,193	927,375	1,190,216	1,359,684
Receivables from Republic of Slovenia budget	8,180	8,509	7,668	7,175	6,963
International Monetary Fund	19,557	21,479	28,221	29,130	23,033
Accrued interest and other assets	8,052	11,978	13,605	23,554	26,543
Tolar financial assets	**16,441**	**2,728**	**3,255**	**1,263**	**808**
Receivables from Republic of Slovenia Succession Fund	8,650	-	-	-	-
Loans to banks	566	438	18	9	-
Reverse repos	6,299	-	1,148	-	-
Accrued interest and other liabilities	926	2,290	2,089	1,254	808
Fixed assets	2,777	2,608	3,094	3,106	3,554
Total assets	**767,371**	**1,136,494**	**1,594,812**	**1,673,844**	**1,617,315**
Liabilities and reserves					
Serviced liabilities					
Foreign currency liabilities	**404,736**	**500,889**	**591,278**	**604,758**	**573,638**
Demand and time deposits	35,997	31,842	30,545	41,059	63,156
Derivatives	9	-	-	-	0
Bank of Slovenia bills	361,168	460,837	552,952	555,260	500,757
IMF and other IFIs	5	5	7	5	1,389
SDR allocation	7,534	8,013	7,643	7,156	6,937
Accrued interest and other liabilities	23	191	131	1,278	1,399
Tolar liabilities	**87,990**	**282,308**	**627,508**	**704,963**	**665,619**
Demand deposits	71,835	85,557	89,804	100,818	104,108
Banks' time deposits	-	-	-	-	156,730
Overnight placements	-	35,372	18,360	8,170	4,800
Bank of Slovenia bills	6,946	125,912	375,636	472,330	266,588
Republic of Slovenia budget deposits	3,411	28,837	134,793	109,674	127,477
International financial institutions	-	-	-	-	264
Accrued interest and other liabilities	5,797	6,629	8,915	13,971	5,651
Banknotes in circulation	139,644	165,778	172,056	186,042	195,352
Funds for Republic of Slovenia budget	3,311	2,107	4,058	755	2,832
Total liabilities	**635,681**	**951,082**	**1,394,900**	**1,496,517**	**1,437,442**
Capital and reserves	131,691	185,411	199,912	177,327	179,873
Total liabilities and reserves	**767,371**	**1,136,494**	**1,594,812**	**1,673,844**	**1,617,315**

Source: Bank of Slovenia

6.3 Important measures taken in 2004

6.3.1 Monetary policy and exchange rate policy measures

January

9 Jan: The Bank of Slovenia cuts interest rates on all monetary policy instruments by 0.25 percentage points: for 60-day tolar bills from 6.0% to 5.75%, the maximum bid rate for 270-day tolar bills from 6.75% to 6.5%, for lombard loan from 7.25% to 7.0%, for overnight deposit from 3.0% to 2.75%, the foreign exchange swap rate from 3.0% to 2.75% and the reverse foreign exchange swap rate from 1.5% to 1.25%.
The Bank of Slovenia abolishes the regular daily offer of the 1-week buy/sell-back of foreign currency bills. Henceforth it offers the instrument to banks as required.

12 Jan: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 15 January 2004.

27 Jan: The Bank of Slovenia changes the required reserves system for the February maintenance fulfilment period (beginning 27 January 2004): the maintenance period if now fully laged, and the method for calculating interest on required reserves is altered.

February

5 Feb: The Bank of Slovenia offers banks final purchases from the balance of foreign exchange swaps.

6 Feb: The Bank of Slovenia cuts interest rates on all monetary policy instruments except overnight deposit by 0.25 percentage points: for 60-day tolar bills from 5.75% to 5.5%, the maximum bid rate for 270-day tolar bills from 6.5% to 6.25%, for lombard loan from 7.0% to 6.75%, the foreign exchange swap rate from 2.75% to 2.5% and the reverse foreign exchange swap rate from 1.25% to 1.0%.

The Governing Board of the Bank of Slovenia grants the Monetary and Exchange Rate Policy Committee the power to set the interest rate for occasional interventions using the 1-week buy/sell-back of foreign currency bills in the range between the valid 60-day tolar bill and lombard loan rates.

9 Feb: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 10 February 2004.

The Bank of Slovenia restarts regular weekly offers of the 1-week buy/sell-back of foreign currency bills. The amount offered is at least SIT 2 billion, with more as required. The Bank of Slovenia extends them once a week, and banks bid the interest rate. The minimum bid rate for the first offer is 5.6%, but is gradually reduced by the Bank of Slovenia, to 5.5% on 23 March, 5.25% on 6 April, 5.0% on 14 April, 4.95% on 11 May, 4.9% on 18 May, 4.85% on 25 May, 4.8% on 1 June, 4.75% on 8 June and 4.7% on 15 June.

March

2 and 9 Mar: The Bank of Slovenia offers banks final purchases from the balance of foreign exchange swaps.

5 Mar: The Bank of Slovenia cuts the interest rate on 270-day tolar bills from 6.25% to 5.75%. At the same time it changes the offer of 270-day tolar bills from a weekly auction to a limited-quantity closed offer, restricting the subscribers to banks that in the previous three months have conducted a foreign exchange swap with the Bank of Slovenia, with the amount of subscription being restricted to the minimum amount of foreign exchange swapped in that period.

16 Mar: The Bank of Slovenia changes the weekly offer of the 1-week buy/sell-back of foreign currency bills from an auction to a closed offer. The Bank of Slovenia makes a discretionary ruling on the quantity assigned after receiving banks' bids.

18 Mar: The Bank of Slovenia cuts the interest rate for 60-day tolar bills from 5.5% to 5.25%, and the interest rate for 270-day tolar bills from 5.75% to 5.5%.

