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BANK OF SLOVENIA

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Mr. President, Honorable Members of Parliament,

The Governing Board of the Bank of Slovenia adopted on its 201st regular session on 28 March 2000 the 1999 business report and the annual financial statements for the year 1999, together with the opinion on the state of the Bank's affairs given by the authorized auditors PricewaterhouseCoopers AG, Zürich.

Let me highlight some of the most significant issues, which determined the framework for the monetary and exchange rate policies of the Bank.

A number of structural changes took place in early 1999: the EU Association Agreement came into force on February 1. Its enforcement can be considered a milestone in the area of capital flows, their additional liberalization in particular. The new Banking Law was adopted in the same month. The law brought banking in line with the relevant European Banking Directives. Among others, it introduced the possibility for the establishment of foreign bank branches and additional foreign competition in the field of financial intermediation. The interbank agreement on deposit interest rate ceiling expired on March 1. The Parliament adopted the new Foreign Exchange Law in April. The law introduced foreign currency accounts for resident legal persons and ensured equal treatment of residents and non-residents, and a higher degree of capital mobility. The Law on Value Added Tax (VAT) came into force on July 1. An increased domestic activity in the form of a temporary surge in domestic demand (reflected both on domestic market and imports) prior to VAT introduction was particularly characteristic of the second quarter of 1999. Finally, the new Securities Law and the Pension Law were adopted.

The new legislation affected to a great extent the decisions of market participants. In the first half of the year, economic growth was mainly fuelled by accelerated growth in domestic real private consumption, accompanied by higher consumer credit activity. The increase in spending was centered largely on durable goods, automobiles in particular. In the second half of the year economic growth was due to an increase in foreign demand reflecting an upturn in the European economy.

Developments were shaped by changes in the external environment – the slowdown in some and economic difficulties in other countries with which Slovenia used to have a significant current account surplus (and to a lesser extent by the Russian and Kosovo crises). As a consequence, their economic growth and purchasing power declined substantially. At the same time, on international markets oil and some other commodity prices started increasing. The current account recorded, for the first time since independence, a deficit, as high as 2.9% of GDP. Borrowing abroad increased to the extent that only 3/4 were covered by the international reserves at the end of the year, while both, the reserves and the external debt were still on about the same level as at the end of 1998. Economic growth would have been even lower if it was not for the increased credit activity with foreign countries and for foreign direct investment. Therefore, it is necessary in future to give more attention to domestic savings in order to achieve a long-term stable growth and the aspired EU membership.

CPI inflation fell to 4.3% in the year to June 1999, and amounted to only 2.7% on December 1998/June 1999 basis. However, the introduction of VAT had a major impact on price growth in the third quarter (some 3.4% between July and September) and, together with increasing oil prices, an impact on the annual CPI. The CPI average amounted to 6.1%, and the December/December CPI 8%. Unlike in the previous year, consumer price growth was uneven; it varied greatly from item to item and from service to service.

Competitiveness of a national economy is, among other things, also dependent on the wage level. Gross wage growth reached 3.3% against 1998 in real terms due to the developments in the private sector at the end of the year and those in the public sector during the year. It actually reached the current level of growth in productivity. Such growth of wage costs negatively affects competitiveness of our economy and has a negative impact on the macroeconomic situation.

The above developments dictated the Bank's monetary policy in pursuit of the ultimate objective: European price and inflation level. M 3 remained the narrow monetary policy target with a target growth range between 16% and 24%. The realized M 3 growth reached 16%, the bottom of its target range. Domestic liabilities of the banking sector accounted for most of the M 3 growth. The narrow money aggregate M1 and M 2-growth structure shows that maturity of bank deposits changed and that on average demand for liquidity increased. Household deposits increased by modest 7% in real terms (against 14.3% in 1998), mostly due to the above-mentioned surge in domestic demand ahead of the introduction of VAT.

The development also had an impact on the domestic foreign exchange markets where demand exceeded supply for most of the year, and dictated an even more prudent policy, the Bank's intervention sales and purchase of foreign exchange. A part of the foreign exchange reserves was sold (just above USD 100 million) to cover the current account deficit and the effects of a modest net foreign capital inflow. The effective Tolar exchange rate depreciated by 5.5% in nominal and by 0.6% in real terms (measured by relative consumer prices). Higher than the average was depreciation against the USD (8.6% in nominal and 5.3% in real terms). However, Tolar appreciated somewhat against some major European currencies – e.g. by 0.4% against DEM and by 0.5% against ATS and FF (in real terms).

Domestic interest rates reflected the declining inflation in the first half of the year on the one hand and the increase in demand for Tolar loans on the other hand. The Bank adjusted its monetary policy instrument rates to the current inflation. With other words, short-term deposit rates remained relatively stable, long-term rates, on the other hand, increased in the second half of the year. Similar was the development of bank lending rates, especially long-term. They increased from the lowest level in February of 6.8% above the Base Rate to 8% above the Base Rate in December.

As evident at first glance, and certainly even more so from the annual report itself, the changes in the domestic and the external environment were substantial. The impact of the external environment on activity was partly offset by encouraging results in domestic stability. However, inflationary expectations *increased in the same period. Given the openness of the Slovenian economy and its dependence on international trade, undergoing globalization and requiring total liberalization of capital controls, it seems reasonable to expect and look for further economic growth, but only with further domestic stability.*

Economic growth in a long-term stable environment is the only guarantee for successful integration of Slovenia in the European Union. An easing of domestic monetary policy cannot replace structural reforms still needed and cannot bring about better results in terms of stability. An increase in national savings is certainly an imperative, it is the base for new investments and further reduction of interest rates, and so is a moderate wage growth below that of our competitors from the European Union, and a balanced budget based on the present level of real growth. Monetary policy can make a substantial contribution on the national level. Any other scenario can lead Slovenia away from its target. Only a consensus among social partners, and a coordinated action of the fiscal, incomes and monetary policies can bring about the targeted results. Parliament does and should play a major role with this.

I take this opportunity to thank all of you for your cooperation, support, understanding and confidence, and to express my wish and hope that such cooperation will continue and further develop in the future. I also find this a good opportunity to thank the Bank's Board Members for their efforts and constructive contribution to the efficient and effective monetary policy.

Finally, I thank all my associates and the Bank staff for their daily contribution to the implementation of monetary policy and to identification of the most efficient measures aimed at further reduction of inflation and increase of confidence in and stability of the Tolar.

Ljubljana, March 28, 2000

Dr. France Arhar
Governor

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1. ECONOMIC ENVIRONMENT

1.1. Global Economic Environment

The adoption of the Euro by eleven Member States of the European Union was the most significant event of 1999, but so were the development of crude oil and other commodity prices, the interest rate development and the economic recovery of Slovenia's major economic partners.

World economic growth increased to 3.3 %

After the slowdown to 2.5% in 1998, the world economy recovered and is estimated (by the IMF) to have grown at 3.3%. The economy of the EU grew by 2.2% and that of the U.S.A. by 4.0%. After the sharp decline in 1998, the Japanese economy is estimated to have grown at 0.7%. Among the EU member countries, major economic partners of Slovenia, the French economy grew above the average (at 2.7%), and that of Italy and Germany below the average (at 1.3% and 1.4% respectively). The GDP of Croatia is estimated to have dropped by 1.5%, that of the Czech Republic by 0.5%. The Russian economy is estimated to have grown at 1.7% (after a decline by 4.6% in 1998), the Polish at 3.9% and the Hungarian at 4.1%.

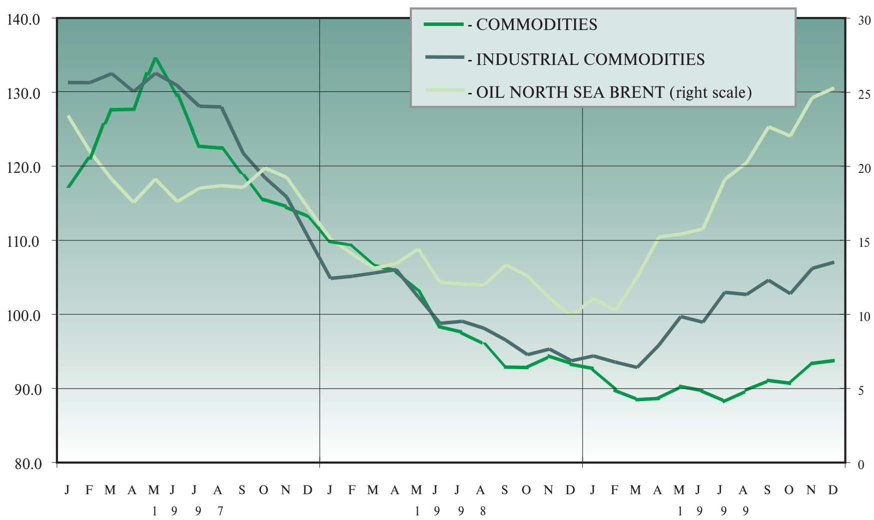
Foreign demand increased in the second half of the year

According to the OECD, international trade increased by 4.9%. The seven Slovenian major trading partners, without Croatia, increased their imports of goods by 4.7% (among them Germany by 5.5%). Foreign demand was less favourable in the first half of 1999, but increased during the summer and even more towards the end of the year.

High crude oil prices

After the decline during the previous two years, prices of crude oil took an upward turn in March 1999. While the price for the North Sea Brent was still USD 11.1 per barrel in January, it climbed up to USD 25.3 per barrel in December 1999, an increase of 130%. The crude oil price increased on average by 40% against 1998. As a consequence, import prices increased and so did consumer and producer prices. The downward trend of international US Dollar-denominated commodity prices stopped in the second half of the year.

Figure 1: **Commodity** (1998=100) **and Oil Prices** (North Sea Brent in USD per barrel) **in International Markets** (1997-1999)



Source: The Economist, London; OPEC Bulletin, Vienna.

In spite of the increase, the average commodity prices in 1999 were still 9.5% below those of the previous year, whereof food 17.5% and industrial commodities on about the level of the 1998 average (an increase by 0.1%). The share of base commodities (groups 0 – 4 according to SITC) reached 17.3% in Slovenian commodity imports and 6.3% in exports.

Decline in value of new European currency

The single European currency was introduced in January. In the first month after its introduction its average exchange rate was USD 1.16. The Euro depreciated against the USD throughout 1999 and reached USD 1.01 by the end of the year. In the course of 1999, the USD appreciated against the single European currency by nearly 15%.

Terms of trade worsened by 0.4 %

Slovenian terms of trade worsened on average by only 0.4% (against an improvement of 2.5% in 1998) in spite of the increasing oil prices. Slovenian US Dollar denominated export prices decreased by 8.9% against the 1998 average, and the US Dollar denominated import prices decreased by 8.6%, the above mentioned appreciation of the USD included. The appreciation of the USD not taken into account, the Slovenian US Dollar denominated export prices declined by 4.4% and the import prices by 4.0%.

Low interest rates in international markets

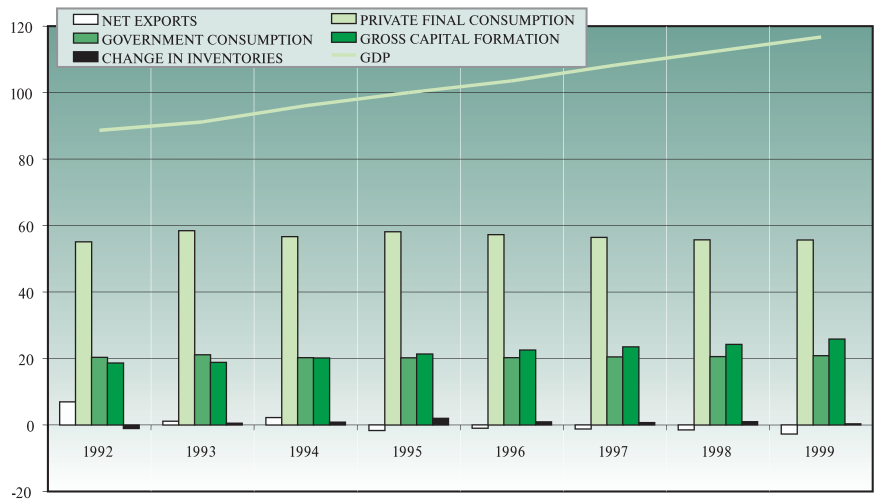
Interest rates in international financial markets remained low in spite of indications of an increase throughout the year. The average USD 3-months LIBOR amounted to 5.41% (in December 6.13%), and for the Euro 2.96% (in December 3.44%).

1.2. Gross Domestic Product, Employment and Labour Costs

GDP growth estimated at 4 %

GDP is estimated to have grown at 4% in real terms, against 3.9% in 1998. Growth was slow to start with and accelerated in the second quarter - prior to the introduction of VAT – and remained on satisfactory level in the second half of the year with the economies of the European Union on their way out of the slowdown.

Figure 2: **GDP Structure** (1992-1999; GDP 1995=100)



Source: Statistical Office of RS and Institute of Macroeconomic Analysis and Development.

Surge in domestic demand is the key growth factor

Unlike in the previous two years, the influence of domestic demand on growth exceeded that of foreign demand. Domestic demand increased by 4.7% against a 4.6% decrease in 1998.

Investment increased above the average (14%, especially in the fields of construction and infrastructure) and so did government spending (5.1%)

Exports of goods and services increased by 3.6%, starting in the second half of the year (against 7% in 1998 and 11.3% in 1997); their share in GDP dropped by one percentage point to 55.7%. As regards domestic demand, investment increased most (14%) and above the average, which was also the case in public spending (5.1% against 5.6% in 1998). Exceptional growth of investment in building construction were recorded. Investment in road construction, railroad and telecommunication infrastructure also increased. With the current account in a substantial deficit, the gross domestic savings, unlike in the previous years, remained below the level of gross investments. Final consumption increased by 3.7%, more than it did in the previous years (2.3% in 1998 and 3.3% in 1997).

Gross investment exceeded gross domestic savings

The increase of real value added is estimated at 3.2%, somewhat less than in 1998 (3.7%). Against the GDP, it increased at a slower pace, by 0.8%, which is due to a substantial increase in net production and import taxes, to an increase in domestic

Table 1: **Selected Economic Indicators**

	1993	1994	1995	1996	1997	1998	1999[1]
Real growth of gross domestic product[2] in %	2.8	5.3	4.1	3.5	4.6	3.9	4.0
Gross domestic product in USD millions	12,673	14,386	18,744	18,878	18,206	19,523	19,801
Gross domestic product in USD per capita	6,366	7,233	9,431	9,481	9,163	9,847	10,004
Structure of Gross domestic product in % of GDP							
Agriculture, forestry and fishing	4.5	4.0	3.9	3.8	3.7	3.4	3.4
Industry and construction	33.4	34.4	32.6	32.7	32.9	33.1	32.6
- Manufacturing industry	25.9	26.2	24.6	24.1	24.3	24.0	23.6
Services	49.9	49.0	50.2	50.6	51.5	51.2	50.8
Added value - total	86.1	85.5	84.8	85.0	86.1	85.7	84.8
Compensation of employees	60.1	58.0	57.2	54.8	53.6	52.3	51.7
Taxes on production and imports, minus subsidies	13.9	14.2	14.8	15.3	14.9	15.4	16.5
Gross operating surplus and mixed income	26.0	27.8	27.9	29.9	31.6	32.2	31.8
- Exports of goods and services	58.8	60.0	55.2	55.6	57.1	56.7	55.7
- Imports of goods and services	57.7	57.8	56.8	56.5	58.3	58.1	58.4
Net exports	1.1	2.2	-1.6	-1.0	-1.2	-1.4	-2.7
Private final consumption	58.5	56.7	58.1	57.3	56.5	55.7	55.7
Government consumption	21.1	20.2	20.2	20.2	20.5	20.6	20.8
Gross investment	19.3	20.9	23.4	23.5	24.2	25.2	26.2
Active population[3] in thousands	930	936	952	943	978	978	967
Employed and selfemployed	792	781	882	874	906	901	895
Unpaid family members and informal kind of jobs	53	70	53	52	65	58	58
Unemployed	85.0	85.0	70.0	69.0	72.0	77.0	72.0
Unemployment rate (% of unemployed in active population)	9.1	9.1	7.4	7.3	7.4	7.9	7.4
Real growth of gross wage per employed in %	13.3	3.6	5.1	5.1	2.4	1.6	3.2
Real growth of labour productivity in %	4.6	5	3.3	4.4	5.1	3.9	3.3

1 Data (except for real GDP growth and real growth of average gross wage) for 1999 estimated by Institute of Macroeconomic Analysis and Development.
2 Since 1995 in constant prices of 1995, previously in constant prices of 1992.
3 Internationally comparable data by ILO methodology.
Source: Statistical Office of RS and Institute of Macroeconomic Analysis and Development.

demand and imports ahead of introduction of value added tax. A decrease of value added was recorded in mining (-5%), supply of electricity, gas and water (-5%). Value added increased above the average in civil construction (9.9%) and trade (4.9%).

Box 1: **Ownership Transformation Process Completed**

Transformation of ownership of companies, until the late eighties still "social", took place by distribution, sale or nationalization of capital.

The process first started in the late eighties pursuant to the Yugoslav legislation. Since transformation of status and legal ownership was not subject to any supervision at that time, a revision took place later in the framework of the revising of the process as such. As many as 1,122 cases were revised and the damage supposedly incurred to 658 companies in social ownership established at SIT 86,174 million.

The bulk of the companies were privatized pursuant to the Law on Ownership Transformation of Socially Owned Companies adopted in 1992. The managing board of a company was able to decide on the manner of transformation (except in cases of public entities, forestry, cooperatives, banks, insurance companies, companies engaged in gambling, bankrupt companies and some other minor exceptional cases). The law provided for a combination of different possible methods and required an obligatory transfer (40%) of shares of the existing social capital as follows: 10% of ordinary shares to the Pension Fund, 10% to the Compensation Fund and 20% to Development Fund for further distribution among the Authorized Investment Companies. The remaining 60% could be privatized as follows: internal distribution and sale to employees up to 40% of ordinary shares (also against privatization vouchers), public sale of up to 60% of ordinary shares, sale of company assets total or transfer of shares to the Development Fund and increase of capital.

A special feature of the privatization process was the distribution of privatization vouchers in nominal value SIT 567 million (corresponding to about 40% of the social capital of companies undergoing ownership transformation) to more than 2 million citizens in October 1993, the individual value of vouchers depending on the citizen's age. The vouchers could be used for purchase of shares of the employer, the shares of Authorized Investment Companies, purchase of shares in public sale and purchase of any other shares offered for sale against vouchers. According to estimates of December 1999, the demand (vouchers) in Authorized Investment Companies exceeded the supply (shares of companies) by SIT 158.1 billion. This "privatization gap" is to be closed in the course of privatization of state owned companies (in addition to SIT 100.1 billion worth of stakes in state owned companies/public power utilities, a portion of controlling stakes in state owned banks, insurance companies and steelworks, and additional assets of about SIT 18 billion are to be transferred).

Companies were obliged to prepare their privatization plans by the end of 1994 and deliver these to the Privatization Agency. By July 31, 1998 first approval was issued by the Agency to 1,436 privatization plans with the opening balance capital total of SIT 1,148.3 billion, whereof SIT 784.7 social capital. By the end of 1998, ownership transformation was completed based on the second approval issued by the Agency to 1,381 companies; shares of 141 companies were transferred to the Development Fund. Bankruptcy or liquidation procedures were initiated in 82 companies. Privatization took quite a long time due to a number of problems related to the Slovenian transition to a market economy.

The composition of capital in companies privatized pursuant to Privatization Law is as follows: 27% owned by internal owners - employees, 17% owned by Authorized Investment Companies, 15% owned by state funds, 9% purchased in public sales, and 32% having other owners (for the most the state, old ownership structures, cooperatives and beneficiaries under denationalization processes). Internal owners prevail in smaller work-intensive companies. Unlike some other countries in transition, non-residents were not given an important role in the process. There was no fresh capital from abroad; some residents even postponed direct investment until privatization was completed. The process affected general economic activity, investment trends and formation of additional production capital. Completion of privatization process triggered new investment, increased profitability and efficiency of companies.

The government plans to privatize stakes of state-owned companies worth SIT 2,000 billion. The Insurance business Law adopted in January 2000 paves the way for privatization of insurance companies. Privatization plans include the two state-owned banks, transportation infrastructure, telecommunications, public power utilities and others.

The growth of value added in manufacturing slowed down to an estimated 2.7% (against 5.1% in 1998). Its output remained on the 1998 level, the industrial production, on the other hand, dropped by 0.5%.

Real wage growth 3.2%…

Wages grew at a considerably higher pace than in 1998 and faster than the envisaged 2% in real terms, in spite of the agreement on wage growth in 1999 among the social partners. Real average gross wage grew at 3.2% and nearly reached the level of the growth in productivity. Wages in manufacturing increased by 2.8% in real terms. Productivity increased by 3.3% and remained below that of 1998 (3.9%) and 1997 (5.1%). Labour costs (51.7%) did not decrease at the pace of the previous years (from 64.1% of GDP in 1992 on average by 2 percentage points per year, reaching 52.3% of GDP in 1998). The share of production and import taxes increased by 18.7%, given that taxes on goods and services increased by 1.1 percentage point, and that import taxes declined by 0.3 percentage point. However, the operating surplus remained on the level of 1998: 22% of GDP.

… and growth of productivity 3.3%

Relatively favourable changes in labour market

Employment was favourable, partly due to methodological changes in recording the employed: as of January 1999 this category includes those employed in public works, prior to that date recorded as unemployed, and partly due to implementation of the Law on Labour and Unrecorded Employment. The increase in domestic demand and accelerated growth in some industries also spurred employment. The number of workers employed by entrepreneurs increased most and so did the number of self-employed. It also increased in enterprises and institutions. Employment kept increasing in services (1.6% against 1998), most of all in real estate, rental and business services. A further decline in employment was recorded in agriculture (-3.7%), manufacturing and civil construction (- 0.4%) and mining. Still, some other industries recorded an increase. Almost all manufacturing industries but wood and metal manufacturing recorded a decline. The decline was strongest in production of leather and vehicle production and ship construction.

Unemployment rate by ILO standards 7.4%

The number of internationally comparable active persons decreased by 11,000, of which 5,000 (5% of active persons) unemployed. After a slight increase in 1998 (7.9%), the unemployment rate decreased to the level of 1997 (7.4%). The unemployment rate varies from region to region. The highest rate of unemployment is recorded in the Drava, the Mura, Savinja, the middle and the lower Sava regions. Women, young people (seeking their first job), persons above 40 years of age and persons with low qualifications are the critical groups. The authorities have put in place a set of active policies (Long-term Labour Market Development Strategy until 2006, National Labour Action Plan for 2000 and 2001) to solve the problem of unemployment.

1.3. Public Finances

New legislation adopted

Major structural measures were adopted in public finances: the Accounting Law was adopted in April, the indirect tax system was reformed with the introduction of Value Added Tax and Excise Duties in July, the Law on Public Finances was adopted in September, and Pension Law in December 1999.

Budget deficit 0.6% of GDP

The consolidated government sector ended up with a deficit of SIT 23 billion (0.6% of GDP), which is less than projected. The deficit was lower than that of 1998 by 0.15 percentage point due to a more rapid growth of revenue than spending.

Budget deficit below that of 1998 by 0.15% due to faster growth of revenue (taxes on goods and services)...

General government revenue increased by 13.6% in nominal terms, its share increased from 43.0% in 1998 to 44.2% of GDP. Most of the increase was due to increases in several taxes on goods and services by 25.0%, holding a share of 16.7% of GDP. The share of customs tariffs decreased by 0.2 percentage point to 1.3%, and so did social contributions, property tax and non-tax revenues.

... than spending, among which transfers (subsidies in particular).

Investment by the government reached the highest level ever

Revenue growth reached 13.1% in nominal terms and held a share of 44.8% of GDP (against 43.8% in 1998). On the spending side, transfers increased most by 14.7% (subsidies increased by 0.2 percentage point of GDP or 28% and transfers to households by 0.3 percentage point or 12.7%). The share of pensions increased to 12.3% of GDP (against 12.1% in 1998). The implementation of the new Pension Law should ensure that their share remains on the same level during the next few years. Investment by Government increased by as much as 32.5% (0.5 percentage point of GDP) and reached by far the highest level ever: 3.0% of GDP.

1999 revenues included VAT for 1999 collected in January 2000

Pursuant to the Budget Law, VAT and excise duty revenues charged and levied for 1999 but collected by the end of January 2000 (about SIT 34 billion and SIT 11 billion respectively; in 1998, SIT 22 billion of sales tax collected by mid-January 1999) were included into the fiscal year 1999 to close the revenue gap incurred upon introduction of VAT. The Public Finance Law adopted in 1999 limits the revenue management to that collected by the end of the current year.

Repayments of debt by the Republic of Slovenia amounted to SIT 132 billion (3.7% of GDP). Repayments of principal due and prepayments amounted to SIT 81 billion

Box 2: **Introduction of VAT and Excise Duties**

As of July 1 1999 the value-added tax and excise duties replaced the old sales tax system as part of the EU alignment process in the field of legislation and public finances.

Introduced were the VAT general rate of 19% and the reduced rate of 8%. They apply to supply of goods and services by taxable persons on the territory of the Republic of Slovenia and on imports of goods into Slovenia. Exempt from VAT are public services like postal, medical, social security and some other services, as well as exports of goods and export-related services. There are about 66,000 persons liable to payment of VAT in Slovenia. The number exceeds that calculated on the basis of data from 1997 (about 52,000).

The Law on Excise Duties introduces several excise duties to replace special levies on items with less flexible prices (alcohol, tobacco, oil products and natural gas), produced in Slovenia or imported. Taxable persons under this law are producers and importers of such products. The level of excise duties is determined in relation to quantity, except in the case of tobacco products.

In addition to the above, some laws regulating taxation of some other goods and services were adopted in 1999: taxes on transactions with immovable property, on insurance business, on sales of motor vehicles and on gambling. Payment of VAT by taxable persons is due on the last day of calendar month in which goods were delivered and services supplied. This is why the inflow of general government revenues is subject to strong fluctuation. But still the level tax revenues collected in 1999 (including those for December 1999 actually collected in January 2000) met the expectations.

As expected, the introduction of VAT had an impact on the price level (due to changes in relative prices and effectively higher taxes). It was of great importance to prevent the complete spillover effect on wage growth. To this end the social partners concluded a special agreement on wage growth prior to the expiry in 1999 of the Law on Minimum Wage and on Wage Adjustment in force since mid 1997. The law allowed for wage adjustments up to 85% of CPI in the first six months (2.3%) in August. Should the CPI at the end of 1999 have reached 6.8% (against December 1998), then the wage increase for the next month would have equaled 85% of CPI for the same period. However, the above special agreement excluded the effect of VAT on price growth from wage adjustment both in August and in January 2000 and kept wage growth moderate.

or 2.3% of GDP (SIT 66.4 billion to domestic creditors and SIT 14.6 billion to foreign creditors). Repayments to domestic banks amounted to SIT 33.3 billion; payments under government bonds issued SIT 32.6 billion.

Domestic government bond issued (RS 14) amounted to SIT 6.3 billion. In addition, the government took loans from domestic banks in an amount of SIT 24.5 billion. Treasury bonds with maturity of 3 months were issued on a monthly basis (SIT 2.5 - 4 billion per month), those with maturity of 6 months were first issued in October and every two months thereafter (SIT 2 billion every two months).

EUR 400 million Eurobonds issued

Central Government debt increased to 25% of GDP

Foreign borrowing by the government includes the Eurobond issue of EUR 400 million and loans taken abroad of USD 17 million. According to preliminary data, the government cash and deposit accounts increased by SIT 14.2 billion. Central government debt amounted to SIT 893.3 billion or 25% of GDP (against 23.6% in 1998), whereof about 56% domestic and 44% external debt (against 38% in 1998).

Box 3: **Pension Reform**

The Parliament enacted the Pension and Disability Insurance Law on December 10, 1999 (Official Gazette of RS No. 106/99) that set the pension reform in motion. The law introduces the following major changes:
- new rates of minimum contribution for self-employed;
- separate contributions for disability allowance and for allowance for physical impairment as a consequence of employment injury or occupational disease;
- smaller gap in rights between women and men;
- retirement is made more flexible;
- right to state pension is introduced for persons above 65 who have not fulfilled the conditions for a pension, nor do they have another adequate financial source to live on;
- introduces a multi-pillar pension scheme.

The first pillar contains the present obligatory pay-as-you-go scheme based on solidarity among generations. The new second pillar contains the supplementary pension and disability insurance of persons insured under compulsory and voluntary insurance. The third pillar adds voluntary individual pension and disability insurance based on personal savings accounts. The compulsory insurance (first pillar) carrier and provider shall be the Pension and Disability Insurance Fund. Compulsory insurance shall be paid by the insured, employers and in part by the budget. It shall also be financed by the Capital Fund of the Pension and Disability Insurance and by other sources. There is more than one carrier to the second pillar: the supplementary insurance under compulsory insurance is carried by the Supplementary Pension Insurance Fund, the carriers of voluntary supplementary pension and invalidity insurance, on the other hand, by pension funds. The employers shall pay compulsory supplementary insurance contributionsfor specific categories of employees (working under especially demanding conditions); voluntary supplementary insurance shall be paid by employers and persons insured. The third pillar adds voluntary individual pension insurance provided by organized pension funds. It is tax deductible and aimed at persons which cannot or do not wish to be included in the second pillar voluntary supplementary scheme.

Pursuant to the pension reform the retirement age will gradually be raised (over 15 years). After the transition period the retirement conditions will be as follows:
- minimum retirement age for women and men 58;
- full pension qualifying occupational period 38 years for women and 40 years for men;
- full retirement age 61 for women and 63 for men.

The minimum retirement age of a mother and the full retirement age of both parents shall be reduced by a certain number of months on account of parenthood, depending on the number of children born or adopted. Pension benefits shall be scaled back gradually. In case of full retirement age attained, pension shall be determined dependent on the pension qualifying occupational period. In case of minimum retirement age, the pension will be calculated based on a smaller percentage of individual earnings while employed.

