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Abbreviations:

AJPES	Agency of the Republic of Slovenia for Public Legal Records and Related Services
AUP	Average unit price of a mutual fund
BAS	Bank Association of Slovenia
BoS	Bank of Slovenia
BRIC	Brazil, Russia, India, China
CCBM	Correspondent Central Banking Model
CSCC	Central Securities Clearing Corporation
DS	Debt securities
ECB	European Central Bank
ECBC	European Covered Bond Council
EFAMA	European Funds and Asset Management Association
EFTA	European Free Trade Association
EIOPA	European Insurance and Occupational Pensions Authority
EMU	Economic and Monetary Union
EONIA	Euro OverNight Index Average (weighted average interest rate for overnight credit)
ERM2	Exchange Rate Mechanism 2
ESCB	European System of Central Banks
EU16	Euro area
EU27	EU Member States
EU3	European Union Member States prior to enlargement of 1 May 2004 that are not members of the euro area (Denmark, Sweden, UK)
EU8	Poland, Hungary, Czech Republic, Slovenia, Slovakia, Estonia, Latvia, Lithuania

EURIBOR	Interbank interest rate at which representative banks in the euro area offer deposits to one another
Eurostat	Statistical Office of the European Communities
IFs	Investment funds
IMF	International Monetary Fund
Leaseurope	European Federation of Leasing Company Associations
LJSE	Ljubljana Stock Exchange
LTI	Loan-to-income ratio
LTV	Loan-to-value ratio
MCs	Management companies
MF	Mutual fund
OECD	Organisation for Economic Co-operation and Development
OFIs	Other financial institutions
P/E	Price-to-earnings ratio
PDII	Pension and Disability Insurance Institute
RTGS (system)	Real-Time Gross Settlement
S&P	Standard and Poor's
SAS	Slovenian Accounting Standards
SBI TOP	Blue-chip index at Ljubljana Stock Exchange
SI O/N	Interest rate on unsecured interbank euro-denominated overnight deposits between Slovenian credit institutions and euro area credit institutions
SLA	Slovenian Leasing Association
Slonep	Slovenian real estate portal (www.slonep.net)
SMA	Securities Market Agency
SMARS	Surveying and Mapping Authority of the Republic of Slovenia
SORS	Statistical Office of the Republic of Slovenia
TARS	Tax Administration of the Republic of Slovenia
TR	Turnover ratio
WFE	World Federation of Exchanges

Note: the analytical demarcation of the banking system in this publication into homogeneous groups of banks, namely large domestic banks, small domestic banks and banks under majority foreign ownership, is not the product of value judgements, but is based on the attributes of their operations, in particular their funding structure.

CONCLUSIONS

The renewed contraction in economic activity at home and the mounting of the European debt crisis in the second half of 2011 are the key factors in the ongoing uncertainty in the financial sector. The profound impact on the Slovenian economy of the financial crisis, which is now in its fourth year, is increasingly being reflected in the banks' performance and the quality of the credit portfolio. This is even more the case given corporates' high financial dependence on bank loans, their excessive indebtedness and the major commercial and ownership cross-links between them. The underperformance of an increasing number of corporates, which has been reflected in a doubling of the number of bankruptcy proceedings initiated in the past year compared with 2009, and the steadily shrinking value-added in individual sectors of the economy are an indication of the slow pace of business and financial restructuring in a large portion of the economy. Non-financial corporations' leverage remains relatively high at 143.5%, and actually increased last year, contrary to expectations. The over-indebtedness of the real sector, whose debt increased to 99% of GDP, and the lack of urgency in reducing financial leverage by increasing equity are continuing to limit corporate creditworthiness. The poorly developed capital market, where liquidity is poor, where there has been a fall of 30% in the stock market and where attempts to sell equity acquired as collateral for outstanding debt have lacked transparency, does not represent a serious alternative for corporate financing. In the past year the corporate sector has issued only EUR 16 million in new long-term bonds, and has only undertaken two issues of short-term commercial paper. In addition to net repayments of bank loans, increasing insolvency has also brought a reduction in business-to-business financing via commercial loans, or has seen them mutate into normal business-to-business loans. It is this very increase in insolvency and the number of bankruptcy proceedings that represents a major threat of a continuing deterioration in the quality of business-to-business debt, which constitutes 28% of non-financial corporations' total debt. Write-downs of business-to-business debt will translate into a diminished ability to regularly repay bank loans.

Households remain relatively regular in making repayments to banks, although low growth in disposable income and the continuing rise in unemployment has brought an increase in the proportion of defaulters in this sector too.

The banking sector ended the last financial year with high aggregate losses, as a result of the gradual decline in net interest income and high impairment and provisioning costs, which amounted to 84% of the banks' gross income last year. Income risk remains significant for the banks in the current year, as a result of the contraction in lending activity and persistently high impairment and provisioning costs, which are reducing their capacity to generate capital internally.

Credit risk worsened at the banks last year. The proportion of bad debts from debtors more than 90 days in arrears in settling their liabilities increased more than in 2009 during the sharpest contraction in economic activity. The rising trend in the ratio of bad debts to total classified claims has nevertheless slowed in recent months, while the ratio actually declined at certain banks, most notably the banks under majority foreign ownership. The deterioration in the quality of the credit portfolio is not merely the result of a rise in the proportion of claims against debtors in arrears, but also of a sustained decline in bank lending activity. The banks have succeeded in reducing their financial leverage primarily via loan repayments by good clients, and less via recapitalisations, while at the same time they have achieved relatively high progress of 40% in restructuring past-due loans, which could bring an increase in the proportion of bad loans in the future. The banks are insufficiently involved with corporates in their business and financial restructuring, and are not making sufficient effort to retain good clients by means of greater interest differentiation. The banks' passivity and erroneous assessment in this process are leading to larger write-downs of bad debts, and not only to an increase in impairments. The two factors in last year's increase in impairments were the increase in bad debts and the devaluation of assets accepted as loan collateral. The decline in the value of assets is a result of the urgent deleveraging processes that are simultaneously underway in the corporate sector and the banking sector, and which will also take place in the public sector in the future.

Additional uncertainty is being brought to the banking sector by the process of funding restructuring: the net repayment of liabilities to the rest of the world and slow growth in deposits by the non-banking sector. Despite the contraction in loans, this has been reflected in a slow decline in the LTD ratio for the non-banking sector. The aforementioned ratio remains too high at 136%, and will have to be reduced in the years ahead. The Bank of Slovenia has already responded to the threat of baseless competition for domestic deposits by means of extreme deposit rate offers. Such behaviour by the banks has no impact on aggregate growth in deposits, but merely results in difficult-to-predict switching of deposits between banks. The banking system's refinancing risk and liquidity risk were reduced by non-standard ECB operations, although this merely postponed the problem of refinancing in the rest of the world. As they themselves and long-term sovereign debt underwent downgradings, the banks saw their borrowing costs on international lending markets rise, or their access to these resources limited.

Another factor in the availability and cost of the banking system's foreign funding is the lack of progress in the urgent recapitalisation of the largest bank under majority government ownership. The adequate recapitalisation of the banks is a prerequisite for the beginning of a new credit cycle, as average capital adequacy at Slovenian banks remains below the EU average, despite last year's increase. With the recapitalisations on hold, the requisite size thereof and hence the capital risk are growing. More-intensive consolidation of the banking system via mergers, links and acquisitions is vital to increasing the effectiveness and ease of access to the requisite capital.

The current economic crisis is increasingly becoming a Slovenian problem, and it cannot be overcome merely through the promotion of exports and investment, or structural changes at the level of fiscal consolidation. There is also a need to make changes to the legal regulation of the commercial activities of business entities, changes in corporate governance, changes in the legal relationships between the creditors and owners of firms in difficulty, and changes in the business models of firms and banks, whose growth will not be based solely on an increase in financial leverage via borrowing at home and in the rest of the world. The possible aggravation of the European debt crisis would only worsen the domestic situation, given the heavy dependence on foreign funding, while a faster recovery in the most important trading partners would only ease Slovenia's problems, but would not eliminate them. The re-establishment of a stable financial system with soundly functioning banks will therefore be a lengthy process, closely linked to the aforementioned requisite changes.

Marko Kranjec, Ph.D.
Governor

EXECUTIVE SUMMARY

The Slovenian economy fell into recession in the second half of last year, under the influence of a decline in domestic consumption and the adverse situation on international markets, which held back growth in exports. A decline in investment activity was a reflection of the reticence in taking longer-term business decisions in the uncertain situation, the over-indebtedness of the corporate sector and the limitations in financing.

Dependence on foreign funding increased to 39% of GDP, as a result of inadequate savings and a lack of capital.[1] The banking system made net debt repayments on the international financial markets, while the government sector undertook borrowing. The net external debt thus remained at the level of 32% of GDP, but interest expenditure is increasing.

As a result of the rejection of structural reforms and the pressure on the public finances, the rating agencies acted on their previous warnings and downgraded the long-term sovereign debt last autumn and this January. At the same time they downgraded the Slovenian banks, which both raised their funding costs and restricted their access to foreign funding. The postponement of fiscal consolidation and the recapitalisation of the banks under majority government ownership could further reduce access to foreign funding.

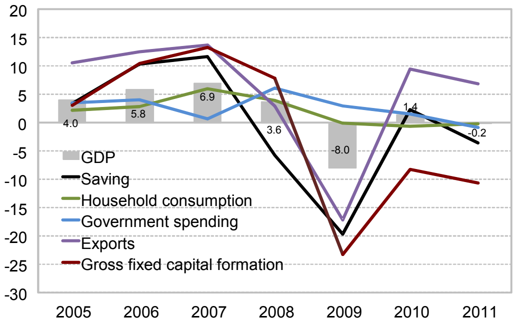
During the last two years Slovenian households felt the impact of rising unemployment and restricted wage growth, although growth in disposable income had been low even before that. Household financial assets declined last year, although their low-risk investments displayed an upward trend. Households hold 37.5% of their financial assets in deposits at domestic banks. Household financial liabilities stagnated last year. The proportion of bank loans to households accounted for by housing loans increased to 55%, although their growth is declining. Growth in consumer loans has been negative since the middle of 2010. Households saw their debt servicing burden increase last year, while the increase in credit risk in this sector has been reflected in a rise in the proportion of loans repaid in arrears. Households' interest rate risk is increasing as a result of the rising proportion of loans with variable interest rates, and as a result of lengthening maturities. Exposure to the risk of a change in the Swiss franc's exchange rate against the euro is declining as a result of the smaller stock of loans in Swiss francs or with a currency clause tied to it.

According to SORS figures, prices of used housing on the domestic market fell by 0.7% last year, while prices of new-build housing rose by 4.1%. New-build housing accounted merely for just over 16% of all transactions in residential real estate. The number of transactions in new-build housing fell faster than the number of transactions in used housing, an indication of the greater over-valuation of new-build housing relative to used housing. Commercial real estate prices stagnated last year.

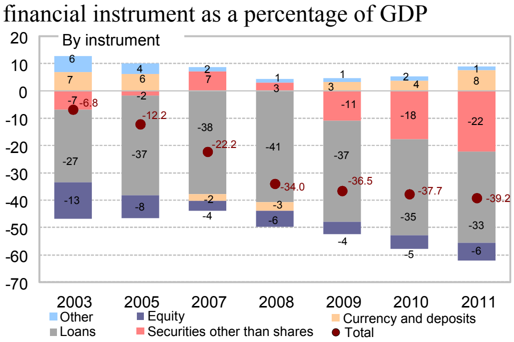
The value of new housing loans fell by a quarter last year. The banks noted a decline in demand for housing loans in the second half of the year, while further tightening their credit standards. Lower growth in household lending and

[1] The figures for inter-sector financial claims and liabilities are illustrated in Table 1.1 of the statistical appendix.

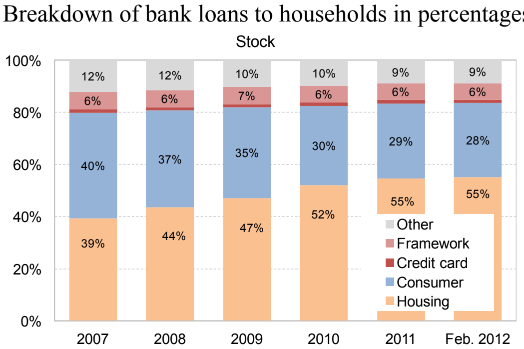
Annual growth in selected macroeconomic aggregates in percentages



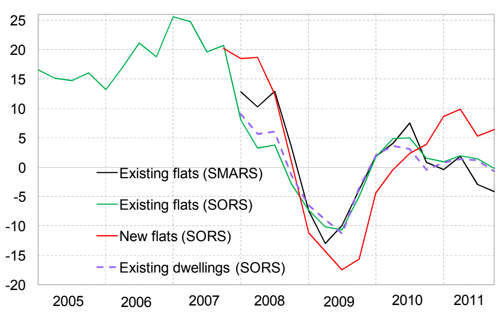
Net financial position against the rest of the world by financial instrument as a percentage of GDP



Breakdown of bank loans to households in percentages



Year-on-year growth in prices of used and new-build housing in Slovenia in percentages



lower household purchasing power will bring a fall in housing prices. Relatively high corporate indebtedness was the main limiting factor in corporate financing last year. Corporates made debt repayments to domestic banks, non-monetary financial institutions and households. The annual flow of corporate financing declined from 22% of GDP in 2008 to 1.1% of GDP last year. As a result of liquidity problems and insolvency, business-to-business financing was also considerably limited.

Corporate financing from the rest of the world rose to near its pre-crisis level, at EUR 1.4 billion. The largest rises were recorded in manufacturing and in wholesale and retail trade, the sectors that simultaneously recorded the largest reductions in their borrowing from domestic banks. The loss of the best clients, particularly export-oriented corporates, is a major factor in the increase in income risk at Slovenian banks. This could accelerate further, if the uncompetitive local business environment and adverse financing conditions mean that corporates begin transferring their financial operations to the rest of the world.

The inflow of equity into corporates amounted to a modest EUR 363 million last year. Corporates in all but three sectors, one of which was construction, reduced their debt at banks. The clients with low creditworthiness that do not have the potential to encourage lending through creditworthy demand have remained in the banks' portfolios. At the same time, some new bank loans merely represent an extension of old loans to corporates with repayment problems. This type of lending is exposing the banks to credit risk vis-à-vis debtors, some of which at least cannot be restructured. The banks also remain too passive in corporates' business and financial restructuring.

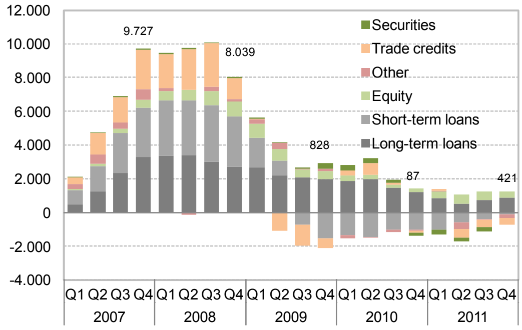
The corporate debt-to-equity ratio rose slightly last year, to 143.5%, as a result of capital revaluations during stock market falls. The high leverage of Slovenian corporates remains a key factor preventing impetus in lending growth and the start of a new investment cycle. Corporate recapitalisation is thus an urgent prerequisite for emerging from the crisis, but the reduction in the stock of lending as corporates reduce their financial leverage will make this impossible.

A feature of corporate debt financing in Slovenia is that the interest rates are higher than the euro area average, although the spread is diminishing. The reasons are the excessive risks taken up by Slovenian banks in the pre-crisis period, their higher funding costs, the competition for deposits, the higher corporate indebtedness in Slovenia, the long and expensive bankruptcy proceedings and the inelasticity in demand for loans. The risk premiums in lending rates stagnated last year, but remain above 3 percentage points, well above the pre-crisis levels. The banks further tightened their credit standards in the final quarter of 2011.

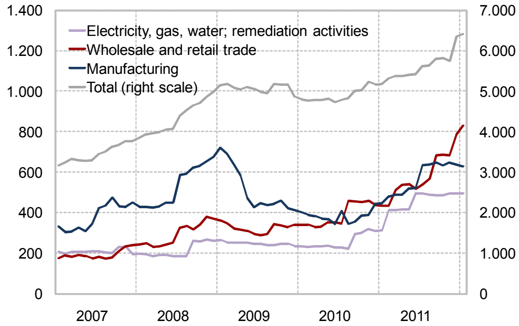
As a result of the increase in the proportion of newly approved corporate loans with variable interest rates, corporates are becoming more exposed to the risk of a rise in interest rates, their exposure having already surpassed the euro area average. Despite a decline in corporate indebtedness, interest payments increased by 3.8% last year as a result of the prevalence of variable remuneration.

The consolidation process again failed to get underway in the Slovenian banking system last year. This would improve the cost effectiveness of the banks and their access to capital.

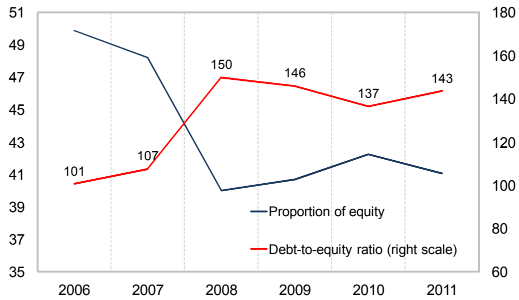
Corporate borrowing by instrument, annual moving total of flows in EUR million



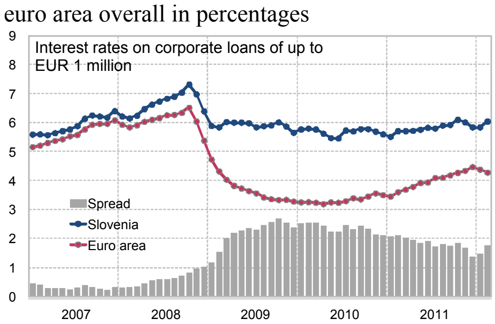
Stock of corporate loans from the rest of the world for selected sectors in EUR million



Corporate debt-to-equity ratio in percentages



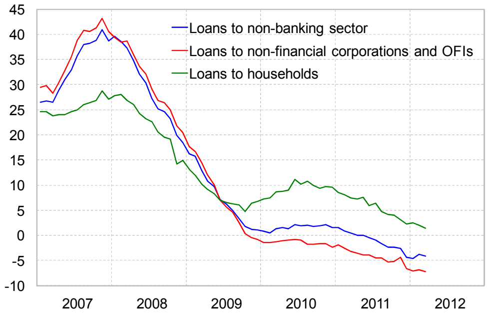
Interest rates on corporate loans in Slovenia and in the euro area overall in percentages



There was no significant change in ownership structure, while total assets declined by 3.1%.

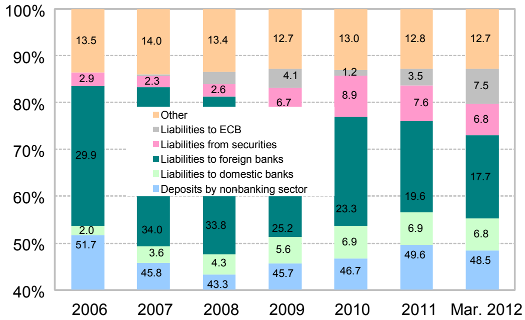
A crunch in lending to the non-banking sector was a key feature of last year and the early part of this year. The largest declines in the stock of loans were recoded by the corporate sector (sectoral breakdown), short-term loans (maturity breakdown) and the large domestic banks (breakdown by bank groups). There were a number of reasons for the crunch in lending. In light of the low creditworthy demand from corporates and the expected decline in demand for household loans, the deterioration in the quality of the portfolio, the decline in wholesale funding and the relatively low capital adequacy compared with other EU banks are additional factors preventing higher supply of loans to the non-banking sector.

Growth in loans to the non-banking sector in percentages



The banks continued to restructure their funding by making debt repayments on foreign wholesale markets and by increasing funding from the Eurosystem to 7.5% of total liabilities via their participation in 3-year LTROs last December and this February. The banks thereby temporarily reduced their refinancing risk, and earned time to modify their funding models. The government sector gradually reduced its deposits at banks, which accounted for 11% of the total stock of deposits by the non-banking sector in February. The LTD ratio declined slightly last year, but remains relatively high at 136%. Bank funding costs rose over the first ten months of last year as a result of rising market interest rates. The banks reduced their costs by reducing the stock of securities, the most expensive type of funding.

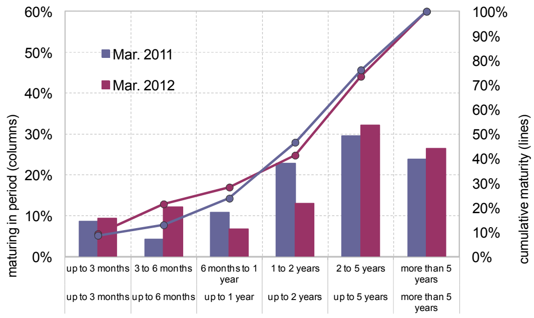
Breakdown of bank funding in percentages



Last year the Slovenian banking system recorded a loss for the second consecutive year, which amounted to EUR 436 million according to unaudited figures. The key factor in the loss was an increase in impairment and provisioning costs to 84% of the disposal of the banking system's gross income. The large loss brought a decline in capital adequacy and a lack of internal resources for recapitalisation.

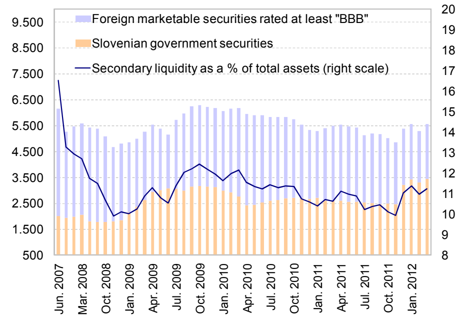
The average residual maturity of debt to foreign banks shortened last year. The proportion of liabilities maturing within one year stood at 33% in December, up almost 10 percentage points on a year earlier. The banks have EUR 4.1 billion of liabilities to foreign banks maturing in 2012.

Maturing of liabilities to foreign banks by maturity interval in percentages



Liquidity risk was moderate last year, and almost unchanged compared with 2010. The first-bucket liquidity ratio remained relatively high for all bank groups in the first quarter of this year, although there was greater variation between individual banks than before the outbreak of the crisis. Another result of the adjustment in the structure of bank funding in the past year was a trend of decline in the stock of secondary liquidity until the first months of this year, when it temporarily increased to more than 11% of total assets.

Changes in the stock of secondary liquidity (monthly averages in EUR million) and ratio of secondary liquidity to total assets in percentages



Credit risk increased, and had the largest adverse impact on the banking system. The proportion of claims being settled more than 90 days in arrears increased by 3.8 percentage points to 11.2%, and stood at 18.5% in the corporate sector. The quality of the banks' investments in non-monetary financial institutions and the quality of the small business portfolio also deteriorated.

The deterioration in the quality of the portfolio of non-financial corporations was most pronounced at the large domestic banks, and vis-à-vis construction firms, half of whose claims are settled more than 90 days in arrears. A large proportion of bad debts was partly the result of lengthy bankruptcy proceedings during which the bad debts remained on the banks' balance sheets, despite the very small likelihood of their repayment. The stock of claims against firms in bankruptcy had increased to EUR 1.7 billion by the end of last year, and to 7% of total classified claims against non-financial corporations. Another factor in the deterioration in indicators of the quality of the credit portfolio was the contraction in loans, as newly approved loans are generally classified in the lowest credit ratings.

The rating structure of claims deteriorated, as the proportion of higher-rated claims declined and the proportion of lower-rated claims increased. Impairments and provisioning had increased to EUR 3.3 billion by this February. Coverage of classified claims by impairments exceeded 6.7%. All this indicates the need for the banks to take an active approach to bad investments, including working with firms in difficulty on their thorough restructuring, and accelerating the write-off of those claims that are highly unlikely to be repaid. If 2010 saw firms in the worst crisis to date, last year saw the consequences spread to bank balance sheets.

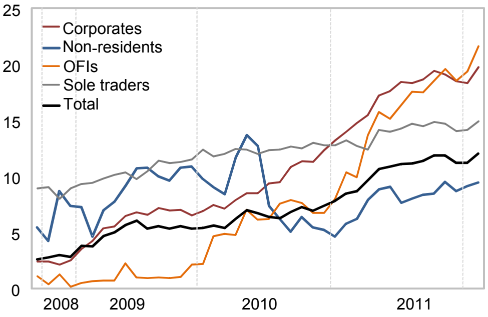
Interest rate risk as measured by the difference between the average repricing periods of asset and liability interest rates increased. The largest increases were at the banks under majority foreign ownership, while the small domestic banks were the most heavily exposed. The banks are exposed to the risk of a rise in interest rates, exposure within a period of one year increasing in particular.

Currency risk is low, and declined further last year. Foreign currency assets and liabilities account for less than 5% of total assets and liabilities, and there was no change worthy of any note in the gap between them. The net long foreign exchange position declined to just 0.4% of regulatory capital last year. The stock of loans in Swiss francs is declining.

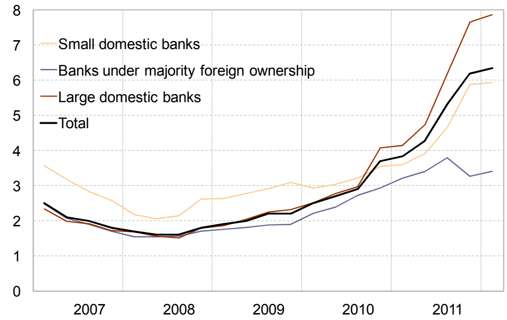
The banking system's capital adequacy increased, primarily as a result of the decline in capital requirements caused by the decline in turnover, and partly as a result of capital increases. The increase would have been larger, had the stock of hybrid instruments not declined, and had high impairment and provisioning costs not brought a large operating loss in the final quarter of last year. Even as the own funds structure improved, the gap by which capital adequacy trails the EU average widened. As at the end of 2011 half of Slovenian banks did not meet the level of 9% for the core Tier 1 capital ratio set as a reference at the European level. These are merely more arguments in favour of recapitalisation, which would ease the transition to more appropriate methods of funding and facilitate lending.

Insurers operated at a profit in 2011, increasing their total assets and gross written premium. The increase in the latter was very small because of the adverse economic situation; health insurance premium increased most. Insurance penetration stagnated, yet increased in the euro area overall, so that the development indicator for Slovenia worsened. There was a merely symbolic increase in the claims ratio, as it improved for non-life insurance but deteriorated for life insurance. Insurers increased their assets covering technical provisions. Written premium for credit insurance

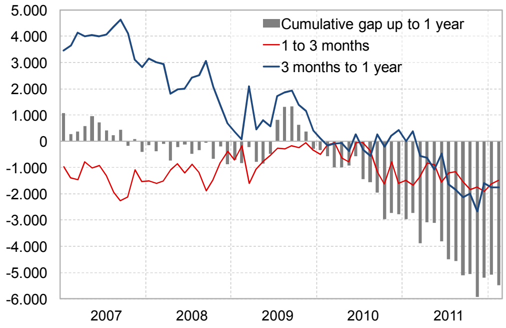
Proportion of total classified claims more than 90 days in arrears by client segment in percentages



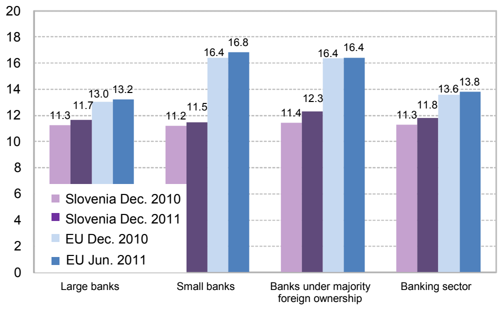
Proportion of non-performing assets by bank group in percentages



Gap between interest-sensitive assets and liabilities by individual bucket in EUR million



Capital adequacy by bank group on a consolidated basis in comparison with the EU average in percentages



declined. The conditions of low interest rates nevertheless remain unfavourable to long-term life insurance and pension insurance. Similarly, further downgradings of long-term government securities would have an adverse impact on insurers' performance.

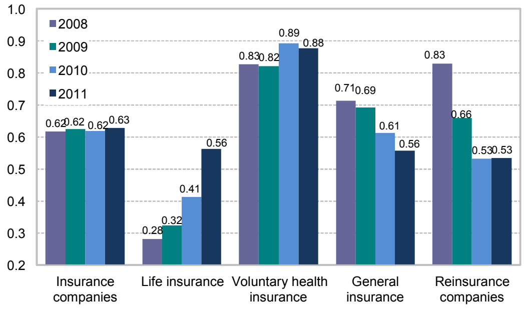
The investment funds' assets under management declined by a fifth last year, as a result of net withdrawals of EUR 77.2 million and fall of 14.4% in the weighted average unit price. The ratio of the investment funds' assets under management to GDP declined from 12% before the crisis to 5.1%. The number of mutual funds nevertheless increased last year. The process of investment companies converting into mutual funds was also completed. The integration between investment funds and the banking sector stagnated. Management companies under majority bank ownership accounted for 40% of the domestic investment funds' total assets under management. Their debt at the banks increased as the unstable situation on the financial markets meant that they needed more liquid assets. The mutual funds' demand for liquid assets is an indication of the breakdown of investors, among whom the household sector is prevalent. Since the negative experience of 2008, they have become more sensitive to making withdrawals after any changes in mutual funds' returns.

The main factor in the net withdrawals from mutual funds was the household sector, whose withdrawals were four times higher than in the previous year as a result of the deterioration in the situation on the labour market and the preference for safer investments. The net withdrawals requested by the corporate sector were much lower than those of households. Insurers more than halved their net payments into mutual funds last year. This investor behaviour is unsurprising, as fewer than one in eight mutual funds recorded a positive return. The equity funds, which account for two-thirds of the sector, were prevalent among those recording a loss. The proportion of investments in foreign securities, particularly those from outside the EU, is increasing at all types of mutual fund, which is increasing their sensitivity to changes on international capital markets.

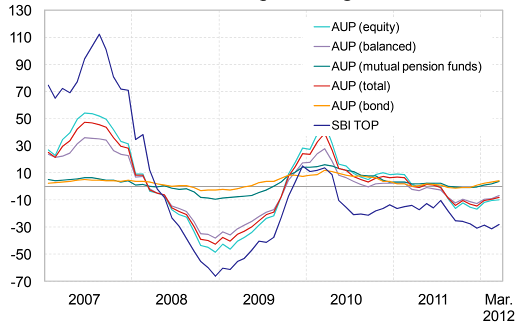
The situation on the Slovenian capital market deteriorated significantly. As liquidity remained low, the SBI TOP fell by 30.7% last year, to a level last seen in 2003. The market capitalisation of shares fell by almost a third, while the market capitalisation of bonds rose by 9.6%, with bank bonds prevalent in the breakdown. The corporate sector's proceeds from bond issues amounted to just EUR 63 million last year. The number of listed securities also fell in a situation when the corporate sector needs to be recapitalised for the stability of the entire financial system.

Leasing business declined last year as a result of a decline in the volume of new business, the termination of agreements, and impairments. Equipment leasing declined by more than real estate leasing. This latter is declining as a result of the decline in demand for commercial and residential real estate. The average maturity of new transactions in real estate is shortening. The risk in the leasing sector is the result of its high leverage. Leasing companies primarily fund themselves in the rest of the world, most notably those under foreign ownership, whose funding comes from non-resident related parties, as a result of which Slovenian banks' exposure to this sector is merely 4% of loans to the non-banking sector. Leasing companies operated at a loss in 2011 for the third consecutive year.

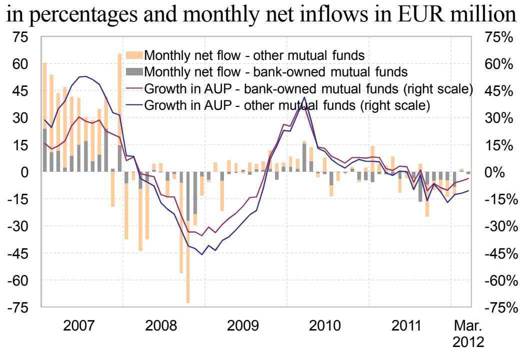
Claims ratio for major types of insurance



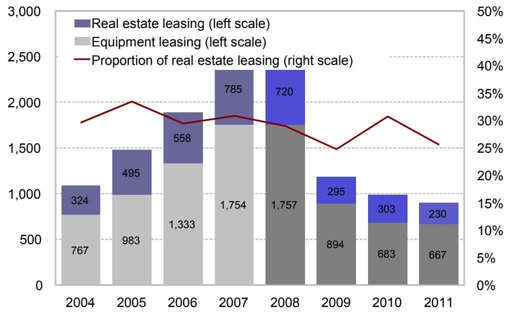
Year-on-year change in the average unit price of mutual funds and the SBI TOP in percentages



Mutual funds: year-on-year change in the average unit price in percentages and monthly net inflows in EUR million



Volume of new leasing business in EUR million



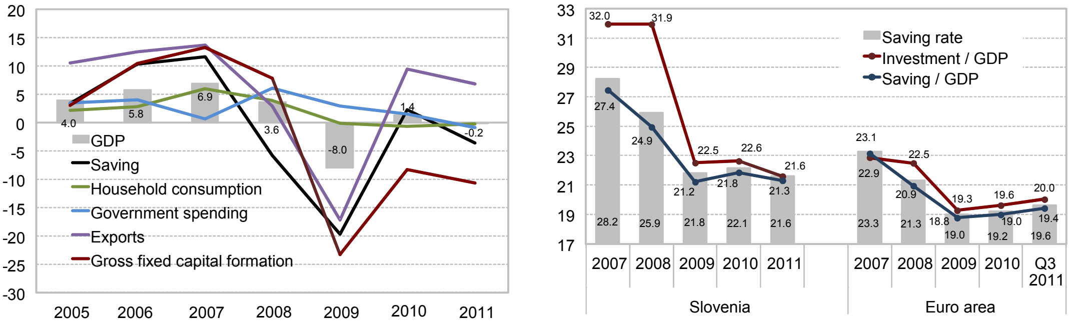
Payment systems and securities clearing and settlement systems functioned reliably last year. The only exception was operational problems in the pan-European Union TARGET2 payment system, which prevented the usual start of the business day on 25 July, and brought down all the national components of the system. The quick action to rectify the problems was evidence of its effectiveness.

1 ECONOMIC TRENDS AND INTER-SECTOR FINANCIAL CLAIMS AND LIABILITIES

Economic activity declined in 2011 as a result of lower domestic consumption and the adverse situation on international markets.

A recovery in economic activity in the first half of 2011 was followed by a renewed slide into recession. Quarterly GDP growth slowed significantly in the second half of the year, which left GDP down 0.2% in year-on-year terms at the end of the year. The situation deteriorated as a result of a decline in domestic consumption, which was the product of both a contraction in government spending and a decline in household consumption caused by falling employment and a real decline in wages. The uncertain situation on international markets had a profound impact on economic activity. This reduced export growth, which is a significant engine for the export-oriented economy.

Figure 1.1: Annual growth in selected macroeconomic aggregates at fixed prices in percentages (left), and saving rate[2] and ratio of investment and saving to GDP in percentages (right)

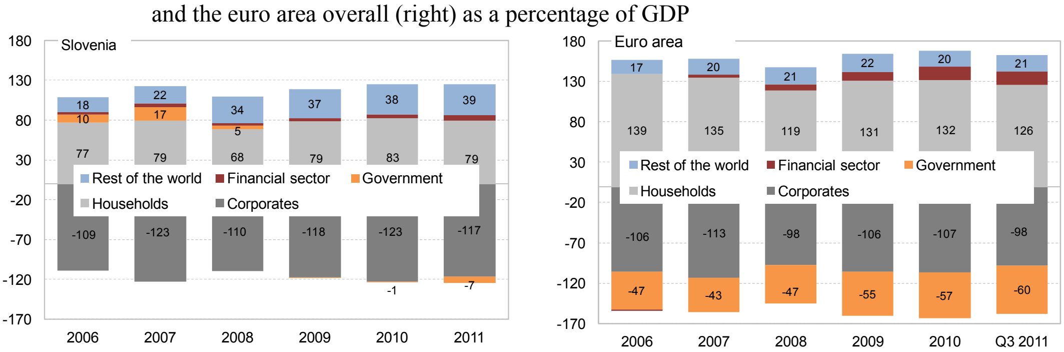


Sources: SORS, ECB

The low levels of investment and saving are increasing the uncertainty surrounding the economic recovery in the coming years.

Expectations of economic recovery declined sharply, which had an impact on the behaviour of households, the real sector and the financial sector. The ratio of investment to GDP in 2011 was down a third on its pre-crisis level. This was the result of the large-scale withholding of investment and caution in long-term business decisions by all sectors of the economy, and also of the limited access to financing for investment as a result of corporate indebtedness. In a crisis situation, in the context of low domestic and foreign demand, it is difficult for corporates to reduce their relative indebtedness. The saving rate was also down on 2010, having increased in the euro area overall. Although the ratios of investment and saving to GDP in Slovenia are higher than the euro area averages, the two variables are declining. This will further slow the recovery of the domestic economy in the coming years.

Figure 1.2: Net financial position of individual economic sectors in Slovenia (left) and the euro area overall (right) as a percentage of GDP



Sources: Bank of Slovenia, ECB, Eurostat

Slovenia's dependence on foreign financing is double its pre-crisis level.

The dependence on foreign financing is still increasing. Given insufficient saving, the lack of own capital and the need to refinance existing resources, the domestic economy was forced to seek financing in the rest of the world. As a result, Slovenia's net financial liabilities to the rest of the world increased to 39% of GDP. This means that Slovenia's

[2] The saving rate is an indicator calculated from sectoral accounts, and is the ratio of gross saving to gross disposable income. In addition to employee compensation and social security benefits, it includes gross operating surplus from manufacturing, other current transfers (e.g. compensation from non-life insurance, and property-related income such as interest and corporate profit distributions), but does not include changes in value or capital gains.

dependence on foreign financing is almost double its pre-crisis level. The financial sector, banks in particular, made heavy debt repayments, while in contrast the government sector increased its debt via issues of debt securities. This is an indication of a change in the ultimate responsibility for liabilities, not of debt repayments or a reduction in the Slovenian economy's dependence on the rest of the world.

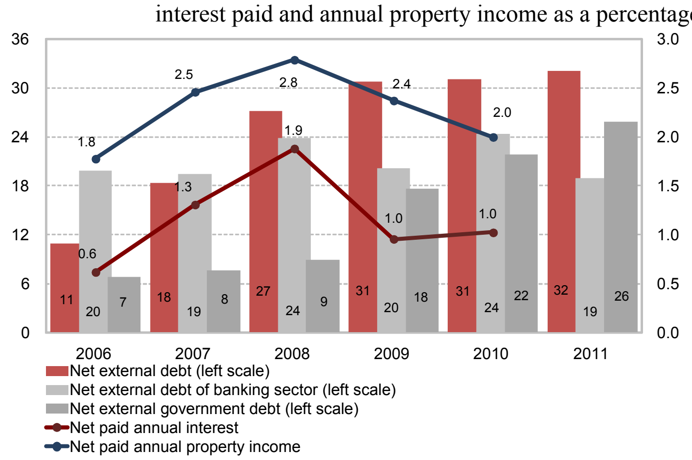
The net financial positions of other sectors show a decline in households' net claims, which is in line with the decline in household real income. Corporates are gradually repaying debt, as a result of which their net financial liabilities are declining, although they remain above the euro area average. This will also have an impact on the possibility of further borrowing to stimulate the real economy.

Rest of the world

The net external debt remains at levels similar to the previous year, but the switching of borrowing from the banking sector to the government sector is more pronounced.

The net external debt in 2011 remained at levels similar to those in the previous two years, at 32% of GDP. Last year saw a sharp switch in borrowing from the banking sector to the government sector. The government primarily borrowed by issuing bonds in the first half of 2011, which is why its net external debt increased by 4 GDP percentage points. The banking sector's net external debt fell by a very similar amount in 2011. This was an expression of the banking sector's difficulty in accessing funding on the international financial markets. This was particularly the case in the second half of the year, when the situation on the international financial markets deteriorated and several Slovenian banks were downgraded.

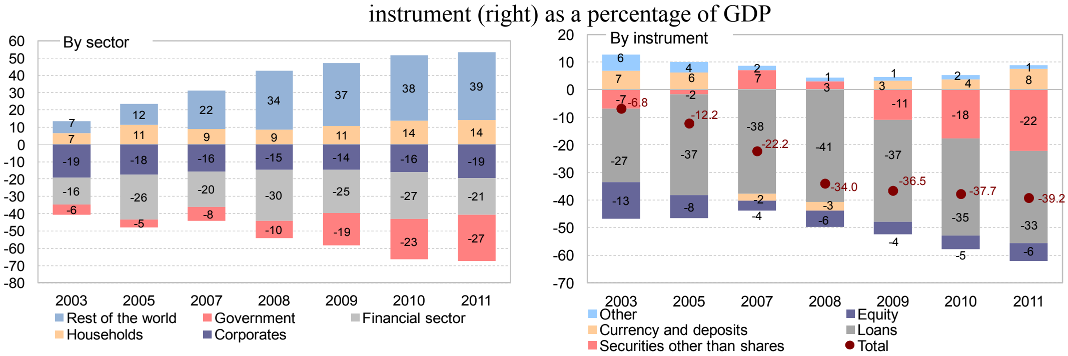
Figure 1.3: Net external debt of Slovenia and the government sector, net annual interest paid and annual property income as a percentage of GDP



Note: The difference between the net external debt and the net financial position against the rest of the world in the financial accounts is the result of differences in methodology. The external debt does not include equity, for example.

Sources: Bank of Slovenia, SORS

Figure 1.4: Net financial position against the rest of the world by sector and net financial position of the rest of the world against the Slovenian economy (left) and net financial position against the rest of the world by financial instrument (right) as a percentage of GDP



Note: The financial sector does not include central bank, while the position against the rest of the world is given for the entire domestic economy.

Source: Bank of Slovenia

The debt servicing burden fell in 2010, but is expected to increase as a result of the higher net external debt and higher funding costs.

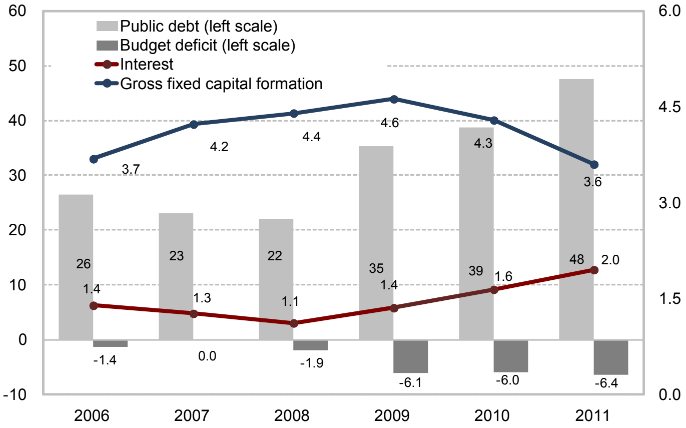
The debt servicing burden vis-à-vis the rest of the world stagnated in 2010, or fell further in the case of net annual interest paid, primarily because of the lower increase in net external debt and low interest rates. The debt servicing burden is expected to have increased in 2011, as the increase in the net external debt was larger in relative terms. Furthermore, the downgradings of sovereign debt and banks in the second half of the year brought a rise in funding costs in the rest of the world. The financial sector's higher funding costs and its uncertainty in obtaining funding in the rest of the world are having an adverse impact on the recovery in growth in the real sector.

Government sector

The general government debt is significantly less than the euro area average, but is increasing.

The general government debt increased from 39% to 48% of GDP in 2011, primarily as a result of issues of long-term securities (10-and 15-year bonds, and 18-month treasury bills), which totalled almost EUR 4 billion. The level of public debt is lower than the euro area average of 87% of GDP, and is still within the official limits of the Maastricht criteria. The rapid increase in public debt is nevertheless a cause for concern. It increased by almost 20% over the first three quarters of 2011, compared with growth of 5.2% in the euro area overall.

Figure 1.5: Public debt, budget deficit, interest payments and gross government investment as a percentage of GDP



Source: SORS

The cost of servicing the public debt increased as a result of the downgrading of long-term sovereign debt in 2011. Interest expenditure reached 2.0% of GDP. Together with the increased expenditure on social security the increased debt servicing burden saw the state budget deficit widen to 6.4% of GDP.

Financial sector

In 2011 the financial sector saw losses for the banks and pessimism on the capital markets.

A feature of the financial sector last year was the banking sector's repayments of debt in the rest of the world. In addition, the banks recorded significant losses at the end of the year, which is reducing their attraction for investors.

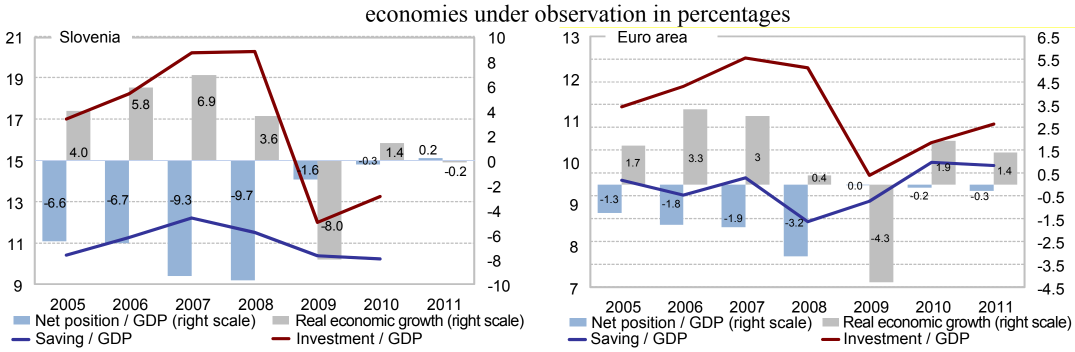
Slovenia's capital market is still showing a negative trend: in December the SBI TOP recorded its worst annual fall since 2008. The volume of trading was low, as investors withdrew from investments in securities, particularly in the second half of the year. The domestic mutual funds' assets under management also declined, as net withdrawals were made throughout the year.

Corporate sector

In contrast to the euro area, Slovenia is expected to have recorded a decline in investment in the corporate sector in 2011, SMEs in particular.

The ratio of non-financial corporations' investments to GDP rose slightly in 2010 to 13.2%, primarily as a result of favourable expectations of emergence from the crisis. The overall ratio in the euro area rose in 2010 and 2011 to reach 10.9%, an indication of the recovery of the corporate sector. Slovenia saw the opposite dynamic in 2011, the SORS survey of business trends in the manufacturing sector revealing a decline in the proportion of firms that made investments. SMEs made the largest cuts in investment.

Figure 1.6: Investment, saving and net position in transactions of non-financial corporations as a percentage of GDP, and real economic growth in the economies under observation in percentages

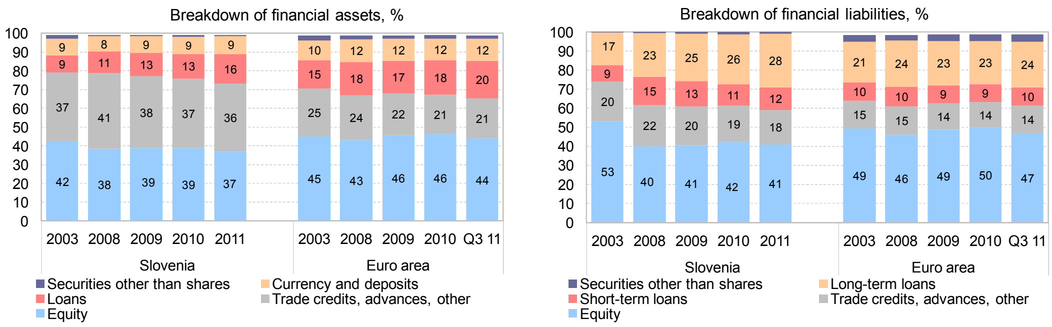


Note: The Q3 figure for the euro area is the sum of the last four quarters. The net financial position illustrates the difference between financial transactions from assets and liabilities in the period in question.
Sources: Bank of Slovenia, SORS, ECB, Eurostat

Despite a contraction in corporate loans, financial leverage in this sector remains relatively high, which is not encouraging for investment or economic activity.

The breakdown of corporate financial liabilities reveals an increase of 3 percentage points in the proportion of total liabilities accounted for by short-term and long-term loans, as a result of the negative revaluation of equity and a decline in the stock of business-to-business financing. Without recapitalisations and disinvestment, it will be difficult to reduce corporate financial leverage. The current pace is restricting creditworthiness and access to financing, and is curbing investment. The ratio of corporate financial assets to GDP also declined as a result of the decline in equity, an indication of the urgency of investment restructuring in the corporate sector. By contrast, the stagnation in the real sector will pass through into a fall in employment and lower household income.

Figure 1.7: Breakdown of non-financial corporations' financial assets (left) and liabilities (right) in percentages



Sources: Bank of Slovenia, Eurostat

Household sector

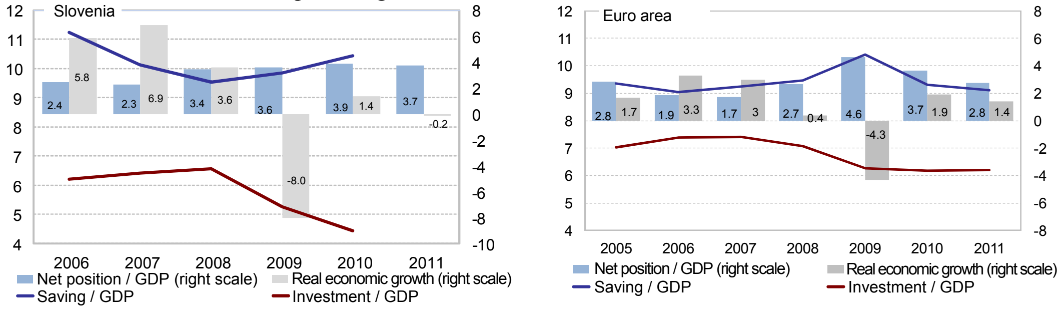
Increased uncertainty on the labour market and a decline in real wages are expected to have had an adverse impact on household consumption and saving in 2011.

The ratio of households' investment to GDP declined by almost 1 percentage point in 2010 as a result of the uncertainty in the economy, which was reflected in a rise in unemployment. The ratio of saving to GDP increased in 2010, while growth in loans to households also increased. Growth in loans began to decline in 2011, which was also reflected in a decline in the ratio of the household sector's net position in financial transactions to GDP. Given the increased uncertainty surrounding economic growth in the Slovenian economy, rising unemployment and a decline in real wages, the saving and investment rates are expected to have declined further in 2011. In the euro area the two items remained more or less unchanged in 2011.

Household financial assets declined primarily as a result of value changes in equity. Despite lower growth in loans, the proportion of household financial liabilities accounted for by bank loans increased.

Household financial assets declined, while the breakdown shifted in the direction of an increase in deposits and a decline in investments in investment funds and equity. This was the result primarily of a fall in the value of these types of investments, and partly of the sale of these assets. The stock of household financial liabilities was unchanged in 2011. There was an increase in the proportion of total household liabilities accounted for by bank loans to more than three-quarters, while the stock of leasing loans and corporate lending declined.

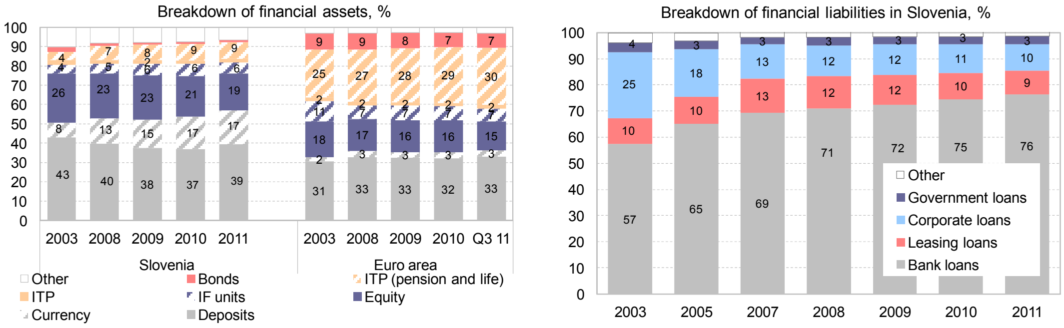
Figure 1.8: Investment, saving and net position in transactions of households as a percentage of GDP, and real economic growth in the economies under observation in percentages



Note: The Q3 figure for the euro area is the sum of the last four quarters. The net financial position illustrates the difference between financial transactions from assets and liabilities in the period in question.

Sources: Bank of Slovenia, SORS, ECB, Eurostat

Figure 1.9: Breakdown of household financial assets in Slovenia and the euro area (left), and breakdown of household financial liabilities in Slovenia (right) in percentages



Note: ITP: insurance technical provisions; IF: investment funds. Includes the household sector, together with non-profit institutions serving households (S.14 + S.15).

Sources: Bank of Slovenia, ECB

1.1 Country risk

Country risk ratings

Slovenia's country risk was downgraded.

Last autumn saw the first downgradings of long-term sovereign debt and certain banks. Moody's downgraded Slovenia from Aa2 to Aa3 on 26 September 2011. Fitch followed on 28 September 2011, downgrading Slovenia from AA to AA- with a negative outlook. Standard & Poor's then downgraded Slovenia from AA to AA- on 19 October 2011. Further downgradings then followed in December 2011 for Slovenia and several other European countries.

Slovenia's most recent downgradings came in January and February 2012. In January S&P and Fitch downgraded Slovenia from AA- to A+ with a negative outlook and from AA- to A respectively. Moody's downgraded Slovenia from A1 to A2 in February.

According to S&P, January's downgrading was a reflection of "deepening political, financial, and monetary problems within the European Economic and Monetary Union". In its arguments S&P cited the Slovenian economy's susceptibility to shifts in external demand, expectations that external financing costs could remain elevated for an extended period of time, and high leverage in the corporate sector, which weighs on asset quality and profitability in the financial sector. S&P's view was that the main support for the rating was the relatively large export base that contributes to economic growth, and a track record of fiscal prudence that has kept debt levels moderate despite recent increases. It also stated that further downgradings could result from the government's lack of resolve in beginning a credible reform programme, for example of the labour market and the pension system. Moody's cited very similar reasons for its own downgrading.

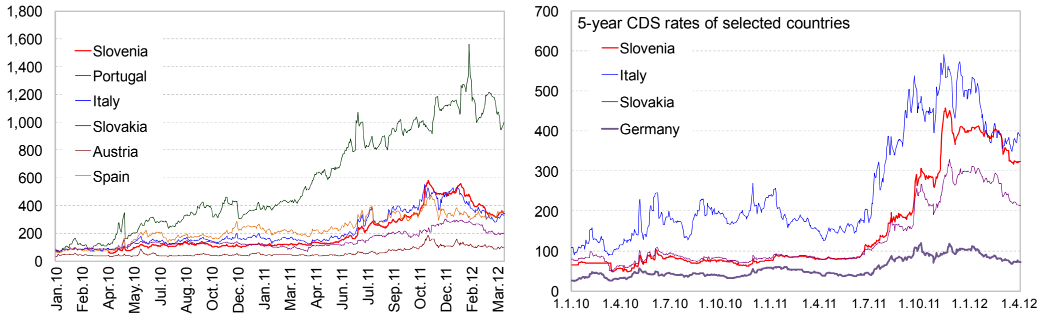
Risk premium on Slovenian government securities

The risk premium on Slovenian government securities over the German benchmarks rose in 2011, before falling in the first quarter of 2012.

In the first quarter of 2012 the premiums on Slovenian government bonds over the German benchmark averaged 308 basis points for 3-year bonds and 414 basis points for 10-year bonds. The risk premium rose throughout 2011, but fell slightly in the first quarter of 2012. The main factors in last year's rise in the premiums were Slovenia's downgradings and the spread of the euro area debt crisis.

The premiums on Slovenian 10-year government bonds over the German benchmark averaged 118 basis points in the first quarter of 2011, and 254 basis points in the third quarter. The premiums of the euro area periphery countries rose in the third quarter as a result of the worsening debt crisis. The premiums on Slovenian 10-year government bonds were particularly pronounced in tracking the movement of Spanish and Italian government securities. The premiums on Slovenian 10-year bonds over the German benchmark peaked in mid-November of last year at more than 560 basis points, and after the first 10 days of January at 550 basis points, then began to fall. The fluctuation in the risk premiums was partly the result of the domestic political and economic situation, which drained confidence in the effective management of the fiscal situation and the successful consolidation of public finances.

Figure 1.10: Premiums on 10-year government bonds of Slovenia and selected countries over the German benchmark in basis points (left), and 5-year credit default swap rates in percentages



Source: Bloomberg

There were also increases in the prices of insurance for selected other countries' debt (CDS) in 2011.

Prices of credit default swaps (CDSs) are displaying similar movements to bond premiums. The spread between 5-year CDSs for Slovenia and Germany stood at 290 basis points in the first quarter of 2012, compared with just 32 basis points in the same period last year.

2 HOUSEHOLD SECTOR

The most notable features of 2011 for the household sector were rising unemployment and limited wage growth. The decline in household financial assets was primarily seen in capital losses and disinvestment. Deposits remained the most common form of household saving, but increased by less than during the previous year. While households are a significant source of bank funding, the banks competed among themselves primarily through favourable long-term interest rates. Households also decided in favour of deposit transfers on the basis of security of investment, and the better interest rate offered on loans. Household deposits increased as a result, particularly at the banks under majority foreign ownership.

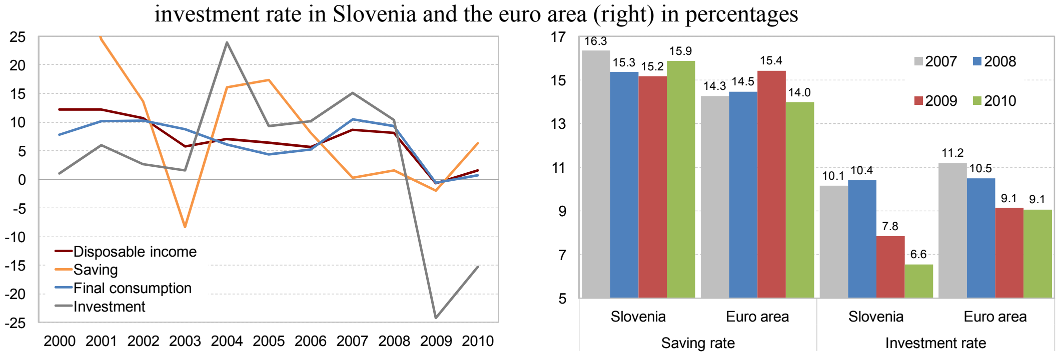
Slovenian households reduced their liabilities in 2011, and were less indebted than in the euro area overall. The small decline in net financial assets and an increase in the ratio of household debt to disposable income are nevertheless having an impact on household debt repayment risk.

2.1 Macroeconomic background for households

Growth in household disposable income and final consumption was low in 2010.

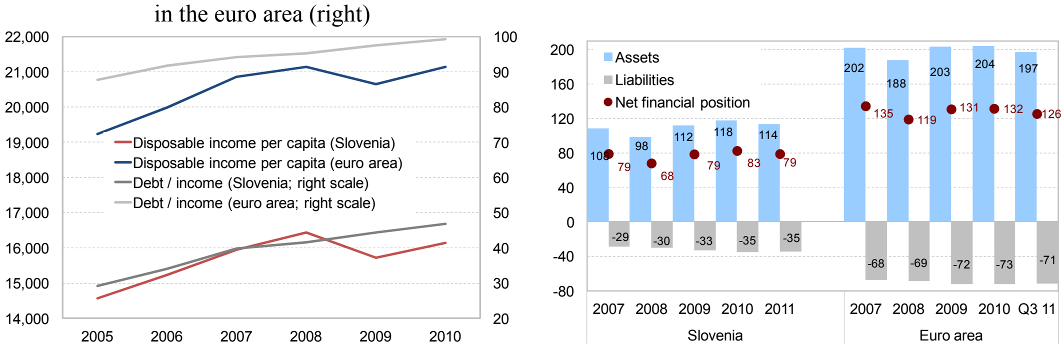
Growth in household disposable income was low in 2010. Disposable income per capita, adjusted for Slovenian price levels, stood at 76% of average disposable income in the euro area. This growth was a factor in the low growth in final consumption. Consumption was also down as a result of the higher ratio of savings to disposable income. The household saving rate was almost 2 percentage points higher than the euro area average of 14%.

Figure 2.1: Year-on-year growth in disposable income, saving, final consumption and investment of households in Slovenia (left) and household saving rate and investment rate in Slovenia and the euro area (right) in percentages



Sources: SORS, Eurostat

Figure 2.2: Gross disposable income per capita in EUR and ratio of debt (loans) to income in percentages (left), and financial assets, liabilities and net financial position of households as a percentage of GDP in Slovenia and in the euro area (right)



Sources: SORS, Eurostat, ECB

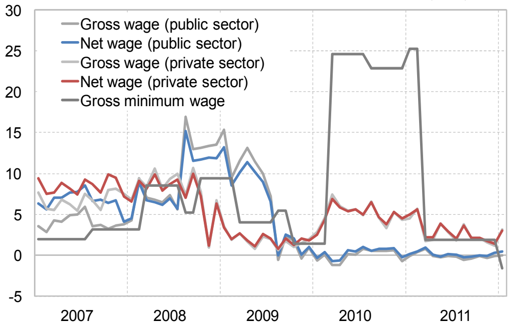
Slovenian households are less indebted than those in the euro area overall, but there is risk, because of their lower net financial assets.

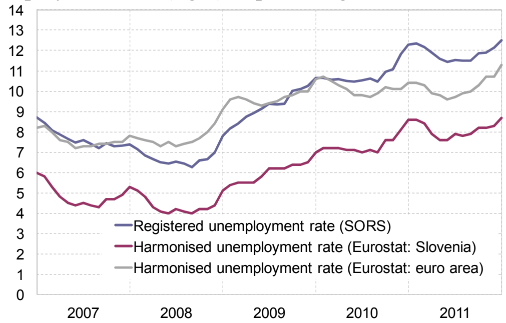
With a debt to disposable income ratio[3] of 47%, Slovenian households are among the least-indebted in the euro area, where the average ratio is now almost 100%. There is

[3] The indicator is calculated according to the Eurostat definition, where the disposable income is adjusted for the change in net household equity in pension fund reserves.

nevertheless risk in this sector in Slovenia, given that net financial assets are lower than the euro area average. In the event of an external macroeconomic shock, this could affect their ability to repay debts.

Figure 2.3: Year-on-year growth in net and gross wages in the private and public sectors (left) and unemployment rate (right) in percentages





Sources: SORS, Eurostat

Unemployment rose in 2011, which is reducing the real total wage bill.

The harmonised unemployment rate in Slovenia rose to 8.5% in 2011, which is still less than in the euro area overall, where unemployment is growing faster and reached 10.6% at the end of 2011. The level of unemployment in Slovenia nevertheless remains a cause for concern, as it is reducing the real total wage bill as wage growth remains low in the private sector while stagnating in the public sector.

2.2 Household financial assets

Household financial assets declined by 1.7%, which was reflected in capital losses and disinvestment.

Household financial assets fell by 1.7% last year to EUR 41.1 billion. The proportion of investments accounted for by equity declined to less than 20%, having declined continually in recent years as a result of capital losses and disinvestment. There were similar developments with regard to bonds and investment funds. Households' capital losses from these investments last year reached more than a third of the amount of capital losses during the outbreak of the financial crisis, which has had an adverse impact on consumption. Another factor in the decline in household assets was the net repayment of trade credits and advances and of other claims. By contrast, the trend of increase in safer investments[4] continued, albeit to a lesser extent than in the previous year. This was in line with lower wage growth, limited income from equity, and the resulting lower household disposable income.

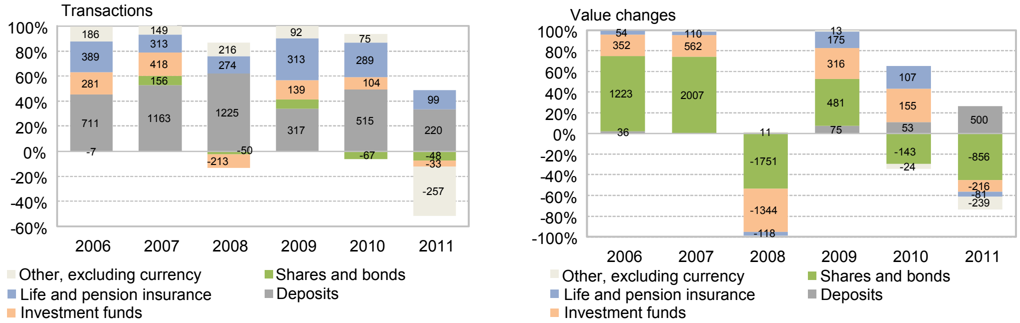
Table 2.1: Stock of household financial investments by instrument

	2006	2007	2008	2009	2010	2011
Total, EUR million	31,978	37,407	36,627	39,574	41,800	41,086
growth, %	13.1	17.0	-2.1	8.0	5.6	-1.7
change in stock, EUR million	3,699	5,429	-780	2,947	2,226	-714
as % GDP	103.0	108.2	98.3	112.1	118.0	115.3
	Breakdown, %					
Currency	10.6	10.4	13.2	14.6	16.6	17.4
Deposits	37.9	35.5	39.7	37.7	37.1	39.5
Bonds	1.6	1.4	1.4	1.3	1.2	1.2
Loans	2.6	2.3	2.5	2.4	2.3	1.7
Equity	25.4	27.5	23.2	22.9	21.2	19.3
Investment funds	7.7	9.2	5.1	5.9	6.2	5.7
Life insurance	4.5	4.5	4.7	5.2	5.5	5.7
Pension insurance	2.0	2.2	2.5	2.8	3.0	3.0
Other	7.7	7.0	7.6	7.2	6.9	6.4

Source: Bank of Slovenia

[4] Deposits increased by 3%, net household equity in life insurance reserves by 1.6% and net household equity in pension fund reserves by 2.2%. The increase in deposits was the result not only of transactions, but also of value changes resulting from exchange rate differences.

Figure 2.4: Breakdown of transactions (left) and value changes (right) in individual forms of household financial asset in EUR million and percentages



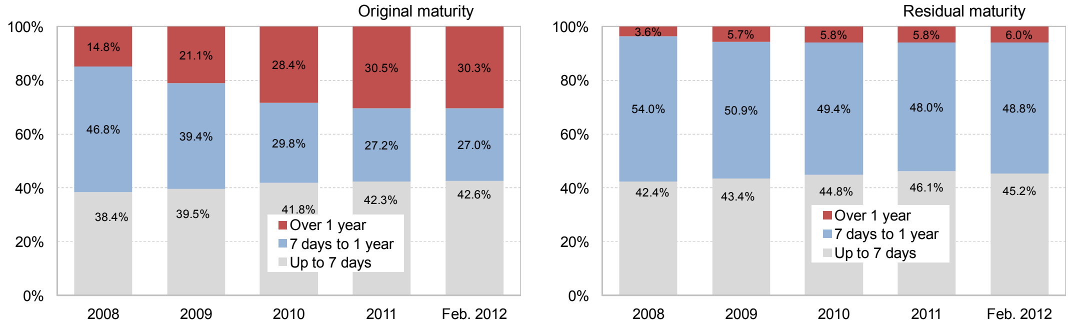
Note: Value changes are changes in market prices and exchange rates, and other changes (reallocation of financial instruments/sectors, changes in methodology, write-downs of claims/debts).

Source: Bank of Slovenia

Household deposits are becoming increasingly long-term. Households mostly opt for deposits of just over 1 year, as a result of higher interest rates.

Households have the largest proportion of their assets (37.5% of the total) invested in deposits at domestic banks. The maturity breakdown of household deposits has changed greatly in the financial crisis. Long-term deposits accounted for just 14.8% of total deposits in 2008, compared with 30.3% at the end of 2011 in terms of original maturity. However, the maturity breakdown according to residual maturity indicates that households most often opt for fixed terms of just over 1 year, as the proportion of long-term deposits according to this criterion is just 5.8%. This growth is probably the result of higher interest rates on long-term deposits, which for household deposits were 1.7 percentage points higher than short-term deposit rates in 2011. The average spread at euro area banks is just 0.4 percentage points. Interest rates on short-term deposits have been lower than the euro area average since the beginning of 2010, while interest rates on long-term deposits have been higher for more than five years. The banks are trying to use this differentiation of interest rates to encourage saving over longer periods, as the availability of long-term funding on the international financial markets has declined significantly as a result of the crisis.

Figure 2.5: Proportion of stock of households deposits accounted for by deposits of up to 7 days, deposits of 7 days to 1 year and deposits of more than 1 year in terms of original maturity (left) and residual maturity (right) in percentages



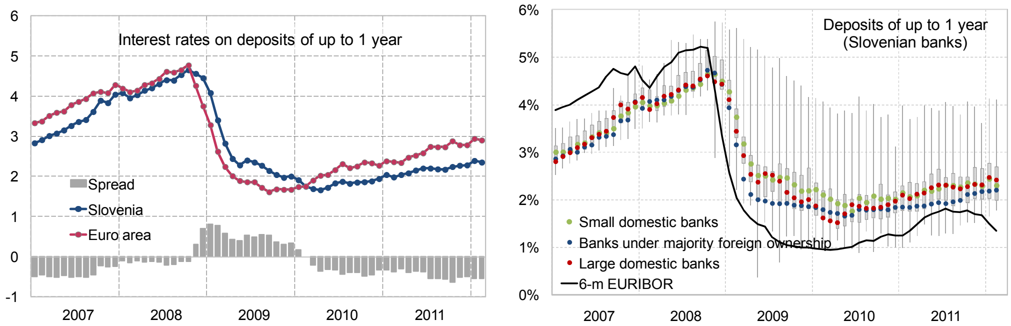
Source: Bank of Slovenia

The decline in the dispersion of interest rates on long-term deposits is an indication of the banks' fierce competition for long-term funding.

The spread at Slovenian banks between the highest and lowest interest rates on household deposits of up to 1 year averaged 2.6 percentage points last year, approximately twice as much as before the crisis. In the case of deposits of more than 1 year the average spread was smaller, at 2 percentage points, 0.4 percentage points less than in 2010. The decline in the dispersion of interest rates on long-term deposits is an indication of the banks' fiercer competition for long-term funding on the domestic deposits market. Interest rates are particularly rising at the fourth quartile of banks, which could inject additional instability into the banking system as deposits are switched by the clients most responsive to changes in interest rates. This will inflict additional uncertainty on the banks in the management of funding and liquidity, without helping to bring a significant increase in total deposits. The Bank of Slovenia responded to this systemic risk with measures adopted in February 2012. The measures require banks that are more exposed to the risk of an excessive rise in interest rates to meet higher capital requirements. The small domestic banks offered households the highest average interest rates on deposits of up to

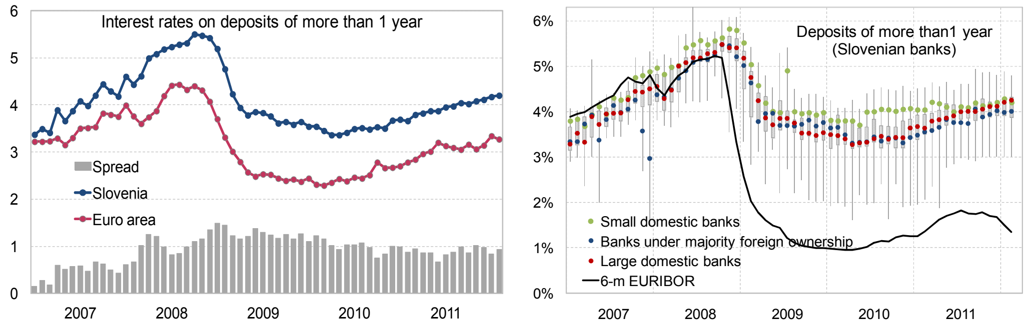
1 year and deposits of more than 1 year, while the banks under majority foreign ownership offered the lowest interest rates.

Figure 2.6: Interest rates on household deposits of up to 1 year in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)



Source: Bank of Slovenia

Figure 2.7: Interest rates on household deposits of more than 1 year in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)

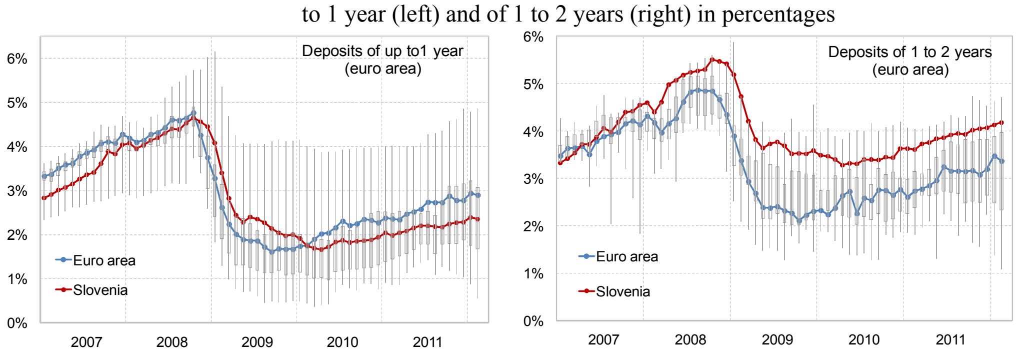


Source: Bank of Slovenia

Higher interest rates in 2011 did not bring an increase in household saving at the domestic banks.

Despite the higher interest rates, the increase in household deposits at the domestic banks in 2011 was smaller than at the banks under majority foreign ownership. Household deposits increased by EUR 216 million at the banks under majority foreign ownership, but by just EUR 31 million at the domestic banks. The ratio was the reverse in 2010. Interest rates were not the sole factor in deposit switching in 2011. It is likely that were two other factors: concerns over security and trust, and the lower lending rates at the banks under majority foreign ownership. Banks usually make it a condition for loan approvals that clients transfer their business to them, or the clients decide to do so themselves. The highest growth in loans to households during the previous period was recorded by the banks under majority foreign ownership.

Figure 2.8: Distribution of interest rates on household deposits in the euro area of up to 1 year (left) and of 1 to 2 years (right) in percentages



Source: Bank of Slovenia

The spread between the euro area countries with the highest and the lowest interest rates on household deposits is widening.

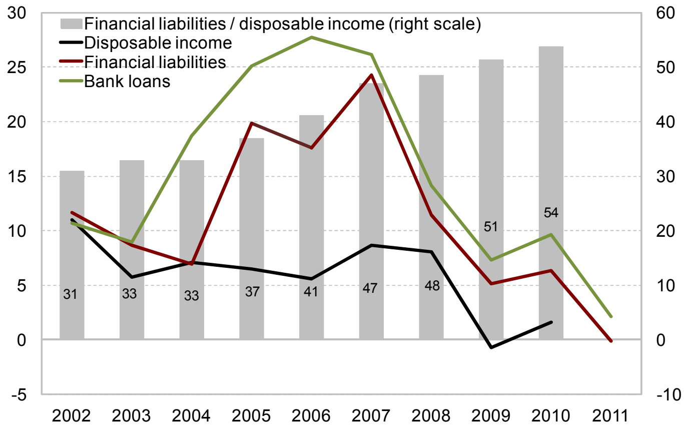
The average spread between the countries with the highest and lowest interest rates on household deposits of up to 1 year stood at 3.1 percentage points in 2011, the smallest figure since the outbreak of the crisis. The average spread on household deposits of 1 to 2 years was similar, at 2.4 percentage points. The rapid rise in interest rates on deposits of all maturities in the euro area periphery countries in late 2011 and early 2012 brought a significant increase in the spread. Slovenian banks are in the third quartile for deposits of up to 1 year, and in the highest quartile for deposits of more than 1 year. The highest interest rates on household deposits are in Cyprus, Greece and Portugal.

2.3 Household borrowing

Despite an increase in long-term bank loans, household borrowing declined in 2011.

Households reduced their liabilities by 0.1% last year, having recorded an increase of 6.3% in the previous year. The total decline in liabilities amounted to EUR 14 million. The decline was primarily the result of repayments of loans to other financial intermediaries and of trade credits and advances, while there was a further increase in long-term loans from banks, albeit at a slower rate than in the previous year. The ratio of financial liabilities to disposable income increased to 53.7% in 2010, and is likely to have increased further in 2011, as disposable income is expected to record low growth or even decline while growth in household debt is expected to gradually slow.

Figure 2.9: Annual growth in disposable income, financial liabilities, and bank loans to households, and ratio of total financial liabilities to annual disposable income in percentages



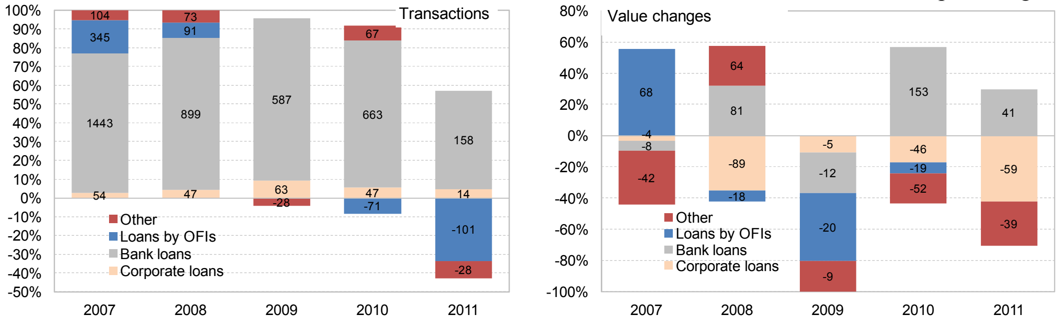
Sources: Bank of Slovenia, SORS

Table 2.2: Stock of household financial liabilities by instrument and household disposable income

	2006	2007	2008	2009	2010	2011
Financial liabilities, EUR million	8,093	10,054	11,203	11,778	12,520	12,506
growth, %	17.6	24.2	11.4	5.1	6.3	-0.1
change, EUR million	1,210.0	1,961.0	1,149.0	575.0	742.0	-14.0
as % of GDP	26.1	29.1	30.1	33.4	35.4	35.1
	Breakdown, %					
Loans	83.7	85.7	86.6	87.5	88.0	88.3
corporates	4.2	3.8	3.1	3.4	3.2	2.9
banks	67.8	68.9	70.6	72.0	74.3	75.9
other financial intermediaries	10.0	12.2	11.6	10.8	9.5	8.7
other	1.7	0.8	1.4	1.2	1.0	0.8
Other	16.3	14.3	13.3	12.5	12.0	11.7
Disposable income, EUR million	19,697	21,410	23,138	22,971	23,334	-
change, EUR million	1,047	1,713	1,728	-167	363	-
growth, %	5.6	8.7	8.1	-0.7	1.6	-
as % of GDP	63.4	61.9	62.1	65.1	65.9	-
Debt as % of disposable income	41.1	47.0	48.4	51.3	53.7	-

Sources: Bank of Slovenia, SORS

Figure 2.10: Breakdown of transactions (left) and value changes (right) for individual forms of household financial liabilities in EUR million and in percentages



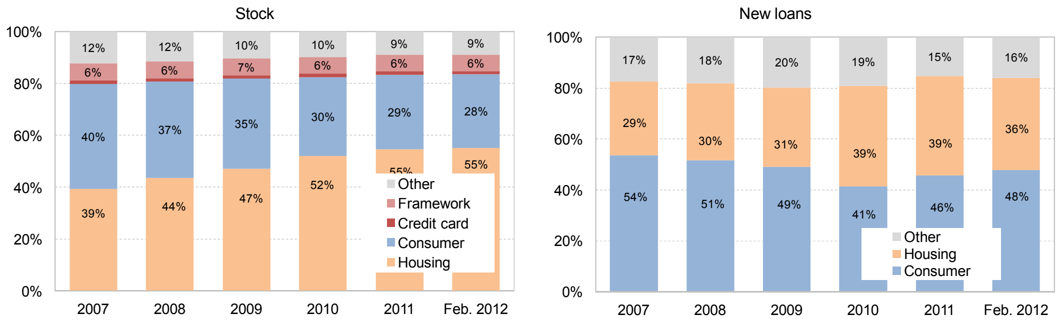
Note: Value changes are changes in market prices and exchange rates, and other changes (reallocation of financial instruments/sectors, changes in methodology, write-downs of claims/debts).

Source: Bank of Slovenia

Demand for housing loans resulted in a decline in growth in these loans, which nevertheless remains higher than the euro area average.