April

2 Apr: The Bank of Slovenia cuts the interest rates on all instruments of monetary policy: for 60-day tolar bills from 5.25% to 4.75%, for 270-day tolar bills from 5.5% to 5.0%, for lombard loan from 6.75% to 6.25%, for overnight deposit from 2.75% to 2.5%, the foreign exchange swap rate from 2.5% to 2.25% and the reverse foreign exchange swap rate from 1.0% to 0.75%.

6 Apr: The Bank of Slovenia changes the weekly offer of the 1-week buy/sell-back of foreign currency bills to a daily offer.

7 Apr: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 9 April 2004.

15 Apr: The Bank of Slovenia offers banks final purchases from the balance of foreign exchange swaps.

May

3 May: The Bank of Slovenia changes the daily offer of the 1-week buy/sell-back of foreign currency bills to a 7-day buy/sell-back of securities. The Bank of Slovenia expands the range of suitable securities from euro- and dollar-denominated Bank of Slovenia bills to tolar-denominated Bank of Slovenia bills and Republic of Slovenia treasury bills. In addition to banks, savings banks may now participate in the offer.

5 May: The Bank of Slovenia offers banks final purchases from the balance of foreign exchange swaps.

7 May: The Bank of Slovenia cuts the interest rates on all instruments of monetary policy: for 60-day tolar bills from 4.75% to 4.5%, for 270-day tolar bills from 5.0% to 4.75%, for lombard loan from 6.25% to 5.75%, for overnight deposit from 2.5% to 2.25%, the foreign exchange swap rate from 2.25% to 2.0% and the reverse foreign exchange swap rate from 0.75% to 0.5%.

10 May: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 11 May 2004.

June

4 Jun: The Bank of Slovenia cuts the interest rates on all instruments of monetary policy except overnight placements: for 60-day tolar bills from 4.5% to 4.25%, for 270-day tolar bills from 4.75% to 4.5%, for lombard loans from 5.75% to 5.5%, the foreign exchange swap rate from 2.0% to 1.75% and the reverse foreign exchange swap rate from 0.5% to 0.25%.

7 Jun: The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The intervention lasts until 9 June 2004.

17 Jun: The Bank of Slovenia cuts the interest rates on all instruments of monetary policy except overnight deposit and the reverse foreign exchange swap: for 60-day tolar bills from 4.25% to 4.0%, for 270-day tolar bills from 4.5% to 4.25%, for lombard loan from 5.5% to 5.0%, for the 7-day buy/sell-back of securities from 4.7% to 4.5% and the foreign exchange swap rate from 1.75% to 1.5%.

22 Jun: The Bank of Slovenia cuts the interest rate on the 7-day securities swap from 4.5% to 4.45%.

23 Jun: The Bank of Slovenia changes all offers of instruments of monetary policy and exchange rate policy so that at any time in the future they can be altered or cancelled with effect on the same day. At the same time it also changes the deadlines for submitting banks' bids.

28 Jun: The Bank of Slovenia enters the ERM II. The central exchange rate is set at SIT 239.640 to the euro, with a lower intervention point of SIT 203.694 and an upper intervention point of SIT 275.586 to the euro (15% above or below the central rate).
The Bank of Slovenia cuts the foreign exchange swap rate from 1.5% to 1.0%.
The Bank of Slovenia intervenes on the foreign exchange market by setting the base exchange rate. The signalled exchange rate is SIT 239.64 to the euro (the same as the central exchange rate), and the intervention selling and buying exchange rates are SIT 239.16 and SIT 240.12 (base rate ±0.2%). The intervention lasts until 1 July 2004.

29 Jun: The Bank of Slovenia cuts the interest rate on the 7-day buy/sell-back of securities from 4.45% to 4.4%.

July

2 Jul: The Bank of Slovenia raises the reverse foreign exchange swap rate from 0.25% to 1.0%.

6 Jul: The Bank of Slovenia cuts the interest rate on the 7-day buy/sell-back of securities from 4.4% to 4.25%.

20 Jul: The Bank of Slovenia cuts the interest rate on 270-day tolar bills from 4.25% to 4.20%.

27 Jul: The Bank of Slovenia makes an outright final sale of SIT 7.2 billion worth of euros to banks.

30 Jul: With the first series of 270-day tolar bills subscribed in a special offer maturing, the Bank of Slovenia offers banks long-term deposits at the Bank of Slovenia. Subscription is limited to banks that at each maturity receive money from maturing special offer 270-day tolar bills, and has an upper limit of the bank's share in the total sum of special offer tolar bills maturing each time. The interest rate is equal to the interest rate on 60-day tolar bills plus 0.2 percentage points. Interest is paid every two months. All the subscribed deposits mature in two tranches, on 31 January and 28 February 2007.

October

7 Oct: For the last time the Bank of Slovenia offers 270-day tolar bills to banks in the form of a limited-quantity closed offer.

27 Oct: The Bank of Slovenia changes the required reserve system for the November maintenance period (beginning 27 October 2004): it abolishes the daily requirement to hold at least 50% of the requirement from the previous period in the settlement account with the Bank of Slovenia, includes issuers of electronic money to institutions subject to required reserves, defines the procedure for exemption from the required reserves system when operations are wound up, and conditions for the use of a zero rate requirement for repo transactions when the conditions specified in the financial insurance act are fulfilled.