1.4. Financial Market

Monetary financial intermediaries prevail with a market share of 70%

As of December 31, 1998 monetary financial intermediaries held a market share of 70% (24 banks, 6 savings banks and 70 savings and loan undertakings) in terms of the balance sheet total. The balance sheet total of non-monetary financial intermediaries (46 authorized investment companies, 15 mutual funds, 14 insurance companies, of which 10 insurance and 4 reinsurance companies, and 80 leasing companies) does not exceed half of that of credit institutions. 28 non-bank brokers (bank brokers, also financial agents, are included in the balance sheets of banks) account for only one percent of the balance sheet total of financial sector.

Banks are still the most important financial intermediaries with a share of 98% in the balance sheet total of all credit institutions and 68% of balance sheet total of the financial sector.

Authorized investment companies most important among non-bank financial intermediaries

Authorized Investment Companies (which had had shares of social capital transferred to them on the one hand, and collected privatization vouchers on the other hand) hold a share of 57% in the balance sheet total of non-bank financial intermediaries. Their liabilities amounted to SIT 599 billion at the end of 1999, privatization vouchers account for more than half of this amount, more than 50% of which still is not covered by the corresponding company shares.

The operation of financial agents (a total of 28 stockbrokers and 10 banks) is measured by way of total investments mediated. As at mid 1999 they amounted to SIT 529 billion, which ranks them equal to the authorized investment companies.

Insurance and reinsurance companies are about half the size of authorized investment companies. Leasing companies also play a major role among the non-bank financial intermediaries.

Only 8 primary sales in 1999

Primary market sales were modest. A total of 8 initial public offerings took place in 1999 (6 bonds and 2 shares).

Box 4: **Securities Market Law**

The legal framework adopted in 1999 regulates the securities market and establishes the supervisory authority. Aiming at harmonization of the existing legislation with EU directives, the **Dematerialized Securities Act** and the **Securities Market Law** were adopted in 1999.

The new Securities Market Law is based on the **principles** ensuring transparency, safety and prudence, honesty in operation and introduces supervision of the market. Among others, the law specifies more systematically the conditions and the procedures for public offerings. It also imposes stricter capital requirements on stockbrokers, introduces stricter risk management rules based on EU directives. New is the section on guarantees of investors' claims on stockbrokers.

The Securities Market Law **stipulates** the procedures of operation of organized markets and fulfillment of obligations from transactions on such market, and specifies transactions with standard financial instruments. Pursuant to the law, the Securities Market Agency is an independent public institution in charge of supervision of the securities market and of its participants. Its legal standing is comparable to that of the Bank. It is not part of the government. Its tasks and responsibilities in the non-bank sector are similar to those of the Bank in the banking sector.

At the end of 1999, the Ljubljana Stock Exchange traded a total of 236 securities issued by 209 issuers (180 shares and 56 bonds). The market capitalization amounted to SIT 920 billion, equal to 28% of GDP. The value of transactions increased by 53% to SIT 266 billion. 84% of transactions involved shares, such as those of pharmaceutic companies Krka and Lek, commercial companies Mercator and Merkur and oil derivatives distributor Petrol. Trading with shares of Authorized Investment Companies increased (and equaled 25% of all trade in shares). Slovenian Stock Exchange Index (SBI) increased by 5.6%, that of Authorized Investment Companies (PIX) by 3%.

SBI increased by 5.6%

Transactions outside the organized market totaled SIT 135 billion, an increase of 37% against 1998.

Foreign portfolio investment was negative. Nonresidents net sold securities worth SIT 1.6 billion.

At the end of 1999, the Central Securities Clearing Corporation (CSCC) held a total of 879 securities (789 shares and 90 bonds) issued by 780 registered issuers. The market (or book, whichever was available) value of shares amounted to SIT 2,239 billion (69% of GDP), the market (or nominal, whichever was available) value of bonds SIT 436 billion (13% of GDP).

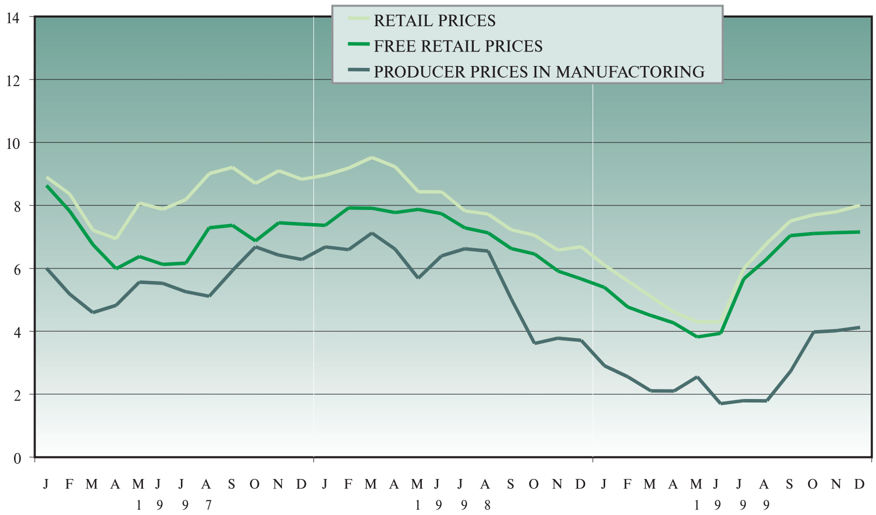
Portfolio investments of residents into securities issued by non-residents abroad amounted to SIT 20.5 billion (94% in bonds), and their investments into securities issued by residents abroad SIT 20.1 billion (89% in bonds).

1.5. Prices

The impact of external factors and domestic structural changes on prices was significant. Consumer prices increased by 8.0% (December/December) respectively 6.1% (1999 average/1998 average).

CP inflation increased (from 6.5% in 1998 to 8.0%)

Figure 3: **Prices** (annual growth rate from 1997 to 1999 in %)



Source: Statistical Office of RS and Bank of Slovenia.

Against the background of a favourable external environment, the deflation of industrial production prices in industrial countries in particular, CP inflation fell to 4.3% in the year to June 1999. However the introduction of VAT on July 1 had a major impact on the price level. The impact lasted some 3 months, which was less than expected.

Even more significant was the impact of the increase in oil and oil derivatives prices on international markets on the accelerated CP growth.

Free market prices increased by 7.2%

As all over the world, oil derivative prices increased most (21.7%)

Free market prices increased by 7.2% (against 5.7% in 1998). Significantly higher than before was the growth of food product prices (6.6% against 3.1% in 1998); on the other hand, growth of industrial production prices (6.8%) and of prices of services (8.5%) was similar to that in 1998. Growth of oil derivative prices was the fastest, as much as 21.7%. Prices in manufacturing which had been falling since 1992 faster than consumer prices increased by only 4.1%.

1.6. Balance of Payments

Current account deficit recorded for the first time: USD 581 million…

Current account recorded a deficit of USD 581 million (2.9% of GDP) after four years of being close to balanced. The deficit was partly financed by the net capital inflow, leading to a fast growth of foreign debt (the exchange rate differentials not taken into account). The official foreign exchange reserves dropped by USD 145 million.

…due to an increase in foreign trade deficit, a lower surplus in services, labour and capital income

Against 1998 the current account deficit increased by USD 578 million, of which the deficit in foreign trade was USD 382 million. The surplus in services was lower by USD 148 million, that in labour and capital income by USD 55 million.

Exports and imports in USD decreased…

Foreign trade deficit (according to balance of payments statistics with exports and imports F.O.B.) amounted to USD 1,157 million or 5.8% of GDP (against USD 775 million or 4.0% of GDP in 1998). According to preliminary data, exports of goods, expressed in USD, amounted to USD 8.546 million, a decrease by 5.6 % against 1998. Imports of goods in USD also decreased. Imports (CIF) totaled USD 9.954 million, a decrease by 1.5% against 1997. The export – import ratio reached 89.5%.

…and increased in real terms.

Growth of foreign trade in real terms exceeded that expressed in USD. The impact of changes in export and import prices (index 91.1 and 91.4 respectively) not taken into account, exports increased by 4.0% and imports by 7.9% in real terms.

According to trade statistics, the trade deficit (exports FOB, imports CIF) amounted to USD 1.409 million, and increased by USD 348 million or one-third against 1998. Faster growth of imports than exports of goods, but also less favourable terms of trade (0.4%) were the reason for the increase.

Contribution of foreign demand to economic growth was significant even though the growth of exports reached only half of that of the previous year. Foreign demand decreased in the first half of the year. It was offset by a temporary surge in domestic demand. Higher foreign demand led to an increase of exports in the second half of the year. Competitiveness of Slovenian economy measured by the market share of Slovenian exports in the European Union member countries deteriorated somewhat.

Imports increased prior to introduction of VAT

Among other factors, the introduction of VAT affected imports. Imports of investment and consumer goods increased considerably in June, ahead of VAT introduction as of July 1, which resulted in a substantial trade deficit (USD 296 million according to trade statistics). Imports declined during the subsequent months, but increased again towards the end of the year due to an increase of domestic economic activity and subsequent increase in imports of intermediate goods. Imports were also spurred by higher foreign demand resulting from increased foreign economic activity.

Imports of capital goods increased most

Imports of capital goods increased most, as was the case in previous years. Their share in total imports amounted to 16.5% (according to BEC classification), an increase of 0.9 percentage points against 1998. The share of consumer goods in total imports increased by 0.6 percentage point to 26.9%. The share of intermediate goods decreased by 1.5 percentage point to 56.6%. Exports of intermediate goods accounted for 51.4% of total exports, an increase by 1.6 percentage point against 1998. Exports of capital goods decreased by 0.3 percentage point to 9.8%. Likewise, exports of consumer goods decreased by 1.3 percentage point to 38.8%.

Trade with European Union predominated…

…with a deficit in trade with France and Italy, and the highest surplus in trade with Germany

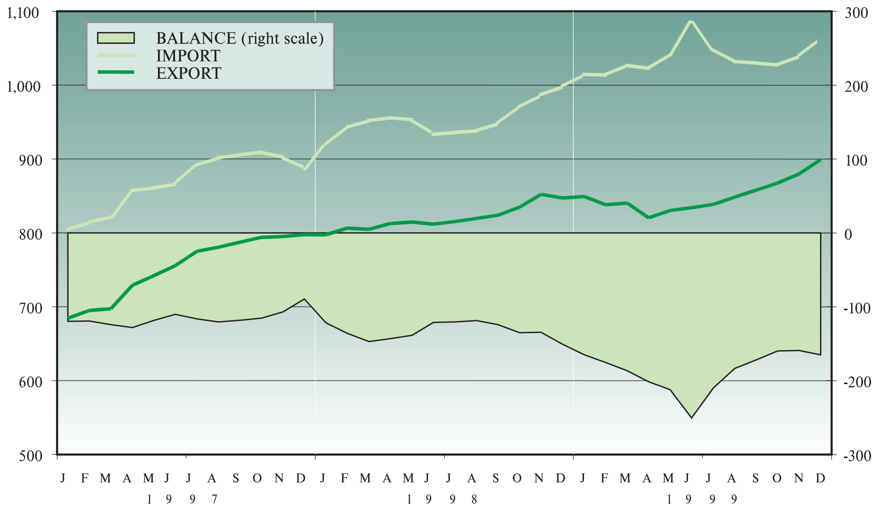
The regional composition of exports and imports changed slightly. With a share of 66.1% in exports and of 68.6% in imports European Union member countries kept their position as Slovenia's main trading partners. Among the member countries, Germany kept the largest share (exports 30.7%, imports 20.1%), followed by Italy (13.8% and 16.8%), Austria (7.3% and 8.0%) and France (5.7 and 11.0%). Despite a surplus of USD 621 million in trade with Germany, trade with EU countries ended in a deficit of USD 1.180 million (against USD 1,089 million in 1998), of which USD 602 million in trade with France and USD 449 million in trade with Italy. With an increase in trade surplus with Germany by USD 139 million, this country remained Slovenia's most important trading partner.

Lower surplus with successor states to SFR Yugoslavia and CIS countries

Trade with CEFTA increased

Slovenia recorded a surplus in trade with successor states to former SFR Yugoslavia (USD 724 million against USD 805 million in 1998) and with the CIS countries (USD 11 against USD 114 million in 1998). Trade with CEFTA member countries increased above the average. Imports from CEFTA countries increased by 2.3% (and represented 7.3% in total imports), and exports by 8.7% (and represented 8.5% in total imports).

Figure 4: **Volume Exports and Imports** (in USD) **and Foreign Trade Balance** (in constant prices of 1995) (1997-1999; seasonally adjusted)



Source: Bank of Slovenia.

The deficit in trade of goods and services increased from USD 261 million in 1998 to USD 791 million, i.e. from 1.4% to 4.2% of GDP. Trade in goods accounted for 72% and that of services for 28% of the deficit increase.

Surplus on services decreased by USD 148 million…

The surplus on services decreased by USD 148 million to USD 366 million, i.e. to 1.9% of GDP, only half of the highest level ever reached in 1996 (3.7%), owing almost entirely to the decline in surplus on travel. Surplus on travel decreased by USD 129 million to USD 413 million, owing to an increase in expenditure on travel abroad and a decrease in receipts. Receipts on travel decreased by 5% in real terms to USD 1.005 million. Receipts on travel have deteriorated since 1997. Last year, the Kosovo conflict had an additional negative impact.

…mainly due to a decrease in surplus on travel by USD 129 million.

For the first time deficit in construction services

Transport resulted in a surplus of USD 142 million (an increase by USD 10 million against 1998). The surplus registered in construction for many years changed into a deficit of USD 7 million due to a decrease on the export side by USD 14 million to USD 58 million, and an increase on the import side by USD 22 million to USD 65 million. Surplus in intermediation services exchange increased by USD 33 million to USD 42 million.

Other services, which have resulted in a surplus for years, were various business and technical services. In 1999, they resulted in a surplus of USD 115 million, an increase by USD 13 million against 1998.

Table 2: **Regional Composition of Foreign Trade**
(1997-1999, in million USD)

	EXPORT			IMPORT			BALANCE		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
European union (15)	**5,320**	**5.928**	**5,650**	**6,312**	**7,017**	**6,830**	**-993**	**-1,089**	**-1,180**
Austria	565	621	623	789	802	800	-223	-180	-177
France	463	748	491	980	1258	1093	-517	-511	-602
Italy	1,248	1,255	1,176	1,558	1,697	1,674	-310	-442	-499
Germany	2,459	2,572	2,626	1,936	2,089	2,005	523	482	621
CEFTA	**517**	**608**	**622**	**720**	**778**	**844**	**-203**	**-170**	**-222**
Czech republic	147	150	159	234	264	280	-87	-114	-122
Hungary	120	141	145	293	244	266	-172	-103	-122
Poland	155	181	190	58	78	110	97	103	79
EFTA	**87**	**98**	**112**	**194**	**208**	**237**	**-107**	**-110**	**-125**
Noneuropean members of OECD	**340**	**376**	**379**	**546**	**630**	**611**	**-206**	**-254**	**-232**
USA	243	252	258	287	296	292	-44	-44	-33
Successor states to former SFRY	**1,387**	**1,397**	**1,296**	**594**	**593**	**572**	**793**	**805**	**724**
Croatia	837	815	671	466	432	444	371	384	227
CIS countries	**432**	**330**	**213**	**284**	**216**	**201**	**148**	**114**	**11**
Russian federation	326	235	129	250	178	159	76	58	-30
Other countries	**287**	**312**	**274**	**716**	**668**	**660**	**-429**	**-356**	**-386**
TOTAL	**8,369**	**9,051**	**8,546**	**9,366**	**10,111**	**9,954**	**-998**	**-1,060**	**-1,409**

Source: Statistical Office of RS; provisional dyata for 1999.

Net labour income receipts declined

Net labour income receipts declined by USD 24 million to USD 184 million. The net deficit in investment income increased from USD 62 million in 1998 to USD 94 million. Investment income receipts decreased slightly (by USD 8 million to USD 217 million) mainly due to a decline in interest received and in international reserves, but partially also due to inter-currency fluctuations in favour of USD. The investment income expenditures increased by USD 23 million to USD 311 million and reflected not only much higher transfers abroad of investment income (USD 57 million) but also higher interest paid in real terms on foreign loans and on government bonds issued.

Net inflow from current transfers amounted to USD 120 million, an increase by USD 8 million against 1998.

Financial account recorded an increase in gross foreign loans to private sector

Net financial inflow totaled USD 436 million or 2.2% of GDP (against 1.0% in 1998, the lowest level recorded since 1992). Measures taken in the field of capital controls

Table 3: **Balance of Payments**
(1995-1999, in million USD; preliminary data for 1999)

	1995	1996	1997	1998	1999
A. CURRENT ACCOUNT	**-23**	**39**	**37**	**-4**	**-581**
- in % of GDP	***-0.1 %***	***0.2 %***	***0.2 %***	***0.0 %***	***-2.9 %***
1. Goods	-954	-882	-772	-775	-1,157
2. Services	631	704	590	514	366
2.1. Transport	70	76	101	132	142
2.2. Travel	558	687	643	542	413
- of which: exports	1,082	1,230	1,188	1,117	1,005
2.3. Other	3	-59	-154	-160	-189
3. Income	210	155	131	146	90
3.1. Labour income	210	210	208	208	184
3.2. Investment income	0	-55	-77	-62	-94
4. Current transfers	91	62	88	112	120
B. NET FINANCIAL INFLOWS	**513**	**868**	**645**	**204**	**436**
- in % of GDP	***2.7 %***	***4.6 %***	***3.5 %***	***1.0 %***	***2.2 %***
1. Commercial credits	-	163	186	104	379
2. Governent: bonds [1]	125	-75	-6	-20	12
other (including loans)	-70	129	-9	-51	-38
3. Private sector:					
3.1. Direct investment from abroad [2]	176	120	281	165	83
3.2. Portfolio investment from abroad [2]	15	68	92	16	-5
3.3. Loans from abroad	-1	-143	-249	-449	-408
- Banks [1]	445	530	340	279	745
- Enterprises	208	288	3	42	249
3.4. Other (including all outflows)	237	243	337	237	496
- Households					
- Banks, enterprises	6	-103	74	-28	-265
4. Bank of Slovenia	-39	171	-130	18	-112
5. Statistical error	-145	8	66	171	44
C. International reserves (increase (-))	**-490**	**-907**	**-681**	**-201**	**145**
1. Bank of Slovenia	-235	-587	-1,287	-112	126
2. Banks	-254	-320	606	-89	19

Correction to statistical BOP data:
[1] Excluded the book-entry transfer of foreign liabilities from banks to government liabilities (NFA bonds) in June 1996 and deducted transactions of domestic banks with government bonds.
[2] Breakdown of estimated direct and portfolio investment in the period from September 1996 to February 1997 estimated.
Source: Bank of Slovenia.

in February and in September accounted for an increase in foreign loans to private sector but did not spur foreign direct and portfolio investment.

The Government issued Eurobonds of USD 438 million. They resulted in net financial inflow (any such bonds purchased by domestic banks not taken into account) of USD 379 million.

Liabilities of the government under loans taken abroad net increased by USD 12 million.

Net financial inflow to the private sector was modest: USD 39 million. However, the gross financial flow under individual instruments was substantial, with a much higher net inflow under foreign loans on the one hand, unchanged high outflow under foreign commercial loans granted and high outflow by households (currency and deposits) on the other hand.

Lower foreign direct investment in Slovenia and an increase in direct investment abroad by residents

Foreign direct investment deteriorated further. It totaled USD 83 million, half of the volume of 1998. However, direct investment abroad by Slovenian residents increased to USD 44 million, a multiple of that in 1998 and more than the peak reached in 1997 (USD 25 million).

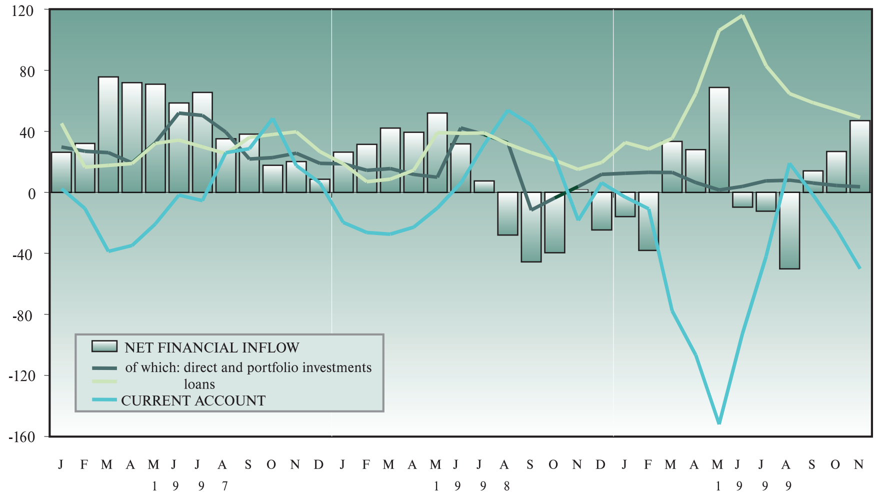
Net sale by foreign portfolio investors

Foreign portfolio investment deteriorated by USD 5 million. Net sale by non-residents was first registered in the second half of 1998 (in August, following the outburst of Russian financial crisis) and prevailed – except in the third quarter – in 1999. Measures allowing residents to invest abroad enforced on September 1 resulted in portfolio investment abroad totaling USD 1.6 million in the last quarter of 1999.

Foreign loans to enterprises and banks increased

After two years of deterioration, the net inflow under foreign loans to enterprises and banks increased substantially and reached USD 745 million (against USD 279 million in 1998). It kept increasing during the year in case of enterprises and reached USD 496 million (against USD 237 million in 1998). Banks net borrowed USD 249 million abroad (against USD 42 million in 1998 and only USD 3 million in 1997, reflecting the capital account restrictions in force).

Figure 5: **Main Balance of Payments Aggregates**
(in million of USD, moving average 3)



Source: Bank of Slovenia.

At the same time, claims of banks under loans granted to non-residents declined from USD 31 million in 1998 to USD 11 million.

High level of net trade credits granted and increase by USD 265 million in holdings of foreign currencies by households

Enterprises net financed foreign countries. Commercial loans granted to non-residents amounted to USD 408 million (against USD 449 million in 1998). Another significant reason for the net outflow were substantial holdings of foreign currencies by households (outside domestic banking system). Such holdings are estimated to have increased by USD 265 million.

International reserves held by the Bank and by banks dropped by USD 145 million

Given the current account deficit of USD 581 million and the net financial inflow of USD 436 million, the international reserves (comprising those held by the Bank and by commercial banks) decreased by USD 145 million to USD 4,103 million (against USD 4,781 million in 1998). Inter-currency fluctuations in favour of USD accounted for major portion of reduction of reserves, USD 533 million.

1.7. External Debt

External debt increased by USD 532 million

External debt increased by USD 532 million to USD 5,491 million. The volume of transactions contributing to external debt increased substantially, by USD 1,167 million. The actual increase in external debt was much lower due to inter-currency fluctuations (by USD 635 million).

New loans taken abroad increased by USD 466 million or 24.4% to USD 2,382.

Loans taken or guaranteed by the Republic of Slovenia increased by 24.5%. Euro-denominated bonds of EUR 400 million (USD 438 million) were issued in March with a maturity of 10 years at a fixed interest rate of 4.735%.

Table 4: **External Debt of Slovenia**
(at end of year 1993 – 1999 in million USD)

	12/31/93	12/31/94	12/31/95	12/31/96	12/31/97	12/31/98	12/31/99
1. Longterm debt - total	1,744	2,172	2,916	3,960	4,041	4,849	5,374
1.1. Public and publicly guaranted	1,206	1,331	1,437	2,025	2,067	2,370	2,542
1.1.1. International organizations	442	472	482	541	569	579	503
1.1.2. Governments and their agencies	281	277	220	229	142	161	147
1.1.3. Private creditors	483	582	735	1,255	1,356	1,630	1,892
1.2. Private nonguaranteed	538	841	1,479	1,935	1,974	2,479	2,832
2. Use of IMF credits	12	7	4	1	-	-	-
3. Shortterm debt	117	79	50	49	135	111	117
Total debt stocks	**1,873**	**2,258**	**2,970**	**4,010**	**4,176**	**4,935**	**5,491**
Undisbursed debt	382	579	431	562	440	494	892

* An increase of the debt in 1996 is mostly due to unallocated debt of former SFR Yugoslavia pursuant to New Financial Agreement from 1988 suceeded to, and payments under bilateral agrement with the German government.

Source: Bank of Slovenia.

State guaranteed loans increased by USD 527 million to USD 700 million. Only 2.9% of such loans were taken by the enterprise sector, the rest by infrastructure (more than 4/5 of loan proceeds were used for road construction and the rest for thermal power plant and for railroads).

Credit activity of the banking sector with foreign countries increased substantially

Credit activity of the banking sector with foreign countries increased by as much as 159.5%. New loans taken abroad registered by banks amounted to USD 410 million, of which USD 335 million were taken for their own account. New loans taken by the private sector other than banks amounted to USD 834 million (a decline by 1.3% against 1998).

Three quarters of new credit arrangements were concluded in currencies of EU member countries

As regards currency composition, 75.3% (USD 1.793 million) of the new credit arrangements were concluded in currencies of EU member countries, 10.6% (USD 253 million) in DEM and 7.9% in ATS.

In terms of maturity, 60.5% (USD 1,441 million) of new loans taken had a maturity over 84 months (a decrease in average maturity composition by 14.3 percentage points against 1998).

As regards the purpose, pure financial credits taken by residents for conversion into Tolars prevailed. They increased by 123% to USD 453 million. In addition, the Republic of Slovenia had USD 116 million monetized, enterprises converted USD 95 million under loans guaranteed by the Republic. USD 664 million drawn under foreign loans were converted into Tolars (an increase by USD 346 million or 108.6% against 1998).

2. MONETARY POLICY

2.1 Monetary Policy Objectives and Money Supply

No change in monetary policy objective

Pursuant to the central bank act, the primary task of the Bank is to maintain stability of the domestic currency and ensure general liquidity of domestic and cross-border payments. As in previous years since its establishment, the Bank pursued a policy aiming at a lowering of inflation. The Bank's clear objective has been to bring inflation down to the European level within a few years' time.

The intermediate target of the Bank since 1997 has been the growth of broad money aggregate M3, which enables medium-term orientation. The impact of M3 on consumer price growth as monetary policy objective is medium-term. This is why the Bank makes use of additional indicators and operational targets for short-term management and decisions, such as the narrow money aggregates, mandatory reserves and realization of instruments made available in open tenders and interest rates on the money market.

Monetary policy influenced by structural changes

In addition to macroeconomic framework not under its control, the Bank also took into account the structural reforms enforced, such as the introduction of VAT, enforcement of the EU Association Agreement and enforcement of the new banking and foreign exchange legislation. The introduction of VAT had a major - albeit temporary - impact on the CPI. CP growth reached 2.7% in the first half, and 5.1% in the second half of 1999. As a consequence, the official indexation rate (Base Rate, abbr. BR, in Slovenian TOM) increased, which, in turn, affected interest rates and subsequently the maturity composition of deposits. Introduction of VAT also had an impact on interest rates and through the balance of payments ultimately on the exchange rate. The EU Association Agreement requires liberalization of capital flows as regards foreign direct investment, trade and financial credit. The new foreign exchange legislation introduced foreign currency accounts with domestic banks for legal persons and export of capital. The effectiveness of the respective law and of the

Box 5: **Narrow Monetary Policy Target for 1999**

On January 22, 1999 the Governing Board of the Bank of Slovenia adopted the narrow monetary policy target for 1999. The M3 average of the last quarter of 1998 was projected to grow within the range of 16% and 24% on yearly basis. The target was based on real annual GDP growth between 3.5% and 4.0%, and on budget deficit not exceeding 0.7%. Introduction of VAT at July 1 and its impact on CPI growth was taken into account. The Governing Board urged the social partners to lead a reasonable wage policy, based on real results and competitiveness of the Slovenian economy.

The actual average annual fourth quarter M3 growth reached 16.0%, the bottom of its target range. On January 25, 2000 the Governing Board stated that the monetary policy of 1999 was in line with the target set. A new M3 growth target was set.

The broad money aggregate M3 comprises nearly all liabilities of the monetary system in domestic currency, and includes government deposits and foreign exchange deposits in banks. Other liabilities comprise capital and reserves. There is still only a limited number of other safe and liquid non-bank instruments available in the market.

Most of the 16.0% annual growth of M3 was due to the growth of demand deposits in banks and with the Bank. The annual growth of this particular aggregate amounted to 22.9%. Foreign currency deposits with banks and with the Bank increased by 21.2%, among others due to introduction of foreign currency accounts for legal persons and due to depreciation of the Tolar. Tolar term and demand deposits in banks and the Bank increased by only 12.1% (against 28.9% in 1998).

EU Association Agreement spurred the foreign exchange flows within the country and with foreign countries. The new Banking Law adopted on February 20 is harmonized with EU directives, it defines the bank status and introduces, among others, a new deposit guarantee scheme and is the basis for efficient and effective bank supervision.

Exchange rate policy in conditions of current account deficit and a surge in foreign currency flows

Within the confines of an annual M3 growth target, monetary policy was flexible and adjusted to the changing conditions. The Bank intervened on the foreign exchange market to ensure as stable development of the exchange rate as possible. Demand for foreign exchange exceeded the supply on the foreign exchange market due to substantial deficit on the current account and modest inflow of foreign capital. Additional demand was the result of a surge in demand ahead of enforcement of structural reforms and inflationary expectations related to such reforms. The revised conditions for conversion stipulated in participation agreements were in effect since the beginning of the year.

Increase of interest rates after introduction of VAT

Given that the interbank agreement on interest rate ceiling expired, interest rates kept declining in the first half, but started increasing in the second half of 1999, mainly due to the impact of VAT on the indexation rate (BR). Short-term Tolar lending rate for enterprises increased to 15.2% (from 12.3% in December 1998), and that for term deposits with maturity 1 month to 9.6% (from 7.0%). Interest rate development in the first half of 1999 was also affected by recommendations of Slovenian Banking Association and by temporary liquidity constraints of banks. Given the relatively low interest rate level, the Bank refrained from further reductions of interest rate on its monetary policy instruments after end of March.

