BANKA SLOVENIJE
EVROSISTEM

FINANCIAL STABILITY

STABILITY OF THE SLOVENIAN BANKING SYSTEM

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The Stability of the Slovenian Banking System report of December 2010 is based on figures and information available at the end of November 2010, except where stated otherwise.

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NOTE:

The demarcation of the banking system into the groups of the large domestic banks, the small domestic banks, and the banks under majority foreign ownership used in this publication is not intended to draw attention to the ownership of the banks. The demarcation is based on the features of the banks' operations, in particular on the prevailing structure of their funding.

CONCLUSIONS

The main features of the development of financial risks and the developments in the Slovenian banking system during the first ten months of 2010 were the slow, unstable recovery in the domestic economy and the uncertain situation in the European financial markets.

The Slovenian economy's high dependence on foreign financing remains one its key features, despite the continuing net repayment of bank loans raised in the rest of the world. Net financial liabilities to the rest of the world actually increased slightly in the first half of the year, to 37% of GDP, on account of the issuance of government securities and bank securities and a decline in investments in foreign securities. The ratio of investment to GDP nevertheless remained at the level of the saving ratio in the national economy during the first half of the year, namely 23%. Investment thus remains down a third on 2007 and 2008. The low level of investment is becoming a new reality for the Slovenian economy, which for renewed economic recovery requires more efficient investment that is less financially extensive. In the uncertain situation on the European financial markets Slovenia's high dependence on net foreign financing represents a significant risk to its banking system, and entails the possibility of risks being transferred to the domestic economy.

The tightening of credit standards for corporate lending by the banks was more intensive in Slovenia than in the euro area overall in the period before the beginning of this year, as a result of the relatively high indebtedness of Slovenian corporates. During the first half of the year the debt-to-equity ratio in the Slovenian corporate sector remained almost unchanged at 146%, even two years after the deepening of the financial crisis, which is extending the financial agony of the Slovenian economy. A vital prerequisite for a sustained economic recovery is not merely to identify new investment opportunities, but to increase equity in part of the real sector. This is confirmed by the rates of growth in loans to non-financial corporations, which remained slightly negative in October.

Despite successful securities issues by certain banks, refinancing risk remains pronounced, particularly at the banks under majority domestic ownership. Low growth in household deposits means that the competition between banks for long-term deposits is increasing uncertainty in funding management. The process of changing the funding structure is increasing the banks' funding costs, which will be reflected in more expensive loans in the future.

Together with increasing payment indiscipline, low and unstable economic growth is bringing a further deterioration in credit risk at banks. The proportion of non-performing claims increased by 0.8 percentage points over the first ten months of the year to 3.0%, although not evenly at all the bank groups. The large banks under majority domestic ownership in particular are notable for a fast-growing and above-average proportion of non-performing claims, while the proportion of non-performing claims remains highest at the small domestic banks. The process of deterioration in the credit portfolio is not yet finished, as is confirmed by the increase in clients' arrears in settling their liabilities to banks. The proportion of claims over 90 days in arrears increased by 1.4 percentage points during the first nine months of the year to 6.8%, most notably among non-financial corporations and sole traders. Arrears of over 90 days have again grown fastest at the small domestic banks this year. This bank group is becoming increasingly vulnerable for this reason, and because of relatively low capital adequacy and the simultaneous increase in competition for deposits by non-banking sectors.

Corporate arrears in the settlement of liabilities indicate a further increase in non-performing claims and impairment costs at banks, with an anticipated adverse impact on the banks' profitability and equity. By aggressively marketing housing loans, the banks are trying to reallocate a portion of the credit exposure from the construction and real estate activities sectors to households. Despite the relatively low indebtedness of Slovenian households compared with the euro area average, this only goes to provide financing for the construction sector's past investment decisions, which are not necessarily optimal.

The increase in funding costs, low credit growth and high impairment and provisioning costs will result in a deterioration in the banks' income position. Income risk will therefore become increasingly significant for the banks in the year ahead, alongside credit risk and refinancing risk. This will be reflected in low performance indicators, and also in lower capacity to generate capital from retained earnings.

The banking system's solvency remains low compared with the average of comparable banks across the EU, the capital adequacy indicators having deteriorated more at the banks under majority domestic ownership than at the banks under majority foreign ownership this year. As a result of the deterioration in the quality of the credit portfolio, the largest decline in the surplus of regulatory capital over the capital requirements was recorded by the small domestic banks, although their risk absorption capacity remains acceptable, at 25%. For confidence to be retained in the banking system and for the banks to be free of disruptions in refinancing, it is vital for owners to be ready to provide them in a timely manner with capital of the requisite size and quality for the rising risks of operation.

EXECUTIVE SUMMARY

With the beginnings of a recovery in foreign demand and moderate GDP growth, the Slovenian economy is adjusting to the reduced level of investment and to the limited domestic saving and demand. In this context the problems of the relatively heavily indebted corporate sector are increasing in the form of poor liquidity and a rise in unsettled financial liabilities between corporates and to banks. The situation in the corporate sector is thus worsening, despite positive economic growth this year, and risks are being transferred to other economic sectors. This is not just a consequence of the financial crisis, but also corporate policy during the era of high economic growth, which relied excessively on debt financing. Higher economic growth that is sustainable in the long term will require greater investment efficiency, recapitalisations instead of mere corporate reorganisations, and an end to the rising dependence on foreign debt-based resources. This would have a beneficial impact on the Slovenian financial system.

The banking system's balance sheet contracted by almost EUR 1.2 billion during the first ten months of this year. The banks repaid EUR 1 billion of debt with the Eurosystem and EUR 1.2 billion of debt with banks in the rest of the world, while the government reduced its deposits by EUR 820 million. At the same time the banks increased their liabilities on the basis of debt securities by EUR 1 billion, while the increase in household deposits was a modest EUR 314 million. On the investment side the banks reduced their claims against banks by EUR 0.9 billion and against the Eurosystem by EUR 0.6 billion, while increasing loans to households and the government by a total of EUR 1 billion. The stock of loans to non-financial corporations declined by EUR 175 million.

The position of the Slovenian banking system deteriorated during the first three quarters of 2010 as its total assets contracted. The main factors were an increase in credit risk, income risk and refinancing risk. Credit risk is increasing as lending to the corporate sector stagnates while lending to households remains solid. The increase in credit risk is being reflected in three ways. First, the deterioration in the quality of the loan portfolio has accelerated. The increase in the proportion of the banking system's classified assets accounted for by non-performing claims during the first nine months of the year was double that in 2009. Second, the proportion of borrowers' liabilities to banks that are over 90 days in arrears is increasing, which heralds further deterioration in the quality of the banks' credit portfolio. The small domestic banks are notable for their above-average growth in and proportion of arrears of over 90 days, while the large domestic banks have seen such arrears at non-financial corporations increase relatively rapidly. Third, non-financial corporations are notable for the pace of growth in their arrears of over 90 days, which accounted for 10.8% of bank claims by September. This is an indication that this year the crisis has hit the corporate sector hardest. Another factor in the increased credit risk at banks is that claims against corporates represent half of the banking system's total classified assets. Of the various categories of borrower, the greatest problem on the banking system's balance sheet is non-performing claims against holding companies, the banks having significantly reduced their non-performing claims against non-residents. The deterioration in the quality of the banks' investment portfolio is reducing creditworthy demand. The banks are not redirecting themselves to lending to the manufacturing sector, which could exploit the growth in foreign demand, while at the same they have increased the proportion of loans to the construction sector. The latter is one of five sectors that are over 90 days in arrears in repaying more than 10% of their liabilities to banks. There was only one such sector at the end of last year.

The household indebtedness indicators are deteriorating, although there has not yet been any notable increase in credit risk in association with this. The relatively high growth in housing loans is becoming a problem.

The banks' income risk is increasing as the pace of creation of impairments and provisioning accelerates because of increased credit risk. The banking system's pre-tax profit during the first ten months of the year amounted to EUR 85.8 million, 36.3% of the comparable figure last year, while impairments and provisioning increased by 58.8% to EUR 506 million. The large domestic banks recorded the largest increase in impairments and provisioning. The likelihood of banks operating at a loss for a sustained period is increasing. ROE has already declined to 2.4%, although it is significantly higher at the banks under majority foreign ownership. Income risk is likely to continue increasing in 2011 for four reasons: the trend of increase in non-performing claims, increasing funding costs, the slowdown in net interest income and the stagnation in lending, which could increase it even further. Without new lending the banks will not be able to satisfactorily replace the lost income and the decline in profit caused by impairments and provisioning. The banks are delaying the revival of lending, indication of which comes from the increase in corporate financing by means of trade credits and business-to-business loans in the first half of 2010. The spread in lending rates between Slovenia and the rest of the world could expand this, thereby reducing the banks' potential income. In September variable interest rates on new corporate loans of up to EUR 1 million at banks in Slovenia were 2.4 percentage points higher than in the euro area overall.

The banks' refinancing risk is increasing, but to date has only been reflected to a lesser extent as a result of the stagnation in certain lending caused by low creditworthy demand and as a result of measures taken by the ECB and the government last year. Refinancing risk is increasing as a result of the combination of increased limitation of funding and price increases. First, in contrast to 2009 the Eurosystem no longer provides funding with a maturity of 1 year to euro area banks, but merely funding of shorter maturities. Second, deposits by non-banking sectors are declining as a result of the gradual decline in the government sector's bank deposits, which had risen sharply in 2009. More than EUR 800 million of these deposits will mature by the end of November 2011, the largest portion at the large banks under majority domestic ownership. Household deposits cannot compensate for this decline, given their diminishing growth. The only positive is that the proportion of household deposits accounted for by long-term deposits is increasing. Third, Slovenian banks can fund themselves by issuing securities on the financial markets, although among the banks under majority domestic ownership it is easier for the large banks and those under majority state ownership, though they remain exposed to the uncertain situation on the financial markets. An increase in demand, and hence borrowing costs on the markets, is likely, although the banks under majority domestic ownership have already seen their borrowing costs rise sharply this year. Refinancing risk remains more concentrated at the banks under majority domestic ownership, which will therefore find it relatively more difficult to increase their lending.

There has been no significant change in other types of risk in banking this year. Liquidity risk as measured by the first-bucket liquidity ratio has not changed significantly. Slovenian banks have remained net creditors on the international interbank lending market, albeit to a lesser extent. Their net debt with the Eurosystem has declined. A slight indication of an increase in liquidity risk came from the decline in the second-bucket liquidity ratio and the decline in secondary liquidity to its level before the financial crisis.

Interest-rate risk as measured by the difference between the average repricing periods for asset and liability interest rates increased during the first nine months of 2010. The difference widened to 1.1 months, but remains lower than in the period before the financial crisis. The increase in interest-rate risk was more pronounced at the banks under majority foreign ownership. Currency risk remains low. The proportion of total assets accounted for by foreign currency assets has declined to 4.6%, while the corresponding figure on the liability side is 3.5%. The net open foreign exchange position has not changed significantly since the end of 2009, and stands at 0.9% of regulatory capital. The currencies of the former Yugoslav republics could depreciate against the euro in the future, but given the low values of the open foreign exchange positions the associated risk is very limited. Loans tied to the Swiss franc or with a Swiss franc currency clause have declined again this year. By October the proportion of loans to non-banking sectors accounted for by such loans had fallen to 4.4%. The associated risk remains concentrated in the housing loans category and in the household sector.

The banking system’s solvency declined slightly during the first three quarters of 2010. Capital adequacy stood at 11.5%. It was slightly above-average at the large domestic banks, the small domestic banks having recorded the largest decline. Comparing the figures with banks across the euro area on a consolidated basis reveals that the small domestic banks and the banks under majority foreign ownership are significantly behind. Tier 1 capital adequacy stood at 9.2%, the small domestic banks again recording a notably poorer figure. The banking system’s original own funds have stagnated, while the quality of the capital structure deteriorated slightly as a result of a slight increase in additional own funds at the large domestic banks at the expense of original own funds. The surplus of regulatory capital over capital requirements is more than 30%, which is a reflection of risk absorption capacity in the event of its realisation.

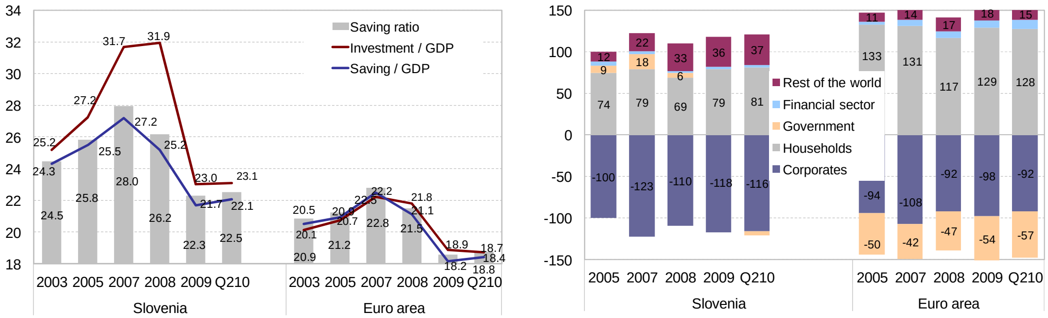
From a saver’s point of view the Slovenian banking system remains safe, but from the point of view of bank owners there need to be decisions made and changes in the banks’ business practices to stop the negative trends as soon as possible. A continuation in the contraction in total assets, an increase in key risks, and operating losses at a small number of banks is the scenario for the near future. Tightening the procedures for recovering non-performing claims or removing them from the balance sheet, increasing lending to good clients with the requisite collateral, and undertaking recapitalisations and consolidation are the measures worth promoting at the banks. Otherwise the position of the Slovenian banking system will deteriorate, and will lead to undesirable measures and changes that would impact on the owners of the banks above all.

1 INTER-SECTOR FINANCIAL CLAIMS AND LIABILITIES

Despite the savings-investment gap narrowing, dependence on foreign funding increased in the first half of 2010.

Following the sharp decline in economic activity in 2009, the ratio of investment to GDP had to be balanced with a reduced saving ratio in the Slovenian economy at a level even lower than in 2003. It has remained at this level in 2010, and will remain there in the future. For this reason, it is not merely the amount of investment, but instead its efficiency that is becoming vital to economic growth in Slovenia. Although the saving ratio in Slovenia is encouraging compared with other countries, the decline of a third in the investment rate compared with the period of high economic growth between 2006 and 2008 will strongly hinder the economic recovery.

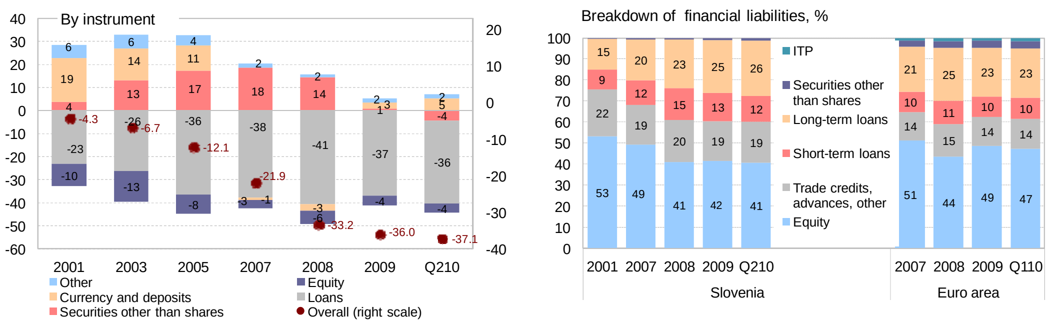
Figure 1.1: Saving ratio, percentage ratios of investment and saving to GDP, and net financial position of individual economic sectors



Sources: Bank of Slovenia, SORS, Eurostat

The financial position of the economic sectors reveals the net external debt to have increased further in the first half of 2010 as a result of an increase in government debt, despite net repayments to the rest of the world made by the banks. The rise in the household sector's surplus is a reflection of the decline in household consumption. However, the level of dependence on foreign financing increased slightly further, despite the narrowing of the savings-investment gap. Foreign refinancing risk is increasing at the level of the national economy, even though two sectors are distinguished by a negative net financial position. The government debt servicing burden will increase as interest rates rise. The same is true of the over-indebtedness of the corporate sector. The high proportion of corporate debt financing could be gradually reduced by inflows of equity and a gradual decline in borrowing. The latter is already underway. This is hindering the economic recovery, with an adverse impact on employment, household income and consumption, government revenues and corporate profits. Corporate recapitalisation from this source will also be limited in the future.

Figure 1.2: Net financial position against the rest of the world as percentage of GDP by instrument (left) and percentage breakdown of non-financial corporations' financial liabilities (right)



Sources: Bank of Slovenia, SORS, Eurostat

Slovenia's net financial liabilities to the rest of the world increased by a further 1 GDP percentage point in the first half of 2010 to stand at 37.1% of GDP. The continuation of the increase of several years' duration in net financial liabilities to the rest of the world in the unstable situation on international financial markets is cause for concern.

The corporate sector has been unable to increase the ratio of equity to financial liabilities. The persistent relatively high corporate indebtedness is limiting creditworthy demand.

There was no improvement in the unfavourable breakdown of non-financial corporations' financial liabilities in the first half of 2010: the proportion accounted for by equity actually declined, there remains a relatively high dependence on trade credits, and financing by means of debt securities issues is still stagnating. The problems are also worsening because the relatively highly indebted corporate sector is unable to increase its relative use of equity financing, which would have a beneficial impact on the revival of lending. The rates of growth in lending to non-financial corporations in the euro area overall and in Slovenia were slightly negative in October 2010 and almost equal. However, given their lower level of indebtedness corporates in the euro area will find it easier to increase creditworthy demand during the economic recovery. At the same time the supply of loans to the corporate sector in Slovenia will remain dependent on the tighter terms of bank borrowing on foreign markets and limited domestic resources, and will be adjusted to the higher corporate indebtedness and the corresponding greater risk.

2 BANK ASSESSMENTS OF DEMAND FOR LOANS, AND CREDIT STANDARDS IN SLOVENIA AND THE EURO AREA [1]

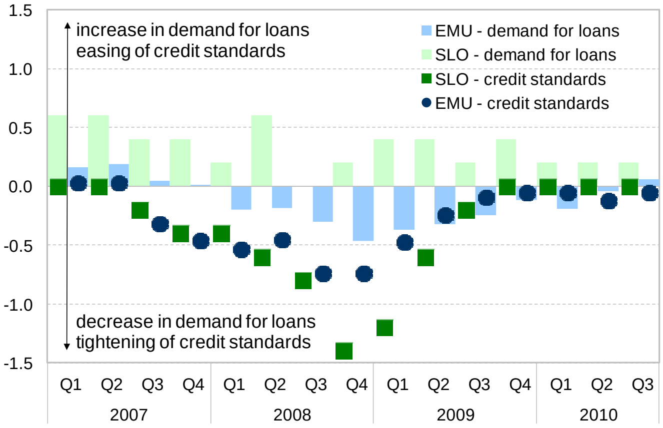
Loans to corporates

Credit standards for corporates have not been tightened in 2010, but demand has only increased slightly.

According to a survey of bank lending activity based on ECB methodology, corporate demand for loans in Slovenia increased only slightly in the first three quarters of 2010. Here it is not necessary that the demand was entirely creditworthy. In the breakdown of the demand, in the third quarter there were very slight indications of an increase in demand from large enterprises and an increase in demand for long-term loans.

The credit standards[2] for corporate loans have not been tightened since the final quarter of last year inclusive, partly as a result of the pronounced tightening in the period between the second half of 2008 and the first half of 2009. The responses to the question on the causes of changes in credit standards this year nevertheless indicate a very slight tightening of lending terms because of anticipated changes in the sector and the risks associated with the required collateral. Margins on corporate loans have mostly not risen this year. Other loan terms have tightened, in particular requirements for loan collateral, and the amount of loans and credit lines.

Figure 2.1: Corporate demand for loans and credit standards



Sources: ECB, Bank of Slovenia

Loans to households

Household demand for housing loans increased more in the first half of the year, but demand declined slightly for consumer loans, while the moderate tightening of credit standards is slowing.

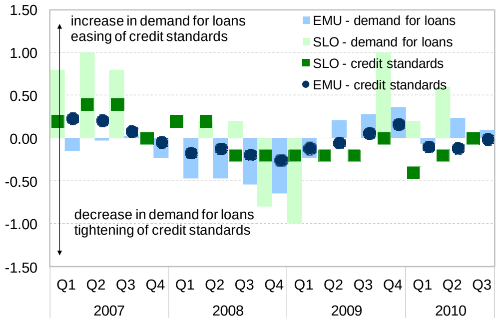
The increase in household demand for housing loans seen since the final quarter of 2009 ended in the third quarter of 2010. The tightening of the credit standards for housing loans was limited in the first half of the year, and even smaller in the second quarter than in the first. The credit standards remained unchanged in the third quarter, while the banks also made no change in loan terms.

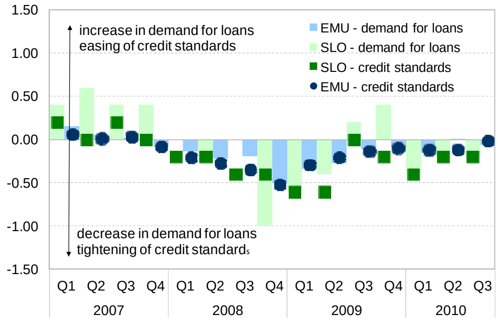
Demand for consumer loans has declined moderately this year. The credit standards increased a little in the first quarter of 2010, but subsequently any tightening was not pronounced.

[1] 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.

[2] Credit standards are defined in the survey as internal guidelines or criteria that reflect the bank's lending policy. Loan terms are specific contractual obligations or elements of the agreement between the bank and the borrower (margin, non-interest costs, loan amount, required collateral, loan clauses and loan maturity).

Figure 2.2: Household demand for housing loans (left) and consumer loans (right), and changes in credit standards





Sources: ECB, Bank of Slovenia

3 CHANGES IN BALANCE SHEET STRUCTURE

3.1 Factors in the decline in total assets in 2010

Growth in total assets declined further in 2010, and stood at 0% in year-on-year terms at the end of October 2010. Total assets declined by EUR 1.2 billion over the first ten months of the year. The decline in growth in total assets coincided with a decline in growth in loans.

The banking system's total assets declined by EUR 1.2 billion during the first ten months of 2010.

Table 3.1: Banking system's balance sheet as at 31 October 2010

	Stock			Increase on	Growth on	Annual
	2008	2009	Oct 2010	Dec 2009	Dec 2009	growth
	EUR million			EUR million	rate, %	
Assets						
Cash	1,243	1,454	811	-643	-44.2	-26.5
Loans	37,561	39,618	39,273	-345	-0.9	1.8
to banks	4,031	5,708	4,804	-904	-15.8	1.5
to non-banking sectors	33,530	33,910	34,469	559	1.6	1.9
of which:						
...corporates (NFCs)	20,245	20,165	19,990	-175	-0.9	-0.5
...households	7,386	7,886	8,501	616	7.8	9.4
...government	506	735	1,082	347	47.3	50.2
...OFIs	2,829	2,719	2,579	-140	-5.1	-9.2
Financial assets / securities	7,280	8,876	8,628	-248	-2.8	-4.5
Other	1,544	1,665	1,745	81	4.8	0.3
Liabilities						
Financial liabilities to Eurosystem	1,226	2,100	1,083	-1,017	-48.4	-15.6
Liabilities to banks	18,146	15,933	14,876	-1,057	-6.6	-2.7
of which to foreign banks	16,091	13,024	11,790	-1,234	-9.5	-7.8
Liabilities to NBS (deposits)	20,612	23,570	23,352	-218	-0.9	-1.5
of which to households	13,210	13,801	14,116	314	2.3	3.8
of which to government	1,857	3,990	3,170	-820	-20.6	-28.9
Debt securities	1,259	3,435	4,426	991	28.9	28.6
Subordinated liabilities	1,597	1,550	1,596	46	3.0	1.6
Equity	3,996	4,295	4,300	5	0.1	-2.1
Other	792	729	824	94	13.0	7.4
Total assets	47,628	51,612	50,458	-1,155	-2.2	0.0

Source: Bank of Slovenia

The banks continued to make repayments in the rest of the world, although to a lesser extent than last year. Having funded the banks in 2009 by increasing its deposits, the government sector has gradually withdrawn deposits this year. The banks' debt to the Eurosystem has halved this year with the maturing of two ECB long-term operations. The increase in household deposits at banks was less than in previous years. On the funding side, the largest increase in 2010 was recorded by resources obtained by means of securities issues, at EUR 1 billion, although even this funding was smaller than last year.

The main factors in the decline in total assets in 2010 have been the maturing of Eurosystem LTROs and the continuing repayment of debts to banks in the rest of the world.

The increase in loans to non-banking sectors during the first ten months of the year was just EUR 0.6 billion, the main contribution to which came from household lending, the stock of loans to non-financial corporations having declined by EUR 175 million. The banks continued to reduce their investments in securities and to reduce the stock of claims against banks and against the central bank.

The increase in loans in 2010 has primarily been the result of lending to households.

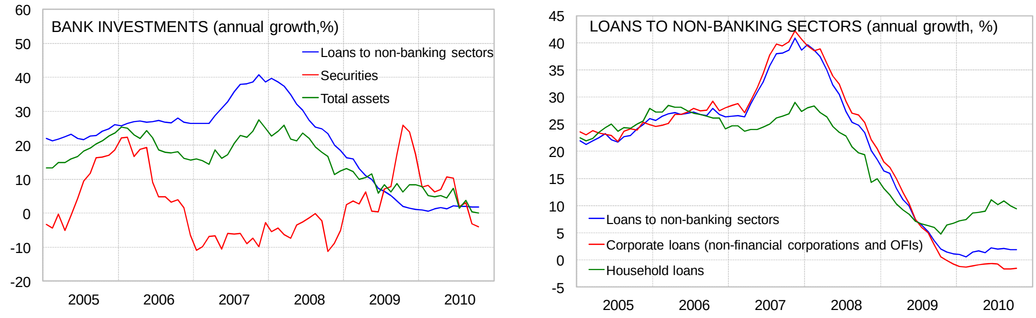
3.2 Standstill in bank lending and changes in bank investment structure

The standstill in bank lending activity has continued this year. The main factors in the standstill were the level of corporate indebtedness, low creditworthy demand, tightened

The standstill in lending activity continued in 2010.

policies in respect of loan collateral, and the maintenance of high premiums over reference interest rates.

Figure 3.1: Year-on-year growth in bank investments (left) and lending activity by sector (right)

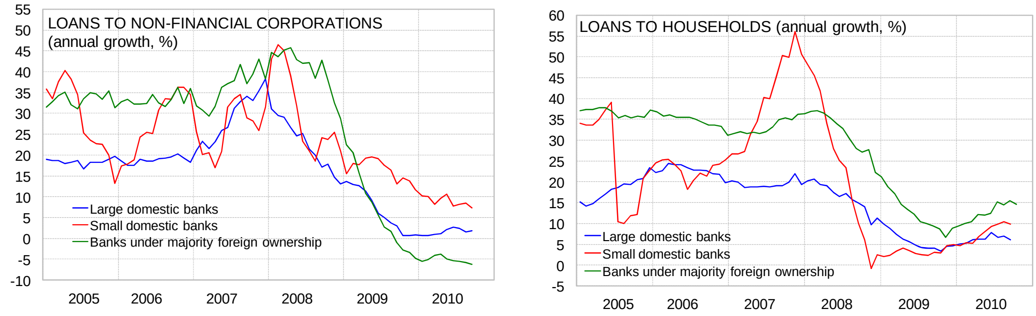


Source: Bank of Slovenia

Low lending activity has been seen at all bank groups.

Lending growth this year has been lower than last year at all the bank groups. Growth in loans to non-banking sectors stood at just 1.9% in October.

Figure 3.2: Year-on-year growth in loans to non-financial corporations (left) and households (right) by bank group

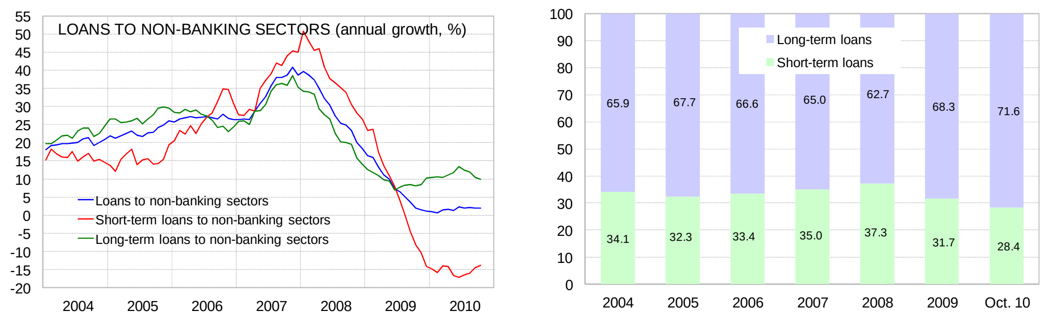


Source: Bank of Slovenia

The banks under majority foreign ownership have placed the greatest restrictions on corporate lending.

The banks under majority foreign ownership recorded the quickest and deepest slowdown in lending to corporates (non-financial corporations). At the same time growth in loans to households remained solid, the average rate this October exceeding last year's rate by just over 1 percentage point. The majority of loans to households in 2010 were long-term, while the banks' stock of short-term loans to households declined this year. Year-on-year growth in housing loans stood at 23.3% in October, while consumer loans recorded a decline of 3.2%.

Figure 3.3: Year-on-year growth in loans to non-banking sectors by maturity (left), and breakdown of loans to non-banking sectors by maturity (right) in percentages



Source: Bank of Slovenia

An increase in the proportion of loans to non-banking sectors accounted for by long-term loans.

The banks have mainly approved short-term loans to corporates this year. The volume of new short-term loans to corporates during the first nine months of the year was 2.7 times that of new long-term loans. However, the stock of short-term loans has recorded a net decline this year, as a result of maturing loans outweighing new loans, and growth in short-term loans is therefore strongly negative.[3] Including the prevalence of long-term loans to households, the proportion of all loans to non-banking sectors that are long-term had increased by 3.3 percentage points by October to 71.6%. Loans to households have a notably high proportion of long-term loans, the figure standing at almost four-fifths in October. The corresponding figure for loans to non-financial corporations approached two-thirds.

3.3 Comparison of interest rates at Slovenian banks with those of the euro area overall

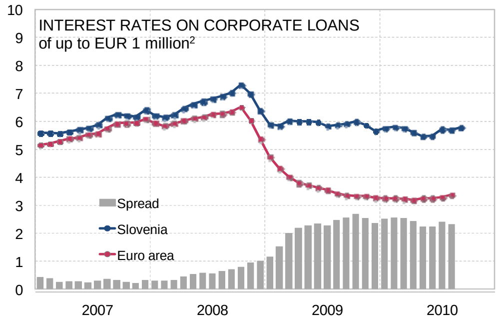
Asset interest rates

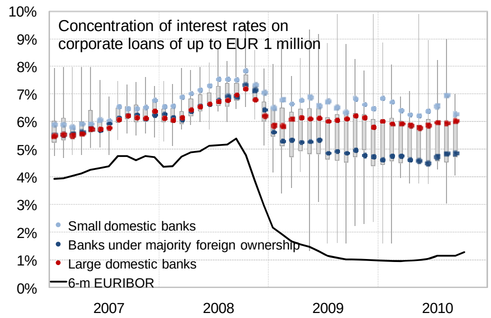
The spreads in Slovenian banks' interest rates on corporate loans reveal that the banks under majority foreign ownership have lower interest rates[4] than the domestic banks. In 2010 the spreads in interest rates between the banks under majority foreign ownership and the large domestic banks[5] have been 1.5 percentage points and more in individual months, although the spreads began to narrow in the third quarter. The reasons for the spreads in interest rates between the individual bank groups and with banks in the euro area are as follows:

Loose lending in the pre-crisis period is preventing the banks from making excessive lending rate cuts.

a) The take-up of excessive risks during the boom, which was not reflected in the relevant calculation of the risk premium in lending rates. In the period before the crisis, during loan approval clients were assigned to ratings in a manner that was over-optimistic with regard to the credit cycle as a whole. Given the need to create additional impairments and therefore to hedge against an excessive decline in profits, the domestic banks are not opting to reduce asset interest rates to the same extent as euro area banks. This is contributing to counter-cyclical action by the banks, which during crisis conditions is having an adverse impact on lending and the pace of economic growth.