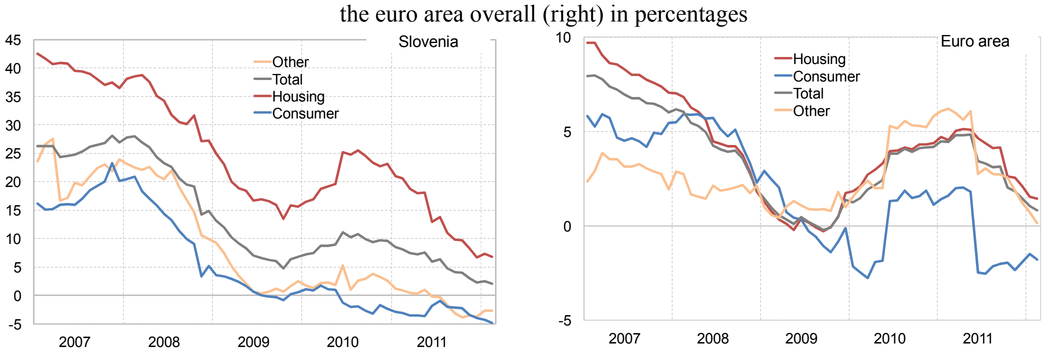
Housing loans accounted for more than half of total loans to households at the beginning of 2010, yet by February 2012 the figure had risen to 55%. Growth in housing loans is declining, primarily as a result of lower household demand for these loans brought by a lack of confidence and the lack of change in the situation on the real estate market. In addition, the banks slightly tightened their credit standards for the approval of housing loans. The volume of new housing loans approved in 2011 was down a quarter on the previous year. While growth in housing loans is declining, growth in household borrowing in the form of consumer loans has been negative continuously since the middle of 2010. A similar dynamic has also been seen recently in the euro area overall, although growth in housing loans is much lower.

Figure 2.11: Breakdown of types of bank loan to households from stock (left) and new loans (right) in percentages



Source: Bank of Slovenia

Figure 2.12: Annual growth in individual types of household loan (left) in Slovenia and the euro area overall (right) in percentages



Sources: Bank of Slovenia, ECB

The household debt repayment burden increased.

Lower growth in loans halted the increase in the loan-to-deposit ratio for households, which stood at 63.4% in 2011. The ratio is nevertheless still at its highest since the outbreak of the crisis. According to bank surveys, the ratio of annual repayments[5] to household disposable income increased by 0.4 percentage points last year to 9.2%.

[5] The latest data for household disposable income is only available for 2010.

Interest payments as a proportion of disposable income remained almost unchanged at 1.1%. The loan repayment burden on households increased overall, which also had an impact on their ability to keep up repayments. The proportion of loans more than 30 days in arrears increased to 5.5%, most notably loans of more than 1 year. The latter was partly the result of private loans being raised for the purpose of assisting small businesses and sole traders hurt by the financial crisis.

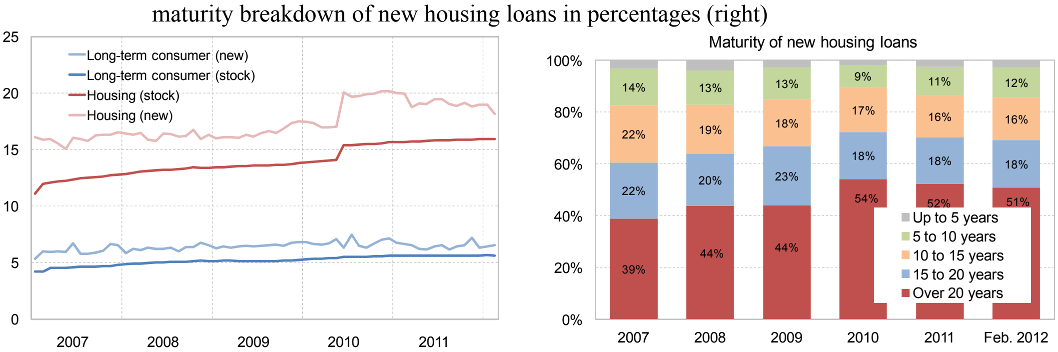
Table 2.3: Household loans and deposits

	2006	2007	2008	2009	2010	2011	Feb. 2012
Loans, EUR million	**5,481**	**6,921**	**7,904**	**8,484**	**9,281**	**9,452**	**9,389**
housing	1,971	2,684	3,411	3,941	4,837	5,163	5,184
consumer	2,337	2,782	2,898	2,914	2,833	2,723	2,668
other	1,173	1,455	1,595	1,629	1,611	1,566	1,537
Loans as % of GDP	**17.7**	**20.0**	**21.2**	**24.0**	**26.2**	**26.5**	
housing	6.3	7.8	9.1	11.2	13.7	14.5	
consumer	7.5	8.0	7.8	8.3	8.0	7.6	
other	3.8	4.2	4.3	4.6	4.5	4.4	
Annual increase, EUR million	**1,136**	**1,440**	**983**	**580**	**797**	**171**	**159**
housing	589	713	727	530	896	326	333
consumer	320	445	116	16	-81	-110	-134
other	227	282	140	34	-18	-45	-40
Annual growth, %	**27.0**	**26.3**	**14.2**	**7.3**	**9.4**	**1.8**	**1.7**
housing	43.1	36.2	27.1	15.5	22.7	6.7	6.9
consumer	16.3	19.0	4.2	0.6	-2.8	-3.9	-4.8
other	25.9	24.0	9.6	2.1	-1.1	-2.8	-2.5
New loans, EUR million	**2,721**	**3,516**	**3,264**	**3,015**	**3,057**	**2,360**	**294**
housing	822	1,028	1,007	963	1,211	905	105
consumer	1,502	1,909	1,718	1,517	1,284	1,062	139
short-term	186	407	378	294	199	179	25
long-term	1,316	1,502	1,341	1,223	1,085	883	114
other	398	579	539	536	563	393	51
Loans / deposits, %	**52.7**	**60.0**	**59.3**	**60.6**	**63.4**	**63.4**	**62.2**
deposits, EUR million	10,396	11,544	13,332	13,998	14,649	14,919	15,098
annual increase, EUR million	858	1,148	1,788	666	651	269	289
annual growth, %	9.0	11.0	15.5	5.0	4.6	1.8	1.9

Note: The bank figures shown are statistical data, not book-keeping figures. The values are therefore comparatively higher. The figures for February 2012 refer to the first two months of the year alone.

Source: Bank of Slovenia

Figure 2.13: Average maturity of various types of housing loan in years (left) and maturity breakdown of new housing loans in percentages (right)

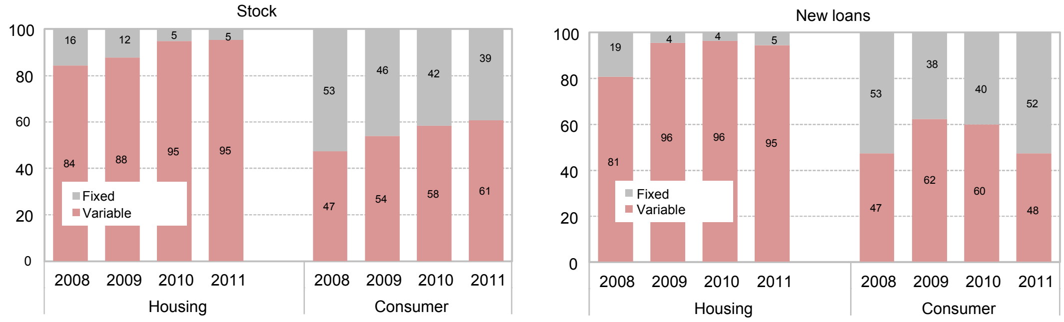


Sources: Bank of Slovenia, ECB

The proportion of loans with a variable interest rate and their average maturities are increasing, as a result of which interest rate risk at households is also increasing.

While the average maturity of the stock of long-term consumer loans was unchanged last year, the average maturity of housing loans increased to 15.9 years. The average maturity of new housing loans reached 19.2 years in 2011, despite a decline in those with a maturity of more than 20 years. The majority (95%) of these loans were approved with a variable interest rate, most frequently tied to the EURIBOR. The proportion of consumer loans with a variable interest rate was significantly lower than that of housing loans. It reached 61% in 2011, a significant increase since the outbreak of the crisis in 2008, when it stood at 47%. This figure is expected to stabilise, as the proportion of new consumer loans with a variable interest rate was down 12 percentage points in 2011. The rise in the proportion of loans with variable interest rates and their average maturities is nevertheless raising the risk of the household sector in the event of a rise in interest rates.

Figure 2.14: Percentage breakdown of housing and consumer loans to households in percentages by type of remuneration for stock (left) and new loans (right)

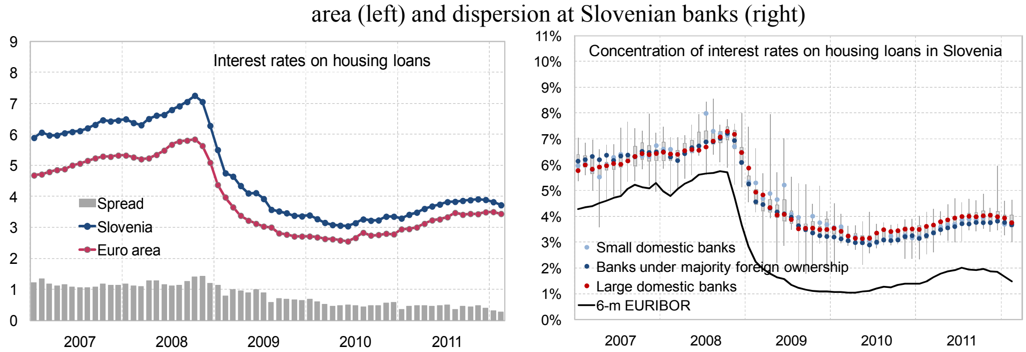


Source: Bank of Slovenia

Interest rates on consumer loans in Slovenia and in the euro area overall are almost equal.

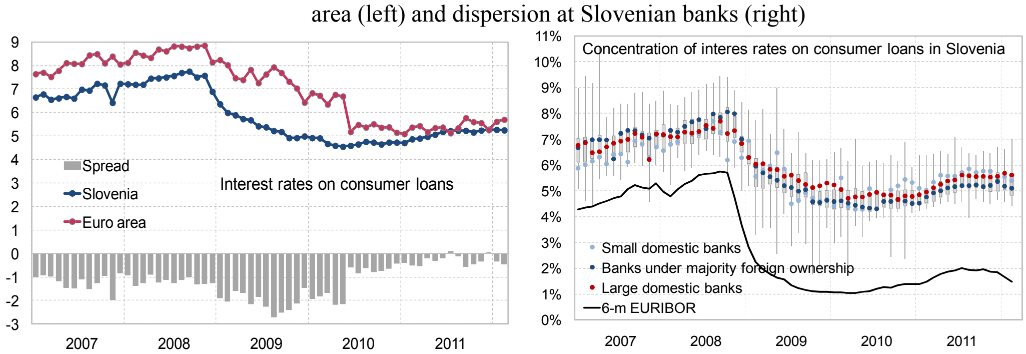
The spread on housing loans between Slovenian banks and euro area banks overall has remained at the level of 0.5 percentage points since the middle of 2009, although it narrowed to 0.3 percentage points during the first two months of 2012. Slovenian banks had lower interest rates on consumer loans than euro area banks overall in past years, but the interest rates virtually equalised in 2011. The average spread diminished from -1.2 percentage points to -0.3 percentage points.

Figure 2.15: Interest rates on housing loans in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)



Source: Bank of Slovenia

Figure 2.16: Interest rates on consumer loans in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)



Source: Bank of Slovenia

The banks under majority foreign ownership had lower interest rates for households in 2011 than the domestic banks.

The spreads between the interest rates of Slovenian banks on household lending are also narrower. The distribution is much denser, particularly for housing loans, on which the spread between the banks with the highest and lowest interest rates averaged 1.5 percentage points in 2011. This was 0.6 percentage points less than the spread on consumer loans. Interest rates on housing loans at the banks under majority foreign ownership were 0.2 percentage points lower on average than interest rates at the domestic banks, while the spread was 0.4 percentage points for consumer loans. Lower interest rates at the banks under majority foreign ownership were the main reason for their greater household lending activity. The banks under majority foreign ownership partly reduced the overall risk of the credit portfolio, as loans to households are less risky on average and require less engagement of bank capital. The banks under majority domestic ownership were less flexible in this process.

2.4 Real estate market

With a slight realignment of prices, the used housing market maintained its volume in 2011 at just below the average of the last nine years. Uncertainty deepened on the market for new-build housing, where survey data suggests the lowest sales in the last five years.

The slowdown in household lending and the price rigidity of stocks of unsold new-build housing have led to a decline in purchases of new build in the past year. Prices nevertheless rose, as a result of the buyer profile and the locations of sales. The price rises also had an adverse impact on affordability and potential buyers' interest. By contrast, price rises are in the interests of investors and financial institutions, for reason of asset value.

Compared with other euro area countries, prices of Slovenian housing relative to household disposable income are high. At existing prices, housing will become even less accessible for households, given the anticipated decline in disposable income, the contraction of expenditure on durables and more expensive borrowing. Expectations of price falls are another factor reducing demand for housing.

Figure 2.17: Year-on-year growth in prices of used and new-build housing in Slovenia (left), and the basic housing price index (2007 = 100) (right) in percentages

Sources: Bank of Slovenia, TARS, SMARS, SORS

Prices of used housing fell in the second half of 2011 to the levels seen in 2007. According to SMARS figures, prices were down 4.1% at the end of 2011 at 1,674 EUR/m^2, and down 13.3% from the peak in the second quarter of 2008. Prices of used housing in Ljubljana last year were down just under 4% at 2,420 EUR/m^2, and were down 14.2% on their peak..

The SORS index, which takes account of the location and quality of housing units sold, reveals a slightly slower pace in the fall of prices of used real estate. Prices of existing housing in Slovenia were down 0.2% in 2011, and were down 7.5% on their peak in the first quarter of 2008. These prices fell by 1.9% in Ljubljana last year, and were down 11.9% on the peak at the end of 2007. The survey data for prices of new-build housing showed the opposite developments. They were up 6.4% in 2011, but down by 8.7% on their peak in the second quarter of 2008. The rise in borrowing costs, the expected recession and the contraction in income all point to a slow decline in prices in 2012.

According to SORS figures, prices of used housing were down 0.7% in 2011, and down 9.7% on their peak in the third quarter of 2008. Prices of new-build housing were up 4.1% last year, but down 11% on their peak.

Table 2.4: Transactions on the real estate market

	Existing residential real estate			New build residential real estate					
Year	Flats	Houses	Total	Flats	Houses	Total	Total residential real estate	New build as % of turnover	Non-residents as % of all purchases
	Number of transactions								
2007	6,310	1,889	8,199	1,745	70	1,820	10,019	18.2	7.3
2008	4,297	1,271	5,568	1,163	263	1,426	6,994	20.4	6.7
2009	3,522	848	4,370	971	364	1,335	5,705	23.4	5.0
2010	4,910	1,424	6,334	1,282	307	1,589	7,923	20.1	3.3
2011	4,441	1,330	5,771	927	182	1,109	6,880	16.1	4.2
	Growth, %								
2008	-31.9	-32.7	-32.1	-33.4	-	-21.6	-30.2		
2009	-18.0	-33.3	-21.5	-16.5	38.4	-6.4	-18.4		
2010	39.4	67.9	44.9	32.0	-15.7	19.0	38.9		
2011	-9.6	-6.6	-8.9	-27.7	-40.7	-30.2	-13.2		

Note: The figures for transactions in new-build housing are survey figures.
Sources: TARS, SORS, Bank of Slovenia calculations

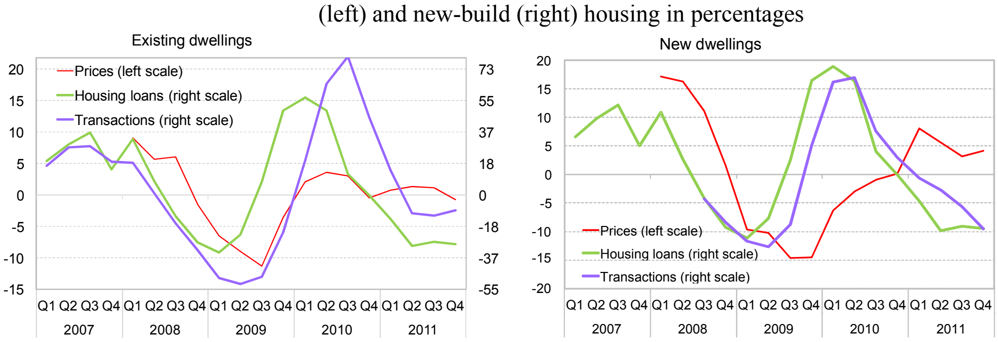
The liquidity of the market in new housing fell sharply compared with that of used housing.

Prior to 2008 the large volume of savings during the expiry of the national savings scheme had an impact on market liquidity, while funds from the sale of investments on the capital markets were also invested in the real estate market. Since the outbreak of the crisis, liquidity has been established in the market in used real estate. Of all transactions in housing in 2011, only 16.1% were in new-build units. New supply was also reduced in part by bankruptcies of construction firms, while sales from bankruptcy estates were unsuccessful without significant price cuts. Alongside the low demand on the active market, this is an indication of the overpricing of new build, which is just under a third more expensive than used real estate on average.

Growth in housing loans is tracked by housing prices with a lag and at a slower pace.

Growth in housing lending has tracked the movement in transactions and real estate prices in past years. High lending growth was tracked by the change in the number of transactions with a slight lag, and then by the adjustment in prices, at a slower pace. The decline in new loans for housing purchases in the second half of 2011 brought a fall in prices of used real estate, which helped to maintain the number of transactions at just 2% below the average of the last nine years. By contrast, there was no such price adjustment in the market of new-build real estate during this period. Rising prices of new-build housing moved in contrast to other indicators in 2011, which reduced liquidity on the new-build market by just under a third.

Figure 2.18: Year-on-year growth in housing loans and transactions and prices of used (left) and new-build (right) housing in percentages



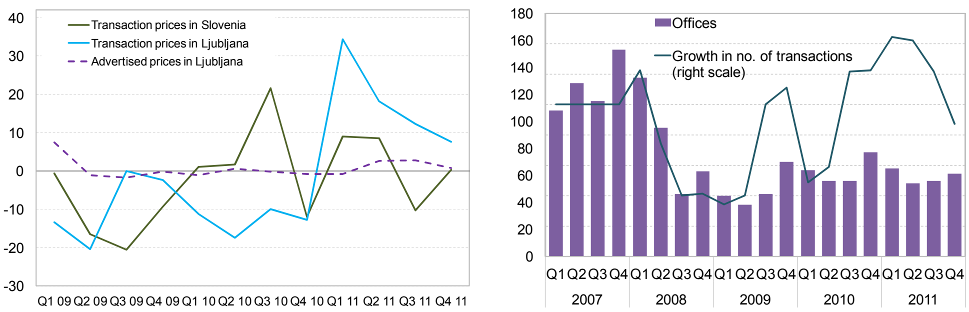
Note: Quarterly moving average used for transactions.
Sources: Bank of Slovenia, SORS

Commercial real estate prices

Office prices were up 0.3% in 2011, but remained down 23.2% on their peak in the third quarter of 2008.

Office prices were almost unchanged at the end of 2011, down 23.2% on their peak in the third quarter of 2008. Last year there was no major pressure from commercial real estate on the valuation of corporate balance sheets or collateral at the banks. Office prices in Ljubljana rose by 7.6% in 2011, but were still down 5.3% on their peak. The small number of transactions means that a statistical interpretation of the movement in commercial real estate prices is limited; the main factor was the location of the sale. There is still excess supply on the market. Some projects are still in progress, as a result of which price rises cannot be expected.

Figure 2.19: Growth in commercial real estate (office) prices (left) and number of transactions included in the calculation of average price and growth therein (right) in percentages



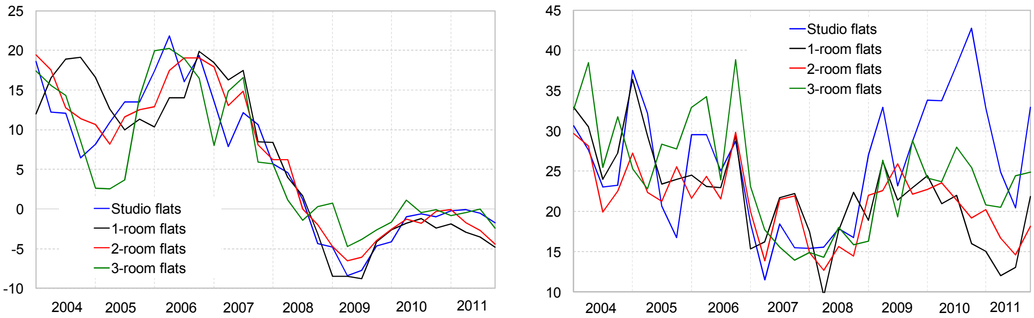
Sources: SMARS, Slonep, Bank of Slovenia calculations

Advertised housing prices in Ljubljana

Advertised prices fell by more than transaction prices in 2011. There was a decline in the expectations of those offering used housing.

The supply of advertised used housing in Ljubljana is making slow price adjustments for the third consecutive year. Studio flats recorded the smallest fall in advertised prices last year, at 1.7%, while prices of larger housing units fell by just over 4% on average. The gap by which advertised prices exceed selling prices narrowed in 2011. Advertised prices were 20% higher than selling prices on average. The narrowest gaps, at 16% and 17% respectively, were for one- and two-room flats, which also see the heaviest volume. A larger change in advertised prices than in realised prices is an indication that seller's expectations of attaining used housing prices have diminished.

Figure 2.20: Year-on-year growth in advertised housing prices (left) and the gap by which advertised prices exceed transaction prices per square metre (right) in percentages



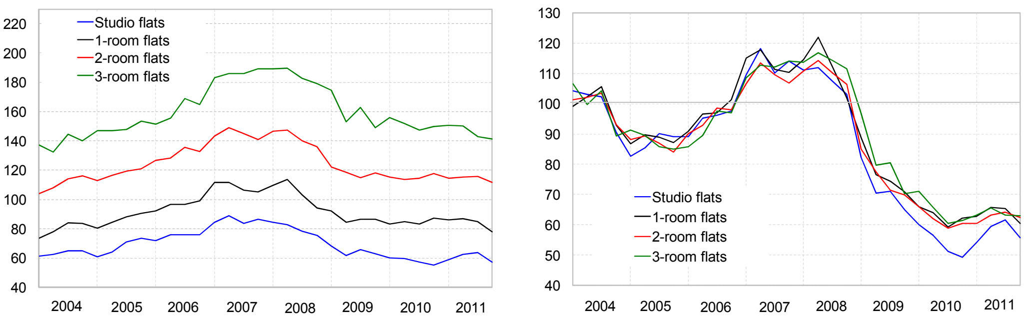
Sources: TARS, SMARS, Slonep, Bank of Slovenia calculations

Housing affordability in Ljubljana

Housing affordability in Ljubljana, which is expressed as the ratio of used housing prices to the annual moving average of net monthly wages, improved slightly in 2011 overall. The net average wage, which was up 1.7% in terms of the annual moving average, and the falls of 3.6% to 9.3% in used housing prices had a beneficial impact on the indicator. There was a deterioration in the affordability of studio flats, prices of which rose by 5.6% after falling for two years. In 2011 an extra 2.1 monthly wages were required on average to buy a studio flat than in the previous year, while the saving on larger flats was 6.1 to 9.5 monthly wages.

According to this indicator, buyers would spend the same number of monthly wages on housing as in 2004. It should be noted in the interpretation of these figures that there was not an actual improvement in affordability for all income brackets, as the main factor in the rise in the average net wage[6] over the last two years has been higher job losses in labour-intensive industries with lower income.

Figure 2.21: Ratio of housing prices to annual moving average of net monthly wages for Ljubljana in percentages (left) and housing affordability index (2004 = 100) (right)



Sources: Bank of Slovenia, SMARS, Slonep, SORS, Bank of Slovenia calculations

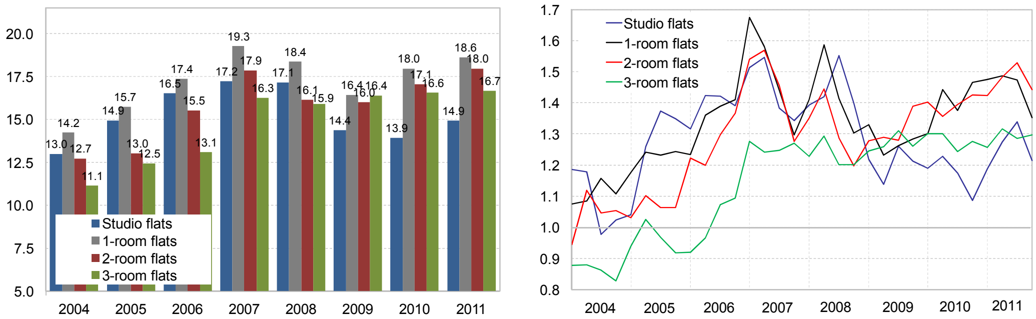
Housing affordability that takes account of lending conditions diminished slightly as a result of higher interest rates.

Once the lending conditions have been taken into account, the affordability of used housing in Ljubljana deteriorated slightly overall last year. The main factor in this was higher interest rates on housing loans. Most loans were approved with a variable interest rate tied to the EURIBOR, which rose by an average of 0.5 percentage points. Given the expense of bank funding, the price of housing loans can be expected to rise in the coming year. Alongside the projected fall in employment and the decline in wages, poor loan availability will result in lower demand for housing. As the economic crisis continues, households are acting with increasing caution in raising loans. Real estate prices are

[6] The average monthly net wage applied in the analysis is the 12-month moving average of average net monthly wages.

therefore likely to fall. The average maturity of loans was up 6 months on last year at 19.2 years. The ratio of housing loan annuities to the average net wage was up slightly at the end of the year, other than for one-room flats; it stood at 35% for studio flats, 48% for one-room flats, 69% for two-room flats and 93% for three-room flats.[7]

Figure 2.22: Ratio of housing prices to rents (P/E) (left), and ratio of actual prices to fundamental prices of housing[8] in Ljubljana calculated on this basis (right)



Sources: Slonep, TARS, SMARS, Bank of Slovenia calculations

Deterioration in the ratio of price to rents.

The housing price to rent (P/E) ratio in Ljubljana deteriorated slightly last year, rents having fallen more on average than real estate prices. From an investment point of view, owners generated a rental yield of 5.4% to 6.7% of the market value of the real estate. The ratio of actual prices to fundamental prices deteriorated slightly. Actual prices were still 22% to 44% higher on average than the fundamental housing prices that should be sustainable in the long term.

The ratio of rents excluding current expenses to the average wage in Ljubljana in 2011 stood at just over a third for studio flats, just under 40% for one-room flats, and more than a half for two-room flats. Adjustments in housing prices are more likely from the point of view of rental yield, as the ratio of rents to household income is high. This would also make the Slovenian real estate market more attractive for the investment of private capital in residential construction for rental purposes. Given the market situation, unsold completed dwellings represent an opportunity for the establishment of a transparent rental market. A well-regulated rental market with a stable yield would give the real estate market greater robustness against imbalances and the real estate cycle.

Supply and demand factors in real estate prices

Growth in household borrowing via housing loans declined.

New housing loans to households amounted to EUR 906 million in 2011, which was down a quarter on the previous year and the lowest figure in the last five years. Loans were approved in the domestic currency. A quarter of the stock of housing loans remains denominated in Swiss francs. The movement of the euro / Swiss franc exchange rate will remain important for Slovenian households, as more than two-thirds of these loans have a residual maturity of more than 10 years. A rise in the EURIBOR, to which 72% of the stock of housing loans is tied, will increase the household debt repayment burden in the coming years.

Diminished access to housing loans will increase the downward pressure on real estate prices.

Growth in the approval of new housing loans declined in the second half of last year, and will remain low in 2012 as a result of the tightening of lending conditions. Lower loan availability will have an adverse impact on volume in real estate, and will increase the downward pressure on real estate prices. There is no pronounced competition via interest rates, which remained above the euro area average. Interest rates at the banks under majority foreign ownership, which are less exposed to the construction sector, are lower on average. Growth in housing loans had declined to 6.5% by March 2012.

The average monthly income of a borrower was 41% higher than the average monthly net wage.

The average LTV ratio for new housing loans stood at 58 in 2011. The trend started to rise markedly in the last five months of last year, when the average stood at 64. According to

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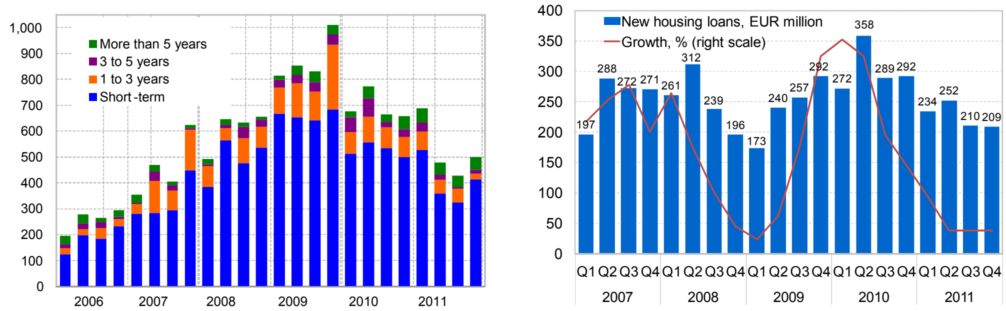
[7] When the annuity is calculated, the assumption is that the purchase of the housing is financed entirely by a loan, subject to terms of approval calculated as an average for the banking system.

[8] The calculation of fundamental housing prices on the basis of the ratio of housing prices to rents (P/E) takes account of the average P/E ratio between 1995 and 2003. A more accurate calculation of the fundamental price would require the calculation of the average P/E over a longer, more stable period of 10 to 15 years. The short time that the Slovenian housing market has functioned normally makes this impossible. The aforementioned limitations must be borne in mind during interpretation, although over a longer timeframe a lower average P/E ratio would be anticipated, and housing would appear to be even more overpriced according to this indicator.

survey figures, for the third consecutive year the banks were more likely to approve loans to clients in the highest income bracket, who are the lowest risk. The average monthly income of a borrower was EUR 1,393, 41% more than the average monthly net wage. The proportion of loans earmarked for the purchase of housing increased slightly, by average of 3.8 percentage points, to 63.2%.

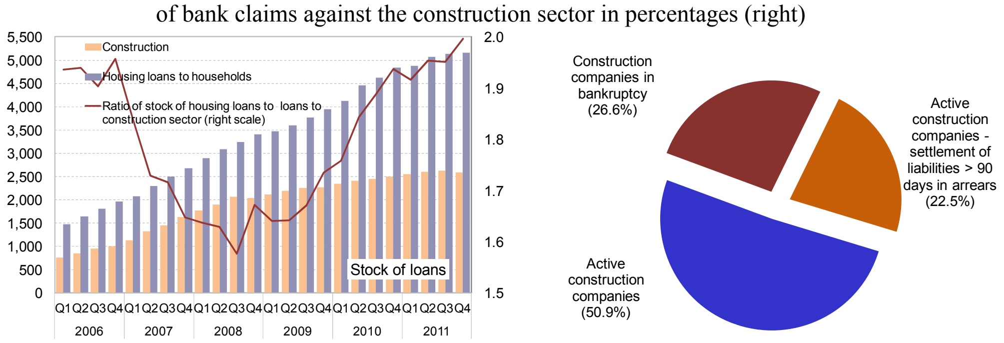
The value of mortgaged housing is more than 1.7 times the value of existing housing loans. If only housing ranked first in mortgage lien priority is included, this ratio falls to 1.4, but it would also be favourable in the event of any fall in real estate values. Residential real estate accounts for 80% of collateral, followed by various types of supplementary insurance offered by insurers.

Figure 2.23: New loans to the construction sector (left) and new housing loans to households (right) in EUR million



Source: Bank of Slovenia

Figure 2.24: Stock of loans to the construction sector and stock of housing loans to households in EUR million and the ratio between them (left) and quality of bank claims against the construction sector in percentages (right)



Sources: Bank of Slovenia, AJPES

The banks are renewing loans to the construction sector to overcome liquidity problems.

After a three-year decline in activity in the construction sector, lending focused primarily on the completion of projects and the renewal of loans to support corporate liquidity and existing investments. New loans in 2011 were down a quarter on 2010, as investment declined and the number of bankruptcies rose. The proportion accounted for by short-term loans remained similar to previous years at 78%. Given the prevalence of annexes to existing contracts, the stock was up just 6.7% or EUR 90 million, the lowest increase in recent years.

The current system of financing for construction, under which construction firms were also investors predominantly using debt financing from banks, is not appropriate from the point of view of risk. Under this system construction firms recorded higher returns during booms, but during the reversal of the business cycle they assume the entire risk of erroneous investment decisions. Given the lack of capital, these were fatal for many firms. The business model in construction should henceforth be modified so that the investors include funds whose money will be invested in the construction of real estate for sale and rental.

Table 2.5: Completed dwellings, building permits issued and gross investment in residential buildings

	2005	2006	2007	2008	2009	2010	2011
	Estimate of housing stock						
Number of dwellings[1]	750,355	757,522	765,552	775,199	783,404	789,501	
Number of dwelling per 1,000 inhabitants	375	377	378	381	385	385	
	New build, including extensions and change of purpose						
Number of new dwellings	7,516	7,538	8,357	9,971	8,561	6,352	
Number of new dwellings per 1,000 inhabitants	3.8	3.7	4.1	4.9	4.2	3.1	
Floor area (m^2)	807,607	860,537	928,941	1,100,436	980,980	821,760	
	Building permits issued						
Number of dwellings	7,235	8,463	10,204	8,376	5,914	4,808	3,732
growth, %	3	17.0	20.6	-17.9	-29.4	-18.7	-22.4
Floor area (m2)	880,751	1,028,024	1,127,420	970,034	736,335	597,600	500,280
	Supply of Housing Fund of the Republic of Slovenia (HFRS)						
Number of dwellings delivered	353	453	685	35	120	51	2
proportion of new dwellings, %	4.7	6.0	8.2	0.4	1.4	0.8	
	Gross investment in residential construction						
Growth, %	22.9	14.6	19.9	18.0	-19.8	-18.5	-17.8
As % of GDP	3.7	3.9	4.2	4.6	3.9	3.2	2.6
	Growth, %						
Construction costs - new build housing[2]	3.2	9.3	4.4	4.7	-4.0	7.3	0.6
material costs	4.3	5.6	5.4	3.2	-3.6	6.7	3.9
labour costs	1.6	13.9	4.0	7.6	-4.7	6.5	-2.9

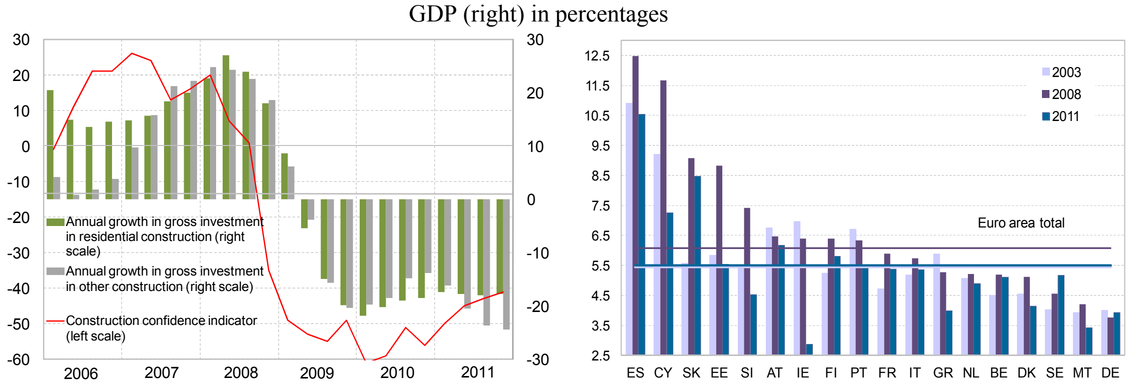
Notes: [1] Housing stock includes inhabited dwellings and temporarily uninhabited dwellings fit for permanent use.
[2] Costs of construction, finishing work, and fixtures on new housing, excluding land costs. The figures for 2011 are for the third quarter.

Sources: SORS, NHF, Bank of Slovenia calculations

The situation in the construction sector will continue to deteriorate in 2012.

The contraction in construction activity will continue in 2012 according to short-term indicators. The number of building permits issued for residential construction is falling for the fourth consecutive year. The figure of 3,732 dwellings planned in 2011 was just over half of the average in the previous decade. The value of construction put in place was down a quarter on the previous year, the largest fall during the crisis; residential construction was down fully 35%. Primarily as a result of the stocks of unsold housing, and given the reluctance to finance new real estate projects, the value of new residential construction contracts fell by a high 60%. In addition to the construction method and the input costs, prices of housing yet to be built will also depend on the price and timing of sales of existing stocks. It is likely that demand for housing yet to be built will be greater than demand for existing new build, designs for which were less than optimal in many cases.

Figure 2.25: Construction confidence indicator and annual growth in gross investment in construction (left) and ratio of value-added in the construction sector to GDP (right) in percentages



Sources: SORS, Bank of Slovenia calculations

Value-added in the construction sector declined to 4.5% of GDP in 2011, below the euro area average. It was down 2.9 percentage points on its peak of 7.4% of GDP in 2008. Only in Ireland, Cyprus, Estonia and Greece did the construction sector have a more intense response to the crisis than in Slovenia.

Box 2.1: Impact on future developments in the real estate market

Construction firms, banks and their subsidiaries

Classified claims against construction firms comprise 12% of the banking system's total classified claims against corporates and sole traders. A large proportion of the investments of leasing companies owned by Slovenian banks are in real estate business. Several banks own companies whose line of business is property management. Real estate projects can be transferred within the group, but from the point of view of the consolidated financial statements this does not reduce systemic risk. The situation in the construction sector deteriorated markedly for the fourth consecutive year, as a result of which there was a deterioration in the quality of the financial sector's claims against it.

Table 2.6: Banking system's classified claims against the construction sector by rating and corporate status in EUR million, and coverage of claims by impairments in percentages as at 31 December 2011

	A		B		C		D and E		Total	
	Classified claims, EUR million	Coverage of claims by impairments, %	Classified claims, EUR million	Coverage of claims by impairments, %	Classified claims, EUR million	Coverage of claims by impairments, %	Classified claims, EUR million	Coverage of claims by impairments, %	Classified claims, EUR million	Coverage of claims by impairments, %
Construction sector - total	691	0.5	856	2.2	766	14.0	1,332	37.0	3,645	17.1
Construction corporates that regularly settle liabilities, excluding bankruptcies	690	0.5	764	2.3	383	10.1	19	18.4	1,856	3.4
Construction corporates that settle liabilities 90 days in arrears, excluding bankruptcies	1	0.4	92	1.3	370	18.1	357	35.9	820	23.9
Construction corporates in bankruptcy			0	0.0	13	13.4	956	37.7	969	37.4

Source: Bank of Slovenia

The deterioration in the banking system's claims against the construction sector remained rapid in the absence of new profitable projects and the inability to rent or sell new build. Merely just over half of all claims against the construction sector were not in arrears at the end of 2011. The proportion of claims in which going concerns are more than 90 days in arrears is increasing, and stood at 23%. Their coverage by impairments stood at 24%, without collateral value being taken into account. The proportion of claims against construction firms in bankruptcy reached 27%. At 37.4%, coverage of these claims by impairments is low, given that just under a half are unsecured. Real estate accounts for more than two-thirds of collateral, and government guarantees for merely 1%.

The subsidiaries are simultaneously recording a similarly paced deterioration in the quality of own investments and investment leasing. On their balance sheets there is an increasing proportion of investment property and inventories of equipment seized under leasing agreements, or obtained via enforcement or via the right of exclusion in proceedings. Arrears in the settlement of clients' liabilities are lengthening, impairment costs are rising, and dependence on funding from related parties is increasing. With total assets of EUR 1.4 billion, the subsidiaries are significantly smaller than the banks, but their losses and recapitalisation are having a major impact on the banks' capital.

Despite the drastic deterioration in claims, banks and construction firms have been passive in managing existing projects. Given the low equity, the restructuring of construction firms' balance sheets is unlikely without the sale of real estate and without new investment. Increasing numbers of firms are going bankrupt. The lengthy duration of the proceedings and the inability to sell assets at the prices equivalent to the collateral valuation means that banks are unable to recover claims in full.

By contrast, when a plan is examined in conjunction with the bank, going concerns primarily see their financing renewed to maintain liquidity. Sale time is lengthening as the number of transactions in new-build real estate remains modest. High refinancing costs and a deterioration in the quality of unsold stocks is reducing the return on completed projects, thereby reducing profit and the ability of construction firms to guarantee the repayment of loans through operating revenues. Many projects were also designed with high input costs and were valued at prices that applied in the context of surplus demand and high liquidity.

Waiting for an improvement in the situation is in the interests of the banks and the construction firms, in order to achieve a reasonable valuation of assets held as collateral. Such action is creating further pressure to downgrade the credit ratings of both sides, and is having an adverse impact on the amount and price of lending to sound projects in the remainder of the economy, which is making the business environment even worse, instead of improving it.

Table 2.7: Attributes and potential additional losses to banks from the liquidation of construction firms in EUR million

	Classified claims, EUR million	Impairments, EUR million	Unsecured claims, EUR million	Potential impairments for unsecured claims, EUR million	Secured classified claims, EUR million	Value of real estate collateral, EUR million	Surplus in value of collateral over classified claims
Construction sector - total	3,645	622	1,363	742	2,282	2,986	1.1
Construction corporates that regularly settle liabilities, excluding bankruptcies	1,856	63	636	573	1,220	1,729	1.3
Construction corporates that settle liabilities 90 days in arrears, excluding bankruptcies	820	196	271	75	549	673	1.2
Construction corporates in bankruptcy	969	363	454	92	514	584	0.7

Source: Bank of Slovenia

The deterioration in the claims and their low coverage by collateral are increasing the losses of the banks and construction firms, which is forcing them into the joint active management of the assets held as collateral. The banks' impairments created to date are insufficient to cover the unsecured portion of the bad debts, as a result of which additional losses are expected. The secured portion of the bad debts is the current estimated value of the real estate collateral. Allowing for survey figures revealing that in 18% of cases there is another mortgage on the same real estate, coverage of claims by the value of real estate collateral is estimated to be sufficient solely for going concerns that settle their liabilities on time. Sales at public auction are generally made at prices below the starting price, which will reduce the successful recovery of the secured portion of the bad debts.

Table 2.8: Position of bank groups in relation to the real estate market in percentages

	Dec. 2011				Proportion of new loans in 2011	
	Market share in terms of total assets	Impairment and provisioning costs as % of gross income	Classified claims against construction sector as % of total classified claims[1]	Breakdown of classified claims in terms of exposure to construction sector	Construction	Housing
Large domestic banks	63	109	14	69	71	42
Banks under majority foreign ownership	29	36	8	22	15	54
Small domestic banks	8	66	12	9	13	4
Banking system	100	84	12	100	100	100

Note: [1] Total classified claims includes classified claims against corporates and sole traders.
Source: Bank of Slovenia

The large domestic banks had the highest exposure to the construction sector at the end of 2011, at 14% of total classified claims against corporates and sole traders. This bank group also has an above-average ratio of impairment and provisioning costs to gross income. This is having an adverse impact on their competitiveness with regard to loans for real estate purchases. Despite a large market share, the large domestic banks approved only 42% of all new housing loans in 2011. Their agreed interest rates were above-average, which could have reduced household demand.

Should real estate prices remain at their current levels, it would be easier for the banks to restructure their balance sheets with a gradual improvement in performance. Construction firms do not have this chance of restructuring their portfolios. A shortage of equity means that the healthy portion of the construction sector can only be saved by disinvestment, which given the developments in the last three years could only be made via an adjustment in real estate prices.

This would initially result in impairment costs in both sectors, which are already arising as a result of the expensive refinancing of existing investments at the construction firms and the impairment of the unsecured portion of claims at the banks. Price adjustments on the supply side would in all likelihood be followed by increased demand for new build, given that demand has been increasing for certain used real estate for two years now. Portfolio cash flow between sectors would have a beneficial impact on repayments by the construction sector and the redirection of banks' exposure to the household sector. The final losses would be probably less than those realised by the sale of bankruptcy estates. An adjustment in housing prices would maintain a significantly slower rate of household borrowing, and would reduce the risk of an inability to pay their liabilities to banks and a rise in interest rates.

International comparison

Prior to the crisis, housing prices in Slovenia rose faster than in other euro area countries. They almost doubled in nominal terms between 2003 and the peak of 2008. Only Estonia, where prices also fell sharply after peaking, recorded higher growth. The downward adjustment in prices in Slovenia had reached 7.5% by the end of 2011, low in comparison with the previous over-valuation and surplus supply on the market.

Real estate markets have responded differently in different euro area countries, given their local attributes. Real estate prices fell significantly in Ireland, Cyprus and Spain, where they are still under pressure from an excess of supply over demand and difficulties in the settlement of liabilities. The housing markets in France, Italy and the Netherlands saw temporary falls in housing prices, but they have now almost returned to their pre-crisis levels. Alongside the abolition of housing incentives as a result of austerity measures and changes in taxation, tightened credit standards will reduce housing affordability in these countries, which will have a renewed negative impact on price movements. A third group of countries consists of Germany, Austria, Belgium and Portugal, where the crisis had little or no impact on the real estate market.

3 CORPORATE SECTOR

Corporate financing in 2011 remained at similarly low levels to the previous two years. Given the lack of financing from domestic creditors, corporates strengthened financing in the rest of the world, particularly at foreign banks. Those sectors achieving positive growth on the basis of export demand are increasingly borrowing in the rest of the world and repaying debt at the domestic banks. As a result of a standstill in equity investment, corporate indebtedness remains at a high level. Foreign owners are repatriating the majority of profits, and there is little inflow of fresh capital.

3.1 Corporate financing and net indebtedness

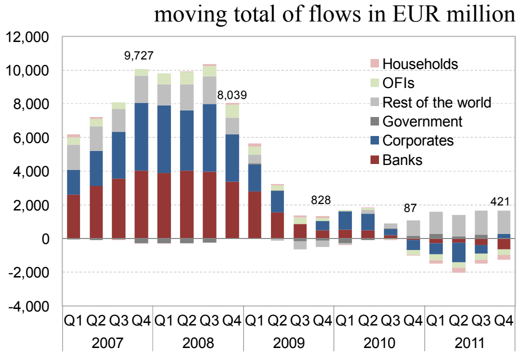
Corporate financing flows

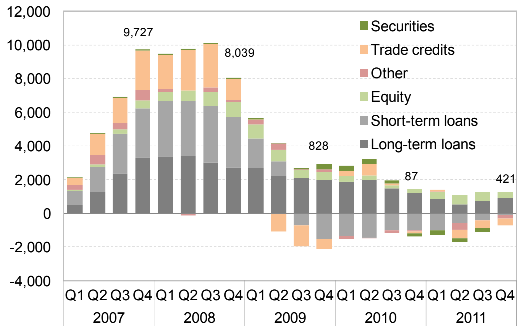
Export demand, which during the decline in domestic consumption was the sole engine of economic recovery in Slovenia, began to decline in the second half of 2011. The decline in investment demand seen over several years continued. Ever since the outbreak of the economic crisis, the most significant limiting factors in the performance of non-financial corporations have been the limited possibility of corporate financing via external resources, via equity and, consequently, via external debt.

Non-financial corporations' flow of financing remained low in 2011.

Given the relatively high corporate indebtedness, the economic recovery in 2011 was not supported by external financing. Non-financial corporations' annual flow of financing amounted to EUR 421 million last year, equivalent to 1.1% of GDP, compared with 22% in 2008. The trend of corporate debt repayment to domestic sectors continued: to banks, non-monetary financial institutions and households. Financing from the rest of the world has increased since the beginning of the economic recovery. The annual flow of financing from the rest of the world reached EUR 1.4 billion last year, approaching the highest levels recorded before the outbreak of the economic crisis.

Figure 3.1: Corporate borrowing by sector (left) and by instrument (right), annual moving total of flows in EUR million

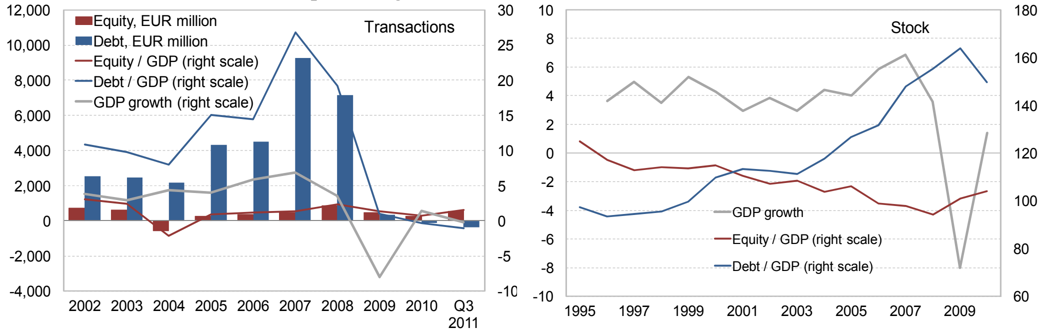




Source: Bank of Slovenia

During the years of boom and rising profits, corporates earmarked relatively little money to strengthening their equity base. Economic growth during these years was supported by high growth in corporate borrowing, while relatively little of the profit was returned to corporates, which would have helped to reduce financial leverage. Insufficient equity investment meant that the corporate capital base fell from 125% of GDP in 1995 to 94% of GDP in 2008. The trend of decline was interrupted during the economic crisis: in 2009 as a result of a sharp decline in GDP, and in 2010 as a result of rising stock market prices bringing a revaluation in equity. The inflow of equity into corporates remained relatively small in those years.

Figure 3.2: Flows (left) and stock (right) of equity and debt in non-financial corporations and GDP growth, in EUR million, in percentages and as a percentage of GDP



Source: Bank of Slovenia

Business-to-business financing via trade credits was weak, in reflection of low domestic demand.

Flows of financing between corporates declined continually from the second half of 2010, and only strengthened slightly towards the end of last year. As a result of liquidity problems and the transmission of insolvency from larger to smaller corporates, in particular those at the end of supply chains, the possibility of business-to-business financing is also diminishing. Trade credits between corporates in Slovenia are declining, because the impulse for economic growth is only coming from the external environment, while the contribution made by domestic demand remains negative.

Table 3.1: Corporate financing flows (total, via loans and via trade credits) in EUR million

	Flows			Stock		Growth
	2009	2010	2011	2010	2011	2011
	(EUR million)					(%)
Total	828	87	421	89,194	86,803	-2.7
growth, %	-89.7	-89.4	381.5	0.4	-2.7	
	of which:					
Loans	476	200	803	33,581	34,573	3.0
business-to-business	488	163	609	3,582	4,439	23.9
from banks	211	40	-554	21,000	20,458	-2.6
from NMFIs	147	-222	-296	2,823	2,488	-11.8
from rest of the world	-414	168	1,116	5,124	6,312	23.2
of which: from corporates	-484	-149	-3	1,018	1,092	3.9
from foreign banks[1]	102	277	895	2,279	3,165	48.1
Trade credits	-603	-117	-387	12,920	11,874	-8.1
business-to-business	-216	-537	-343	7,588	6,602	-13.0
from rest of the world	-439	444	45	4,333	4,356	0.5

Note: [1] The figures for 2011 include a major transaction between a foreign owner and corporates established in Slovenia for property management.

Source: Bank of Slovenia

Corporate financing in the rest of the world is increasing.

An inflow of trade credits continued from the rest of the world, albeit in a slightly smaller volume in the second half of the year, in line with the slowdown in merchandise trade. Loans from the rest of the world are continuing to increase at the same pace. The inflow of loans raised at foreign banks amounted to EUR 895 million in 2011. Borrowing from international financial institutions also increased: corporate loans of EUR 188 million were several times the total amount of borrowing undertaken in 2009 and 2010 together. The result of this growth in loans from the rest of the world was a year-on-year increase of 2.5 percentage points in the proportion of the total stock of corporate loans that they account for to 16.9%.

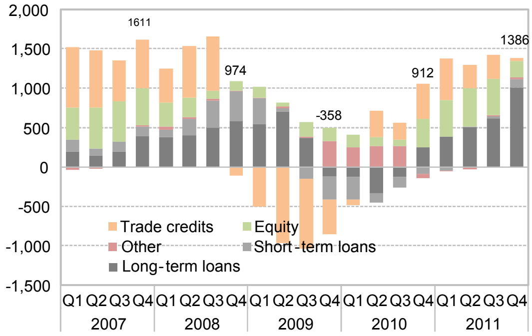
The corporates that undertook net borrowing via loans from the rest of the world were less indebted than non-financial corporations overall in Slovenia. According to the latest available annual reports for 2010, their financial leverage averaged 108.4%, a quarter less than the figure of 143.5% for non-financial corporations overall. The range of financial leverage at these corporates is however extraordinarily wide, and is an indication that alongside the financial position of the corporate in question financing in the rest of the world is affected by other factors, including the interest rate spread between Slovenian banks and euro area banks overall.

Table 3.2: Corporate financing in the rest of the world,stock in EUR million and breakdown in percentages

	Stock at year end			
	2008	2009	2010	2011
Total, EUR million	15,619	15,360	16,552	17,800
growth, %	7.8	-1.7	7.8	7.5
	Breakdown, %			
Securities[1]	0.1	1.9	1.5	1.4
Loans	31.8	31.4	31.0	35.5
of which: at foreign banks	10.7	12.8	13.7	16.0
at MFIs[2]	10.9	11.3	10.6	11.8
at foreign corporates	9.2	6.7	6.1	6.8
Equity	38.3	39.5	40.1	37.3
Trade credits	29.7	27.2	27.4	25.8

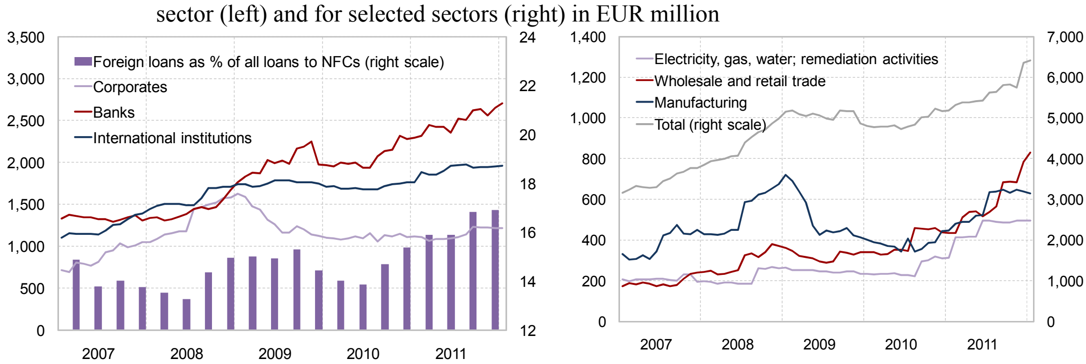
Note: [1] Securities other than shares.
[2] International financial institutions.
Source: Bank of Slovenia

Figure 3.3: Corporate financing flows in the rest of the world, annual moving total of flows in EUR million



Financing via foreign loans in 2011 increased in particular at corporates in the sectors of wholesale and retail trade and manufacturing, i.e. the sectors that most reduced their indebtedness at the domestic banks. This was partly the result of the tightening of the banks' credit standards, and partly the result of the interest rate spread, which in the case of corporates that have the option of choosing a creditor is bringing an increase in borrowing in the rest of the world.

Figure 3.4: Stock of corporate loans from the rest of the world by foreign creditor's sector (left) and for selected sectors (right) in EUR million



Note: A major transaction between a foreign owner and corporates established in Slovenia for property management has been excluded.
Source: Bank of Slovenia

Corporate financing via equity remains low.

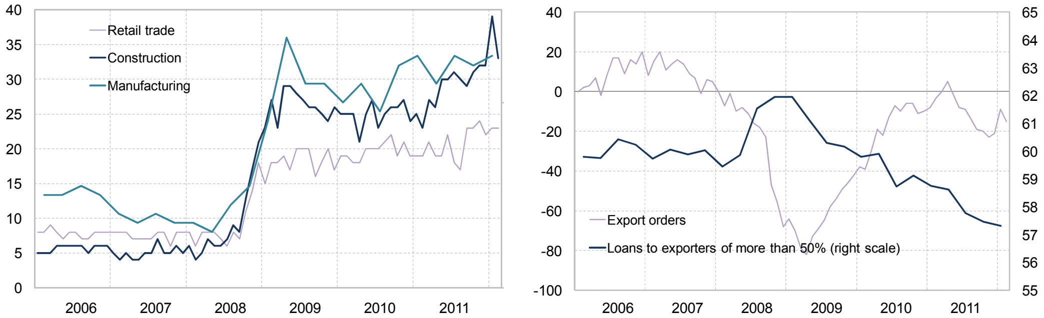
There was no increase in corporate financing via equity in 2011. The inflow of equity into corporates amounted to EUR 363 million last year, of which EUR 134 million was equity flow within the sector of non-financial corporations. Inflows of equity from other sectors amounted to EUR 229 million, mostly from the rest of the world. The total flow of equity into corporates in 2011 was far too small to successfully reduce the excessive financial leverage in the sector. This indicates that the corporate sector's reliance on internal financing is inadequate and overly modest. The household and government sectors withdrew from corporate ownership. The banking sector increased its equity holdings in corporates by EUR 48 million, but only as a result of the exercise of collateral, and not in the role of active owners.

The inflow of capital from foreign investors in the amount of EUR 204 million was roughly at the low level of the last three years, and was significantly lower than in the years prior to the outbreak of the crisis. There has been a trend for several years of declining reinvestment of profits by foreign owners in the further development of subsidiaries in Slovenia. The proportion of retained earnings at corporates under foreign ownership stood at 65% in 2005, but had declined to just 13% by 2011.

Access to financing at banks is still limited.

Corporates have made debt repayments to banks in the last year and a half. The recovery in economic activity, in particular at export-oriented corporates in the manufacturing sector, was not supported by increased financing of these sectors at banks. By contrast, the manufacturing sector made debt repayments to banks in 2011, with exporters making notably rapid repayments. The proportion of total loans to the manufacturing sector accounted for by exporters declined from 62% at the end of 2008 to 57% at the end of 2011. The increase in the sector's financing in the rest of the world is an indication of the more favourable terms of borrowing at foreign banks, and also the general reticence towards corporate financing on the part of the banks in Slovenia.

Figure 3.5: Proportion of corporates citing financing difficulties as a limiting factor (left) and financing of manufacturing (right) in percentages



Note: Loans to exporters of more than 50%: the ratio of loans to manufacturing exporters that generate at least 50% of net turnover via exports to total loans to the manufacturing sector; export orders: balance between responses of higher than normal, the same or lower than normal.

Sources: SORS, Bank of Slovenia

The proportion of loans to the construction sector is increasing at banks.

Corporate borrowing at banks declined in the majority of sectors in 2011. Only in three sectors did the stock of corporate loans increase: the agriculture, forestry and fishing sector, the electricity, gas and water supply and remediation activities sector, and the construction sector. As a result of the persistently high level of indebtedness to banks in the construction sector, the proportion of the total stock of loans to non-financial corporations accounted for by construction firms increased from 9.3% at the end of 2007 to 12.5% at the end of 2011. The banks' portfolios have thus retained clients in sectors with the worst credit ratings on average, instead of the financially stronger corporates that could raise the average quality of the portfolio through new loans. The banks are primarily reducing their financial leverage by reducing loans to sectors that are still repaying their liabilities.

Table 3.3: Increases and breakdown of the stock of loans from banks by sector in EUR million and in percentages

	Manufacturing	Construction	Wholesale and retail trade	Transportation and storage	Accommodation and food service activities	Financial and insurance activities	Real estate activities	Professional, scientific and technical activities	Non-financial corporations overall
2007	713.8	619.1	704.0	361.3	85.2	734.6	291.5	573.1	4,517.7
2008	964.0	410.1	714.3	328.9	127.6	242.8	250.3	156.9	3,438.6
2009	64.3	226.9	-176.6	187.0	79.2	-425.3	21.7	63.4	216.2
2010	48.9	225.0	-4.5	75.1	31.1	-230.1	-15.7	-64.0	138.8
2011	-299.0	102.2	-214.3	-21.2	-7.4	-46.7	-7.2	-112.9	-598.0
	Breakdown of stock of loans by activity, non-financial corporations = 100								
Dec. 2007	26.7	9.3	19.8	8.4	2.5	11.1	5.0	9.3	100.0
Dec. 2011	26.3	12.5	18.3	9.9	3.2	7.2	5.5	8.1	100.0

Note: The purchase of claims from subsidiary banks in the rest of the world by parent banks in Slovenia was another factor in the increase in loans.

Source: Bank of Slovenia

The renewal of old loans constitutes a large proportion of new loans at banks.

For new corporate loans, the banks in many cases merely renew old loans that the corporates in question had difficulties in repaying. Renewed loans for the purpose of loan restructuring accounted for 43% of all new loans in 2011, the banks mostly renewing the loans for periods of less than one year. Two-thirds of new short-term loans to construction firms were merely renewals of previous agreements. There was also a large proportion of short-term renewals of agreements with corporates in the sectors of accommodation and food service activities, financial and insurance activities, real estate activities, and professional, scientific and technical activities, i.e. in sectors that have the greatest difficulty in settling their debts to banks. There is thus an increased risk of banks increasingly reprogramming loans to debtors that will fail to carry out financial restructuring.

Table 3.4: Proportion of new corporate loans accounted for by renewals of maturing loans in percentages

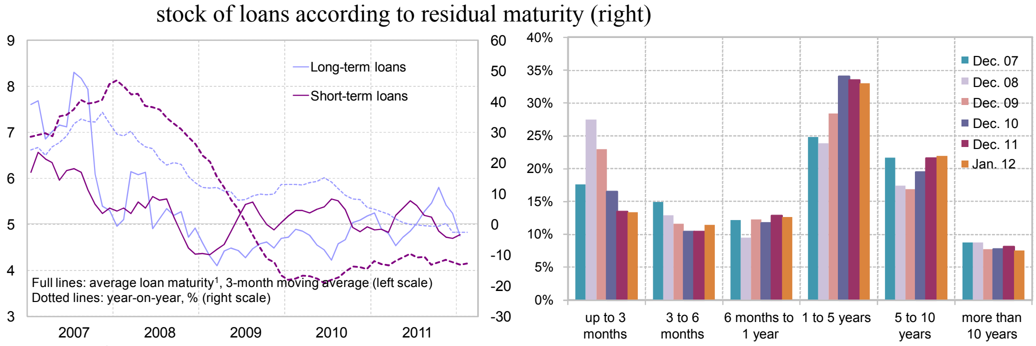
Loan maturity[1]	Manufacturing	Construction	Wholesale and retail trade	Transportation and storage	Accommodation and food service activities	Financial and insurance activities	Real estate activities	Professional, scientific and technical activities	Non-financial corporations
Long-term	40.6	30.8	33.3	39.2	15.5	23.1	50.9	23.4	35.1
Short-term	45.2	65.6	23.4	46.0	77.9	69.5	72.8	59.8	46.6
Total	43.2	58.6	26.1	41.4	47.7	62.7	64.4	49.8	42.7

Note: [1] Loan maturity relates to the maturity of the renewal, and not to the original maturity.
Source: Bank of Slovenia

Long-term loans from banks began to decline in 2011.

Restricted financing at banks was first reflected in a decline in short-term financing, as maturing loans were not renewed in full. The stock of short-term loans to non-financial corporations at banks declined by 37.7% between December 2008 and 2011. As a result of this decline, the maturity breakdown of corporate loans at banks lengthened. The average maturity of new long-term loans also lengthened, which is one of the few favourable shifts in investment financing. The stock of long-term loans to non-financial corporations declined in 2011 for the first time since the outbreak of the economic crisis, ending the year down 2.7% on the end of 2010. The persistent limitations on long-term financing at banks are an indication of the high rate of rejection of applications for investment loans, which stood at 60% in the first half of 2011.[9]

Figure 3.6: Average maturity of new corporate loans at banks (left) and distribution of stock of loans according to residual maturity (right)



Note: [1] The scale on the left vertical axis signifies months in the case of short-term loans and years in the case of long-term loans.
Source: Bank of Slovenia

Corporate financial liabilities

The stock of corporate debt declined in absolute terms and relative to GDP.

The stock of non-financial corporations' financial liabilities had declined to EUR 86.8 billion by the end of 2011, down EUR 2.4 billion on the end of 2010. Transactions during this period were low but positive; the decline was entirely an indication of value changes, in particular the fall in share prices in 2011. The ratio of corporate financial liabilities to GDP increased by 8.6 percentage points to 243.2%. As total financial liabilities declined, corporate debt as a narrower aggregate of indebtedness increased, reaching 99.5% of GDP.[10]

There was a decline in corporate debt to all sectors other than the rest of the world.

Corporate liabilities to all sectors other than the rest of the world declined in 2011. The decisive factor in the decline in corporate financial liabilities in each creditor sector was value changes, in particular the devaluation of equity, which in certain sectors accounted for 70% to 80% of the decline in the stock of financial liabilities. The remaining 20% to 30% of the decline was the result of negative transactions and net debt repayments to the sector in question by corporates. The ratio is different at banks, where corporates are primarily financed via debt instruments, on which value changes had no major impact. The proportion of the stock of corporate debt accounted for by banks declined for the second consecutive year, by 0.2 percentage points to 24.6%.

[9] Bank survey in 2011 on demand for loans.
[10] The majority of the category of "debt" consists of loans (approximately 98%), while other debt instruments that did not decline in 2011 (mainly trade credits) are not included.

Table 3.5: Stock and breakdown of financial liabilities by instrument, and corporate debt in EUR million and percentages

	2007	2008	2009	2010	2011
			(EUR million)		
Total liabilities	89,356	88,629	88,813	89,194	86,803
growth, %	25.3	-0.8	0.2	0.4	-2.7
as % GDP	258.5	237.7	251.5	251.8	243.2
Debt[1]	27,928	33,803	34,513	34,422	35.355[2]
growth, %	30.5	21.0	2.1	-0.3	2.7
as % GDP	80.8	90.7	97.7	97.2	99.5
			Breakdown, %		
In Slovenia	83.8	82.4	82.7	81.4	79.5
corporates	31.1	31.3	30.8	28.2	28.0
banks	20.6	24.5	24.9	24.8	24.6
bank loans	19.6	23.4	23.5	23.5	23.6
NMFIs	7.3	6.1	6.1	5.3	4.8
government	12.0	8.8	8.6	11.0	11.1
households	12.8	11.7	12.3	12.1	11.0
In rest of the world	16.2	17.6	17.3	18.6	20.5
loans at foreign banks	1.5	1.9	2.2	2.6	3.0

Note: [1] Debt includes loans, debt securities (excluding derivatives) and insurance technical provisions, and in the Slovenian corporate sector practically consists solely of loans raised.
[2] The increase in the stock of debt in 2011 was partly the result of status changes (corporate demergers).

Source: Bank of Slovenia

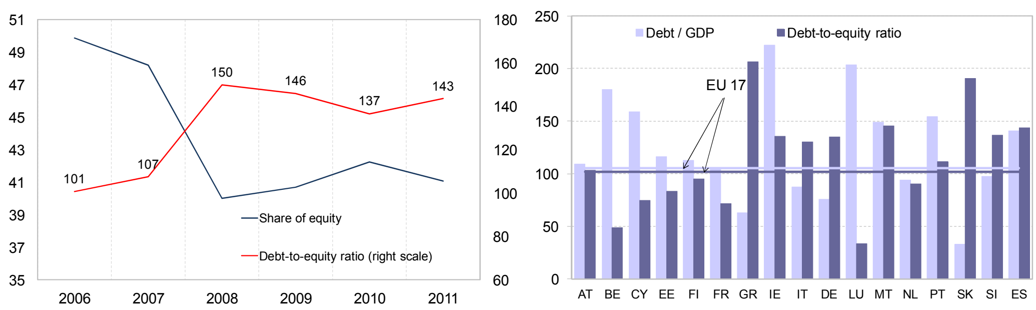
The debt-to-equity ratio rose slightly.

As a result of devaluation, the proportion of corporate financial liabilities accounted for by equity declined by 1.2 percentage points last year to 41.1%. After falling in 2010, the debt-to-equity ratio rose again, to 143.5%. The key factors in the movement in the two indicators were value changes in equity as a result of stock market developments. Although corporates were making debt repayments for the third consecutive year, and inflows of equity into corporates have been positive since 2005, these changes are small compared with changes in the value of capital, which have a key impact on the direction and size of the debt-to-equity ratio.

A reversal in the economic cycle entails a deterioration in the prospects for capital growth from retained earnings.

High corporate indebtedness is one of the most significant limiting factors for new financing at banks. Larger capital contributions by owners and increased direction of profits to further corporate development are essential to reducing indebtedness. The prospects of earnings growth are negative, given the projected contraction in economic activity in 2012. The introduction of new technologies that could contribute to greater profitability, and the consequent expansion of the capital base in the corporate sector, has stalled, partly as a result of a lack of financing. A survey by the Chamber of Commerce and Industry is indicative in this respect, as it confirms that corporate expectations of new investment are negative, having deteriorated further in 2011. The standstill in financial restructuring is thus interacting with the lack of progress in the business restructuring required to revive economic growth.

Figure 3.7: Debt-to-equity ratio in corporate financing (left) and comparison of corporate indebtedness in the euro area in 2010 (right) in percentages



Source: Bank of Slovenia

Non-financial corporations' average indebtedness in the euro area is lower than that of Slovenia. The average debt-to-equity ratio in the euro area stood at 101.6% in December 2010. According to the latest comparable figures, Greece and Slovakia have higher debt financing indicators than Slovenia. Five other countries are at a comparably high level: Ireland, Malta, Spain, Italy and Germany.

Corporate financial assets and net financial position

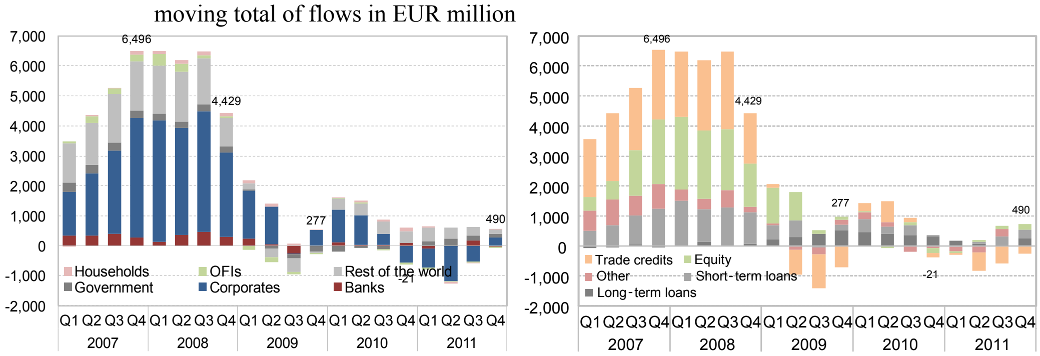
Trade credits to the rest of the world are prevalent among corporate financial investments.

Corporate investments were also small in 2011. The key contributions to the positive flow in total investments came from investments in the rest of the world and, towards the end of the year, investments between corporates. The largest proportion of corporate investments in the rest of the world in 2011 was earmarked for financing sales via trade credits. Trade credits to the rest of the world started to decline as a result of the slowdown in exports. In line with the lack of demand on the domestic market, trade credits granted to domestic sectors were negative for the third consecutive year, i.e. net repayments were made.

Corporate investments in households and banks are declining.

Financing of households via loans and trade credits stalled in 2011, as households made net repayments of debt to corporates. Last year was the first year in which corporates reduced their deposits at banks and in accounts in the rest of the world.

Figure 3.8: Corporate investments by sector (left) and by instrument (right), annual moving total of flows in EUR million

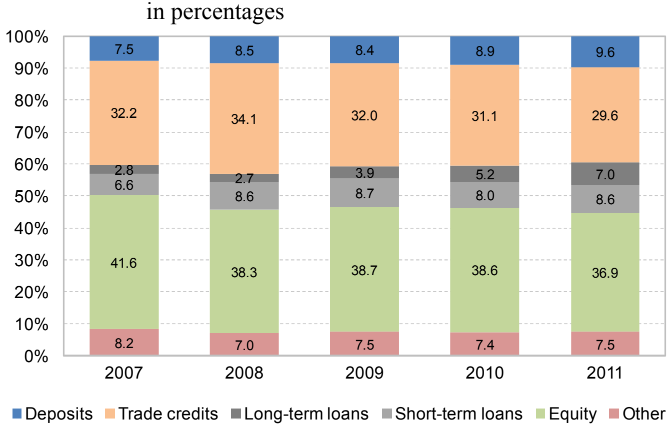


Source: Bank of Slovenia

Investments in foreign corporates are declining as a result of negative reinvested earnings.

Alongside trade credits to the rest of the world, non-financial corporations' financial investments in 2011 notably comprised investments in equity, although most were investments within the corporate sector. Capital investments in corporates in the rest of the world were small, although not because of a slowdown in equity investments, but rather because of the repatriation of profits or because of realised losses at these corporates.

Figure 3.9: Breakdown of the stock of corporate financial investments by instrument in percentages



Source: Bank of Slovenia

Given the large proportion of operating and financial receivables in the breakdown of corporate investments, which amounted to EUR 28.1 billion at the end of 2011, corporates are significantly exposed to credit risk. In the absence of such data for corporates, on the basis of the increasing arrears in the settlement of liabilities to banks and on the basis of judicial enforcement it can be concluded that credit risk is also increasing on the investment side in the corporate sector. Bad investments, which at corporates are primarily in the form of short-term trade credits, are bringing a further deterioration in the liquidity position. Investments in equity exposed to market risk represent an additional risk in corporate investments.

Financing of the rest of the world via loans declined in 2011.

Financing of the rest of the world via loans in 2011 was down on previous years. Prior to 2009, these loans were mostly earmarked for financing subsidiaries in the rest of the world. In 2009 and 2010 loans predominantly comprised loans to foreign owners, which together with profit distributions contributed to a significant outflow of capital from Slovenian corporates to the rest of the world. The flow of loans to parent companies in the rest of the world declined in 2011. Financing of subsidiaries in the rest of the world via loans stopped completely, and net repayments of these loans were made.

Table 3.6: Loans[1] received from and granted to the rest of the world, by type of ownership relation, transactions in EUR million

	Loans from rest of the world				Loans to rest of the world				
	From foreign investors in Slovenia	From Slovenian corporates in rest of the world	Without ownership links	Total	To foreign investors in Slovenia	To Slovenian corporates in rest of the world	Without ownership links	Total	Net loans granted
2008	358	19	568	945	-81	138	45	102	-842
2009	-479	-11	60	-430	116	100	89	305	735
2010	-88	6	255	173	130	44	-2	172	-1
2011	601	14	478	1093	48	-112	-34	-98	-1191
	From EU	From ex-YU	From other countries	Total	To EU	To ex-YU	To other countries	Total	Net loans granted
2008	375	54	515	945	-38	58	82	102	-842
2009	-167	-21	-242	-430	59	209	37	305	735
2010	99	94	-20	173	151	8	12	172	-1
2011	903	-70	260	1093	51	-93	-55	-98	-1191

Note: [1] Includes deposits, long-term trade credits and other debt liabilities, which merely comprise a small portion of the aggregate.
Source: Bank of Slovenia

The net corporate debt position declined to 118.4% of GDP.

The stock of corporate financial investments stood at EUR 44.5 billion at the end of 2011, down EUR 1.1 billion on a year earlier. As a result of the differing amounts of equity in financial liabilities and investments, value changes resulted in a larger decline in liabilities, which had a favourable impact on the net corporate debt position. Net corporate financial liabilities stood at EUR 42.3 billion in December 2011, down 2.9% on the end of 2010, and down 4.6 GDP percentage points at 118.4% of GDP. Net corporate debt at banks declined by 2 GDP percentage points in 2011 to 46.7% of GDP, primarily as a result of the decline in corporate loans.

Table 3.7: Net corporate financial liabilities, stock at year end in EUR million and percentages

	2007	2008	2009	2010	2011
	(EUR million)				
Total	42,369	40,874	41,576	43,553	42,274
growth, %	25.7	-3.5	1.7	4.8	-2.9
as % GDP	122.6	109.6	117.7	123.0	118.4
	Breakdown, %				
In Slovenia	87.2	86.6	87.7	86.9	83.4
banks	32.6	41.4	41.6	39.4	39.3
NMFIs	10.3	9.2	9.3	7.8	7.0
government	20.6	14.1	14.0	18.3	17.7
households	23.9	22.1	23.0	21.6	19.6
In rest of the world	12.8	13.4	12.3	13.1	16.6

Source: Bank of Slovenia

Table 3.8: Corporate loans[1] from and deposits at banks, stock at year end in EUR million and in percentages

	Corporate borrowing at banks		Corporate	Net corporate borrowing at banks		
	Corporate loans		deposits			
	(EUR million)	as % GDP)	(EUR million)	(EUR million)	Ratio	(as % GDP)
	(1)	(2) = (1)/GDP	(3)	(4) = (1-3)	(5) = (1/3)	(6) = (4)/GDP
2006	13,019.7	41.9	3,341.1	9,678.6	3.9	31.2
2007	17,733.8	51.3	3,674.2	14,059.5	4.8	40.7
2008	21,003.7	56.3	3,711.8	17,291.8	5.7	46.4
2009	21,211.3	60.1	3,825.5	17,385.9	5.5	49.2
2010	21,282.9	60.1	4,032.7	17,250.2	5.3	48.7
2011	20,685.1	57.9	4,030.5	16,654.6	5.1	46.7

Note: [1] Loans are disclosed as gross amounts, excluding impairments.
Source: Bank of Slovenia

3.2 Interest rates and interest rate risk for corporates

Asset interest rates for corporates

Slovenian banks' interest rates on corporate loans of up to EUR 1 million were still 1.8 percentage points higher on average in 2011 than the average of euro area banks, but the spread narrowed by 0.6 percentage points. The spread on corporate loans of more than EUR 1 million narrowed by 0.5 percentage points over the aforementioned period to 2.2 percentage points. The trend of a narrowing spread between interest rates in Slovenia and the euro area average has been seen since the beginning of 2010, as a result of the rise in interest rates in the euro area. Interest rates fell in early 2012 as a result of a fall in the EURIBOR caused by a cut in the ECB's key interest rate and the tenders for 3-year LTROs at the ECB.

Slovenian banks' interest rates on corporate loans were higher than the euro area average, but the spread narrowed in 2011.

The banks under majority foreign ownership have lower interest rates than the domestic banks, but average spread declined in 2011. Compared with 2010, the small domestic banks' interest rates on loans of more than EUR 1 million last year were higher on average than those of the large domestic banks, while there was no change in the spread on loans of up to EUR 1 million. The small domestic banks have the highest interest rates on all types of corporate loan.

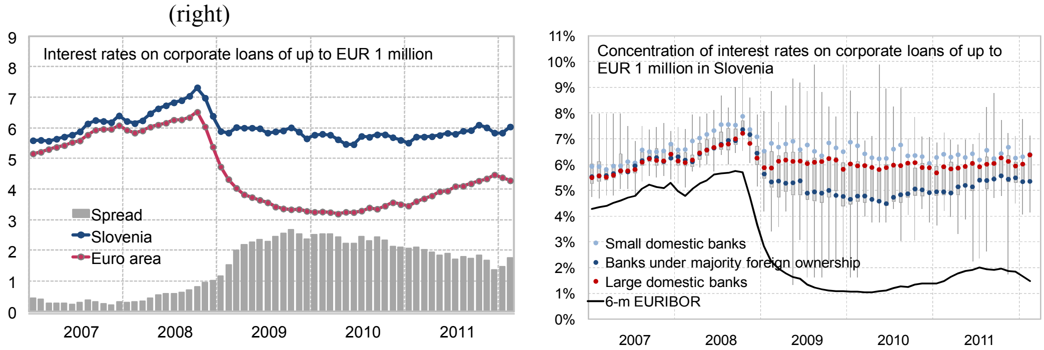
The small domestic banks have the highest interest rates.