Table 5: **Supply of Base Money** (in billion SIT)

	December 31st			Change in quarter 1999				
	1997	**1998**	**1999**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	559.2	593.9	629.6	96.5	-59.6	-34.9	33.7	35.7
2. Domestic liabilities in foreign currency	-301.0	-298.6	-334.3	-77.8	39.4	28.8	-26.2	-35.8
- foreign currency bills	-289.2	-282.4	-310.4	-6.4	2.8	6.5	-30.9	-28.0
- foreign currency deposits of the budget	-11.8	-16.2	-23.9	-71.4	36.6	22.3	4.7	-7.8
3. Net foreign currency assets (1+2)	**258.2**	**295.4**	**295.3**	**18.7**	**-20.2**	**-6.2**	**7.6**	**-0.1**
4. Time deposits of the budget	**-9.0**	**0.0**	**0.0**	**0.0**	**0.0**	**-6.0**	**6.0**	**0.0**
5. Loans to the banks	**18.1**	**3.9**	**25.8**	**16.0**	**3.5**	**11.4**	**-9.0**	**21.9**
- liquidity	0.0	0.0	2.1	7.4	4.5	-10.9	1.1	2.1
- repurchase	13.7	3.5	22.4	7.6	-0.1	14.6	-3.1	18.9
- other loans	4.4	0.5	1.3	1.0	-0.9	7.7	-7.0	0.9
6. Tolar bills	**-75.8**	**-80.1**	**-27.4**	**-20.2**	**43.7**	**8.8**	**20.4**	**52.7**
- 60 days	-24.6	-20.1	0.0	11.6	0.7	1.7	6.0	20.1
- 270 days	-23.8	-33.1	-11.7	-3.7	6.5	14.9	3.8	21.4
- bills with warrants	-17.4	-11.7	0.0	-28.0	24.1	-3.0	18.6	11.7
- other bills	-10.0	-15.3	-15.7	-0.1	12.4	-4.8	-7.9	-0.4
7. Other items net	**-45.8**	**-45.2**	**-83.2**	**-15.9**	**-10.8**	**-1.8**	**-9.6**	**-38.0**
8. Net tolar assets (4 to 7)	**-112.6**	**-121.4**	**-84.8**	**-20.1**	**36.4**	**12.5**	**7.8**	**36.6**
9. Base money (3+8)	**145.6**	**174.0**	**210.5**	**-1.4**	**16.3**	**6.3**	**15.4**	**36.6**
- bank reserves	63.1	74.4	79.4	-4.4	6.7	8.8	-6.2	4.9
- other sight deposits	4.4	5.9	6.2	1.1	0.1	0.4	-1.3	0.3
- currency	78.1	93.7	125.0	1.9	9.5	-2.9	22.9	31.4

Source: Bank of Slovenia.

Public finances ended in a low deficit, as was the case in 1998. However, unlike in 1998, the deficit was not financed by both, domestic and foreign borrowing, it was entirely financed by borrowing abroad.

The government kept decreasing the proportion of regulated prices pursuant to the program it had adopted. Regulated prices increased by 12.6% (against 7.2% growth of free market prices). Crude oil prices increased most (by 21.7%) as a consequence of price development on the international market.

Base money increased by 7.7% in real terms

The nominal increase of base money between December 1998 and December 1999 totaled 16.4% and 7.7% in real terms. Cash in circulation increased by 21.1% (as a consequence of lower inflation and declining interest rates during the year), bank reserves by 11.7% and other demand deposits with the Bank by 5.0%.

Tolar transactions employed to issue and foreign exchange transactions to withdraw base money

Unlike in the years before 1999, the Bank issued base money through Tolar transactions and withdrew it through foreign exchange transactions (sale of foreign exchange) as a result of changed conditions on the foreign exchange market. The Bank net sold foreign exchange in counter-value of SIT 59 billion to banks, and net purchased foreign exchange from the central government in counter-value of SIT 15.3 billion. With the aim to ensure stable development of the exchange rate, the Bank purchased foreign exchange from banks in the first and third quarters, and sold it to banks in the second and last quarters. The net foreign assets of the Bank increased by SIT 35.7 billion due to net purchase by banks of foreign currency denominated bills of SIT 28.8 billion, to an increase in government foreign currency deposits with the Bank by SIT 7.8 billion and to appreciation of USD.

Table 6: **M 3 Supply: Consolidated Balance Sheet of Monetary System**
(in billion SIT)

	Volume per December 31st			Change in quarter 1999				
	1997	**1998**	**1999**	**I**	**II**	**III**	**IV**	**Total**
1. Net foreign assets	**669.2**	**701.8**	**711.6**	**88.5**	**-57.1**	**-13.8**	**-7.8**	**9.8**
2. Domestic assets	**1,142.9**	**1,422.0**	**1,700.7**	**61.4**	**78.9**	**62.1**	**76.2**	**278.6**
General Government: bonds*	249.6	255.4	253.5	20.8	-2.2	-13.4	-7.1	-2.0
loans	69.9	106.6	133.2	8.8	-5.7	14.7	8.7	26.6
Enterprises : securities	40.7	66.9	76.2	-0.6	-4.7	3.2	11.3	9.2
loans	541.8	690.2	798.4	15.9	54,8*	37.6	49.8	158.2
Households: loans	240.9	302.8	439.4	16.5	36,6*	20.0	13.4	86.6
3. Securities issued	-66.8	-73.2	-64.0	-5.0	17.4	2.4	-5.6	9.2
4. Foreign currency deposits of the budget	-11.8	-16.2	-23.9	-71.4	36.6	22.3	4.7	-7.8
5. Other items net	-322.2	-344.2	-411.3	-33.0	-18.5	-5.1	-10.5	-67.1
6. M3 (1 to 5)	**1,411.3**	**1,690.3**	**1,913.1**	**40.5**	**57.4**	**67.9**	**57.0**	**222.8**
- foreign currency deposits at banks	404.7	428.1	497.2	12.1	21.4	24.4	11.2	69.1
7. M2	**1,006.6**	**1,262.2**	**1,415.9**	**28.4**	**36.0**	**43.5**	**45.9**	**153.8**
- time deposits in banks	648.1	829.8	891.2	14.6	-24.5	50.2	21.1	61.4
- time deposits in Bank of Slovenia	9.0	0.0	0.0	0.0	0.0	6.0	-6.0	0.0
- saving deposits	79.1	99.7	124.9	11.2	8.8	3.2	2.1	25.3
8. M1	**270.5**	**332.7**	**399.8**	**2.6**	**51.7**	**-15.9**	**28.7**	**67.1**
- sight deposits at banks	187.9	233.2	268.7	-0.4	42.1	-13.4	7.1	35.5
- sight deposits at Bank of Slovenia	4.4	5.9	6.2	1.1	0.1	0.4	-1.3	0.3
- currency in circulation	78.1	93.7	125.0	1.9	9.5	-2.9	22.9	31.4

* Net of 'other foreign exchange liabilities' of banks to general government (foreign liabilities of banks taken over by the government in 1996).

Source: Bank of Slovenia.

Surplus in structural money market position decreased

The surplus in the structural money market position (see Box 6) kept decreasing, mainly due to large sales of foreign exchange by the Bank. Such development reflected the necessity for the Bank to provide additional liquidity. The Bank issued a total of SIT 84.6 billion of base money through Tolar transactions, of which SIT 52.7 billion net Tolar bills due and SIT 21.9 billion through loans to banks. The total of Tolar bills outstanding increased in the first quarter (by SIT 20.2 billion) and decreased by SIT 72.9 billion by the end of the year. Loans drawn by banks amounted to SIT 25.8 billion.

Real M3 growth December/December 6.6%

Money aggregate M3 (December to December, measured by daily average) increased by 15.1% in nominal and by 6.6% in real terms. In the composition of broad money, Tolar demand deposits and foreign exchange deposits in banks and in the Bank increased most. Term Tolar deposits increased at a slower pace than in the previous year. Foreign exchange deposits grew at a steady pace (except at the time of introduction of foreign exchange accounts for legal persons). The dynamics in development of term and demand Tolar deposits reflected the temporary surge in domestic demand ahead of introduction of VAT and the development of deposit interest rates.

Enterprises substituted domestic with foreign loans

The money aggregate M3 growth was mainly due to increase in loans to non-banking sector, and during the first quarter also due to an increase of net foreign assets. Bank financing of enterprises remained weak due to an increase in foreign loans; it amounted to SIT 167.4 billion (an increase by 22.1%). About one third of all loans taken by enterprises were taken abroad.

Box 6: **Structural Position of Money Market**

The structural position of the money market is the relation of the central bank to domestic (in our case Tolar) money market. The structural position is equal to the net position of autonomous items in the balance sheet of the central bank.

Autonomous items or factors are purely autonomous items in the central bank balance sheet that are out of the control of the central bank and, for that reason, cannot be used as channel for influencing liquidity. In the case of the Bank of Slovenia, such items are: net foreign assets (foreign exchange claims reduced for liabilities), cash in circulation, Tolar and foreign exchange deposits of central government, deposits of other residents and non-residents, reserves and capital. In addition, claims to central government deriving from succession to the former SFR Yugoslavia (and have been unchanged) or deriving from the role of the Bank (agent) through membership of the Republic of Slovenia in the International Monetary Fund. Under the managed floating foreign exchange regime, such autonomy of net foreign assets is conditional.

The choice of and relative importance attributed to individual monetary policy instruments depend on whether the structural position of the money market is in a surplus or in a deficit. It is in a surplus, when the total of autonomous item assets exceeds the total of autonomous item liabilities, and is in a deficit, when the situation is reversed.

Since the beginning of 1997, the net structural position of the Slovenian money market has been sizeable surplus. Base money issued through purchase of foreign exchange substantially exceeds the autonomous demand by non-banks. Mandatory reserves of banks and savings banks with the Bank create additional demand for base money, and yet the net supply needed through monetary policy instruments (structural position plus bank mandatory reserves) has been negative until the end of 1999. The Bank was therefore not a net supplier of liquidity, but net withdrew liquidity through monetary policy instruments. Such circumstances require a different set of instruments from that used when the net structural position of the market is a deficit. Also, the relative influence of and importance attributed to bills issued by the Bank is much higher, and so is the interest rate applied.

Loans to households increased substantially (by 28.6% to SIT 86.2 billion). Most of them were drawn in the second quarter, as a consequence of the surge in domestic demand ahead of the introduction of VAT. Domestic lending to the government sector was weak (increased by 6.8%) due to the fact that foreign loans were used to finance the budget deficit.

Loans to households increased by 28.6%

Net foreign assets of the monetary system increased by only SIT 9.8 billion. Banks net sold foreign exchange on the foreign exchange market in counter-value of SIT 52.5 billion, and in foreign currency exchange offices SIT 11.6 billion. The decline in monetization through net foreign assets reflects the development in the balance of payments. The substantial current account deficit and the outflow due to commercial credits granted were only partially covered by substantial inflow under foreign financial loans.

2.2. Interest Rates

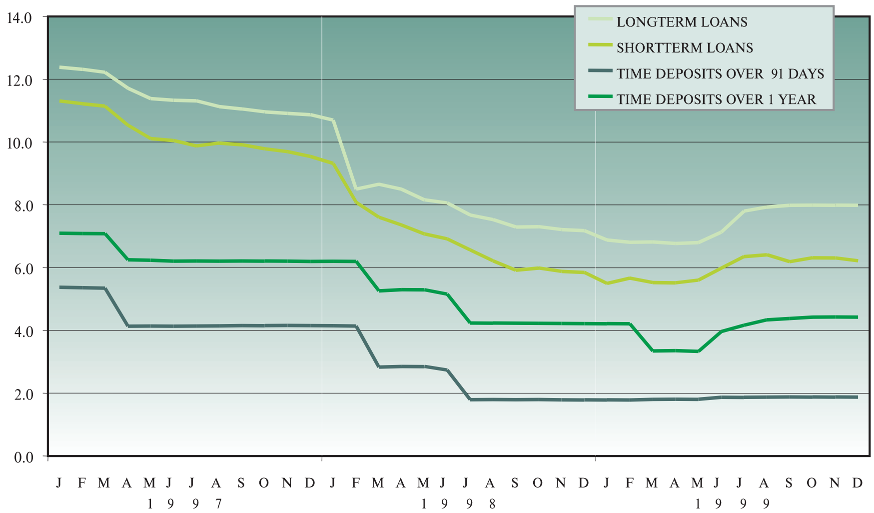
The nominal deposit rates of banks were relatively low in the first half of the year, mainly due to expected impact of VAT on inflation. Rates for term deposits of up to 180 days were negative in real terms. The interest rate reduction was due to expiry of the interbank agreement on a deposit rate ceiling and the recommendations of Slovenian Bank Association for banks to reduce interest rates on selected term deposits. Following the proposal of the Bank, the Association recommended in July and August that banks increase interest rates on term deposits above 181 days and those above one, two and five years respectively. The recommendation had a positive effect (the slope of maturity composition curve increased) and led to stabilization of term deposits with maturities above 180 days.

Low deposit rates ahead of introduction of VAT

The indexation rate (Base Rate, BR, a twelve month average of CPI growth) declined from 6.0% in January to 4.8% in July, and increased rapidly during the second half of the year and reached 8.56% at the end of 1999 on annual basis. On a monthly basis, its development was more stable than in 1998, it increased from 0.4% per month to 0.7% in the second half of the year. The average annual BR amounted to 6.28%.

Decline of BR in the first and increase in the second half of the year

Figure 6: **Average Bank Interest Rates** (above BR in % p.a.)



Source: Bank of Slovenia.

Change in development of deposit…

Development of deposit rates varied. After a decline through a number of years, long-term deposit rates started increasing in the second half of 1999. They first declined from 4.2% to 3.3% over BR in May, and then increased to 4.4% over BR by December. The development of deposit rates for other maturities, especially those below 180 days, was more stable. Interest rate on 3-month deposits increased from 1.8% in January to 1.9% over BR in December.

…and lending rates of banks

Similar to that of deposit rates was the development of lending rates. The declared average long-term lending rates increased from their lowest level of 6.8% in February to 8.0% over BR in December.

Short-term declared lending rates increased from 5.5% in January to 6.2% over BR in December. And yet the minimum short-term lending rates kept declining, from 4.0% to 3.4% over BR and, reflecting differentiation by creditworthiness of clients by banks.

The money market fluctuated in 1999, due to liquidity constraints in the banking sector in February and April (stemming from asset management). The constraints did not have an impact on the real sector. The trend interbank rate amounted to 6.8%, but the actual rate was often quite different due to liquidity constraints mentioned (the monthly average fluctuation was 1.2 percentage points). More significant was the growth of interest rate on 3-month Treasury Bills. It increased from 8.4% in January to 10.0% in December. The 6-month T-bill was first made available in October, with a return of 9.22% at maturity.

Changes in Bank rates reflected the development of inflation, in the first half of the year in particular. The interest rate on 30-day, 270-day and 60-day Tolar bills was reduced in March. However, the Bank did not reduce the initial interest rate quotation in auctions for temporary repurchase of 28-day foreign exchange bills (foreign exchange bill repo) from banks.

Table 7: **Interest Rates of Bank of Slovenia and Money Market Rates**
(monthly average of 1999 in % p.a.)

	Nominal interest rates						Interest rate over tolar revaluation clause TOM*			
	Repo	Tolar bills: 60 days	Tolar bills: 270 days	Interbank market	Treasury bills	TOM	Repo	Tolar bills: 60 days	Tolar bills: 270 days	Interbank market
January	7.93	7.80	9.50	5.56	8.45	6.05	1.78	1.65	3.25	-0.46
February	8.65	7.80	9.50	6.71	8.56	6.72	1.81	1.01	2.60	-0.01
March	7.96	7.77	9.22	6.26	8.45	6.05	1.81	1.62	2.99	0.20
April	11.59	7.00	9.00	7.87	8.66	4.98	6.29	1.92	3.83	2.75
May	9.10	7.00	9.00	8.08	8.00	4.81	4.09	2.09	4.00	3.12
June	8.88	7.00	9.00	6.60	8.60	4.98	3.72	1.92	3.83	1.55
July	8.92	7.00	9.00	7.29	9.29	4.81	3.92	2.09	4.00	2.36
August	7.92	7.00	9.00	6.94	8.98	6.05	1.76	0.90	2.78	0.84
September	7.99	7.00	9.00	6.83	9.65	7.55	0.41	-0.51	1.35	-0.67
October	8.00	7.00	9.00	6.69	9.34	7.30	0.65	-0.28	1.58	-0.57
November	8.09	7.00	9.00	6.77	8.99	7.55	0.50	-0.51	1.35	-0.73
December	8.35	7.00	9.00	6.86	10.04	8.56	-0.20	-1.44	0.41	-1.57

* Calculated from the overall nominal rates for all interest rates, except rates for 270-day Tolar bill.

Source: Bank of Slovenia.

28-day foreign exchange repo was made available on a daily basis. The interest rate applied was subject to auction and reflected the demand for liquidity of the banking system. It reached the highest level in April, 11.6%. The implicit repo rate was stable at 8.0% between August and end of November. It increased temporarily in December due to an increase in demand for cash in view of potential Y2K problems in early January.

Interest rates for other instruments did not vary as much. The interest rate for a five-day liquidity loan was reduced from 9.4% to 8.5% in March. That for overnight liquidity loan was reduced in April, May and June (from 10.5% in April to 7.5% in June). The interest rate applied on supplementary liquidity loan, the loan of last resort, was equal to the interest rate charged on overdue obligations (between 19.2% in May and 22.96 in December).

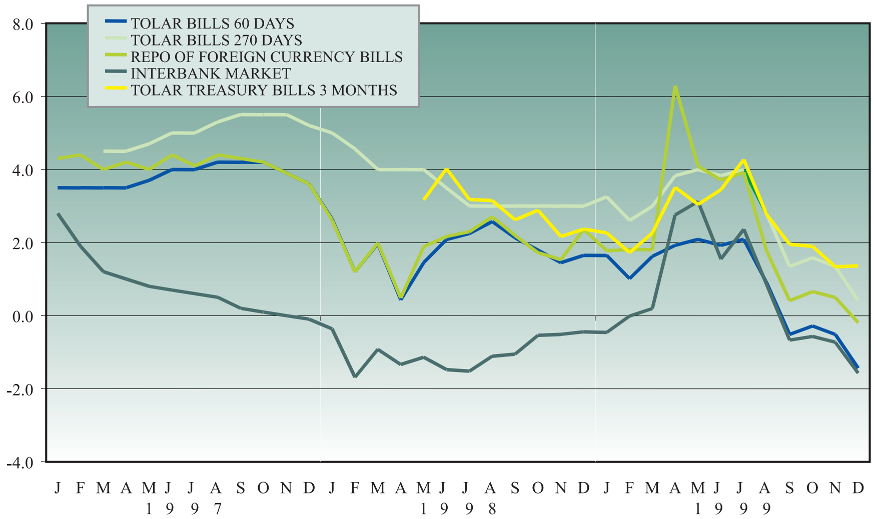
In determining the interest rates for foreign currency denominated bills, the Bank took into account the interest rates of Euromarket instruments with equal maturity. The interest rate applied on DEM-bills in January ranged from 3.08% on 60-day bills to 2.84% on 360-day bills. That applied on USD-denominated bills ranged from 4.81% on 60-day bills to 4.94% on 360-day bills. In December, the interest rate applied on EUR-denominated bills ranged from 3.30% on 60-day bills to 3.63% on 360 day-bills, that on USD-denominated bills from 6.02% on 60-day to 6.16% on 360-day bills.

2.3. Foreign Exchange Market and Exchange Rate

Weak inflow of foreign exchange in last three years

The inflow of foreign exchange into foreign exchange reserves has been declining over the last three years. The inflow amounted to USD 907 billion in 1996, and only USD 201 billion in 1998. For the first time since 1991, demand on the foreign exchange market exceeded the supply. In 1999, the outflow from foreign exchange reserves held by banks and by the Bank amounted to USD 145 billion.

Figure 7: **Bank of Slovenia and Money Market Interest Rates**
(monthly average above BR in % p.a.)



Source: Bank of Slovenia.

The inflow of foreign exchange became much weaker and evident on the current account in the second half of 1998 under the influence of the Asian and Russian crises, and even more so in the first half of 1999, in view of the fiscal reform due. Transactions (of USD 386 million) on the government foreign exchange account not taken into account, the net flow was already negative in the first quarter by USD 190 million. The outflow of foreign exchange increased most in the second quarter of 1999 ahead of introduction of VAT and reached USD 245 million. Outflow decreased to about USD 80 million per quarter during the third and fourth quarters. Demand by enterprises increased most (net USD 271 million), that by foreign exchange offices moderately (USD 57.6 million).

High net outflow ahead of introduction of VAT

Foreign exchange inflow deriving from financial transactions was not sufficient to cover the deficit of USD 581 million on the current account. The Bank covered the difference by way of interventions on the foreign exchange market. The Bank intervened in January and purchased foreign exchange from banks at intervention rate especially in February and March. The situation changed in mid-April, demand increased and exceeded the supply. The Bank increased temporary and final sale of foreign exchange. The latter culminated in May and June, and decreased gradually during the third quarter.

Bank Intervention on foreign exchange market

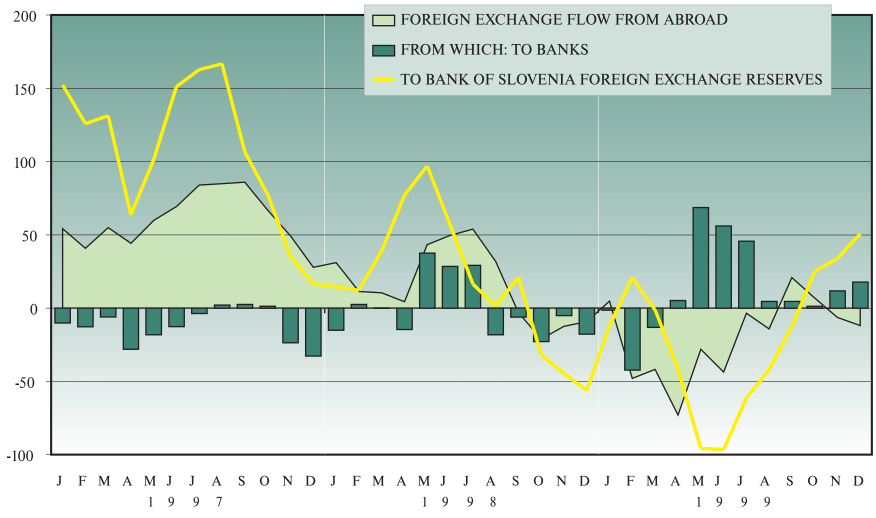
Supply of foreign exchange on foreign exchange market declined due to introduction of foreign currency accounts for legal persons

The introduction of foreign currency accounts for legal persons pursuant to the new foreign exchange law, brought additional instability to the foreign exchange market. The market was balanced in October and November, but demand increased again in the second half of December and led to increased temporary and final sale of foreign exchange by the Bank, at a predetermined rate, resulting in an accelerated depreciation of the Tolar towards the end of the year.

The DEM market exchange rate increased from 96.40 SIT/DEM at end of December 1998 to 97.50 SIT/DEM by the end of the Bank's intervention at a predetermined rate in March. It stayed at this level until the beginning of the second decade in April, and increased to 99.30 SIT/DEM by mid May.

Between May 3 and 27, the Bank gradually reduced the difference between its selling rate and the rate at which banks could purchase foreign exchange from the Bank in order to purchase the 120-day foreign currency bills, from 1.25 to 0.6 percentage

Figure 8: **Foreign Exchange Flows*** (in million USD monthly; moving average 3)



* Inflow from the rest of the world without direct flows from abroad to the Bank (interests etc. and reduced for net payments from foreign exchange account of the budget).

Source: Bank of Slovenia.

point. Such operation was aimed at stabilizing the foreign exchange market rate. Due to accelerated growth of market rates in the second half of June, the Bank made the conditions for purchase of 120-day foreign currency bills more favourable. In June, when the rate of exchange reached 100.80 SIT/DEM, the Bank started intervening at a predetermined selling rate. The rate of exchange declined by 0.6 SIT to 100.20 SIT/DEM by the end of September. Aiming at an increase of market rates, the Bank kept increasing the predetermined intervention rate on weekly basis (by 0.1 SIT/EUR) after September 27 for banks participating in foreign exchange swap and reverse swap. Aiming at cost reduction related to management of foreign exchange and Tolar liquidity by banks, the Bank reduced the interest rate applied to 2.5% on foreign exchange swap and to 2% on reverse swap.

Given the intervention of the Bank, the market rate of exchange gradually increased to 100.90 SIT/DEM at the end of the first decade in December, and due to increase in demand to 101.60 SIT/DEM by the end of December. DEM appreciated against the Tolar by 5.4% between January and December (against 2.2% in 1998).

Appreciation of DEM in foreign currency exchange offices 5.1%

The DEM exchange rate in foreign currency exchange offices lagged behind that on the foreign exchange market until May. It started growing fast afterwards, which lead the Bank to intervene between May 10 and 20 by placing a ceiling of 0.4% on the margin between the buying and the selling rate. The DEM rate reached 100.00 SIT/DEM on May 7, exceeding the market rate by 0.7 SIT. The rate of exchange decreased in foreign currency exchange offices until early July, exceeding the market rate by 0.3 SIT in the second decade. The Bank intervention stabilized it until the end of August; it lagged behind since, but moved in line with the market rate. It reached SIT 101.50/DEM at December 1999, and appreciated by 5.1% in the whole year.

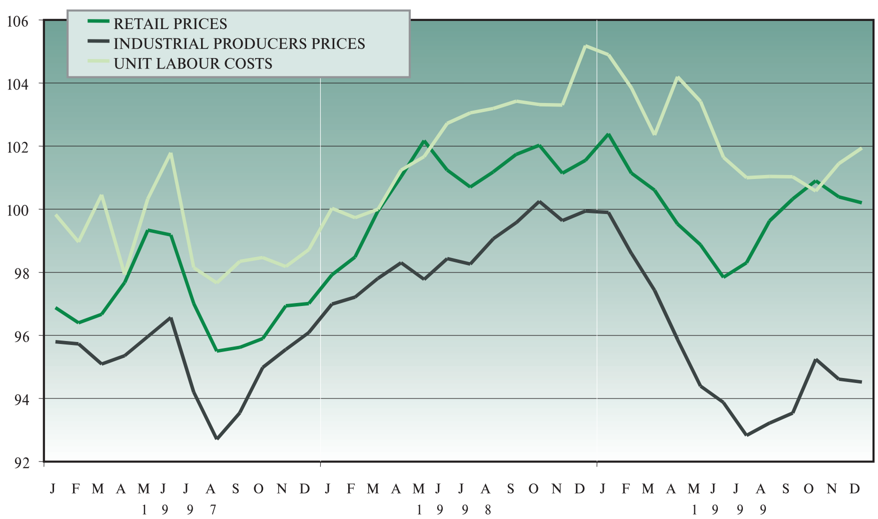
Nominal effective exchange rate increased by 7.8%

The nominal effective exchange rate weighted by the currency basket of Slovenian exports increased in 1999 by 7.8%, i.e. by one third more than that of the DEM alone, among others also due to appreciation of the USD.

Real depreciation of Tolar in 1999 between 1.4% and 5.7%

The real effective exchange rate. Tolar depreciated by 5.7% in real terms when measured by the ratio between the change in exchange rate and the growth of foreign against domestic producer prices (December/December). It depreciated by 3.2% when measured by the relative unit labour cost, and by 1.4% when compared to consumer price growth.

Figure 9: **Real Effective Tolar Exchange Rate** (1995=100)



Source: Bank of Slovenia.

2.4. Instruments Used

The survey of monetary and exchange rate policy instruments used is based on the definition of the structural position of the money market for Slovenia (Box 4, Chapter 2.1.). The instruments concerning purchase and sale of foreign exchange are listed among the exchange rate policy instruments in spite of the limited autonomy of net foreign assets. Against the background of a managed floating rate of exchange, in force in Slovenia since October 1991, the central bank intervenes on the foreign exchange market at its discretion. In addition to the description of the exchange rate instruments disclosed in the balance sheet of the Bank, the survey gives description of other instruments also influencing the rate of exchange, such as conditioning respectively signaling of exchange rate, open (foreign exchange) position, foreign exchange minimum and capital controls imposed.

Monetary Policy Instruments

Structural position of money market shows a smaller surplus

The surplus in the structural position of the money market declined under the influence of exchange rate policy instruments employed by the Bank, of cash in circulation, of deposits by the government and under the influence of other activities of the Bank. The decline is evident from the reduction in volume of Tolar bills outstanding, set off by an increase in temporary repurchase of foreign currency denominated Bank bills by the Bank, and from an increase in Bank loans to banks.

Table 8: **Monetary and Exchange Rate Policy Instruments**
(in million SIT)

	Stock Dec. 31st 1998	Average daily stock per quarter 1999 I.	II.	III.	IV.	Stock Dec. 31st 1999
Loans to banks	**174**	**1,743**	**3,113**	**1,221**	**658**	**3,077**
Lombard loans	0	509	576	34	73	859
Short-term loans	0	0	0	0	0	0
Liquidity loans	0	1,060	2,362	1,028	428	2,065
Other*	174	174	174	158	156	152
Temporary purchase of bills	**3,454**	**7,138**	**16,795**	**23,304**	**16,449**	**18,550**
Bank of Slovenia tolar bills	**81,668**	**94,350**	**81,245**	**58,514**	**45,679**	**28,046**
Tolar bills	66,749	66,045	45,901	39,481	27,516	17,629
Twin bills	3,259	6,127	4,279	1,028	1,139	1,386
Bills with warrants	**11,661**	**22,178**	**31,065**	**18,005**	**17,025**	**9,031**
Joint effect of government term deposits and additional shortterm loans	**0**	**-482**	**66**	**-142**	**-94**	**0**
Received government deposits	0	1,065	3,134	2,394	1,605	0
Additional shortterm loans	0	583	3,201	2,252	1,511	0
Reserves of banks and saving banks**	**73,822**	**74,207**	**76,925**	**80,808**	**82,489**	**84,222**
Required	69,949	72,274	74,677	78,722	78,892	79,322
Excessive reserves	3,873	1,933	2,248	2,085	3,597	4,900
Foreign exchange minimum of banks	**362,440**	**386,549**	**399,799**	**411,739**	**437,722**	**446,609**
Bank of Slovenia foreign exchange bills	**284,773**	**280,707**	**285,999**	**288,890**	**297,344**	**313,245**
Repurchase of foreign exchange	**0**	**2,628**	**2,830**	**3,924**	**5,909**	**3,858**

Source: Bank of Slovenia; accrued interest and discount not included.

