BANKA SLOVENIJE

BANK OF SLOVENIA

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YEAR 2005

BANKA SLOVENIJE
BANK OF SLOVENIA

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## Introduction

At the end of 2005 all the economic convergence indicators set out in the Maastricht treaty had been met, with the exception of completing the two-year period stay within ERM II, the European exchange rate mechanism. In addition to achieving a rate of inflation, which by mid-2005 was already in line with average inflation in the euro area, in November the formal price stability criterion was met. The long-term interest rate criterion, and the two fiscal indicators (public debt and public deficit) were already achieved in previous years. The tolar exchange rate has been stable since ERM II entry, and has remained within a very narrow range around the central rate. The joint programme of the Bank of Slovenia and the Slovenian Government on ERM II entry and euro adoption has therefore achieved all the conditions for nominal convergence, which provides a sound basis for the planned introduction of the single European currency.

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These positive processes have not led to other imbalances, for example in the balance of payments current account. According to preliminary results, in 2005 the current account deficit was low again at 1.1% of GDP, largely due to the high growth in import prices. Economic growth in 2005, at 3.9% of GDP, was in line with the potential and sustainable level. Economic growth continued to be driven by the steady growth in the export of goods and services. It was also boosted by the slight increase in domestic consumption, though that was not excessive, which among others is supported by the balance of payment figures.

Increasing energy prices on global markets were again an adverse international factor in 2005. Some significant shocks hit the market due to the rapid growth of global oil prices. The impact of fuel prices on Slovenian consumption and the inflation basket was significantly higher than in most European countries. During the first half-year the Ministry of Finance was able to mitigate some of the effect of these shocks by means of acyclic adjustments to excise duties. The successful achievement of the inflation target was due largely to a very low core inflation rate (excluding energy prices, seasonal foods and the effects of indirect taxation), which was just 0.8% in 2005. The low inflation rate was also due to increased competition following Slovenia's entry to the European Union in May 2004, which was tied to other positive trends such as in the prices of clothes, footwear and cars.

A moderate growth in labour costs was another reason for the low core inflation rate. Real growth in average gross wages again remained behind the growth in productivity in 2005. This had a positive impact on the labour market; despite the serious problems in labour-intensive sectors, the growth in total employment was around 1% for the second consecutive year, though this is no reason to reduce attention. With a stable exchange rate any growth in labour costs leads directly to a deterioration in firms' international competitiveness.

The reduction in inflation and the anticipated convergence of interest rates due to the planned adoption of the euro at the start of 2007 influenced the continued fall in interest rates for borrowing and saving in tolars. The increased demand for borrowing led to a significant increase in bank lending. In 2005 it could not yet be seen whether that increased borrowing would significantly push up inflation, labour costs or imports. Banks mainly financed the growth in lending by borrowing from foreign banks. However, this rapid growth in borrowing from abroad did not lead to a significant increase in consumption, as most of the funds acquired were converted into various forms of saving and thus into investment at home and abroad. Borrowing by individuals was mainly aimed at financing the construction or purchase of housing. This created favourable economic conditions for the construction industry and related sectors, and has also fuelled growth in property prices, yet has had less of an effect on the balance of payments and the growth in consumer goods prices, which means there is less pressure on wage growth.

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In 2005 the Bank of Slovenia kept its interest rates at the highest level that still permitted it to maintain a stable exchange rate. In June the obligation for banks to subscribe to Bank of Slovenia foreign currency bills was abolished. This had an impact on the growth in foreign currency liquidity, which the Bank of Slovenia absorbed by means of temporary foreign exchange swaps and several outright purchases from the stock of foreign exchange swaps.

The plan to join the EMU will increase the importance of banking supervision, because a healthy and stable financial sector is a pre-condition for a healthy and successful economy. This also what the global and increasing liberal financial market requires of central banks, and is also essential to modern, increasingly complex, financial services. A stable financial system is also needed to effectively fulfil the transmission mechanism of monetary policy and the smooth functioning of payment systems.

The banking system's cost effectiveness increased in 2005, while the quality of classified assets held at banks and savings banks was maintained at previous levels. The rapid growth in risk-adjusted assets meant it exceeded growth in capital adequacy. The proportion of assets accounted for by bad debts fell.

In July 16 banks and one savings bank joined the trans-European real-time gross settlement system for payments in euro (TARGET) via the German central bank. The Bank of Slovenia also carried out an assessment of the securities clearing system via the Central Securities Clearing Corporation (KDD), which is the basis for acquiring ECB recognition that the system complies with the standards for euro monetary policy. Preparations to introduce the euro include adaptations in statistical methods. Given the need to harmonise statistics, in May credit institutions started reporting interest rates to the Bank of Slovenia in a manner complying with ECB requirements.

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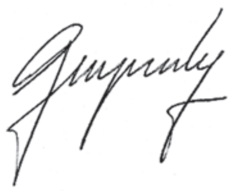
In 2006 Slovenia stands on the brink of adopting the euro and full membership of the European System of Central Banks (ESCB). The policies it has implemented to date have ensured the stability needed. New challenges and new opportunities await, both this year and in the future; two of the most important are without doubt the preparations for the technical introduction of the euro, and then maintaining stability within the operating conditions that exist for the euro area. Even after joining the euro area, Slovenia, like other European countries, will have to face the problems of an aging population and increasing globalisation, which means pursuing the objectives set out in the Lisbon Strategy, while also searching for a balance between economic efficiency and social sustainability.

I would like to take this opportunity, on my own behalf and on behalf of the remaining members of the Governing Board, to thank all the Bank of Slovenia employees for their work in 2005, and all those who are collaborating in the preparations to adopt the euro.

Mitja Gaspari

Ljubljana, April 2006



# 1 THE ECONOMIC ENVIRONMENT

## 1.1 External economic factors

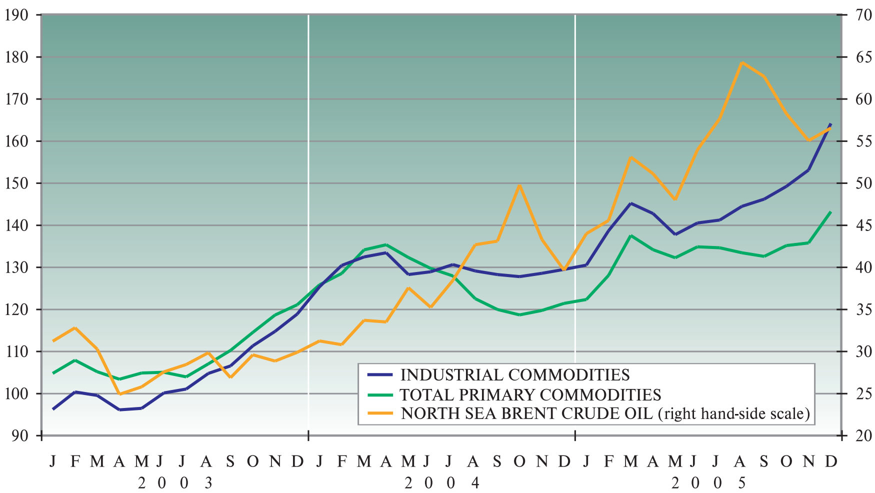
**Global economic growth increased in 2005**

Global economic growth in 2005 gradually improved and, according to IMF assessments, stood at a relatively high 4.3% for the entire year. Economic growth in the euro area until the middle of the year was relatively low, but increased somewhat in the second half of the year. Growth for the entire year stood at 1.4%, which is down on the previous year. US economic growth was higher than in the euro area at 3.5% on average for the year. The US economy slowed down somewhat in the final quarter of the year, due to the high oil prices and damage to the economy caused by hurricanes in the Gulf of Mexico. The Japanese economy increased its growth during the year, and average annual growth is estimated at 2.5%, higher than the growth recorded in the previous year.

**Slow EU growth reflects position of major member states**

The economies of our trading partners in the European Union slowed down a little, but did show signs of an upturn in the second half of the year. Elsewhere economic growth remained relatively good. According to the earliest estimates, the fastest growth recorded by Slovenia's top four EU15 partners was recorded by Austria (1.9%), followed by France (1.4%) and Germany (0.9%), while growth in Italy was exceptionally low at 0.2%. Initial estimates indicate that the economies of the new EU members grew significantly more than those of the older members. Slovakia's economy recorded 5.5% growth, the Czech Republic 4.9%, Hungary 4.1% and Poland 3.3%. In the former Yugoslav republics higher growth was recorded in Croatia, where initial estimates indicate 3.9% growth, and in Bosnia and Herzegovina (6.5%). The rate of growth was down in Serbia (to 6.5%) and Macedonia (to 3.6%).

Figure 1: **World market prices of primary 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

**Oil prices up by around 40%**

Oil prices have grown exceedingly quickly. A barrel of Brent crude averaged USD 54, compared with USD 38 in the previous year. This price increase came mostly as a result of the rapid growth in demand for oil, which was not efficiently satisfied by pumping and especially refinery capacity, which represented a bottleneck in the system. Additional pressure at the end of the summer also came from Hurricanes Katrina and Rita in the Gulf of Mexico, which caused significant damage to the oil industry in the region. Fluctuations in US oil reserves also had an impact on price fluctuations, as well as the geopolitical factors in oil producing countries, as in every year. The continuing violence in Iraq, unrest in Ecuador and Nigeria and the Russia-Ukraine gas dispute at the end of the year were all noteworthy events this year. Average oil production in 2005 was 83.5 million barrels per day.

**Inflation in euro area and US strongly influenced by fast growth in oil prices**

On average inflation was 2.2% in the euro area and 3.4% in the United States in 2005. The rapid growth in oil prices during 2005 caused price increases in both economic regions. Although there was the danger that the high oil prices would lead to higher prices in general due to higher production costs, there was no significant increase in core inflation. Core inflation, excluding the volatile elements food and oil, remained below overall inflation, and was around 1.4% in the euro area, and 2.2% in the United States. The fast growth in oil prices and other volatile prices that represented over half the increase in overall inflation, and which central banks cannot affect via interest rate policy led to the ECB's medium-term inflation target again being exceeded in the euro area. After a short period of inflation at the end of 2004, Japan was mainly subject to deflation in 2005, with an average annual inflation rate of –0.3%.

**ECB raised interest rates at year-end. The Federal Reserve raised them gradually through the year**

The key interest rate was left unchanged at 2.0% for most of the year, until December when the ECB made its first increase in two years, raising it by 0.25 percentage points. The interest rate rise was expected and was due to potential inflationary pressures attributed to two main causes. First, the rapid growth in oil prices that could spill over to other prices. Second, the high liquidity of the euro area due to low interest rates. The US Federal Reserve continued its policy, which started in June 2004, of gradually increasing interest rates throughout the year. By December the key interest rate had reached 4.25%, while the increase for the entire year was two percentage points. The reason for the gradual increase in interest rates was the improved economic growth, which no longer needed the additional stimulation of low interest rates. In addition the low interest rates led to signs of the real estate market overheating, while at the same time there were also inflationary pressures from the fast growing oil prices that could easily lead to more general price rises.

**Dollar strengthened against the euro by 9% in 2005**

Over the year the US dollar generally strengthened against the euro, gaining on average 11% in value over the year. The dollar's appreciation was largely due to the more favourable interest rates differential for the US dollar due to the United States increasing its interest rates. Exchange rates had an adverse effect on import prices due to higher commodities prices, while the rapid growth in oil prices also contributed to the growth in imported inflation.

## 1.2 Gross domestic product, employment and labour costs

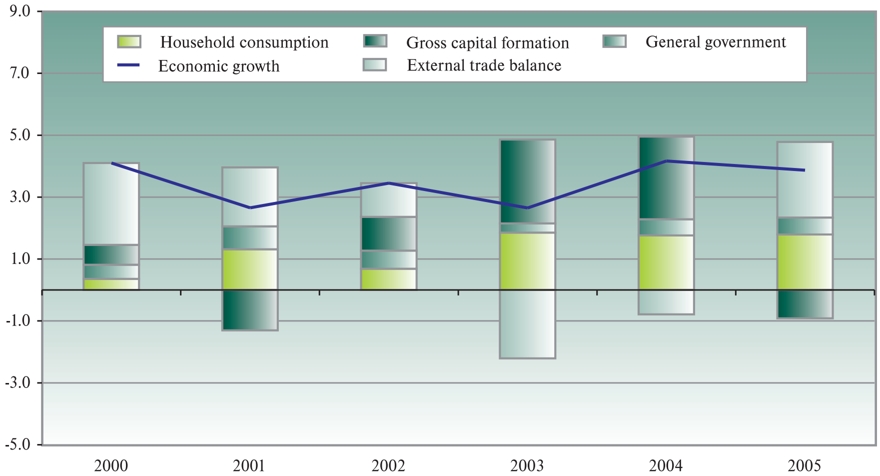
**3.9% economic growth in Slovenia**

Economic activity was again sound in 2005, though growth was somewhat lower than the previous year. At around 3.9% it was approximately the same as the estimated growth in potential GDP. The largest rises in added value were recorded in financial intermediation services (12.7%), in transport (4.8%) and in retail trade (4.4%), while added value declined in agriculture and fishing (down by 3.7% and 4.2% respectively) and electricity, gas and water supply (down 0.8%). This structure of economic growth indicates that activity was primarily influenced by the high level of transactions on financial markets, gradual growth in domestic consumption, and the favourable economic climate abroad.

**Household spending sustainable; foreign trade a major contribution to growth**

Household spending was the fastest growing component (3.3%) of domestic spending, but remained sustainable, while general government spending grew at almost the same rate (3.2%). Total gross fixed capital formation fell (down 3.0%), largely due to reductions in inventories. The negative impact of changes in inventories on GDP growth was 1.7 percentage points, while gross fixed capital formation increased by 3.7%. Foreign trade had a positive impact on economic growth, representing over half the growth in GDP, with a high level of growth in the export of goods and services (9.2%), and a somewhat more subdued growth in the import of goods and services (5.3%). With the current account in deficit in 2005, domestic saving was not sufficient to fully cover gross capital formation.

Figure 2: **Contribution to economic growth**




Sources: Statistical Office of the Republic of Slovenia (SORS), Bank of Slovenia calculations

Table 1: **Composition of Gross Domestic Product**

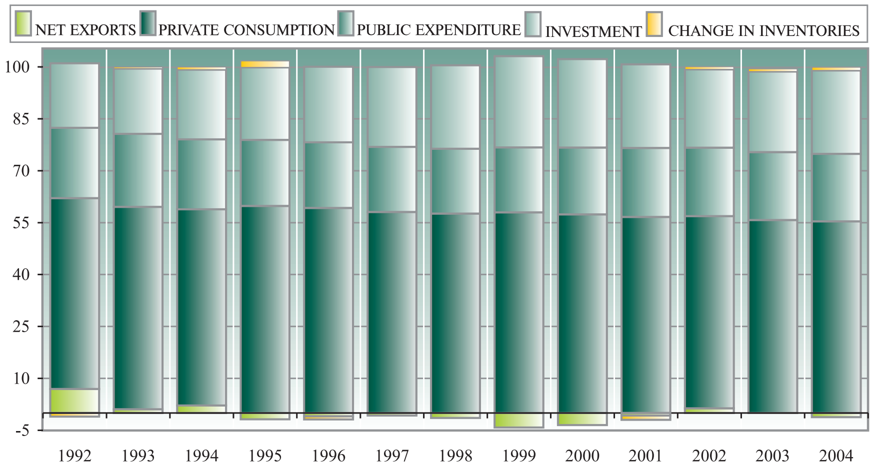
| (%) | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| Household consumption | 0.4 | 1.3 | 0.7 | 1.9 | 1.8 | 1.8 |
| Gross capital formation | 0.6 | -1.3 | 1.1 | 2.7 | 2.7 | -0.9 |
| General government | 0.5 | 0.7 | 0.6 | 0.3 | 0.5 | 0.5 |
| External trade balance | 2.6 | 1.9 | 1.1 | -2.2 | -0.8 | 2.4 |
| Economic growth | 4.1 | 2.7 | 3.5 | 2.7 | 4.2 | 3.9 |

Sources: Statistical Office of the Republic of Slovenia (SORS), Bank of Slovenia calculations

**Manufacturing returns positive growth in added value**

In line with the rather high growth in added value in the manufacturing sector (3.2% growth in 2005) the growth in industrial output for the entire year was 3.1%. The growth dynamics was particularly high in the middle of the year, and strengthened again at the end of the year after a slow down in growth in autumn. The largest increase over the whole year was recorded in capital goods output (8.4%), alongside exceptionally rapid growth in the car industry. Total inventories in industry rose by 5.4% in 2005.

Figure 3: **Composition of gross domestic product**




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

Table 2: **Selected economic indicators**

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| **Real growth of gross domestic product**[1] (%) | 4.1 | 2.7 | 3.5 | 2.7 | 4.2 | 3.9 |
| **Gross domestic product** in EUR millions | 20,974 | 22,099 | 23,673 | 24,876 | 26,171 | 27,635 |
| **Gross domestic product** in EUR per capita | 10,543 | 11,094 | 11,866 | 12,461 | 13,103 | 13,677 |
| | | | | | | |
| **Composition of gross domestic product** (%) | | | | | | |
| Agriculture, forestry and fishing | 2.8 | 2.4 | 2.7 | 2.2 | 2.4 | 2.4 |
| Industry and construction | 32.6 | 32.8 | 33.1 | 33.3 | 33.3 | 31.7 |
| – Manufacturing | 23.8 | 24.4 | 24.7 | 25.1 | 25.3 | 24.8 |
| Services | 53.6 | 54.4 | 54.3 | 54.8 | 54.6 | 51.9 |
| Total value added | 86.5 | 86.9 | 87.2 | 87.2 | 87.1 | 85.2 |
| Compensation of employees | 52.9 | 53.4 | 52.7 | 52.4 | 52.7 | ... |
| Taxes on production and imports less subsidies | 14.8 | 14.6 | 15.1 | 14.9 | 14.7 | ... |
| Gross operating surplus and gross mixed income | 32.3 | 32.0 | 32.2 | 32.8 | 32.6 | ... |
| – Exports of goods and services | 55.6 | 57.2 | 57.1 | 55.8 | 60.2 | 64.8 |
| – Imports of goods and services | 59.1 | 57.9 | 55.8 | 55.9 | 61.4 | 65.2 |
| Net exports | -3.5 | -0.7 | 1.3 | -0.1 | -1.2 | -1.4 |
| Household final consumption expenditure | 57.4 | 56.7 | 55.5 | 55.8 | 55.4 | 55.4 |
| General government final consumption expenditure | 19.3 | 20.0 | 19.7 | 19.6 | 19.5 | 19.6 |
| Gross capital formation | 26.8 | 24.1 | 23.4 | 24.7 | 26.3 | 25.3 |
| | | | | | | |
| **Active population**[2] in thousands | 968 | 979 | 971 | 962 | 1,007 | 1,016 |
| Employed and self-employed | 901 | 916 | 910 | 894 | 943 | 950 |
| Unemployed | 68 | 63 | 62 | 65 | 64 | 66 |
| **Unemployment rate** (ILO) | 7.0 | 6.4 | 6.4 | 6.8 | 6.3 | 6.5 |
| | | | | | | |
| **Real growth in gross wages per employee** (%) | 1.6 | 3.3 | 2.1 | 1.9 | 2.0 | 2.4 |
| **Growth in labour productivity** (%) | 2.6 | 2.8 | 3.8 | 3.1 | 4.0 | 3.2 |

1 Data on national accounts are presented in previous year prices.
2 Internationally comparable data by ILO methodology.
Source: Statistical Office of Republic of Slovenia

**Real growth in average wages (2.4%) below productivity growth**

Against a backdrop of favourable economic conditions, important changes in employment structure, and changes to tax legislation, wage growth in 2005 was somewhat faster than in previous years. Largely due to low public sector wage growth, overall wage growth was sustainable and not inflationary. Year-on-year growth in average gross wages averaged 4.9% in 2005, or 2.4% in real terms. Real growth in gross wages in the tradable sector averaged 4.3% over the twelve months of the year, and was in line with estimated productivity growth. Wage adjustments in both the public and private sector were performed on the basis of wage agreements for the 2004 to 2005, taking into account the projected rise in prices in Slovenia, and the projected rise in prices across the European Union.

**On average employment trends favourable in 2005**

Employment trends were fairly positive in 2005, and in line with the increase in economic activity. However, the state of the labour market in the second half of the year deteriorated slightly, with the decline in employment particularly noticeable in labour-intensive sectors. The number of people in active employment rose on average by 0.5% in 2005, with employment in companies and institutions rising by 1.1% and – after falling for several years – employment also picked up in the small-business sector (0.3%), and was continuing to increase at the end of the year. Unemployment was 0.9% lower than in 2004, with the unemployment rate reaching 10.2% in December, which is the same as the average over the entire year, and slightly higher than in December 2004 (10.1%). Employment rose most in real estate services (6.6%), while there was also a significant rise in employment in construction (4.6%), due in part to changes in methodology. The largest falls in employment were recorded in mining (-4.6%), agriculture (-3.4%), and public administration (-0.5%). Despite significant export activity, employment in the manufacturing sector also fell in 2005 (by 1.8%). 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, and the even more sensitive textile and leather industries), while other areas recorded rapid rises in employment (particularly the car industry, and the metal and metal product manufacturing industry). As in the last few years the rise in the number of employees in the service sector (2.0%) again outweighed the change in employment in industry, which fell by 0.6%, widening the gap between employment trends in the two sectors. The regional pattern of unemployment in 2005 was essentially unchanged, with rates of registered unemployment highest in the Podravska, Pomurska, Savinjska and Posavska regions.

**Active population and number of unemployed increased in 2005, according to ILO methodology**

The internationally comparable figure for the active population, measured using an International Labour Organisation (ILO) survey, increased by just under 9.000 in 2005, while the number of people unemployed increased by just over 2.000. Compared to 2004, the unemployment rate therefore increased slightly in 2005 to an average of 6.5%. The critical groups remain the long-term unemployed, young people (mainly first-time job-seekers), the over-40s and those with poor qualifications.

## 1.3 Prices

**Maastricht inflation criterion met at the end of 2005**

The consumer price index increased in 2005 by 2.5%, which is 1.1 percentage points less than in 2004. It was possible to maintain a sustainable level of overall inflation due to additional reductions in the core inflation[1], which on average amounted to just 0.8% in 2005. The rate at which inflation fell slowed down significantly, due to the rapid growth in energy prices, which were up by 12.2%. At the end of the year Slovenia had met the Maastricht criteria for euro adoption.

**Calculating the reference value for the Maastricht inflation criterion**

One of the conditions for introducing the euro is maintaining a stable inflation rate at or below the reference value set in the Maastricht Treaty. This reference value is 1.5 percentage points above the average of the three EU member states with the best results for price stability. A 12-month moving average inflation rate is used. The basis for the criterion is inflation calculated using the EU standard methodology HICP (Harmonised Index of Consumer Prices), which only differs minimally from the consumer price index using the national methodology. In December Slovenia's average annual inflation rate using the HICP was 2.5%, which was just above the reference value, which that month comprised Finland, the Netherlands and Sweden. Slovenia met the Maastricht inflation criterion in November 2005 for the first time.

1 Core inflation measures the growth in consumer prices, excluding energy prices, seasonal products and the effects of tax changes.

**Core inflation 0.8%**

The slower growth in core inflation was caused by several factors, namely slower labour cost growth, a still negative output gap, slower growth in producer prices, and some one-off shocks that mainly related to increased global competition (with China in particular), and the continued impact of abolishing customs tariff upon EU entry. The internal structure of inflation was less uniform that in past years, while the growth in prices in individual groups varied significantly from the average. Clothing and footwear prices fell on average by 1.0%, food prices by 0.8%, and medical services by 0.3%, while the average level of prices for communication services remained unchanged. Growing at an above-average rate were housing costs (9.1%), household equipment (3.6%), alcoholic drinks and tobacco (3.9%), education services (7.1%) and catering and accommodation services (4.4%), while the growth in prices for transportation services (2.7%) and recreation and culture (2.4%) was closer to the average inflation rate.

**Core inflation caused by negative output gap and moderate growth in labour costs and producer prices**

The renewed acceleration in economic growth over the last two years has almost closed the output gap, which remained negative in 2005, and continued to limit the growth in general prices. European Commission estimates indicate that the output gap in 2005 remained a negative at 1.2% of potential GDP and that the gap will remain negative up to 2008[2]. The low price growth was due to the moderate real growth in labour costs, which remained behind productivity growth. Producer prices for manufactured goods calmed further in 2005, with average growth down 1.6 percentage points to 2.7%. The movement of producer prices for final consumption thus remains favourable, and is not giving rise to any inflationary pressures, with both the year-on-year rate and average rate remaining lower than the rates for consumer prices. The growth in intermediate goods prices kept slowing, so that average growth for 2005 amounted to 3.2%.

**Interest rate spread for long-term securities indicates inflation expectations are calm**

Inflation expectations eased in line with the disinflation. The interest rate spread for long-term securities reduced to within a range of 0.0 to 0.5 percentage points, which indicates the financial markets confidence in past deflationary efforts and stable inflation in the future. The stable exchange rate allowed inflation expectation to be curbed even further in 2005, as the SIT/EUR rate has remained very close to the central rate since Slovenia joined ERM II.

**High growth in oil prices limited impact of Slovenia's EU entry and global competition**

In contrast to these factors, which have allowed inflation to remain sustainable, 2005 also saw a number of transitional effects at the micro-economic level. The recurring growth in global oil prices led to an increase in domestic energy prices. Growth in those prices was up by around four percentage points to 12%, which contributed around 1.3 percentage points to inflation, 0.4 percentage points more than in 2004. The effects of EU entry and abolition of customs duties remained, as did the effects of increased global competition, which both countered the increase in energy prices. The effects of EU entry led to food prices falling in 2005 by an average of 0.8%, car prices by 5.3%, while global competition, primarily from China, led to clothing and footwear prices falling by 1.0%. These falling prices represented a contribution to average inflation of around -0.5 percentage points in 2005, or 0.9 percentage points less than in 2004.

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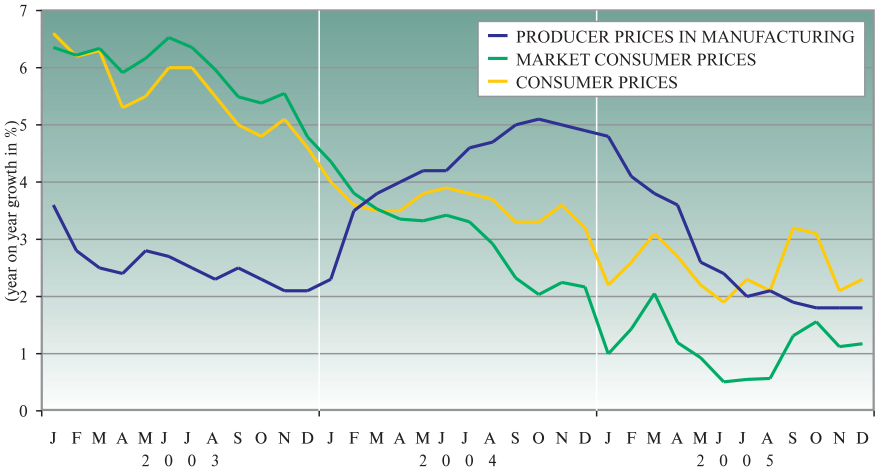
[2] While economic growth was in line with potential growth, the output gap remained negative due to lower growth in previous years.

Figure 4: **Prices**




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

**Administered price grew due to higher oil prices**

Coordinated action by the Bank of Slovenia and the Slovenian Government in 2005 again limited inflationary pressures. The Slovenian Government used counter-cyclical adjustments in excise duties to mitigate the transmission of high oil prices on the world market into domestic prices, and via its administered prices policy prevented the automatic transmission of costs into pricing. Despite the counter-cyclical adjustment of excise duties, by December energy prices had risen by 12.2% in 2005, contributing approximately 1.3 percentage points to the annual inflation rate of 2.5%. In making its adjustments the Government was restricted by the EU directive on minimum excise duties, the minimum level being reached in the first half of the year. Year-on-year growth in administered prices (excluding energy prices) stood at 4.2% in December 2005, with the highest growth figures being recorded for household heating (9.1%), road tolls (5.3%) and textbooks (13.9%). Growth in the municipal service prices (excluding household heating) was below average or even negative in some cases in 2005.

## 1.4 Balance of payments

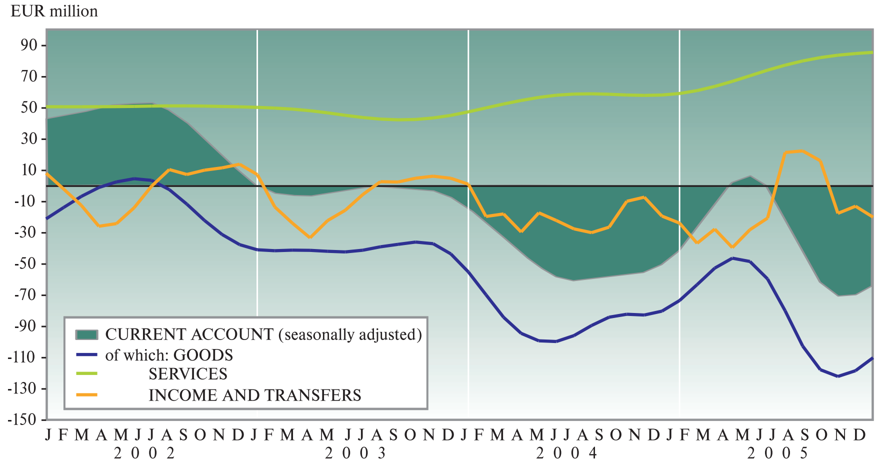
**2005 current account deficit lower than previous year**

In 2005 Slovenia recorded a current account deficit for the third year in succession. The deficit was EUR 301 million or 1.1% of GDP and was around one half lower than the 2004 deficit. The main reasons for the current account deficit in 2005 were the import and export trends, particularly when, against a backdrop of slightly higher domestic spending and adverse price movements, there was a significant upturn in the import of goods. The record surplus in trade in services, the increase in the surplus of transfers and the smaller net outflow from labour and capital income all had a beneficial effect on the current account.

**Trade deficit up slightly**

Slovenia's trade deficit for 2005 was EUR 1.4 billion, or 5.1% of GDP, and was slightly higher than in 2004. The value of Slovenia's exports was EUR 14.3 billion, which is 12% more than in 2004. Imports, growing a bit a more slowly than exports, were worth EUR 15.7 billion, 11.2% higher than in 2004. The coverage of imports with exports increased by over half a percentage point to 91%.

Figure 5: **Balance of payments current account**




Source: Statistical Office of the Republic of Slovenia (SORS), ARC estimates, Bank of Slovenia

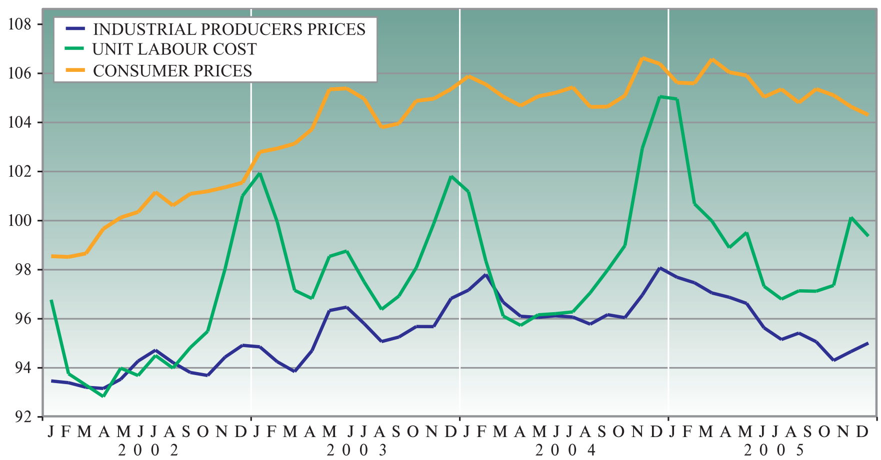
**Growth in volume of imports and exports of goods lower than euro figures indicate**

In terms of volume the growth in imports and exports of goods was slightly lower in 2005 than indicated by the figures expressed in euro. The reason for this difference lies in the fact that the average import-export value indices (import-export prices) calculated in euro in 2005 increased compared to 2004, with the export prices growing more slowly than import prices. The faster growth in import prices, in which intermediate products predominate, was due to the significant impact of growing energy prices (mainly oil) on the world market and increased prices for industrial metals. In addition to the growth the US dollar price for these goods, the value of the US dollar also increased against the euro by just below 13%, further contributing to increased growth in euro import prices. On average in 2005 euro oil prices rose by 42% year-on-year, and industrial metal prices by over 17%.

**Terms of trade deteriorated**

On average 2005 euro export prices rose by 4.2% year-on-year, and euro import prices by 7.2%. The terms of trade, which indicate the difference between import and export prices, deteriorated by 2.6% compared to 2004. The deteriorating terms of trade represented over one third of the entire trade deficit at just under EUR 0.5 billion, 1.8% of estimated GDP.

Figure 6: **Real effective tolar exchange rate**




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

**Real and nominal effective tolar exchange rate depreciated in 2005**

The real and nominal effective tolar exchange rate depreciated in 2005, largely due to changes in the exchange rates of a number of currencies on foreign financial markets. The real effective tolar exchange rate, measured by the ratio of foreign to domestic consumer prices, depreciated by 2%, and by somewhat more (3.1%) if measured in terms of producer prices. Year-on-year depreciation was recorded in the final quarter of 2005 for the real effective tolar exchange rate as measured by relative unit labour costs, but due to high wage growth at the start of the year the real rate appreciated by 0.9% on average in 2005 when measured by relative unit labour costs.

**Demand from abroad positive**

Demand from abroad had a beneficial effect on export growth and economic activity last year. There was a real increase of 4.8% last year in real income from sales in industry. Real income from sale only increased on foreign markets (by 9.1%), while on the domestic market it fell by 2.9%. Real income increased most in capital goods and consumer goods, and grew least in the production of intermediate goods, which also affected the dynamics and structure of goods exports.

**Exports of highly processed products up, higher imports of intermediate goods**

Slovenia's exports of highly processed products increased faster than average in 2005. The year-on-year export of consumer products grew by 16.5%, primarily due to an increase in the road vehicle exports of 36%. Growth in exports of capital goods was more than one third down at 9.3%, while growth in the export of intermediate goods increased by 9.5%. The situation was the reverse on the import side, with imports of intermediate goods recording the largest growth of 13.7%. In addition to the demand for higher production and exports, prices were another factor in this increase, in particular the rise in commodities and energy prices on world markets. Imports of capital goods in the first half of last year were behind those in the same period of 2004, but they rose at a faster rate after the summer. Imports of consumer goods grew by 9.8% year-on-year in 2005, while imports of capital goods were up 4.9%.

**Strong growth in exports to EU**

Owing to above-average growth in exports to EU member states and below-average growth in imports, the regional make-up of Slovenia's merchandise trade also changed in 2005. The proportion of total exports to EU member states rose by just over 1 percentage point year-on-year in 2005 to 67.7%, while imports recorded a decline of 1.5 percentage points to 80.9%. The largest rises on the export side was recorded to countries where exports are largely related to the car industry, reaching as much as 209% for Portugal and 42% for France. Exports to Austria (20%) and Italy (8%) also grew. Exports to Germany also accelerated in the second half of the year, but their growth of 3.2% was well below the average growth in exports to the European Union. Among the new member states, above-average growth was only recorded for exports to the Czech Republic (30%) and Slovakia (just over 22%). High growth of over 20% also recorded in exports to Spain and Sweden. The growth in imports from Slovenia's top four partners was above average for imports from Italy (12%), average for imports from Germany (9.6%), below average from Austria (4.1%), while the only country from which imports were lower than in 2004 was France, down 0.2%.