There are several reasons for the interest rate spreads between the bank groups and with euro area banks overall:

1. During the period of high economic growth and competition for market share, Slovenian banks took up risks that were not sufficiently taken into account in the calculation of the risk premium, as a result of which corporate lending rates were lower. The length of the economic crisis brought a deterioration in the quality of the credit portfolio, as a result of which the need to create impairments arose. This has had a strong impact on operating results and capital adequacy, for which reason Slovenian banks are not reducing asset interest rates as much as banks in the euro area overall. Such behaviour is raising current financing costs for corporates, which in the crisis situation is having an adverse impact on the competitiveness and economic activity of already over-indebted corporates.

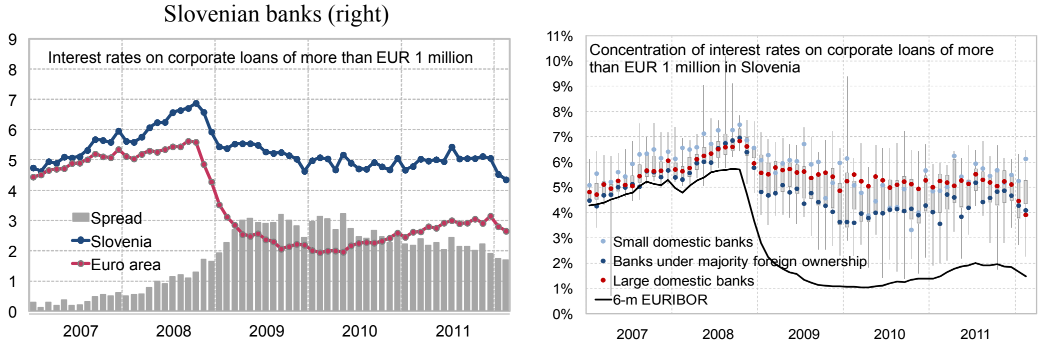
The laxity of lending terms in the pre-crisis period is preventing the banks from reducing corporate lending rates.

Figure 3.10: Interest rates on corporate loans of up to EUR 1 million in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)



Source: Bank of Slovenia

Figure 3.11: Interest rates on corporate loans of more than EUR 1 million in percentages: comparison with the euro area (left) and dispersion at Slovenian banks (right)



Source: Bank of Slovenia

The breakdown of the Slovenian banking system's funding shifted towards more expensive resources.

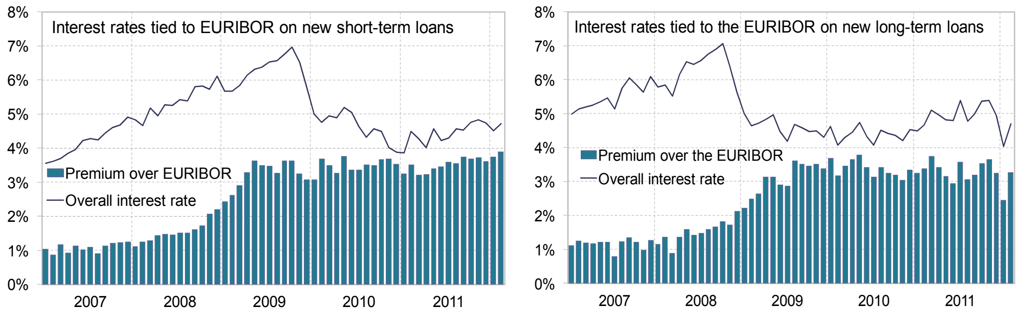
2. As a result of the debt crisis Slovenian banks are finding it harder to access funding on the euro area interbank market, as a result of which liabilities to foreign banks have declined by 26% or EUR 6.1 billion since the end of 2008. The interest rate is rising on the residual stock of liabilities, as a result of a rise in the risk premium. The proportion of total liabilities accounted for by liabilities from securities has increased by 5 percentage points, and securities are the most expensive source of funding. All of this is raising average funding costs, which the banks partly pass on to borrowers in the form of higher lending rates.

3. Given their limited access to funding in the rest of the world, the domestic banks are trying to increase deposits by the non-banking sector. The same is being attempted by the banks under majority foreign ownership, whose business models are no longer based merely on obtaining funding from their parent banks. Furthermore, in light of the recommendations of their supervisory authorities[11] some of the parent banks tightened the loan-to-deposit ratio for new loans. The domestic banks only managed to increase their deposits by the non-banking sector by EUR 37 million in 2011, while the banks under majority foreign ownership attracted an additional EUR 643 million. Increased competition for deposits by the non-banking sector is causing a faster rise in deposit rates, and thus lending rates.

Given the increased credit risk, the banks have started charging corporates significantly higher premiums than before the crisis.

4. Slovenian corporates are more indebted than euro area corporates overall, which is reducing their creditworthiness. Given the increased risk, the banks have begun charging corporates higher premiums than during the pre-crisis period. In addition, they have begun to assess projects and clients more conservatively. The premiums over the reference interest rates did not change significantly in 2011 compared with the previous year, but lending rates rose slightly as a result of a rise in the reference interest rates.

Figure 3.12: Premiums over the EURIBOR and overall interest rate for new short-term (left) and long-term (right) corporate loans in percentages



Source: Bank of Slovenia

5. Another reason for the higher premiums on Slovenian banks' corporate loans is the lengthy and costly bankruptcy proceedings in the country, which reduces the percentage of bank claims recovered. In addition, the process of selling shares and participating interests retained as collateral for unsettled debts is also difficult and lengthy. Low demand as a result of the adverse economic situation and a negative attitude towards foreign investment are the main reasons for this situation.

Given the prevalence of bank financing, demand for corporate loans is relatively inelastic.

6. Slovenian corporates are mostly financed via bank loans, non-financial corporations having issued only EUR 502 million worth of bonds in the last six years. Demand for loans has to date been relatively inelastic,[12] as a result of which the banks have been able to raise interest rates frequently. The slow process of financial integration in the euro area, a lack of experience and the size of Slovenian corporates are the main limiting factors in the expansion of loans raised in the rest of the world. The stock of corporate loans raised at foreign banks amounted to EUR 3.2 billion at the end of the year, 17% of the total stock of corporate loans at Slovenian banks.

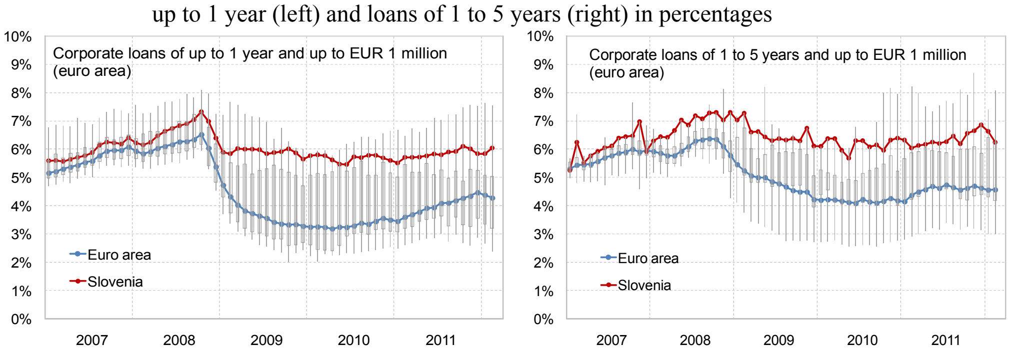
Interest rates on corporate loans in Slovenia are in the highest interest rate quartile.

Slovenian banks' interest rates on corporate loans were in the top (highest) quartile of euro area interest rates in 2011. The spread between the highest and the lowest interest rates on loans of up to EUR 1 million in individual countries averaged 4.3 percentage points last year, 0.4 percentage points more than in 2010. Slovenian banks' interest rates were 1.2 percentage points lower on average than those of the country with the highest

[11] In November the Austrian central bank recommended that banks in the Austrian system should maintain an LTD ratio of 1.1 for new loans and deposits.
[12] A Granger causality test shows that non-financial corporations' lending activity does not depend on the level of the interest rate.

rates. For loans with longer maturities of 1 to 5 years, the spread was higher on average, at 4.5 percentage points. Slovenian banks' interest rates on long-term loans averaged 6.3% in 2011, an average of 1.3 percentage points less than those of the country with the highest rates. Because interest rates in Slovenia are relatively high, there is a possibility that larger, better-performing corporates will raise loans in the rest of the world. The inflow of corporate loans from banks in the rest of the world amounted to EUR 895 million last year, almost three times more than in 2010.

Figure 3.13: Dispersion of interest rates on corporate loans in the euro area for loans of up to 1 year (left) and loans of 1 to 5 years (right) in percentages



Source: Bank of Slovenia

Risk premiums on loans with regard to debtor's credit rating

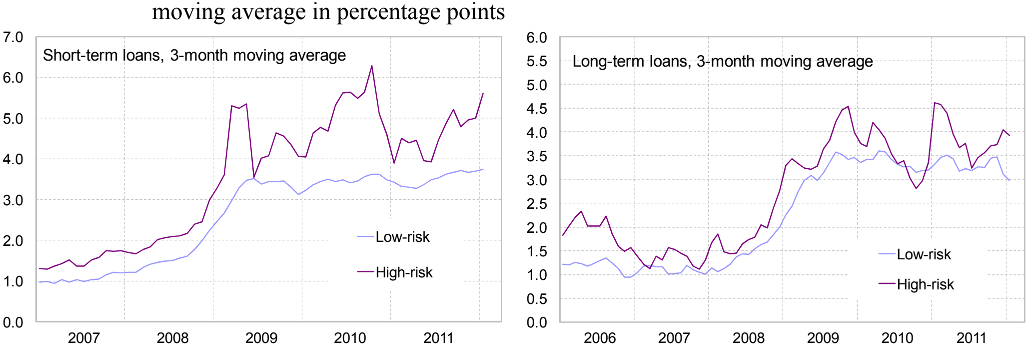
During the years of the economic crisis, the risk premiums that the banks charge high-risk customers increased significantly on short-term corporate loans in particular, from an average of 0.5 percentage points in 2007 and 2008 to more than 1 percentage point during the next three years. The highest risk premium on an annual basis was charged in 2010, when it averaged 1.4 percentage points. The average annual premiums fell again slightly last year, but have again displayed a rising trend since the second half of the year.

Risk premiums last year remained at a similar level to 2010.

Last year's lower risk premium on short-term loans can partly be attributed to the high proportion of new short-term corporate loans accounted for by restructured loans. Although these loans are approved for high-risk clients, the banks are using lower interest rates to try to reduce the debt servicing burden and to increase the likelihood of repayment.

The risk premium on long-term corporate loans was lower than on short-term loans, and its increase relative to the pre-crisis years was also smaller. The premium on long-term loans increased from an average of 0.25 percentage points in 2007 to 0.4 percentage points in 2008, and then remained around that level in 2011. The fluctuations in the risk premiums on these loans are extremely high. Individual loans were even approved for bad clients at more favourable interest rates than for good clients. The favourable loans also include loans to corporates undergoing composition proceedings, when more favourable financing is agreed in the actual proceedings.

Figure 3.14: Premiums over the EURIBOR on short-term (left) and long-term (right) euro-denominated corporate loans, by client credit rating, 3-month moving average in percentage points



Source: Bank of Slovenia

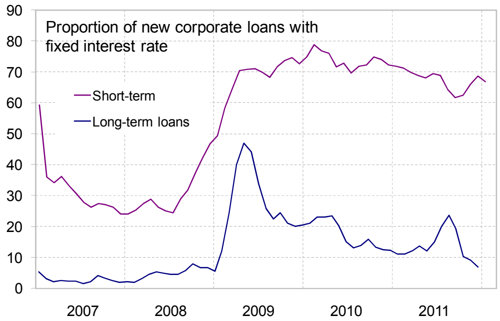
Interest rates for corporates (proportions of fixed and variable remuneration)

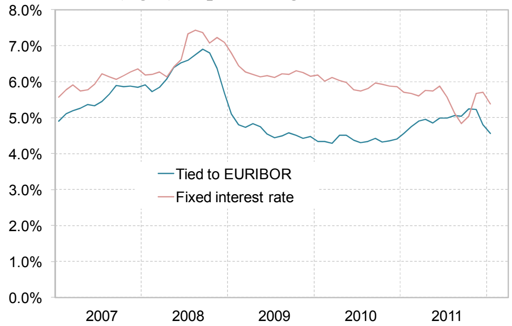
The proportion of new loans with a variable interest rate is increasing.

Corporates mostly borrow from Slovenian banks in euros and at rates tied to market reference interest rates. The proportion of loans with variable interest rates increased in 2010 and 2011, for both long-term and short-term corporate loans. The proportion of new short-term loans accounted for by variable-rate loans averaged 32% during the year.

The increase in the proportion of short-term corporate loans with variable interest rates entails an increase in interest rate risk in this segment of bank loan financing. Given the large proportion of restructured loans, it is likely that variable interest rates are also being passed through into the renewal period, although the repayment period under the agreement is less than one year.

Figure 3.15: Proportion of new loans with a fixed interest rate (left) and interest rates on new long-term corporate loans (right) in percentages





Source: Bank of Slovenia

The interest rate risk to which corporates are exposed as a result of borrowing at variable interest rates is greater in Slovenia than in the euro area overall. According to ECB methodology, which has a broader definition of remuneration at variable interest rates, the proportion of such loans at Slovenian banks reached 96% in 2011, compared with 89.5% in the euro area overall. The difference is larger for loans of small value: 83.8% at banks in the euro area overall compared with 95.0% at Slovenian banks. Corporates can hedge against interest rate risk using appropriate instruments, but their use is not widespread in Slovenia, particularly at small and micro enterprises.

Table 3.9: Proportion of new corporate loans with a variable interest rate[1]

	2008	2009	2010	2011
		(%)		
Euro area	90.3	90.7	89.3	89.5
up to EUR 1 million	86.1	86.0	83.9	83.8
over EUR 1 million	91.6	92.1	91.1	91.5
At domestic banks	99.2	92.5	95.7	96.0
up to EUR 1 million	98.4	94.9	96.0	95.0
over EUR 1 million	99.4	91.9	95.6	96.3

Note: [1] For comparability with ECB methodology, variable-rate loans include loans on which the agreed interest rate is fixed for a period of less than one year (the table includes all short-term loans otherwise shown as fixed-rate loans in the separate disclosure of short-term loans).
Sources: ECB, Bank of Slovenia

Corporate loan repayment burden

According to figures from the annual survey of banks, the debt servicing burden declined last year for the second consecutive year. Payment of principal and interest declined by 15% in 2010 and by 11% in 2011, as a result of corporate debt repayment and the fall in interest rates at banks. Despite the reduced debt burden, interest rate risk was realised last year in increased interest payments. As the stock of corporate borrowing at banks declined, and there was a resulting decline of 11.9% in the principal servicing burden, the prevalence of variable remuneration meant that interest payments on these loans increased by 3.8%.

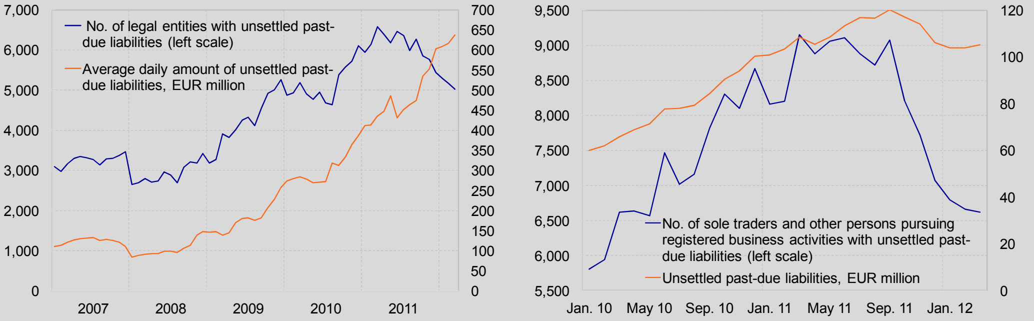
Box 3.1: Insolvency

Negative factors in insolvency in Slovenia

The AJPES figures for insolvency in Slovenia reveal that the three-year rise in the number of legal entities with unsettled past-due liabilities peaked at the end of the first quarter of last year. The number has subsequently fallen by around 1,500 in the following year to around 5,000. The problem of insolvency nevertheless remains urgent:

- the number of corporates with unsettled past-due financial liabilities at the end of the first quarter of this year was around 2,000 more than before 2009. The number of corporates in bankruptcy, liquidation or composition proceedings increased by 199 to 823, and by a further 200 in the first quarter of 2012;
- the increase in the average daily amount of unsettled past-due financial liabilities has not come to a halt;
- the value of the unsettled past-due financial liabilities of sole traders and other individuals pursuing registered business activities at the beginning of this year was at the same level as the previous year, and significantly higher than two years ago;
- the AJPES figures for unsettled past-due financial liabilities only include information from court enforcement orders and from tax debt, and do not include other outstanding liabilities from unpaid invoices between creditors and debtors.

Figure 3.16: Number of legal entities (left) and sole traders and individuals pursuing registered business activities (right) with unsettled past-due liabilities, and average daily amount of unsettled past-due liabilities in EUR million



Source: AJPES

While there was a decline last year in the number of legal entities with unsettled past-due liabilities more than five days in arrears, the increase in the average daily amounts of unsettled past-due liabilities in certain sectors is evidence of the increased impact of insolvency on individual sectors. The construction sector was most prominent, with a figure of EUR 150.4 million, while the transportation and storage sector also recorded a notable increase last year.

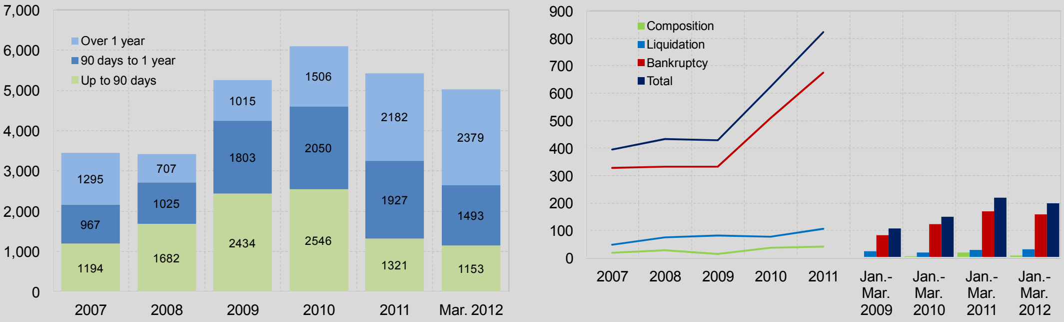
Table 3.10: Number of legal entities with unsettled past-due liabilities more than five days in arrears, and average daily amount of unsettled past-due liabilities, overall and by sector, in EUR million

	Number of legal entities		Growth, %	Average daily amount, EUR million		Growth, %
	Dec. 10	Dec. 11	2010/2011	Dec. 10	Dec. 11	2010/2011
Total	6102	5430	-11.0	387.0	602.3	55.7
Construction	1,319	1,159	-12.1	113.9	150.4	32.1
Wholesale and retail trade, maintenance and repair of motor vehicles	1,330	1,146	-13.8	54.7	86.8	58.7
Professional, scientific and technical activities	671	596	-11.2	42.2	76.1	80.3
Manufacturing	785	635	-19.1	40.6	72.3	78.1
Transportation and storage	377	307	-18.6	22.0	65.0	195.5
Other activities	1,620	1,587	-2.0	8.1	10.8	33.6

Source: AJPES

The figures for the number of legal entities in terms of the continuous period of unsettled past-due liabilities are encouraging, given the decline after 2010, but there is also cause for concern because of the rise in the number of legal entities whose financial liabilities have remained unsettled for a continuous period of more than 90 days. The number more than tripled after 2008, and rose by 58% between the end of 2010 and the end of March 2012. Given the relatively high indebtedness of the corporate sector, the rise in the number of such corporates, most probably not creditworthy yet still going concerns, was a factor in last year's increase in impairments and provisioning in the banking system and the stagnation in lending activity. Last year also saw a rise in the number of legal entities whose financial liabilities have remained unsettled for a continuous period of more than 90 days, an indication of the ongoing rise in the number of composition and bankruptcy proceedings.

Figure 3.17: Number of legal entities according to the continuous period of unsettled past-due liabilities (left) and number of bankruptcy, composition and liquidation proceedings initiated (right)



Source: AJPES

The adverse impact of insolvency on corporate competitiveness, and potential impact on the performance of the banking system.

Operating in the Slovenian business environment with its high level of insolvency has an adverse impact on corporate competitiveness. This could begin to encourage a process of the redirection of corporate financial flows or the relocation of corporate bases from Slovenia to better business environments. The spreads in interest rates on corporate loans are therefore not the only reason that the Slovenian banking system might begin to gradually lose the better part of its customers in the corporate sector. The likelihood of corporates relocating their operations from Slovenia to more favourable environments in order to ensure competitiveness will rise should the macroeconomic situation in Slovenia remain discouraging and the business environment in the country remain comparatively less favourable. Insolvency is one of the elements in which there are large differences between EU countries. In the final consumer segment, accounts were settled in due time by 82.9% of consumers in Germany, just 57.1% of those in Slovakia, and 46.1% of those in Greece, the lowest figure. The average period for settlement of payments between corporates was 16.8 days in Germany, but 70.9 days in Greece.[1] Other research shows that relatively short payment periods and short arrears in consumer and corporate settlement of financial liabilities is typical of northern European countries, including Germany, Slovenia's biggest trading partner, and neighbouring Austria.[2]

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1 Source: Analysis by Ipsos entitled Ten Nations Survey 2011 "European Payment Practices" for EOS (www.eos-solutions.com/fileadmin/user_upload/studies/2011_EOS_Ten_Nations_Survey/20110912_EOS_European_Payment_Practices.pdf). Note: Slovenia was not included in the survey.

2 Source: Intrum Justitia; European Payment Index 2011. Note: Slovenia was not included in the survey.

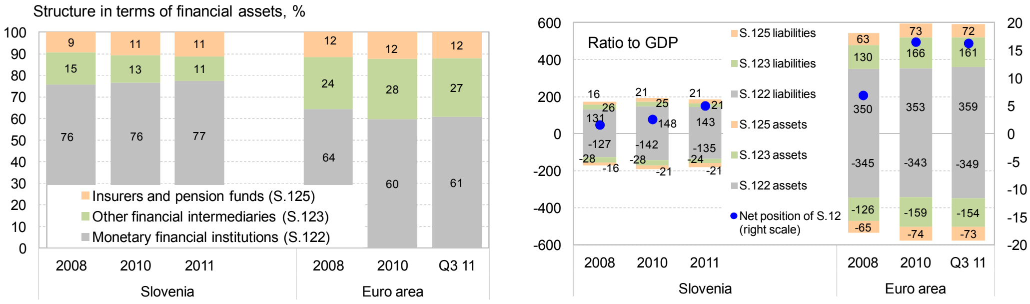
4 FINANCIAL SYSTEM

4.1 Structure of the financial system

The Slovenian financial sector contracted in 2011 to stand at 185% of GDP. The same proportion is more than three times higher in the euro area.

The financial sector's assets were down for the second consecutive year in 2011 to stand at EUR 67 billion or 185% of GDP. At 77% of the financial system overall, the banks remain the most important financial intermediaries, despite the contraction in their total assets due to difficulties in accessing sources of funding on the international markets and lower growth in loans.The structure is more evenly distributed in the euro area, where the proportion of the financial system accounted for by the banks is 16 percentage points lower. The increasing proportion of the financial system's assets accounted for by the banks is also the result of a decline in the total assets of non-bank financial institutions, particularly those of investment funds and leasing companies. The insurance sector was the only sector to record positive growth in assets. The contraction in financial intermediation is significantly more intense in Slovenia on average than in the euro area, where growth remains positive. The difference between the depth of the Slovenian financial system and the financial system in the euro area overall widened.

Figure 4.1: Structure of the financial sector in terms of financial assets (left) and ratio of financial assets, liabilities and net position to GDP by financial sub-sector (right) in percentages



Note: S.122: Other monetary financial institutions (commercial banks and savings banks); S.123: Other financial intermediaries and financial auxiliaries, except insurance corporations and pension funds (including investment funds and leasing companies); S.125 Insurance companies and pension funds.

Sources: Bank of Slovenia, ECB, Eurostat, SORS

Table 4.1: Overview of the Slovenian financial sector

	Total assets, EUR million			Breakdown, %			As % of GDP			Growth, %	
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2010	2011
Monetary financial institutions[1]	52,009	50,760	49,264	76.6	75.9	75.6	147.3	143.3	138.2	-2.4	-2.9
NMFIs	15,856	16,160	15,918	23.4	24.1	24.4	44.9	45.6	44.7	1.9	-1.5
insurers	5,660	6,059	6,315	8.3	9.1	9.7	16.0	17.1	17.7	7.0	4.2
pension companies/funds[2]	1,287	1,538	1,518	1.9	2.3	2.3	3.6	4.3	4.3	19.5	-1.3
investment funds	2,234	2,294	1,816	3.3	3.4	2.8	6.3	6.5	5.1	2.7	-20.8
leasing companies[3]	6,094	5,731	5,731	9.0	8.6	8.8	17.3	16.2	16.1	-6.0	-
BHs, MCs, others[3]	581	538	538	0.9	0.8	0.8	1.6	1.5	1.5	-7.4	-
Total	67,865	66,920	65,182	100.0	100.0	100.0	192.2	189.0	182.9	-1.4	-2.6

Notes: The figures for leasing companies, brokerage houses, management companies and others are obtained from the AJPES database of closing accounts based on the SKD 2008 classification of business activities. The figures for leasing companies include all companies included under financial leasing, activity code K64.91, according to the SKD 2008.
[1] Monetary financial institutions do not include the central bank.
[2] The First Pension Fund is included among pension funds.
[3] Total assets in 2011 according to the figures for the end of 2010.

Sources: Bank of Slovenia, IS, SMA, AJPES

The contraction in financial intermediation is characteristic for nearly the entire financial sector, most notably at the banks.

Contributing significantly to the contraction in the financial sector in relative terms was the banking sector, where total assets as a proportion of GDP fell by five percentage points to 138.2%. Pension companies and pension funds also recorded negative growth in total assets. Growth in the total assets of insurance companies and reinsurance companies was moderate, at 4.2%. The sharp contraction in investment funds was driven by negative growth on the capital markets, and net withdrawals of assets. The leasing sector is limited because it is closely intertwined with the business cycle. Despite the relatively large contraction in financial intermediation via the banks, there was no significant change in the overall structure due to the decline in the total assets of the majority of other non-banking financial intermediaries. The proportion of financial intermediaries accounted for by certain sectors is gradually increasing. Thus, supervision of this segment of the financial sector will become increasingly important in the future.

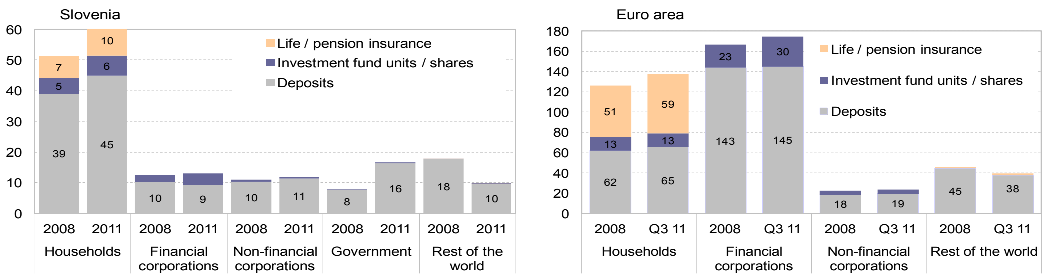
Comparison of financial institutions in terms of intermediation of savings

Deposits account for the majority of savings.

Having increased last year to 45% of GDP, household savings still primarily take the form of bank deposits. This is largely an expression of households' preference for safer investments and the decline in economic activity. Life insurance and pension insurance as a proportion of GDP remained at 10% in 2011, an increase on the period prior to the financial turmoil, but significantly lower than in the euro area, where the aforementioned forms of insurance have reached 59% of GDP. A significant divestment of equities and accompanying losses were recorded again last year. As a result, the value of these assets as a percentage of GDP was close to the level seen in 2008, when that value reached its lowest value.

Government deposits were up in 2011 as a result of borrowing via debt security issues in the past year. Foreign deposits contracted further primarily due to the continuing debt repayments by the domestic banks to the rest of the world.

Figure 4.2: Value of intermediated financial assets by instrument owned by individual sectors as a percentage of GDP in Slovenia (left) and the euro area (right)



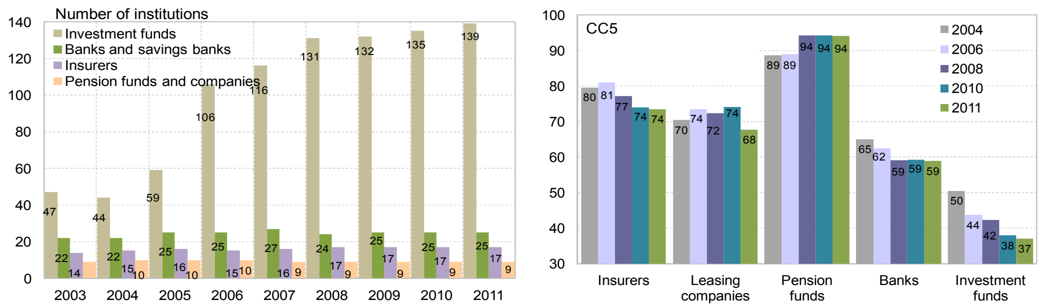
Note: The central bank is not included in the figures for Slovenia.
Sources: Bank of Slovenia, ECB, Eurostat, SORS

Market concentration in the financial sector

Market concentration has remained unchanged in recent years, except in the investment fund sector.

The number of institutions in different segments of the financial sector has not changed over the last three years, except in the investment fund segment, where four additional investment funds operated in 2011, which contributed to the trend of a gradual decline in concentration in this segment of the financial sector. There was also a considerable decline in the concentration coefficient at leasing companies over the last year as a result of changes in the value of transactions at individual companies. Rigid market concentration is characteristic of other groups of financial institutions. With regard to pension funds, this can be attributed in part to the underdevelopment of this segment of financial services, while the ownership structure is contributing to a trend of gradual decline in concentration in the banking and insurance sectors. The consolidation of smaller financial institutions in these sectors would affect their operational and cost-effectiveness and improve accessibility to capital, while increasing competition on the market. The consolidation of institutions from various segments of the financial sector is also important. There are only two financial conglomerates in Slovenia.

Figure 4.3: Number of financial institutions of different type (left), and market concentration of the five largest (CC5; right, in percentages)



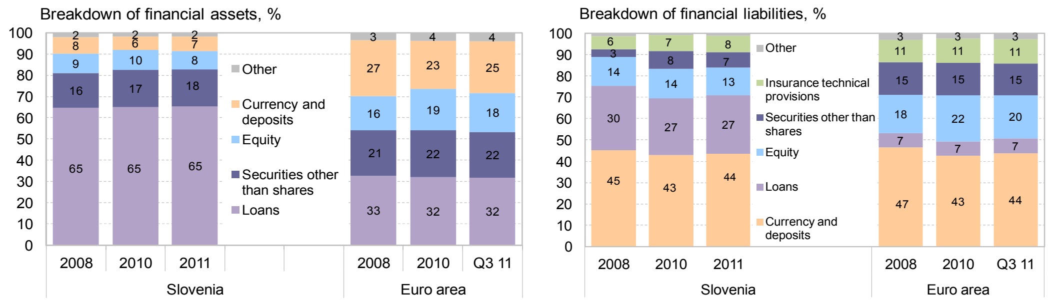
Note: The CC5 index is calculated in terms of total assets, with the exception of leasing companies, for which it is calculated in terms of volume of business. Insurers include two reinsurance companies; their total assets are for the end of the third quarter of 2010. Pension fund figures do not include the First Pension Fund, as a closed fund that does not allow any more contributions.
Note: Bank of Slovenia, ISA, SMA, BAS, SLA

Comparison of the breakdown of the Slovenian financial sector's financial assets and liabilities with the euro area

The Slovenian financial system is based more on the traditional functioning of financial intermediaries than in the euro area.

Despite a decline, loans still accounted for two thirds of final assets last year, two times higher than the euro area. The latter reflects the predominance of the banking sector and the traditional way in which financial intermediaries operate, as well as the low level of development of non-bank financial institutions and the capital market in Slovenia. The poor development of alternative forms of financing for Slovenian corporates continues to slow the recovery from the economic crisis.

Figure 4.4: Breakdown of the financial sector's financial assets (left) and liabilities (right) in percentages



Sources: Bank of Slovenia, ECB

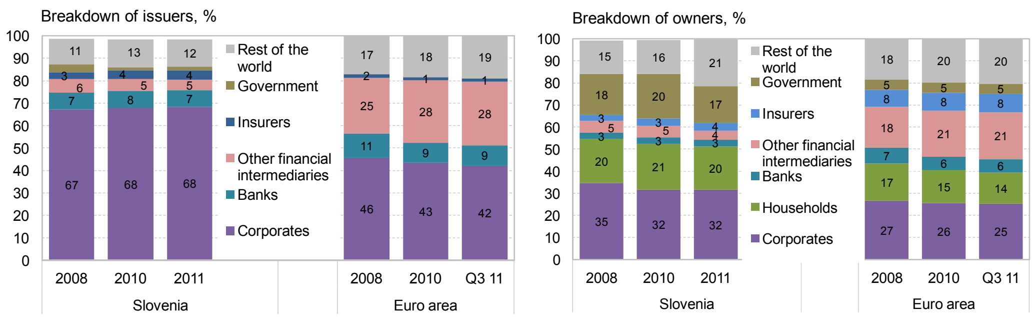
At 44%, currency and deposits represent the prevailing forms of the financial sector's liabilities. The proportion of the financial sector's liabilities accounted for by loans stagnated at 27%, despite the banks' debt repayments to the rest of the world. The financial sector's dependence on borrowing via loans remains high, as the proportion of liabilities accounted for by loans is merely 7% in the euro area. The proportion accounted for by equity has not risen, despite capital injections. More significant capital increase will thus be required for the normalisation of financial intermediation. The proportion of liabilities accounted for by equity is 7 percentage points lower in Slovenia than in the euro area. With the expected new capital regulations, a more significant increase in the proportion of equity will be required by the banks and insurers.

The breakdown of issuers of equity was practically unchanged in 2011 compared with the previous year. Corporates still account for more than two thirds of the aforementioned issuers. At 38%, financial institutions also account for a high proportion in the euro area, while that proportion remains rather low in Slovenia, at 16%. This is the result of a difference in the ownership structure of the financial sector.

Government ownership is above-average in Slovenia compared with the euro area.

The proportion of equity held by the government declined to 17% in 2011 primarily due to the revaluation of government-held securities and the associated capital losses. Nevertheless, this proportion is significantly higher than the average for the euro area, where government ownership of equity is 5%. The proportion of equity held by households was also down, owing to the sale of assets and the associated capital losses. The aforementioned proportion is much higher than in the euro area, as households are indirect holders of equity via investment funds, pension funds and insurers.

Figure 4.5: Breakdown of equity issuers (left) and owners (right) in percentages



Note: Equity: F.5 Shares and other equity according to the ESA 95 definition. It includes issued share capital, units in investment funds and ownership in other corporate forms such as limited liability companies and unlimited partnerships.

Sources: Bank of Slovenia, ECB

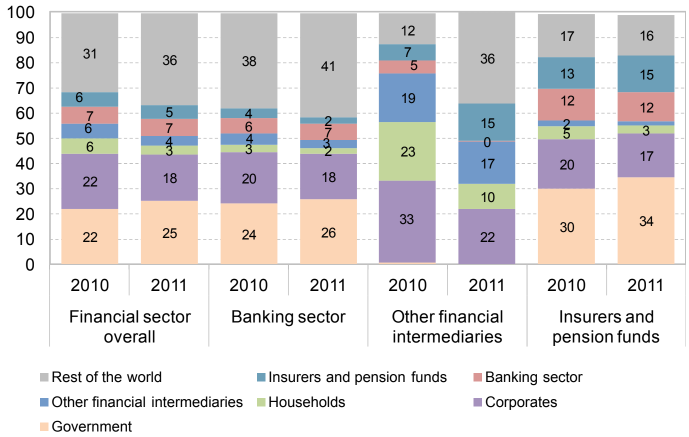
Capital links in the financial sector

Cross-ownership between financial institutions is low. The ownership proportions accounted for by the government and the rest of the world were up as a result of capital increases.

Cross-ownership between domestic financial institutions declined by 3 percentage points in 2011. The proportion of the financial sector overall accounted for by the banks, insurers, pension funds and other financial intermediaries was 16%. The risk of transmitting infections within the financial system is therefore low. The government increased the capital of NLB last year, taking the proportion of government ownership of this sector to more than one quarter. Taking into account both direct and indirect ownership,[13] government ownership at the end of the year amounted to 37% of the banking sector's total assets. Government ownership in the financial sector is significantly higher in Slovenia than the average of the euro area. This is also seen in the insurance sector, where the proportion of government ownership is 34%. The need for the diversification of ownership will be even more evident in the future due to the consolidation of public finances.

The ownership proportion of non-residents in the banking sector was up on account of their participation in the recapitalisation of certain banks. A change in the role of non-residents is also seen in the ownership structure of other financial intermediaries, which is linked to the squeezing out of minority shareholders of Aktiva Naložbe by the Dutch company SEI Holding. Nevertheless, the ownership proportion of non-residents is low compared to the euro area. Consequently, the market share of the banks under majority foreign ownership in Slovenia is the lowest among the countries of Central and South-east Europe. Households and corporates continue to reduce their direct exposure to the financial sector, an indication of the protracted nature of the economic crisis.

Figure 4.6: Ownership structure of financial sectors in percentages



Note: Includes direct ownership only.
Sources: CSCC, Bank of Slovenia calculations

Mutual exposure of the financial sector

The banks' exposure to other financial sectors is low. By contrast, the exposure of insurers and pension funds rose to 23.5% of total financial assets.

The banks' exposure to other financial intermediaries declined last year to 4.0%, while their exposure to insurers was unchanged at 0.3% of total assets. The proportion of banks' capital investments at insurers rose to 7.3%, while the proportion accounted for by the sector of other financial intermediaries remained at a similar level to the previous year, at 10.4%. The banks' exposure via loans was down in this segment of the financial sector, to 4.9%, primarily as a result of lower lending to leasing companies, which is in line with the lower volume of leasing business.

In contrast to the banks' relatively low exposure to the rest of the financial sector, other financial intermediaries, at 5.7% of total assets, and insurers and pension funds, at 23.5% of total assets, are considerably more exposed to the banking sector. The majority of investments of the aforementioned sectors are in bank deposits. In the harsh economic conditions, insurers and pension funds are exposed to the risk of the transmission of infections from other financial sectors.

[13] Indirect government ownership includes ownership of KAD, SOD, PDP and companies under the majority ownership of the aforementioned institutions and the Republic of Slovenia.

Table 4.2: Investment links between Slovenian financial institutions

	2006	2008	2010	2011	2006	2008	2010	2011
	Domestic banks' exposure to[1]							
	other financial intermediaries (S.123)				insurers and pension funds (S.125)			
Value, EUR million	1,415	2,501	2,290	2,060	61	164	155	140
bank investments in debt securities[3]	14	0	0	0	14	18	11	9
bank loans granted	1,151	2,328	2,104	1,899	0	53	25	18
bank capital investments	250	173	186	161	47	93	119	113
As % of:								
total bank financial assets	4.1	5.1	4.4	4.0	0.2	0.3	0.3	0.3
bank investments in debt securities	0.2	0.0	0.0	0.0	0.2	0.3	0.2	0.1
bank loans granted	5.4	6.4	5.3	4.9	0.0	0.1	0.1	0.0
bank capital investments	15.8	11.0	10.5	10.4	3.0	5.9	6.7	7.3
	Exposure to domestic banks of[2]							
	other financial intermediaries (S.123)				insurers and pension funds (S.125)			
Value, EUR million	698	602	479	407	826	1,287	1,701	1,777
investments in bank deposits	506	320	243	245	405	686	962	1,148
investments in bank debt securities	139	104	59	53	338	421	576	540
investments in bank capital	53	178	177	109	83	180	163	89
As % of:								
total financial assets of S.123 / S.125	8.3	6.6	5.7	5.7	17.0	21.8	23.2	23.5
investments in bank deposits	99.8	98.2	98.4	94.2	98.5	98.0	99.6	99.8
investments in debt securities	33.3	38.5	24.6	20.3	12.0	12.7	14.6	13.8
capital investments	1.6	6.2	6.2	4.9	6.9	13.4	8.9	4.8

Notes: The table shows the investment links between the banking sector, and both the sector of other financial intermediaries (including investment funds and leasing companies) and the sector of insurers and pension funds.
[1] Investments by domestic banks in the other two sectors via equity, debt securities and loans granted. The proportion of total bank financial assets accounted for by the aforementioned investments, and the ratio of exposure to the two aforementioned sectors via a particular instrument to the total value of the instrument are also illustrated.
[2] Investments by other financial intermediaries and insurers in bank equity, debt securities and deposits. The proportion of the total assets of these two sectors accounted for by these investments and the proportion of exposure to banks via a particular instrument are also given.
[3] DS: debt securities.

Source: Bank of Slovenia

4.2 Financial markets

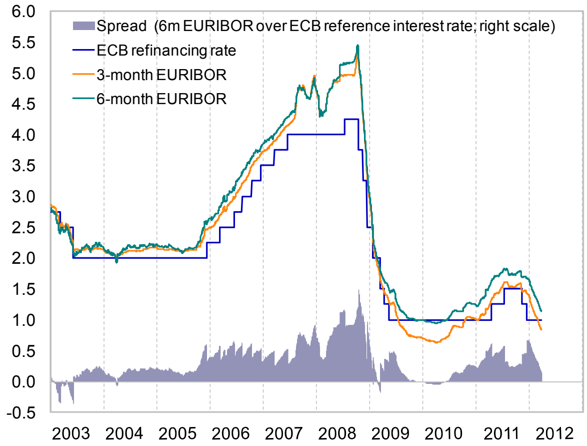
4.2.1 Money market

Developments on the euro area money market in the first half of 2011 were influenced by a rise in ECB's reference interest rate to 1.50% in July, and the resulting general rise in all market interest rates. Contributing further was a decline in the banks' excess liquidity due to the maturing of long-term Eurosystem refinancing operations from 2010.

Excess liquidity raised via LTROs contributed to the fall in the general level of market interest rates in the second half of 2011.

The value of the euro area's reference interest rate on overnight deposits, the EONIA, averaged 0.87% last year, but had fallen to 0.63% by the end of the year. Contributing to this in the second half of the year was an increase in liquidity via the banks' participation in LTROs and the gradual fall in the ECB's reference interest rate to the level recorded at the end of 2010, of 1%. The Eurosystem's liquidity supply led to a decline in market interest rates in the first quarter of 2012.

Figure 4.7: Comparison of the EURIBOR market with the ECB refinancing rate in percentages

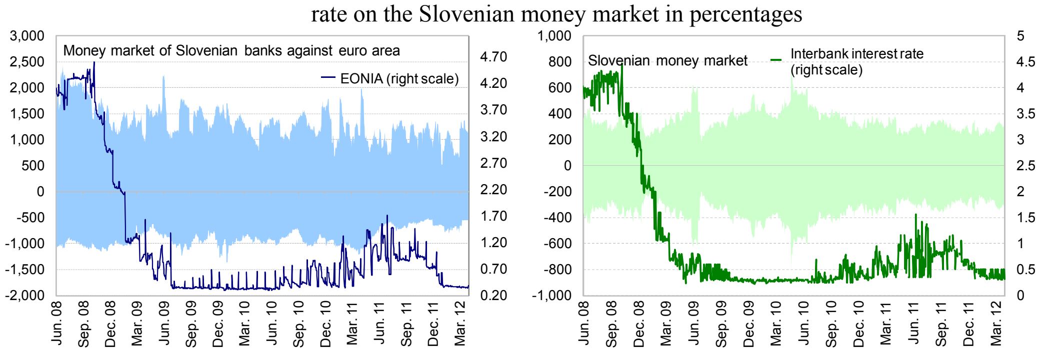


Source: Bank of Slovenia

The Slovenian banking system was again a net creditor of the rest of the world on average in 2011.

Slovenian banks invested the majority of liquidity obtained via the Eurosystem in short-term investments and deposits placed in the rest of the world, and in loans on the domestic interbank market. At EUR 339 million, the banking system's net claims on the market for unsecured short-term loans to foreign banks were almost unchanged on average in 2011 relative to 2010. Likewise, the stocks of loans granted and loans raised on the domestic interbank market were practically unchanged.

Figure 4.8: Stock of unsecured deposits of Slovenian banks placed and received on the euro area money market (left) and the Slovenian money market (right) in EUR million, and movement of the EONIA and the interbank interest rate on the Slovenian money market in percentages



Source: Bank of Slovenia

The escalation of the debt crisis in certain euro area countries and the growing needs of the Slovenian banks for liquid assets to repay their liabilities to the rest of the world resulted in a decrease in short-term unsecured loans raised at foreign banks and a reduction in deposits placed at banks in the rest of the world. Net claims on the interbank market for unsecured loans to the rest of the world stood at EUR 601 million at the end of the first quarter of 2012, up EUR 262 million on the previous year's average, primarily as a result of the banks' strong response to LTROs at the Eurosystem.

4.2.2 Capital Market

In the context an illiquid capital market, the Slovenian stock market index was down 30.7% at the end of 2011.

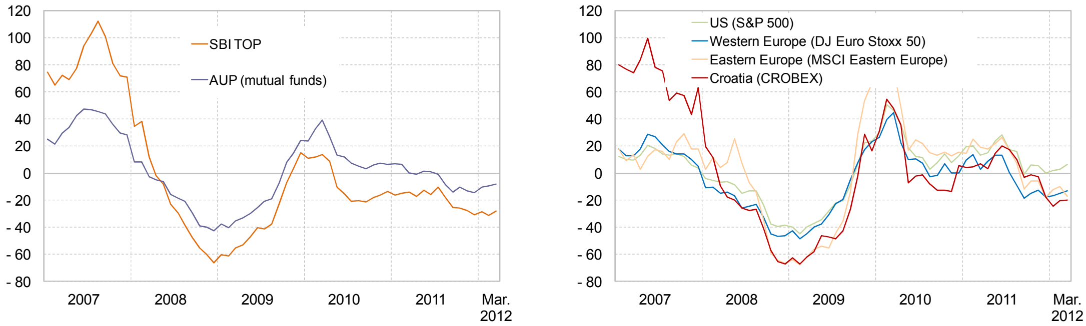
In the context of an illiquid capital market, the Slovenian SBI TOP index was down 30.7% at the end of 2011. The loss recorded last year by the Slovenian stock market index was almost comparable with the loss of 47.7% seen at the outset of the crisis in 2008. The value of the SBI TOP is at the level recorded in 2003. Even relatively good half-yearly corporate operating results were unable to boost investors' confidence in 2011. The downgrading of Slovenia by the three largest international ratings agencies followed, pushing the Slovenian stock market index down further in the second half of 2011. Likewise, the escalation of the European debt crisis and the contraction in economic activity in the final quarter of 2011 did not improve the situation. There was no significant rise in confidence in the Slovenian capital market in the first quarter of 2012, and the SBI TOP ended March 2012 down 28% in year-on-year terms, at 599.

The majority of companies listed on the stock exchange are struggling with excessive debt and outdated business models. Sales of shares seized as collateral for unpaid liabilities to the banks are too slow and lack transparency. Domestic and foreign investors thus turn to other markets.

The majority of major stock market indices, with the exception of the US, were down in 2011.

The situation on the international capital markets was very volatile in 2011, resulting in falls on all major stock market indices towards the end of the year. The sole exception was the S&P 500 index, which remained positive throughout 2011 and ended March 2012 up 6.2% in year-on-year terms, owing to the publication of mostly better economic data and the encouraging operating results of certain major corporates in the US. There were numerous factors that contributed to the global volatility, from the escalation of the debt crisis in certain euro area countries to political tensions in certain countries in North Africa and the Middle East, which are important oil producers.

Figure 4.9: Year-on-year growth in domestic (left) and foreign (right) stock exchange indices in percentages



Source: LJSE, Bloomberg

The number of listed securities was down, despite the fact that corporates require fresh capital in the adverse economic conditions.

The decline in the number of listed securities on the Ljubljana Stock Exchange continued last year and had an adverse effect on the stock exchange's liquidity. The number of listed securities fell from 158 to 139 in 2011. The bond market, in particular, contracted. There were nine fewer bonds at the end of 2011 relative to the previous year, while the number of listed shares fell by five. The number of shares of investment companies was also down due to the completion of the legally required transformation of investment companies into mutual funds. Corporates are withdrawing from the stock exchange, as the associated costs outweigh the benefits of listing. This is especially characteristic for corporates listed on the OTC market, as they were listed on the aforementioned market in accordance with privatisation legislation, and not voluntarily. Also contributing to the withdrawal are persistently higher reporting and corporate governance standards. There are very few new listings on the prime market, despite the corporates' needs for fresh capital. The NKBM Group executed a successful public offering of shares in 2011, and listed these shares on the Warsaw Stock Exchange. Shares of Krka were also listed on the Warsaw Stock Exchange in 2012. By listing their shares on a foreign stock exchange, the aforementioned companies are attempting to improve trading liquidity and increase recognition with foreign investors, as there are an insufficient number of domestic investors for their successful development.

The market capitalisation of shares was down 30.6% in 2011, while the volume of trading in shares was up slightly.

The market capitalisation of shares[14] on the domestic capital market gradually declined last year to stand at EUR 4,872 million at the end of the year, down 30.6% on the end of 2010. At 89%, corporate shares account for the majority of the market capitalisation of shares, followed by the shares of insurers (6%) and bank shares (5%). Contributing to the lower market capitalisation was the delisting of seven shares from the regulated market, only one of which was delisted due to bankruptcy and one due to composition proceedings. At the same time, two new shares were admitted for trading on the Ljubljana Stock Exchange. Triglav shares were transferred from the standard market to the prime market at the end of November 2011, which could improve cooperation with domestic and foreign investors and increase the liquidity of the shares. In contrast to market capitalisation, which was down on account of lower share values, the volume of trading in shares was up last year, but was still nearly 60% lower than in 2008. The volume of trading in shares was EUR 394.5 million in 2011, up 9.3% on 2010, primarily as the result of an increase in trading in Mercator shares by EUR 64.7 million. Investors were considerably more inclined to trading in prime market shares, while trading in standard market shares was down by one half.

[14] Shares in investment companies are not included in the market capitalisation of shares or in volume.

Table 4.3: Overview of Slovenia's regulated capital market

	2007	2008	2009	2010	2011	Mar. 2012
			Shares			
Market capitalisation						
EUR million	19,740.1	8,468.4	8,462.2	6,994.4	4,872.8	4,921.7
as % GDP	58.7	22.8	24.2	19.5	13.8	13.9
annual growth, %	71.5	-57.1	-0.1	-16.9	-30.3	-25.2
% held by non-residents	5.9	7.1	7.2	10.0	12.3	13.1
Volume						
EUR million	3,034.8	952.6	719.8	360.8	394.5	74.8
as % GDP	9.0	2.6	2.1	1.0	1.1	0.2
annual growth, %	109.1	-68.6	-24.4	-49.9	9.3	-45.1
Annual growth in SBI TOP, %	71.0	-66.1	15.0	-13.5	-30.7	-28.0
P/E (prime)	33.8	10.6	19.4	43.2	93.1	154.3
Dividend return (prime), %	1.0	3.9	2.1	2.1	3.2	3.4
			Bonds			
Market capitalisation						
EUR million	5,934.6	6,795.4	10,821.5	13,192.8	14,459.3	13,463.5
as % GDP	17.6	18.3	30.9	36.8	40.9	38.1
annual growth, %	-10.5	14.5	59.2	21.9	9.6	-14.3
Volume						
EUR million	165.9	257.0	156.3	108.9	59.6	13.8
as % GDP	0.5	0.7	0.4	0.3	0.2	0.0
annual growth, %	-11.8	54.9	-39.2	-30.3	-45.3	-45.1

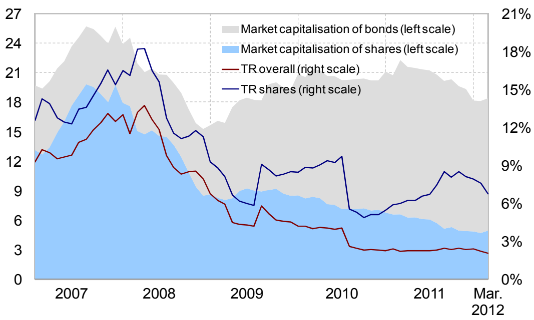
Note: Excludes listed investment companies and mutual funds. Block trades are included.
Sources: LJSE, SORS

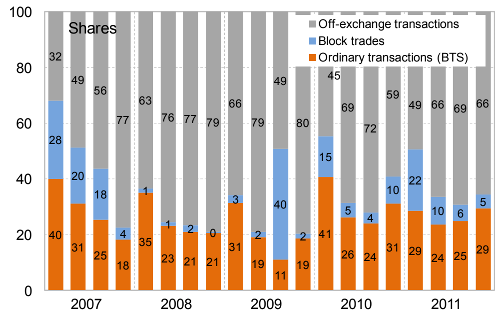
The market capitalisation of bonds was up 9.6% due to the listing of 11 new bonds.

The market capitalisation of bonds has risen since 2008, and was up 9.6% last year. Last year's increase was primarily the result of the listing of two bank bonds, two government bonds, two financial corporate bonds and five non-financial corporate bonds. Just one bond was delisted from trading on the stock exchange, for reason of corporate bankruptcy. At 92.1% government bonds still account for the highest proportion of market capitalisation, followed by bank bonds (5%) and corporate bonds (2.6%). Despite the significant number of newly issued bonds, the volume of trading in bonds was down nearly 45.3% in 2011, at EUR 59.6 million. At EUR 29.7 million, second-issue SOD bonds were the most heavily traded in 2011. The turnover ratio of bonds in 2011 remained at almost the same level as at the end of 2008, a reflection of the low liquidity on the Ljubljana Stock Exchange for more than three years.

The total volume of trading on the Ljubljana Stock Exchange was down 4.6% in 2011, an indicator of the persistently low level of liquidity and the resulting unattractiveness of the stock exchange for domestic and foreign investors. Share prices demonstrated a negative trend and did not respond to the positive changes on developed foreign markets. The unattractiveness of Slovenian securities for foreign investors was also seen in structural imbalances between supply and demand for government bonds, as Slovenia's better credit rating resulted in a higher risk premium than certain countries with a poor credit rating.

Figure 4.10: Market capitalisation on the Ljubljana Stock Exchange in EUR billion, and annual turnover ratios (left), and percentage breakdown of trading in shares by type of transactions (right)





Note: Excludes listed investment companies and mutual funds. The turnover ratio (TR) is the ratio of annual volume to market capitalisation at the end of the period. Block trades are included.
Source: LJSE

Slovenian corporates do not make sufficient use of opportunities to obtain financing on the capital market, as they only raised EUR 63 million in this manner in 2011, despite the contraction in the banks' lending activity. The annual number of bond issues by non-financial corporations was the highest to date, representing a positive shift in the development of this segment of the market [15]. With the issue of commercial paper by two major corporates, the short-term debt market has also been formed in Slovenia. There was a significant decline in the number and scope of bank bond issues in 2011, an indication of the unattractiveness of such investments. The conditions for issuing bank bonds were very unfavourable in 2011 due to the downgrading of Slovenia. The reasons that corporates do not seek financing on the capital market more frequently lie in a lack of knowledge, higher costs, the insufficient scope of issues and a lack of corporate recognition in Slovenia and the rest of the world.

Table 4.4: Overview of number of new bonds issues by residents in Slovenia and in the rest of the world, and total value

	Issued in Slovenia				Value, EUR million	
	Bank	Financial	Government	Non-financial corporations	Total	of which: NFCs
2006	8	2	2	1	1,161	6
2007	7	0	0	3	178	7
2008	6	2	1	3	1,891	50
2009	6	2	3	2	4,209	77
2010	5	1	2	0	2,696	0
2011	2	2	2	5	4,028	63
Mar. 2012	0	1	0	0	2	0
	Issued in rest of the world					
2006	1	0	0	0	50	0
2007	1	0	1	0	1,100	0
2008	0	0	0	0	0	0
2009	2	0	0	1	2,300	300
2010	4	0	0	0	1,350	0
2011	2	0	0	0	500	0

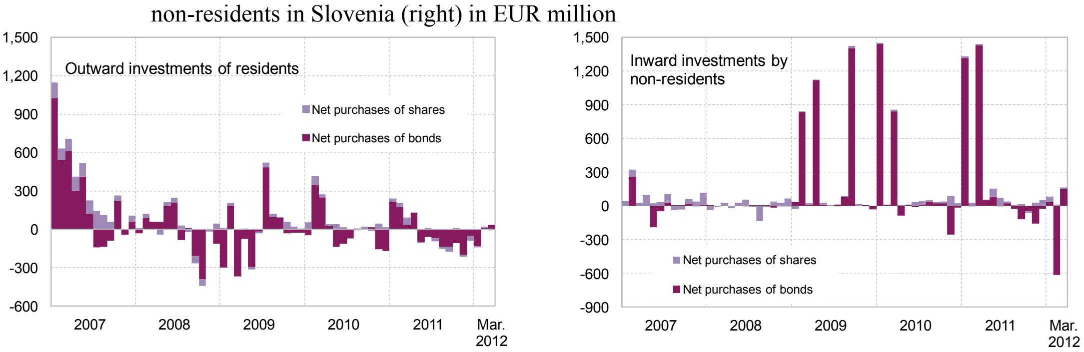
Sources: CSCC, Bank of Slovenia

Investment links with the rest of the world

Non-residents' net purchases of securities in Slovenia amounted to EUR 2.8 billion in 2011, up 24.1% on 2010. The demand of non-residents was greatest during government bonds issues. Non-residents made net purchases of EUR 2.5 billion of all debt securities, an increase of 24.9% on 2010. Net purchases by non-residents peaked in January and March last year, when the RS69 and RS70 government bonds were issued, each in the amount of EUR 1.5 billion with yields to maturity of 4.38% and 5.13% respectively.

Non-residents' net purchases in Slovenia were up 24.1% on 2010 to stand at EUR 2.8 billion in 2011.

Figure 4.11: Monthly net investments by residents in the rest of the world (left) and by non-residents in Slovenia (right) in EUR million



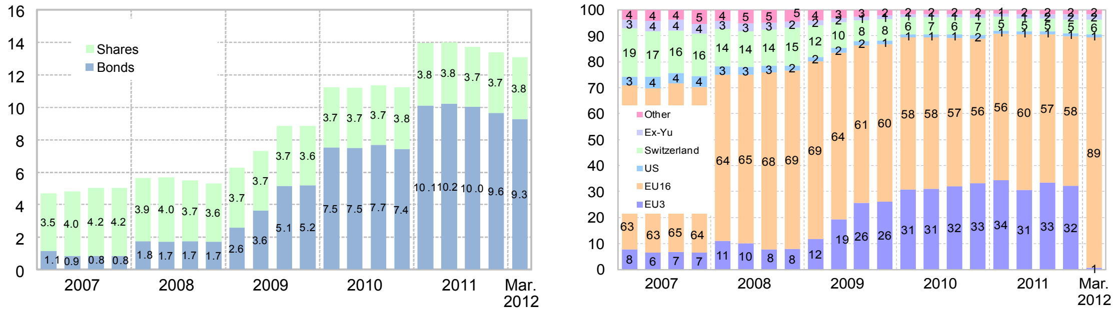
Sources: CSCC, Bank of Slovenia, own calculations

The proportion of non-residents' investments accounted for by debt securities was significantly higher than the proportion accounted for by equities owing to the size and liquidity of the bond market. The proportion of the market capitalisation of shares accounted for by non-residents was 13.1% at the end March 2012, an increase of slightly less than 2 percentage points on March last year.

[15] The proportion of total debt accounted for by corporate debt securities stood at 9.3% at the end of the third quarter of 2011 in the euro area, an increase of almost 2 percentage points since 2007. That proportion stood at around 1.6% in Slovenia at the end of 2011.

Non-residents' net purchases of equities were up 17.6% last year to total EUR 295.7 million. The largest net purchases were made by residents of Croatia, Poland and Austria.

Figure 4.12: Stock of non-residents' investments in securities of Slovenian issuers in EUR billion (left), and regional percentage breakdown (right)



Note: Bonds were transferred from the fiduciary account of a UK bank to the fiduciary account of a Belgian bank in January 2012.
EU3: UK, Denmark, Sweden
EU16: euro area
Ex-YU: former Yugoslav republics

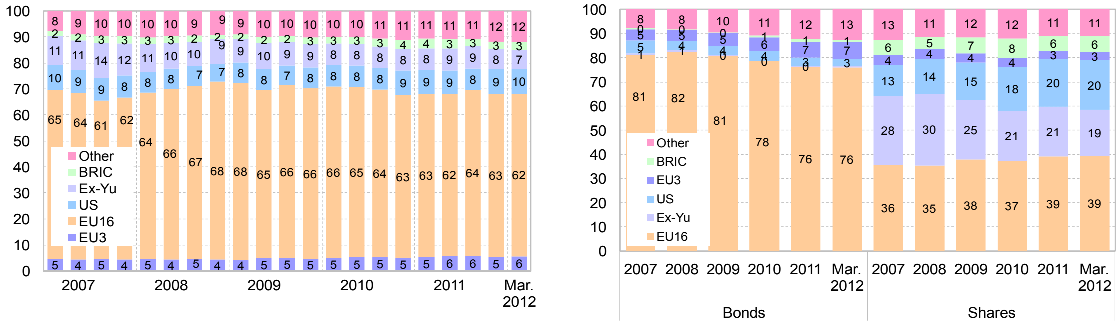
Sources: CSCC, own calculations

The stock of Slovenian investors' investments in the securities of foreign issuers stood at EUR 7.6 billion in 2011, down 10.4% on 2010.

The stock of investments by Slovenian investors in the securities of foreign issuers was EUR 7.6 billion, down 10.4% on the end of 2010 and equivalent to 21.5% of GDP. Residents made sales of EUR 50.7 million in shares of foreign issuers in 2011, the highest annual net sales of the last seven years, indicating an attempt to divest investments in the rest of the world with the aim of improving liquidity. A similar situation was seen on the bond market of foreign issuers, where net sales reached their highest value to date, at EUR 334.1 million. Such high net sales of foreign securities suggest difficulties in accessing financial assets. Slovenian investors are resolving their liquidity problems by seeking internal reserves. The largest net sales of foreign shares were made by other financial intermediaries, excluding insurers and pension funds, and by the household sector in the amounts of EUR 70.2 million and 40.9 million respectively. The majority of the aforementioned net sales were distributed fairly evenly across euro area countries, Canada, the BRIC countries and the US. The sector of domestic insurers and pension funds continued to make net purchases of foreign securities (shares in the amount of EUR 62 million and bonds in the amount of EUR 159.4 million), with the majority of their investments placed in euro area countries and the former Yugoslav republics. This is due to insurance contracts with an investment risk concluded prior to the crisis and increases in the capital of subsidiaries. The domestic banks made net sales of EUR 490.4 million, primarily of euro area bonds, while increasing their investments in domestic securities. This reflects an increasing focus on domestic securities and a lack of confidence in foreign issuers.

In the regional breakdown of investments in the rest of the world by residents, there was a small decrease in exposure to issuers from the euro area in 2011 and an evenly distributed increase in exposure to issuers from the US and the former Yugoslav republics. The proportion of investments in foreign bonds accounted for by issuers from the euro area was down 2 percentage points at 76%, while the proportion of investments in foreign shares rose from 37% to 39%. A continued withdrawal from the markets of the former Yugoslav republics is evident in the structure of investments in shares. The stock market indices of the aforementioned countries fluctuated well below zero during the second half of 2011, while the economic recovery is increasingly uncertain.

Figure 4.13: Regional breakdown of investments by residents in foreign securities overall (left), and bonds and shares separately (right) in percentages



Note: EU3: UK, Denmark, Sweden
EU16: euro area
BRIC: Brazil, Russia, India, China
Ex-YU: former Yugoslav republics
Source: Bank of Slovenia

Table 4.5: Overview of investment links with the rest of the world

	2007	2008	2009	2010	2011	Mar.12
	Residents' investments in rest of the world					
Shares						
stock, EUR billion	4.1	2.3	2.9	3.3	2.8	2.9
as % GDP	11.7	6.2	8.3	9.2	7.8	8.2
annual growth, %	55.9	-43.2	25.5	13.9	-15.9	-16.7
as % of total stock of ISEs	11.9	9.4	12.4	15.5	14.1	14.6
net purchases, EUR billion	1.04	0.00	0.15	0.28	-0.05	-0.01
Bonds						
stock, EUR billion	5.7	5.3	5.2	5.2	4.8	4.8
as % GDP	16.4	14.4	14.9	14.4	13.5	13.6
annual growth, %	95.2	-5.7	-2.6	-0.8	-7.1	-13.2
as % of total stock of ISDSs	87.3	74.6	43.2	37.8	30.1	30.2
net purchases, EUR billion	2.87	-0.22	-0.27	-0.04	-0.33	-0.09
	Non-residents' investments in Slovenia					
Shares						
stock, EUR billion	4.2	3.6	3.6	3.8	3.7	3.8
as % GDP	12.2	9.7	10.4	10.7	10.6	10.8
annual growth, %	30.6	-14.8	1.2	5.0	-2.0	-0.4
as % of total stock of ISEs	12.3	14.7	15.6	18.0	18.9	19.2
net purchases, EUR billion	0.48	0.02	0.03	0.25	0.30	0.08
Bonds						
stock, EUR billion	0.8	1.7	5.2	7.4	9.6	9.3
as % GDP	2.4	4.6	14.9	20.7	27.2	26.2
annual growth, %	-7.4	103.2	205.1	42.5	30.1	-8.5
as % of total stock of ISDSs	12.9	23.8	43.2	54.3	60.5	58.2
net purchases, EUR billion	0.11	0.89	3.40	2.01	2.51	-0.44

Note: The 2012 figures are for net purchases in the first three months of the year only. Includes all investments in Slovenia by non-residents, in both listed and unlisted securities.
DS: debt securities
ES: equities
Sources: CSCC, Bank of Slovenia, SORS, own calculations

Box 4.1: Exposure to debt securities from euro area periphery countries

At the end of March 2012, Slovenian residents held EUR 410.3 million in debt securities from Portugal, Ireland, Italy, Greece and Spain, representing 8.5% of their investments in foreign debt securities. Slovenian residents reduced their investments in debt securities from the periphery countries by 39.3% in year-on-year terms. The largest proportion of investments in the debt securities of the periphery countries are in Italy (54% of the total) and Spain (26.6%). At 0.6%, the proportion of investments in the debt securities of Greece, which faced the most significant debt-related problems and also received the most financial aid from the International Monetary Fund and the EU in 2011, was negligible in March 2012. Slovenian residents also reduced their investments in debt securities issued by other countries, by 9.5%.

Table 4.6: Exposure of Slovenian sectors to the debt securities of the periphery countries at the end of March 2012 in EUR million

Sector	Exposure to periphery countries, EUR million			Exposure to periphery countries as % of investments		
	Bank DS	Government DS	Other DS	Bank DS	Government DS	Other DS
Non-financial corporations						
Banks and savings banks	96.8	77.6	14.7	4.1	3.3	0.6
Other financial intermediaries		1.2	3.9		0.8	2.5
Financial auxiliaries						
Insurers and pension funds	71.7	55.1	82.1	3.4	2.6	3.9
Government		5.0	1.7		5.3	1.8
Households	0.3	0.1	0.1	0.5	0.1	0.1
Non-profit institutions		0.0			2.5	
Total	168.8	139.0	102.4	3.5	2.9	2.1

Note: DS: debt securities.
Source: Bank of Slovenia

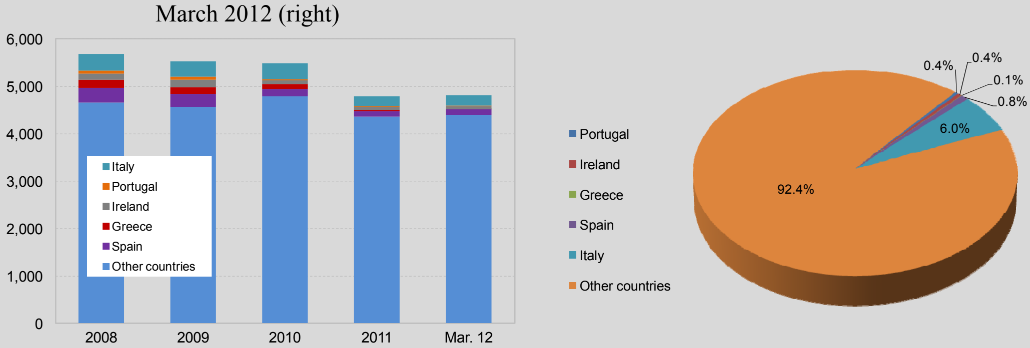
The insurance and banking sectors held the largest proportions of Slovenian residents' investments in the debt securities of Portugal, Ireland, Italy, Greece and Spain in March 2012, at 50.9% and 46.1% respectively. The banking and insurance sectors are also prevalent in the euro area overall. Three quarters of the banking and insurance sectors' investment in the debt securities of peripheral countries are accounted for by bank and government bonds. Government bonds from the periphery countries accounted for 6% of the banking system's portfolio of debt securities, while bank bonds accounted for 9.7%. The equivalent figures for the insurance sector were 9.8% for government bonds and 11.5% for bank bonds.

Table 4.7: Exposure of Slovenian sectors to the debt securities of issuers in the euro area and other countries at the end of March 2012

Sector	Euro area DS, EUR million			DS of other countries, EUR million		
	Bank DS	Government DS	Other DS	Bank DS	Government DS	Other DS
Non-financial corporations	40		11	2		4
Banks and savings banks	780	1,155	46	217	131	19
Other financial intermediaries	13	25	72	9	7	32
Financial auxiliaries						
Insurers and pension funds	513	378	518	180	238	268
Government	15	29	20	2	19	10
Households	23	2	19	7	3	7
Non-profit institutions	1					
Total	1,385	1,588	685	416	398	339

Note: DS: debt securities.
Source: Bank of Slovenia

Figure 4.14: Regional percentage breakdown of residents' investments in the periphery countries and other countries in EUR million (left) and regional percentage breakdown of the Slovenian banking system's investments in bank and government bonds from the periphery countries and other euro area countries as at the end of March 2012 (right)



Source: Bank of Slovenia

5 BANKING SECTOR

5.1 Structural features of the banking sector

Banking sector size and changes of status

The total number of credit institutions was the same at the end of last year as in 2010 at 25, of which 19 were banks, three were savings banks and three were branches of foreign banks. The consolidation of the banking system, which would improve cost-effectiveness and reduce the costs of capital, is not proceeding as expediently as necessary or as desired given the crisis, with the aim of maintaining financial stability.

A total of 25 credit institutions operated in Slovenia last year.

The Bank of Slovenia confirmed notifications from 22 new credit institutions last year. As a result of the reclassification and revocation of certain notifications, the total number of the credit institutions was down to 296 at the end of last year, while the number of special credit institutions stood at three. Two new categories of financial institutions were introduced in 2011: payment institution and electronic money issuing companies. A number of existing credit institutions and special financial institutions were reclassified to these two categories: 17 institutions to payment institutions and 11 institutions to electronic money issuing companies.

Banks are the most important financial intermediaries in terms of total assets, while the proportion of savings banks is negligible and barely exceeds 1% of the banking system's total assets. The banks had total assets of EUR 48.7 billion in December last year, while those of savings banks stood at EUR 495 million. The banking system’s total assets thus amounted to 137% of GDP. The total assets of banks and savings banks as a percentage of GDP were down 5 percentage points last year as a result of a decline in total assets. The banking system’s total assets were down in 2011 for the second consecutive year, by EUR 1,570 million. The cumulative decline in the banking system's total assets in 2010 and 2011 was thus EUR 2.8 billion or 5.4%, an indication of disintermediation and a reduction in the banks' financial leverage.

The banking system's total assets stood at 137% of GDP at the end of 2011.

Table 5.1: Total assets of banks compared with GDP

	2006	2007	2008	2009	2010	2011
Total assets, EUR million	33,868	42,343	47,628	51,612	50,319	48,769
GDP (current prices), EUR million	31,045	34,563	37,280	35,311	35,417	35,638
Total assets as % of GDP	109	123	128	146	142	137
No. of bank employees	11,707	11,829	12,045	11,994	11,735	11,587

Source: Bank of Slovenia

Bank ownership

There were 11 banks under majority foreign ownership operating in Slovenia at the end of last year, three of which were branches of foreign banks. There were also 11 banks under majority domestic ownership, one of which was under full domestic ownership. The proportion of the banks' equity held by non-residents was up 2 percentage points last year to stand at 39%, of which the proportion held by non-residents with equity holdings exceeding 50% stood at 29.8%. Government ownership as measured by equity was up slightly last year to stand at 22.7%, primarily as a result of the increase in NLB's capital by the government last April

The ownership structure of the banking system did not change significantly last year.

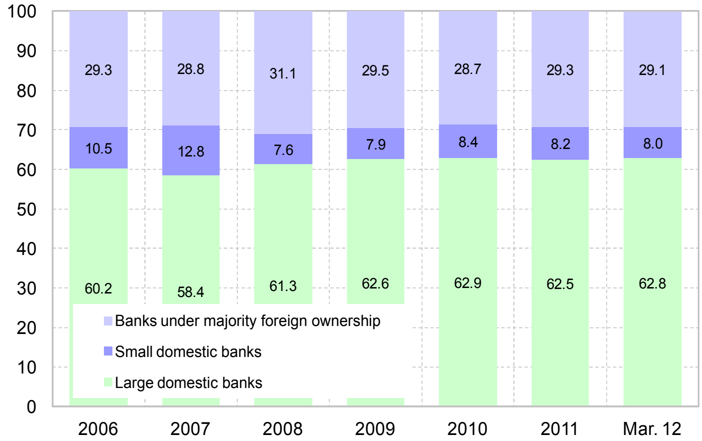
Table 5.2: Ownership structure of the banking sector (in terms of equity)

(%)	2006	2007	2008	2009	2010	2011
Central government	17.9	15.1	17.7	20.5	20.1	22.7
Other domestic entities	44.4	47.2	44.1	43.0	42.9	38.2
Non-residents	37.7	37.8	38.2	36.6	37.1	39.0
non-residents (over 50% control)	27.7	26.8	27.6	26.8	27.9	29.8
non-residents (under 50% control)	10.0	11.0	10.6	9.8	9.2	9.3

Source: Bank of Slovenia

The banks are divided into three groups in the Financial Stability Review: the large and small domestic banks, and the banks under majority foreign ownership. Each bank is classified into one group only. An analytical breakdown of the banking system into homogeneous groups, based on the characteristics of the banks' operations, in particular the prevailing form of bank funding, is applied.

Figure 5.1: Market shares of banks under majority foreign ownership and under majority domestic ownership in terms of total assets in percentages



Source: Bank of Slovenia

Concentration in the banking sector

Market concentration in the banking system diminished somewhat last year.

Market concentration as measured by the market share of the largest banks declined slightly last year. Similarly, concentration on the banking market as measured by the Herfindahl-Hirschman index also diminished. Market concentration as measured by the aforementioned index was higher in terms of liabilities to the non-banking sector than in terms of lending. A decline in the aforementioned index reflects a more balanced distribution of savings in the form of bank deposits in the most recent period.

Table 5.3: Market concentration of the Slovenian banking market as measured by the Herfindahl-Hirschman index, and market share of the top three/five banks

	2007	2008	2009	2010	2011	Change 2011/2010
	Herfindahl-Hirschman index					
Total assets	1,313	1,292	1,282	1,169	1,132	-37
Total assets (euro area)	659	687	663			
unweighted	1,032	1091	1076			
Loans to non-banking sector	1,214	1,231	1,179	1,138	1,092	-46
Liabilities to non-banking sector	1,477	1,619	1,630	1,516	1,440	-76
Liabilities to banks	1,170	1,229	1,054	1,260	1,204	-56
	Market share of top 3 banks, %					(percentage points)
Total assets	49.0	48.0	47.9	46.1	45.2	-0.9
Loans to non-banking sector	47.0	46.6	46.0	46.3	44.9	-1.4
Liabilities to non-banking sector	54.2	56.6	56.5	55.2	54.1	-1.1
Liabilities to banks	41.4	36.4	46.2	54.3	53.4	-0.9
	Market share of top 5 banks, %					(percentage points)
Total assets	59.9	59.4	60.1	59.8	59.5	-0.3
Total assets (euro area)	44.1	44.7	44.6			
unweighted	54.7	57.1	57.0			
Loans to non-banking sector	58.4	59.3	58.7	59.4	58.8	-0.6
Liabilities to non-banking sector	65.8	65.7	68.8	67.8	66.0	-1.8
Liabilities to banks	50.9	51.2	61.3	68.3	67.5	-0.8

Sources: Bank of Slovenia, ECB: Report on EU Banking Structures, September 2010

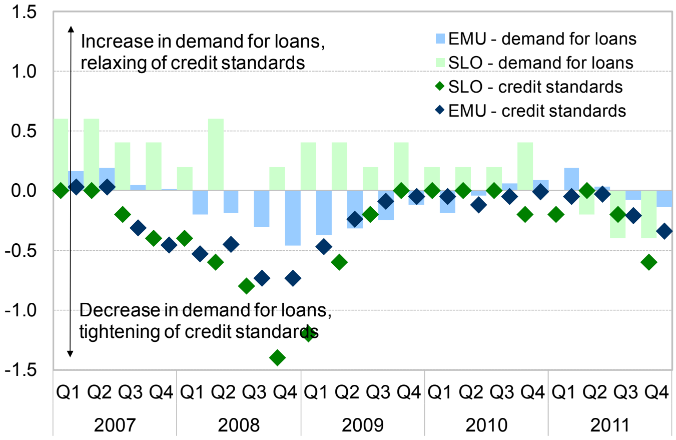
5.2 Banks' assessment of demand for loans and credit standards in Slovenia and the euro area[16]

Corporate loans

The banks reported falling demand for corporate loans for the first time in 2011, and tightened their credit standards towards the end of the year.

The survey responses of the banks indicate that demand for corporate loans began to decline in Slovenia in 2011. This was mainly the result of lower demand from large corporates and lower demand for long-term loans. The banks attributed the declining demand in Slovenia primarily to lower fixed capital formation and the use of other sources of financing. Credit standards for corporate loans began to tighten significantly again in the second half of the year. The same is true for the euro area overall. The main reasons given by the Slovenian banks for the aforementioned tightening are the risks associated with a particular sector to which they responded primarily by raising the premiums over interest rates on higher-risk loans and in part by tightening non-price lending conditions.

Figure 5.2: Corporate demand for loans and credit standards



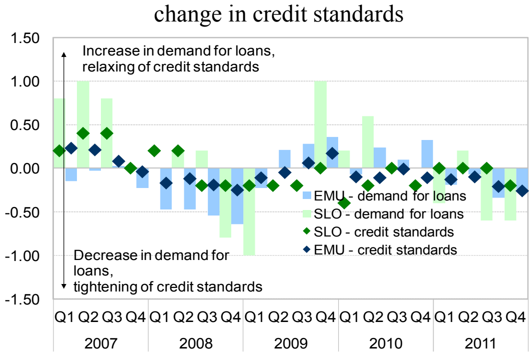
Source: ECB, Bank of Slovenia

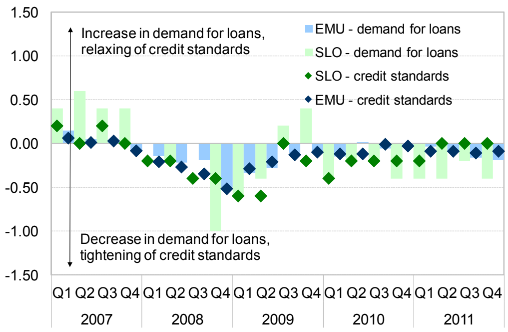
Loans to households

Household demand for loans was down, particularly in the second half of 2011.

Worthy of note with regard to household loans in Slovenia is the declining demand for housing loans in the second half of 2011, which the banks explained as a result of the situation on the housing market and a lack of consumer confidence. At the same time, the banks tightened their credit standards slightly towards the end of the year. There was a similar change in the situation on the euro area housing loan market overall. Declining demand for consumer loans in Slovenia continued in 2011, while the slight tightening of credit standards came to a halt, in contrast to the euro area.