Loans

Bank loans gained importance

Loans of the Bank to banks gained importance. The average amount of such loans outstanding increased from SIT 0.7 billion in 1998 to SIT 1.6 billion (included for the first time is the long-term special purpose loan of SIT 152 million granted prior to monetary independence on October 8, 1991). Drawings were substantial in February and between April and July.

Lombard loan is a five-day loan made available on permanent basis at one percentage point above the discount rate (the latter was reduced to 8% p.a. as of January 1999). Banks could temporarily draw on 5% instead of the usual 2.5% of Bank of Slovenia foreign currency bills or Treasury bills pledged to ensure additional liquidity needed due to Y2K. Drawings were substantial in February and in April. The average amount of such loan outstanding in 1999 amounted to SIT 298 million.

Increase in drawings under liquidity loans

Liquidity loans serve to regulate short-term Tolar liquidity of the banking system. The daily average of liquidity loans outstanding amounted to SIT 1.2 billion (against SIT 357 million in 1998). Banks mostly drew on loans against pledge of Tolar bills (52% of all liquidity loans drawn average), overnight liquidity loans (28%) and under liquidity loans of last resort (20%). Banks could draw on loans with maturity of three and five days respectively against pledge of 12-day and 30-day Tolar bills respectively. The daily average of the two liquidity loans outstanding amounted to SIT 636 million (of which 3-day loan 62%, and five-day loan 38%).

Box 7: **Special Liquidity Loan with Participation of Banks**

Special liquidity loan with participation of banks was first made available in August 1996 aiming at reduction of liquidity risk and at facilitating the fine-tuning of bank liquidity. Banks were also obliged to match the maturity of assets and liabilities, to report on large depositors and on Tolar liquidity.

The loan is available to banks facing liquidity problems, which are unexpectedly not able to attract new depositors or borrow on the interbank market, and are not eligible for the Bank's loans due to non-availability of appropriate securities. Any such bank can obtain liquidity loan from the Bank with one or more banks participating. The participating bank is obliged to pledge to the Bank securities issued by the Bank or the Republic of Slovenia; the beneficiary bank pledges other first-class securities or grade A claims to participating bank in return.

The Bank concludes special agreements with participating banks on a yearly basis. The participating bank is obliged to take a special liquidity loan up to the amount agreed upon from the Bank at first call at a predetermined interest rate and maturity. The participating banks are obliged to hold an appropriate securities portfolio against compensation of a certain percentage p.a. of the amount made available. The Bank determines the beneficiary bank, the interest rate and maturity of such loan, and the securities to be pledged by the beneficiary bank to the participating bank in return. The special agreement limits the difference between the interest rate on the Bank's loan to the participating bank and the loan of participating bank to the beneficiary bank.

Pursuant to amendment to decision on special liquidity loans with participation of banks adopted in April 1999, the Bank can take measures in the beneficiary bank, such as appoint an extraordinary board of management to the bank, or determine or limit the utilization of such loan.

Overnight liquidity loan is available to banks, which are not creditors on the interbank market. The Bank makes such loan available on the evening interbank market when supply is scarce in spite of good liquidity of the system or when the Bank wants to influence the market lending rates. Banks can draw on such loan dependent on collateral available. The bank made such loan available between April and July due to weaker liquidity of the system. After that, the Bank made the loan available on certain days (due dates for VAT and excise duties, pensions) when the needs exceeded the balances on settlement accounts. The yearly average of overnight liquidity loans outstanding amounted to SIT 346 million, the monthly peak was reached in May (SIT 2.2 billion).

Liquidity loan of last resort is available at any time to banks facing liquidity problems. The interest applied is equal to that for overdue obligations. Most of such loans were drawn in April (monthly average of loan daily outstanding SIT 1.1 billion) and June (SIT0.9 billion). The daily average of such loan outstanding in 1999 amounted to SIT 238 million.

Special liquidity loan with participation of banks is available to banks facing liquidity problems, which are suddenly not able to attract new depositors nor borrow in the interbank market, and are not eligible for the Bank's loans due to non-availability of adequate securities. The Bank concluded the fourth consecutive yearly agreement with 21 banks on their availability for participation in such loans against compensation of 1.5% of the amount made available. No such loan was extended in 1999.

Temporary purchase of foreign exchange bills

The Bank offers daily to purchase its foreign currency bills from banks at the Bank's buying rate, obliging them to repurchase such bills after 28 days at the rate of exchange which is subject to auction. In addition, such banks are obliged to purchase from enterprises, during the first week after such temporary purchase by the Bank, foreign exchange receivables equal to 120% of the temporary repurchase. The Bank abolished the latter conditionality in February.

Temporary purchase of bills increased substantially

The daily quotas of temporary purchase varied between DEM 8 and 25 million, in dependence of developments on the money market. The average demand totaled 103%, the average realized purchase 62% of the quota made available. As of July, the quota was denominated in EUR. The average daily purchase amount outstanding totaled SIT 15.9 billion (3.5 times more than in 1998); it is the largest amount outstanding among all instruments.

Tolar bills

The variety of Tolar bills made available was similar to that in 1998. The Bank issued bills less frequently and abolished 270-day bills.

Decline in Tolar bills outstanding

All Tolar bills (simple, with warrants and twin bills) outstanding amounted to SIT 82 billion at December 31, 1998, SIT 110 billion at March 31, 1999 and SIT 28 billion at December 31, 1999. The daily average amount outstanding declined by 25% to SIT 70 billion.

Tolar bills are short-term registered dematerialized securities of various maturities made available to banks (2, 12, 30, 60 or 270 days) and savings banks (7, 14, 60 or 270 days). Except for bills with maturities of 60 and 270 days, they are not issued in series. The 28-day Tolar bill is sold at a discount and made available in tenders on weekly basis.

The monthly average of daily outstanding bills declined, except during summer. The December average (SIT 24 billion) was down to one third of the January average (SIT 74 billion).

The maturity composition of Tolar bills outstanding varied. The share of bills with shorter maturity (up to 30 days) decreased from SIT 16.7 billion in January to SIT 1.7 billion in May in favour of bills with longer maturities. However, the share of the latter declined substantially in the course of the year due to redemptions under 60- and 270-day bills due. The share of bills with shorter maturities increased.

Twin bills are short-term materialized transferable securities issued to the bearer. They comprise a Tolar and foreign currency part, are bought in Tolars at a discount and are redeemed half in Tolars and half in German marks. The two parts can be traded separately. They are available to banks and through them to households and enterprises. Revaluation clause applies to the Tolar part.

Twin bills did not play an important role in 1999. At maturity in mid May, twin bills of SIT 4.2 billion were redeemed. Newly issued twin bills with maturity in March 2000 were made available in April. A total of SIT 1.4 billion was subscribed until the end of 1999.

Bills with warrants are transferable dematerialized registered securities with maturity of six months. They are bought at a discount and bear a nominal annual interest rate. A warrant (consisting of several detachable parts) attached acts as a hedge against higher inflation and smaller devaluation of SIT against DEM and USD respectively than projected. Holders of warrants are able to buy new Tolar bills (without warrants) or foreign currency bills with maturity longer than 120 days at a discount, depending on the number of warrants accepted by the Bank, and on the increase in consumer prices and the Bank's middle exchange rates compared to official projections of inflation. In 1999, the Bank started issuing such bills three times a year, each time with maturity of six months. The last, the 14th, series was issued on December 1, 1999. No warrant was attached this time.

14th and last series of bills with warrants issued

The volume of such bills outstanding amounted to SIT 11.7 billion at the beginning of the year, it increased to SIT 39.1 billion in March due to the high discount offered for subscription of the new series in February and an increase in primary sales without discount. The volume decreased with redemptions taking place in June, September and December. The average volume of such bills outstanding decreased by 22.1% to SIT 22.1 billion.

Discount realized in 1999 under purchase of foreign currency bills totaled EUR 910,000, USD 884,000, and that under purchase of Tolar bills SIT 1.1 billion. At end of December 13,036 warrant parts under thirteenth issue remained unemployed.

Mandatory reserves

Banks, savings banks and savings co-operatives are obliged to have minimum reserve holdings with the Bank. The requirement applies against all Tolar deposits, loans taken and securities issued and held by non-banking sectors. The level of such reserve holdings depends on maturity of deposits: 12% of sight deposits and term deposits with maturity of up to 30 days, 6% of deposits with maturity between 31 days and up to three months, 2% of deposits with maturity between three and six months, 1% of deposits with maturity between six months and one year, and 0% of deposits over one year.

As of December 1998, the Bank abolished the special reserve accounts for banks directly participating in the real time gross settlement system (RTGS) obliging them to hold the minimum reserves on the new settlement account with the Bank. Balances on such settlement accounts and cash in hand are employed to meet the requirement in case of directly participating banks, and balances on the special reserves accounts and cash in hand in case of indirectly participating banks in RTGS. The settlement and the special reserve accounts are remunerated at 1% p.a., but remuneration applies to the amount of calculated reserves for the previous month only.

The calculation base for mandatory reserves increased by 13.5%…

The calculation base for mandatory reserves increased by 13.5% (against 29.0% in 1998) to SIT 1,365.6 billion. Term deposits up to one year increased by 12.6%, those above one year by 16.3%. The share of term deposits above one year increased to 23.2%.

…and calculated reserves increased by 13.4%…

The **calculated reserves** increased by 13.4% to SIT 79.3 billion at December 1999. The average reserve requirement on all deposits increased by 0.2 interest points to 5.9% due to the change in deposit composition in favour of short-term deposits. The average calculated reserve requirement on deposits up to one year amounted to 7.7% (against 7.4% in 1998).

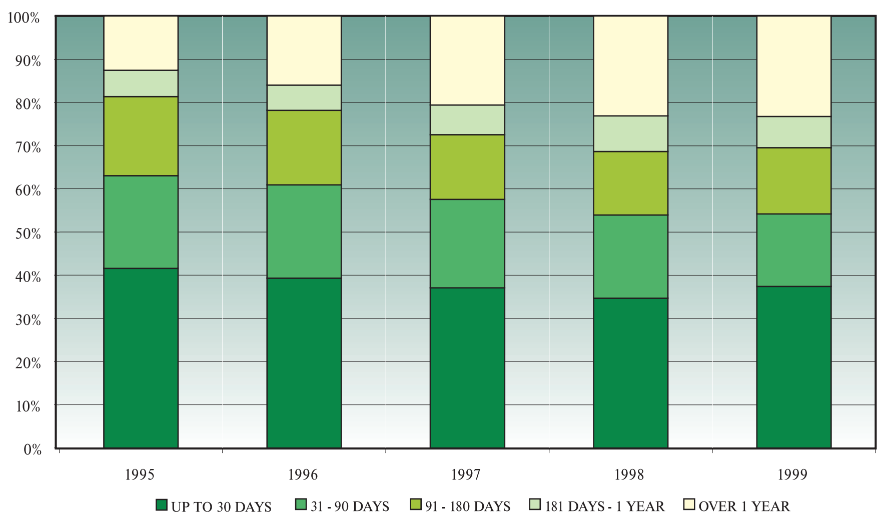
…and the lowest ever reserve holdings above the level required.

The **actual reserve holdings** exceeded the calculated requirement on average by 3.2% (against 4.1% in 1998), the lowest excess percentage ever since 1995. The daily reserve holdings on the settlement and the special reserve account should reach at least 50% of the calculated daily requirement. It is possible for banks to use such reserve requirement holdings to meet settlement needs over night against payment of interest equal to that charged for overdue obligations.

Deposits by Central Government, Supplementary Short-Term Loan

The Bank of Slovenia provides banking services to the Central Government pursuant to the respective decision-based agreement concluded. Central Government made 11 term deposits of between 2 and 29 days each (on average 9 days) at 4% p.a., Such deposits totaled SIT 83.0 billion, their daily average SIT 2.1 billion.

Figure 10: **Average Composition of Tolar Deposits** (1995 – 1999)



Source: Bank of Slovenia.

The impact of transfer of these deposits (budget liquidity surplus) from banks to the Bank was neutralized by the Bank's supplementary short-term loan made available to such banks. Supplementary short-term loan is given to banks in dependence of and in amounts equal to or exceeding term deposits received from the Ministry of Finance for a period equal to the term of such deposit, but not exceeding three months. The share of an individual bank in the total volume made available is determined by its share in the foreign exchange position total of banks. The Bank made the loan available 12 times. The interest rate charged by the Bank was 8% until May and 6% after May. A total of SIT 94.5 billion was made available (exceeding the level of deposits by 14%), 86% thereof actually drawn by banks. The daily average of loans outstanding amounted to SIT 1.9 billion. The average maturity of loans outstanding was 9 days.

A credit facility was made available to the Central Government in December 1997 for drawings necessary for the execution of the budget, in dependence of the overall balance on deposit accounts with the Bank. The Bank determined the level of such credit facility for 1999 at between SIT 4.4 billion and SIT 16.0 billion. Any amounts drawn were repaid on the very same day they were drawn.

Exchange Rate Policy Instruments

Various possibilities for management of exchange rate

The Bank manages the exchange rate by means of various instruments. It buys and sells foreign exchange on temporary and on final basis in order to create demand or supply on the foreign exchange market. Additional exchange rate management tools are based on the agreement the Bank concluded with banks on their participation in interventions on foreign exchange market (see Box 8), obliging them either to use a predetermined exchange rate or limit the exchange rate margin respectively with clients. The Bank also manages the exchange rate by means of foreign currency denominated bills, by prescribing to banks the foreign exchange minimum and the foreign exchange open position in their balance sheets, and by means of capital controls.

Purchase and sale of foreign exchange

The Bank made this instrument available to all banks. The Bank also purchased and sold foreign exchange from banks based on agreements concluded with banks on their participation in its interventions on foreign exchange market. In addition, the Bank purchased and sold foreign exchange depending on the needs of Central Government for cross-border payments, and pursuant to any other business conducted on behalf and for the account of the Central Government.

The Bank purchased a total of SIT 59.7 billion and sold SIT 99.8 billion to banks and the Central Government. Together with redemptions under the foreign exchange part of twin bills, these transactions accounted for a reduction against 1998 in net annual cumulative Tolars issued based on foreign exchange transactions by SIT 44.2 billion to SIT 214.0 billion.

According to volume, the most significant instrument of the Bank intervention on the foreign exchange market was the sale of foreign exchange to banks for purchase of foreign currency denominated bills.

The transactions of temporary purchase of foreign exchange from banks by the Bank totaled SIT 27.0 billion and those of obligatory repurchase of foreign exchange by banks from the Bank SIT 23.5 billion. No transactions of temporary purchase based on the agreement with banks on their participation in interventions on foreign exchange market actually took place.

Signaling and conditionality

The Bank uses conditionality mechanisms in its agreement on participation of banks in its interventions of the foreign exchange market to signal its exchange rate policy intentions.

All contractual intervention possibilities employed by the Bank except for temporary sale of foreign exchange

Unlike in 1998, when the Bank employed only one contractual intervention possibility to monitor the exchange rate on the foreign exchange market (conditionality of buying rate), the Bank made use of all contractual possibilities except the temporary sale of foreign exchange. The Bank prescribed the minimum buying rate to banks between January and March and purchased excess foreign exchange from them. The Bank limited the margin between the buying and the selling rate to 0.4% during a period of 10 days given the instability on the market in mid May.

The Bank's intervened with a selling rate in July and August to hold back the depreciation of the Tolar. For the mayor part of 1999, the Bank prescribed the minimum buying rate to banks that had sold foreign exchange to the Bank on temporary basis. However, the limitation did not obstruct the market rate growth during periods of autonomous growth.

Foreign currency denominated bills

The Bank has issued foreign currency denominated bills since 1992 as transferable, registered, non-series, dematerialized securities. They are available to banks on

Box 8: **Contractual Participation of Banks in the Bank's Interventions on the Foreign Exchange Market**

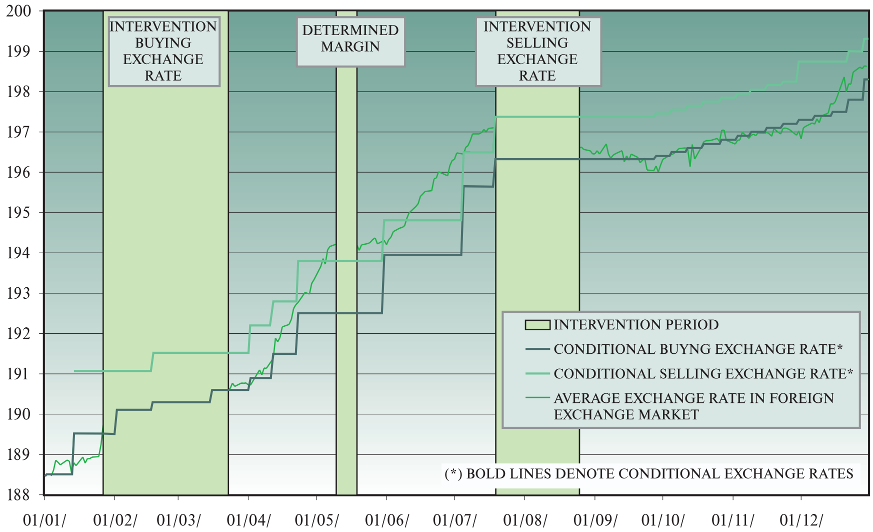
In 1997, the Bank proposed to banks the conclusion of an agreement on their participation in foreign exchange market interventions. The agreement specified the rights and obligations of banks and of the Bank. The agreement has been in force since 1998. Twelve banks signed the agreement, holding a share of 70% of the foreign exchange and the foreign currency exchange office market total. The banks are remunerated at 0.05% p.a. of the foreign asset average classified under reserves in foreign currencies. The Annex to agreement concluded in early 1999 regulates the participation of banks in different types of intervention:

- **Intervention buying rate**: The participating banks purchase foreign exchange and foreign cash at an intervention rate determined by the Bank. The participating bank can sell any excess foreign exchange to the Bank. The banks chosen are those participating banks which have been successful in the auction bidding for the difference between the intervention buying rate and the rate at which they sell foreign exchange to the Bank. The Bank determines the intervention rate and the intervention period at its discretion in line with the exchange rate policy intentions.
- **Intervention selling rate**: The participating banks sell foreign exchange and foreign cash at an intervention rate during the intervention period. Any shortage can be covered by purchase from the Bank. Banks qualify as participating banks in the same way they do in case of the intervention buying rate. The intervention selling rate and intervention period are determined in the same way as above.
- **Maximum exchange rate margin**. The Bank may prescribe to participating banks the maximum margin between the selling and the buying rate for a period of up to 3 months. The margin should not be lower than 0.3%.
- **Temporary purchase of foreign exchange**. The Bank makes this instrument available to banks on permanent basis. The Bank offered to buy foreign exchange from banks in order to enable them to manage the open foreign exchange position. The participating banks undertake the same obligations as regards their activity on the foreign exchange market and in foreign currency exchange offices as in the case of intervention buying rate.

Temporary sale of foreign exchange. The Bank offers to sell foreign exchange to banks on temporary basis. The participating banks undertake the same obligations as in the case of intervention buying rate. Also, in case of both, temporary purchase and sale of foreign exchange, the intervention rates and periods are determined by the Bank at its discretion.

permanent basis, and through banks to other legal entities. They are purchased at a discount in DEM (up to February 1999) and EUR respectively or USD. Those with maturity of 180, 270 or 360 days can be purchased at a discount based on warrants. The actual discount depends on the difference between the Bank's middle exchange rate and the official inflation projections, and on the number of warrant parts eligible as determined by the Bank for a particular issue. The interest rate applied reflects the relevant changes in international markets.

Figure 11: **Intervention rates of exchange** (in SIT/EUR) **and intervention periods**



Source: Bank of Slovenia.

Table 9: **Purchase and sale of foreign exchange**

	1998		1999	
	millions of EUR	billions of SIT	millions of EUR	billions of SIT
Purchase	**358.7**	**66.3**	**169.3**	**32.7**
Purchase with right to sell and subscription of bills	28.4	5.3		
Purchase at intervention purchase exchange rate	260.1	48.1	39.0	7.5
Payments for the government	70.1	12.9	130.3	25.2
Sale	**184.2**	**34.3**	**391.3**	**76.3**
For purchase of foreign currency bills	27.0	5.1	333.3	65.1
Sales by interventional exchange rate			6.5	1.3
Payments for the government	157.2	29.2	51.5	9.9
Temporary purchase	**576.8**	**106.1**	**139.0**	**27.0**
Temporary purchase (open tender)	507.8	93.3	10.0	1.9
Interventional temporary purchase by contract	69.0	12.8	129.0	25.2
Repurchase of foreign exchange	**622.8**	**115.6**	**119.5**	**23.5**
Temporary repurchase (open tender)	553.8	102.6	10.0	1.9
Interventional temporary repurchase by contract	69.0	13.0	109.5	21.6

* Employed are current exchange rate Tolar/DEM and DEM/EUR.
Source: Bank of Slovenia.

Foreign currency bills make banks eligible for almost any loan of the Bank

Foreign currency bills make banks eligible for almost any loan of the Bank – for Lombard, liquidity and short-term loans; they can also be temporarily sold to the Bank. Claims under foreign currency bills can serve as collateral. Foreign currency bills with maturity of up to 120 days serve to comply with the Bank's requirement on foreign exchange minimum. The respective regulation prescribes that banks fulfil at least 60% of the calculated requirement with foreign currency bills. Foreign currency bills with maturity up to 120 days accounted for 85% of all foreign currency bills outstanding.

Foreign currency denominated bills of SIT 283.7 billion were purchased in January. The total of such bills outstanding stayed on about the same level until October, and increased towards the end of the year, reaching SIT 310.9 billion in December. Within the 10% increase in bills outstanding total, foreign currency bills purchased under the Bank's foreign exchange minimum requirement increased by 23%; other purchase decreased by 35%. At December 1999, 87% of such bills outstanding were EUR-denominated and 13% USD-denominated.

Foreign Exchange Minimum (liquid assets in foreign currencies)

The Bank requires that banks hold minimum daily working balances (foreign exchange minimum) in form of foreign exchange and liquid foreign exchange assets abroad to meet their settlement obligations deriving from foreign exchange deposits of residents and non-residents, and Tolar term deposits (foreign currency deposits converted into Tolars) conditioned by sales of foreign currency on expiry.

Change in methodology for calculation of foreign exchange minimum

Pursuant to new methodology adopted in early 1999, the prescribed ratios for foreign currency deposits increased dependent on maturity, and the cross border payments were exempt from the requirement. The prescribed ratios for the minimum reserve in foreign exchange were the following: 100% for demand deposits and term deposits of up to 30 days, 95% for term deposits between 31 and 90 days, 75% for term deposits between 91 days and one year, 35% for term deposits over one year. The requirement and the same ratios also apply to balances on foreign exchange accounts of legal persons as of their introduction.

The minimum reserves of banks in foreign exchange increased from SIT 378 billion in January to SIT 447 billion, of which household foreign exchange savings deposits accounted for SIT 44 billion, and balances on foreign exchange accounts of entrepreneurs for SIT 23 billion. The actual foreign exchange minimum holdings exceeded the level prescribed. The average excess holdings were highest between June and October, with a peak in August (23.5%) and the lowest excess level in April (10.1%).

Banks complied with the requirement with appropriate balances on accounts with foreign first-class banks and with foreign cash in hand and checks, with net foreign currency claims on domestic and foreign banks, with short-term claims on the Bank, with the Bank's foreign currency bills (with maturities of up to 120 days), with first-class foreign securities. The prescribed minimum holdings of the Bank's foreign currency bills were 60% of the required foreign exchange minimum.

Open foreign exchange position

The requirement is imposed as protection of banks against foreign exchange risk. The Bank prescribed to banks involved in foreign currency operations the daily open foreign exchange position, which should not exceed 20%, and the monthly average, which should not exceed 10% of their regulatory capital. The requirement applies neither to Tolar claims, nor to off-balance sheet items.

At December 31, 1999, the aggregate open foreign exchange position of banks was short; foreign exchange liabilities of banks exceeded the assets by SIT 8.037 billion (3.8% of regulatory capital of banks). 16 banks ended up with open short foreign exchange position, 9 banks with an open long foreign exchange position.

Foreign exchange liabilities of banks exceeded their foreign exchange claims

Foreign portfolio investment

The Association Agreement between Slovenia and the European Union came into effect on February 1, 1999. The Agreement obliges Slovenia to fully liberalize (i.e. exempt from custody account requirement altogether) foreign direct investment on the one hand, but allows for a transitional period of four years in deregulation of portfolio investment.

Therefore capital controls imposed by the Bank on foreign portfolio investment remain in force. Foreign portfolio investors shall purchase securities via brokers or domestic banks to the debit of custody account open with one of the authorized banks (against payment of custody fee). Upon each portfolio investment operation, the authorized banks are obliged to pay the premium for the purchase of foreign currency options with the Bank, except in case when the non-resident investor pledges to abstain from any disposal of such portfolio investment during a period of one year.

Capital controls on foreign portfolio investment remain in force

During the first and second quarters of 1999, the foreign currency option premium charged was equal to 2.5% of the portfolio investment per quarter. It was reduced to 0.7% for the third and fourth quarter of 1999. The option gives the holder the right to purchase foreign exchange from the Bank.

The foreign currency option premium reduced to 0.7%

Surveillance of implementation of monetary policy measures

The Bank surveys the implementation of its monetary policy measures and compliance with conditions and rules governing its market interventions by means of indirect control and direct examination in banks and savings banks. Indirect control is a continuous process, carried out via regular control of reports and other documentation delivered by banks and savings banks to the Bank. In addition, the Bank occasionally also carries out on-site examinations of books and other documentation in banks and savings banks.

The Bank established a total of 16 cases of non-compliance (against 23 in 1998), whereof 5 in banks, 1 in savings banks and 10 in credit and loan undertakings. Non-compliance was established in mandatory reserve requirement and in compliance with conditions and rules governing the Bank's open market interventions. The Bank issued penal decrees in 12 cases, the measures taken depending on the nature and extent of non-compliance. Among such measures, temporary prohibition to purchase the Bank's bills and temporary limitation of asset growth prevailed.

16 cases of non-compliance established

The Bank issued warnings and requests for due orderliness in cases of minor non-compliance.

The Bank carried out 21 on-site controls of foreign currency exchange operations in the first half of 1999, out of which 9 in authorized banks and 12 in contractual foreign currency exchange offices. The Bank notified the district attorney of deficiencies accordingly in 2 cases and the Foreign Exchange Inspectorate of the Republic of Slovenia in four cases. The Bank issued 15 decisions on termination of legal proceedings.

The Bank carried out three examinations of banks in the area of foreign exchange operations; based on non-compliance established, the Bank issued one penalty decree limiting access to the Bank's long-term bills.

3. BANKING SECTOR

Enforcement of both, the EU Association Agreement and the new banking law brought about changes in the legal base, which had an impact on the banking sector.

3.1. Structure of Banking Sector

One takeover, a new foreign bank subsidiary and a branch

Consolidation of the banking sector has taken place since late 1994, resulting in a reduction of the number of banks, the most significant in 1998 with two acquisitions and one liquidation. Another bank acquisition took place in 1999, and a new bank and a branch were registered in the court register. At December 31, 1999 the total number of banks operational in Slovenia increased by one compared to December 31, 1998.

Just one banking group left

Establishment of four banking groups in 1997 was the most significant step in consolidation of the banking sector. Out of the four established, only one is still operational – that of the Nova Ljubljanska Banka (NLB). In addition to NLB it comprises Banka Zasavje d.d., Trbovlje, Pomurska banka d.d., Murska Sobota, Koroška banka d.d., Slovenj Gradec, Banka Velenje d.d., Velenje and Banka Domžale d.d., Domžale. In 1998 Hmezad banka d.d., Žalec was acquired by Banka Celje d.d., Celje and of UBK univerzalna banka d.d., Ljubljana by SKB banka d.d., Ljubljana. In 1999 M banka d.d., Ljubljana was taken over by Banka Koper d.d., Koper.

Box 9: **Convergence with European Banking Legislation**

Negotiations of the Republic of Slovenia with the European Union in the field of freedom to provide services cover banking, insurance business, securities market, investment funds and non-financial services. The respective legislation has been aligned, to a large extent, with that of the European Union, especially so the banking legislation.

Screening of the relevant legislation took place in February 1999. Slovenia prepared and delivered its negotiation position on Chapter 3 – Freedom to Provide Services in the second half of 1999, requesting transitional periods (starting on the expected date of EU accession) in the alignment with the EU directives in two cases.

The first request concerns capital adequacy requirement for savings institutions and Savings and Loan Undertakings established prior to enforcement of the new Banking Act (prior to February 20,1999). The new Banking Act stipulates the minimum capital required for savings banks and Savings and Loan Undertakings at SIT 186 million. A transitional period of five years following the enforcement of the new Banking Act and two years following the expected date of EU accession respectively (until December 31, 2004), will enable them to fully meet this and other requirements related to risk management and safe and prudent management of operations.

The second request concerns the deposit insurance scheme. Slovenia requests a transitional period of three years after the expected date of EU accession (until December 31, 2005). The new Banking Act introduces a new deposit guarantee scheme in line with the European directive by abolishing the guarantee of the Republic of Slovenia and by limiting the deposit guarantee to SIT 3.7 million per depositor. It also introduces deposit guarantee for legal persons, enterprises of a certain size. The Banking Act specifies the deposits eligible for such guarantee and those that are not covered by such guarantee. The new deposit insurance scheme shall come into effect on January 1, 2001. Slovenia is of the opinion that, given the need to provide for additional liquidity pursuant to the new deposit insurance scheme, Slovenian banks will not be in position to offer any but the minimum deposit guarantee required and will therefore not be competitive in the European Union.