**Imports to countries of the former Yugoslavia grew faster than exports from those countries**

Imports are growing faster than exports in trade with the former Yugoslav republics. Exports to these countries grew by 10% year-on-year, while imports were up 28%. The largest increases in trade last year were with Serbia and Montenegro (exports: 15%, imports: 65%), and Croatia (exports: 12%; imports: 18%). While exports to Bosnia and Herzegovina increased by just 5.0% (imports: 36%), exports to Macedonia actually fell by 4%, while imports increased by 12%. The growth in trade with Russia was also above average in 2005 (exports: 11.4%; imports: 5.5%).

Table 3: **Regional breakdown of trade in goods**

| | EXPORTS | | | IMPORTS | | | TRADE BALANCE | | |
|---|---|---|---|---|---|---|---|---|---|
| EUR million | 2003 | 2004 | 2005 | 2003 | 2004 | 2005 | 2003 | 2004 | 2005 |
| **European Union (25)** | **7,551** | **8,505** | **9,688** | **9,255** | **11,647** | **12,722** | **-1,705** | **-3,142** | **-3,034** |
| Austria | 827 | 955 | 1,149 | 1,052 | 1,864 | 1,940 | -225 | -909 | -791 |
| France | 638 | 822 | 1,169 | 1,229 | 1,166 | 1,164 | -591 | -344 | 5 |
| Italy | 1,478 | 1,664 | 1,803 | 2,240 | 2,673 | 2,997 | -762 | -1,009 | -1,194 |
| Germany | 2,611 | 2,760 | 2,849 | 2,359 | 2,872 | 3,149 | 252 | -112 | -300 |
| **New member states** | **956** | **1,068** | **1,233** | **1,023** | **1,247** | **1,438** | **-67** | **-179** | **-205** |
| Czech Republic | 205 | 245 | 317 | 308 | 345 | 378 | -103 | -101 | -61 |
| Hungary | 223 | 249 | 282 | 352 | 540 | 599 | -129 | -291 | -317 |
| Poland | 311 | 344 | 362 | 189 | 189 | 237 | 121 | 155 | 125 |
| Slovakia | 162 | 174 | 211 | 163 | 173 | 209 | -1 | 1 | 2 |
| **EFTA** | **176** | **166** | **219** | **221** | **240** | **219** | **-45** | **-74** | **0** |
| **Non-European OECD members** | **586** | **633** | **561** | **761** | **596** | **548** | **-175** | **38** | **13** |
| United States | 410 | 400 | 294 | 294 | 166 | 145 | 116 | 234 | 149 |
| Canada | 21 | 20 | 26 | 46 | 40 | 43 | -25 | -20 | -17 |
| South Korea | 19 | 13 | 15 | 82 | 73 | 70 | -62 | -60 | -55 |
| **Countries of former Yugoslavia** | **1,967** | **2,251** | **2,476** | **613** | **805** | **1,027** | **1,354** | **1,446** | **1,449** |
| Bosnia and Herzegovina | 471 | 491 | 515 | 78 | 152 | 206 | 393 | 339 | 309 |
| Croatia | 1,007 | 1,167 | 1,304 | 444 | 510 | 605 | 562 | 656 | 699 |
| Serbia and Montenegro | 143 | 139 | 134 | 22 | 27 | 29 | 121 | 112 | 105 |
| Macedonia | 346 | 455 | 523 | 68 | 113 | 187 | 278 | 341 | 336 |
| **Countries of former Soviet Union** | **498** | **604** | **686** | **374** | **384** | **389** | **124** | **220** | **297** |
| Russian Federation | 348 | 420 | 468 | 311 | 316 | 334 | 36 | 104 | 134 |
| **Other countries** | **507** | **624** | **685** | **1,015** | **471** | **823** | **-508** | **153** | **-138** |
| **TOTAL** | **11,285** | **12,783** | **14,315** | **12,239** | **14,143** | **15,728** | **-954** | **-1,360** | **-1,413** |

Note: Export f.o.b. and import c.i.f..
Source: Statistical Office of the Republic of Slovenia (SORS); data for 2005 are preliminary

**Trade deficit with EU25 has grown for a number of years**

In 2004 Slovenia's trade deficit with European Union member states (EU25) increased by EUR 1.4 million, while last year it fell by EUR 0.1 billion to EUR 3 billion or 11% of GDP. At the same time Slovenia recorded a surplus in its trade balance with non-EU countries, which was EUR 1.8 billion in 2004, and EUR 1.6 billion last year, just under 6% of estimated GDP.

**Trade in services grew faster than trade in goods**

Trade in services grew faster than trade in goods in 2005. Year-on-year growth in exports of services outstripped that in exports of goods by just under 4 percentage points, while for imports the gap was just 0.2 percentage points. The faster growth in trade in services was accompanied by an increase in the proportion of services in goods and services exports, increasing by 0.5 percentage points to 18.2%, its highest level in the last five years, and increasing by 0.3 percentage points in imports to 16.8%, which is the same as the level reached in 2002. In 2005 the export of services stood at EUR 3.2 billion, a year-on-year increase of 15.9%, while imports grew by 10.9% to EUR 2.3 billion. With exports of services growing faster than imports, the surplus in trade in services rose year-on-year by EUR 212 million to a record EUR 898 million.

**Largest surplus recorded in tourism**

Results in the tourism sector were the largest factor in the services surplus in 2005. Revenues from tourism were up 10.3% year-on-year at EUR 1.45 billion, despite the number of foreign visitors to Slovenia increasing by just 4% and the number of overnight stays by foreign visitors only increasing by a little over 1%. Given the relatively small increase in the number of foreign visitors, the high tourism revenues indicate a change in the spending habits of foreign visitors to Slovenia. Expenditure on tourism grew more slowly than income, and at EUR 748 million was just 6.0% higher than in 2004. The surplus in tourism of EUR 699 million was larger even than the overall surplus in trade in services recorded in 2004.

**Favourable changes in balance of transport services**

There were also good results in the transport sector. Revenues from transport grew by 14.1% year-on-year, while expenditure on transport was up 8.1%, taking the surplus up more than one-third to EUR 398 million. There was a net deficit of EUR 199 million in other services, down EUR 45 million on 2004. The largest increases, on both the import and export sides, were recorded by miscellaneous business services, prominent among which were exports of foreign trade intermediation services, which more than doubled year-on-year.

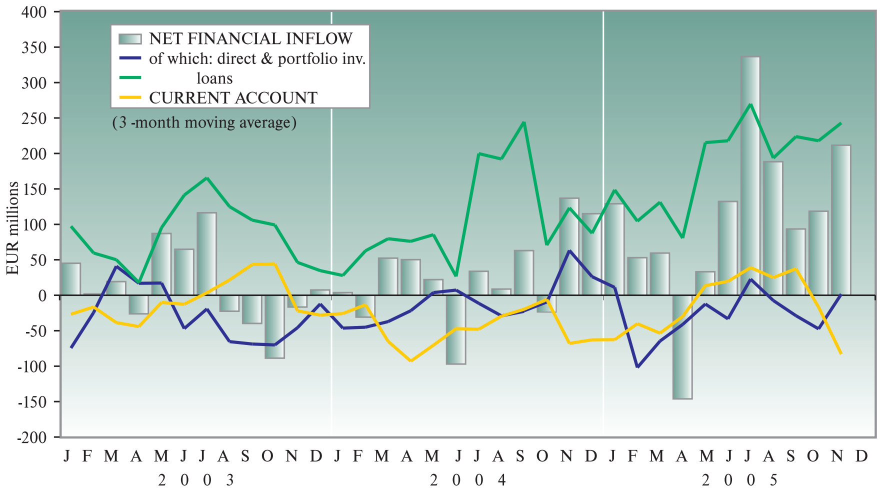
**Net balance of payments income negative**

Net income in the balance of payments was negative in the amount of EUR 226 million in 2005. Net labour income has been falling for a number of years, and fell by EUR 11 million last year to EUR 162 million. The deficit in capital income was down EUR 34 million from 2004 at EUR 388 million (the figures for reinvested earnings in Slovenia are provisional estimates). With external debt rising to EUR 4.2 billion, interest payments to the rest of the world rose by 16%. The largest increase in capital income was recorded by income and expenses from investments in securities. The net inflow from such investments rose by just under EUR 20 million year-on-year to EUR 142 million. Revenues from Bank of Slovenia bonds and debt securities accounted for two-thirds of the revenues.

**Contribution of transfers to current account doubled**

The contribution to the current account made by net transfers more than doubled from 2004. Net inflows from transfers totalled EUR 61 million. The surplus derives entirely from other transfers with the rest of the world, as official transfers recorded a net outflow of EUR 52 million in 2005, despite increased disbursement of money from the EU budget.

Figure 7: **Financing the current account**




Source: Bank of Slovenia

**Financial flows up again**

After two years of relatively low net financial inflows, in 2005 they once more reached 5.5% of GDP, as in 2002. The private sector recorded a net inflow of EUR 2.2 billion, while the state sector reduced foreign debt, as it had in the previous four years.

**Growth in private sector's foreign liabilities**

The private sector's gross financial transactions with the rest of the world reached 26% of GDP, 4 percentage points up on 2004, and 10 percentage points more than in 2003. The increase is due to the growth in the private sector's foreign liabilities, which reached 50% growth, while foreign investment was only slightly higher than in 2004.

**High portfolio investment abroad continues**

Financial investments abroad by the private sector reached EUR 2.65 billion in 2005, 3.0% more than in 2004. High portfolio investment abroad continued, and exceeded all other forms of investment in volume for the first time in 2005. The financing of foreign trade partners via loans also increased rapidly, while trade credits remained at their 2004 level.

Table 4: **Balance of payments**

| EUR million | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| **A. CURRENT ACCOUNT** | **-583** | **38** | **344** | **-81** | **-544** | **-301** |
| *- in % of GDP* | *-2.8* | *0.2* | *1.5* | *-0.3* | *-2.1* | *-1.1* |
| 1. Goods | -1,227 | -684 | -265 | -543 | -1,009 | -1,034 |
| 2. Services | 489 | 536 | 620 | 541 | 686 | 898 |
| 2.1. Transport | 149 | 203 | 249 | 260 | 323 | 398 |
| 2.2. Travel | 489 | 504 | 508 | 523 | 606 | 699 |
| - exports | 1,045 | 1,105 | 1,143 | 1,186 | 1,312 | 1,448 |
| 2.3. Other | -149 | -171 | -137 | -242 | -244 | -199 |
| 3. Income | 29 | 43 | -153 | -173 | -250 | -226 |
| 3.1. Labour income | 174 | 167 | 169 | 176 | 173 | 162 |
| 3.2. Investment income | -145 | -124 | -323 | -349 | -423 | -388 |
| 4. Current transfers | 125 | 144 | 142 | 94 | 29 | 61 |
| **B. NET FINANCIAL INFLOW** | **1,089** | **1,724** | **1,099** | **149** | **411** | **1,506** |
| - in % of GDP | 5.3 | 7.9 | 5.4 | 0.6 | 1.6 | 5.5 |
| 1. Private sector | 727 | 1,510 | 1,445 | 162 | 628 | 2,186 |
| 1.1. Claims | -403 | 296 | -1,552 | -1,854 | -2,570 | -2,648 |
| Capital transfers | - | - | -237 | -245 | -247 | -277 |
| Outward FDI | -72 | -161 | -162 | -418 | -442 | -453 |
| Portfolio investments | -24 | -87 | -144 | -160 | -483 | -649 |
| Trade credits[1] | -194 | -249 | -135 | -116 | -238 | -225 |
| Loans | -72 | 19 | -214 | -214 | -277 | -377 |
| Households | -13 | 797 | -592 | -606 | -756 | -600 |
| 1.2. Liabilities | 1,130 | 1,213 | 2,997 | 2,016 | 3,200 | 4,836 |
| Capital transfers | - | - | 74 | 81 | 132 | 140 |
| Inward FDI | 149 | 412 | 1700 | 300 | 662 | 427 |
| Portfolio investments | 28 | 11 | 27 | -13 | 263 | 327 |
| Trade credits[1] | - | - | 94 | 58 | 207 | 237 |
| Loans | 953 | 649 | 932 | 1,193 | 1,668 | 2,669 |
| Deposits at banks | 34 | 152 | 130 | 428 | 236 | 1,012 |
| 1.3. Other, net | -61 | -34 | -28 | -127 | -96 | -46 |
| 2. Government[2] | 307 | 114 | -86 | -82 | -231 | -372 |
| 3. Bank of Slovenia | 13 | -10 | -51 | -24 | 108 | 94 |
| 4. Net errors and omissions | 41 | 110 | -193 | 93 | -94 | -402 |
| **C. CHANGE IN RESERVES:** | **-506** | **-1,762** | **-1,443** | **-68** | **133** | **-1,205** |
| 1. BoS | -206 | -1,436 | -1,840 | -241 | 239 | -283 |
| 2. Banks | -300 | -326 | 397 | 173 | -106 | -922 |

1 Before 2002 trade credits were represented as net trade credits (claims netted by liabilities).
2 The transactions of domestic banks with government bonds are excluded.
Source: Bank of Slovenia

**Growth in portfolio investment strong in 2005, but down on 2004 figures**

Slovenian portfolio investment growth calmed somewhat in 2005, after the very high 200% growth recorded in 2004. The causes of growth also changed. While the high growth in 2004 was due to changes in the structure of the domestic financial market, mainly high cash inflows into mutual funds, which partially directed the money abroad, growth in 2005 was due to the liberalisation of restrictions on investments by mutual funds in foreign securities, which led them to restructure their portfolios. Total investments in foreign securities amounted to EUR 649 million in 2005, a third more than in 2004. Banks invested a further EUR 548 million in foreign securities, which are accounted for within their foreign exchange reserves and not included in the totals and growth figures for portfolio investment given above.

**Moderate growth in FDI abroad**

The gradual rise in outward foreign direct investment continued. In 2005, it was 2.5 times higher than in 2004. The investments were almost entirely capital in investments, and only a small proportion were debt claims and liabilities between affiliated company. Outward FDIs have exceeded EUR 400 million per year for the last three years (compared to just EUR 160 million in the two years before than), with the growth in investment in former Yugoslavia contributing significantly to that figure, representing a very high proportion of FDI in 2005 at 82%.

**Volume of trade credits to non-residents similar to 2004**

In 2005 Slovenian companies reduced the volume of their trade credits to non-residents compared to 2004, down to EUR 225 million. The rising exports of goods and services reduced the importance of trade credits in the financing of exports. At the end of 2005, the stock of trade credits, particularly short-term, reached almost EUR 3.5 billion, with a similar geographical distribution to 2004. Half of all of Slovenia's trade credits abroad are from EU states, 29% from former Yugoslav states, and just under 8% from other European countries.

**Capital transfers and loans to non-residents up**

Capital transfers consist almost entirely of subsequently agreed discounts on exported goods. They were 13% higher than in 2004 and reached a value of EUR 277 million. At the same time growth in the volume of lending to foreign partners using financial loans exceeded 30% for the second consecutive year. Banking sector loans were the most prominent in terms of volume and level of growth in both years, and reached EUR 275 million in 2005. After two years of relatively low lending to foreign trade partners (about EUR 70 million per year), the volume of approved loans increased to EUR 102 million in 2005.

**Strong financial flows to private sector due to borrowing abroad by banks**

Financial inflows into the private sector for the entire year have grown by over 50% for the last two years. The volume of financial inflows was largely a reflection of high levels of borrowing abroad by the banking sector. The inflow of foreign loans into companies, which increased by almost one third in 2004, fell by 58% in 2005 to just EUR 297 million. Companies covered most of their financing with domestic banks, which vastly reduced the need for companies to borrow abroad by offering large-scale competitive loans, mainly in foreign currency. The minimal growth of domestic deposits led banks to acquire the necessary financing abroad. In past years the inflow of foreign loans into banks increased at high rates: from growth of 98% in 2003 and 46% in 2004 to 146% in 2005, reaching EUR 2.37 billion. Banks used non-resident deposits, mainly from foreign banks, as an additional source of financing their domestic lending. Non-resident deposits increased by over one billion euro in 2005.

**Inflow of foreign portfolio investments high again**

Foreign portfolio investments in the private sector made their first significant appearance in 2004 when they reached EUR 263 million, and inflows were 25% higher in 2005. There was a large increase in foreign portfolio investments in company shares, which achieved year-on-year growth of 264% at EUR 125 million. Investments in Slovenian bonds, mainly in the banking sector, were worth EUR 188 million. In contrast to the private sector, the government sector recorded a net financial outflow for portfolio investments, due to Eurobonds worth EUR 500 million maturing in May 2005. The reinvestment by non-residents in Republic of Slovenia bonds and treasury bills meant that the net outflow of portfolio investment by the government sector was lower, at around EUR 300 million net.

**Foreign direct investment somewhat down**

Foreign direct investments amounted to EUR 427 million in 2005, EUR 235 million less than one year previously. Over half of investments were investment in equity, while the remainder consisted of estimated reinvested earnings. Unlike in previous years, when some foreign investment took the form of borrowing from foreign owners, in 2005 these flows represented just a small net outflow of EUR 19 million for the entire year.

**Higher volume of trade credits for imports**

Slovenian companies took out even more trade credits to finance imports in 2005 than in 2004, when growth in this form of financing imports was at a high 257%. In 2005 trade credits received exceeded credits issued for the first time. Most trade credits are received by Slovenian importers from exporters from the European Union, and this item recorded its highest growth in 2005. In line with the growth in imports, the value of subsequently agreed discounts on imported goods increased, from EUR 132 million in 2004 to EUR 140 million in 2005.

**Increased debt mainly from bank sector borrowing abroad**

The gross external debt stood at EUR 19.6 million at the end of 2005, a rise of EUR 4.3 million in one year. The main contributor to the increased debt was banking sector borrowing abroad, mainly through foreign loans, and to a lesser extent via increased non-resident deposits. The banking sector's external debt increased in 2005 by EUR 3.6 billion to EUR 8.4 billion, while its proportion in overall external debt increase by 11.5 percentage points to 43%. The debt of companies and other financial organisations reached EUR 7.8 million, rising mainly due to trade credits and less due to foreign loans. The government sector, which has made net repayments of its external debt since 2002 and borrows on the domestic financial market, has in that time reduced its proportion of overall external debt from 24% to 10.8%, or by EUR 500 million to EUR 2.1 billion in absolute terms.

Table 5: **Slovenia's external debt and foreign exchange reserves**

| Stock at end of period; in EUR million | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| **Gross external debt** | **9,491** | **10,403** | **11,484** | **13,259** | **15,271** | **19,565** |
| 1. Long-term debt | 5,895 | 7,349 | 8,206 | 9,556 | 11,509 | 14,471 |
| *in % of GDP* | 62.1 | 70.6 | 71.5 | 72.1 | *75.4* | *74.0* |
| - of which: bonds and notes | 1,748 | 1,934 | 1,935 | 2,074 | 2,098 | 2,068 |
| loans | 3,983 | 5,117 | 5,910 | 6,975 | 8,582 | 10,896 |
| 1. Short-term debt | 2,283 | 2,222 | 2,296 | 2,448 | 2,631 | 3,838 |
| *in % of GDP* | 24.1 | 21.4 | 20.0 | 18.5 | *17.2* | *19.6* |
| - of which: trade credits | 1,834 | 1,690 | 1,693 | 1,663 | 1,860 | 2,302 |
| currency and deposits | 401 | 396 | 383 | 558 | 550 | 887 |
| 3. Intercompany lending | 1,312 | 831 | 981 | 1,255 | 1,131 | 1,257 |
| *in % of GDP* | 13.8 | 8.0 | 8.5 | 9.5 | *7.4* | *6,4* |
| **Short term debt by remaining maturity[1]** | **4,382** | **4,569** | **4,484** | **4,590** | **5,358** | **6,573** |
| **Net external debt [2]** | **791** | **-422** | **-1,962** | **-493** | **859** | **2,429** |
| Foreign exchange reserves | 4,705 | 6,513 | 7,842 | 7,703 | 7,491 | 8,832 |
| *FX reserves/GDP (%)* | 22.9 | 29.7 | 33.4 | 31.0 | *28.6* | *32.4* |
| *FX reserves/imports (months)* | 4.6 | 6.1 | 7.1 | 6.7 | *5.6* | *6.0* |
| *Gross debt/GDP (%)* | 46.1 | 47.7 | 48.8 | 53.3 | *58.4* | *71.5* |
| **FX reserves/short-term debt by maturity (%)** | **107.4** | **142.6** | **174.9** | **167.8** | **139.8** | **134.2** |

[1] Short-term debt by remaining maturity consists of non-equity debt to the rest of the world with remaining maturity of 12 months or less.

[2] Gross external debt minus gross external claims. Starting with 2002 are also included claims belong to the fund SOD.

Source: Bank of Slovenia

Gross foreign claims rose more slowly in 2005 than the gross external debt, and were up by EUR 2.7 billion to EUR 17.1 billion, which increased net external debt by EUR 1.6 billion to EUR 2.4 billion. Again the major contribution to the increase in net external debt came from the banking sector, which was the only sector to increase its net foreign borrowing, with all other sectors reducing theirs.

**Gross foreign claims grew more slowly than gross external debt**

The net financial inflow for the entire year significantly exceeded the current account deficit, which led to growth in Slovenia's total foreign exchange reserves of EUR 1.34 billion, up to EUR 8.83 billion. At the end of the year the reserves were worth 32.4% of GDP, and were sufficient to cover 6 months' imports of goods and services; both indicators represent an improvement on the state one year before. The total foreign exchange reserves exceeded short-term debt by remaining maturity 34%, which is slightly less than at the end of 2004.

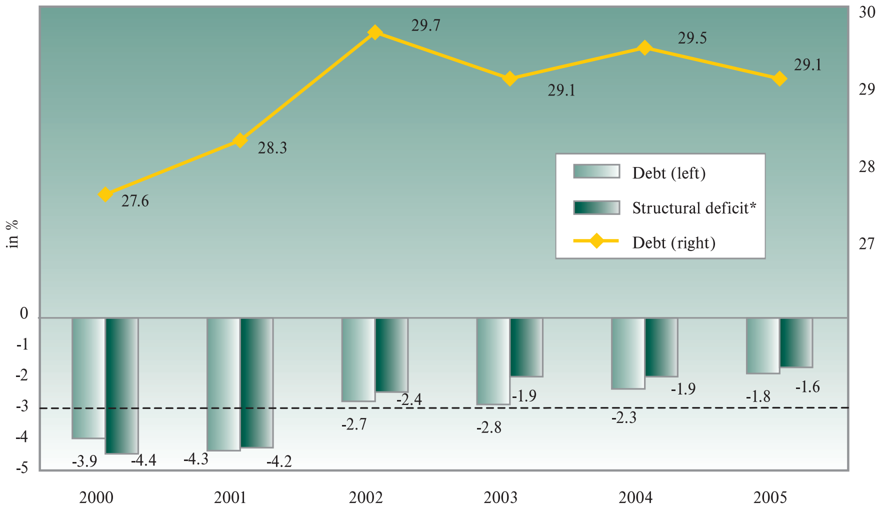
**Strong growth for Slovenia's foreign exchange reserves**

## 1.5 Public finances

In 2005 Slovenia again met both of the fiscal Maastricht criteria. The general government deficit is limited to just 3% of GDP, and the general government debt to 60% of GDP, both calculated using the 1995 European System of Accounts methodology. The March 2006 General Government Deficit and Debt Report put Slovenia's general government deficit in 2004 at 1.8% of GDP according to ESA95 methods, while the general government debt was 29.1% of GDP at the end of 2005, slightly lower than at the end of the previous year. This data forms the basis for checking the compliance of the reference values for the general government deficit and debt[3].

**According to the ESA95 methodology Slovenia again met both fiscal Maastricht criteria in 2005**

Figure 8: **General government deficit and debt according to ESA95 methodology**




* The cyclical component is based on Bank of Slovenia calculations using data up until October 2005. See *Poročilo o denarni politiki* (Monetary Policy Report), Bank of Slovenia, November 2005.

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

The general government deficit, which covers the four general government treasuries – the national budget, local budgets, the Pension and Disability Insurance Institute[4] and the Health Insurance Institute – amounted to SIT 72 billion in 2005 or 1.1%

**According to the national methodology the general government deficit was 1.1% of GDP**

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3 The General Government Deficit and Debt Report is prepared according to the 1995 European System of Accounts methodology, which ensures that states follow the same standards and definitions of categories, classifications and the same accounting rules. The ESA 95 methodology defines in detail the criteria for classifying units in institutional sectors and reporting individual transactions. An important element of the methodology is the time when a transaction is recorded. The accrual basis is used, which entails recording transactions when a claim or liability occurs.

4 Only compulsory insurances are taken into account for these two insurance institutes.

of GDP, while in 2004 it amounted to 1.4% of GDP[5]. A deficit was recorded for the national budget, while the Pension and Disability Insurance Institute budget was balanced, after a significant transfer of 3.86% of GDP from the national budget. Local budgets and the Health Insurance Institute recorded a surplus.

In June the National Assembly adopted a rebalance procedure for the 2005 national budget, which set out higher revenues and expenditures than in the previous budget, while the planned deficit was reduced by SIT 20 billion, or 0.3% of GDP. According to preliminary data, Slovenia's deficit for 2005 is in line with the rebalanced figure.

**Economic trends had positive impact on public finances**

The improvement in Slovenia's general government figures was last year largely due to favourable macroeconomic developments, including increased employment and relatively high household consumption. The structural general government deficit therefore probably remained more or less unchanged.

**Rapid growth in income revenues from corporate income tax and VAT**

General government revenues in 2005 amounted to SIT 2,870 billion or 43.8% of GDP, which is 4.4% more than the previous year in real terms. Revenues from corporate income tax and value added tax grew the fastest. Corporate income tax receipts increased by 12% in real terms in 2005, while VAT receipts increased by 10% in real terms. Income tax revenues grew at a below average rate, with a real increase of around 0.7%. The largest year-on-year fall was recorded for revenues from taxes on international trade, which fell by 53% in real terms. The reduction in the income tax rate and increase in earnings led to a reallocation of tax sources.

**Oil duties reached legal minimum**

Duties on refined petroleum products were reduced to the lowest level permitted by EU legislation in July 2005. At the same time the fall in revenues was replaced by increasing duties on tobacco products, as Slovenia must bring such duties into line with EU directives. Revenues from duties increased by 5.8% in 2005 to SIT 230 billion.

**Current transfers among fastest-growing expenditures**

In 2005 general government expenditure amounted to SIT 2,942 billion or 44.9% of GDP, 3.7% more in real terms than in 2004, and remained behind the growth in revenues. Current transfers grew fastest and were worth SIT 1,342 billion in 2005. Expenditures on subsidies and unemployment benefit transfers grew fastest in this group. The growth of expenditures on investments and goods and services was slower than planned. Investment expenditures, which include transfers, amounted to SIT 248 billion in 2005, an increase of 1.9% on the previous year.

**Real expenditures on pensions grew more than in 2004**

Expenditures on pension grew faster in 2005 than in 2004, and were up 2.8% in real terms, reaching SIT 714 billion. The growth was due to harmonising pensions with the new Pension and Disability Insurance Act, and an increase in the number of pensioners. In 2005 pensions were increased three times, in February, March and November. The new Pension and Disability Insurance Act increased the annual supplement for pensioners, which led to an increase in expenditure of SIT 3.5 billion. The number of pensioners increased in 2005, by 1.4%, with the fastest growth being in the number of state pensions. The number of old age pensioners increased by 2.2%, continuing the pattern of at least 2% annual growth since 2000.

[5] The consolidated public finance balance sheet, which includes the national budget, the pension & disability and the health insurance institutes, and local budgets is prepared accorded on the cash-basis principal in line with IMF methodology. Due to the methodological differences (mainly in sectorisation and use of cash basis) these data differ from that required to check compliance with the fiscal criterion for general government deficit, which is presented at the end of the chapter.

**Public sector employment up slightly**

Expenditure on public sector wages was 1.8% higher in real terms than in the previous year and amounted to SIT 614 billion. The change is the result of both growth in public sector employment and growth in the average gross wage in the public sector. Public sector employment increased by 1.6% in 2005, measured according to the national accounts methodology. The average gross wage in the sector increased by 0.8% last year.

**Surplus in financial claims and investments account**

The financial claims and investments account recorded a surplus of SIT 6 billion in 2005. Repayments received for loans granted and sales of capital shares amounted to a total of SIT 16 billion, while loans granted and increases in capital shares totalled SIT 10 billion.

**General government debt 25.5% of GDP in 2005**

The Central government debt was SIT 1.67 billion at the end of 2005, or 25.5% of GDP. Approximately two thirds of the debt was owed to the domestic sector, the reminder was external debt. A significant part of the debt consists of government securities, mostly with long-term maturity. The remaining revenue from the sale of the interest in the NLB bank – in the amount of SIT 83 billion or 1.2% of GDP – was used for early repayment of debt in 2005. Republic of Slovenia debt guarantees accounted for SIT 652 billion, or approximately 9.9% of GDP.

**Proportion of external debt continues to fall as proportion of internal debt increases**

The core strategic policy in managing the public debt was again borrowing on the domestic market in 2005. At the end of December domestic debt therefore represented three-quarters of total debt. The financing account for all four general government treasuries recorded a net debt repayment of SIT 3 billion for 2005. The government borrowed SIT 126 billion net domestically and reduced external borrowing by SIT 129 billion. It continued to issue 3-year, 5-year and 10-year bonds with a fixed nominal interest rate in 2005.

**Ministry of Finance stops issuing 1-month treasury bills**

At the end of 2005 the Ministry of Finance issued a decision terminating the issue of 1-month treasury bills, in agreement with the Bank of Slovenia, with the final series being issued on 1 December last year. Liquidity increased with the introduction of official market makers and the inclusion of long-term government securities.

Table 6: **Government consolidated balance sheet and debt**

| | 2004 | | | 2005 | | | y-o-y |
|---|---|---|---|---|---|---|---|
| | in bio SIT | (% GDP) | share | in bio SIT | (% GDP) | share | growth |
| *Consolidated balance sheet** | | | | | | | |
| **Revenue** | **2,683** | **42.9** | **100.0** | **2,870** | **43.1** | **100.0** | **7.0** |
| Taxes | 2,447 | 39.1 | 91.2 | 2,608 | 39.2 | 90.9 | 6.6 |
| - on goods and services | 857 | 13.7 | 31.9 | 938 | 14.1 | 32.7 | 9.5 |
| - contributions | 899 | 14.4 | 33.5 | 956 | 14.4 | 33.3 | 6.2 |
| - income | 507 | 8.1 | 18.9 | 537 | 8.1 | 18.7 | 6.0 |
| EU inflows | 44 | 0.7 | 1.6 | 72 | 1.1 | 2.5 | 65.3 |
| Rest | 192 | 3.1 | 7.2 | 189 | 2.8 | 6.6 | -1.5 |
| **Expenditure** | **2,768** | **44.3** | **100.0** | **2,942** | **44.2** | **100.0** | **6.3** |
| Current expenditure | 1,234 | 19.7 | 44.6 | 1,283 | 19.3 | 43.6 | 4.0 |
| Current transfers | 1,250 | 20.0 | 45.1 | 1,342 | 20.2 | 45.6 | 7.3 |
| Investment exp and transfers | 244 | 3.9 | 8.8 | 248 | 3.7 | 8.4 | 1.9 |
| Payment into EU budget | 41 | 0.7 | 1.5 | 68 | 1.0 | 2.3 | 68.4 |
| **Balance** | **-85** | **-1.4** | | **-72** | **-1.1** | | |
| | | | | | | | |
| **Debt of central government ** | **1,600** | **25.6** | | **1,674** | **25.5** | | |
| **Debt of the Republic of Slovenia (ESA 95)** | **1,845** | **29.5** | | **1,903** | **29.1** | | |

* Data in the table are based on national methodology, except for the general government's debt, which is based on ESA 95.
** The debt of the Republic of Slovenia is exclusively the central government's debt.
Source: Ministry of Finance

# 2 MONETARY POLICY

## 2.1 The conduct of monetary policy

**Price stability remains the Bank of Slovenia's main guideline**

The main objective of the Bank of Slovenia is price stability. In 2005 the Bank of Slovenia conducted its monetary policy in line with the Bank of Slovenia Act, the Bank of Slovenia Monetary Policy Guidelines from November 2001, and the Programme for ERM II Entry and Adoption of the Euro, which was adopted by the Bank of Slovenia and the Slovenian government in November 2003. The programme represented a joint commitment 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.

**Interest policy subordinate to maintaining stability of tolar since ERM II entry**

After joining ERM II on 28 June 2004, the Bank of Slovenia's monetary policy became subordinate to maintaining a stable exchange rate with the euro. This means that key Bank of Slovenia interest rates are now dependent on factors that are not under the direct control of the Bank. Two particularly important factors are the level of interest rates in the euro area, which are based on the conduct of the ECB's monetary policy, and the risk premium which is shaped on the basis of foreign and domestic investors' perception of the country and currency risk.

**Bank of Slovenia again maintained stable exchange rate in 2005**

In 2005 the Bank of Slovenia again maintained a stable nominal exchange rate for the tolar against the euro. Since ERM II entry discrepancies between the market rate for euro and the central rate of SIT 239.640 to the euro have been negligible. In 2005 the deviations from the central rate were below 0.1%.

**Major instruments are FX swaps, 60-day tolar bills, and liquidity ladder**

The conduct of monetary policy is based on instruments relating to maintaining a stable exchange rate, liquidity provisions and liquidity absorption if required, and supervision over changes in the maturity of banks' short-term sources of financing. The most important instruments include foreign exchange (forward) swaps and reverse swaps, 60-day tolar bills, and the liquidity ladder.

**Key Bank of Slovenia interest rates remained unchanged**

The Bank of Slovenia did not make any significant changes to its key interest rates in 2005. After restrictions that came with ERM II in 2005 began to apply, the Bank of Slovenia kept interest rates at the highest level permitted in line with exchange rate stability, and in that way was attempting to see off any inflationary pressures that could be triggered by excess lending and private consumption.

**Interest rate for 60-day tolar bills remained unchanged in 2005**

Over the same period the Bank of Slovenia's interest rate on 60-day tolar bills was 4.0% throughout 2005, and the lombard loan rate was 5.0%. At the beginning of April the Bank of Slovenia raised the foreign exchange swap rate from 1.25% to 1.5%. It then raised its refinancing rate to 3.5%, which is calculated as the ECB refinancing rate plus the Bank of Slovenia's foreign exchange swap price. As the ECB raised its key interest rate by 25 base points at the start of December, the Bank of Slovenia's refinancing rate increased further, and amounted to 3.75% at the end of 2005.

**Approaching transition to the euro encouraged structural changes …**

With the planned introduction of the euro in mind, the Bank of Slovenia continued to make certain structural adjustments to monetary policy instruments aimed at easing the transition to the operational conditions in the Eurosystem. These adjustments relate to the minimum foreign currency liquidity within the framework of the liquidity ladder, the stock of swapped foreign exchange, and the system of required reserves.

**… including a reduction in minimum foreign exchange liquidity**

To increase bank flexibility in operations on foreign exchange markets, in 2005 the Bank of Slovenia continued the process of relaxing the minimum prescribed liquidity, a process that started the previous year. It also offered to exchange foreign exchange swaps with outright purchases. In 2005 the percentage of mandatory subscription of Bank of Slovenia foreign currency bills was cut from 35% to 25%, while in July 2005 the mandatory subscription was finally abolished. The balance of foreign currency bills had fallen from SIT 500.8 billion at the end of 2004 to SIT 323.9 billion by the end of 2005. In 2005 the Bank of Slovenia also offered banks the opportunity to make an outright purchase of foreign exchange from cumulative Bank of Slovenia swaps.

**Changes in required reserve levels**

The Bank of Slovenia continued its gradual adjustment of the required reserve instrument to ECB rules. In March 2005 it reduced the required reserve level for 90-day tolar-denominated liabilities from 4.5% to 2.0%, meaning that the required reserve level of all liabilities with a maturity of up to two years is 2.0%, which is in line with euro system arrangements. Banks and saving banks were required to subscribe the amount of liquidity released by the reduction in required reserves (SIT 37 billion) to a long-term deposit at the Bank of Slovenia maturing in March 2007.