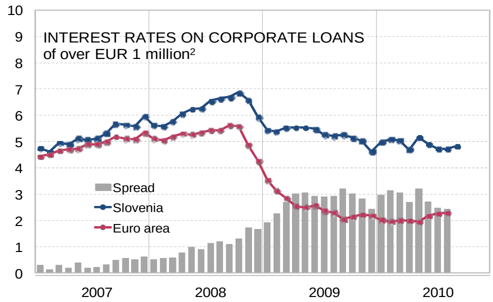
Figure 3.4: Interest rates on corporate loans of up to EUR 1 million in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)

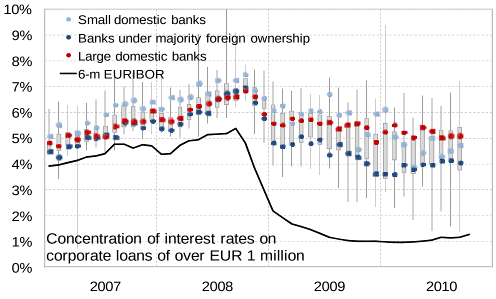




Source: Bank of Slovenia

Figure 3.5: Interest rates on corporate loans of over EUR 1 million in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)





Source: Bank of Slovenia

[3] Another factor has been that in line with a Bank of Slovenia recommendation in connection with the liquidity ladder banks have been obliged to reclassify short-term loans that are continually rolled over as long-term loans since autumn 2009.
[4] The banks under majority foreign ownership approve a quarter of all new corporate loans.
[5] The large domestic banks approve around 70% of all new corporate loans.

Funding is on average more expensive for Slovenian banks than for euro area banks overall.

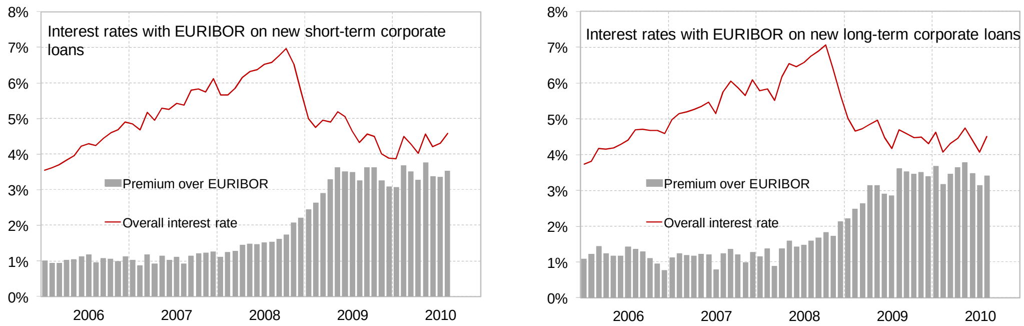
b) Rising funding costs, particularly at the banks under majority domestic ownership. Slovenian banks have greater difficulty than euro area banks in accessing funding on the international market. Given their limited ability to raise loans at foreign banks, the domestic banks are trying to increase the relative importance of deposits by non-banking sectors and the proceeds of bond issues. The issue of bonds by Slovenian banks is more expensive than for euro area banks because of smaller volume and higher underwriting costs. A comparison of the yields on government bonds, which are generally lower than those on bank bonds, reveals differences in funding costs for bond issues between Slovenian banks and euro area banks. The spread between the yields on Slovenian and German long-term government bonds widened to 1.2 percentage points in the third quarter of 2010. Long-term deposits, as an important source of funding for domestic banks, have recently been more expensive in Slovenia than in the euro area overall.

Only banks in the Baltic States and eastern European countries have lower turnover per employee than Slovenian banks.

c) Slovenian banks have lower turnover and total assets per employee than the euro area average. At the end of 2008 Slovenian banks had an average total assets per employee of EUR 4 million, compared with a euro area average of just over EUR 13 million. Total assets per employee is gradually increasing, and reached EUR 4.4 million in 2010.

d) The relatively higher indebtedness of Slovenian corporates compared with the euro area average is reducing their creditworthiness. Banks punish lower creditworthiness with higher risk premiums during a time of financial crisis. The risk assessment for new loans was higher than before the crisis, premiums rising by around 2 percentage points to around 3.5 percentage points.

Figure 3.6: Premiums over the EURIBOR and overall interest rates on new short-term corporate loans (left) and long-term corporate loans (right) in percentages

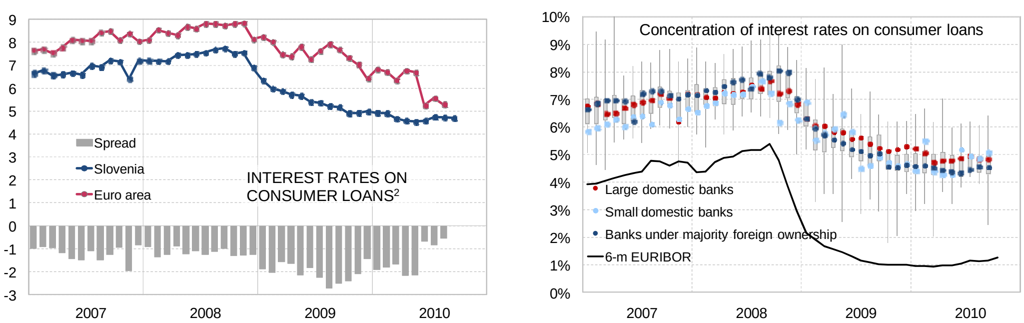


Source: Bank of Slovenia

e) Lengthy procedures for recovering unsettled liabilities from debtors. Another factor in the higher premiums on corporate loans at Slovenian banks is the long and expensive bankruptcy proceedings in Slovenia, which took on even greater significance during the crisis.

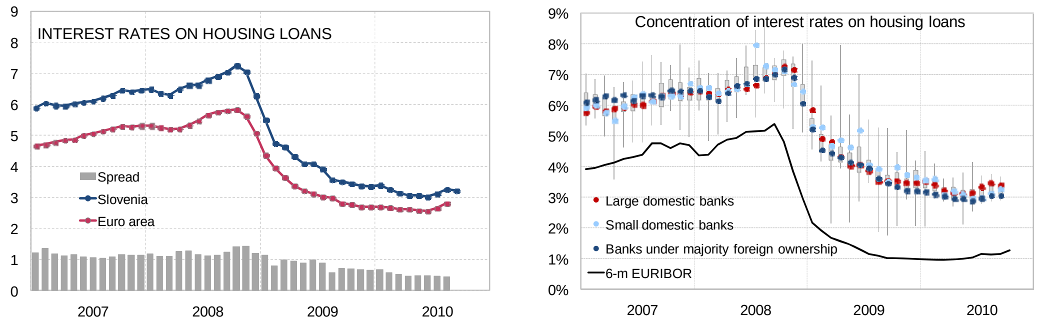
The premium over the 6-month EURIBOR increased sharply after the outbreak of the crisis both on corporate loans and on consumer and housing loans. The distribution of interest rates on housing loans has contracted significantly in 2010, partly as a result of heavy competition in this market segment.

Figure 3.7: Interest rates on consumer loans in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)



Source: Bank of Slovenia

Figure 3.8: Interest rates on housing loans in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)



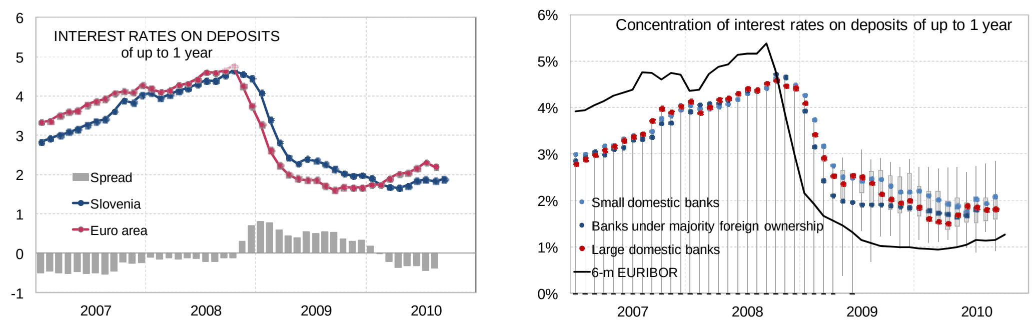
Source: Bank of Slovenia

Liability interest rates

During the crisis, differences in funding structure at the various Slovenian bank groups began to widen. In 2009 when the spreads in interest rates between the individual bank groups began to widen, the domestic banks found it harder to obtain funding. As liabilities to the rest of the world matured, they saw a rise in the importance of domestic funding, of which household deposits were the most favourable source in terms of price, and above all in terms of quality. Last year the domestic banks cut interest rates on household deposits by less than the banks under majority foreign ownership (and euro area banks), most notably on household deposits of up to 1 year. Interest rates on deposits of over 1 year remain higher in Slovenia than in the euro area overall, although the spreads are narrowing. Before the crisis interest rates on deposits, particularly deposits of up to 1 year, were lower than the 6-month EURIBOR, but after the crisis liability interest rates overtook the reference rate and have since remained above it.

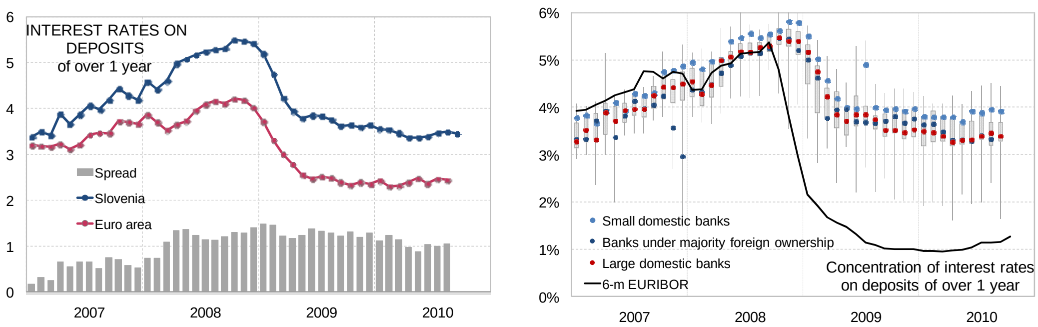
Fierce competition for deposits is narrowing the spread in interest rates between the various bank groups in Slovenia.

Figure 3.9: Interest rates on household deposits of up to 1 year in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)



Source: Bank of Slovenia

Figure 3.10: Interest rates on household deposits of over 1 year in percentages compared with the euro area (left) and distribution of interest rates at Slovenian banks (right)



Source: Bank of Slovenia

The intense competition between banks for household deposits has continued in 2010. The small domestic banks and the savings banks, for whom household deposits are traditionally a major source of funding, are notable for long-term deposits with higher interest rates. The rise in interest rates at the large domestic banks and the banks under majority foreign ownership entails additional competition for the smaller banks. In the last two years the distribution of interest rates at Slovenian banks has widened, particularly on deposits of over 1 year, where several banks under majority foreign ownership whose funding is provided by the parent banks are notable for lower interest rates. The spread between interest rates in Slovenia and interest rates in the euro area overall in the segment of deposits of over 1 year has narrowed in 2010, while in the segment of deposits of up to 1 year euro area interest rates have surpassed interest rates at Slovenian banks. Despite the competition, Slovenian banks are unable to rapidly raise interest rates because of the deterioration in operating results. At the same time the spreads between the interest rates at the banks are not leading to a faster increase in deposits, but merely to migration between banks by savers. The continuation of such an interest rate policy could cause liquidity difficulties for the small banks and savings banks in particular. The abolition of the 100% guarantee for deposits at the end of 2010, after which deposits will be guaranteed up to EUR 100,000, could have a certain impact on the migration of some savings between banks.

Certain banks offer "deposits" whose return is not set by interest rates, but by the movement of indices or prices of other financial and non-financial products. These are structured financial products that are a type of investment product, and their purpose is to attract additional funds from savers.

3.4 Bank funding

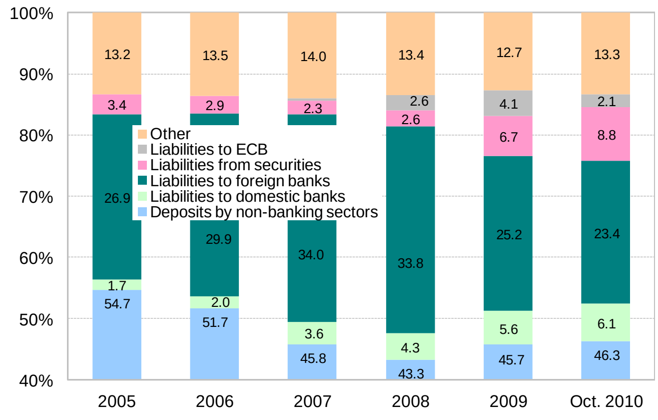
This year has seen a continuation of debt repayments in the rest of the world by the banks, a decline in liabilities to the Eurosystem, and the gradual withdrawal of government deposits, while bank funding via debt securities issues has been just half of that recorded last year.

The process of debt repayment in the rest of the world by the banks has continued this year, albeit more slowly. By the end of October the banks' debt to the rest of the world was down 8% on a year earlier. They have made a cumulative net repayment in the rest of the world of EUR 1.2 billion this year, compared with more than EUR 3 billion last year. The banks are no longer using government deposits to compensate for the loss of funding from the rest of the world, the government sector having gradually reduced its bank deposits by EUR 0.8 billion. As expected, with the maturing of the first two Eurosystem LTROs the banks had reduced their liabilities to the Eurosystem from EUR 2.1 billion to EUR 1.1 billion by the end of October. A further EUR 0.7 billion in liabilities from the third and final 12-month LTRO are to mature at the end of the year. The banks have partly compensated for the loss of funding this year with issues of debt securities. Three banks have issued a total of EUR 1 billion of debt securities.

This year's increase in household deposits has been lower than in previous years.

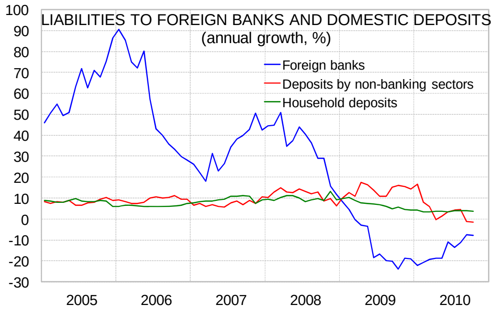
At EUR 314 million, the increase in household deposits over the first ten months of this year was less than in previous years. Total deposits by non-banking sectors were down EUR 218 million over the first ten months of the year as a result of the decline in government deposits.

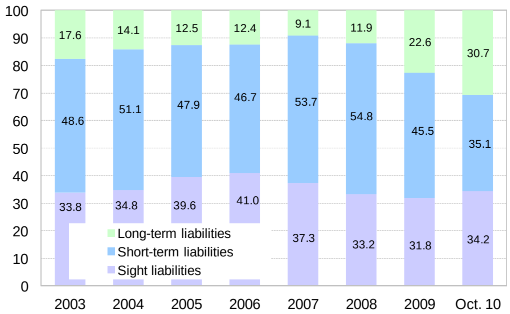
Figure 3.11: Structure of bank funding in percentages



Source: Bank of Slovenia

Figure 3.12: Year-on-year growth in bank funding (left) and maturity breakdown of deposits by non-banking sectors (right) in percentages





Source: Bank of Slovenia

Differences in funding structure at individual bank groups

Deposits by non-banking sectors account for half of total liabilities at the banks under majority domestic ownership.

The differences in funding methods between the individual bank groups are increasing. Deposits by non-banking sectors accounted for almost half of total liabilities in October at the large domestic banks, but 59% of the total at the small domestic banks. The banks under majority foreign ownership are significantly less reliant on this form of funding, although the proportion of their total liabilities accounted for by deposits by non-banking sectors has increased to 36% in just under two years. The increase is partly the result of the banks under majority foreign ownership recording the largest decline in total assets this year, while at the same time the increase in household deposits accounted for slightly more than half of the net increase in total deposits by non-banking sectors.

The large domestic banks have almost halved their ratio of liabilities to foreign banks to total assets over the last three years to 15%.

Household deposits are the most important form of funding for the banks under majority domestic ownership, accounting for almost a third of total liabilities. By contrast, the banks under majority foreign ownership primarily fund themselves using money obtained from banks in the rest of the world. The figure has remained close to half of total liabilities. The large domestic banks have recorded the largest decline in the proportion of total liabilities accounted for by liabilities to foreign banks over the last three years, the figure standing at just 15% in October 2010. At the small domestic banks, which throughout have had the lowest proportion of liabilities to foreign banks, the figure had fallen to 2% by October 2010.

As a result of this year's decline in nominal total assets and new issues of securities in the amount of EUR 1 billion, the proportion of total liabilities accounted for by issued securities increased by 2 percentage points to 8.8%, the large domestic banks recording the largest increase, to 13%. With this year's securities issues almost compensating for the repayments at foreign banks, there was no further decline in the ratio of bank funding on wholesale markets to total liabilities in October compared with a year earlier. Issued securities and liabilities to foreign banks together accounted for just over 32% of the banking system's total liabilities in October.

Table 3.2: Forms of funding as a proportion of total liabilities by individual bank group

(%)	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Banking system
		Liabilities to foreign banks		
2007	29.0	6.2	52.3	34.0
2008	27.7	6.8	52.3	33.8
2009	18.1	4.6	46.5	25.3
Oct. 2010	14.9	2.0	48.0	23.4
		Deposits by non-banking sectors		
2007	49.3	59.0	34.6	45.8
2008	47.8	56.7	31.1	43.3
2009	49.6	59.2	33.7	45.7
Oct. 2010	49.4	58.9	35.8	46.3
		Household deposits		
2007	31.9	30.6	20.8	28.6
2008	32.0	30.6	18.6	27.7
2009	30.3	30.3	18.2	26.7
Oct. 2010	31.1	31.2	20.3	28.0
		Issued debt securities		
2007	2.8	6.5	0.0	2.3
2008	3.5	6.4	0.0	2.6
2009	10.0	5.2	0.0	6.7
Oct. 2010	12.9	7.9	0.0	8.8
		Liabilities to Eurosystem		
2007	0.3	0.8	0.5	0.4
2008	2.1	3.0	3.3	2.6
2009	3.9	6.4	3.7	4.1
Oct. 2010	2.2	4.7	1.4	2.1

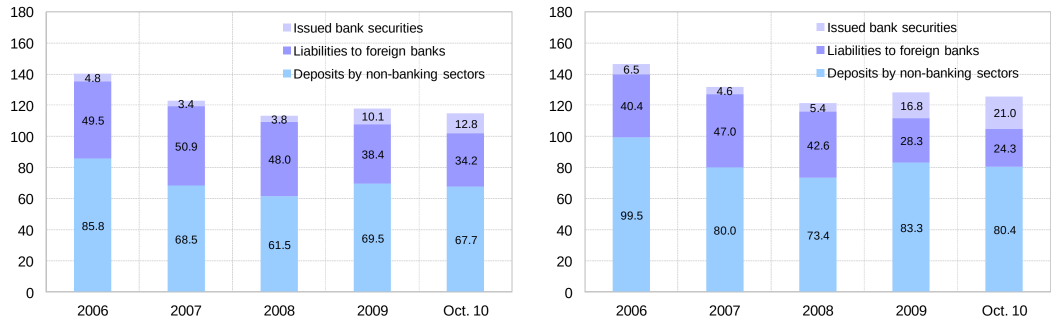
Source: Bank of Slovenia

Change in coverage of loans to non-banking sectors by deposits

Coverage of loans by deposits in October was similar to the end of last year.

The coverage of loans to non-banking sectors by deposits had deteriorated slightly by October. In the context of weak household saving and the withdrawal of government deposits from banks, the main reason for this was the standstill in lending activity. Ignoring government deposits, the coverage of loans by deposits stood at 59% at the end of October 2010, and was comparable to the coverage at the end of December 2009. The coverage of loans by liabilities to foreign banks has declined this year, while the coverage of loans by banks' issued securities has increased slightly.

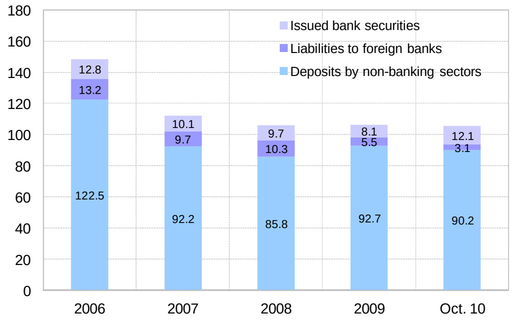
Figure 3.13: Coverage of loans to non-banking sectors by funding in the banking system (left) and at the large domestic banks (right) in percentages

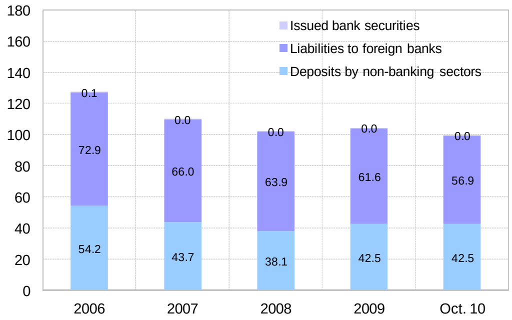


Source: Bank of Slovenia

The coverage of loans by deposits by non-banking sectors is a reflection primarily of the importance of individual forms of funding with regard to the different bank groups. At the end of October coverage of loans to non-banking sectors by deposits by non-banking sectors stood at 80% at the large domestic banks, and 90% at the small domestic banks, while the figure was significantly lower at the banks under majority foreign ownership at 42.5%. The coverage of loans by foreign bank funding stood at just over 24% at the large domestic banks, but at 57% at the banks under majority foreign ownership. In October the coverage of loans by issued securities stood at 21% at the large domestic banks and 12% at the small domestic banks. The banks under majority foreign ownership did not fund themselves by means of debt securities issues.

Figure 3.14: Coverage of loans to non-banking sectors by funding at the small domestic banks (left) and the banks under majority foreign ownership (right) in percentages





Source: Bank of Slovenia

4 INCOME STATEMENT AND BANK PERFORMANCE INDICATORS

The increase in income risk is being reflected in a sharp decline in the banking system's profit.

At EUR 86 million, the banking system's pre-tax profit during the first ten months of the year was just 36.3% of that in the same period last year. Net interest income in the first ten months of the year was up 13.8% on last year. The rise in net interest income was the result of a faster decline in interest expenses than interest income. The banking system's interest margin rose slightly as a result of the rise in net interest income outpacing growth in total assets.

The decline in the banking system's net non-interest income was the result of losses from trading in financial assets. Growth in gross income has nevertheless been positive this year. Operating costs and labour costs have stagnated this year.

Income risk

High impairment and provisioning costs are the largest factor in the banks' decline in profit.

During the first ten months of the year the banks created 59% more impairments and provisioning than in the same period last year. At 41.7%, the ratio of impairment and provisioning costs to gross income was far higher than in the same period last year (27.2%), and the pre-crisis figure of just 11.4%. The increase in credit risk has been fully reflected this year in higher impairment and provisioning costs.

Table 4.1: Income statement for January to October 2010

	2009	Breakdown	2009	Breakdown	2010	Breakdown	Annual growth
EUR million unless stated	Jan-Dec	%	Jan-Oct	%	Jan-Oct	%	in Oct 2010, %
Interest income	2,095		1,755		1,705		-2.8
Interest expenses	1,163		999		845		-15.4
Net interest	932	65.4	756	64.4	860	70.9	13.8
Non-interest income	493	34.6	418	35.6	352	29.1	-15.7
of which net fees and commission	336	23.5	281	23.9	284	23.4	1.3
of which net gains/losses from financial assets and liabilities held for trading	42	2.9	47	4.0	-37	-3.0	-177.6
Gross income	1,425	100.0	1,174	100.0	1,212	100.0	3.3
Operating costs	765	53.7	618	52.7	620	51.2	0.3
of which labour costs	415	29.1	342	29.1	343	28.3	0.3
Net impairments and provisioning	500	35.1	319	27.2	506	41.7	58.8
of which net impairments of financial assets at amortised cost and provisioning	434	30.4	310	26.4	444	36.6	43.4
Pre-tax profit	161	11.3	236	20.1	86	7.1	-63.7
Taxes	39		42		17		…
Net profit	122		194		69		…

Source: Bank of Slovenia

The banks will be exposed to income risk as a result of high loan impairment costs, the standstill in lending, and less-favourable projections for interest income.

The banks will be exposed to significant income risk in the future. Impairment and provisioning costs will remain high, because the increase in credit risk will continue. The stagnation in lending growth is another factor that will increase income risk. Insofar as the banks do not increase lending, the flow of interest income will gradually diminish. At the same time net interest income will increase more slowly as a result of the expected rise in bank funding costs and the rising difficulty of lending to the corporate sector in particular, where the spread between interest rates in Slovenia and the rest of the world is relatively high. The ability to pass the increased funding costs on to the borrower will be increasingly limited.

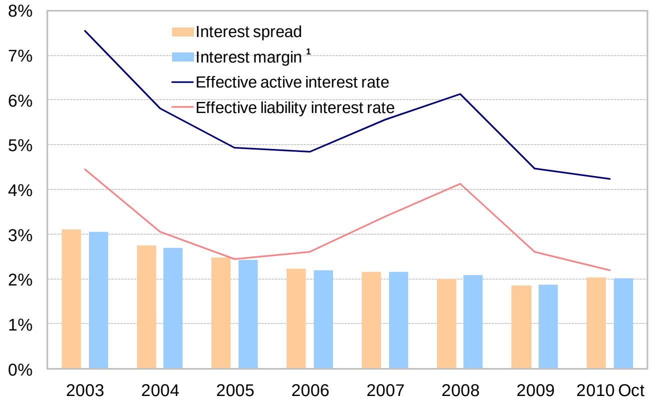
Net interest income and interest margin

Positive growth in net interest, which has exceeded growth in total assets this year, has raised the interest margin. The growth in net interest is the result of a decline in the banking system's interest expenses (down 15.4%), while interest income has remained almost at last year's level (down 2.8%). Lower interest expenses are primarily the result of a decline in liability interest rates. Beneficial effects based on interest expenses cannot be expected in the future, because liability interest rates will not decline further. At the same time the structure of bank funding is becoming less favourable in cost terms, and the banking system's interest margin will begin to decline again.

Liability interest rates have declined more than asset interest rates in 2010.

The average effective asset interest rate has declined by 0.25 percentage points this year, and the average effective liability interest rate by 0.42 percentage points. The decline was slower than last year. The greater decline in liability interest rates than in asset interest rates is being reflected in an increase in the banking system's interest spread and interest margin.

Figure 4.1: Movement in average asset and liability interest rates, interest spread and interest margin on interest-bearing assets



Note: [1] The value for October is calculated cumulatively for the period from January to October 2010.
Source: Bank of Slovenia

Differences in the generation and disposal of gross income by bank group

Growth in net interest income has been positive this year at all the bank groups. The largest increase was at the small domestic banks, at 28.3%. All the bank groups recorded a decline in net non-interest income, the small domestic banks recording the largest, at 29%.

Operating costs recorded a nominal decline of 1.7% at the banks under majority foreign ownership, and a very moderate increase at the other two bank groups. This year there was no significant variation between the bank groups in the ratio of operating costs to gross income; the figure was over a half at each group.

Table 4.2: Generation and disposal of the banking system's gross income by bank group

	Net interest		Non-interest income		Operating costs		Impairments and provisioning		Profit	
	Year-on-year growth, %									
	Dec. 09	Oct. 10	Dec. 09	Oct. 10	Dec. 09	Oct-10	Dec. 09	Oct. 10	Dec. 09	Oct-10
Large domestic banks	-5.0	10.4	28.0	-17.5	-2.2	0.9	74.7	64.4	-57.6	-99.0
Small domestic banks	9.9	28.3	29.7	-29.0	6.8	3.7	51.9	15.9	-10.2	3.4
Banks under majority foreign ownership	3.7	16.6	-3.6	-6.5	-1.8	-1.7	120.4	61.7	-39.1	-9.9
Banking system	-1.3	13.8	18.7	-15.7	-1.4	0.3	79.8	58.8	-47.6	-63.7
	Ratio to gross income, %									
	Net interest		Non-interest income		Operating costs		Impairments and provisioning		Profit	
	Dec. 09	Oct. 10	Dec. 09	Oct. 10	Dec. 09	Oct. 10	Dec. 09	Oct. 10	Dec. 09	Oct. 10
Large domestic banks	63.3	69.4	36.7	30.6	52.5	51.1	39.4	48.7	8.1	0.2
Small domestic banks	64.0	76.1	36.0	23.9	50.5	50.5	36.1	34.9	13.4	14.6
Banks under majority foreign ownership	70.4	72.4	29.6	27.6	57.4	51.6	25.1	29.7	17.5	18.8
Banking system	65.4	70.9	34.6	29.1	53.7	51.2	35.1	41.7	11.3	7.1

Source: Bank of Slovenia

Income risk has increased more sharply at the banks under majority domestic ownership.

All the bank groups recorded sharp increases in impairment and provisioning costs in 2010: 64% at the large domestic banks, 62% at the banks under majority foreign ownership and 16% at the small domestic banks.

The banks under majority foreign ownership generated an ROE of 6.48% during the first ten months of the year, compared with 0.67% at the domestic banks. The financial intermediation margin was relatively similar at the two bank groups during the same period. It stood at 2.79% at the domestic banks, and at 2.84% at the banks under majority foreign ownership. During the same period the domestic banks operated with a slightly lower interest margin, at 1.96%, than the banks under majority foreign ownership, at 2.15%. Similarly, the ratios of operating costs to average assets were comparable, at 1.54% at the banks under majority foreign ownership and 1.42% at the domestic banks.

Table 4.3: Bank performance indicators to October 2010 in percentages

(%)	2008	2009	Oct. 09	Oct. 10
	End of period			
Profitability				
Financial intermediation margin[1]	3.00	2.88	2.87	2.84
ROA	0.68	0.32	0.58	0.20
ROE	8.14	3.85	6.90	2.40
Interest margin on interest-bearing assets	2.21	1.99	1.95	2.13
Net non-interest income / operating costs	53.56	64.45	67.54	56.77
Operating costs				
Labour costs / average assets	0.9	0.8	0.8	0.8
Other costs / average assets	0.8	0.7	0.7	0.6
Quality of assets				
Impairments of financial assets measured at amortised cost / gross assets	2.5	3.0	2.9	3.9

Note: [1] Gross income / average assets
Source: Bank of Slovenia

5 LIQUIDITY RISK

Liquidity risk as measured by the first-bucket liquidity ratio has not changed significantly this year. For a long time now the banks have maintained a high first-bucket liquidity ratio, which was increased in the past by bank operations related to the issue of bonds, SID banka and government deposits at banks, and funding by means of Eurosystem long-term refinancing instruments after the outbreak of the crisis. By the end of October 2010 the banks had reduced part of their secondary liquidity, by EUR 0.4 billion, it having increased by EUR 1.3 billion after the outbreak of the financial crisis in 2009. The banks also have available a relatively large proportion of free eligible collateral for Eurosystem operations.