Figure 5.3: Household demand for housing loans (left) and consumer loans (right) and change in credit standards





Source: ECB, Bank of Slovenia

[16] Five Slovenian banks take part in the survey. Methodological limitations mean that the results for Slovenia and for the euro area as a whole are not directly comparable, and the substantive conclusions are less solid than in quantitative analyses.

5.3 Changes in balance sheet structure

The banking system's total assets declined by 3.1% or EUR 1.6 billion in 2011.

The banking system's total assets have been contracting since 2010. Year-on-year growth in total assets stood at -3.1% at the end of last year. Total assets were down by EUR 1,570 million. The declining growth in total assets is a result of the banks' debt repayments on the wholesale markets on the one hand, and of a contraction in lending and investments in securities on the other.

The volume of wholesale bank funding was down nearly EUR 3 billion last year.

Debt repayments to banks in the rest of the world in the amount of EUR 2.2 billion exceeded debt repayments in 2010 by EUR 0.9 billion. The banks made debt repayments to banks in the rest of the world of EUR 8.1 billion from October 2008 to March 2012. The banks made additional debt repayments of EUR 786 million via debt security issues, bringing the reduction in the banks' debt on the wholesale financial market to EUR 2.96 billion or 6% of total assets. Contributing most to the moderate increase in deposits by the non-banking sector were an increase in government deposits of EUR 259 million and an increase in household deposits of EUR 247 million. Despite the lag in growth in household deposits compared to the years before the outbreak of the crisis, growth has remained positive despite the adverse economic conditions.

Loans to the non-banking sector were down EUR 1.5 billion last year.

Loans to the non-banking sector were down EUR 1,495 million in 2011 primarily due to a decrease in loans to non-financial corporations (of EUR 1,168 million) and to other financial institutions (of EUR 320 million). Growth in household loans was also down. The net increase in these loans in 2011 was merely one quarter of the increase recorded the previous year. The banking system's investments in securities were also down, by EUR 400 million.

Table 5.4: Market shares and growth in total assets and loans to the non-banking sector by individual bank group in percentages

(%)	Market shares					Growth				
	2008	2009	2010	2011	Mar. 12	2008	2009	2010	2011	Mar. 12
Total assets										
large banks	61.3	62.6	62.9	62.5	62.8	7.7	10.8	-2.1	-3.8	-5.3
banks under majority foreign ownership	31.1	29.5	28.7	29.3	29.1	21.8	2.6	-5.1	-0.9	-1.2
small banks	7.6	7.9	8.4	8.2	8.0	18.2	12.8	3.9	-6.0	-6.0
overall	100	100	100	100	100	12.5	8.4	-2.5	-3.1	-4.2
Loans to non-banking sector										
large banks	56.7	56.8	57.3	55.9	55.2	13.9	1.2	2.5	-6.5	-7.2
banks under majority foreign ownership	36.2	35.6	35.0	36.2	36.7	25.7	-0.5	0.0	-1.1	0.2
small banks	7.1	7.7	7.7	7.9	8.2	22.0	9.0	2.6	-2.7	-0.8
overall	100	100	100	100	100	18.5	1.1	1.6	-4.3	-4.1

Source: Bank of Slovenia

5.3.1 Stalled lending and changes in the structure of the banks' investments

Year-on-year growth in loans to the non-bank sector was negative in the amount of EUR 636 million or -4.1%.

The contraction in loans to the non-banking sector, which began in the middle of 2011, continues in 2012. A slight turnaround in the growth was seen in the first months of the year. The net increases in loans, however, even if impairments are excluded (according to the gross principle), remain negative. Year-on-year growth in loans to the non-banking sector was -4.1% at the end of March 2012, while the net decrease in loans excluding impairments was EUR 636 million.

The volume of corporate loans has contracted since the end of 2009, year-on-year growth of -7.2% having been recorded, while growth in household loans continues to decline, and stood at 1.4% in March.

The volume of loans to non-financial corporations and other financial institutions has been contracting since the end of 2009, while growth in loans to households and the government is positive. Despite the deteriorating quality of the credit portfolio, the contraction in loans to the non-banking sector and the restructuring of the credit portfolio have led to a decrease in capital requirements and a contraction in total assets. The process of reducing leverage is not restricted to the corporate sector, but is being undertaken by the banks as well. Growth in loans to non-financial corporations and other financial institutions stood at -4.8% and -9.9% respectively in March 2012. Growth in loans to households continues to decline, but remains positive at 1.4%. The banks only recorded a notably positive growth rate in loans to the general government, where the volume of loans was up EUR 312 million in the first three months of 2012.

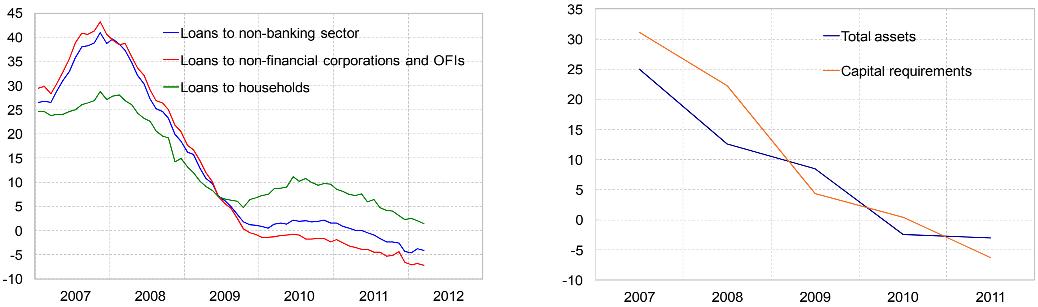
The volume of short-term loans has contracted most.

In addition to short-term loans, long-term loans have also contracted since the end of 2011, year-on-year growth of -4.1% having been recorded in March. The slower contraction in long-term loans than short-term loans is a result of the rapid turnover and maturity of short-term loans, the restructuring of existing loans to clients in difficulty and the collateral received by the banks on long-term loans.

Loans to the non-banking sector have declined most notably at the large banks, where year-on-year growth was -7.2% in March 2012, while the volume of loans to the non-banking sector has stagnated at the banks under majority foreign ownership since the end of 2009.

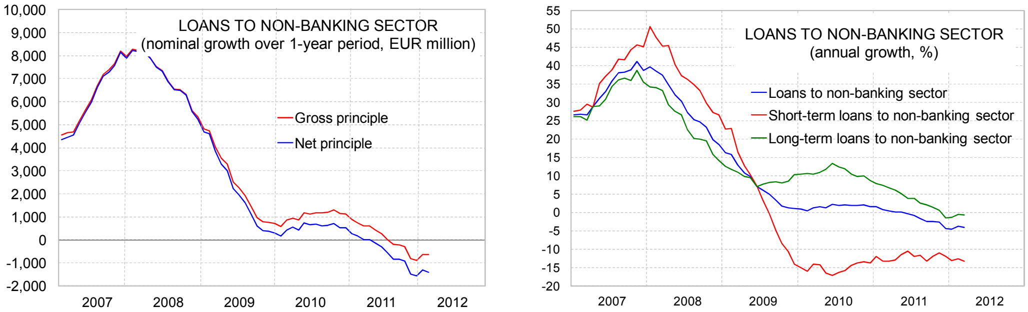
The lowest growth is recorded by the large banks.

Figure 5.4: Year-on-year growth in loans to the non-banking sector (left), and year-on-year growth in total assets and capital requirements (right) in percentages



Source: Bank of Slovenia

Figure 5.5: Gross and net (including impairments) nominal increase in loans in EUR millions (left) and year-on-year growth in loans to the non-banking sector by maturity (right) in percentages

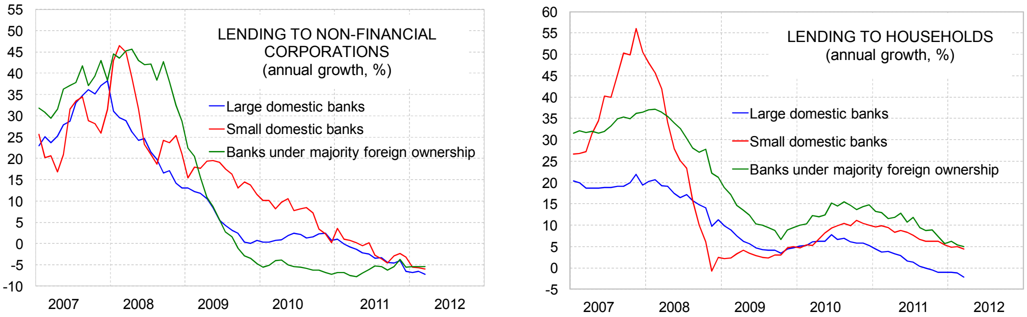


Source: Bank of Slovenia

The banks under majority foreign ownership began to adjust the structure of lending to economic sectors more rapidly than the banks under majority domestic ownership at the outset of the financial crisis. The banks under majority foreign ownership reduced their lending to non-financial corporations relatively rapidly, and increased lending to households, in particular in the form of housing loans. This bank group was more effective in reducing the credit risk associated with its portfolio and used its capital more rationally. The domestic banks adjusted to growth at a much slower pace. This is particularly true of the small banks which, in addition to their ties to the domestic market, offer a limited range of services, with a focus primarily on lending to and receiving deposits from the non-banking sector. The pro-cyclical behaviour of the banks under majority domestic ownership was more pronounced than at the banks under majority domestic ownership as the economy slid into recession in 2009. However, the aforementioned business decision was reflected in the higher quality of their credit portfolio and in a less pronounced contraction in corporate loans in the last year compared to the banks under majority domestic ownership.

The behaviour of the banks under majority foreign ownership is more pro-cyclical than the domestic banks.

Figure 5.6: Year-on-year growth in loans to non-financial corporations (left) and to households (right) by bank group in percentages



Source: Bank of Slovenia

Factors limiting lending growth:

The contraction in lending to the non-banking sector and, in particular, to non-financial corporations is a result of the general economic situation and domestic supply and demand factors.

Negative economic growth, high premiums over reference interest rates, an increase in bankruptcies, a high level of debt, the situation in the construction sector, and stagnating sales revenues and new orders are limiting corporate demand for loans.

Demand for loans remains relatively low in the context of renewed decline in economic growth during the second half of 2011. Economic growth was -0.2% in 2011 and -2.8% in the final quarter, while investment growth was -12.3%. Corporates sales revenues and new orders have stagnated. The construction sector, where value added was down 20.3% in 2011, has been hit hardest of all sectors. The number of initiated insolvency proceedings is rising, and has doubled in two years. Corporates are burdened by excessive debt. Corporate financial leverage remains high due to losses, which reduce their capital, and has begun to rise again.

The unfavourable economic conditions, high corporate debt, rising insolvency and persistently high premiums over reference interest rates[17] reduce the ability of corporates to service existing debt, increase their restraint in investment decisions, and reduce corporate creditworthiness, preventing them from planning expected cash flows. All of the above is also reflected in lower demand for corporate loans.

Unemployment, limited growth in wages and austerity measures are driving down demand for loans by households.

The banks can also expect lower demand for household loans in 2012. Unemployment continues to rise. Corporates are hiring less due to the adverse economic situation, while wage growth is limited. Announced austerity measures will further affect the household sector, most notably in the public sector, although social policy measures will affect other groups of the population as well.

The supply of loans is limited most by the following factors: 1. the quality of the credit portfolio; 2. operating losses; 3. the level of capital; and 4. access to sources of funding.

In the context of low creditworthy demand from corporates and the expected decline in demand for household loans, the problems faced by the banks act as an additional factor preventing higher demand for loans to the non-banking sector. The main problems in the banking sector that are inhibiting credit growth include the deteriorating quality of the credit portfolio and the resulting high impairment costs, operating losses and an insufficient level of capital to achieve a capital adequacy comparable with other EU countries. All of these factors make it difficult to access and thus increase the costs of wholesale funding.

Whether or not the banks will use sources from the ECB to increase lending growth will depend on: 1. the economic situation; 2. the rollover rate of liabilities to foreign banks; and 3. growth in deposits and the loan-to-deposit ratio for the non-banking sector.

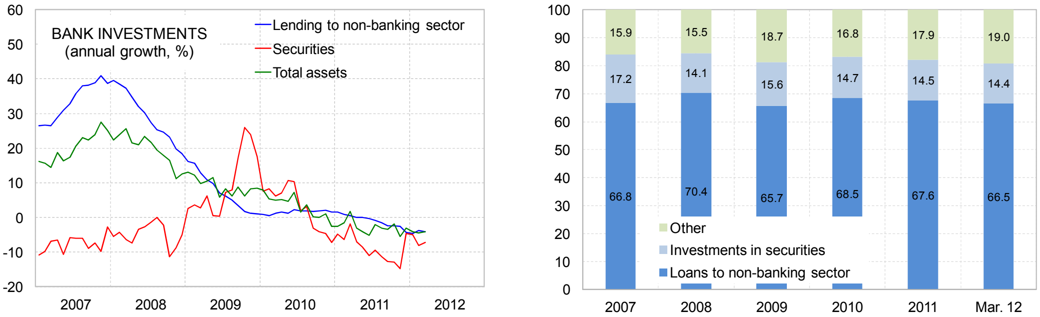
Three-year LTROs via the ECB are expected to have a positive impact on the supply of loans. Slovenian banks have raised a sufficient level of funding via LTROs to significantly reduce uncertainty regarding the repayment of maturing liabilities to foreign banks and from issued securities. Whether or not these funds will funnel into higher lending growth depends on several factors. One important factor will be the economic situation and an improvement in corporate cash flows that will facilitate the regular repayment of loans. Another factor is the rollover rate for maturing liabilities to foreign banks. The key to how quickly the latter begins to rise will depend on the supply of bank loans. A third important factor in the supply of loans will be growth in deposits and the loan-to-deposit ratio for the non-banking sector. The ratio was down 10.1 percentage points in 2011, but remains high at 136.2%. However, the extent of potential funds to increase deposits is limited in the context of the unfavourable economic conditions and low wage growth. Competition between the banks for deposits via extremely high deposit interest rates only leads to higher lending rates, which reduces the competitiveness of the Slovenian banks relative to foreign banks. Lending growth will remain limited for some time at the banks under majority foreign ownership due to the high LTD ratio for the non-banking sector. When the banks under majority foreign ownership begin to lend again to non-financial corporations, this will be a good indication that lending to the non-banking sector is improving.

The banks used sources raised at the ECB to repay liabilities, to increase claims against banks and the central bank and for investments in securities.

The banks are reducing the stock of investments in securities even more than loans to the non-banking sector. Year-on-year growth in the former was -7.8% in March 2012. However, the stock of investments in securities was up 2.8% in March on account of funds raised via 3-year LTROs at the ECB. Total assets were up EUR 1.37 billion, of which currency and claims against the central bank were up EUR 748 million, (current) claims against foreign banks by EUR 546 million and investments in securities by 215 million. Of the latter, investments in non-government debt securities held for trading were up EUR 134 million while investments in government securities held to maturity were up EUR 82 million.

[17] The premium over the EURIBOR on new short-term corporate loans stood at 3.9 percentage points in February 2012, up 0.3 percentage points on the end of 2011. The premium on long-term loans stood at 3.3 percentage points, at the same level recorded at the end of 2011.

Figure 5.7: Year-on-year growth in bank investments (left) and ratios to total assets (right) in percentages



Source: Bank of Slovenia

The stock of debt securities was down EUR 791 million over the first 11 months of 2011 at EUR 6.4 billion or 13.1% of total assets. The stock then rose by EUR 648 million to EUR 7 billion or 14.2% of total assets by the end of March 2012. Despite an increase in the aforementioned proportion, the figure still differs significantly from the figures at EU banks of comparable size. The ratio of debt securities to total assets stood at 17.6% at medium-size EU banks and 18.4% at small banks in the middle of 2011.

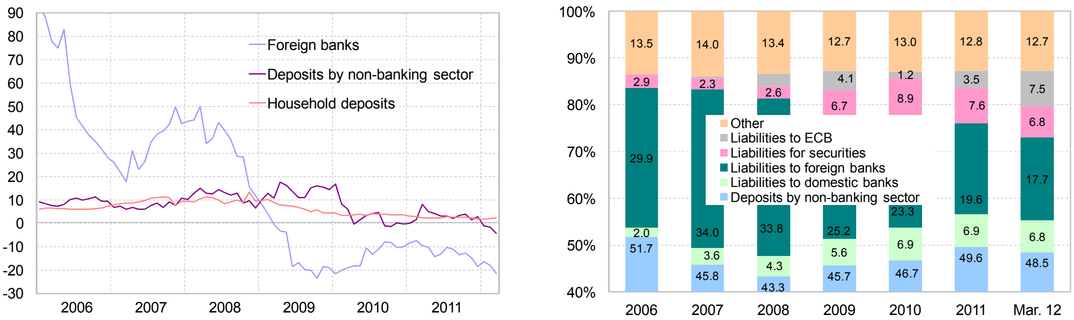
The proportion of total assets accounted for by debt securities increased to 14.2%.

5.3.2 Bank funding

The stock of bank funding on the wholesale market was down EUR 2.96 billion last year. The banks continued to make debt repayments to the rest of the world in the first months of this year. Having stood at 31% at the end of 2010, the proportion of total assets accounted for by sources obtained on the wholesale financial markets fell to 24.5% in March. Government deposits at the banks were also down for the majority of last year, except in the first quarter when they were up due to the issue of Slovenian government bonds. The banks primarily sought funding via ECB operations in the final quarter of 2011 and the first quarter of 2012 due to the continuing adverse situation on the international interbank market. Liabilities to the Eurosystem were up by EUR 1.1 billion last year to EUR 1.7 billion, and up by a further EUR 2 billion in the first quarter of this year. Sources obtained via long-term operations at the ECB have significantly reduced refinancing risk, at least for 2012.

Last year was characterised by the banks' debt repayments to the rest of the world, a small increase in government and household deposits, and an increase in the banks' liabilities to the

Figure 5.8: Growth in funding (left) and the breakdown of banks' funding (right) in percentages

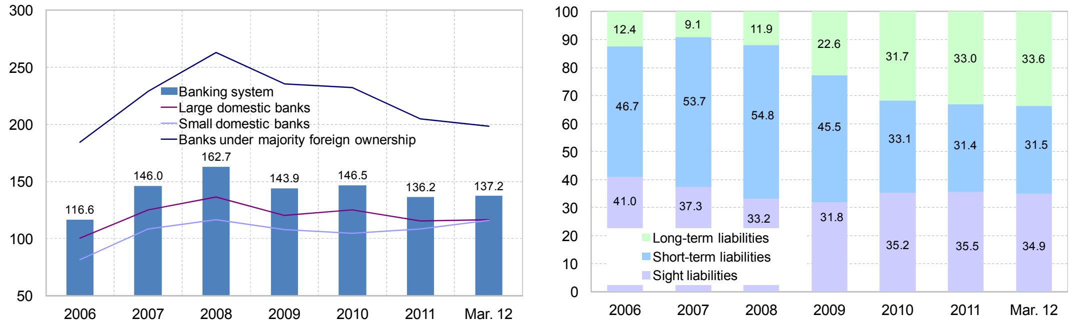


Source: Bank of Slovenia

At EUR 247 million, the net increase in household deposits was down on pre-crisis growth for the third consecutive year. Total deposits by the non-banking sector were up EUR 679 million or 2.9%, raising the proportion of total assets accounted for by deposits by the non-banking sector nearly 3 percentage points to 49.6%, in part as a result of the contraction in total assets. The banks dealt with limited sources of funding, particularly in the final quarter of 2011.

The increase in household deposits at the banks was low, but positive.

Figure 5.9: Ratio of loans to the non-banking sector to deposits by the non-banking sector at year-end by bank group (left) and breakdown of banks' sight, short-term and long-term liabilities to the non-banking sector (right) in percentages



Source: Bank of Slovenia

The ratio of loans to the non-banking sector to deposits by the non-bank sector declined last year.

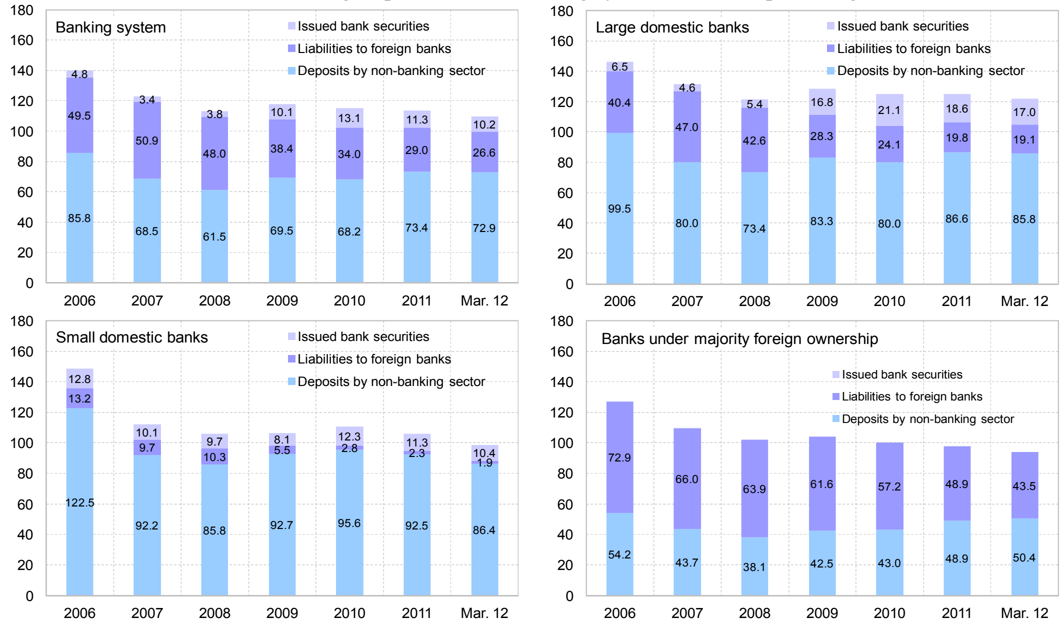
The ratio of loans to the non-banking sector to deposits by the non-banking sector (loan-to-deposit or LTD ratio) fell to 136%. The aforementioned ratio is a reflection of the importance of funding that the banks obtain from their clients. The banks' debt repayments on the wholesale markets in the form of loans and issued securities during the crisis (2008-2011) have resulted in a decline in the value of the LTD ratio, which leads to a slight improvement in the long-term sustainability of funding. Nevertheless, the process of reducing the banks' financial leverage is slow and will continue in the future.

The ratio of loans to the non-banking sector to deposits by the non-banking sector remains high. An increase in government deposits and a decrease in the stock of loans led to an improvement in the aforementioned ratio. The differences in the LTD ratio between individual bank groups narrowed last year. The highest ratio is recorded by the banks under majority foreign ownership, at close to 200%. The ratio has, however, fallen most notably at this bank group over the last three years. The latter indicates that these banks are focusing increasingly on attracting household deposits and that their business model for growth, which is based on sources obtained from parent banks in the rest of the world, is inappropriate in the long-term and is being amended.

Coverage of bank loans by sources of funding

The coverage of loans by deposits by the non-banking sector improved by 5.2 percentage points to 73.4%. In the context of a relatively small increase in deposits by the non-banking sector, the main reason for the aforementioned improvement lies in the decline in loans. The coverage of loans by liabilities to foreign banks has been declining for several years. The coverage of loans by issued bank securities was also down last year.

Figure 5.10: Coverage of loans to the non-banking sector by various sources by bank group and for the banking system overall in percentages



Source: Bank of Slovenia

At the end of last year the coverage of loans to the non-banking sector by deposits by the non-banking sector stood at 87% at the large domestic banks, and 93% at the small domestic banks, while the figure at the banks under majority foreign ownership was merely 49%. However, coverage improved by 6 percentage points at the latter. The coverage of loans by foreign bank funding was slightly less than 20% at the large domestic banks, but remains at nearly 50% at the banks under majority foreign ownership. The coverage of loans by issued securities fell to 17% at the large domestic banks at the end of last year, owing to the early repurchase of bonds by certain banks, and stood at 11% at the small domestic banks.

The coverage of loans by funding is better at the banks under majority domestic ownership than at the banks under majority foreign ownership.

This all points to the urgency to continue the restructuring of bank funding. The proportions of deposits and debt securities must be raised in the context of a simultaneous reduction in the proportion of funding via loans raised in the rest of the world. Changes in the structure of funding will only gradually lead to a reduction in the Slovenian banks' still very high dependence on funding from the rest of the world and thus their high sensitivity to the unstable situation on the international financial markets.

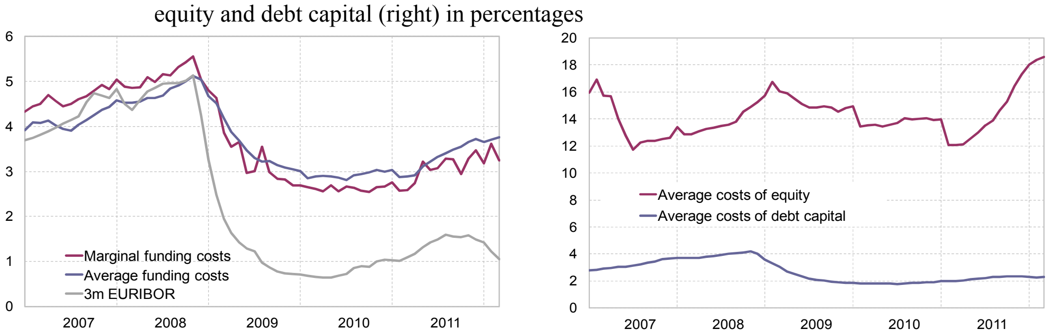
5.3.3 Costs of bank funding

The banks' average funding costs stood at 3.8% at the end of February 2012, an increase of 0.9 percentage points in the last year and exceeding the lowest level recorded in June 2010 by 1 percentage point. Funding costs rose until October owing to rising market interest rates and only to a lesser degree due to a change in the structure of bank funding. Market interest rates on the international financial markets began to fall following the cutting of the ECB's key interest rate on 9 November 2011, and following the adoption of measures by the ECB. The 3-month EURIBOR fell from 1.58% to 0.86% from October 2011 to March 2012.

Rising market interest rates until October led to an increase in bank funding costs in 2011.

The proportion of funding accounted for by relatively more expensive sources was down in 2011.[18] The banks' debt repayments on the wholesale financial markets were accompanied by a decrease in the proportion of sources accounted for by debt securities and liabilities to foreign banks. On the other hand, measures adopted by the ECB led to an increase in the proportion of liabilities to the Eurosystem.

Figure 5.11: Average and marginal bank funding costs (left) and average costs of equity and debt capital (right) in percentages



Source: Bank of Slovenia

Equity is the most expensive form of funding, the average costs having stood at 14.3% in 2011. The costs of equity have risen since the final months of 2010 to stand at 18% in February 2012 as the result of a fall in share prices. The average cost of debt financing rose by 0.27 percentage points in the year ending February, and by 0.5 percentage points from June 2010, when costs reached their lowest level, until the end of the February 2012. At 3.3%, the most expensive form of debt financing remains the issue of securities, followed by funding via deposits by the non-banking sector at 2.3%, and funding raised at foreign banks at 2.0%. The costs of Eurosystem sources remain at 1%. The increase in the costs of funding via deposits by the non-banking sector and liabilities to foreign banks amounted to 0.5 percentage points and 0.8 percentage points respectively from June 2010 until February 2012. Contributing most to the increase in the former were rising deposit interest rates, while the main factor in the increase in the latter was a rise in the risk premium.

Average funding costs rose until October last year.

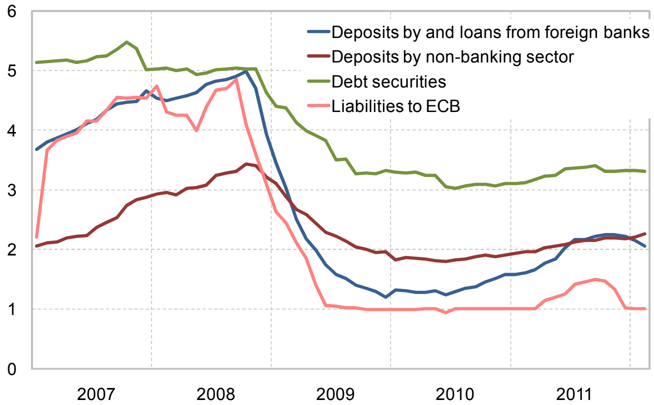
Bank funding in the rest of the world via the issue of securities was down in 2011, in part due to early repurchases. The banks thus reduced the proportion of funding accounted for

Last year the banks reduced the stock of securities, which represent the most expensive form of funding.

[18] The banks' funding costs are calculated on a pre-tax basis. The costs of debt are calculated on the basis of the movement of interest rates on deposits by the non-banking sector, liabilities to the rest of the world (e.g. to banks in the form of loans and deposits, to the ECB and to other sectors) and debt securities (including subordinated debt securities). The costs of equity are estimated using a two-stage dividend discounting model for banks whose shares are listed on the Ljubljana Stock Exchange.

by the most expensive sources. This brought an end to the trend characteristic of the first two years of the crisis, when the banks compensated for the lack of funding from foreign banks by issuing debt securities with a government guarantee.

Figure 5.12: Average costs of banks' debt financing in percentages

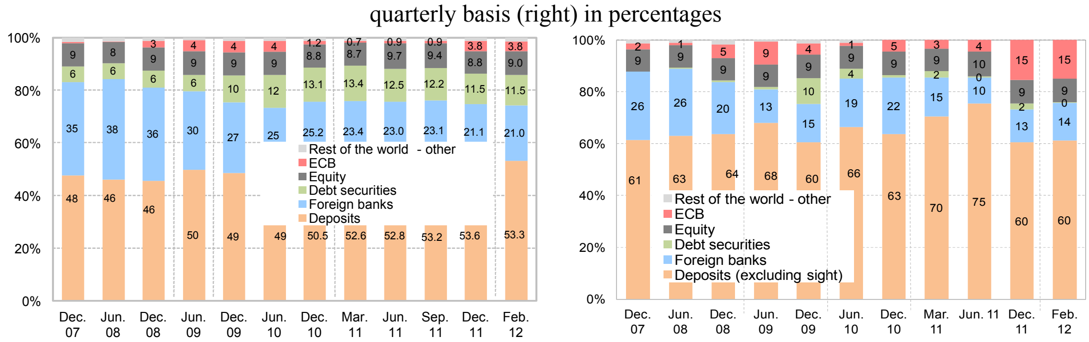


Source: Bank of Slovenia

Last year's changes in the structure of funding were primarily a result of the banks' debt repayments to the rest of the world and funding via the LTROs at the ECB.

The increase in the proportion of funding accounted for by deposits by the non-banking sector is a result of the banks' debt repayments on the wholesale markets and the resulting contraction in total assets. The proportion of funding accounted for by deposits by the non-banking sector recorded the highest growth from December 2010 until February 2012, from just over 50% to 53%, as the aforementioned source was relatively less expensive than issued securities or liabilities to foreign banks in the second half of last year. The proportion of funding accounted for by liabilities to foreign banks fell by more than four percentage points to 21%, while the proportion accounted for by liabilities from debt securities also fell, to 11.5%. As expected, the proportion of the least expensive sources of bank funding, i.e. liabilities to the ECB, began to rise at the end of 2011, and had doubled by March 2012 to stand at 7.5% of total assets.

Figure 5.13: Breakdown of stock (left) and flows of bank funding on half-yearly and quarterly basis (right) in percentages



Source: Bank of Slovenia

Differences in funding costs between bank groups[19]

The banks under majority foreign ownership have the lowest average funding costs. However, the difference compared with the other bank groups is narrowing.

The lowest average funding costs in February 2012 were recorded by the banks under majority foreign ownership, at 3.3%, followed by the large domestic banks at 3.9% and the small domestic banks at 4.2%. Funding costs have risen at all bank groups in the last year, most notably at the banks under majority foreign ownership, by 1 percentage point. Funding costs were up 1.1 percentage points at the banks under majority foreign ownership compared with June 2010, when funding costs reached their lowest level, up 0.9 percentage points at the large domestic banks and up 0.8 percentage points at the small domestic banks.

The banks under majority foreign ownership still have the most cost-effective structure of funding owing to a high proportion of foreign sources (of more than 40%), primarily from their parent banks. That proportion, however, was down at this bank group, while the proportion of liabilities from deposits by the non-banking sector was up. The replacement of cheaper sources in the rest of the world with more expensive sources in Slovenia had

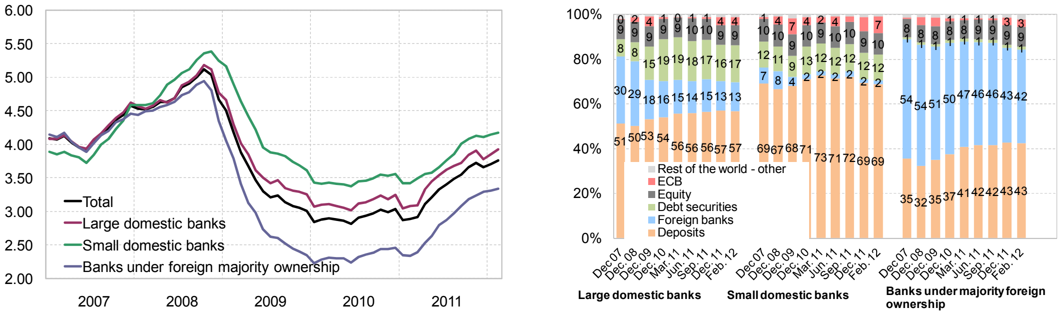
[19] The estimate of costs of equity is the same for all bank groups owing to the limited number of bank shares listed on the Ljubljana Stock Exchange. The differences in bank funding costs arise solely due to differences in the costs of debt capital and the proportions of funding accounted for by equity by individual bank group.

an adverse impact on funding cost at this bank group. Thus, the difference in funding costs between bank groups has narrowed.

The proportion of the large domestic banks' sources accounted for by liabilities to foreign banks has declined by 16 percentage points over the last three years, while the proportion accounted for by issued securities has risen by 11 percentage points. That increase, however, is primarily the result of securities issues during the first two years of the crisis.

The proportion of funding accounted for by liabilities to foreign banks fell most notably at the large domestic banks.

Figure 5.14: Average funding costs (left) and breakdown of funding (right) by bank group in percentages

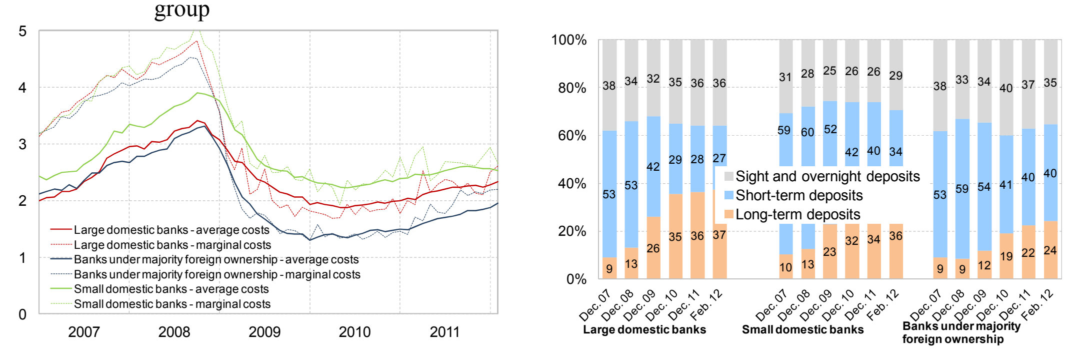


Source: Bank of Slovenia

The banks under majority foreign ownership have focused increasingly on retail banking during the crisis. The proportion of funding accounted for by deposits has risen as a result, but remains below that of the domestic banks. The differences between the domestic banks and the banks under majority foreign ownership in terms of funding costs in the form of deposits narrowed last year. Funding costs in the form of deposits by the non-banking sector at the large domestic banks exceeded those same costs at the banks under majority foreign ownership by 0.38 percentage points in February 2012, compared with 0.56 percentage points in December 2010. The same is true for the small domestic banks, where funding costs in the form of deposits exceeded the costs at banks under foreign majority ownership by 0.58 percentage points.

The banks under majority foreign ownership are increasing their proportion of funding accounted for by deposits by the non-banking sector.

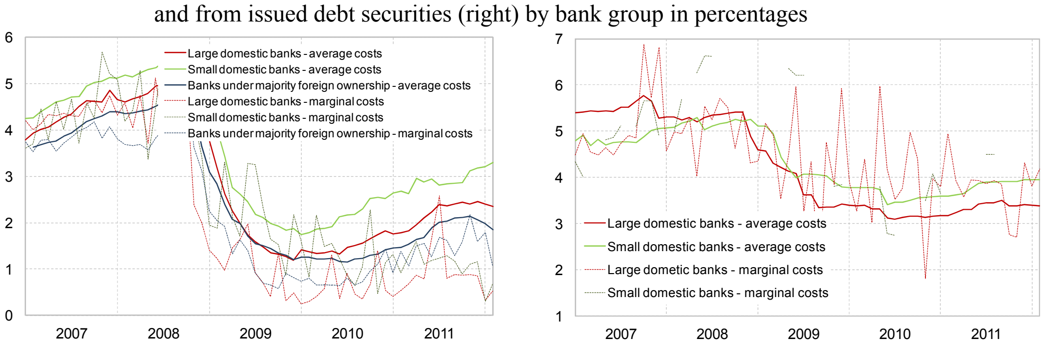
Figure 5.15: Average and marginal funding costs for deposits by the non-banking sector (left) and original maturity breakdown of deposits (right) by bank group



Source: Bank of Slovenia

The average funding costs of the large domestic banks at banks in the rest of the world stood at 2.4% in February 2012, one half of a percentage point higher than the same costs at the banks under majority foreign ownership.

Figure 5.16: Average and marginal funding costs for liabilities to foreign banks (left) and from issued debt securities (right) by bank group in percentages



Source: Bank of Slovenia

The increase in bank funding costs came to a halt after October 2011. The overall costs of bank debt financing remained at a level of around 2.3% between November 2011 and February 2012. The reasons for the halt in growth in funding costs lie in the cutting of the ECB's key interest rate, the fall in EURIBOR rates on the financial markets, debt repayments by the banks via securities and the banks' participation in the ECB's long-term operations, which bear the lowest interest rate. Another factor in falling funding costs will be a decrease in the proportion of bank securities, due to their scheduled maturity or early repurchases by the banks. On the other hand, a rise in deposit interest rates will result in a slight increase in funding costs owing to the relatively strong competition between the banks for non-bank deposits.

Differences in the structure of funding by individual bank group

The proportion of total assets accounted for by bank funding on the wholesale markets had fallen to one quarter by March 2012. Following an increase in the proportion of total liabilities accounted for by securities during the first two years of the crisis, that same proportion declined in the first quarter of 2012. A similar trend can be expected in the future due to the maturing of securities and the unfavourable conditions on the financial markets for issuing new securities. The proportion of total assets accounted for by sources raised at the ECB was up most notably towards the end of 2011 and in March 2012, to reach 7.5% for the banking system overall and 8.2% at the banks under majority domestic ownership.

Table 5.5: Forms of funding as a proportion of total assets by individual bank group

(%)	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Banking system overall
	Liabilities to foreign banks			
2008	27.7	6.8	52.3	33.8
2009	16.8	3.5	48.9	25.2
2010	15.0	1.7	47.8	23.3
2011	12.0	1.5	40.8	19.6
Mar. 2012	11.1	1.3	36.4	17.7
	Deposits by non-banking sector			
2008	47.8	56.7	31.1	43.3
2009	49.6	59.2	33.7	45.7
2010	49.8	60.3	36.0	46.7
2011	52.4	60.3	40.8	49.6
Mar. 2012	50.1	58.3	42.2	48.5
	Household deposits			
2008	32.0	30.6	18.6	27.7
2009	30.3	30.3	18.2	26.7
2010	31.4	31.7	20.9	28.4
2011	32.6	34.6	22.6	29.8
Mar. 2012	32.0	35.0	22.9	29.6
	Government deposits			
2008	4.3	6.6	2.5	3.9
2009	8.7	10.9	4.7	7.7
2010	6.9	10.2	2.9	6.0
2011	7.9	10.8	3.2	6.7
Mar. 2012	6.7	9.0	3.3	5.9
	Issued debt securities			
2008	3.5	6.4	0.0	2.6
2009	10.0	5.2	0.0	6.7
2010	13.2	7.8	0.0	8.9
2011	11.2	7.4	0.0	7.6
Mar. 2012	9.9	7.0	0.0	6.8
	Liabilities to the Eurosystem			
2008	2.1	3.0	3.3	2.6
2009	3.9	6.4	3.7	4.1
2010	0.9	3.1	1.2	1.2
2011	3.4	5.6	3.1	3.5
Mar. 2012	8.2	8.2	5.8	7.5

Source: Bank of Slovenia

5.4 Profitability and performance indicators

Income risk

High impairment and provisioning costs, lower net interest and the low level of non-interest income are increasing the bank's income risk.

Contributing to the banks' increasing exposure to income risk, in addition to the realisation of credit risk, is the declining volume of loans, which reduces the banks' interest income. Additional pressure on net interest income is generated by the increase in funding costs, which has halted since November following the cutting of interest rates and the restructuring of the banks' sources of funding, while interest rates on deposits are rising. At 5.5% in the first quarter of 2012, growth in interest expenses continued to outstrip growth in interest income (of 1.5%). Thus, net interest was down 3%. Owing to the adverse situation on the capital and foreign exchange markets and lower income from fees and commissions, the banks are also currently limited significantly in terms of non-interest income.

Table 5.6: Banking sector income statement

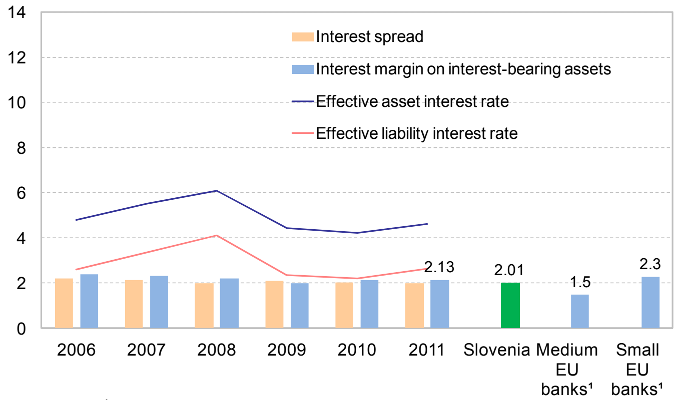
	Amount, EUR million			Growth, %			Ratio to gross income, %		
	2010	2011	Mar. 2012	2010	2011	Mar. 2012	2010	2011	Mar. 2012
Net interest	1038	1007	248	11.3	-3.0	-3.1	70.4	70.5	72.6
Net non-interest income	437	422	94	-11.5	-3.3	-3.1	29.6	29.5	27.4
of which net fees and commissions	343	340	84	2.3	-1.0	-2.3	23.3	23.8	24.5
of which net gain/loss on financial assets and liabilities held	-49	-11	-6	…	…	…	-3.3	-0.8	-1.8
Gross income	1474	1429	342	3.4	-3.1	-3.1	100	100	100
Operating costs	766	763	180	0.1	-0.4	-1.1	51.9	53.4	52.6
labour costs	413	408	101	-0.5	-1.2	-2.2	28.0	28.6	29.6
Net income	709	666	162	7.3	-6.0	-5.3	48.1	46.6	47.4
net impairments and provisioning	810	1196	182	62.1	47.7	44.0	54.9	83.7	53.2
of which impairments and provisioning at amortised cost	639	947	172	47.2	48.3	58.2	43.3	66.3	50.5
Pre-tax profit	-101	-530	-20	-163.0	-423.8	-143.8	-6.9	-37.1	-5.8
corporate income tax	-3	-95	-2	-108.0	…	…	-0.2	-6.6	-0.5
Net profit	-98	-436	-18	-180.6	…	…	-6.7	-30.5	-5.2

Source: Bank of Slovenia

The structure of the banking system's gross income was unchanged last year.

The proportion of gross income accounted for by net interest last year was comparable to the previous year. The same is true for the net interest margin on interest-bearing assets, which stood at 2.1%. Net interest income was down in all bank groups last year, most notably at the large domestic banks (by nearly 6%), while the decline was smallest at the banks under majority foreign ownership, at 2.2%. At 13%, the relatively high growth in interest expenses at the banks under majority foreign ownership was a reflection of the banks' shift to deposits by the non-banking sector and the raising of the corresponding interest rates.

Figure 5.17: Average effective asset and liability interest rates calculated from interest income and expenses, interest spread and interest margin in percentages



Note: [1] The separate figures for the interest margin are for 2011 in Slovenia and for 2010 for EU Member States, and were calculated as the ratio of net interest income to total assets. The interest margin for EU banks was taken as the net interest margin for medium-sized banks and small banks.

Sources: Bank of Slovenia, ECB, Consolidated Banking Data, August 2011

Figure 5.18: Proportion of banks' gross income accounted for by net interest and net non-interest income (left) and the disposal of gross income (right) in percentages

Source: Bank of Slovenia

The realisation of credit risk, which is a result of the adverse economic conditions, is resulting in a significant rise in impairment and provisioning costs.

Additional credit risk was realised by the banks last year. The proportion of gross income accounted for by impairment and provisioning costs was up 29 percentage points on 2010 to stand at 84%. At 109%, the large domestic banks stand out in terms of impairment and provisioning costs as a proportion of gross income. That proportion was two thirds at the small domestic banks and 36% at the banks under majority foreign ownership. Impairment and provisioning costs remained high in the first quarter of 2012, accounting for more than one half of the gross income generated by the banks. Impairment and provisioning costs accounted for merely one tenth of the banking system's gross income prior to the outbreak of the crisis. Last year's operating costs were comparable with the previous year, and were actually down 2.8% at the large domestic banks.

The banking system's operating costs in 2011 were comparable with the previous year.

The banking system generated a loss last year for the second successive year. According to unaudited figures, the banking system's pre-tax loss amounted to EUR 530.1 million, exceeding the loss generated in 2010 by EUR 429 million. The banking system recorded a negative ROE of 12.5%. Last year's interest margin on total assets and the non-interest margin on total assets were comparable to those recorded in 2010.

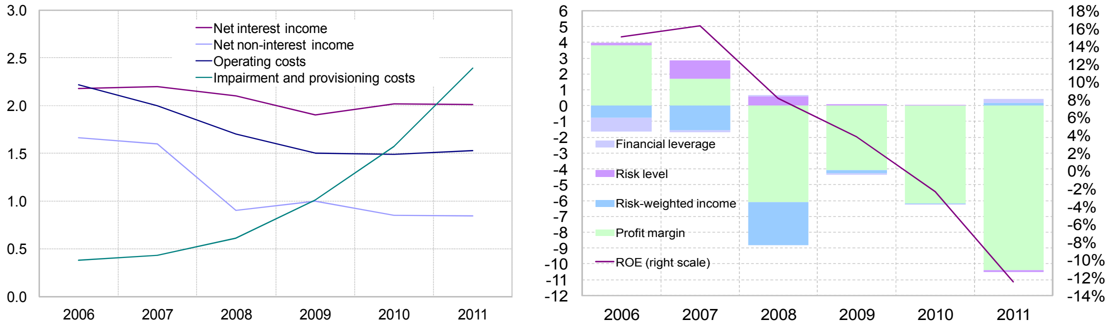
Table 5.7: Bank performance indicators in percentages

(%)	2006	2007	2008	2009	2010	2011
ROA	1.25	1.36	0.67	0.32	-0.20	-1.06
ROE	15.06	16.28	8.14	3.85	-2.36	-12.50
Cost / gross income	57.76	52.75	57.05	53.68	51.95	53.40
Interest margin on interest-bearing assets	2.35	2.32	2.20	1.99	2.13	2.13
interest margin on total assets	2.18	2.15	2.08	1.88	2.02	2.01
Non-interest margin	1.67	1.63	0.92	0.99	0.85	0.85
Gross income / av erage assets	3.85	3.78	3.00	2.87	2.87	2.86

Source: Bank of Slovenia

At 2.97% last year, the financial intermediation margin at the banks under majority foreign ownership was slightly higher than at the domestic banks, where it stood at 2.82%. At 2.21%, the interest margin at the banks under majority foreign ownership was 0.2 percentage points higher than the interest margin achieved by the banks under majority domestic ownership. ROE was negative at the banks under majority domestic ownership last year, but positive at the banks under majority foreign ownership, at 2.4%. All of this points to the greater efficiency of the banks under majority foreign ownership in generating revenues and controlling costs, in particular impairment and provisioning costs, compared with the banks under majority domestic ownership.

Figure 5.19: Net interest income, net non-interest income, operating costs and net provisioning as a percentage of average assets (left), and movement in ROE and impact of four factors on the direction of the movement in ROE (right)



Source: Bank of Slovenia

If the movement in the banks' ROE is analysed by breaking down profitability into the four components (profit margin, risk-weighted income, risk level and financial leverage), we find that a sharply lower profit margin contributed to the decline in the banking system's profitability for the second consecutive year. The contribution of other components to the decrease or increase in profitability was negligible.

Table 5.8: Breakdown of ROE into four factors

Year	Profit margin pre-tax profit / gross income	*	Risk-weighted income gross income / risk-weighted assets	*	Risk level risk-weighted assets / total assets	*	Financial leverage total assets / equity	=	Profitability ROE
2006	0.32		0.06		0.66		12.12		0.151
2007	0.36		0.05		0.71		12.05		0.163
2008	0.23		0.04		0.77		12.17		0.081
2009	0.11		0.04		0.78		11.91		0.039
2010	-0.07		0.04		0.78		11.98		-0.024
2011	-0.37		0.04		0.79		11.74		-0.125

Source: Bank of Slovenia

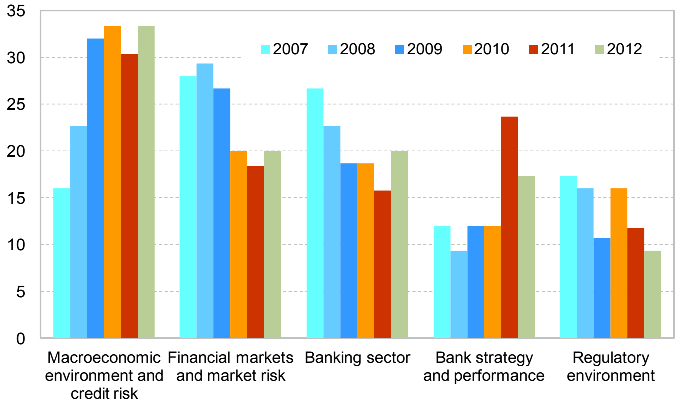
5.5 Risks in the banking sector

Survey of risks in the banking sector

Banks expect an increase in the relative importance of risks associated with the macroeconomic environment and credit risk, risks associated with the financial markets and risks in the banking sector.

Based on survey responses, the banks expect an increase in risks associated with the macroeconomic environment over the next year, in particular an increase in credit risk, as the following factors continue to have a negative impact on lending: deterioration in the creditworthiness of borrowers, their relatively high level of debt and deterioration in the quality of collateral. A second reason from the domestic environment given by the banks for the increase in risks is the situation on the real estate market, while the expectation of low economic growth in the international environment represents another reason.

Figure 5.20: Results of 2007 to 2012 surveys on main origins of risk for the coming year in percentages



Sources: Bank of Slovenia, annual bank surveys

Among the reasons for risks associated with the financial markets, the majority of banks pointed to the increased costs of and limited access to funding on the financial markets and their low liquidity. The increased assessment of the risks in the banking sector was driven by four factors. Increasing competitive pressures can be linked to the anticipated fiercer competition for savings deposits and to a limited number of creditworthy borrowers. In the context of an unchanged number of banks and savings banks in Slovenia, good clients are searching for financing in the rest of the world. The banks stated as a reason for the increase in risks in the banking sector an expected increase in the cost of and limited access to sources of funding on the interbank market, while they are less concerned about changes in the ownership structure and management of banks, and operational risks linked to the functioning of information systems.

Downgrading of Slovenian banks

Last year the ratings agencies Moody's and Fitch Ratings downgraded the government-guaranteed bonds of four Slovenian banks owing to the downgrading of Slovenia.

Ratings agencies take into account the high likelihood of state aid.

In formulating its deposit ratings for NLB d.d., NKBM d.d. and Abanka d.d., Moody's took into account the high likelihood of systemic state aid, should it be required by the aforementioned banks. The same applies to the credit ratings and assessment of external support for NLB d.d. and NKMB d.d. issued by Fitch Ratings. These were justified by the state's ownership stake in the aforementioned banks, the state's participation in past capital injections and the systemic importance of the banks. Fitch Ratings also stated the government's intent to remain a major shareholder of the banks. It also warned that delays in government support for banks and measures adopted for the further privatisation of banks could also result in changes to their credit ratings.

The government's impact on the credit rating of banks under state ownership was seen in the increase in NKBM d.d.'s capital in May 2011, when Fitch Ratings downgraded NKBM d.d., indicating as the reason a moderate negative revision of the assessed future likelihood that NKBM d.d. will receive state aid in a timely manner. Fitch Ratings took into account the fact that the government maintained its approximately 51% stake after the aforementioned capital injection. The reasons given for the downgrading of the bank's outlook and assessment of external support were the government's overdue and merely indirect participation in the capital injection, contrary to official statements with regard to maintaining the state's stake in the bank during the capital increase, and the lack of a clear strategy regarding the bank's future ownership structure.

Downgrading of banks.

Banks were also downgraded last year owing to the protracted public finance consolidation process and the protracted process of increasing the capital of banks under majority state ownership. The following downgrades were of particular note. In December 2011 Moody's downgraded three banks from Investment-Grade to Speculative-Grade. The aforementioned agency downgraded the long-term deposit ratings of NLB d.d. and NKBM d.d. from "Baa3" to "Ba1", and to "Ba2" for Abanka Vipa d.d. It also downgraded the same three banks' short-term deposit ratings from "Prime-3" to "Non-Prime", the lowest of the four possible ratings.

The ratings agency Fitch Ratings also downgraded Slovenian banks last year. Abanka Vipa d.d., Banka Celje d.d. and Gorenjska Banka d.d. were all downgraded to Speculative-Grade last September. Probanka d.d. received the same rating back in 2009. Fitch Ratings downgraded the long-term ratings of NLB d.d. and NKBM d.d. from "A-" to "BBB" last year, and their short-term ratings from "F2" to "F3". Both ratings are the lowest ratings in the Investment-Grade category. In February this year Fitch Ratings placed the ratings of NLB d.d., NKBM d.d., Abanka Vipa d.d. and Probanka d.d. on review for a possible downgrading.

5.6 Liquidity risk and refinancing risk

The downgrading of Slovenia's long-term sovereign debt rating and several Slovenian banks in the second half of the 2011 contributed to the continuing tightened funding conditions for Slovenian banks on the international financial markets.

The stock of newly raised loans in the rest of the world was down by more than one third last year compared with the previous year, as a result of rising premiums over the reference interest rates and due to limited access to foreign sources of funding. The banks will see EUR 4.1 billion of their total liabilities to banks in the rest of the world mature over the next one-year period from December 2011, including liabilities from issued debt securities.

By participating in the ECB's longer-term refinancing operations, the banks have balanced refinancing risk, which increased last year owing to the shortening of maturities on liabilities to banks in the rest of the world. The banks further mitigated refinancing risk in 2012 by participating in February's 3-year LTRO. The Slovenian banking system thus ensured a sufficient level of funding for the repayment of liabilities in 2012, and is successfully balancing refinancing risk, despite the uncertain conditions on the interbank market.

Government deposits still accounted for 11% of all deposits by the non-banking sector at the end of February of this year. Nevertheless, the government is gradually withdrawing its deposits from the banking system. The stock of bank deposits by the Ministry of Finance, which represent the majority of government deposits, averaged EUR 2.7 billion last year, but had fallen below EUR 1.9 billion at the beginning of the second quarter of 2012. Bank deposits by the Ministry of Finance in the amount of EUR 0.3 billion mature in the one-year period from the end of the first quarter of 2012. Central government deposits in the amount of EUR 0.54 billion, of the total stock of EUR 2.7 billion in March 2012, mature for payment over the same period.

The protracted period of limited access to the international financial markets at increasingly higher interest rates will, together with the withdrawal of government deposits at the banks, have an adverse effect on the banking system's lending activity in 2012. Funds raised via 3-year LTROs represent a merely temporary source that prevents a more rapid reduction in the financial leverage of the banks and temporarily reduces their refinancing risk.

The banking system's liquidity risk, as measured by the first-bucket liquidity ratio, remained comparable to 2010 last year.

5.6.1 Refinancing risk on the financial markets

In raising funds on wholesale markets in the rest of the world, the banks only partly succeeded in rolling over maturing liabilities in 2011. The rate of refinancing of maturing liabilities was 37% last year at the level of the banking system. At 55%, the banks under majority foreign ownership maintained a relatively high proportion of rolled over maturing liabilities owing to their policy of borrowing from parent banks.

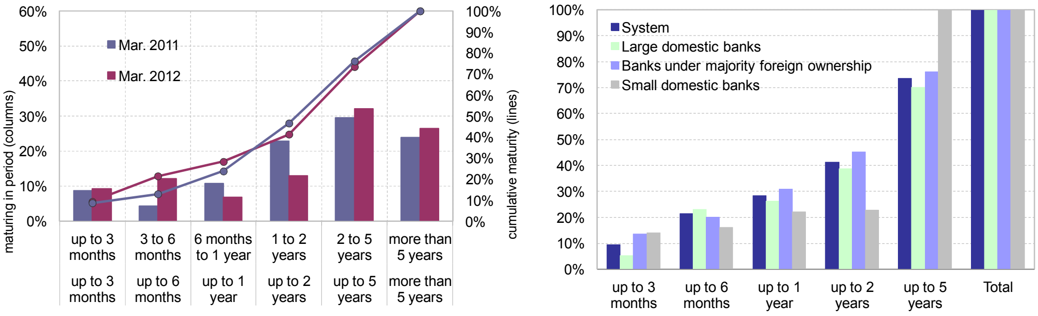
The banking system made debt repayments to banks in the rest of the world of EUR 2.4 billion in 2011, the majority by the large domestic banks.

Excluding debt from issued debt securities, the banks reduced their debt to foreign banks by 19% in 2011. Repayments were equally distributed between the domestic banks and the banks under majority foreign ownership. Including issued debt securities, debt to the rest of the world was down EUR 2.4 billion, most notably at the large domestic banks, by EUR 1.3 billion. As a result, the stock of liabilities to banks in the rest of the world stood at EUR 12.3 billion at the end of 2011, the domestic banks accounting for EUR 6.5 billion of that amount. A further EUR 1.1 billion in debt repayments to the rest of the world, including issued debt securities, were made in the first quarter of 2012, the domestic banks and the banks under majority foreign ownership each accounting for around one half.

The maturity breakdown of maturing debt to the rest of the world shortened significantly. A total of EUR 4.1 billion in liabilities to banks in the rest of the world will mature in 2012.

The maturity of debt to foreign banks shortened significantly last year. The proportion of liabilities to banks in the rest of the world with a maturity of up to 1 year was up 9.9 percentage points on the end of 2010 to stand at 33% or EUR 4.1 billion in value terms. The maturity breakdown of liabilities to banks in the rest of the world shortened for all bank groups, most notably at the large domestic banks as a result of liabilities from issued debt securities with a government guarantee that will mature in July and September 2012. Liabilities to banks in the rest of the world maturing in 2012 stood at EUR 1.9 billion at the large domestic banks at the end of 2011, representing 31% of their total liabilities to banks in the rest of the world, an increase of EUR 0.9 billion or 18 percentage points on the end of 2010. The short-term liabilities of the banks under majority foreign ownership to banks in the rest of the world accounted for 36% of their total liabilities to foreign banks, or EUR 2.1 billion. Nearly all of those liabilities, however, were to parent banks. Liabilities to banks in the rest of the world totalled EUR 11.2 billion at the end of the first quarter of 2012, while the maturity structure shortened further.

Figure 5.21: Maturing of liabilities to foreign banks by maturity interval (left) and bank group (right) in percentages



Source: Bank of Slovenia

Table 5.9: Maturing of liabilities to foreign banks (loans, deposits, securities) and the maturity breakdown as at 31 March 2012 for the banking system and by bank group in percentages

(%)	Cumulative maturing of liabilities to foreign banks				Breakdown of liabilities by maturity			
	System	Large domestic banks	Banks under majority foreign ownership	Small domestic banks	System	Large domestic banks	Banks under majority foreign ownership	Small domestic banks
Total, EUR million	11,195	5,719	5,242	234				
Overnight, sight	0.9	1.4	0.3	0.1	0.9	1.4	0.3	0.1
Up to 1 month	3.6	3.7	3.3	6.0	2.7	2.3	3.0	5.8
1 to 3 months	9.3	5.2	13.6	14.0	5.8	1.5	10.3	8.0
3 to 6 months	21.5	23.1	20.0	16.2	12.2	17.9	6.4	2.2
6 months to 1 year	28.4	26.2	31.0	22.0	6.8	3.0	11.0	5.9
1 to 2 years	41.4	38.6	45.2	22.9	13.0	12.5	14.2	0.9
2 to 3 years	50.1	42.7	59.4	23.3	8.8	4.1	14.3	0.4
3 to 4 years	68.8	65.6	70.9	100.0	18.7	22.9	11.5	76.7
4 to 5 years	73.5	70.0	76.1		4.7	4.4	5.2	0.0
5 to 7 years	83.8	72.6	95.2		10.3	2.6	19.1	0.0
7 to 10 years	89.0	79.9	98.4		5.3	7.4	3.2	0.0
10 to 15 years	92.6	85.4	100.0		3.5	5.5	1.6	0.0
More than 15 years	100.0	100.0			7.4	14.6	0.0	0.0
Total					100.0	100.0	100.0	100.0

Source: Bank of Slovenia

The stock of new loans raised at banks in the rest of the world was down in both bank groups, most notably at the banks under majority foreign ownership.

The worsening of the situation on the euro area interbank market was reflected in the stock of new loans raised at banks in the rest of the world, which totalled EUR 1.6 billion in 2011, down 36% on the previous year. The domestic banks reduced their stock of new loans by EUR 377 million or 43%, to a total of EUR 0.5 billion. Exclusively new long-term loans were reduced in the aforementioned bank group, although such loans still account for the majority of new transactions, at 88%.

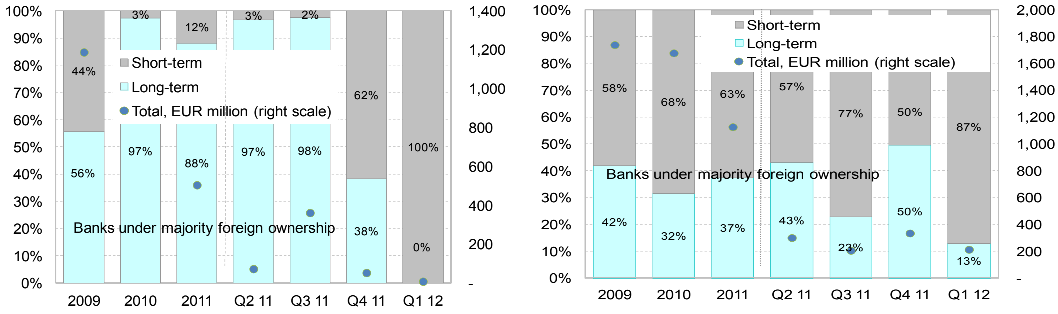
By contrast, the banks under majority foreign ownership reduced their stock of newly raised loans by EUR 551 million, primarily by reducing short-term loans. The proportion of newly raised loans accounted for by long-term loans rose to 37% in this bank group. Last year's relatively sharp decline in the stock of newly raised loans indicates Slovenian banks' limited access to the international financial markets, while at the same time it reduces the need for borrowing as a result of lower credit demand in the context of low economic activity.

Table 5.10: New loans of banks raised at foreign banks by maturity and currency

	Loans by maturity, EUR million			Breakdown by currency, %		
	Total	Short-term	Long-term	CHF	EUR	Other
2007	5,304.8	1,877.8	3,426.9	8.2	91.5	0.3
2008	4,862.0	2,408.8	2,453.2	5.2	93.5	1.3
2009	2,924.8	1,536.4	1,388.5	11.2	88.8	0.0
2010	2,557.2	1,172.5	1,384.6	13.3	83.5	3.2
2011	1,629.7	764.8	865.0	23.1	75.6	1.3
Q1 2011	306.2	224.2	82.0	43.6	56.4	0.0
Q2 2011	372.0	173.0	199.0	19.5	74.8	5.7
Q3 2011	565.5	167.0	398.6	14.5	85.5	0.0
Q4 2011	386.0	200.6	185.4	22.9	77.1	0.0

Source: Bank of Slovenia

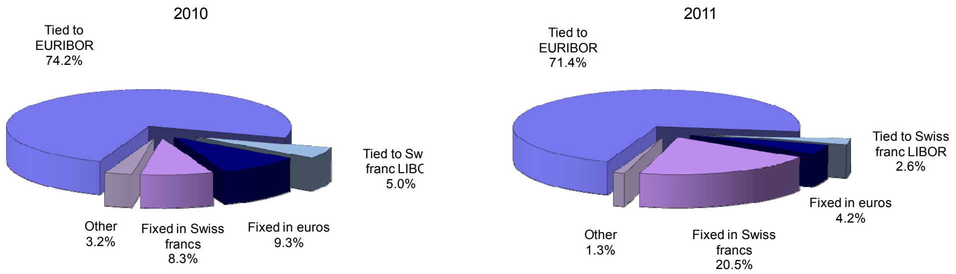
Figure 5.22: Maturity breakdown of new loans for banks under domestic ownership (left) and banks under majority foreign ownership (right) in percentages



Source: Bank of Slovenia

The banks primarily raised loans in the rest of the world in the domestic currency with a variable interest rate. Nevertheless, the proportion of bank borrowing in Swiss francs was up 12.2 percentage points last year to stand at 21%. The majority of these loans were raised with a fixed interest rate.

Figure 5.23: Breakdown of banks' new loans in the rest of the world by type of remunerations (average for the year)



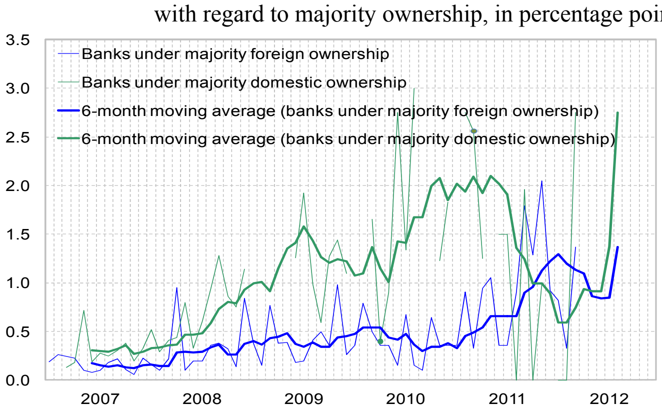
Source: Bank of Slovenia

The borrowing terms of the banks under majority foreign ownership remain more favourable than those of the domestic banks.

The banks were subject to a sustained rise in premiums over reference interest rates on new loans raised in the rest of the world. Contributing to the aforementioned rise in premiums, in addition to the worsening of the debt crisis in certain euro area countries, are lower expectations regarding future economic growth and the downgrading of Slovenia's sovereign debt rating and certain Slovenian banks.

The domestic banks achieved an average premium over the EURIBOR last year of 2.1 percentage points, an increase of 0.4 percentage points on a year earlier. The premium over the EURIBOR reached 2.5 percentage points on average in the final quarter of 2011. The premiums achieved by the banks under majority foreign ownership were also up last year, by 0.5 on average. However, at 0.9 percentage points over the EURIBOR, they are one half of the premiums achieved by the domestic banks. The borrowing terms in the rest of the world achieved by the banks under majority foreign ownership remain significantly more favourable, primarily as a result of their direct borrowing from their parent banks.

Figure 5.24: Premiums over EURIBOR for banks' loans raised in the rest of the world, with regard to majority ownership, in percentage points



Source: Bank of Slovenia

5.6.2 Bank funding from the Eurosystem

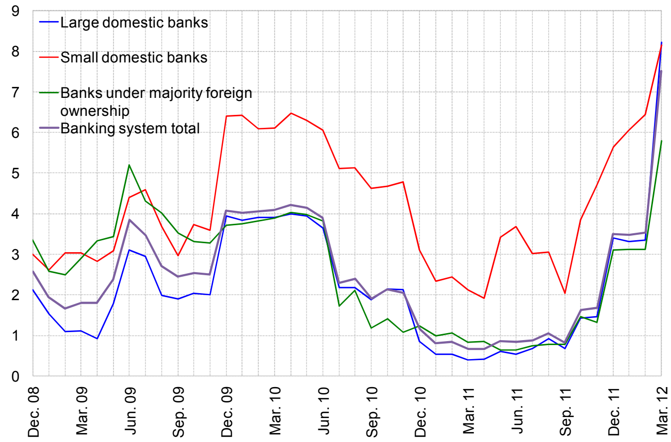
Liabilities to the Eurosystem totalled EUR 1.7 billion at the end of 2011 and EUR 3.7 billion at the end of the first quarter of 2012, representing 7.5% of the banking system's total assets.

The majority of bank funding in the second half of 2011 took the form of ECB operations due to the adverse situation on the international financial markets. Liabilities to the Eurosystem were up EUR 1.1 billion in 2011, to stand at EUR 1.7 billion or 3.5% of total assets. The majority of the banks' liabilities to the Eurosystem were the result of December's 3-year LTRO, to which the funds raised at October's 1-year auction were transferred. As a result, the maturity of funds raised at the ECB in October was extended to three years. The large domestic banks recorded the largest increase in liabilities to the Eurosystem in 2011, of EUR 765 million.

The banks further increased their liabilities to the Eurosystem by EUR 2 billion in the first quarter of 2012 to EUR 3.7 billion, on account of their participation in February's 3-year LTRO. Liabilities to the Eurosystem as a proportion of the banking system's total assets reached 7.5%. That proportion was up most notably at the large domestic banks, by 4.9 percentage points to 8.2%, the same level recorded by the small domestic banks. Liabilities to the Eurosystem as a proportion of total assets are lower at the banks under majority foreign ownership, at 5.8%.

Funds raised via 3-year LTROs represent a temporary source of bank funding that prevented a more rapid reduction in the financial leverage of the banks. Low growth in deposits by the non-banking sector in the context of rapid debt repayments by the banks on the international financial markets has led to the accelerated restructuring of bank funding, a process which continues. Increased borrowing via the 3-year LTRO has merely given the banks time to adjust their funding business models and to reduce their dependence on funding from the international financial markets or via direct borrowing from banks in the rest of the world.

Figure 5.25: Liabilities to the Eurosystem as a proportion of total assets by bank group in percentages

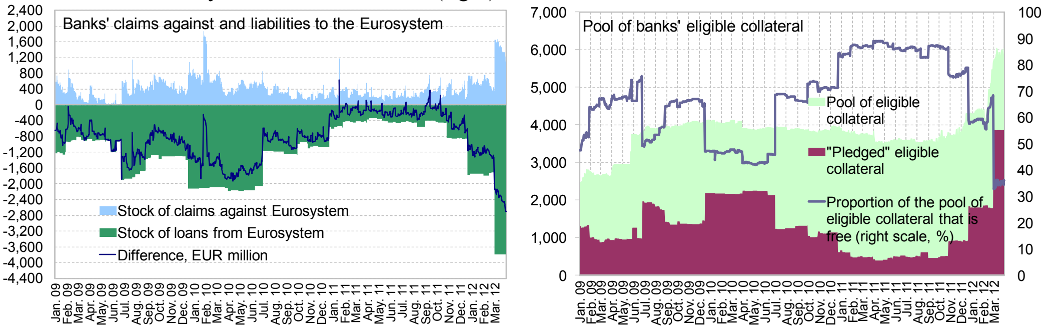


Source: Bank of Slovenia

The proportion of the pool of eligible collateral for Eurosystem operations that is free fell to its lowest level at the end of March 2012, at 36%.

The pool of eligible collateral at the Eurosystem expanded by EUR 389 million last year to EUR 4.3 million, providing the banks a sufficient level of such funding. After averaging 86% until the end of the third quarter of 2011, the proportion of the pool of eligible collateral for Eurosystem operations that is free fell to 58% at the end of the year. That proportion had fallen further by the end of the first quarter of 2012, but remains at a satisfactory 36% of the pool of eligible collateral for Eurosystem operations, which stood at EUR 6 billion at the end of March 2012.

Figure 5.26: Commercial banks' claims, liabilities and net position vis-à-vis the Eurosystem in EUR millions (left), and pool of eligible collateral at the Eurosystem in EUR millions (right)



Source: Bank of Slovenia

Any further downgrading of Slovenia will reduce the pool of eligible collateral at the Eurosystem.

Despite the relatively strong response of banks to 3-year LTROs, the proportion of the pool of eligible collateral for Eurosystem operations that is free remains at a satisfactory level. Any further downgrading of Slovenia's long-term sovereign debt rating, which at the end of the first quarter of 2012 stood at "A2" (Moody's) "A" (Fitch Ratings) and "A+" (S&P), could result in a decline in the aforementioned proportion in the future.

The downgrading of Slovenia to between "BBB+" and "BBB-" would result in an increase in deduction items for government securities and government-guaranteed assets and eliminate the assets of public sector entities from the overall pool of eligible collateral for Eurosystem operations. This would result in a reduction in the pool of eligible collateral for Eurosystem operations by approximately 12% relative to the end of the first quarter of 2012, to EUR 5.2 billion.

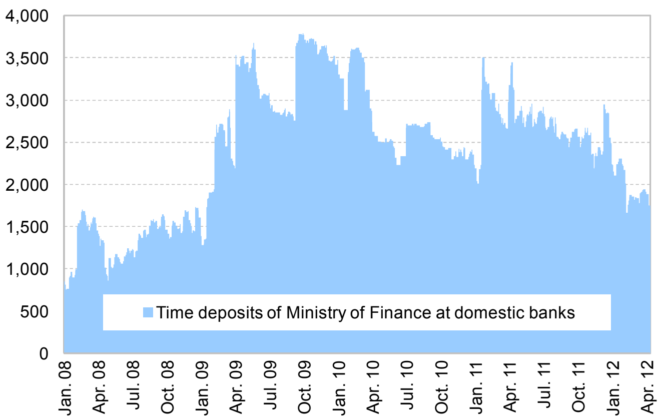
Government deposits at banks

Refinancing risk was realised last year, as the government did not roll over its sources at banks.

Despite last year's increase in government deposits at banks of EUR 259 million, government deposits are expected to decline gradually. Government deposits were up in the first quarter of last year owing to the issue of two government bonds, each in the amount of EUR 1.5 billion, which was reflected in an increase in government deposits at banks to EUR 4.6 billion. Government deposits were down EUR 1.7 billion at the end of March 2012 EUR, to stand at EUR 2.9 billion. They still accounted for 5.9% of the banking system's total assets and 12% of all deposits by the non-banking sector. In addition to the banks' debt repayments on the wholesale markets, the decline in government deposits has resulted in the contraction of the banking system's total assets.

At EUR 2.7 billion, the average stock of deposits by the Slovenian Ministry of Finance in 2011 was comparable to the previous year. Similarly, the stock of deposits by the Slovenian Ministry of Finance at the end of 2011 was comparable with the stock at the end of the previous year, at EUR 2.2 billion. These deposits fell to EUR 1.9 billion by the end of March 2012. A gradual reduction in Ministry of Finance deposits can be expected for the remainder of the current year.

Figure 5.27: Stock of deposits by the Slovenian Ministry of Finance at banks in EUR million



Source: Bank of Slovenia

According to figures at the end of the first quarter of 2012, EUR 338 million, or 18% of total deposits by the Slovenian Ministry of Finance in the amount of EUR 1.9 billion, will mature over the next one-year period, while 40% will mature over the next two-year period.

The banking system's total liabilities to the (central) government amounted to EUR 2.9 billion at the end of the first quarter. A total of 38% or EUR 1.1 billion of these liabilities mature over the next six months, while 43% or EUR 1.2 billion mature over the next year.

At the end of the first quarter of 2012 the proportion of total assets accounted for by government deposits was highest at the small domestic banks (9%), followed by the large domestic banks (6.7%) and the banks under majority foreign ownership (3.3%).

Debt securities issued

The banks made early repurchases of debt securities last year and in the first quarter of 2012.

The banks reduced their liabilities from issued debt securities last year and in the first quarter of this year. Debt repayments of EUR 786 million and EUR 347 million were made last year and in the first quarter of 2012 respectively. Thus the stock of bank debt securities was reduced to EUR 3.3 billion. According to figures at the end of the first quarter of 2012, liabilities from debt securities in the amount of EUR 1.6 billion will mature over the next one-year year period. The majority of maturing liabilities from debt securities over the next six months, i.e. until the end of the third quarter of 2012, relates to government-guaranteed debt securities issued by NLB and Abanka in 2009.

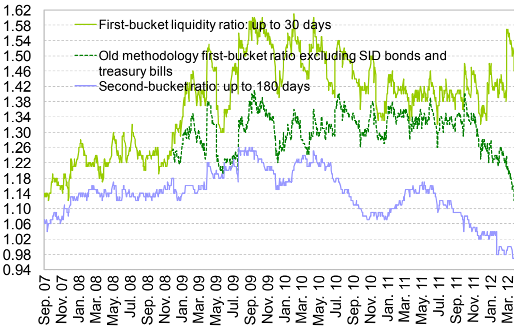
SID banka made a partial early repurchase of SI01 bonds in the amount of EUR 305 million last April. NLB and Abanka made early repurchases of government-guaranteed bonds last year and in the first quarter of 2012. Thus the stock of liabilities from the bonds issued in 2009 fell to EUR 777 million at NLB and to EUR 281 million at Abanka at the end of the first quarter of this year. There were several reasons for the early repurchases: a) to reduce the cost of the associated government guarantee, which amounts to nearly 1 percentage point; b) to replace more expensive sources with cheaper sources of funding raised by the banks via LTROs at the ECB; and c) to manage liquidity – through early repurchases, the banks reduce the pressure that could arise if the liabilities from debt securities were repaid in their entirety at maturity.

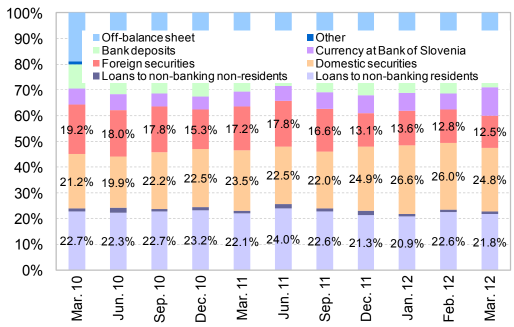
5.6.3 Liquidity ratios

Liquidity risk remains moderate and unchanged relative to 2010.

Liquidity risk as measured by the first-bucket liquidity ratio was moderate last year and unchanged relative to the previous year. It averaged 1.40, down 0.07 on the 2010 average. On the asset side, a decrease in investments in foreign securities and in short-term loans to domestic and foreign banks contributed most to the decline in the first-bucket liquidity ratio. The domestic banks also managed liquidity through the partial early repurchase of government-guaranteed debt securities. Despite a change in the calculation methodology at the beginning of October 2011,[20] the first-bucket liquidity ratio remained below last year's average at all the bank groups. The banking system maintains an adequate level of liquidity, which has remained higher than in the period before the outbreak of the economic and financial crisis in 2008.

Figure 5.28: Daily liquidity ratios for the first and second buckets of the liquidity ladder





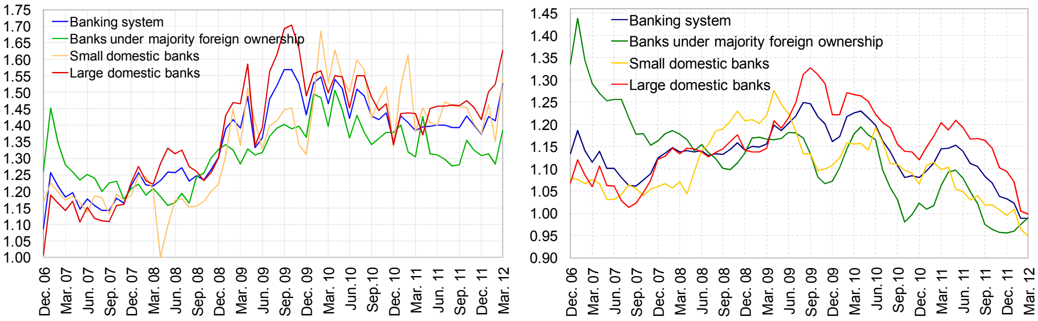
Source: Bank of Slovenia

[20] The change in the methodology for calculating the first-bucket liquidity ratio entered into force on 1 October 2011 with the Resolution amending the Resolution on minimum requirements for ensuring an adequate liquidity position (Official Gazette of the Republic of Slovenia, Nos. 28/07, 55/07, 83/07 and 74/11). On the liability side, the weight of sight deposits by households and non-financial corporations was reduced from 50% to 40%. Similarly, the weight in the second-bucket liquidity ratio was reduced by 10 percentage points, from 45% to 35%.