## 2.2 Money and credit

**Slow growth in base money**

Between December 2005 and December 2005 base money increased by SIT 19.4 billion, or by 6.5%. The average for the year was approximately at the level in 2004 and amounted to SIT 289.7 billion. The reduction in base money in the first quarter and the notable increase in the final quarter are related to seasonal trends in economic activity. Among the components of base money, there was an increase in issued banknotes and banks' settlement accounts, while overnight deposits fell.

Table 7: **Base money supply**

| | As at 31 December | | | Quarterly changes during 2005 | | | | |
|---|---|---|---|---|---|---|---|---|
| SIT billion | **2003** | **2004** | **2005** | **I** | **II** | **III** | **IV** | Total |
| **1. Net foreign assets** | 1,644.7 | 1,582.8 | 1,671.3 | 16.1 | 42.4 | 24.2 | 5.9 | 88.5 |
| **2. Domestic liabilities in foreign currency** | -592.3 | -563.8 | -404.8 | 28.4 | -15.6 | 90.6 | 55.6 | 159.0 |
| – foreign currency bills | -555.3 | -500.8 | -323.9 | 19.9 | -31.8 | 115.8 | 72.9 | 176.8 |
| – Budgetary foreign currency deposits | -37.1 | -63.0 | -80.8 | 8.5 | 16.3 | -25.3 | -17.3 | -17.8 |
| **3. Net foreign currency assets (1+2)** | **1,052.4** | **1,019.1** | **1,266.5** | **44.4** | **26.8** | **114.8** | **61.5** | **247.4** |
| **4. Budgetary time deposits** | **-105.8** | **-125.1** | **-0.6** | **13.8** | **84.9** | **-2.0** | **27.8** | **124.5** |
| **5. Loans to banks** | **0.1** | **0.1** | **0.1** | **0.0** | **0.0** | **0.0** | **-0.0** | **0.0** |
| **6. Tolar bills** | **-472.3** | **-423.3** | **-728.7** | **-72.4** | **-68.5** | **-107.4** | **-57.1** | **-305.4** |
| **7. Long-term deposit** | **0.0** | **-156.7** | **-203.5** | **-42.2** | **-4.4** | **-0.1** | **0.0** | **-46.8** |
| **8. Other net liabilities** | **-183.1** | **-173.2** | **-220.5** | **-14.2** | **-36.4** | **6.2** | **-2.9** | **-47.2** |
| **9. Net tolar assets (4 to 8)** | **-761.2** | **-721.6** | **-949.6** | **-72.7** | **-20.0** | **-103.2** | **-32.2** | **-228.0** |
| **10. Monetary base (3+9)** | **291.2** | **297.5** | **316.9** | **-28.3** | **6.8** | **11.6** | **29.3** | **19.4** |
| – notes issue | 186.0 | 195.4 | 214.2 | -5.0 | 14.0 | -1.6 | 11.5 | 18.9 |
| – settlement account | 91.1 | 94.0 | 97.7 | -18.6 | -7.4 | 13.1 | 16.5 | 3.6 |
| – overnight deposits | 8.2 | 4.8 | 1.5 | -4.7 | -0.1 | 0.0 | 1.5 | -3.3 |
| – other deposits at BS | 5.9 | 3.3 | 3.5 | 0.0 | 0.3 | 0.1 | -0.2 | 0.2 |

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

**Bank of Slovenia created base money through net foreign assets**

Net foreign currency assets in 2005 increased by SIT 247.4 billion, while net tolar assets fell by SIT 228 billion. The balance of foreign currency bills and long-term deposits increased by SIT 305.4 billion and by SIT 46.8 billion respectively, while the balance of budget time deposits fell by SIT 124.5 billion. The net effect of loans on base money was neutral. Other flows contributed SIT 47.2 billion to the reduction in base money.

**Slow growth in broad money aggregates and slowdown in M1 growth**

Growth in the broad money aggregates was slow in 2005. The average rate of growth in M2 was 5.7%, while that of M3 was 6.5%. Growth in M1 was significantly higher, its average year-on-year rate standing at 21.4%, but over the year fell, and was 13.0% at the end of year. The rapid growth in M1 at the start of the year was largely due to the households receiving large bonuses at the end of 2004.

**Faster growth in tolar time deposits than foreign currency time deposits**

Tolar time and sight deposits were prevalent in the M3 structure at banks. Time tolar deposits accounted for SIT 142 billion in the overall M3 of SIT 220 billion, while sight tolar deposits were worth SIT 117 billion. The reduction in government time tolar deposits at the Bank of Slovenia is largely due to repayments of Eurobonds and early repayment of some domestic government bonds. The increase in foreign currency deposits was about two times less than the increase in tolar time deposits. The proportion of foreign currency deposits in broad money remained above the 30% level. The reason for growth in tolar time deposits being faster than in foreign currency deposits is primarily the result of higher tolar interest rates than foreign currency interest rates in the conditions of the stable exchange rate. The gradual decline in tolar interest rates and the planned introduction of the euro have seen the structure of tolar deposits shift towards shorter maturities. The proportion of M2 accounted for by long-term tolar time deposits fell from 11.2% in December 2004 to 9.0% in December 2005, while M1 increased as a proportion of M2 over the same period from 36.1% to 38.9%.

Table 8: **Supply of M3: consolidated balance sheet of the monetary system**

| | As at 31 December | | | Quarterly changes during 2005 | | | | |
|---|---|---|---|---|---|---|---|---|
| SIT billion | **2003** | **2004** | **2005** | **I** | **II** | **III** | **IV** | Total |
| **1. Net foreign assets** | **1,264.6** | **877.1** | **427.8** | **-132.3** | **-122.3** | **-57.0** | **-137.6** | **-449.3** |
| **2. Domestic assets** | **3,123.3** | **3,741.4** | **4,544.0** | **234.7** | **116.2** | **185.0** | **266.6** | **802.5** |
| General government: bonds | 494.5 | 600.9 | 641.0 | 75.0 | -67.3 | 17.9 | 14.5 | 40.1 |
| loans | 143.5 | 144.0 | 172.1 | -6.9 | 20.3 | -0.6 | 15.4 | 28.1 |
| Enterprises: debt securities | 152.9 | 166.4 | 207.0 | -12.8 | 21.0 | -1.0 | 33.3 | 40.6 |
| loans | 1,688.6 | 2,050.3 | 2,544.0 | 143.9 | 84.6 | 112.1 | 153.1 | 493.7 |
| Households: loans | 643.8 | 779.8 | 979.8 | 35.5 | 57.6 | 56.7 | 50.3 | 200.1 |
| **3. Other net liabilities** | **-607.8** | **-579.9** | **-713.5** | **-46.7** | **-57.4** | **-3.4** | **-26.1** | **-133.6** |
| | | | | | | | | |
| **4. M3 (1 to 5)** | **3,780.1** | **4,038.7** | **4,258.4** | **55.7** | **-63.4** | **124.6** | **102.8** | **219.7** |
| – foreign currency deposits at banks and BS | 1,064.4 | 1,217.4 | 1,294.8 | 16.2 | 5.1 | 38.1 | 18.0 | 77.5 |
| – securities in foreign currency | 3.7 | 2.1 | 2.6 | -1.8 | 1.7 | -0.7 | 1.3 | 0.6 |
| **5. M2** | **2,711.9** | **2,819.2** | **2,960.9** | **41.2** | **-70.2** | **87.1** | **83.5** | **141.7** |
| – time deposits at banks | 1,591.2 | 1,471.7 | 1,614.0 | 70.1 | -53.0 | 89.4 | 35.7 | 142.3 |
| – time deposits at BS | 105.8 | 125.1 | 0.6 | -13.8 | -84.9 | 2.0 | -27.8 | -124.5 |
| – securities in tolars | 217.7 | 203.6 | 195.2 | -8.5 | 5.4 | 2.1 | -7.3 | -8.4 |
| **6. M1** | **797.2** | **1,018.9** | **1,151.2** | **-6.6** | **62.3** | **-6.3** | **82.9** | **132.3** |
| – demand deposits at banks | 627.0 | 838.1 | 954.8 | -3.0 | 52.2 | -6.0 | 73.5 | 116.7 |
| – demand deposits at BS | 14.1 | 12.8 | 9.2 | -1.8 | -2.9 | 1.2 | -0.2 | -3.7 |
| – currency in circulation | 156.0 | 167.9 | 187.2 | -1.8 | 13.0 | -1.5 | 9.6 | 19.3 |

Source: Bank of Slovenia

**Flows with rest of world make negative contribution to broad money growth**

Credits by domestic banks alone contributed to the creation of M3 in 2005, 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 449 billion. With the current account in balance, the decline in NFA is to a great extent the result of an increase in outward portfolio investments, bank borrowing abroad, and foreign currency lending to domestic non-bank sectors.

**By sector, corporate and household borrowing increased**

Bank credits increased by SIT 803 billion in 2005, of which SIT 534 billion was in the corporate sector, SIT 200 billion in the household sector and SIT 68 billion in the government sector. Overall bank credits in 2005 exceeded the increase in 2004 by 29.8%, the year-on-year growth rate rising from 19.8% in December 2004 to 21.5% in December 2005. In terms of sector, there was a significant rise in corporate and household borrowing and decrease of government borrowing.

**Year-on-year growth in domestic corporate credits 24.1%**

In 2005 the rise in domestic credits to non-financial corporations exceeded those in 2004 by 42.4%, with year-on-year growth rising from 20.4% in December 2004 to 24.1% in December 2005. Household borrowing was strong, almost 50% more than the level recorded in 2004. The strengthening of corporate and household borrowing was connected to the fall in interest rates at banks, the strengthening of economic activity, and private consumption. Replacing foreign sources of financing with domestic sources further contributed to increased corporate borrowing, while for households it was the release of funds from the National Housing Saving Scheme, simplifications to the process for taking out a loan, and increased competition on the credit market. The government borrowed SIT 68 billion from domestic banks in 2005, of which SIT 28 billion was in the form of loans and SIT 40.1 billion was through bond issues.

**Foreign currency borrowing predominated**

Foreign currency loans again prevailed in borrowing in 2005. The proportion of the increase in lending that they account for rose from just over 60% in 2004 to almost 90% in 2005. The net borrowing of non-financial corporations was almost entirely in foreign currency. Foreign currency borrowing by households also strengthened, accounting for almost half of the growth in household borrowing over the year.

## 2.3 Interest rates and the money market

**Fall in lending and deposit rates slowed down**

The continuing reduction in year-on-year inflation in 2005 was reflected in the reduction of tolar loans as well as deposit interest rates at banks. The rate of decline in 2005 was however significantly lower than in previous years. While the year-on-year reduction in tolar deposit interest rates in December 2004 moved within in a range from 1.6 to 1.9 percentage points, the range narrowed up to 0.6 percentage points in 2005. Likewise, the range for tolar loan interest rates narrowed from between 1.3 and 2.8 percentage points in 2004 to between 0.1 and 0.5 percentage points in 2005. In 2005 tolar deposits were characterised by a greater reduction in nominal interest rates for longer-term deposits, and tolar loans by a greater reduction in nominal interest rates for shorter-term loans. A comparison of short-term lending and deposit rates indicates that in 2005 the interest rates on short-term tolar loans fell more than nominal interest rates on short-term tolar deposits. In contrast interest rates on long-term tolar loans fell less than interest rates on long-term tolar deposits.

**Convergence of nominal interest rates on tolar deposits to interest rates on foreign currency deposits and tolar deposits with foreign currency clause**

In 2005 interest rates on tolar deposits fell, while interest rates rose on foreign currency deposits and tolar deposits with a foreign currency clause. The largest reduction in long-term interest rates on tolar deposits was made in September 2005, when the interest rate on time deposits with a maturity of over two or five years fell for the first time significantly below the interest rates on short-term deposits and remained at that low level until the end of the year. In December 2005 the interest rate on tolar deposits for one to three months was highest at 3.12%, while the interest rate for tolar deposits over five years was lowest at 2.97%. During 2005 the interest rate on tolar demand deposits also fell, from 0.46% in December 2004, to 0.31% in December 2005. In contrast the return on foreign currency deposits increased in 2005, particularly in the second half of 2005 and after an increase in ECB interest rates in December 2005. At the end of 2005 the range on interest rates on tolar and foreign currency deposits was largest

(1.76 percentage points) for short-term deposits of up to three months and smallest (0.69 percentage points) for long-term deposits with a maturity of over one year. In the second half of 2005, particularly in December, interest rates on tolar deposits with a foreign currency clause also increased, faster for long-term deposits. In December 2005 the tolar deposit with a foreign currency clause offering the lowest return was the 90-day deposit, with an interest rate of 1.8% or 0.44 percentage points above the comparable interest rate for a foreign currency deposit, and 1.32 percentage points below the comparable nominal interest rate for a tolar deposit; the highest was the interest rate on tolar deposits with a foreign currency clause for deposits over one year, which was 2.8% or 0.44 percentage points above the comparable interest rate for a foreign currency deposit and 0.25 percentage points below the comparable nominal interest rate for a tolar deposit.

**Convergence of nominal interest rates on tolar loans with interest rates on tolar loans with a foreign currency clause**

In 2005 nominal interest rates on tolar loans were reduced, while interest rates on tolar loans with a foreign currency clause rose, as did interest rates on newly approved short-term and long-term foreign currency lending to non-financial corporations. The largest decline in lending rates in 2005 was for consumer credit, reduced by 0.53 percentage points to 7.36%, while the smallest reduction was for house purchases loans, reduced by just 0.09 percentage points to 6.59%. Since 2002 there has been a growing trend towards convergence between nominal interest rates on short-term and long-term corporate lending, with the year-on-year reduction of 0.38 percentage points for short-term lending (down to 7.62%) and 0.27 percentage points for long-term lending (down to 7.68%), in December 2005. Interest rates on corporate lending with a foreign currency clause increased in 2005, due to the rise in ECB interest rates at the end of 2005. In December 2005, the interest rates had increased from 5.5% to 5.7% year-on-year on short-term and from 5.2% to 6.4% year-on-year on long-term corporate lending with a foreign currency clause.

Table 9: **Lending and deposit interest rates offered by banks**

| | % | | in percentage points | |
|---|---|---|---|---|
| | Dec.-2004 | Dec.-2005 | Dec.-2004/Dec.-2003 | Dec.-2005/Dec.-2004 |
| **Tolar deposits with nominal interest rate** | | | | |
| demand deposits | 0.46 | 0.31 | 0.00 | -0.15 |
| over 1 month | 3.23 | 3.12 | -1.56 | -0.11 |
| over 3 months | 3.10 | 3.07 | -1.67 | -0.03 |
| over 6 months | 3.16 | 3.11 | -1.70 | -0.05 |
| over 1 year | 3.37 | 3.05 | -1.72 | -0.32 |
| **Tolar deposits with foreign exchange clause** | | | | |
| over 1 month | 1.60 | 1.80 | -2.6 | 0.2 |
| over 3 months | 1.60 | 2.00 | -2.8 | 0.4 |
| over 6 months | 1.70 | 2.30 | -2.8 | 0.6 |
| over 1 year | 2.30 | 2.80 | -2.0 | 0.5 |
| **Foreign exchange deposits** | | | | |
| demand deposits | 0.38 | 0.36 | -0.03 | -0.02 |
| up to 90 days | 1.19 | 1.36 | -0.03 | 0.17 |
| from 91 days to 1 year | 1.52 | 1.75 | -0.05 | 0.23 |
| over 1 year | 1.98 | 2.36 | 0.13 | 0.38 |
| **Tolar loans with nominal interest rate** | | | | |
| short-term loans to business | 8.00 | 7.62 | -1.94 | -0.38 |
| long-term loans to business | 7.95 | 7.68 | -2.75 | -0.27 |
| consumption loans | 7.89 | 7.36 | -1.71 | -0.53 |
| housing loans | 6.68 | 6.59 | -1.33 | -0.09 |
| **Tolar loans with foreign exchange clause** | | | | |
| short-term loans to business | 5.50 | 5.70 | -3.00 | 0.20 |
| long-term loans to business | 5.20 | 6.40 | -4.10 | 1.20 |
| housing loans | 5.50 | 5.50 | -2.60 | 0.00 |

Note: The strong drop in interest rates on tolar deposits and loans with a foreign exchange clause in 2004 is a consequence of the indexation of the exchange rate EUR/SIT on 28 June 2004.
Source: Bank of Slovenia

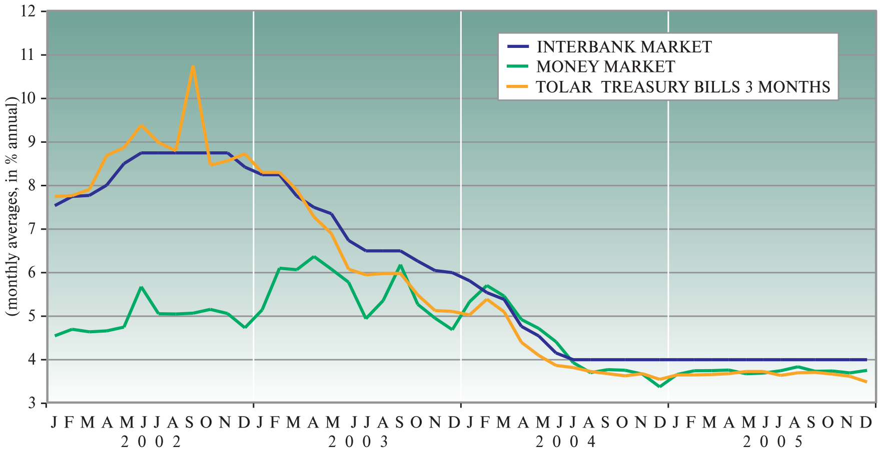
**Gap between realised interest rates in Slovenia and realised interest rates in the euro area narrowed**

As in the euro area, realised interest rates on consumer lending in Slovenia exceeded realised interest rates on corporate lending and house purchases loans. During 2005 the realised tolar interest rates fell on all forms of loan, while the comparable interest rates in the euro area increased slightly. While the realised tolar interest rates on consumer credit largely converged toward comparable interest rates in the euro area, realised tolar interest rates on corporate lending and house purchases loans remained 1.8 and 1.94 percentage points respectively above comparable rates in the euro area. It must be pointed out that these interest rates do not include insurance and other administrative costs that are otherwise included in the effective interest rate.

**Introduction of secondary market in government securities to increase their liquidity**

In September 2005 the Ljubljana Stock Exchange set up a secondary market for trading in government securities in collaboration with the Ministry of Finance, where trading is carried out through appointed market makers. This new system has increased the liquidity of treasury bills and government bonds and eliminated the need for 1-month treasury bills. Thus, on 1 December the Ministry of Finance issued the final series of 1-month treasury bills. The high growth in interest rates in auctions for all treasury bills at the start of 2005, and the slowdown in the reduction of interest rates on treasury bills during 2005 compared to the previous years, meant that most treasury bills traded at a higher interest rate in 2005 than in December 2004. Interest rates for all except 1-month treasury bills only fell below the December 2004 level at the final auction at the end of 2005. The interest rate on the interbank market fluctuated significantly during 2005, and in December reached 3.76%, 0.38 percentage points above the December 2004 level.

Figure 9: **Bank of Slovenia and money market interest rates**




Source: Bank of Slovenia

**Bank of Slovenia did not change its interest rates during 2005**

With the exception of structural adjustments on 8 April 2005, when the Bank of Slovenia raised the foreign exchange swap rate by 0.25 percentage points to 1.5%, all other Bank of Slovenia interest rates remained unchanged throughout 2005. The interest rate on 60-day treasury bills remained at 4.0% throughout 2005. The interest rate offered on long-term tolar deposits also remained unchanged at 0.2 percentage points above the interest rate on 60-day treasury bills. Lombard loans remained at 5%. On 1 December the ECB increased its refinancing rate for the first time since October 2000, raising it by 0.25 percentage points to 2.25%. This led to an increase in the refinancing rate at the Bank of Slovenia from 3.5% to 3.75%.

Table 10: **Bank of Slovenia and money market interest rates**

| | Lombard loan | Bank of Slovenia tolar bills | Interbank market | Treasury bills | | |
|---|---|---|---|---|---|---|
| | 1-day | 60-day | up to 30-days | 3-months | 6-months | 12-months |
| January | 5.00 | 4.00 | 3.66 | 3.65 | 3.55 | 3.50 |
| February | 5.00 | 4.00 | 3.75 | 3.65 | 3.78 | 3.50 |
| March | 5.00 | 4.00 | 3.75 | 3.66 | 3.78 | 3.70 |
| April | 5.00 | 4.00 | 3.76 | 3.68 | 3.69 | 3.70 |
| May | 5.00 | 4.00 | 3.68 | 3.73 | 3.69 | 3.70 |
| June | 5.00 | 4.00 | 3.69 | 3.73 | 3.78 | 3.70 |
| July | 5.00 | 4.00 | 3.75 | 3.64 | 3.78 | 3.61 |
| August | 5.00 | 4.00 | 3.84 | 3.70 | 3.75 | 3.61 |
| September | 5.00 | 4.00 | 3.73 | 3.71 | 3.75 | 3.58 |
| October | 5.00 | 4.00 | 3.74 | 3.67 | 3.67 | 3.58 |
| November | 5.00 | 4.00 | 3.70 | 3.62 | 3.67 | 3.48 |
| December | 5.00 | 4.00 | 3.76 | 3.49 | 3.50 | 3.48 |

Note: Monthly averages for 2005; in %, annual.
Source: Bank of Slovenia

**Slovenia meets Maastricht criterion on long-term interest rates**

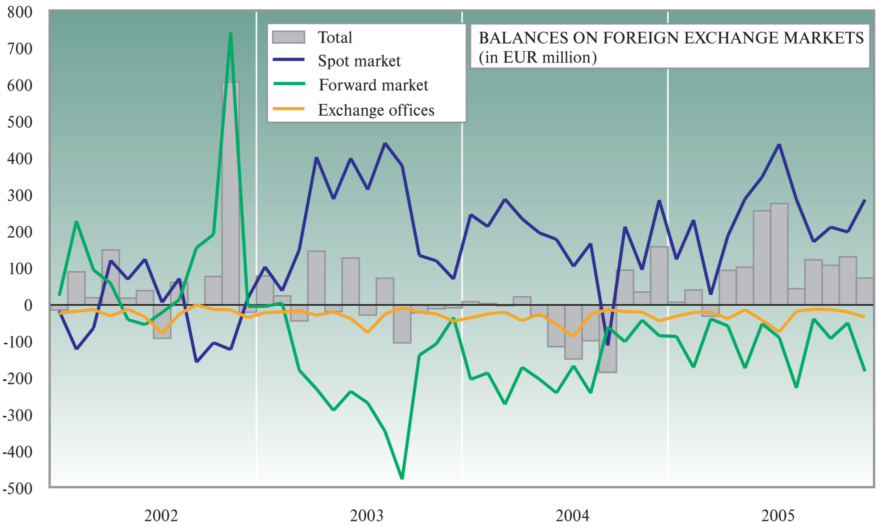
In 2005 Slovenia remained in compliance with the Maastricht criterion on long-term interest rates. In December the interest rate on the RS59 reference government security was 3.69%, while the Maastricht criterion was 5.37%.

## 2.4 Foreign exchange market and the exchange rate

**Surplus of supply on foreign exchange markets**

In 2005 overall supply of foreign currency on the foreign exchange markets exceeded demand by EUR 1.23 billion, or 4.5% of GDP. In the first quarter supply and demand for foreign exchange were more or less in balance, while supply exceeded demand in every month from April to December. The largest supply surplus was in June and July when it totalled EUR 534 million.

Figure 10: **Foreign currency flows**




Source: Bank of Slovenia

**Surplus of supply on spot market and demand surplus on foreign exchange forward market**

The foreign exchange supply exceeded demand on the spot market in every month. The net supply of foreign exchange amounted to EUR 2.81 billion, with non-residents accounting for 80%, private individuals for 11% and companies 9%. On the forward market banks recorded net foreign exchange sales throughout the year, a total of EUR 1.25 billion being sold, of which EUR 1.32 billion was to non-residents, while they purchased EUR 72 million net from non-financial corporations. Demand for foreign currency in exchange offices exceeded supply by EUR 240 million.

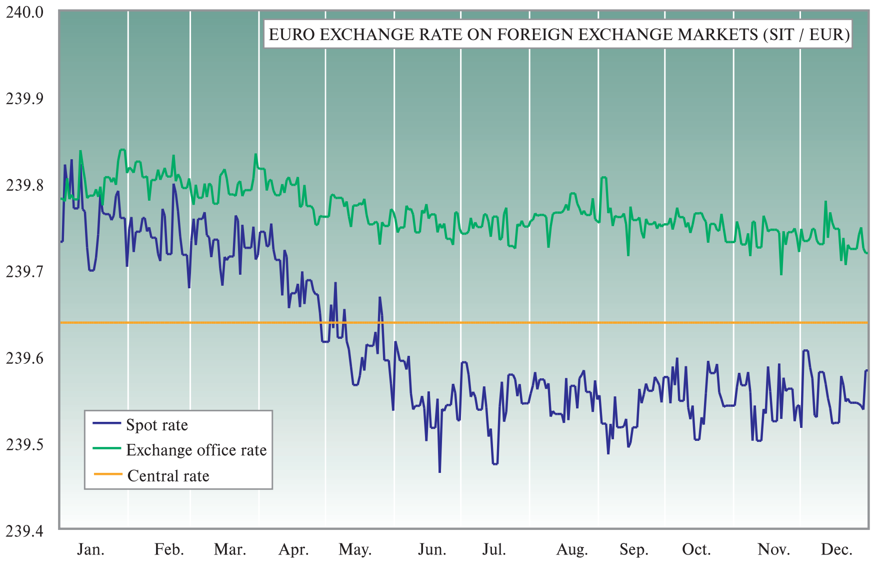
**Difference between central parity and market exchange rate negligible**

The supply surplus on the foreign exchange markets was reflected in a slight appreciation in the market rate for the tolar against the euro, but deviations from the central parity rate were negligible. The largest exchange rate deviation on the spot market was no more than 0.1% of the central rate. The tolar exchange rate on the spot market was stable in the first quarter, and depreciated on average by 0.04% compared to the central rate. The supply surplus on the foreign exchange market led to it appreciated by 0.1% in April and May. Since June the exchange rate has remained stable, and on the appreciated side of the central rate. Over that period the average deviation from the central rate was 0.04%.

**Bank of Slovenia made net purchase of SIT 235.1 billion of foreign exchange in 2005**

The Bank of Slovenia made a net purchase of SIT 235.1 billion worth of foreign exchange in 2005. By offering to exchange foreign exchange swaps with outright purchases it purchased SIT 414.7 billion in foreign exchange. The foreign exchange swap stock fell by SIT 60.9 billion, while the reverse swap stock increased by SIT 4.3 billion. The Bank of Slovenia sold SIT 114.7 billion of foreign exchange to the Ministry of Finance for the purpose of external payments. The relatively high purchase of foreign exchange from banks is largely due to the gradual reduction and abolition of mandatory subscription to Bank of Slovenia foreign currency bills, which led to the balance for this instrument falling by SIT 176.8 billion.

Figure 11: **Euro exchange rate on foreign exchange markets**




Source: Bank of Slovenia

## 2.5 Use of monetary policy instruments

### 2.5.1 Exchange rate policy instruments

When Slovenia joined the ERM II on 28 June 2004, maintaining a stable exchange rate became the operational objective of monetary policy. After that date the Bank of Slovenia maintained the tolar exchange rate against the euro within a narrow range around the central rate, which was set at SIT 239.640 to the euro.

**Bank of Slovenia's agreement on cooperation with commercial banks helps maintain stable exchange rate**

The Bank of Slovenia's agreement on cooperation with commercial banks in interventions on foreign exchange markets is a basic Bank of Slovenia instrument. Participating banks have unlimited access to tolar and foreign currency liquidity, which they acquire through foreign exchange swaps. These foreign exchange swaps support effective short-term liquidity management. The price for tolar or foreign currency liquidity determines the conditions required to maintain a stable exchange rate.

**Developments on the foreign exchange market did not require intervention to influence the exchange rate**

Deviations from the central rate were very small, so the Bank of Slovenia did not have to intervene in the market to manage the exchange rate. It did, however, carry out some outright foreign exchange purchases with which it reduced the stock of foreign exchange swaps. Throughout the year, participating banks were able to exchange tolar for foreign currency liquidity, and vice versa, at the Bank of Slovenia using foreign exchange swaps on a standing basis. On five occasions in 2005 the Bank of Slovenia offered participating banks the option to purchase outright from them foreign currency worth SIT 420 billion (it actually purchased foreign currency worth SIT 414.7 billion). The amount outstanding of foreign exchange swaps fell from SIT 225.7 billion at the end of 2004 to SIT 164.8 billion at the end of 2005, while the outstanding amount of reverse foreign exchange swaps increased by SIT 4 billion. In 2005 structural interventions of this kind amounted to 6.3% of GDP.

### 2.5.2 Monetary policy instruments

**Surplus in structural position of the money market**

The Bank of Slovenia implements its monetary policy in a structural liquidity surplus of the money market, which further increased in 2005 due to the monetisation of foreign exchange inflows via the balance of payments. These inflows were especially high in the second half of the year, creating a corresponding need to neutralise their impact on the liquidity available to the banking system (sterilisation).

**Liquidity absorption of SIT 305 billion**

In 2005 the Bank of Slovenia used tolar bills and long-term deposits to absorb liquidity. The Bank of Slovenia made constant use of 60-day tolar bills in the form of a standing facility, but by July replaced 270-day tolar bills with occasional limited-quantity offers of long-term deposits maturing at the start of 2007. The interest rate on the long-term deposits is equal to the interest rate on 60-day tolar bills plus 20 basis points, i.e. 4.2%. In 2005 the balance of liquidity absorption instruments grew by SIT 305.4 billion to SIT 728.7 billion (as at 31 December). At the end of 2005, 60-day tolar bills accounted for 72% of all liquidity absorbing instruments liquidity, and long-term deposits for 28%.

Table 11: **Use of monetary and exchange rate policy instruments**

| SIT million | As at 31-Dec.-04 | Quarterly in 2005 I. | II. | III. | IV. | As at 31-Dec.-05 |
|---|---|---|---|---|---|---|
| **Monetary policy instruments** | | | | | | |
| Tolar bills | 266,588 | 292,119 | 319,803 | 419,541 | 505,192 | 525,184 |
| Long-term deposits | 156,730 | 160,703 | 202,003 | 203,482 | 203,490 | 203,490 |
| | | | | | | |
| Overnight placements | 4,800 | 483 | 672 | 759 | 2,117 | 1,500 |
| Lombard loan | 0 | 0 | 22 | 14 | 0 | 0 |
| 7-day temporary purchase of securities | 0 | 2,408 | 846 | 336 | 272 | 0 |
| | | | | | | |
| Reserves of credit institutions | | 108,368 | 72,163 | 74,039 | 75,935 | |
| Required | | 107,897 | 71,649 | 73,647 | 75,409 | |
| Excess | | 471 | 514 | 392 | 526 | |
| | | | | | | |
| **Exchange rate policy instruments** | | | | | | |
| Foreign exchange swap | 225,716 | 253,269 | 242,067 | 232,482 | 194,364 | 164,766 |
| Reverse foreign exchange swap | 479 | 887 | 2,594 | 833 | 2,177 | 4,791 |
| | | | | | | |
| Memo: | | | | | | |
| Foreign currency bills | 503,324 | 503,104 | 466,931 | 455,819 | 343,915 | 325,158 |
| Government time deposits * | 124,725 | 109,436 | 73,192 | 21,702 | 22,403 | 0 |

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

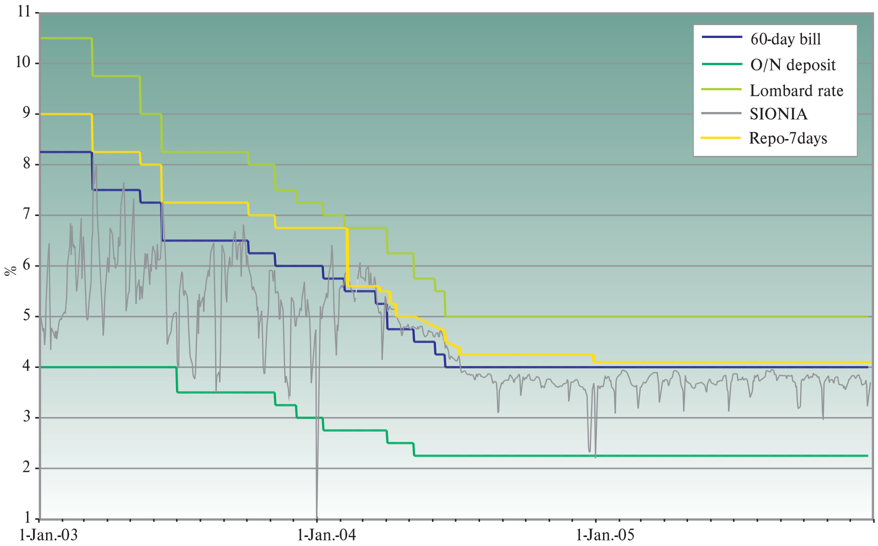
**Three standing facilities in addition to sterilisation instruments**

As well as using sterilisation instruments the Bank of Slovenia offered three standing facilities to banks and savings banks on a daily basis. At their own initiative, banks and savings banks were able to place money in the overnight deposit facility or borrow money overnight through a lombard loan facility. The interest rates at which banks and savings banks can deposit money overnight with the Bank of Slovenia or borrow money overnight from the Bank of Slovenia represent the lower and upper limits of the band within which interest rates vary for overnight money on the interbank money market (SIONIA) in normal circumstances. The interest rates on these two facilities are the lowest and highest policy interest rates of the Bank of Slovenia. In addition to lombard loans, banks also had the possibility of acquiring liquidity via the 7-day temporary purchases of securities facility, with the possibility of the Bank of Slovenia restricting the volume should circumstances dictate. That was not necessary as only negligible use was made of this channel of liquidity provision.

**Level of effective required reserves changed in 2005**

As part of the gradual adaptation of the required reserves to ECB arrangements, the Bank of Slovenia made changes to the required reserves at the beginning 2005. It cut the ratio applied on tolar-denominated liabilities with a maturity of up to 90 days from 4.5% to 2%. Consequently, from 22 February – 21 March calculation period onwards, , the required reserves ratio for all liabilities with a maturity of up to two years was set at 2%, and the ratio for liabilities with a maturity over 2 years at 0%. Banks and savings banks invested the excess liquidity arising from the reduction in required reserves ratios into long-term deposits with the Bank of Slovenia at the start of the April maintenance period (27 March – 26 April).

Figure 12: **Price of monetary policy instruments**




Source: Bank of Slovenia

**Abolishing 1-month treasury bills had positive impact on liquidity**

In certain periods activities carried out by the Bank of Slovenia on behalf of the Ministry of Finance can have a significant impact on banking system liquidity. However, the redemption of Ministry of Finance tolar time deposits worth SIT 83 billion in May, stemming from the sale of NLB bank in 2002, did not have an impact on the banking system's liquidity, as the Ministry of Finance used those funds to purchase foreign currency from the Bank of Slovenia to repay maturing Eurobonds. The abolition of 1-month treasury bills issuance by the Ministry of Finance at the end of November, and the subsequent release in December of SIT 28 billion in proceeds that the Ministry used to deposit at the Bank of Slovenia upon issue, had a positive impact on liquidity.

## 2.5.3 Prudential control instruments

**Liquidity ladder**

**Daily monitoring of tolar and foreign currency liquidity**

In October 2001 the Bank of Slovenia passed (and later amended) a decision on the minimum liquidity to be maintained by banks, thus 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 within banks and the regulation of all items involved in the calculation of the liquidity ratios. Liquidity ratios are calculated as the ratio of claims and liabilities by term to maturity, separated into a tolar and foreign 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.