Slovenian banks' claims against the international market for unsecured euro area loans have declined slightly this year.

Slovenian banks have remained net creditors on the international market for unsecured euro area loans, albeit to a lesser extent than in 2009. By the middle of November the stock of claims had declined by EUR 170 million from 2009 to EUR 1.3 billion. With liabilities unchanged at EUR 923 million, the net position of Slovenian banks against the rest of the world in the middle of November 2010 was down EUR 337 million on 2009. The stock of claims against banks in the rest of the world began to increase in the second half of November, which was reflected in an increase in the banks' net position against the rest of the world, which passed EUR 0.7 billion in the last ten days of the month. The reason for the increase in the net position was the banks' preparations for repayments of liabilities on the basis of the final Eurosystem LTRO of last year, which matures on 23 December this year.

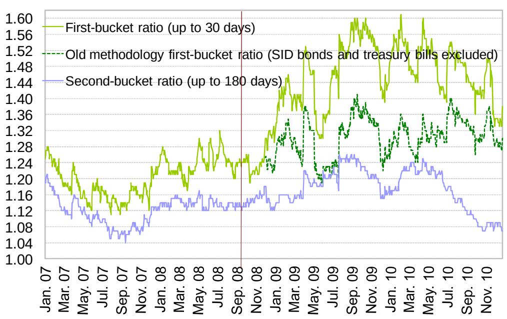
The first-bucket liquidity ratio averaged 1.48 over the first eleven months of 2010, thus remaining at its average level of last year. The approach of the maturity of the 12-month LTROs was a factor in the temporary decline in the ratio in early June and at the end of August. Similarly, the ratio declined by 0.07 to 1.38 on 23 November.

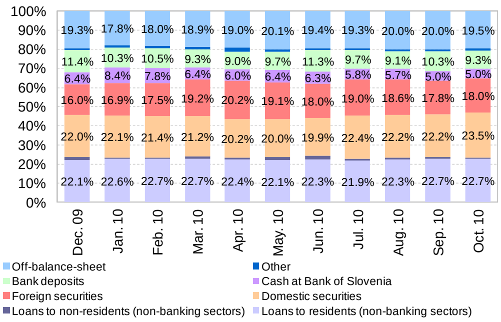
The second-bucket liquidity ratio has declined to its pre-crisis level.

There have been major changes in the second-bucket liquidity ratio. Since June it has gradually declined from a value of 1.21, reaching its pre-crisis level of 1.08 by early October. The decline was the result of a decline of EUR 1.9 billion in investments for the second-bucket liquidity ratio calculation and an increase of EUR 1.1 billion in liabilities. The main factor in the increase in liabilities in the calculation of the second-bucket liquidity ratio was the shortening of the average maturity of liabilities to banks and savings banks and of deposits by non-banking sectors.

In the period between 1 year and 2 years, when both of the bank bonds issued last year in the amount of EUR 2 billion mature, both ratios would decline were the stock of claims to remain unchanged.

Figure 5.1: Daily first-bucket and second-bucket liquidity ratios (left) and percentage breakdown of assets included in the calculation of the first-bucket liquidity ratio (right)

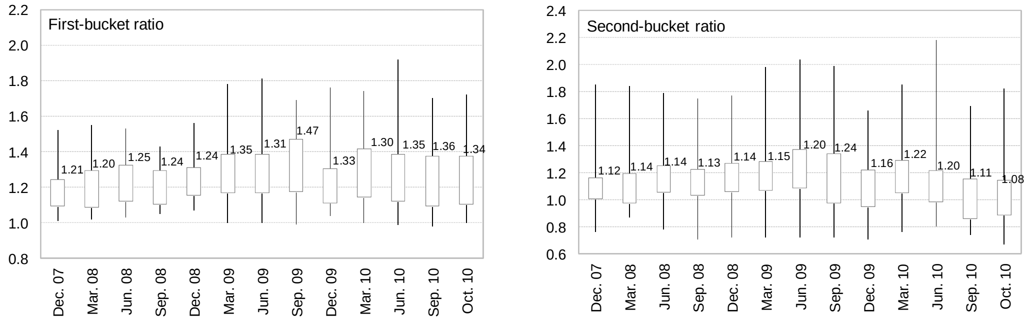




Source: Bank of Slovenia

Although the first-bucket liquidity ratio remains at a relatively high level, its distribution across individual banks remains wider than before the outbreak of the crisis. The same is true of the second-bucket liquidity ratio, the distribution of which across individual banks remained wide as it declined in the second half of this year.

Figure 5.2: Distribution of first-bucket liquidity ratio (left) and second-bucket liquidity ratio (right), monthly averages



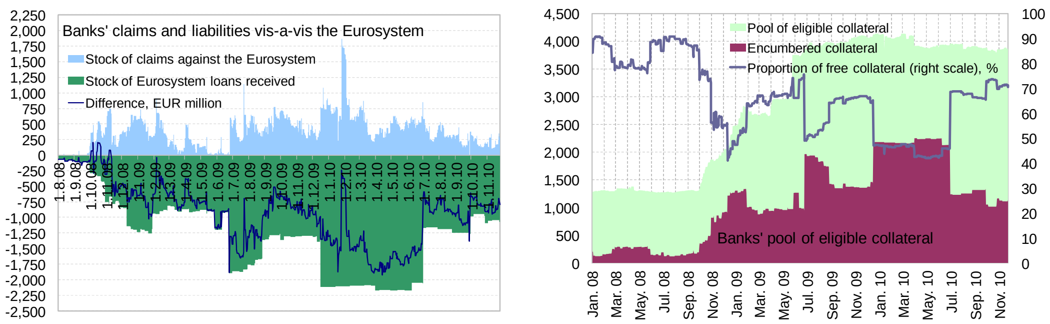
Source: Bank of Slovenia

Slovenian banks' net debt to the Eurosystem has declined by a half.

By the end of November Slovenian banks' net debt to the Eurosystem had declined by just over a half from the previous December to EUR 1 billion, mainly as a result of the maturing of two 12-month LTROs. The net debt declined by EUR 892 million in July and by EUR 283 million in September when the 6-month and 3-month LTROs matured simultaneously. At the end of December a further EUR 728 million from the final 12-month LTRO is maturing, as a result of which the banks' net debt to the Eurosystem will decline again.

The pool of eligible collateral for the Eurosystem fluctuated around EUR 3.9 billion over the first eleven months of this year. The proportion of the pool of eligible collateral that is free varied in line with the movement of the banks' debt with the Eurosystem. The maturing of Eurosystem refinancing instruments caused an increase of 23 percentage points in the free proportion to 69% in July, and to 73% at the end of September. The proportion of the pool of eligible collateral for Eurosystem operations that is free will increase further by the end of the year.

Figure 5.3: 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)



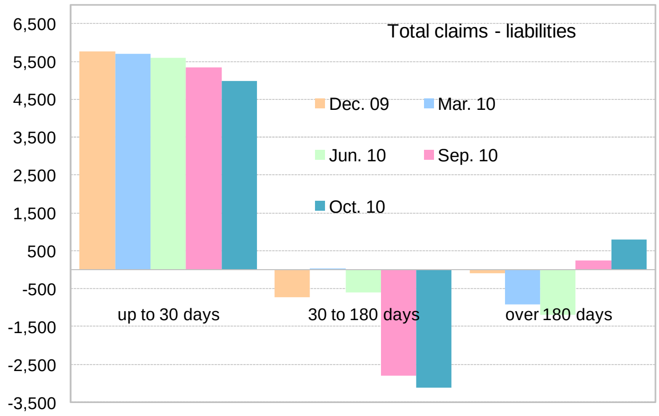
Source: Bank of Slovenia

The negative gap in the second bucket of the liquidity ladder has widened notably in the second half of 2010.

The extremely long liquidity gap[6] in the bucket with residual maturity of up to 30 days has gradually been shortening in the second half of 2010. In the third quarter there was a significant increase in the negative gap in the bucket with maturity of 30 to 180 days, primarily as a result of a shortening of maturities of the banks' liabilities to the Eurosystem and foreign banks.

[6] The liquidity gap is calculated as the difference between total claims and total liabilities according to the liquidity ladder methodology.

Figure 5.4: Liquidity gap as the difference between total assets and total liabilities defined in the liquidity ladder methodology in EUR millions



Source: Bank of Slovenia

The banks' secondary liquidity has declined.

The stock of secondary liquidity at the banks averaged EUR 5.7 billion in October, down EUR 0.4 billion on last December. The main reason for the decline was a decline in the proportion of bank investments accounted for by government securities, while the amount of foreign securities rated at least BBB remained almost unchanged. The ratio of the banking system's secondary liquidity to total assets has declined by 0.5 percentage points this year to 11.4%. The stock of secondary liquidity at the banks increased relatively sharply in the first year of the crisis, and is still relatively high compared with the period before the outbreak of the crisis, for which reason this year's moderate decline in these assets at the banks is not significantly increasing liquidity risk.

6 REFINANCING RISK

The banks are most exposed to refinancing risk over the next one- to two-year period when one quarter of all liabilities to the rest of the world totalling EUR 3.6 billion and EUR 1.3 billion in government deposits mature. Refinancing risk is rising for Slovenian banks owing to the relatively high ratio of loans to non-banking sectors to deposits by non-banking sectors, the relatively low capital adequacy of certain banks and due to the uncertain situation on the European financial market.

Maturing liabilities from 12-month longer-term Eurosystem refinancing operations (LTRO) in the amount of EUR 0.7 billion and government deposits in the amount of EUR 0.5 billion, and a likely renewed decline in liabilities to foreign banks will result in the further contraction of the banking system's total assets by the end of this year.

The decline in deposits by non-banking sectors this year was driven by the withdrawal of government deposits from banks. At EUR 314 million, growth in household deposits at banks over the first ten months of the year was down sharply on the growth recorded in previous years.

Funding conditions in the rest of the world remain tight. The majority of bank borrowing in the rest of the world this year was short-term and at interest rates that were higher than the pre-crisis rates. Interest rates on loans from the rest of the world rose sharply, in particular for the domestic banks. While the banks under majority foreign ownership have succeeded in rolling over nearly all loans, albeit primarily in the short term, the banks under domestic ownership have rolled over less than half of loans. The structure of maturing liabilities to foreign banks is more favourable at the large domestic banks, with the majority of liabilities (37% of all liabilities to the rest of the world or EUR 2.8 billion) in the maturity bucket of 1 to 2 years.

The maturity breakdown of maturing liabilities to the rest of the world at the domestic banks has improved slightly owing to the issue of securities. The maturity breakdown has deteriorated at the banks under majority foreign ownership owing to the recent predominance of short-term funding.

Bank funding costs are rising gradually owing to the changing structure of sources of bank funding, in which the proportion of more expensive sources is rising, and due to rising market interest rates. In the context of the currently uncertain situation on the European financial markets, the funding costs of Slovenian banks will be reflected in higher interest rates on loans.

6.1 Sources of bank funding

a) Deposits by non-banking sectors

Deposits by non-banking sectors declined owing to the withdrawal of government deposits and weak growth household deposits at banks.

Deposits by non-banking sectors declined by EUR 218 million over the first ten months of the year, the decline in government deposits contributing EUR 820 million to this. Household deposits recorded year-on-year growth of just 3.7% in October. This year's increase in deposits by non-financial corporations is negligible, while growth in deposits by other financial institutions was somewhat better, the latter, however, representing a relatively insignificant source of bank funding.

Bank funding by means of household deposits remains absent. Growth in these deposits, which still represent 60% of all deposits by non-banking sectors and are equivalent to 28% of the banking system's total assets, averaged merely 3.7% compared with 6.9% last year.

The maturity breakdown of deposits by non-banking sectors is changing in favour of long-term deposits. Long-term deposits by non-banking sectors accounted for 30.7% at the end of October 2010, up 8 percentage points on the end of 2009. Long-term deposits accounted for merely one tenth of deposits by non-banking sectors at the end of 2008. The reason for the lengthening of maturities is the increase in the proportion of long-term household deposits and the fact that the majority of the increase in government deposits last year was in the form of long-term deposits.

The maturity breakdown of household deposits is changing as the result of a declining proportion of short-term deposits and a rising proportion of long-term deposits. Short-term deposits have declined by EUR 1,071 million this year in the context of an overall increase in household deposits of EUR 314 million. Long-term deposits and sight deposits have risen by a total of EUR 1,386 million over the same period, the former by EUR 1,018 million and the latter by EUR 368 million. The proportion of household deposits accounted for by long-term deposits was up 6.8 percentage points on the end of last year to stand at 27.4% at the end of October. The proportion of short-term deposits declined to 31.5%, while the proportion of sight deposits rose to 41.1%.

Declining growth in household deposits at banks was characteristic of 2009 in the absence of sales of securities held by households on the capital markets and in the context of rising unemployment. The trend of declining household deposits continued this year. Growth in household deposits at banks over the first ten months of 2010 was down nearly one fifth on the same period last year. The economic position of one household group deteriorated further owing to the slow economic recovery. Employment earnings have declined as a result, which explains the lower growth in sight deposits. Certain claims have also been settled in physical form owing to difficulties with payment discipline. At the same time, a portion of households with stable earnings have opted to purchase residential property, which has also consumed a portion of savings at banks.

b) Government deposits at banks:

Government deposits at banks are gradually declining.

Having increased in January 2010 by EUR 0.9 billion following the issue of two bonds in the amount of EU 2.5 billion, government deposits declined in other months. The exception was June, when EUR 600 million in government deposits at the Bank of Slovenia matured. The government deposited the majority of these funds at banks. The average stock of the government's, or the Ministry of Finance's bank deposits fell from EUR 3.5 billion in 2009 to EUR 2.7 billion this year (as at 24 November). The stock of government deposits is expected to fall below EUR 2 billion by the end of 2010.

Slightly less than EUR 0.5 billion in government deposits mature by the end of 2010. Alongside maturing liabilities to the Eurosystem, the government's failure to roll over maturing deposits will result in a contraction in the banking system's total assets. More than one half of government deposits have a maturity of between one and two years. The majority of these deposits are concentrated at the large domestic banks, with nearly two thirds of these types of liabilities maturing.

Table 6.1: Maturing liabilities from government deposits at banks as at 23 November 2010

	Cumulative maturing of government deposits				Maturity breakdown of liabilities			
(%)	Large domestic banks	Banks under majority foreign ownership	Small domestic banks	Banking system	Large domestic banks	Banks under majority foreign ownership	Small domestic banks	Banking system
Total, EUR million	**1,718**	**284**	**389**	**2,391**				
Up to 1 month	2.3	0.0	32.1	6.9	2.3	0.0	32.1	6.9
1 to 3 months	12.3	12.7	61.7	20.4	10.0	12.7	29.6	13.5
3 to 6 months	22.8	25.4	95.1	34.9	10.5	12.7	33.4	14.5
6 months to 1 year	22.8	25.4	95.1	34.9	0.0	0.0	0.0	0.0
1 to 2 years	87.4	81.7	95.1	88.0	64.6	56.3	0.0	53.1
Over 2 years	100.0	100.0	100.0	100.0	12.6	18.3	4.9	12.0
Total					100.0	100.0	100.0	100.0

Source: Bank of Slovenia

The banks under majority domestic ownership have higher liabilities to the government as a proportion of total assets than the banks under majority foreign ownership. In October 2010 liabilities to the government accounted for 9.9% of total assets at the small domestic banks, 7.2% at the large domestic banks and just 3.2% at the banks under majority foreign ownership.

c) Issue of bank securities on the financial markets

Bank funding by means of debt security issues halved this year compared with last year.

Bank funding by means of securities issues halved over the first ten months of this year compared with the previous year. SID banka issued a 5-year bond in April in the amount of EUR 750 million with a coupon rate of 3%. In June Factor banka and Deželna banka

Slovenije issued 5-year bonds, each in the amount of EUR 100 million. On 12 November SID banka issued a 4-year bond in the amount of EUR 50 million with an interest rate tied to the 6-month EURIBOR with a premium of 83 basis points.

d) Bank funding via Eurosystem operations

Banks' liabilities to the Eurosystem from 12-month LTROs matured in 2010.

Having sharply increased funding via the Eurosystem last year, the banks' long-term refinancing instruments matured this year. Banks' liabilities to the Eurosystem nearly halved to EUR 1.2 billion with the maturity of the first 12-month LTRO in June in the amount of EUR 1.05 billion. The banks repaid two thirds of funds received from the Eurosystem in September, when EUR 395 million in liabilities arising from 3-, 6- and 12-month LTROs matured. Banks prepared in November and December for the repayment of the third 12-month LTRO in the amount of EUR 728 million, which mature on 23 December. The banks used this form of funding merely to compensate for previously typical sources of funding. Longer-term investments cannot be funded by sources from the Eurosystem due to their short-term nature.

6.1.2 Bank liabilities to the rest of the world

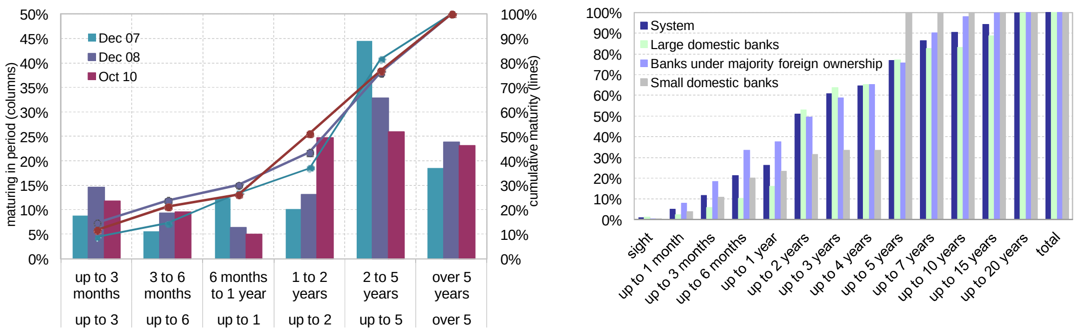
The banks under majority foreign ownership are more successful in obtaining funding, but also face tight funding conditions.

Bank funding conditions in the rest of the world remained tight in 2010: the volume of new loans is modest, maturities are primarily short-term and interest rates are higher than those prior to the financial turmoil. The banks made significant repayments to the rest of the world (of EUR 1.2 billion) in 2009, but have managed to maintain a slightly higher level of debt over the first ten months of 2010 at EUR 14.9 billion.[7]

The banks under majority foreign ownership are more successful in obtaining funding in the rest of the world owing to their ties with parent banks. They have rolled over 97% of maturing loans from the rest of the world in the last 12 months, compared with just 47% at the banks under majority domestic ownership.

The maturities on new loans and deposits raised by the banks under majority foreign ownership in the rest of the world are shorter than the pre-crisis maturities. The maturity breakdown of these sources has shortened considerably as a result. At the banks under majority foreign ownership, 34% of total liabilities to foreign banks had a maturity of up to 6 months in October 2010, which is nearly three times more than in December 2007.

Figure 6.1: Maturing of liabilities to foreign banks by maturity interval (left) and by bank group (right) as at 31 October 2010 in percentages



Source: Bank of Slovenia

The maturity structure of liabilities to foreign banks is more favourable at the domestic banks.

The maturity breakdown of liabilities to foreign banks is most favourable at the domestic banks. Contributing most to this was the issue of bonds in the rest of the world, initially by the large domestic banks in 2009, followed by the small domestic banks this year. The proportion of liabilities with a maturity of up to 6 months is 10% at the large domestic banks, down 9 percentage points on the end of 2007. That proportion is higher at the small banks at 20%, and is likewise more favourable than at the banks under majority foreign ownership.

[7] In addition to liabilities to the rest of the world from loans raised and deposits at foreign banks, the figure includes debt securities issued by banks in the rest of the world.

Table 6.2: Maturing of liabilities to foreign banks and maturity breakdown as at 31 October 2010 for the banking system and by bank group in percentages

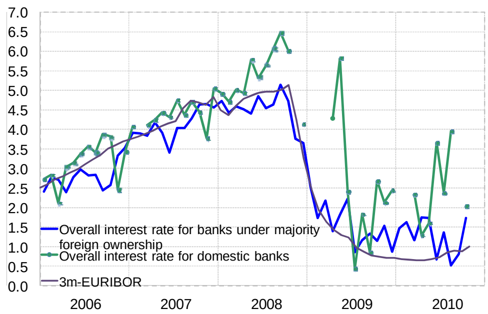
	Cumulative maturing of liabilities to foreign banks				Maturity breakdown of liabilities			
	Banking system	Large domestic banks	Banks under majority foreign ownership	Small domestic banks	Banking system	Large domestic banks	Banks under majority foreign ownership	Small domestic banks
Total, EUR million	14,781	7,581	6,930	270				
	Breakdown, %							
Overnight, sight	0.8	1.1	0.4	0.2	0.8	1.1	0.4	0.2
Up to 1 month	5.0	2.5	7.8	3.8	4.2	1.4	7.4	3.6
1 to 3 months	11.8	6.0	18.2	10.9	6.8	3.5	10.4	7.2
3 to 6 months	21.3	10.2	33.5	20.1	9.5	4.2	15.3	9.2
6 months to 1 year	26.3	16.1	37.6	23.3	5.0	5.9	4.1	3.2
1 to 2 years	51.1	53.1	49.6	31.6	24.7	37.0	11.9	8.3
2 to 3 years	60.9	63.7	58.9	33.6	9.8	10.6	9.4	2.1
3 to 4 years	64.7	65.3	65.3	33.6	3.8	1.6	6.3	0.0
4 to 5 years	76.9	77.2	75.7	100.0	12.2	11.9	10.5	66.4
5 to 7 years	86.5	82.6	90.3		9.6	5.4	14.6	
7 to 10 years	90.6	83.3	98.2		4.1	0.7	7.9	
10 to 15 years	94.3	88.9	100.0		3.7	5.6	1.8	
15 to 20 years	99.9	99.7			5.6	10.9		
Over 20 years	100.0	100.0			0.1	0.3		
Total					100.0	100.0	100.0	100.0

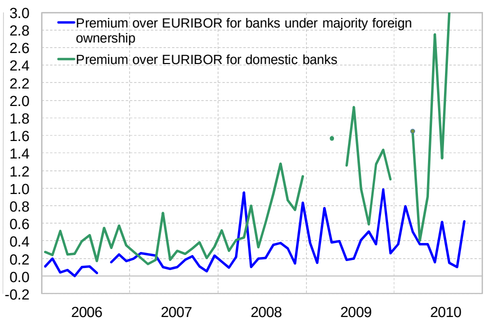
Source: Bank of Slovenia

The risk premium rose further in 2010.

Funding conditions in the rest of the world have tightened, in particular for the domestic banks. Interest rates on loans to the domestic banks rose sharply this year, while premiums over the EURIBOR reached 3 percentage points. On average, the banks under majority foreign ownership borrowed under more favourable conditions. Funding, however, has become more expensive for these banks given the shortening of maturities on sources obtained.

Figure 6.2: Overall interest rates (left) and premiums over the EURIBOR (right) on bank loans in the rest of the world with respect to majority ownership in percentages





Source: Bank of Slovenia

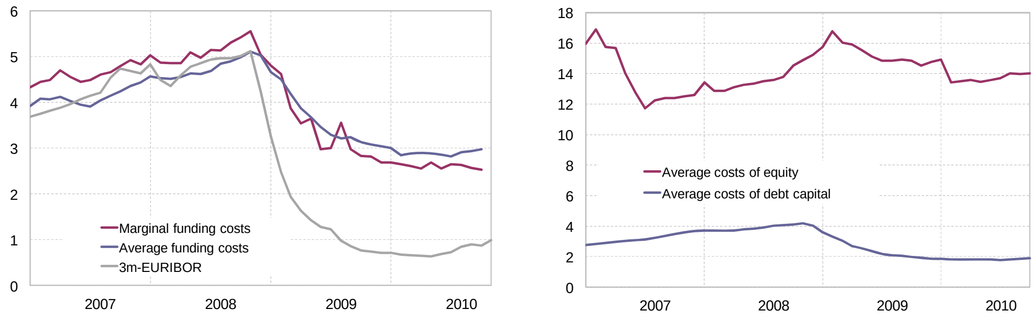
6.2 Bank funding costs

The increase in funding costs is the result of rising market interest rates and the rising proportion of more expensive sources of funding.

At the end of the third quarter of 2010, rising average bank funding costs reached the level recorded at the end of 2009, at slightly less than 3%. The rise in funding costs in 2010 was the result of rising market interest rates and the rising proportion of relatively more expensive sources of funding.[8] The 3-month EURIBOR rose by nearly 0.3 percentage points over the first 10 months of 2010. Market participants expect the EURIBOR to continue rising. The proportion of funding accounted for by issued debt securities rose during the first half of 2010, while the proportion of funds raised at the Eurosystem and foreign banks declined. There were no significant issues of securities in the third quarter of 2010, while borrowing at foreign banks was up.

[8] The sources of bank funding taken into account in the calculation represent 93% of the banking system's total assets (September 2010). The banks' funding costs are calculated on a pre-tax basis. The costs of debt capital are estimated on the basis of movements in interest rates on deposits by non-banking sectors, liabilities to the rest of the world (banks [loans and deposits], the ECB and other sectors) and debt securities (including subordinated debt securities). The costs of equity are estimated by means of a two-stage dividend discounting model for banks whose shares are listed on the Ljubljana Stock Exchange.

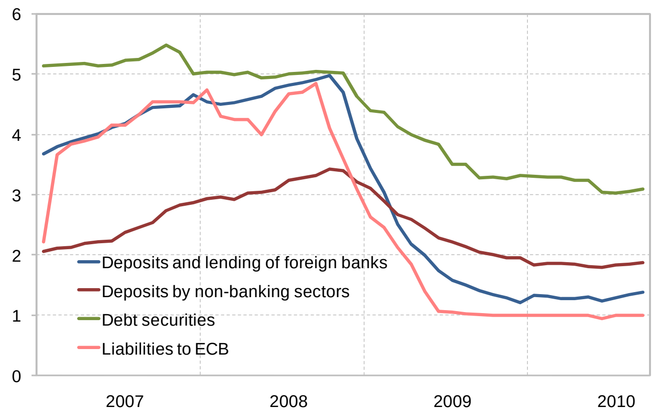
Figure 6.3: Average and marginal funding costs (left) and average costs of equity[9] and debt capital (right) in percentages



Sources: Bank of Slovenia, LJSE

The most expensive form of funding is equity, the cost of which fluctuated at around 14% this year. In the third quarter of 2010, all forms of debt financing followed the rise in market interest rates. At more than 3%, the most expensive form of debt financing remains the issue of debt securities, followed by funding via deposits by non-banking sectors, at slightly less than 2%, and funding raised at foreign banks at around 1.4%. The costs of funds raised at the Eurosystem fluctuate at around 1%. Alongside funds raised at the Eurosystem, the costs of funds raised at foreign banks recorded the sharpest decline over the last two years (by 3.5 percentage points). The proportion of total funding accounted for by the aforementioned source has recorded the sharpest drop (of 10 percentage points) owing to the adverse situation. The banks were forced to substitute for these sources with relatively more expensive forms of funding.

Figure 6.4: Average costs of bank's debt financing in percentages



Source: Bank of Slovenia

The domestic banks compensated for lost funding by issuing debt securities.

Primarily the larger Slovenian banks have compensated for lost funding from foreign banks by issuing debt securities, the proportion of which in the overall structure of funding has doubled in the last year. The raising of funds via the issue of debt securities was rare in the Slovenian economy prior to the crisis. This source of funding has become indispensable at the banks under majority domestic ownership since the outbreak of the crisis. Entering the international bond market was made more difficult due to a lack of recognition on the market. The government guarantee, which is a temporary measure, allowed the banks to access sources of funding at relatively favourable prices on the international markets, despite fierce competition.

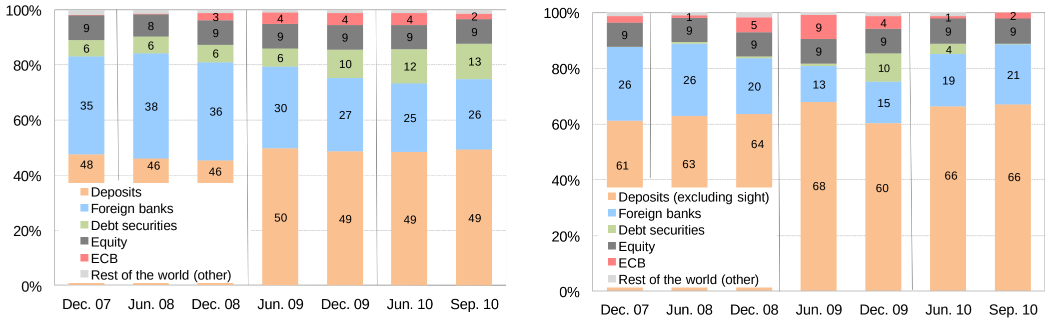
The competition for funding from households is very fierce.

The banks can be expected to attempt to strengthen their retail banking operations, as household deposits represent one of the highest-quality sources of funding. Household savings are also important for non-banking financial intermediaries, who compete with bank deposits via their own products such life insurance, mutual fund units and voluntary

[9] The costs of equity were down at the beginning of 2010 owing to the inclusion of dividends paid for 2009. NKBM did not pay dividends for 2009; dividends paid by Abanka were significantly lower that the previous year. Lower dividend payments resulted in an increase in the ratio of retained earnings, but not in absolute terms with respect to 2008 in the context of lower profits (particularly in the case of NKBM). Expected long-term corporate growth potential therefore declined. The lower costs of equity at the beginning of 2010 were thus primarily the result of lower long-term growth potential.

supplementary pension insurance. The adverse situation on the labour market has a double-edged effect on savings. The uncertain economic situation leads to increased savings, while the most important factor in savings is lower disposable income. The saving rate of Slovenian households stood at 15.9% in 2009[10]. A year earlier, when the unemployment rate began to rise at the end of the year (with the outbreak of the global crisis), the saving rate was lower, at 15.5%.

Figure 6.5: Structure of the stock of bank funding (left) and half-yearly and quarterly flows of bank funding (right) in percentages



Source: Bank of Slovenia

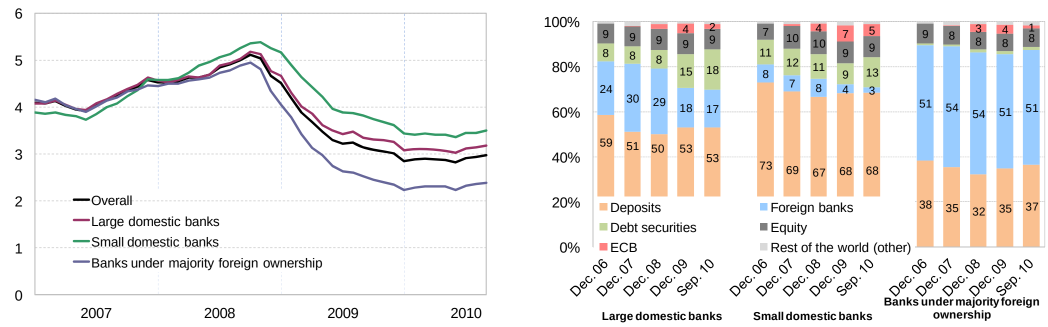
Differences in funding costs between bank groups[11]

The banks under majority foreign ownership have the most favourable structure of funding in terms of costs.

At the end of September 2010, the banks under majority foreign ownership had the lowest average funding costs at 2.4%, followed by the large domestic banks at 3.2%. The spread between these two bank groups has not changed significantly over the last six months. The banks under majority foreign ownership have the most favourable structure of funding in terms of costs, as more than 50% of sources are from foreign banks.