19 Nov and 3 Dec: The Bank of Slovenia offers banks outright final purchases from the balance of foreign exchange swaps. 23 Dec: The Bank of Slovenia raises the foreign exchange swap rate from 1.0% to 1.25%. 29 Dec: The Bank of Slovenia cuts the interest rate on the 7-day buy/sell-back of securities from 4.25% to 4.1%.	**November and December**

6.3.2 Banking supervision measures

regulation on the harmonisation of the minimum share capital of banks and savings banks	**January**
regulation amending the regulation on the financial reports and accounts of banks and savings banks guidelines for implementing the regulation on the financial reports and accounts of banks and savings banks (methodology for compiling balance sheets and income statements) guidelines for implementing the regulation on the financial reports and accounts of banks and savings banks (method for calculating indicators) instructions for compiling guaranteed deposit reports	**February**
regulation amending the regulation on the granting of special liquidity loans with the participation of banks regulation amending the regulation on the capital adequacy of banks and savings banks regulation on the conditions to be met by credit intermediaries regulation amending the regulation on the minimum level of liquidity to be maintained by banks guidelines for implementing the regulation on the minimum level of liquidity to be maintained by banks instructions for compiling the report on the tolar liquidity flows of banks instructions for reporting on major depositors instructions for calculating certain typical lending and deposit rates of banks and savings banks for non-bank sectors instructions for compiling the report on the declared lending and deposit rates of banks and savings banks regulation on submission of bank and savings bank information instructions for compiling the report on the daily liquidity of banks instructions for compiling the ten-day report on the book status of bank accounts instructions for compiling the report on interbank deposits instructions for compiling the report on the declared lending and deposit rates of banks and savings banks instructions for compiling the report on the deposit market regulation amending the regulation on large exposures of banks and savings banks regulation on reports by branches of member-state banks	**April**
regulation on reporting on the effective interest rates of banks and savings banks in accordance with the consumer credit act regulation amending the regulation on reports by branches of member-state banks	**May**
regulation amending the regulation on the minimum level of liquidity to be maintained by banks	**June**

	regulation amending the regulation on the capital adequacy of banks and savings banks
July	instructions for compiling the report on the deposit market regulation on the conditions to be met by banks and savings banks in order to provide banking services and other financial services regulation amending the regulation on the minimum level of liquidity to be maintained by banks
September	regulation amending the regulation on the granting of special liquidity loans with the participation of banks regulation amending the regulation on electronic money issuing companies regulation amending the regulation on the minimum level of liquidity to be maintained by banks regulation amending the regulation on the capital adequacy of banks and savings banks regulation on the minimum scope and content of audits and auditors' reports
October	regulation on the publication of the audited annual report and other information for branches of member-state banks
November	regulation amending the regulation on the capital adequacy of banks and savings banks
December	regulation amending the regulation on reports by branches of member-state banks regulation amending the regulation on submission of bank and savings bank information

6.4 Governance and organisation

6.4.1 Changes in the make-up of the Governing Board in 2004

In accordance with Article 38 of the Bank of Slovenia Act, Boštjan Jazbec,Ph.D., became a full-time employee of the Bank of Slovenia.

By virtue of a regulation published in the Official Gazette of the Republic of Slovenia (No. 83/04 of 29 July 2004), Andrej Rant was appointed a vice-governor of the Bank of Slovenia for a term of six years, his term of office beginning on 13 January 2005.

6.4.2 Make-up of the Governing Board as at 31 December 2004

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)

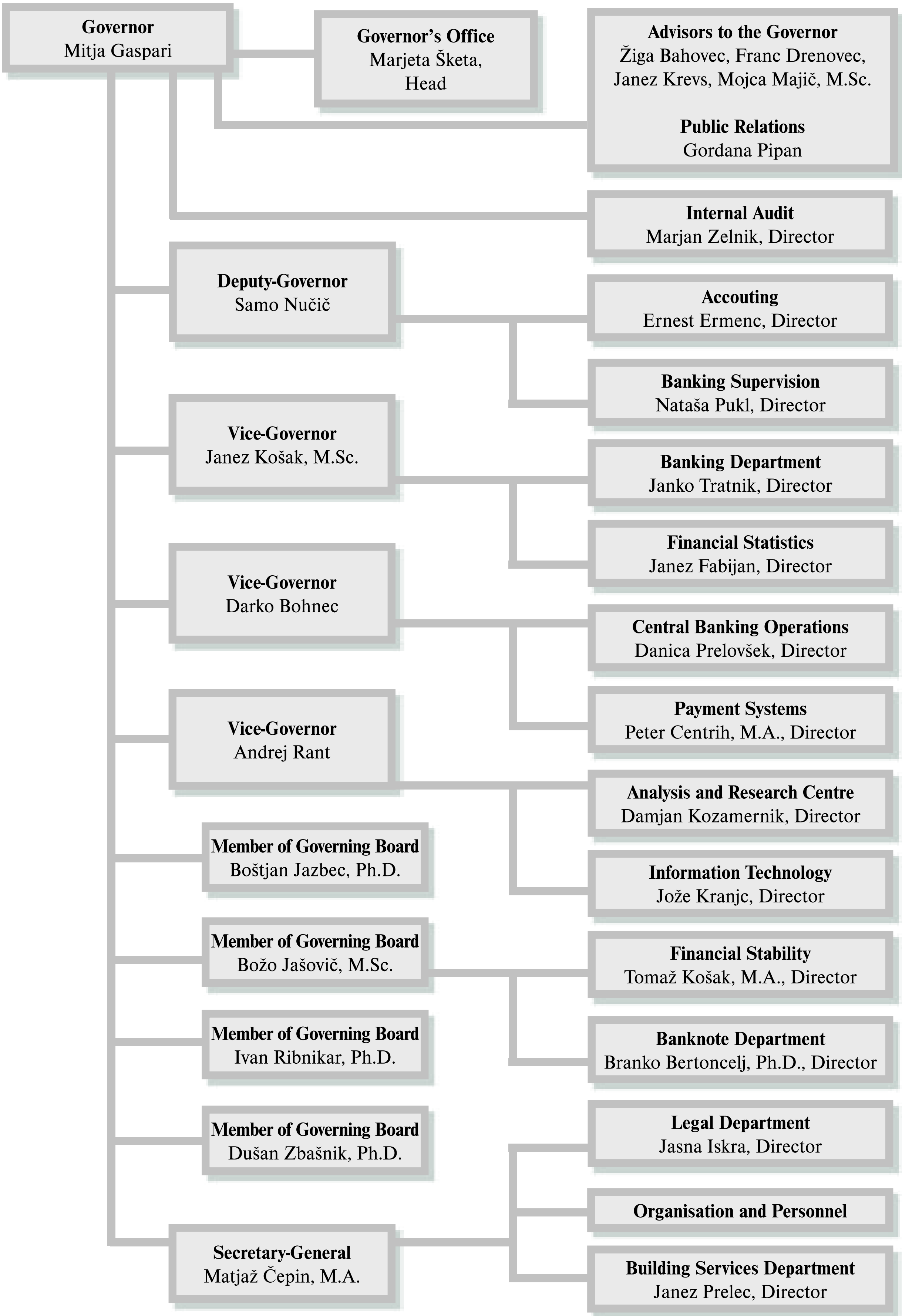
Božo Jašovič, M.Sc.