**Abolition of mandatory subscription to BS treasury bills to meet minimum level of foreign currency liquidity**

The decision also prescribes a minimum level of liquid foreign currency investments and mandatory subscription of Bank of Slovenia foreign currency bills. In 2005 the minimum level of liquid investments in foreign currency remained unchanged at 70%, and the level of mandatory subscription to foreign currency bills was abolished in July. The amendment made to the decision in July 2005 represented another step in the development of the liquidity decision. From 1 January 2006 all banks will have weighted liabilities for sight deposits of households and businesses.

**Banks that signed a special participation agreement only have to meet a combined liquidity ratio**

The Bank of Slovenia allowed banks that signed the agreement on participation in foreign exchange market intervention to meet a combined 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. Only three banks or foreign bank branches had failed to sign the agreement by the end of 2005.

**Average liquidity ratio 1.12 in category 1 and 1.09 in category 2**

The average liquidity ratio for all banks stood at 1.10 for both category one and two at the end of 2004, while at the end of 2005 it was 1.12 in category one and 1.09 in category two.

**Foreign currency bills**

**No changes in offer of foreign currency bills**

In 2005 the Bank of Slovenia made no changes to its offer of foreign currency bills. Banks were able to purchase bills of three different maturities, 60, 90 and 120 days, denominated in two different currencies, euro and US dollars. Demand for foreign currency bills arises primarily from the requirements of the resolution on the minimum liquidity level of commercial banks, which regulates the liquidity risk associated with the banks' foreign currency liabilities and is described below.

**Bank of Slovenia requirement for adequate collateral for loans**

The Bank of Slovenia required adequate collateral in all monetary policy lending transactions, as well as for intraday loans. Foreign currency bills were the most frequently used form of collateral in 2005.

**Special liquidity loans granted with the participation of banks**

**Agreements on willingness to cooperate in liquidity loans continued**

In 2005 the Bank of Slovenia continued to conclude agreements with banks with the purpose to prevent a systemic risk caused by sudden lack of bank liquidity. An agreement valid until January 2007 (tenth in succession) has been signed by Bank of Slovenia with 16 banks. In 2005, as has been the case in every year since the loan was introduced, the mechanism for the participation of signatory banks was not triggered.

### 2.5.4 Oversight of instrument implementation

**Oversight of required reserves**

Oversight of banks' implementation of the required reserves, led to one decision being issued to a bank for not meeting the reserve requirement, and the measure imposed was a payment of compensation. One bank was also subject to oversight of the implementation of the Regulation on Required reserves and the Regulation on Submission of Certain Data by Banks and Savings Banks. As no irregularities were found the oversight procedure was concluded with a decision terminating the procedure.

**Oversight of foreign exchange dealings**

In 2005 the Bank of Slovenia's supervision of exchange office operations included conducting 85 examinations of licensed exchange offices and ten examinations of banks contracted to oversee licensed exchange offices. Due to violations found in foreign exchange operations, three exchange offices were served with a conditional six-month withdrawal of the Bank of Slovenia licence to perform exchange office operations, and a proposal to initiate minor offence proceedings was submitted to the National Foreign Exchange Inspectorate. In one case the findings were also sent to the Office for Money Laundering Protection for further investigation. In 2005 the Bank of Slovenia issued six decisions revoking and six decisions issuing a licence for foreign exchange dealing. On 31 December 2005 there were 133 valid decisions on issuing a licence for foreign exchange operations on record.

# 3 BANKING SECTOR

## 3.1 Composition of the banking sector

**In 2005 Slovenia had 19 banks, 3 foreign bank branches and 3 savings banks**

At the end of 2005 there were 19 banks operating in Slovenia (six of which were foreign subsidiaries), three foreign branches and three savings banks. Over the year the number of credit institutions increased by one bank, one foreign bank branch and one savings bank. Commencing operations in 2005 were BAWAG banka d.d. entered in the Register of Companies on 28 July 2005, Zveza Bank, reg. Zadruga z omejenim jamstvom, Ljubljana branch, entered in the Register of Companies on 21 January 2005, and Hranilnica Vipava d.d., (which operated as HKS Vipava p.o. before being reorganised). At the end of 2004 there were two savings banks and a further two savings and loan undertakings, however both ceased to operate in 2005. The last savings and loan undertaking was reorganised on 20 September 2005 as the savings bank Hranilnica in Posojilnica Vipava d.d. (Hranilnica Vipava d.d.).

**No major changes in bank ownership occurred in 2005**

There were no major changes in ownership structure in 2005. In addition to the six subsidiaries and three branches under majority foreign ownership, five banks were under full domestic ownership and eight banks under majority domestic ownership. Of the eight banks in majority domestic ownership, two had less than 1% foreign capital. After three years, the proportion of capital owned by non-residents (in terms of equity) rose once more from 32.4% to 35.1% (of which 19.6% was held by non-residents that hold more than 50% of the voting rights). The reason for the increase in the proportion of non-residents is the establishment of a new bank in Slovenia (BAWAG banka d.d.) and an increase in the proportion of non-resident owners of Abanka Vipa d.d. On 31 December 2005 the proportion of foreign owners as measured by total assets was 1.6 percentage points higher than the proportion as measured by equity. The country's second-largest bank (as measured by total assets), Nova Kreditna banka Maribor d.d., and the twelfth largest bank Poštna banka Slovenije d.d. remain under majority state ownership.

Table 12: **Ownership structure of banking sector (in terms of equity)**

| % | 31-Dec.-03 | 31-Dec.-04 | 31-Dec.-05 |
|---|---|---|---|
| Non-residents (more than 50% management rights) | 16.60 | 16.50 | 19.60 |
| Non-residents (less than 50% management rights) | 15.80 | 15.90 | 15.50 |
| Central government | 19.40 | 19.10 | 18.10 |
| Other domestic persons | 48.20 | 48.60 | 46.80 |

Source: Bank of Slovenia

Table 13: **Ownership structure of banking sector (in terms of total assets)**

| % | 31-Dec.-03 | 31-Dec.-04 | 31-Dec.-05 |
|---|---|---|---|
| Non-residents (more than 50% management rights) | 18.70 | 19.10 | 21.20 |
| Non-residents (less than 50% management rights) | 17.30 | 17.10 | 17.40 |
| Central government | 23.80 | 23.50 | 22.60 |
| Other domestic persons | 40.20 | 40.40 | 38.80 |

Source: Bank of Slovenia

The ratio of total assets of banks and savings banks to GDP is rising from year to year, although it remains considerably below the EU average. At the end of 2005 it was 94.5%.

**54 authorisations for banking and financial services were issued in 2005**

In 2005 the Bank of Slovenia issued a total of 54 authorisations for various types of banking and financial services, for qualifying holdings, mergers, and for holding office as a member of the management board. It rejected one application for an authorisation to acquire a qualifying holding, and one application for authorisation to hold office as member of a management board.

Table 14: **Comparison of average total assets and GDP**

| SIT million | 2002 | 2003 | 2004 | 2005[1] |
|---|---|---|---|---|
| Average total assets of banks and savings banks | 4,217,835 | 4,841,493 | 5,367,482 | 6,288,341 |
| GDP at current prices | 5,314,494 | 5,747,168 | 6,191,161 | 6,651,500[2] |
| Average total assets (as % of GDP) | 79.4 | 84.2 | 86.7 | 94.5 |

Note: [1]Excluding the branch of Nova Ljubljanska Banka in Italy.
[2]Estimation for 2005.
Source: Bank of Slovenia

## 3.2 Income statement

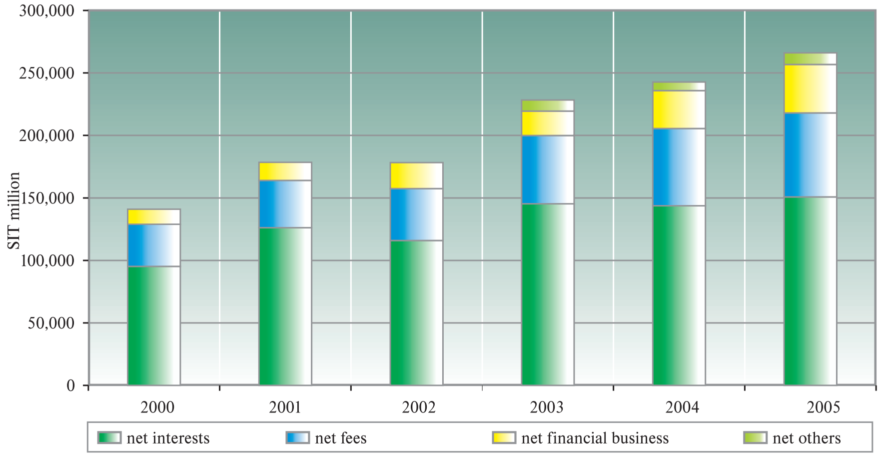
**Banking system profits up 11.1% in real terms**

The operating result[6] for banks[7] and bank branches in 2005 amounted to SIT 63.9 billion (banking system's pre-tax profit) and was significantly higher than the figures recorded in past years. The banking system's operating result in 2005 was SIT 7.8 billion higher than the previous year, representing real[8] growth of 11.1% (and nominal growth of 13.9%). Nominally the largest increase came from earnings from net financial transactions and net interest.

**Net interest rates grew slightly but still lag behind other gross income components**

Net interest in 2005 amounted to SIT 150.8 billion and after two consecutive years decreasing grew slightly in real terms (by 2.4%), but still lags behind other components of gross income. Net fees amounted to SIT 67.2 billion and grew in real terms by 6.0% over 2005, which is less than in 2004. In 2005 there was again a high rate of growth in earnings from net financial transactions, as they grew in real terms by 24.8% to SIT 38.7 billion, though this is well behind the growth in 2004, when real growth was 49.9%. The highest real growth (31.6%) in the gross income structure was the minor item net of other income[9], which amounted to SIT 9.4 billion. The increase came from other operating revenues.

Figure 13: **Gross income**




Source: Bank of Slovenia

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6 All 2005 figures are unaudited.
7 All figures in the income statement and balance sheet exclude the NLB branches abroad.
8 Calculated using the consumer price index in 2005.
9 Net other income includes other operating revenues, extraordinary revenues, other operating expenses and extraordinary expenses.

Banks' gross income in 2005 amounted to SIT 266 billion, up by SIT 23.3 billion, or 6.9% in real terms. Real growth was 4.6 percentage points higher than in 2004. The importance of interest earnings in total gross income fell, while net financial transaction earnings grew in importance. Net fees remained stable at around quarter of gross income.

**6.9% real growth in gross bank income**

In 2005 banks created SIT 43.8 billion of net provisions, which is SIT 4.8 billion more than in 2004.

**Net provisions SIT 4.8 billion higher**

Table 15: **Principal items of adjusted income statement**

| | Amount in millions of tolars | | Share in % | | Nominal growth in % | |
|---|---|---|---|---|---|---|
| | 2004 | 2005* | 2004 | 2005 | 2004/2003 | 2005/2004 |
| Net interests | 143,678 | 150,754 | 59.2 | 56.7 | -1.4 | 4.9 |
| Net fees and commissions | 61,872 | 67,245 | 25.5 | 25.3 | 12.7 | 8.7 |
| Net financial transactions | 30,268 | 38,731 | 12.5 | 14.6 | 55.3 | 28.0 |
| Net other | 6,934 | 9,355 | 2.9 | 3.5 | -21.8 | 34.9 |
| Gross income | 242,753 | 266,086 | 100.0 | 100.0 | 6.0 | 9.6 |
| Operating expenses | 147,729 | 158,408 | 60.9 | 59.5 | 3.2 | 7.2 |
| – labour (staff) expenses | 76,967 | 80,592 | 31.7 | 30.3 | 6.9 | 4.7 |
| **Net income** | **95,024** | **107,678** | **39.1** | **40.5** | **10.8** | **13.3** |
| Net provisions & net write-offs | -38,908 | -43,757 | -16.0 | -16.4 | 2.4 | 12.5 |
| **Profit/loss before tax** | **56,115** | **63,921** | **23.1** | **24.0** | **17.5** | **13.9** |
| **Profit/loss after tax** | **36,758** | **51,475** | **15.1** | **19.3** | **17.3** | **40.0** |

Source: Bank of Slovenia

**Introduction of IFRS to banks in 2006**

In accordance with Regulation 1606/2002 of the European Parliament and the Council on the application of international accounting standards, the application of the International Financial Reporting Standards (IFRS) is mandatory in the compilation of the consolidated financial statements of all companies whose securities are listed on one of the organised securities markets in EU member states. Companies with equity securities were required to comply with these standards from 1 January 2005, while companies with debt securities must comply with IFRS no later than from 1 January 2007.

In light of this, in order to avoid duplication of financial statements (according to local standards, and the IFRS), banks have decided to directly apply the IFRS. Amendments were made to the Companies Act (Official Gazette of the Republic of Slovenia, no 139/04 – ZGD-H), while the Bank of Slovenia issued a regulation prescribing that banks and savings banks must submit their reports in accordance with the IFRS for the financial year beginning on 1 January 2006. In mid-2005 it also issued instructions for IFRS introduction regulating the management of accounts and financial reports, the methodology for compiling financial statements, chart of accounts, method of transfer to IFRS, loss assessment for credit risk, etc.

The Bank of Slovenia therefore replaced the financial statement schemes based on Directive 86/635/EEC on the Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions, with new financial statement schemes based on the new reporting system for bank annual reports prepared by the Expert Group on Accounting and Auditing (EGAA), which is a group within the Committee of European Banking Supervisors (CEBS).

The introduction of the IFRS will have a significant impact on banks' financial statements, on the total assets, net profit, and capital disclosed, and hence bank capital adequacy. The greatest effects on financial statements that banks expect from the switch to the IFRS is to come from the release of provisions, the end of the equity method, and the revaluation of assets held for trading to fair value. It will now be far easier to compare the financial statements of domestic banks with those of banks or companies from other countries.

### 3.2.1 Net interest income

**Net interest up SIT 7.1 billion**

Net interest in 2005 was SIT 7.1 billion higher than in 2004. As in the previous two years there was a decline in interest income and interest expenses, but it was far less sharp. The fall in interest expenses was greater (7.5% in real terms) that the fall in interest income, which almost maintained their 2004 level.

**Interest income reflects reduction in lending rates and changing currency structure of assets**

The reduction in lending interest rates continues to affect the level of interest income, as does the changing currency structure of interest-bearing assets. Despite vigorous lending to non–financial institutions, interest income from loans remained at 2004 levels, due to the increase in cheaper borrowing by non-financial institutions and in part to households in foreign currency, while tolar debts were being repaid. Interest income from bank deposits increased by SIT 7.9 billion. This is due to the growth in deposits with foreign banks and the subscription to long-term deposits at the Bank of Slovenia in 2004, which banks used to partially replace tolar treasury bills. This plus the reduced interest rates on Bank of Slovenia treasury bills, and lower investments in government securities also contributed to a decline of SIT 10.3 billion in interest income from securities. Other interest income increased by SIT 1.5 billion, primarily income from trading in derivatives.

**Interest expenses were affected by the fall in deposit rates and the shortening of average maturity periods**

The most important factors influencing the amount of interest expenses in 2005 were the decline in deposit interest rates, and the shortening of average maturity periods for non-bank sector deposits (fall of SIT 12.2 billion). The small range of the deposit rates offered and the pace of economic growth dictated that non-financial companies would opt for shorter-maturity time deposits. The maturity term also shortened for household deposits, as households turned in part to alternative investments. Interest expenses on securities remained at 2004 levels. The expansion of borrowing from foreign banks led to interest expenses on loans and advances received in foreign currency increasing by SIT 7.6 billion.

### 3.2.2 Net non-interest revenue

**Earnings from net fees in real terms by 6.0%**

Earnings from net fees totalled SIT 67.2 billion in 2005, a rise of SIT 5.4 billion, or 6.0% in real terms. Fees increased largely due to an increase in fees for administrative services, fees for payment transactions in Slovenia, and fees for foreign transactions. There was a significant decrease in fees for foreign payment transactions (10.4%), while fees for credit transactions and guarantees remained relatively stable. This also affected the net fee structure, with the proportion of fees for administrative services and fees for payment transactions within Slovenia increasing to a level where banks acquired over half their fee income from these two items.

**Strong real growth of 24.8% in net financial transactions**

Net financial transactions amounted to SIT 38.7 billion in 2005, with high real growth of 24.8% (SIT 8.5 billion), which is mainly due to higher income from capital investments in other independent financial organisations and other independent companies; this increased by SIT 7.0 billion and was realised in three banks. Significantly lower growth was recorded in net re-valued income from trading securities (SIT 2.6 billion) and net income from sales of securities (SIT 1.2 billion), while net income from trading in derivatives fell by SIT 2.6 billion. Income from capital investment account for the largest proportion of net revenues from financial transactions, followed by revenues from trading securities and revenues from foreign exchange trading. The proportion of net financial transactions in gross bank income rose for the second consecutive year, reaching 14.6%.

### 3.2.3 Banks' operating expenses

**Operating costs up by 4.6% in real terms**

After growth had slowed in previous year, operating expenses again increased in 2005, with real growth at 4.6%. Labour costs, and depreciation and other costs increased. The growth in costs remained 2.3 percentage points lower than growth in gross income. The rapid growth in total assets was matched by a fall in the costs to average total assets ratio.

**Introducing IFRS and euro led to higher costs**

During 2005 banks prepared for the introduction of the IFRS and for the anticipated introduction of the euro, which affected both the growth in consultancy service costs (real growth of 40.8%) and the growth in the cost of other services (real growth 13.2%), which along with labour costs nominally contributed most to the overall growth of costs. Only three banks recorded lower operating costs in real terms, and they hold a high joint market share of 43%. Banks already cover two thirds of operating costs (67.1%) with net non-interest income, while four banks fully financed operating costs with net non-interest income.

**Labour costs up slightly**

A slight real growth in labour costs was recorded (real growth of 2.1%). In 2005 this was largely due to higher gross wages (3.3% real growth) and higher staff bonuses, while there was a significant decline in severance pay and early retirement payments. Labour costs increased for all except three large banks.

### 3.2.4 Net provisions

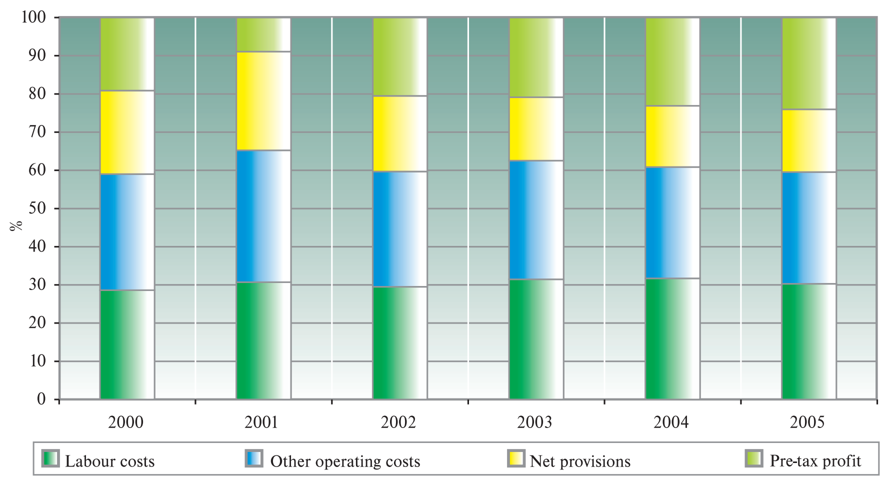
**Significant increase in provisions**

In 2005 the volume of provisions in the banking system increased significantly, with net provisions amounting to SIT 43.8 billion, SIT 4.8 billion (12.5%) more than in 2004. Growth in new provisioning is not in line with growth in lending to non-bank sectors, which increased by 24.2% in 2005. The volume of provisions increased relatively equally in each month, the exception being June, when three times the monthly average was provisioned. Most of the year monthly net provisions were higher than for the respective months in 2004. This does not reflect actual movements for individual banks as three banks increased provisions by SIT 11.1 billion compared to 2004, while two reduced them by SIT 6.4 billion. For other banks the changes were smaller, however some banks did increase their provisions, while other reduced theirs.

**No deterioration in asset quality**

Despite the lively growth in lending, it is estimated that there was no deterioration in asset quality. As at 31 December 2005 the proportion of A-rated claims increased compared to the end of 2004, and reached a very positive 83.4%.

Figure 14: **Disposal of banks' gross income**




Source: Bank of Slovenia

**Profit to gross income ratio up again in 2005**

In 2005 banks used 59.5% of their gross income to cover operating costs and 16.4% for net provisions, while 24.0% of the gross income represented pre-tax profit. The profit to overall gross income ratio grew for the fourth consecutive year, its proportion increasing at the expense of operating costs and net provisions.

### 3.2.5 Bank performance indicators

**Average return on assets stable**

The average return on assets remained stable, as banks compensated for the decline in interest income and growth in operating costs with non-interest income. The number of banks achieving above-average return on assets remained steady. With year-on-year growth in average total assets (14.7% in real terms) higher than growth in gross income (6.9% in real terms), there was a further fall in the gross income per average assets indicator from 4.56% to 4.25%. The cost-effectiveness indicator (operating costs per average assets) continued to improve, as the growth in operating costs remained over 10 percentage points behind the growth in average assets.

Table 16: **Selected bank performance indicators**

| % | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| Gross income/average total assets | 5.9 | 5.0 | 5.4 | 4.8 | 4.6 | 4.3 |
| Return on average assets | 1.1 | 0.5 | 1.1 | 1.0 | 1.1 | 1.0 |
| Return on average equity | 11.4 | 4.8 | 13.3 | 12.5 | 13.3 | 13.8 |
| Net interest margin | 4.7 | 3.6 | 3.7 | 3.2 | 2.8 | 2.5 |
| Non-interest margin | 1.54 | 1.67 | 1.95 | 1.74 | 1.86 | 1.84 |
| Operating costs/average total assets | 3.5 | 3.3 | 3.2 | 3.0 | 2.8 | 2.5 |

Source: Bank of Slovenia

**Average return on equity improved**

The average return on equity improved by 0.5 percentage points and the number of banks achieving above-average values for this indicator increased slightly. Return on equity strengthened slightly as the growth in bank capital value does not automatically equate to the growth in total assets or growth in profit. After rising in 2002 (as a result of the abolition of general equity capital revaluation), it first fell slightly in 2003, then rose again in the following years thanks to profit growing faster than capital in real terms. Banks meet capital adequacy requirements by issuing subordinated capital-equivalent instruments.

**The interest margin continued to fall, while the non-interest margin remained stable**

The interest margin continues to fall, as banks' earnings from net interest are falling despite real growth in gross interest-bearing assets, due to lower interest rates and changes in the currency structure of liabilities and investments. Two banks differ significantly from the average interest margin, one bank having a margin much higher than average, and another much lower. The divergences are greater than in 2004. The non-interest margin has remained stable. It mainly increased for banks that realised a high net income from financial transactions in 2005.

## 3.3 Interest rates and interest rate spread

**The proportion of interest-bearing liabilities accounted for by non-bank sector deposits declined to 66.2%**

The proportion of deposits by non-bank sectors in the composition of average interest-bearing liabilities declined from 72.9% at the end of 2004 to 66.2% at the end of 2005. With borrowing from foreign banks more prominent, the proportion of average interest-bearing liabilities accounted for by bank deposits rose (from 20.6% to 26.9%), while there was also a slight rise in the proportion accounted for by liabilities from subordinated liabilities (from 2.2% to 2.7%).

Table 17: **Effective lending and deposit interest rates**

| annual % | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| Average lending rate | 10.61 | 9.30 | 8.85 | 7.34 | 5.65 | 4.79 |
| Average deposit rate | 6.54 | 6.24 | 5.60 | 4.45 | 3.06 | 2.44 |
| Interest rate spread | 4.07 | 3.06 | 3.25 | 2.89 | 2.59 | 2.35 |

Source: Bank of Slovenia

**Rise in proportion of lending to the non-bank-sectors**

Within 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 of lending to non-bank sectors (from 58.3% to 60.3% of interest-bearing assets) at the expense of a decline in the proportion of investments in securities (from 32.1% to 28.6% of interest-bearing assets).

**Fall in lending and deposit interest rates continued**

There is a clear declining trend in effective lending and deposit rates (we compared the level of interest income/expenses with the relevant interest-bearing assets/liabilities), with deposit rates declining more slowly than lending rates, meaning the interest rate spread is contracting further. There was a fall of 0.86 percentage points in lending rates last year, and a decline of 0.62 percentage points in deposit rates.

## 3.4 Balance sheet

**Large increase in total assets for banking system overall and for individual banks**

In 2005 the total assets of the banking system[10] increased by SIT 1,301 billion[11] and at the end of year amounted to SIT 6,980 billion. Total assets grew in nominal and real terms in 2005 overall and for every individual bank in the system. Banks in majority foreign ownership continue to grow at an above-average rate. The banking system's total assets nominal growth compared to last year was 22.9%, while real growth was 20.1%[12] (in 2004 nominal growth was 12.3%, and real growth 8.8%), which is the highest real growth of the past five years. Above-average growth in total banks assets continued for banks under majority foreign ownership for the third consecutive year, reaching 39.1% in 2005.

**The market share of the larger banks fell again**

As the two previous years, 2005 was characterised by a reduction in the market share of larger banks, and an increase in the market share of foreign-owned banks. Over the year the market share of the eight largest banks in terms of total assets (together representing over 80% of the market) fell by 1.1 percentage points.

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


Source: Bank of Slovenia

[10] Banks and EU member state bank branches.
[11] In 2004 it increased by SIT 621 billion.
[12] With respect to inflation.

**Principle source of financing remained borrowing from foreign banks**

As in previous years the principal source of financing in 2005 was borrowing at foreign banks. Foreign borrowing further strengthened in 2005, and grew by 83.3% (43.6% in 2004). Liabilities to foreign banks increased by SIT 846 billion, and amounted to SIT 1,861 billion at the end of the year, 26.7% of liabilities. Banks used this money to finance 65% of the increase in total assets (49.6% in 2004). Most banks increased borrowing from foreign banks compared to previous years, though smaller domestic banks did not follow this trend.

Table 18: **Total assets and market share of banks**

| | Total assets (SIT millions) | | Nominal growth (%) | | Market share (%) | |
|---|---|---|---|---|---|---|
| Banka | 31-Dec.-04 | 31-Dec.-05 | 04/03 | 05/04 | 31-Dec.-04 | 31-Dec.-05 |
| Nova LB d,d, Ljubljana | 1,864,772 | 2,197,268 | 8.6 | 17.83 | 32.8 | 31.5 |
| Nova KB d.d. Maribor | 602,948 | 715,868 | 10.8 | 18.73 | 10.6 | 10.3 |
| Abanka Vipa d.d. Ljubljana | 481,845 | 598,259 | 11.4 | 24.16 | 8.5 | 8.6 |
| SKB banka d.d. Ljubljana | 387,325 | 463,545 | -1.1 | 19.68 | 6.8 | 6.6 |
| BA CA d.d. Ljubljana | 299,414 | 451,276 | 30.6 | 50.72 | 5.3 | 6.5 |
| Banka Koper d.d. Koper | 333,280 | 433,144 | 8.9 | 29.96 | 5.9 | 6.2 |
| Banka Celje d.d. Celje | 361,317 | 409,524 | 11.3 | 13.34 | 6.4 | 5.9 |
| Gorenjska banka d.d. Kranj | 279,688 | 320,236 | 13.8 | 14.50 | 4.9 | 4.6 |
| R. Krekova banka d.d. Maribor | 159,484 | 217,569 | 25.7 | 36.42 | 2.8 | 3.1 |
| Hypo Alpe-Adria-bank d.d. Ljubljana | 135,734 | 202,735 | 55.4 | 49.36 | 2.4 | 2.9 |
| Probanka d.d. Maribor | 122,845 | 153,855 | 20.2 | 25.24 | 2.2 | 2.2 |
| Poštna banka Slovenije d.d. Maribor | 110,972 | 122,701 | 9.6 | 10.57 | 2.0 | 1.8 |
| Deželna banka Slovenije d.d. Ljubljana | 101,179 | 121,058 | 49.9 | 19.65 | 1.8 | 1.7 |
| Kaerntner Spar.AG | 69,368 | 110,734 | 44.7 | 59.63 | 1.2 | 1.6 |
| Volksbank-Ljudska banka d.d. Ljubljana | 84,364 | 98,915 | 18.8 | 17.25 | 1.5 | 1.4 |
| Banka Domžale d.d. Domžale, BsNLB | 85,010 | 93,649 | 9.7 | 10.16 | 1.5 | 1.3 |
| Factor banka d.d. Ljubljana | 73,078 | 92,038 | 32.5 | 25.94 | 1.3 | 1.3 |
| Koroška banka d.d. Sl. Gradec, BsNLB | 71,347 | 78,572 | 5.8 | 10.13 | 1.3 | 1.1 |
| Banka Zasavje d.d. Trbovlje, BsNLB | 51,284 | 59,703 | 18.3 | 16.42 | 0.9 | 0.9 |
| BAWAG d.d. Ljubljana | 0 | 26,743 | 0.0 | 0.00 | 0.0 | 0.4 |
| BKS Bank AG Ban. podružnica Ljubljana | 3,240 | 12,071 | 0.0 | 272.61 | 0.1 | 0.2 |
| Zveza Bank podružnica Ljubljana | 0 | 456 | 0.0 | 0.00 | 0.0 | 0.0 |
| All banks | 5,678,494 | 6,979,921 | 12.7 | 22.92 | 100.0 | 100.0 |

Source: Bank of Slovenia

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

Liabilities to non-bank sectors grew significantly slower than total assets in 2005, and totalled SIT 3,833 billion at the end of the year. Tolar deposits saw the main increase. Deposits by non-bank sector rose by SIT 306 billion or 8.7% last year, a rate of growth significantly behind that of total assets. The largest contribution to growth came from household deposits at SIT 134 billion, though their growth was behind last year's at 5.7%. Non-financial corporation deposits grew throughout the year, with growth strengthening towards the end of the year reaching overall growth of 17.0%. Government deposits also increased. Almost 85% of non-bank sector sources of financing was tolar-denominated due to the higher return on 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 54.9% at the end of 2005. The decline can be seen at all banks, but varies greatly. Decline is deepest in banks that have been borrowing abroad more.

**Almost no major securities issues**

In 2005 there were no large securities issues, with the exception of one bank, as the banks selected other ways of acquiring financing. As a number of individual issues reached maturity their overall volume increased by just 6.7%.

**Book capital increased by 12.4%**

Book capital as at 31 December 2005 amounted to SIT 518 billion. It had increased by 12.4%. The increase includes that part of profit transferred to the reserves in accordance with the Companies Act. In 2005 one new bank was established, six banks underwent recapitalisation, with the subscribed capital rising by a total of SIT 8 billion. Banks did not carry out a general equity capital revaluation in 2005, 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. The volume of subordinated liabilities banks can account for as capital for the purposes of capital adequacy increased by 18.4%. In 2005 five banks issued subordinated liabilities, while nine banks reduced their volume.

Table 19: **Principal items in banking sector balance sheet**

| | Amount in millions of tolars | | Share in % | | Nominal growth in % | | Real growth in % |
|---|---|---|---|---|---|---|---|
| | 31-Dec.-04 | 31-Dec.-05 | 31-Dec.-04 | 31-Dec.-05 | 04/03 | 05/04 | 05/04 |
| Deposits with central bank | 141,041 | 143,631 | 2.5 | 2.1 | -0.3 | 1.8 | -0.5 |
| Loans and advances to the banking sector | 507,509 | 682,495 | 8.9 | 9.8 | 47.0 | 34.5 | 31.5 |
| Loans and advances to the non- bank sectors[1] | 3,069,814 | 3,811,501 | 54.1 | 54.6 | 21.0 | 4.2 | 21.4 |
| *- Loans and advances to non-financial institute* | *1,937,975* | *2,357,925* | *34.1* | *33.8* | *21.4* | *21.7* | *18.9* |
| *- Loans and advances to households* | *763,608* | *962,068* | *13.4* | *13.8* | *21.4* | *26.0* | *23.2* |
| *- Loans and advances to government* | *142,928* | *155,012* | *2.5* | *2.2* | *0.7* | *8.5* | *6.0* |
| *- Loans and advances to others[2]* | *225,304* | *336,496* | *4.0* | *4.8* | *32.4* | *49.4* | *46.0* |
| Securities | 1,642,530 | 1,954,486 | 28.9 | 28.0 | -4.5 | 19.0 | 16.3 |
| Other assets | 317,600 | 387,806 | 5.6 | 5.6 | 1.5 | 22.1 | 19.4 |
| **Total assets** | **5,678,494** | **6,979,919** | **100.0** | **100.0** | **12.3** | **22.9** | **20.2** |
| Liabilities to the banking sector | 1,117,640 | 1,981,484 | 19.7 | 28.4 | 33.7 | 77.3 | 73.3 |
| Liabilities to the non-bank sectors | 3,526,437 | 3,832,704 | 62.1 | 54.9 | 7.0 | 8.7 | 6.2 |
| *- Liabilities to non-financial institutions* | *636,152* | *744,573* | *11.2* | *10.7* | *2.7* | *17.0* | *14.4* |
| *- Liabilities to households* | *2,341,252* | *2,475,364* | *41.2* | *35.5* | *9.5* | *5.7* | *3.4* |
| *- Liabilities to government* | *135,356* | *207,661* | *2.4* | *3.0* | *-14.3* | *53.4* | *50.0* |
| *- Liabilities to others[2]* | *413,677* | *405,107* | *7.3* | *5.8* | *9.3* | *-2.1* | *-4.3* |
| Liabilities arising from securities | 224,938 | 240,101 | 4.0 | 3.4 | 4.0 | 6.7 | 4.3 |
| Other liabilities | 348,704 | 407,748 | 6.1 | 5.8 | 20.1 | 16.9 | 14.3 |
| Capital | 460,775 | 517,882 | 8.1 | 7.4 | 9.5 | 12.4 | 9.9 |
| **Total liabilities** | **5,678,494** | **6,979,919** | **100.0** | **100.0** | **12.3** | **22.9** | **20.2** |

Note: [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] Other: other financial organisations, non-profit household service providers, non-residents.

Source: Bank of Slovenia

**Increase in banks total assets mainly went towards lending to non-bank sectors – up 24.2%**

Banks directed the majority of the increase in total assets to lending to non-bank sectors, in particular to households and non-financial companies. The trend towards increased lending to non-bank sectors that began in 2003 continued, with growth of 24.2%. Investments in non-bank sectors amounted to SIT 3,812 billion at the end of the year, having risen by SIT 742 billion over the year. High levels of lending in the final months of the year contributed to the high level of growth.

Foreign-owned banks achieved a high relative growth in lending to the non-bank sectors with 37.7%, but with a nominal growth of 63.5% domestic-owned banks maintained a similar proportion to 2004.

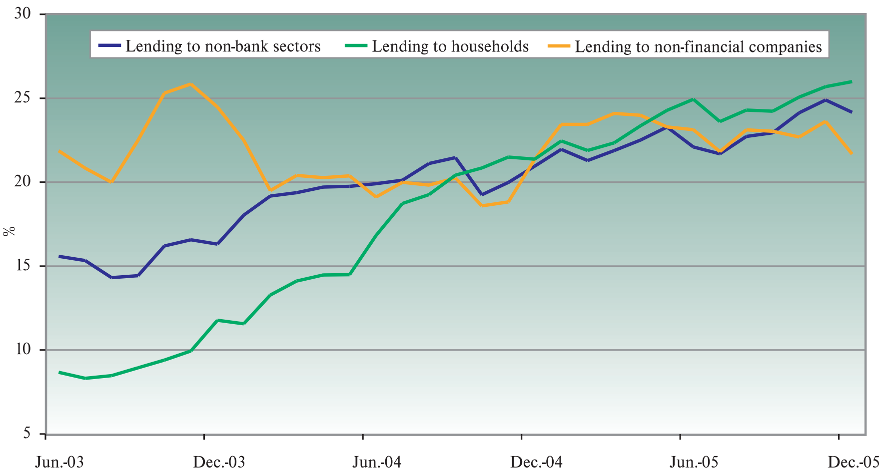
**Large increase in investments in non-bank sectors and lending to households increased again**

The largest input into non-bank sector investments come from loans to non-financial companies (SIT 420 billion), and at 21.7% the growth index remained at the level of the previous year. Lending to households, which remained high throughout the year, fell slightly towards the end of the year. Nevertheless growth of 26% was recorded, 4.6 percentage points higher than the previous year. In the final two months of 2005 banks increased their lending to other financial institutions, which was expressed in a 62.1% increase in investments in that sector. Lending to the government was weak.