The spread in funding costs between individual bank groups began to rise towards the end of 2008 in the context of the deteriorating situation on the market. This was also reflected in differences between asset interest rates. During this period, the domestic banks found it very difficult to raise funds at foreign banks. The proportion of the domestic banks' funding accounted for by sources from foreign banks has fallen by 12 percentage points in the last two years. Also available to the aforementioned banks, in addition to funds from the Eurosystem, were relatively more expensive sources, deposits by non-banking sectors and securities issues. Thus the domestic banks did not lower interest rates on deposits to the same extent as the banks under majority foreign ownership during this period. The proportion of bank funding accounted for by the issue of securities also rose, by 10 percentage points.

Figure 6.6: Average funding costs (left) and the structure of the stock funding by bank group (right) in percentages



Sources: Bank of Slovenia, LJSE

Retail banking is becoming increasingly important for the banks under majority foreign ownership as well.

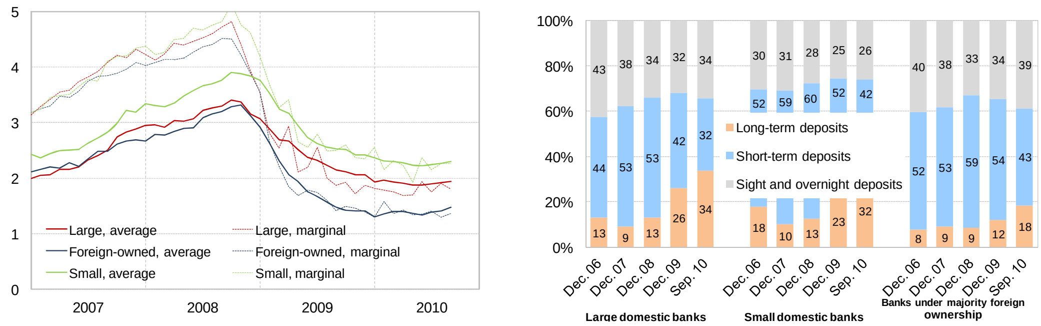
The banks under majority foreign ownership are dedicating an increasing amount of attention to retail banking. The proportion of funding accounted for by deposits has risen by 5 percentage points in the last two years, approaching the level recorded in 2006 of around 38%. The banks under majority foreign ownership began converging their interest

[10] Saving rate = gross saving / gross disposable income

[11] The estimate of costs of equity is the same for all groups of banks 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.

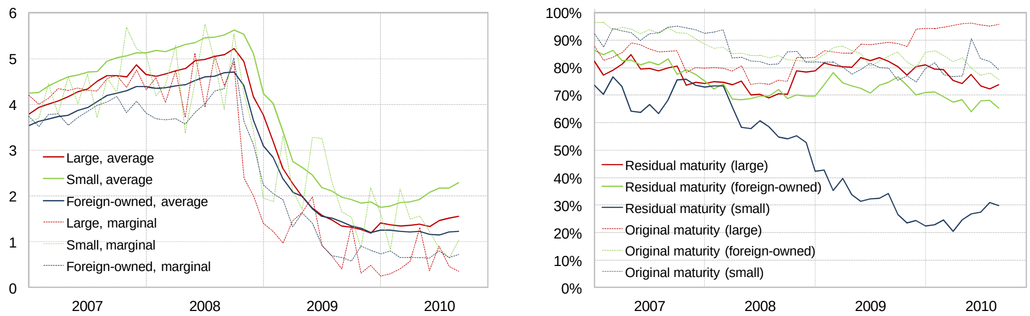
rates on deposits with those of the domestic banks in 2010, and even exceeded them in certain segments of operations. The differences in funding costs between the aforementioned bank groups are narrowing in the deposit segment. The small domestic banks and other financial intermediaries also represent stiff competition on the deposit market. The domestic banks have a higher proportion of long-term deposits than the banks under majority foreign ownership, where the spread in interest rates is higher, but narrowing. Deposit maturities are also lengthening with respect to residual maturity, which results in higher bank funding costs, but improves the banks' interest-rate gaps.

Figure 6.7: Average and marginal funding costs for deposits by non-banking sectors[12] (left) and the original maturity breakdown of deposits (right) by bank group



Source: Bank of Slovenia

Figure 6.8: Average and marginal funding costs for liabilities to foreign banks (left) and the proportion of liabilities to foreign banks with a residual and original maturity of more than 1 year (right) by bank group in percentages



Source: Bank of Slovenia

The banks under majority foreign ownership raise funds at foreign banks under more favourable terms than the domestic banks.

Bank funding costs are expected to rise gradually. Market participants expect market interest rates to continue rising, while there is no reason to expect the structure of bank funding to improve in terms of costs. Higher bank funding costs will be reflected in higher interest rates on loans.

[12] The overall interest rate is illustrated, without regard to deposit maturity or the depositor's sector.

7 CREDIT RISK

The quality of the credit portfolio has continued to deteriorate in 2010. Household lending has continued to stagnate, despite the recovery in economic activity seen in export-oriented manufacturing sectors for the second consecutive quarter. Corporates are searching for sources of financing in other sectors and in the rest of the world; thus the banks are risking the loss of opportunities to increase profits and improve the quality of the portfolio through new projects and clients. The banking system's credit portfolio is also deteriorating owing to the continuing increase in banks' exposure to those sectors where the liquidity position continues to deteriorate and where there are no signs of an economic recovery.

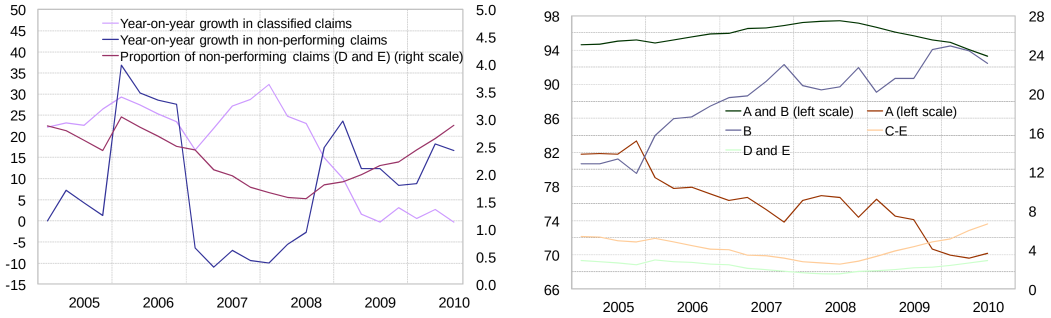
The structure of the credit portfolio is more favourable at the banks under majority foreign ownership who have maintained their proportion of non-performing claims below the banking system average by shifting their investments to lower-risk sectors and by limiting their exposure to risk factors. A better client structure than the domestic banks in high-risk sectors also indicates a higher level of prudence and the more rapid collection of non-performing claims at the banks under majority foreign ownership. Longer arrears are growing more rapidly at the domestic banks, particularly in the most indebted sectors, which points to a further deterioration in the quality of the credit portfolio.

7.1 Quality of the credit portfolio

Non-performing claims accounted for 3.0% of the banking system's classified claims in October.

The deterioration of the banking system's credit portfolio continued in 2010. Year-on-year growth in the banking system's classified claims has fluctuated at close to zero since the middle of 2009, and was negative in September. The proportion of non-performing claims rose by a further 0.8 percentage points over the first ten months of 2010 to stand at 3.0% of classified claims in October. The high growth in non-performing claims over the first ten months of the year points to annual growth that is double the growth recorded in 2009 of 0.4 percentage points.

Figure 7.1: Year-on-year growth in classified and non-performing claims (left) and the breakdown of claims by credit rating (right) in percentages



Source: Bank of Slovenia

The banks downgraded 2.3% of classified claims from less risky claims to higher-risk claims over the first ten months of 2010. Since the credit portfolio began deteriorating in the middle of 2008, the banks have reclassified 4.4% of classified claims to higher-risk claims, of which 3.0% to C-rated claims and 1.4% to non-performing claims (rated D and E).

Table 7.1: Ratings breakdown of classified claims and coverage of claims by impairments and provisions

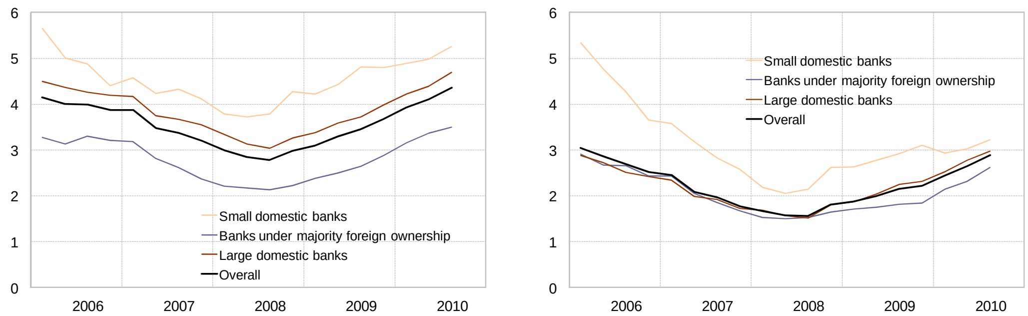
	31.12.2008			31.12.2009			31.10.2010		
	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %	Classified claims	Impairments	Coverage of claims by impairments, %
Total, EUR million	47,129	1,403	3.0	48,935	1,827	3.7	50,284	2,264	4.5
	Breakdown, %			Breakdown, %			Breakdown, %		
A	74.4	8.8	0.4	70.7	7.0	0.4	70.1	6.1	0.4
B	22.7	34.4	4.5	24.5	30.8	4.6	22.8	22.5	4.4
C	1.0	8.7	24.8	2.6	16.2	23.2	4.1	23.2	25.5
D	1.0	20.8	62.3	1.4	24.7	62.9	2.1	28.8	61.6
E	0.8	27.2	100.0	0.8	21.2	100.0	0.9	19.4	100.0

Source: Bank of Slovenia

A large portion of the banks' lending activity is accounted for by the extension and roll-over of existing loans, which illiquid and indebted clients have difficulty repaying. The banks persist in lending arrangements with bad clients on account of the consequences they would face if they stopped approving loans, i.e. a further deterioration in the financial positions of clients, particularly of those to which the banks are most exposed.

The most favourable portfolio structure in terms of credit risk in 2010 was again at the banks under majority foreign ownership, although the downgrading of claims was most evident at these banks this year. The proportion of non-performing claims at the banks under majority foreign ownership rose by 0.8 percentage points, 0.1 percentage points higher the average for the banking system. Due to the slower deterioration in the credit portfolio in 2008 and 2009, the proportion of non-performing claims of 2.6% is below the banking system average of 2.9%. In line with their more favourable credit portfolio structure, the banks under majority foreign ownership had the lowest coverage of claims by impairments and provisions at 3.5% compared with 4.4% for the banking system overall.

Figure 7.2: Coverage of classified claims by impairments (left) and proportion of non-performing claims by bank group (right) in percentages



Source: Bank of Slovenia

The quality of the credit portfolio at the large domestic banks also deteriorated more over the first nine months of this year than in 2009. The proportion of non-performing claims was up 0.7 percentage points to stand at 3%. The coverage of claims by impairments and provisions was up accordingly, by 0.7 percentage points to 4.7%.

The small domestic banks have the highest proportion of non-performing claims and the highest coverage of claims by impairments and provisions.

The small domestic banks already had the highest proportion of non-performing claims prior to the outbreak of the financial turmoil. The quality of the small banks' credit portfolio deteriorated less in 2010 than the other bank groups (an increase in the proportion of non-performing claims of 0.1 percentage points). Nevertheless, the structure of the small banks' credit portfolio was less favourable than the banking system average in September 2010. The highest proportion of non-performing claims in the balance sheets of the small banks (3.2%) indicates greater prudence in rating clients and a less favourable portfolio structure in terms of credit risk. A similar relationship with the other bank groups is also seen in the coverage of claims by impairments and provisions: coverage was already higher at the small domestic banks than at the other bank groups prior to the outbreak of the financial turmoil, and remains higher at 5.3%, despite slower growth in 2010.

Table 7.2: Arrears in the settlement of liabilities to banks by client segment

	Classified claims			Proportion of classified claims in arrears for client category						
					total arrears			arrears of over 90 days		
	Dec. 08	Dec. 09	Sep. 10		Dec. 08	Dec. 09	Sep. 10	Dec. 08	Dec. 09	Sep. 10
Total, EUR million	47,129	49,757	50,539		4,347	5,108	5,893	1,532	2,690	3,451
							%			
Corporates	52.6	50.4	50.4	100.0	12.6	12.6	18.3	3.5	6.6	10.8
OFIs	5.8	5.2	4.8	100.0	3.2	6.6	12.4	0.5	2.2	8.0
Household sector	18.8	19.0	20.0	100.0	13.2	11.8	-	2.9	3.8	-
sole proprietors	2.2	1.9	2.1	100.0	16.9	20.7	22.1	9.3	11.9	12.5
households	16.6	17.1	17.9	100.0	12.7	10.7	-	2.1	2.8	-
Non-residents	15.5	15.7	13.9	100.0	12.2	18.9	9.8	7.3	10.9	5.1
Government	2.5	3.1	3.9	100.0	3.3	2.3	0.4	0.6	0.1	0.1
Banks and savings banks	4.4	6.5	7.0	100.0	0.9	1.4	0.3	0.9	0.4	0.2
Central bank	0.3	0.0	0.0	100.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.1	0.1	0.1	100.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	9.2	10.3	11.7	3.3	5.4	6.8

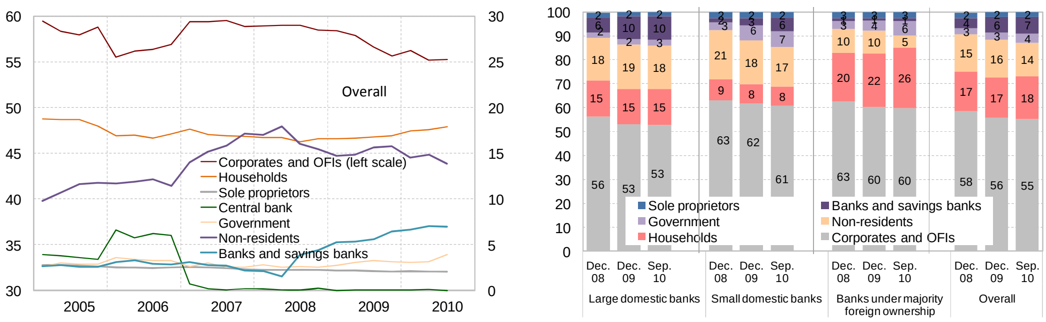
Note: [1] The figures for 2008 and 2009 for households are estimated on the basis of figures from the spring 2010 bank survey. The assessment is also taken into account in the aggregate of households.
Source: Bank of Slovenia, bank survey

Arrears in the settlement of liabilities to banks continue to increase, particularly the arrears of non-financial corporations.

Arrears in clients' settlement of liabilities to banks continue to increase, and point to a further deterioration in the quality of the credit portfolio. The proportion of claims more than 90 days in arrears rose by 1.4 percentage points over the first nine months of 2010 to stand at 6.8% of the banking system's classified claims. Non-financial corporations were notable in 2010 in terms of the rate of growth of arrears. The proportion of classified claims against this client segment more than 90 days in arrears reached 10.8% in September, up 4.2 percentage points on the end of 2009. A higher proportion of longer arrears in the settlement of liabilities to banks was only disclosed by sole traders who, given their small proportion of banks' portfolios, represent inappropriately smaller burdens for the banks.

In 2010 the banks reduced their exposure to non-residents, who until the end of 2009 represented the second highest-risk client segment, immediately following sole traders. They primarily reduced their poorer quality claims, which improved the average quality of claims against this client segment. The proportion of banks' classified claims accounted for by non-residents fell to 13.9% over the first nine months of the year, the proportion of claims more than 90 days in arrears having halved compared with December 2009 to 5.1%.

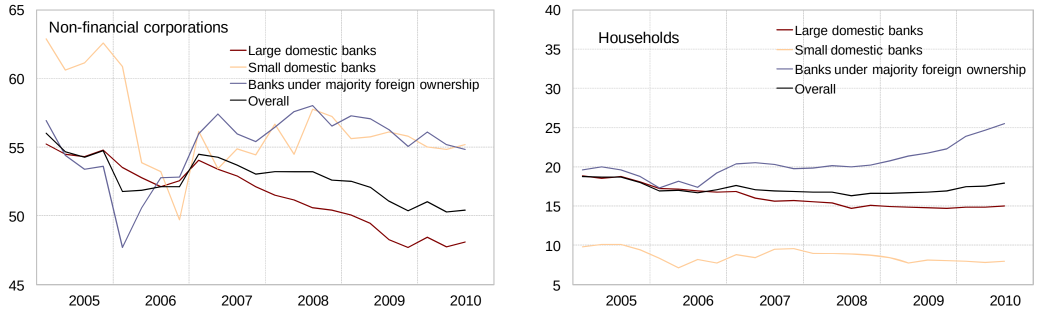
Figure 7.3: Breakdown of classified claims by sector and total (left), and by bank group (right) in percentages



Source: Bank of Slovenia

The total arrears and arrears of more than 90 days of non-monetary financial institutions rose sharply, primarily owing to the arrears of financial holding companies. Together with non-financial holding companies (registered as non-financial corporations), this sector still represents one of the focal points of banks' bad claims.

Figure 7.4: 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

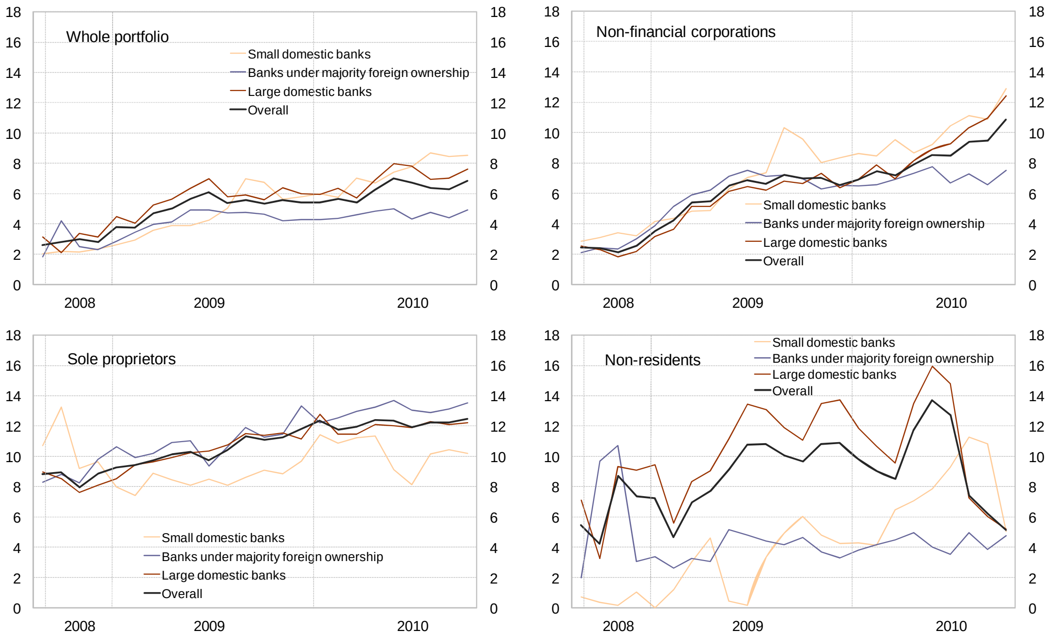
Changes in the structure of the portfolio differ by bank group.

The banks have amended their investment policies taking into account the risk posed by individual groups of clients, which has led to a change in the structure of their portfolios relative to the period prior to the financial turmoil. The most significant change was seen in the credit portfolio of the banks under majority foreign ownership, where the proportion of corporates and OFIs was down 3 percentage points on the end of 2008, and the proportion of non-residents was down 5 percentage points, while the proportion of households was up 6 percentage points over the same period. The proportion of the portfolio accounted for by corporates was also down at the banks under majority domestic ownership (by 3.3 percentage points at the large banks and by 2.4 percentage points at the small banks), while there was no significant change to the proportion of the portfolio accounted for by households. The proportion of non-residents was down 4 percentage points at the small domestic banks and was unchanged over the same period at the large domestic banks.

The portfolio of non-financial corporations is worst in terms of arrears at the small domestic banks, and significantly better at the banks under majority foreign ownership.

Arrears of more than 90 days have risen fastest at the small domestic banks over the last two years, and reached 8.5% of classified claims over the first nine months of the year, representing the highest proportion among all bank groups. At 4.5%, the proportion of longer arrears is significantly lower at the banks under majority foreign ownership. Non-financial corporations account for a similar proportion of the credit portfolio at both of the aforementioned bank groups. There is, however, a concentration of clients with a below average rating at the small banks, which indicates a high and rising proportion of arrears of more than 90 days (12.9%). Non-financial corporations' longer arrears were also up sharply at the large domestic banks. In contrast, there has been no significant change in the portfolio of non-financial corporations in terms of longer arrears at the banks under majority foreign ownership since the middle of 2009, likely owing in part to the more effective and timely collection of claims. The proportion of non-financial corporations' arrears of more than 90 days averages around 7.5%.

Figure 7.5: Arrears of more than 90 days by bank group for various client segments in percentages



Source: Bank of Slovenia

The different quality of the portfolio of non-financial corporation has a decisive impact on the quality of the banking system's overall portfolio owing to the prevailing proportion of non-financial corporations in the structure of bank investments. The quality of this portion of the portfolio has been deteriorating further at the banks under majority domestic ownership since the middle of 2010, while the gap with the banks under majority foreign ownership is widening. In line with the different quality of the portfolio of non-financial corporations, the proportion of non-performing claims at the banks under majority foreign ownership is also lowest at 2.5%, and highest at the small domestic banks at 4.1%.

Table 7.3: Proportions of non-performing claims of non-financial corporations by bank group

	31/12/2008		31/12/2009		30/9/2010	
	Classified claims	Proportion of non-performing claims, %	Classified claims	Proportion of non-performing claims, %	Classified claims	Proportion of non-performing claims, %
Total, EUR million	24,830	1.8	25,096	2.6	25,418	3.5
	Breakdown, %		Breakdown, %		Breakdown, %	
Large domestic banks	56.8	1.9	57.4	3.1	58.8	3.9
Small domestic banks	7.7	3.3	8.2	3.8	8.6	4.1
Banks under majority foreign ownership	35.5	1.3	34.4	1.5	32.6	2.5

Source: Bank of Slovenia

Major differences in the quality of the portfolio between banks groups are also evident in claims against non-residents.

Rising arrears at sole traders is not as pronounced as at non-financial corporations. The quality of this portion of the portfolio is better at the small domestic banks. The differences between the bank groups with respect to non-residents narrowed in the second half of 2010 owing to the liquidation of a portion of claims against non-residents, particularly at the large domestic banks. No new data regarding arrears are available for households (the most recent available data are from surveys for 2009 and 2010). The low proportion of non-performing claims against households (1.6%) and their relatively low growth in 2010 (by 0.2 percentage points) indicate relatively low risk associated with this client segment. There is increased risk of future growth in arrears at non-monetary financial institutions, this growth in arrears being most evident at the large domestic banks. Claims against non-residents represent low risk in terms of arrears at the banks under majority foreign ownership, as the majority of claims relate to investments in foreign financial institutions (primarily in parent banks), while the majority of non-residents at other banks are represented by other foreign (non-financial) sectors.

Box 7.1: Analysis of the ratings structure of the credit portfolio of debtors

The ratings structure of the credit portfolio of debtors is one of the indicators of the banking system's exposure to credit risk. For a bank, all clients represent a certain level of risk of default, but the risk is highest for clients assigned lower ratings.

In the analysis, the ratings structure in 2009 is compared with the structure from previous years, and includes all clients who were indebted to at least one Slovenian bank, have available balance sheet and income statement data and whose total exposure to a bank exceeds EUR 1,000.

The structure of the credit portfolio deteriorated significantly in 2009. The proportion of the lowest risk clients (rated A) fell by more than 5 percentage points in 2009 compared with the average from 2005 to 2008, while the proportion of bad clients (rated D and E) rose by 1.24 percentage points. Among new clients, the proportion of D- and E-rated clients (2.40%) remained low in 2009 as expected, as banks did not approve loans for such clients in most cases. The number of new clients in 2009 was down 26.7% on 2008.

Figure 7.6: Ratings structure for existing and new clients for the period 2005 to 2009

Source: Bank of Slovenia

The reason for the previously described change in the structure of debtors lies in the significant deterioration in macroeconomic conditions in 2009. In line with changes in the economic situation, corporate operating conditions change, and consequently the creditworthiness of corporates. Moreover, the banks become more prudent in assessing the quality of clients during a recession, and are generally more pessimistic in this regard.

The proportion of C-rated clients rose most in 2009 (by 2.09 percentage points) with respect to the average from 2005 to 2008. There were no major downgradings to D and E ratings. There are two main reasons for such behaviour by the banks. First, in this way it is not necessary for the banks to create impairments of the same magnitude as those required had the clients been downgraded to D and E ratings. Second, the banks expect a rapid economic recovery and thus an improvement in client creditworthiness.

From the ratings structure of clients who had a lending arrangement with the same bank for at least five years (from 2005 to 2009), it is evident that the ratings structure has deteriorated over time. After five years, the proportion of clients with the highest rating declined by 9.30 percentage points, while the proportion of D- and E-rated clients rose by 3.91 percentage points. On the one hand, the deterioration in the ratings of the same clients is to be expected, as several factors can arise over the long term that increase the likelihood of the initially assessed credit risk rising. Numerous studies indicate that the majority of credit risk is generated in a period of growth, when the banks apply looser loan approval standards. The majority of credit risk is realised when a reversal occurs in the business cycle. This was also seen in 2009, when the structure of all clients and the structure of clients with a lending arrangement with the same bank for at least five years deteriorated significantly in conjunction with the recession.

Table 7.4: Ratings structure for the same business entities from 2005 to 2009 in percentages

	2005	2006	2007	2008	2009
A	64.22	61.99	60.55	59.86	54.92
B	29.81	30.84	30.83	30.35	31.20
C	3.78	4.14	4.86	5.83	7.88
D	1.58	2.25	2.78	2.75	4.55
E	0.61	0.78	0.99	1.21	1.55
Total	100.00	100.00	100.00	100.00	100.00
Total number	13,848	13,848	13,848	13,848	13,848

Source: Bank of Slovenia

Transition matrices, which illustrate the probability of business entities migrating between ratings, confirms the previous findings, as the probability of a downgrading rose in 2009 compared with the average from 2005 to 2008, while the probability of an upgrading declined. In 2009 there was a significant increase in migration out of the A rating (by 3.9 percentage points), primarily to ratings B and C. By contrast, the probability of upgrading declined. Despite the deteriorating economic situation in 2009, there was a greater probability of an upgrading from the D rating than a downgrading, which indicates the banks' hesitancy to assign clients lower ratings.

Table 7.5: Probability of transitions between ratings in percentages

Average transition matrix, 2005-2008

		Current year				
		A	B	C	D	E
previous year	A	90.98	7.09	1.14	0.52	0.26
	B	9.19	81.71	6.06	2.82	0.21
	C	4.69	15.28	68.69	9.70	1.65
	D	4.35	5.52	5.69	77.57	6.87
	E	3.73	1.46	1.33	1.73	91.74

	Upgrading	No change in rating	Downgrading
A		90.98	9.02
B	9.19	81.71	9.09
C	19.97	68.69	11.35
D	15.56	77.57	6.87
E	8.26	91.74	

Transition matrix 2009

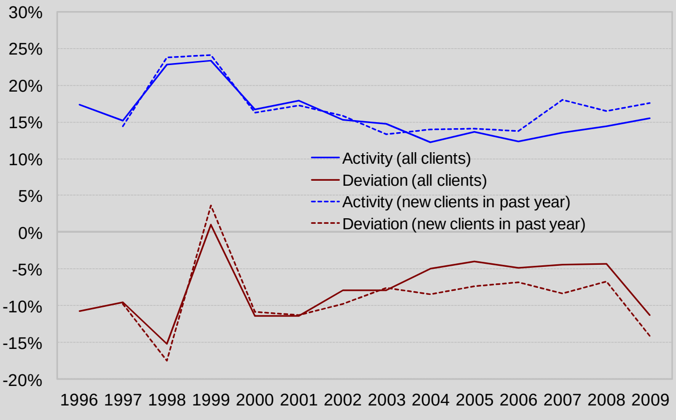
		2009				
		A	B	C	D	E
2008	A	87.09	9.41	2.16	0.97	0.37
	B	3.83	81.90	9.32	4.53	0.42
	C	1.13	9.90	71.07	15.70	2.19
	D	0.46	4.58	5.80	79.24	9.92
	E	0.00	0.54	0.42	1.68	97.06

	Upgrading	No change in rating	Downgrading
A		87.09	12.91
B	3.83	81.90	14.27
C	11.03	71.07	17.89
D	10.84	79.24	9.92
E	2.94	97.06	

Source: Bank of Slovenia

We can derive information regarding changes to the structure of the entire portfolio on the basis of activity and deviation, which are calculated from the transition matrices. The activity illustrates the proportion of corporates whose rating changed during the period in question. The deviation illustrates whether a larger number of corporates underwent a downgrading (negative deviation) or an upgrading (positive deviation). The activity and deviation are illustrated separately for all clients and for clients borrowing anew in the preceding year.

Figure 7.7: Activity and deviation for all clients and for clients borrowing anew in the preceding year



Source: Bank of Slovenia

Relative to the previous year, the activity among all clients in 2009 was up by just over 1 percentage point, while the deviation was up almost 7 percentage points. This is an indication that the majority of clients that migrated in 2009 underwent a downgrading. An increased migration from the A rating, where the majority of clients are concentrated, results in a significant increase in the deviation.

Credit risk assessed on the basis of the ratings structure of clients increased in 2009. A large portion of this increase was on account of a significant deterioration in macroeconomic conditions in 2009, which led to a deterioration in corporate operating conditions. Problems related to corporate liquidity and indebtedness are also rising. Increased credit risk in 2009 was in part driven by the looser standards applied by the banks during a period of economic and lending growth. It can also be derived from the facts presented above that the banks assigned clients lower rating in 2009, and were hesitant to downgrade clients to the lowest ratings (D and E). There is thus the risk of a more significant deterioration in the credit portfolio in the coming years. This has already been seen in 2010, when the proportion of D- and E-rated claims is rising, as is the proportion of corporates with arrears of more than 90 days.

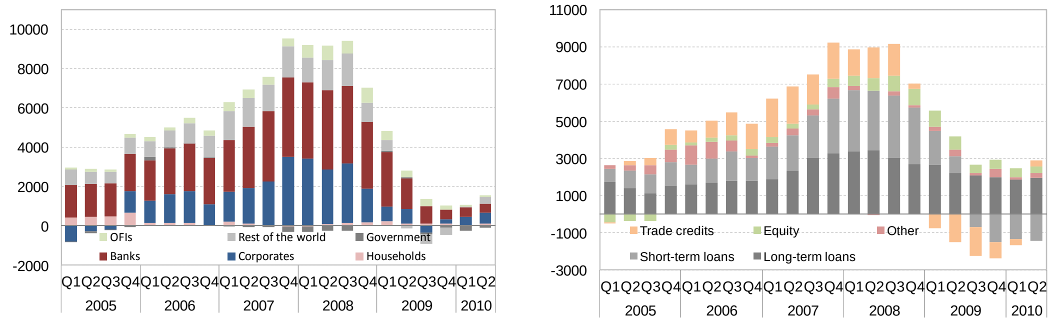
7.2 Non-financial corporations

With the improving economic climate on Slovenian corporates' export markets, opportunities are once again opening for more buoyant economic activity. Orders, particularly from the rest of the world, are rising, while the significance of insufficient demand has diminished as a limiting factor in the operations of manufacturing companies, initially at a modest rate and then more intensely in the second half of the year. Companies from the service sectors are still facing insufficient demand owing to an increased focus on the domestic market. Companies from both sectors still state difficulties in financing as one of the most important limiting factors in operations.[13]

This year's economic activity in the corporate sector has been supported by financing from domestic and foreign partners and via financing from domestic banks.