Slovenia expects to fully align its legislation (except in cases of transitional period requested) with respect to Chapter 3 – Freedom to Provide Services – by December 31, 2002.

A new bank established after a break of five years

Hypo Alpe Adria banka d.d., Ljubljana, established in 1999, wholly owned subsidiary of a foreign bank, was the only new bank established in five years.

First foreign branch established

The new Banking Act, adopted in February 1999, introduced the possibility for establishment of foreign bank branches in Slovenia under certain conditions. The first such banking license was issued by the Bank of Slovenia to Kärntner Sparkasse AG, Klagenfurt, Austria in June 1999. Its Slovenia Branch was registered in the court register in September 1999.

The Bank of Slovenia approved the establishment of two foreign bank representative offices in 1999. At December 31, 1999 there was a total of 9 foreign bank representative offices operational in Slovenia.

At December 31, 1999 the Slovenian banking sector comprised 25 banks (4 foreign bank subsidiaries and one branch) and 6 savings banks and 68 credit and loan undertakings. Compared to 1998, the number of savings banks remained unchanged and the number of credit and loan undertakings reduced by 2.

The market share (measured by the balance sheet total) of the savings banks and credit and loan undertakings remained very small – 2.1% (whereof savings banks 0.4% and credit and loan undertakings 1.7%).

Box 10: **Foreign Bank Branches**

The new Banking Act introduces the possibility for foreign banks to establish branch offices in Slovenia. Such branches are not independent legal persons.

In line with the Second Council Directive, the new Banking Act introduces a uniform banking license, clearly differentiating between banks from EU member states and those from other foreign countries. The Second Council Directive makes it possible for banks domiciled in EU member states holding a banking license issued by their authorities in charge to provide such banking services in any other member state, be it in form of a branch or subsidiary.

The above differentiation will become effective with the date of full membership of Slovenia in the European Union. Until then, the banks domiciled in the EU member countries will still need the banking license of the Bank for establishment of a branch and will not be allowed to provide banking and financial services directly. As a condition to such banking license, the Bank may require endowment capital in form of a deposit or other form of guarantee for settlement of any liabilities of such branch deriving from its operation in Slovenia. Branches of foreign banks are subject to supervision by the Bank.

Stipulations of the Banking Act relating to risk management, data protection, their books and business reports, internal and external audit and the board of management apply to foreign bank branches accordingly.

Foreign bank branches are part of deposit insurance systems of their home countries. The level and scope of such insurance given to depositors of the foreign bank branch in Slovenia should not exceed the level given to Slovenian depositors by the deposit insurance scheme pursuant to the Banking Act. Should the deposit guarantee scheme of the domicile country of a foreign bank branch be below the level provided by the Banking Act, or in case of absence of the deposit guarantee scheme as such, the foreign bank branch shall become part of the Slovenian deposit guarantee scheme. The Bank shall determine the procedure and other conditions.

Out of the 25 operational banks in 1999, 11 were wholly owned by domestic entities (as at December 31, 1998) and 5 wholly owned or controlled by non-residents. The remaining 9 were majority owned by domestic entities (the share of foreign owners in more than half of these were lower than 1%). All banks but the state owned Nova Ljubljanska banka and Nova Kreditna banka Maribor (together holding a market share of nearly 40%, in terms of the balance sheet total) and the indirectly state owned Poštna banka Slovenije d.d. were in majority private ownership. The savings banks were wholly owned by domestic persons and are in majority private ownership.

5 out of 25 banks wholly owned by non-residents

The fast development of the banking sector is also evident from the balance-sheet total of banks/GDP ratio. The ratio increased by 2.7 percentage points to over 75% of GDP. Likewise, the balance-sheet total of banks, savings banks and credit and loan undertakings increased by 2.7 percentage points to almost 77% of GDP.

Growing balance-sheet total of the banking sector

Banks and savings banks shall comply with the new Banking Act by August 20, 2000. The banking licenses issued in compliance with the old Banking Act remain in force until then. Three banks had already obtained the new license for banking and provision of some other financial services before December 31, 1999. Out of the remaining 22 banks, 13 held an unlimited banking license (8 thereof for commercial and investment banking, 5 for commercial banking only).

August 20, 2000 the deadline for compliance with the new Banking Act

3.2. Operation of Banks

According to unaudited data, the **balance sheet total** of all Slovenian banks increased by 13.8% in nominal and by 5.3% in real terms to SIT 2,673.9 billion at December 31, 1999. Moderate growth has been typical of the last few years.

Balance sheet total increased by 5.3% in real terms

While the balance sheet total of most (20) banks increased in nominal and real terms, that of three banks decreased in real terms. The growth rates vary from bank to bank between 9.4% and 27.5%. Balance sheet totals of the newly established foreign bank subsidiary and branch grew above the average.

Table 10: **Banking Licenses Granted and Rejected** in 1999

	Type of license*	number of	
		granted	rejected
1.	Banking license	-	-
	License to provide banking services	2	-
2.	License for establishment of a foreign bank branch	1	-
3.	Approval to merger or acquisition	1	-
4.	Approval/License to establish bank representative office in Slovenia	2	-
5.	Approval to domestic shareholder to acquire a stake exceeding 15% of the capital	2	-
	Approval to acquire a qualified stake	8	5
6.	Approval to nonresidents to become shareholders	-	-
7.	License to provide additional banking services	1	2
	License to provide other financial services	24	-
8.	License to provide securities services	1	-
9.	License to members of the Board of Management	18	1
	Total	60	8

* The terminology employed in the licensing procedures up to February 20, 1999 is based on the old banking act (Law on Banks and Savings Banks) and differs somewhat from that employed in licensing procedures pursuant to the new Banking Law.

Source: Bank of Slovenia.

Market shares of the biggest banks fairly stable

Market shares (measured by the unconsolidated balance sheet totals of the largest banks have been fairly stable. The market share of the three largest banks has varied between 50.6% and 53% since 1994, that of the largest five between 62.0% and 63.3%, that of the seven largest banks between 71% and 73.7%, and that of the ten largest banks between 79.7% and 82.5%.

Non-bank deposits declined

The **average composition of bank liabilities** shows a decline in non-bank deposits (enterprise sector, households, General Government, other financial organizations, non-profit providers of services to households, and non-residents) from 70% to 69.3% due to a slowdown in deposits by households and a decline in deposits by the enterprise sector, the General Government and non-residents.

The slow-down in growth of deposits of enterprise sector has been evident since 1997. As a consequence of the decline in deposit rates, deposits by enterprise sector declined in the first quarter, reached the end-of December 1998 level again in June, and increased slightly in the second half of 1999. In spite of such upturn in the second half, and in spite of the introduction of foreign currency accounts as of September, the overall deposit growth amounted to only 2.2% in nominal, and to 5.4% in real terms.

Household deposits increased

Household deposits held the largest share in bank liabilities to non-banks (55.6% of liabilities to non-banks and 38.6% of liabilities total at December 1999). They grew at a nominal rate of 13.9%, while their growth rate even exceeded 20% in the years before. Short-term deposits increased slightly in the first quarter, declined in April and May and started growing in summer. Long-term deposits increased slightly in the second half of the year. In the composition of deposits, the share of short-term deposits decreased (from 52.3% in 1998 to 50.1%), and that of demand deposits increased (from 41.8% to 42.3%). The share of long-term deposits increased from 5.9% to 7.6%, among others also due to new products made available.

Considerable growth of household foreign currency deposits for the first time since 1996

For the first time since 1996, the real growth of household foreign currency deposits, especially savings accounts and short-term deposits, increased considerably, by 3.1%. This was the reason why the share of foreign currency deposits in the household deposits total declined at a slower pace than in the previous years, by only 1 percentage point to 44.8%.

Table 11: **Balance Sheet Totals and Market Shares of Largest Banks**

Bank	Balance sheet total in SIT mill.		Nominal growth in %		Market share in %	
	Dec. 31st 1998	Dec. 31st 1999	1998/1997	1999/1998	Dec. 31st 1998	Dec. 31st 1999
NLB *	648,595	738,575	18.1	13.9	27.6	27.6
NKBM	285,029	321,813	19.9	12.9	12.1	12
SKB banka	281,184	307,741	16.7	9.4	12	11.5
Banka Koper	137,190	167,905	14	22.4	5.8	6.3
Banka Celje	135,094	155,712	23.7	15.3	5.7	5.8
Abanka	123,151	149,342	19.5	21.3	5.2	5.6
Gorenjska banka	108,041	130,310	19.1	20.6	4.6	4.9
Total of 7 largest banks	**1,718,284**	**1,971,399**	**18.4**	**14.7**	**73.1**	**73.7**
Total of all banks	**2,350,359**	**2,673,958**	**16.2**	**13.8**	**100**	**100**

* Data of NLB Branch in Italy at December 31, 1999 not included.
Source: Bank of Slovenia.

Household deposits comprise savings accounts and deposits by independent entrepreneurs with a share of 1.8% (1% of deposit total by non-banking sector). These deposits increased by 34% in nominal terms in 1999.

Other non-bank deposits comprise those by the General Government, other financial organizations, non-residents, non-profit service providers to households. Deposits by General Government declined by one percentage point to 11.2%, those by non-residents by one-half of a percentage point to 2.5%.

Liabilities to banks increased

Against such background, banks turned to the banking sector. Liabilities to the Bank and to foreign banks contributed substantially to their balance sheet growth, especially so in summer. Liabilities to banks increased from 9.2%% to 10.6% of the average liability composition.

The share of bank liabilities related to securities issued declined by one-half percentage point to 1.9%. Capital accounted for a share of 10.2%, other liabilities for 8%. Both changed only slightly.

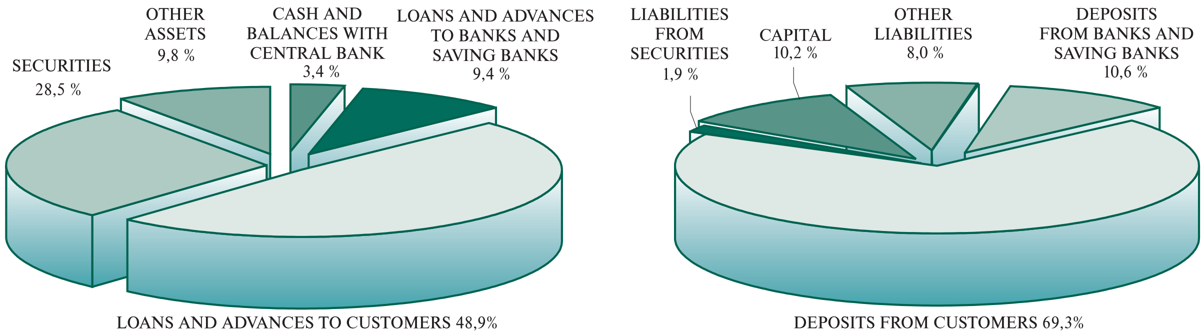
Loans to non-banking sector increased, primarily to households and real sector

The average composition of bank assets shows an increase in loans and advances to customers other than banks (from 44.2% to 48.9%). Loans to households increased considerably in the first half of the year, reflecting the higher demand for long-term credits ahead of introduction of VAT. The demand by households declined and became moderate in the second half, when the demand by the real sector for short-term loans increased, also due to the fiscal reform. Growth of loans to the real sector and to households (23.5% and 25.1% in nominal terms) was still lower than in 1998 (25.4% and 26.6%), but still resulted in a bigger share of such bank assets in the composition of assets total.

Comprised in the loans to the non-banking sector are loans to General Government with a share of 9%. Due to an increase in short-term loans to other financial intermediaries, the share of loans to other financial intermediaries in the composition of loans to non-banks increased from 1.5% to 2.3%.

Loans by non-residents accounted for 1.5% of loans to non-banking sector.

Figure 12: **Average Composition of Bank Liabilities and Assets** at December 31, 1999



Source: Bank of Slovenia.

Investment in securities decreased

In the past few years, investments in securities accounted for more than one third of the bank assets total. In 1999, their share declined to 28.5%, mainly due to a decline in investments in the Bank's Tolar bills, which was partially offset by an increase in investments in foreign currency denominated bills. The latter accounted for 43.2% and the former for only 3.1% of their securities portfolio. Investment in government securities remained substantial with a share of 42.3%. The share of other securities (bank shares, other shares, other securities issued by banks, non-residents, etc.) increased from 9.8% to 11.4%. The increase was mainly due to the fact that banks invested in securities of the enterprise sector towards the end of the year aiming at tax benefit.

The share of **loans and advances to banks** in the average composition of bank assets remained almost unchanged (9.4% against 9.3% in 1998). The share of **cash in hand** and **balances on accounts with the Bank** has been at 3% for a few years, that of other assets at about 10%.

The maturity composition of non-bank deposits in the first half of 1999 against that at December 1998 changed due to an increase in demand deposits. The change in favour of shorter maturities was also due to the expiry of the interbank agreement on deposit rates, the subsequent decline of deposit rates and the expectations prior to the introduction of VAT. A change in favour of longer maturities within the short-term deposits (especially deposits of above 181 days) was evident in the second half of the year.

Loans to households increased in the first and short-term loans to real sector in the second half of 1999

Long-term loans to households increased substantially in the first half of 1999. The demand by households was smaller in the second half, while demand for short-term loans by the enterprise sector increased.

Secondary liquidity of banks declined from 17.5% on 1997 to 15.5% in 1998 and to 14% (SIT 374.7 billion) of the balance sheet total in 1999. Second liquidity declined by 4.5% in real terms during 1999, due to the decline in Tolar bills outstanding.

Banks managed liquidity risks well and complied with the requirement to match the maturity composition of foreign assets and liabilities pursuant to the respective decision of the Bank (Official Gazette 40/99) throughout the year.

Table 12: **Deposits by and Loans to Non-Banking Sector by Maturity** (in %)

	Dec. 31st 1998	March 31st 1999	June 30st 1999	Sep. 30st 1999	Dec. 31st 1999
Demand deposits of nonbanks	33.3	33.9	37.4	35.4	34.9
Shortterm deposits of nonbanks	57.9	57.7	54.8	56.4	56.8
Longterm deposits of nonbanks	8.8	8.4	7.8	8.1	8.4
Total deposits of nonbanks	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Shortterm loans to nonbanks	57.2	56.2	55.3	56.3	56.8
Longterm loans to nonbanks	42.6	43.6	44.5	43.5	43.1
Claims from guarantees issued	0.2	0.2	0.2	0.2	0.2
Total loans to nonbanks	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Bank of Slovenia.

Composition of deposits by maturity less favourable

The change in composition of deposits by maturity and the declining secondary liquidity of banks were also evident from the asset to liability ratios. At December 1998, the ratio was 2.37 for first grade assets, 1.56 for second and 1.30 for third grade assets. The ratios changed to 1.98, 1.42 and 1.21 respectively in 1999. Concentration of deposits kept declining. Banks reported that the share of the largest thirty depositors (banks and individuals excluded) in overall deposits declined on average from 53.3% in 1997, to 51.8% in 1999. Deposit concentration was below the average in three largest banks, between 32.6% and 48.7%. The liquidity risk was offset by the relatively high permanent share of household deposits.

Decline in concentration of deposits

The shares of foreign exchange liabilities and assets declined

The share of **foreign exchange liability average of banks in the average bank liabilities total** declined from 35.8% in 1997 to 31.5% in 1998 and to 30.4% at December 31, 1999. Likewise, the share of **average foreign exchange assets** in the **average foreign assets total** declined from 32.8% to 30.3% and to 29.5% in the same period. Both, the foreign exchange liabilities and assets grew at an equal rate in the first half of 1999. However, foreign exchange liabilities grew slightly faster than the assets in the second half of the year. Foreign exchange liabilities increased by 14.4%, and the assets by 13.6% in the whole of 1999. The level of foreign exchange liabilities exceeded on average that of the assets by 3% (against 4.1% in 1998). Therefore, the balance sheet structure of banks did not change substantially in spite of the introduction of foreign exchange accounts for legal persons as of September 1, 1999.

Profit of banks declined due to loss in three banks

Pre-tax profit of banks totaled SIT 20.1 billion in nominal terms. Net revaluation gain amounted to SIT 25.3 billion. Profit declined against 1997 (SIT 21 billion) and 1998 (SIT 26 billion) in real terms. Three banks reported losses, one of them of SIT 5.5 billion.

After-tax profit amounted to SIT 10 billion against SIT 16 billion in 1998.

Table 13: Basic Composition of Balance Sheet of Banks
(at December 31, 1998 and 1999)

	Amount in SIT millions		Nominal growth in %		Real growth in %
	Dec. 31st 1998	Dec. 31st 1999	98/97	99/98	99/98
Deposits with Central bank	84,696.00	88,758.00	14.60	4.80	-3.00
Loans to banks	227,331.00	246,752.00	5.80	8.50	0.50
Loans to nonfinancial enterprises	622,200.00	768,206.00	25.40	23.50	14.30
Loans to households	346,016.00	430,018.00	29.30	24.30	15.10
Loans to government	103,799.00	124,719.00	50.40	20.20	11.30
Securities	714,566.00	708,365.00	3.60	-0.90	-8.20
Other assets	251,751.00	307,140.00	19.40	22.00	13.00
Total assets	**2,350,359.00**	**2,673,958.00**	**16.20**	**13.80**	**5.30**
Liabilities to banks	223,738.00	295,327.00	9.60	32.00	22.20
Liabilities to nonfinancial enterprises	386,392.00	394,925.00	11.60	2.20	-5.40
Liabilities to households	904,934.00	1,033,559.00	20.10	14.20	5.80
Libilities to government	206,074.00	208,773.00	18.40	1.30	-6.20
Libilities from securities	57,649.00	44,755.00	10.00	-22.40	-28.10
Other liabilities	315,290.00	417,216.00	19.30	32.30	22.50
Capital	256,281.00	279,403.00	12.50	9.00	0.90
Total liabilities	**2,350,359.00**	**2,673,958.00**	**16.20**	**13.80**	**5.30**

Source: Bank of Slovenia.

Net interest income declined in real terms….

…net fees and commissions receivable increased

Net interest income earned by banks that had increased at a slower pace in 1998 in nominal terms, decreased in 1999 by 2.9% in real terms. Net fees and commissions receivable increased by 3.2% in real terms, especially owing to fees and commissions on inland payments, on administration services and credit transactions. The net financial operations (profit gained on financial transactions reduced for any loss on financial transactions, plus income on securities) increased by one third, especially owing to higher income on securities (income on capital investments, dividend on marketable securities) and income on purchase and sale of foreign exchange.

Extraordinary expenses of banks declined. As a consequence the item "net other items" declined in real terms (comprising extraordinary expenses, extraordinary earnings, other earnings from operation, revaluation of capital, fixed assets and direct investment, and other expenses).

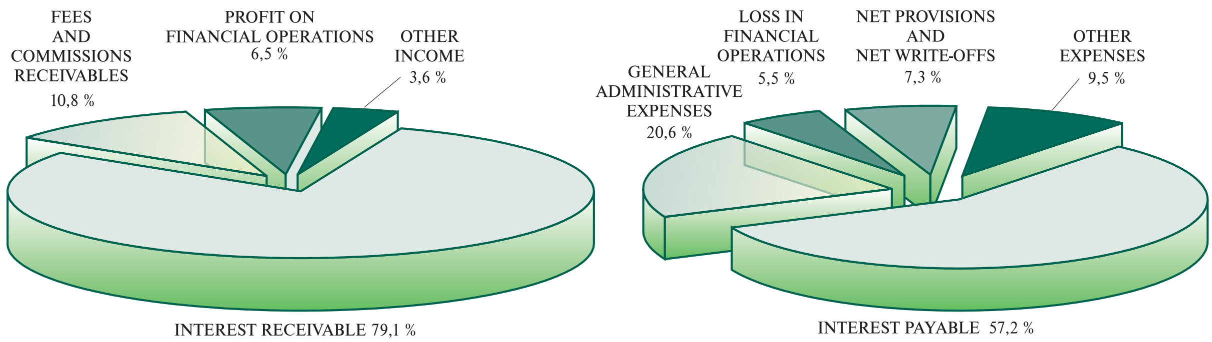
The nominal growth of **gross bank earnings** remained on the level of 1998 (9%). The real gross earnings remained on the 1998 level in spite of the decline in net interest earnings and only slight increase in fees and commissions receivable. The share of net interest receivable kept its downward trend and the net fees and commissions receivable their upward trend.

Table 14: **Main Items in Profit and Loss Account of Banks** (1998-1999)

	Amount in SIT mill.		Share in %		Nominal growth in %	
	1998	1999*	1998	1999	98/97	99/98
Net interest income	90,153	94,504	74	71	6.7	4.8
Net fees and comissions	30,206	33,652	25	25	12.2	11.4
Net financial operations	6,691	9,513	5	7	-10.3	42.2
Net other	-5,162	-4,335	-4	-3	-32.5	-16.0
Gross income	**121,888**	**133,334**	**100**	**100**	**9.6**	**9.4**
Operating costs	77,106	86,987	63	65	13.5	12.8
- from which: labour cost	38,343	43,538	31	33	8.4	13.5
Net income	**44,782**	**46,347**	**37**	**35**	**3.4**	**3.5**
Net provisions and net write-offs	-18,806	-26,213	-15	-20	-15.4	39.4
Profit before tax	**25,976**	**20,134**	**21**	**15**	**23.2**	**-22.5**
Profit after tax	**16,061**	**10,066**	**13**	**8**	**4.7**	**-37.3**

* Data of NLB Branch in Italy not included.
Source: Bank of Slovenia.

Figure 13: **Composition of Bank Income and Expenses** in 1999



Source: Bank of Slovenia.

Operating expenses that had been declining in nominal terms in the previous years increased by 4.5% in real terms against 1998. Labour costs increased by 5.1% mainly due to increase in gross salary expenses, service related expenses, expenses for advisory, auditing, accounting and other services. Gross salary expenses accounted for one third (32.7%) of labour costs.

Provisions made by banks increased by 7.4% to SIT 26.2 billion. The bank with the highest loss accounted for most of the increase.

Return on average assets was just above 1% (between 1.1% and 1.3%) up to December, and fell to 0.8% in December owing to provisions made by the one bank mentioned above. **Return on average** equity was above 10% between January and end of November (between 10.6% and 14.3%), and fell to 7.8% in December.

Operating expenses (composed of general administrative expenses, depreciation, tax, contributions, membership-fees etc.) **over average bank assets decreased slightly to 3.4%** owing to faster growth of the average balance sheet total (7.7% in real terms) than the growth of operating expenses (4.5% in real terms).

Net interest margin reduced…

The **net interest margin** declined from 4.9% in 1997 to 4.5% in 1998 and to 4.0% in 1999. It varied from bank to bank between 1.3% and 7.3%.

…and so was the interest spread.

The **interest spread, i.e.** the difference between the average real deposit and real lending Tolar rates for clients other than banks declined from 3.7 percentage points in the last quarter of 1998 to 3.3 percentage points in the last quarter of 1999.

… and the capital adequacy of banks

Capital adequacy of the banking system declined for the first time to 19.7% in 1996, then to 19.0% in 1997, to 16.0% in 1998 and to 13.9% in 1999 (the minimum capital adequacy ratio required is 8%). The capital adequacy of banks remains fairly high. It increases the safety net against existing and potential non-performing assets and enables banks to support a considerable growth in risk assets.

Table 15: **Indicators of Bank Efficiency**

	Dec. 31st 1997	**Dec. 31st 1998**	**Dec. 31st 1999**
Return on average assets	1.1	1.2	0.8
Return on average equity	10.3	11.3	7.8
Net interest margin	4.9	4.5	4
Labour cost/average assets	1.9	1.8	1.7
Other operating expenses/Average assets	1.7	1.8	1.7

Source: Bank of Slovenia.

In spite of the decline due to methodological changes…

The Decision on Calculation of Capital, on Capital Requirements and Capital Adequacy of Banks and Savings banks (Official Gazette 32/99) came in force as of May 1999. Pursuant to the Decision, long-term intangible assets and provisions for A graded clients are no longer included (numerator), and the current profit only under the condition that it has been confirmed by the external auditor. In addition, the weighted assets (denominator) include derivative financial instruments, exposure to banks and assets secured by a lien are weighted as higher risk (somewhat lower in case of a lien on real estate).

…capital adequacy exceeded the minimum required

The new methodology first applied to bank reports at June 30, 1999. The lowest capital adequacy reported was 8.8% and the highest as much as 40.9%. At December 31, 1999 the capital adequacy of eleven banks was below the average of 13.9%, that of three banks below 10%.

By way of importance, credit risk comes next with the operational risk in Slovenian banks, and within this category, exposure to a single customer or a group of related persons in particular. Large exposure to a single customer is defined as exposure equal to or exceeding 10% of the bank capital (Decision on High Exposure of Banks and Savings Banks, Official Gazette 32/99). Pursuant to the decision, the aggregate large exposure shall not exceed 800%, and the maximum exposure to a single customer shall not exceed 25% of the bank capital.

Large exposure of all banks satisfactory

Aggregate large exposure of banks remained well below the maximum allowed. Three banks reported large exposure to a single customer and a group of related persons larger than the maximum allowed, and four banks reported large exposure exceeding 20% of the bank capital to customers directly or indirectly under its control and to customers which control the bank directly or indirectly. The Bank expects banks to comply with the stipulations of the above decision by the time transition period expires (December 31, 2001).

Quality of bank credit portfolio improved

Credit risk assessment is based on the criteria set out in the Decision on Classification of Balance and Off-Balance Sheet Items of Banks and Savings Banks (Official Gazette 32/99). Within the credit portfolio, a slight decline against 1998 in claims to group A (by 1.1 percentage point), a decline by 0.1 percentage point in claims to group C, and a decline by 0.3 percentage point in claims to group D is evident. The decline was offset by an increase in claims to group B by 1.2 percentage point and group E by 0.2 percentage point. The composition of credit portfolio remains about the same even with claims to the Bank and to the Republic of Slovenia excluded (Table 16, in italic).

Table 16: **Classification of Balance Sheet and Off-Balance Sheet Assets of Banks**

Group	Dec. 31st 1998		Dec. 31st 1999	
A	89.6	*(-85,7)*	88.5	*(-85)*
B	5.0	*(-6,9)*	6.2	*(-8,2)*
C	2.1	*(-2,8)*	2.0	*(-2,7)*
D	1.8	*(-2,5)*	1.5	*(-2)*
E	1.5	*(-2,1)*	1.7	*(-2,2)*

Source: Bank of Slovenia.

The share of bad and doubtful claims in the gross assets total grew at a faster pace (21.2%) than did the balance sheet total (13.8%). The quality of credit portfolio did not change substantially, the share of bad and doubtful claims increased slightly against 1998 (from 10.9% to 11.6%). The share of value adjustments and provisions in gross assets total remained unchanged (6.3%). Provisions for claims of lower quality were of adequate level, the value adjustments of bad and doubtful assets amounted to 54.8%.

At December 31, 1999 the aggregate exposure (balance and off-balance sheet) of banks to credit risk amounted to SIT 3,109.6 billion (balance sheet claims accounted for SIT 2,541.0 and off-balance-sheet claims for SIT 568.6 billion). Provisions and value adjustments increased by 30.2% and exceeded the minimum required. Exposure to a single borrower hardly changed (SIT 111.2 million in 1998, SIT 111.9 million in 1999).

Banks paid more attention to financial standing and creditworthiness of households and individual entrepreneurs. As a consequence, claims to such borrowers were downgraded.

3.3. Operation of Savings Banks

The balance sheet total of the six savings banks amounted to SIT 11.0 billion. Whereas the balance sheet totals of all savings banks increased in real terms in 1998, those of two savings banks declined in real terms in 1999. The balance sheet total of all savings banks increased in 1999 by 16.0% in nominal and by 7.4% in real terms (the growth was similar to that of banks). Savings banks maintained the moderate 0.4% market share (one accounted for 55% of this share, and three savings banks for 74%).

They hold a market share of 0.4%

Savings banks differ in terms of size and composition of balance sheet. Whereas deposits of the enterprise sector declined in banks in real terms, they increased substantially in savings banks. Their share in the average liability composition increased by 6 percentage points to 22.4%. Likewise, household deposits increased (by 45% in real terms). The latter accounted for 22% of the average composition of liabilities, deposits of the banking sector for less than 10%.

Deposits by enterprise sector and household deposits increased

Table 17: **Exposure of Banks and Value Adjustments and Provisions Made**
(in million SIT)

	Dec. 31st 1997		Dec. 31st 1998		Dec. 31st 1999	
	Aggregate exposure	Adjustments, provisions	Aggregate exposure	Adjustments, provisions	Aggregate exposure	Adjustments, provisions
A	2,067,463	1,325	2,442,371	683	2,753,256	16,727
B	100,241	11,772	137,094	15,613	194,348	22,265
C	53,040	17,386	56,335	16,780	63,738	18,676
D	40,352	27,925	50,155	30,774	46,782	27,444
E	32,885	32,877	41,023	41,035	51,444	51,440
Total	**2,293,981**	**91,285**	**2,726,979**	**104,885**	**3,109,568**	**136,552**

Source: Bank of Slovenia.

Substantial real growth of loans to households

Loans to households accounted for more than two thirds of total assets. Within this category, loans to natural persons increased most, by 20.2%. Loans to the banking sector and the enterprise sector declined and accounted for less than 10% of the average asset composition. Four savings banks invested in the Bank bills throughout the year. Still, the share of such investment declined by 50% to 1.5% of the balance sheet total.

The majority of loans granted to natural persons in 1999 were long-term. As a consequence, the share of long-term credit in total assets increased to 49.7%.

All savings banks recorded profit

The six savings banks ended the year with profit. The pre-tax profit total of all banks amounted to SIT 181.5 million (an increase by SIT 141.4 million), after-tax profit to SIT 141 million. Savings banks maintained the level of their real gross profit (an increase by 1.5% in real terms) due to an increase in net fees and commissions receivable (an increase by 4.2% in real terms). The net interest earnings remained on the 1998 level. Better operating results are also due to the lower level of provisions (SIT 49.6 million against SIT 172 million in 1998). One savings bank suspended more provisions in 1999 than it made. Profitability of most of the savings banks deteriorated, the average return on assets amounted to 1.7%, but varied from savings bank to savings bank between 0.4% and 2.4%.