**Foreign currency lending a feature of 2005**

Foreign currency lending was a feature of 2005, with 91.5% of all investments to non-bank sectors realised in foreign currency. Non-financial companies repaid tolar loans (SIT 53.4 billion), while increasing their foreign currency liabilities by SIT 473.4 billion. This was also seen to a lesser extent in lending to the government, sole traders and non-residents. For private individuals tolar borrowing continued to predominate, representing 60% of all approved loans tolar-denominated. This was a reason for change in the foreign currency structure of investment in non-bank sectors. The proportion of lending to non-bank sectors in foreign currency increased by 11 percentage points, reaching 45.9% by the end of 2005.

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




Source: Bank of Slovenia

**Two causes of increased investment by banks**

There are two main reasons for the increased investment by banks (up by SIT 175 billion, or 34.5%). First, banks continue to subscribe to long-term deposits at the Bank of Slovenia, which means they increased their tolar deposits. Second, the funds acquired from foreign banks are temporarily being diverted to foreign accounts, then gradually transferred to non-bank sector lending.

**Investments in securities rose again and particularly in tolar bills**

Banks increased their investments in securities by SIT 312 billion in 2005, after a significant fall in such investments the previous year. Changes in regulations[13] meant that since June 2005 banks have no longer been required to subscribe to foreign currency bills at the Bank of Slovenia, so this form of investment has fallen (by SIT 177.6 billion or 35.5%). Banks directed the funds released to tolar treasury bills and foreign securities due to the favourable interest rates and security.

[13] Banks had to cover a set percentage of prescribed foreign currency liabilities by investing in foreign currency bills.

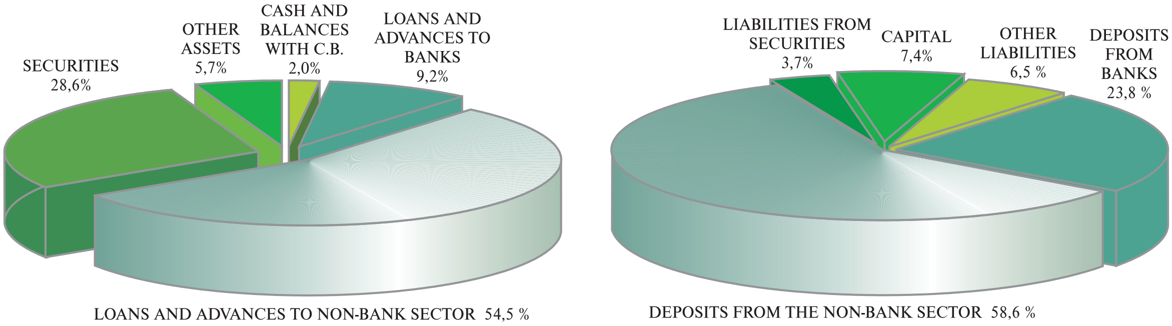
Investments in Bank of Slovenia tolar bills (up by SIT 249.7 billion or 94%) were an alternative to investing in foreign currency bills for domestic banks, and a source of income for foreign banks. Investments in other securities[14] (up by SIT 199.7 billion or 72.6%), largely the choice of domestic banks, mainly involved foreign securities with a high credit rating that banks can use in the euro area as collateral for claims against the central bank.

## 3.4.1 Structure of bank sources of assets and investments

**Bank liabilities structures changes with growth in liabilities to other banks**

Increased borrowing from foreign banks led to a change in the average liabilities composition. Liabilities to banks increased as a proportion of the whole, for the third consecutive year. Over that period the proportion has increased by 12.4 percentage points (by 5.6 percentage points in the last year alone), and already amounts to almost one quarter of all liabilities. The increasing prevalence of liabilities to banks is almost entirely down to the reduction in liabilities to non-bank sectors. Although with 58.6% of total liabilities non-bank sectors remain the main source of bank assets, their proportion has fallen over the last three years by 12.3 percentage points (by 5.1 percentage points in the last year). This is due to low growth in household deposits, as individuals have moved their money towards more profitable investment alternatives.

Figure 17: **Average structure of bank sources of assets and investments in 2005**




Source: Bank of Slovenia

**Increasing proportion of non-bank sector loans**

The dynamic lending to the non-bank sectors is reflected in the increased proportion of loans to non-bank sectors, which rose 2.3 percentage points to 54.5%. The proportion of investments in banks increased by 1.9 percentage points, as financing acquired from foreign banks is temporarily held in foreign bank deposits before gradually being released as loans. There was a larger fall in the proportion of securities in average assets (3.2 percentage points), mainly due to trends in 2004.

## 3.4.2 Structure of banks’ sources of assets and investments by maturity and currency

**Proportion of short-term deposits continue to fall, and long-term loans overtook short-term loans for the first time**

Short-term time deposits are prevalent among non-bank sector deposits, though the proportion is falling, and in 2005 only maintained the same level as in the previous year. The reduction in long-term deposits deepened (by 3.9% in 2005), which is seen in the reduced proportion they represent in the overall structure. Only sight deposits are increasing (by SIT 290.1 billion or 23.6%), and already represent 39.6% of all non-bank sector deposits. On the investment side, long-term loans have been growing more strongly than short-term loans for several years in

[14] Securities not issued by the Republic of Slovenia or the Bank of Slovenia.

succession, and in 2005 grew by SIT 434 billion or 28.7% (short-term loans grew by SIT 247 billion or 16.0%). For the first time long-term loans overtook short-term loans in the overall structure of non-bank sector loans.

**Liabilities to banks continue to take the place of non-bank sector deposit**

Non-bank sector deposits are increasingly being replaced by liabilities to banks as a source of financing. The proportion of non-bank sector deposits with shorter maturity fell within the structure of average interesting-bearing liabilities, and in 2005 stood at 66.2% (down 6.6 percentage points). The proportion of average debts to banks is on the increase and already represents 26.9% of average interest-bearing assets. For this reason the proportion of interest-bearing liabilities increased in 2005 by 4.1 percentage points to 28.7%.

Table 20: **Maturity structure of deposits by and lending to non-bank sectors**

| % | 31-Dec.-02 | 30-Jun.-03 | 31-Dec.-03 | 30-Jun.-04 | 31-Dec.-04 | 30-Jun.-05 | 31-Dec.-05 |
|---|---|---|---|---|---|---|---|
| Sight deposits of non-banking sector | 32.1 | 33.7 | 33.8 | 37.5 | 34.8 | 36.3 | 39.6 |
| Short-term deposits of non-banking sector | 58.4 | 56.1 | 57.3 | 54.5 | 57.6 | 56.4 | 53.6 |
| Long-term deposits of non-banking sector | 9.5 | 10.3 | 8.9 | 8.0 | 7.7 | 7.3 | 6.8 |
| **Total deposits of non-banking sector** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |
| Short-term loans to non-banking sector | 54.1 | 53.8 | 52.4 | 52.9 | 50.0 | 50.6 | 48.0 |
| Long-term loans to non-banking sector | 45.9 | 46.1 | 47.5 | 47.1 | 50.0 | 49.4 | 52.0 |
| Claims arising from guarantees | 0.1 | 0.1 | 0.1 | 0.0 | 0.1 | 0.0 | 0.0 |
| **Total loans to non-banking sector** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

Source: Bank of Slovenia

**Growth in foreign currency deposits 38%, growth in tolar deposits 14.9%**

In 2005 foreign currency deposits grew by 38.0%, much more than deposits in tolars (14.9%), which is largely due to increased borrowing from foreign banks. Foreign currency liabilities increased by SIT 740 billion, increasing by 7.8 percentage points as a proportion of total liabilities. The growth of non-bank sector deposits in domestic and foreign currency remained behind total asset growth. Despite this, growth was more vigorous in tolar-denominated deposits (11.2%), which held true for all sectors except other financial organisations. Banks invest their foreign currency deposits to foreign currency lending to non-bank sectors. Foreign currency lending to the non-bank sectors increased by SIT 809 billion (58.6%), while domestic currency lending to non-bank sectors only increased by SIT 108 billion (4.9%), reflected in the fact that the proportion of foreign currency lending in the overall composition of non-bank sector lending increased by 6.2 percentage points. The change in the currency structure was most pronounced in lending to non-financial companies, where there was repayment of tolar borrowing (by 4.9%) while foreign currency borrowing increased (55.1%). At the end of 2005 the proportion of loans made to non-financial companies in foreign currency was 56.5%, significantly more than the tolar loans. The reduced investment in foreign currency-denominated securities is largely due to changes in Bank of Slovenia regulations, as after July 2005 banks were no longer required to subscribe to Bank of Slovenia foreign currency bills. As banks directed part of the funds this change released into Bank of Slovenia tolar bills, the proportion of foreign currency-denominated securities fell by 2.7 percentage points.

Table 21: **Currency structure of principal balance sheet items**

| % | Share at 31-Dec.-04 in SIT | Share at 31-Dec.-04 in foreign currency | Share at 31-Dec.05 in SIT | Share at 31-Dec.05 in foreign currency |
|---|---|---|---|---|
| Deposits with central bank | 2.3 | 0.2 | 1.8 | 0.2 |
| Loans and advances to the banking sector | 3.5 | 5.5 | 3.5 | 6.3 |
| Loans and advances to the non-bank sectors | 35.2 | 18.8 | 29.6 | 25.0 |
| Securities | 18.0 | 10.9 | 19.8 | 8.2 |
| Other assets | 5.1 | 0.5 | 4.7 | 0.9 |
| **Total assets** | **64.1** | **35.9** | **59.3** | **40.7** |
| Liabilities to the banking sector | 4.7 | 15.0 | 5.6 | 22.8 |
| Liabilities to the non-bank sectors | 40.6 | 21.5 | 36.8 | 18.2 |
| Liabilities arising from securities | 3.9 | 0.1 | 3.4 | 0.1 |
| Other liabilities | 4.4 | 1.7 | 4.0 | 1.8 |
| Capital | 8.1 | 0.0 | 7.4 | 0.0 |
| **Total liabilities** | **61.7** | **38.3** | **57.2** | **42.8** |

Source: Bank of Slovenia

## 3.5 Asset quality

**Limits on maximum allowable exposure not exceeded**

Monitoring credit risk composition and 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 are key elements of credit risk management. As at 31 December 2005, no bank had exceeded 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).

Table 22: **Classification of balance-sheet and off-balance-sheet bank assets, adjustments and provisions**

| | 31-Dec.-04 | | | | 31-Dec.-05 | | | |
|---|---|---|---|---|---|---|---|---|
| | Aggregate exposure | | Value adj. provisions | | Aggregate exposure | | Value adj. provisions | |
| | SIT million | % | SIT million | % | SIT million | % | SIT million | % |
| A | 4,001,552 | 81,7 | 40,170 | 15.7 | 5,036,205 | 83.4 | 49,109 | 17.6 |
| B | 624,126 | 12.7 | 63,448 | 24.9 | 715,698 | 11,8 | 73,611 | 26.3 |
| C | 121,050 | 2.5 | 32,367 | 12.7 | 143,338 | 2.4 | 37,854 | 13.5 |
| D | 69,614 | 1.4 | 40,051 | 15.7 | 64,641 | 1.1 | 36,944 | 13.2 |
| E | 79,059 | 1.6 | 79,060 | 31.0 | 81,505 | 1.3 | 81,494 | 29.1 |
| **Total** | **4,895,401** | **100.0** | **255,096** | **100.0** | **6,041,388** | **100.0** | **279,012** | **100.0** |

Source: Bank of Slovenia

**Value of large exposures increased**

The total of large exposures (a bank's exposure to an individual person or company calculated according to the regulation on large exposures that reaches or exceeds 10% of the bank's capital) in the banking system increased during 2005, reaching 227% of capital at the end of the year. The total number of large exposures was up 52 from the end of 2004. Five banks recorded a large exposure total of more than 300% of their capital.

Table 23: **Bank exposure with regard to capital**

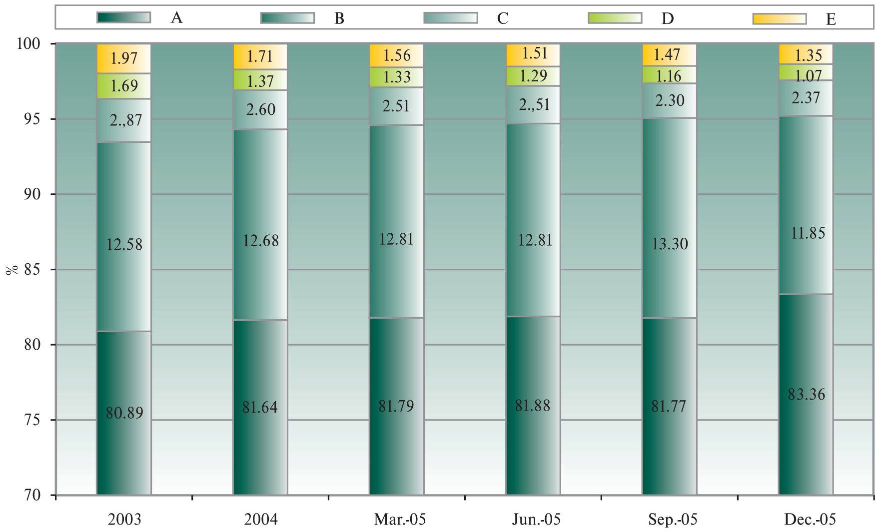
| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| Total large exposures / capital (%) | 209 | 195 | 214 | 196 | 227 |
| Number of large exposures | 280 | 256 | 296 | 253 | 305 |
| Number of banks with large exposures of more than 300% of capital | 5 | 4 | 4 | 3 | 5 |

Source: Bank of Slovenia

**Total exposure rose 22.3%**

The total exposure of banks as at 31 December 2005 amounted to SIT 8,247 billion (of which SIT 6,868 billion was claims on the balance sheet and SIT 1,379 billion was off-balance-sheet claims), while classified assets amounted to SIT 6,041 billion or 73.3% of total exposure. Total exposure had risen by 22.3% by the end of 2005, while classified balance-sheet and off-balance-sheet assets rose by 23.4%. In 2004 total exposure rose by 12.2%, while classified assets rose by 19.7%.

Figure 18: **Composition of banking sector credit portfolio**




Source: Bank of Slovenia

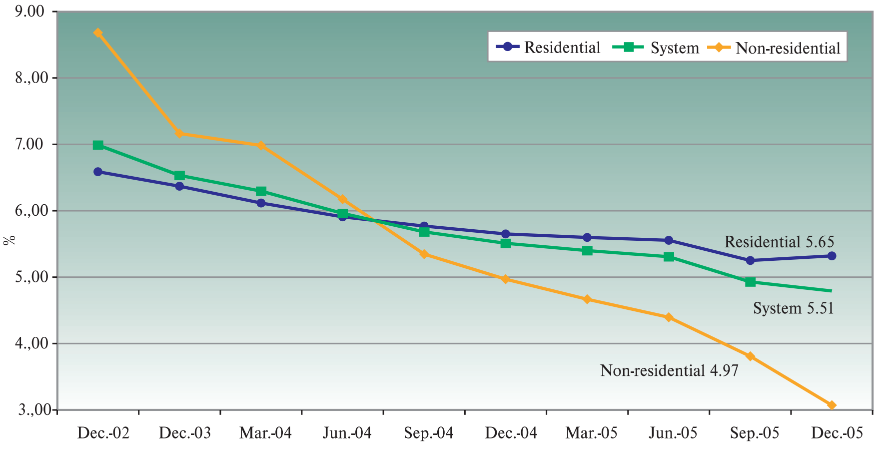
**Credit risk composition improved despite high lending levels**

The credit risk composition had improved by the end of 2005, although there was a high level of lending activity by banks and hence a greater possibility of lending to weaker customers, given the more intense competition. Analysing the credit portfolio of the entire banking system shows that the proportion of claims graded as Category A rose by 1.62 percentage points with a corresponding decline in those graded as Categories B to E (Category B declining 0.9 percentage points, with Category C declining 0.42 percentage points, Category D by 0.27 percentage points, and Category E by 0.14 percentage points).

**Favourable movement in non-performing claims**

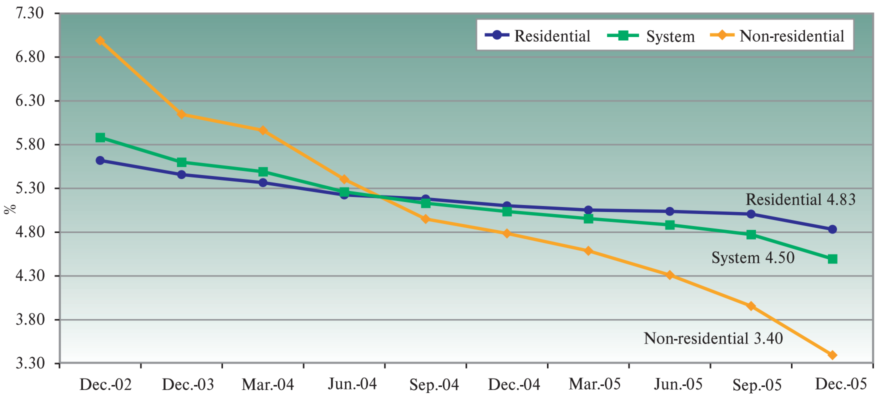
Movement in non-performing claims (claims graded as Category C, D or E) was favourable in 2005, with the total proportion that they account for continuing to decline. A comparison of domestic and foreign banks shows that this proportion is declining more sharply in foreign banks, with the figure of 3.07% at the end of 2005 already significantly below the average for the banking system (4.79%). Domestic banks are also recording a decline in the proportion of non-performing assets, but the decline is less sharp and the figure of 5.32% at the end of 2005 was above the system average.

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




Source: Bank of Slovenia

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




Source: Bank of Slovenia

**Average default risk fell**

A decline in the average default risk[15], and a consequent improvement in the credit risk composition was recorded for both groups of banks. The average default risk of assets in the banking system fell from 5.60% at the end of 2004 to 5.04% at the end of 2005, with the decline slightly more pronounced at foreign banks, where the figure had fallen below the average to reach 3.4% by the end of the year.

**Banks were most exposed to customers in service sector**

As at 31 December 2005 banks were most exposed to customers in the service sector, their proportion falling by 1.8 percentage points from 2004 to 54.1%. The reduction was due in equal measure to the fall in the proportion of risk-free government securities (from 8.9% to 7.8%) as the fall in the proportion of Bank of Slovenia securities (from 13.8% to 12.7%) and the somewhat lower exposure to trade and repair of motor vehicles, and transport and warehousing (by 0.3 percentage points and 0.4 percentage points respectively). The risk of motor vehicle trade and repair, the highest-risk sector, fell by 0.7 percentage points in 2005. Meanwhile the proportion of borrowing for property and rent increased by just under one percentage point while the level of risk fell (by 0.8 percentage points).

[15] 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 according.

Table 24: **Composition of classified assets by sector and average credit risk of sector**

| | 31-Dec.-04 | | 31-Mar.-2005 | | 30-Jun.-05 | | 30-Sep.-05 | | 31-Dec.-05 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | propor. % | average risk | propor. % | average risk | propor. % | average risk | propor. % | average risk | propor. % | average risk |
| **A. Industry** | **21.0** | **6.2** | **21.0** | **6.0** | **21.0** | **6.1** | **20.4** | **6.0** | **20.5** | **5.8** |
| - metals and machinery | 4.1 | 4.4 | 4.1 | 4.3 | 4.2 | 4.2 | 4.1 | 4.2 | 4.2 | 4.1 |
| - chemicals | 2.6 | 6.3 | 2.6 | 6.4 | 2.5 | 6.4 | 2.5 | 6.3 | 2.4 | 5.3 |
| - foodstuffs | 2.0 | 5.8 | 2.2 | 5.0 | 2.1 | 5.5 | 2.1 | 5.9 | 2.1 | 5.9 |
| - construction | 5.6 | 5.0 | 5.5 | 5.2 | 5.7 | 5.1 | 5.6 | 5.0 | 5.6 | 4.3 |
| - energy supply | 1.0 | 3.7 | 1.0 | 3.5 | 1.0 | 3.0 | 0.9 | 2.7 | 1.0 | 2.4 |
| **B. Services** | **55.9** | **4.7** | **56.1** | **4.6** | **55.4** | **4.5** | **54.4** | **4.4** | **54.1** | **4.1** |
| - vehicle trade and repair | 10.3 | 6.7 | 10.2 | 6.6 | 9.9 | 6.6 | 9.9 | 6.4 | 10.0 | 6.0 |
| - transport, warehousing | 3.6 | 3.4 | 3.5 | 3.3 | 3.4 | 3.2 | 3.2 | 3.2 | 3.2 | 3.4 |
| - financial intermediation | 20.4 | 2.1 | 20.5 | 2.0 | 21.4 | 2.0 | 20.5 | 1.9 | 19.8 | 1.9 |
| - Bank of Slovenia | 13.8 | | 13.9 | | 14.5 | | 13.7 | | 12.7 | |
| - real estate, leasing | 8.1 | 5.1 | 7.9 | 5.0 | 8.1 | 4.9 | 8.2 | 4.8 | 9.0 | 4.3 |
| - public admin, defence, social security | 10.5 | 1.7 | 11.1 | 1.7 | 10.3 | 1.6 | 10.2 | 1.6 | 9.8 | 1.5 |
| - government securities | 8.9 | | 9.6 | | 8.2 | | 8.1 | | 7.8 | |
| **C. Households** | **13.5** | **3.9** | **13.4** | **3.9** | **13.5** | **3.8** | **13.4** | **3.7** | **13.0** | **3.6** |
| **D. Non-residents** | **9.6** | **5.3** | **9.5** | **5.5** | **10.1** | **5.3** | **11.7** | **4.8** | **12.4** | **4.2** |
| **Total** | **100.0** | **5.0** | **100.0** | **5.0** | **100.0** | **4.9** | **100.0** | **4.8** | **100.0** | **4.5** |

Source: Bank of Slovenia

**Proportion of borrowing and risk both fell for highest-risk industries**

The proportion of borrowing (by 0.5 percentage points to 20.5%) and the credit risk (by 0.4 percentage points to 5.8%) both fell for the highest-risk industrial sectors by the end of 2005. Exposure to the household sector was also down, its proportion falling to 13%, down 0.5 percentage points. There was a strong rise in exposure to non-residents of 2.8 percentage points (to 12.4%), while risk fell by 1.1 percentage points.

**EU member states predominant in figures on exposure to individual countries**

EU member states were prevalent within the exposure structure by country groups at the end of 2005, accounting for 65.4% of the total (69% including the EFTA countries), although this proportion has fallen in the last two years (5.8 percentage points). As in previous years the proportion of exposure to the countries of the former Yugoslavia is continuing and now stands at 19.2% (an increase of 3.8 percentage points, mainly at the expense of EU states). The proportion of exposure to other countries increased, the major countries within that group being Russia (25.1%) and the United States (31.1%).

Table 25: **Exposure to particular groups of countries**

| | 31-Dec.-02 | | 31-Dec.-03 | | 31-Dec.-04 | | 31-Dec.-05 | |
|---|---|---|---|---|---|---|---|---|
| SIT million, % | Amount | Propor. | Amount | Propor. | Amount | Propor. | Amount | Propor. |
| EU | 369,721 | 76.4 | 350,114 | 67.6 | 448,386 | 69.3 | 648,781 | 63.5 |
| Efta | 25,586 | 5.3 | 30,927 | 6.0 | 28,149 | 4.3 | 56,469 | 5.5 |
| Countries of former Yugoslavia | 37,748 | 7.8 | 65,930 | 12.7 | 99,516 | 15.4 | 195,679 | 19.2 |
| Cefta | 9,549 | 2.0 | 12,292 | 2.4 | 4,214 | 0.7 | 11,253 | 1.1 |
| Others | 41,407 | 8.6 | 58,872 | 11.4 | 66,898 | 10.3 | 109,527 | 10.7 |
| Total | 484,011 | 100.0 | 518,135 | 100.0 | 647,163 | 100.0 | 1,021,709 | 100.0 |
| Proportion of classified assets accounted for by non-residents | 11.4% | | 10.6% | | 9.6% | | 12.4% | |

Source: Bank of Slovenia

## 3.6 Capital and capital adequacy ratio

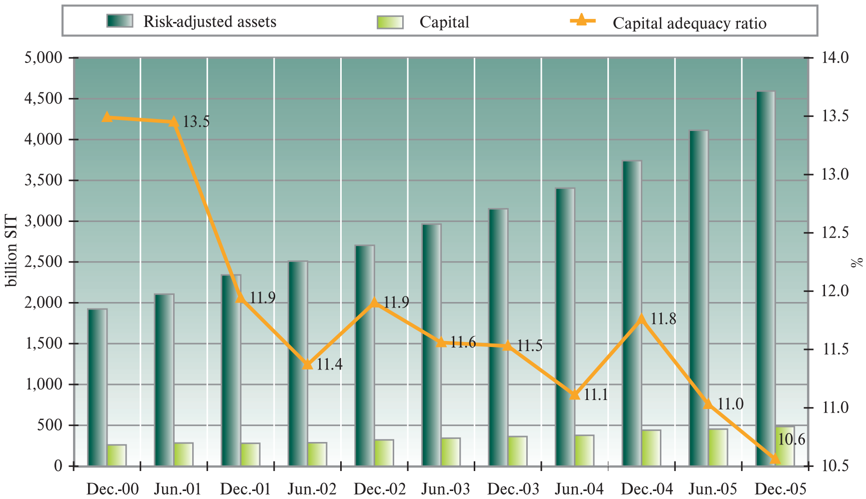
**Capital adequacy ratio reached lowest point at the end of 2005**

While from 2001 to 2004 the capital adequacy ratio fluctuated within a relatively narrow band between 11.1% and 11.9%, in 2005 it fell below 11% for the first time, and reached its lowest value at the end of the year. The biggest factor in the fall in capital adequacy was the increased growth in lending and the higher volume of currency-risk-adjusted items, within in a context of capital growth being slower than the risk-adjusted assets. As at 31 December 2005, the capital adequacy of the Slovenian banking system was 10.56% (as at 31 December 2004 it was 11.76%) and within the year it fell by 1.2 percentage points.

**Banking system's capital increased by 10.3% in 2005**

The banking system's capital at the end of 2005 stood at SIT 485 billion, a rise of SIT 45 billion or 10.3% on the standing at the end of 2004. The largest increase was in primary capital (SIT 70 billion), with the increase in supplementary capital significantly less (SIT 13 billion), while the main fall was the notable increase in capital deduction items in the form of capital investments worth SIT 37 billion.

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




Source: Bank of Slovenia

**Primary capital increased compared to the supplementary one**

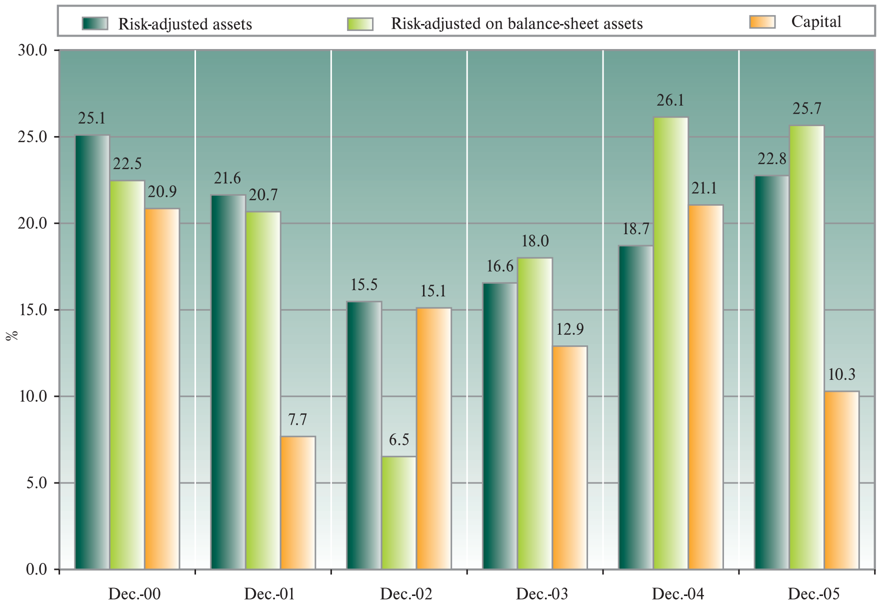
The ratio of primary capital to supplementary capital last year moved slightly towards primary capital, and at the end of 2005 was 68.9% to 31.1% (at the end of 2004 it broke down as 66.3% primary capital versus 33.7% supplementary). The increase in primary capital is largely the result of an increase of SIT 29 billion in share capital and capital reserves, an increase in innovative instruments of SIT 16 billion, and increased profit reserves of SIT 18 billion, while other primary capital items remained more or less unchanged. Seven banks increased their share capital and capital reserves. The increased supplementary capital was mainly the result of increases in hybrid instruments (SIT 8.1 billion), while there was a reduction in subordinated debt (SIT 2.8 billion). Capital investments, which represent a capital deduction item, rose by SIT 37 billion in 2005 to SIT 107 billion, the proportion of capital that they account for increasing by 6.1 percentage points from 15.8% at the end of 2004 to 22% at the end of 2005.

**Strengthening of risk-adjusted assets**

Risk-adjusted assets totalled SIT 4,594 billion at the end of 2005, up SIT 852 billion or 22.8% from the end of 2004. The largest factor in the increase was the increase of SIT 793 billion or 24.8% in credit-risk-adjusted assets. Currency-risk-adjusted assets increased by SIT 43.1 billion or 17.8% while market-risk-adjusted assets increased by SIT 15.9 billion or 5.1 percentage points. Within the credit-risk-adjusted assets there was a large increase of SIT 733 billion or 25.7% in risk-adjusted balance-sheet assets, while there was also an increase of SIT 60 billion or

17.9% in risk-adjusted off-balance-sheet assets. The capital requirements for market risk at the end of 2005 were met by 14 out of 19 banks (compared to 16 at the end of 2004), while on average the proportion trading turnover in total turnover was 15.3%, which is 0.6 percentage points more than at the end of 2004.

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




Source: Bank of Slovenia

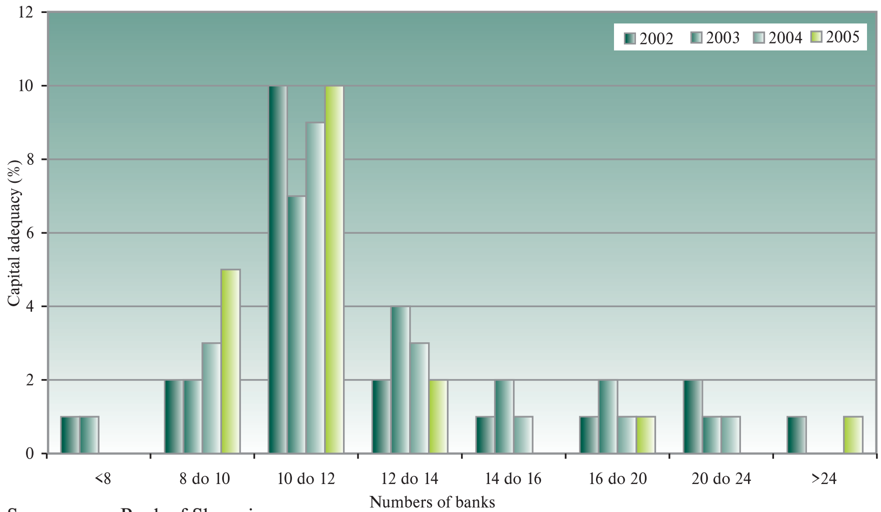
**More capital was used to cover all capital requirements in 2005 than in 2004**

At the end of 2005 some 81.3% of capital was used for covering all capital requirements in the banking system, up 8.3 percentage points from the figure of 73% at the end of 2004. 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 banks met the minimum capital adequacy requirement**

All the banks met the minimum capital adequacy requirement as at 31 December 2005. In comparison with 2004 there was a significant shift towards the 8% to 10% interval (from three to five) and the 10% to 12% interval (from nine to ten) at the expense of a decline in the number of banks in other intervals, i.e. in the interval from 12% to 14% (from three to two) in the interval from 14% to 16% (from one to one) and the 20% to 24% interval (from 1 to 0). Only one bank had a capital adequacy over 24%.

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




Source: Bank of Slovenia

## 3.7 Banking supervision

**Special focus on supervising bank activities and euro readiness**

In on-site examinations of banks and savings banks during 2005, inspectors from the Banking Supervision Department examined the standard areas of examination – prevention of money laundering, IT systems, market risk (including the internal (FX) models of two banks) and credit risk (increasing among Slovenian banks) – and also paid special attention to supervise the actions and readiness of banks and savings banks for the introduction of the euro. Mention should also be made of full-scope examinations to determine the “risk profiles” of banks and savings banks, in relation to the new methodology for risk monitoring in banks and savings banks.

**On-site examinations in 2005**

In 2005 a total of 68 regular examinations, 18 supplementary examinations and a number of brief one-day examinations or monitoring of operations in a specific area. Breaches found during the on-site examinations led to the Bank of Slovenia issuing six orders to rectify breaches, two decisions starting a procedure to conditionally prohibit performance of specific banking transactions, two calls for the statement of facts and circumstances of relevance to decisions on required minimum capital adequacy ratio, and a number of decisions and resolutions rejecting appeals, extending deadlines on orders, and concluding procedures against banks. As an administrative body for minor offences, the Bank of Slovenia also issued two decisions on breaches – both in the form of reminders. The Bank of Slovenia’s supervisory powers also extend to other entities if there is reasonable suspicion they are performing banking services without authorisation from the Bank of Slovenia. In 2005, on the basis of referrals from relevant government institutions (of the Market Inspectorate of the Republic of Slovenia), Bank of Slovenia inspectors carried out eight on-site examinations of companies suspected of engaging in activities without Bank of Slovenia authorisation, and three examinations based on referrals from the Office for Money Laundering Protection.

**On-site Examinations of financial organisations abroad owned by Slovenian banks**

In 2005 Banking Supervision Department inspectors continued to examine banks and other financial organisations abroad that are owned by Slovenian banks. In 2005 a Memorandum of Understanding was signed with the Banking and Payments Authority of Kosovo. The Bank of Slovenia now has 11 MoUs with foreign supervisory authorities. Based on these MoUs, inspectors examined or assisted in examinations of the operations of finance companies that are subsidiaries of the NLB group (four examinations; three with a team from home supervisory authority, and one independent examination), and in one examination of a foreign-owned Slovenian bank together with the parent bank’s supervisory authority. Six annual meetings were also held with foreign supervisory authorities, either at the Bank of Slovenia or at the foreign supervisory authority (National Bank of Serbia, National Bank of the Republic of Macedonia, Central Bank of Montenegro, Banking Agency of the Federation of Bosnia and Herzegovina and the Republika Srpska, Banking and Payments Authority of Kosovo, the Austrian Financial Market Authority – FMA and the Austrian National Bank – OeNB).