The value of the first-bucket liquidity ratio began to rise again in November and December 2011. Using sources obtained via LTROs, the banks increased their investments in Slovenian government securities and, to a lesser extent, short-term unsecured loans raised at banks in the rest of the world. The value of the shift in funds raised to Slovenian government securities primarily derives from the possibility of increasing the value of the pool of eligible collateral for Eurosystem operations and achieving acceptable yields. The value of the first-bucket liquidity ratio stood at 1.56 at the end of the first quarter of 2012, an increase of 0.08 on the end of 2011, primarily as the result of an increase in the use of the ECB deposit facility by the banks.

The trend of a declining second-bucket liquidity ratio since the middle of the second quarter of 2011 continued. The decline in the second-bucket liquidity ratio is primarily a result of the pending maturity of issued debt securities and the shortening of maturities on liabilities to the rest of the world.

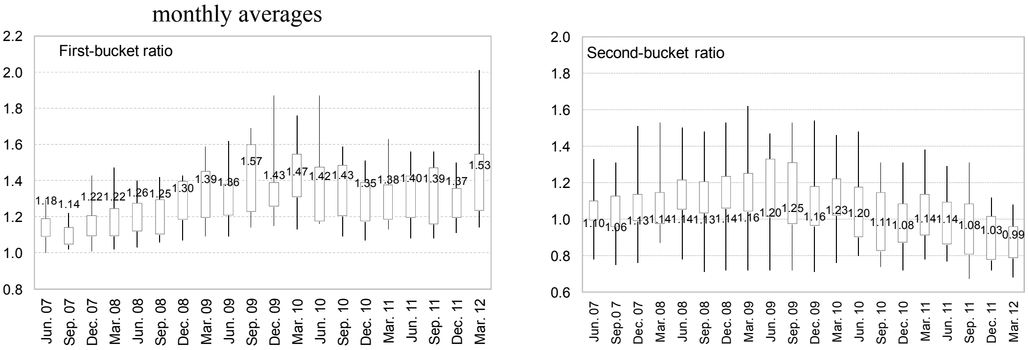
Figure 5.29: Liquidity ratio for first bucket (0 to 30 days; left), and second bucket (0 to 180 days; right) of the liquidity ladder by individual bank group, monthly averages



Source: Bank of Slovenia

The first-bucket liquidity ratio remained at a relatively high level at all bank groups in the first quarter of 2012, while its distribution across individual banks widened relative to the end of last year. This is an indication of differing liquidity management policies, as certain banks have become more conservative in their investments, while access to additional sources of liquidity from parent banks in the rest of the world is relatively simple for some banks. By contrast, the decline in the second-bucket liquidity ratio continued in the first quarter of 2012 at all bank groups, while the gaps between banks continue to narrow.

Figure 5.30: Distribution of first-bucket (left) and second-bucket (right) liquidity ratios, monthly averages



Source: Bank of Slovenia

The Bank of Slovenia adopted measures to reduce the risk of an unexpected shortfall in liquidity.

In order to mitigate the risk of a shortfall in liquidity, the Bank of Slovenia adopted a measure in April 2012,[21] whereby the first-bucket liquidity ratio will be more representative of the actual liquidity situation and the investments of an individual bank at a specific point in time. The aforementioned measure will have the greatest impact on the calculation of the first-bucket liquidity ratio by the banks under majority foreign

[21] The change in the methodology for calculating the first-bucket liquidity ratio will enter into force on 1 October 2012 with the Resolution amending the Resolution on minimum requirements for ensuring an adequate liquidity position (Official Gazette of the Republic of Slovenia, Nos. 28/07, 55/07, 83/07, 74/11 and 26/12). In off-balance-sheet assets, the proportion of credit lines and undrawn portion of loans taken into account for calculating the first-bucket liquidity ratio will be reduced from the current 100% to 75% by 1 October 2012, and to 50% by 1 April 2013.

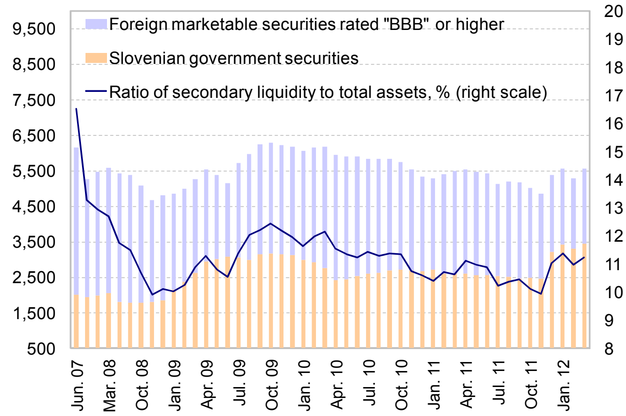
ownership, which use credit lines and the undrawn portion of loans as instruments to manage liquidity to a greater extent than the domestic banks.

Secondary liquidity

The stock of secondary liquidity was unchanged in 2011, while the proportion accounted for by domestic securities was up.

The stock of secondary liquidity declined steadily last year, and was down EUR 0.5 billion in year-on-year terms by November 2011, primarily due to maturing foreign securities. The banking system's secondary liquidity returned to the level recorded at the end of 2010, of EUR 5.4 billion, owing to the issue of 18-month Republic of Slovenia treasury bills. This resulted in a change in the proportion of domestic securities included in the calculation of secondary liquidity, which was up 9 percentage points at the end of 2011 to stand at 60%. The proportion of total assets accounted for by secondary liquidity, which declined steadily during the year, stood at 11% at the end of the year with the issue of Republic of Slovenia treasury bills. The somewhat higher share was entirely the result of a contraction in the banking system's total assets by EUR 1.6 billion.

Figure 5.31: Changes in the stock of secondary liquidity (monthly averages in EUR million) and ratio of secondary liquidity to total assets in percentages



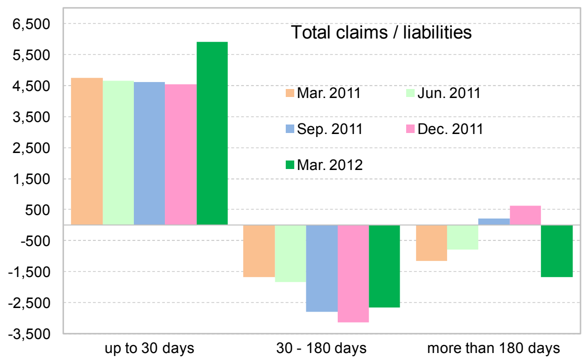
Note: Secondary liquidity is calculated from liquidity ladder data as the sum of the monthly average of Slovenian government securities (taking into account Bank of Slovenia bills up to March 2007 inclusive) and foreign marketable securities rated BBB or higher.
Source: Bank of Slovenia

Liquidity gap

The negative liquidity gap in the interval of more than 180 days widened due to the participation of banks in 3-year LTROs.

The positive liquidity gap in the bucket with a residual maturity of up to 30 days last year averaged EUR 4.7 billion last year. The gap widened by a further EUR 1.4 billion in the first quarter of 2012, relative to the end of last year, due to surplus funds raised via 3-year LTROs. As a result, the liquidity gap in the interval of more than 180 days remained negative due to the raising of long-term sources of bank funding, and averaged EUR 1.7 billion in the first quarter of 2012.

Figure 5.32: Liquidity gap as the difference between total assets and total liabilities defined in the liquidity ladder methodology in EUR millions



Source: Bank of Slovenia

5.7 Credit risk

The stagnation in lending last year resulted in the further deterioration in the quality of the banking system's credit portfolio. Bad clients remain an element of the banks' portfolios, corporates in bankruptcy proceedings in particular representing an increased burden on the future profits and the capital of banks. The most significant deterioration in the quality of the portfolio is seen at the large domestic banks, where the concentration of non-performing high-value loans is higher, in particular loans to corporates in bankruptcy proceedings, the same being true for the banks under majority foreign ownership and the small domestic banks. Several years of deterioration in the banks' credit portfolios owing to non-performing loans could have a negative effect on potential capital investors.

The deterioration in the quality of the credit portfolio and rising impairment costs are, on the one hand, a result of the protracted economic crisis and complex business and capital ties that were forged between corporates during the privatisation process and now act as a conduit for transferring the negative effects of the crisis, and the underestimation of credit risks during the period of high lending growth prior to the outbreak of the crisis on the other hand.

5.7.1 Credit standards

Loan-to-income (LTI) ratio

The maximum LTI ratio was unchanged in 2011.

The maximum LTI ratio was unchanged in 2011, the banking system average having stood at 54%. The aforementioned ratio varies by individual bank, ranging from one half to two thirds of the borrower's monthly income.

The proportion of newly approved loans to households where the LTI ratio exceeds 33% was up slightly. The proportion of loans with an LTI ratio exceeding 50% was higher for housing loans at 7.7%, and lower for consumer loans at 3.2%. The proportion of the latter was down slightly compared with the previous year.

Table 5.11: Loan-to-income (LTI) ratio in percentages

	Average maximum LTI under bank's business policy	Actual proportion of newly approved housing loans with		Actual proportion of newly approved consumer loans with	
		LTI >= 33%	LTI >= 50%	LTI >= 33%	LTI >= 50%
2010	54.0	47.3	7.3	25.4	4.3
2011	54.0	48.2	7.7	27.0	3.2

Note: LTI is the ratio of the loan instalment to the borrower's income.
Source: Bank survey

Loan-to-value (LTV) ratio

The LTV ratio on loans to households with real estate collateral declined.

The average LTV ratio on loans to corporates with real estate collateral was up slightly last year, from 69.9% to 71.2%. The banks at which the LTV ratio declined gave as a reason the fact that real estate is only one form of loan collateral, while other forms were not included in their ratio. The LTV ratio on corporate loans is more favourable than on loans to household, the ratio having fallen last year on both housing loans and other loans to households. The average LTV ratio on newly approved housing loans was 54.7% last year, while the ratio on other loans was 42.3%.

Table 5.12: Average loan-to-value (LTV) ratio for newly approved loans with real estate collateral in percentages

	LTV for real estate collateral	
	2010	2011
Corporate loans	69.9	71.2
Non-housing loans to households	46.0	42.3
Housing loans	57.0	54.7

Note: LTV is the ratio of the loan to the value of pledged collateral expressed in percentages.
Source: Bank survey

The banks approved more loans to corporates with securities collateral per unit of collateral, but required the submission of the other forms of collateral. The amount of loans on which the LTV ratio exceeded internal requirements reached EUR 755.7 million last year, or 7% of all corporate loans (based on a sample of banks that responded to this question). Of the aforementioned loans, the banks requested additional collateral on loans in the amount of EUR 112.8 million, or 1.1% of all corporate loans.

These indicators show that the banks have maintained tighter loan approval criteria or supplemented existing forms of collateral with new forms.

Table 5.13: Average loan-to-value (LTV) ratio for loans with securities collateral

	LTV for securities / mutual funds units collateral, %		Loans whose LTV rose above the internally defined LTV in 2011		Loans for which banks obtained additional collateral in 2011	
	2010	2011	value, EUR million	proportion of all corporate loans, %	value, EUR million	proportion of all corporate loans, %
Corporate loans	88.8	102.2	755.7	7.0	112.8	1.1
Non-housing loans to households	65.5	66.4	5.9	0.2	2.0	0.1
Housing loans	93.3	82.2	2.5	0.1	0.0	0.0

Note: LTV is the ratio of the loan to the value of pledged collateral expressed in percentages.
Source: Bank survey

5.7.2 Arrears in loan repayment

The deterioration in the quality of the banking system's credit portfolio continued in 2011 and in early 2012. The weak economic recovery, which lasted until the second half of last year, was unable to halt the aforementioned trend. The underestimation of credit risks in the period of high lending growth also contributed to the trend.

Table 5.14: Breakdown of classified claims by client segment in terms of number of days in arrears in the settlement of liabilities to banks in EUR million and in percentages

	Classified claims			Proportion of claims in arrears for group of clients					
				all arrears			arrears of more than 90 days		
	Dec. 2010	Dec. 2011	Feb. 2012	Dec. 2010	Dec. 2011	Feb. 2012	Dec. 2010	Dec. 2011	Feb. 2012
Total, EUR million	49,766	49,467	49,645	6,822	9,462	9,245	3,688	5,547	5,989
						%			
Corporates	49.8	49.1	48.9	21.3	28.8	30.0	12.3	18.5	19.7
OFIs	4.8	4.4	4.3	19.2	25.3	29.4	6.9	18.9	21.7
Households[1]	20.3	20.7	20.5	9.8	10.2	-	4.0	4.5	-
sole traders	2.0	2.1	2.0	21.1	21.7	25.9	12.8	14.1	14.9
other households[1]	18.3	18.6	18.5	8.6	8.9	-	3.1	3.5	-
Non-residents	12.8	11.4	11.7	12.6	15.5	17.0	5.2	8.7	9.5
Government	4.0	5.7	6.3	1.4	28.6	2.1	0.1	0.8	0.7
Banks and savings banks	7.6	7.5	7.4	1.4	0.2	0.8	0.2	0.1	0.4
Central bank	0.6	0.8	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.1	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	13.6	19.1	18.6	7.4	11.2	12.1

Note: [1] The figures for 2010 and 2011 for households are estimated on the basis of figures from the bank survey. The assessment is also taken into account in the aggregate of households.
Sources: The Bank of Slovenia, bank survey

Non-performing claims accounted for 11.2% of classified claims at the end of 2011, and for 18.5% at non-financial corporations.

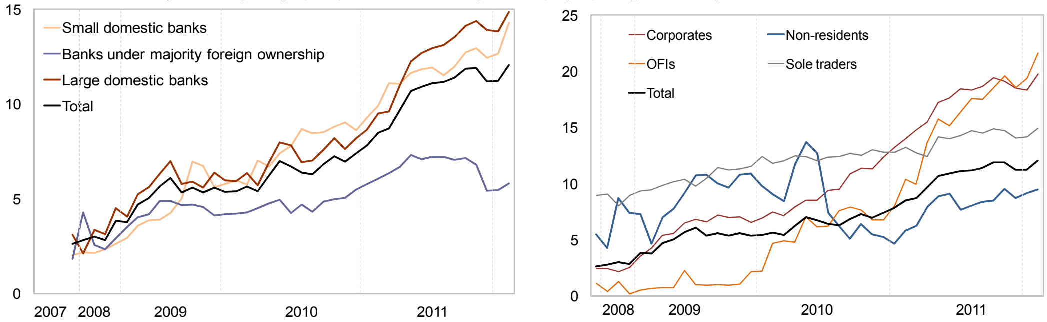
The proportion of non-performing bank claims, defined as claims more than 90 days in arrears, rose last year by 3.8 percentage points to stand at 11.2% at the end of the year. Because non-financial corporations account for nearly 50% of the banking system's classified claims, arrears in this portion of the portfolio have a decisive impact on the quality of the banking system's overall portfolio. The rise in non-performing claims against non-financial corporations has slowed slightly since the second half of last year. Arrears of more than 90 days in this sector had risen to 18.5% by the end of the last year and to 19.7% by February of this year.

There was a notably rapid deterioration last year in the portion of the banking system's credit portfolio accounted for by non-monetary financial institutions. Non-performing claims against this client segment nearly tripled last year, primarily as a result of major financial holding companies. The deterioration in this portion of the portfolio has continued this year, with no signs of slowing.

The arrears of sole traders are growing at a slower pace than the arrears of corporates.

The quality of the banking system's portfolio is more stable in the sector of small businesses (sole traders) which, with the highest proportion of arrears at the outset of the economic crisis (at 9%), represents the greatest credit risk for the banking sector. The proportion of non-performing claims against sole traders increased gradually until the end of last year, to stand at 14.1%. The increase in arrears in this sector slowed during the period of economic growth in 2010 and the first half of 2011, which indicates the greater level of responsiveness of this portion of the portfolio to the economic situation. Because there is generally a high correlation between the survival of sole traders and small enterprises and the success of their operations, this portion of the banks' portfolios is rid most rapidly of non-performing loans, and is less burdened by corporates in insolvency proceedings than is the case for larger corporates. At the same time, the recovery in this segment of the economy, which is the largest in terms of the number of enterprises and the weakest economically, is highly dependent on the financial situation of larger corporates and the pace of their recovery.

Figure 5.33: Arrears of more than 90 days as a proportion of banks' classified claims by bank group (left) and client segment (right) in percentages

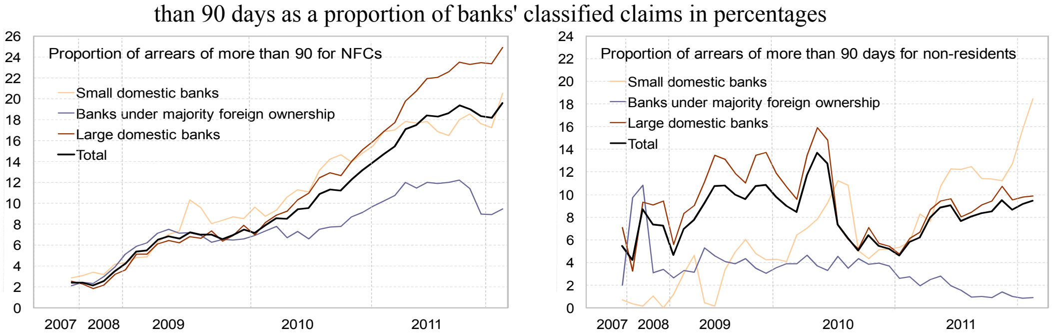


Source: Bank of Slovenia

The quality of the portfolio accounted for by non-residents deteriorated at the banks under majority domestic ownership.

Claims against non-residents more than 90 days in arrears were also up last year, but only at the banks under majority domestic ownership. Around two thirds of loans to the sector of non-residents are accounted for by foreign non-financial organisations at the domestic banks. Arrears of more than 90 days at the large domestic banks have risen from just over 5% at the end of 2010 to 9.9% in February this year, and to 18.5% at the small domestic banks. By contrast, the banks under majority foreign ownership stand out for their small proportion of non-performing claims against non-residents, owing to the different structure of non-residents in the portfolios of these banks, where the majority are investments in parent banks in the rest of the world.

Figure 5.34: Non-financial corporations' (left) and non-residents' (right) arrears of more than 90 days as a proportion of banks' classified claims in percentages

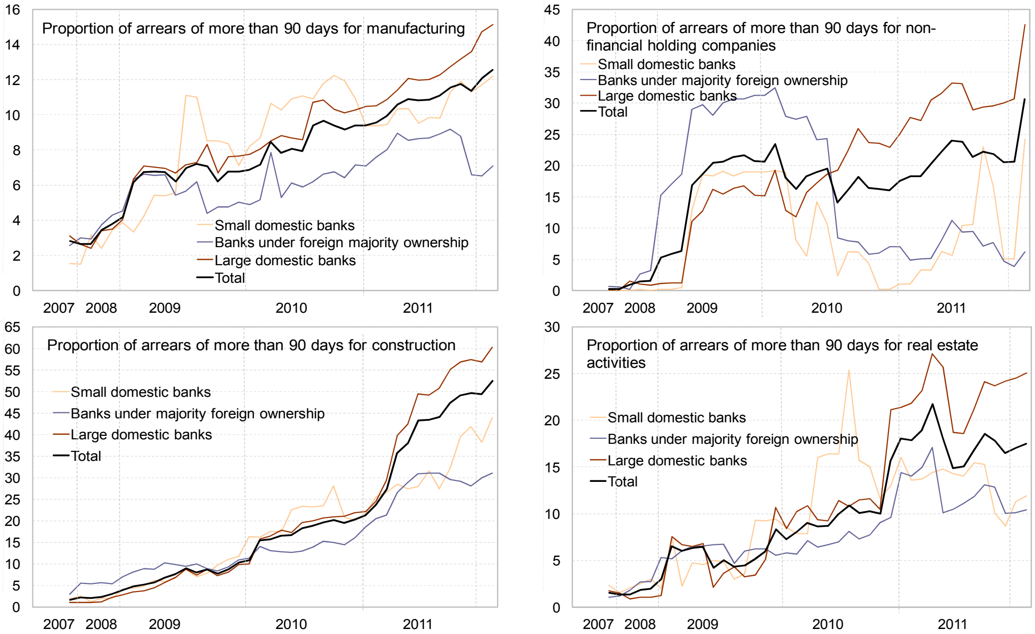


Source: Bank of Slovenia

The deterioration in the quality of the portfolio at the large domestic banks accelerated last year.

The quality of the portfolio deteriorated most rapidly at the large domestic banks last year. Arrears of more than 90 days as a proportion of total classified claims reached 13.9% by the end of the year in the aforementioned bank group, the highest among all bank groups. Contributing in particular to the deterioration in the portfolio of the large domestic banks was the deteriorating quality of the portfolio of non-financial corporations, where the proportion of arrears of more than 90 days reached 23.5% at the end of the year, significantly higher than the other two bank groups.

Figure 5.35: Arrears of more than 90 days as a proportion of banks' classified claims in selected segments of non-financial corporations in percentages



Source: Bank of Slovenia

The banking system's portfolio of non-financial corporations is deteriorating, particularly at the large domestic banks.

Contributing to the deterioration in the quality of the banks' portfolio of non-financial corporations is the weakening financial position of specific clients on the one hand and the growing proportion of such client in the breakdown of the banks' investments on the other. Due to their diminished appetite to take up risk and the need to reduce financial leverage, the banks find it increasingly difficult to approve loans to good clients when their previous loans have been repaid, while they extend or restructure loans to bad clients who are unable to repay those loans. The average quality of the banks' portfolio thus deteriorates, which is particularly true for the large domestic banks, where the concentration of high value loans to insolvent corporates is highest. Financial leverage at the banks is reduced primarily through net loan repayments by good clients.

The proportion of non-performing claims against the construction sector reached 52.4% in February 2012.

Claims against corporates from the construction sector more than 90 days in arrears accounted for one half of the portfolio against the aforementioned sector, that proportion having risen to 52.4% February this year. The proportion of non-performing claims against the construction sector stood at 60.2% at the large domestic banks. Exposure to the most problematic sectors has risen, particularly at the banks under majority domestic ownership, due to the tighter credit standards applied by banks, which limit lending to new clients, while clients in default remain a part of the banks' portfolio. Thus the proportion of the large domestic banks' classified claims against non-financial corporations accounted for by the construction sector stood at 16.7% at the end of last year, up 2.4 percentage points on the end of 2009. The structure of the portfolio of non-financial corporations deteriorated at a somewhat slower pace at the other bank groups: the small domestic banks recorded a two-year increase in the proportion accounted for by the construction sector of 0.5 percentage points, while the banks under majority foreign ownership recorded an increase of 0.7 percentage points over the same period.

The differences between bank groups in terms of the quality of claims against non-financial corporations are widening.

In addition to the construction sector, the large domestic banks also stand out in terms of the poor quality of the portfolio with regard to manufacturing, financial intermediation (the impact of holding companies), real estate activities, and information and communication activities. The small domestic banks have a notably poorer portfolio than the other bank groups with regard to accommodation and food service activities, and transportation and storage. However, exposure to the aforementioned activities is low, as together they account for 4% of the portfolio of non-financial corporations. The portfolio of the banks under majority foreign ownership bears the least risk in terms of the proportion of arrears of more than 90 days in all sectors of non-financial corporations. The deterioration in the quality of the portfolio in certain sectors was followed by a relatively rapid improvement in this bank group, indicating that they are more efficient in dealing with non-performing claims. Having recorded an increase of 0.3 percentage points to stand at 9.0% of classified claims at the end of 2011, the proportion of and growth in non-performing claims against non-financial corporations were notably lower at the banks under majority foreign ownership than in the other bank groups.

Table 5.15: Breakdown of banks' classified claims against non-financial corporations and the proportion of liabilities to banks settled more than 90 days in arrears by bank group and by sector at the end of 2011 in percentages

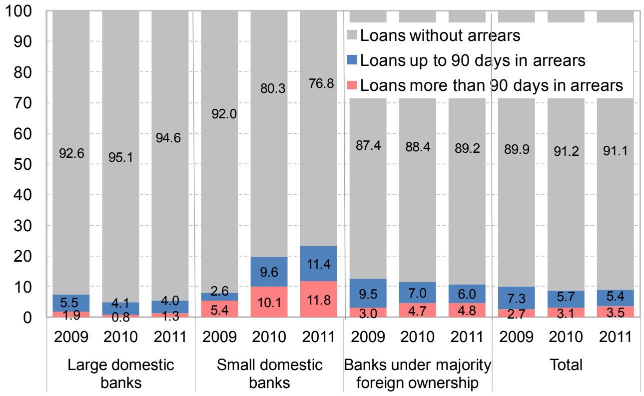
	Breakdown of classified claims against non-financial corporations, %				Proportion of claims against sector more than 90 days in arrears			
	Banking sector	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Banking sector	Large domestic banks	Small domestic banks	Banks under majority foreign ownership
Agriculture, forestry, fishing, mining, quarrying	1.2	1.1	1.5	1.4	9.4	8.0	12.7	10.2
Manufacturing	25.9	27.2	24.6	23.8	11.4	13.6	11.3	6.6
Electricity, gas, water; remediation services	4.4	4.0	3.3	5.6	2.2	3.0	3.2	0.9
Construction	14.4	16.7	14.9	9.9	49.6	57.4	41.8	28.1
Wholesale and retail trade	18.3	16.5	21.5	20.9	11.8	15.0	12.9	6.6
Transportation and storage	9.2	9.3	1.9	11.0	11.3	15.8	39.9	2.6
Accommodation and food service activities	2.8	3.0	2.1	2.7	14.4	14.7	38.0	9.0
Information and communication activities	2.4	2.5	1.4	2.5	25.5	37.1	18.5	4.1
Financial and insurance activities	6.3	6.6	8.5	5.2	20.7	30.1	5.0	4.7
Real estate activities	4.8	3.7	5.3	6.6	17.4	24.2	8.7	10.0
Professional, scientific and technical activities	8.3	7.5	13.5	8.4	20.2	22.7	20.2	16.3
Public services	1.9	1.8	1.6	2.1	5.1	3.3	7.6	7.3
Total	100.0	100.0	100.0	100.0	18.5	23.5	17.6	9.0
Total, EUR million	24,203	14,640	2,056	7,508	4,479	3,436	362	681

Note: The figures do not include savings banks.
Source: Bank of Slovenia

Non-performing claims against households were up slightly, particularly at the small domestic banks.

Households represent one of the banks' least risky client segments, although non-performing claims as a proportion of the banking system's investments have also risen slightly in this segment. The proportion of households' claims settled more than 90 days in arrears stood at 3.5% at the end of last year, a year-on-year increase of 0.4 percentage points. There are major differences between the bank groups in this part of the portfolio[22]. The proportion of claims more than 90 days in arrears was 11.8% at the small domestic banks at the end of last year, but significantly lower at the large domestic banks, at 1.3%. At the banks under majority foreign ownership, where the proportion of classified claims accounted for by households rose to 29% last year, non-performing claims in the amount of 4.8% represent a higher burden than at the other bank groups in relative terms. A further deterioration in this portion of the portfolio can be expected in the context of a renewed deterioration in the economic situation, rising unemployment and, in particular, in the light of the government's planned measures to reduce social security expenditure.

Figure 5.36: Breakdown of claims against households more than 90 days in arrears by bank group in percentages



Sources: Bank of Slovenia, bank survey

Claims against corporates in bankruptcy account for 7% of classified claims against non-financial companies.

Claims against corporates in bankruptcy, for which the likelihood of repayment is very low, have an adverse impact on the quality of the banks' portfolios. Due to the length of associated proceedings, these claims remain in the banks' portfolios for several years following the initiation of the bankruptcy proceedings. The stock of claims against non-financial corporations in bankruptcy increased from EUR 89 million at the end of 2008 to EUR 1,690 million at the end of 2011, and to 7% of total classified claims against non-financial corporations. One quarter of classified claims against the construction sector at the end of last year related to corporates in bankruptcy. The sector of professional, scientific and technical activities also stands out with 11.2% of claims against this relating to corporate in bankruptcy, while that proportion is below average in the manufacturing sector at 5.9%.

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22 The quality of survey data regarding the arrears of households is not necessarily at the same level as the data for the rest of the portfolio, for which data is reported monthly.

Table 5.16: Banks' classified claims against non-financial companies in bankruptcy in EUR million and as a proportion of total claims against non-financial corporations by sector and in percentages

	Dec. 2008		Dec. 2011	
	Classified claims against corporates in bankruptcy, EUR million	Proportion of total classified claims against sector, %	Classified claims against corporates in bankruptcy, EUR million	Proportion of total classified claims against sector, %
Agriculture, forestry, fishing, mining, quarrying	2	0.8	15	4.5
Manufacturing	38	0.6	360	5.9
Electricity, gas, water; remediation services	2	0.2	0	0.0
Construction	10	0.3	900	25.5
Wholesale and retail trade	20	0.4	83	1.9
Transportation and storage	2	0.1	27	1.1
Accommodation and food service activities	1	0.1	4	0.6
Information and communication activities	3	0.4	24	4.1
Financial and insurance activities	0	0.0	12	0.8
Real estate activities	2	0.1	40	3.7
Professional, scientific and technical activities	9	0.4	225	11.2
Public services	0	0.0	0	0.1
Total	89	0.4	1,690	7.0
No. of proceedings initiated during year	86		681	

Source: Bank of Slovenia

The likelihood of additional major losses exists due to the write-off of claims against corporates in bankruptcy.

The majority of claims against corporates in bankruptcy is concentrated at the large domestic banks, at 82.4%. The burden on the portfolio of non-financial corporations by claims in bankruptcy is also highest in this bank group, at 9.6%. A significant increase in the number of new bankruptcy proceedings in the past three years indicates that claims against corporates in bankruptcy will continue to burden the banks' portfolios for the next several years, if changes are not made in current bankruptcy proceeding practices. Classified claims against corporates against which bankruptcy proceedings were initiated during the last three years amounted to EUR 1,639 million (96% of total claims against corporates in bankruptcy). Impairments averaging less than 50% of the value of the aforementioned claims have been created, without taking into account collateral, which is an important instrument for Slovenian banks in mitigating risks. In the coming years these claims will represent the threat of new losses and the resulting decrease in capital due to the further devaluation of assets pledged as collateral.

Table 5.17: Banks' classified claims against non-financial corporations in bankruptcy and proportion of total claims against non-financial corporations by bank group in EUR million and percentages

	Dec. 2008		Dec. 2011		
	claims against corporates in bankruptcy, EUR million	total classified claims against sector, %	claims against corporates in bankruptcy, EUR million	Breakdown, %	total classified claims against sector, %
Large domestic banks	50	0.4	1,393	82.4	9.6
Small domestic banks	16	0.9	112	6.6	5.4
Banks under majority foreign ownership	22	0.3	185	11.0	2.5
Total	89	0.4	1,690	100.0	7.0

Source: Bank of Slovenia

Box 5.1: Arrears of more than 90 days as a measure of the banks' non-performing claims

According to the valid reporting methodology, arrears include the past-due unpaid liabilities of an individual debtor, when the amounts in arrears exceed EUR 1,000. Here, liabilities in arrears include total classified claims against an individual customer, irrespective of the fact that a delay may have only occurred with respect to one smaller claim. According to the applicable reporting threshold, there are also cases when a larger debtor is classified as a debtor in default to the full extent of its debt at an individual bank due to a minor unpaid liability (e.g. costs or guarantees), although the debtor in question settles its liabilities on a regular basis.

Individual countries have different criteria for defining non-performing claims. A direct comparison of claims is therefore not possible. The thresholds for defining defaults are set according to various criteria: in addition to a threshold in an absolute amount, a relative threshold, which amounts in arrears must reach before reporting begins, is applied in some countries, while other countries apply a combination of relative and absolute thresholds.

With the entry into force of the Regulation on the assessment of credit risk losses in April 2012, daily arrears in the settlement of liabilities are taken into account when the sum of all arrears of an individual debtor exceeds 2% of actual exposure to that debtor or EUR 50,000. According to the same criteria, the banks will also begin to report only the value of those financial assets that are actually in arrears, i.e. separately from other claims that debtors settle on a regular basis.

Even in the context of these modified criteria, it should be noted that the equal treatment of claims more than 90 days in arrears and non-performing claims (i.e. non-performing loans) is not entirely correct, as the value of collateral, which is meant to represent expected cash flow in the event of redemption, is not taken into account. Therefore, the value of a claim in arrears is not entirely non-performing, but only that portion that exceeds the realisable value of collateral.

The revised Bank of Slovenia regulation also allows for the more expedient write-off of claims, even if no legal basis for the conclusion of collection proceedings exists, provided that the banks assess during the aforementioned proceedings that the claims will not be paid. The banks will thus write off unsecured claims against debtors that are more than three years in arrears or in bankruptcy proceedings for more than one year, and claims secured by real estate collateral more than five years in arrears or for which the bank in question did not receive any payment from the redemption of collateral over the same period.

The write-off of claims in bankruptcy according to these criteria could reduce the proportion of arrears of more than 90 days by 0.4 percentage points for the portfolio overall, to 10.8%, and to a greater extent in the portfolio of non-financial corporations, as the majority of claims that can be written off are in this part of the portfolio.

5.7.3 Portfolio diversification

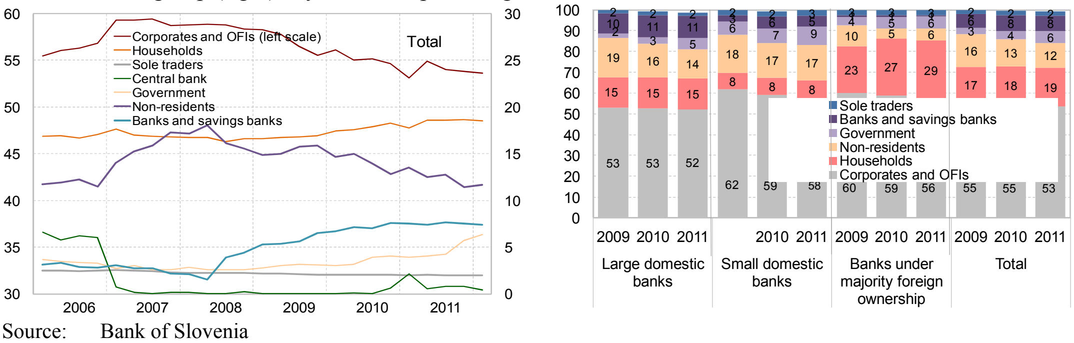
The banks are reducing the proportion of the portfolio accounted for by corporates, most notably the banks under majority foreign ownership.

The banks reduced the proportion of classified claims accounted for by corporates by a further 2 percentage points last year. The most notable reduction in the aforementioned proportion, of 3 percentage points, was achieved by the banks under majority foreign ownership. The latter are also the only banks in the last three years to reduce their claims against the corporate sector and to increase their exposure to households, which are relatively less risky.

The banks' exposure to sole traders is decreasing.

The banks have reduced their exposure to sole traders since the outbreak of the economic crisis, both with regard to the structure and in absolute terms. The fluctuation in this client segment of the banks' portfolios is significant owing to the relatively small size of these clients, a higher frequency of closures and the establishment of new companies (sole traders). Fewer opportunities to provide quality collateral represent another reason that these clients use external sources instead of bank loans. The stock of claims against sole traders has risen only at the small domestic banks in the period since the outbreak of the crisis.

Figure 5.37: Breakdown of classified claims by sector and total (left), and by bank group (right) at year-end in percentages

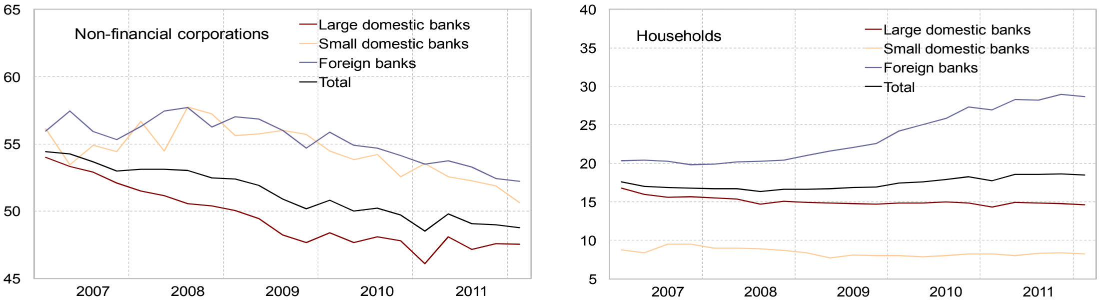


Source: Bank of Slovenia

The proportion of the investments of the banks under majority foreign ownership accounted for by households rose further last year.

The restructuring of the household loan market continued last year, with further growth in the market share of the banks under majority foreign ownership. Claims against households accounted for an average of 29% of the aforementioned banks' portfolios, an increase of 8.6 percentage points since the beginning of the economic crisis, when a more notable restructuring of the banks' portfolios began.

Figure 5.38: Proportion of the banking system's classified claims accounted for by non-financial corporations (left) and households (right) by bank group in percentages



Source: Bank of Slovenia

The proportion of investments accounted for by the government sector, and banks and savings banks has risen in all bank groups over the last three years, an indication of the banks' diminishing appetite for risk, in particular at the banks under majority foreign ownership. The proportion of investments accounted for by the two aforementioned sectors has nearly doubled over three years at the large domestic banks, to 16%, while that proportion has risen by 9 percentage points at the small domestic banks, to 14.1%.

Despite a declining proportion of the portfolio accounted for by non-financial corporations, the quality of the portfolio is worst at the large domestic banks.

Despite a decrease in the proportion of the banking system's portfolio accounted for by non-financial corporations, the quality of the portfolio has continued to deteriorate, as the proportion of clients from higher-risk sectors has risen. The proportion of the banks' classified claims accounted for by corporates from the construction sector has risen by 1.8 percentage points over the last two years, while the proportion accounted for by the manufacturing sector has fallen by 0.6 percentage points, despite the positive economic growth over the same period. The quality of the portfolio of non-financial corporations is worst at the large domestic banks, resulting in the lowest quality of the overall portfolio of all bank groups.

Table 5.18: Loans and banks' classified claims against non-financial corporations by sector at year-end, structure and year-on-year growth, in EUR million and percentages

	Loans to non-financial corporations[1]				Classified claims against non-financial corporations					
	total, EUR million	increase, EUR million	breakdown, %		total, EUR million	breakdown, %	change in breakdown, percentage points		year-on-year growth, %	
	2011	2011	2010	2011	2011	2011	2010	2011	2010	2011
Agriculture, forestry, fishing, mining, quarrying	282	24	1.2	1.4	298	1.2	0.1	0.1	5.9	2.9
Manufacturing	5,405	-299	27.0	26.3	6,298	25.9	-0.2	-0.4	-0.6	-3.6
Electricity, gas, water; remediation activities	717	52	3.1	3.5	1,080	4.4	0.1	0.5	1.7	10.3
Construction	2,571	102	11.7	12.5	3,516	14.4	1.1	0.7	8.8	3.2
Wholesale and retail trade	3,747	-214	18.8	18.3	4,424	18.3	-0.3	-0.5	-1.5	-4.5
Transportation and storage	2,028	-21	9.7	9.9	2,232	9.2	0.2	0.4	2.2	2.0
Accommodation and food service activities	665	-7	3.2	3.2	683	2.8	0.1	-0.1	2.2	-4.7
Information and communication activities	424	-66	2.3	2.1	595	2.4	-0.1	-0.2	-3.0	-10.6
Financial and insurance activities	1,470	-47	7.2	7.2	1,541	6.3	-0.9	-0.2	-12.2	-4.6
Real estate activities	1,122	-7	5.3	5.5	1,100	4.8	-0.1	-0.2	-1.7	-6.6
Professional, scientific and technical activities	1,657	-113	8.4	8.1	2,006	8.3	-0.1	0.0	-1.5	-2.1
Public services	430	-1	2.0	2.1	460	1.9	0.2	0.0	10.2	-4.1
Total	20,517	-598	100.0	100.0	24,233	100.0			0.0	-2.0

Note: [1] Loans are in gross amounts, excluding impairments.
Source: Bank of Slovenia

5.7.4 Credit rating structure of claims

The banks downgraded claims at a faster pace last year than in previous years. The proportion of total classified claims accounted for by the highest rated claims (A and B) stood at 88.7% at the end 2011, down 8.5 percentage points on the end of 2008. The banks downgraded 2.5% of the portfolio to the lowest credit rating categories (D and E), compared with 0.4% in 2009 and 1.4% in 2010). D- and E-rated claims thus accounted for 6.2% of total classified claims. That proportion had risen to 6.4% by February 2012.

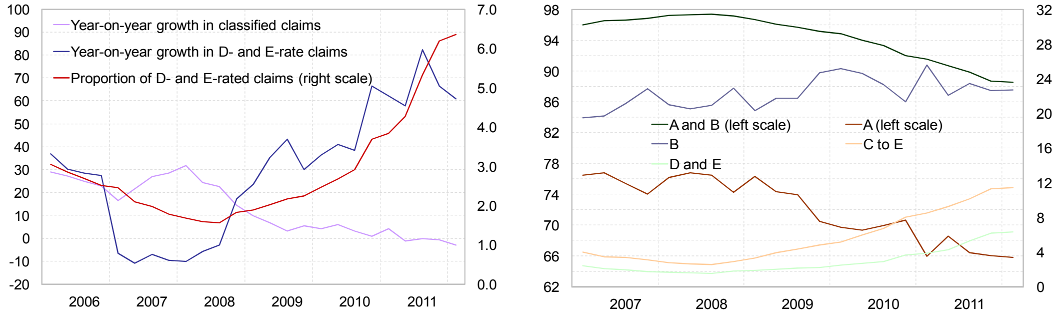
Impairment and provisioning costs have risen at an annual rate of just over 30% during the last two years, and stood at EUR 3.3 billion in February 2012, while the coverage of classified claims by impairments increased to 6.7%.

Table 5.19: Credit rating structure of claims and coverage of claims by impairments and provisions in EUR million and percentages

	31 December 2010			31 December 2011			29 February 2012		
	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %
Total, EUR million	49,766	2,420	4.86	49,467	3,247	6.56	49,645	3,325	6.70
	Breakdown, %			Breakdown, %			Breakdown, %		
A	70.60	5.7	0.4	66.02	3.3	0.3	65.84	3.2	0.3
B	21.35	19.8	4.5	22.67	14.6	4.2	22.70	14.5	4.3
C	4.35	22.4	25.0	5.11	20.9	26.8	5.11	20.3	26.6
D	2.91	35.8	60.0	5.50	50.6	60.4	5.62	51.1	60.9
E	0.79	16.3	100.1	0.70	10.6	100.0	0.74	11.0	100.1

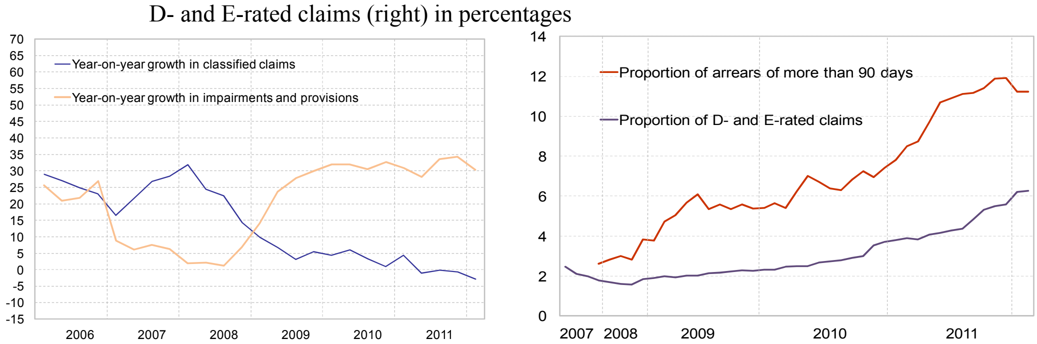
Source: Bank of Slovenia

Figure 5.39: Year-on-year growth in classified claims, and D- and E-rated claims (left) and the breakdown of claims by credit rating (right) in percentages



Source: Bank of Slovenia

Figure 5.40: Comparison of year-on-year growth in classified claims with growth in impairment and provisioning costs (left), and comparison of the proportion of claims more than 90 days in arrears with the proportion of D- and E-rated claims (right) in percentages



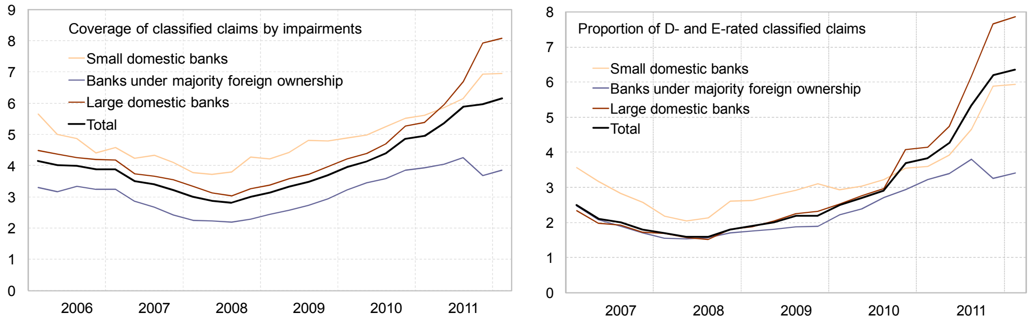
Source: Bank of Slovenia

The quality of the portfolio of the large domestic banks deteriorated the most in 2011.

The pace at which the large domestic banks reclassified claims to the highest-risk credit rating categories accelerated sharply last year. The proportion of D- and E-rated claims was up 3.6 percentage points to 7.7% over a one-year period. Impairments were up accordingly, particularly in the last months of the year, which resulted in the high losses generated by this bank group last year.

The rapid increase in impairment costs is a result of a sharp rise in non-performing claims and the devaluation of assets received as collateral. Some of the reasons for the poor quality of the banks' portfolio lie in past decisions during the period of high lending growth, when the banks were overly optimistic in assessing clients' ability to repay debts. Other reasons lie in the fact that corporates, which were financially sound with a bright outlook during the period of high borrowing, found themselves dragged into financial difficulties owing to complex capital and business ties. The need to create additional impairments and the resulting deterioration in the banks' operating results are driven by a sharp drop in the value of securities and a partial decrease in the value of real estate and other assets pledged by borrowers as loan collateral.

Figure 5.41: Coverage of classified claims by impairments (left) and the proportion of D- and E-rated claims (right) by bank group in percentages



Source: Bank of Slovenia

The small domestic banks sped up their reclassification of claims to the lowest credit rating categories.

The increase in non-performing claims against non-financial corporations also had a significant effect on the small domestic banks last year, the aforementioned banks also speeding up the pace of reclassifications to the lowest credit rating categories. The proportion of D- and E-rated claims was up 2.4 percentage points to 5.9% in this bank group over a one-year period, while the coverage of total claims by impairments reached 6.9%. Further changes in the quality of the portfolio of the small domestic banks depend primarily on to what extent SMEs are affected by future negative developments, as the aforementioned client segment accounts for a higher portion of the portfolio in relative terms than at the other bank groups.

The deterioration in the portfolio of the banks under majority foreign ownership came to a halt last year.

In contrast to domestic banks, the deterioration in the portfolio of the banks under majority foreign ownership came to a halt last year. The improved quality of specific parts of the portfolio and restructuring to less risky investments contributed to lower growth in non-performing claims, the diminished need to downgrade claims and to the decreased need to create additional impairments. The proportion of claims accounted for by D- and E-rated claims was up 0.3 percentage points at the banks under majority foreign ownership to stand at 3.3%, while the coverage by impairments declined by 0.2 percentage points, to 3.7%. The transfer of the non-performing portion of the portfolio from one bank to its parent bank in the rest of the world contributed to the aforementioned decline. However, even excluding that transaction, the increase in the coverage by impairments was low in this bank group, at 0.3 percentage points for all of 2011.

Table 5.20: Coverage of classified claims more than 90 days in arrears and D- and E-rated claims by impairments by client segment, excluding collateral, in percentages

	Coverage of total classified claims by impairments			Coverage of claims more than 90 in arrears by impairments			Coverage of D- and E-rated claims by impairments		
	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2009	Dec. 2010	Dec. 2011	Dec. 2009	Dec. 2010	Dec. 2011
Corporates	4.7	6.5	9.4	36.0	34.5	39.2	71.4	66.4	65.0
OFIs	2.3	5.1	9.6	22.4	36.4	29.0	71.0	48.6	58.4
Households	4.1	4.0	3.6	-	-	-	86.3	79.9	66.6
sole traders	8.3	8.9	8.8	46.6	48.4	43.7	80.8	74.7	74.7
other households	3.6	3.4	3.0	-	-	-	87.9	81.6	64.4
Non-residents	2.7	4.2	6.6	14.0	44.0	32.9	75.8	73.0	66.8
Government	0.2	0.1	0.1	43.0	11.8	3.3	59.4	58.7	87.4
Banks and savings banks	0.2	0.2	0.5	35.7	42.1	12.1	64.1	100.0	97.3
Total coverage	3.7	4.9	6.6	29.1	36.0	37.8	75.9	68.5	64.9
	Total classified claims			Total arrears of more than 90 days			Total D- and E-rated claims		
EUR million	49,257	49,766	49,467	2,651	3,688	5,547	1,106	1,840	3,065
- as % of GDP	139.5	140.5	138.6	7.5	10.4	15.5	3.1	5.2	8.6

Source: Bank of Slovenia

The banks' highest coverage of classified claims by impairments is recorded for claims against non-financial corporations and OFIs.

Having risen 4.5 percentage points on the previous year to stand at 9.6% at the end of 2011, the coverage of classified claims by impairments by individual client segment was highest for claims against OFIs. The increase is a result of the rapid deterioration in this portion of the portfolio last year. At 9.4% and 2.9 percentage points respectively, slightly lower coverage by impairments and lower growth was recorded in claims against non-financial corporations. Impairments in the household sector have decreased in absolute terms since the second quarter of 2010, resulting in a reduction in the coverage of classified claims against households by impairments from 3.6% at the end of 2009 to 3% at the end of 2011.

A total of 37.8% of claims more than 90 days in arrears are covered by impairments, excluding collateral.

Other indicators of the coverage of the portfolio by impairments, which relate exclusively to the non-performing portions of the portfolio, excluding and taking into account collateral, are appropriately higher. The coverage of classified claims more than 90 days in arrears by impairments, excluding collateral, stood at 37.8% at the end of 2011, an increase on previous years. This indicator is the highest for sole traders (43.7%) and non-financial corporations (39.2%), followed by non-residents (32.9%) and OFIs (29.0%), if only higher-risk client segments are noted. Claims more than 90 days in arrears are covered in part by collateral received, for which reasons fewer impairments are created.

The coverage of D- and E-rated claims is 64.9%.

Coverage is higher for D- and E-rated claims, at 64.9%. The level of coverage of these claims has fallen over the last two years as a result of the reclassification of claims from higher credit rating categories to D-rated claims which, in contrast to E-rated claims, have not been fully impaired, and the changing ratio between D- and E-rated claims. The coverage of D- and E-rated claims in higher-risk client segments ranges from 58.4% at OFIs to 74.7% at sole traders.

Table 5.21: Credit rating structure of classified claims against households and coverage of claims by impairments and provisions in percentages

	31 December 2010			31 December 2011			29 February 2012		
	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %
Total, EUR million	9,082	311	3.4	9,237	279	3.0	9,195	288	3.1
	Breakdown, %			Breakdown, %			Breakdown, %		
A	94.0	16.0	0.6	85.2	11.0	0.4	84.8	10.6	0.4
B	1.7	2.5	5.0	10.4	7.3	2.1	10.7	7.6	2.2
C	1.4	12.0	30.4	1.0	9.8	31.0	1.1	10.9	31.0
D	1.5	28.4	64.3	3.2	65.8	62.3	3.2	64.7	63.6
E	1.4	41.1	100.0	0.2	6.1	100.0	0.2	6.2	100.0

Source: Bank of Slovenia

The coverage of claims against the construction sector by impairments rose sharply to stand at 17.4% at the end of 2011.

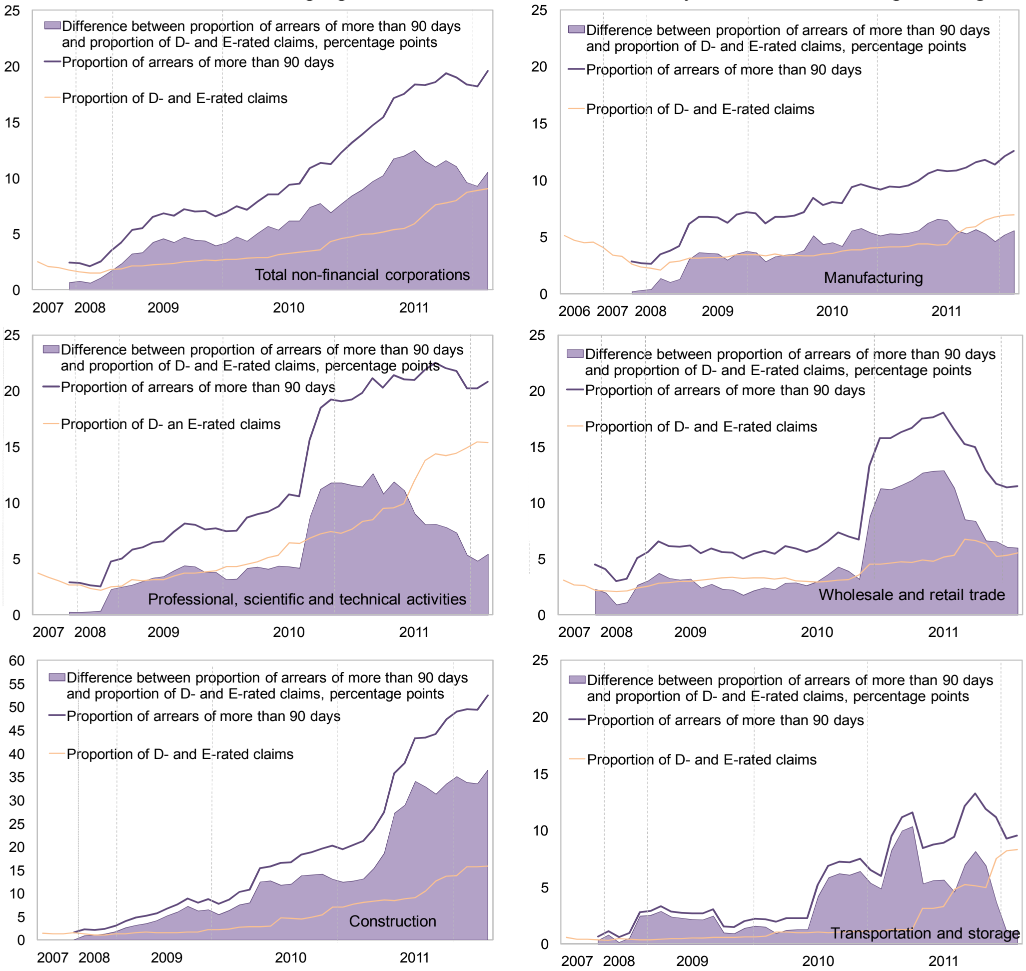
Having doubled from the previous year to 17.4%, the coverage of claims against corporates from the construction sector stands out among non-financial corporations. The proportion of D- and E-rated claims against the construction sector likewise doubled, to 15.7%. Given that non-performing claims against the construction sector account for more than half of that sector's portfolio and that claims against corporates in bankruptcy account for one quarter of the portfolio, the probability that additional impairments will be created in the context of falling real estate prices is high. This is particularly true given the difference between the value of collateral in the portfolio and the actual market value, which would be seen when the collateral is redeemed.

Table 5.22: Coverage of classified claims by impairments, and D- and E-rated against non-financial corporations by sector

	Impairments of classified claims, EUR million		Coverage of classified claims by impairments, %		Classified claims rated D and E: value, EUR million	Classified claims rated D and E: as % of total classified claims	
	2010	2011	2010	2011		2010	2011
Agriculture, forestry, fishing, mining, quarrying	22	21	6.5	6.9	15	4.5	4.9
Manufacturing	371	456	5.8	7.2	427	4.1	6.8
Electricity, gas, water; remediation activities	14	17	1.4	1.6	8	0.5	0.8
Constructions	297	613	8.6	17.4	554	7.0	15.7
Wholesale and retail trade	315	329	6.8	7.4	233	4.5	5.3
Transportation and storage	72	139	3.1	6.2	170	1.0	7.6
Accommodation and food service activities	31	45	4.5	6.5	39	2.9	5.7
Information and communication activities	51	71	7.7	11.9	27	2.1	4.5
Financial and insurance activities	169	211	11.2	13.7	277	10.5	18.0
Real estate activities	68	90	5.8	8.2	81	3.8	7.4
Professional, scientific and technical activities	205	264	9.8	13.2	304	7.2	15.1
Public services	15	17	3.3	3.7	8	1.5	1.6
Total	1,629	2,271	6.6	9.4	2,142	4.7	8.8

Source: Bank of Slovenia

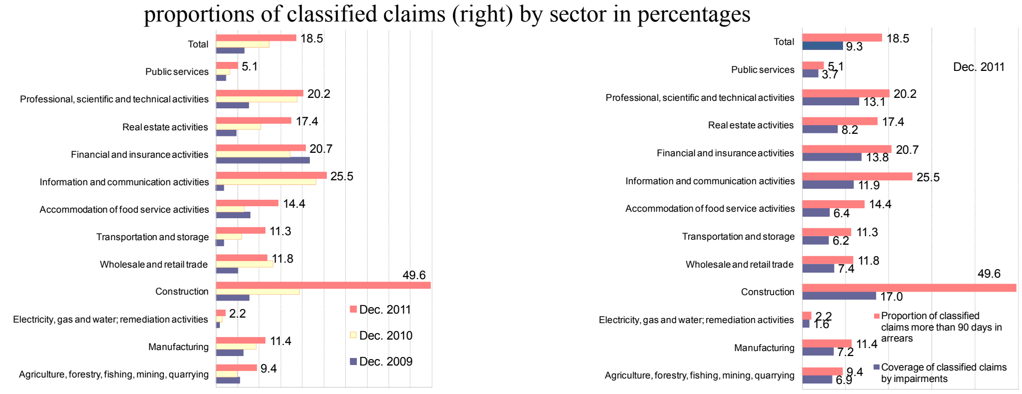
Figure 5.42: Comparison of arrears of more than 90 days with D- and E-rated claims as a proportion of banks' classified claims by individual sector in percentages



Source: Bank of Slovenia

An increase in the downgrading of claims is also seen in other sectors. The proportion of D- and E-rated claims in the sector of professional, scientific and technical activities had doubled by the end of 2011 in the context of slowing growth in arrears of more than 90 days over the last three quarters. The proportion accounted for by the highest-risk categories rose from 1% to 7.6% in the transportation and storage sector in the context of a decline in the proportion of longer arrears in recent months. Arrears of more than 90 days have fallen sharply in the last six months in the sector of wholesale and retail trade, while the process of downgrading continues. Thus, the value of the portfolio is increasingly closer to the actual quality of claims.

Figure 5.43: Claims more than 90 days in arrears as a proportion of banks' classified claims against non-financial corporations (left) and comparison of claims more than 90 days in arrears with impairment and provisions as proportions of classified claims (right) by sector in percentages



Source: Bank of Slovenia

Box 5.2: Analysis of the credit risk associated with non-financial corporations, and assessment of the probability of default, impairment costs and the coverage of classified claims by impairments for 2012 and 2013 based on a sample of clients

The quality of the credit portfolio deteriorated in 2011. The proportion of bad clients and the probability of default both rose, indicating a rise in new clients in default. The first section presents an analysis of the credit risk associated with non-financial corporations, as the main source of deterioration in the credit portfolio, through the use of various indicators that are based on clients' credit ratings and their arrears in the repayment of loans. This is followed by estimates of the probability of default by non-financial corporations, impairment costs and the coverage of classified claims by impairments in 2012 and 2013.

Analysis of the credit risk associated with non-financial corporations on the basis of the credit ratings and arrears in the repayment of loans

This analysis includes non-financial corporations that were indebted to at least one Slovenian bank in the period from 2000 to 2011 and are not in bankruptcy proceedings. The credit ratings of non-financial corporations and their arrears in the repayment of loans are used as measures of credit risk. All data in the tables and figures refer to the number of clients and not to classified claims against these clients.

The credit rating structure deteriorated significantly in 2011. The proportion of lowest-risk customers with a credit rating of A and B decreased by 3.8 percentage points, while the proportion of bad clients with a credit rating of D and E increased by 3 percentage points to 10.1%. The deterioration in the credit rating structure was more significant in 2011 than in 2009, when real GDP fell by 8%.

Table 5.23: Credit rating structure of non-financial corporations in percentages

	2007	2008	2009	2010	2011
A	57.35	57.93	53.65	51.44	45.56
B	32.72	31.68	32.97	33.94	36.06
C	5.23	6.06	7.52	7.50	8.30
D	3.40	3.15	4.36	4.64	5.32
E	1.30	1.18	1.50	2.48	4.77

Source: Bank of Slovenia

The proportion of non-financial corporations that repay loans in arrears rose by 8.4 percentage points between 2007 and 2011, while the proportion of those who repay loans more than 90 days in arrears rose by 5.7 percentage points. Arrears in the repayment of loans also indicate that the credit portfolio deteriorated most in 2011, when the proportion of corporates more than 90 days in arrears rose by 2.7 percentage points to 9.2%.

Table 5.24: Breakdown of non-financial corporations' arrears in the repayment of loans in percentages

	2007	2008	2009	2010	2011
No delay	93.14	90.88	89.35	88.11	84.72
1 to 90 days	3.42	4.99	5.05	5.41	6.12
More than 90 days	3.44	4.13	5.61	6.47	9.16

Source: Bank of Slovenia

The reasons for the deterioration in the credit portfolio lie on both the side of the non-financial sector and banks, and in the institutional structure:

(1) The economy slipped back into recession in 2011 following the modest recovery in 2010. Current forecasts indicate that the recession will continue in 2012 and deepen somewhat. Such conditions severely hamper corporate operations, which is also seen in the number of bankruptcy proceedings initiated, which at 675 in 2011 were double the number recorded in 2009.
(2) Strong business and ownership ties between corporates lead to the rapid transmission of the effects of insolvency between corporates and reduce their creditworthiness.
(3) Due to the weak economic situation, there is no growth in new loans that would improve the quality of the credit portfolio. The banks do not differentiate enough between good and bad clients in terms of interest rates. Good clients are therefore seeking sources of financing in the rest of the world.
(4) The banks' increased risk take-up during a period of high economic growth leads to a further deterioration in their portfolio in the context of deteriorating economic conditions, as many of these highly indebted clients are unable to repay loans.
(5) The pro-cyclical behaviour of the banks, which are more pessimistic in their assessment of clients in poor economic conditions, also affects the downgrading of clients. The increase in the proportion of bad clients on the basis of arrears, which are independent of how the banks assess credit risk, indicates that the main source of the deterioration in the credit portfolio are difficulties in the real sector, and not the changing attitude of the banks to the risks associated with clients.
(6) Relatively few write-offs are made owing to protracted claim collection proceedings against insolvent debtors. Claims against corporates thus remain a part of classified claims for an extended period, thereby increasing the stock of non-performing claims.

Table 5.25: Credit rating structure for the same non-financial corporations at an individual bank in percentages

	2007	2008	2009	2010	2011
A	62.05	61.40	56.12	52.74	44.90
B	31.62	30.60	31.96	32.12	34.62
C	3.77	5.17	7.13	7.88	9.00
D	1.99	2.20	3.82	4.69	5.92
E	0.57	0.62	0.98	2.56	5.56

Source: Bank of Slovenia

The credit ratings of clients who had a lending arrangement with the same bank from 2007 to 2011 have deteriorated over time, most notably in 2011. The proportion of A- and B-rated clients declined by 14.2 percentage points over the same five-year period, while the proportion of D- and E-rated clients rose by 8.9 percentage points. The deterioration in credit ratings is to be expected, as several factors may arise over the long term that increase the likelihood that the risk associated with a particular client will be realised. The decline in the proportion of A-rated clients by 7.8 percentage points in 2011 indicates a possible new wave of deterioration in the credit portfolio and the associated increase in the proportion of bad clients in the coming years. This is also illustrated by a transition matrix, from which it is evident that the credit ratings of 21.3% of A-rated clients in 2010 deteriorated in 2011.

Table 5.26: Probability of transitions between credit ratings in percentages

Average transition matrix 2001-2008

		current year				
		A	B	C	D	E
previous year	A	90.76	7.07	1.33	0.60	0.24
	B	9.47	80.48	6.02	3.70	0.33
	C	4.04	11.53	72.05	10.28	2.09
	D	2.45	3.85	4.21	81.11	8.38
	E	1.93	1.26	0.97	2.13	93.72

Transition matrix 2009

		2009				
		A	B	C	D	E
2008	A	87.09	9.41	2.16	0.97	0.37
	B	3.83	81.90	9.32	4.53	0.42
	C	1.13	9.90	71.07	15.70	2.19
	D	0.46	4.58	5.80	79.24	9.92
	E	0.00	0.54	0.42	1.68	97.06

Transition matrix 2010

		2010				
		A	B	C	D	E
2009	A	87.60	9.19	1.91	0.85	0.45
	B	7.28	81.16	6.92	4.17	0.47
	C	1.77	14.11	63.79	15.13	5.20
	D	0.52	2.80	6.74	62.45	27.49
	E	0.81	0.00	0.40	2.42	96.37

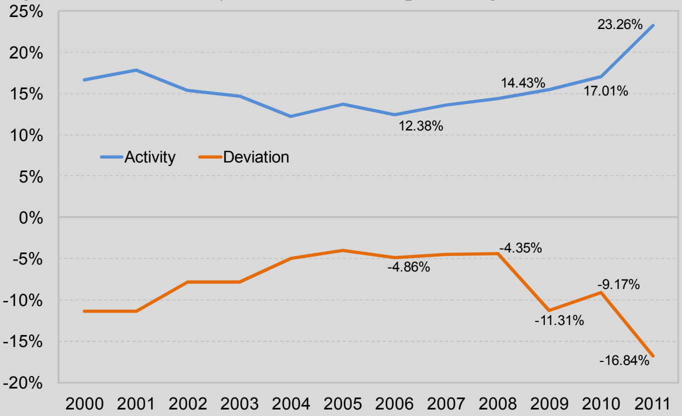
Transition matrix 2011

		2011				
		A	B	C	D	E
2010	A	78.66	17.26	2.24	1.19	0.65
	B	6.56	77.91	8.58	5.03	1.92
	C	1.18	7.35	62.67	17.05	11.76
	D	0.17	1.56	5.55	56.72	35.99
	E	0.16	0.65	1.14	0.82	97.23

Source: Bank of Slovenia

There was a significant increase in activity[3] and deviation[4] in 2011. The significant increase in the proportion of transitions to lower credit ratings indicates that the banks are still aware of the deteriorating conditions. Following a slight improvement in 2010, deviation deteriorated significantly again in 2011. This means that in 2011 the credit rating deteriorated for a greater number of corporates or improved for a smaller number of corporates compared with 2010.

Figure 5.44: Activity and deviation[4] in percentages



Source: Bank of Slovenia

The default rate rose in the period from 2008 to 2011 on the basis of both credit ratings and arrears in the repayment of loans. This means that the banks are downgrading an increasing number of clients to D and E ratings, or that an increasing number of clients have begun to repay loans more than 90 days in arrears owing to difficult operating conditions. The default rate also indicates that the credit portfolio deteriorated most significantly in 2011.

Table 5.27: Default rates on the basis of credit ratings and corporate arrears in the repayment of liabilities in percentages

	2008	2009	2010	2011
A, B, C ratings → D, E ratings[1]	1.92	3.47	3.90	5.79
Arrears of less than 90 days → arrears of more than 90 days[2]	2.76	3.93	3.98	5.37

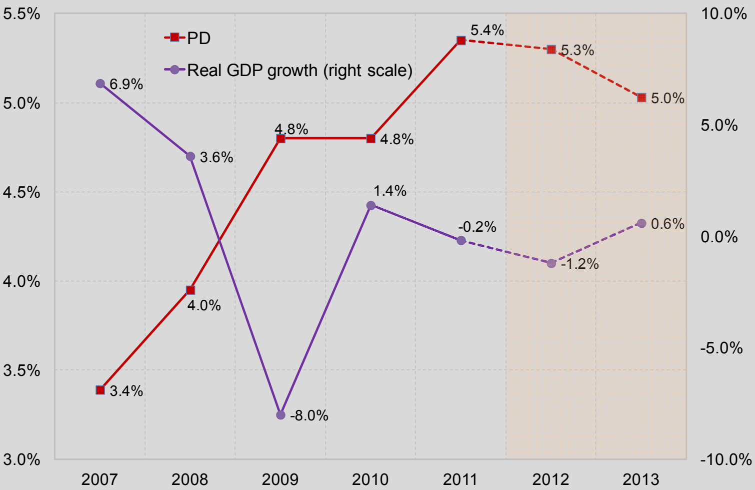
Note: Includes every client-bank relationship.
[1] Proportion of clients who migrated from A, B or C credit ratings to D or E ratings.
[2] Proportion of clients who had arrears of less than 90 days in the previous year and arrears of more than 90 days in the current year.
Source: Bank of Slovenia

Assessment of the probability of default by non-financial corporations for 2012 and 2013

The estimate of probability of default[5] (PD) is based on client arrears in the repayment of loans. A business entity is in default if it is more than 90 days in arrears at any bank during a specific year. This includes non-financial corporations that were indebted to at least one Slovenian bank between 2007 and 2010 and that reported balance sheet and income statement data.

Following a significant increase in PD during 2011 and according to estimates, PD is expected to remain at a similar level in 2012, when the economy is forecast to contract by 1.2% according to Bank of Slovenia[6] projections. According to estimates, PD will fall to 5% in 2013, when a gradual economic recovery, and thus credit growth, are expected. This is still, however, above the level recorded in 2009 and 2010.

Figure 5.45: Probability of default and real GDP growth in percentages



Sources: Bank of Slovenia, own estimates

PD measures the flow of clients to default status over a one-year period. Despite the slight improvement in PD expected in 2012, when GDP is forecast to contract by 1.2%, the proportion of clients with arrears of more than 90 days will continue to rise as a result of the slow strengthening of lending growth. PD will remain high over the next two years, higher even than in 2009, when GDP fell by 8%. Changes in economic growth and PD are disproportionate. In 2009, when economic growth fell by 11.6 percentage points, PD was up 0.8 percentage points in year-on-year terms, while the decline in growth of just 1.6 percentage points in 2011 resulted in an increase in PD of 0.6 percentage points. This shows that the deteriorating economic situation in 2011 was not the main factor behind the rise in PD, which was, to a greater extent, the result of specific factors (primarily high corporate indebtedness) that hinder corporate operations.

Estimated impairment costs and coverage of classified claims by impairments in 2012 and 2013

Similar to the proportion of bad clients, there was also a significant increase in impairment costs from credit risk and the coverage of classified claims by impairments in 2011. Impairment costs are estimated at the aggregate [7]level and at the individual bank level by multiplying PD, loss given default (LGD) and exposure at default (EAD), so that expected loss equals EL = PD * LGD * EAD,[8] for a specific portion of the portfolio of exposures by sector. A major difference between the two approaches is that the assessment at the aggregate level takes into account expected credit growth in 2012 and 2013, while the second approach is carried out on the basis of a static balance sheet.

According to both estimates, impairment costs will decline gradually over the next two years. The assessment for 2012 is more pessimistic using the approach of EL = PD * LGD * EAD, in which a slight increase in LGD is taken into account. Because LGD in 2013 is expected to remain at the 2012 level in the context of a gradual economic recovery, the banks will be forced to create additional impairments only for those clients that enter default. Consequently, impairment costs will decline by EUR 213 million in 2013 to EUR 639 million, the level recorded in 2010.

Table 5.28: Impairment costs in EUR million and coverage of classified claims by impairments in percentages

	2007	2008	2009	2010	2011	2012	2013
Impairment costs, EUR million - aggregate equation	132	168	434	639	932	784	743
Impairment costs, EUR million - EL = PD * LGD * EAD	132	168	434	639	932	852	639
Coverage of classified claims by impairments, %[1]	3.2	3.0	3.7	4.8	6.5	8.0	9.2

Note: EL – expected loss; PD – probability of default; LGD – loss given default; and EAD – exposure at default.
[1] Includes estimated impairment costs using the equation EL = PD * LGD * EAD.
Sources: Bank of Slovenia, own estimates

Despite the gradual decrease in impairment costs in 2012 and 2013, the coverage of classified claims by impairments is still expected to rise, but at a slower pace. The balance of impairments will continue to rise rapidly owing to the still-high impairment costs and the expected low level of write-offs in the context of protracted insolvency proceedings. At the same time, only a gradual strengthening in lending growth can be expected, meaning the ratio of impairment to classified claims will increase.

[3] Activity illustrates the proportion of corporates whose credit ratings changed.
[4] Deviation is calculated as the number of clients whose credit ratings improved less the number of clients whose credit ratings deteriorated, relative to the number of clients who have a credit arrangement with the same bank in the current and previous year.
[5] The dependent variable is binary and equal to 1, if a corporate is more than 90 days in arrears in the repayment of its liabilities to at least one bank in the period "t", and settled its liabilities to all banks less than 90 days in arrears in the period "t -1". Various corporate indicators (micro variables) and selected macroeconomic variables are taken into account as explanatory variables. The output of the model, which is assessed using a random effects probit model, is the probability of default for every client in every year. Aggregate PD is calculated as the average PD of all clients in a specific year, in line with Basel recommendations. Estimates of PD for 2012 and 2013 are based on projections of the macroeconomic variables included in the model.
[6] Price Stability Report, April 2012
[7] Quarterly impairment costs associated with loans to the non-banking sector are explained by delays in industrial production, loans to the non-banking sector, the 6-month EURIBOR, inflation and the default rate, forecasts of which are derived from PD estimates.
[8] The assessment entails the aggregate of calculations at the individual bank level for four sectors: corporates, households, financial institutions and the government. A customer is in default if it is more than 90 days in arrears in the repayment of its liabilities or if it has a credit rating of D or E. PD for an individual bank by sector is based on the percentage change in the estimated PD of non-financial corporations. PD thus declines by 0.8% in 2012 and by 5.3% in 2013. LGD is assumed to increase by the same amount in 2012 as it did in 2011, i.e. by 2.1 percentage points, and remain at this level in 2013. The calculation is performed separately for clients that were in default during the previous year, and separately for clients that are only affected by a change in LGD.

5.7.5 Loan collateral

Breakdown of collateral for newly approved loans

The proportion of newly approved unsecured loans was up slightly in 2011.

According to bank survey data, loan collateral criteria were loosened slightly last year, as the proportion of unsecured new loans was up 4.2 percentage points to slightly more than one-quarter. This is the first increase since 2008, when the proportion of unsecured loans stood at around 47%. The proportion of all loans accounted for by unsecured loans was up 3.4 percentage points owing to the higher proportion of newly approved unsecured loans. A decrease in the fair value of collateral also contributed to the increase in the proportion of unsecured loans. The proportion of unsecured loans was up in 2011 due to the banks' increased focus on the tightening of price-related lending conditions. However, the banks also reported in the last quarter that they had tightened collateral requirements. In 2010 the banks focused more on tightening collateral requirements and to a lesser degree on tightening price-related lending conditions.

Table 5.29: Breakdown of corporate loans by type of collateral in percentages

(%)	Stock of loans		New loans	
	Dec. 2010	Dec. 2011	2010	2011
Type of collateral				
Secured loans	81.8	78.4	78.9	74.7
real estate collateral	41.0	41.7	26.5	28.6
at insurer	0.7	0.7	0.1	0.4
securities and mutual funds units as collateral	7.8	7.3	9.5	7.0
other forms of collateral	32.3	28.7	42.6	38.7
Unsecured loans	18.2	21.6	21.1	25.3

Source: Bank survey

Banks were more cautious in previous years when approving housing loans, and approved only a small portion of loans without collateral. The proportion of newly approved unsecured housing loans was merely 4.4% in 2011, the lowest level in the last four years. The proportion of newly approved loans with real estate collateral has risen primarily due to a decrease in other forms of collateral.

Table 5.30: Breakdown of collateral on housing loans in percentages

(%)	Stock of loans		New loans	
	Dec. 2010	Dec. 2011	2010	2011
Type of collateral				
Secured loans	92.2	94.6	93.6	95.6
real estate collateral	69.7	73.9	68.1	73.7
at insurer	11.6	11.6	12.4	11.7
securities and mutual funds units as collateral	0.1	0.1	0.2	0.3
other forms of collateral	10.8	8.9	13.0	10.0
Unsecured loans	7.8	5.4	6.4	4.4

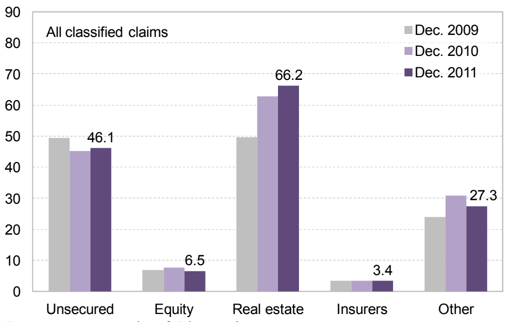
Source: Bank survey

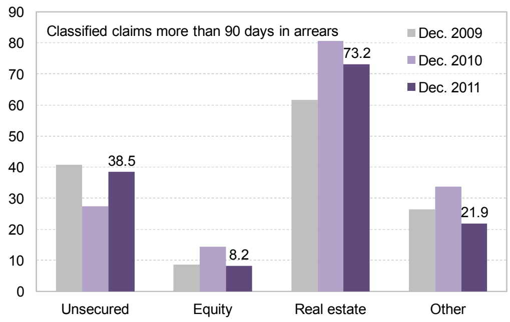
Coverage of the credit portfolio by collateral

The proportion of banks' unsecured claims rose to 46.1% in 2011.

The coverage of banking system's credit portfolio by collateral deteriorated slightly in 2011, as the proportion of unsecured claims rose by 0.8 percentage points. This was primarily due to an increase in exposure to the government of 1.7 percentage points, and a decline in the fair value of assets received as collateral. There was a sharp increase in the proportion of unsecured claims more than 90 days in arrears, to fully reach the value recorded at the end of 2009. The proportion of secured claims more than 90 days in arrears secured by other forms of collateral was down 11.8 percentage points. The proportion of non-performing claims secured by real estate collateral exceeded the proportion of total claims secured by the same form of collateral by seven percentage points in 2011. The reason for the higher proportion lies in the changing breakdown of claims, as the construction sector accounted for nearly one third of all claims more than 90 days in arrears at the end of 2011.

Figure 5.46: Coverage of all bank claims (left) and coverage of classified claims more than 90 days in arrears (right) by collateral in percentages





Source: Bank of Slovenia

The coverage of classified claims by residential real estate increased, while coverage by other types of collateral declined.

At the end of December 2011 the value of all collateral received was 3.5% higher than the value of classified claims, including unsecured claims, a decrease of 1.4 percentage points compared with the end of 2010. Only the coverage of classified assets by residential real estate collateral increased in 2011, by 3.3 percentage points, while the coverage for other types of collateral was down. The risk of a fall in real estate prices has increased during the crisis due to low economic growth, the adverse situation in the construction sector and declining growth in housing loans. An additional risk, which actually declined last year and to which the banks are exposed with respect to real estate collateral, derives from the established banking practice of entering several mortgages on the same real estate. According to survey data, this risk diminished in 2011, as the proportion of loans that are predominantly secured with real estate and for which the banks have priority in the redemption of collateral rose 10 percentage points to stand at 82%. The redemption of collateral is difficult during a period of low real estate market liquidity, while the associated procedures are protracted. The banks therefore prefer to reschedule loans. Difficulties in redeeming collateral force the banks to focus more on the quality of the borrower's cash flow and less on the value of collateral. The risk of overvaluing collateral is also rising due to a lack of transparency in the recording of real estate transactions and the valuation of real estate in mortgage applications.

The coverage of claims against households by collateral rose by 6.7 percentage points.