Boštjan Jazbec, Ph.D.

Ivan Ribnikar, Ph.D.

Dušan Zbašnik, Ph.D.

6.4.3 Organisation of the Bank of Slovenia as at 31 December 2004



6.4.4 Governing Board commissions and committees as at 31 December 2004

- Monetary and Exchange Rate Policy Committee (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 Holding 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.)
- Risk Management Commission (president: Boštjan Jazbec, Ph.D.)
- Bank of Slovenia Audit Committee (president: Boštjan Jazbec, Ph.D.)

6.5 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. 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 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	Analytical and methodological presentations in monetary field, balance of payments 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 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 to central banking. Content of articles may be analytical, or merely informative
Financial Stability Report • annual • English translation	Analytical monitoring of developments in the banking sector, and articles by experts on maintaining financial stability
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 information 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

6.6 Glossary

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

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 deposit

Capital (in regulatory sense) – An amount calculated on the basis of primary and supplementary capital that banks can use to cover their capital requirements in accordance with 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:
- laims 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 subject to rehabilitation or composition proceedings
- claims on debtors who are subject to bankruptcy proceedings;
- claims on debtors who frequently pay their liabilities 91 to 180 days in arrears and occasionally 181 do 365;

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

Category E comprises:
- claims on debtors 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 subsectors: the central bank, other monetary financial institutions, other financial intermediaries excluding insurers and pension funds, ancillary financial institutions, and insurers 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 insurers and pension funds, ancillary financial institutions, and insurers 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

Foreign exchange intervention:

Direct foreign exchange intervention – The direct purchase or sale of foreign currency by the Bank of Slovenia on the interbank foreign exchange market

Indirect foreign exchange intervention – The setting of the exchange rate on foreign exchange markets facilitated for the Bank of Slovenia by the agreement on cooperation in foreign exchange market intervention

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

Interest spread (nominal) – The difference between the average nominal interest rate the bank earns on its investments and the 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 by 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 granting of loans, using newly created or issued money

Money market – The market on which participants gather and invest short-term assets and trade them through instruments with an original maturity of up to one year

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

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

Non-interest margin – The ratio of non-interest income to average assets

Open (foreign exchange) position – Unequalised foreign currency items on the balance sheet of a bank. There may be more claims or more 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 – Capital investments in customers in the same group (subsidiaries, associates and joint ventures) 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, 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

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

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

Sionia – The interest rate for overnight placements on the interbank market

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 base money. 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 base money

Swap – The 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 – The officially determined indexation rate for claims and liabilities computed as average monthly inflation (since January 1998, the retail price index, previously the cost of living index) for the most recent month or the most recent period (currently 12 months)

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

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

7 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.

PRICEWATERHOUSECOOPERS

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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, 2004, as set out on pages 4 to 23 ("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 AG

A. Schönenberger M. Schmidt

Statement of income and expenditure

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

	Notes	2004	2003
Operating income:			
Interest income	4	**60,662**	74,978
Interest expenses	5	**44,975**	67,841
Net interest income		**15,688**	7,137
Net foreign exchange gain/loss		**-5,312**	-16,593
Gain (loss) from unrealized price revaluation of securities		**-409**	-8,996
Gain (loss) from unrealized gold revaluation		**-498**	740
Net investment income		**9,469**	-17,712
Fee and commission income		**1,682**	1,660
Fee and commission expense		**486**	426
Net fee and commission income		**1,196**	1,234
Other operating income		**367**	322
Total operating income		**11,032**	-16,156
Operating expenses	6	**5,524**	4,971
Provisions and write-offs	7	**398**	704
Operating surplus available for appropriation		**5,110**	-21,830
Appropriations:			
Transfer/Release to special reserves for foreign exchange differences		**-5,312**	-16,593
Transfer/Release to special reserves – price risks		**-906**	-8,256
Financial results after the appropriation of net foreign exchange gain/loss and gain/loss from unrealized price revaluation		**11,329**	3,019
Transfer to general reserves		**8,497**	2,264
Total transfer to reserves	14	**2,278**	-22,585
Provision for transfer of surplus to the budget of RS		**2,832**	755
Total appropriations		**5,110**	-21,830

The notes on pages 8 to 23 form an integral part of the financial statements.