**Bank of Slovenia continued cooperation with other two supervisory authorities**

Cooperation with the other two Slovenian supervisory authorities on the financial market (Securities Market Agency and Agency for Insurance Supervision) took the form of exchanging of data between the institutions. The Rules on Reciprocal Cooperation between Supervisory Agencies regulate cooperation between the Bank of Slovenia, the Securities Market Agency and the Agency for Insurance Supervision. The Coordinating Body was founded on the basis of the rules, presided over by the minister for finance, with cooperation from the Governor of the Bank of Slovenia, the presidents of the councils of experts of the Securities Market Agency and Agency for Insurance Supervision. MoUs have been signed between the Bank of Slovenia and the two agencies, in line with the Rules. Supervisory authorities are required to inform the relevant institution if they find any infringements or breaches that fall under the auspices of other authorities.

### 3.7.1 Bank readiness for the introduction of the euro

**Monthly reporting on preparations for the euro**

In January 2005, the Bank of Slovenia began a wide range of activities aimed at ensuring that banks and all their systems will be properly prepared for the introduction of the new currency, by launching a plan of recommended activities and preparations for euro adoption. The Bank of Slovenia has been monitoring the implementation and timetabling of these activities using the monthly reports that banks are obliged to submit. In September and October 2005, the Bank of Slovenia carried out the first round of on-site examinations at banks, which were intended to uncover any problems during the first phase of activities, which covers setting up project groups and identifying changes that will be needed.

**Close supervision of euro preparations will continue in 2006**

The Bank of Slovenia will continue its close supervision of preparations for the euro throughout 2006. The supervision will include the regular monthly reports from banks and quarterly (or more frequent) comments from internal audit departments on the project status, as well as two further rounds of on-site examinations. The first round of examinations starts in March, while the second round is planned for September and October 2006.

### 3.7.2 Prevention of money laundering

**Systematic examination of bank compliance with money-laundering legislation**

In 2005 the Bank of Slovenia continued its systematic examination of banks' legislative compliance and risk management capacity in relation to money laundering prevention. The examination focused on the following areas: organisational and staffing conditions including a contact person for money laundering prevention, service implementation with an emphasis on identification and reporting of transaction to the Office for Money Laundering Prevention, the functioning of internal audit departments that should provide independent checking of compliance with internal policies, the role of information technology in creating records and detecting unusual and suspicious events.

**Banks generally do have systems to implement the legal provisions in place**

The examinations performed suggest that, in general, banks do have a system in place to implement the legal provisions. They have appointed contact persons for communications with the Office for Money Laundering Prevention, and are implementing the legally prescribed checks on cash transactions over SIT 3 million and reporting transactions over SIT 5 million to the Office for Money Laundering Prevention.

**Irregularities**

The largest number of irregularities were detected in relation to the opening and management of accounts for foreign legal entities that do not trade or manufacture in the state in which they are registered (mainly countries from off-shore jurisdictions such as Delaware in the United States, the British Virgin Islands, St. Kitts & Nevis, etc.), while a number of irregularities were also found relating to foreign individuals. The Bank of Slovenia took appropriate action in all such cases.

**Bank of Slovenia finds awareness of money laundering too low in Slovenia**

However, banks still treat the issue of money laundering prevention as a legal obligation alone, with too little recognition of the fact that it is a form of operational risk. Bank of Slovenia assessments indicate that the Slovenian banking industry still displays a lack of awareness and an erroneous belief that there is little likelihood of money laundering occurring in banks in Slovenia. In most cases the money laundering prevention system still only covers cash transactions, while the higher risk field of operations involving foreign banks and foreign legal entities still warrants little attention from banks.

### 3.7.3 Information technology

**Inspectors carry out IT examinations**

In 2005 Bank of Slovenia inspectors carried out a number of examinations into information technology in individual banks. The examinations concerned information systems, including banks' capabilities for managing the risks inherent in information systems, and for managing risks that are a consequence of weaknesses in their information systems. These risks arise from the failure to properly account for clients' credit and market risk, the liquidity risk from poor monitoring of cash flows, and finally the inaccurate reporting to the Bank of Slovenia.

**Risk usually relative to inconsistencies in information system**

Most banks face these risks, with their seriousness usually being related to the number of inconsistencies in the bank's information system, and the extent to which it is operated correctly and properly supervised. Examinations by Bank of Slovenia inspectors indicated that most banks in Slovenia were exposed to risks of this kind. Information technology has a special role to play in the introduction of the euro.

**Data security**

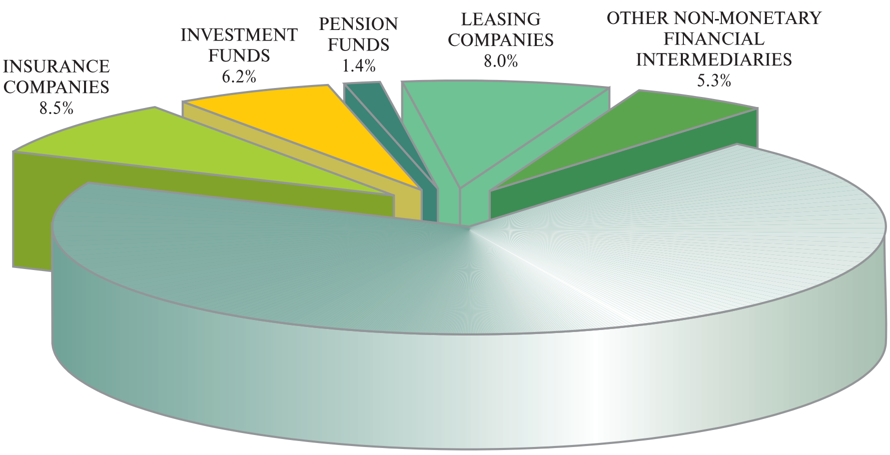
Another important field of information technology is data security. During examinations carried out in 2005, Bank of Slovenia inspectors found that in practice no bank has already fully set up an information security system in line with ISO 17799 standards. The projects are underway, but a sufficient level of security has not yet been reached. The Bank of Slovenia assesses that the banks' managements are paying too little attention to this issue, and failing to treat these projects as priorities. Computerisation of transactions means that banks are increasingly exposed to various attempts at fraud and other unauthorised uses or changes to data and information.

# 4 FINANCIAL MARKETS

**The Slovenian financial market is dominated by monetary financial institutions**

The Slovenian financial market is dominated by monetary financial institutions, which represent 70% of total assets. Low interest rates have led to savings moving away from bank deposits towards alternative investments such as mutual funds, foreign securities, life insurance and pension funds. The total assets of non-monetary financial institutions are therefore increasing and were worth 38% of GDP at the end of 2004. Mutual funds developed rapidly in 2005 and their number increased to 18. The number of other financial institutions did not change significantly. At the end of 2005, non-monetary financial institutions included 51 mutual funds, 8 investment companies, and 16 insurance companies (of which 14 insurance companies and 2 reinsurance companies). Of the pension providers, seven were mutual pension funds, four were pension companies and two were insurance companies. There were 15 brokerage houses and 18 banks among the authorised securities market participants.

Figure 24: **Financial intermediaries by total assets**




Data for 31-Dec.-04

Source: Bank of Slovenia, Insurance Supervision Agency, Association of Management Companies, Securities Market Agency, Agency for Public Legal Records and Related Services (AJPES)

**Total assets of investment companies lower at end of 2005**

The total assets of investment companies fell by 31% to SIT 200 billion, largely due to the transformation of three of them into mutual funds. In 2005 there was less interest for investment company shares than in 2004. Annual trading in their shares fell to below 60% of the volume recorded in 2004, and the lower demand was reflected in the PIX index, which recorded negative annual growth (down 12%) by the end of 2005.

Table 26: **Composition of Slovenia's financial system**

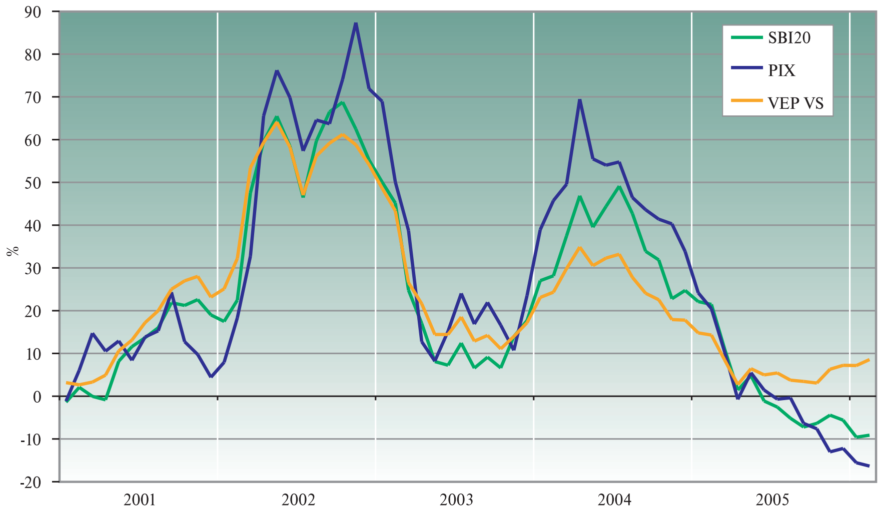
| Total assets | 2002 | | 2003 | | 2004 | |
|---|---|---|---|---|---|---|
| | mio SIT | % | mio SIT | % | mio SIT | % |
| **Monetary financial institutions** | **4,623,220** | **72.9** | **5,122,664** | **72.8** | **5,711,052** | **70.7** |
| **Non-monetary financial institutions** | **1,715,801** | **27.1** | **1,911,643** | **27.2** | **2,369,229** | **29.3** |
| Insurers | 498,163 | 7.9 | 588,753 | 8.4 | 684,426 | 8.5 |
| Pension funds | 55,541 | 0.9 | 80,164 | 1.1 | 113,979 | 1.4 |
| Investment funds | 517,973 | 8.2 | 439,181 | 6.2 | 499,966 | 6.2 |
| Leasing companies | 387,340 | 6.1 | 488,030 | 6.9 | 642,406 | 8.0 |
| Others | 256,783 | 4.1 | 315,514 | 4.5 | 428,453 | 5.3 |
| Total | 6,339,020 | 100.0 | 7,034,307 | 100.0 | 8,080,281 | 100.0 |

Source: Bank of Slovenia, Agency for Insurance Supervision, Association of Management Companies, Securities Market Agency, Agency for Public Records and Services

**Lower net inflows into domestic mutual funds reduced proportion of domestic investment**

The total assets of mutual funds increased by 58% in 2005 to SIT 332 billion, due to the aforementioned transformation of three investment companies, as the net annual inflow of SIT 33 billion, and 7% annual return on their assets. In 2005 net annual inflows into mutual funds reached just 40% of the inflows the previous year. The reason is the high level of competition from foreign mutual funds operating in Slovenia[16] which achieved over SIT 21 billion in net inflows in 2005. An important reason for the reduced net inflows into mutual funds is the lower level of return, which is mainly due to unfavourable conditions on the domestic capital market. At the start of 2005 the fact that domestic shares represented 43% of mutual funds' investments meant that the domestic capital market still had a significant influence on their returns. By the end of 2005, mutual funds had increased the proportion of foreign investments by 23 percentage points to almost 40% overall, in part due to the liberalisation of legal restrictions on investments abroad. Lower demand for domestic shares had a further negative impact on the performance of the SBI20 index. At 7% the annual return of mutual funds for 2005 was considerably higher than the return of the Slovenian stock market index (SBI20), which was negative, falling by 5.6%.

Figure 25: **Annual return on mutual funds (VEP), PIX index and SBI20**




Source: Bank of Slovenia

**Insurance companies predominate among non-monetary financial institutions**

Insurance companies form the largest group among non-monetary financial institutions, with 8.5% of total assets. Their gross effective premiums of SIT 384 billion and gross claims of SIT 224 billion in 2005 resulted in a claims-to-premium ratio of 0.58 last year. Slovenia lags behind the EU average for the proportion of collected life insurance premium. Higher growth in life insurance premiums is therefore to be expected. In 2005 growth was 15%, and represented a quarter of all collected premium. The proportion of life insurance premiums tied to investment fund units in overall life insurance premiums increased to 22.5%. Insurance company investments increased by over 15% to SIT 635 billion, more than half of which were life insurance investments. Given the large savings component of life insurance, investments in government and other debt securities predominate among insurance company investments at 63%. The increasing importance of life insurance tied to mutual fund units means that the structure of mutual fund coupons increased by four percentage points to 7%.

16 At the end of March 2006 there were 113 foreign mutual funds operating in Slovenia.

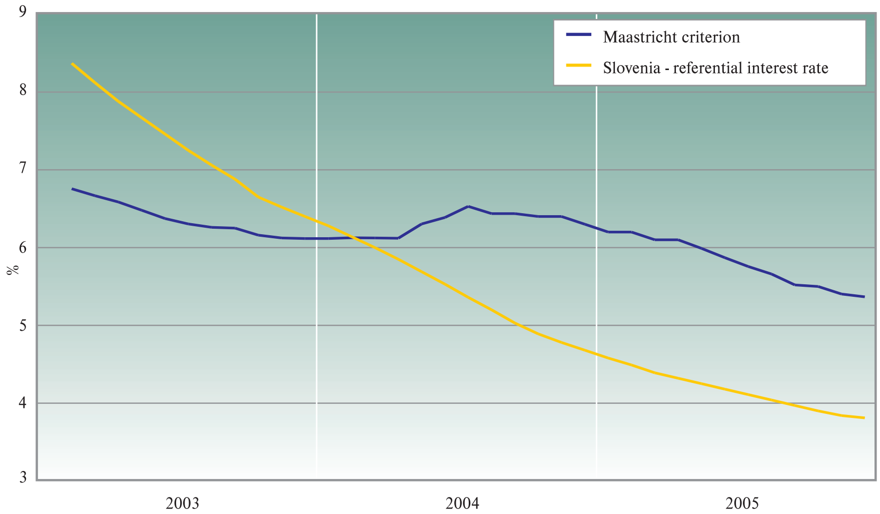
Given the long-term instability of the existing pension system the development of voluntary supplementary pension insurance is very important. At the end of 2005 there were 428,000 insurees with this form of pension, meaning 53% of the working population (49.3% of these were insured via mutual pension funds). In 2005 mutual pension funds, pension companies and insurance companies collected premium worth SIT 44 billion for voluntary supplementary insurance, which is 2% up on 2004. The total value of investments held by pension providers at the end of 2005 was SIT 141.9 billion, 49% more than at the end of 2004. Most funds were invested in government and other securities, with other debt instruments predominating among other those other securities. The existing, rather conservative, investment policies of pension funds are due in part to legally defined minimum guarantees in the return they must provide.

**428,000 people covered by voluntary supplementary pension insurance**

There were no initial public offerings of securities on the primary market in 2005, as Slovenian non-financial companies continue to finance themselves mainly through the banking system and via occasional closed recapitalisation and closed bond issues. The Republic of Slovenia issued bonds on the domestic market with a total value of SIT 413 billion (SIT 191 billion worth of bonds matured during the same period). In September 2005 the low liquidity of the market in government bonds led to the creation of TUVL – the market for secondary trading in government securities on the Ljubljana Stock Exchange. In the final four months of 2005, 58% of total trading on the Ljubljana Stock Exchange was on this market. The long-term government security RS59, which was issued at the beginning of 2005, functions as a reference security for movements in bond prices. Its value increased significantly over the year, before falling somewhat towards the end of the year, due to the increase in euro area interest rates. Its average annual trend indicates a clear growth in the value of bonds and thus a trend of falling long-term interest rates, which are inversely related to bond prices.

**In 2005 there were no primary offers of securities**

Figure 26: **12-month moving average in long-term interest rates**




Source: Bank of Slovenia

### Maastricht interest rate criterion

Meeting the Maastricht interest rate criterion requires the prospective EMU member to keep its long-term interest rates within two percentage points of the non-weighted average interest rate in the three EU member states with the best price stability performance. A 12-month moving average of the yield on 10-year government bonds is used for the calculation. In Slovenia the 11-year RS59 bond has been used since the start of 2005 as a reference bond.

Slovenia has met the Maastricht interest rate criterion since February 2004. The falling gap between Slovenia's long-term interest rates and the reference value has led to an ever lower risk premium being demanded by investors on purchasing Slovenian government bonds. The risk premium includes credit risk, and inflation and exchange rate risk. The ever decreasing gap is a positive assessment by the market of Slovenia's deflation and exchange rate stability.

**Share and bond issuers and holders**

At the end of December 2005, a total of 1,043 securities from 827 issuers were registered at the Central Securities Clearing Corporation (KDD), of which 920 were shares and 123 were bonds. The market or book value of shares registered at the Central Securities Clearing Corporation at the end of 2005 was SIT 4,463 billion (69% of GDP). By far the most prominent share issuers were non-financial companies (80% of the total value), followed by banks (11%), other financial intermediaries (5%) and insurers (3%). The largest group of shareholders were non-financial companies (29%), followed by the government (23%), the general public (18%), the rest of the world (13%), other financial intermediaries (10%), banks (4%) and insurers (2%). The value of bonds registered at the Central Securities Clearing Corporation, by market or nominal value, stood at SIT 1,671 billion at the end of 2005 (26% of GDP). The most important bond issuer was the government (78% of the total value), followed by banks (14%), non-financial companies (7%) and insurers (1%). The main holders of bonds were banks (46%), followed by insurance companies (23%), the general public (8%), the government (7%), rest of the world (7%), non-financial corporations (5%), and other financial intermediaries (4%).

**Total market capitalisation up 5%**

At the end of December 2005, 227 securities from 148 issuers were being traded on the Ljubljana Stock Exchange (22% of those registered at the Central Securities Clearing Corporation), of which 122 were shares and 99 were bonds. Total market capitalisation rose by 5% in 2005 to SIT 3,210 billion, equivalent to 50% of GDP. The volume of trading during the year was SIT 441 billion, an increase of 11% on 2004. Over two thirds of that volume was in block trades. The largest volume was in shares (51%), followed by bonds (41%) and investment companies (8%). The most heavily traded shares in 2005 were Mercator, Krka, Petrol, Pivovarna Union and Gorenje.

**Significant growth in investments in securities issued abroad**

At the end of December 2005 residents held SIT 726 billion in investments in securities issued abroad by non-residents (50% in bonds), which is SIT 412 billion more than one year before, and SIT 49 billion in investments in securities issued abroad by residents (86% in Republic of Slovenia Eurobonds). Residents held SIT 443 billion of debt securities issued on foreign markets, SIT 357 billion being held by the government.

**Net inflow of non-resident investment in securities**

Investments by non-residents in Slovenian securities totalled SIT 123 billion in 2005, but taking the maturity of treasury bills into consideration the net inflow was just SIT 114 billion. The inflows were therefore considerable, but nowhere near levels that could lead to a stock market bubble or threaten financial stability. On the other hand, investments by non-residents had a positive impact on the liquidity of the domestic capital market.

**Growth in financial investments abroad by residents reflects financial expansion**

The growth in financial investments abroad by residents undoubtedly reflects the increasing financial deepening in Slovenia in recent years. The falling interest rates have meant that households, companies and finance companies have had greater opportunity to increase their financial investments, which consequently increases the need for diversification. The limited absorption capacity of the domestic market has inevitably led to outflows of financial investments abroad. From an economic point of view this is a very positive development, as individuals therefore reduce their exposure to one economy. This indicates the additional advantage of adopting the euro, which encourages more efficient financial allocation by eradicating currency risk.

# 5 OTHER ACTIVITIES

## 5.1 Management of foreign exchange reserves

The foreign exchange reserves of the Bank of Slovenia are defined as:

- cash in foreign currency and foreign exchange holdings abroad
- prime securities from foreign issuers
- monetary gold
- holdings of special drawing rights (SDRs) and the reserve tranche at the IMF

**Net foreign exchange reserves increased, manily due to outright purchase of reverse swaps**

In 2005 the Bank of Slovenia's foreign exchange reserves grew from EUR 6,542 million to EUR 6,895 million. The portion of foreign exchange reserves for which the Bank of Slovenia has liabilities towards the domestic sector on the basis of subscribed foreign currency bills and foreign currency accounts held by banks and the government at the Bank of Slovenia fell in 2005 by EUR 662 million, from EUR 2,352 million to EUR 1,690 million. Meanwhile the other portion of the reserves, net assets without foreign exchange liabilities, rose in 2005 from EUR 4,190 million to EUR 5,205 million. The increase is largely due to outright purchases from reverse foreign exchange swaps. The value of Slovenia's monetary gold fell due to the sale of some of the gold. Besides official foreign exchange reserves and holdings at the IMF, the total claims of the Bank of Slovenia on the rest of the world include certain other assets such as the fiduciary accounts in Luxembourg at Dresdner Bank and Société Générale, worth a total of EUR 57 million at the end of 2005.

Table 27: **Reserves and foreign exchange reserves of the banking system**

| EUR million | BANK OF SLOVENIA | | | | | | | BANKS |
|---|---|---|---|---|---|---|---|---|
| | International monetary reserves | | | | | Including counter-value of liabilities in foreign currency* to residents | Claims against the rest of the 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 | 0.0 | 14.9 | 1,405.9 | 1,420.9 | 982.6 | 132.8 | 1,297.6 |
| 1996 | 0.1 | 0.1 | 14.9 | 1,837.9 | 1,853.0 | 1,032.4 | 27.2 | 1,488.4 |
| 1997 | 0.1 | 0.1 | 15.7 | 2,987.3 | 3,003.1 | 1,612.1 | 37.4 | 978.2 |
| 1998 | 0.1 | 0.2 | 55.8 | 3,048.5 | 3,104.6 | 1,580.3 | 40.0 | 1,031.2 |
| 1999 | 0.1 | 1.6 | 107.3 | 3,050.3 | 3,159.3 | 1,694.4 | 51.8 | 1,053.5 |
| 2000 | 0.1 | 4.0 | 88.5 | 3,343.3 | 3,435.9 | 1,862.8 | 62.4 | 1,361.2 |
| 2001 | 76.2 | 5.7 | 91.3 | 4,810.5 | 4,983.7 | 2,212.9 | 86.2 | 1,703.0 |
| 2002 | 79.9 | 6.7 | 115.9 | 6,578.9 | 6,781.4 | 2,523.8 | 81.3 | 1,263.2 |
| 2003 | 80.9 | 7.3 | 115.7 | 6,675.0 | 6,879.0 | 2,502.5 | 69.8 | 1,024.8 |
| 2004 | 77.8 | 8.2 | 87.9 | 6,367.9 | 6,541.8 | 2,351.5 | 74.2 | 1,116.4 |
| 2005 | 70.4 | 9.8 | 43.5 | 6,770.7 | 6,894.5 | 1,689.6 | 83.4 | 2,061.4 |

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

Source: Bank of Slovenia

**Management of the Bank of Slovenia's foreign exchange reserves**

The Governing Board of the Bank of Slovenia lays down basic rules on a quarterly basis for the management of the Bank of Slovenia's foreign exchange reserves, separated according to risk. The management of foreign exchange reserves and changes in investment composition took place within these rules and with respect to the events and expectations of international financial markets. More detailed information on the structure of the foreign exchange reserves as at 31 December 2005 are given in the financial statements chapter.

## 5.2 Payment transactions of Bank of Slovenia customers

### 5.2.1 Operations for the government sector

**End of 1-month treasury bills**

Since 2001 the Bank of Slovenia and the Ministry of Finance have had a contract on joint operations on the money market. The aim of this contract was the continued development of the money market, based on 1-month treasury bills. In line with this contract, the Ministry of Finance deposited the money raised from treasury bills with the Bank of Slovenia, to be used to balance budget liquidity; since 2004 it has been used to balance the government's single treasury account. The sale of 1-month treasury bills took place via weekly auctions, with their total value reached SIT 28 billion. Once market makers had been appointed for secondary trading in securities, the Ministry of Finance stopped issuing 1-month treasury bills by the end of the year, and the contract with the Bank of Slovenia ended by mutual agreement.

**Managing budget user accounts**

**Bank of Slovenia manages treasury accounts for government and municipalities**

The Bank of Slovenia manages the government's single treasury account, and 192 municipal treasury accounts, open in a number of currencies. The accounts of direct and indirect users of the national and municipal budgets, the Health Insurance Institute of Slovenia and the Institute of Pensions and Disability Insurance of Slovenia (included in the single treasury account system as laid down in the Public Finances Act), were opened as sub-accounts of the government or municipal treasury accounts. The sub-accounts are managed by the Public Payments Administration of the Republic of Slovenia, to which direct and indirect users of the national and municipal budgets present payment instructions and from which they receive the full set of return information regarding payment transactions performed. In 2005, SIT 5,768.5 billion in inflows and the same in outflows were conducted through the government single treasury account and SIT 5,292.8 billion in inflows and the same in outflows through the municipal treasury accounts. In addition to the single treasury accounts, the Bank of Slovenia also manages 96 special foreign currency accounts for the government and other budget users.

**International payment transactions**

The Bank of Slovenia performs payment transactions with the rest of the world and other transactions for the Republic of Slovenia on the basis of the Payment Transactions Act.

**Net sales of EUR 477 million in foreign exchange to budget users**

In 2005 the Bank of Slovenia performed EUR 1,150 million worth of payments to the rest of the world and paid out EUR 7.1 million in cash. Payments worth EUR 496 million were made from the rest of the world, and EUR 1.6 million in foreign currency remittances were made. A total of EUR 614 million in foreign currency was sold to budget users and EUR 138 million in foreign currency was purchased from them. Analysis of the currency composition of inflows and outflows shows that 80.4% of inflows were in euro, 7.0% were in US dollar, 12.3% in tolar, and a mere 0.3% in other currencies, while 68.2% of outflows were in euro, 3.7% were in US dollar 26.7% were in tolar and 1.4% were in other currencies.

The Bank of Slovenia manages tolar and foreign exchange accounts for foreign financial institutions and EU institutions, via which foreign currency worth EUR 284. million was sold in 2005, with inflows of EUR 689 million and outflows of EUR 687 million recorded.

**Fiscal stamps, securities certificates and notes and coins**

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

**New 500 tolar commemorative coin to mark 100th anniversary of Sokol associations**

The Bank of Slovenia issued into circulation 200,000 copies of a new bimetallic circulation-standard commemorative 500 SIT coin to mark the 100th anniversary of Slovenian "Sokol" national and gymnastic associations. The quantity of coins in circulation in 2005 increased by 7.2%, with the proportion of coins in the overall composition of cash in circulation increasing to 1.6% (1.4% in 2004).

**6648 commemorative coins sold**

In 2005 gold and silver commemorative coins were issued to mark 100 years of Slovenian film, and gold, silver and circulation standard coins to mark the 100th anniversary of the Sokol associations. In total, 6,648 commemorative coins were issued at the Bank of Slovenia treasury and via commissioners (banks) in 2005 (8650 in 2004), comprising 2,150 gold (1,891 in 2004 and 4,498 silver coins (6759 in 2004).

The first Slovenian banknotes (the payment notes that preceded the tolar) are exchangeable at the Bank of Slovenia treasury without any time limit. Exchanges increased by 46.6% in 2005 (it had fallen by 77.0% in 2004).

**Payment notes exchangeable without time limit**

A total of 5,139 treasury receipts and outlays of tolar cash and 20,983 inward and outward payments of foreign currency for travel expenses and other requirements of government bodies were undertaken (compared with 5,187 treasury receipts and outlays of tolar cash and 23,562 inward and outward payments of foreign currency in 2004).

## 5.2.2 Managing Central Securities Clearing Corporation (KDD) member accounts

**Bank of Slovenia opens new accounts in 2005**

In 2005 the Bank of Slovenia opened a guarantee fund monetary account and a fiduciary account for custodial services for the Central Securities Clearing Cooperation. The Bank of Slovenia also manages accounts for members of Central Securities Clearing Cooperation (hereinafter: KDD members), which are used for cash settlement of securities transactions. At the end of the 2005 there were 27 KDD members, including 12 commercial banks and 15 brokerage houses, with open transaction accounts for customer funds and clearing accounts at the Bank of Slovenia.

In 2005 SIT 1,043.8 billion in inflows and SIT 1,047.1 billion in outflows were conducted through the KDD account and KDD member accounts.

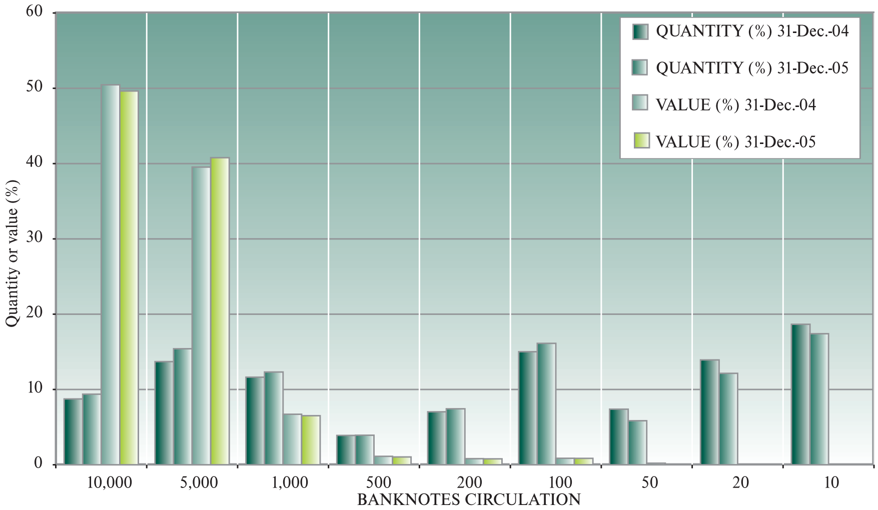
## 5.3 Banknote department

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

**Main cash denominations are 10,000 and 5,000 tolar notes**

As at 31 December 2005 there were 113.2 million banknotes in circulation with a total value of SIT 213.8 billion (including cash at banks). The value of banknotes in circulation rose by 9.1% compared to 2004, while the quantity of banknotes fell by 1.3%. At the end of 2005 banknotes represented 98.4% of cash in circulation by value and 18% of volume. The most important denomination remains the 10,000 tolar banknote, although its proportion of overall value in circulation fell to 49.6%, from 50.5% in 2004.

Figure 27: **Banknotes in circulation by volume and denomination**




Source: Bank of Slovenia

The proportion of value represented by 5,000 tolar notes increased from 39.5% of the total value of banknotes in circulation in 2004 to 40.8% in 2005. These two banknotes are the system's main denominations. The importance of the 1000 tolar banknotes is gradually falling both in terms of volume and value. It represented 6.5% of the overall value of banknotes in circulation in 2005, compared to 6.7% in 2004. The average value and volume of the banknotes 10, 20, 50, and 500 tolar-denominated banknotes also fell. This largely due to these banknotes being replaced by coins of the same value (except for the 500 tolar note).

**13.1 million banknotes withdrawn from circulation**

A total of 13.1 million banknotes (compared with 27.4 million in 2004), of which the largest group was 2.8 million 50 tolar notes, were taken out of circulation and destroyed in order to maintain an appropriate quality of banknotes in use.

**Supplying tolar cash**

Tolar cash was supplied to government through the Bank of Slovenia's banknote depots at five commercial banks, for which the Bank of Slovenia set a quarterly treasury maximum and checked their operations on a daily basis. All these depots operated in accordance with the rules, and no irregularities in their operations were discovered last year.

**Printing banknotes**

The increased demand for banknotes within the cash circulation and the exchange of worn and damaged notes led to the printing of 3 million 10,000 tolar notes in 2005, 5 million 1000 tolar notes, and 2 million 500 tolar notes.

Table 28: **Cash in circulation**

| SIT billion | 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 | 186.0 | 1.9 | 187.5 |
| 2004 | 195.4 | 2.8 | 198.1 |
| 2005 | 214.2 | 3.5 | 217.7 |

Note: Data as at 31 Dec..
Source: Bank of Slovenia

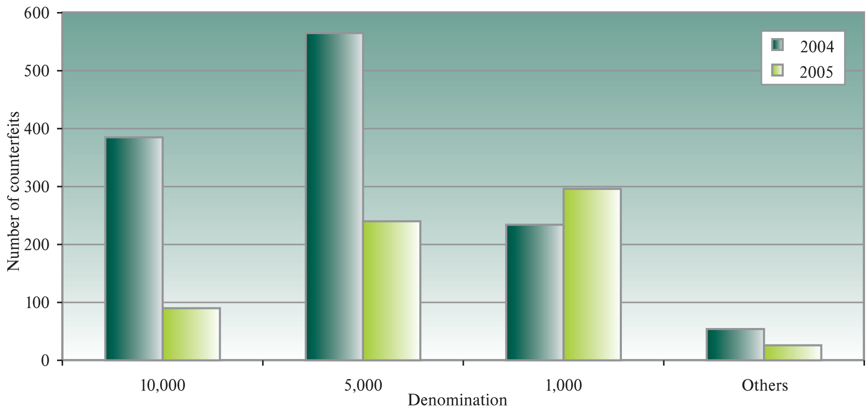
**652 counterfeit notes examined**

The Bank of Slovenia examined 652 counterfeit tolar banknotes discovered and confiscated on the territory of the Republic of Slovenia (compared with 1238 in 2004). There were 90 examples of 10,000 tolar notes, 240 examples of 5000 tolar notes, 296 examples of 1000 tolar notes and 26 examples of other denominations. The value of counterfeit tolar banknotes in 2005 fell, and represented 0.011‰ of cash in circulation. Most of the counterfeit notes, by volume and value, were in the three major denominations (10,000, 5000 and 1000 tolars). The Bank of Slovenia's work against counterfeiting included cooperation with the Ministry of the Interior (National Analysis Centre – NAC and the Coin National Analysis Centre – CNAC) as well as the ECB, EU, Interpol and Europol. According to data sent to the Bank of Slovenia by the Forensic Investigation Centre at the Ministry of the Interior, the centre examined 1058 foreign currency counterfeits in 2005, compared to 645 in 2004.

**Largest drop in counterfeits is for 10,000 tolar note**

Compared to the previous year the number of counterfeit 10,000 tolar notes fell by 76.6%, counterfeit 5000 tolar notes by 57.5% while the number of counterfeit 1000 tolar notes increased by 26.5%.

Figure 28: **Comparison of counterfeit tolar notes examined in 2004 and 2005**




Source: Bank of Slovenia

**Forged notes usually lack watermarks and other security features**

The quality of the tolar counterfeits discovered in 2005 did not differ significantly from those found in 2004, though there was an increase in quality detected in foreign currency counterfeits that were seized. The counterfeit are printed on commercial paper and in most cases have no security features (e.g. watermark, coloured security fibres, security threads, fluorescent features).

## 5.4 Payment systems

### Joining TARGET

**Bank of Slovenia remote participant in TARGET since 2004**

TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer System) is a real time gross settlement system for payments in euro that operates since 1 January 1999. It comprises 16 interconnected national real-time gross settlement systems operated by the central banks of the EU15 and Poland, and the ECB payment mechanism. The basic objective of the TARGET system is to support implementation of Eurosystem monetary policy, and to ensure secure, reliable and efficient settlement of payments, with the basic aim of contributing to the integration and stability of the euro money market. NCBs have the obligation to become a TARGET member with the adoption of the euro, and are permitted to become a member under certain conditions before that occurs. In 2004 the Governing Board of the Bank of Slovenia decided to join TARGET via the German RTGS system, with the Bank of Slovenia starting its participation as a remote participant in the same year. At the beginning of 2005 the decision was made to gradually establish the connection of Slovenian banks in the same manner, enabling access to a rapid and more cost-effective settlement of euro payments before the introduction of the euro in Slovenia. In July, 16 banks and one savings bank have joined TARGET via the direct remote participation in German RTGS system, which means they are ready for introduction of the euro in the field of large-value payments. Technically the introduction of the euro will not bring any changes regarding large-value payments, whereas banks will also settle domestic large-value payments via the German RTGS system. Other Slovenian banks that did not join TARGET for business or legal reasons in July 2005, will have the opportunity to do so in 2006.