Coverage by real estate collateral increased most in the household sector primarily owing to better collateral on new housing loans. The value of collateral in the form of residential and commercial real estate is 11.1% higher than the total value of classified claims against households. The coverage of claims by other forms of collateral declined, which reflects the banks' increased selectivity with regard to collateral. Together with other forms of collateral, the coverage of classified claims against households rose to 147.6%, an increase of 6.7 percentage points comparing to the end of 2010.

Table 5.31: Collateral on classified claims by client segment at the end of 2011 in percentages

		Comparison of collateral[2] with classified claims, %						
			Secured					
	Classified claims, EUR million	Unsecured[1]	Shares, equity and mutual funds units as collateral	Commercial real estate as collateral[3]	Housing as collateral[3]	At insurer	Other	Total value of collateral[3]
Corporates	24,566.8	35.3	10.2	71.3	7.1	0.0	36.1	124.7
OFIs	2,229.6	52.1	21.8	11.3	2.0	0.0	31.7	66.8
Households	10,397.8	30.0	0.5	16.1	95.4	16.4	19.2	147.6
Non-residents	5,724.6	65.8	4.0	30.6	3.0	0.1	23.6	61.2
Government	2,888.2	77.6		3.4	0.2		22.1	25.7
Banks and savings banks	3,736.8	95.6		0.2	0.0		4.0	4.3
Total	50,130.3	46.1	6.5	42.5	23.7	3.4	27.3	103.5

Note: [1] The figure includes unsecured claims and claims secured with forms of collateral that are not taken into account in banks' calculation of impairments and provisions (e.g. collateral in the form of bills of exchange).
[2] Collateral is stated at fair value.
[3] With regard to collateral in the form of real estate, several banks may enter a mortgage on the same property. In such cases, the value of the mortgage at each successive bank is reduced by the value of the banks' claims with priority in the possible redemption of the collateral. Consequently, the value of these forms of collateral is multiplied both for these forms of collateral and as an aggregate.
The figures include branches.

Source: Bank of Slovenia

The coverage of claims against non-monetary financial institutions by collateral is low.

Classified claims against corporates are also largely secured with real estate, this form of collateral covering 78.4% of the value of all classified claims. Households and non-financial corporations are the only client segments in which the value of all collateral received exceeds the value of classified claims. The coverage of claims against corporates by collateral was down 2.7 percentage points on the end of 2010, while the coverage of claims against non-monetary financial institutions was up 1.3 percentage points. Collateral on claims against non-monetary financial institutions is quite low and covers just 66.8% of the value of classified claims against this sector. The proportion of unsecured claims against non-monetary financial institutions was down 0.1 percentage points on the end of 2010, but remains high at 52.1%. Growth in classified claims more than 90 days in arrears was two times higher than the average in this sector last year. It is highly likely that problems in collecting these claims will escalate in the coming months. The reason lies in the breakdown of collateral on claims against this sector, in which more than half of the classified claims are secured by other forms of collateral, and shares and participating interests. The proportion of unsecured claims against non-residents was up 3.4 percentage points in 2011 to stand at 65.8%. The reasons for the high proportion of unsecured claims lie in the low level of risk associated with these claims, which relate to the banks' subsidiaries in the rest of the world and foreign financial institutions, and also owing to their short maturities.

Table 5.32: Collateral on classified claims more than 90 days in arrears by client segment at the end of 2011 in percentages

	Classified claims, EUR million	Comparison of collateral[2] with classified claims, %						
			Secured					
		Unsecured[1]	Shares, equity and mutual funds units as collateral	Commercial real estate as collateral[3]	Housing as collateral[3]	At insurer	Other	Total value of collateral[3]
Corporates	4,502.7	36.9	7.3	62.7	10.6	0.0	24.8	105.5
OFIs	410.9	60.0	31.3	20.8	0.3		7.0	59.5
Households	145.8	31.0		89.2	41.1	0.2	29.1	159.5
Non-residents	494.3	34.4	0.2	94.0	8.5		6.8	109.4
Government	22.3	98.0		1.3	0.6		1.5	3.4
Banks and savings banks	4.6	100.0						
Total	5,580.5	38.5	8.2	62.8	10.4	0.0	21.9	103.4

Notes: [1] The figure includes unsecured claims and claims secured with forms of collateral that are not taken into account in banks' calculation of impairments and provisions (e.g. collateral in the form of bills of exchange).
[2] Collateral is stated at fair value.
[3] With regard to collateral in the form of real estate, several banks may enter a mortgage on the same property. In such cases, the value of the mortgage at each successive bank is reduced by the value of the banks' claims with priority in the possible redemption of the collateral. Consequently, the value of these forms of collateral is multiplied both for these forms of collateral and as an aggregate.
Only sole traders are included. No figures regarding arrears are available for households.
The figures include branches.
Source: Bank of Slovenia

The coverage of claims more than 90 days in arrears was down 25.4 percentage points in 2011.

The proportion of unsecured claims more than 90 days in arrears rose by 11.1 percentage points in 2011 to stand at 38.5%, down slightly comparing to end of 2009 when it stood at 41%. The coverage of the entire portfolio by collateral decreased by 25.4 percentage points during the same period, primarily due to a decrease in the coverage of claims against corporates, by more than 26 percentage points, and against non-monetary financial institutions, by almost 22 percentage points. The breakdown of collateral on classified claims more than 90 days in arrears deteriorated most notably at non-monetary financial institutions, where the proportion of unsecured claims was up 20.5 percentage points comparing to the end of 2010. Taking into account the fact that this proportion was only slightly more than 8% at the end of 2009, the banks underestimated the likelihood of such a deterioration in this part of the portfolio and the depreciation in the value of collateral. The main causes for the aforementioned rise in the proportion of unsecured claims lie in a decrease in the fair value of the assets held as collateral and the breakdown of collateral in this sector, in which financial instruments covered 59% of classified claims at the end of 2010 and slightly less than one third of classified claims at the end of 2011. The value of financial instruments has fallen sharply over the last three years, as these financial instruments primarily include shares and participating interests in Slovenian corporates. At the same time, the banks are considerably more conservative in valuing non-marketable financial instruments owing to low economic growth and the lack of liquidity on the capital market.

Table 5.33: Collateral on classified claims more than 90 days in arrears by bank group at the end of 2011 in percentages

	Classified claims, EUR million	Comparison of collateral[2] with classified claims, %						
		Unsecured[1]	Shares, equity and mutual funds units as collateral	Commercial real estate as collateral[3]	Housing as collateral[3]	At insurer	Other	Total value of collateral[3]
Savings banks	2.1	76.7		48.2	33.3	0.0	16.7	98.2
Small domestic banks	492.5	28.0	7.4	107.0	27.4	0.0	28.4	170.9
Banks under majority foreign ownership	811.4	28.7	5.3	64.2	24.3	0.0	38.0	134.7
Large domestic banks	4,274.5	41.6	8.9	57.5	5.8	0.0	16.2	89.6
Total	5,580.5	38.5	8.2	62.8	10.4	0.0	20.5	103.4

Notes: [1]The figure includes unsecured claims and claims secured with forms of collateral that are not taken into account in banks' calculation of impairments and provisions (e.g. collateral in the form of bills of exchange).
[2] Collateral is stated at fair value.
[3] With regard to collateral in the form of real estate, several banks may enter a mortgage on the same property. In such cases, the value of the mortgage at each successive bank is reduced by the value of the banks' claims with priority in the possible redemption of the collateral. Consequently, the value of these forms of collateral is multiplied both for these forms of collateral and as an aggregate.
The figures include branches.
Source: Bank of Slovenia

The proportion of unsecured claims more than 90 days in arrears increased most at savings banks and the large domestic banks in 2011.

Savings banks and the large domestic banks recorded the sharpest rises in the proportion of unsecured claims more than 90 days in arrears in 2011, by 37.6 or 15.9 percentage points respectively, while the figure for the other two bank groups was virtually unchanged. Primarily the coverage of claims by commercial real estate and other forms of collateral was down at the large domestic banks, by 16.3 and 17.4 percentage points respectively. The overall coverage of claims more than 90 days in arrears by collateral was down 38.1 percentage points at the aforementioned banks as a result. The coverage of claims by collateral increased at the small domestic banks and the banks under majority foreign ownership. The reason for the increase in the proportion of unsecured claims at the large domestic banks lies primarily in this bank group's exposure to certain major clients, whose operations have deteriorated significantly over the last year. In addition, the banks are encountering the problem of a lack of eligible collateral for these clients.

Construction

At 8% of classified claims, the large domestic banks were most exposed to corporates from the construction sector.

The banking system's exposure to the construction sector was up 0.2 percentage points last year, but only at the domestic banks. At 8.0% of classified claims, the large domestic banks are most exposed to corporates from the construction sector, followed by the small domestic banks, the banks under majority foreign ownership and savings banks. The proportion of unsecured claims rose by 2.3 percentage points, but only at the large domestic banks. The coverage of claims by impairments was up sharply, indicating an increase in the proportion of non-performing claims against the construction sector. The latter, however, remains low given the lack of liquidity on the real estate market.

Table 5.34: Coverage of classified claims by impairments and collateral, and breakdown of collateral on the banks' classified claims against the construction sector, December 2011

	Classified claims against corporates					Classified claims more than 90 days in arrears			
			Coverage by impairments						
(% unless stated)	Claims, EUR million	Proportion of total claims of group	Dec. 2010	Dec. 2011	Proportion unsecured	Proportion of total claims against corporates in sector	Coverage by impairments	Proportion unsecured	Real estate collateral / classified claims
				Construction					
Large domestic banks	2,446.3	8.0	9.8	21.2	41.4	57.4	33.7	45.6	61.5
ow nership	762.1	5.3	5.7	7.6	32.4	27.9	22.8	25.8	89.6
Small domestic banks	305.6	7.7	7.8	11.8	20.2	41.8	23.0	16.8	117.1
Savings banks	2.4	0.6	2.4	3.0	45.3	6.4	11.9	51.0	164.9
Total	3,516.4	7.1	8.6	17.4	37.6	49.6	31.6	41.1	69.0
				Real estate activities					
Large domestic banks	547.2	1.8	6.9	11.2	14.8	24.2	32.0	19.9	91.9
ow nership	443.5	3.1	4.4	5.0	22.5	11.2	36.2	17.1	106.0
Small domestic banks	108.0	2.7	5.4	6.7	27.0	8.7	49.9	21.7	151.6
Savings banks	1.3	0.3	0.8	1.0	15.8	0.2	50.0	100.0	0.0
Total	1,099.9	2.2	5.8	8.2	19.1	17.4	34.0	19.2	98.5
				Non-financial corporations in sectors of construction and real estate activities					
Large domestic banks	2,993.4	9.7	9.2	19.4	36.6	51.3	33.6	43.4	64.1
ow nership	1,205.6	8.4	5.2	6.7	28.8	21.7	25.3	24.2	92.7
Small domestic banks	413.6	10.4	7.1	10.4	21.9	33.1	24.8	17.1	119.5
Savings banks	3.7	0.9	2.0	2.3	34.7	4.2	12.4	51.6	162.7
Total	4,616.3	9.3	7.9	15.2	33.2	41.9	31.8	38.9	71.9

Note: The figures do not include branches.
Source: Bank of Slovenia

Nearly 50% of all the banks' classified claims against the construction sector were more than 90 days in arrears at the end of 2011.

The proportion of the banking system's total classified claims against the construction sector accounted for by claims more than 90 days in arrears has risen from 7.7% at the end of 2009 to 49.6%, indicating a significant deterioration in the situation in this sector over the last two years. More than 57% of the large domestic banks' total classified claims against the construction sector were more than 90 days in arrears at the end of 2011, an increase of 36.5 percentage points relative to the end of 2010 and up 50.3 percentage points on the end of 2009. The quality of claims against the construction sector has deteriorated the least at the banks under majority foreign ownership. The proportion of unsecured claims against the construction sector more than 90 days in arrears rose by 18.5 percentage points, most notably at the large domestic banks. Despite the substantial increase in the proportion of unsecured claims, coverage by impairments was down 1.1 percentage points to 31.6% in 2011. The significant increase in the proportion of unsecured claims against the construction sector indicates that even well-positioned corporates from the construction sector faced major problems last year.

Non-performing claims against the construction sector are primarily secured by real estate collateral.

At the end of 2011 the total value of collateral was 8% lower than the value of claims against the construction sector more than 90 days in arrears, representing a massive deterioration relative to the previous year when the value of collateral exceeded the value of claims by 40%. Pledged real estate, a great deal of which has yet to be completed, accounts for the largest proportion of collateral. The value of pledged real estate covered

69% of the associated portion of claims against corporates from the construction sector at the end of 2011, down nearly 34 percentage points on the end of 2010. Despite the substantial increase in the proportion of non-performing claims and the significant proportion of real estate pledged as collateral for these claims, the impact on real estate prices was very limited owing to the complex and protracted legal proceedings in bankruptcy and foreclosure cases.

Holding companies

The large domestic banks account for the majority of non-performing claims against holding companies.

The banking system's exposure to holding companies was up at all bank groups in 2011, by 0.1 percentage points at the domestic banks and by 0.8 percentage points at the banks under majority foreign ownership. The majority of claims more than 90 days in arrears are concentrated at the large domestic banks, at just over one third. Holding companies represent less of a risk at the other bank groups. At 5.7% of total claims, the small domestic banks are most exposed to holding companies in relative terms. There are, however, no holding companies with longer arrears.

Collateral on non-performing claims against holding companies is insufficient.

The coverage of non-performing claims against holding companies by collateral was only 83% at the end of 2011, with coverage by shares and participating interests totalling 45%, down 17.4 percentage points on the previous year. Because the majority are shares held by these holding companies, the banks could face major problems redeeming such collateral due to the poor liquidity of the domestic capital market and the negative attitude to foreign capital.

Table 5.35: Coverage of classified claims by impairments and collateral, and the breakdown of collateral on the banks' classified claims against holding companies, December 2011

	Classified claims against holding companies					Classified claims more than 90 days in arrears				
			Coverage by impairments							
(% unless stated)	Total, EUR million	Proportion of total claims of group	Dec. 2010	Dec. 2011	Proportion unsecured	Total, EUR million	Proportion of total claims against holding companies	Coverage by impairments	Proportion unsecured	Shares and equity collateral / classified claims
Large domestic banks	1,332.9	4.3	13.6	20.6	33.1	482.8	36.2	44.5	45.1	45.3
Banks under majority foreign ownership	459.2	3.2	8.4	3.9	28.5	29.9	6.5	14.1	13.5	31.8
Small domestic banks	225.3	5.7	6.7	14.4	30.9	17.9	7.9	33.2	15.9	58.3
Savings banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	2,017.3	4.1	11.8	16.1	31.8	530.6	26.3	42.4	42.3	45.0

Note: The figures do not include branches.
Source: Bank of Slovenia

5.8 Interest-rate risk

Interest rate risk as measured by the difference between the average repricing periods for asset and liability interest rates was up 0.2 months in 2011 to stand at 3.1 months. The banks' exposure to the risk of rising interest rates is increasing.

The banks are exposed to rising interest rates.

The banks' exposure to a rise in interest rates, in terms of interest-rate gaps, rose sharply in 2011. The cumulative interest-rate gap in the interval of up to 1 year was negative at the end of 2011 in the amount of EUR 5.2 billion, an increase of EUR 2.4 billion on the end of 2010.

The risk of rising interest rates increased at all bank groups, but most notably at the banks under majority foreign ownership in relative terms. Among the bank groups, the small domestic banks are the most sensitive to interest-rate risk, while savings banks are most sensitive in the banking system overall.

5.8.1 Average period of change in interest rates

The difference between the average repricing periods for asset and liability interest rates widened in 2011.

Interest-rate risk as measured by the difference between the average repricing periods for asset and liability interest rates was up in 2011. The rise in interest rate risk, which began in April 2011, continued in the first two months of 2012. The banks' exposure to the risk of rising interest rates is increasing.

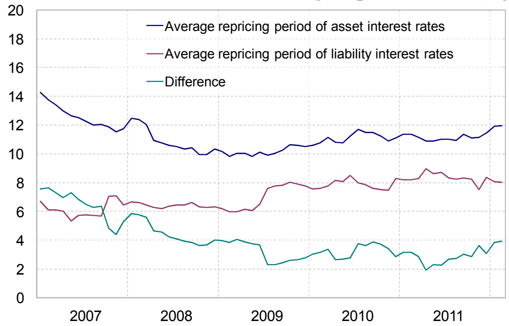
The average repricing period for liability interest rates was 0.1 months longer last year relative to the end of 2010, but has shortened since the end of the first quarter of 2011. The reason for the lengthening lies in the increase in the proportion of long-term deposits and the decrease in the proportion of short-term deposits, while the proportion of sight deposits began to rise slightly at the end of 2011. The trend of a declining proportion of short-term deposits has been present since the end of 2008 and is closely tied to the spread between long-term and short-term interest rates on deposits, which has averaged nearly 2 percentage points during the aforementioned period. The maturity of debt securities and funds raised at foreign banks has shortened. However, the banks participated in 3-year LTROs in December 2011 and February 2012, which partially offset the impact of shortening maturities. The average repricing period for liability interest rates is not expected to change significantly until the end of 2012.

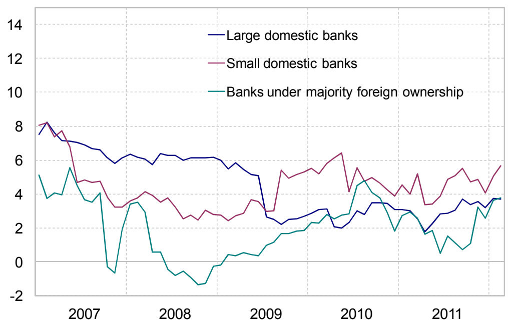
At the end of 2011 the average repricing period for asset interest rates was 3.1 months longer than the average repricing period for liability interest rates, up 0.2 months on the difference at the end of 2010. The reason for the widening of the aforementioned gap lies in the lengthening of the average repricing period for asset interest rates in the second half of last year as a result of an increase in the proportion of long-term loans in the maturity breakdown of loans to the non-banking sector, which has persisted since 2009. The proportion of long-term loans to banks and the proportion of long-term securities were also up last year.

The banking system's exposure to the risk of rising interest rates will probably not increase in 2012.

The average repricing period for asset interest rates, which stood at 11.5 months at the end of 2011, is unlikely to change significantly in 2012, as the proportion of long-term loans is at historically high levels. Given that the average repricing period of liability interest rates will not change significantly in 2012 on account of central bank sources of funding, the banking system's exposure to rising interest rates will probably not increase.

Figure 5.47: Average repricing period for interest rates in months (left) and the difference between the average repricing period for interest rates by bank group in months (right)





Source: Bank of Slovenia

Interest-rate risk increased most notably at the banks under majority foreign ownership in 2011.

The differences between bank groups in terms of exposure to interest-rate risk measured by the average repricing period for asset and liability interest rates narrowed slightly at the end of 2011. The value of the aforementioned indicator was lowest at the banks under majority foreign ownership in December 2011, at 2.6 months, up 0.8 months on the end of 2010. The value of the indicator was up 0.1 months comparing to the end of 2010 at the large domestic banks, and up 0.2 months at the small domestic banks. The reason for the widening of the gap at the banks under majority foreign ownership lies primarily in the shortening of the repricing period for liability interest rates, while the reason for the widening of the gap at the domestic banks lies in the lengthening of the repricing period for asset interest rates.

The small domestic banks are most exposed to the risk of rising interest rates.

The risk of rising interest rates increased at all bank groups, but most notably at the banks under majority foreign ownership in relative terms. The reason for increasing interest-rate risk at the banks under majority foreign ownership lies in the shortening of maturities on sources from parent banks due to the escalation of the euro area debt crisis, particularly in the second half of 2011. The small domestic banks have been the most exposed to the risk of rising interest rates of all bank groups since the middle of 2009. Interest-rate risk diminished at savings banks in 2011. They are, however, more exposed to a rise in interest rates than other banks. In February 2012 the difference between the average repricing period for interest rates was 11.7 months at savings banks, which is six months more than at the small domestic banks.

5.8.2 Interest-rate gap

The banks' exposure to a rise in interest rates over a period of one year rose sharply in 2011. The cumulative interest-rate gap in the interval of up to 1 year was negative at the end of 2011 in the amount of EUR 5.2 billion, an increase of EUR 2.4 billion on the end of 2010. The value of assets with a residual maturity of up to 1 year declined by EUR 2.2 billion during this period, while the value of liabilities with a residual maturity of up to 1 year increased by EUR 227 million.

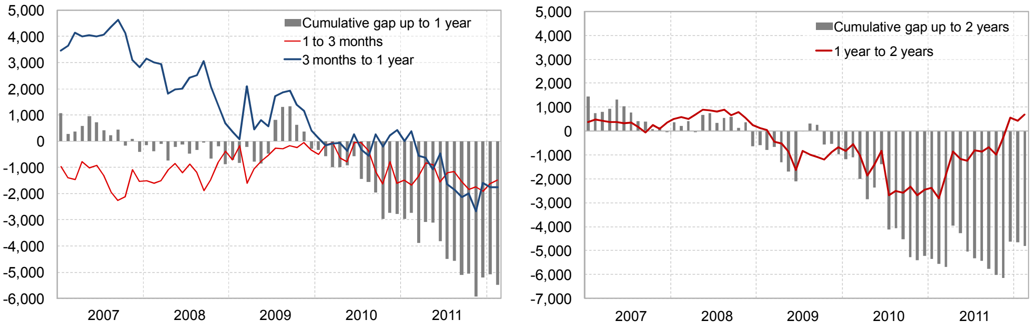
The negative interest gap of up to 1 year widened most notably at the large domestic banks in 2011, by EUR 2.2 billion to EUR 2.4 billion. The reason for the widening of the gap at the large domestic banks lies primarily on the assets side, where loans were down EUR 1.3 billion and debt securities were down EUR 706 million. On the liability side, there was an increase in debt securities with a maturity of up to 1 year, while loans raised declined. The negative gap at the banks under majority foreign ownership widened by EUR 248 million to EUR 2.8 billion. The small domestic banks had a positive interest-rate gap during the same period in the amount of EUR 139 million, and thus were not exposed to a rise in interest rates in this interval. The positive gap, however, had narrowed to EUR 10 million by the end of February 2012. Savings banks also had a negative gap of up to 1 year in 2011 in the amount of EUR 127 million, the gap having narrowed by EUR 16 million by the end of 2011 relative to the end of 2010.

The negative interest-rate gap of up to 1 year widened significantly at the large domestic banks.

The widening of the negative gap of up to 1 year is primarily the result of the widening of the negative interest-rate gap of 3 months to 1 year by EUR 2 billion, an indicator of the maturing of securities issued in 2009. Assets for which the interest rate is repriced in an interval of 3 months to 1 year were down EUR 1.4 billion in 2011. Liabilities for issued securities were up EUR 1.1 billion on the liability side, while the stock of loans raised was down EUR 457 million. Liabilities for issued securities were down due to the shortening of the residual maturity of government-guaranteed bonds that were repurchased early.

The negative interest-rate gap of 3 months to 1 year widened most in 2011.

Figure 5.48: Gap between the interest-sensitive assets and liabilities by individual bucket in EUR million



Source: Bank of Slovenia

Given the gap in the bucket of up to 2 years, the Slovenian banking system is highly exposed to a rise in interest rates. That exposure, however, declined by EUR 596 million in 2011. The cutting of the ECB's key interest rate in November and December 2011, by 0.5 percentage points to 1%, and 3-year LTROs in December 2011 and February 2012 resulted in a decrease in the required yields on the bonds of the majority of euro area countries. The differences between yields remain above average. The risk premium is therefore the main element in the setting of market interest rates.

The risk premium is the main factor in the setting of market interest rates owing to the euro area debt crisis.

5.8.3 Basis risk

At the end of 2011 interest-sensitive assets exceeded interest-sensitive liabilities by EUR 446 million, or 0.9% of the banking system's total assets, the gap having narrowed by 1.7 percentage points with respect to the end of 2010, a continuation of the trend of recent years. Interest-sensitive assets were down 4.5% in 2011, while interest-sensitive liabilities were down 2.7%.

The trend of a narrowing gap between interest-rate sensitive assets and interest-rate sensitive liabilities continues.

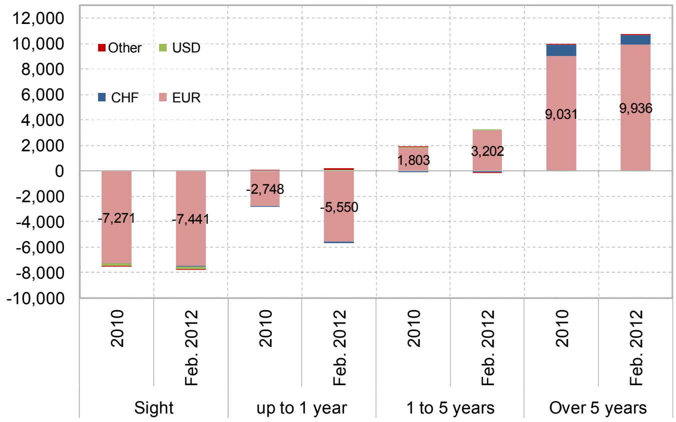
Interest-rate gaps by currencies

The banks are exposed to the risk of rising interest rates in the maturity interval of up to 1 year, primarily in the domestic currency and Swiss francs. The situation is the complete opposite in longer maturity intervals. The exceptions are investments in Swiss francs, where the interest-rate gap in the interval of 1 to 5 years remains negative. Exposure to interest-rate risk in other currencies is negligible.

There were no major changes in the currency breakdown of interest-sensitive items. Exposure to a rise in interest rates increased primarily in the domestic currency in the interval of up to 1 year, by EUR 2.8 billion, but decreased in longer maturity buckets by EUR 2.3 billion. The proportion of the net position accounted for by the Swiss franc was down 1.4 percentage points relative to 2010 to stand at 5.6%, as the banks generally did not conclude new transactions in this currency. The proportion accounted for by the US dollar and other currencies was up slightly.

Exposure to a rise in interest rates increased in the domestic currency in the interval of up to 1 year, but decreased in longer maturity buckets.

Figure 5.49: Currency breakdown of net interest-rate positions by individual bucket of residual maturity in EUR million



Source: Bank of Slovenia

Gaps by type of reference interest rate

The proportion of interest-sensitive items tied to reference interest rates was up on the asset side and down on the liability side.

Interest-rate risk also arises from the mismatch of interest-sensitive assets and liabilities in relation to the reference interest rate. In 2011 the proportion of interest-sensitive items tied to reference interest rates was up 0.9 percentage points on the asset side, and down 2.5 percentage points on the liability side. The gap between the proportion of interest-sensitive assets and liabilities tied to reference interest rates was up 3.4 percentage points to stand at 30.9 percentage points, which increases the banks' sensitivity to falling reference interest rates. The gap had widened by a further 1.4 percentage points by the end of February 2012.

Table 5.36: Structure of interest-rate sensitive assets and liabilities by reference interest rate in percentages

	Interest-sensitive assets				Interest-sensitive liabilities			
	Dec. 09	Dec. 10	Dec. 11	Feb. 12	Dec. 09	Dec. 10	Dec. 11	Feb. 12
Stock, EUR million	49,368	46,522	44,700	44,050	46,168	45,239	44,254	43,579
Percentage tied to reference interest rate	53.0	62.5	63.4	63.2	33.2	34.9	32.4	30.9
	Proportion of tied items accounted for by individual reference rates, %							
EURIBOR								
1-month	8.2	6.0	6.6	7.2	10.7	6.0	2.8	2.3
3-month	29.3	29.0	30.2	30.7	31.3	35.2	37.0	35.4
6-month	51.7	54.7	53.8	53.5	46.9	49.8	49.3	51.2
1-year	2.1	1.8	1.5	1.4	0.4	1.1	0.3	0.3
LIBOR CHF								
1-month	0.5	0.4	0.3	0.3	0.3	0.1	0.0	0.0
3-month	1.8	1.5	1.3	1.2	3.3	3.9	3.9	4.2
6-month	3.1	2.8	2.6	2.6	2.4	1.5	1.4	1.4
1-year	1.6	1.5	1.4	1.4	1.2	0.9	1.0	1.1
Central bank interest rate	0.2	1.3	1.5	0.8	2.6	0.0	2.2	2.2
Other	1.5	1.0	0.9	0.9	1.1	1.6	2.1	2.0

Source: Bank of Slovenia

The most frequently used reference interest rate on both the asset and liability sides is the 6-month EURIBOR. The proportion of items tied to the 6-month EURIBOR was down on the asset side, while the proportion of items tied to the 1- and 3-month EURIBOR was up.

Long positions in the EURIBOR lengthened in 2011.

The banks lengthened their long position in the EURIBOR reference interest rate in 2011, while the long position in the Swiss franc LIBOR narrowed slightly. The most significant lengthening in the overall net position, of 1.5 percentage points, was recorded in the 1-month EURIBOR. The banking system's exposure to falling interest rates has thus increased, but only with respect to balance sheet items tied to reference interest rates.

Table 5.37: Interest-rate gap in interest-sensitive assets by reference interest rate in percentages

(%)	Overall net position				Net position by bucket, Feb. 2012			
	Dec. 2009	Dec. 2010	Dec. 2011	Feb. 2012	Sight	Up to 1 year	1 to 5 years	More than 5 years
EURIBOR								
1-month	1.0	1.7	3.3	3.9	0.0	1.6	0.9	1.3
3-month	5.8	6.1	7.2	8.5	0.0	1.5	1.3	5.7
6-month	12.8	17.3	18.2	18.2	-1.2	2.4	6.6	10.4
1-year	1.0	0.7	0.8	0.8	0.0	0.0	0.2	0.6
LIBOR CHF								
1-month	0.2	0.2	0.2	0.2	0.0	0.1	0.0	0.1
3-month	-0.1	-0.4	-0.4	-0.5	0.0	0.1	-0.1	-0.5
6-month	0.9	1.3	1.2	1.2	0.0	-0.1	0.0	1.3
1-year	0.5	0.6	0.5	0.5	0.0	0.0	-0.3	0.8

Source: Bank of Slovenia

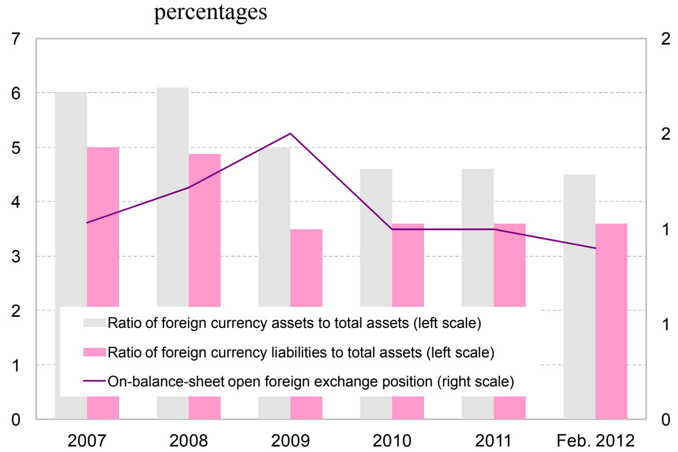
5.9 Currency risk

Relatively low currency risk diminished further in 2011.

The Slovenian banking system's currency risk fell last year. The banks' net open foreign exchange position stood at EUR 17 million or 0.4% of regulatory capital at the end of 2011. With a net open foreign exchange position of 1.5% of regulatory capital, the small banks were most exposed to currency risk.

The proportion of total assets accounted for by foreign currency assets was 4.5% in February 2012, while the proportion accounted for by foreign currency liabilities was 3.6%, at the level recorded in 2010 and 2011. The on-balance-sheet foreign exchange position was long in the amount of 0.9% of total assets.

Figure 5.50: Ratio of foreign currency liabilities and foreign currency assets to total assets, and on-balance-sheet open foreign exchange position in percentages



Source: Bank of Slovenia

Currency breakdown and open foreign exchange position

The proportion of the bank's total assets accounted for by on- and off-balance sheet items was down 9.1% on the asset side and 7.9% on the liability side in 2011. In the currency breakdown, there was a notable decrease in the proportion accounted for by the Swiss franc and an increase in the proportions accounted for by the US dollar, the currencies of the European Economic Area and other currencies. There was also a slight decrease in the proportion of foreign currency investment fund units, which indicates that the banks are withdrawing their assets from such investments.

Table 5.38: Currency breakdown of on- and off-balance-sheet assets and liabilities

	2009		2010		2011	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Total foreign currency excluding euros, EUR million	3,383	3,342	3,637	3,572	3,308	3,291
year-on-year growth, %	-14.2	-15.0	7.5	6.9	-9.1	-7.9
Breakdown of currencies other than euros			(%)			
global currencies	90.4	92.4	92.3	94.5	90.1	90.9
Swiss francs	61.3	62.4	60.6	62.0	55.1	55.8
pound sterling	1.8	1.9	1.4	1.4	1.9	1.9
US dollar	25.5	26.3	28.3	29.0	31.0	31.0
Canadian dollar	0.7	0.7	0.5	0.5	0.7	0.7
Japanese yen	0.7	0.7	1.0	1.1	0.8	0.8
Australian dollar	0.4	0.4	0.5	0.5	0.8	0.8
EEA currencies	3.9	3.8	2.7	2.2	4.9	5.5
Other currencies	4.2	3.8	3.5	3.3	4.0	3.5
CIU	1.4	0.0	1.5	0.0	0.9	0.0

Note: EEA: European Economic Area, i.e. the EU, Iceland and Norway; CIU: foreign exchange position in collective investment undertaking units.
Source: Bank of Slovenia

The net open foreign exchange position narrowed in 2011 to stand at EUR 17 million or 0.4% of regulatory capital.

The net open foreign exchange position narrowed to EUR 17 million or 0.4% of regulatory capital in 2011. Contributing most to this was the shortening of the long foreign exchange position in investment fund units, from EUR 53 million at the end of 2010 to EUR 30 million in 2011. The banks had net short foreign exchange positions in most major global currencies, except in US dollars, and are thus exposed to the risk of appreciation of these currencies. Net long foreign exchange positions were recorded primarily in other currencies and investment fund units, meaning that the banks are exposed to a depreciation in their value. Exposure to currency risk in absolute terms was low last year in all currencies and bank groups, and did not pose a significant threat to banks due to losses arising from changes in exchange rates.

Table 5.39: Net open foreign exchange positions by currency in EUR million

			2011			
	2009	2010	Banking system	Large domestic banks	Small domestic banks	Banks under majority foreign ownership
Global currencies	-28.9	-20.1	-9.6	-12.9	0.1	3.1
US dollar	-14.7	-8.4	4.4	5.4	0.0	-1.0
Swiss franc	-12.3	-9.9	-13.4	-17.1	-0.4	4.1
Other (GBP, CAD, AUD, JPY)	-1.8	-1.8	-0.6	-1.1	0.5	0.0
EEA currencies	4.9	20.5	-18.0	-18.6	0.3	0.3
Other currencies	17.2	11.9	15.3	9.3	5.4	0.5
CIU	48.2	52.6	29.6	29.4	0.2	0.0
Total, EUR million	41.4	64.9	17.2	7.2	6.0	3.9
As % of regulatory capital	0.9	1.4	0.4	0.3	1.5	0.4

Note: EEA: European Economic Area, i.e. the EU, Iceland and Norway; CIU: foreign exchange position in collective investment undertaking units.
Source: Bank of Slovenia

With a net open foreign exchange position of 1.5% of regulatory capital, the small banks were most exposed to currency risk in 2011, followed by banks under majority foreign ownership with a net open foreign exchange position of 0.4% of regulatory capital and the large banks with a net open foreign exchange position of 0.3% of regulatory capital.

5.9.2 Borrowing in Swiss francs

The stock of loans in Swiss francs or with a Swiss franc currency clause was down 15% in 2011 to stand at EUR 1,588 million. The reason lies in the fact that the banks only approved new loans in Swiss francs in exceptional circumstances. The stock of housing loans, which accounts for around 66% of all loans in Swiss francs or with a Swiss franc currency clause, was down 8.6% in 2011. Expressed in Swiss francs, these loans were down 11% in year-on-year terms.

Table 5.40: Stock and year-on-year growth of loans in Swiss francs or with a Swiss franc currency clause

	Non-banking sector	Non-financial corporations	OFIs	Government	Households: All loans	Households: Housing loans
	Stock of loans, EUR million					
2010	1,868.1	429.5	134.4	6.0	1,298.2	1,128.3
2011	1,588.0	288.5	130.5	5.5	1,163.6	1,031.8
Feb. 2012	1,549.0	275.0	119.5	5.4	1,149.1	1,021.1
	Growth, %					
2010	-1.2	-7.6	-22.5	-6.4	4.1	9.0
2011	-15.0	-32.8	-2.9	-9.2	-10.4	-8.6
Feb. 2012	-11.9	-27.9	-8.9	-6.2	-7.4	-5.6

Source: Bank of Slovenia

The proportion of the total stock of loans to the non-banking sector tied to the Swiss franc or with a Swiss franc currency clause is gradually declining, and stood at 4.1% at the end of 2011. Among euro area countries, Austria (13.4%) and Luxembourg (5.6%) had a higher proportion of Swiss francs loans in September 2011.

Table 5.41: Loans tied to the Swiss franc exchange rate by bank group

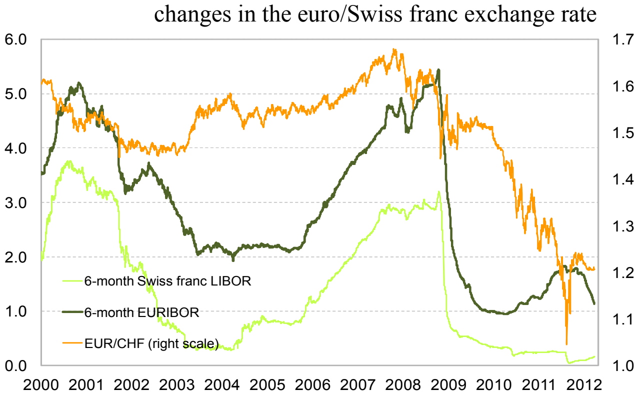
	Year-on-year growth, %		Proportion of all loans to non-banking sector tied to Swiss franc, %		Proportion of loans at particular bank group, %	
	2010	2011	2010	2011	2010	2011
Large domestic banks	-2.6	-10.0	31.5	32.5	2.4	2.2
Small domestic banks	0.4	-32.6	1.1	0.8	0.6	0.5
Banks under majority foreign ownership	-1.5	-13.9	67.4	66.7	9.9	8.6
Total	-1.2	-15.0	100.0	100.0	4.6	4.1

Source: Bank of Slovenia

The Swiss franc appreciated by 2.8% against the euro in 2011, representing a relatively insignificant increase in the loan burden on borrowers compared with 2010. Owing to the negative effects of the Swiss franc's appreciation against the euro on the Swiss economy, the Swiss National Bank undertook on 6 September 2011 to purchase unlimited quantities of foreign currencies in order to maintain the euro/Swiss franc exchange rate above 1.2. That measure has stabilised the euro/Swiss franc exchange rate and somewhat reduced the burden associated with the repayment of loans in Swiss francs or with a Swiss francs currency clause. In its monetary policy report of 15 March 2012, the Swiss National Bank warned that the value of the Swiss franc was still high, and that it intends to further devalue the currency in the future.

The Swiss franc appreciated by 2.8% against the euro in 2011.The euro/Swiss franc exchange rate has stabilised since 6 September.

Figure 5.51: LIBOR reference interest rate for Swiss francs and the EURIBOR and changes in the euro/Swiss franc exchange rate



Source: Bank of Slovenia

5.10 Bank solvency

The banking system's capital adequacy indicators improved in 2011. The gap, however, by which they lag behind the EU average has widened. Efforts to meet capital requirements with the highest-quality capital have led to an improvement in the structure of capital, while the banks' interest to increase the stock of subordinated debt and hybrid instruments is diminishing. The deteriorating quality of the credit portfolio is reflected in an increase in capital requirements for past-due and regulatory high-risk items and in a decrease in the scope of items tied to profit[23]. Because previous capital increases were insufficient, the banks are reducing their capital requirements.

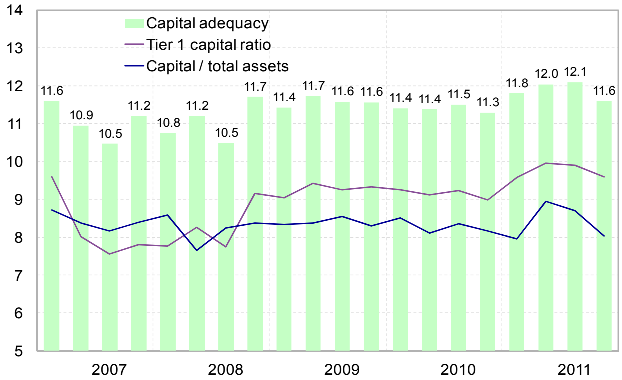
Owing to pressure from investors and ratings agencies, the banks must also comply with informal rules relating to capital adequacy, although there is no basis for the latter in current regulations. The banks under majority foreign ownership demonstrate greater efficiency in that respect, as owners are able to respond quickly to shore up capital, while the domestic banks, in particular the banks under direct and indirect state ownership, have more difficulty securing a sufficient level of capital. Banks that generated losses are unable to strengthen their capital via retained earnings, leaving them other possibilities to meet capital adequacy requirements, such as recapitalisation, reducing deduction items and reducing capital requirements, in particular the latter, which entails reducing the scope of operations.

5.10.1 Capital adequacy

Capital adequacy was up 0.3 percentage points in 2011 to stand at 11.6%.

The banking system's capital adequacy stood at 11.6% at the end of 2011, up 0.3 percentage points on the previous year. The aforementioned indicator rose steadily until the end of the third quarter to stand at 12.1%, primarily on account of recapitalisations and a contraction in the scope of operations. Capital adequacy then fell by 0.5 percentage points in the final quarter of the year. The key reasons for this decline lie in the large amount of additional impairments in the final quarter and the resulting operating loss. The banks generated an after-tax loss of EUR 433.5 million in 2011, EUR 345.8 million of the aforementioned amount in the final quarter. Another major reason was a decrease in the stock of hybrid instruments by EUR 100 million.

Figure 5.52: Basic indicators of the banking system's capital adequacy in percentages



Source: Bank of Slovenia

The Tier 1 capital ratio and the core Tier 1 capital ratio were both up 0.6 percentage points to stand at 9.6% and 8.9% respectively.

Also affecting the Tier 1 capital ratio, in addition to recapitalisations and the contraction in the scope of operations, were operating losses, but not the decline in the stock of hybrid instruments. As a result, the increase in the Tier 1 ratio outstripped the increase in the overall capital adequacy ratio in 2011. The Tier 1 capital ratio was up 0.6 percentage points to stand at 9.6%, while the core Tier 1 capital ratio was up by the same amount to stand at 8.9% at the end of the year. The ratio of book capital to total assets was down 0.2 percentage points in 2011 to 8%, but primarily due to the higher operating losses generated in the final quarter of the year, as the aforementioned ratio was still 8.7% at the end of the third quarter.

Table 5.42: Basic indicators of the banking system's capital adequacy in percentages

	2007	2008	2009	2010	2011
Capital adequacy	11.2	11.7	11.6	11.3	11.6
Tier 1 capital ratio	7.8	9.2	9.3	9.0	9.6
Core Tier 1 capital ratio	7.3	8.6	8.7	8.3	8.9
Book value of capital / total assets	8.4	8.4	8.3	8.2	8.0

Source: Bank of Slovenia

The banks under majority foreign ownership achieve the highest capital adequacy, while the large banks achieve the lowest.

The movement in capital adequacy ratios varies significantly between the banks. The capital adequacy of the large domestic banks was down 1.2 percentage points in the final

[23] Reserves and retained earnings, minority interests, revised earnings for the financial year and revaluation surpluses.

quarter of 2011 to stand at 11.3%, primarily owing to operating losses generated and a decrease in the stock of hybrid instruments, the aforementioned decline being the smallest of all bank groups. In previous years the large banks recorded the highest capital adequacy, while the banks under majority foreign ownership recorded the lowest. That ratio began to change back in 2010, and became more pronounced last year. The capital adequacy of the banks under majority foreign ownership was up 1 percentage point in the fourth quarter to 12.3%, the highest value of this ratio among all bank groups. The optimisation of required capital and the risks associated with operations is considerably more evident at the banks under majority foreign ownership than at the domestic banks.

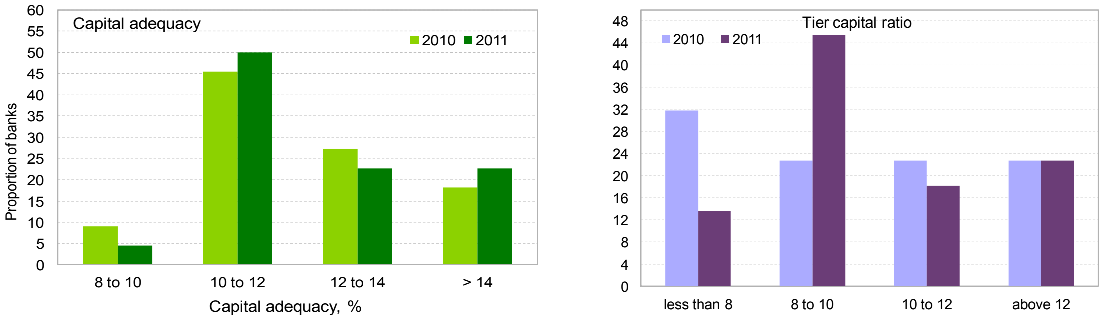
Figure 5.53: Capital adequacy (left) and Tier 1 capital ratio (right) by bank group in percentages

Source: Bank of Slovenia

The distribution of the banks in terms of capital adequacy ratios has shifted to higher values.

The increase in capital adequacy can also be seen in the positive movement of the distribution of capital adequacy ratios to higher values. The number of banks with a capital adequacy between 10% and 12%, and exceeding 14% was up. This transition is even more pronounced in the Tier 1 capital ratio, where there was a sharp decrease in the proportion of banks with a ratio of less than 8%, while the proportion of banks with the ratio of between 8% and 10% doubled.

Figure 5.54: Distribution of banks' capital adequacy (left) and Tier 1 capital ratio (right) in percentages



Source: Bank of Slovenia

5.10.2 Decomposition of capital adequacy

Capital adequacy increased in 2011 as the result of a decrease in capital requirements. The effect of capital injections was negated by operating losses.

The decomposition of the banking system's capital adequacy[24] indicates that capital adequacy increased primarily owing to a decrease in capital requirements, which was driven by the continuing contraction in the scope of the banks' operations. The contribution of capital requirements to the increase in capital adequacy was 0.72 percentage points in 2011, while the contribution of capital was -0.41 percentage points. Recapitalisations represented the most significant contribution. Assuming all other items at the level of the previous year, recapitalisations would have contributed 1.1 percentage points to the increase in capital adequacy. At the same time, however, the contribution of profit-related items was negative in the amount of 1 percentage point. A decrease in additional own funds and an increase in deduction items also contributed to the decrease in capital adequacy.

[24] The contribution of individual components to the change in the capital adequacy over a one-year period has been calculated.

Table 5.43: Decomposition of the banking system's capital adequacy for the 2009 to 2011

Banking system	Capital adequacy, % 2009	2010	2011		Effect of individual factors on capital adequacy in percentage 2009	2010	2011
CA previous year: capital (t-1) / CR (t-1)	11.70	11.56	11.28				
recapitalisations	12.11	11.56	12.40	recapitalisations	0.41	-0.01	1.12
profit	12.30	11.27	11.39	profit	0.19	-0.29	-1.01
other	12.44	11.27	11.40	other	0.14	0.01	0.00
additional own funds	12.34	11.34	11.06	additional own funds	-0.10	0.06	-0.34
Effect on capital: capital (t) / CR (t-1)	12.07	11.33	10.87	deduction items	-0.27	-0.01	-0.19
				Total capital	**0.37**	**-0.23**	**-0.41**
CR for credit risk	11.64	11.30	11.50	CR for credit risk	-0.43	-0.03	0.63
CA at year end: capital (t) / CR (t)	11.56	11.28	11.60	CR for other risks	-0.07	-0.02	0.09
				Total CR	**-0.51**	**-0.05**	**0.72**
Difference: CA (t) - CA (t-1)	**-0.14**	**-0.28**	**0.31**	**Total**	**-0.14**	**-0.28**	**0.31**

Note: CA – capital adequacy; CR – capital requirements.
Source: Bank of Slovenia

The large banks maintained their level of capital adequacy by reducing capital requirements. Capital adequacy would have otherwise been down 0.9 percentage points.

The large domestic banks used recapitalisations to the largest extent to increase their capital, but also recorded the highest operating losses, which completely negated the positive contribution of those recapitalisations. There was a notable decrease in additional own funds owing to a decrease in subordinated debt and hybrid instruments. Capital adequacy would have decreased by 0.9 percentage points in 2011 if the large banks would not have reduced their financial leverage by contracting their balance sheets, resulting in a reduction in capital requirements. Following two years of decline, the large banks maintained their capital adequacy at the level of the previous year in 2011 due to the reduction in capital requirements.

5.10.3 Structure of capital

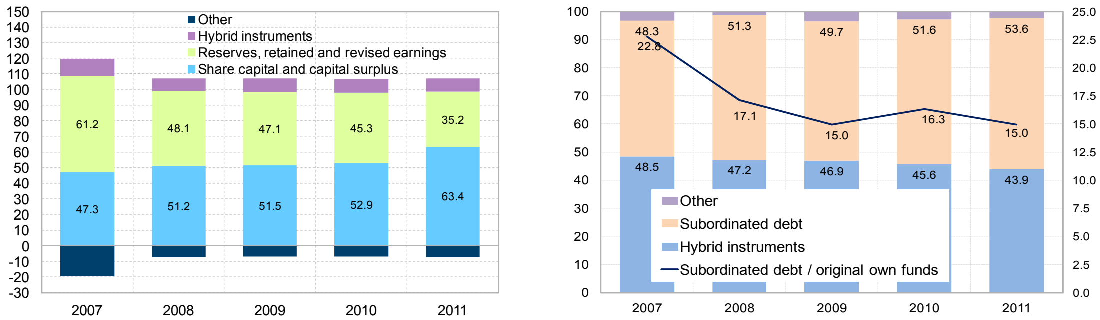
Primarily the banks under majority foreign ownership increased their original own funds.

The banking system's original own funds were up EUR 45 million in 2011 to stand at EUR 4,046 million at the end of the year. Primarily the banks under majority foreign ownership increased their original own funds, by EUR 105 million, while six banks, covering all bank groups, reduced their original own funds in 2011.

Capital injections had a positive impact, while operating losses acted to reduce original own funds.

The main factor in the increase in original own funds at the banking system level were capital injections, which resulted in an increase in share capital and the capital surplus of EUR 449 million. The stock of items tied to profit was down EUR 387 million owing to operating losses. The remainder of the decrease is a result of the exclusion of hybrid instruments, as the surplus of hybrid instruments was up at certain banks due to the reduction in original own funds.

Figure 5.55: Components of original own funds (left), and components of additional own funds and the ratio of subordinated debt to original own funds (right) in percentages



Source: Bank of Slovenia

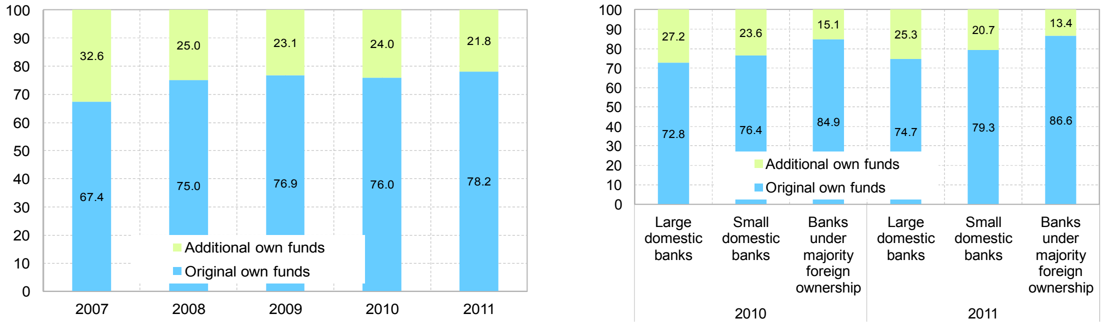
Additional own funds were down due to a decrease in subordinated debt and hybrid instruments.

In contrast to original own funds, the banking system's additional own funds were down EUR 135 million in 2011 to stand at EUR 1,130 million at the end of the year. The stock of hybrid instruments, together with the surplus of hybrid instruments from original own funds, was down EUR 88 million, while the stock of subordinated debt was down EUR 47 million.

The structure of capital is improving, while the proportion of original own funds is increasing.

Because additional own funds were down at all bank groups or decreased more than original own funds, the structure of capital continued to improve, both at the level of the banking system and at all bank groups. The small domestic banks recorded the highest increase in the proportion of original own funds in 2011, of 2.8 percentage points. At 86.6%, the banks under majority foreign ownership have the highest proportion of original own funds and capital before deduction items.

Figure 5.56: Structure of capital prior to deductions for the banking system as a whole (left) and by bank group (right) in percentages

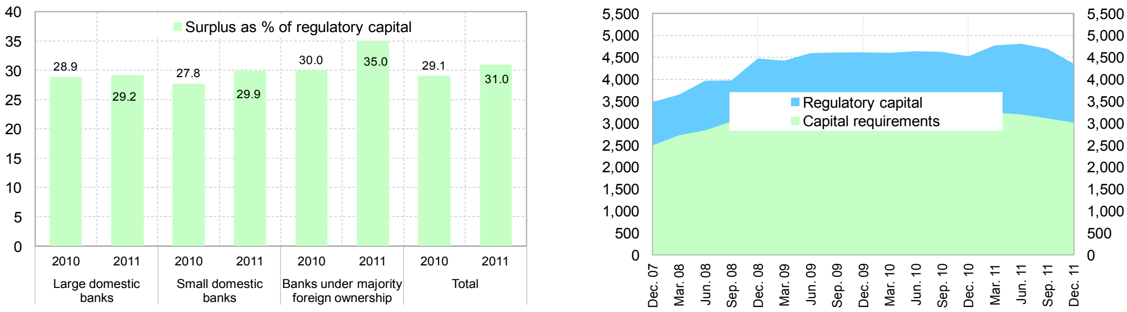


Source: Bank of Slovenia

Deduction items were up EUR 75 million in 2011 to stand at EUR 817 million. The majority of the increase (64%) relates to the large banks, while 38% relates to the banks under majority foreign ownership. The large banks increased deduction items arising from investments in financial institutions and their instruments, while the increase at the banks under majority foreign ownership was driven by other items. The small banks reduced their stock of deduction items.

Deduction items were up primarily at the large banks.

Figure 5.57: Surplus of regulatory capital over capital requirements in percentages (left), and regulatory capital and capital requirements in EUR million (right)



Source: Bank of Slovenia

Regulatory capital was down EUR 164 million or 3.6% relative to the previous year, to stand at EUR 4,359 million at the end of 2011. Original own funds for the calculation of capital adequacy remained at the level of the previous year. The surplus of regulatory capital over capital requirements was up 0.9 percentage points to stand at 31% at the end of the year. The highest surplus was recorded by the banks under majority foreign ownership, at 35%, while the lowest surplus was recorded by the large banks, at 29.2%.

Regulatory capital stood at EUR 4,359 million at the end of 2011, representing a surplus over capital requirements of 31%.

5.10.4 Capital requirements

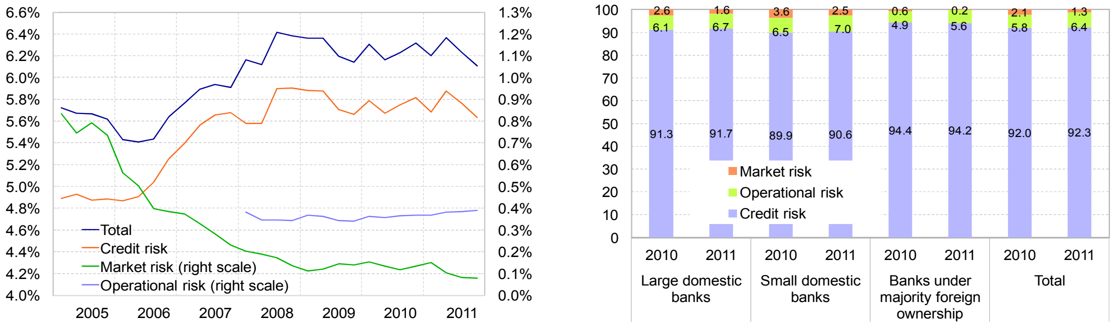
The ratio of capital requirements to total assets has fluctuated at around 6.2% since 2009, reflecting the banks' reluctance to take up additional risks. The dynamics of the aforementioned ratio are defined by capital requirements for credit risk, which continue to increase as a proportion of total capital requirements. Capital requirements for credit risk accounted for 92.3% of banking system's total capital requirements at the end of 2011. The largest proportion is achieved by the banks under majority foreign ownership, at 94.2%, while the small banks achieve the lowest proportion, at 90.6%.

The fluctuation of the ratio of capital requirements to total assets at around 6.2% since 2009 is an indication that the banks are not taking up additional risks.

Only capital requirements for operational risk increased in 2011. The key reason lies in higher growth in gross income in previous years compared to 2011. Because only two banks use the advanced measurement approach, the average three-year gross income for the period 2008 to 2010 was used to define capital requirements for operational risk in 2011. Total capital requirements for operational risk were up most (by 10.7%) at the banks under majority foreign ownership which, at 5.6%, have the lowest proportion among all bank groups. The large banks recorded the smallest increase in total capital requirements for operational risk, of 0.3%. Capital requirements for operational risk as a proportion of total capital requirements are highest at the small banks, at 7%. The proportion of capital requirements accounted for by capital requirements for operational risk was up 0.6 percentage points for the banking system overall to stand at 6.4%.

The banks' capital requirements for operational risk are rising due to high growth in gross income in recent years.

Figure 5.58: Ratio of capital requirements to total assets (left) and the structure of capital requirements (right) in percentages



Source: Bank of Slovenia

Capital requirements for market risk are decreasing owing to valuation at market value and a focus on basic banking activities.

The importance of the trading book is diminishing, and with it capital requirements for market risk, owing to the valuation of instruments at market value, which have fallen sharply in recent years, and due to the banks' focus on basic banking activities. Capital requirements for market risk were down 43% in 2011, to stand at merely 1.3% of the banking system's capital requirements.

Capital requirements for credit risk were down 6% last year.

Capital requirements for credit risk were down in all bank groups in 2011, most notably at the large banks (by 8%) and least notably at the banks under majority foreign ownership (by 2.2%). Capital requirements for credit risk were down 6% for the banking system overall.

The deteriorating quality of the credit portfolio is increasing capital requirements for past-due and regulatory high-risk items.

Given the deterioration in the quality of the credit portfolio, all bank groups are expected to increase their capital requirements for past-due items. The nominal increase in capital requirements for past-due items was similar to that recorded in 2009 at the domestic banks, and lower than 2009 and comparable with 2010 at the banks under majority foreign ownership. The fact that the banks under majority foreign ownership have fewer problems with the quality of the credit portfolio is illustrated by the decrease in capital requirements for regulatory high-risk items, which increased further at the other bank groups. At 14.5% of total capital requirements for credit risk, the small banks stand out with an extremely high proportion of capital requirements for regulatory high-risk items.

Table 5.44: Breakdown of capital requirements for credit risk

	2010				2011				Change			
	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Total	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Total	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Total
Capital requirements for credit risk, EUR million	1,855.71	280.42	815.43	2,951.56	1,706.95	270.63	797.80	2,775.39	-148.76	-9.79	-17.63	-176.17
	Breakdown of capital requirements for credit risk, %								Change, percentage points			
General government, international organisations	0.8	1.7	1.7	1.1	0.7	1.5	0.4	0.7	-0.1	-0.2	-1.3	-0.4
Institutions	11.3	6.2	2.4	8.4	11.7	5.4	2.7	8.5	0.3	-0.8	0.4	0.1
Corporates	55.5	49.3	51.6	53.8	51.0	45.4	51.0	50.4	-4.5	-4.0	-0.6	-3.4
Retail banking	17.4	13.7	32.5	21.2	17.6	15.8	33.1	21.9	0.3	2.1	0.6	0.7
Exposures secured by real estate	0.0	7.7	1.1	1.0	0.3	7.3	1.7	1.4	0.3	-0.4	0.6	0.3
Past-due items	3.5	2.4	3.7	3.4	5.6	5.3	4.2	5.1	2.1	2.9	0.5	1.7
Regulatory high-risk categories	7.9	13.7	3.9	7.4	9.4	14.5	2.8	8.0	1.5	0.8	-1.1	0.6
Other	3.6	5.3	3.1	3.7	3.8	4.9	4.0	4.0	0.2	-0.4	0.8	0.3

Source: Bank of Slovenia

The banks are attempting to mitigate the negative effects of the deterioration in the quality of the credit portfolio by adjusting other capital requirements.

In addition to capital injections, the banks are also attempting to balance the negative effects of the deterioration in the quality of the credit portfolio, which are transmitted to capital via impairment costs and operating losses and to total capital requirements via capital requirements for past-due and regulatory high-risk items, by adjusting their capital requirements.

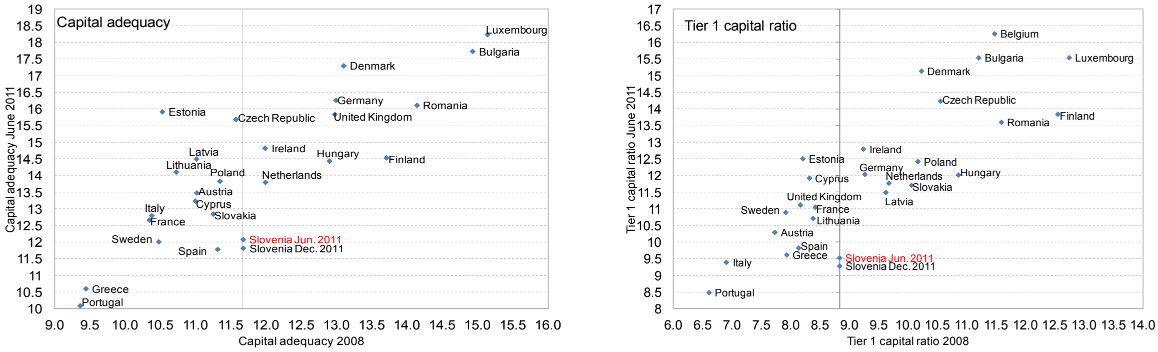
The banks are reducing their exposure and thus the level of capital requirements. They are mitigating risk through greater diversification by reducing those capital requirements for which they stood out relative to other banks in terms of high proportions. By reducing their exposure to corporates, the banks are also reducing the risk of exposure by increasing exposure to institutions and retail banking, and exposures secured by real estate collateral, which bear lower risk weights.

5.10.5 Comparison of capital adequacy with the EU – consolidated data

Slovenian banks did not follow the rapid increase in the capital adequacy ratios of banks from other EU Member States.

In 2011 the capital adequacy ratios of Slovenian banks reached their highest value in the last ten years. Capital adequacy of 12%, achieved by Slovenian banks in the middle of 2011 and maintained until the end of September, was last exceeded in September 2001. However, the gap by which the capital adequacy of the Slovenian banks lags behind other countries is nevertheless widening. Capital adequacy requirements will increase sharply in the immediate future. These are not necessarily formal requirements. Valid regulations require capital adequacy of 8% and a Tier 1 capital ratio of 4%. The EBA, however, has established a temporary core Tier 1 capital ratio requirement of 9% until the end of June 2012 for systemically significant banks on the basis of the results of pan-European stress tests. This requirement is also met by other banks, even though they are not obliged to do so, as the effect of market participants, ratings agencies and competition between banks, and the impact of banks that lend sources to other banks is so significant in the uncertain economic conditions that a lag in the level of capital adequacy behind other comparable banks quickly raises questions about the quality of the banks. Slovenian banks have not been particularly successful in fulfilling these objectives in recent years. While capital adequacy and the Tier 1 capital ratio of the Slovenian banking system were comparable with the average for EU Member States in 2008, they had fallen well below that average by 2011.

Figure 5.59: Capital adequacy (left) and Tier 1 capital ratio (right) in 2008 and the first half of 2011 in the EU Member States in percentages

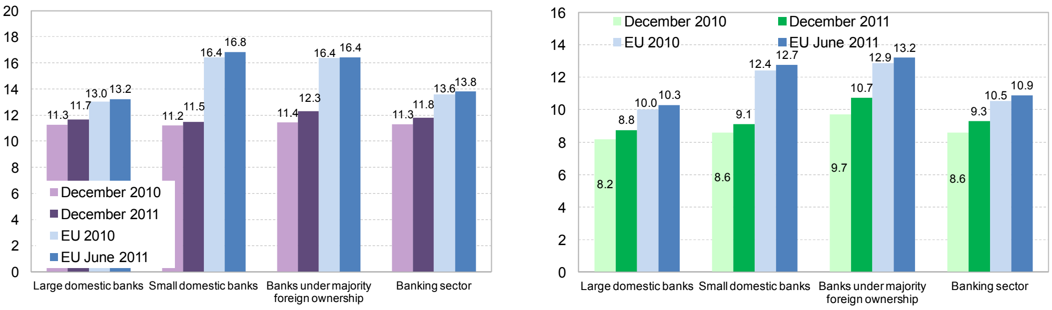


Sources: ECB (SDW), Bank of Slovenia

All bank groups lag behind comparably sized EU banks, the gap being smallest at the large banks.

The capital adequacy of all groups of Slovenian banks lags behind the EU average for banks of comparable size. The gap remains the smallest for the large Slovenian banks compared with the average for medium-sized EU banks.

Figure 5.60: Capital adequacy (left) and Tier 1 capital ratio (right) compared with the EU, figures on a consolidated basis in percentages



Sources: ECB (SDW), Bank of Slovenia

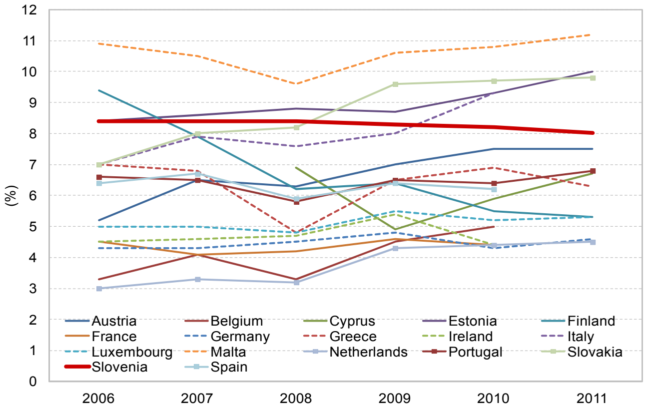
Slovenia's ratio of book capital to total assets is one of the highest among EU Member States.

More encouraging is the comparison of the ratio of book capital to total assets, where Slovenia is among the countries with a relatively higher value of this indicator. This means that insufficient capital injections do not represent the only factor in the gap by which Slovenian banks lag behind other EU Member States in terms of capital adequacy. Other important factors include regulations and the extent to which the banks exploit the opportunities presented by those regulations. However, potential investors, creditors and ratings agencies compare the final values of capital adequacy, without delving into the details of the calculations.

Slovenian banks primarily use standardised approaches and apply conservative risk weights.

Slovenian banks primarily use the standardised approach, while only a smaller number of banks use internal models and advanced approaches. The banks meet capital requirements with on-balance-sheet and off-balance-sheet items. The small Slovenian banks use hybrid instruments from original own funds. The Slovenian banks also have a higher level of deduction items compared with other countries, in which banks do not have capital investments in other financial institutions. The use of weights in the calculation of capital requirements is crucial. Here, the Slovenian banks are very conservative and do not apply or do not have the possibility to apply lower weights, because, for example, their counterparties do not have credit ratings from recognised agencies. Thus the Slovenian banks use a weight of at least 50% for 80% of their exposure to institutions and a weight of at least 100% for practically their entire exposure to corporates, while a risk weight of at least 75% is applied for 98% of their exposure to retail banking. Exposures secured by real estate collateral, for which the banks apply reduced weights of 35% and 50%, account for merely 1.2% of overall exposure.

Figure 5.61: Ratio of book capital to total assets



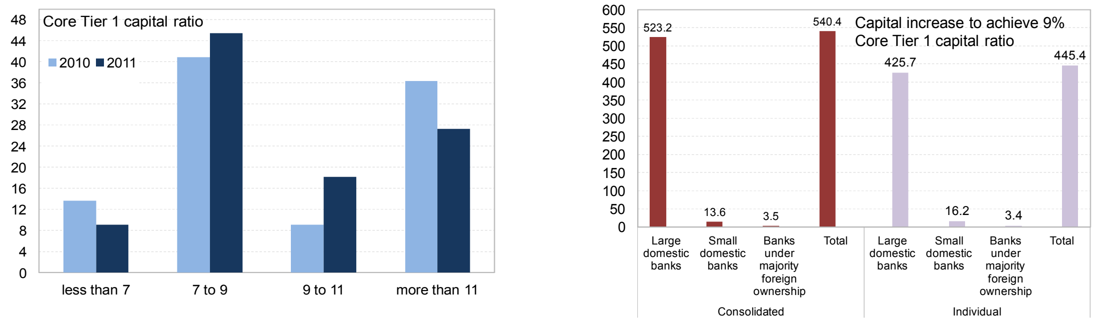
Sources: IMF, Financial Soundness Indicators, September 2011; Bank of Slovenia (figures for 2011 for Slovenia)

5.10.6 Capital deficit

One half of banks on a consolidated basis do not achieve the 9% core Tier 1 capital ratio.

At the end of 2011 the Slovenian banking system as a whole and one half of banks on a consolidated basis did not achieve a core Tier 1 ratio of 9%, which represents the reference value for sufficient capital at the EU level.

Figure 5.62: Distribution of banks in terms of core Tier 1 capital ratio in percentages (left) and deficit in capital to achieve a 9% core Tier 1 ratio in EUR million (right)



Source: Bank of Slovenia

The banks would have to increase their capital by EUR 540 million to achieve a core Tier 1 capital ratio of 9%, and around twice that amount to achieve the EU average.

According to figures at the end of 2011, recapitalisations in the amount of EUR 540 million would be required for all Slovenian banks to achieve a 9% core Tier 1 capital ratio on a consolidated basis. Twice that amount in recapitalisations, or around EUR 1 billion, would be required for Slovenian banks to achieve the average of EU Member States or the average of comparably sized EU banks in terms of capital adequacy and the Tier 1 capital ratio. The largest recapitalisations are required by the large banks, which are also under the greatest pressure from investors, as sources of funding are also raised on the international financial markets.

Additional operating losses this year would only further exasperate the need to increase capital.

To that end, the operations of the banks in the near future are also important. Forecasts of economic growth and the banks' operating results for 2012 still do not indicate optimism. Impairment costs associated with the banks' credit portfolios will remain high in 2012.

Based on the assessments of impairment costs by bank presented in Box 5.1,[25] and depending on the movement in other impairment costs and gross income, the banks will have to increase their capital by between EUR 200 million and EUR 500 million over the next two years to maintain their operations at the current level[26] and achieve a core Tier 1 capital ratio of 9%[27].

Box 5.3: Chronological review of Bank of Slovenia measures to mitigate the effects of the financial crisis

The Bank of Slovenia analysed and warned of the risks and vulnerability of the banking system, prior to the outbreak of the financial crisis. In accordance with these assessments, it adopted systemic measures and actively worked towards mitigating the effects of systemic risks. Examples of such measures were the introduction of the prudential filter in 2006 and action taken in the context of a rise in Swiss franc loans. Both measures acted to maintain the already high lending growth achieved prior to the outbreak of the crisis.

In early 2006 the Bank of Slovenia introduced the prudential filter as a deduction item from original own funds to correspond with the introduction of the International Financial Reporting Standards (IFRS), which meant a significant reduction in the scope of required impairments. Thus, accumulated provisions and impairments at that time were not transferred to profit to be distributed to shareholders, but were transferred to capital. Despite numerous efforts by the banks and external auditors to abolish the prudential filter, the Bank of Slovenia maintained this form of reserves until October 2008, when the financial crisis intensified. By abolishing the prudential filter, the Bank of Slovenia acted anti-cyclically to mitigate the contraction in the banks' lending activities in the early period of the crisis's development. The abolishment of the prudential filter resulted in an increase in regulatory capital of EUR 308 million, which had the favourable effect of increasing the capital adequacy of the majority of banks.

In a letter back in 2006, the Bank of Slovenia warned of the management of risks arising from foreign currency loans, loans tied to foreign currencies and credit products that expose clients to market risk. It warned the banks that they must establish an appropriate and effective risk management system, required the comprehensive notification of clients about the characteristics of products offered by the banks, and required the banks to initially offer clients their products in euros at all times. At the end of 2007 the Bank of Slovenia also required that the banks assess a client's creditworthiness if, despite being briefed on currency risk, the client still wishes to raise a loan in a foreign currency or tied to a foreign currency, by taking into account the raising of an equivalent loan, and considering the amount determined as such as the maximum possible loan amount. Year-on-year growth in new loans to the non-banking sector tied to the Swiss franc was thus -38% in 2008 and -65% in 2009. The banks have not approved loans to households tied to the Swiss franc exchange rate since 2009.

Since 2007 the Bank of Slovenia has recommended every year that the banks use a major portion of disclosed profit to create reserves and thus increase capital. To that end, the 2008 Financial Stability Review warned the banks of the less than optimal structure and scope of capital linked to high credit growth, and of the rising proportion of subordinated instruments in the structure of regulatory capital.

Specific measures to mitigate the effects of the financial crisis following its outbreak:

2008

In addition to the abolishment of the prudential filter in October, which slowed the contraction in the banks' lending activities by improving their capital adequacy, the Bank of Slovenia also revised the calculation of liquidity ratios for the value of assets pledged as collateral at the central bank in the first bucket of the liquidity ladder. Thus, the regulatory barrier to drawing liquid funds at the ECB was eliminated.

In November the Bank of Slovenia called on banks to limit the level of interest rates on sight and short-term deposits, as the transfer of deposits between banks in the context of a full government guarantee only increased the instability of deposits, instead of encouraging additional saving. The announced possible use of measures to sanction continuing inappropriate interest-rate policies, by which the Bank of Slovenia was at liberty to change how the aforementioned deposits are taken into account in the calculation of the liquidity ratio, proved unnecessary. It also called on banks to create a higher level of impairments and provisions, by taking into account the effects of the deterioration in the economic situation on the operations of corporates from specific sectors.

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[25] Estimated impairment costs according to the formula EL = PD * LGD * EAD.

[26] Assuming a static, i.e. unchanged, balance sheet.

[27] The upper limit is determined on the assumptions that gross income will decline by 3% in 2012, similar to 2011, and remain at this level in 2013. Also taken into account is the assumption that the other impairment and provisioning costs, which do not relate to credit risk, created by the banks in 2012 will be at the level recorded in 2011, and down slightly on that amount in 2013. This means that 2012 would be only marginally better than 2011 in terms of results, while results would improve in 2013, although the banking system as a whole would still generate a loss. A more optimistic scenario assumes that other impairment costs in 2011, which do not relate to credit risk, were the result of one-off events, and that the scope of such impairment and provisioning costs would be significantly smaller over the next two years. This scenario also assumes that gross income will remain at the 2011 level in 2012 and 2013 in the context of an unchanged balance sheet. The figures are on an individual basis.

2009

In the context of rising credit risk, the Bank of Slovenia called for the appropriate valuation of specific instruments and for an adequate level of impairments and provisions. It also warned that impairments and provisions may not reflect in full the deteriorating situation, which had become increasingly more evident. At the same time, it called on banks to coordinate their planned lending activities with available and stable sources of funding, and to allocate the majority of earnings generated in 2008 to reserves. The Regulation on the assessment of credit risk losses of banks and savings banks was amended to require monthly reporting (and disclosure in the income statement) of impairments and provisions, and classified claims. At the same time, a requirement for additional information regarding collateral on claims was introduced in the reporting system.

In June the Bank of Slovenia warned of the need for improvements in risk management at the banks. A letter from the Bank of Slovenia included requirements regarding the repeated (i.e. more than twice) rolling over of short-term loans without cash flows arising from the repayment of loan principals. To that end, the banks may not include such loans in the calculation of liquidity ratios for first and second buckets of the liquidity ladder, and must create a sufficient level of impairments for the aforementioned loans. At the same time, a requirement was issued that regulatory high-risk exposures should also include the financing of acquisition activities. In June the Bank of Slovenia adopted recommendations for coordinated action by creditor banks in the event of corporates in financial difficulties.

2010

Despite a recovery in economic activity in 2010, uncertainty on the financial markets continued with the escalation of the debt crisis in certain euro area countries. For this reason, the Bank of Slovenia sent a letter to the banks calling on them to allocate the profit generated in 2009 to other profit reserves with the aim of strengthening their capital. At the same time, it warned the management board of the banks that they should assess the need to increase capital in 2010, and to prepare for and carry out capital increases in a timely manner on the basis of the aforementioned assessment.

In July the Bank of Slovenia adopted a decision, by which the banks must, in the scope of the internal capital adequacy assessment process (ICAAP), cover 80% of internally assessed capital requirements with original own funds calculated in accordance with the regulation governing the calculation of capital. The measure was aimed at improving the structure of the quality of the banks' capital, as it became clear that the financial crisis was developing into a deep economic crisis.

In order to improve the system for managing problematic investments, in October the Bank of Slovenia amended the Regulation on risk management and assessment of internal capital adequacy for banks and savings banks by tightening requirements regarding the treatment and monitoring of problematic loans (e.g. systematic treatment, the establishment of IT-supported records for monitoring repayments and write-offs, etc.).

2011

In January the Bank of Slovenia banks once again called on banks to assess their needs for capital in 2011, and to draw up procedures for their strengthening accordingly. It called upon the management boards of the banks to adopt resolutions at general meetings on the allocation of profits to reserves with the aim of strengthening the banks' capital.

The Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks was amended in September, such that the weights applied to the sight deposits of households and non-financial corporations were reduced by 10 percentage points to 40% in the first bucket and to 35% in the second bucket of the liquidity ladder, thus bringing the treatment of such deposits in line with the treatment envisaged in the scope of the LCR liquidity standard. This reduced the banks' liabilities for investments in the first and second buckets by more than EUR 800 million, thus making it easier to manage the structure of investments. Exposure to rising refinancing risk was reduced as a result of a renewed, significant deterioration in the situation on the European financial market. This also alleviated the pressure on the reduced lending activity of the banks.

A letter sent to the banks in November outlined recommendations for the more efficient collection of non-performing claims, either directly from the debtor or via the redemption of collateral.

2012

In February the Bank of Slovenia adopted amendments to the internal capital adequacy assessment process (ICAAP) guidelines, such that increased profitability risk arising from liability interest rates will require additional capital in the scope of the ICAAP for a period of one year in advance. The measure reduces the banks' exposure to profitability risk by encouraging greater prudence in setting the level of liability interest rates, which also has a positive impact on the level of lending rates in the economy overall.

In March the Bank of Slovenia amended the definitions of past due items and significant credit exposure in arrears in connection with the definition of default for the purpose of calculating capital requirements for credit risk. A loan obligation in arrears is significant at the latest when it exceeds 2% of the open exposure or EUR 50,000 for more than 90 days, but is at least EUR 200 (previously EUR 1,000 EUR for corporate clients and EUR 100 for retail clients). The same definition was introduced in April for the purpose of identifying clients in default in the scope of reporting banks' exposures to individual clients. Reporting by the banks was also supplemented to include reporting on the amount of an exposure where a client is more than 90 days in arrears. With the aforementioned amendments, the definition of clients in default is more comparable with the definition applied by other euro area countries.
By amending the Regulation on the minimum requirements for ensuring an adequate liquidity position at banks and savings banks in April, the Bank of Slovenia tightened conditions regarding the inclusion of credit lines and the undrawn portion of loans, such that the aforementioned instruments are not included in the calculation of liquidity to their full amount, but gradually up to the amount of 50% of their value. The measure is aimed at reducing exposure to liquidity risk due to the persistent adverse situation on the financial markets, while bringing these sources of liquidity more in line with the requirements of the LCR liquidity standard.

With the aim of reducing the proportion of non-performing investments in the banks' balance sheets, which is rising due to protracted collection procedures, and with the aim of accelerating the process of redeeming real estate collateral, the Regulation on the assessment of credit risk losses of banks and savings banks was amended in April, such that the banks will be forced to write off financial assets measured at amortised cost which, during the collection process, they assess will not be recovered and which meet the conditions for derecognition from the statement of financial position according to the IFRS. The aforementioned financial assets must be accounted for off-balance-sheet until the legal basis is secured for the conclusion of collection proceedings. This measure will reduce the proportion of non-performing investments by slightly less than 1 percentage point.