Balance sheet

at 31 December (in millions of tolars)

	Notes	31.12.2004	31.12.2003
Assets			
Financial assets			
Foreign currency assets			
Gold and gold receivables	8	**18,646**	19,143
Cash and deposits		**178,046**	400,209
Derivative financial instruments	9	**39**	48
Investment securities available for sale		**1,359,684**	1,190,216
Receivables from the Republic of Slovenia		**6,963**	7,175
International Monetary Fund		**23,033**	29,130
Accrued interest and other assets	10	**26,543**	23,554
Total		**1,612,953**	1,669,475
Domestic currency assets			
Due from banks		**-**	9
Accrued interest and other assets		**808**	1,254
Total		**808**	1,263
Fixed assets	11	**3,554**	3,106
Total assets		**1,617,315**	1,673,844
Liabilities and reserves			
Serviced liabilities			
Foreign currency liabilities			
Current accounts and deposits to banks		**63,156**	41,059
Derivative financial instruments		**0**	-
Bank of Slovenia bills		**500,757**	555,260
IMF and other international financial organisations		**1,389**	5
SDR allocation	12	**6,937**	7,156
Accrued interest and other liabilities		**1,399**	1,278
Total		**573,638**	604,758
Domestic currency liabilities			
Current accounts and deposits		**104,108**	100,818
Commercial banks' deposits		**156,730**	-
Overnight deposits		**4,800**	8,170
Bank of Slovenia bills		**266,588**	472,330
Republic of Slovenia deposits		**127,477**	109,674
International financial organisations		**264**	-
Accrued interest and other liabilities		**5,651**	13,971
Total		**665,619**	704,963
Banknotes in circulation	13	**195,352**	186,042
Provision for transfer of surplus to the budget of RS		**2,832**	755
Total liabilities		**1,437,442**	1,496,517
Capital and Reserves	14	**179,873**	177,327
Total liabilities and reserves		**1,617,315**	1,673,844

The notes on pages 8 to 23 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 2002	**2,000**	**55,882**	**142,030**	**-**	**199,912**
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	0	2,264	-24,849	-	-22,585
Balance at 31 December 2003	**2,000**	**58,145**	**117,181**	**-**	**177,327**
Arising in the period					
Operating surplus	-	-	-	5,110	5,110
FX gains/losses	-	-	-5,312	5,312	-
Transfer/Release to special reserves -price risk	-	-	-906	906	-
Operating surplus retained in general reserve	-	8,497	-	-8,497	-
Contributions to welfare fund	-	268	-	-	268
Provisions for transfer to RS	-	-	-	-2,832	-2,832
Total movement	-	8,765	-6,219	-	2,546
Balance at 31 December 2004	**2,000**	**66,911**	**110,962**	**-**	**179,873**

An analysis of the movements in each category within 'Reserves' is presented in Note 14.

The notes on pages 8 to 23 form an integral part of the financial statements.

Statement of cash flows

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

	Notes	2004	2003
Cash flows from operating activities			
Interest received		**59,766**	66,077
Interest paid		**-49,426**	-69,124
Other		**-3,756**	-3,055
Net cash flow from operating activities		**6,584**	-6,101
Cash flows from investing activities			
Purchase of securities		**-713,185**	-1,200,709
Proceeds from sale of securities		**534,208**	913,496
Purchase of time deposits		**-13,093,315**	-16,193,578
Proceeds from redemption of time deposits		**13,326,889**	16,388,715
Loans and reverse repo to domestic banks		**-627,200**	-62,909
Repayment from domestic banks		**627,209**	64,066
Purchase of fixed assets		**-470**	-287
Proceeds from sale of fixed assets		**2**	18
Net cash flow from investing activities		**54,138**	-91,188
Cash flows from financing activities			
Issue of banknotes in circulation		**9,311**	13,985
Issue of Bank of Slovenia bills	18	**5,897,685**	5,819,155
Repayment of Bank of Slovenia bills	18	**-6,004,336**	-5,720,375
Republic of Slovenia deposit		**14,128**	-11,573
Other, net		**-220**	-4,528
Net cash flow from financing activities		**-83,432**	96,664
Exchange rate effect		**313**	52
Net cash flow from all activities		**-22,397**	-574
Cash and cash equivalents at beginning of year		**-114,919**	-114,345
Cash and cash equivalents at end of year	19	**-137,316**	-114,919
Increase (decrease) in cash and cash equivalents		**-22,397**	-574

The notes on pages 8 to 23 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on February 24, 2005 and these audited financial statements were approved by the Governing Board on April 21, 2005 and were signd 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.

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 and two hundred and seventy 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 2004. 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

	2004 SIT millions	2003 SIT millions
Interest income from foreign currency		
Income on gold assets	**42**	40
Interest on deposits	**6,523**	11,257
Income on investment securities	**46,799**	40,278
Interest on International Monetary Fund deposits	**421**	414
Total	**53,784**	51,989
Interest income from domestic currency		
Interest on loans to banks	**50**	55
Interests from Reverse – repo agreements	**573**	107
Swap gains	**6,255**	22,827
Total	**6,878**	22,989
Total interest income	**60,662**	74,978

Income on investment securities consists of the following:

	2004 SIT millions	2003 SIT millions
Interest income	**46,512**	39,812
Gains less losses from investment securities on sale	**287**	466
Total investment income on marketable securities, net	**46,799**	40,278

5. Interest expenses

	2004 SIT millions	2003 SIT millions
Interest expenses on foreign currency		
Interest on current accounts and deposits	**499**	302
Interest on Bank of Slovenia bills	**10,637**	12,158
Total	**11,136**	12,460
Interest expenses on domestic currency		
Interest on current accounts	**1,008**	897
Interest on commercial banks' deposits	**2,291**	-
Interest on overnight deposits	**15**	81
Interest on Republic of Slovenia deposits	**6,363**	9,241
Interest on Bank of Slovenia bills	**24,158**	45,162
Other interest	**3**	-
Total	**33,839**	55,382
Total interest expenses	**44,975**	67,841

6. Operating expenses

	2004 SIT millions	2003 SIT millions
Staff costs	**3,277**	2,937
Administration costs	**1,817**	1,535
Printing and minting costs	**258**	289
Other	**172**	209
Total operating expenses	**5,524**	4,971

The Bank employed 408 employees on 31 December 2004 (2003: 394 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 72 million (2003: SIT 58 million).