**Preparations for transition to euro and new TARGET system**

Due to the changeover to the euro the main activities within the Bank of Slovenia and in its relationship with the ECB and the German central bank in 2005 entailed preparing legal bases and the organisation of relations with banks within the TARGET system after the introduction of the euro, as well as preparations to upgrade technical support within the Bank of Slovenia, and defining of the accounting procedures for the requirements of central bank accounting. In parallel with preparations within the ESCB for the first new member states to adopt the euro, preparations are ongoing for the new generation of the TARGET system (TARGET2, which will be a single system replacing the large number of interconnected systems), which the ECB plans to bring on line in November 2007. As this will mean that the first new members of the euro area will only be full members of the existing system for 11 months, an agreement between the ECB and their central banks was reached to the effect that TARGET membership will take place via an existing national system connected to TARGET, i.e. differently to how participation was organised for members from the EU15.

**All ESCB credit operations must have appropriate collateral**

In accordance with the ESCB Statute, all ESCB credit operations must be covered by adequate collateral in the form of eligible assets, recorded in the register of the eligible securities settlement system. This means that when the euro is introduced, the securities settlement systems in the new member states that will be used for Eurosystem credit operations must be in compliance with the requirements of the ECB Standards for the use of EU securities settlement systems in ESCB credit operations. The process to formally assess the compliance of the domestic securities settlement system (the Central Securities Clearing Corporation – KDD) for use in ESCB credit operations began in September. By the end of 2005, the Bank of Slovenia, in its role as primary assessor, had prepared its own formal assessment of the KDD system, using the KDD's self-assessment as the basis. In 2006 the ECB will also prepare a formal assessment of the KDD system's compliance. Based on the two assessments a joint report on KDD compliance for use in Eurosystem credit operations will be prepared, and the KDD system will then be approved for use in such operations, unless major deficiencies are discovered in the KDD system designs or operations.

**Eurosystem allows credit institutions to use assets held abroad**

The Eurosystem also enables credit institutions to use eligible assets held outside their home country. To that end, a special mechanism was put in place within the ESCB to enable the delivery of these assets to home central banks (correspondent central bank model – CCBM) the aim of which is to ensure that all financial assets that are eligible as collateral for Eurosystem credit operations are available to counterparties, irrespective of where in the euro area the financial assets are located. Upon the entry to the Eurosystem the Bank of Slovenia also has to set up the technical support required for CCBM. The Bank of Slovenia actively started preparatory work at the beginning of 2005, within a wider project to set up the Bank of Slovenia's collateral system.

The Bank of Slovenia is also monitoring preparations to introduce the euro within the banking environment. These have increased intensity since the start of 2005. In April a document entitled The Changeover to the Euro, Changes in Payment Systems and Payment Transactions in Banks was issued, which in May was taken as the basis for coordinated preparations for the introduction of the euro within the banking environment. It defines the starting points for preparations of processing centres for card payments and ATM operations, initiatives to introduce new payment instrument standards and define the main procedures for the changeover with regard to cashless payments and the consequent changes in the interbank payment systems. The Bank of Slovenia also provided ongoing support to banks in this field, in line with the national programme to introduce the euro, via the group organising euro changeover projects at the Bank of Slovenia, which also established a mechanism to monitor preparations to introduce the euro within the Bank Association of Slovenia and to ensure the work is appropriately organised.

**Bank of Slovenia releases plan for euro changeover**

**Oversight of payment systems**

On the basis of the Bank of Slovenia Act and the Payment Transactions Act, the Bank of Slovenia is in charge of payment system oversight. The objective of payment system oversight is to protect the financial system from possible systemic consequences if one or more payment system participants has financial difficulties, and to ensure the operational security and efficient functioning of payment systems. The Bank of Slovenia formalised the organisation of its payment system oversight with internal acts derived from the legal basis, the Core Principles for Systemically Important Payment Systems[17], adopted by the Governing Board of the Bank of Slovenia as the basis for oversight activities and the ESCB guidelines in this field. A special emphasis was placed on properly separating the functions of managing RTGS and Giro Clearing[18] payment systems and the oversight of payment systems. An oversight methodology was also prepared based on the ECB methodology for oversight of the TARGET system.

**Bank of Slovenia in charge of payment system oversight**

In 2005 the Bank of Slovenia oversaw payment systems in accordance with its responsibilities, on the basis of the regular and ad hoc reports that payment system operators are required to submit to the Bank of Slovenia, and also on the basis of on-site controls of payment system operators. In January an oversight assessment of the Giro Clearing system was carried out (the oversight assessment of the RTGS system was carried out at the end of 2004), and in October and November oversight assessments of the private payment system operators (Bankart and Banka Koper) were carried out. On this basis the Bank of Slovenia issued recommendations for adapting the payment systems to the requirements of the legal basis and guidelines of the Core Principles. The payment system operators used the recommendations to prepare action plans setting out actions and deadlines for implementing the recommendations. The operators make quarterly progress reports on the implementation of individual recommendations.

**Payment system operators submit quarterly reports on implementation of recommendations**

**Standards for securities clearing and settlement in the European Union**

In October 2004 the ECB Governing Council and Committee of European Securities Regulators (CESR) adopted the Standards for Securities Clearing and Settlement Systems in the EU, which set out the basis for establishing appropriate oversight functions for securities clearing and settlement systems in individual EU states.

**EU securities clearing and settlement standards adopted in October 2004**

17 The Core Principles for Systemically Important Payment Systems were issued in 2001 by the Bank for International Settlements (BIS), and set out general guidelines on the formation and functioning of payment systems.

18 The RTGS system is the real-time gross settlement system enabling participants to individually and immediately settle large-value payments and urgent payments via settlement accounts at the Bank of Slovenia. The Giro Clearing system is a multi-lateral net payment system enabling the execution of low-value payments between participants, with settlement of positions between participants carried out via the RTGS system.

**Work on the standards and methodology suspended in October 2005**

The standards will come into effect after the preparation and approval of an appropriate methodology for assessing systems compliance. At the end of 2004 the ESCB-CESR working group, which included a Bank of Slovenia representative, started to work on defining the methodology for standards, which was almost completed in 2005, with just a few open issues remaining. The remaining unresolved issues and particularly some uncertainties regarding the introduction of the directive on clearing and settlement that could lead to the standards having to be changed meant that in October 2005 the CESR and ECB Governing Council decided to temporarily suspend further work on the standards and methodology.

**Changes of the Payment Transactions Act and the Regulation 2560/2001 on cross-border payments**

**Payment Transactions Act brought into line with EU directive**

With the establishment of connections of the Bank of Slovenia to the Pan-European payment systems in 2004 an assessment of Slovenian legislation's compliance with Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems was carried out. The assessment was carried out by independent legal experts, and was also submitted to the ECB for scrutiny. The assessment and ECB finding indicated that the Payment Transactions Act (Official Gazette of the Republic of Slovenia, nos. 30/02, 15/03 and 37/04; hereinafter: ZPlaP) had some deficiencies or ambiguities which raised doubts about whether the directive has been properly implemented in Slovenian legislation. The Bank of Slovenia consequently prepared the amendments to the Payment Transactions Act to cater for these deficiencies.

**Constitution Court annuls some ZplaP provisions on content and accessibility of account register**

In November, the Bank of Slovenia received a decision from the Constitutional Court of 27 October 2005 annulling the first and second paragraph of Article 29 of the ZPlaP (content and public nature of the Registry of transaction accounts), inasmuch as they refer to natural persons that do not operate as sole traders. The Constitutional Court's stated in the grounds for its decision that the ZPlaP does not include a clear definition of the purpose for collecting data on account holders that are natural persons but not sole traders for the Registry of transaction accounts, and therefore the provision of the first paragraph of Article 29 of the ZPlaP setting out the collection of such data was in contravention of Article 38 of the Constitution. Also found to be in contravention of the Constitution was the second paragraph of Article 29 of the ZPlaP, which states that all data held on an individual account holder in the Registry of transaction accounts is public and accessible via a website, as this expressly permits the use of personal data for any purpose, which is automatically in contravention of Article 38 of the Constitution. The Constitution Court decision cancelled the section of the Registry of transaction accounts relating to natural persons due to the failure of the ZPlaP to provide an adequate personal data protection arrangements.

**End of transition period on threshold value for EU regulation on cross-border payment in euro**

On 1 January 2006 ends the transitional period relating to the threshold limit defined by Regulation 2560/2001 on Cross-Border Payments in Euro in relation to the obligation for charges for euro payments to be the same for payments in Slovenia and cross-border payments. According to the Regulation, once the transitional period expires the threshold value will increase from EUR 12,500 to EUR 50,000. Despite the increase in the threshold for same-charge payments, the Regulation still stipulates the threshold of EUR 12,500 for payments where the member states cannot prescribe the reporting obligation for the requirements of balance of payments statistics. After the expiry of the transitional period from the Regulation, payment services providers are obliged to charge users the same charges for domestic and cross-border payments in value up to EUR 50,000, although the execution of cross-border payments above the EUR 12,500 includes additional costs for providers due to reporting obligations for balance of payments statistics. The European Commission otherwise studied the possibility of amending Regulation 2560/2001 and also increasing the threshold to EUR 50,000 in relation to a prohibition on the reporting obligation, however the ECB and member states warned that this would lead to too great loss of data of use to implementing monetary policy. The ECB also proposed that the threshold amount for reporting remain at EUR 12,500 for at least two more years.

**Draft directive on payment services in the internal market**

**Draft directive on payment services on internal market**

As part of the activities to establish a single euro payments area, the European Commission drafted a directive on payment services in the internal market, which should ensure a comprehensive legal basis for regulating the relationships between payment service providers and users and ensuring equal conditions for payment services providers in the EU. The new directive will enable the replacement of the existing legal arrangements for payment services at the EU level, which have actually reduced legal certainty in the field of payment services, due to the lack of a comprehensive approach and the existence of different national legal systems.

**Commission ordered extensive research into EU payment services market**

The Commission based the draft directive on results and findings of a wide-ranging research into the state of the payment services market in the EU. The research indicated that there were significant differences between member states in relation to payments costs, payment infrastructure, efficiency and competition as well as in the legal arrangements. The draft directive should harmonise national regulations regarding payment services and thus the conditions for providing payment services for the entire EU territory (uniform conditions for payment services providers and standard licence). A further aim of the directive is to harmonise national arrangements relating to the rights and obligations between payment service providers and users (minimum standards regarding rights and obligations). The Commission expects a uniform framework that defines the conditions for payment services provision as well as the type and content of payment services to encourage competition between service providers, and thus increase service quality and reduce the costs of payment transactions for users.

**Bank of Slovenia and Ministry of Finance contributed to drafting new directive**

The Commission invited representatives of different interest groups and expert groups to participate in the drafting process. The Bank of Slovenia and the Ministry of Finance cooperated in the directive drafting process within the Payment Systems Government Expert Group at the European Commission. In December 2005, the European Commission submitted the draft into the adoption process before the Council and the European Parliament and in an official consultation procedure before the ECB and the European Economic and Social Committee. The final harmonisation procedure in working bodies of the Council and Parliament and the consultation procedure should be concluded in 2006. The new directive should be adopted by the end of 2006 and implemented into member states' national legislation by the beginning of 2008 at the latest.

**Activities of ESCB and EU working bodies on payment and settlement systems**

**Bank of Slovenia cooperates in CCBM for the first time**

In 2005 Bank of Slovenia representatives participated for the first time in the *Correspondent Central Banking Model (CCBM) Group of Experts.* The establishment of a CCBM in Slovenia is a condition for euro area entry, so cooperation in the group is vital for establishing and harmonising operations with other central banks. Preparatory activities for the TARGET2 system led to participation in the TARGET2 migration project group, also covering the preparations for the migration to the new system, including preparations for testing.

**Working bodies for EU payment and settlement systems move forward**

In 2005 work continued in a number of working bodies in the field of EU payment and settlement systems, including the European Payments Council (EPS) and the *Contact Group on Euro Payments Strategy (COGEPS).*

**Additional represetatives added to EPC working group and similar organisational structure set up in Slovenia**

The EPC is a working body that represents the European banking sector, and was established in May 2002 to lead the project to create SEPA – the Single Euro Payments Area[19]. In the second half of 2004, the Bank Association of Slovenia appointed a representative to the EPC, however there later arose the need for more detailed coverage of the SEPA content. Given the importance of the subject, in 2005 the Bank of Slovenia launched an initiative to appoint additional representatives to the EPC working groups, and to set up similar organisational structures in the domestic environment, i.e. within the Bank Association of Slovenia, which banks adopted. The EPC approved the appointment of an additional two Slovenian representatives to EPC working bodies, in the electronic credit transfers working body, and the support group for legal issues. At the end of the year a representative of the Bank Association of Slovenia was appointed to a special committee that is responsible for the implementation of the SEPA objectives.

**COGEPS group set up**

COGEPS was set up to formalise dialogue and coordination between the EPC and ECB, with its main area of operation being the harmonisation of SEPA implementation strategies for large-value and low-value payments. The COGEPS group continued work in 2005, and the Bank of Slovenia actively followed the work of the group and also participated in its November meeting (the central banks of the Czech Republic, Slovakia and Slovenia have had the possibility of participating in turn as observers in meetings since joining the European Union).

**Payment systems statistics**

**Number and volume of RTGS transactions increasing**

In 2005 there were 1,403,876 transactions with a total value of SIT 62,694 billion settled through the RTGS system, which is a 2.4% increase in the number and 28.5% increase in the value of transactions, compared to 2004. On average 5,571 transactions were settled per day, with an average value of SIT 44.7 million per transaction. In 2005 the Giro Clearing net settlement system, the second most important inter-bank payment system, processed 49,418,652 transactions with a total value of SIT 5,027 billion, which means a 1.7% increase in the number and 3.8% increase in the value of transactions compared to 2004. The net settlement value of these payments via the RTGS system was SIT 980 billion or 19.5% of the gross value of transactions, meaning a netting ratio of 80.5%. On average 196,106 transactions were processed daily, with an average value of SIT 101,721.

**97% of settlements via Giro Clearing system**

The total number of transactions settled through both systems in 2005 was 50,822,528, of which 2.7% were processed through the RTGS and 97.2% through the Giro Clearing system (compared with 2.7% and 97.3% respectively in 2004). The total value of transactions settled through the two systems in 2005 was SIT 67,721 billion, of which the RTGS accounted for 92.6% and the Giro Clearing system 7.4% (compared with 91% and 9 % respectively in 2004).

**Bank of Slovenia facilitates bank participation in STEP2**

The Bank of Slovenia also enabled Slovenian banks to participate in the STEP2 The pan-European payment system (single entry point), which allows the processing of low-value cross-border payments in euro (from 1 January 2006 the threshold was increased from 12,500 to 50,000 euro). In 2005, a total of 354,947 transactions were sent and 166,798 transactions received via the single entry point. The value of outflows was EUR 1,074 million, the value of inflows EUR 545 million.

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[19] The objective of creating the SEPA is to ensure the execution of payments within and between EU states under the same conditions, which will fully utilise the advantages of the euro and the single market.

## 5.5 Statistical system

**Responsibility to collect statistics for ESCB**

As a member of the European System of Central Banks (ESCB) the Bank of Slovenia fulfils a statistical function on the basis of the ESCB statute and the European Central Bank, as one of the institutions authorised to carry out the statistical research programme, according to the National Statistics Act and other authorisations. The Bank of Slovenia's main statistics work covers the wider areas of monetary, financial and balance of payment statistics. It is increasing involved in statistical processes in the field of public finances and general economic statistics. The obligations to harmonise statistics for EMU entry within the ESCB and cooperation with the EU statistics system Eurostat are areas of special focus.

**Statistics obligations for EMU inclusion**

In 2005 the changes carried out within the preparations for joining the European Monetary Union increased alongside the implementation of regular statistical tasks. By joining the ESCB the Bank of Slovenia assumed certain statistical obligations that it must complete prior to Slovenia joining the EMU. According to the statute of the ESCB and ECB, member states must implement all the necessary measures at the national level to collect statistical data required to implement the ECB statistical reporting requirements and implement the statistical preparations for becoming EMU members on time. The ECB therefore prepares checks progress every six months on the fulfilment of statistical obligations for new member states.

**MoU on macro-economic and financial statistics with Ministry of Finance and SORS**

The interdependence of individual statistics means that cooperation between institutions responsible for different statistics is essential in ensuring the implementation of statistical reporting requirements. The Bank of Slovenia, Ministry of Finance and the Statistical Office therefore signed a memorandum of understanding on macro-economic and financial statistics, modelled on the memoranda of understanding and cooperation between the ECB and Eurostat. The memorandum defined the responsibilities of individual signatories and the method of cooperation between them in submitting Slovenian macro-economic and financial statistics to the European Commission, Eurostat and the European Central Bank. The subject of the memorandum includes cooperation in maintaining standard classifications of institution sectors, as a special classification in the provision of macro-economic and financial statistics. The official sector classification is managed by the Agency for Public Legal Records and Related Services (APLRRS) as part of the Business Register of Slovenia.

**Statistical basis**

The Bank of Slovenia is responsible for producing a complex set of financial accounts and monetary and balance of payments statistics. These statistics are mainly based on data from direct and indirect reports from banks and companies and on balance of trade data prepared by the Statistical Office of the Republic of Slovenia (SORS), in cooperation with the Customs Administration of the Republic of Slovenia (CARS).

**Direct data reporting on financial accounts via APLRRS**

Direct data reporting for financial accounts continues to run successfully via the APLRRS. The gradual development of Slovenian finance accounts in 2005 continued in 2005 with the preparation of annual accounts in line with Eurostat regulations for 2004. The obligation for reporting on non-financial corporations (S.11) applies to those with total assets over SIT 200 million.

**Revision of 2001-2004 financial accounts to ensure consistency**

The financial accounts for 2001-2004 were revised in 2005 to make them consistent with other key statistics, mainly connected to general government (S.13) and the rest of the world (S.2). Harmonising financial account data for the general government sector with data on non-financial account data and EDP data (Excessive Deficit Procedure) was done by comparing sources and sector classification with representatives from the Ministry of Finance and the Statistical Office of the Republic of Slovenia.

**First publication of financial accounts in Slovenia**

The revised consolidated and non-consolidated data on financial accounts in Slovenia for 2001-2004 were first published in November 2005 in a statistical publication, together with information on the methodology and composition of financial accounts.

**Transition to quarterly direct reporting for financial accounts**

The ECB requirement to calculate financial accounts quarterly led to the transition from annual to quarterly direct reporting of financial accounts. This reached the required reporting level for general government units (S.13), with total assets not exceeding SIT 2 billion. The financial accounts for 2004, which the ECB also requires, remain to be assessed.

**Reporting to ECB starts of MFI harmonised balance sheet data**

In 2005 reporting on other monetary financial institutions (MFI – Sector S.122) was stabilised, adapted to the requirements of harmonisation of ECB monetary and bank statistics and prescribed by the resolution and instructions from July 2004. On this basis, the Bank of Slovenia's balance sheet and valuation data and aggregates of other MFIs were first submitted to the ECB in accordance with ECB/2001/13 guidelines on a monthly and quarterly basis, including the relevant time series for 2004. The Bank of Slovenia also started to submit numerous supplementary classifications of monetary and banking statistics in accordance with the requirements of the ECB/2003/2 guidelines, including data on the structural statistics of credit institution operations (related to the banking supervision function) and payment systems. On the basis of the time series received, the ECB started to implement and gradually increase quality controls for submitted data.

**Credit institutions start reporting harmonised interest rate data in May 2005**

In May 2005 credit institutions in Slovenia also started reporting interest rates to the Bank of Slovenia in accordance with instructions from July 2004, harmonised with the requirements of Regulation ECB/2001/18 (MIR statistics). The reporting was broken down further in November to include the requirements for separate reporting on banks' effective interest rates, lending and deposit rates, major depositors and updated requirements for data on interest risk assessment. This brought together the data requirements for statistical and banking supervision within the BS1O report. Combining data requirements for ECB and other central bank requirements within the wider system of reporting is explicitly permitted in ECB regulations for the purposes of reducing reporting costs.

**Direct balance of payments reporting concept prepared**

The Bank of Slovenia prepared a new plan for its balance of payment statistics on the direct reporting by participants in transactions with non-residents. The EU regulation on cross-border payments in euro, which requires the end of reporting on balance of payment statistics below a set reporting threshold made the Bank of Slovenia reach a special agreement with banks to continue reporting in the interim period until the introduction of the euro, which will enable the consistent balance of payments statistics to be maintained during the ERM2 period.

**Bank of Slovenia also submits public finance and general economic statistics to ECB**

The Bank of Slovenia is obliged to submit other data to the ECB, especially in the field of public finance and general economic statistics. The most important data are for the Maastricht economic criteria, i.e. long-term interest rates, the budget deficit, public debt and the harmonised consumer price index, and are prepared by the Statistical Office of the Republic of Slovenia and/or the Ministry of Finance in accordance with an agreement between the institutions. The Bank of Slovenia has also successfully concluded the technological side of its inclusion in the ESCB statistical information system. The overall exchange of statistical data with the ECB takes place on the basis of the GESMES/TS technical standards.

The Bank releases data on its website in accordance with the IMF's Special Statistical Data Dissemination Standards for Slovenia, prepared together with SORS and the Ministry of Finance. The standards require the regular publication of methodologically sound key macroeconomic figures according to an advance release calendar. Observance of these standards enhances macroeconomic accountability, permitting early identification of financial problems, and is therefore important in gaining access to international financial markets. With the data on external debt in accordance with the international standard, which the Bank of Slovenia started to publish in 2003, Slovenia was in full compliance with all the requirements of the IMF's special data dissemination standards.

**Bank of Slovenia meets IMF dissemination standards**

## 5.6 International cooperation

**International Monetary Fund**

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

**Slovenia's IMF quota remains unchanged**

Since 1998 Slovenia has been among the IMF member countries that finance loans under the Financial Transactions Plan (FTP). In 2005, Slovenia did not participate in FTP payments, but did receive a proportion of returned IMF loans from previous years from New Guinea, Indonesia, Pakistan, Romania, Bolivia and Brazil worth a total of SDR 41.1 billion. At the end of December 2005 Slovenia's reserve tranche position at the IMF stood at SDR 36.1 million.

**Slovenia's received returned IMF loans within FTP**

The report for Slovenia on consultations under Article IV of the IMF Articles of Agreement undertaken every year by the IMF mission, was discussed by the IMF Executive Board in July 2005. The report was published the same month. A visit by IMF representatives took place in March 2005 in relation to the consultations.

**Report on Art. IV consultations with IMF**

**The European Central Bank and the European System of Central Banks**

When Slovenia joined the European Union on 1 May 2004, the Bank of Slovenia became a member of the European System of Central Banks, which comprises the European Central Bank (ECB) and all the national central banks of the EU member states. The Governor of the Bank of Slovenia is a member of the ECB General Council and participates at its meetings. The General Council is the third decision-making body of the ECB, in addition to the Governing Council and the Executive Board and will function as long as there are member states that have not adopted the euro. The General Council comprises the President and the Vice-President of the ECB and the governors of the NCBs of all EU member states. Bank of Slovenia experts participated in sessions of committees and their working groups when they sat as the ESCB, i.e. with all EU national central banks.

**Bank of Slovenia an ESCB member**

The Bank of Slovenia's key for subscription of the ECB's Capital is 0.3345%. In line with the Statute of the ESCB and ECB, the national central banks' percentage shares in the key for subscription to the ECB are weighted relative to the relevant member state's proportion of overall EU population and GDP. The national central banks are the sole subscribers to and holders of the capital of the ECB. The NCBs of the member-states that have introduced the euro have paid up their entire shares of the ECB's capital. The NCBs of EU member states that have not yet introduced the euro have not paid up their entire share, but only 7% of the amount that they would have to pay up had they introduced the euro. The current total of paid-up subscribed ECB capital from all central banks is EUR 4,089.3 million. On EU entry, the Bank of Slovenia paid the minimum percentage of subscribed ECB capital, in the amount of EUR 1.3 million.

**ECB subscription key at 0.3345%**

**European Union**

**Bank of Slovenia membership in EFC, EFBS and CMFB**

On joining the ESCB the Bank of Slovenia also gained membership of Economic and Financial Committee (EFC) and its sub-committees, the Committee of European Banking Supervisors (CEBS) and its working groups, and the –Committee on Monetary, Financial and Balance of Payments statistics (CMFB).

**Other**

**Talks on Yugoslav succession continue**

In 2005 the Bank of Slovenia also participated in the implementation of the agreement on the succession to the Socialist Federal Republic of Yugoslavia.

# 6 ANNEXES

## 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 the 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 the prohibition on 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 the liabilities of these entities or purchase debt instruments from them. The Act allows exceptions to the prohibition which are applicable to banks, savings banks and other financial institutions in public ownership if they are obliged to fulfil the same conditions as other banks, savings banks and financial institutions, financing the Republic of Slovenia's liabilities to the International Monetary Fund, operations related to the issue of coins not exceeding 10% of the value of coins in circulation, and the intra-day bridging loans granted to the public sector provided there is no renewal option.

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 Five-year income statement and balance sheet

Table 29: **Five-year income statement for 1 January to 31 December**

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **Operating income** | | | | | |
| Interest and similar income | 43,774 | 60,228 | 74,512 | 60,376 | 58,101 |
| Interest expense and similar charges | 25,529 | 42,321 | 67,841 | 44,975 | 37,593 |
| **Net interest income** | **18,244** | **17,907** | **6,671** | **15,401** | **20,508** |
| Net foreign exchange gain/loss | 22,397 | -8,588 | -16,593 | -5,312 | 27,564 |
| Gain (loss) from price revaluation of securities | 4,781 | 10,814 | -8,530 | -122 | -11,040 |
| Gain (loss) from gold revaluation | -63 | 1,550 | 740 | -498 | 6,653 |
| **Net investment income** | **45,360** | **21,684** | **-17,712** | **9,469** | **43,685** |
| Fee and commission income | 1,123 | 1,793 | 1,660 | 1,682 | 2,036 |
| Fee and commission expense | 356 | 406 | 426 | 486 | 457 |
| Net fee and commission income | 768 | 1,387 | 1,234 | 1,196 | 1,579 |
| Other operating income | 289 | 382 | 322 | 367 | 325 |
| **Total operating income** | **46,417** | **23,452** | **-16,156** | **11,032** | **45,589** |
| Operating expenses | 3,930 | 4,396 | 4,971 | 5,524 | 5,916 |
| Provisions and write-offs | 7,690 | 498 | 704 | 398 | 1,070 |
| **Operating surplus available for appropriation** | **34,798** | **18,558** | **-21,830** | **5,110** | **38,603** |
| | | | | | |
| **Appropriations:** | | | | | |
| Transfer/Release to special reserves for foreign exchange differences | 22,397 | -8,588 | -16,593 | -5,312 | 27,564 |
| Transfer/Release from special reserves – price risk (securities) | 3,972 | 9,365 | -8,995 | -409 | -7,497 |
| Release from general reserves – price risk (securities) | - | - | - | - | -3,557 |
| Transfer/Release to special reserves – price risk (gold) | -63 | 1,550 | 740 | -498 | 6,653 |
| Financial results after the appropriation of net foreign exchange gain/loss and gain/loss from unrealized price revaluation | 8,491 | 16,231 | 3,018 | 11,329 | 15,440 |
| Transfer to general reserves | 6,322 | 12,173 | 2,264 | 8,497 | 11,580 |
| **Total transfer to reserves** | **32,628** | **14,500** | **-22,584** | **2,278** | **34,743** |
| Provision for transfer of surplus to the budget of RS | 2,107 | 4,058 | 755 | 2,832 | 3,860 |
| **Total appropriations** | **34,798** | **18,558** | **-21,830** | **5,110** | **38,603** |

Source: Bank of Slovenia

Table 30: **Five-year balance sheet as at 31 December**

| | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| **Financial assets** | | | | | |
| **Foreign currency assets** | **1,131,158** | **1,588,462** | **1,669,475** | **1,612,953** | **1,689,882** |
| Gold and gold receivables | 16,869 | 18,403 | 19,143 | 18,646 | 16,873 |
| Cash and deposits | 492,109 | 592,862 | 400,209 | 178,046 | 321,635 |
| Derivative financial instruments | 21 | 328 | 48 | 39 | 35 |
| Financial assets at fair value through P/L | 580,193 | 927,375 | 1,190,216 | 1,359,684 | 1,304,626 |
| Receivables from the Republic of Slovenia | 8,509 | 7,668 | 7,175 | 6,963 | 7,395 |
| International Monetary Fund | 21,479 | 28,221 | 29,130 | 23,033 | 12,803 |
| Accrued interest and other assets | 11,978 | 13,605 | 23,554 | 26,543 | 26,515 |
| **Domestic currency assets** | **2,728** | **3,255** | **1,263** | **808** | **748** |
| Receivables from Republic of Slovenia budget | - | - | - | - | - |
| Due from banks | 438 | 18 | 9 | - | - |
| Reverse – repo agreements | - | 1,148 | - | - | - |
| Accrued interest and other assets | 2,290 | 2,089 | 1,254 | 808 | 748 |
| Fixed assets | 2,608 | 3,094 | 3,106 | 3,554 | 3,643 |
| **Total assets** | **1,136,494** | **1,594,812** | **1,673,844** | **1,617,315** | **1,694,273** |
| **Liabilities and reserves** | | | | | |
| **Serviced liabilities** | | | | | |
| **Foreign currency liabilities** | **500,889** | **591,278** | **604,758** | **573,638** | **417,148** |
| Current accounts and deposits to governmental institutions | 31,842 | 30,545 | 41,059 | 63,156 | 82,466 |
| Derivative financial instruments | - | - | - | 0 | 1 |
| Bank of Slovenia bills | 460,837 | 552,952 | 555,260 | 500,757 | 323,938 |
| IMF and other international financial organisations | 5 | 7 | 5 | 1,389 | 1,789 |
| SDR allocation | 8,013 | 7,643 | 7,156 | 6,937 | 7,358 |
| Accrued interest and other liabilities | 191 | 131 | 1,278 | 1,399 | 1,596 |
| **Domestic currency liabilities** | **282,308** | **627,508** | **704,963** | **665,619** | **844,401** |
| Current accounts | 85,557 | 89,804 | 100,818 | 104,108 | 104,286 |
| Commercial banks' deposits | - | - | - | 156,730 | 203,490 |
| Overnight deposits | 35,372 | 18,360 | 8,170 | 4,800 | 1,500 |
| Bank of Slovenia bills | 125,912 | 375,636 | 472,330 | 266,588 | 525,184 |
| Republic of Slovenia deposits | 28,837 | 134,793 | 109,674 | 127,477 | 2,682 |
| International financial organisations | - | - | - | 264 | 271 |
| Accrued interest and other liabilities | 6,629 | 8,915 | 13,971 | 5,651 | 6,988 |
| Banknotes in circulation | 165,778 | 172,056 | 186,042 | 195,352 | 214,248 |
| Provision for transfer of surplus to the budget of RS | 2,107 | 4,058 | 755 | 2,832 | 3,860 |
| **Total liabilities** | **951,082** | **1,394,900** | **1,496,517** | **1,437,442** | **1,479,657** |
| Capital and Reserves | 185,411 | 199,912 | 177,327 | 179,873 | 214,616 |
| **Total liabilities and reserves** | **1,136,494** | **1,594,812** | **1,673,844** | **1,617,315** | **1,694,273** |

Source: Bank of Slovenia

## 6.3 Important measures taken in 2005

### 6.3.1 Monetary policy and exchange rate policy measures

**February** The Bank of Slovenia has revoked the provision according to which credit institutions that have failed to repay one-day liquidity loans by the end of payment transactions had to take a lombard loan at the lombard loan interest rate plus 4 percentage points. Now they can take loans at the lombard loan rate without paying the premium.

**March** The Bank of Slovenia changed the required reserve system for the April fulfilment period (from 27 March): the level of required reserves for tolar deposits up to 90 days was cut from 4.5% to 2.0%. Institutions subject to minimum reserve requirements had to subscribe the amount of liquidity released (SIT 36.9 billion) on 29 March 2005 to a long-term deposit at the Bank of Slovenia that matures on 30 March 2007.

**April** The Bank of Slovenia offered banks the outright purchase of EUR 300 million from the stock of foreign exchange swaps.

The Bank of Slovenia raised the foreign exchange swap rate from 1.25% to 1.5%.

**June** The Bank of Slovenia offered banks the outright purchase of EUR 200 million from the stock of foreign exchange swaps.

**July** The Bank of Slovenia offered banks the outright purchase of EUR 350 million from the stock of foreign exchange swaps.

**September** The Bank of Slovenia offered banks the outright purchase of EUR 500 million from the stock of foreign exchange swaps.

**December** The Bank of Slovenia offered banks the outright purchase of EUR 400 million from the stock of foreign exchange swaps.

The 0.25 percentage point increase in the minimum bid rate for main refinancing operations of the Eurosystem to 2.25% led to an increase in the Bank of Slovenia's refinancing rate from 2.5% to 3.75%.

### 6.3.2 Banking supervision measures

**January** Regulation amending the regulation on the minimum level of liquidity to be maintained by banks. Minimum standards for trading and other services in banks.

**February** Regulation amending the regulation on the minimum level of liquidity to be maintained by banks.

Regulation on the introduction of international financial reporting standards for banks and savings banks.

**April** Regulation amending the regulation on the minimum level of liquidity to be maintained by banks.

Regulation amending the regulation on conditions to be met by credit intermediaries.

| | |
|---|---|
| Guidelines for electronic submission of capital and capital adequacy reports (KAP forms).<br><br>Guidelines for implementing resolution on reporting by monetary financial institutions N-1. | **April** |
| Regulation amending the regulation on the granting of special liquidity loans with the participation of banks. | **June** |
| Regulation amending the regulation on the minimum level of liquidity to be maintained by banks.<br><br>Regulation on compliance of the operations of Slovenska izvozna družba, d.d., Ljubljana, with regulations governing bank operations.<br><br>Regulation amending the regulation on the capital adequacy of banks and savings banks.<br><br>Regulation on the Financial Reports and Annual Accounts of Banks and Savings Banks.<br><br>Chart of accounts for banks and savings banks (consolidated text).<br><br>Guidelines for implementing the regulation on the financial reports and accounts of banks and savings banks (methodology for compiling balance sheets and income statements).<br><br>Regulation amending the regulation on the capital adequacy of banks and savings banks<br><br>Regulation on the assessment of credit risk losses by banks and savings banks.<br><br>Guidelines on the transition to the international financial reporting standards.<br><br>Average effective interest rates of banks and savings banks for consumer credit.<br><br>Regulation on the minimum level of liquidity to be maintained by banks.<br><br>Regulation amending the regulation on the minimum level of liquidity to be maintained by banks. | **July** |
| Regulation amending the regulation on the determination and reporting of the value of investments by banks and savings banks in equity of non-financial organisations and in tangible fixed assets.<br><br>Guidelines on implementing the resolution on the assessment of credit risk losses by banks and savings banks. | **October** |
| Regulation amending the regulation on the assessment of credit risk losses by banks and savings banks. | **November** |
| Regulation amending the regulation on the minimum level of liquidity to be maintained by banks.<br><br>Regulation amending the regulation on reports by branches of member-state banks.<br><br>Instructions for compiling guaranteed deposit reports.<br><br>Instructions for compiling the report on the tolar liquidity ladder ratios for savings banks. | **December** |

### 6.3.3 Procedure pursuant to the Minor Offences Act

In 2005 the Bank of Slovenia issued two decisions on infringements or breaches of minor offence legislation, within its duties to oversee the implementation of laws involving minor offences. This was due to its new function as an administrative body for minor offences pursuant to the Minor Offences Act, which entered into force on 1 January 2005.