According to the available figures, the banks had yet to throw their support behind the early stages of the economic recovery by the end of October. Corporate financing via loans has yet to show growth. Figures regarding a recovery in corporate financing during the first half of the year indicate that corporates are turning to other sectors, the rest of the world and other corporates in particular, for sources of financing. The financing of Slovenian corporates via loans strengthened during the first half of 2010, and via trade credits in the second quarter. Financing via trade credit from the rest of the world also increased, which points to efforts being made by foreign partners to stimulate their own activities. With the situation in terms of financing unchanged at the domestic banks, economic growth during the first half of the year was supported by financing from foreign and domestic partners, while we assess that the financing of non-financial corporations by foreign banks also strengthened during the second half of the year.

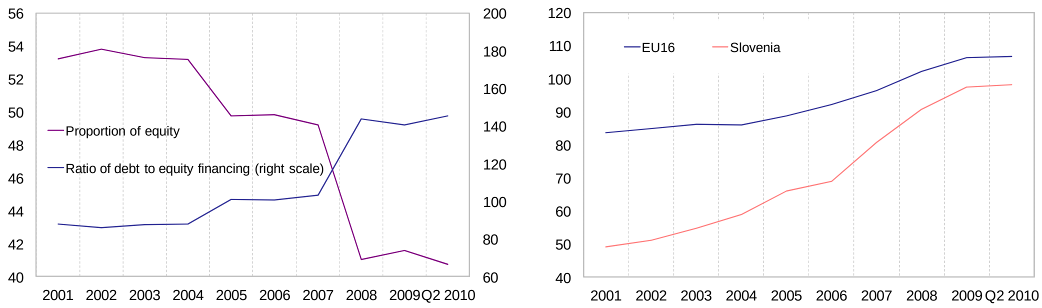
Figure 7.8: Financing flows of non-financial corporations by sector (left) and instrument (right), annual moving total of flows in EUR million



Source: Bank of Slovenia

Sources of financing will be more accessible for larger and economically stronger corporates. If the domestic banks lag behind the foreign banks in adjusting to increased corporate demand for financing, the risk of loss of potential future income will increase.

Figure 7.9: Debt-to-equity ratio in corporate financing (left) and increase in ratio of corporate debt to GDP in Slovenia and the euro area (right)



Source: Bank of Slovenia

The relatively high indebtedness of Slovenian corporates remains an ongoing problem two years following the outbreak of the financial turmoil, which confirms the still-high debt-to-equity ratio in corporate financing. This ratio jumped from 103% prior to the financial crisis to more than 140%, and has remained at a relatively high level in 2010.

[13] Source: SORS

Corporate financing in the rest of the world will be stimulated not only by a possible faster response from foreign banks, but by the high spread in interest rates between Slovenian and euro area banks. In September variable interest rates on new loans at banks in Slovenia were 2.4 percentage points higher than in the euro area, and by slightly less than 2 percentage points on less frequently raised loans with a fixed interest rate (for an initial period of at least one year).

Banks are risking the loss of income with their excessively slow response to the need for corporate financing.

Table 7.6: Banks' classified claims against non-financial corporations by sector, structure and year-on-year growth, in EUR million and percentages

	Loans to non-financial corporations[1]			Classified claims against non-financial corporations					
	Total	Breakdown, %		Total	Breakdown, %	Change in breakdown, percentage points		Year-on-year growth, %	
	2010	2009	2010	2010	2010	2009	2010	2009	2010
Agriculture, forestry, fishing, mining	287	1.4	1.3	333	1.3	0.1	0.0	10.1	5.0
Manufacturing	5,679	26.6	26.5	6,501	25.5	0.2	-0.5	1.9	0.6
Electricity, gas, water, remediation	672	2.9	3.1	1,039	4.1	0.8	0.2	25.2	11.5
Construction	2,442	10.8	11.4	3,484	13.7	0.7	1.1	6.8	11.3
Wholesale and retail trade	4,059	19.1	18.9	4,831	19.0	-1.1	-0.3	-4.3	-0.6
Transportation and storage	2,227	10.0	10.4	2,440	9.6	0.8	0.3	10.9	6.9
Accommodation and food service activities	635	3.0	3.0	700	2.7	0.4	0.0	15.8	1.7
Information and communication activities	484	2.4	2.3	656	2.6	0.0	-0.2	0.1	-9.3
Financial and insurance activities	1,630	7.9	7.6	1,700	6.7	-2.1	-0.3	-22.0	-2.0
Real estate activities	1,089	5.3	5.1	1,180	4.6	0.1	-0.3	2.4	-8.0
Professional, scientific and technical activiti	1,799	8.7	8.4	2,151	8.4	0.0	-0.1	1.2	0.4
Public services	424	1.9	2.0	469	1.8	0.2	0.1	11.8	10.0
TOTAL	21,427	100.0	100.0	25,486	100.0			1.1	2.0

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

In the context of a stagnation in lending to non-financial corporations overall, in 2010 the banks maintained a relatively high supply of loans to the sectors of construction and transportation and storage. The supply of new loans has also been low this year to manufacturing sectors, which are among the first to feel the positive effects of rising foreign demand owing to their export orientation. The proportion of bank loans accounted for by these sectors was down slightly over the first nine months of 2010 to 26.5%. The proportions of loans accounted for by the sectors of construction and transportation and storage rose further, by 0.6 percentage points and 0.4 percentage points respectively. The banks' increasing exposure to the most indebted sectors contributes to the further deterioration of the quality of the baking system's credit portfolio. Maintaining the existing range of clients and investments, and failure to expand the credit portfolio via new projects has a similar adverse effect.

Further growth in lending to the sectors of construction and transportation and storage in the context of stagnation in lending to other sectors.

Table 7.7: Increases in loans by sector in EUR million

	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 (total)
2005	542.9	141.2	489.6	135.3	62.0	296.5	87.1	145.6	1,844.9
2006	581.7	313.0	180.1	236.3	53.6	238.7	294.9	241.0	2,302.6
2007	695.3	616.8	717.7	349.3	84.4	750.9	285.0	553.3	4,516.6
2008	962.0	416.6	720.2	321.1	118.3	253.6	244.5	162.8	3,439.5
2009	46.2	240.3	-184.6	228.5	73.1	-429.4	22.6	63.2	240.5
2010	80.6	182.9	54.4	125.7	10.1	-21.4	-34.4	-25.1	417.7

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

The proportion of non-performing claims against non-financial corporations rose from 2.6% at the end of 2009 to 3.5% in September 2010. Deterioration of the portfolio of non-financial corporations this year was noteworthy in the construction sector, where the proportion of non-performing claims more than doubled to stand at 4.8%. The most significant increase this year and the highest proportion of non-performing claims (6.8%) was achieved by professional, scientific and technical activities. The significant increase in risk in this sector is accompanied by the increased coverage of claims by impairments, which stood at 8.5% in September, compared with 5.7% for non-financial corporations overall. The banks only recorded improved coverage of the portfolio by impairments in

Non-financial corporations: deterioration in the quality of the portfolio of claims against the sectors of construction and professional, scientific and technical activities.

the financial intermediation sector, in which the problem of longer arrears broke out back in the middle of 2009.

Table 7.8: Coverage of classified claims by impairments and proportions of non-performing claims of non-financial corporations by sector

	Impairments of classified claims, EUR million		Coverage of classified claims by impairments, %		Classified claims rated D and E: amount, EUR million	Classified claims rated D and E: as proportion of total classified claims, %	
	2009	Sep 2010	2009	Sep 2010	Sep 2010	2009	Sep 2010
Agriculture, forestry, fishing, mining	23	22	7.0	6.8	15.9	4.9	4.6
Manufacturing	342	361	5.2	5.6	254.9	3.4	3.9
Electricity, gas, water	10	13	1.0	1.3	5.9	0.1	0.5
Construction	154	231	4.9	6.7	167.9	2.2	4.8
Wholesale and retail trade	222	270	4.6	5.6	149.9	3.2	3.1
Transportation and storage	40	63	1.7	2.6	24.9	0.6	1.0
Accommodation and food service activities	28	32	4.0	4.6	19.9	2.9	2.7
Information and communication activities	27	30	4.0	4.6	13.9	1.2	2.0
Financial and insurance activities	133	166	7.5	9.6	51.9	2.6	3.0
Real estate activities	46	61	3.8	5.3	39.9	1.6	3.3
Professional, scientific and technical activities	123	181	5.8	8.5	144.9	3.9	6.8
Public services	14	17	3.1	3.6	7.9	0.8	1.5
Skupaj	1,162	1,447	4.6	5.7	886.9	2.6	3.5

Source: Bank of Slovenia

Corporates' arrears in the settlement of liabilities to banks point to a further increase in non-performing claims and impairments, with an anticipated adverse impact of the banks' profitability and equity. Arrears of more than 90 days already accounted for 10.8% of the banks' portfolio of non-financial corporations in September, meaning a more rapid deterioration in the portfolio relative to 2009 (an increase of 4.2 percentage points compared with an increase of 3.1 percentage points for all of 2009).

The proportion of classified claims accounted for by arrears of more than 90 days ranges from 10% to 20% in the five sectors that account for 36% of all classified claims.

At the end of 2009, only in the financial intermediation sector did the proportion of arrears of more than 90 days exceed one tenth of the portfolio. In September the aforementioned sector was joined by construction (18.7%), real estate activities (11%), professional, scientific and technical activities (15.4%) and information and communication activities (20.1%). The five aforementioned sectors account for 36% of all classified claims of non-financial corporations.

The problem of longer corporate arrears in the financial intermediation sector is particularly pressing at the large domestic banks, where 22.9% of claims are more than 90 days in arrears. That proportion has fallen below 10% at the other bank groups. Corporates in arrears from the construction sector represent a significant burden on the portfolios of the small domestic banks, where nearly one quarter of claims against the construction sector are more than 90 days in arrears. The proportion of such claims is significantly lower in the portfolio of the banks under majority foreign ownership at 14%.

The proportion of longer arrears in claims against corporates from the retail sector is above-average at the small domestic banks at 11.2%, but below 8% in the other bank groups.

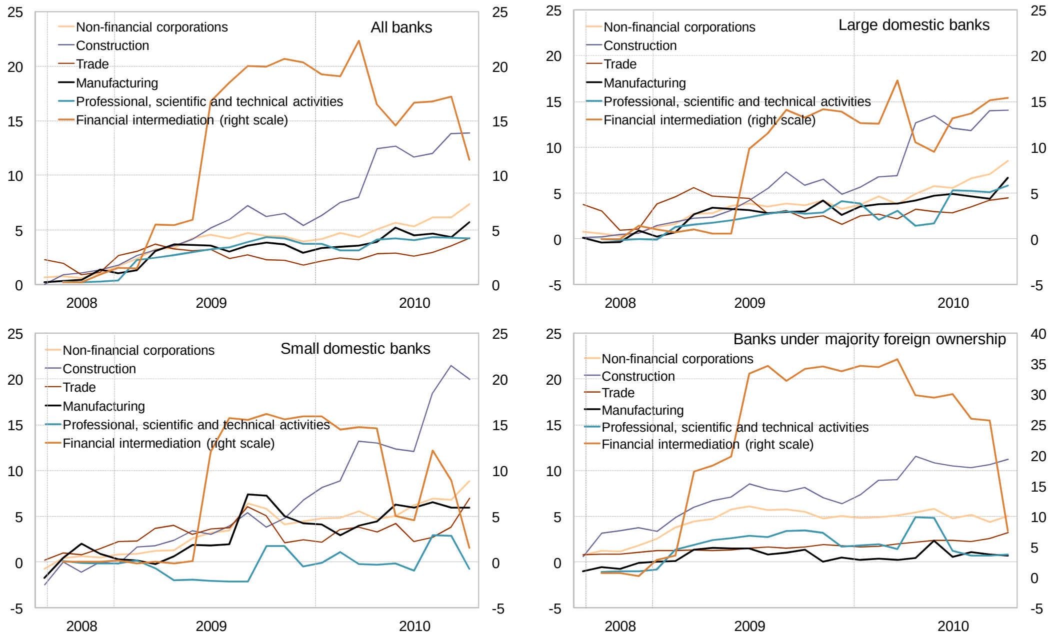
Table 7.9: Arrears of non-financial corporations by sector

	No. of corporates with arrears	Proportion of corporates at banks with arrears, %			Average no. of days in arrears	Proportion of classified assets of corporates in arrears in bank portfolio, %		
		Total	With arrears of over 90 days			Total	Arrears of over 90 days	
		Sep. 10	Dec. 09	Sep. 10		Sep. 10	Dec. 09	Sep. 10
Agriculture, forestry, fishing, mining	42	18.5	12.0	13.2	418	11.6	5.5	5.1
Manufacturing	764	19.1	11.0	12.5	344	15.7	6.3	9.6
Electricity, gas, water, remediation	24	8.8	3.7	4.0	69	4.4	0.8	0.8
Construction	832	28.1	15.2	21.2	276	28.2	7.7	18.7
Wholesale and retail trade	1251	18.8	13.1	13.6	485	12.9	5.1	7.3
Transportation and storage	317	23.4	15.0	17.1	145	15.4	1.9	6.7
Accommodation and food service activities	261	25.3	16.9	18.6	330	14.0	7.9	7.7
Information and communication activities	146	10.8	6.0	7.8	186	26.0	1.8	20.1
Financial and insurance activities	26	17.0	13.8	13.1	209	27.7	21.6	16.8
Real estate activities	153	23.0	10.8	13.5	222	22.3	4.8	11.0
Professional, scientific and technical activities	580	11.5	6.9	8.2	298	25.2	7.6	15.4
Public services	135	10.8	6.1	6.8	275	7.3	2.2	3.0
Total	4,532	18.1	11.1	12.9	298	18.3	6.6	10.8

Source: Bank of Slovenia

The widening of the gap between growth in longer arrears and non-performing claims indicates a likely increase in non-performing claims in the future. The downgrading of claims has lagged considerably for corporates from the construction sector at the large domestic banks, and even more so at the small banks. Despite their above-average proportion of non-performing claims in the highest-risk sectors, the small domestic banks do not exceed the rapid growth in claims with longer arrears in the sectors of retail trade and construction.

Figure 7.10: Difference between the arrears of non-financial corporations of more than 90 days and the proportion of non-performing claims by bank group in percentages



Note: The figures were previously quarterly, but are monthly from March 2001 onwards.
Source: Bank of Slovenia

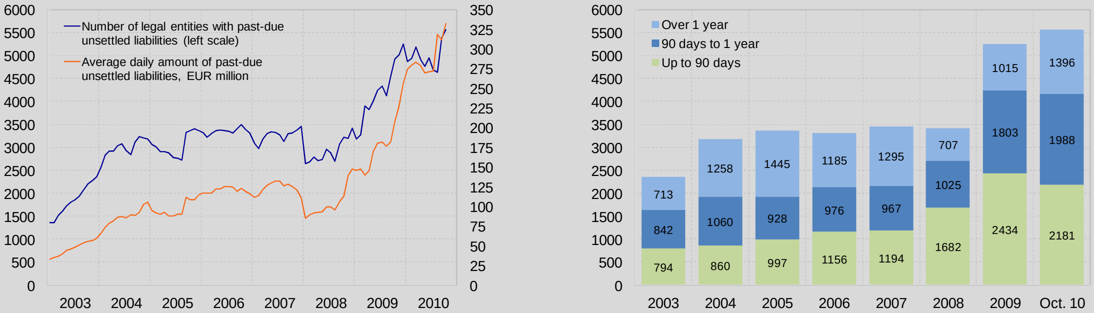
The structure of the portfolio at the banks under majority foreign ownership has followed the quality of clients in terms of longer arrears better than at the domestic banks. The reason is not so much due to the downgrading of claims, as it is due to more prudent exposure to risk and likely owing to the more successful collection of claims in arrears.

Box 7.2: Growing past-due corporate liabilities

The fact that past-due corporate liabilities are growing not only to banks but to the government and other corporates as well warns of increasing liquidity problems in the corporate sector. Judging solely on the basis of developments in past-due corporate liabilities, the crisis has intensified in Slovenia this year.

The problem of payment indiscipline is illustrated by AJPES figures regarding unsettled past-due liabilities. The AJPES figures only include figures from court enforcement orders and from official tax debts, but not the remaining unsettled liabilities from unpaid invoices between creditors and debtors. The problem of financial indiscipline is thus more severe than indicated by the AJPES figures.

Figure 7.11: Number of legal entities with unsettled past-due liabilities and average daily amount of unsettled past-due liabilities (left), and the number of legal entities according to the unbroken period of unsettled past-due liabilities (right)



Source: AJPES

The number of legal entities with unsettled past-due liabilities rose by 14% over the first ten months of 2010 to stand at 5,565 at the end of October. The average daily amount of unsettled past-due liabilities increased even more (by 29.6%) over the same period. The period in which liabilities are settled in arrears has lengthened: the number of legal entities with unsettled liabilities more than 90 days in arrears has risen by 20.1%, while the number of legal entities with unsettled liabilities less than 90 days in arrears has declined by 10.4%.

In 2010 the number of legal entities and the average daily amount of unsettled past-due liabilities remain highest in the construction sector, while the retail sector is also worthy of note.

Table 7.10: Number of legal entities with unsettled past-due liabilities and average daily amount of unsettled past-due liabilities, total and largest sectors

	No. of legal entities			Average daily amount, EUR million		
	Dec. 08	Dec. 09	Oct. 10	Dec. 08	Dec. 09	Oct. 10
Total	3,414	5,252	5,565	147.3	256.7	332.7
Construction	732	1,288	1,234	27.0	78.2	96.7
Financial and insurance activities	41	55	76	24.1	46.2	48.9
Wholesale and retail trade	806	1,083	1,217	32.2	38.1	44.9
Manufacturing	431	662	693	18.5	28.9	35.6
Professional, scientific and technical activities	354	537	610	17.6	20.8	33.7
Other	1,050	1,627	1,735	27.9	44.5	72.8

Source: AJPES

Payment indiscipline is a complex systemic problem, which is worrisome in Slovenia not only due to its extent and growth, but primarily owing to the previous ineffective measures to resolve the issue. At the same time, entrepreneurs also have an impact on payment indiscipline through their operational behaviour (i.e. through the use of inadequate forms of payment collateral). The long-term development of payment indiscipline has been facilitated by the Slovenian business environment, which is not restrictive enough with respect to debtors and presents too much of burden for creditors (an example of this is the complexity of protracted enforcement proceedings). Small enterprises and sole traders in particular are affected by the latter, depending on their operations with larger corporates.

In contrast to Slovenia, the problem of financial liabilities settled in arrears has eased in the majority of European countries. The payment duration in days declined by 1 day this year to 18 days. However, the proportion of such claims has risen from 2.4% to 2.6%. A comparison between countries (in which Slovenia was not included) indicates that contractual deadlines and payment delays are shortest in the Scandinavian countries, Germany and Austria, and longest in Italy, Greece, Spain and Portugal.[1]

[1] Source: European Payment Index 2010 (http://economico.sapo.pt/public/admin/tinymce/jscripts/tiny_mce/plugins/filemanager/files/intrumjustitia.pdf)

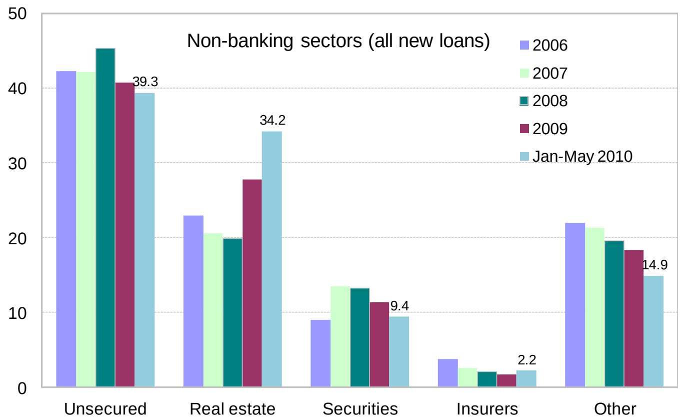
7.3 Loan collateral

Breakdown of collateral for newly approved loans

Banks tightened their loan collateral standards further in 2010.

The banks tightened their collateral standards further in 2010. Over the first five months of the year, the proportion of unsecured newly approved loans was lower than in the previous four years. Despite the aforementioned decline, that proportion remains relatively high for the banking system overall, at 39.3%, owing to changes in the sectoral and maturity breakdown of loans. Changes in collateral are more pronounced at the sectoral level and in terms of loan type, and better reflect the banks' tightened policies with regard to collateral.

Figure 7.12: Breakdown of collateral for new loans to non-banking sectors in percentages



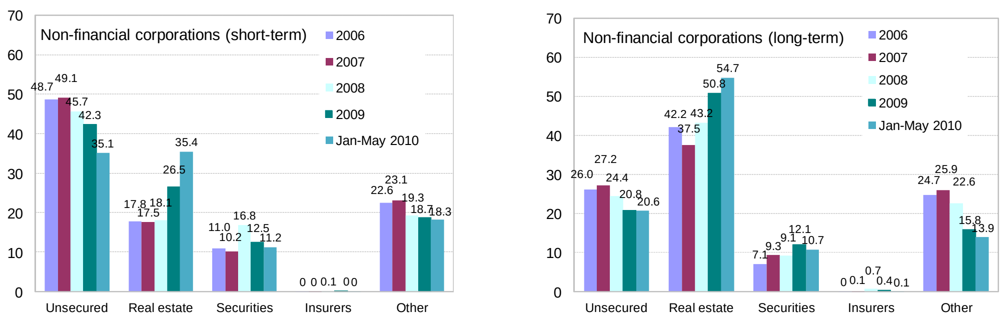
Source: Bank of Slovenia

Collateral on corporate loans: the proportion of unsecured loans is declining in the context of a rising proportion of loans secured by real estate collateral.

Non-financial corporations have been hit harder by the tightening of collateral standards than households, which is to be expected given the differences in the risks presented by these client segments. The proportion of unsecured loans accounted for by short-term loans to non-financial corporations fell by 3.4 percentage points in 2009, and by an additional 7.2 percentage points over the first five months of 2010 to stand at 35.1%. The proportion of new unsecured loans accounted for by long-term loans is lower: having fallen to just under 21% in 2009, that proportion remained unchanged in 2010.

The increasing importance of real estate collateral continued in 2010. The proportion of new loans to non-financial corporations with real estate collateral rose sharply. Over the first five months of 2010, the banks received real estate collateral for 55% of newly approved long-term loans and 35% of short-term loans to non-financial corporations. The growing role of this form of collateral in 2009 and 2010 is the result of the high number of loans to the construction sector as a proportion of newly approved loans in the aforementioned period.

Figure 7.13: Breakdown of collateral for new short-term loans (left) and long-term loans (right) to non-financial corporations in percentages



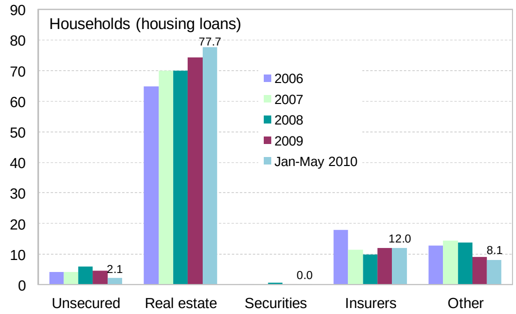
Source: Bank of Slovenia

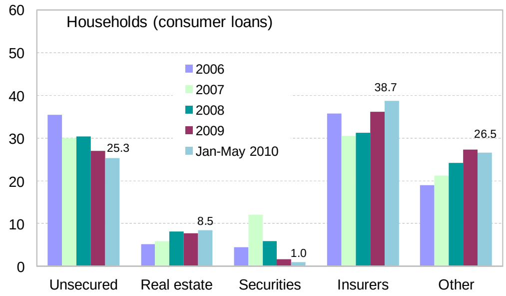
Collateral on household loans: rising proportion of loans secured by real estate collateral and via insurers for consumer loans.

Household loans are most frequently secured with real estate and with insurers, depending on the type of loan. The proportion of other forms of collateral (e.g. bank guarantees, deposits, sureties and other forms) and the proportion of unsecured loans are declining.

The proportion of housing loans secured by real estate rose to 78%, primarily owing to a decline in other forms of collateral. At 39% and rising, insurers represent the prevailing form of collateral for consumer loans.

Figure 7.14: Breakdown of collateral for new housing loans (left) and consumer loans (right) to households in percentages





Source: Bank of Slovenia

Coverage of the credit portfolio by collateral

The highest proportion of banks' unsecured claims is against non-residents, while the lowest proportion of unsecured claims is against households.

The proportion of the banking system's credit portfolio accounted for by unsecured loans was down owing to stricter loan approval terms. The proportion of unsecured loans fell to 43.3% in September, compared with nearly 50% at the end of 2009. That proportion is significantly higher for newly approved loans owing to lower standards in the past and the high proportion of loans with the shortest maturities. The highest proportion of the banking system's unsecured claims is against the government and banking sectors, which is in line with the short maturities of these claims and the low level of risk. Non-residents stand out among other client segments, with the highest proportion of unsecured loans at 66%. Claims against foreign financial institutions with the shortest maturities represent a large portion of claims against non-residents, while the banks' exposure to this client segment declined this year in the highest-risk portion of the portfolio. The proportion of unsecured claims against households recorded the sharpest decline of 10 percentage points. Claims against households remain the best secured segment of claims given the relatively low level of risk with respect to households, as reflected in a relatively low proportion of liabilities paid in arrears and a low proportion of non-performing claims.

Table 7.11: Collateral for classified claims by client segment at the end of September 2010 in percentages

		Ratio of collateral[2] to classified claims, %							
		Unsecured[1]							
	Classified claims, EUR million	Sep 2010	Change since Dec 2009, percentage points	Shares, other equity and mutual fund units	Commercial property[3]	Residential property[3]	Insurer	Other form of collateral	Total collateral[3]
Corporates	25,253.5	34.1	-6.5	10.8	68.6	6.1	0.0	38.2	123.7
OFIs	2,360.6	53.1	-0.8	23.3	8.6	0.4	0.0	30.8	63.2
Households	10,057.1	22.3	-10.0	1.0	15.1	80.3	17.3	23.3	137.1
Non-residents	6,889.2	66.7	-3.4	4.3	25.7	2.4	0.3	20.7	53.4
Government	1,973.7	77.6	-5.7		2.0	0.2		21.2	23.5
Banks and savings banks	3,533.7	95.8	-0.8			0.0		5.9	5.9
Central bank	2.6	100.0							
Other	49.5	100.0							
Total	50,119.8	43.3	-6.1	7.3	41.6	19.6	3.5	29.5	101.5

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 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.

Source: Bank of Slovenia

High coverage of claims against households and corporates by real estate.

The coverage of classified claims by real estate collateral improved further this year. Measured at fair value, real estate collateral covers 61% of classified claims, up 11 percentage points on the end of 2009. The banks had the highest coverage of classified claims by real estate (both residential and commercial property) for their claims against corporates (75%) and their claims against households (95%). The coverage of claims by real estate in both of the aforementioned client segments improved further relative to the end of 2009.

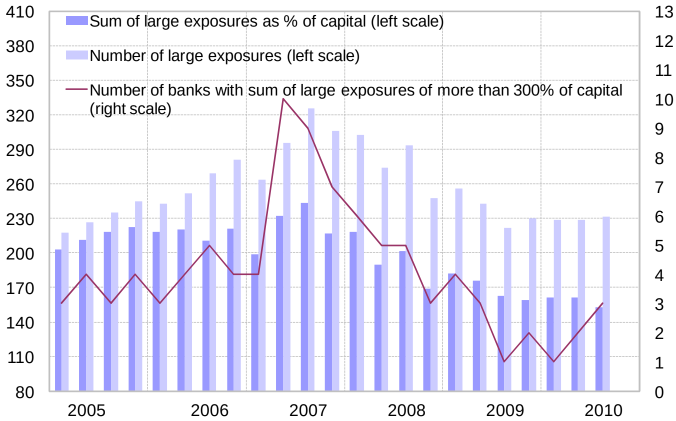
The total value of collateral received is 24% higher than the value of total claims against corporates and 37% higher than the value of claims against households, including unsecured claims.[14] Coverage by collateral is less than 100% for the remaining client segments.

7.4 Large exposures

The number of large exposures was unchanged, while the sum of large exposures was down.

Having declined last year, the number of large exposures remained at the level recorded at the end of 2009 over the first three quarters of 2010. The number of large exposures stood at 230 in September. The sum of large exposures demonstrated a similar dynamic over the first six months of the year and then fell to 153% of the banking system's capital in the third quarter. The sum of large exposures exceeded 300% of capital at three banks in September.

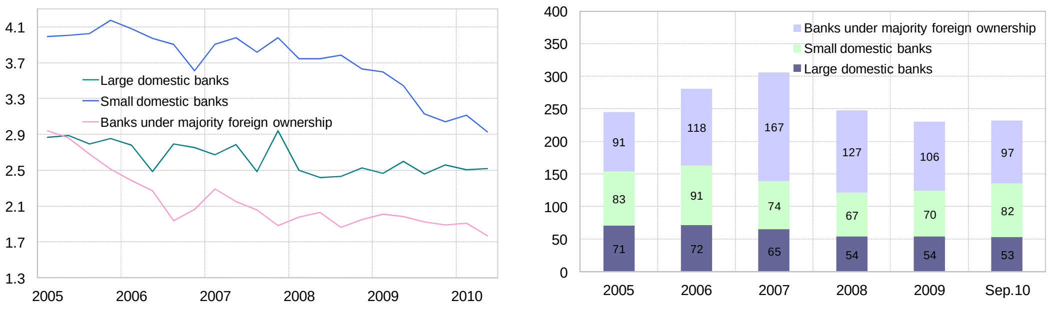
Figure 7.15: Sum and number of the banking sector's large exposures



Source: Bank of Slovenia

Exposure to credit risk as measured by large exposures declined until September 2010 at the small domestic banks and at the banks under majority foreign ownership. The average size of large exposures fell by 0.2 percentage points at these two bank groups, to 2.9% of regulatory capital at the small domestic banks and to 1.8% at the banks under majority foreign ownership. The average size of large exposures was up 0.1 percentage points at the large domestic banks to 2.5% of regulatory capital, the level at which it has fluctuated since the beginning of 2009.

Figure 7.16: Average size of large exposures as a percentage of regulatory capital (left) and number of large exposures by bank group (right)



Source: Bank of Slovenia

[14] 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 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.

8 INTEREST-RATE RISK

Interest-rate risk as measured by the difference between the average repricing periods of asset and liability interest rates rose over the first ten months of 2010, but remained below the level prior to the outbreak of the financial turmoil. The aggregate 1-year cumulative gap turned distinctly short in 2010 owing to the restructuring of liabilities and the reprogramming of assets, meaning an increase in interest-rate risk in the context of rising interest rates. The lengthening of already long positions in key reference interest rates mitigates interest-rate risk to a lesser degree owing to the anticipated rise in interest rates.

Given the movements in interest rates on futures contracts, market interest rates are expected to continue rising, increasing the likelihood of an increase in interest-rate risk.

At 2.1 percentage points in September 2010, the difference between the average asset and liability interest rates was similar to the level recorded at the end of 2009.