Operating expenses grew at a moderate pace (1.8% in real terms) and labour cost grew slowly (2.8% in real terms). As a consequence, operating expenses over average bank assets - albeit still higher than in banks – declined to 5.0%, labour costs over average bank assets to 2.4% (against 3.4% and 1.7% respectively in banks).

The interest margin has been on the downward track. It declined by one-half percentage point to 5.1%, but still exceeded that in banks (4.0%).

At December 1999, credit exposure of savings banks totaled SIT 10.4 billion. Their credit portfolio improved: the share of A-graded claims increased by 2.8 percentage points to 91.4%. The share of B-graded claims declined to 4.0%, C-graded claims to 1.3% and D-graded claims to 1.0%. E-graded claims increased slightly (to 2.3%).

The share of bad and doubtful claims in the gross assets total declined from 11.5% to 8.7%. Value adjustments and provisions for bad and doubtful assets increased from 53.4% to 66.5%.

The large exposure total of savings banks lies way below the maximum allowed. Also, the large exposure to a single borrower or related customer group, as well as exposure to other persons of the group remained within limits prescribed.

Compared to banks, interest rates increased

The level of deposit and lending rates was substantially higher than in banks. The real lending rate amounted to 8.3% (against 5.8% in banks), and the real deposit rate 4% (against 2.5% in banks). Likewise, the interest spread of 4.3 percentage points exceeded that of banks (3.3 percentage points).

The capital adequacy average of savings banks amounted to 14.4%. Capital adequacy of three savings banks exceeded the average, that of three exceeded the minimum required but was below the average.

3.4. Supervision of Banks and Savings Banks

Supervision and surveillance of banks is a continuous process

Supervision and surveillance of banks and savings banks is a continuous process based on regular reports submitted by banks to the Bank, on analyses and control of such reports by analysts of the Bank Supervision Department, and on on-site examinations.

Analysts participate in evaluation of operating results of banks and savings banks, in procedures related to issue of new or changes of the existing banking licenses, they advise banks on implementation of standards for safe and sound operation, they evaluate their proposals for new systemic solutions, they monitor observance by banks of minimum standards prescribed for safe, sound and prudent operation, monitor the efficiency of banks permanently based on data and information provided by banks at least once per month, they participate in preparatory work for on-site examinations and in meetings held with bank management and in meetings with other supervisory institutions and certified auditors, they prepare working documents for different committees and other bodies of the Bank. Analysts immediately inform examiners and the head of Bank Supervision Department of any irregularities detected. They decide to carry out an on-site examination at their discretion.

Respective measures are taken and their implementation is monitored by both, analysts and examiners in case of any irregularities established in the process of surveillance.

Full-scope and targeted examinations

In the past three years full scope on-site examinations were carried out yearly in 9 to 13 banks and savings banks, in addition to 18 to 30 examinations of selected areas (target examinations) yearly.

In line with the bank supervision strategy adopted by the Bank full scope examinations are to be reduced to 7 to 9 per year, and the number of targeted examinations to increase to about 30. At least one on-site examination per year shall take place in each bank and savings bank, but also more than one could well be possible. Fields of targeted examinations are determined at the discretion of the Bank. Risk management in information technology is just one of them.

39 on-site examinations in banks and savings banks

In 1999, a total of 39 on-site examinations were carried out in banks and savings banks, out of which 9 full-scope (8 in banks, 1 in a savings bank) and 30 targeted examinations (22 in banks and 8 in savings banks).

Special attention paid to Y2K compliance

Especially in the second half of 1999, examiners paid special attention to the Y2K compliance of banks and savings banks. They informed the Governing Board accordingly on quarterly basis. Based on the findings of such targeted examinations, the supervisory officials held meetings with bank management whenever deemed necessary and issued penalty decrees in case of any non-compliance established.

The Banking Act makes on-site examinations in legal entities, related to banks, possible

Pursuant to the new Banking Act, the Bank is authorized to supervise bank-related persons at its discretion. It is also authorized to supervise any other persons who are reasonably suspect of providing banking services without a Bank license. Based on such provisions, on-site examinations were also carried out, for the first time, in three companies (bank subsidiaries, non-banks). Likewise, based on the report by Market Inspectorate General of the Republic of Slovenia, on-site examinations were carried out in three companies suspected of providing banking services against the law.

Regular annual meetings take place with the management of banks and savings banks – upon conclusion of a full-scope examination or at any other time - to assess operating results, a bank's standing and strategic development plans. The Bank considers such exchange of views and information between the management and the supervisory authority very important. It makes timely and appropriate action possible in case of problems.

Cooperation with other supervisory institutions

The Bank examiners have cooperated with other supervisory institutions in the country and abroad. 8 joint targeted examinations of safekeeping deposits of materialized securities were carried out in banks with the Securities Market Agency.

The full-scope examinations were mainly focused on:

- credit and securities portfolio,
- capital adequacy compliance,
- risk management compliance,
- evaluation of profitability,
- bank liquidity and deposits of customers,
- adequacy and efficiency of internal control,
- equity investments and fixed assets,
- management of the bank and internal audit,
- information technology with special emphasis on Y2K compliance etc.

Target examinations primarily focused on:
- loans to corporations,
- loans to individuals and entrepreneurs,
- securities portfolio,
- correctness of accounting data disclosed,
- information technology, especially Y2K compliance etc.

4. OTHER FUNCTIONS

4.1. Management of International Reserves

International reserves of the Bank comprise
- foreign cash and balances on accounts abroad,
- first-class foreign securities,
- monetary gold,
- reserve tranche with the International Monetary Fund,
- SDR holdings with the International Monetary Fund.

International reserves of the Bank declined from USD 3,639 million to USD 3,168 million. The portion of foreign exchange reserves (foreign cash, deposits abroad and foreign securities purchased) offset by a counter-claim of domestic sectors (based on foreign currency denominated Bank bills and foreign exchange accounts of banks and of the Central Government with the Bank) declined from USD 1,878 million to USD 1,699 million. The Bank's own foreign exchange reserves (not offset by any counterclaim) declined from USD 1,732 million to USD 1,372. Other foreign currency assets of the Bank in addition to such foreign exchange reserves and holdings with the IMF include the balance on fiduciary account in Luxembourg. Due to its participation in the Operational Budget of the IMF (in lending operations to Azerbaijan, Pakistan and Zimbabwe in particular), and to payment made under the eleventh general review of its quota increase in February, the holdings with the IMF increased from USD 65 million to 107.6 million.

At December 1999 foreign exchange reserves of the Bank amounted to USD 3,168 million…

…out of which USD 1,372 million without counterclaim.

The Governing Board sets the guidelines for management of foreign exchange reserves of the Bank and revises them on quarterly basis. The guidelines include but are not limited to currency structure, average maturity of deposits and securities, selection of counterparty (deposits are allowed only with counterparties of highest long-term rating).

Table 18: **International Reserves and Foreign Exchange Reserves of the Banking System** (in million USD)

	BANK of SLOVENIA						BANKS
	International monetary reserves					Other foreign assets	Foreign exchange reserves
	Gold	SDRs	Reserve position in IMF	Foreign Exchange	Total		
Dec. 31st 1998	**0.1**	**0.2**	**65.4**	**3,572.9**	**3,638.5**	**46.8**	**1,208.60**
Jan. 31st 1999	0.1	0.2	67.0	3,476.5	3543.8	51.9	1,125.30
Feb. 28th 1999	0.1	0.3	93.6	3,330.1	3,424.1	51.8	1,131.60
Mar. 31st 1999	0.1	0.3	93.0	3,774.8	3,868.2	51.8	918.6
April 30st 1999	0.1	0.3	92.6	3,667.2	3,760.2	51.8	942.2
May 31st 1999	0.1	0.6	92.1	3,438.5	3,531.3	51.7	1,019.50
June 30st 1999	0.1	0.6	102.2	3,207.9	3,310.8	51.8	1,115.20
July 31st 1999	0.1	0.6	104.4	3,185.2	3,290.3	51.8	1,128.70
Aug. 31st 1999	0.1	1.1	109.4	3,081.0	3,191.6	51.8	1,186.0
Sep. 30st 1999	0.1	1.1	111.3	3,082.9	3,195.4	53.8	1,213.0
Oct. 31st 1999	0.1	1.1	110.7	3,058.6	3,170.5	51.9	1,202.50
Nov. 30st 1999	0.1	1.6	109.8	3,072.8	3,184.3	51.8	1,105.40
Dec. 31st 1999	**0.1**	**1.6**	**107.6**	**3,058.8**	**3,168.1**	**51.9**	**1,044.40**

Source: Bank of Slovenia.

Lower credit risk

In line with the strategy of the Governing Board, the Bank increased the portion of foreign exchange reserves invested in securities (primarily issued by sovereign borrowers) and by doing so, increased liquidity and reduced the credit risk.

4.2. Banking Services to Central Government

Cross-border Payments

Pursuant to the Law on the Bank of Slovenia, the Bank clears cross-border payments and performs any other transactions in foreign currencies for the account of Central Government. The Bank cleared outgoing payments of EUR 374.4 million, incoming payments of EUR 440.3 million, met obligations under letters of credit of EUR 7.2 million, processed EUR 7.3 million of outgoing cash payments and EUR 1.4 million of cash repayments. The Bank sold EUR 51.5 million to, and purchased EUR 130.3 million from the Central Government. Drawings on foreign loans and donations from abroad account for the difference between the two amounts.

The Republic of Slovenia raised money by way of EUR 400 million bond issue on the international market (USD 438 million). Pursuant to the agreement concluded with the Bank, the Ministry of Finance conversion is done by the Bank on a timely notice basis. The Ministry of Finance requested conversion of EUR 11.5 million in June and July accordingly.

Slovenia repaid a portion of unallocated debt of former SFR Yugoslavia to the following Paris Club members: Japan…

Pursuant to the law on the ratification of the respective bilateral agreement on succession to unallocated debt of former SFR Yugoslavia, Slovenia assumed 16.39% of such unallocated debt of USD 7.1 million (interest included) in July, and repaid the whole amount in August.

…Switzerland, Norway and Italy.

The Republic of Slovenia duly serviced all its obligations under foreign loans; repayments amounted to USD 240 million (principal and interest). Slovenia also repaid all the amounts outstanding to the following Paris Club members: Switzerland, Norway and Italy.

Payments to fiduciary account with Dresdner Bank Luxembourg of obligations succeeded to under the 1975 and 1983 Osimo and Rome Treaties respectively, concluded between the former SFR Yugoslavia and Italy, amounted to USD 4.9 million. At December 31, 1999 the balance on this account totaled USD 40.7 million (interest not included).

Securities Services (Fiscal Stamps and Government Bonds)

Pursuant to the respective agreement, the Bank prepared the issue and distribution of, and took custody of fiscal stamps on behalf of and for the account of the Ministry of Finance.

Administrative and fiscal stamps in nominal value of SIT 2.4 billion were issued. They and comprised 225.445.000 various tobacco stamps bearing safety features.

The Bank also processed 47.926 coupons redeemed of government bonds RS 02.

There were 3,280 Tolar cash transactions (incoming and outgoing cash payments) and 17,570 in foreign currencies 17,570.

4.3. Processing and Distribution of Cash

The Bank processed and duly distributed Tolar notes within the country. The new cash processing-machine contributed to better quality of banknotes in circulation by duly sorting out and destroying the worn-out notes.

At December 1999, 109 million banknotes were in circulation of nominal value SIT 143 billion…

At December 31, 1999, 109 million banknotes with nominal value of SIT 143 billion were in circulation (approximately 55 banknotes per citizen; see Figure 14; cash in banks included). Banknotes in circulation increased in terms of volume by 16%, in terms of value by 36% against 1998, among others due to Y2K uncertainty and expectations. The volume of the following denominations increased most: SIT 10,000 (by 47%), SIT 5,000 (by 30%) and SIT 1,000 (by 23%).

At the beginning of 1999 the Bank had additional 12 million and 6 million pieces of SIT 1,000 and SIT 5,000 denominations respectively printed aiming at replacement of worn-out and damaged notes.

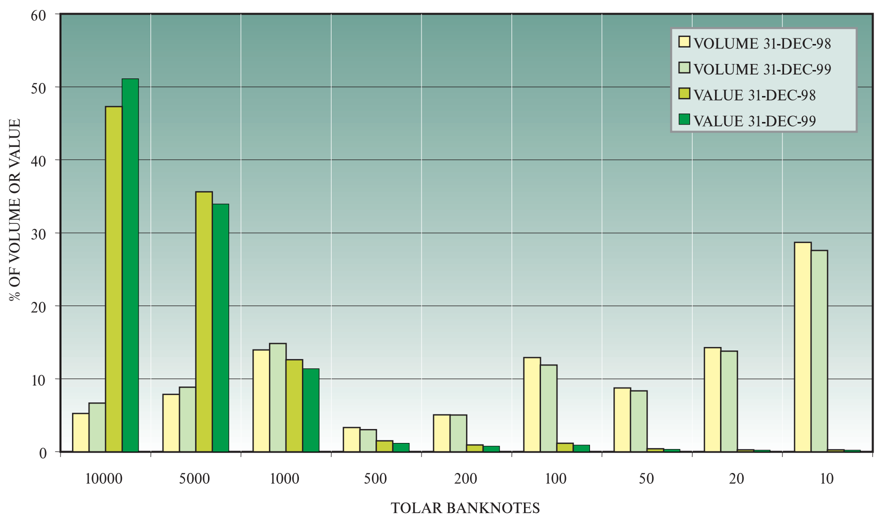
The Bank processed 75.8 million banknotes, and duly sorted out and destroyed 17.1 million worn-out and damaged banknotes (composition by denomination: 4.3 million of 10 SIT, 2.4 million of 20 SIT, 1.8 million of 50 SIT, 3.2 million of 100 SIT and 5.3 million of other denominations).

Every three months, the Bank determined the maximum cash in hand allowed to be kept by regional units of Agency for Payments Processing (APP). The Bank controlled their compliance and their operations on daily basis. No irregularities were established.

…and 300 million coins with nominal value SIT 634 million.

37 million coins of 5, 2 and 1 SIT were put in circulation in 1999. Together with coins put in circulation since 1993, a total of 300 million coins (1,500 tons in weight) were in circulation (on average 150 coins per citizen), an increase by 14% (or 19 coins per citizen) against 1998. Their nominal value amounted to SIT 634 million. 2,019 memorial coins were sold, of which 740 golden and 1,279 silver coins. No new memorial coin was issued in 1999.

Figure 14: **Composition of Banknotes in Circulation by Quantity and Denomination** (end of 1998 and 1999 in %)

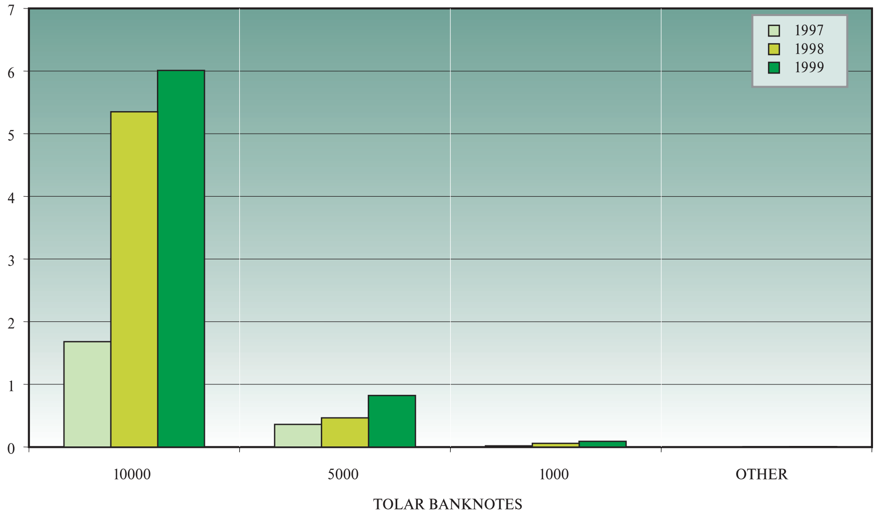


Source: Bank of Slovenia.

The volume of Tolar counterfeit notes increased

The Bank examined 6,947 counterfeit banknotes (against 12,661 in 1998) discovered and seized on the territory of Slovenia. Most of them were foreign currency (6,079 against 11,960 in 1998) - Italian Lira, German Mark and US Dollar. The Bank cooperated with the Ministry of the Interior and with Interpol.

Figure 15: **Tolar Counterfeit Notes by Value of Denomination**
in million SIT (1997-1999)



Source: Bank of Slovenia.

Box 11: **Cash Distribution Reform**

Migration of cash payment transactions to banks addresses both, direct and indirect supply of banks with cash, as well as transfer of incoming and outgoing cash payment operations by legal persons from the Agency for Payments (APP) to banks.

In line with the project, the Bank established a system of contractual depots of banknotes in seven selected (based on public tender) commercial banks – depositaries, with the old distribution network of APP still in place. Banks use the depots either directly, i.e. based on respective contracts with depositary banks, or indirectly, i.e. by means of purchase and sale of cash from depositary banks or from other banks.

Eight depots were established with the following seven selected banks and on the following locations: Banka Celje d.d., in Celje, Banka Koper d.d., in Koper, Gorenjska banka d.d., in Kranj, Nova Ljubljanska banka d.d., in Ljubljana, nova Kreditna banka Maribor d.d., in Maribor and a temporary depot in Ajdovščina, Pomurska banka d.d., in Murska Sobota and Dolenjska banka d.d., in Novo mesto.

For economic reasons, only one depot for coins was set up in Škofja Loka. It became operational as of July 1, 1999. With the new depot in place, organization, technology, and safety of processing and distribution of coins improved. During the transition period (ending on September 30, 1999) banks could make use of both, the APP facilities and the newly established depots, and only the new depots afterwards.

A joint working group of the Bank and the APP prepared a pilot project for migration of cash transactions of legal entities to commercial banks. The project proved successful during the trial period and is to be implemented as scheduled in the payment systems reform.

There were more attempts to cash in Tolar counterfeit notes (colour reproductions). The nominal value of Tolar counterfeit notes seized amounted to SIT 6.921.370 and is, compared to that of banknote in circulation total, not significant. The Ministry of the Interior requested examinations of 601 counterfeit notes of 10,000 SIT, 164 counterfeit notes of 5,000 SIT, and 87 counterfeit notes of SIT 1,000 and 16 counterfeit notes of other denominations. Compared to 1998, the volume of counterfeit notes increased most in the following denominations: SIT 10,000 (by 12%), SIT 5,000 (by 76%) and SIT 1,000 (by 55%).

Activities of Cash Distribution Department also include storage, distribution and redemption of securities issued by the Bank. The department processed 14,480 twin bills issued, and 20,452 parts of such bills and 20,452 bills with warrants redeemed.

4.4. Payment Systems Reform

Payment systems reform continued

Payment systems reform continued according to schedule as a joint project of the Bank, the Ministry of Finance, Agency for Payments of the Republic of Slovenia (APP), domestic banks, the Bankers' Association and the Central Statistical Office. Consolidation and stabilization of Real Time Gross settlement and Giro Clearing (net system for low value payments), as well as preparatory activities for transfer of accounts of legal entities from APP to banks took place in 1999.

Consolidation and stabilisation of operation of both systems mainly comprised inclusion of credit and debit transactions on accounts of legal entities with APP into RTGS and Giro clearing systems. Figures 16 and 17 clearly demonstrate the volume and value of such payments.

Gradual inclusion of payments into RTGS and Giro Clearing

APP has participated in RTGS from the very beginning, since the daily position of banks with the Bank comprised balances of bank accounts with APP. However, APP did not participate in the Giro Clearing System to start with.

Integration of APP into the RTGS and Giro clearing systems was gradual, as planned, and started on March 1, when payment orders to the debit of accounts of legal entities with APP were for the first time included in the new systems. Only one way integration of APP (it was only submitting payments to RTGS and Giro clearing and receiving nothing from the systems – credits payments to legal entities were still processed within the APP itself) was achieved by this step, which significantly affected the operation of Giro clearing. The unilateral participation of APP in the systems resulted in an increase of share of net settlement in gross value of payments settled, and an increase in liquidity needs by banks (with APP), as APP processed payment orders of banks in favour of legal entities but did not receive any payments in favour of banks (they were channelled to the settlement accounts of banks with the Bank.

The above situation called for inclusion of credit payments to accounts of legal entities with APP into the systems. Inclusion of payments into RTGS started in autumn. By October 1999 payments in favour of accounts with APP were fully included. Inclusion of low value payments into the Giro clearing was gradual and was not completed by the end of 1999.

RTGS system was operational during 254 days and achieved 99,84% reliability of operation. 511,321 large value and urgent payments in total value of SIT 23,184.37 billion were settled (on average, 2,013 payments of SIT 45.34 million per day).

Giro clearing system settled 9,789,220 low value payments in totalling SIT 1,259.30 billion The net cash flow, settled through the RTGS, reached 1.077,41 billion SIT, i.e. 85,56% of the total gross value of payments (on average 38,540 payments of SIT 128,641 SIT daily).

Getting the banks ready for transfer of accounts of legal entities

Preparatory work for transfer of corporate accounts from APP to banks – the actual goal of the reform - continued. Large and medium-size legal entities participated in the pilot project designed as follows:

- legal entities still hold accounts with APP, which still provides payment services;
- banks maintain the so-called shadow accounts of selected legal entities;
- legal entities establish a closer relationship with the bank by submitting payment orders to selected bank(s) (and no longer to APP); banks provide legal entities with statements of account;
- banks submit payment orders to APP on behalf and for the account of such legal entities and are responsible for the accuracy of payment orders submitted.

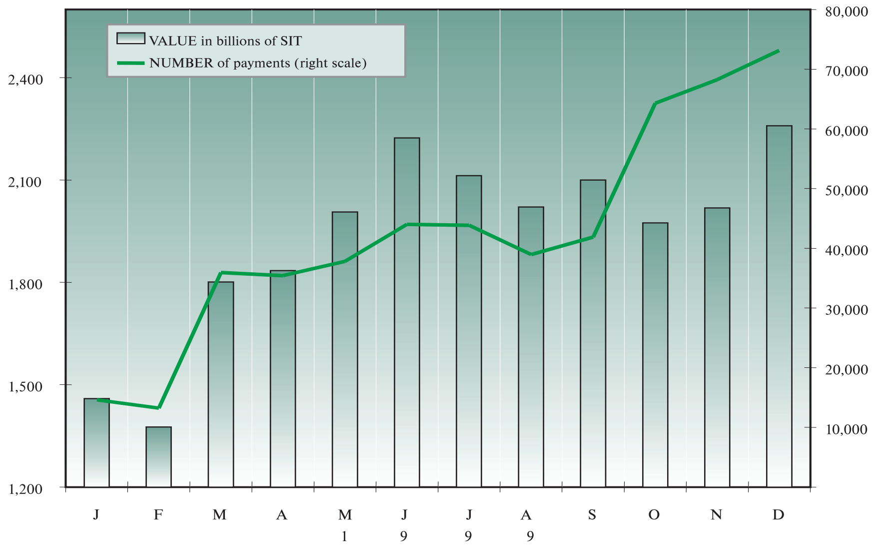
The pilot project aims at:

- getting the banking system ready to take over and keep accounts of legal entities, and provide all other services to them;
- gaining experience for transfer of accounts (by both, banks and legal entities);
- getting all banks ready to simultaneously take the accounts over;
- finding out to what extent the banks are ready to provide such services (based on respective criteria).

Terms and conditions for opening of accounts in banks and respective contract drafted

The respective working group drafted the terms and conditions for opening of transaction accounts (for both, legal and natural persons) in a bank, as well as the respective contract. The latter serves as base for participation of legal entities in the pilot project, but will also apply once the transaction accounts are opened.

Figure 16: **RTGS Cleared Transactions** in 1999



Source: Bank of Slovenia.

Based on documents prepared by the Bank, the Ministry of Finance and APP, the Government has adopted the decision on gradual transfer of accounts of legal entities from APP to banks. The decision stipulates that the Bank will propose and the Ministry of Finance and the APP Board will determine the date of the beginning of such transfer. According to reform schedule, the transfer is expected to be completed by September 30, 2001.

Accounts expected to be transferred to banks by September 30, 2001

Criteria (technical and formal) for transfer of accounts have been prepared pursuant to par. 3 of Article 73 of the Law on APP. They shall be verified by the Bank Governor and by the Minister of Finance. The Bank will issue the respective licenses to banks taking the criteria into consideration.

Criteria for transfer of accounts in place

The Bank established a central registry of transaction accounts in banks. It is to serve as technical support to banks and as uniform database on such accounts. The registry is now in place for accounts of legal persons, that for natural persons is planned to be established by the end of 2000. The registry will enable control of account numbers and provide information to authorised institutions.

Central registry of transaction accounts established

Banks and savings banks shall keep and update the registry of accounts of their customers. They shall keep the data accurate and up to date. For the time being, the Bank shall see to it that the central registry is operational.

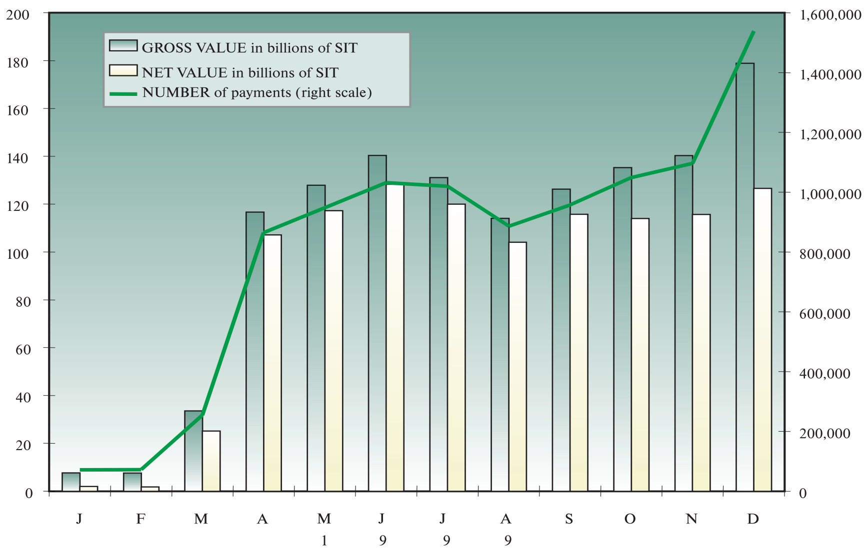
On November 23, 1999, settlement of net positions in domestic operations with Europay products (credit and payment cards Eurocard/MasterCard and debit cards Maestro and Cirrus) started through RTGS. This was another step towards the goal of the Bank to settle all national clearing systems (the first was Giro Clearing) through RTGS. Different as in case of Giro clearing is the role of the Bank in this case: the Bank is the settlement agent and Europay International is the clearing agent providing to the Bank information on daily net positions of 7 participating banks.

Daily settlement of net positions in domestic operations with Europay products started in November

As part of the payment systems reform, efforts have been made to set up a Single Treasury Account (STA) of the Ministry of Finance with the Bank. Co-ordinated activities of the Bank and the Ministry of Finance have started at the end of 1998 and have resulted in establishment of the STA on 24 June 1999. According to schedule, transactions are included gradually, for the time being only incoming and outgoing payments related to the treasury bills.

Single Treasury account

Figure 17: **Transactions Cleared by Giro Clearing System** in 1999



Source: Bank of Slovenia.

Changes in payment instruments

Changes in standardised payment instruments were implemented in 1999 in line with changes and amendments to Instructions on the Format, Contents and Use of Special Payment Instruments (standardised pre-printed optically readable payment instruments used for payments to public utility corporations) and Method of Settlement of Obligations by Means of Standing Order, Direct Debit and Direct Credit, effective as of October 10, 1998. As of February 1, 1999, use of any forms for payment orders developed by the creditors themselves, is prohibited.

Amendments to the above Instructions rendered possible the use of the above special payment instruments in case, when due to type of obligation it is not possible for the creditor to pre-print the exact amount due. Such is the case with value-added tax and payments tied to Tolar exchange rate on the due date, etc.

New Law on Payment Operations drafted

The Bank endeavoured to draft the new Law on Payment Operations together with the Ministry of Finance and APP. The first draft was amended in line with proposals made by the three parties involved, by ministries, government Legislation Office and by relevant parliamentary committees. The new draft was submitted to Parliament for the first reading in early December.

The first part of this Law deals with payment services, direct relationships among participants in payment systems, and with payment systems as a publicly recognised institutional infrastructure. The second part deals with gradual transfer of accounts to banks and respective procedures, to be determined by the Ministry of Finance and the Bank. It also deals with operation of APP in transitional period, and determines the termination of its operation. To ensure continuity of all tasks and responsibilities, for which APP had the mandate, the Law also stipulates the establishment of a public institution, Agency for Public Records and Services and Bureau for Public Payments, as part of the Ministry of Finance.

The Agency is scheduled to take over the function of statistical analysis of payment operations, and the Bureau for Public Payments to provide information on revenues and expenditures and act as an accounting service to the Ministry of Finance as regards the single treasury account.

4.5. Statistics

Statistics provide important data in support of several functions of the Bank, such as monetary policy. They provide financial and macroeconomic statistical data to users within the country and abroad (among others the International Monetary Fund, Eurostat and OECD). They fully comply with the requirements of the international financial organizations of which Slovenia is member or strives to become one.

Banking and monetary statistics, balance of payments, international investment position

Pursuant to the National Program of Statistical Research, the Bank is obliged to collect, compile and publish banking and monetary statistics, balance of payments and international investment position. The majority of such data is based on direct reports by banks and enterprises to the Bank, with the exception of data on foreign trade. These are supplied to the Bank by the Central Statistical Office based on customs declarations. The Bank also collects, compiles and disseminates data on contemporary payment instruments, financial markets, financial accounts etc.