In accordance with the Bank of Slovenia Act (Official Gazette of the Republic of Slovenia, No. 58/02), the number of the Governing Board members was reduced from 11 to 9 in September 2003. The number of full-time employed members increased from 5 to 7. In 2004 the remuneration of the Governing board members of the Bank were of SIT 182 million (2003: SIT 127 million)

7. Provisions and write-offs

	2004 SIT millions	2003 SIT millions
Due to finances institutions	**-2**	4
Contingent liabilities	**400**	700
Total provisions	**398**	704

8. Gold and gold receivables

	2004 SIT millions	2003 SIT millions
Gold	**42**	42
Gold deposits	**18,603**	19,101
Total gold and gold receivables	**18,646**	19,143

9. Derivative financial instruments

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements in 2003 and in 2004 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:

	2004		2003	
	Fair value	**Notional amount**	Fair value	Notional amount
	mio SIT	**mio SIT**	mio SIT	mio SIT
Foreign exchange swaps				
- to be received forward against EUR	**39**	**225,718**	48	503,748
- to be given forward against EUR	**0**	**479**	-	-
Total derivative financial instruments	**39**	**226,198**	48	503,748

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. Accrued interest and other assets

	2004	2003
	mio SIT	mio SIT
Paid-up capital of the ECB	**312**	-
Capital investments in other non-residents	**4.893**	3.201
Accrued interest and other assets	**21.338**	20.353
Total	**26.543**	23.554

On 1 May 2004 Slovenia joined the European Union and consequently the Bank became a member of the European System of Central Banks (ESCB). In accordance with Article 28 of the Statute of the ESCB and the ECB the Bank became the subscriber of the capital of the ECB. Sub-item Accrued interest and other assets represents the Bank's participating interest in the ECB. Subscriptions depend on shares which are fixed in accordance with Article 29.3 of the ESCB Statute and which must be adjusted every five years. Tje share of the Bank in the ECB's capital is 0,3345% and was calculated in accordance with Article 29 of the Statute of the ESCB, on the basis of population and GDP data provided by the European Commission. As Slovenia does not participate in the euro area, the transitional provisons of Article 48 of the Statute apply. Consequently, the Bank was required to pay-up a minimal contribution of 7% of its subscribed capital to the ECB upon entry to the ESCB on 1 May 2004 amounting to EUR 1.302.967 (SIT 312 million).

Keys for subscriptions of the ECB's capital and amounts of paid-up capital are as follows:

Central bank	Capital key until 30 April 2004	Subscribed capital until 30 April 2004	Paid-up capital until 30 April 2004	Capital key from 1 May 2004	Subscribed capital from 1 May 2004	Paid-up capital from 1 May 2004
	%	EUR	EUR	%	EUR	EUR
Nationale Bank van België/Banque Nationale de Belgique	2.8297	141,485,000	141,485,000	2.5502	141,910,195	141,910,195
Deutsche Bundesbank	23.4040	1,170,200,000	1,170,200,000	21.1364	1,176,170,751	1,176,170,751
Bank of Greece	2.1614	108,070,000	108,070,000	1.8974	105,584,034	105,584,034
Banco de España	8.7801	439,005,000	439,005,000	7.7758	432,697,551	432,697,551
Banque de France	16.5175	825,875,000	825,875,000	14.8712	827,533,093	827,533,093
Central Bank and Financial Services Authority of Ireland	1.0254	51,270,000	51,270,000	0.9219	51,300,686	51,300,686
Banca d'Italia	14.5726	728,630,000	728,630,000	13.0516	726,278,371	726,278,371
Banque centrale du Luxembourg	0.1708	8,540,000	8,540,000	0.1568	8,725,401	8,725,401
De Nederlandsche Bank	4.4323	221,615,000	221,615,000	3.9955	222,336,360	222,336,360
Oesterreichische Nationalbank	2.3019	115,095,000	115,095,000	2.0800	115,745,120	115,745,120
Banco de Portugal	2.0129	100,645,000	100,645,000	1.7653	98,233,106	98,233,106
Suomen Pankki-Finlands Bank	1.4298	71,490,000	71,490,000	1.2887	71,711,893	71,711,893
Total euro-area NCBs	***79.6384***	*3,981,920,000*	*3,981,920,000*	***71.4908***	*3,978,226,562*	*3,978,226,562*
Česká národní banka	-	-	-	1.4584	81,155,136	5,680,860
Danmarks Nationalbank	1.7216	86,080,000	4,304,000	1.5663	87,159,414	6,101,159
Eesti Pank	-	-	-	0.1784	9,927,370	694,916
Central Bank of Cyprus	-	-	-	0.1300	7,234,070	506,385
Latvijas Banka	-	-	-	0.2978	16,571,585	1,160,011
Lietuvos bankas	-	-	-	0.4425	24,623,661	1,723,656
Magyar Nemzeti Bank	-	-	-	1.3884	77,259,868	5,408,191
Central Bank of Malta/Bank Ċentrali ta' Malta	-	-	-	0.0647	3,600,341	252,024
Narodowy Bank Polski	-	-	-	5.1380	285,912,706	20,013,889
Banka Slovenije	-	-	-	0.3345	18,613,819	1,302,967
Národná banka Slovenska	-	-	-	0.7147	39,770,691	2,783,948
Sveriges Riksbank	2.6636	133,180,000	6,659,000	2.4133	134,292,163	9,400,451
Bank of England	15.9764	798,820,000	39,941,000	14.3822	800,321,860	56,022,530
Total non-euro area NCBs	***20.3616***	*1,018,080,000*	*50,904,000*	***28.5092***	*1,586,442,685*	*111,050,988*
Total euro area and non-euro area NCBs	**100.0000**	**5,000,000,000**	**4,032,824,000**	**100.0000**	**5,564,669,247**	**4,089,277,550**

11. Fixed assets

	Land and buildings SIT millions	Computers & equipment SIT millions	Total SIT millions
Cost or valuation			
At 1 January 2003	2,869	2,727	5,596
Additions	46	314	360
Disposals	-	-249	-249
At 1 January 2004	2,915	2,792	5,707
Additions	298	556	854
Disposals	-	-44	-44
At 31 December 2004	**3,213**	**3,304**	**6,517**
Depreciation			
At 1 January 2003	617	1,884	2,501
Disposals	-	-248	-248
Charge for the year	22	326	348
At 1 January 2004	640	1,962	2,602
Disposals	-	-44	-44
Charge for the year	23	381	404
At 31 December 2004	**663**	**2,300**	**2,963**
Net book value			
At 31 December 2004	**2,550**	**1,004**	**3,554**
At 31 December 2003	2,275	830	3,106

At 31 December 2004 an amount of SIT 1,383 million relating to investment properties in Austria (2003: SIT 1,115 million) is included in land and buildings.