## 6.4 Governance and organisation

### 6.4.1 Composition of the Governing Board as at 31 December 2005

**The 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
(Vice-Governor of the Bank of Slovenia)

Andrej Rant
(Vice-Governor of the Bank of Slovenia)

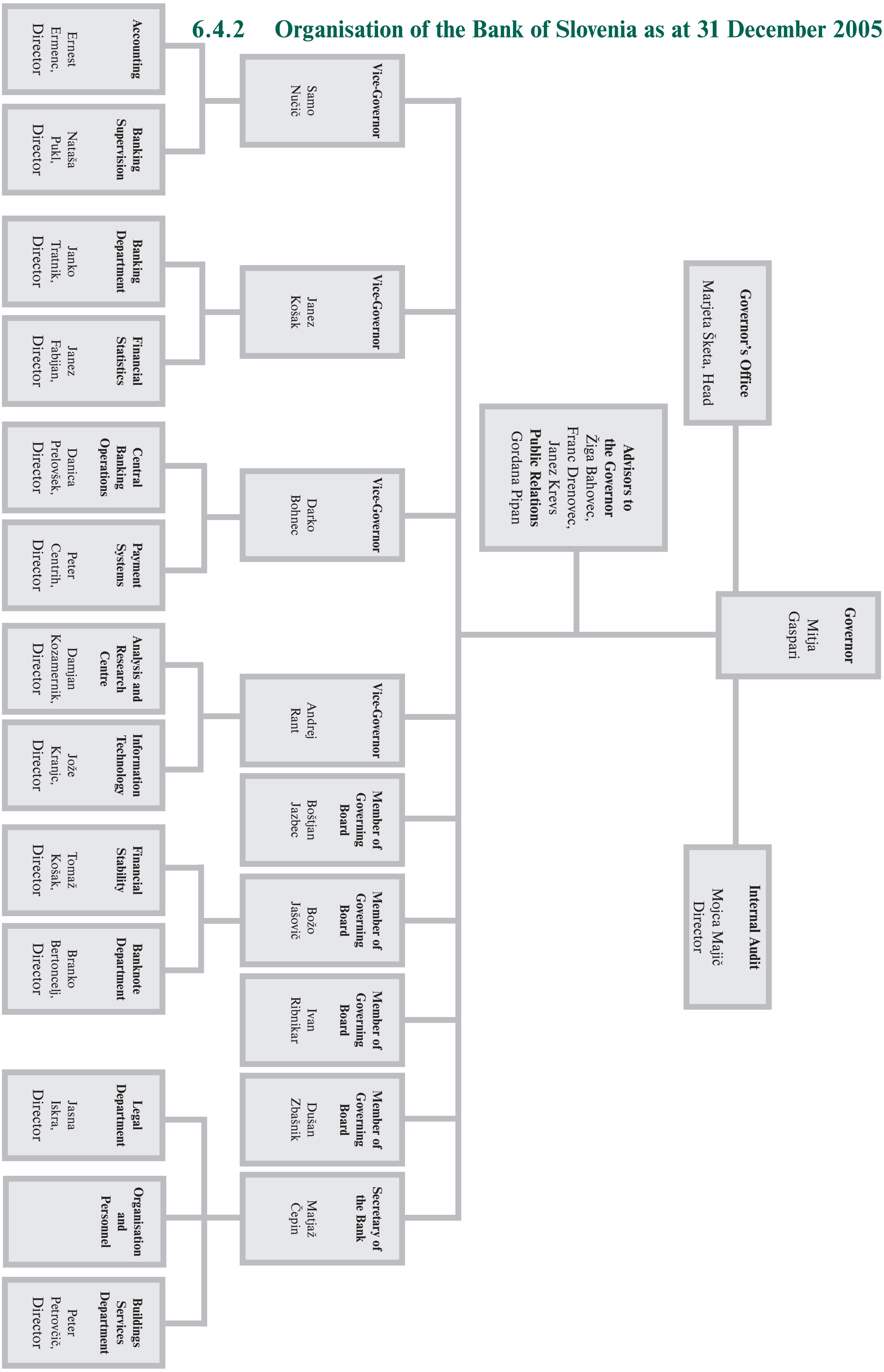
Božo Jašovič
(Member of the Governing Board of the Bank of Slovenia)

Boštjan Jazbec
(Member of the Governing Board of the Bank of Slovenia)

Ivan Ribnikar
(Member of the Governing Board of the Bank of Slovenia)

Dušan Zbašnik
(Member of the Governing Board of the Bank of Slovenia)

## 6.4.2 Organisation of the Bank of Slovenia as at 31 December 2005



### 6.4.3 Governing Board commissions and committees in 2005

- 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 Nucic).
- 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).
- Research Commission (president: Ivan Ribnikar).
- Risk Management Commission (president: Boštjan Jazbec).
- The Bank of Slovenia Audit Committee (president: Boštjan Jazbec) was abolished 1 September 2005.

## 6.5 Publications and website

| Title and basic information | Content |
|---|---|
| **Monthly Bulletin**<br>• Monthly<br>• in Slovene<br>• 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**<br>• annual (released in spring)<br>• in Slovene<br>• 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 Banking Supervision**<br>• annual (released in autumn)<br>• 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**<br>• annual<br>• bilingual<br>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**<br>• quarterly<br>• n Slovene | Analytical and methodological presentations in monetary field, balance of payments and related areas |
| **Financial Markets**<br>• quarterly<br>• in Slovene | Statistical review of non-monetary financial intermediaries, the securities market and interest rates |
| **Monetary Review**<br>• Monthly<br>• in Slovene | Analysis of current macroeconomic trends with a detailed breakdown of monetary and balance of payments developments |
| Monetary Policy Report<br>• half-yearly<br>• 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**<br>• annual<br>English translation | Analytical monitoring of developments in the banking sector, and articles by experts on maintaining financial stability |
| **Website**<br>• Slovene index<br>http://www.bsi.si/...<br>.../html/kazalo.html<br>• English index<br>http://www.bsi.si/...<br>.../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 sight 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 Journal of the Republic of Slovenia, No 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 ratings A to E based on the estimated ability of the debtor to meet the liabilities to the bank when they fall due.

The A-rating 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;

The B-rating comprises:
- claims on debtors whose cash flows 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;

The C-rating comprises:
- claims on debtors whose cash flows 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 financing for 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;

The D-rating comprises:
- claims on debtors who are highly likely to default
- claims on debtors who are illiquid and insolvent
- claims on debtors in respect of whom a motion for the initiation of composition or bankruptcy proceedings has been filed with a competent court

- claims on debtors who are 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 a reasonable expectation still exists that the claims will partly be covered;

The E-rating comprises:
- claims on debtors that are not expected to be repaid
- claims on debtors whose legal status is in dispute.

**ESCB –** The European System of Central Banks.

**Financial institutions –** In the official sector classification based on ESA95, the financial institutions sector is divided into five sub-sectors: the central bank, other monetary financial institutions, other financial intermediaries excluding 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 sight 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 via 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 –** Unbalanced 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.

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

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

**Tolar indexation clause (Slovenian abbreviation: TOM) –** 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).

# 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.

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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 the Bank of Slovenia for the year ended December 31, 2005, as set out on pages 4 to 24 ("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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

PricewaterhouseCoopers Ltd.

A. Schönenberger M. Schmidt

Zürich, March 28, 2006

## Statement of income and expenditure

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

| | Notes | 2005 | 2004 |
|---|---|---|---|
| **Operating income:** | | | |
| Interest and similar income | 4 | **58,101** | 60,376 |
| Interest expense and similar charges | 5 | **37,593** | 44,975 |
| **Net interest income** | | **20,508** | 15,401 |
| Net foreign exchange gain/loss | | **27,564** | -5,312 |
| Loss from price revaluation of securities | | **-11,040** | -122 |
| Gain (loss) from gold revaluation | | **6,653** | -498 |
| **Net investment income** | | **43,685** | 9,469 |
| Fee and commission income | | **2,036** | 1,682 |
| Fee and commission expense | | **457** | 486 |
| **Net fee and commission income** | | **1,579** | 1,196 |
| Other operating income | | **325** | 367 |
| **Total operating income** | | **45,589** | 11,032 |
| Operating expenses | 6 | **5,916** | 5,524 |
| Provisions and write-offs | 7 | **1,070** | 398 |
| **Operating surplus available for appropriation** | | **38,603** | 5,110 |
| | | | |
| **Appropriations:** | | | |
| Transfer/Release to special reserves for foreign exchange differences | | **27,564** | -5,312 |
| Release from special reserves – price risk (securities) | | **-7,497** | -409 |
| Release from general reserves – price risk (securities) | | **-3,557** | - |
| Transfer/Release to special reserves – price risk (gold) | | **6,653** | -498 |
| **Financial results after the appropriation of net foreign exchange gain/loss and gain/loss from unrealized price revaluation** | | **15,440** | 11,329 |
| Transfer to general reserves | | **11,580** | 8,497 |
| **Total transfer to reserves** | 14 | **34,743** | 2,278 |
| Provision for transfer of surplus to the budget of RS | | **3,860** | 2,832 |
| **Total appropriations** | | **38,603** | 5,110 |

The notes on pages 8 to 24 form an integral part of the financial statements.

## Balance sheet
at 31 December (in million of tolars)

| | Notes | **31.12.2005** | 31.12.2004 |
|---|---|---|---|
| **Assets** | | | |
| **Financial assets** | | | |
| **Foreign currency assets** | | | |
| Gold and gold receivables | 8 | **16,873** | 18,646 |
| Cash and deposits | | **321,635** | 178,046 |
| Derivative financial instruments | 9 | **35** | 39 |
| Financial assets at fair value through P/L | | **1,304,626** | 1,359,684 |
| Receivables from the Republic of Slovenia | | **7,395** | 6,963 |
| International Monetary Fund | | **12,803** | 23,033 |
| Accrued interest and other assets | 10 | **26,515** | 26,543 |
| **Total** | | **1,689,882** | 1,612,953 |
| **Domestic currency assets** | | | |
| Accrued interest and other assets | | **748** | 808 |
| **Total** | | **748** | 808 |
| **Fixed assets** | 11 | **3,643** | 3,554 |
| **Total assets** | | **1,694,273** | 1,617,315 |
| **Liabilities and reserves** | | | |
| **Serviced liabilities** | | | |
| **Foreign currency liabilities** | | | |
| Current accounts and deposits to governmental institutions | | **82,466** | 63,156 |
| Derivative financial instruments | | **1** | 0 |
| Bank of Slovenia bills | | **323,938** | 500,757 |
| IMF and other international financial organisations | | **1,789** | 1,389 |
| SDR allocation | 12 | **7,358** | 6,937 |
| Accrued interest and other liabilities | | **1,596** | 1,399 |
| **Total** | | **417,148** | 573,638 |
| **Domestic currency liabilities** | | | |
| Current accounts | | **104,286** | 104,108 |
| Commercial banks' deposits | | **203,490** | 156,730 |
| Overnight deposits | | **1,500** | 4,800 |
| Bank of Slovenia bills | | **525,184** | 266,588 |
| Republic of Slovenia deposits | | **2,682** | 127,477 |
| International financial organisations | | **271** | 264 |
| Accrued interest and other liabilities | | **6,988** | 5,651 |
| **Total** | | **844,401** | 665,619 |
| Banknotes in circulation | 13 | **214,248** | 195,352 |
| Provision for transfer of surplus to the budget of RS | | **3,860** | 2,832 |
| **Total liabilities** | | **1,479,657** | 1,437,442 |
| Capital and Reserves | 14 | **214,616** | 179,873 |
| **Total liabilities and reserves** | | **1,694,273** | 1,617,315 |

The notes on pages 8 to 24 form an integral part of the financial statements.

## Statement of changes in equity

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

| | Capital of the BoS | General reserve | Special Reserve | Operating surplus/ Deficit | Total equity |
|---|---|---|---|---|---|
| **Balance at 31 December 2003** | **2,000** | **58,145** | **117,181** | **-** | **177,327** |
| 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** |
| **Arising in the period** | | | | | |
| Operating surplus | - | - | - | 38,603 | 38,603 |
| FX gains/losses | - | - | 27,564 | -27,564 | - |
| Transfer/Release to special reserves -price risk (securities) | - | - | -7,497 | 7,497 | - |
| Transfer /Release to general reserves - price risk (securities) | - | -3,557 | - | 3,557 | - |
| Transfer/Release to special reserves -price risk (gold) | - | - | 6,653 | -6,653 | - |
| Operating surplus retained in general reserve | - | 11,580 | - | -11,580 | - |
| Provisions for transfer to RS | - | - | - | -3,860 | -3,860 |
| Total movement | - | **8,023** | **26,720** | - | **34,743** |
| **Balance at 31 December 2005** | **2,000** | **74,934** | **137,682** | **-** | **214,616** |

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

The notes on pages 8 to 24 form an integral part of the financial statements.

## Statement of cash flows

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

| | Notes | 2005 | 2004 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | **58,450** | 59,766 |
| Interest paid | | **-37,647** | -49,426 |
| Other | | **-3,360** | -3,756 |
| **Net cash flow from operating activities** | | **17,443** | 6,584 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of securities | | **-692,796** | -713,185 |
| Proceeds from sale of securities | | **763,332** | 534,208 |
| Purchase of time deposits | | **-12,665,193** | -13,093,315 |
| Proceeds from redemption of time deposits | | **12,556,317** | 13,326,889 |
| Loans and reverse repo to domestic banks | | **-52,377** | -627,200 |
| Repayment from domestic banks | | **52,377** | 627,209 |
| Purchase of fixed assets | | **-603** | -470 |
| Proceeds from sale of fixed assets | | **4** | 2 |
| **Net cash flow from investing activities** | | **-38,939** | 54,138 |
| | | | |
| **Cash flows from financing activities** | | | |
| Issue of banknotes in circulation | | **18,896** | 9,311 |
| Issue of Bank of Slovenia bills | 18 | **6,216,849** | 5,897,685 |
| Repayment of Bank of Slovenia bills | 18 | **-6,093,662** | -6,004,336 |
| Republic of Slovenia deposit | | **-111,283** | 14,128 |
| Other, net | | **-3,623** | -220 |
| **Net cash flow from financing activities** | | **27,177** | -83,432 |
| | | | |
| Exchange rate effect | | **-463** | 313 |
| **Net cash flow from all activities** | | **5,218** | -22,397 |
| | | | |
| Cash and cash equivalents at beginning of year | | **-137,316** | -114,919 |
| Cash and cash equivalents at end of year | 19 | **-132,098** | -137,316 |
| **Increase (decrease) in cash and cash equivalents** | | **5,218** | -22,397 |

The notes on pages 8 to 24 form an integral part of the financial statements.

The unaudited financial statements were approved by the Governing Board on 2. March 2006 and these audited financial statements were approved by the Governing Board on 6. April 2006 and were signed on its behalf by:

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

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

## Notes to the financial statements

### 1. Constitution

The Bank of Slovenia (the Bank) is the central bank of the Republic of Slovenia. It was constituted by the Law on the Bank of Slovenia dated 25 June 1991. In 2002 the 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 the 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 Board under the historical cost convention as modified by the revaluation of gold, financial assets designated at fair value through profit and loss, 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 and expense is recognised in the statement of income and expenditure for all interest bearing instruments using the effective interest method.

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 on an accrual basis.

#### 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.

**Financial assets at fair value through profit or loss**

In December 2003 the IASB published amendments to several standards, including IAS 39. This new standard was applied for the first time, applying the transitional provisions of the standard. One of the major changes was that the option to account for Fair value changes of financial instruments classified as available for sale in the income statement was revoked. These changes would have to be reflected in equity. As the Bank monitors and manages its securities portfolio on a fair value basis, which is reflected in the internal reports for key management and the external available financial information and the existing accounting treatment would not be changed materially, the bank decided to designate this portfolio as at fair value through profit and loss.

The Bank classifies its financial assets as financial assets at fair value through profit or loss. This category comprises of fixed and floating rate interest bearing instruments and is designated by management. Gains and losses arising from changes in the fair value of the financial assets are included in the income statement in the period in which they arise. The fair values of quoted investments in active markets are based on current last prices. The effect of securities price changes appears in the Statement of Income and Expenditure under the item Gain (loss) from price revaluation of securities.

**Derivative financial instruments**

The bank does not use derivative financial instruments except foreign exchange swap arrangements with domestic banks 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.

**Impairment of financial assets**

If there is objective evidence that an impairment loss on loan and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows, including amounts recoverable from guarantees and collateral discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

**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.

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

| | 2005 | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| **Interest income from foreign currency** | | |
| Income on gold assets | **14** | 42 |
| Interest on deposits | **5,402** | 6,523 |
| Income on financial assets at fair value through P/L | **48,867** | 46,512 |
| Interest on International Monetary Fund deposits | **445** | 421 |
| **Total** | **54,728** | 53,498 |
| | | |
| **Interest income from domestic currency** | | |
| Interest on loans to banks | **15** | 50 |
| Interests from Reverse – repo agreements | **39** | 573 |
| Swap gains | **3,319** | 6,255 |
| **Total** | **3,373** | 6,878 |
| | | |
| **Total interest income** | **58,101** | 60,376 |

Income on financial assets at fair value through P/L consists of the following:

| | 2005 | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| Interest income | **48,867** | 46,512 |
| Gains less losses from financial assets at fair value through P/L | **-11,040** | -122 |
| **Total investment income on marketable securities, net** | 37,827 | 46,390 |

## 5. Interest expenses

| | 2005 | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| **Interest expenses on foreign currency** | | |
| Interest on current accounts and deposits to governmental institutions | **889** | 499 |
| Interest on Bank of Slovenia bills | **9,728** | 10,637 |
| **Total** | **10,617** | 11,136 |
| | | |
| **Interest expenses on domestic currency** | | |
| Interest on current accounts | **828** | 1,008 |
| Interest on commercial banks' deposits | **8,201** | 2,291 |
| Interest on overnight deposits | **23** | 15 |
| Interest on Republic of Slovenia deposits | **2,288** | 6,363 |
| Interest on Bank of Slovenia bills | **15,621** | 24,158 |
| Other interest | **15** | 3 |
| **Total** | **26,976** | 33,839 |
| | | |
| **Total interest expenses** | **37,593** | 44,975 |

**Fixed assets**

Investment properties located in Austria and not used by the Bank itself are carried at fair value and are not depreciated. The Bank's policy is to obtain an independent appraisal by an external certificated valuer and to revalue these properties once every 5 years. The property's fair value is determined by the average of market values of land and buildings and theirs net present values of rental income. The last revaluation was performed in 2004. Property revaluations are taken to reserves. All other fixed assets are stated at cost and net of depreciation except for land, which is not depreciated.

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.

**Provisions**

Provisions for legal claims are recognised when the bank has a present legal or constructive obligation as a result of past events; it is more likely than not than an outflow of resources will be required to settle the obligation: and the amount has been reliably estimated.

**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. Realized gains or losses represent the difference between the selling price and last revaluation price. Revaluations are prepared on a monthly basis.

The special reserves may only be used to cover a shortfall deriving from unrealized losses 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.

## 6. Operating expenses

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| Staff costs | **3,595** | 3,277 |
| Administration costs | **2,018** | 1,817 |
| Printing and minting costs | **160** | 258 |
| Other | **143** | 172 |
| **Total operating expenses** | **5,916** | 5,524 |

The Bank employed 414 employees as at 31 December 2005 (2004: 408 employees).

In accordance with the contract between the Bank and the Trade union from March 2002 Bank employees have been included into Voluntary supplementary pension insurance, which is defined as a contribution plan. Staff costs include contribution of the Bank for Voluntary supplementary pension insurance of SIT 75 million (2004: SIT 72 million).

In 2005 the remuneration of the Governing board members of the Bank was of SIT 201 million (2004: SIT 182 million).

## 7. Provisions and write-offs

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| Due to financial institutions | **0** | -2 |
| Contingent liabilities | **1,070** | 400 |
| **Total provisions** | **1,070** | 398 |

## 8. Gold and gold receivables

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| Gold | **32** | 42 |
| Gold deposits | **16,841** | 18,603 |
| **Total gold and gold receivables** | **16,873** | 18,646 |

## 9. Derivative financial instruments

### Foreign exchange swaps and currency forwards

The Bank entered into certain foreign exchange swap agreements in 2004 and in 2005 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:

| | **2005** | | 2004 | |
|---|---|---|---|---|
| | **Fair value** | **Notional amount** | Fair value | Notional amount |
| | **SIT million** | **SIT million** | SIT million | SIT million |
| Foreign exchange swaps | | | | |
| - to be received forward against EUR | **35** | **164,780** | 39 | 225,718 |
| - to be given forward against EUR | **1** | **4,792** | 0 | 479 |
| **Total derivative financial instruments** | | **169,572** | | 226,198 |

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

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| Paid-up capital of the ECB | **312** | 312 |
| Capital investments in other non-residents | **5,199** | 4,893 |
| Accrued interest | **21,003** | 21,338 |
| Other assets | **1** | 0 |
| **Total** | **26,515** | 26,543 |

Capital investments in other non-residents represents BIS shares of SIT 5,178 million (2004: SIT 4,872 million) and SWIFT shares of SIT 21 million (2004: SIT 21 million).

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. The 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 provisions 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 million | Computers & equipment SIT million | Total SIT million |
|---|---|---|---|
| **Cost or valuation** | | | |
| At 1 January 2004 | 2,915 | 2,792 | 5,707 |
| Additions | 298 | 556 | 854 |
| Disposals | - | -44 | -44 |
| At 1 January 2005 | 3,213 | 3,304 | 6,517 |
| Additions | 13 | 555 | 568 |
| Disposals | - | -205 | -205 |
| **At 31 December 2005** | **3,226** | **3,654** | **6,880** |
| **Depreciation** | | | |
| At 1 January 2004 | 640 | 1,962 | 2,602 |
| Disposals | - | -44 | -44 |
| Charge for the year | 23 | 382 | 405 |
| At 1 January 2005 | 663 | 2,300 | 2,963 |
| Disposals | - | -205 | -205 |
| Charge for the year | 23 | 456 | 479 |
| **At 31 December 2005** | **686** | **2,551** | **3,237** |
| **Net book value** | | | |
| **At 31 December 2005** | **2,540** | **1,103** | **3,643** |
| At 31 December 2004 | 2,550 | 1,004 | 3,554 |

At 31 December 2005 an amount of SIT 1,383 million relating to investment properties in Austria (2004: SIT 1,383 million) is included in land and buildings.

## 12. SDR allocation

| | **2005** SIT million | 2004 SIT million |
|---|---|---|
| SDR allocation | **7,358** | 6,937 |
| **Total SDR allocation** | **7,358** | 6,937 |

The SDR allocation liability has an interest rate of 3.03% at 31 December 2005 (2004: 2.22%). Interest paid by the Bank is recharged directly to the Republic of Slovenia, thereby giving a nil effective interest. 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:

| | | 2005<br>SIT million | 2004<br>SIT million |
|---|---|---|---|
| SIT | 10 | **197** | 210 |
| SIT | 20 | **275** | 313 |
| SIT | 50 | **331** | 415 |
| SIT | 100 | **1,825** | 1,689 |
| SIT | 200 | **1,683** | 1,583 |
| SIT | 500 | **2,223** | 2,192 |
| SIT | 1,000 | **13,946** | 13,086 |
| SIT | 5,000 | **87,214** | 77,074 |
| SIT | 10,000 | **106,150** | 98,385 |
| Total | | **213,844** | 194,947 |
| Tolar coupons | | **404** | 405 |
| **Total** | | **214,248** | 195,352 |

## 14. Capital and reserves

| | 2005<br>SIT million | 2004<br>SIT million |
|---|---|---|
| **Balance at 1 January** | **179,873** | 177,327 |
| Transfer/Release to special reserve for foreign exchange differences | **27,564** | -5,312 |
| Release from special reserve – price risk (securities) | **-7,497** | -409 |
| Release from general reserves - price risk (securities) | **-3,557** | - |
| Transfer/Release to special reserve – price risk (gold) | **6,653** | -498 |
| Transfer to general reserve | **11,580** | 8,497 |
| Contributions to the welfare fund | **-** | 268 |
| **Balance at 31 December** | **214,616** | 179,873 |
| **Represented by** | | |
| Initial capital of the Bank of Slovenia | **2,000** | 2,000 |
| Special reserve for foreign exchange differences | **129,236** | 101,672 |
| Special reserve – price risk (securities) | **-** | 7,497 |
| Special reserve – price risk (gold) | **8,446** | 1,793 |
| General reserve | **73,551** | 65,528 |
| Investment properties revaluation | **1,383** | 1,383 |
| **Total reserves** | **214,616** | 179,873 |

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 2004 and in 2005 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 Governing Board believes that sufficient provision has been made in the accounts for any expected loss from future settlement. Detailed information in accordance with IAS 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** | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| | **SIT million** | SIT million | **SIT million** | SIT million |
| **Assets** | | | | |
| Cash and deposits | **321,635** | 178,046 | **321,939** | 178,116 |
| Due to the banks | - | - | - | - |
| **Liabilities** | | | | |
| Current accounts and deposits to banks | **82,466** | 63,156 | **82,669** | 63,192 |
| Bank of Slovenia bills in foreign currency | **323,938** | 500,757 | **324,820** | 501,922 |
| Commercial banks' deposits | **203,490** | 156,730 | **205,925** | 157,358 |
| Bank of Slovenia bills in domestic currency | **525,184** | 266,588 | **527,016** | 268,422 |
| Republic of Slovenia deposits | **2,682** | 127,477 | **2,682** | 128,582 |

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. Financial asset with the IMF consists of SDR account, Republic of Slovenia Quota, Security Account and No.1 Account with the IMF. Item is shown on a net basis according to the reserve trance position role as of Bank's own reserves (IMF Articles of Agreement).

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 2005 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 2005:

| | EUR | USD | Other | Total |
|---|---|---|---|---|
| | % | % | % | % |
| Sovereign bonds | **38.71** | **9.82** | **3.30** | **51.83** |
| Supranational securities | **2.12** | **1.61** | **1.33** | **5.06** |
| Foreign banks securities | **35.72** | **3.24** | **4.15** | **43.11** |
| **December 31, 2005** | **76.55** | **14.67** | **8.78** | **100.00** |
| 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 |

## Interest rate risk

Average effective interest rates:

| | Reprising period | | | | |
|---|---|---|---|---|---|
| | 3 months or less | 3 months to 1 year | Over 1 year | 2005 Total | 2004 Total |
| | % | % | % | % | % |
| **Assets** | | | | | |
| **Foreign currency assets** | | | | | |
| Gold and gold receivables | - | - | 0.06 | 0.06 | 0.07 |
| Cash and deposits | 2.81 | 3.52 | - | 2.86 | 2.67 |
| Derivative financial instruments | 1.50 | - | - | 1.50 | 1.25 |
| Financial assets at fair value through P/L | 3.04 | 3.28 | 3.30 | 3.28 | 2.76 |
| International Monetary Fund | 2.46 | - | - | 2.46 | 2.00 |
| **Liabilities** | | | | | |
| **Foreign currency liabilities** | | | | | |
| Current accounts and deposits to governmental institutions | 2.56 | 3.51 | - | 2.81 | 1.67 |
| Derivative financial instruments | 1.00 | - | - | 1.00 | 1.25 |
| Bank of Slovenia bills | 2.38 | 2.98 | - | 2.45 | 2.09 |
| **Domestic currency liabilities** | | | | | |
| Current accounts | 0.75 | - | - | 0.75 | 0.91 |
| Commercial banks' deposits | - | - | 4.20 | 4.20 | 4.20 |
| Overnight deposits | 2.25 | - | - | 2.25 | 2.25 |
| Bank of Slovenia bills | 4.00 | - | - | 4.00 | 4.08 |
| Republic of Slovenia deposits | 1.00 | - | - | 1.00 | 3.46 |

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

## Interest sensitivity of assets and liabilities

(SIT million)

| | Reprising period | | | |
|---|---|---|---|---|
| | **3 months or less** | **3 months to 1 year** | **Over 1 year** | **2005 Total** |
| **Assets** | | | | |
| **Foreign currency assets** | | | | |
| Gold and gold receivables | 32 | - | 16,841 | **16,873** |
| Cash and deposits | 299,923 | 21,712 | - | **321,635** |
| Derivative financial instruments | 35 | - | - | **35** |
| Financial assets at fair value through P/L | 104,275 | 241,141 | 959,210 | **1,304,626** |
| Receivables from the RS | 37 | - | 7,358 | **7,395** |
| International Monetary Fund | 12,803 | - | - | **12,803** |
| **Total assets** | **417,105** | **262,853** | **983,409** | **1,663,367** |
| **Liabilities** | | | | |
| **Foreign currency liabilities** | | | | |
| Current accounts and deposits to governmental institutions | 60,641 | 21,825 | - | **82,466** |
| Derivative financial instruments | 1 | - | - | **1** |
| Bank of Slovenia bills | 288,229 | 35,709 | - | **323,938** |
| IMF and other IFO | 1,787 | - | 2 | **1,789** |
| SDR allocation | - | - | 7,358 | **7,358** |
| **Domestic currency liabilities** | | | | |
| Current accounts | 104,286 | - | - | **104,286** |
| Commercial banks' deposits | - | - | 203,490 | **203,490** |
| Overnight deposits | 1,500 | - | - | **1,500** |
| Bank of Slovenia bills | 525,184 | - | - | **525,184** |
| Republic of Slovenia deposits | 2,682 | - | - | **2,682** |
| International financial organisations | 271 | - | - | **271** |
| **Total liabilities** | **984,581** | **57,534** | **210,850** | **1,252,965** |
| **Net interest sensitivity gap** | **-567,476** | **205,319** | **772,559** | **410,402** |
| **December 31, 2004** | | | | |
| Total assets | 281,942 | 281,692 | 1,022,776 | 1,586,410 |
| Total liabilities | 904,124 | 101,523 | 226,561 | 1,232,207 |
| Net interest sensitivity gap | -622,182 | 180,169 | 796,215 | 354,203 |

## 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 2005:

| | SIT | EUR | USD | Other | Total |
|---|---|---|---|---|---|
| | SIT million | SIT million | SIT million | SIT million | SIT million |
| **Assets** | | | | | |
| **Foreign currency assets** | | | | | |
| Gold and gold receivables | - | - | - | 16,873 | **16,873** |
| Cash and deposits | - | 235,535 | 46,140 | 39,960 | **321,635** |
| Derivative financial instruments | - | 35 | - | - | **35** |
| Financial assets at fair value through P/L | - | 999,525 | 190,662 | 114,439 | **1,304,626** |
| Receivables from the RS | - | - | - | 7,395 | **7,395** |
| International Monetary Fund | - | - | - | 12,803 | **12,803** |
| Accrued interest and other assets | - | 17,561 | 2,512 | 6,442 | **26,515** |
| **Domestic currency assets** | 748 | - | - | - | **748** |
| **Total assets** | **748** | **1,252,656** | **239,314** | **197,912** | **1,690,630** |
| **Liabilities** | | | | | |
| **Foreign currency liabilities** | | | | | |
| Current accounts and deposits to governmental institutions | - | 50,360 | 31,775 | 331 | **82,466** |
| Derivative financial instruments | - | 1 | - | - | **1** |
| Bank of Slovenia bills | - | 288,612 | 35,326 | - | **323,938** |
| IMF and other IFO | - | 1,787 | - | 2 | **1,789** |
| SDR allocation | - | - | - | 7,358 | **7,358** |
| Accrued interest and other liabilities | | 1,187 | 363 | 46 | **1,596** |
| **Domestic currency liabilities** | 844,401 | - | - | - | **844,401** |
| **Total liabilities** | **844,401** | **341,947** | **67,464** | **7,737** | **1,261,549** |
| **Net balance sheet position** | **-843,653** | **910,709** | **171,850** | **190,175** | **429,081** |
| **Off-balance sheet net position** | - | **-169,572** | - | - | **-169,572** |
| **December 31, 2004** | | | | | |
| Total assets | 808 | 1,214,736 | 200,675 | 197,542 | 1,613,761 |
| 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 |

## Maturities of assets and liabilities

(SIT million)

| | Remaining period to the contractual maturity date | | | |
|---|---|---|---|---|
| | 3 months or less | 3 months to 1 year | Over 1 year | 2005 Total |
| **Assets** | | | | |
| **Foreign currency assets** | | | | |
| Gold and gold receivables | - | - | 16,873 | **16,873** |
| Cash and deposits | 299,923 | 21,712 | - | **321,635** |
| Derivative financial instruments | 35 | - | - | **35** |
| Financial assets at fair value through P/L | 104,275 | 241,141 | 959,210 | **1,304,626** |
| Receivables from the RS | 37 | - | 7,358 | **7,395** |
| International Monetary Fund | 2,354 | - | 10,449 | **12,803** |
| Accrued interest and other assets | 12,682 | 8,635 | 5,198 | **26,515** |
| **Domestic currency assets** | | | | |
| Accrued interest and other assets | 441 | 83 | 224 | **748** |
| **Total assets** | **419,747** | **271,571** | **999,312** | **1,690,630** |
| **Liabilities** | | | | |
| **Foreign currency liabilities** | | | | |
| Current accounts and deposits to governmental institutions | 60,641 | 21,825 | | **82,466** |
| Derivative financial instruments | 1 | - | - | **1** |
| Bank of Slovenia bills | 288,229 | 35,709 | - | **323,938** |
| IMF and other IFO | 1,787 | - | 2 | **1,789** |
| SDR allocation | - | - | 7,358 | **7,358** |
| Accrued interest and other liabilities | 1,385 | 211 | - | **1,596** |
| **Domestic currency liabilities** | | | | |
| Current accounts | 104,286 | - | - | **104,286** |
| Commercial banks' deposits | - | - | 203,490 | **203,490** |
| Overnight deposits | 1,500 | - | - | **1,500** |
| Bank of Slovenia bills | 525,184 | - | - | **525,184** |
| Republic of Slovenia deposits | 2,682 | - | - | **2,682** |
| International financial organisations | 271 | - | - | **271** |
| Accrued interest and other liabilities | 6,636 | 352 | - | **6,988** |
| **Total liabilities** | **992,602** | **58,097** | **210,850** | **1,261,549** |
| **Maturity gap** | **-572,855** | **213,474** | **788,462** | **429,081** |
| **December 31, 2004** | | | | |
| Total assets | 273,050 | 272,741 | 1,067,970 | 1,613,761 |
| Total liabilities | 910,125 | 102,407 | 226,726 | 1,239,258 |
| Maturity gap | -637,074 | 170,334 | 841,244 | 374,503 |

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 tasks is to ensure liquidity of payments within the country. The nature of these activities is 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

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| **Source** | | |
| Banks deposits | **46,760** | 156,730 |
| Tolar bills | **258,596** | - |
| **Total** | **305,356** | 156,730 |
| | | |
| **Disbursement** | | |
| Foreign currency bills | **-182,169** | -57,639 |
| Tolar bills | - | -205,742 |
| **Total** | **-182,169** | -263,381 |
| | | |
| **Total net source/disbursement** | **123,187** | -106,651 |

## 19. Supplemental cash flow information: cash and cash equivalents

| | **2005** | 2004 |
|---|---|---|
| | **SIT million** | SIT million |
| **Foreign currency assets** | | |
| Cash | **11,893** | 5,281 |
| **Total assets** | **11,893** | 5,281 |
| | | |
| **Foreign currency liabilities** | | |
| Demand deposits | **-35,399** | -30,675 |
| **Domestic currency liabilities** | | |
| Commercial banks' demand deposits | **-97,664** | -94,033 |
| Overnight deposits | **-1,500** | -4,800 |
| Non-bank deposits | **-9,428** | -13,089 |
| **Total liabilities** | **-143,991** | -142,597 |
| | | |
| **Cash and cash equivalents** | **-132,098** | -137,316 |

Foreign currency cash assets include IMF balances of SIT 2,354 million (2004: SIT 1,958 million) and do not include time deposits of SIT 294,828 million (2004: SIT 162,166 million) or other assets of SIT 14,459 million (2004: SIT 12,557 million).

Foreign currency demand deposits do not include restricted deposits of SIT 47,067 million (2004: SIT 32,482 million).

Domestic currency liabilities include overnight deposits of SIT 1,500 million (2004: SIT 4,800 million), Republic of Slovenia deposits of SIT 2,680 million (2004: SIT 2,750 million) and tolar accounts of central banks and of the European Commission of SIT 271 million (2004: SIT 264 million). They do not include liabilities to KDD of SIT 145 million.