Compliance with international standards

The Bank prepares the above statistics in compliance with the standards prescribed by the International Monetary Fund and Eurostat. The Bank is also in the process of adopting the requirements of the European Central Bank. Slovenia has subscribed to and the Bank (as national coordinator) has introduced and fully implemented the Special Data Dissemination Standards of the IMF. The Bank publishes the economic and financial data for Slovenia in accordance with these standards on its website. Such data are prepared in cooperation with the Central Statistical Office and the Ministry of Finance. The Bank assured integrity, consistency, transparency of data, timeliness of publication (in line with the publication calendar) and ready access to such web site. The basic economic and financial data are available on the web under http://www.bsi.si/imf/. The Bank also fully complied with the additional IMF requirement concerning the data template on international reserves and the foreign currency liquidity. It is the Bank's firm decision to implement and comply with other international standards which may be under way. The Bank considers transparency to be vital for timely detection of any problems and in providing to the international financial markets.

Data published in hard copy and on the website

Main macroeconomic data are published in the Monthly Bulletin, which is available in hard copy and on the Bank's Internet home page (Slovenian and in English versions). Data on Slovenian investment position are published in the Bank's annual Investment Report. The publication Financial Markets (in Slovenian only) is published on quarterly basis. The publications are also available on the website. Rapid reports containing key data and information on the balance of payments are available on the website.

4.6. International Relations and Cooperation

Cooperation of the Bank with central banks of developed countries

The Bank further intensified the existing good cooperation with central banks - members of the Bank for International Settlements (BIS), with other central banks and with international financial and other institutions. As was the case in previous years, quite a few foreign central bank officials visited the Bank, held lectures and discussed topics of mutual interest with the Bank officials and staff. On the other hand, the Bank officials and staff made short targeted study visits to foreign central banks to discuss particular issues. Equally beneficial was participation of the Bank's officials in specialized seminars, workshops (some of them tailor-made, addressing particular issues, held in the Bank), conferences and roundtables organized by foreign central banks and international institutions and by regional and other associations. Such activities helped the Bank clarify any remaining queries and get the expertise needed. No doubt, such contacts also added to better understanding of accomplished transition processes in Slovenian financial and banking sector by the international financial community and by foreign investors.

Cooperation also with central banks of countries in transition.

The Bank has gladly shared information and its own know-how and experience with central banks of other countries in transition and EU candidate countries. The Bank officials also participated in different conferences of regional associations and groups; the Bank hosted of the regional group conference of bank supervisors in September 1999.

Cooperation with the European Central Bank

Cooperation with the European Central Bank started in 1999. In addition to informal meetings, there were meetings held on the expert level regarding harmonization of bank legislation, statistics and payments systems.

Capital controls in line with the EU Association Agreement

Negotiations of Slovenia (and other candidate countries of the first group) with the European Commission continued. The EU Association Agreement came into force on February 1, 1999. The Bank aligned capital controls with the stipulations of the Agreement. As was the case in the previous year, the Bank officials played an active role in negotiations between Slovenia and the European Commission, participated in bilateral screenings of legislation and in preparatory work for negotiations concerning financial services, capital transactions and economic and monetary union.

Officials of the Bank participated in negotiations on succession to the former SFR Yugoslavia pursuant to the Dayton Accord.

The Bank continued to pursue a comprehensive settlement of succession to and division of the assets of the former central bank of the former SFR Yugoslavia held in the books of the Bank for International Settlements (BIS) and the shares registered in the name of that central bank. BIS granted a short-term credit facility of USD 50 million to the Bank in September. The Bank pledged to the BIS any share of the currency and gold assets deposited with the BIS in the name of central bank of the former SFR Yugoslavia that, as a result of a final settlement among all parties concerned, may be allocated to the Bank.

Slovenia endorsed the quota increase pursuant to the Board of Governors Resolution No. 53-2 on 45% increase in Quotas of Fund Members under Eleventh General Review. Its quota increased by SDR 18.7 million to SDR 231.7 million, its share to 0,109% of voting rights total.

In 1998, the Executive Board of the International Monetary Fund (IMF) included Slovenia - the very first country in transition - on the list of members considered sufficiently strong as to participate in the Operational Budget of the IMF. Its participation in 1999 amounted to SDR 13.4 million (in loans granted to Azerbaijan, Zimbabwe and Pakistan).

Slovenia also participated in the HIPC (Heavily Indebted Poor Countries) initiative of the IMF aiming at reduction of the debt burden in such countries. Slovenia participated with SDR 0.3 million earmarked on the SCA –2 account (Special Contingent Account) with the IMF.

5. FINANCIAL STATEMENTS

Statement of responsibilities of the Governing Board

The Law on the Bank of Slovenia (the Bank) and the Statutes of the Bank require the Governing Board to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the surplus or deficit of the Bank for that period. In preparing those financial statements the Governing Board is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Bank will continue in business.

The Governing Board has a general responsibility for taking such steps as are reasonably open to it to safeguard the assets of the Bank.

Report of the Auditors

To the Governing Board of the Bank of Slovenia

We have audited the balance sheet of the Bank of Slovenia ("the Bank") as of 31 December 1999 and 1998 and the related statements of income and expenditure, of changes in equity and of cash flows for the years then ended as set out on pages 73 to 87 ("the financial statements"). These financial statements are the responsibility of the Bank's Governing Board. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing as promulgated by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of 31 December 1999 and 1998, and the results of its operations and its cash flows for the years then ended in accordance with International Accounting Standards and Slovenian Law.

PricewaterhouseCoopers AG

A. Schönenberger
Authorised Auditors

K. Morscher

Zürich, 28 March 2000

Statement of income and expenditure

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

	Notes	**1999**	1998
Operating income:			
Income from financial assets		**21,433**	29,188
Net foreign exchange gain/loss		**38,399**	-4,753
Total income from financial assets	4	**59,832**	24,435
Expenses on serviced liabilities	5	**16,885**	24,701
Net investment income		**42,947**	-266
Other income	6	**952**	1,299
Other expenses	7	**408**	286
Total operating income		**43,491**	747
Operating expenses	8	**3,298**	2,923
Provisions		**-**	312
Operating surplus/deficit available for appropriation		**40,193**	-2,489
Appropriations:			
Transfer/Release to foreign exchange reserves		**38,399**	-4,753
Financial results after the appropriation of net foreign exchange gain/loss		**1,795**	2,264
Transfer/Release to general reserves		**1,555**	1,457
Total transfer/release to reserves	13	**39,954**	-3,297
Provision for transfer of surplus to the budget of RS		240	807
Total appropriations		**40,193**	-2,489

Balance sheet

at 31 December (in millions of tolars)

	Notes	**1999**	1998
Assets			
Financial assets	9	**672,404**	614,040
Fixed assets	10	**2,914**	2,372
Total assets		**675,318**	616,412
Liabilities and reserves			
Serviced liabilities	11	**443,106**	462,063
Banknotes in circulation	12	**142,489**	104,667
Provision for transfer of surplus to the budget of RS		**240**	807
Total liabilities		**585,834**	567,538
Reserves	13	**89,484**	48,874
Total liabilities and reserves		**675,318**	616,412

The notes on pages 76 to 87 form an integral part of the financial statements.

Statement of changes in equity

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

	General reserve	Foreign exchange reserve	Revaluation reserve	Welfare reserve	Operating surplus/deficit	Total equity
Balance at 31 December 1997	**3,616**	**47,480**	**500**	**530**	**-**	**52,126**
Operating surplus	-	-	-	-	-2,489	-2,489
FX gains/losses	-	-4,753	-	-	4,753	-
Operating surplus retained in general reserve	1,457	-	-	-	-1,457	-
Property revaluations	-	-	-	-	-	-
Contributions to welfare fund	-	-	-	45	-	45
Provisions for transfer to RS	-	-	-	-	-807	-807
Total movement	1,457	-4,753	-	45	-	-3,252
Balance at 31 December 1998	**5,072**	**42,727**	**500**	**575**	**-**	**48,874**
Operating surplus	-	-	-	-	40,193	40,193
FX gains/losses	-	38,399	-	-	-38,399	-
Operating surplus retained in general reserve	1,555	-	-	-	-1,555	-
Property revaluations	-	-	615	-	-	615
Contributions to welfare fund		-	-	41	-	41
Provisions for transfer to RS	-	-	-	-	-240	-240
Total movement	1,555	38,399	615	41	-	40,610
Balance at 31 December 1999	**6,627**	**81,126**	**1,115**	**616**	**-**	**89,484**

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

The notes on pages 76 to 87 form an integral part of the financial statements.

Statement of cash flows

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

	Notes	**1999**	1998
Cash flows from operating activities			
Interest received		**22,339**	28,824
Interest paid		**-18,666**	-24,549
Other		**-1,939**	-2,099
Net cash flow from operating activities	14	**1,734**	2,176
Cash flows from investing activities			
Increase/decrease in foreign deposits		**20,703**	-26,524
Increase in fixed assets		**-308**	-622
Increase/decrease in loans to domestic banks		**-17,998**	5,710
Net cash flow from investing activities		**2,397**	-21,436
Cash flows from financing activities			
Issue of circulating currency		**37,898**	19,094
Bank of Slovenia bills, net	15	**-43,579**	-6,231
Other, net		**1,419**	-5,504
Net cash flow from financing activities		**-4,262**	7,359
Exchange rate effect		**-1,426**	-428
Net cash flow from all activities		**-1,557**	-12,330
Opening cash balance		**-74,341**	-62,011
Closing cash balance	16	**-75,898**	-74,341
Increase (decrease) in cash balance		**-1,557**	-12,330

The notes on pages 76 to 87 form an integral part of the financial statements.

These financial statements were approved by the Governing Board on 28 March 2000 and were signed on its behalf by:

Dr. France Arhar
President of the Governing Board and
Governor of the Bank of Slovenia

In accordance with Article 82 of the Law on the Bank of Slovenia these financial statements have still to be approved by the Parliament of the Republic of Slovenia.

Notes to the financial statements

1 Constitution

The Bank of Slovenia (the Bank) is the central bank of the Republic of Slovenia. It was constituted by the Law on the Bank of Slovenia dated June 25, 1991. The Bank is self governing and is an independent institution with its own distinct legal personality. The Republic of Slovenia guarantees the obligations of the Bank which is supervised by Parliament. The Bank shall take care of the stability of domestic currency and of general liquidity of payments within the country and with foreign countries.

2 Accounting standards and conventions

These financial statements have been prepared in accordance with International Accounting Standards (IAS) as promulgated by the International Accounting Standards Committee under the historical cost convention, except as detailed below. These were adopted by the Governing Board at the 90th meeting on 9 May 1995.

3 Specific accounting policies

Income recognition

Interest income is recognised in the statement of income and expenditure as it accrues, other than interest of doubtful collectibility which is credited to a suspense account and excluded from interest income. The closing balance of the suspense account is netted in the balance sheet against accrued interest receivable. Suspended interest is written off when there is no longer any realistic prospect of it being recovered.

Fees and commissions receivable mainly arise from payment and settlement services, supervisory and regulatory functions and the distribution of fiscal stamps on behalf of the state.

Foreign currencies

Foreign currency financial assets and liabilities have been translated into Tolars (SIT) using the middle exchange rates of the Bank of Slovenia applying at the balance sheet date. Transactions in foreign currencies have been translated into SIT using exchange rates applying on the settlement dates of those transactions.

Marketable securities

The Bank invests in marketable securities as a part of its management of international reserves. Marketable securities are carried at the lower of amortized cost and market value.

Bills with warrants

The discount and coupon on bills with warrants, which are included in serviced liabilities, are amortised over the total period over which the bills and any related financing are outstanding, in proportion to the value of the related indebtedness. Future potential discount costs inherent in the warrants outstanding on bills in issue is estimated by the Bank and the amortisation related to the current year is accrued in the accounts as an expense and liability. Amounts are adjusted in future periods as the actual utilisation and value of warrants presented is determined.

Derivative financial instruments

The bank does not use derivative financial instruments except foreign exchange swap arrangements with domestic banks for purposes of implementing monetary policy and managing loans to banks. The amounts related to foreign exchange swap agreements are not recognised in the balance sheet until the settlement date.

Fixed assets

Investment properties located in Austria are carried at fair value and are not depreciated. The Bank's policy is to obtain an outside appraisal and revaluation of these properties once every 5 years. All other fixed assets are stated at cost and net of depreciation except for land, which is not depreciated. Property revaluations are taken to reserves.

Depreciation is provided on a straight line basis so as to write off the cost of the assets over their estimated useful lives at the following annual percentage rates:

Buildings	1.3 – 1.8 %
Computers	20 – 33 %
Other equipment	10 – 25 %

Gains and losses on disposal of fixed assets are determined as the difference between net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the statement of income and expenditure.

Banknotes in circulation

Banknotes issued by the Bank represent a charge on the Bank in favour of the holder and are recognised as a liability at face value.

Cash flows

Cash is defined as net freely transferable cash in convertible currency and demand deposits.

Cash flows from investing activities comprise cash movements in Bank portfolios, arising from the performance of the functions of the central bank. Also included are cash flows arising from movements in IMF Special Drawing Rights and fixed assets. Cash flows from financing activities are those arising from the issue of currency, the issue of Bank of Slovenia bills and movements in Republic of Slovenia deposits. Operating activities include income and expenditure cash flows not included as investing or financing activities.

Cash movements in portfolios have been presented net.

Taxation

The Bank is not subject to Slovenian profit taxes.

Appropriations

In accordance with the Law on the Bank of Slovenia, net foreign exchange gains are transferred to foreign exchange reserves. Foreign exchange reserves can only be used for covering the realised foreign exchange loss. Any remaining surplus after transfer to the general reserves is appropriated by the Republic of Slovenia. A loss is covered from the Bank's general reserves; if these prove insufficient, the loss shall be covered from the budget of the Republic of Slovenia.

Changes in accounting policies

There have been no changes in accounting policies since the previous year.

Implementation of IAS 39: Financial Instruments - Recognition and Measurement

The Bank has not yet implemented IAS 39 which is effective for periods on or after 1 January 2001. While the impact of IAS 39 is still being evaluated, management does not expect the effect to be material.

4 Income from financial assets

	1999 SIT millions	1998 SIT millions
Income from foreign currency assets		
Interest on deposits	**6,674**	14,220
Investment income on marketable securities, net	**12,046**	13,076
Interest on International Monetary Fund deposits	**550**	97
Net foreign exchange gain/loss	**38,399**	-4,753
Total	**57,669**	22,640
Income from domestic currency assets		
Interest on loans to banks	**2,163**	1,795
Interest on loans to the Republic of Slovenia	**-**	-
Total	**2,163**	1,795
Total income from financial assets	**59,832**	24,435

Investment income on marketable securities consists of the following:

	1999 SIT millions	1998 SIT millions
Interest income	**18,642**	13,439
Gains on sale of securities, net	**1,696**	1,503
Unrealised loss upon revaluation	**8,292**	1,866
Total investment income on marketable securities, net	**12,046**	13,076

Net foreign exchange gain/loss arises from the following exchange rate changes:

	1999 SIT millions	1998 SIT millions
EUR	**6,548**	1,681
USD	**22,668**	-5,267
Other	**9,183**	-1,167
Net foreign exchange gain/loss	**38,399**	-4,753

5 Expenses on serviced liabilities

	1999 SIT millions	1998 SIT millions
Expenses on foreign currency liabilities		
Interest on current accounts and deposits	**809**	399
Interest on Bank of Slovenia bills	**9,110**	13,028
Total	**9,918**	13,426
Expenses on domestic currency liabilities		
Interest on current accounts and deposits	**636**	352
Interest on Republic of Slovenia deposits	**113**	101
Interest on Bank of Slovenia bills	**6,217**	10,822
Total	**6,966**	11,275
Total expenses on serviced liabilities	**16,885**	24,701

6 Other income

	1999 SIT millions	1998 SIT millions
Fees and commissions receivable	**699**	1,054
Other income	**253**	245
Total other income	**952**	1,299

7 Other expenditure

	1999 SIT millions	1998 SIT millions
Commissions and fees for banking services	**408**	286
Total other expenditure	**408**	286

8 Operating expenses

	1999 SIT millions	1998 SIT millions
Staff costs	**1,841**	1,698
Administration costs	**1,183**	1,053
Printing and minting costs	**159**	70
Other	**114**	103
Total operating expenses	**3,298**	2,923

9 Financial assets

	1999				1998
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
	SIT millions				
Foreign currency assets					
Cash and deposits	**181,102**	**-**	**-**	**181,102**	260,545
Marketable securities	**203,338**	**63,111**	**157,534**	**423,983**	314,660
Receivables from the Republic of Slovenia	**-**	**390**	**6,870**	**7,260**	6,781
International Monetary Fund	**21,490**	**-**	**-**	**21,490**	10,582
Accrued interest and other	**1,125**	**1,382**	**4,607**	**7,115**	8,348
Total	**407,055**	**64,883**	**169,011**	**640,948**	600,916
Domestic currency assets					
Receivables from Succession Fund of the RS	**-**	**-**	**8,650**	**8,650**	8,650
Loans to banks	**21,857**	**171**	**152**	**22,180**	4,151
Accrued interest and other	**395**	**23**	**208**	**626**	323
Total	**22,252**	**194**	**9,010**	**31,456**	13,124
Total financial assets	**429,306**	**65,077**	**178,021**	**672,404**	614,040

Average effective interest rates on financial assets.

	1999				1998
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
	%				
Foreign currency assets					
Cash and deposits	**4.03**	**-**	**-**	**4.03**	4.00
Marketable securities	**3.55**	**4.46**	**5.03**	**4.23**	4.53
Receivables from the Republic of Slovenia	**-**	**-**	**-**	**-**	-
International Monetary Fund	**3.49**	**-**	**-**	**3.49**	2.98
Domestic currency assets					
Receivables from Succession Fund of the RS	**-**	**-**	**-**	**-**	-
Loans to banks	**8.11**	**11.55**	**8.00**	**8.13**	7.99

Deposits with other banks and loans to other banks have a carrying amount equal to the principal less specific provisions (1999: SIT 878 million, 1998: SIT 891 million). Interest is paid on maturity.

Market value of marketable securities is SIT 424.000 million (1998: SIT 316.973 million) and it exceeds the book value for SIT 17 million (1998: SIT 2.313 million). Marketable securities pay interest mostly semi-annually.

The deposits with the International Monetary Fund represent the Reserve Tranche Position and Special Drawing Rights (SDR) and pay interest on a quarterly basis.

Receivables from the Republic of Slovenia have a carrying value equal to principal and are mostly funded by Special Drawing Rights allocations. Interest borne on the funding is recharged directly to the Republic.

The Succession Fund of the Republic of Slovenia was established in February 1993 (Official Gazette of the Republic of Slovenia 10/93) as an intermediary in the process of the division of assets and liabilities of former Yugoslavia. It assumed, on behalf of the Republic of Slovenia, all the claims on and the obligations to the former National Bank of Yugoslavia which included SIT 8,650 million due to the Bank. This amount will be repaid after the settlement of claims and liabilities of the Republic of Slovenia and the states of the former SFR Yugoslavia. The amount is not interest bearing and has no fixed repayment term and therefore the fair value of this asset is less than the carrying value. Due to the uncertainty relating to the likely repayment term of this asset, no estimation of the fair value has been provided. However, the Governing Board considers that the carrying value of this asset fairly represents the amount which will be recovered.

The Governing Board considers that the fair value of financial assets, except as mentioned above, is not materially different from the carrying value.

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

Currency concentration and maturity analysis

The nature and manner in which the Bank conducts its operations, principally in relation to monetary policy management and foreign currency reserve management, give rise to currency concentrations in the financial assets. This primarily arises from country and counterparty concentration of exposures.

Basic guidelines for the management of the Bank's international reserves are set by the Governing Board of the Bank and revised on a quarterly basis; the guidelines prescribe the currency structure, average term of deposits and of investments in foreign securities, as well as selection of foreign banks.

These concentrations of risk by currency and type of counterparty are as follows at 31 December 1999.

	SIT	EUR	USD	Other	Total
	%	%	%	%	%
Sovereign issuers	**1.35**	**13.84**	**6.45**	**2.77**	**24.40**
Domestic banks	**3.33**	**-**	**-**	**-**	**3.33**
Foreign banks	**-**	**46.91**	**18.49**	**6.87**	**72.27**
December 31, 1999	**4.68**	**60.75**	**24.94**	**9.64**	**100.00**
December 31, 1998	2.14	57.70	23.37	16.79	100.00

Financial assets at 31 December 1999 will mature within the following periods analysed by currency (in millions of tolars):

	SIT	EUR	USD	Other	Total
	%	%	%	%	%
Up to 1 month	21,990	117,460	42,972	7,273	189,695
1 to 3 months	261	33,746	12,797	-	46,804
3 to 12 months	194	72,062	24,894	6,938	104,089
1 year and over	9,010	185,196	87,013	50,597	331,817
December 31, 1999	**31,456**	**408,464**	**167,676**	**64,809**	**672,404**
December 31, 1998	13,124	354,301	143,525	103,091	614,040

Credit Risk Concentration

All marketable securities are interest bearing bonds. All marketable securities and deposits are held with foreign banks.

All foreign banks in which the Bank places funds have a credit rating of at least AA- as graded by Fitch IBCA. The maximum credit risk exposure at 31 December 1999 in the event other parties fail to perform their obligations is the amount recorded in the financial statements as financial assets. Sovereign issuers' exposure consists of OECD countries, the Republic of Slovenia and the Succession Fund of the Republic of Slovenia. Loans to domestic banks are collateralized. The Governing Board believes that there is no significant concentration of credit risk.

10 Fixed assets

	Land and buildings	Computers & equipment	Total
	SIT millions	SIT millions	SIT millions
Cost or valuation			
At 1 January 1998	1,787	1,603	3,390
Additions	160	493	653
Disposals	-	-93	-93
At 1 January 1999	1,947	2,004	3,950
Additions	80	221	301
Investment properties revaluation	615	-	615
Disposals	-	-107	-107
At 31 December 1999	**2,641**	**2,118**	**4,759**
Depreciation			
At 1 January 1998	522	796	1,318
Disposals	-	-91	-91
Charge for the year	16	336	352
At 1 January 1999	538	1,041	1,578
Disposals	-	-106	-106
Charge for the year	18	354	373
At 31 December 1999	**556**	**1,289**	**1,846**
Net book value			
At 31 December 1999	**2,085**	**828**	**2,914**
At 31 December 1998	1,409	963	2,372

Included in land and buildings at 31 December 1999 and 1998 is an amount relating to investment properties in Austria (1999: SIT 1.115 million, 1998: SIT 500 million).

11 Serviced liabilities

	1999				1998
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
	SIT millions				
Foreign currency liabilities					
Current accounts and deposits	**23,990**	**-**	**-**	**23,990**	16,356
SDR allocation	**6,868**	**-**	**-**	**6,868**	5,772
IMF and other international financial organisations	**-**	**-**	**58**	**58**	59
Bank of Slovenia bills	**248,108**	**63,901**	**-**	**312,009**	284,865
Accrued interest and other liabilities	**122**	**-**	**-**	**122**	29
Total	**279,088**	**63,901**	**58**	**343,048**	307,080
Domestic currency liabilities					
Current accounts and deposits	**65,167**	**-**	**-**	**65,167**	66,515
Bank of Slovenia bills	**17,069**	**10,032**	**-**	**27,101**	79,904
Republic of Slovenia deposits	**2,303**	**-**	**-**	**2,303**	2,317
Accrued interest and other liabilities	**868**	**268**	**4,352**	**5,487**	6,246
Total	**85,406**	**10,300**	**4,352**	**100,058**	154,983
Total serviced liabilities	**364,495**	**74,201**	**4,410**	**443,106**	462,063

Average effective interest rates on serviced liabilities.

	1999				1998
	Repricing period				
	3 months or less	3 months to 1 year	Over 1 year	Total	Total
	%				
Foreign currency liabilities					
Current accounts and deposits	**4.40**	**-**	**-**	**4.40**	4.02
SDR allocation	**-**	**-**	**-**	**-**	-
IMF and other international financial organisations	**-**	**-**	**-**	**-**	-
Bank of Slovenia bills	**3.70**	**4.01**	**-**	**3.76**	3.83
Domestic currency liabilities					
Current accounts and deposits	**0.97**	**-**	**-**	**0.97**	0.97
Bank of Slovenia bills	**6.50**	**8.47**	**-**	**7.21**	8.04
Republic of Slovenia deposits	**1.00**	**-**	**-**	**1.00**	1.00

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

The SDR allocation liability carried an interest rate of 3,90% at 31 December 1999 (1998: 3,64%). Interest paid by the Bank is recharged directly to the Republic of Slovenia, thereby giving a nil effective interest rate.

Bank of Slovenia bills

Bank of Slovenia bills are comprised of the following at 31 December:

	1999	1998
	SIT millions	SIT millions
Foreign currency bills	**311,286**	283,214
Tolar bills	**17,629**	66,770
Bills with warrants	**8,765**	11,470
Twin bills	**1,430**	3,316
Total Bank of Slovenia bills	**339,110**	364,769

Tolar bills are issued with maturities from two to two hundred and seventy days. Foreign currency bills are issued at a discount in either USD or EUR with maturities from two to twelve months. Twin bills are short-term securities issued in bearer form which are comprised of a Tolar and a foreign currency part. They can be bought in Tolars at a discount with redemption in Tolars and in DEM. Bills with warrants are short-term securities issued in bearer form in Tolars. Warrants attached to the bills enable the holder to buy new Tolar bills (without additional warrant) or foreign currency bills at a discount.

Currency concentration and maturity analysis

Financial liabilities at 31 December 1999 will mature within the following periods analysed by currency (in millions of tolars):

	SIT	**EUR**	**USD**	**Other**	**Total**
Up to 1 months	74,430	99,026	26,737	142	200,334
1 to 3 months	10,977	134,207	12,109	-	157,292
3 to 12 months	10,300	50,829	13,072	-	74,201
1 year and over	4,352	-	58	6,868	11,278
December 31, 1999	**100,058**	**284,061**	**51,976**	**7,010**	**443,106**
December 31, 1998	154,983	249,598	49,610	7,872	462,063

12 Banknotes in circulation

Value of banknotes in circulation by denomination:

		1999	1998
		SIT millions	SIT millions
SIT	10	**301**	270
SIT	20	**300**	269
SIT	50	**455**	411
SIT	100	**1,295**	1.211
SIT	200	**1,096**	955
SIT	500	**1,651**	1,557
SIT	1,000	**16,160**	13,165
SIT	5,000	**48,233**	37,090
SIT	10,000	**72,590**	49,333
Total		**142,082**	104,261
Tolar coupons		**407**	406
Total		**142,489**	104,667

13 Reserves

	1999 SIT millions	1998 SIT millions
Balance at 1 January	**48,874**	52,126
Transfer/Release of foreign exchange reserve	**38,399**	-4,753
Transfer/Release of general reserve	**1,555**	1,457
Investment properties revaluation	**615**	-
Contributions to the welfare fund	**41**	45
Balance at 31 December	**89,484**	48,874
Represented by		
Foreign exchange reserve	**81,126**	42,727
General reserve	**6,627**	5,072
Investment properties revaluation	**1,115**	500
Welfare fund	**616**	575
Total reserves	**89,484**	48,874

The general reserve has been established in recognition of the economic and other risks inherent in the discharge of the Bank's responsibilities, and its portfolio of financial assets.

The foreign exchange reserve relates to cumulative net foreign exchange gains which by law are only available to offset any future net foreign exchange losses and are not distributable.

The welfare fund has been established to provide recreational and other facilities for the staff of the Bank. The assets representing the fund are included in the Bank's balance sheet and any movement in asset values is taken directly to reserves.

14 Reconciliation of operating cash flows with reported operating surplus

	1999 SIT millions	1998 SIT millions
Reported operating surplus	**40,193**	-2,489
Non-cash items		
Net unrealised foreign exchange (gain) loss	**-37,805**	4,495
Depreciation	**370**	349
Total	**-37,435**	4,845
Movements in other working capital items		
Changes in interest receivable	**900**	-361
Changes in interest payable	**-1,781**	164
Changes in other accruals	**-143**	17
Total	**-1,024**	-180
Net cash flow from operating activities	**1,734**	2,176

15 Supplemental cash flow information: cash flows from Bank of Slovenia bills

	1999	1998
	SIT millions	SIT millions
Source		
Tolar bills	**-**	8,361
Foreign currency bills	**10,125**	-
Twin bills	**-**	3,201
Total	**10,125**	11,562
Disbursements		
Tolar bills	**-49,119**	-
Foreign currency bills	**-**	-12,076
Bills with warrants	**-2,618**	-5,718
Twin bills	**-1,967**	-
Total	**-53,704**	-17,793
Total net source	**-43,579**	-6,231

16 Supplemental cash flow information: cash balance

	1999	1998
	SIT millions	SIT millions
Foreign currency assets		
Cash	**1,618**	325
Total assets	**1,618**	325
Foreign currency liabilities		
Demand deposits	**-10,046**	-5,833
Domestic currency liabilities		
Commercial banks demand deposits	**-61,253**	-62,863
Non-bank deposits	**-6,217**	-5,969
Total liabilities	**-77,515**	-74,666
Cash balance	**-75,898**	-74,341

Foreign currency cash assets do not include time deposits of SIT 169.822 million.

Foreign currency demand deposits do not include restricted deposits of SIT 13.945 million.

17 Commitments and off balance sheet instruments

Letters of Credit

The aggregate amounts of outstanding letters of credit at the year end were:

	1999	1998
	SIT millions	SIT millions
Foreign currency letters of credit	**175**	1,528

Foreign exchange swaps

The Bank entered into certain foreign exchange swap agreements in 1999 which require the Bank to buy EUR for SIT in the total nominal value of SIT 3,8 billion.

	1999	1998
	SIT millions	SIT millions
Amounts to be received forward against EUR	**3,848**	-

Because of the short term nature of these transactions, the fair value does not differ materially.

Bills with warrants

The Bank issued SIT 54 billion of bills during 1999 with 114.000 warrants attached. Each bill has a maximum of three (11., 12. and 13. issue) warrants attached, 14. issue has no warrants attached. The warrants represent a contractual obligation by the Bank to sell SIT, EUR or USD bills, with maturities of 180 days to 360 days, at an additional discount based on the value of the warrant. The value of the warrant is calculated by the Bank on a monthly basis and represents the difference between the actual inflation and projected inflation for additional discount on SIT bills and between projected inflation and actual devaluation of SIT against EUR and USD for EUR or USD bills respectively. The warrants have a maturity of 6 months from the date of issue. At 31 December 1999, there were 13.036 issued but unexercised warrants. The future potential discount costs of these warrants are estimated by the Bank and amortised over the total period during which the bills with warrants and the newly issued bills (resulting from the presentation of warrants) are outstanding. The provision for the amortisation estimated for unexercised warrants which relates to the year ending 31 December 1999 is recorded as a liability and expense in the accounts. Amounts are adjusted in future periods as the actual utilisation and value of warrants presented is determined.