Amounts included in income statement:

	2004 SIT millions	2003 SIT millions
Rental income from investment properties	**202**	190
Direct operating expenses	**140**	139
Total income from investment properties	62	51

12. SDR allocation

	2004 SIT millions	2003 SIT millions
SDR allocation	**6,937**	7,156
Total SDR allocation	6,937	7,156

The SDR allocation liability carried an interest rate of 2.22% at 31 December 2004 (2003: 1.57%). 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.

13. Banknotes in circulation

Value of banknotes in circulation by denomination:

		2004 SIT millions	2003 SIT millions
SIT	10	**210**	234
SIT	20	**313**	423
SIT	50	**415**	563
SIT	100	**1,689**	1,516
SIT	200	**1,583**	1,619
SIT	500	**2,192**	2,151
SIT	1,000	**13,086**	12,871
SIT	5,000	**77,074**	73,253
SIT	10,000	**98,385**	93,005
Total		**194,947**	185,636
Tolar coupons		**405**	405
Total		**195,352**	186,042

14. Reserves

	2004 SIT millions	2003 SIT millions
Balance at 1 January	**177,327**	199,912
Transfer/Release to special reserve for foreign exchange differences	**-5,312**	-16,593
Transfer/Release to special reserve – price risk	**-906**	-8,256
Transfer to general reserve	**8,497**	2,264
Contributions to the welfare fund	**268**	-
Balance at 31 December	**179,873**	177,327
Represented by		
Initial capital of the Bank of Slovenia	**2,000**	2,000
Special reserve for foreign exchange differences	**101,672**	106,985
Special reserve – price risk	**9,290**	10,196
General reserve	**65,528**	57,031
Investment properties revaluation	**1,383**	1,115
Total reserves	**179,873**	177,327

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.

15. Commitments and off-balance sheet instruments

Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements in 2003 and in 2004 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.

16. 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**	
	2004	2003	**2004**	2003
	mio SIT	mio SIT	**mio SIT**	mio SIT
Assets				
Cash and deposits	**178,046**	400,209	**178,116**	400,303
Due to the banks	**-**	9	**-**	9
Liabilities				
Current accounts and deposits to banks	**63,156**	41,059	**63,192**	41,091
Bank of Slovenia bills in foreign currency	**500,757**	555,260	**501,922**	556,356
Commercial banks' deposits	**156,730**	-	**157,358**	-
Bank of Slovenia bills in domestic currency	**266,588**	472,330	**268,422**	481,964
Republic of Slovenia deposits	**127,477**	109,674	**128,582**	113,188

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.

17. 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 2004 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, new EU member states 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 2004:

	EUR	USD	Other	Total
	%	%	%	%
Sovereign bonds	**42.73**	**8.17**	**2.22**	**53.11**
Supranational securities	**3.16**	**1.94**	**1.61**	**6.72**
Foreign banks securities	**34.42**	**2.42**	**3.32**	**40.17**
December 31, 2004	**80.30**	**12.54**	**7.16**	**100.00**
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

Interest rate risk

Average effective interest rates:

	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	2004 Total	2003 Total
	%	%	%	%	%
Assets					
Foreign currency assets					
Gold and gold receivables	-	0.07	-	0.07	0.27
Cash and deposits	2.69	2.36	-	2.67	2.19
Derivative financial instruments	1.25	-	-	1.25	0.50
Investment securities available for sale	2.43	2.44	2.86	2.76	2.81
International Monetary Fund	2.00	-	-	2.00	1.44
Domestic currency assets					
Due from banks	-	-	-	6.25	6.25
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	1.59	2.36	-	1.67	1.22
Derivative financial instruments	1.25	-	-	1.25	-
Bank of Slovenia bills	2.09	2.16	-	2.09	1.91
Domestic currency liabilities					
Current accounts and deposits	0.91	-	-	0.91	0.92
Commercial banks' deposits	-	-	4.20	4.20	-
Overnight deposits	2.25	-	-	2.25	3.00
Bank of Slovenia bills	4.07	4.21	-	4.08	6.82
Republic of Slovenia deposits	2.17	4.00	4.20	3.46	6.31

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

Interest sensitivity of assets and liabilities

(SIT millions)

	Repricing period			
	3 months or less	3 months to 1 year	Over 1 year	2004 Total
Assets				
Foreign currency assets				
Gold and gold receivables	42	18,603	-	**18,646**
Cash and deposits	170,996	7,050	-	**178,046**
Derivative financial instruments	39	-	-	**39**
Investment securities available for sale	87,807	256,039	1,015,838	**1,359,684**
Receivables from the RS	25	-	6,937	**6,963**
International Monetary Fund	23,033	-	-	**23,033**
Total assets	**281,942**	**281,692**	**1,022,776**	**1,586,410**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	56,361	6,796	-	**63,156**
Derivative financial instruments	0	-	-	**0**
Bank of Slovenia bills	451,641	49,116	-	**500,757**
IMF and other IFO	1,383	-	6	**1,389**
SDR allocation	-	-	6,937	**6,937**
Domestic currency liabilities				
Current accounts and deposits	104,108	-	-	**104,108**
Commercial banks' deposits	-	-	156,730	**156,730**
Overnight deposits	4,800	-	-	**4,800**
Bank of Slovenia bills	240,977	25,611	-	**266,588**
Republic of Slovenia deposits	44,590	20,000	62,887	**127,477**
International fiancial organisations	264	-	-	**264**
Total liabilities	**904,124**	**101,523**	**226,561**	**1,232,207**
Net interest sensitivity gap	**-622,182**	**180,169**	**796,215**	**354,203**
December 31, 2003				
Total assets	482,504	140,838	1,022,587	1,645,930
Total liabilities	729,180	558,131	7,161	1,294,473
Net interest sensitivity gap	**-246,676**	**-417,293**	**1,015,426**	**351,457**