This review only includes key systemic supervisory measures and the measures for ensuring financial stability that applied to the entire banking system and that reduced the banking system's exposure to key risks during the financial and economic crisis. There were also numerous supervisory measures that were aimed at eliminating deficiencies and breaches at specific banks.

6 NON-BANKING FINANCIAL INSTITUTIONS

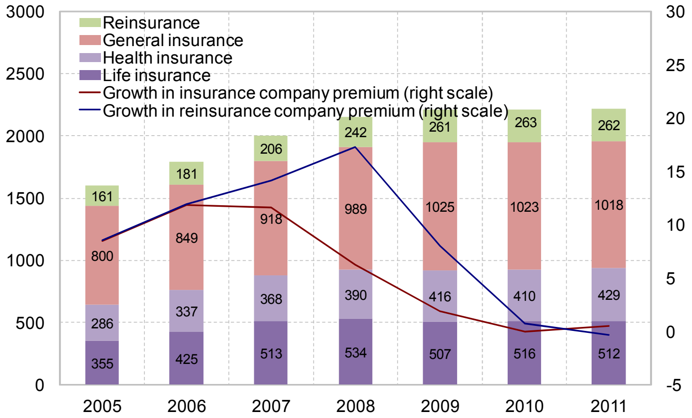
6.1 Insurers

6.1.1 Features of insurers' business and comparison with the EU

The process of reducing the high concentration in the insurance sector continues.

There were 16 insurance companies and two reinsurance companies operating in Slovenia last year. The number of insurance companies was up last year with the establishment of Modra zavarovalnica d.d. during the transformation of Kapitalska družba d.d. in October 2011. Modra zavarovalnica d.d. took over the management of the Closed Mutual Pension Fund for Civil Servants (ZVPSJU), the Capital Mutual Pension Fund (KVPS), the First Pension Fund of the Republic of Slovenia (PPS) and the Guarantee Fund of the PPS (KS PPS). The largest insurance company accounted for 36% of written premiums last year, while the three largest accounted for 63% of the market. Concentration in the insurance sector is decreasing very slowly. The largest life insurance company covers 41% of the life insurance market, while the largest general insurance company covers 34% of the general insurance market. The market share of the largest reinsurance company was unchanged relative to the previous year at 54%.

Figure 6.1: Gross written premium by type of insurance in EUR million (left scale) and annual growth in percentages (right scale)



Source: ISA

Written premium was down for general insurance and life insurance, but up for health insurance.

Gross written premium was up 0.5% in 2011 compared with the previous year. The main reason for the low growth in gross written premium is the deteriorating economic situation, which is driving down the volume of underwritten insurance. Written premium was down 0.7% for life insurance and 0.4% for general insurance, but was up 4.6% for health insurance.

Table 6.1: Total gross written premium and gross written life insurance premium of insurance companies expressed in various categories for Slovenia in 2011 and for selected countries in 2010

	Slovenia	Euro area	EU 27	Portugal	Austria	Germany	UK
Total premium, EUR billion	2.0	802.8	1,105.4	16.4	16.7	177.2	225.2
per capita, EUR	956	2,257	2,037	1,527	1,986	2,132	3,224
as % GDP	5.5	8.2	8.4	9.5	5.9	7.1	11.9
Life insurance premium, EUR billion	0.5	478.7	677.9	12.2	7.6	86.1	150.4
per capita, EUR	250	1,323	1,267	1,137	896	1,044	2,417
as % of total premium	26.1	59.6	61.3	74.4	45.1	48.6	66.8
as % GDP	1.4	4.8	5.2	7.1	2.6	3.5	8.9

Sources: ISA, Swiss Re, Bank of Slovenia calculations

The adverse economic situation and diminishing consumer purchasing power have had a negative impact on demand for life and accident insurance. Life insurance premium recorded the sharpest growth in 2011 (of 4.6%) to stand at EUR 428.5 million, while voluntary supplementary pension insurance premium recorded the sharpest fall (of 6.3%) to stand at EUR 46.3 million. An increase in supplementary health insurance premium drove the growth in total health insurance premium, while the decrease in voluntary supplementary pension insurance premium was the result of the adverse economic situation, which is not favourable for additional savings. Growth in premium was negative for the third consecutive year for this reason.

Deterioration in the indicator of the level of development – 42.3% of premium per capita compared with euro-area countries.

Insurance penetration remained at around the same level as the previous year, at 5.5% of GDP, equivalent to EUR 956 per capita. Insurance penetration rose in euro area countries in 2010, followed by a decline in this indicator of the level of development to 42.3%. The Slovenian life insurance sector still lags well behind Europe. Premium per capita was EUR 250 in 2011, down 0.9% on the previous year, representing 18.9% of the euro area average. Further closing of the gap in the level of development of insurance in euro area countries can be expected when economic growth strengthens and disposable household income rises.

Life insurance and contractual integration of insurers

The total assets of life insurance amounted to EUR 3,303 million at the end of 2011, or 58.0% of insurers' total assets. Written life insurance premium was down 0.7% in 2011, while the number of policyholders was down 1.4% as a result of the economic crisis and diminishing consumer purchasing power. The number of unit-linked life insurance policyholders was up, despite a decrease in written premium, primarily as the result of moratoriums. In 2011 the proportion of total written premium accounted by life insurance fell to the level recorded in 2009. The proportion of life insurance premium accounted for by traditional insurance was up 0.7 percentage points, while the proportion accounted for by voluntary supplementary pension insurance recorded the sharpest fall, of 0.5 percentage points.

In the life insurance segment overall, early terminations (with or without redemption) were up 31.4% on 2010. The increase in early terminations relative to the previous year was seen in all categories of life insurance. The most likely cause is the financial distress faced by policyholders and their disappointment with returns on insurance policies.

Table 6.2: Insurers' written premium in EUR million and number of policyholders for life insurance and pension insurance

	2008	2009	2010	2011	2008	2009	2010	2011
Life insurance total					Growth, %			
premium, EUR million	534	507	516	512	4.1	-5.1	1.8	-0.7
number of policyholders	1,196,312	1,206,786	1,289,533	1,271,939	4.9	0.9	6.9	-1.4
Unit-linked life insurance					Proportion of life insurance, %			
premium, EUR million	252	233	246	243	47.1	45.9	47.6	47.5
number of policyholders	361,639	432,509	478,079	523,211	30.2	35.8	37.1	41.1
Voluntary supplementary pension insurance								
premium, EUR million	57	49	49	46	10.7	9.8	9.6	9.0
number of policyholders	123,281	81,295	82,530	83,737	10.3	6.7	6.4	6.6

Source: ISA

The trend of increasing integration of banks and insurers in the marketing of insurance products continued in 2011. The volume of transactions in terms of written life insurance premium was up 22.9% in 2011 at EUR 47.5 million. This marketing channel (i.e. banks) accounted for 9.3% of insurers' written life insurance premium in 2011.

Insurers' financial statements[28]

Insurers' total assets stood at EUR 5.7 billion at the end of 2011.

Insurers' total assets were up 4.7% to EUR 5.7 billion during the 2011 financial year. The total assets of general insurance were down 0.4% during the same period, while those of life insurance were up 8.8% to stand at EUR 3.3 billion. The total assets of reinsurance companies were down 0.3% to stand at EUR 622 million between the third quarter of 2010 and the third quarter of 2011.

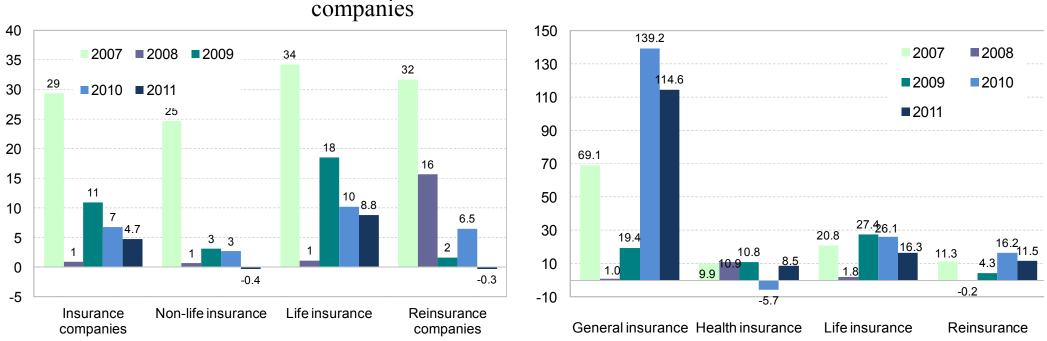
Low interest rates have a favourable impact on the assets and a negative impact on the liabilities of insurers.

Low interest rates and the resulting high prices of investment-grade debt securities characterised 2011. Changes in interest rates affect both the asset and liability side of insurers' balance sheets. The prices of bonds are high due to low interest rates, which has a favourable impact on insurers' assets. Such securities account for a high proportion of Slovenian insurers' investments, resulting in an increase in their total assets in 2011. The negative impact of low interest rates is also significant in life insurance and pension insurance contracts. Insurers must take into account lower long-term interest rates to calculate the present value of future liabilities, which results in higher liabilities. This

[28] The financial statements are unaudited.

problem has a particularly negative impact on the operations of insurers, who underwrote a large number of insurance policies with a guaranteed return, and on the operations of providers of supplementary pension insurance, who are required by law to ensure policyholders a minimum guaranteed return on paid-in premium. The providers of these forms of insurance are unable to generate promised returns for policyholders with their investment portfolio during a period of low returns on the capital markets. The difference between the guaranteed and actual return must be provided from provisions. If this is insufficient, owners must provide funds via recapitalisations. A sustained period of low interest rates increases the risk that insurers and voluntary pension insurance providers will become capitally inadequate. The overall effect of the low interest rates on the balance sheets of insurers depends on the maturity of an individual insurer's assets and liabilities. It is typically true for life insurance and pension insurance that the maturity of liabilities is longer than that of assets. Therefore, the effect is for the most part negative.

Figure 6.2: Growth in total assets in percentages (left) and result from ordinary activities in EUR million (right) of insurance companies and reinsurance companies

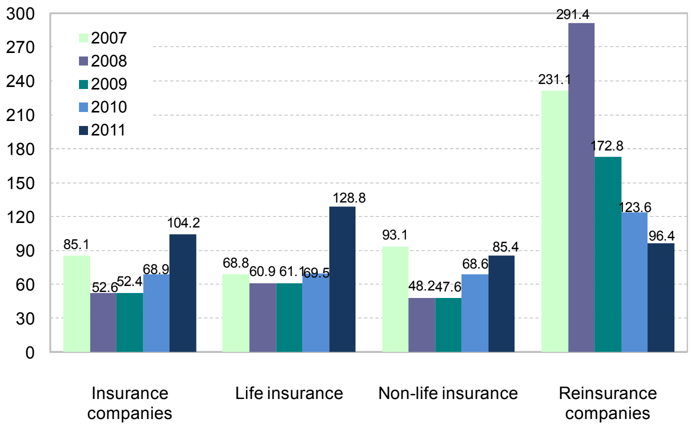


Note: The figures for reinsurance companies in 2011 relate to the end of the third quarter.
Source: ISA

Insurance and reinsurance companies generated a profit last year.

The performance of insurers improved last year, despite the adverse economic situation. Insurers generated a net profit of EUR 99 million. Three life insurance companies and one health insurance company generated a loss. Those insurers generating a loss accounted for 6.9% of gross written life insurance premium. The profitability indicators of insurers nearly reached the pre-crisis level of 2006. ROE and ROA stood at 10.5% and 1.8% respectively last year.

Figure 6.3: Surplus of available capital over minimum capital requirements at insurance companies and reinsurance companies in percentages



Note: The figures for reinsurance companies in 2011 relate to the end of the third quarter.
Source: ISA

The capital of four insurers was increased last year, in the total amount of EUR 40.2 million at life insurance companies and EUR 25.8 million at general insurance companies. The objectives of the capital increases included growth of insurers, compliance with the Solvency II Directive and ensuring target credit ratings.

Strategic investments in the Balkans represent major problems for insurers. It is highly likely that insurers with companies in the aforementioned region will require recapitalisations in the future[29].

The introduction of the Solvency II Directive will bring about significant changes in the future. Insurers have been preparing for full introduction in 2014 for several years. The gradual introduction of the aforementioned directive will begin a year earlier. In addition, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) are developing new accounting standards for insurers that will facilitate the improved comparability of the financial statements of insurers from different countries.

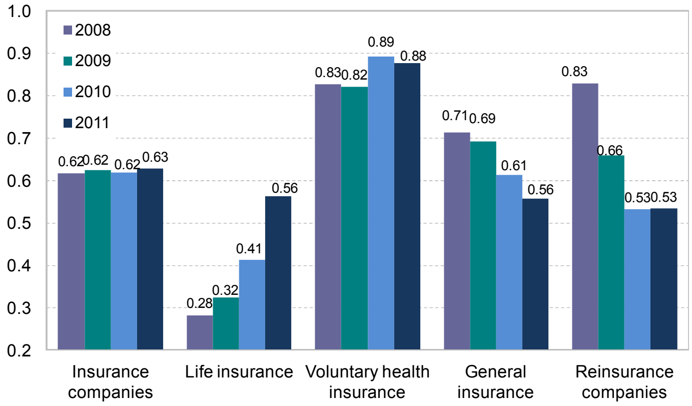
6.1.2 Stability of the insurance sector

Underwriting risk

The claims ratio improved for general insurance and deteriorated for life insurance.

The claims ratio at insurers as measured by the ratio of gross claims paid to gross written premium rose by 0.01 index points in 2011 to stand at 0.63.The claims ratio in general insurance improved as a result of adequate reinsurance and a larger decline in claims paid than in gross insurance premium. The claims ratio for life insurance deteriorated by 0.15 index points. The main reason lies is the deterioration in the claims ratio for pension insurance, where there was a pronounced rise in claims for survival and early termination of insurance. The proportion of insurers' risk retained in general insurance remained at 80.8%.

Figure 6.4: Claims ratio for major types of insurance



Source: ISA

The risk of extraordinary events, natural disasters and extreme weather conditions is rising as a result of climate change, which leads to an increase in damages paid owing to a rise in loss events. The operations of insurance companies, and in particular reinsurance companies, around the world were characterised by catastrophic events in 2011, including floods in Australia, earthquakes in New Zealand and Japan, tornadoes in the United States and the eruption of a volcano in Iceland. There were no major natural disasters or catastrophic events in Slovenia in 2011, which is one of the main reasons for the more favourable claims ratio for general insurance claims at insurance companies and reinsurance companies.

As of 21 December 2012 insurers will no longer be allowed to take into account a policyholder's gender as a risk factor in insurance policies. This will lead to changes in the premiums charged for health, accident, annuity, pension and life insurance. This results in the risk that insurers will systematically select policyholders to achieve the best possible ratio between genders.

On 18 April 2011 the European Commission filed suit with the European Court due to the non-compliance of regulations governing supplementary health insurance with EU law. The Court partially affirmed the European Commission suit on 26 January 2012. Slovenia

[29] In November 2010 Zavarovalnica Triglav d.d. established the holding company Triglav INT d.d., to which it transferred its participating interests in subsidiary insurance companies of the Triglav Group outside of Slovenia in 2011. In April 2012 the two companies signed an agreement with the International Finance Corporation on recapitalisation. Through a EUR 25 million contribution, the International Finance Corporation will become holder of a 16.7% participating interest in Triglav INT d.d.

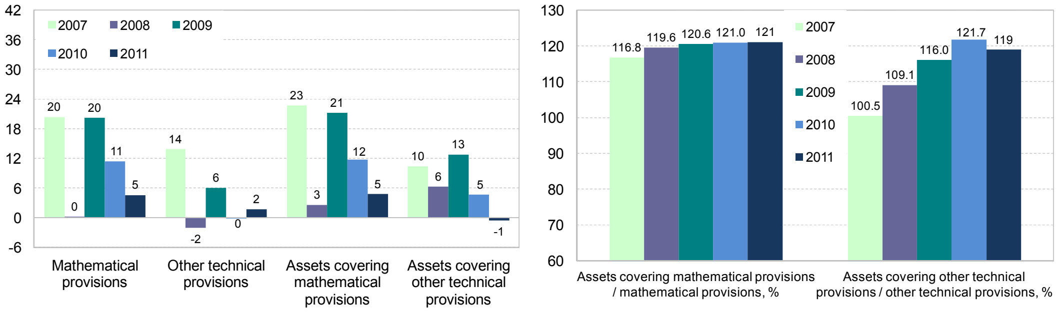
will therefore have to change the way it finances its healthcare system. Government proposals for healthcare reform are not known yet. The insurance sector is expected to contract by one fifth with the abolishment of additional health insurance. Health insurance is one of the most important insurance products offered by Slovenian insurers.

Investment risk

Coverage of insurance technical provisions by assets covering technical provisions decreased to 120.3%

Assets covering technical provisions rose by 2.8% last year to EUR 4,614 million, or 12.9% of GDP. The ratio of assets covering mathematical provisions to assets covering technical provisions rose again, to 1.8. Coverage of net insurance technical provisions by the assets covering technical provisions decreased by 0.9 percentage points in 2011 to 120.3%. The coverage of the mathematical provisions by assets covering mathematical provisions for life insurance and health insurance increased last year by 0.1 percentage points to 121.1%. The calculation of provisions is based on an accounting approach.

Figure 6.5: Growth in net insurance technical provisions and assets for general insurance and life insurance (left), and coverage of net insurance technical provisions by assets covering technical provisions (right) in percentages

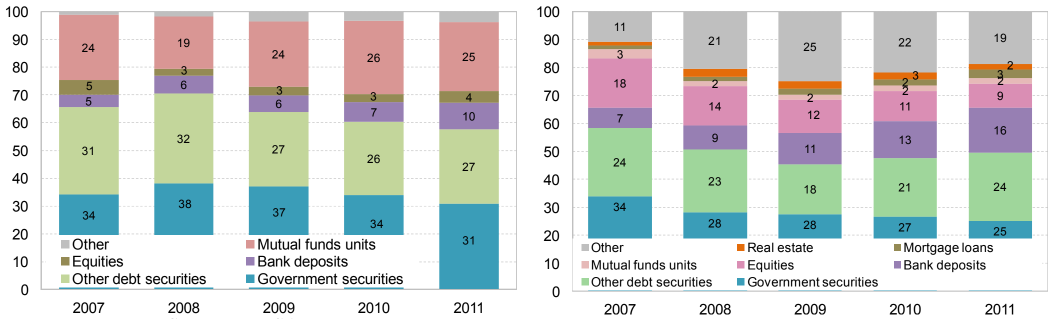


Sources: ISA, Bank of Slovenia calculations

The proportion of insurers' investments accounted for by the safest forms of investments in deposits, government securities and other debt securities has risen since 2009. The proportion of insurers' total investments accounted for by the safest forms of investments stood at 63.3% at the end of 2011. Slovenian insurers generally have a higher proportion of conservative investment than their euro area counterparts.

Deposits recorded the largest increase as a proportion of life insurance investments, by 2.4 percentage points, to stand at 9.5%. The reasons lie in an increased number of early terminations of long-term agreements and the high interest rates on deposits offered by banks, which represented an attractive investment alternative for insurers last year. The proportion of investments accounted for by debt securities declined by 2.6 percentage points to 57.6%. The proportion of investments in foreign securities remained at the same level recorded in 2010, at 43.3%. The proportion of general insurance investments accounted for by deposits was up 3 percentage points to stand at 16.2%. The proportion of equities was down 2.1 percentage points to stand at 8.6%.

Figure 6.6: Structure of insurers' assets covering mathematical provisions (left) and assets covering technical provisions other than mathematical provisions (right) in percentages



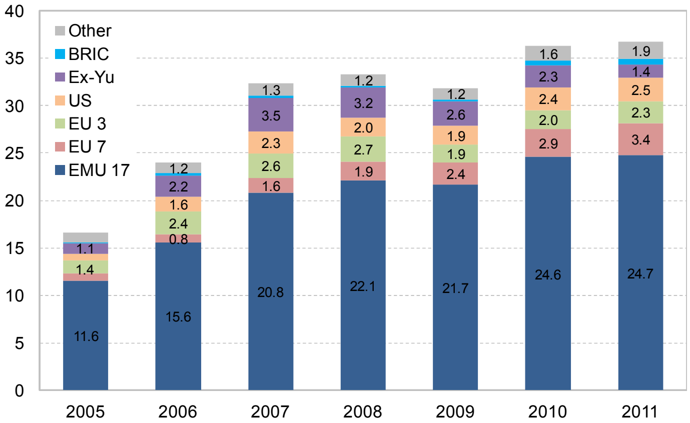
Source: ISA

Insurance companies are gradually reducing their proportion of domestic investments.

Insurers still demonstrate a greater propensity to invest in domestic securities than is otherwise logical given the size of the domestic market relative to the global capital market. The so-called "*home bias*" thus remains pronounced. The proportion of total investments accounted for by investments in the securities of domestic issuers stood at

63.3% at the end of 2011, down 0.5 percentage points on the previous year. The entire insurance sector's investments in the rest of the world totalled EUR 2,666 million last year. Net purchases of foreign debt securities amounted to EUR 159.1 million, with half of those purchases in the securities of euro area countries. The net purchases of foreign equities in the amount of EUR 57.8 million were partly the result of recapitalisations at branches in the rest of the world, in particular in the former Yugoslav republics. Insurers again generated high capital losses from investments in the equities of companies from the former Yugoslav republics, in the amount of EUR 84 million. Losses were covered in part by positive revaluation in the amount of EUR 30 million from investments in the equities of companies from euro area countries and the US.

Figure 6.7: Proportion of life insurance investments accounted for by foreign investments in percentages



Source: Bank of Slovenia

Insurers are highly exposed to the Slovenian government.

Insurers do not have a high proportion of investments in the countries where the debt crisis has been most pronounced. Investments in Italian, Irish and Spanish securities accounted for 3.2% of the entire insurance sector's investments at the end of 2011, and for 8.7% of all investments in foreign securities. Insurers created additional impairments for Greek securities this year. In terms of credit risk, any further downgrading of Slovenia would entail increased risk for the insurance sector. Slovenian government bonds accounted for 17.4% of the insurance sector's investment portfolio or EUR 1,263 million at the end of 2011. The value of the aforementioned investments fell during the second half of 2011 owing to a rise in the required yield on these bonds, which had a negative impact on the asset side of insurers' balance sheets.

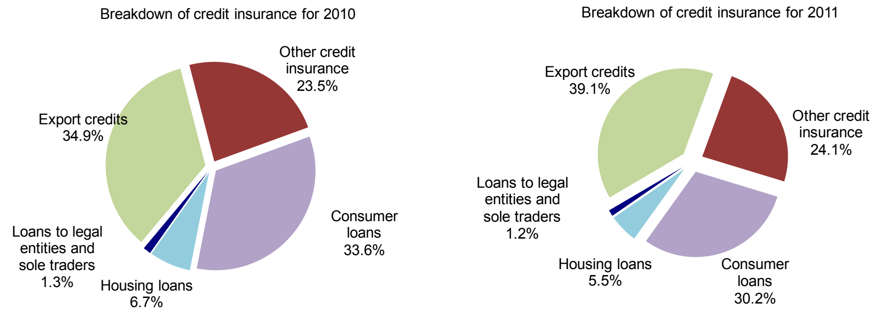
The government holds a significant participating interest in major insurers. The downgrading of Slovenia could thus result in the downgrading of insurance companies and reinsurance companies. In addition, the reinsurance company Pozavarovalnica Sava reports that some of its transactions are directly linked to maintaining an "A" credit rating. Zavarovalnica Triglav and the reinsurance company Pozavarovalnica Triglav maintained their "A" Standard & Poor's credit rating in 2011, while the reinsurance company Pozavarovalnica Sava maintained its "A-" Standard & Poor's credit rating .

6.1.3 Influence of insurers on the stability of the banking sector via credit insurance

Written credit insurance premium was down, while the claims ratio improved.

Written credit insurance premium was down 3.8% in 2011, as a result of the bank's reduced lending activity last year. The claims ratio, which rose sharply in 2009 and 2010, and reached 0.99 in 2010, improved slightly to stand at 0.86 due to a sharper decline in claims paid than in premium written. Claims paid were down 17.0%. Insurers achieve the best claims ratio in insurance for securing export claims and housing loans. The claims ratio was worst in insurance for sole traders and other legal entities owing to difficulties in the repayment of liabilities, and due to bankruptcy and composition proceedings. The proportion of insurers' total written premium accounted for by credit insurance fell to 2.3%, and to 3.1% as a proportion of written general insurance premium.

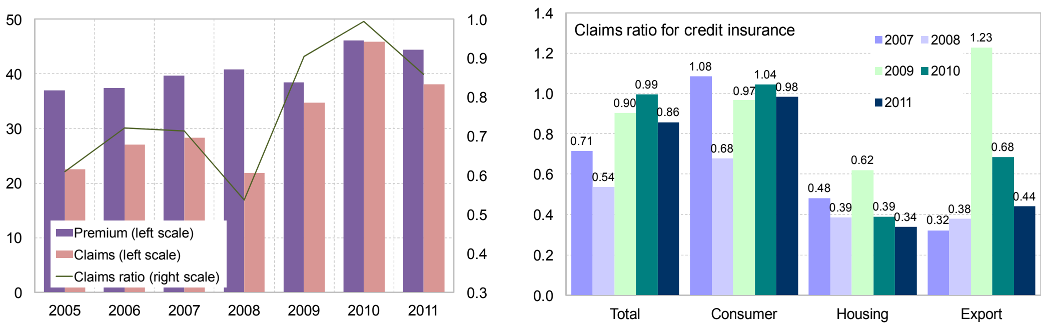
Figure 6.8: Breakdown of written premium from credit insurance in percentages



Source: ISA

The sum insured for consumer loans declined by 13.7% last year, while the sum insured for housing loans was down 21.7%. At 73.1% and 66.0% respectively, written premium for consumer loans and written premium for housing loans were at the level of written premium in the year prior to the crisis, i.e. in 2006. The reasons for the aforementioned decline lie in the reduced volume of loans to households and reduced private consumption. The sum insured for export credits was up 7.6% last year.

Figure 6.9: Written premium and claims paid in EUR million, and claims ratio for credit insurance



Source: ISA

The tightening of banks' credit standards has resulted in an increase in the proportion of credit insurance written by Slovenian insurers on loans to the non-banking sector in recent years. The sum insured by Slovenian insurers for credit insurance stood at EUR 7,189 million at the end of 2011, the proportion of loans to the non-banking sector covered by the aforementioned sum having risen to 21.8%. The sum insured for export credits was up 13.1% in 2011 relative to the previous year, at EUR 4,196 million. The sum insured for credit insurance on housing and consumer loans stood at EUR 527 million at the end of 2011, down 15.6% relative to 2010. The sum insured for credit insurance as a proportion of loans to households was down 1.3 percentage points on 2010 to stand at 6.0%.

6.2 Voluntary supplementary pension insurance

The first 10-year period elapsed for policyholders in 2011, entitling them to a lump-sum payment of funds saved. The total number of policyholders covered by voluntary supplementary pension insurance via pension companies and insurers fell by 6,153 last year. The number of policyholders decreased by 3.5% at pension companies and by 0.5% at insurers. The number of mutual pension fund policy holders increased by 3,720 or 1.5% over the same period. The reasons for the differences between providers in terms of changes in the number of policyholders lie in the differences in the duration of insurance policies. The majority of policyholders were included in corporate pension funds until 2003. Mutual pension funds achieved a nearly 50% share of all policyholders with the adoption of the Collective Supplementary Pension Insurance Act in 2003 and the inclusion of public sector employees in collective supplementary insurance. It is important to emphasise that the objective of additional pension savings is to supplement the old-age pension. Withdrawing funds after 10 years of savings therefore has an adverse impact on efforts to achieve this objective.

The participation of employees in supplementary pension insurance is high, although they pay low premiums.

Employee participation in voluntary supplementary pension insurance is relatively high, as 61.90% of all pension and disability insurance policyholders are included. The problem remains the low average monthly premium paid by policyholders. In 2011 the average gross premium paid per policyholder was EUR 32.3 for insurers, EUR 41.1 for pension companies and EUR 34.3 for mutual pension funds. Such low premiums will not provide policyholders a high level of supplemental old-age pension.

Pension reform is crucial due to demographic trends.

The pressure is increasing on the compulsory pension and disability insurance fund. The number of policyholders at the Pension and Disability Insurance Institute fell by 1.4%, while the number of pensioners was up 2.8%. This led to a deterioration in the ratio of the workforce in employment to the number of pensioners to 1.48. The main reason for the deterioration in the aforementioned ratio is the continuing economic crisis. The registered unemployment rate was up 0.3 percentage points at the end of 2011, relative to the end of the previous year, to 12.1%. In addition, there is a gradual but clear trend of an ageing population. Eurostat's Europop2010 population projection estimates that the proportion of the Slovenian population over the age of 65 will increase from 16.5% in 2010 to 31.6% in 2060, while the proportion of the working-age population will fall from 69.4% in 2010 to 54.8% in 2060. According to these projections, there will be nearly 58 persons over the age of 65 for every 100 persons of working age in 2060, while that figure stood at 24 in 2010.

There is also a risk of an unexpected prolongation in life expectancy, referred to as "*longevity risk*". A key risk factor is the difference between the expected and actual life expectancy of the population. The government and voluntary supplementary pension insurance providers are most exposed to the aforementioned risk. Risks to financial stability derive from the increased risk of unsustainable fiscal policy, the instability of the pension system and the insolvency of supplementary pension insurance providers due to the unexpected increase in their liabilities. From the government's point of view, one potential solution to the problem is to adjust the retirement age to the prolongation of the expected life expectancy of the population[30]. The liabilities from the pension contracts of supplementary pension insurance providers are based on mortality tables. Analyses of the expected life expectancy of the population have shown that past life expectancy forecasts were underestimated (Bongaarts and Bulatao, 2000[31]). The most significant errors were made in the categories of the youngest and oldest members of the population owing to excessively high assumptions regarding birth and mortality rates. The assumption used in the projections that the prolongation of life expectancy of the population would come to a halt was wrong (Shaw, 2007[32]). Over the last 25 years, the life expectancy of Slovenes in the 60 to 64 age group has lengthened by around five years for men and seven years for women.

Table 6.3: Voluntary supplementary pension insurance providers: number of policyholders, written premium and assets

	2007	2008	2009	2010	2011
Number of policyholders	486,816	512,343	532,716	539,650	537,217
Breakdown, %					
mutual pension funds	47.4	46.6	46.3	46.9	47.8
insurers	23.3	24.1	24.6	23.6	23.6
pension companies	29.3	29.3	29.1	29.5	28.6
Written premium, EUR million	220	243	231	233	228
Breakdown, %	9.1	10.4	-4.8	0.9	-2.1
mutual pension funds	43.2	42.0	45.9	45.6	46.0
insurers	21.2	24.7	21.4	21.2	20.3
pension companies	35.6	33.3	32.7	33.2	33.8
Assets, EUR million	956	1,212	1,528	1,794	1,846
Breakdown, %					
mutual pension funds	45.9	39.9	42.4	42.5	44.2
insurers	12.3	22.1	21.5	21.3	21.3
pension companies	41.8	38.0	36.1	36.2	34.5

Sources: ISA, SMA

[30] This applies, for example, to the retirement age in Denmark from 2025 onwards.

[31] J. Bongaarts and A.B. Rodolfo, 2000. *Beyond Six Billion: Forecasting the World's Population*. Washington: National Academy Press.

[32] C. Shaw, 2007. Fifty Years of United Kingdom National Population Projections: How Have They Been Accurate? Office for National Statistics, *Population Trends 128*, pp. 8-23.

Growth in the average pension was 0.3% last year, lower than the growth in the average net wage of 2.1%. The average age of new pension claimants was up two months last year to 60.3 years.

The required yield on long-term Slovenian government bonds rose in 2011 to stand at 6.9% at the end of the year. A further rise in the required yield on government securities in the future would have a direct impact on the operations of supplementary pension insurance providers, who must ensure policyholders a minimum guaranteed return on the paid-in net voluntary supplementary premium. The minimum return may not be less than 40% of the average annual yield on Slovenian government securities with a maturity of more than 1 year. The Ministry of Finance of the Republic of Slovenia, which calculates and publishes the minimum guaranteed return, published a revised calculation method in January this year. The return will be calculated once a year, and will include the annual average returns of the previous 24 months. This measure slowed the increase in the minimum guaranteed return that would have otherwise occurred under the previous calculation method. A guaranteed minimum annual return of 1.56% applies in 2012.

Table 6.4: Structure of pension funds' assets in Slovenia at the end of 2011 and in selected European countries at the end of 2010 in percentages

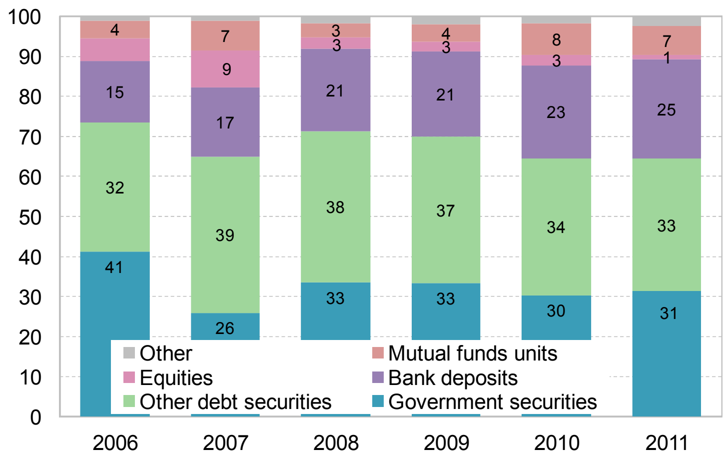
	Slovenia	Portugal	Austria	Germany	Netherlands
Structure of investments, %					
currency and deposits	24.9	10.9	8.5	3.1	4.4
debt securities	64.4	49.5	49.8	41.9	56.2
shares	1.1	21.7	32.2	5.2	19.5
mutual funds units	7.2				
other	2.4	17.9	9.5	49.8	19.8

Note: OECD figures include investments in investment funds. Their investments are disclosed by type of security.
Sources: ISA, SMA, OECD Pension Markets in Focus, October 2011, Issue 8

Failure to meet the minimum guaranteed return by supplementary pension insurance providers.

Last year only four voluntary supplementary pension insurance providers generated a return that exceeded the minimum guaranteed return[33]. The average annual return achieved by insurers and pension funds from voluntary supplementary pension insurance investments was 1.7% in 2011, while annual growth in the average unit price of mutual pension funds was -1.5%. One of the reasons for the difference in the average annual return achieved by the two groups is the different method used in the valuation of investments. Pension companies and insurers may value debt securities that they intend to hold to maturity at amortised cost, while mutual pension funds must value all investments at market value. The varying valuation methods affect the assets and returns of funds. Returns are therefore disclosed separately for specific groups of providers.

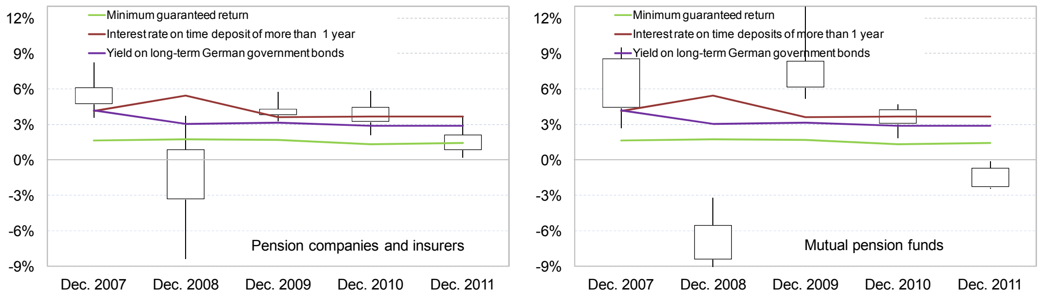
Figure 6.10: Structure of voluntary supplementary pension insurance providers' investments (left)



Sources: ISA, Bank of Slovenia

[33] The figures regarding the annual return of two insurers are based on an estimate provided by the ISA, and not on publicly available figures. These figures were not yet available to the public at the end of April.

Figure 6.11: Dispersion of returns of supplementary pension insurance providers, pension companies and insurers (left), and mutual pension funds (right) in percentages



Sources: ISA, SMA, Bank of Slovenia, ECB

Ensuring the minimum guaranteed return remains a key challenge for providers in the future. The majority of providers' investments are conservative investments that achieve a low rate of return. In addition, a significant portion of providers' investments are in Slovenian government securities, the value of which falls at exactly the same time the guaranteed return rises. There is an increased risk in such circumstances that owners will have to increase the capital of funds. The problem is further exasperated by the withdrawal of policyholders following the expiry of the associated 10-year period.

Ensuring a guaranteed return could also become a problem if voluntary supplementary pension insurance providers begin restructuring their portfolios in favour of higher-risk investments with the aim of achieving higher returns. There was no notable shift by providers to higher-risk investments last year. Providers have increased the proportion of their assets accounted for by deposits owing to the expected withdrawal of policyholders from pension insurance schemes and high deposit interest rates.

6.3 Investment funds

The investment funds' assets under management decreased by 20.8% in 2011 to stand at EUR 1.8 billion at the end of the year. The decrease was driven by net withdrawals of EUR 77.2 million and a 14.4% decrease in the weighted average unit price. In accordance with the law, the conversion of all the investment companies into mutual funds was completed in 2011.

The investment funds' assets under management decreased by 20.8% in 2011 in the context of net withdrawals in the amount of EUR 77.2 million and a 14.4% decrease in the average unit price of mutual funds.

Table 6.5: Overview of investment funds

	2007	2008	2009	2010	2011	Mar. 2012
	Assets, EUR million					
Investment funds	4,138	1,912	2,234	2,294	1,816	1,913
Mutual funds	2,924	1,513	1,856	2,054	1,816	1,913
of which foreign MFs	367	130	192	217	153	146
annual net inflows into MFs	470	-304	18	25	-77	-12
Investment companies	1,213	398	377	241	0	0
	Breakdown, %					
Mutual funds	70.7	79.2	83.1	89.5	100	100.0
Investment companies	29.3	20.8	16.9	10.5	0	0.0
	Growth, %					
Investment funds	45.4	-53.8	16.8	2.7	-20.8	-15.6
Mutual funds	51.6	-48.2	22.7	10.6	-11.5	-6.0
Investment companies	32.4	-67.2	-5.3	-36.2	-100.0	-100
AUP	28.0	-42.8	24.0	6.5	-14.4	-8.0

Sources: SMA, LJSE, own calculations

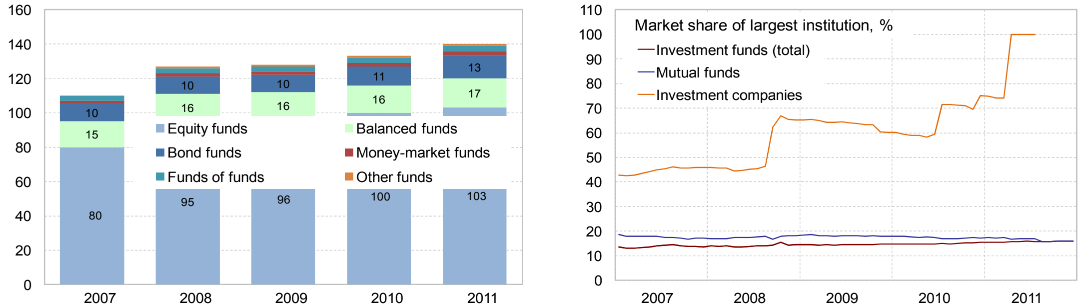
A total of 11 new domestic mutual funds were established in 2011,[34] while KD ID and NFD 1 were transformed into mutual funds in April and August respectively. Six sub-funds of the company Alta Skladi ceased to operate, as did one flexible mutual fund. There were thus 140 domestic mutual funds on the market at the end of 2011, the majority

The legally prescribed period for the transformation of all investment firms into mutual funds ended in August 2011.

[34] The term "mutual funds" is used in the text instead of "investment funds" for the sake of consistency.

of which were equity funds. The number of foreign mutual funds marketed in Slovenia rose by 33 from the beginning of 2011 until the end of March 2012 to stand at 248. The number of umbrella funds decreased from 13 to 10 in 2011, as KBM Infond assumed management of Krekova and Probanka funds, and the Alta Group assumed management of DUS Krona funds. The rationalisation of operations is resulting in an increasing number of mergers of management companies, the number of which is declining as a consequence. Nevertheless, the number of funds in which investors can invest continues to grow. A large number of mutual funds broadens the selection for investors, but reduces the transparency of the market while requiring investors to be better informed in their decisions. The media began to publish information regarding the selection of the best mutual funds with the aim of helping investors in their investment decisions, which are not necessarily always objective.

Figure 6.12: Number of mutual fund types (left) and market concentration of mutual funds (right) by year



Source: SMA

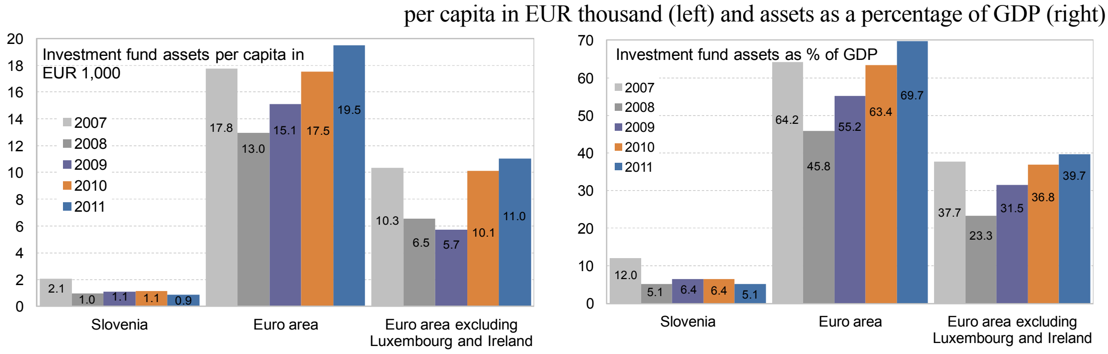
The market concentration of the domestic mutual funds decreased further last year. Only one fund held a market share of more than 7%, while none of the remaining 139 funds had a market share exceeding 5%.

Comparison of Slovenian investment funds with the euro area

Euro area investment funds were more profitable than Slovenian investment funds.

The domestic investment funds' assets per capita decreased by 21% relative to the previous year to stand at EUR 880 at the end of 2011. Investment funds in the euro area were significantly more active and profitable. The ratio of investment funds' assets to GDP was 12% in Slovenia prior to the outbreak of the crisis, but was merely 5.1% of GDP in 2011. The aforementioned decrease was primarily a result of a decrease in investment fund assets, despite the lower GDP in Slovenia. Savings in the form of mutual funds are on the decline in Slovenia, as investors prefer the advantages of deposits. The financial crisis has halted the development of this segment of the market to a great extent, as investors suffered major losses owing to the highly risky composition of portfolios. The withdrawal of investors from investment funds also came relatively late, when falling stock market indices were already strongly reflected in the devaluation of investments.

Figure 6.13: Comparison between Slovenia and the euro area in investment fund assets per capita in EUR thousand (left) and assets as a percentage of GDP (right)

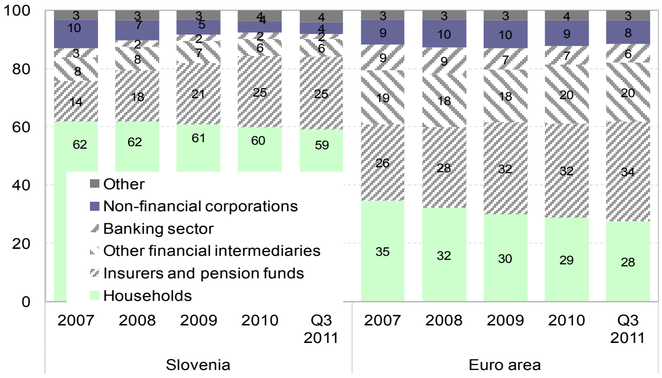


Sources: ECB, SMA, Eurostat, EFAMA, SORS

Slovenian investment funds are more exposed to the impulsive decisions of investors due to the structure of the latter.

The breakdown of ownership of investment fund units and shares in Slovenia still differs markedly from the overall breakdown in the euro area. The proportion of investment funds held by the insurance sector is increasing in Slovenia and the euro area. At 59% in the third quarter of 2011, the proportion held by households remains above average in Slovenia, despite net withdrawals of EUR 100 million. The overall proportion held by households in the euro area was almost one half lower. The high proportion of investment funds held by households in Slovenia is a consequence of the markedly lower depth of financial intermediation. The mutual funds sector in Slovenia is therefore much more exposed to the impulsive reactions of investors as a result of developments on the financial markets. As a consequence, managers must monitor the level of funds' liquidity with more prudence.

Figure 6.14: Percentage breakdown of ownership of investment fund units/shares



Note: The units/shares of all investment funds (investment companies and mutual funds), both domestic and foreign, are taken into account.
Sources: Bank of Slovenia, ECB

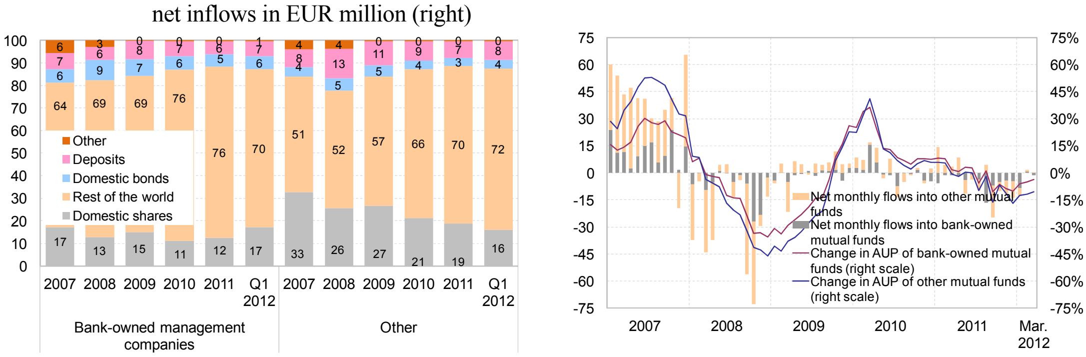
Interaction between investment funds and the banking sector

Management companies under majority bank ownership managed 40% of the domestic investment funds' assets last year. At 23.2%, the largest management company attracted the highest proportion of net inflows into investment funds. The majority of other management companies recorded net withdrawals in 2011.

Net withdrawals from mutual funds totalled EUR 77.2 million in 2011.

Net withdrawals from mutual funds totalled EUR 77.2 million in 2011. One quarter of the aforementioned amount was paid out by non-bank mutual funds, while three quarters were paid out from mutual funds under majority bank ownership. Such high net withdrawals from bank mutual funds were a result of the sale of Probanka DZU and KBM Infond, and associated transactions. Probanka DZU and KBM Infond together accounted for almost half of net withdrawals in 2011. Losses further fed investors' lack of confidence in the banks and in the management companies under majority bank ownership and, consequently, in the mutual funds those management companies manage. Also contributing to this was the sharp decline in the average unit price of funds operated by bank-owned management companies, which grew by 36% in 2010, exceeding the growth recorded in the most prosperous period of expansion, but ended 2011 with a 10.2% fall. The average unit price of funds operated by non-bank management companies was down 17% in 2011.

Figure 6.15: Comparison of mutual funds operated by management companies under majority bank ownership and others: investment structure in percentages (left), and annual growth in average unit price in percentages and monthly net inflows in EUR million (right)



Sources: SMA, own calculations

Last year the mutual funds operated by management companies under majority bank ownership maintained the same proportion of investments held in the rest of the world. The slight redistribution of investments from domestic bonds to domestic shares and deposits was a result of the transformation of the investment company NFD 1 into a mutual fund. Non-bank management companies increased their proportion of investments held in the rest of the world considerably (by 4 percentage points) and reduced their proportion of investments in domestic shares and deposits. The reasons for the increase in investments in foreign securities lie in the illiquidity of the Slovenian capital market, poor corporate governance and a lack of information for investors. Also contributing to the increase were better-than-expected operating results from the US and the resulting improvement in sentiment on the international financial markets.

The management companies required a higher level of liquid assets last year.

The management companies required a higher level of liquid assets last year due to the unstable situation on the international financial markets, resulting in an increase in debt at banks. The stock of management companies' direct debt at the domestic banks stood at EUR 88.1 million at the end of 2011, up 42.7% on the end of 2010. The increased need for liquid assets by mutual funds can also be attributed to an increase in the risk of transmitting shocks from one part of the financial sector to another. The banks' total exposure to management companies amounted to EUR 300.4 million at the end of 2011, up 11.6% on the previous year. Exposure was only up vis-à-vis two management companies. The first was due to the transformation of an investment company into a mutual fund, which requires a higher level of liquid assets in the event of investors' withdrawal, while the other was on account of borrowing for the take over of two competitor management companies.

Mutual fund investors

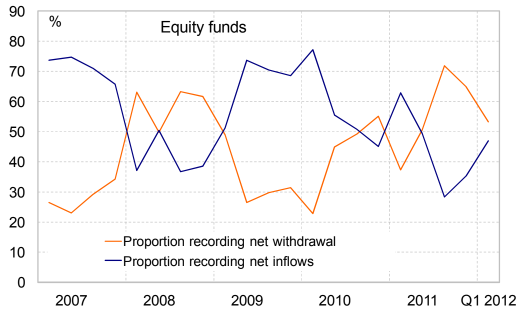
Table 6.6: Changes in the mutual funds' assets under management as a result of net inflows and other factors in EUR million

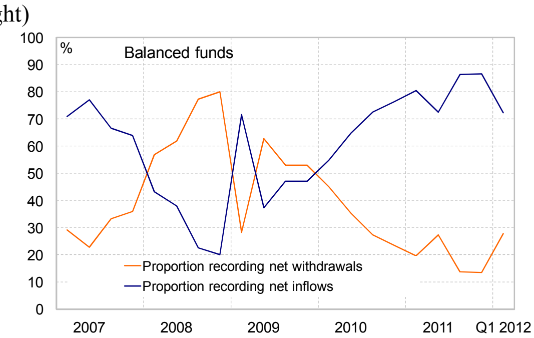
	Bond	Balanced	Equity	Money-market	Total
			2009		
Net inflows	5	-20	36	-4	18
Capital gains	2	142	181	0	325
Assets, year end	39	628	1,173	14	1,856
			2010		
Net inflows	27	-43	43	-2	25
Capital gains	3	73	97	0	173
Assets, year end	69	659	1,313	12	2,054
			2011		
Net inflows	18	-74	-34	13	-77
Capital gains	0	-83	-78	0	-160
Assets, year end	87	502	1,201	26	1,816

Sources: SMA, own calculations

The first four months of last year were marked by increased optimism in mutual funds, while investors made net withdrawals of EUR 77.2 million during the rest of the year due to the deteriorating situation. Such a high level of net withdrawals was primarily the result of a lack of investors' confidence in the financial markets due to negative developments linked to the euro area debt crisis, and the search for safer investments and the resulting divestment by some investors. On account of their investment policy, the majority of mutual funds hold a predominant proportion of their investments in foreign securities. Yields are therefore largely dependent on the situation on foreign financial markets. Inflows and withdrawals therefore fluctuate accordingly.

Figure 6.16: Proportion of mutual funds recording net inflows and proportion of mutual funds recording net withdrawals, for equity funds (left) and balanced funds (right)



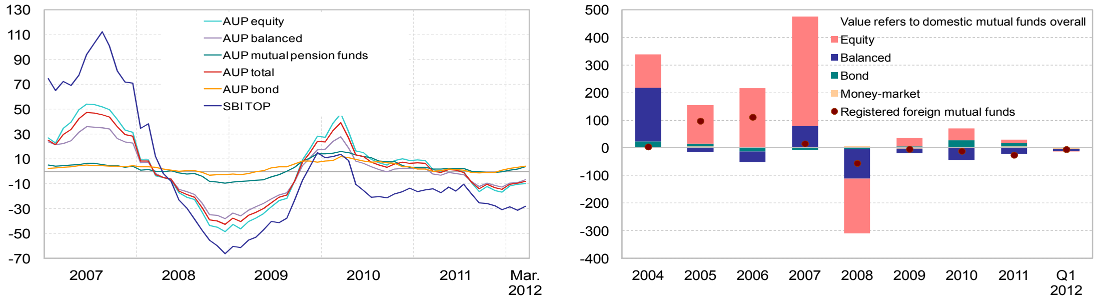


Source: SMA

Investors responded more rapidly last year to the fall in the average unit price than they did at the outbreak of the crisis.

Mutual fund investors responded more rapidly to the fall in the average unit price in the second half of 2011 than they did at the outset of the crisis in 2008. The largest fall in the average unit price at that time, of 47%, was comparable to last year's largest fall of 39%. The negative experiences of investors who invested in mutual funds in 2008 and consequently suffered major capital losses are now reflected in a greater willingness to restructure investments with regard to the type of mutual fund and in more expedient decisions to make withdrawals. The average unit price was down 14% at the end of 2011, and down 8% in March 2012.

Figure 6.17: Year-on-year change in the average unit price of mutual funds and the SBI TOP in percentages (left) and annual inflows into mutual funds in EUR million (right)

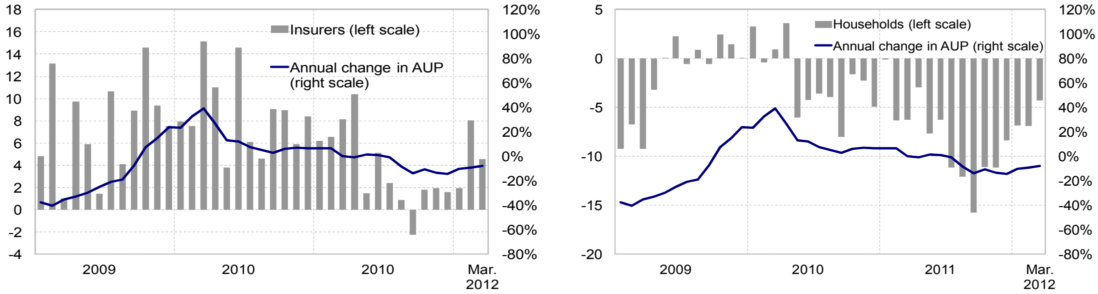


Sources: SMA, LJSE, the Bank of Slovenia

Households requested four times more in net withdrawals, while insurers and pension funds reduced their net inflows by more than one half.

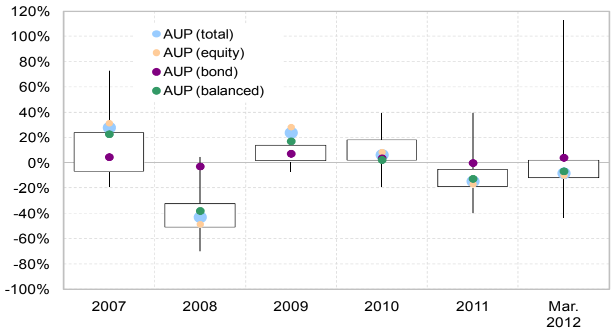
The response of the household sector to the uncertain conditions and the fall in the value of the average unit price was most notable, the aforementioned sector having requested net withdrawals of EUR 100 million in 2011, nearly four times the amount of withdrawals requested in 2010. This is primarily an indication of the adverse situation on the labour market and an increasing lack of confidence in these types of financial investments in the context of high volatility on the financial markets. The corporate sector followed households by withdrawing EUR 23.7 million from domestic mutual funds. Net inflows into mutual funds from the insurance and pension funds sector were down more than one half in 2011. Insurers and pension funds actually requested net withdrawals in September 2011, the first time this has happened in three years. The banks also requested net withdrawals, of EUR 9.8 million. The reason for the higher net withdrawals by pension funds lies in the diminished risk associated with their investments owing to a guaranteed rate of return, while insurers are faced with an increasing number of maturing unit-linked life insurance policies and growth in the number of early terminations. The banks are focusing more attention on marketing deposits and thus a negative net flow is expected, as structured products represent the main source of the banks' investments in mutual funds.

Figure 6.18: Monthly net inflows from the insurance sector (left) and monthly net inflows from households (right) in EUR million and annual growth of the average unit price in percentages



Sources: SMA, own calculations

Figure 6.19: Classification of mutual funds in terms of annual return at year end in percentages



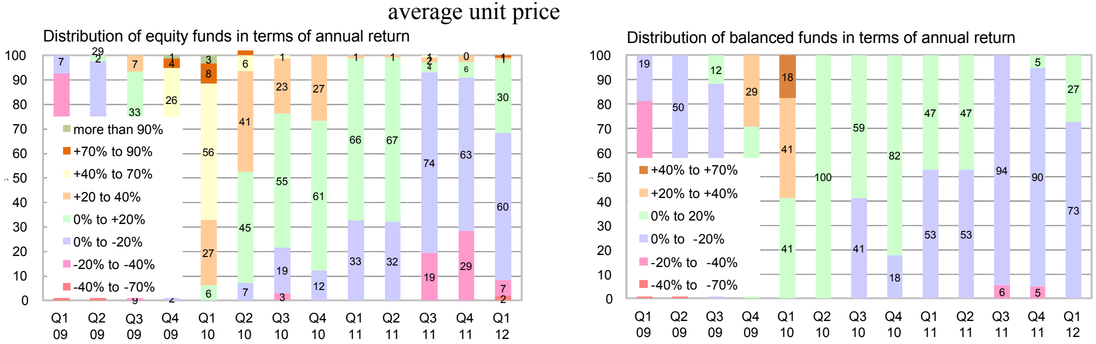
Note: As the funds have been ranked according to annual return at the end of the year, only those funds in existence for at least one year are included. The figure shows the variation in annual returns between funds, and the relative standing of particular types of fund compared with mutual funds overall. The rectangles represent the 50% of mutual funds whose annual returns are higher than the bottom quartile of the funds, and lower than the top quartile.

Sources: SMA, own calculations

The majority of mutual funds generated a negative return in 2011.

The proportion of mutual funds that recorded a negative return was up again last year. Less than one eighth of all funds recorded a positive annual return, the majority of which were bond funds and funds focusing on healthcare. Equity funds recorded significantly higher losses in 2011 and in early 2012 compared with balanced funds. The larger proportion of funds generating higher losses is primarily a result of negative information and developments on the global capital market.

Figure 6.20: Relative percentage distribution of domestic equity funds (left) and domestic balanced funds (right) in terms of year-on-year change in average unit price

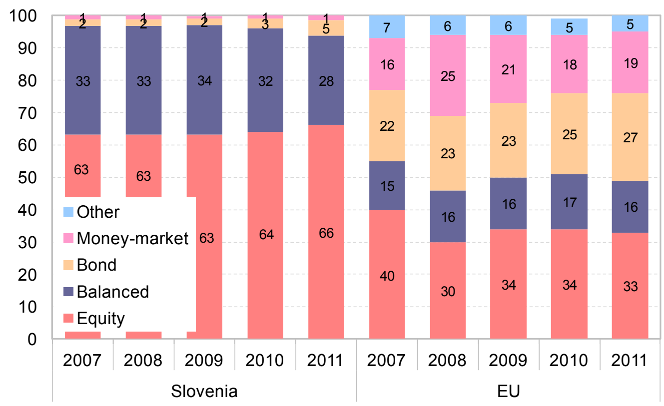


Source: SMA

Net withdrawals were very high in the final quarter of 2011, forcing managers to increase their liquid assets as a proportion of investments from 9.5% to 11.6%. The increased need for liquid assets is an indicator of the more rapid response of investors to the deterioration in the performance of mutual funds than seen in the first two years following the outbreak of the financial crisis.

Change in the breakdown of mutual funds' investments

Figure 6.21: Comparison of the breakdown of mutual funds' assets by type in Slovenia and the EU in percentages



Sources: SMA, EFAMA

Investors have begun to shift towards more stable and safer investments.

A comparison of the breakdown of mutual funds by type indicates EU investors' diminishing appetite for risk, as they have restructured their assets from higher-risk equity and balanced funds to less risky bond and money-market funds. A change in the breakdown of mutual funds in Slovenia is not so apparent. At 66%, equity funds maintained their dominant share of the market last year. Funds with an investment policy focusing on the markets of the former Yugoslav republics accounted for merely 2.8% of total mutual fund assets at the end of 2011.

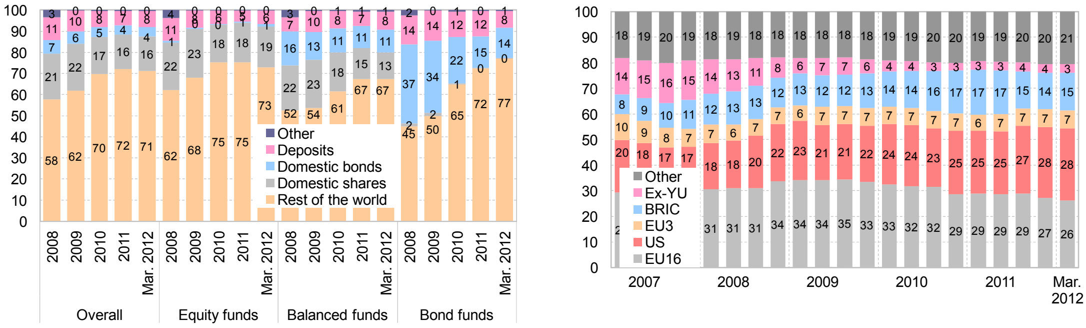
The European debt crisis and the downgrading of certain countries and financial institutions has led to the mass migration of investors, who have begun to shift to more stable and safer investments. The average unit price of balanced mutual funds had fallen by 16.8% by the end of December, while the average unit price of equity funds was down 12.5%. As a result, investors had requested net withdrawals of EUR 74.3 million from balanced funds and EUR 33.8 million from equity funds by the end of 2011. The opposite is true of the average unit price of money-market funds, which rose throughout 2011 and ended December up 2.1%. Investors recorded net inflows of EUR 13 million as a result.

The average unit price of bond funds recorded positive year-on-year growth at the beginning of 2011, with growth falling to zero by the end of the year and investors having recorded net inflows of EUR 18.1 million.

Mutual funds' investments in the rest of the world rose by 2 percentage points last year to stand at EUR 16.9 million.

The mutual funds' investments in the rest of the world are rising gradually, as investing in Slovenian securities is unattractive due to poor liquidity, the slow restructuring of the Slovenian corporate sector and a lack of communication with investors. The proportion accounted for by investments in the rest of the world was up 2 percentage points to stand at EUR 16.9 million. The proportion accounted for by domestic shares was down 1 percentage point at EUR 3.9 million which, in addition to actual sales, is also a result of revaluation. The proportion of mutual funds' assets accounted for by investments in domestic bonds and deposits was also down 1 percentage point.

Figure 6.22: Percentage breakdown of mutual fund investments (left) and regional percentage breakdown of investments in foreign shares by the entire other financial intermediaries sector (right)



Note: BRIC: Brazil, Russia, India and China.
EU3: UK, Denmark, Sweden
EU16: euro area
Ex-YU: former Yugoslav republics
Source: SMA

There has been a notable gradual decrease in investments in euro area shares owing to the European debt crisis, while positive macroeconomic developments have resulted in a rise in the proportion of investments in the US. Lower economic growth and the associated structural problems have led to a fall in the equity markets of the BRIC countries[35], which was also reflected in Slovenian mutual funds as a decline in the proportion of investments accounted for by shares from the BRIC countries.

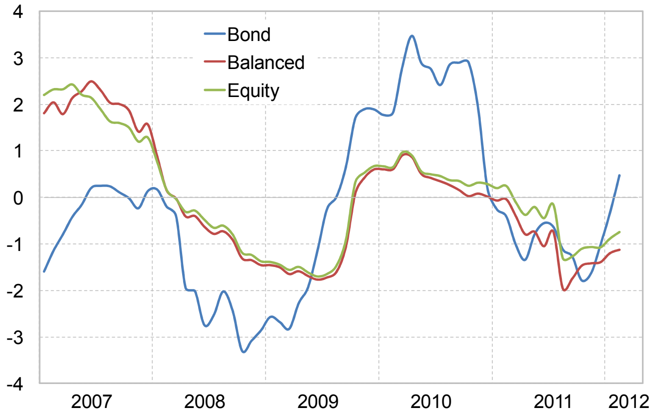
Performance of mutual funds

High volatility on the bond market in 2011 had a major impact on the efficiency of balanced and bond funds.

The efficiency[36] of balanced and equity funds as measured by Sharpe and Sortino indices was relatively coordinated until the beginning of 2011. The efficiency of balanced funds was lower in 2011 owing to the debt crisis in Europe, which resulted in a higher level of volatility on the bond market throughout the year. This also resulted in a sharp decline in the efficiency of bond funds, which was actually negative throughout the year. This means that it would be better to invest in 10-year German government bonds. Conditions on the bond market only eased after the intervention of the European Central Bank via 3-year LTROs. The returns on the majority of bonds fell rapidly and the efficiency of bond funds turned positive again. This was not the case for equity and balanced funds, the efficiency of which remains negative, despite a significant rise in the equity markets at the end of 2011 and in the first quarter of 2012. These funds entered the market at a slow pace and missed the majority of growth during this period. Given the uncertainty on the financial markets, a more conservative investment policy can be expected to some extent. The reason for the lagging of growth in the efficiency of balanced and equity funds lies in the changing structure of investments, as the proportion of investments in bonds is likely to decline throughout the year due to uncertainty on the bond market.

[35] BRIC: Brazil, Russia, India, China
[36] Information regarding the efficiency of investment and management activities is illustrated by the risk-adjusted return, which is defined as an individual funds' ratio of return to risk. The most commonly used measurements of efficiency, which measure return per unit risk, are the Sharpe and Sortino indices, which measure return per unit risk. The only difference between the two indices is the method used to measure risk.

Figure 6.23: Efficiency on the mutual fund market



Note: The Sharpe index measures the ratio of a fund's return over the risk-free return on investment to the standard deviation in the fund's return. The Sortino index also measures the ratio of a fund's return over the risk-free return on investment to the standard deviation in the fund's return. However, only those values that are lower than the risk-free return are taken into account in the calculation of the standard deviation. The higher the index, the greater is the efficiency of the management of the mutual fund. The yield on 10-year German government bonds is taken as the risk-free return. The figure illustrates the weighted value of the two indices for each type of funds.

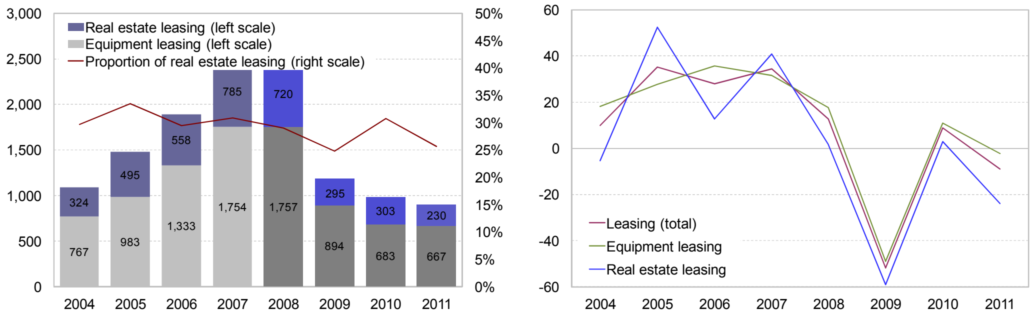
Sources: SMA, Bloomberg, own calculations

6.4 Leasing companies

The stock of leasing business was down 8% in 2011 to stand at EUR 3.6 billion. The proportion accounted for by real estate transactions was up 3.4 percentage points at 57.5%.

The leasing sector's operations were affected last year by lower economic activity and the deteriorating creditworthiness of clients. The stock of leasing business was down 8% at EUR 3.6 billion due to a decrease in new transactions, the termination of agreements and impairments. Equipment leasing was down 15% at EUR 1.5 billion, while real estate leasing was down 3% at EUR 2.1 billion. Leasing companies are tied commercially to the banking system. Leasing companies under the majority ownership of banks in Slovenia account for one quarter of leasing companies' total assets and have an above average proportion of investments in real estate. Divestment is slow due to the low liquidity of the real estate market.

Figure 6.24: New leasing business[37] in EUR million and the proportion accounted for by real estate leasing in percentages (left), and annual growth in new transactions in percentages (right)



Sources: SLA, BAS

The volume of new equipment leasing business was down 2% in 2011, while the volume of new real estate leasing business was down 24%.

The volume of leasing business amounted to EUR 898 million last year, down 9% on the previous year. According to figures from the BAS's leasing committee, the four largest leasing companies had a market share of 60% in terms of new leasing business, while their market share in terms of the stock of leasing business is estimated at 55%. The exposure of Slovenian banks to leasing companies is merely 5% of classified claims. The banks are primarily exposed to smaller leasing companies. More than two thirds of the aforementioned exposure relates to three leasing companies that accounted for 21% of new leasing business and 18% of the stock of leasing business.

[37] Leasing business is presented at original cost until 2008 due to the availability of figures, and at financed value going forward, excluding the financing of inventories since 2010.

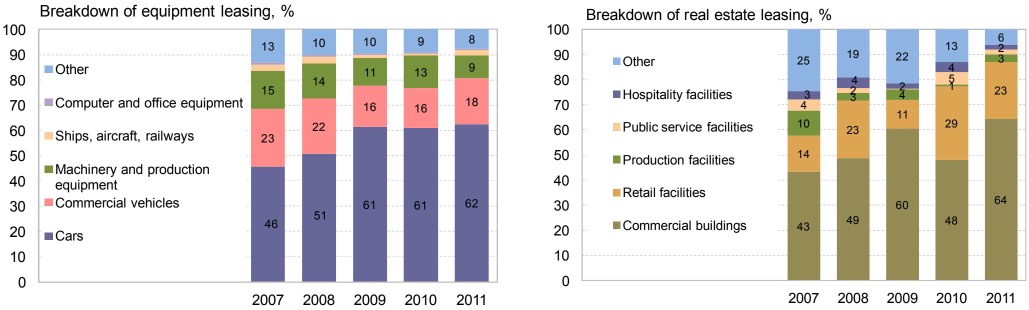
The financing of new equipment was down 2% in the context of deteriorating conditions in the manufacturing and construction sectors. New real estate leasing business was down 24%. Leasing companies will focus on enhancing equipment leasing due to the situation on the real estate market.

The proportion of new business accounted for by equipment leasing rose to 74%.

The proportion of new leasing business accounted for by equipment leasing was up 5 percentage points at 74%. The majority of equipment leasing continues to be accounted for by the financing of car purchases which, together with commercial vehicles, accounted for 81%. Slightly less than two thirds of new real estate leasing business was accounted for by commercial real estate, while residential real estate accounted for 23%.

The majority of leasing business was earmarked for the financing of the economy. Natural persons accounted for two thirds of equipment leasing business, down 2 percentage points on the previous year. Natural persons accounted for merely 1% of real estate leasing business. The average LTV ratio as measured by the ratio of the approved amount of financing to the value of the subject of the agreement remains high, at 80% for equipment leasing and 92% for real estate leasing.

Figure 6.25: Percentage breakdown of real estate leasing (left) and equipment leasing (right)



Sources: SLA, BAS

Loans approved by leasing companies were down 27% at EUR 95 million due to high impairment costs over the past two years. Natural persons accounted for 63% of all approved loans.

The majority of new transactions was concluded with the private service sector.

The volume of equipment leasing business was virtually unchanged. The loss of a portion of industrial production was offset by an increase in the volume of business with the private service sector, which resulted in an increase in the volume of finance leasing of equipment. There was no significant change in the maturity of newly approved transactions, the majority of which were approved with a maturity of 10 years or less. Of those transactions, 76% of agreements had a maturity of up to 5 years.

Real estate leasing has declined due to lower demand for commercial and residential real estate.

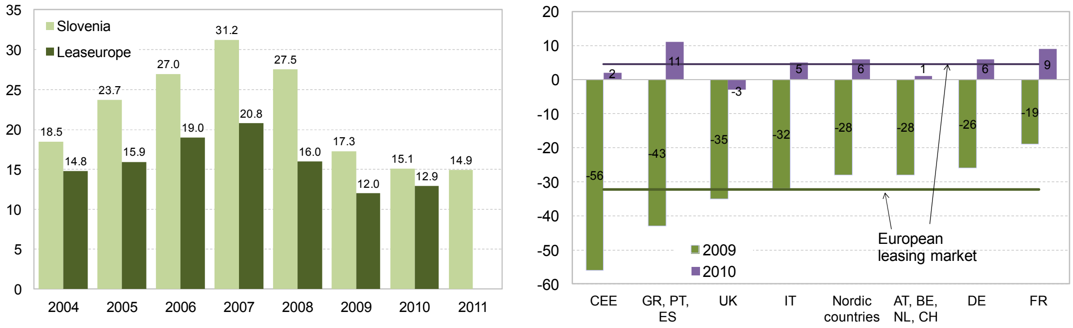
Leasing companies, which represented an important source of financing for the construction sector prior to the crisis, have temporarily withdrawn from the aforementioned sector. The supply of inventories of finished and unfinished real estate is large. Newly approved real estate transactions were down 41% last year relative to the average of the previous four years. A drop in corporate activity has led to a decline in demand for commercial real estate. In addition to unoccupied commercial real estate, the balance sheets of leasing companies also disclose an increased number of housing units that have not been rented or sold. Due to the slow pace of divestment, impairment costs are expected to rise again in 2012.

The maturity of new real estate leasing business shortened in 2011.

At 82%, the private service sector also accounts for the highest proportion of new real estate transactions. The increase in the aforementioned proportion is a result of a significant fall in leases in the public sector, manufacturing and construction. The maturity of new agreements has shortened notably, as just under half of all transactions concluded had a maturity of up to two years. That proportion is up 34 percentage points on the average of the previous three years.

The volume of new business was up 4.6% on the European leasing market in 2010. The highest growth was recorded by Spain, Poland, Estonia and Sweden, while the lowest growth was recorded by Romania, Bulgaria, Greece and Hungary. Initial estimates indicate 7% growth in new business in 2011. The cooling of the economy led to a deterioration in operating results in the final quarter of last year, and remains the most significant limiting factor for the growth in business in 2012.

Figure 6.26: Ratio of leasing business to gross fixed capital formation (left) and growth in new leasing business in selected European countries (right) in percentages



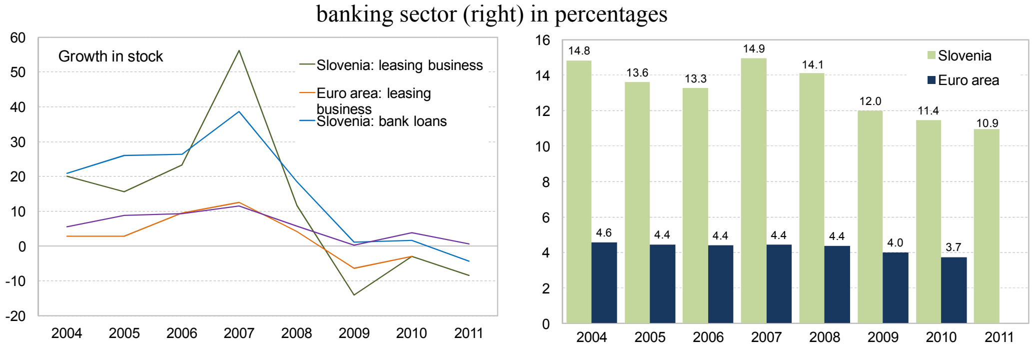
Sources: SLA, BAS, SORS, Leaseurope

The ratio of leasing business to gross fixed capital formation was down in 2011[38] for the fourth year in a row, to 14.9%. At 15.1% in 2010, the aforementioned ratio was for 2.2 percentage points higher than the European average. The decline in leasing business following the outbreak of the crisis outpaced the decline in investment, as a result of lower demand and high funding costs. The ratio of leasing business to bank loans to the non-banking sector exceeded 10% in 2011. In 2010 the aforementioned ratio was 7.7 percentage points higher than the euro area average, where it declined to 3.7%.

SMEs who use leasing as a source of financing invest more on average than those that do not use leasing.

The findings from research based on a sample of the countries[39] that account for 83% of European GDP indicate the proportion of corporate financing via leasing was higher at SMEs in 2010 than at large corporates. SMEs finance 16.7% of their investments through leasing. That proportion is expected to rise again for 2011.

Figure 6.27: Growth in the stock of leasing business and bank loans to the non-banking sector (left) and the ratio of leasing business to bank loans to the non-banking sector (right) in percentages



Sources: SLA, BAS, Bank of Slovenia, ECB

Performance of leasing companies

European leasing companies generated a profit over the last two years, until the final quarter of 2011, when uncertainty in the corporate sector increased. Impairment costs were up at the end of 2011 and are expected to have a negative effect on operating results in 2012.[40]

Leasing companies generated a loss.

This is not true of Slovenian leasing companies, which have generated a loss since 2009 due to small orders, investments, private consumption and the deterioration in the quality

[38] The decline in the ratio of leasing business to gross fixed capital formation in 2008 was a result of the transition from original cost as the basis for the valuation of business to the financed value, which is not available for previous years. The penetration rate calculated at original cost, which is methodologically comparable to previous rates, was actually somewhat higher in 2008 than the rate achieved in 2007.

[39] Source: Leaseurope. The countries included in the research were Germany, France, the United Kingdom, Italy, Spain, the Netherlands, Poland and Sweden which account for 78% of the European leasing market.

[40] Source: Leaseurope

of the portfolio. Leasing business is cyclically linked to economic growth. The recession and difficulties in raising funding in the financial sector will lead to the severe restructuring of the balance sheets of corporates to which leasing companies are exposed, which will further hinder the settlement of liabilities by clients.

Leasing companies operate with a high level of financial leverage. The debt-to-equity ratio was 23 at the end of 2011, representing a higher financial leverage than recorded by the banks. The risk associated with the loss of planned cash flows is high. With fewer new transactions that could improve the structure of investments, the negative operating result is the result of a loss of interest income due to the contraction in activity and arrears in the settlement of liabilities by clients, high impairment costs and repossessed items. Several leasing companies increased their capital last year. Arrears in the settlement of liabilities to banks also lengthened.

Finance leasing of investments is based primarily on sources from the rest of the world.

A total of 28% of leasing companies' liabilities were of a domestic nature at the end of 2011, while the remainder were liabilities to the rest of the world. The majority of the leasing companies under foreign ownership borrow directly from associates in the rest of the world, although there is a bank from the same ownership group present on the Slovenian market. Loans account for 92% or EUR 4.8 billion of leasing companies' total liabilities. Slovenian banks contributed EUR 1.3 billion to the financing of investments, representing 4% of loans to the non-banking sector.

As the main source of funding, bank loans frequently have a shorter maturity than leasing investments. The maturity mismatch between funding and investments increased profits in the past, but increases refinancing risk in adverse conditions.

Table 6.7: Performance of leasing companies and sources of funding

							Growth, %				
	2006	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
Total assets, EUR million	3,779	5,029	5,926	5,926	5,553	5,118	33.1	17.8	0.0	-6.3	-7.8
Capital, EUR million	216	247	279	208	208	209	14.2	13.0	-25.5	0.0	0.8
Total profit/loss, EUR million	46	49	28	-38	-32	-22	5.9	-43.3	-237.8	16.3	31.5
ROA, %	1.4	1.1	0.5	-0.6	-0.6	-0.4					
ROE, %	23.4	21.1	10.5	-15.7	-15.4	-10.5					
Financial and operating liabilities, EUR million	3,539	4,750	5,604	5,675	5,302	4,867	34.2	18.0	1.3	-6.6	-8.2
liabilities to banks and companies in group / total assets, %	94	94	95	96	95	95					
Liabilities to rest of the world, EUR million	2,676	3,478	4,155	4,145	4,008	3,680	30.0	19.4	-0.2	-3.3	0.0
liabilities to rest of world / total assets, %	71	69	70	70	72	72					
Finance costs from impairments and write-offs of financial assets, EUR million	3	3	12	128	177	136					

Note: The figures from financial statements include leasing companies, whose key business is the provision of leasing transactions and which are included under K64.91 in the SKD 2008 classification of business activities).
Source: AJPES

7 FINANCIAL INFRASTRUCTURE

7.1 Payment systems

Given the size of its total transaction value and its role providing liquidity for the banking system, the TARGET2-Slovenija system is an important payment system for financial stability in Slovenia. As the national component of the centralised pan-European system for individual (gross) settlement of euro payments in real time (TARGET2), it is operated by the Bank of Slovenia. Because TARGET2 is technologically set up as a single shared platform of the Eurosystem, oversight of the system's functioning is centralised under the aegis of the ECB.