Litigation and other provisions

There are certain legal claims pending or threatened, where the Bank is involved which have not yet been settled. The Governing Board believes that sufficient provision has been made in the accounts for any expected loss from future settlement.

6. ANNEXES

6.1. Legal Status and Tasks

The Bank of Slovenia (“the Bank) was established on June 25, 1991 pursuant to the Law on the Bank of Slovenia and based upon the Constitutional Law on Implementation of the Basic Constitutional Charter on Independence of the Republic of Slovenia. The Bank actually became monetary authority upon introduction of Slovenian legal tender (Tolar), on October 8, 1998.

Pursuant to Article 152 of the Constitution of the Republic of Slovenia, the Bank is independent and directly accountable to the Parliament.

By Constitution the Bank of Slovenia is independent and accountable to Parliament…

The Governing Board of the Bank and the Governor are the managing bodies of the Bank. The Governing Board consists of eleven members: the Governor (Chairman of the Governing Board), Deputy Governor, three Vice-Governors and six external members – independent experts. The President of State proposes and the Parliament appoints the Governor and the six external members. The Governor proposes and the Parliament appoints the Deputy Governor and the Vice-Governors. All members of the Board are appointed for a term of six years. The Board takes all decisions by two-third majority.

Pursuant to the law, the main responsibility of the Bank is to maintain stability of domestic currency and general liquidity of domestic and cross-border payments. To this end, the Bank

…and responsible for stability of Slovenian currency and of general liquidity in domestic and cross-border payments.

- regulates the quantity of money in circulation,
- ensures general liquidity of banks and savings banks, and of cross-border payments.
- supervises and surveys banks and savings banks,
- issues banknotes and puts those and coins in circulation,
- prescribes reporting and information systems,
- prescribes rules for implementation of deposit guarantee scheme,
- provides banking services to Central Government.

The Bank has other tasks and responsibilities pursuant to the Banking Act, the Foreign Exchange Law and the Securities Market Law.

The Bank is independent in adopting and implementing monetary policy and in performing other tasks and responsibilities. The Governing Board and the Governor are accountable to the Parliament. The Bank reports to the Parliament twice a year, and has its Annual Financial Statements and the financial plan for the current year confirmed by the Parliament.

Pursuant to the law, the Bank is only allowed to give short-term credit to Republic of Slovenia; the volume of such credit is limited to a maximum of 5% of the budget and of one fifth of the anticipated budget deficit respectively.

6.2. Important Decisions Adopted and Measures Taken in 1999

6.2.1. Monetary and Exchange Rate Policy Measures

January

Discount and Lombard Rates of the Bank
The Bank reduced the Discount Rate from 10% (in force since April 10, 1995) to 8%, and the Lombard Rate from 11% to 9% on January 1. Interest rate for overdue payments changed accordingly.

The Bank intervened with purchase and sale of foreign exchange from and to banks on a temporary basis
On January 13, the Bank offered to purchase and sell foreign exchange from and to participating banks (signatories of respective agreement with the Bank), obliging them to repurchase and resell such foreign exchange respectively two months later. The Bank revoked availability of such instruments previously made to all banks.

Intervention on foreign exchange markets
The Bank intervened at a predetermined buying rate between January 27 and March 29.

February

Tolar deposit on foreign financial credits
As of February 1 the new decision adopted on mandatory Tolar deposits on drawings under foreign financial credits came in force. The deposit varied between 0% and 30% of the proceeds at discretion of the governor. No deposit was actually paid. The measure was abolished as of September 1 pursuant to decision taken by the Governing Board on June 22. Banks were obliged to offer such foreign exchange for sale to the Bank during the time the measure was in force. No actual sale took place.

Temporary purchase of foreign exchange with obligatory repurchase two weeks later
The Bank changed the original instrument to the effect that after February 16 it only purchased USD and EUR (before also DEM, ITL, ATS, FRF)

Foreign currency bills of the Bank
As of February 16 the Bank issued EUR- in place of DEM-denominated bills (face value EUR 25.000)

March

Tolar bills
The Bank reduced interest rates on 30-day (from 6.4% to 4.5%), 60-day (from 7.8% to 7.0%) and 270-day bills (from 9.33% to 9.0%)

Bills with warrants
Following the eleventh issue on March 1, the Bank issued such bills on quarterly basis. The main characteristics of the eleventh issue were the same as those of the tenth issue.

Temporary purchase (sale) of foreign exchange with obligatory repurchase (resale) two months later
The Bank reduced the implicit buying rate to 7.2% and selling rate to 6.8% as of March 31.

April

Twin bills
The Bank issued the twelfth issue on April 1 at a reduced interest rate on the foreign currency part, from 3% to 2.75%.

Overnight liquidity loan
The Bank made such loan available to banks between April 20 and 26.

Temporary purchase of foreign currency bills
The Bank temporarily increased the volume of such bills available from DEM 8 million to 20 million.

Sale of foreign exchange to banks for their purchase of foreign currency bills
The Bank gradually increased the surcharge above the Bank selling rate from 0.7% to 1.25%.

May

Twin bills
The characteristics of the twelfth issue (issued on April 1) were changed prior to availability: the dates of issue and maturity, the interest rate on the foreign currency part reduced from 2.75% to 2% p.a.

Temporary purchase of foreign currency bills by the Bank
The Bank increased for a certain time the volume of foreign currency bills it offered to purchase from DEM 8 million to DEM 12 million.

Overnight liquidity loan
The Bank made such loan available between May 3 and 25 at 8% p.a.

Intervention on foreign exchange markets
The Bank prescribed to participating banks (signatories of respective agreement with the Bank) that the margin between the buying and the selling rate for foreign cash is not to exceed 0.4% between May 10 and 19.

Sale of foreign exchange to banks for purchase of foreign currency bills
The Bank increased the surcharge above the Bank selling rate from 1.25% to 2.40%, and then gradually reduced it to 0.60% by the end of the month; the measure kept the Bank's selling rate at 194.20 SIT/EUR.

June

Overnight liquidity loan
The Bank made such loan available to banks between June 28 and July 14 at 7.5% p.a.

July

Temporary purchase of foreign currency bills from banks by the Bank
The Bank increased twice the volume of such bills it offered to temporarily purchase from banks from DEM 12 million to DEM 25 million. After July 21, the amounts purchased by the Bank and the purchase rate are expressed in and refer to EUR. The Bank temporarily purchased EUR 12 million of such bills from banks.

Sale of foreign exchange to banks for purchase of foreign currency bills
The Bank gradually reduced the surcharge above the Bank selling rate and kept the selling rate at 196.70 SIT/EUR until July 15, and at 19.18 SIT/EUR from July 16 to August 4.

Intervention on foreign exchange market
The Bank intervened at the predetermined selling rate between July 19 and August 25.

August

Sale of foreign exchange to banks for purchase of foreign currency bills
The Bank abolished changes in surcharges to the selling rate and fixed the surcharge at 0.15% until further notice.

Tolar bills
The Bank increased the interest rate on 30-day bills from 4.5% to 5.5% on August 5.
The Bank increased the initial interest rate on 28-day bills from 6.1% to 6.5%.

Measures related to first due date for VAT and excise duties
The Bank increased the amount of the daylight credit facility to the Ministry of Finance to SIT 16 billion
Based on term deposits of the Ministry of Finance with the Bank, the Bank made an additional short-term facility of SIT 20 billion available to banks a few days ahead of the first due date with value date August 31 and made disbursements at 8:00 a.m. (as opposed to usual 1:00 p.m.)
The Bank made the overnight credit facility available between August 30 and September 1 at 7.5%.

September

Bills with warrants
The Bank issued the 13th issue on September 1 and limited the number of warrant coupons eligible for discount to 3.

Temporary purchase of foreign currency bills by the Bank obliging banks to repurchase them
The Bank reduced the volume of this instrument to EUR 8 million on September 7.

October	**Temporary purchase (sale) of foreign exchange with mandatory repurchase (sale) after two months** The Bank increased the predetermined exchange rates twice a week and kept the spread between the two at SIT 1.05. **Overnight liquidity facility** The Bank made the facility available on October 10 at 7.5%.
November	**Bills with warrants** On November 10, the Bank announced the 13th and last issue of bills with warrants. **Temporary purchase (sale) of foreign exchange with mandatory repurchase (sale) after two months** The Bank reduced the implicit purchase rate to 5% and the selling rate to 2% on November 11, and further reduced the purchase rate to 2.5% sand increased the exchange rate spread to SIT 1.44. **Sale of foreign exchange to banks for purchase of foreign currency bills** The Bank increased the surcharge above the selling rate from 0.15% to 0.68% on November 11.
December	**Bills with warrants** The Bank issued the 14th issue without a warrant on December 1 at 8.5%. This was the last time that banks could buy such bills at a discount (eligible for discount were the warrant coupons of the 13th issue). **Y2K** The Bank increased the availability of Lombard loan from 2.5% to 5%of the value of securities pledged between December 27, 1999 and January 3, 2000. The Bank made overnight liquidity loans available between December 29 and 30 at 7.5%. Since no payment transactions took place on December 31, the Bank made purchase of cash available to banks by means of liquidity loans of last resort or liquidity loans against pledge of 12-day Tolar bills.

6.2.2. Supervisory Measures

March	**Amendment to Decision on Chart of Accounts for Banks and Savings Banks** **Instructions for reporting on large depositors** The instructions oblige banks to report on the largest 30 depositors on monthly basis (amount, currency, beginning and due date of term deposits, interest rate applied).
May	**Decision on Calculation of Own Funds, Capital Requirements and Capital Adequacy of Banks and Savings Banks** The Decision determines in detail the method of calculation. It prescribes capital requirements for credit and currency risks, and those related to capital holdings in excess to the maximum allowed in non-financial institutions. Stipulations on capital requirements concerning currency risks shall apply as of June 30, 2000. Banks shall duly calculate and deliver them to the Bank on quarterly basis. **Decision on Large Exposure of Banks and Savings Banks** The Decision limits exposure to a single customer or related customer group, and the exposure to other members of the group. The decision also closely defines large exposure and limits the large exposure total to capital (own funds).

Decision on Classification of Balance and Off-Balance Sheet Assets by Banks and Savings Banks **May**

The decision prescribes the methods for credit and country risk calculation. In addition to detailed criteria for item classification into risk groups, it also stipulates rules for calculation of potential loss, suspension of income and keeping of credit files.

Decision on Special Provisions by Banks and Savings Banks

The decision prescribes special provisions (level and method) against potential losses deriving from credit and country risk. It also prescribes provisions for other risks.

Decision on Detailed Determination of Reports Pursuant to Article 127 of the Banking Act

The decision elaborates on the contents of such reports, on manner and periodicity. Article 127 concerns significant facts and circumstances in bank operation.

Decision on Foreign Currency Mismatch (Open Foreign Exchange Position)

The decision stipulates that banks involved in foreign exchange operations shall calculate their foreign exchange position on daily basis. The daily short and long foreign exchange position respectively shall not exceed 20% of the bank capital, the average monthly open position shall not exceed 10% of the bank capital.

Decision on Books of Account and Year-End Report of Banks and Savings Banks

The decision prescribes the chart of accounts, the type and form of financial accounts, the contents of year-end reports and appendices to such reports, valuation of items in books of account and contents, manner and periodicity of delivery of other reports concerning the accounts on their books.

Decision on Minimum Scope of Audit and Contents of Audit Report

The decision prescribes in detail the form, scope and contents of external audit and audit report. External audit shall comprise the audit of the year-end report and consolidated annual report (prepared in line with the Decision on Books of Account and Year-End Report of Banks and Savings Banks, and with the subject decision). Subject of external audit shall be in particular the financial accounts, changes in bank capital, provisions and write-offs, effect of consolidation, compliance with rules and regulations concerning risk management, internal audit, accounting, information technology, reporting to the Bank, valuation of balance and off-balance sheet items and accounting policies.

Decision on Mandatory Matching of Maturity composition of Assets and Liabilities

Banks are obliged to match the maturity composition of assets and liabilities. The decision classifies assets into three types in terms of maturity and determines the level of respective liabilities.

Instructions for Implementation of Decision on Classification of Balance and Off-Balance Sheet Assets by Banks and Savings Banks

Instructions determine the contents, form and manner of compliance and delivery of respective reports (including reports on provisions made). Banks are obliged to submit such reports on quarterly basis.

Instructions for Preparation of Reports on Tolar Liquidity

Banks are obliged to submit daily reports on expected Tolar flows for the current and the next working day and on expected Tolar incoming and outgoing payments for five largest customers. Banks shall prepare the reports in a prudent way, meaning that they will only include such incoming payments as can reasonably be expected, and all such outgoing payments, which are reasonably due on such day.

May	**Instructions for Computation of Some Key Deposit and Lending Rates of Banks and Savings Banks** Instructions prescribe quarterly computation of key deposit and lending rates by maturity, for banking and non-banking sector, for Tolar rate above the Base Rate and for Tolar rates in case of foreign currency clause. **Instructions for Asset Restructuring by Banks and Savings Banks** The instructions determine the assets eligible, the manner and the applicable accounting rules and the valuation of assets. In case of a change in lending conditions, they prescribe provisioning and partial write-offs, suspension of income and classification by creditworthiness. They prescribe write-offs and provisioning in case of reduction of such claims. They prescribe valuation of tangible fixed assets and financial assets or a combination of both for the purpose of partial or full settlement of claim. The instructions prescribe respective write-offs, provisioning and suspension of income. They also prescribe the procedures when by way of restructuring a third party becomes debtor. **Instructions for Implementation of Decision on Books of Account and Year-End Report of Banks and Savings Banks** They prescribe the methodology for preparation of financial statements. **Instructions for Preparation of 10-Day Reports on Bank Accounts** They prescribe the methodology for preparation of such reports containing bookkeeping data on loans to and deposits by non-banking sector. Banks prepare such reports on the 10th, the 20th and the last day in a month. **Instructions for Monthly Reports on Bank Accounts** They prescribe the contents, method, form and manner of delivery of such reports.
June	**Decision on Detailed Method of Calculation of Liabilities and Assets in Determination of Net Indebtedness** The decision prescribes the method of calculation of net indebtedness of bank counterparty. Net indebtedness can be one of the reasons why such net debtor does not qualify for a member post in the supervisory board of a bank or savings bank. **Decision on Determination of and Prudential Reporting on Value of Bank Holdings in Non-Financial Organizations and Investment in Tangible Fixed Assets** The Banking Law limits such investments to 60% of the bank capital, and such single investment to 15% of the bank capital. The investment total into land, buildings, business equipment and capital of non-financial organizations shall not exceed the bank capital. Banks are required to report every three months. Any excess investment shall be covered by additional capital. **Decision on Annual Supervision Fee and Supervision Remuneration** The decision determines the fee and remuneration to be paid by banks to the Bank, in dependence of volume of risk-weighted assets. Remuneration is to be paid by a bank in case of a supervisory measure taken by the Bank when irregularities established; it is calculated based on the actual time of Bank examiners employed. **Amendment to Decision on Books of Account and Year-End Report of Banks and Savings Banks** **Amendment to Instructions for Implementation of Decision on Books of Account and Year-End Report of Banks and Savings Banks**
August	**Amendment to Decision on Books of Account and Year-End Report of Banks and Savings Banks**
November	**Amendment to Decision on Detailed Determination of Reports Pursuant to Article 127 of the Banking Act**

Decision on Adjustment of Savings and Loan Undertakings to the Banking Law	**December**

Savings and Loan Undertakings shall gradually comply with stipulations of the Banking Law. Full compliance is required by February 2004. Non-compliance shall be sanctioned by means of compulsory liquidation.

Decision on Consolidated Supervision
Consolidated supervision is mandatory in the case of any bank controlling another bank or other banks, other financial organizations or companies providing ancillary banking services and has acquired a stake in the capital of such entities respectively. Such banks shall comply with the minimum capital requirement on consolidated basis, with the capital adequacy requirement and exposure of the whole group to single members or to groups of related persons, and with requirement as regards investment in non-financial organizations. Members of the group shall organize adequate internal controls which will ensure that all data necessary for consolidated supervision are submitted to the Bank and that they are true and fair.

Decision on determination of conditions for a banking license and on documents to be submitted based on which the Bank can evaluate the ability of the applicant to provide the services enumerated in the application.

Decision on determination of documentation to be submitted by a foreign bank requesting approval for establishment of a branch, based on which the Bank can evaluate the ability of such branch to provide the services enumerated in the application.

Decision on Reporting about planned disposal of shares

Decision on Conditions to be Fulfilled by Other Financial Intermediaries

6.3. Profit and Loss Account and Balance Sheet – 5 Year Record

Data for five years

from January 1 to December 31 (in million SIT)

	1995	1996	1997	1998	1999
Operating income:					
Income from financial assets	12,791	14,941	19,475	29,188	21,433
Net foreign exchange gain/loss	5,201	8,131	16,797	-4,753	38,399
Total income from financial assets	**17,992**	**23,072**	**36,273**	**24,435**	**59,832**
Expenses on serviced liabilities	11,040	9,310	17,727	24,701	16,885
Net investment income	**6,952**	**13,762**	**18,546**	**-266**	**42,947**
Other income	534	511	381	1,299	952
Other expenses	89	147	676	286	408
Total operating income	**7,397**	**14,125**	**18,251**	**747**	**43,491**
Operating expenses	1,718	2,181	2,670	2,923	3,298
Provisions		579	718	312	
Operating surplus/deficit available for appropriation	**5,680**	**11,366**	**14,862**	**-2,489**	**40,193**
Appropriations:					
Transfer/Release to foreign exchange reserves	5,201	8,131	16,797	-4,753	38,399
Financial results after the appropriation of net foreign exchange gain/loss	479	3,235	-1,935	2,264	1,795
Transfer/Release to general reserves		2,312	-1,935	1,457	1,555
Total transfer/release to reserves	5,201	10,443	14,862	-3,297	39,954
Provision for transfer of surplus to the budget of RS	479	923		807	240
Total appropriations	**5,680**	**11,366**	**14,862**	**-2,489**	**40,193**

Data for five years

on December 31 (in million SIT)

	1995	1996	1997	1998	1999
Assets					
Financial assets	309,224	361,496	593,441	614,040	672,404
Fixed assets	1,390	1,657	2,072	2,372	2,914
Total assets	**310,614**	**363,153**	**595,512**	**616,412**	**675,318**
Liabilities and reserves					
Serviced liabilities	219,504	253,578	457,734	462,063	443,106
Banknotes in circulation	63,904	71,441	85,653	104,667	142,489
Provision for transfer of surplus to the budget of RS	479	923		807	240
Total liabilities	**283,887**	**325,941**	**543,386**	**567,538**	**585,834**
Reserves	26,727	37,212	52,126	48,874	89,484
Total liabilities and reserves	**310,614**	**363,153**	**595,512**	**616,412**	**675,318**

6.4. Governing Board and Organization Chart

6.4.1. Members of Governing Board at December 31, 1999:

CHAIRMAN OF GOVERNING BOARD

Dr. France Arhar
(Governor of the Bank)

MEMBERS OF GOVERNING BOARD

Samo Nučič
(Deputy Governor)

Darko Bohnec
(Vice Governor)

Mag. Janez Košak
(Vice Governor)

Andrej Rant
(Vice Governor)

Tatjana Fink
(Trimo, Trebnje)

Mag. Bine Kordež
(Merkur, Kranj)

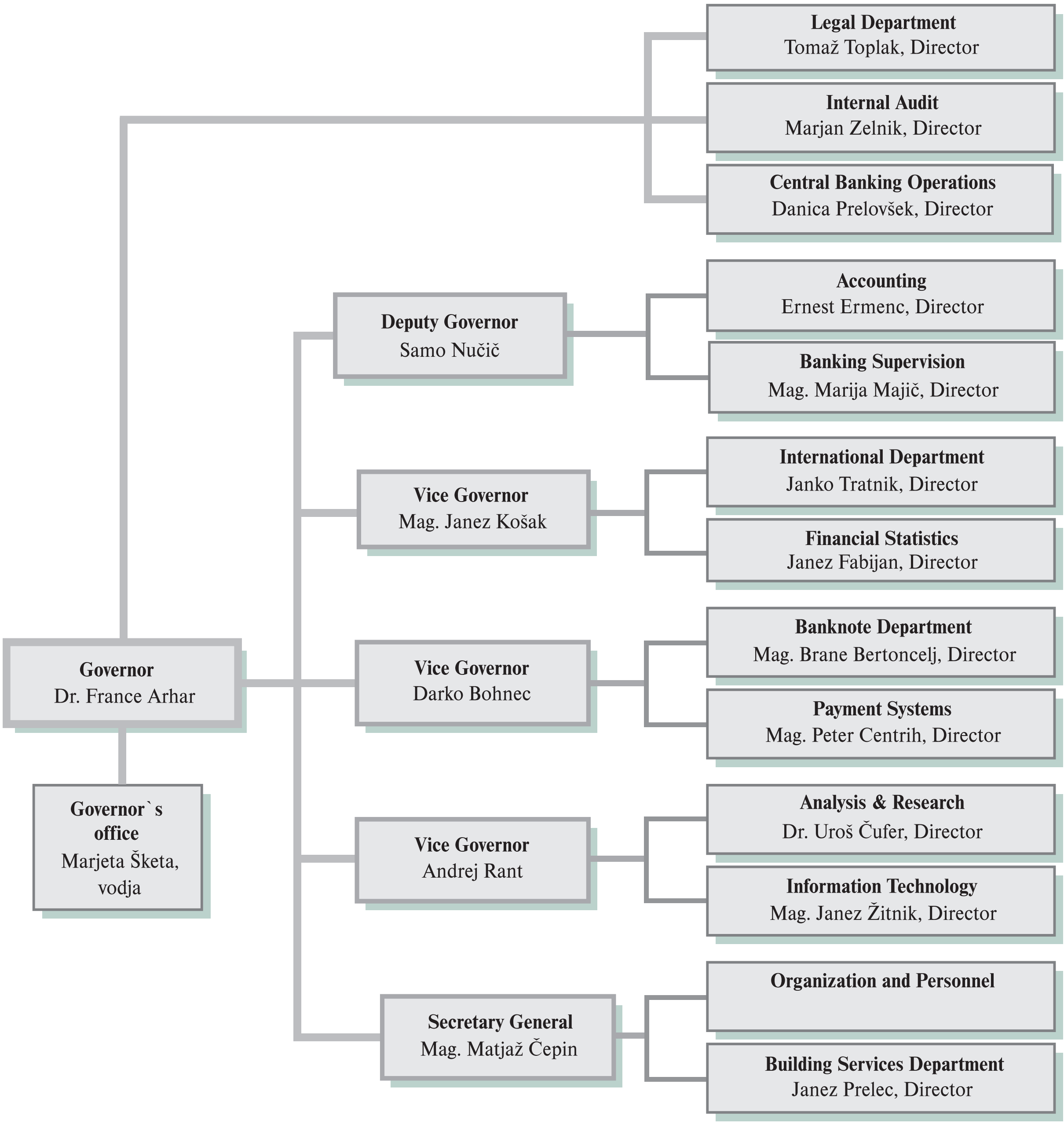
Mag. Vladimir Lavrač
(Institute of Economic Research, University Ljubljana)

Dr. Leon Repovž,
(Faculty of Business Administration and Economics, Maribor)

Dr. Ivan Ribnikar
(Faculty of Economics, University of Ljubljana)

Dr. Dušan Zbašnik
(Faculty of Business Administration and Economics, Maribor)

6.3.3. Organization Chart of the Bank at December 31, 1999



6.5. Publications and Website

Publications **Contents**	**Title, frequency of issue, language**
Macroeconomic statistical data; monetary statistics, exchange rates, data on economic relations with foreign countries. Current development in figures; notes on methodology; list of banks holding the Bank's license; data release calendar.	**Monthly Bulletin** ❖ Monthly ❖ Slovenian, English
Annual Report as prepared for the Parliament of the Republic of Slovenia. Report on economic development, monetary policy, operation of banks and the Bank, and on other tasks of the Bank.	**Annual Report** ❖ Annual ❖ Slovenian, English
Report on operation of banks, on supervision of bank operations, on development of supervisory legal framework.	**Report on Supervision of Banking Operations** ❖ Annual (in autumn) ❖ Slovenian, English
Statistical survey of Slovenian direct investment abroad and of foreign direct investment in Slovenia (on annual basis)	**Direct Investment** ❖ Annual ❖ Slovenian, English
Speeches held by the Governor in Parliament, analytical and methodological survey of monetary, balance of payments and other issues.	**Surveys and Analyses** ❖ Quarterly ❖ Slovenian
Statistical survey of other financial intermediaries, of securities market and interest rates.	**Financial Markets** ❖ Quarterly ❖ Slovenian
Analytical survey of current macroeconomic situation with detailed breakdown/ analyses of monetary and balances of payments developments.	**Monetary survey** ❖ Monthly ❖ Slovenian
Presentation of the Bank, Slovenian banknotes and coins, laws, rules and regulations concerning the Bank functions, etc. Up-to-date rates of exchange, interest rates, securities issued by the Bank, data time series. Publications.	**Website** Home page index: **http://www.bsi.si/eng/index.html**

6.6. Glossary

Balance sheet total: the aggregate amount of bank assets or liabilities.

Base or high powered money: Currency in circulation, bank reserves and sight deposit money with the Bank.

Base rate (BR, in Slovenian TOM): Officially established indexation rate for claims and liabilities calculated as average inflation rate (since January 1998 based on consumer price index) of the last month or of the last few months (since May 1997 of last 12 months).

Capital: The sum total of subscribed capital and foundation capital of savings banks, of share premium account, reserves, capital revaluation adjustments, net profit or loss brought forward from the previous period and net profit or loss for the financial year.

Capital adequacy: Ratio between the regulatory capital and risk-weighted assets total.

Connected person: An entity controlling the bank directly or indirectly or which the bank controls directly or indirectly, or an entity, which is controlled directly or indirectly by the same entity as the bank.

Foreign currency (denominated) bill (FCB): short-term security issued by the Bank of Slovenia, subscribed and redeemed in foreign currency.

Foreign exchange minimum: The minimum amount of foreign exchange reserves or assets that banks are required to hold.

Large exposure: Any exposure of a bank to a single customer exceeding 10% of the bank capital.

Mandatory reserve: The amount of assets, usually set as percentage of deposits and other bank liabilities, that banks are required to hold on a special account with the Bank and as cash in hand.

Monetary aggregates (M1, M2 and M3): monetary aggregates with differentiated liquidity grade. **M1** is of highest liquidity grade and comprises banknotes and coins in circulation and sight Tolar deposits with domestic banks and with the Bank. **M2** comprises M1, Tolar savings accounts and term deposits with domestic banks and with the Bank. **M3** comprises M2 and household foreign currency deposits in domestic banks.

Monetization: A change in financial assets that banks and the Bank buy, into money; they namely buy such (financial) assets, i.e. claims, (or extend credits) with newly issued or newly created money.

Money market: Interbank financial market where first class short-term securities are traded.

(Net) interest margin: The ratio between net interest income (difference between real and revaluation interest income and expenses) and average gross interest bearing assets.

Net provisions: The total of value adjustments, expenses from provisions made, income from provisions suspended and expenses from long-term provisions.

Nominal interest rate: the interest rate total composed of indexation (revaluation) part (based on inflation) and of the real interest rate.

(Nominal) interest rate differential: The difference between the average nominal interest rate earned on assets and the average nominal interest rate paid on liabilities.

Open (foreign exchange) position: Foreign exchange assets in excess of foreign exchange liabilities of a bank (long position) or vice versa (short position).

Operating expenses: General administrative expenses (labour cost and other expenses), depreciation and taxes.

Other assets: Equity investments in related (dependent) and unrelated (independent) parties, tangible fixed assets, intangible long-term assets, capital subscribed but not paid and own shares, prepayments and accrued income and other assets like checks, interest rate claims, commissions etc.

Other liabilities: Accruals and deferred income, long-term and general provisions and other liabilities.

Provisions: General provisions against contingent risks and special provisions against potential losses deriving from balance and off-balance-sheet items and against country risk. Banks are obliged to make general provisions equal to 1 % of assets classified into grade A (claims on Bank of Slovenia and the Republic of Slovenia exempt) irrespective of their capital adequacy ratio until December 31, 2000. **Net provisions:** The difference between the claims written off total and value adjustment of doubtful claims, expenses from long-term provisions made, income from provisions cancelled and expenses from long-term provisions.

Purchase with right: Offer made by the Bank to banks to purchase foreign exchange from them giving them the right to sell additional quantities to the Bank in the future.

Regulatory capital: The sum total of core (tier 1) and supplementary (tier 2) capital, reduced for any direct and indirect capital investments, loans and other equity investments in banks, savings banks and other legal persons fully or majority owned directly or indirectly by the bank, of claims and liabilities (without a first class collateral) to legal persons and individual entrepreneurs owned by bank employees, members of the Board of Management and of the Supervisory Board and by members of their families respectively, and of claims and off-balance sheet items guaranteed by hybrid and debt instruments up to the amount not exceeding that included in the supplementary capital.

Revaluation (indexation) rate: Part of the nominal Tolar lending and deposit rates intended as compensation for the current inflation rate to the lender and depositor respectively.

Secondary liquidity: (Assets comprising) Tolar and foreign currency denominated bills issued by the Bank and bonds issued by the Republic of Slovenia.

Sterilization: In general, sale of short-term Government bonds (Treasury Bills) by the central bank to offset the impact of foreign exchange purchased from banks on the quantity of base money. In Slovenia, sterilization means sale of foreign currency denominated and Tolar bills by the Bank to neutralize the impact of foreign exchange purchased from banks on the quantity of base money.

Tolar bills (TB): Short-term Tolar securities issued by the Bank.