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 2004:

	SIT	EUR	USD	Other	Total
	SIT millions	SIT millions	SIT millions	SIT millions	SIT millions
Assets					
Foreign currency assets					
Gold and gold receivables	-	-	-	18,646	**18,646**
Cash and deposits	-	104,083	28,427	45,536	**178,046**
Derivative financial instruments	-	39	-	-	**39**
Investment securities available for sale	-	1,091,889	170,486	97,309	**1,359,684**
Receivables from the RS	-	-	-	6,963	**6,963**
International Monetary Fund	-	-	-	23,033	**23,033**
Accrued interest and other assets	-	18,725	1,762	6,056	**26,543**
Domestic currency assets	808	-	-	-	**808**
Total assets	**808**	**1,214,736**	**200,675**	**197,542**	**1,613,761**
Liabilities					
Foreign currency liabilities					
Current accounts and deposits	-	38,515	24,410	232	**63,156**
Derivative financial instruments	-	0	-	-	**0**
Bank of Slovenia bills	-	458,257	42,500	-	**500,757**
IMF and other IFO	-	1,383	-	6	**1,389**
SDR allocation	-	-	-	6,937	**6,937**
Accrued interest and other liabilities		1,182	183	33	**1,399**
Domestic currency liabilities	665,619	-	-	-	**665,619**
Total liabilities	**665,619**	**499,336**	**67,093**	**7,209**	**1,239,258**
Net balance sheet position	**-664,811**	**715,400**	**133,582**	**190,333**	**374,503**
Off-balance sheet net position	-	**-226,198**	-	-	**-226,198**
December 31, 2003					
Total assets	1,263	1,343,677	197,467	128,331	1,670,738
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

Maturities of assets and liabilities

(SIT millions)

	Remaining period to the contractual maturity date			
	3 months or less	3 months to 1 year	Over 1 year	2004 Total
Assets				
Foreign currency assets				
Gold and gold receivables	-	-	18,646	**18,646**
Cash and deposits	170,996	7,050	-	**178,046**
Derivative financial instruments	39	-	-	**39**
Investment securities available for sale	87,807	256,039	1,015,838	**1,359,684**
Receivables from the RS	25	-	6,937	**6,963**
International Monetary Fund	1,958	-	21,075	**23,033**
Accrued interest and other assets	11,737	9,598	5,208	**26,543**
Domestic currency assets				
Accrued interest and other assets	489	53	266	**808**
Total assets	**273,050**	**272,741**	**1,067,970**	**1,613,761**
Liabilities				
Foreign currency liabilities				
Current accounts and deposits	56,361	6,796		**63,156**
Derivative financial instruments	0	-	-	**0**
Bank of Slovenia bills	451,641	49,116	-	**500,757**
IMF and other IFO	1,383	-	6	**1,389**
SDR allocation	-	-	6,937	**6,937**
Accrued interest and other liabilities	1,291	108	-	**1,399**
Domestic currency liabilities				
Current accounts and deposits	104,108	-	-	**104,108**
Commercial banks' deposits	-	-	156,730	**156,730**
Overnight deposits	4,800	-	-	**4,800**
Bank of Slovenia bills	240,977	25,611	-	**266,588**
Republic of Slovenia deposits	44,590	20,000	62,887	**127,477**
International finacial organisations	264	-	-	**264**
Accrued interest and other liabilities	4,710	776	165	**5,651**
Total liabilities	**910,125**	**102,407**	**226,726**	**1,239,258**
Maturity gap	**-637,074**	**170,334**	**841,244**	**374,503**
December 31, 2003				
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.

18. Supplemental cash flow information: cash flows from Bank of Slovenia bills

	2004	2003
	SIT millions	SIT millions
Source		
Banks depozits	**156,730**	-
Tolar bills	-	101,730
Disbursment		
Foreign currency bills	**-57,639**	-2,950
Tolar bills	**-205,742**	-
Total	**-263,381**	-2,950
Total net disbursment	**-106,651**	98,780

19. Supplemental cash flow information: cash and cash equivalents

	2004	2003
	SIT millions	SIT millions
Foreign currency assets		
Cash	**5,281**	3,326
Total assets	**5,281**	3,326
Foreign currency liabilities		
Demand deposits	**-30,675**	-5,432
Domestic currency liabilities		
Commercial banks' demand deposits	**-94,033**	-91,087
Overnight deposits	**-4,800**	-8,170
Non-bank deposits	**-13,089**	-13,557
Total liabilities	**-142,597**	-118,245
Cash and cash equivalents	**-137,316**	-114,919

Foreign currency cash assets include IMF balances of SIT 1,958 million (2003: SIT 1,738 million) and do not include time deposits of SIT 162,166 million (2003: SIT 385,337 million) or other assets of SIT 12,557 million (2003: SIT 13,284 million).

Foreign currency demand deposits do not include restricted deposits of SIT 32,482 million (2003: SIT 35,627 million).

Domestic currency liabilities include Republic of Slovenia deposits of SIT 2,750 million (2003: SIT 3,825 million) and tolar accounts of central banks and of the European Commission of SIT 264 million.