The effectiveness of measures adopted in the event the TARGET2 system fails to operate properly proved effective in July 2011 when a major problem occurred in the system's operations.

According to the findings from oversight in 2011, TARGET2 functioned normally and without major deviations, except on 25 July 2011 when operational difficulties prevented the start of normal daily operations. From a technical point of view, the aforementioned difficulties were the most widespread since the payment system was established in 2007, as they persisted for three hours and led to the failure of all national components of the TARGET2 system. The fact that the problems occurred in the early morning and given the quick measures taken to process payments while the system was not functioning, the effects on payment system participants and the entire financial system were limited. An analysis showed the measures adopted in the event the TARGET2 fails to function properly are effective. The TARGET2 payment system operator adopted measures after the aforementioned event aimed at preventing the recurrence of similar events.

The development of a system for monitoring the operations of TARGET2-Slovenija payment system participants is planned for 2012.

A system for monitoring the operations of participants in the scope of the TARGET2-Slovenija system is planned for 2012. The system will include the monitoring of the volume of payment flows and use of liquidity. The establishment of a monitoring system is based on the initiative of the Eurosystem and also derives from the needs of the Bank of Slovenia. Balances on the settlement accounts in this payment system are crucial to providing liquidity to the domestic banking system. TARGET2-Slovenija is therefore a systemically important payment system. The objectives of monitoring the operations of TARGET2-Slovenia participants are the identification of patterns in individual payment system participants' operations by the payment system operator, the identification of changes in participants' operations that could reflect difficulties in their operations and the production of analyses. The design of the system is based on best practices relating to the monitoring of operations in payment systems through the use of analytical and statistical methods and by accessing data in real time.

Due to the large number of transactions processed daily, the SEPA internal credit transfer (SEPA ICT) payment system operated by Bankart d.o.o. is also important for Slovenia. The system is designed to process retail credit transfers (up to EUR 50,000) in line with the rules of the single euro payments area (SEPA). It functions according to the principles of calculating an individual participant's net claims or net liabilities in the payment system vis-à-vis other participants. The Settlement Guarantee Scheme, which was set up to manage financial risk in the payment system in the event of a participant's inability to settle its liabilities, was not activated in 2011. In 2011 the Bank of Slovenia regularly monitored changes in the volume of payments in the SEPA ICT system and events that could affect the security and efficiency of the system's functioning. It did not identify any increase in risks.

Table 7.1: Value and number of transactions in the TARGET/TARGET2 and Giro Clearing/SEPA ICT payment systems

	Year					Year-on-year growth, %				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
TARGET/TARGET2[1]										
value, EUR billion	364.7	410.4	507.6	530.1	501.0	14.8	12.5	23.7	4.4	-5.5
number of transactions, million	0.73	0.66	0.67	0.65	0.65	-53.5	-9.6	1.2	-3.0	-0.2
Giro clearing/SEPA ICT										
value, EUR billion	45.7	49.1	44.9	45.4	46.7	99.3	7.5	-8.6	1.2	2.9
number of transactions, million	53.62	55.91	55.13	56.13	64.92	2.9	4.3	-1.4	1.8	15.7

Note: [1] Transactions between participants in the TARGET2-Slovenia system (domestic payments).
Source: Bank of Slovenia

The volume of transactions was down in the TARGET2-Slovenija system and up in the SEPA ICT system.

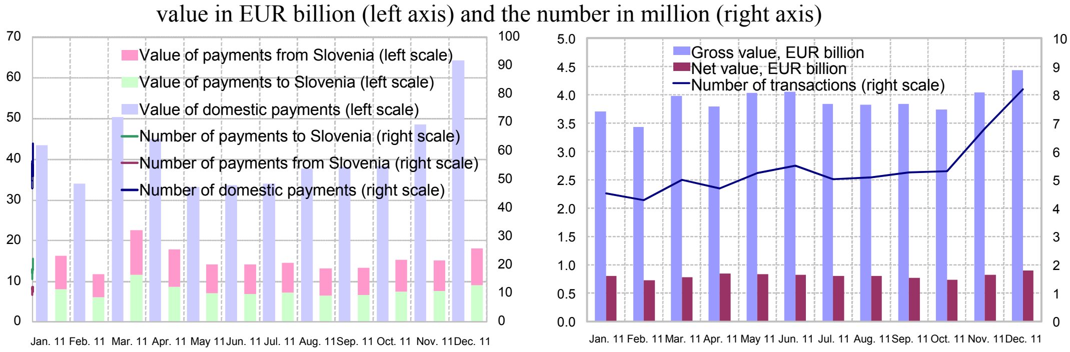
The value and number of transactions in the TARGET2-Slovenija system were down in 2011, while the number and value of transactions in the SEPA ICT system were up. The total value of transactions in the TARGET2-Slovenija and SEPA ICT systems were 14.1 and 1.3 times Slovenia's GDP respectively in 2011.

Transactions between participants (domestic payments) accounted for the majority of transactions processed in the TARGET2-Slovenija system in December, as the number of payments by participants generally rises at the end of the year. The reasons for the increase in the value of transactions lie primarily in the placement at and repayment of short-term deposits from credit institutions, and the expanded use of deposit facility instruments and intraday loans.

The TARGET2-Slovenija system also allows for cross-border transactions and thus gives rise to the cross-border transfer of risks. The volume of such transactions is low relative to the settlement of domestic payments, although the number and, in particular, the value of cross-border transfers were up in 2011. The reason lies primarily in the increase in the volume of cross-border liquidity flows between subsidiary and parent banks.

With the exception of operational problems that affected the entire TARGET2 system on 25 July 2011, the TARGET2-Slovenija system was available at all times in the scope of the established schedule in 2011.

Figure 7.1: TARGET2-Slovenia: domestic and cross-border payments; value in EUR billion (left axis) and the number in thousand (right axis) and SEPA ICT: value in EUR billion (left axis) and the number in million (right axis)



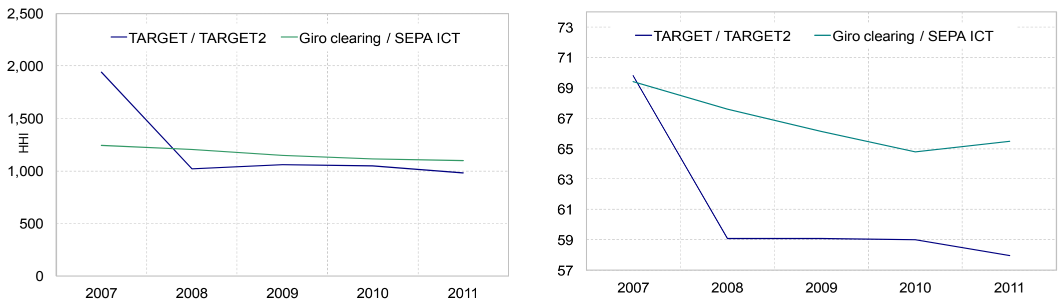
Sources: Bank of Slovenia and Bankart d.o.o.

The number of transaction in the SEPA ICP system was up in 2011 as a result of the gradual replacement of special payment orders with universal payment orders. Transactions based on special payment orders were processed in the scope of other interbank arrangements, while universal payment orders are processed as SEPA credit transfers in the SEPA ICT system. The largest increase occurred in the final two months of 2011, before the processing of special payment orders was abolished at the end of the year. Nevertheless, the impact of these payments on the total value of SEPA ICT payments was minimal owing to the low average value thereof. The average offsetting rate was almost 80% in 2011. Thus, cash flows in the amount of merely one fifth of the gross value were required to settle participants' liabilities from transactions in the payment system, reducing the liquidity needs of participants accordingly.

Exposure to systemic risk stagnated in 2011.

Concentration of the number of transactions by participant, as an indicator of systemic risk in the payment system, is illustrated by the Herfindahl-Hirschman index. Concentration, and thus risk, were down negligibly in the TARGET2-Slovenija and SEPA ICT systems relative to 2010.

Figure 7.2: Concentration of the number of transactions in the TARGET/TARGET2 and Giro Clearing/SEPA ICT systems (Herfindahl-Hirschman Index; left) and proportion of total number of transactions accounted for by the five largest participants (excluding the Bank of Slovenia; right)



Source: Bank of Slovenia

The proportion of transactions in the TARGET2-Slovenija system accounted for by the five largest participants was down 1.03 percentage points, while the same proportion was up 0.66 percentage points in the SEPA ICT system. The reason lies in a sharp increase in the number of transactions by the largest system participants as a result of the migration from special payment orders to universal payment orders, i.e. SEPA credit transfers.

7.2 Securities clearing and settlement systems

The Central Securities Clearing Corporation (CSCC) is a systemically important institution in Slovenia with regard to the clearing and settlement of securities. It provides for the issuing of securities, the management of share registers and the management of security holders' accounts. The CSCC also operates settlement systems to settle transactions concluded at the Ljubljana Stock Exchange, and to settle transactions concluded outside the regulated market in accordance with the principles of settlement versus payment or settlement free of payment. The Bank of Slovenia uses the latter for collateral in Eurosystem credit operations.

The Bank of Slovenia regularly monitored changes to legislation and the functional arrangements of the CSCC in 2011, changes in and the structure of the number of transactions in the securities settlement system and other events that could affect the functioning of the CSCC. The CSCC functioned in 2011 without notable deviations from its established schedule of operation. The guarantee fund, which the CSCC uses in the event participants encounter liquidity problems in the settlement of securities transactions, was not activated during the year.

Risk management in securities settlement systems is important due to the extensive use of eligible securities as collateral for Eurosystem operations.

On the basis of the Statute of the ESCB, all credit operations of ESCB central banks must be fully secured by means of eligible collateral. This includes securities booked and settled at the CSCC. The functioning of the CSCC is therefore important to the Bank of Slovenia owing to the use of eligible securities booked at the CSCC as collateral for the credit operations of the Bank of Slovenia and other ESCB central banks. The Correspondent Central Banking Model (CCBM) facilitates the central banks' access to securities held at the CSCC. Because the use of CSCC services by central banks also requires the monitoring and assessment of settlement and operational risk management at the CSCC, the Bank of Slovenia and ECB worked together in 2011 to begin preparing a new assessment of the compliance of the CSCC's functioning with Eurosystem reference standards. The results of the aforementioned assessment will be published in 2012.

In 2011 Slovenian banks and savings banks pledged a monthly average of EUR 1,903.6 million in eligible domestic securities as collateral, down 10.8% on 2010. Nevertheless, the use of this form of eligible collateral (which also includes bank loans and cash deposits) remains extensive, its value fluctuating in 2011 between a low of EUR 1,757 million in April and a high of EUR 2,183 million in December. Foreign banks' interest in using securities registered at the CSCC also rose in 2011. The average monthly value of Slovenian securities used as collateral for the credit operations of other ESCB central banks increased by 72.4% in 2011, relative to 2010, to EUR 222.4 million.

STATISTICAL APPENDIX

1. Inter-sector financial claims and liabilities

Table 1.1 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of 2011 as a percentage of GDP

(As % GDP)	Claims						
	Domestic sectors					Rest of the world	Total
Liabilities	Corporates	Financial sector	Government	Households	Total		liabilities
Corporates	67.2	70.7	26.6	26.2	190.6	49.2	239.8
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.3	1.5	0.1	0.1	1.9	0.7	
loans	12.3	63.5	0.6	1.8	78.2	17.5	
equity	33.4	4.6	21.5	20.5	80.1	18.4	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	21.2	1.1	4.4	3.8	30.5	12.7	
Financial sector	16.7	37.4	18.5	70.0	142.6	62.4	205.0
currency and deposits	11.0	9.9	11.9	50.9	83.8	17.3	
securities other than shares	0.3	4.0	0.2	0.2	4.8	8.1	
loans	0.3	18.1	0.1	0.1	18.7	30.6	
equity	2.9	4.5	5.9	6.7	20.1	5.5	
insurance technical provisions	1.2	0.6	0.0	11.7	13.5	0.5	
other	0.9	0.2	0.2	0.4	1.7	0.3	
Government	5.9	18.5	12.7	1.8	38.9	29.1	68.0
currency and deposits	0.1	0.0	7.2	0.1	7.5	0.0	
securities other than shares	0.2	14.4	0.3	0.8	15.7	27.3	
loans	0.5	3.7	0.2	0.0	4.5	0.7	
equity	0.1	0.0	2.1	0.0	2.2	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	5.0	0.3	2.8	0.9	9.0	1.2	
Households	3.4	29.8	1.0	0.0	34.2	0.0	34.2
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	
loans	0.9	29.1	0.2	0.0	30.3	0.0	
equity	0.0	0.0	0.0	0.0	0.0	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	2.4	0.7	0.8	0.0	3.9	0.0	
Total	93.3	156.6	58.8	98.0	406.3	140.7	547.0
currency and deposits	11.2	9.9	19.1	51.1	91.3	17.3	
securities other than shares	0.7	19.9	0.6	1.1	22.3	36.1	
loans	14.1	114.6	1.3	2.0	131.6	48.8	
equity	36.5	9.2	29.5	27.2	102.4	23.9	
insurance technical provisions	1.2	0.6	0.0	11.7	13.5	0.5	
other	29.6	2.4	8.2	5.1	45.2	14.2	
Rest of the world	29.9	55.2	2.3	14.2	101.5		101.5
currency and deposits	0.5	12.8	0.0	12.7	26.0		
securities other than shares	0.2	25.7	0.3	0.2	26.3		
loans	5.2	9.4	0.9	0.0	15.5		
equity	9.0	6.9	0.7	1.0	17.6		
insurance technical provisions	0.0	0.0	0.0	0.3	0.3		
other	15.1	0.3	0.4	0.0	15.7		
Total claims	123.2	211.7	61.1	112.2	507.9	140.7	648.6

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world.

Source: Bank of Slovenia

Table 1.2 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of 2010 as a percentage of GDP

(As % GDP)	Claims						
	Domestic sectors					Rest of the world	Total
Liabilities	Corporates	Financial sector	Government	Households	Total		liabilities
Corporates	71.1	75.9	27.7	30.1	204.8	46.7	251.5
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.3	1.7	0.1	0.1	2.2	0.7	
loans	10.1	67.3	0.5	2.5	80.3	14.5	
equity	36.3	5.6	22.6	23.0	87.5	18.7	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	24.4	1.3	4.6	4.5	34.8	12.8	
Financial sector	18.1	37.1	16.7	70.8	142.6	69.3	212.0
currency and deposits	11.3	9.8	9.8	50.4	81.4	18.9	
securities other than shares	0.3	6.0	0.3	0.2	6.9	8.7	
loans	0.4	15.1	0.0	0.1	15.7	35.5	
equity	4.0	5.4	6.2	7.6	23.2	5.6	
insurance technical provisions	1.2	0.6	0.0	12.0	13.8	0.3	
other	0.7	0.2	0.4	0.4	1.7	0.3	
Government	5.2	16.2	9.8	1.8	33.0	25.0	58.0
currency and deposits	0.1	0.0	5.3	0.1	5.5	0.0	
securities other than shares	0.2	12.3	0.4	0.8	13.6	23.3	
loans	0.1	3.6	0.2	0.0	4.0	0.5	
equity	0.0	0.0	2.1	0.0	2.1	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	4.8	0.3	1.8	0.9	7.8	1.2	
Households	3.7	30.2	1.0	0.0	34.9	0.0	34.9
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	
loans	1.1	29.4	0.3	0.0	30.8	0.0	
equity	0.0	0.0	0.0	0.0	0.0	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	2.6	0.8	0.7	0.0	4.1	0.0	
Total	98.3	159.6	55.3	102.7	415.4	141.0	556.4
currency and deposits	11.5	9.8	15.1	50.6	86.9	18.9	
securities other than shares	0.8	20.0	0.8	1.1	22.7	32.7	
loans	11.8	115.6	1.0	2.6	130.7	50.5	
equity	40.3	11.0	30.9	30.7	112.8	24.4	
insurance technical provisions	1.2	0.6	0.0	12.0	13.8	0.3	
other	32.6	2.7	7.4	5.8	48.3	14.3	
Rest of the world	30.6	56.8	2.0	13.8	103.3		103.3
currency and deposits	0.5	12.5	0.0	11.9	25.0		
securities other than shares	0.2	26.1	0.5	0.2	26.9		
loans	5.1	9.9	0.3	0.0	15.3		
equity	9.5	8.0	0.9	1.4	19.8		
insurance technical provisions	0.0	0.0	0.0	0.3	0.3		
other	15.3	0.2	0.3	0.0	15.9		
Total claims	128.9	216.4	57.2	116.5	518.6	141.0	659.6

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world.

Source: Bank of Slovenia

Table 1.3 Inter-sector financial claims and liabilities of the institutional sectors of the Slovenian economy at the end of 2009 as a percentage of GDP

(As % GDP)	Claims						
	Domestic sectors					Rest of the world	Total
Liabilities	Corporates	Financial sector	Government	Households	Total		liabilities
Corporates	77.5	77.9	21.7	30.7	207.7	43.5	251.2
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.3	1.5	0.1	0.1	2.0	0.8	
loans	10.6	68.2	0.4	2.5	81.7	13.7	
equity	37.6	6.7	17.0	23.6	85.0	17.2	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	28.9	1.5	4.2	4.4	39.1	11.8	
Financial sector	18.3	40.1	20.0	67.4	145.8	74.4	220.1
currency and deposits	10.9	14.8	12.3	48.7	86.6	24.0	
securities other than shares	0.4	5.1	0.3	0.2	5.9	6.3	
loans	0.7	14.0	0.0	0.2	14.8	37.6	
equity	4.3	5.4	6.5	7.1	23.3	5.8	
insurance technical provisions	1.3	0.7	0.0	10.8	12.8	0.3	
other	0.8	0.2	1.0	0.4	2.4	0.3	
Government	5.1	16.8	15.4	1.8	39.1	20.3	59.4
currency and deposits	0.1	0.0	8.4	0.1	8.7	0.0	
securities other than shares	0.2	14.0	0.4	0.9	15.4	18.7	
loans	0.1	2.4	0.4	0.0	2.9	0.4	
equity	0.0	0.0	4.3	0.0	4.3	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	4.7	0.4	1.8	0.9	7.8	1.2	
Households	3.7	28.3	0.9	0.0	32.9	0.0	33.0
currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	
securities other than shares	0.0	0.0	0.0	0.0	0.0	0.0	
loans	1.1	27.5	0.3	0.0	28.9	0.0	
equity	0.0	0.0	0.0	0.0	0.0	0.0	
insurance technical provisions	0.0	0.0	0.0	0.0	0.0	0.0	
other	2.6	0.9	0.6	0.0	4.1	0.0	
Total	104.7	163.3	58.1	99.9	425.5	138.2	563.7
currency and deposits	11.0	14.8	20.7	48.8	95.3	24.0	
securities other than shares	0.8	20.5	0.8	1.1	23.3	25.8	
loans	12.5	112.2	1.1	2.6	128.3	51.7	
equity	41.9	12.1	27.8	30.8	112.6	23.0	
insurance technical provisions	1.3	0.7	0.0	10.8	12.8	0.3	
other	37.2	3.0	7.6	5.7	53.3	13.3	
Rest of the world	29.0	60.4	1.5	10.7	101.6		101.6
currency and deposits	0.5	16.7	0.0	9.0	26.3		
securities other than shares	0.2	26.0	0.4	0.1	26.7		
loans	4.4	10.2	0.0	0.0	14.6		
equity	9.9	6.8	0.8	1.3	18.8		
insurance technical provisions	0.0	0.1	0.0	0.3	0.4		
other	14.0	0.6	0.3	0.0	14.9		
Total claims	133.8	223.7	59.6	110.5	527.2	138.2	665.3

Note: The table is based on financial accounts compiled by the Bank of Slovenia. The unconsolidated figures have been restructured into the form of a matrix with the aim of illustrating the underlying mutual financial ties between domestic institutional sectors and the rest of the world.

Source: Bank of Slovenia

2. Banking sector

Table 2.1 Banking sector's balance sheet: amounts in EUR million and growth rates in percentages

	Value, EUR million					Growth, %				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
ASSETS	42,343	47,628	51,612	50,319	48,753	25.0	12.5	8.4	-2.5	-3.1
1) Cash	604	1,243	1,454	1,121	1,374	-42.9	105.9	17.0	-22.9	22.6
2) Loans to banks	4,072	4,031	5,708	4,815	4,662	32.8	-1.0	41.6	-15.7	-3.2
3) Loans to non-banking sector	28,302	33,530	33,910	34,450	32,955	38.6	18.5	1.1	1.6	-4.3
3.1 Currency breakdown										
domestic currency	26,669	31,506	32,274	32,969	31,639	193.2	18.1	2.4	2.2	-4.0
foreign currency	1,633	2,024	1,636	1,481	1,316	-85.6	23.9	-19.2	-9.5	-11.1
3.2 Maturity breakdown										
short-term	9,893	12,515	10,744	9,271	8,159	45.0	26.5	-14.1	-13.7	-12.0
long-term	18,409	21,015	23,166	25,179	24,796	35.4	14.2	10.2	8.7	-1.5
3.3 Sector breakdown										
non-financial corporations	17,039	20,245	20,165	19,766	18,598	37.8	18.8	-0.4	-2.0	-5.9
households	6,429	7,386	7,886	8,646	8,843	27.1	14.9	6.8	9.6	2.3
government	465	506	735	1,162	1,242	-18.9	8.9	45.1	58.2	6.9
OFIs	2,114	2,829	2,719	2,584	2,264	68.1	33.8	-3.9	-5.0	-12.4
other	2,255	2,564	2,405	2,291	2,008	94.4	13.7	-6.2	-4.7	-12.4
4) Financial assets/securities	7,720	7,280	8,876	8,274	7,866	-2.2	-5.7	21.9	-6.8	-4.9
4.1 Currency breakdown										
domestic currency	6,506	6,232	7,419	6,862	6,661	29.7	-4.2	19.0	-7.5	-2.9
foreign currency	56	21	10	29	22	-97.2	-63.0	-49.7	178.8	-23.7
4.2 Maturity breakdown										
short-term	1,192	1,107	1,869	731	333	-43.3	-7.2	68.8	-60.9	-54.5
long-term	5,369	5,146	5,560	6,161	6,351	9.1	-4.2	8.0	10.8	3.1
4.3 Sector breakdown										
government	4,283	4,079	5,094	4,465	4,893	57.5	-4.8	24.9	-12.4	9.6
Bank of Slovenia	0	0	0	0	0	....	....	....	....	....
other	3,437	3,201	3,782	3,809	2,973	1.4	-6.9	18.1	0.7	-21.9
5) Capital investments	615	627	696	691	714	43.9	2.0	11.0	-0.8	3.3
6) Other	1,031	917	969	969	1,182	2.5	-11.1	5.6	0.0	22.0
LIABILITIES	42,343	47,628	51,612	50,319	48,753	25.0	12.5	8.4	-2.5	-3.1
1) Liabilities to the Eurosystem	157	1,226	2,100	581	1,703		683.4	71.3	-72.3	193.2
2) Liabilities to banks	15,929	18,146	15,933	15,213	12,928	47.5	13.9	-12.2	-4.5	-15.0
foreign banks	14,410	16,091	13,024	11,721	9,542	42.5	11.7	-19.1	-10.0	-18.6
3) Deposits by non-banking sector	19,381	20,612	23,570	23,509	24,188	10.7	6.4	14.3	-0.3	2.9
3.1 Currency breakdown										
domestic currency	18,848	20,127	23,120	23,024	23,588	61.7	6.8	14.9	-0.4	2.4
foreign currency	532	485	450	485	600	-90.9	-8.9	-7.2	7.8	23.7
3.2 Maturity breakdown										
short-term	17,626	18,151	18,233	16,063	16,202	14.9	3.0	0.5	-11.9	0.9
long-term	1,754	2,461	5,337	7,446	7,985	-19.0	40.3	116.8	39.5	7.2
3.3 Sector breakdown										
non-financial corporations	3,674	3,712	3,825	4,035	4,031	9.9	1.0	3.1	5.5	-0.1
households	12,105	13,210	13,801	14,292	14,539	9.3	9.1	4.5	3.6	1.7
government	1,510	1,857	3,990	3,030	3,289	35.6	22.9	114.9	-24.1	8.5
OFIs	1,145	1,058	1,124	1,282	1,478	-20.9	-7.5	6.3	14.0	15.3
other	946	775	828	871	852	79.2	-18.1	6.8	5.2	-2.2
4) Securities	963	1,259	3,435	4,498	3,712	-1.3	30.6	172.9	31.0	-17.5
4.1 Currency breakdown										
domestic currency	962	1,259	3,435	4,498	3,712	-0.7	30.8	172.9	31.0	-17.5
foreign currency	1	0	0	0	0	-85.1	-95.1	…	…	…
4.2 Maturity breakdown										
short-term	11	108	8	12	175	49.4	845.6	-92.7	48.3	1,391.0
long-term	952	1,151	3,427	4,487	3,537	-1.7	20.9	197.8	30.9	-21.2
5) Provisions	208	176	174	175	230	12.6	-15.4	-0.8	0.4	31.2
6) Subordinated debt	1,470	1,597	1,550	1,585	1,457	48.1	8.6	-2.9	2.2	-8.0
7) Capital	3,556	3,996	4,295	4,118	3,929	25.2	12.4	7.5	-4.1	-4.6
8) Other	680	617	555	640	606	19.3	-9.3	-10.0	15.3	-5.3

Source: Bank of Slovenia

Table 2.2 Banking sector's balance sheet: as a proportion of total assets, and ratio to GDP in percentages

	As % of total assets					As % GDP				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
ASSETS	100.0	100.0	100.0	100.0	100.0	122.5	127.8	146.2	142.1	136.8
1) Cash	1.4	2.6	2.8	2.2	2.8	1.7	3.3	4.1	3.2	3.9
2) Loans to banks	9.6	8.5	11.1	9.6	9.6	11.8	10.8	16.2	13.6	13.1
3) Loans to non-banking sector	66.8	70.4	65.7	68.5	67.6	81.9	89.9	96.0	97.3	92.5
3.1 Currency breakdown										
domestic currency	63.0	66.1	62.5	65.5	64.9	77.2	84.5	91.4	93.1	88.8
foreign currency	3.9	4.2	3.2	2.9	2.7	4.7	5.4	4.6	4.2	3.7
3.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
short-term	23.4	26.3	20.8	18.4	16.7	28.6	33.6	30.4	26.2	22.9
long-term	43.5	44.1	44.9	50.0	50.9	53.3	56.4	65.6	71.1	69.6
3.3 Sector breakdown										
non-financial corporations	40.2	42.5	39.1	39.3	38.1	49.3	54.3	57.1	55.8	52.2
households	15.2	15.5	15.3	17.2	18.1	18.6	19.8	22.3	24.4	24.8
government	1.1	1.1	1.4	2.3	2.5	1.3	1.4	2.1	3.3	3.5
OFIs	5.0	5.9	5.3	5.1	4.6	6.1	7.6	7.7	7.3	6.4
other	5.3	5.4	4.7	4.6	4.1	6.5	6.9	6.8	6.5	5.6
4) Financial assets/securities	18.2	15.3	17.2	16.4	16.1	22.3	19.5	25.1	23.4	22.1
4.1 Currency breakdown										
domestic currency	15.4	13.1	14.4	13.6	13.7	18.8	16.7	21.0	19.4	18.7
foreign currency	0.1	0.0	0.0	0.1	0.0	0.2	0.1	0.0	0.1	0.1
4.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
short-term	2.8	2.3	3.6	1.5	0.7	3.4	3.0	5.3	2.1	0.9
long-term	12.7	10.8	10.8	12.2	13.0	15.5	13.8	15.7	17.4	17.8
4.3 Sector breakdown										
government	10.1	8.6	9.9	8.9	10.0	12.4	10.9	14.4	12.6	13.7
Bank of Slovenia	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
other	8.1	6.7	7.3	7.6	6.1	9.9	8.6	10.7	10.8	8.3
5) Capital investments	1.5	1.3	1.3	1.4	1.5	1.8	1.7	2.0	2.0	2.0
6) Other	2.4	1.9	1.9	1.9	2.4	3.0	2.5	2.7	2.7	3.3
LIABILITIES	100	100	100	100	100	122.5	127.8	146.2	142.1	136.8
1) Liabilities to Eurosystem	0	3	4	1	3	0.5	3.3	5.9	1.6	4.8
2) Liabilities to banks	37.6	38.1	30.9	30.2	26.5	46.1	48.7	45.1	43.0	36.3
foreign banks	34.0	33.8	25.2	23.3	19.6	41.7	43.2	36.9	33.1	26.8
3) Deposits by non-banking sector	45.8	43.3	45.7	46.7	49.6	56.1	55.3	66.7	66.4	67.9
3.1 Currency breakdown										
domestic currency	44.5	42.3	44.8	45.8	48.4	54.5	54.0	65.5	65.0	66.2
foreign currency	1.3	1.0	0.9	1.0	1.2	1.5	1.3	1.3	1.4	1.7
3.2 Maturity breakdown						0.0	0.0	0.0	0.0	0.0
short-term	41.6	38.1	35.3	31.9	33.2	51.0	48.7	51.6	45.4	45.5
long-term	4.1	5.2	10.3	14.8	16.4	5.1	6.6	15.1	21.0	22.4
3.3 Sector breakdown						0.0	0.0	0.0	0.0	0.0
non-financial corporations	8.7	7.8	7.4	8.0	8.3	10.6	10.0	10.8	11.4	11.3
households	28.6	27.7	26.7	28.4	29.8	35.0	35.4	39.1	40.4	40.8
government	3.6	3.9	7.7	6.0	6.7	4.4	5.0	11.3	8.6	9.2
OFIs						3.3	2.8	3.2	3.6	4.1
other	2.2	1.6	1.6	1.7	1.7	2.7	2.1	2.3	2.5	2.4
4) Securities	2.3	2.6	6.7	8.9	7.6	2.8	3.4	9.7	12.7	10.4
4.1 Currency breakdown										
domestic currency	2.3	2.6	6.7	8.9	7.6	2.8	3.4	9.7	12.7	10.4
foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4.2 Maturity breakdown										
short-term	0.0	0.2	0.0	0.0	0.4	0.0	0.3	0.0	0.0	0.5
long-term	2.2	2.4	6.6	8.9	7.3	2.8	3.1	9.7	12.7	9.9
5) Provisions	0.5	0.4	0.3	0.3	0.5	0.6	0.5	0.5	0.5	0.6
6) Subordinated debt	3.5	3.4	3.0	3.1	3.0	4.3	4.3	4.4	4.5	4.1
7) Capital	8.4	8.4	8.3	8.2	8.1	10.3	10.7	12.2	11.6	11.0
8) Other	1.6	1.3	1.1	1.3	1.2	2.0	1.7	1.6	1.8	1.7

Source: Bank of Slovenia

Table 2.3 Banking sector's income statement: amounts in EUR million and growth rates in percentages

	Value, EUR million					Growth, %				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
1. Net interest income	816	945	932	1,038	1,007	18.3	15.7	-1.3	11.3	-3.0
1.1 Interest income	1,954	2,615	2,095	2,055	2,184	37.5	33.8	-19.9	-1.9	6.3
1.2 Interest expenses	1,138	1,671	1,163	1,017	1,178	55.6	46.8	-30.4	-12.6	15.8
2. Net non-interest income	617	416	493	437	422	17.3	-32.6	18.7	-11.5	-2.9
2.1 Net fees and commissions	336	340	336	343	340	9.0	1.0	-1.2	2.3	-1.0
2.2 Net financial transactions	136	-115	42	-49	-11	39.7	-184.4	…	…	…
2.3 Net other	145	191	116	142	93	20.5	31.8	-39.1	22.3	-34.5
3. Gross income (1+2)	1,433	1,360	1,425	1,474	1,429	17.9	-5.1	4.8	3.4	-3.0
4. Operating costs	756	776	765	766	763	7.7	2.7	-1.4	0.1	-0.4
labour costs	402	412	415	413	408	9.4	2.6	0.8	-0.5	-1.2
5. Net income (3-4)	677	584	660	709	668	31.9	-13.7	13.0	7.3	-5.7
6. Net provisions	163	278	500	810	1,196	36.0	70.5	79.8	62.1	48.3
7. Total costs (4+6)	919	1,054	1,265	1,576	1,959	11.8	14.7	20.0	24.6	24.6
8. Pre-tax profit (3-7)	514	306	161	-101	-530	30.6	-40.4	-47.6	-163.0	426.4
9. Taxes	102	59	39	-3	-95	12.8	-42.8	-33.9	-108.0	…
10. Net profit (8-9)	412	248	122	-98	-436	36.0	-39.8	-50.8	-180.6	…

Source: Bank of Slovenia

Table 2.4 Banking sector's income statement: as proportion of gross income and as proportion of total assets in percentages

	As % of gross income					As % of total assets				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
1. Net interest income	57	69	65	70	70	1.9	2.0	1.8	2.1	2.1
1.1 Interest income	136	192	147	139	153	4.6	5.5	4.1	4.1	4.5
1.2 Interest expenses	79	123	82	69	82	2.7	3.5	2.3	2.0	2.4
2. Net non-interest income	43.0	30.6	34.6	29.6	29.6	1.5	0.9	1.0	0.9	0.9
2.1 Net fees and commissions	23	25	24	23	24	0.8	0.7	0.7	0.7	0.7
2.2 Net financial transactions	9	-8	3	-3	-1	0.3	-0.2	0.1	-0.1	0.0
2.3 Net other	10	14	8	10	6	0.3	0.4	0.2	0.3	0.2
3. Gross income (1+2)	100	100	100	100	100	3.4	2.9	2.8	2.9	2.9
4. Operating costs	53	57	54	52	53	1.8	1.6	1.5	1.5	1.6
labour costs	28	30	29	28	29	0.9	0.9	0.8	0.8	0.8
5. Net income (3-4)	47	43	46	48	47	1.6	1.2	1.3	1.4	1.4
6. Net provisions	11	20	35	55	84	0.4	0.6	1.0	1.6	2.5
7. Total costs (4+6)	64	77	89	107	137	2.2	2.2	2.5	3.1	4.0
8. Pre-tax profit (3-7)	36	23	11	-7	-37	1.2	0.6	0.3	-0.2	-1.1
9. Taxes	7	4	3	0	-7	0.2	0.1	0.1	0.0	-0.2
10 Net profit (8-9)	29	18	9	-7	-31	1.0	0.5	0.2	-0.2	-0.9

Source: Bank of Slovenia

Table 2.5 Average effective asset and liability interest rates calculated from interest income and expenses, interest spread and interest margin in percentages

(%)	2006	2007	2008	2009	2010	2011
Average asset interest rate	4.81	5.51	6.09	4.45	4.23	4.63
Average liability interest rate	2.59	3.37	4.11	2.61	2.20	2.63
Interest-rate gap between effective interest rates	2.22	2.14	1.98	1.84	2.03	2.00
Net interest margin in interest-bearing assets	2.37	2.33	2.20	1.99	2.13	2.13

Source: Bank of Slovenia

Table 2.6 Selected performance indicators for the banking sector

	2006	2007	2008	2009	2010	2011
1) Profitability and margins, %						
ROA	1.3	1.4	0.7	0.3	-0.2	-1.1
ROE	15.1	16.3	8.1	3.9	-2.4	-12.5
CIR	57.8	52.7	57.1	53.7	51.9	53.3
financial intermediation margin	3.9	3.8	3.0	2.9	2.9	2.9
interest margin (per total assets)	2.2	2.2	2.1	1.9	2.0	2.0
non-interest margin (per total assets)	1.7	1.6	0.9	1.0	0.9	0.9
net interest margin (per interest bearing assets)	2.4	2.3	2.2	2.0	2.1	2.1
interest spread	3.8	2.3	2.3	2.3	2.4	2.3
2) Structure of assets and liabilities, %						
2.1 Maturity breakdown of loans to non-banking sector						
short-term loans / loans	33.4	35.0	37.0	31.7	26.9	24.8
long-term loans / loans	66.6	65.0	63.0	68.3	73.1	75.2
2.2 Maturity breakdown of deposits to non-banking sector						
short-term deposits / deposits	87.6	90.9	88.1	77.3	68.3	66.9
long-term deposits / deposits	12.4	9.1	11.9	22.7	31.7	33.1
2.3 Regional breakdown of loans						
to residents	94.4	92.2	92.5	93.1	93.5	94.1
to non-residents	5.6	7.8	7.5	6.9	6.5	5.9
2.4 Foreign currency sub-balance						
foreign currency assets / total assets	45.9	6.0	6.1	5.0	4.6	4.7
foreign currency liabilities / total assets	46.8	5.0	4.9	3.5	3.6	3.6
difference	-0.8	1.1	1.2	1.5	1.0	1.1
foreign currency loans / loans	55.9	6.4	6.4	5.2	4.5	4.7
foreign currency deposits / deposits	53.3	5.9	6.0	4.5	4.7	4.8
foreign currency loans / loans (non-banking sector)	55.4	5.8	6.0	4.8	4.3	4.0
foreign currency deposits / deposits (non-banking sector)	33.4	2.7	2.4	1.9	2.1	2.5
2.5 Securities						
securities / loans to non-banking sector	37.3	26.1	21.1	24.4	22.3	22.2
2.6 Sector breakdown						
corporates						
corporate loans / loans to non-banking sector	66.7	67.7	68.6	67.5	64.9	63.3
foreign currency corporate loans / corporate loans	65.4	3.7	3.4	2.3	1.9	1.3
households						
household loans / loans to non-banking sector	24.9	22.9	22.3	23.4	25.3	27.0
foreign currency household loans / household loans	23.2	10.2	12.9	10.6	9.9	8.8
government						
loans to government / loans to non-banking sector	2.8	1.6	1.5	2.2	3.4	3.8
rest of the world						
liabilities to foreign banks / total assets	29.9	34.0	33.7	25.0	23.3	19.6
3) Asset quality						
impairments, EUR million	1,233.8	1,311.1	1,403.2	1,827.2	2,422.0	2,422.0
classified claims, EUR million	31,581.0	40,541.6	47,129.2	49,757.3	49,766.3	49,735.0
impairments / classified claims, %	3.9	3.2	3.0	3.7	4.9	6.5
non-performing claims / classified claims, %	2.5	1.8	1.8	2.2	3.7	6.1
impairments for non-performing claims / classified claims, %	84.3	86.4	79.3	75.9	68.6	64.9
non-performing claims / regulatory capital, %	31.0	20.8	19.1	24.1	40.8	70.8
non-performing claims minus impairments / capital, %	4.9	2.8	4.0	5.8	12.8	24.9
sum of large exposures / capital, %	221.2	217.4	168.7	159.2	…	…
4) Interest-rate risk						
gap between interest-bearing assets and liabilities, percentage points	3.7	5.0	4.8	6.2	2.5	0.9
interest-bearing assets / assets, %	91.3	95.1	94.2	96.0	92.5	91.7
interest-bearing liabilities / liabilities, %	87.6	90.1	89.4	89.8	90.0	90.8
5) Currency risk						
open foreign exchange position / regulatory capital, %	25.8	0.9	0.2	0.9	1.4	0.4
6) Liquidity						
average liquid assets / average short-term deposits by non-banking sector, %	9.7	8.37	34.33	36.2	43.0	40.3
average liquid assets / average total assets, %	4.5	3.6	13.78	13.8	14.3	13.4
first-bucket liquidity ratio	1.13	1.21	1.24	1.3	1.4	1.3
second-bucket liquidity ratio	1.15	1.13	1.14	1.2	1.1	1.0
debt securities / total assets, %	20.8	16.02	13.47	14.9	15.0	14.2
7) Solvency and capital structure, %						
capital adequacy (solvency ratio)	11.1	11.2	11.7	11.6	11.3	11.6
Tier 1 capital ratio	8.3	7.8	9.2	9.3	9.0	9.6
additional own funds / original own funds	38.0	48.5	33.3	30.0	31.6	27.9

Source: Bank of Slovenia

Table 2.7 Selected performance indicators for the banking sector

(%)		Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Total
Ratio of deposits by non-banking sector to loans to non-banking sector	2007	80.0	92.2	43.7	68.5
	2008	73.4	85.8	38.1	61.5
	2009	83.3	92.7	42.5	69.5
	2010	80.0	95.6	43.0	68.2
	2011	86.6	92.5	48.9	73.4
	Mar. 12	85.8	86.4	50.4	72.9
Ratio of short-term deposits by non-banking sector to short-term loans to non-banking sector	2007	113.3	94.3	89.5	105.1
	2008	93.2	86.3	84.7	90.3
	2009	97.3	89.8	112.9	99.9
	2010	77.9	79.2	104.2	83.9
	2011	86.3	71.8	124.8	93.2
	Mar. 12	84.0	71.0	128.6	93.2
Ratio of liabilities to foreign banks to liabilities to non-banking sector	2007	47.0	9.7	66.0	50.9
	2008	42.6	10.3	63.9	48.0
	2009	28.3	5.5	61.6	38.4
	2010	24.1	2.8	57.2	34.0
	2011	19.8	2.3	48.9	29.0
	Mar. 12	19.1	1.9	43.5	26.6
Ratio of loans to foreign banks to total assets	2007	29.0	6.2	52.3	34.0
	2008	27.7	6.8	52.3	33.8
	2009	16.8	3.5	48.9	25.2
	2010	15.0	1.7	47.8	23.3
	2011	12.0	1.5	40.8	19.6
	Mar. 12	11.1	1.3	36.4	17.7
Ratio of debt securities to total assets	2007	19.9	17.0	7.2	16.0
	2008	17.2	14.8	5.8	13.5
	2009	18.0	18.9	7.2	14.9
	2010	16.4	19.1	8.1	14.3
	2011	16.6	19.8	7.6	14.2
	Mar. 12	16.5	18.9	7.9	14.2
ECB liquidity ratio: ratio of cash and claims against banks to liabilities to banks	2007	37.3	48.8	16.9	29.4
	2008	39.2	55.8	14.8	29.1
	2009	71.5	61.3	18.7	45.0
	2010	67.0	69.8	8.9	39.0
	2011	81.3	58.8	12.5	46.7
	Mar. 12	99.3	52.5	12.8	56.0

Source: Bank of Slovenia

Table 2.8 Changes to the credit ratings of Slovenian banks by Moody's in the period January 2011 to March 2012

	NLB d.d.	NKBM d.d.	Abanka Vipa d.d.	SID banka d.d.	Factor banka d.d.
	27 January 2011: placement of NLB d.d., NKBM d.d. and Abanka Vipa d.d. on watchlist for possible downgrading				
Deposit and financial strength ratings	"A3"/"D+", placed on RW[2]	"Baa1"/"D", placed on RW[2]	"Baa1"/"D+", placed on RW[2]		
Subordinated debt rating	"Baa1", placed on RW[2]				
Hybrid instrument rating	"Ba1", placed on RW[2]	"Ba2", placed on RW[1,2]	"Ba3", placed on RW[2]		
	8 June 2011: downgrading of NLB d.d., NKBM d.d. and Abanka Vipa d.d.				
Deposit and financial strength ratings	downgraded to "Baa3"/"Prime-3"/"E+", negative outlook, from "A3"/"Prime-2"/"D+"	downgraded to ""Baa3"/"Prime-3"/"D-", negative outlook, from "Baa1"/"Prime-2"/"D"	downgraded to "Baa3"/"Prime-3"/"D-", negative outlook, from "Baa1"/"Prime-2"/"D+"		
Subordinated debt rating	downgraded to "Ba1" from "Baa1"				
Hybrid instrument rating	downgraded to "B1" from "Ba1"	downgraded to "Ba3" from "Ba2"[1]	downgraded to "B2" from "Ba3"		
	26 September 2011: downgrading of government-guaranteed bank bonds, placement of banks and their instruments in watchlist				
Deposit rating	"Baa3"/"Prime-3", placed on RW[2]	"Baa3"/"Prime-3", placed on RW[2]	"Baa3"/"Prime-3", placed on RW[2]		
Long-term rating				downgraded to "Aa3" from "Aa2", placed on RW[2]	
Subordinated debt rating	"Ba1", placed on RW2				
Hybrid instrument rating	"B1", placed on RW[2]	"Ba3", placed on RW[1,2]			
Government-guaranteed bond rating	downgraded to "Aa3" from "Aa2"		downgraded to "Aa3" from "Aa2"	downgraded to "Aa3" from "Aa2"	
	9 November 2011: downgrading of government-guaranteed Eurobond of Factor banka d.d.				
Government-guaranteed bond rating					downgraded to "Aa3"/RW from "Aa2"
	23 December 2011: downgrading of banks and their securities				
Deposit and financial strength ratings	downgraded to "Ba1"/"Non-prime"/"E+", negative outlook, from "Baa3"/"Prime-3"/"E+"	downgraded to"Ba1"/"Non-prime"/"D-", negative outlook, from "Baa3"/"Prime-3"/"D-"	downgraded to "Ba2"/"Non-prime"/"E+", negative/stable outlook, from "Baa3"/"Prime-3"/"D-"		
Long-term rating				downgraded to "A1", negative outlook from "Aa3"	
Subordinated debt rating	downgraded to "Ba2"/RW[2] from "Ba1"				
Hybrid instrument rating	"B1", placed on RW[2]	"Ba3", placed on RW[1]	downgraded to "Caa1", negative outlook, from "B2"		
Government-guaranteed bond rating	downgraded to "A1", negative outlook, from "Aa3"		downgraded to"A1", negative outlook, from "Aa3"	downgraded to" A1", negative outlook, from "Aa3"	downgraded to"A1", negative outlook, from "Aa3"
	15 February 2012: downgrading of government-guaranteed bonds				
Long-term rating				downgraded to"A2", negative outlook, from "A1"	
Government-guaranteed bond rating	downgraded to"A2", negative outlook, from "A1"		downgraded to"A2", negative outlook, from "A1"	downgraded to"A2", negative outlook, from "A1"	downgraded to"A2", negative outlook, from "A1"
	25 April 2012: downgrading of banks				
Deposit and financial strength ratings	downgraded to"Ba2"/"Non-prime"/"E+", placed on RW[2] from "Ba1"/"Non-prime"/"E+"	downgraded to "Ba2"/"Non-prime"/"E+", placed on RW[2] from "Ba1"/"Non-prime"/"D-"	downgraded to"Ba3"/"Non-prime"/"E+", placed on RW[2] from "Ba2"/"Non-prime"/"E+"		
Subordinated debt rating	downgraded to "B3"/RW[2] from "Ba2"				
Hybrid instrument rating	downgraded to "Caa1"/RW[2] from "B1"	downgraded to "B3" from "Ba3", placed on RW[1,2]	downgraded to "Caa2"/RW[2] from "Caa1"		

Note: [1] NKBM d.d. has two hybrid instruments.
[2] RW means the placement of a credit rating on the so-called *Watchlist*.

Source: Moody's

Table 2.9 Changes to the credit ratings of Slovenian banks by Fitch Ratings in the period January 2011 to March 2012

	NLB d.d.	NKBM d.d.	Abanka Vipa d.d.	Probanka d.d.	Banka Celje d.d.	Gorenjska banka d.d.	Banka Koper d.d.
	18 February 2011: placement of Banka Celje d.d. on watchlist						
Long-term rating					"BBB", placed on RWE[1]		
Short-term rating					"F3", placed on RWE[1]		
Support rating					"3", placed on RWE[1]		
Country ceiling rating					"BB+", confirmed		
	7 April 2011: placement of NKBM d.d. on watchlist						
Long-term rating		"A-", placed on RWN[2]					
Short-term rating		"F2", confirmed					
Support rating		"1", placed on RWN[2]					
Country ceiling rating		"A-", placed on RWN[2]					
Individual rating		"C/D", unchanged					
Hybrid instrument rating		"BB", unchanged					
	12 May 2011: downgrading of NKBM d.d. and Probanka d.d.						
Long-term rating		downgraded to "BBB+" from "A-", removed from RWN[2], stable		downgraded to "BB-" from "BB", stable outlook			
Short-term rating		"F2", unchanged		"B", confirmed			
Support rating		downgraded to "2" from "1", removed from		"4", confirmed			
Country ceiling rating		downgraded to "BBB+" from "A-", removed from RWN[2]		"B+", confirmed			
Individual rating		"C/D", confirmed		"D", confirmed			
Hybrid instrument rating		downgraded to "BB-" from "BB"					
	29 September 2011: downgrading of several banks						
Long-term rating	downgraded to "BBB" from "A-", stable outlook	downgraded to "BBB" from "BBB+", stable outlook	downgraded to "BB-" from "BBB-", stable outlook	downgraded to "B" from "BB-", stable outlook	downgraded to "BB" from "BBB", negative outlook, removed from RWE[1]	downgraded to "BB" from "BBB", negative outlook from stable	"A+", confirmed, negative outlook from stable
Short-term rating	downgraded to "F3" from "F2"	downgraded to "F3" from "F2"	downgraded to "B" from "F3"	"B", confirmed	downgraded to "B" from "F3", removed from RWE[1]	downgraded to "B" from "F3"	"F1", confirmed
Support rating	downgraded to "2" from "1"	"2", unchanged	"3", confirmed	"4", confirmed	"3", confirmed, removed from RWE[1]	"3", confirmed	"1", confirmed
Country ceiling rating	downgraded to "BBB" from "A-"	downgraded to "BBB" from "BBB+"	downgraded to "BB-" from "BB+"	downgraded to "B" from "B+"	downgraded to "BB-" from "BB+"	downgraded to "BB-" from "BB+"	
Viability rating	downgraded to "b" from "bb-"	downgraded to "bb" from "bb+"	downgraded to "bb-" from "bbb-"	downgraded to "b-" from "bb-"	downgraded to "BB" from "BBB", negative outlook, removed from RWE1	downgraded to "bb" from "bbb"	downgraded to "bb+" from "bbb-"
Individual rating	downgraded to "D/E" from "D"	"C/D", confirmed	downgraded to "D" from "C"	downgraded to "D/E" from "D"	downgraded to "C/D" from "C"	downgraded to "C/D" from "C"	downgraded to "C/D" from "C"
Hybrid instrument rating		downgraded to "B+" from "BB-"	downgraded to "B" from "BB"				
Government-guaranteed bond rating	downgraded to "AA-" from "AA"		downgraded to "AA-" from "AA"				
	11 October 2011: downgrading of Banka Koper d.d.						
Long-term rating							downgraded to "A-" from "A+", negative outlook
Short-term rating							downgraded to"F2" from
Support rating							"1", confirmed
	22 December 2011:						
Long-term rating							"A-", placed on RWN[2]
Short-term rating							"F2", placed on RWN[2]
Support rating							"1", placed on RWN[2]
	1 February 2012: downgrading of government-guaranteed bonds						
Long-term rating	"BBB", confirmed, negative outlook from stable	"BBB", confirmed, negative outlook from stable	"BB-", unchanged				
Short-term rating	"F3", confirmed	"F3", confirmed	"B", unchanged				
Support rating	"2", confirmed	"2", confirmed	"3", unchanged				
Country ceiling rating	"BBB", confirmed	"BBB", confirmed	"BB-", unchanged				
Viability rating	"b", unchanged	"bb", unchanged	"BB-", unchanged				
Hybrid instrument rating		"B+"/RWN, unchanged	"B", unchanged				
Government-guaranteed bond rating	downgraded to "A" from "AA-"		downgraded to "A" from "AA-"				
	8 February 2012: downgrading of Banka Koper d.d.						
Long-term rating							downgraded to "BBB+" from "A-", negative outlook, removed from RWN[2]
Short-term rating							"F2", confirmed, removed from RWN[2]
Support rating							downgraded to "2" from "1", removed from RWN[2]
	20 February 2012:						
Long-term rating	"BBB", placed on RWN[2]	"BBB", placed on RWN[3]	"BB-", placed on RWN[2]	"B," placed on RWN[2]	"BB", unchanged, negative outlook	"BB", unchanged, negative outlook	
Short-term rating	"F3", placed on RWN[2]	"F3", placed on RWN[3]	"B", confirmed	"B", confirmed	"B", unchanged	"B", unchanged	
Support rating	"2", placed on RWN[2]	"2", placed on RWN[3]	"3", placed on RWN[2]	"4", placed on RWN[2]	"3", placed on RWN[2]	"3", placed on RWN[3]	
Country ceiling rating	"BBB", placed on RWN[2]	"BBB", placed on RWN[3]	"BB-", placed on RWN[2]	"B", placed on RWN[2]	"BB-", placed on RWN[2]	"BB-", placed on RWN[3]	
Viability rating	"b", unchanged	"bb", unchanged	downgraded to "b" from "bb-"	"b-", unchanged	"bb", unchanged	"bb", unchanged	
Individual rating							
Hybrid instrument rating		"B+", confirmed, removed from RWN[2]	downgraded to "CCC" from "B", removed from RWN[2]				
Government-guaranteed bond rating	"A", confirmed		"A", confirmed				

Note: [1] RWE means the placement of a credit rating on a watch list for confirmation (so-called Rating Watch Evolving).
[2] RWN means the placement of a credit rating on a watch list for a possible downgrade (so-called Rating Watch Negative).

Source: Fitch Ratings

3. Financial system

Table 3.1 Structure of the financial system

	Total assets, EUR million		Structure, %		As % GDP		No. of institutions	
	2010	2011	2010	2011	2010	2011	2010	2011
Monetary financial institutions[1]	50,760	49,283	75.9	75.8	143.3	138.3	25	25
banks	50,319	48,788	75.2	75.1	142.1	136.9	22	22
privately owned	39,506	36,991	59.1	56.9	111.5	103.8	-	-
domestic	19,953	18,401	29.8	28.3	56.3	51.6	-	-
foreign	19,554	18,590	29.2	28.6	55.2	52.2	-	-
government-owned	10,813	11,797	16.2	18.2	30.5	33.1	-	-
savings banks	441	495	0.7	0.8	1.2	1.4	3	3
NMFIs	16,143	15,711	24.1	24.2	45.6	44.1	-	-
insurers[2]	6,041	6,108	9.0	9.4	17.1	17.1	17	17
pension funds[3]	1,538	1,518	2.3	2.3	4.3	4.3	10	10
investment funds	2,294	1,816	3.4	2.8	6.5	5.1	135	139
leasing companies[4]	5,731	5,731	8.6	8.8	16.2	16.1	21	21
BHs, MCs and others[4]	538	538	0.8	0.8	1.5	1.5	-	-
Total	66,903	64,993	100.0	100.0	188.9	182.4	-	-

Notes: Figures for financial institutions that are not banks, insurers, pension companies or pension and investment funds are obtained from the AJPES database of annual accounts based on the SKD 2008 classification. The figures for leasing companies include all companies included under financial leasing, activity code K64.91, according to the SKD 2008.
[1] Monetary financial institutions do not include the central bank.
[2] The figures for the total assets of reinsurance companies are for the end of the third quarter of 2011.
[3] The First Pension Fund is included among pension funds.
[4] Total assets in 2011 according to the figures for the end of 2010.

Sources: Bank of Slovenia, ISA, SMA, AJPES, BAS

Table 3.2 Market concentration of individual types of financial institution

		Banks		Insurers		Pension funds		Investment funds		Leasing companies	
		2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
HHI	all companies	1,149	1,110	2,225	2,157	2,115	2,217	458	447	1,590	1,363
	five largest	1,006	966	2,147	2,076	2,105	2,207	376	369	1,497	1,206
Share, %	five largest	59	59	74	74	94	94	38	37	74	68
	largest	27	26	43	42	32	35	15	16	32	29

Note: The Herfindahl-Hirschman Index (HHI) is calculated in terms of total assets, with the exception of leasing companies, for which it is calculated based on the volume of business. The figures for pension funds do not include the First Pension Fund, which is a closed pension fund that does not envisage further inflows.

Sources: Bank of Slovenia, ISA, SMA, AJPES, BAS

Table 3.3 Financial indicators for individual types of financial institution

	2007	2008	2009	2010	2011
	Pre-tax profit, EUR million				
Banks	514.2	306.3	160.5	-101.2	-471.0
Insurers[1]	117.5	-2.8	17.7	91.1	108.5
Leasing companies	489.0	277.1	-381.8	-319.5	
Management companies	34.6	21.3	6.5	-6.0	
	ROA, %				
Banks	1.36	0.67	0.32	-0.20	-1.00
Insurers[1]	2.63	-0.06	0.33	1.56	1.76
Leasing companies	11.10	5.06	-6.44	-5.57	
Management companies	15.98	9.83	4.33	-4.91	
	ROE, %				
Banks	16.28	8.14	3.85	-2.36	-11.69
Insurers[1]	12.90	-0.28	1.85	8.86	9.54
Leasing companies	211.15	105.39	-156.84	-153.70	
Management companies	23.01	15.15	7.74	-8.86	

Note: [1] Net profit for the accounting period (profit after tax) is taken into account for insurance companies and reinsurance companies.
The figures for reinsurance companies are for the first three quarters of 2011. Note: Data for leasing companies include those companies, whose core activity is the provision of leasing business.

Sources: Bank of Slovenia, ISA, AJPES

Table 3.4 Direct ownership structure of the Slovenian financial system (shares valued at market price or book value) in percentages

Holders / ISSUERS	Banks	Other financial intermediaries	Insurers and pension funds	Corporates	Total
	Ownership structure, %				
2007					
Non-financial corporations	17	33	22	32	30
Banks	7	8	6	2	3
Other financial intermediaries	5	16	1	10	9
Insurers and pension funds	3	7	9	2	2
Government	26	1	47	24	23
Households	8	32	6	19	18
Non-residents	34	2	9	11	13
Other	1	2	1	1	1
Total	100	100	100	100	100
2008					
Non-financial corporations	24	31	19	39	35
Banks	5	4	11	3	4
Other financial intermediaries	5	19	4	8	8
Insurers and pension funds	5	4	15	1	3
Government	21	1	31	19	19
Households	3	25	5	15	13
Non-residents	38	13	15	13	17
Other	0	3	0	1	1
Total	100	100	100	100	100
2009					
Non-financial corporations	21	27	19	38	33
Banks	6	6	10	4	5
Other financial intermediaries	5	20	4	7	7
Insurers and pension funds	4	5	11	2	3
Government	25	1	36	20	21
Households	3	27	6	16	14
Non-residents	37	12	13	12	17
Other	0	1	1	1	1
Total	100	100	100	100	100
2010					
Non-financial corporations	20	33	20	32	30
Banks	6	5	12	4	4
Other financial intermediaries	4	19	2	5	5
Insurers and pension funds	4	7	13	1	2
Government	24	1	30	31	28
Households	3	23	5	14	12
Non-residents	38	12	17	12	17
Other	0	1	1	1	1
Total	100	100	100	100	100
2011					
Non-financial corporations	18	22	17	29	27
Banks	7	0	12	3	4
Other financial intermediaries	3	17	2	5	5
Insurers and pension funds	2	15	15	2	3
Government	26	0	35	32	30
Households	2	10	3	14	11
Non-residents	42	36	16	14	20
Other	0	0	1	1	1
Total	100	100	100	100	100

Sources: CSCC, Bank of Slovenia calculations

4. Insurers

Table 4.1 Total assets and operating results of insurance companies and reinsurance companies

	2007	2008	2009	2010	2011	2008	2009	2010	2011
	Value, EUR million unless state					Growth, %			
	Insurance companies								
Total assets	4,550	4,590	5,091	5,435	5,693	0.9	10.9	6.8	4.7
non-life insurance	2,251	2,265	2,335	2,398	2,389	0.7	3.1	2.7	-0.4
life insurance	2,299	2,325	2,755	3,037	3,303	1.1	18.5	10.2	8.8
Results									
result from general insurance[1]	69.1	1.0	19.4	139.2	114.6	-98.6	1860.8	615.9	-17.7
result from health insurance[1]	9.9	10.9	10.8	-5.7	8.5	9.9	-0.7	-152.8	-248.6
result from life insurance[1]	20.8	1.8	27.4	26.1	16.3	-91.5	1446.5	-4.8	-37.5
income from investments	118.7	104.0	99.1	98.6	80.1	-12.4	-4.7	-0.5	-18.8
expenses from investments	21.2	86.9	69.9	96.2	83.8	309.3	-19.6	37.7	-12.9
net profit[2]	95.1	2.9	23.1	77.9	99.3	-97.0	696.9	237.1	27.5
ROE, %	12.42	0.34	2.99	9.27	10.53				
ROA, %	2.36	0.06	0.48	1.48	1.79				
	Reinsurance companies[3]								
Total assets	485	561	570	624	622	15.7	1.6	9.5	-0.3
Results									
result from general insurance	11.3	-0.2	4.3	2.4	11.5	-101.5	2563.7	-43.6	374.7
income from investments	31.3	27.0	18.1	12.9	15.4	-13.9	-33.0	-28.6	19.4
expenses from investments	6.9	30.6	21.0	7.1	10.4	343.0	-31.5	-66.2	46.6
net profit	22.4	-5.7	-5.4	1.8	9.2	-125.6	5.0	133.5	405.5
ROE, %	15.48	-3.16	-2.99	1.00	4.84				
ROA, %	5.25	-1.10	-0.96	0.31	1.48				

Notes: [1] Result from ordinary activities.
[2] Net profit for the accounting period is calculated after taxes.
[3] The figures for reinsurance companies in 2011 relate to the end of the third quarter.
Sources: ISA, Bank of Slovenia calculations

Table 4.2 Capital adequacy of insurance companies and reinsurance companies

	2007	2008	2009	2010	2011	Growth, % 2008	2009	2010	2011
	Insurance companies (total)								
Minimum capital requirement, EUR million	261.0	275.2	286.6	300.1	343.5	5.5	4.1	4.7	14.5
Surplus, EUR million	222.2	144.8	150.1	206.8	358.0	-34.8	3.6	37.8	73.1
Surplus / minimum capital requirement, %	85.1	52.6	52.4	68.9	104.2	-38.2	-0.5	31.6	51.2
	Life insurance[1]								
Surplus / minimum capital requirement, %	68.8	60.9	61.1	69.5	128.8				
Original own funds / net technical provisions, %	10.4	10.3	8.6	8.2	13.3				
	Non-life insurance								
Surplus / minimum capital requirement, %	93.1	48.2	47.6	68.6	85.4				
Original own funds / net written premium, %	45.3	36.9	36.0	38.2	38.8				
	Reinsurance companies[2]								
Minimum capital requirement, EUR million	26.1	26.1	29.0	31.5	34.3	0.0	11.3	8.6	9.2
Surplus, EUR million	60.2	75.9	50.1	39.2	33.0	26.1	-34.0	-21.8	-14.8
Surplus / minimum capital requirement, %	231.1	291.4	172.8	124.5	96.4	26.1	-40.7	-28.0	-22.0
Original own funds / net written premium, %	107.0	105.6	92.2	125.5	131.9	-1.3	-12.6	36.0	44.5

Note: [1] The value of share capital in the life insurance segment increased last year owing to the recapitalisations of insurers and the establishment of Modra zavarovalnica d.d., whose share capital totals EUR 152.2 million, resulting in a 181.4% increase in share capital in the life insurance segment.
[2] The figures for reinsurance companies in 2011 relate to the end of the third quarter.
Sources: ISA, Bank of Slovenia calculations

Table 4.3 Claims ratios for the main types of insurance

	2007	2008	2009	2010	2011
	Insurance companies				
Total	0.56	0.62	0.62	0.62	0.63
Life insurance	0.27	0.28	0.32	0.41	0.56
Voluntary health insurance	0.80	0.83	0.82	0.89	0.88
General insurance	0.62	0.71	0.69	0.61	0.56
motor vehicle liability insurance	0.55	0.55	0.57	0.56	0.55
motor vehicle insurance	0.77	0.87	0.89	0.77	0.70
accident insurance	0.39	0.39	0.38	0.37	0.36
other property insurance	0.76	1.04	0.86	0.62	0.52
fire and natural disaster insurance	0.60	1.14	0.69	0.55	0.40
credit insurance	0.71	0.54	0.90	0.99	0.86
other general insurance	0.64	0.61	0.62	0.54	0.48
	Reinsurance companies				
Total	0.56	0.83	0.66	0.53	0.53

Source: ISA

Table 4.4 Coverage of net insurance technical provisions by the assets covering technical provisions

	2007	2008	2009	2010	2011
Insurance technical provisions, EUR million	3,056	3,033	3,464	3,703	3,834
growth, %	17.5	-0.8	14.2	6.9	3.6
Assets covering technical provisions, EUR million	3,357	3,493	4,115	4,489	4,614
growth, %	17.5	4.0	17.8	9.1	2.8
Assets covering technical provisions / insurance technical provisions, %	109.8	115.2	118.8	121.2	120.3
Assets covering technical provisions / GDP, %	9.7	9.4	11.6	12.4	12.9
Mathematical provisions, EUR million	1,748	1,752	2,105	2,346	2,454
growth, %	20.4	0.2	20.2	11.4	4.6
Assets covering mathematical provisions, EUR million	2,042	2,095	2,539	2,838	2,973
growth, %	22.7	2.6	21.2	11.8	4.7
Assets covering mathematical provisions / mathematical provisions, %	116.8	119.6	120.6	121.0	121.1
Assets covering mathematical provisions / GDP, %	5.9	5.6	7.2	7.9	8.3
Other technical provisions, EUR million	1,308	1,281	1,359	1,357	1,380
growth, %	13.9	-2.1	6.1	-0.2	1.7
Assets covering technical provisions less assets covering mathematical provisions, EUR million	1,315	1,398	1,576	1,651	1,641
growth, %	10.3	6.3	12.8	4.7	-0.6
Assets covering technical provisions less assets covering mathematical provisions / other technical provisions, %	100.5	109.1	116.0	121.7	118.9
Assets covering technical provisions less assets covering mathematical provisions / GDP, %	3.8	3.7	4.5	4.6	4.6

Sources: ISA, SORS, Bank of Slovenia calculations

Table 4.5 Selected indicators for compulsory and voluntary supplementary pension insurance

						Growth, %			
	2007	2008	2009	2010	2011	2008	2009	2010	2011
	Compulsory pension insurance								
Average no. of policyholders at the PDII (1)	879,090	904,084	894,886	881,992	869,869	2.8	-1.0	-1.4	-1.4
Average no. of pensioners[1] (2)	543,473	551,258	560,428	573,238	589,147	1.4	1.7	2.3	2.8
Ratio (1)/(2)	1.62	1.64	1.60	1.54	1.48	1.4	-2.6	-3.6	-4.0
Average pension, EUR[2] (3)	512	554	570	577	578	8.3	2.9	1.1	0.3
Net average wage, EUR (4)	835	900	930	967	987	7.8	3.4	3.9	2.1
Ratio (3)/(4)	0.61	0.62	0.61	0.60	0.59	0.5	-0.5	-2.6	-1.9
Average age of new pension recipients	59.7	59.6	59.9	60.2	60.3	-0.1	0.6	0.4	0.3
men	61.8	61.9	62.0	61.8	61.8	0.1	0.1	-0.3	-0.1
women	57.6	57.6	58.1	58.4	58.7	0.0	0.9	0.6	0.4
	Voluntary supplementary pension insurance								
No. of voluntary supplementary pension insurance policyholders (5)	486,816	512,343	532,716	539,650	537,217	5.2	4.0	1.3	-0.5
Workforce in employment (6)	864,361	880,252	844,655	818,975	817,311	1.8	-4.0	-3.0	-0.2
Ratio (5)/(6)	0.56	0.58	0.57	0.62	0.66	3.3	8.4	4.5	-0.2
Assets, EUR million	956	1,212	1,528	1,794	1,846	26.9	26.1	17.4	2.9
assets as % of GDP	2.8	3.3	4.3	5.0	5.2	17.6	32.9	15.2	4.1
assets as % of household financial assets	2.6	3.3	3.8	4.3	4.5	29.6	16.7	11.1	4.7
Written premium, EUR million	220	243	231	233	228	10.4	-4.8	0.9	-2.1
premium as % of PDII tax revenues	7.5	7.4	7.0	7.0	6.8	-0.4	-5.9	-0.5	-2.9

Notes: [1] Includes recipients of any type of pension: old-age, disability, family, widow’s, military, farmer’s and state
[2] Includes old-age, disability, family and widow's pensions, less tax prepayment.
Sources: SMA, ISA, Bank of Slovenia, SORS, PDII

5. Investment funds

Table 5.1 Overview of investment funds: assets and net inflows of mutual funds in EUR million and year-on-year returns in percentages

	Mutual funds				(Authorised) investment companies – Assets				Total investment funds	
	Net inflows	Assets		AUP	PIDs		ICs		Assets	
	EUR million	EUR million	Growth	Growth	EUR million	Growth	EUR million	Growth	EUR million	Growth
2000	5	45	22%	4%	2,393	-4%	-	-	2,438	-
2001	7	61	37%	23%	2,287	-4%	-	-	2,348	-4%
2002	122	231	277%	54%	1,352	-41%	578	-	2,161	-8%
2003	107	389	68%	17%	550	-59%	894	55%	1,833	-15%
2004	339	877	126%	18%	-	-	1,209	35%	2,086	14%
2005	138	1,385	58%	7%	-	-	835	-31%	2,220	6%
2006	163	1,929	39%	19%	-	-	916	10%	2,845	28%
2007	470	2,924	52%	28%	-	-	1,213	32%	4,138	45%
2008	-304	1,513	-48%	-43%	-	-	398	-67%	1,912	-54%
2009	18	1,856	23%	24%	-	-	377	-5%	2,234	17%
2010	25	2,054	11%	6%	-	-	241	-36%	2,294	3%
2011	-77	1,816	-12%	-14%	-	-	0	-100%	1,816	-21%

Sources: AMC, SMA, LJSE, own calculations

Table 5.2 Assets of EU and Slovenian investment funds in EUR billion and in percentages

		Asset value	Annual growth	Breakdown by asset type, %				
		EUR billion	(%)	Equity	Bond	Balanced	Money-market	Other
EU	2007	6,203	4.2	40	22	15	16	7
	2008	4,593	-25.4	30	23	16	25	6
	2009	5,299	16.7	34	23	16	21	6
	2010	5,990	11.5	34	25	17	18	5
	2011	6,481	8.2	33	27	16	19	5
Slovenia	2007	2.9	51.3	63	2	33	1	0
	2008	1.5	-48.8	63	2	33	1	0
	2009	1.8	21.6	63	2	34	1	0
	2010	2.3	11.3	64	3	32	1	0
	2011	1.8	-11.5	66	5	28	1	0

Sources: Bank of Slovenia, EFAMA

Table 5.3 Mutual funds: number, assets and net inflows in EUR million and returns in percentages

						Growth, %				
	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
Number										
total	110	127	128	133	140	10.1	15.5	0.8	3.9	5.3
equity	80	95	96	100	103	11.1	18.8	1.1	4.2	3.0
bond	10	10	10	11	13	11.1	0.0	0.0	10.0	18.2
balanced	15	16	16	16	17	6.3	6.7	0.0	0.0	6.3
money-market	2	2	2	2	3	0.0	0.0	0.0	0.0	50.0
other	-	1	1	1	1	-	-	0.0	0.0	0
Assets										
domestic mutual funds, EUR million	2,924	1,513	1,856	2,054	1,816	51.6	-48.2	22.7	9.6	-11.5
equity, % of total	68	63	63	64	66	17.7	-6.8	0.0	1.2	3.1
bond, % of total	1	2	2	3	5	-47.4	78.6	-0.4	29.7	66.7
balanced, % of total	31	33	34	32	28	-23.0	9.4	1.0	-5.8	-12.5
bank-owned, % of total	28	33	39	36	40	-6.5	20.1	15.2	-5.7	9.8
non-bank, % of total	72	67	61	64	60	2.7	-7.8	-7.6	3.3	-5.6
foreign mutual funds, EUR million	367	130	189	217	142	19.4	-64.7	45.8	12.8	-100.0
Net annual inflows										
domestic mutual funds, EUR million	470	-304	18	25	-77	187.3	-164.6	-106.0	25.6	-414.86
equity, % of total	84	-200	66	37	24					
bond, % of total	-1	-5	2	24	13					
balanced, % of total	16	-105	35	37	53					
bank-owned, % of total	31	28	52	19	74					
non-bank, % of total	69	72	48	81	26					
foreign mutual funds, EUR million	2	-55	-4	-11	-25					
Annual growth in AUP, %										
total	28	-43	24	6	-14					
equity	32	-48	28	9	-16					
bond	5	-3	7	4	1					
balanced	23	-38	17	2	-12					
bank-owned	19	-35	26	8	-10					
non-bank	31	-46	23	6	-17					

Note: The figures for foreign mutual funds only include those officially marketed in Slovenia.
Sources: SMA, own calculations

Table 5.4 Breakdown of investment fund investments by type in percentages

(%)	2007	2008	2009	2010	2011
Mutual funds					
shares	29	21	22	17	16
bonds	5	7	6	5	4
bank deposits	10	11	10	8	7
foreign investments	55	58	62	70	72
other	2	3	0	0	0

Source: SMA

6. Leasing companies

Table 6.1 Comparison of the Slovenian leasing sector with European leasing companies in percentages

(%)	2005	2006	2007	2008	2009	2010	2011
Slovenian leasing companies							
growth in business	35.1	28.0	34.3	12.6	-52.0	8.9	-9.0
leasing business / gross investment	23.7	27.0	31.2	27.5	17.3	15.1	14.9
breakdown of business							
real estate leasing	33.5	29.5	30.9	29.1	24.8	30.7	25.6
equipment leasing	66.5	70.5	69.1	70.9	75.2	69.3	74.4
equipment and real estate leasing by individuals	21.0	19.2	19.5	17.7	20.8	24.7	24.6
European leasing companies							
growth in business	11.6	16.9	11.2	-7.8	-32.3	4.6	7.3
leasing business / gross investment	15.9	19.0	20.8	16.0	12.0	12.9	
breakdown of business							
real estate leasing	17.1	15.5	13.7	11.5	12.2	13.2	
equipment leasing	82.9	84.5	86.3	88.5	87.8	86.8	

Notes: Available figures facilitate the presentation of leasing business at original cost until 2008, and at financed value going forward, excluding the financing of inventories since 2010.
Gross investment includes gross fixed capital formation other than investments in residential buildings for reason of comparability with the Leaseurope figures.
The figure for growth in European leasing business for 2011 is provisional.

Sources: Leaseurope, SORS, BAS, SLA

7. Real estate market

Table 7.1 Growth in residential real estate by country in percentages

Country	Type of index	Growth, %					Cumulative growth prior to peak		Cumulative adjustment after peak	
		2007	2008	2009	2010	2011				
SI	Existing flats	20.3	-2.8	-4.9	1.6	-0.2[1]	95.0	[03H1-08Q3]	-7.5	[08Q3-11H2]
EE	New and existing flats	3.4	-16.6	-34.0	5.1	6.5[1]	145.2	[04H1-07H1]	-43.3	[07H1-11H1]
FR	Existing dwellings	5.7	-1.6	-5.9	7.0	7.0[1]	67.6	[03H1-07H2]	1.1	[07H2-11H1]
ES	New and existing dwellings	5.1	-1.4	-7.3	-3.5	-6.2	65.2	[03H1-08H1]	-18.2	[08H1-11H2]
ES	Existing dwellings	NA	-9.6	-5.9	-1.7	-7.3[1]	NA		-21.4	[07H2-11H1]
BE	Existing dwellings	8.9	3.9	-0.1	5.9	3.3[1]	62.4	[03H1-08H2]	5.7	[08H2-11H1]
IE	New and existing dwellings	4.2	-8.9	-19.8	-11.2	-11.8[1]	54.3	[03H1-07H2]	-39.5	[07H2-11H1]
MT	New and existing dwellings	0.6	-3.8	-2.0	-0.2	-1.3[1]	50.3	[03H1-07H1]	-8.5	[07H1-11H1]
GR	New and existing flats	4.3	1.1	-4.6	-6.1	-5.1	39.5	[03H1-08H2]	-14.9	[08H2-11H2]
FI	Existing dwellings	4.9	-1.8	4.1	6.6	1.9	34.5	[03H1-08H1]	9.7	[08H1-11H2]
IT	New and existing dwellings	4.5	1.6	-0.6	0.4	0.9[1]	32.2	[03H1-08H2]	0.3	[08H2-11H1]
NL	Existing dwellings	4.3	2.2	-5.1	-0.8	-3.0	23.2	[03H1-08H2]	-8.7	[08H2-11H2]
NL	Existing flats	5.1	2.4	-4.8	-0.4	-3.1	17.3	[04H1-08H2]	-8.2	[08H2-11H2]
PT	New and existing dwellings	1.5	4.7	-0.7	2.2	-0.8	12.2	[03H1-08H2]	0.7	[08H2-11H2]
AT	New and existing dwellings	4.2	1.5	2.6	5.9	2.6[1]	12.0	[03H1-07H2]	12.5	[07H2-11H1]
DE	New and existing dwellings	-0.4	2.7	-0.6	1.5	2.5	7.4	[03H1-08H2]	3.3	[08H2-11H2]
CY	New and existing dwellings	22.2	12.8	-3.5	-4.3	-4.9[1]	NA		-10.9	[08H2-11H1]
SK	Existing dwellings	28.9	12.9	-13.3	-1.7	-3.5	NA		-17.9	[08H1-11H2]

Note: [1] The latest figure is for the end of the first half of 2011.
Sources: ECB, SORS

8. Capital Market

Table 8.1 Overview of the regulated securities market in EUR million and in percentages

	Market capitalisation (EUR million)	Market capitalisation (as % GDP)	Volume (EUR million)	Volume (as % GDP)	Turnover velocity	Annual change in SBI TOP, %
2002	9,073	39.2	2,007	8.7	0.221	-
2003	10,190	40.6	1,420	5.7	0.139	-
2004	12,726	47.0	1,655	6.1	0.130	29.3
2005	13,395	46.7	1,840	6.4	0.137	2.8
2006	18,838	60.8	1,805	5.8	0.096	56.6
2007	26,696	77.4	3,324	9.6	0.125	71.0
2008	15,488	41.7	1,286	3.5	0.083	-66.1
2009	19,668	56.2	904	2.5	0.046	15.0
2010	20,453	57.1	493	1.4	0.023	-13.5
2011	19,332	54.7	454	1.3	0.023	-30.7

Sources: LJSE, SORS

Table 8.2 Number of issuers and issued securities on the Ljubljana Stock Exchange and number registered securities at the CSCC

	2007	2008	2009	2010	2011	2007	2008	2009	2010	2011
LJSE						Year-on-year change				
number of issuers	119	107	97	88	76	-11	-12	-10	-10	-14
number of issued securities	188	187	174	158	139	-17	-1	-13	-10	-12
shares	89	86	85	75	68	-13	-3	0	-13	-9
bonds	89	90	85	79	70	-4	1	-5	-8	-11
investment companies	7	4	4	4	1	0	-3	0	0	-75
number of members	24	23	25	25	27	0	-1	2	0	8
CSCC						Proportion of LJSE issuers and securities at CSCC, %				
number of issuers	803	764	742	738	700	15	14	13	12	11
number of issued securities	995	943	912	891	841	19	20	19	18	17
shares	877	821	795	792	754	10	10	11	9	9
bonds	112	111	107	94	87	79	81	79	84	80
investment companies	7	4	4	4	1	100	100	100	100	100

Sources: LJSE, CSCC

Investments by residents in the rest of the world

Table 8.3 Investments by residents in securities issued in the rest of the world in EUR million and in percentages

	2007	2008	2009	2010	2011
Growth in investments in rest of the world, %	77.7	-21.6	4.8	4.9	-10.7
Total investments in rest of the world, EUR million	9,767	7,655	8,041	8,458	7,557
	Breakdown by sector, %				
Banks	47	55	47	47	41
Other financial intermediaries	19	12	15	16	16
Insurers	17	24	27	26	31
Households	10	4	6	6	6
Corporates	3	1	2	2	2
Other	4	4	3	4	3

Sources: CSCC, Bank of Slovenia, own calculations

Investments by non-residents in Slovenia

Table 8.4 Investments by non-residents in securities issued in Slovenia in EUR million and in percentages

	2007	2008	2009	2010	2011
Growth in investments by non-residents, %	22.4	5	40	21	19
Total investments by non-residents, EUR million	5,054	5,295	8,855	11,219	13,371
	Breakdown by domestic sector, %				
Corporates	55	36	21	18	15
Banks	26	29	18	14	12
Other financial intermediaries	1	3	1	1	1
Insurers	2	2	2	1	1
Government	16	30	58	66	72

Sources: CSCC, Bank of Slovenia, own calculations