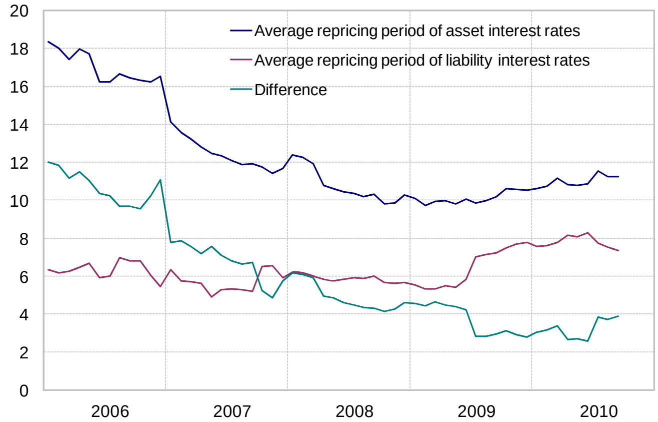
8.1 Average repricing periods for interest rates

The difference between the average repricing period for asset and liability interest rates widened.

Interest-rate risk as measured by the difference between the average repricing periods for asset and liability interest began to rise in the second half of 2010 in conjunction with the shortening of the average repricing period for liability interest rates. The shortening of maturities on funds raised at foreign banks and fewer issues of new securities in 2010 had the greatest impact on the shortening of the repricing period for liability interest rates. This shortening is expected to continue, particularly if the banks are unable to substitute maturing (short-term) sources with fixed-rate sources with longer maturities.

The average repricing period for asset interest rates lengthened by 0.7 months over the first three quarters of 2010, while the average repricing period for liability interest rates shortened by 0.4 months. In September 2010 the average repricing period for asset interest rates was 3.9 months longer than the average repricing period for liability interest rates, up 1.1 months on the difference at the end of 2009. The difference remains relatively low with regard to the previous year, and does not represent a more serious increase in interest-rate risk.

Figure 8.1: Average repricing period for interest rates in months



Source: Bank of Slovenia

Interest-rate risk increased most over the first three quarters of 2010 at the banks under majority foreign ownership.

A comparison between the bank groups indicates significant differences in the dynamic of interest-rate risk measured by the difference between the average repricing period for asset and liability interest rates. The value of this indicator is lowest at the large domestic banks, where it stood at 3.5 months at the end of September 2010, up 0.8 months on the end of 2009. The large domestic banks did not issue bonds of significant value in 2010, and those issued in 2009 were mainly 3-year bonds. The aforementioned indicator deteriorated sharply at the banks under majority foreign ownership (by 2.3 months to stand at 4.2 months at the end of September 2010), primarily owing to the shortening of the average repricing period for liability interest rates.

8.2 Interest-rate gap

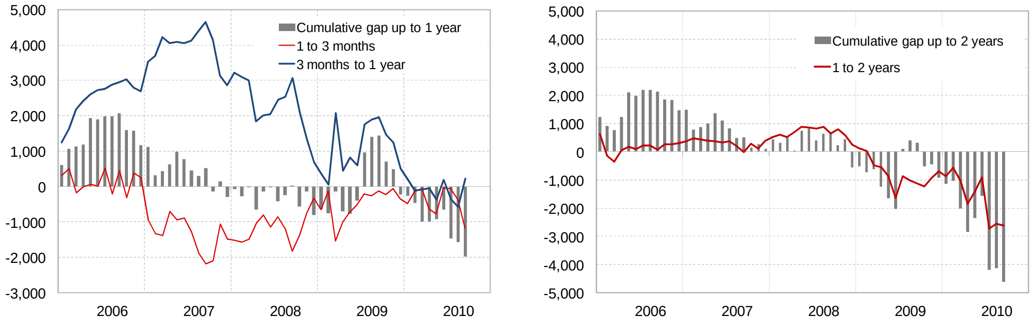
In terms of the cumulative interest-rate gap, in 2010 exposure to a rise in interest rates rose to EUR 2 billion in the interval of up to 1 year. The value of assets with a residual maturity of up to 1 year is declining faster than the value of liabilities. The negative interest-rate gap of up to 1 year widened sharply at the banks under majority foreign ownership, primarily as the result of declining claims from loans. The reasons lie in the longer maturities on newly approved housing loans and the reclassification of revolving loans to long-term.

The interest-rate gap of up to 1 year widened sharply at the banks under majority foreign ownership.

The widening of the negative gap of up to 1 year is the result of the widening of the negative interest-rate gap of 1 to 3 months. The interest rate gap of 3 months to 1 year fluctuated at around zero in 2010, with slightly higher fluctuations on the negative side.

Thus, similar to the negative interest rate gap of up to 1 year, the negative gap of 1 to 2 years also widened significantly in 2010. The reason lies in an increase in liabilities at the large domestic banks owing to the issue of 3-year bonds by NLB in the amount of EUR 1.5 billion in the middle of 2009 and by Abanka in the amount of EUR 0.5 billion in September 2009.

Figure 8.2: Gap between interest-sensitive assets and liabilities by individual bucket in EUR million



Source: Bank of Slovenia

8.3 Basis risk

At the end of the third quarter of 2010, interest-sensitive assets exceeded interest-sensitive liabilities by EUR 1.8 billion, or 3.5% of the banking system's total assets. This gap has narrowed by 2.5 percentage points since the end of 2009. There was a decline in interest-sensitive assets and liabilities in 2010, the former having declined significantly more. At the end of September 2010, interest-sensitive assets and liabilities represented 93% and 90% of total assets respectively.

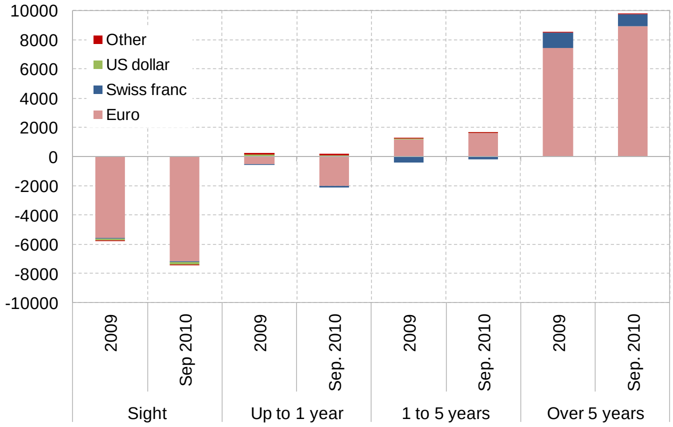
Interest-sensitive assets increased by 5% over the first nine months of 2010.

Interest-rate gaps by currency

The banks are primarily exposed to a rise in interest rates in the domestic currency and in Swiss francs. They are also slightly exposed to the US dollar, primarily in shorter maturity buckets.

There were no major changes in the currency breakdown of interest-sensitive items. The appreciation of the Swiss franc resulted in a decline in the proportion of interest-sensitive items accounted for by that currency, while the proportion accounted for by the domestic currency rose. The proportion of the net interest-rate position accounted for by the domestic currency was up 1.8 percentage points in 2010.

Figure 8.3: 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 proportions of interest-sensitive assets and interest-sensitive liabilities tied to reference interest rates rose.

Another source of interest-rate risk is mismatching in the structure of interest-sensitive assets and liabilities with respect to the type of reference interest rate. At the end of September 2010, the proportion of interest-sensitive items tied to reference interest rates was up 6 percentage points on the end of 2009 at nearly 60% on the asset side, and up 2 percentage points to more than 35% on the liability side. The gap between the proportion of interest-sensitive assets and liabilities tied to reference interest rates thus rose to 24 percentage points.

Table 8.1: Structure of interest-sensitive assets and liabilities by reference interest rate

	Interest-sensitive assets				Interest-sensitive liabilities			
	Dec. 07	Dec. 08	Dec. 09	Sep. 10	Dec. 07	Dec. 08	Dec. 09	Sep. 10
Stock, EUR million	40,173	45,440	49,368	47,619	37,919	42,426	46,168	45,834
Proportion with reference rate, %	59.6	65.4	53.0	59.7	38.3	39.2	33.2	35.3
	Proportion of items tied to a reference rate accounted for by individual reference rate, %							
EURIBOR								
1-month	19.6	17.4	8.2	6.6	23.2	18.6	10.7	7.4
3-month	23.0	24.0	29.3	28.4	24.7	28.2	31.3	35.5
6-month	45.7	47.0	51.7	54.4	41.1	41.4	46.9	45.5
1-year	2.2	1.9	2.1	1.9	1.3	1.6	0.4	1.1
Swiss franc LIBOR								
1-month	1.1	0.7	0.5	0.4	0.2	0.4	0.3	0.2
3-month	1.8	2.2	1.8	1.5	2.5	3.0	3.3	3.9
6-month	2.5	3.2	3.1	2.9	1.6	3.2	2.4	1.5
1-year	1.5	1.6	1.6	1.5	1.9	1.6	1.2	0.8
Central bank interest rate	0.1	0.1	0.2	1.5	0.0	0.0	2.6	2.5
Other	2.4	1.9	1.5	1.0	3.5	2.1	1.1	1.6

Source: Bank of Slovenia

Around 90% of interest-sensitive assets and liabilities are tied to the EURIBOR.

The most frequently used reference interest rate on both the asset and liabilities sides is the EURIBOR, in particular the 6-month EURIBOR. The proportion of assets tied to the 6-month EURIBOR was up over the first ten month of 2010, while the decline in the proportion of assets tied to the 1-month EURIBOR was more notable. The proportion of liabilities tied to the 3-month EURIBOR was up, while the proportion of items tied to the 1-month EURIBOR was down.

The proportion of items tied to the second most important reference interest rate, the Swiss franc LIBOR, is declining owing to repayments and a halt in the approval of new loans tied to the Swiss franc. The Swiss franc LIBOR accounts for 6.3% of interest-sensitive assets and liabilities.

The long positions in key interest rates lengthened over the first nine months of 2010.

The banks lengthened their long positions in the majority of key reference interest rates (the exception being the 3-month EURIBOR) over the first ten months of 2010, which is favourable in the context of an expected rise in reference interest rates.

Table 8.2: Interest-rate gap in interest-sensitive items by type of reference interest rate in percentages

(%)	Overall net position				Net position by bucket, Sep 2010			
	Dec. 07	Dec. 08	Dec. 09	Sep. 10	Sight	Up to 1 year	1 to 5 years	Over 5 years
EURIBOR								
1-month	3.3	4.6	1.0	1.4	0.0	0.0	-0.1	1.6
3-month	4.8	5.4	5.8	4.9	0.0	1.4	-0.4	3.9
6-month	12.4	15.6	12.8	17.0	0.0	2.4	6.8	7.8
1-year	0.9	0.7	1.0	0.8	0.0	0.1	0.1	0.6
Swiss franc LIBOR								
1-month	0.6	0.3	0.2	0.2	0.0	0.0	0.0	0.1
3-month	0.2	0.3	-0.1	-0.4	0.0	0.1	-0.2	-0.4
6-month	0.9	0.9	0.9	1.2	0.0	0.0	-0.2	1.5
1-year	0.2	0.5	0.5	0.6	0.0	0.0	-0.1	0.7

Source: Bank of Slovenia

9 CURRENCY RISK

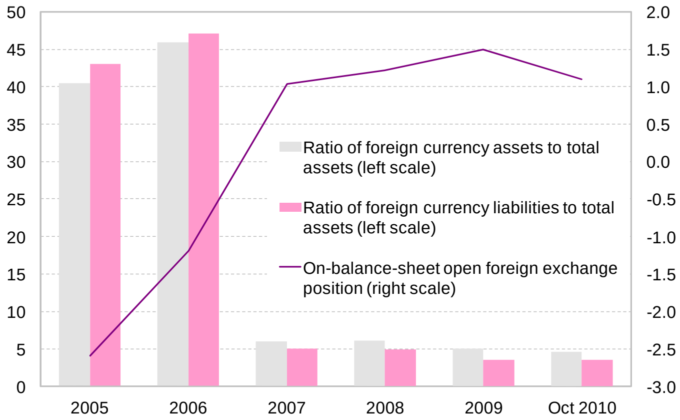
Currency risk remained low in September 2010.

The Slovenian banking system's currency risk remained low over the first nine months of 2010. The net open foreign exchange position stood at 0.9% of regulatory capital. The large domestic banks are most exposed to currency risk, with a long net foreign exchange position of 1.4% of regulatory capital. The banking system's most open foreign exchange position was in collective investment undertakings at EUR 50.3 million or 1.1% of regulatory capital.

The on-balance sheet long foreign exchange position declined.

The proportion of total assets accounted for by foreign currency assets fell to 4.6% in October 2010, while the proportion of foreign currency liabilities remained at the level recorded in 2009, at 3.5%. As a result, the on-balance sheet long foreign exchange position declined to 1.1% of the banking system's total assets.

Figure 9.1: Foreign currency assets, foreign currency liabilities and on-balance-sheet open foreign exchange position as a percentage of total assets



Source: Bank of Slovenia

9.1 Currency breakdown and open foreign exchange position

The banking system's on- and off-balance sheet items were up slightly in September 2010 compared with the previous year, in part as the result of the appreciation of the Swiss franc and US dollar, which account for the majority of assets and liabilities exposed to currency risk.

Table 9.1: Currency breakdown of on- and off-balance sheet assets and liabilities

	December 2008		December 2009		September 2010	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Total foreign currency other than euros, EUR million	3,942	3,932	3,383	3,342	3,669	3,629
year-on-year growth, %	-78.4	-78.5	-14.2	-15.0	3.8	3.9
Breakdown of foreign currency other than euros			(%)			
Global currencies	94.7	95.9	90.4	92.4	91.5	93.3
Swiss franc	61.0	61.6	61.3	62.4	59.3	60.4
pound sterling	1.9	1.9	1.8	1.9	1.3	1.3
US dollar	30.3	31.0	25.5	26.3	29.2	29.8
Canadian dollar	0.4	0.4	0.7	0.7	0.5	0.4
Japanese yen	0.7	0.7	0.7	0.7	0.8	0.9
Australian dollar	0.4	0.4	0.4	0.4	0.5	0.4
EEA currencies	2.2	2.2	3.9	3.8	3.5	3.4
Other currencies	2.2	1.9	4.2	3.8	3.6	3.3
CIU	1.0	0.0	1.4	0.0	1.4	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 stood at EUR 40 million of 0.9% of regulatory capital in September 2010.

At EUR 40 million or 0.9% of regulatory capital, the banking system's net open foreign exchange position in September 2010 was at a similar level to that recorded at the end of 2009. This is less than the on-balance sheet foreign exchange position, which also includes off-balance sheet instruments such as futures contracts, options and guarantees used by the banks to hedge against exchange rate fluctuations. The banking system held a net short foreign exchange position in major global currencies, and is therefore exposed to the risk of the appreciation of these currencies against the euro. Movements in the Swiss franc and US dollar exchange rates in particular were unfavourable for the banking system in 2010. Long net foreign exchange positions were recorded primarily in investment units and in other currencies, including those of the former Yugoslav republics. These currencies (in particular the Serbian dinar) have depreciated sharply over the last year, and are expected to depreciate further against the euro in 2011, which represents potential losses for the banking system owing to the long net foreign exchange positions in these currencies. Nevertheless, currency risk for the Slovenian banking system is low owing to the low values of open foreign exchange positions. The open foreign exchange position according to the Bank of Slovenia's definition deriving from capital requirements stood at EUR 87.2 million or 1.9% of regulatory capital in September 2010.

Table 9.2: Open foreign exchange positions by currency in EUR million equivalent

	Net position			Larger of sum of long positions and sum of short positions		
	Dec. 2008	Dec. 2009	Sep. 2010	Dec. 2008	Dec. 2009	Sep. 2010
Global currencies	-39.5	-28.9	-28.0	49.5	37.1	40.5
US dollar	-22.9	-14.7	-13.2	26.8	19.1	19.6
Swiss franc	-19.2	-12.3	-14.8	19.6	14.6	17.7
other (GBP, CAD, AUD, JPY)	2.6	-1.8	-0.1	5.7	3.4	3.2
EEA currencies	1.1	4.9	5.2	4.4	5.0	5.3
Other currencies	9.9	17.2	12.5	10.1	25.2	19.1
CIU	38.0	48.2	50.3	38.0	48.2	50.3
Total	9.5	41.4	40.0	62.6	86.6	87.2
As % of regulatory capital	0.2	0.9	0.9	1.5	1.9	1.9

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 large domestic banks were most exposed to currency risk, with a long net foreign exchange position of 1.4% of regulatory capital in September 2010.

Table 9.3: Open foreign exchange positions by bank group, September 2010, in EUR million

	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Overall
Global currencies	-22.3	1.0	-6.9	-28.0
US dollar	-12.1	0.1	-1.2	-13.2
Swiss franc	-9.0	0.5	-6.3	-14.8
other (GBP, CAD, AUD, JPY)	-1.2	0.4	0.6	-0.1
EEA currencies	4.7	0.3	0.2	5.2
Other currencies	9.7	2.1	0.7	12.5
CIU	50.1	0.2	0.0	50.3
Total	42.3	3.7	-6.0	40.0
As % of regulatory capital	1.4	0.9	-0.6	0.9

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

9.2 Borrowing in Swiss francs

Year-on-year growth in Swiss franc lending to non-banking sectors was negative.

Borrowing in Swiss francs was affected in 2010 by the sharp appreciation of that currency. Year-on-year growth in Swiss franc loans to non-banking sectors stood at -9.1% in October 2010. The value of new housing loans to households in Swiss francs was up 1.2% in year-on-year terms in October 2010. This increase is the result of the sharp appreciation of the Swiss franc, which increases the stock of Swiss franc loans expressed in euros. The banks approved very few new housing loans in Swiss francs in 2010. Expressed in Swiss francs, year-on-year growth in loans to non-banking sectors and housing loans to households in Swiss francs stood at -17.6% and -8.2% respectively in October 2010.

Table 9.4: Stock and year-on-year growth of loans in Swiss francs or with a currency clause tied to the Swiss franc

	Non-banking sectors	Non-financial corporations	OFIs	Government	Households: All loans	Households: Housing loans
	Stock of loans, EUR million					
2008	2,403.8	743.6	226.6	7.4	1,426.2	1,125.8
2009	1,891.4	464.8	173.3	6.4	1,246.9	1,034.9
Oct. 2010	1,760.5	415.4	126.7	5.6	1,212.3	1,050.3
	Year-on-year growth, %					
2008	21.1	-5.1	34.7	-0.2	39.1	46.3
2009	-21.3	-37.5	-23.5	-13.5	-12.6	-8.1
Oct. 2010	-9.1	-16.2	-27.8	-15.6	-3.7	1.2

Source: Bank of Slovenia

The proportion of Swiss franc loans is gradually declining.

The proportion of loans to non-banking sectors tied to the Swiss franc exchange rate or with a currency clause continues to decline, and stood at 4.4% in October 2010. The proportion of all housing loans in Swiss francs or with a currency clause tied to the Swiss franc remains more important in relative terms, at 23%. That proportion is gradually declining.

Table 9.5: Loans tied to the Swiss franc exchange rate by bank group

	Year-on-year growth, %		Proportion of total banking system loans tied to Swiss franc, %		Proportion of total loans at bank group, %	
	2009	Oct. 2010	2009	Oct. 2010	2009	Oct. 2010
Large domestic banks	-19.5	-8.7	31.7	30.5	2.6	2.2
Small domestic banks	-7.1	-10.7	1.1	1.1	0.7	0.6
Banks under majority foreign ownership	-21.4	-9.9	67.2	68.4	9.8	9.5
Overall	-21.3	-9.1	100.0	100.0	4.9	4.4

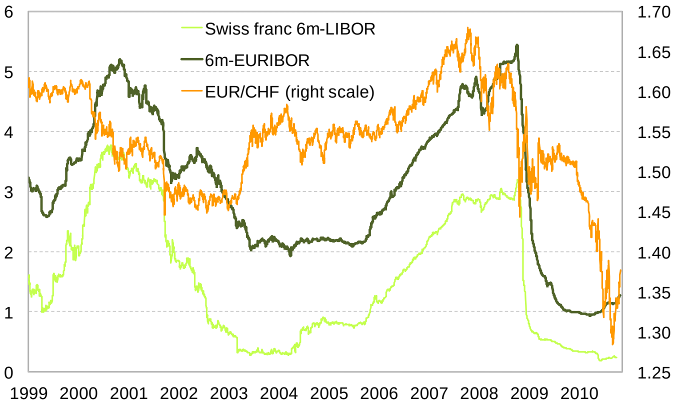
Source: Bank of Slovenia

The Swiss franc appreciated against the euro in 2010.

The Swiss franc appreciated by 7.6% against the euro over the first 10 months of 2010, reaching its highest value in mid-September 2010, when the euro/Swiss franc exchange rate fell slightly below 1.30. The reasons for the Swiss franc's appreciation against the euro lie primarily in the more rapid growth of the Swiss economy compared with other European economies and in the public finance problems in certain euro area countries.

The 6-month Swiss franc LIBOR continues to lag behind the 6-month EURIBOR, and has recently fluctuated around the Swiss central bank's target interest rate of 0.25%. Recently, the EURIBOR has risen slightly primarily owing to the expected normalisation of the liquidity situation. The market expects the EONIA to rise from its current spread of 0.35%-0.85% towards the ECB's key interest rate (1%) owing to a decline in the excess bank liquidity in the context of the withdrawal of the full allotment of loans to banks. This also explains in part the euro's recent rise against the Swiss franc.

Figure 9.2: Swiss franc LIBOR reference interest rate, EURIBOR and movement in the euro/Swiss franc exchange rate



Source: Bank of Slovenia

10 BANK SOLVENCY

Capital adequacy stood at 11.5% in September 2010, down slightly on the end of 2009. The same is true of the Tier 1 capital adequacy, which stood at 9.2%. Both indicators are below the European average. Growth in regulatory capital and capital requirements was negligible this year. Changes in the breakdown of capital requirements for credit risk reflect declining corporate lending and banks' diminished appetite to take up additional risks. The most significant increase in the breakdown of capital requirements for credit risk was recorded by capital requirements for past-due items[15], which reflects the deteriorating quality of the credit portfolio.

Solvency indicators have deteriorated more at the domestic banks than at the banks under majority foreign ownership, in particular at the small domestic banks, which also deviate most from the European average. The Tier 1 capital adequacy of the small domestic banks, which have had the lowest capital adequacy for some time, declined by a further 0.3 percentage points. The banking system's capital quality structure has deteriorated, in particular at the large domestic banks owing to losses generated in current operations. Moreover, the potential for increasing subordinated debt has diminished in this bank group. The risk absorption capacity of the domestic banks was down slightly, but up slightly at the banks under majority foreign ownership.

In the context of a gradual economic recovery and anticipated changes to ratings regulations in Basel III, the banks will be forced to increase the proportion of high-quality forms of capital and improve capital adequacy should they wish to increase lending. Of key importance is improving Tier 1 capital adequacy, which the financial markets find increasingly important, and which affects changes in banks' credit ratings and thus conditions for obtaining sources of funding. This increases the banks' dependency on the will and capacity of owners to increase their banks' capital.

10.1 Capital adequacy

Capital adequacy was down slightly in the end of 2009.

The banking system's capital adequacy stood at 11.5% in the third quarter of 2010, down 0.1 percentages points on the end of 2009. The same is true for Tier 1 capital adequacy, which stood at 9.2%. Despite stagnating lending growth, growth in capital requirements outstripped growth in capital. The ratio of the book value of capital to total assets was up 0.1 percentage points to 8.4%, a reflection of declining leverage.

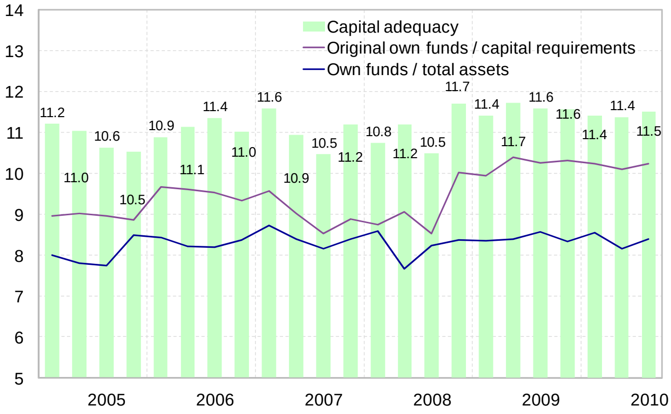
Table 10.1: Banking system's basic capital adequacy indicators in percentages

	2005	2006	2007	2008	2009	Sep. 2010
Capital adequacy	10.5	11.0	11.2	11.7	11.6	11.5
Original own funds / capital requirements	8.9	9.3	8.9	10.0	10.3	10.2
Tier 1 capital / capital requirements	7.6	8.3	7.8	9.2	9.3	9.2
Book capital / total assets	8.5	8.4	8.4	8.4	8.3	8.4

Source: Bank of Slovenia

[15] A past-due claim or item is an exposure where the obligor has defaulted on payment of the full exposure or a part thereof in excess of EUR 100 for more than 90 days.

Figure 10.1: Banking system's basic capital adequacy indicators in percentages



Source: Bank of Slovenia

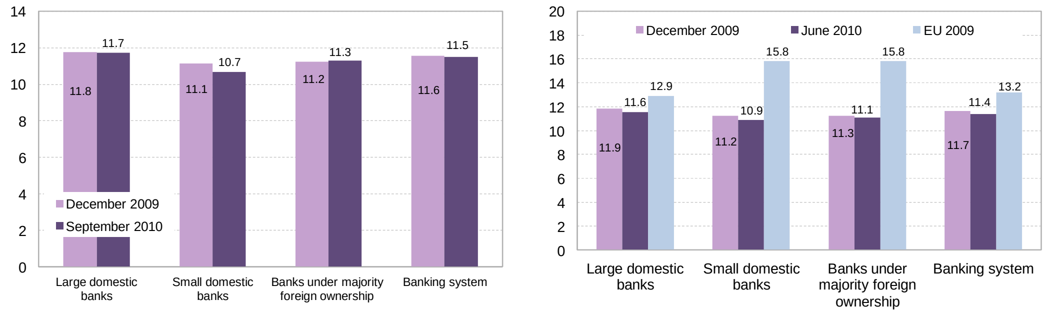
Capital adequacy deteriorated at the domestic banks and improved at the banks under majority foreign ownership.

The capital adequacy of the domestic banks deteriorated, while that of the banks under majority foreign ownership improved. At 11.7%, the large domestic banks continued to have the highest capital adequacy in September 2010, despite a decline of 0.1 percentage points relative to the end of 2009. The small domestic banks recorded the largest deterioration in capital adequacy of 0.4 percentage points to 10.7%. The latter recorded the highest growth in capital requirements of 4.6%. The capital adequacy of the banks under foreign majority ownership improved last year, but remains below the banking system average.

Capital adequacy on a consolidated basis is below the European average.

On a consolidated basis, the capital adequacy of the Slovenian banking system is below that of comparable banks[16] in the EU for 2009. The capital adequacy of the small banks is the furthest below the EU average, the gap standing at 4.9 percentage points, followed by the banks under majority foreign ownership at 4.7 percentage points. In the context of unchanged capital requirements, the small domestic banks would need to increase regulatory capital by 45% to reach the same average level of capital adequacy on a consolidated basis as comparable EU banks. They are followed by the banks under majority foreign ownership, which would require an increase in regulatory capital of 42%, and the large domestic banks, which would require an increase of 12%.

Figure 10.2: Capital adequacy by bank group on an individual basis (left) and on a consolidated basis compared with the EU average (right) in percentages



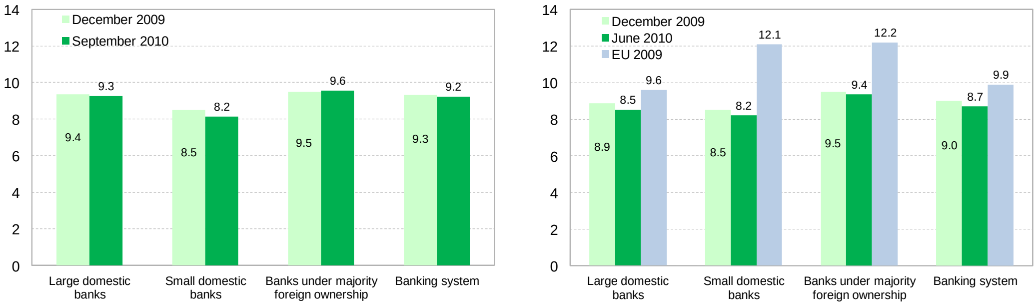
Sources: Bank of Slovenia, EU Banking Sector Stability, ECB, September 2010

The banking system's Tier 1 capital adequacy stood at 9.2% at the end of the third quarter of 2010.

Tier 1 capital adequacy stood at 9.2% at the end of the third quarter of 2010, and deteriorated at the domestic banks and improved at the banks under majority foreign ownership relative to December 2009. The Tier 1 capital adequacy of the small domestic banks, which have had the lowest capital adequacy for some time, declined by a further 0.3 percentage points.

[16] The capital adequacy of the large domestic banks is compared with the capital adequacy of comparable EU banks in terms of total assets.

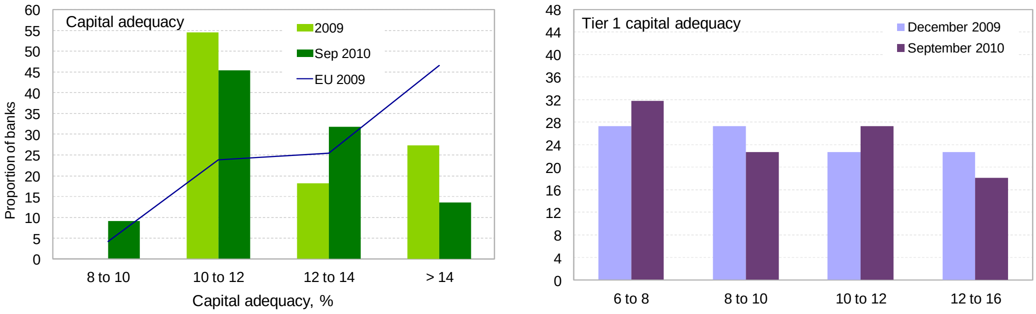
Figure 10.3: Tier 1 capital adequacy by bank group on an individual basis (left) and on a consolidated basis compared with the EU average (right) in percentages



Sources: Bank of Slovenia, EU Banking Sector Stability, ECB, September 2010

There was a negative shift towards lower intervals in the distribution of banks over the first nine months of 2010 in terms of capital adequacy and Tier 1 capital adequacy. The distribution of indicators deteriorated most at the small domestic banks. The distribution of the capital adequacy of the Slovenian banking system is less favourable than the EU average. The proportion of banks with a capital adequacy exceeding 14% is significantly higher in Europe overall and sharply lower in the intervals below 12%.

Figure 10.4: Distribution of banking system's capital adequacy (left) and Tier 1 capital adequacy (right) in percentages



Sources: Bank of Slovenia, EU Banking Sector Stability, ECB, September 2010

10.2 Structure of capital

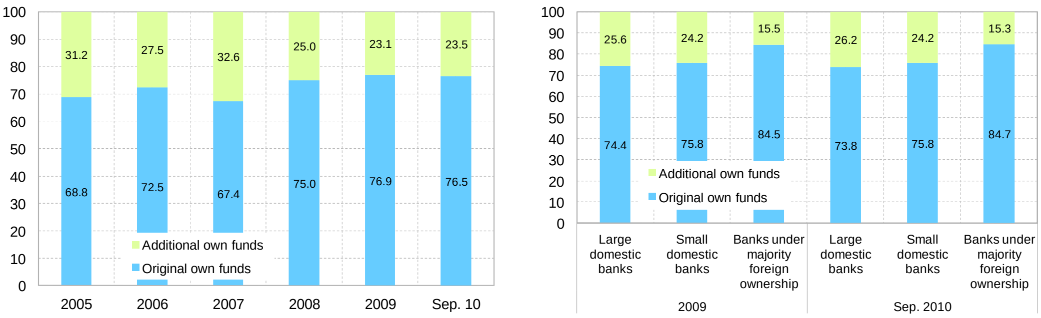
The banking system's original own funds stood at EUR 4,113 million at the end of September 2010, down EUR 3 million on December 2008. The decline was the result of a lower capital surplus and an increase in deduction items from original own funds.

Original own funds were at the level recorded in December 2009.

The banking system's capital quality structure deteriorated. The proportion of the banking system's capital accounted for by original own funds prior to deductions was down 0.4 percentage points at the end of the third quarter of 2010 to stand at 76.5%. This is not, however, true for all bank groups. The quality of capital only deteriorated at the large domestic banks.

The capital quality structure deteriorated at the large domestic banks.

Figure 10.5: Structure of banking system's capital prior to deductions (left), and by bank group (right) in percentages



Source: Bank of Slovenia

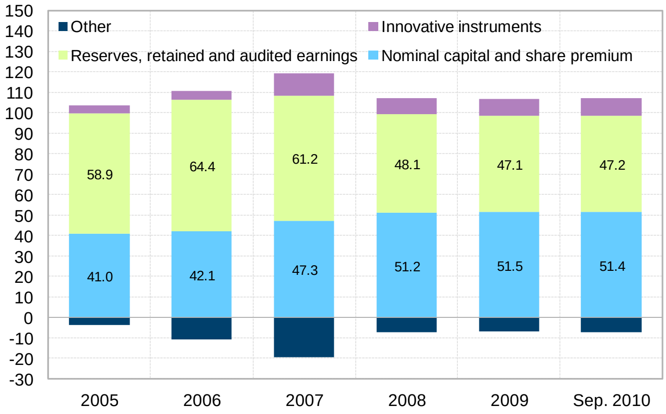
Losses generated in current operations have curbed growth in original own funds.

The proportion of original own funds accounted for by items related to earnings was up 0.1 percentage points. The main factor in the modest increase in original own funds were the losses generated in current operations, which were up EUR 43 million on the end of 2009 to stand at EUR 49 million. Five banks generated losses over the first nine months of the year.

Banks' needs for additional own funds are rising.

Banks will be forced to obtain higher-quality forms of capital in the future. Income risk is increasing in the context of the continuing stagnation in lending to non-banking sectors and the deterioration of the credit portfolio which, through deteriorating operating results, will have an adverse impact on banks' capacity to generate capital internally. At the same time, the stock of innovative instruments, which the banks will be forced to partially replace owing to regulatory changes, was unchanged at EUR 349 million. This means that owners will be forced to maintain or increase banks' original own funds via capital increases.

Figure 10.6: Components of original own funds in percentages



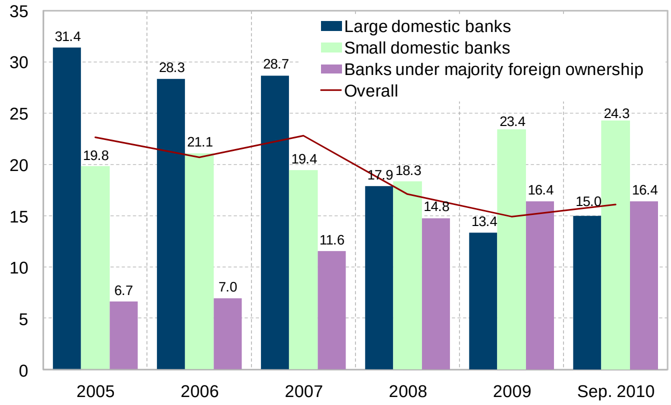
Source: Bank of Slovenia

Subordinated debt was up EUR 47 million, primarily owing to the large domestic banks.

Additional own funds I stood at EUR 1.26 billion, up EUR 27 million on December 2009, primarily owing to an increase in subordinated debt in the amount of EUR 47 million. Consequently, the ratio of subordinated debt to original own funds was up 1.1 percentage points to stand at 16.1% in the context of virtually unchanged original own funds. At the same time, the potential for increasing subordinated debt was down EUR 48 million to stand at EUR 1.39 billion.

The large domestic banks recorded the largest increase in the ratio of subordinated debt to original own funds, of 1.6 percentage points. The same banks consequently recorded the largest decrease in the potential to increase subordinated debt, of EUR 46 million to EUR 953 million. The ratio of subordinated debt to original own funds was down 0.9 percentage points at the small domestic banks.

Figure 10.7: Ratio of subordinated debt to original own funds by bank group in percentages

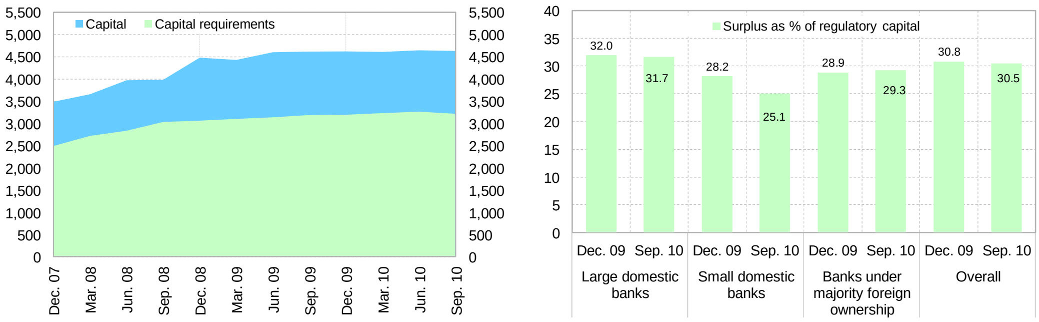


Source: Bank of Slovenia

Growth in regulatory capital has slowed, while the surplus of regulatory capital over capital requirements has declined.

Regulatory capital amounted to EUR 4.6 billion at the end of the third quarter of 2010, the level recorded in December 2009, while year-on-year growth slowed further to stand at 0.3% in September. Growth in capital requirements, which at 0.7% is still higher than growth in regulatory capital, was also lower over the first ten months of this year, primarily owing to the stagnation in lending growth. At the end of September 2010, the surplus of regulatory capital over the capital requirements of the banking system was down 0.3 percentage points on the end of 2009 at 30.5%, which has slightly diminished the banking system's risk absorption capacity. The latter is particularly true for the small domestic banks, while the surplus at the banks under majority foreign ownership was up.

Figure 10.8: Regulatory capital and capital requirements in EUR million (left) and surplus of capital over capital requirements as percentage of regulatory capital (right)



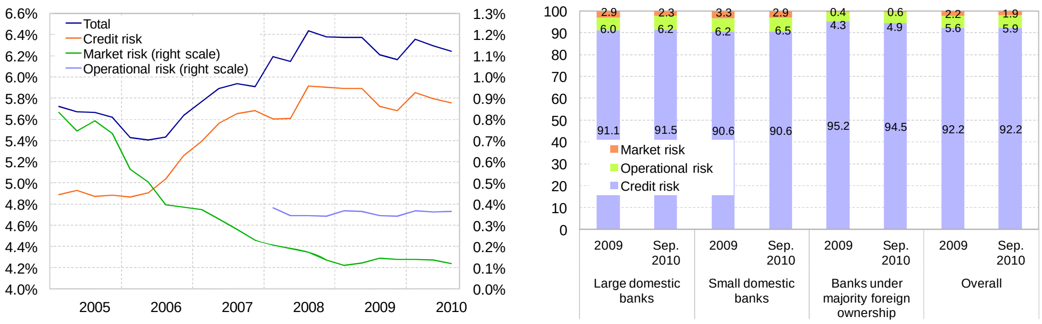
Source: Bank of Slovenia

10.3 Capital requirements

Growth in capital requirements is low owing to the stagnation in lending to non-banking sectors.

Capital requirements were up by merely 0.7% over the first nine months of 2010 to stand at EUR 3.2 billion. Contributing to this due to the stagnation in lending to non-banking sectors was low growth in capital requirements for credit risk, which account for the majority of capital requirements at 92.2% (unchanged). Capital requirements increased primarily at the domestic banks, while capital requirements for credit risk were down at the banks under majority foreign ownership. Capital requirements for operational risk increased in all bank groups, while capital requirements for market risk at the banking system level were down, in particular at the domestic banks.

Figure 10.9: Ratio of capital requirements to total assets (left) and structure of capital requirements by bank group (right) in percentages



Source: Bank of Slovenia

Banks' exposure to corporates has declined.

Changes in the breakdown of capital requirements for credit risk reflect declining corporate lending and thus banks' diminished appetite to take up additional credit risks. Capital requirements for exposures to corporates recorded the sharpest decline, by EUR 47 million or 2.8%.

Capital requirements for past-due items have risen, particularly at the large domestic banks.

The quality of the credit portfolio deteriorated over the first nine months of 2010, as seen in increasing capital requirements for past-due items, which contributed most to the overall increase in capital requirements for credit risk, as the former were up EUR 35 million or 36%. The differences between bank groups in this regard are significant. Capital requirements for past-due items were up 49% or EUR 30 million at the large domestic banks, accounting for 88% of the total increase. Capital requirements for past-due items were up 15% at the banks under majority foreign ownership and just 5% at the small domestic banks.

The small domestic banks remain the most vulnerable bank group with respect to capital requirements for credit risk. Capital requirements for regulatory high-risk items recorded the highest growth (of 27%) over the first nine months of 2010 among capital requirements for credit risk at the small domestic banks; the proportion of total capital requirements they account for is thus higher than the other bank groups. The proportion of capital requirements for items secured by real estate declined by 0.3 percentage points at the small banks to 7.8%, which remains well above the banking system average of 1%.

Table 10.2: Capital requirements for credit risk for the banking system and bank groups in EUR million and breakdown in percentages

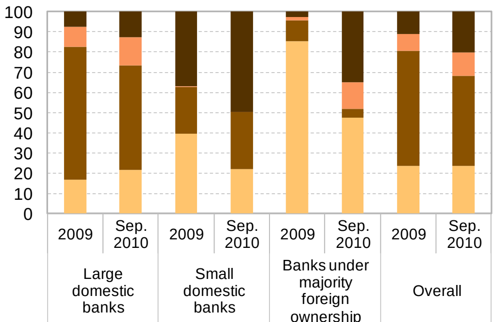
	2009				Sep 2010				Change			
	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Overall	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Overall	Large domestic banks	Small domestic banks	Banks under majority foreign ownership	Overall
Capital requirements for credit risk, EUR million	1,837.3	275.4	831.6	2,944.2	1,856.9	288.1	821.7	2,966.6	19.7	12.7	-9.9	22.5
	Breakdown of capital requirements for credit risk, %								Change, percentage points			
Public sector, international organisations	0.4	1.0	1.2	0.7	0.6	1.6	1.6	1.0	0.2	0.6	0.4	0.3
Institutions	11.2	5.6	3.3	8.4	11.2	5.7	2.9	8.4	0.1	0.1	-0.4	0.0
Corporates	58.5	54.6	55.3	57.2	56.6	51.7	53.3	55.2	-1.9	-3.0	-1.9	-2.0
Retail	17.0	13.1	29.8	20.2	17.3	13.5	31.4	20.9	0.4	0.4	1.7	0.7
Secured by real estate	0.0	8.1	0.6	0.9	0.0	7.8	0.9	1.0	0.0	-0.3	0.3	0.1
Past-due items	3.4	3.1	3.2	3.3	5.0	3.1	3.7	4.5	1.6	0.0	0.5	1.1
Regulatory high-risk items	5.5	9.5	3.9	5.5	5.7	11.5	3.2	5.6	0.2	2.0	-0.7	0.1
Other	4.0	5.0	2.7	3.7	3.5	5.2	2.9	3.5	-0.5	0.2	0.2	-0.2

Source: Bank of Slovenia

Capital requirements for market risks were down at the domestic banks.

Capital requirements for market risks were down 14.8% to stand at EUR 61.1 million at the end of the third quarter of 2010 owing to declining bank investments in securities. The major factor in the aforementioned decline was the large domestic banks, which reduced capital requirements for equity instruments by 37%. In contrast to the domestic banks, the banks under majority foreign ownership increased their capital requirements for market risks by 35%, primarily owing to higher capital requirements for settlement risk.

Figure 10.10: Breakdown of capital requirements for market risks by bank group in percentages



	Large domestic banks 2009	Large domestic banks Sep. 2010	Small domestic banks 2009	Small domestic banks Sep. 2010	Banks under majority foreign ownership 2009	Banks under majority foreign ownership Sep. 2010	Overall 2009	Overall Sep. 2010
Other	7.4	12.8	36.8	49.6	2.8	35.3	11.2	20.3
Foreign currency	10.0	13.7	0.8	0.3	1.7	13.1	8.3	11.6
Equity financial instruments	66.0	52.2	22.9	28.1	10.0	4.2	57.0	44.4
Debt financial instruments	16.7	21.4	39.6	22.0	85.6	47.6	23.5	23.7

Source: Bank of Slovenia

Capital requirements for operational risk stood at EUR 18.6 million at the end of September 2010, up 5.9% on the end of 2009. They were up in all bank groups, the small banks having recorded the largest increase of 12.5%.

APPENDICES

1. HOUSEHOLD SECTOR

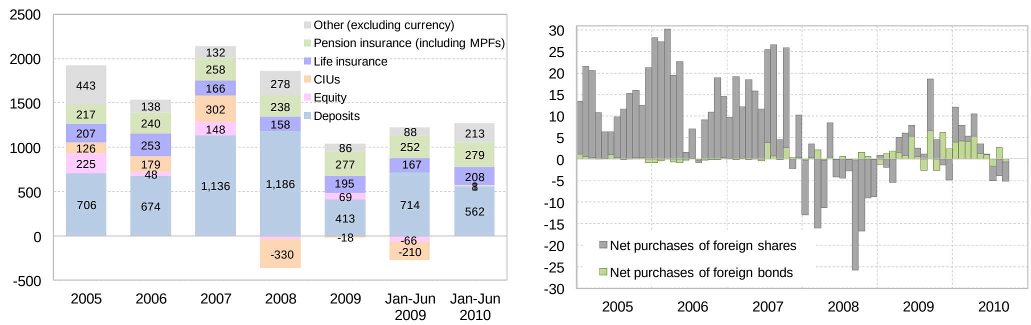
In the context of excessively high growth in housing loans, the indicators of household indebtedness at banks has deteriorated owing to deteriorating payment discipline, a rise in the number of unemployed (by 18.7% on average over the first nine months of 2010 relative to the same period in 2009) and a decline in household income. The macroeconomic situation will further aggravate the position of households, but to a lesser degree than in previous quarters.

Households' financial assets

Households' financial assets increased by 3.7% over the first six months of 2010, while the trend of an increase in investments in traditional forms of savings continued.

Households' financial assets were up 3.7% on December last year over the first six months of 2010 to stand at EUR 40.7 billion. The trend of an increase in safer investments since the outbreak of the financial turmoil has continued. Households also channelled their investments into traditional forms of savings in the first half of 2010, such as deposits, which were up 3.5%, and pension and life insurance, which recorded growth of 6.1%. Positive developments on the bond market led to an increase in assets invested in life and pension insurance. Households suffered capital losses from investments in the shares of domestic issuers. In contrast, the stock of assets in Slovenian collective investment undertakings was up 5%, solely as the result of positive value changes, as mutual fund units are primarily spread among securities on developed markets and rapidly emerging economies that have recorded growth this year. There was no significant interest from households in foreign collective investment undertakings.

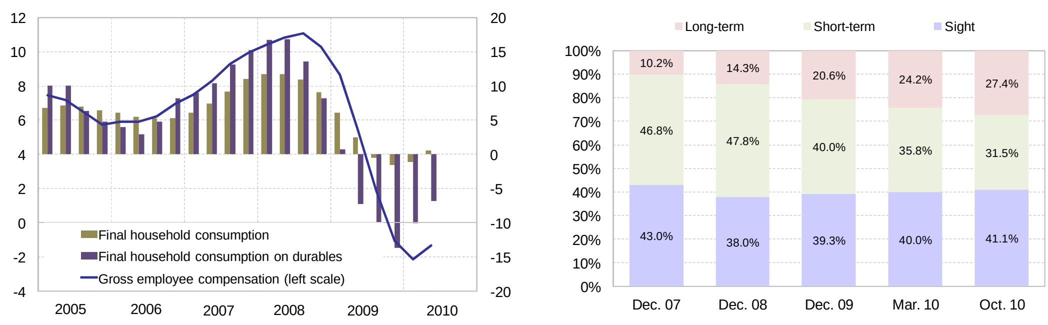
Figure 1.1: Household transactions according to financial accounts data in EUR million (left) and net household investments in foreign shares and bonds in EUR million (right)



Source: Bank of Slovenia

Direct investment by households in foreign shares was negligible over the first three quarters of 2010, despite growth on the majority of global stock markets. With EUR 20 million in direct net purchases of bonds, primarily of developed European countries, households followed the positive situation on the bond markets somewhat more closely than in the same period last year.

Figure 1.2: Growth in gross employee wages and final household consumption (left) and maturity breakdown of bank deposits (right) in percentages



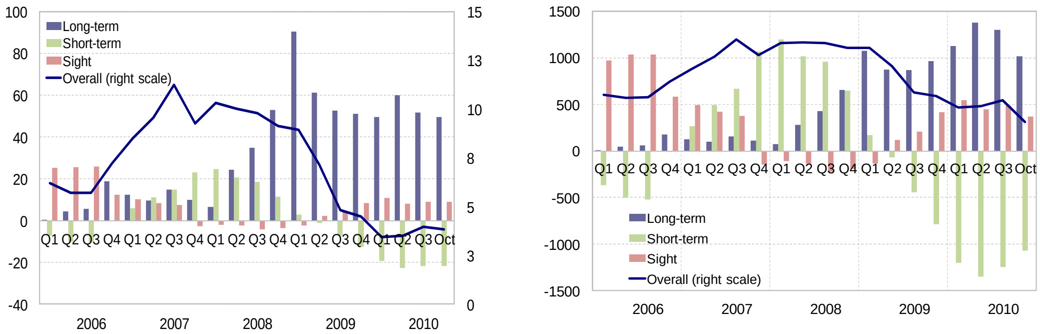
Sources: Bank of Slovenia, SORS

Growth in household deposits at banks was down owing to lower regular employee wages and bonuses.

The period that followed the outbreak of the financial turmoil has been unfavourable for households owing to declining economic activity and the resulting increase in unemployment. Consequently, gross employee wages, in particular bonuses, have declined, while social security benefits have increased, which is preventing savings. In the context of low final household consumption, which was down 6.8% for consumer durables over the first six months of 2010, growth in household deposits at banks in the amount of EUR 315 million was down 18.2% over the first nine months of the year compared with the same period last year. The average maturity of household deposits continues to lengthen. The proportion of time deposits at banks of more than 1 year was up 6.7 percentage points in October 2010 on the end of 2009. Longer-term deposits are favourable for bank funding, while indicating that households will not channel their funds to higher-risk forms of investments on the capital markets in the near future.

The low growth in deposits is partly the result of a lack of corporate cash flows and the associated payment indiscipline. In specific cases, companies did not pay their employees wages during the transitional period between insolvency and financial restructuring or composition or bankruptcy proceedings. According to forecasts regarding the situation on the labour market, the contraction in earnings from wages will be less severe next year. Developments in the future income of households will be a key factor in their ability to repay liabilities.

Figure 1.3: Growth in household deposits at banks (left) in percentages and annual net increase (right) in EUR million



Source: Bank of Slovenia

A portion of household deposits was used for housing purchases, while there were no significant inflows to bank deposits from housing sales.

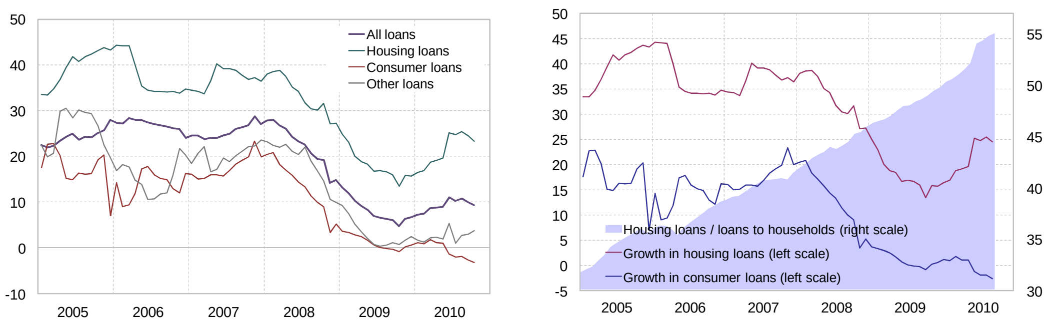
An increase of more than 50% in the sales of used residential dwellings over the first three quarters of 2010 compared with the same period in 2009 had no impact on the increase in household deposits. Because there were no major shifts in financial assets to other forms of savings, it is likely that some sellers of used housing opted to purchase new housing (according to survey data such sales were up 53%). It is most likely that households used a portion of time deposits for housing purchases, resulting in lower growth in bank deposits.

Household borrowing

Household borrowing was up 4.4% over the first six months of 2010, primarily in the form of long-term bank loans.

At 4.4%, growth in household borrowing over the first two quarters of 2010 was somewhat more intensive than in the same period last year. The main factor was long-term loans raised at banks and other financial intermediaries. The increase in the stock of household loans from banks was 60% higher over the first ten months of 2010 compared with the same period last year.

Figure 1.4: Growth in household loans in percentages



Source: Bank of Slovenia

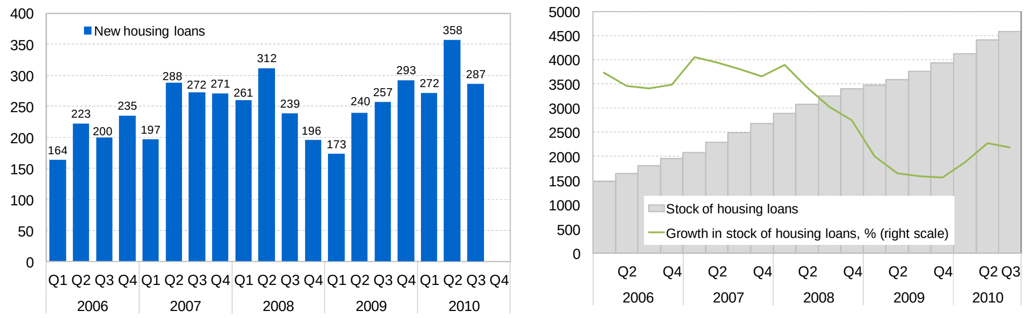
Demand for housing loans in the domestic currency increased.

Given the situation on the real estate market and the slightly better terms of borrowing, household demand for housing loans was up sharply. Newly approved housing loans were up 36.6% over the first three quarters of 2010 compared with the same period last year. Similar to last year, the household sector did not borrow in Swiss francs this year, and thus avoided additional currency risk associated with the appreciation of the Swiss franc. Such loans still account for 23% of the stock of housing loans owing to this form of borrowing in the past. Today, this means a greater loan repayment burden, particularly for lower-income households.

Premiums over the EURIBOR were down slightly, but remain above average at 2 percentage points.

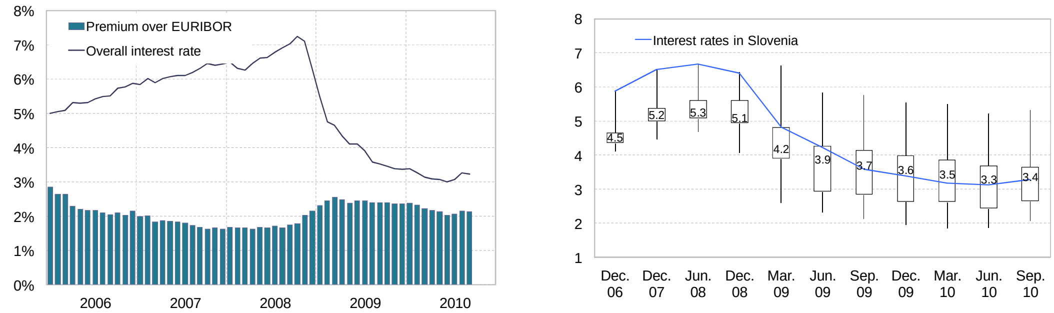
During the first three quarters of 2010, 92% of all approved housing loans were with a variable interest rate tied to the EURIBOR. Average premiums over the EURIBOR were 0.2 percentage points lower than the 2009 average, but remain at a high level at 2 percentage points. Slovenian interest rates on housing loans in 2010 were at the level of the average interest rates of EMU countries. Improved accessibility to long-term housing loans was reflected in the lengthening of the average maturity on approved loans by 3.3 years relative to last December to stand at 19.8 years in September 2010.

Figure 1.5: Volume of newly approved housing loans (left) and stock of housing loans (right) in EUR million, and growth in the stock of housing loans (right) in percentages



Source: Bank of Slovenia

Figure 1.6: Premiums over the EURIBOR and average Slovenian interest rate in percentages (left), and dispersion of interest rates on newly approved housing loans by euro area country in percentages (right)



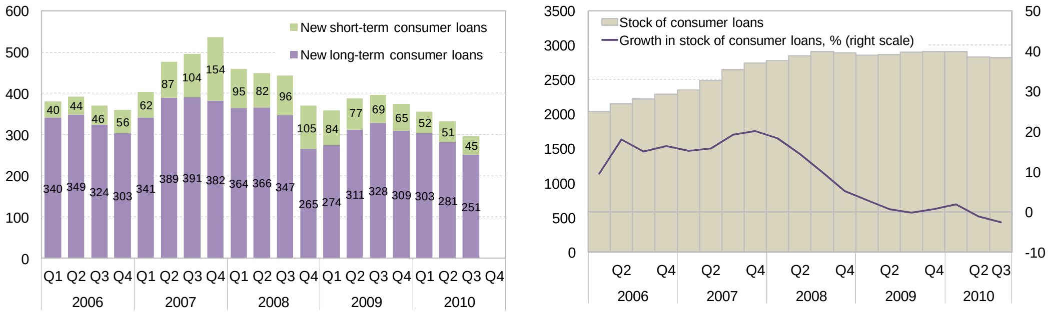
Sources: Bank of Slovenia, ECB

Growth in household borrowing in the form of consumer loans declined for the second consecutive year.

Growth in household borrowing in the form of consumer loans slowed already in 2009, and continued to slow over the first three quarters of 2010. At -35.3% for short-term and -8.6% for long-term consumer loans, growth was lower than last year. Loans with a fixed interest rate accounted for 93% of newly approved short-term consumer loans, up 9 percentage points on last year.

With 60% of newly approved consumer loans with a variable interest rate over the first three quarters of 2010 (up 6 percentage points on 2009), consumers are assuming the risk of changing interest rates.

Figure 1.7: Volume of newly approved consumer loans (left) and stock of consumer loans (right) in EUR million, and growth in the stock of consumer loans (right) in percentages

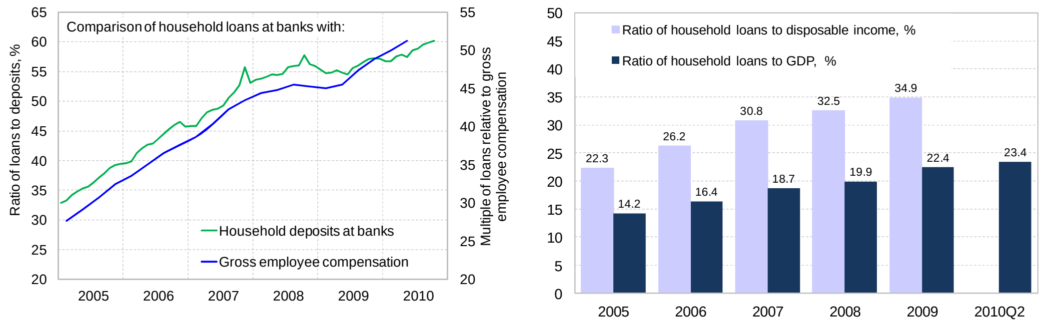


Source: Bank of Slovenia

Indicators of household indebtedness continue to deteriorate. The ratio of household loans to gross wages was up 2.4 percentage points over the first six months of 2010 to 51.3% (up 5.3 percentage points in year-on-year terms). The ratio of loans to disposable household income rose by 2.3 percentage points to 34.9% back in 2009, while that ratio is expected to be higher again in 2010. Nevertheless, Slovenian households, at 34.1% of GDP, remain considerably less indebted than their euro area counterparts (74.5% of GDP in the first quarter of 2010).

Indicators of household indebtedness continue to deteriorate.

Figure 1.8: Indicators of household indebtedness expressed as the ratio of bank loans to bank deposits and gross employee wages (left) and to disposable income and GDP (right)



Source: Bank of Slovenia

Effect of the real estate market on household assets

During the first three quarters of 2010, transactions on the real estate market were up 50% on the same period last year, but remain down sharply on pre-crisis figures. Used housing prices were up 3% over the same period, while new housing prices were up 2.1% according to survey figures.

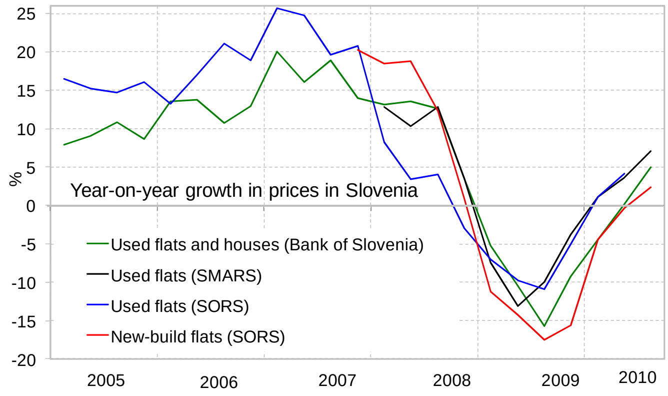
The number of transactions on the real estate market was up over the first three quarters of 2010, while real estate prices were also up slightly.

On the one hand, housing demand was up during this period, supported by newly approved housing loans, while on the other hand, no new construction projects were approved. The aim of investors is to reduce the stock of housing and improve their balance sheets. Investors could use housing to achieve better conditions for continued financing at banks while at the same maintaining real estate prices at current levels. Banks loans renewed for construction companies are primarily aimed at supporting current operations. New housing loans also indirectly contribute to the debt repayment of investment firms and construction companies.

The sharp contraction in housing investment has an adverse effect on the real estate market, primarily owing to the presence of household demand. Housing construction is a multi-year process which, if it stalls for a longer period, will cause supply to lag behind demand, as was the case prior to the crisis. This could result in renewed higher growth in prices and a deterioration in indicators of housing accessibility.

The contraction in housing projects has had an adverse effect on the real estate market.

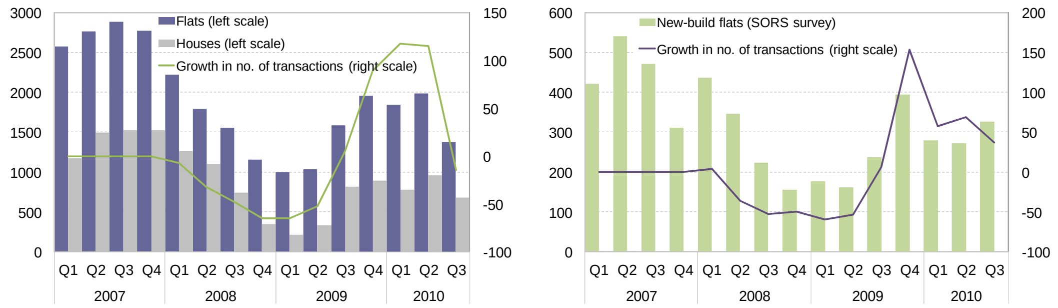
Figure 1.9: Year-on-year growth in prices of used and new residential real estate in percentages



Source: Bank of Slovenia

The past experiences of countries indicate that the adjustment of real estate prices in the short term could be over or underestimated with respect to the long-term trend owing to the delayed adjustment in the real estate supply, which has a decisive effect on the volatility of demand.

Figure 1.10: Number of recorded transactions in flats and houses (left) the number of new housing transactions on the basis of survey-based research (right)



Note: The sample in the survey regarding new builds conducted by the SORS in 2007 and 2008 included transactions representing nearly half of all completed dwellings built for the market by construction companies during the aforementioned years. The growth in sales of new dwellings in the amount of 15% of transactions in the final quarter of 2009 was the result of newly included companies in the statistical research.

Sources: SMARS, SORS

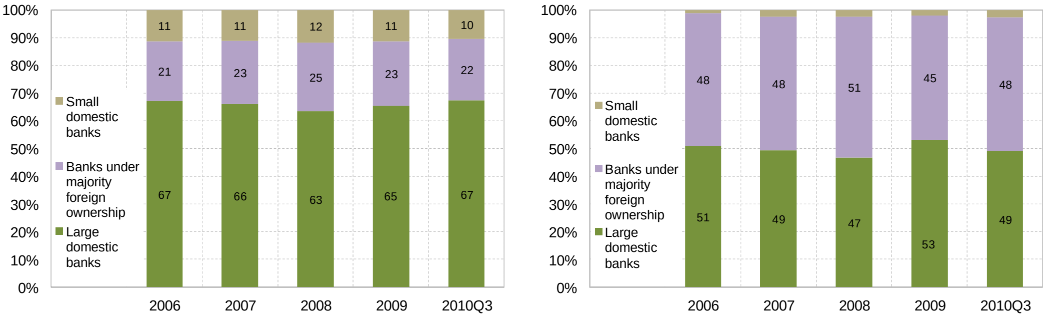
The banks are becoming increasingly involved in the sale of housing from projects they financed in the construction phase.

Cyclical fluctuations in the banking and construction sectors frequently coincide. The real estate market is more closely tied to fluctuations in the banking sector because investors in Slovenia are also construction companies and vice versa. In a period of uncertainty and overly indebted investors, those banks which in past years were more exposed to the construction sector attempt to reach a target group of clients with various housing loan offers. Together with investors, they offer clients unsold dwellings, which they financed in the past during the construction phase, with the aim of achieving a specific selling price. In this way, they mitigate the risk of default, as households are significantly less indebted than corporates from the construction sector. The banks also mitigate the risk of ineligible collateral on loans to construction companies.

The large domestic banks account for more than two thirds of the banking system's exposure to the construction sector.

During the first three quarters of 2010, three banks, which in September 2010 accounted for 60% of the total exposure to the construction sector, approved 43% of all new housing loans to households. If this involves a sale in the scope of a project in which the banks financed construction, the bank's claims are transferred from the investors to typically lower-risk households. In recent months, the banks under majority foreign ownership, which are not significantly exposed to construction companies, have competed successfully with lower interest rates in the housing loan segment. Competition amongst the banks vis-à-vis interest rates on housing loans has generally increased in 2010, which could lead to the lowering of premiums over the EURIBOR.

Figure 1.11: Proportion of banks' exposure to the construction sector (left) and proportion of newly approved housing loans (right) in percentages



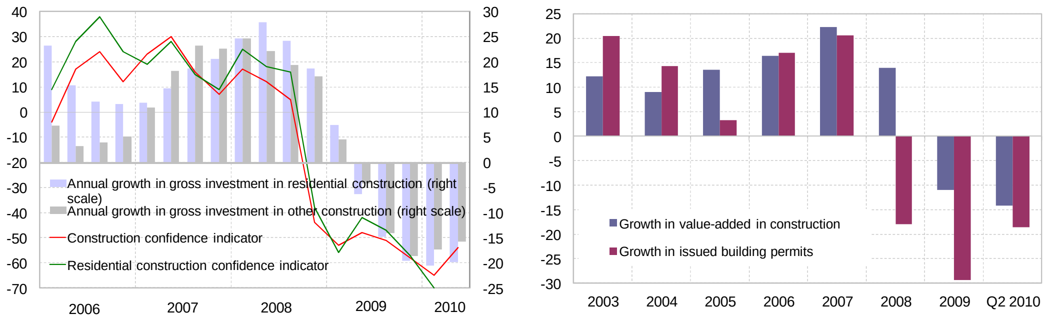
Source: Bank of Slovenia

Factors limiting corporate operations are similar to those seen last year.

The value of the construction confidence indicator,[17] which is the average of the balance of current total orders and employment expectations, has fluctuated at record low levels since the first quarter of 2009. In 2010 fully 57% of construction companies stated a high level of competition as the primary reason for the limitations on their operations. The same companies noted increased demand on the market, particularly in the second half of the year. Half of those surveyed, however, believe that demand remains too low.

The number of building permits issued continues to decline. According to provisional figures, 19% fewer building permits were issued for flats and houses during the first three quarters of 2010 compared with the same period last year. Owing to the high level of impairments created by the banks for loans to the construction sector and the relatively high indebtedness of construction companies, the latter find it difficult to secure financial resources for new projects. Companies also incur high maintenance costs for empty flats, the prices of which do not adjust sufficiently to market demand. These are the main reasons for the declining number of construction permits issued, which could drive up real estate prices in the future owing to the void in construction.

Figure 1.12: Business trends and annual growth in gross investment in construction (left) and annual growth in value-added in construction and building permits issued for flats and houses (right) in percentages



Note: Figures for construction permits issued in the last year relate to the third quarter of 2010.
Sources: SORS, Bank of Slovenia calculations

[17] Source: SORS

2. CAPITAL MARKET AND COLLECTIVE INVESTMENT UNDERTAKINGS

Capital market

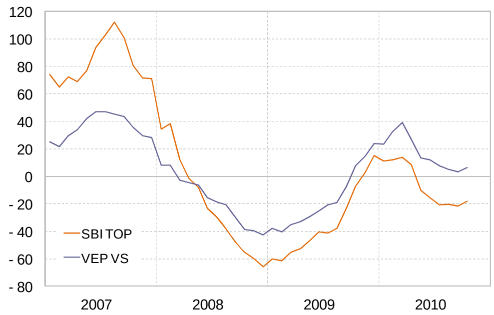
The SBI TOP index was down 18.3% in year-on-year terms at the end of October 2010.

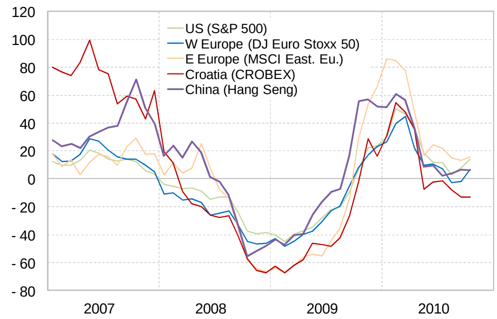
Uncertainty on the capital markets increased further in the second half of 2010 following the release of relatively weak operating results for 2009. Having recorded growth in 2009, the Ljubljana Stock Exchange's SBI TOP index has declined again in 2010. The index closed October 2010 at 865.4 points, down 18.3% on a year earlier. The volatile fluctuation in the index reflects the uncertain economic situation and weak corporate operating results.

On 15 October 2010 the Ljubljana Stock Exchange stopped calculating the LJSEX, the successor to the SBI 20 and the SBI. Its role was assumed by the SBI TOP index.

Global markets recorded cautious growth in 2010 following a year of recovery. Indices achieved very high annual growth at the end of 2009 and during the first quarter of 2010, followed by a sharp decline in growth rates, which nevertheless remain positive. At the end of October 2010, the US S&P 500 and the European DJ Euro Stoxx 50 were up 14.2% and 6.9% respectively in year-on-year terms. Investors have again turned more conservative and demonstrated less of an appetite for investment risk. The indices of less-developed markets, which rose sharply in 2009, recorded more moderate gains until the end of October 2010 (the MSCI Eastern Europe rose by 15.7%, while the Chinese Hang Seng rose by 6.2%). Annual growth in indices on less liquid markets, where growth was less pronounced in 2009, turned negative in 2010. The Croatian CROBEX, Macedonian MBI-10 and Serbian BELEX 15 were down 12.8%, 38.9% and 21.2% respectively in year-on-year terms at the end of October.

Figure 2.1: Annual growth in domestic (left) and foreign (right) stock exchange indices in percentages





Sources: LJSE, Bloomberg

The P/E ratio of the SBI TOP index declined over the first ten months of 2010, nearing the values of global indices. A higher P/E ratio on the Slovenian market is expected owing to its low liquidity. Based on the current situation, it can be concluded that share prices on the Ljubljana Stock Exchange will not fall excessively, provided that corporate losses do not rise.

Tabel 2.1 P/E ratios for the SBI TOP and selected global indices

	SBI TOP	DJ EURO STOXX 50	S&P 500	DAX	MSCI EM EAST. EUROPE
Dec. 06	17.7	12.9	16.9	14.2	12.3
Dec. 07	22.5	9.3	17.2	13.7	13.1
Dec. 08	22.9	15.2	14.8	10.4	5.3
Dec. 09	24.5	15.4	18.0	44.6	10.7
Oct. 10	17.1	12.3	14.9	14.3	8.9

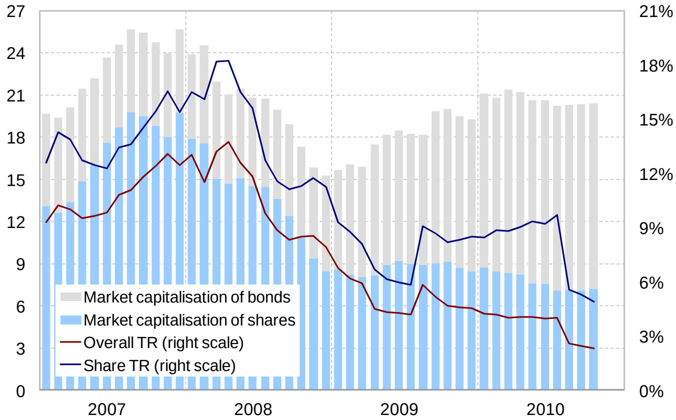
Source: Bloomberg

The market capitalisation of shares was down 21.6% at the end of October 2010, while the market capitalisation of bonds was up 7.1% in year-on-year terms.

The market capitalisation of shares on the Ljubljana Stock Exchange declined in 2010, to stand at EUR 7,186 million at the end of October, down 21.6% on the end of October 2009. The number of shares delisted over the first ten months of 2010 was down on the same period last year. Falls in shares prices were the main reason for the declining value of market capitalisation. The turnover ratio (TR) declined again this year owing to the low volume of trading. The average monthly volume of trading was EUR 28.7 million.

Having recorded high growth in 2009, the market capitalisation of bonds rose by merely 7.1% over the first ten months of 2010 (compared with 53.6% over the same period last year) owing to fewer government bond issues. After accounting for 98.3% of the nominal value of all newly issued bonds in 2009, government bond issues accounted for 92.4% of newly issued bonds on the Ljubljana Stock Exchange over the first ten months of 2010. The volume of newly issued bonds was also down over the first ten months of 2010, as the nominal value of newly issued bonds of EUR 2,706.7 million was down 33.5% on the comparable period in 2009. The volume of trading in bonds was again low in 2010. The average monthly volume of trading was EUR 10.2 million, down 25% on the same period in 2009.

Figure 2.2: Market capitalisation on the Ljubljana Stock Exchange in EUR billion and annual turnover ratios (TR)



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 year. The volume includes block trades.
Source: LJSE

Tabel 2.2 Overview of Slovenia's regulated capital market

	2005	2006	2007	2008	2009	Oct 2010
			Shares			
Market capitalisation						
amount, EUR million	6,694.8	11,513.1	19,740.1	8,468.4	8,462.2	7,186.0
as % of GDP	24.2	38.7	58.7	22.8	24.2	20.2
annual growth, %	-5.9	72.0	71.5	-57.1	-0.1	-21.6
non-residents' proportion, %	3.3	4.8	5.9	7.1	7.2	9.3
Average monthly volume						
amount, EUR million	78.40	120.94	252.90	79.38	59.98	28.68
annual growth, %	1.0	54.3	109.1	-68.6	-24.4	-56.3
Annual change in SBI TOP, %	-5.6	37.9	78.1	-67.5	10.4	-18.3
P/E ratio (prime market)	18.7	23.5	32.6	8.3	23.0	44.1
Dividend yield (prime market)	1.6	1.4	1.0	2.7	1.8	2.1
			Bonds			
Market capitalisation						
amount, EUR million	6048.3	6631.6	5934.6	6,795.4	10,821.5	13,239.1
as % of GDP	21.9	22.3	17.6	18.3	30.9	37.1
annual growth, %	31.0	9.6	-10.5	14.5	59.2	21.8
Average monthly volume						
amount, EUR million	62.45	15.68	13.82	21.42	13.03	10.24
annual growth, %	58.1	-74.9	-11.8	54.9	-39.2	-25.1

Note: Excludes listed investment companies and mutual funds.
The volume includes block trades.
Sources: LJSE, SORS

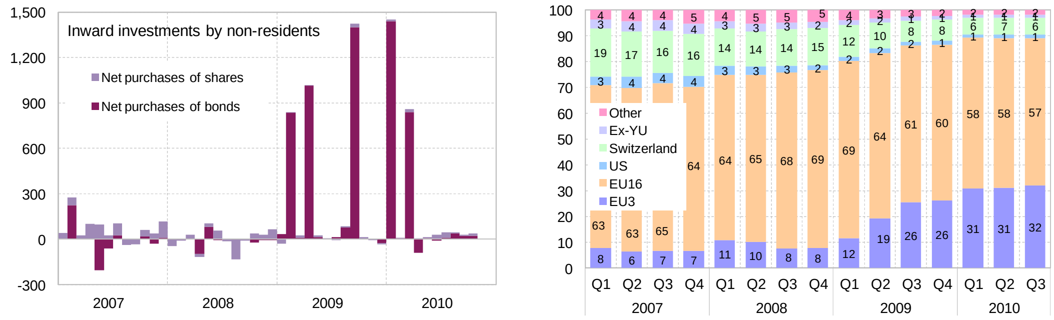
Investment links with the rest of the world

Demand for debt securities was highest from non-residents, while demand for equities was up again owing to low share prices.

Net flows with the rest of the world fell sharply in 2010 compared with 2009 due to the debt crisis in certain European countries. Over the first ten months of 2010, non-residents made net purchases of EUR 2,286.3 million in debt securities, primarily government securities (down 32.9% on the same period in 2009). Demand for Slovenian equities was also up sharply in 2010 compared with 2009. Non-residents made net purchases of EUR

142.9 million in Slovenian shares over the first ten months of 2010, up 276.4% on the same period in 2009.

Figure 2.3: Non-residents' monthly net investments in Slovenia in EUR million (left) and regional breakdown in percentages (right)



Notes: The RS63 government bond issued on the MTS Slovenia system is not included among the net purchases of bonds made by non-residents in 2008.
Includes investments in listed shares and bonds, and in those not listed on the exchange.
EU3: UK, Denmark and Sweden; EU16: euro area; Ex-YU: former Yugoslav republics.

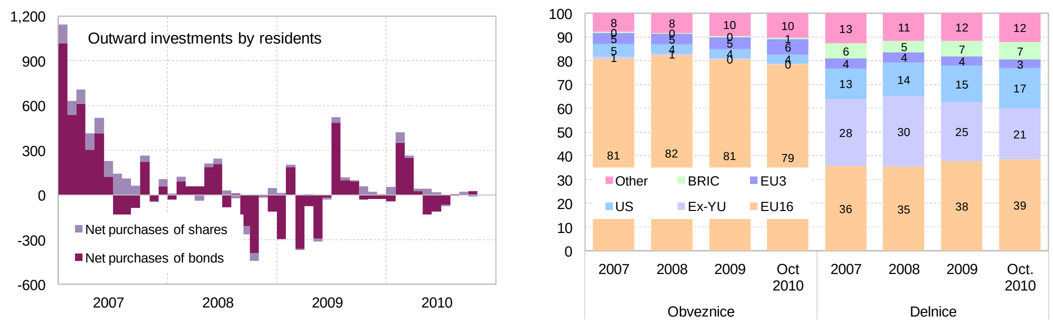
Sources: CSCC, Bank of Slovenia, own calculations

Foreign investors were more optimistic with regard to the future of Slovenian corporates and took advantage of the currently low share prices to purchase equities. The proportion of the market capitalisation of shares on the Ljubljana Stock Exchange accounted for by non-residents remains low, having risen from 7.2% to 9.3% over the first ten months of 2010. The proportion of all equities of Slovenian issuers held by non-residents increased from 15.7% to 17.4%. Investors from Austria were the most active purchasers. The proportion of debt securities held by non-residents rose from slightly less than one quarter in 2008 to just under one half in 2009 to more than one half at the end of October 2010, primarily owing to major purchases of government securities. The majority of purchases and sales were made by residents of the UK; Luxembourg and Austria.

Declining growth in residents' investments in foreign securities continued in 2010.

Having recorded net sales last year, residents made net purchases of EUR 292.1 million in foreign bonds and EUR 212.1 million in foreign shares over the first ten months of 2010. The largest net purchases of foreign equities were made by the insurance sector (EUR 91.8 million, primarily from the euro area) and the sector of other financial intermediaries (EUR 86.8 million, from the euro area, the BRIC countries[18] and the US). The insurance sector also made the largest net purchases of debt securities (EUR 275.4 million). The banks primarily sold debt securities (EUR 61.8 million) over the first ten months of 2010.

Figure 2.4: Residents' monthly net investments in the rest of the world in EUR million (left) and the regional breakdown of investments by residents in foreign securities, separately for bonds and shares in percentages (right)



Note: EU3: UK; Denmark and Sweden; EU16: euro area; BRIC: Brazil, Russia, India and China; Ex-YU: former Yugoslav republics.

Source: Bank of Slovenia

The stock of residents' investments in foreign securities stood at EUR 8,676.8 million at the end of October 2010, up 8.1% on the end of 2009. Debt securities account for the highest proportion of the total at 64.2%. In regional terms, the euro area accounts for the majority of investments at 64.2%, followed by the US at 8.6% and the former Yugoslav republics at 7.9%. There was no significant change in the breakdown of investments in 2010 relative to 2009. Growth in assets exceeded the average growth in indices on the

[18] Brazil, Russia, India and China.

international markets. The majority of changes were in line the movement in share prices on the international securities markets: the proportions of investments in the euro area and US were up, while the proportion of investments in the former Yugoslav republics was down.

Exposure to the debt securities of the PIIGS countries[19]

At the end of October 2010, Slovenian residents held EUR 825.5 million in debt securities from the PIIGS countries (Portugal, Ireland, Italy, Greece and Spain), representing 14.8% of the entire stock of their investments in foreign debt securities. Among the PIIGS countries, Italy (41.9% of investments in the debt securities of all PIIGS countries) and Spain (30.0% of investments in the debt securities of all PIIGS countries) account for the highest proportions. Slovenian residents reduced their investments in the debt securities of the PIIGS countries by 14.7% compared with the end of 2009, while increasing their investments in the debt securities of other countries by 11.9% over the same period. This shift is partly the result of a fall in the value of securities from the PIIGS countries, and partly the result of a withdrawal from the aforementioned markets.

At the end of October 2010, securities from the PIIGS countries accounted for 14.8% of Slovenian residents' portfolio of debt securities.

Tabel 2.3 Exposure of Slovenian sectors to the debt securities of the PIIGS countries as at 31 October 2010

	Exposure to PIIGS DS, EUR million			PIIGS DS as % of total investments in DS		
Sector	Bank DS	Government DS	Other DS	Bank DS	Government DS	Other DS
Non-financial corporations	0.6	0.1	0.7	0.9	0.2	1.1
Banks and savings banks	159.6	344.8	16.1	4.8	10.4	0.5
Other financial intermediaries	0.4	5.4	3.2	0.4	4.7	2.8
Insurance corporations and pension funds	72.7	130.2	73.5	3.9	7.0	4.0
Government	1.0	13.1	2.0	0.6	7.9	1.2
Households	0.8	0.9	0.1	1.5	1.6	0.2
Non-profit institutions		0.0			2.5	
Total	235.1	494.5	95.6	12.1	34.4	9.7

Note: DS: debt securities; PIIGS: Portugal, Ireland, Italy, Greece and Spain.
Source: Bank of Slovenia

In October 2010 the banking and insurance sectors together accounted for 92.8% of all Slovenian residents' investments in foreign debt securities (the banks having accounted for 59.5% and insurance companies 33.3%). Due to the conservative nature of the investments of these institutions, the breakdown of investments was primarily weighted towards government and bank bonds (84.2% of all investments in foreign debt securities). Government bonds from the PIIGS countries account for 17.2% of the banking system's portfolio of debt securities and 20.2% of the insurance sector's portfolio of debt securities. The two sectors were slightly less exposed to bank bonds from the PIIGS countries, which accounted for 13.2% of the banking sector's portfolio and 11.7% of the insurance sector's portfolio. Investments were unevenly distributed among the PIIGS countries. Among its investments in the debt securities of the PIIGS countries in the amount of EUR 520.4 million, the banking sector was most exposed to Italy (accounting for 60.4% of bank bonds and 44.4% of government bonds) and to Spain (accounting for 31.4% of bank bonds and 27.7% of government bonds). The insurance sector's investments in the PIIGS countries are evenly distributed, with Spain, Italy, Greece, Ireland and Portugal accounting for 33.9%, 28.3%, 19.6%, 17.9% and 0.2% respectively.

The banking system held bonds from issuers from the PIIGS countries in the amount of EUR 520.4 million at the end of October 2010.

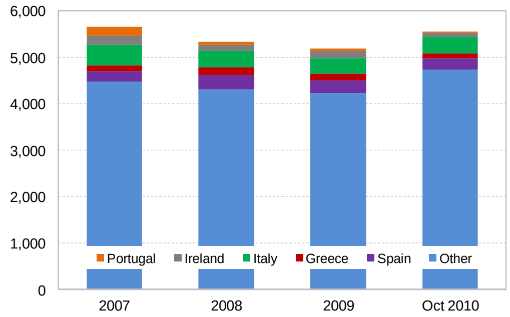
[19] Portugal, Ireland, Italy, Greece and Spain.

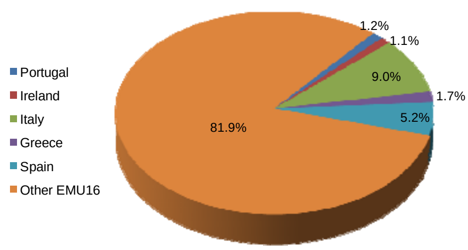
Tabel 2.4 Exposure of Slovenian sectors to the debt securities of euro area issuers as at 31 October 2010

	Exposure to euro area DS, EUR million			Exposure to DS of other countries, EUR million		
Sector	Bank DS	Government DS	Other DS	Bank DS	Government DS	Other DS
Non-financial corporations	17.0	0.7	4.5	2.2	0.3	37.9
Banks and savings banks	879.0	141.1	37.1	334.3	1,868.3	46.0
Other financial intermediaries	10.7	2.4	19.5	9.1	14.4	59.1
Financial auxiliaries	0.0		0.0	0.0		0.2
Insurance corporations and pension funds	433.5	183.8	191.5	188.7	461.0	394.3
Government	20.7	25.4	17.7	19.4	41.2	41.4
Households	18.0	2.9	4.5	4.2	1.6	22.0
Non-profit institutions	0.2	0.0	0.0	0.1	0.0	0.6
Total	1,379.1	356.3	274.9	557.9	2,386.8	601.6

Note: DS: debt securities
Source: Bank of Slovenia

Figure 2.5: Regional breakdown of residents' investments in the PIIGS countries and other countries in EUR million (left) and the regional breakdown of Slovenian banking system's investments in bank and government bonds from the PIIGS countries and the euro area as at 31 October 2010 (right)





Source: Bank of Slovenia

Collective investment undertakings

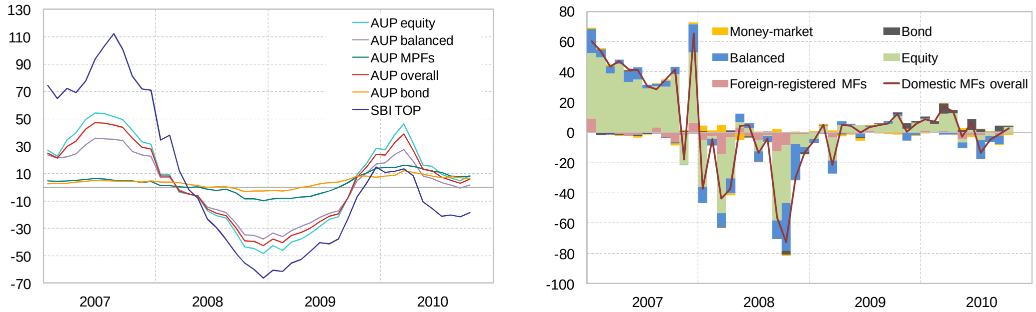
Mutual fund assets were up 6.7% over the first ten months of 2010, while the value of investments companies' assets was down 26.9%.

The assets of collective investment undertakings were up 1.0% over the first ten months of 2010 to stand at EUR 2,256.4 million. The proportion of collective investment undertakings accounted for by mutual funds rose from 83.1% to 87.8% over the same period. Mutual fund assets were up 6.7% to EUR 1,980.5 million owing to net inflows of EUR 32.6 million and favourable price developments.

Over the first ten months of 2010, equity and bond funds recorded total net inflows of EUR 63.1 million, while balanced and money-market funds recorded net outflows of EUR 29.7 million. Relatively higher net inflows into mutual funds were characteristic of the second half of 2009 and the first half of 2010. The insurance sector recorded the largest net inflows into mutual funds (of EUR 88.5 million), while the other sectors primarily recorded net outflows.

Annual growth in the average unit price of mutual funds stood at 6.2% at the end of October 2010, strongly outpacing growth in the SBI TOP index (-18,3%). Mutual funds were successful primarily owing to the improved diversification of investments. Investment companies with an investment strategy focusing primarily on Slovenian corporates generated poor results. The value of investment companies' assets was down 26.9% over the first ten months of 2010.

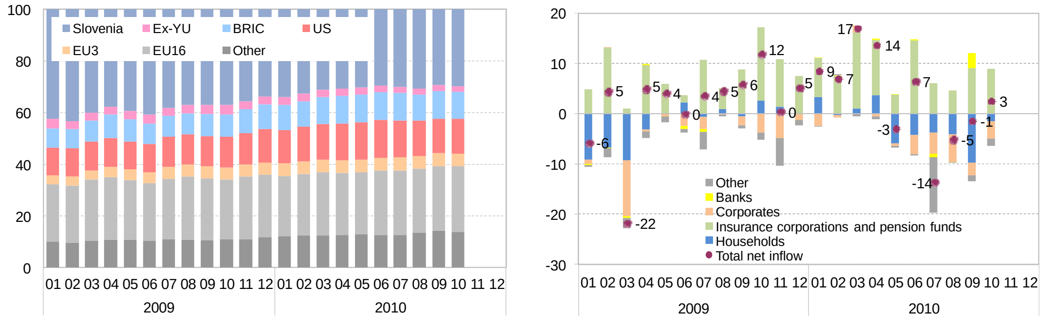
Figure 2.6: Annual change in the average unit price of mutual funds and the SBI TOP in percentages (left) and net cash flows into mutual funds in EUR million (right)



Sources: SMA, LJSE, Bank of Slovenia

At the end of October 2010, Slovenian securities still accounted for the highest proportion (29.7%) of mutual funds' portfolios, followed by investments in securities from the euro area (25.3%), the US (13.5%) and the BRIC countries (10.5%). The investment focus of mutual funds did not change significantly during the last year. Minor changes in the breakdown of investments are primarily a reflection of different developments on the international securities markets.

Figure 2.7: Regional breakdown of mutual fund investments in percentages (left) and net cash flow into mutual funds by sector in EUR million (right)



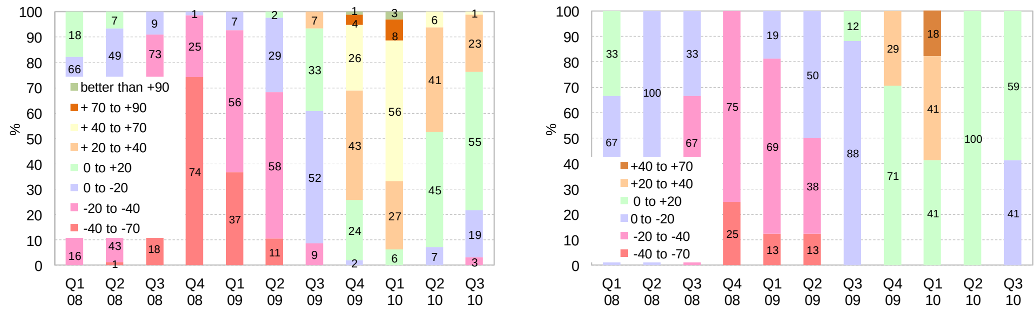
Note: BRIC: Brazil, Russia, India and China; EU3: UK; Denmark and Sweden; EU16: euro area; Ex-YU: former Yugoslav republics

Sources: SMA, Bank of Slovenia

The highest return at the end of October 2010 was recorded by equity mutual funds with growth in unit prices of 8.5%, followed by bond funds at 6.6%.

The classification of mutual funds in terms of return was quite dispersed at the end of October 2010. The gap between equity and balanced funds and bond and money-market funds closed owing to falling returns on the international equity markets. The highest return was recorded by equity mutual funds with growth in unit prices of 8.5% at the end of October, followed by bond funds at 6.6%, balanced funds at 1.7% and money-market funds with an annual return on average unit prices of 1.7%. Only 24% of equity funds achieved a return of 20%, while no balanced funds, bond funds or money-market funds achieved a return of more than 20%.

Figure 2.8: Relative distribution of domestic equity funds (left) and domestic balanced funds (right) in terms of annual change in average unit price



Source: SMA, own calculations

Outflows from mutual funds were up again in the first half of 2010, resulting in an increased proportion of liquid assets in the third quarter of 2010.

The proportion of liquid assets[20] declined further in the first half of 2010, and then returned to the level recorded at the beginning of the year during the second half of 2010 in the context of increased demand for payments from mutual funds. The proportion of total assets accounted for by liquid assets stood at 10.7% at the end of October 2010, up 0.7 percentage points on the end of 2009.

Tabel 2.5 Liquid assets as a proportion of mutual funds' total assets in percentages

(%)	Bond	Balanced	Equity	Money-market	Overall
Q1 2008	30.2	11.7	9.2	99.5	11.1
Q2 2008	36.8	10.7	8.9	99.2	10.5
Q3 2008	39.9	10.4	9.7	99.7	11.2
Q4 2008	37.1	11.4	11.1	99.5	12.8
Q1 2009	38.5	11.3	8.3	99.6	11.4
Q2 2009	39.6	18.3	9.0	99.8	14.0
Q3 2009	37.1	16.6	8.1	99.4	12.4
Q4 2009	36.2	15.3	7.4	99.3	11.4
Q1 2010	30.5	14.0	7.0	99.4	10.6
Q2 2010	27.6	12.8	6.4	99.1	9.9
Q3 2010	29.1	13.8	6.9	99.1	10.7

Sources: SMA, own calculations

[20] Liquid assets include cash, deposits, money-market instruments and government bonds.