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Mr. President, respectable Members of the Parliament,

I am honoured, especially so in view of the recent fifth anniversary of introduction of Slovenian currency, to present you with the report on activities of the Bank of Slovenia in 1996, on monetary policy and the prospects, together with financial statements audited and the opinion on the state of the Bank's affairs given by the authorised auditors KPMG, London, as required by law. As is the custom, I also submit herewith my general comments on the developments of the past year.

The main characteristics of monetary policy in 1996 and the relevant influential developments can be seen from the data and tables contained herein. They were basically as follows: process of stabilisation continued and inflation was kept under control and within the one-digit framework in spite of unfavourable domestic and world-wide economic trends. Confidence in domestic currency was additionally strengthened; by structure, approximately half of household deposits are in domestic, and half in foreign currencies - a considerable change from 1991 when 80% of all household deposits were in foreign currencies. Small but not unimportant changes also took place in term structure of deposits; time deposits with maturities over one year increased by 4 percentage points. Yet these achievements cannot be considered satisfactory. National savings are the basis for a fresh flow of investment, these, in turn, create new jobs, and the latter are guarantee for further economic growth. The level of national savings is still far too low (between 21% and 23% of GDP), in particular for the economy still involved in several processes of transition to market economy: in privatisation, structural adjustment, rehabilitation and consolidation of the banking system.

In such circumstances, the desire for yet stronger and sustainable economic growth and higher employment is always present and very often combined with the need for foreign financial resources, be it in form of classical loans or other forms of investment. In striving for such financial resources, Slovenian economy should be cautious and reasonable, since many of us still recall the circumstances of high indebtedness in not too distant past. In addition, the relatively small size of the country calls for a political decision as regards the optimum ownership structure between domestic and foreign persons. World-wide globalisation, consolidation of public finance within the European Union, freedom of capital movements, lowering of production costs and further reduction of inflation rate are certainly some of the issues the small and open Slovenian economy will need to take into account and attend to as price taker and not price maker on the international markets.

In view of the above, all efforts based on widest consensus possible should be made towards lowering of expenditure on all levels of social and economic activities in order to render better and stronger competitiveness of Slovenian entities on the international markets. It is a well known fact that Slovenian inflation is predominantly a cost inflation; in targeting still lower inflation, all efforts should therefore be made to preserve sound public finance, to have incomes policy based on achievements in productivity and economic growth, to stimulate national savings and have these better support domestic entities against foreign competition on the international markets.

All such endeavours should get additional incitement in the first country rating assigned to Slovenia by the three main international rating companies: the best sovereign rating ever assigned to a country in transition certainly obliges all of us to strive for yet better results. This is the only way to bring us closer to the countries of the European Union, to our economic partners accounting for exchange of two thirds of the Gross Domestic Product.

It was in such domestic and international economic environment that the Bank conducted its monetary policy in 1996. At a first glance, some of its parameters are very similar to those characteristic of 1994: considerable surplus of foreign currencies deriving from the balance of payments flows, resulting in growth of foreign exchange reserves held by the Bank by well over

USD 600 million. The current account surplus was very symbolic in 1996, but still the foreign exchange reserves held by the Bank increased by slightly less than USD 600 million. The structure of the balance of payments shows that it was due to capital flows and an increase of external debt that foreign currency reserves increased last year. Under such circumstances and bearing in mind its primary task - stability of the Tolar, the Bank needed to make sure that capital inflow surplus be channelled into foreign currency reserves, for this very surplus could have put the Tolar under pressure on foreign exchange market. The measures taken by the Bank rendered the exchange rate more stable. The average exchange rate for the German Mark in December was nominally only 2.2% above that of December 1995; in the exchange bureaux it even dropped 1% below the level of December 1995. These flows and activities can also be seen from the balance sheet of the Bank: its foreign assets increased by over 78 billion Tolars. In other words, the Bank purchased about 47 billion Tolar worth of foreign currencies during 1996, and reduced Tolar credits to banks by over 27 billion Tolars in spite of liquidity constraints during summer, stemming from liquidation procedure introduced in one of domestic banks. Yet the quantity of base money increased by only 17% against 1995. The Bank's own securities and repos offered replaced direct loans to banks, so that the se accounted only for a negligible portion of the Bank's financial assets. The level of monetary effects of foreign exchange transactions on the quantity of money was therefore about 5.6 times that of 1992, and the level of base money 3.4 times, and foreign exchange reserves held by the Bank, reduced for liabilities in foreign exchange to domestic entities, 5.8 times those of 1992.

All such movements and activities are well reflected in the financial results of the Bank. Having analysed and adopted the financial statements for last year, the Governing Board of the Bank conscientiously adopted the decision to assign the net profit of over 2 billion Tolars to the General Reserve, to be employed in support of the stabilisation oriented monetary policy. Members of the Governing Board fully share the opinion that such reserve is a minimum investment bringing a maximum benefit to the entire economy, since the transaction potential of central bank money is considerably stronger than that of budgetary funds.

In view of such development, the monetary stance will need to reduce the costs of further disinflation and be even more consistent with other areas of economic policy, with the incomes and fiscal policies. It is only through such co-ordinated approach that the two main objectives can be attained: a more stable environment and further economic growth.

Allow me to take this opportunity to thank you for your co-operation, any and all proposals given and constructive critique exerted in our mutual endeavours to find the right way for the young independent Slovenia in the direction towards the European Union. No doubt, we will encounter yet new obstacles and will have to fight against them and find new solutions and new incentives based on forbearance and consensus. It is important that we will refrain from any requirement for an increase of money in circulation in the first place, since "a little bit more" can ease and facilitate on the short run, but is sure to bring about higher inflation, slower economic growth and destabilisation on the long run. The Bank of Slovenia and its Governing Board have fully been aware of the fact that no currency is borne with a guarantee for its stability and that this needs to be brought about by all of us. In view of that, the best contribution of the Bank to the endeavours of Slovenian economy can then be as stable Tolar as possible.

Dr. France Arhar
Governor

Ljubljana, March 28, 1997

I. LEGAL STATUS AND RESPONSIBILITIES

The Bank of Slovenia (“the Bank”) was established as the central bank within the framework of the legislation promulgated on 25 June, 1991, when, among others, the Law on the Bank of Slovenia was adopted as one of the most important systemic laws, together with the Basic Constitutional Charter on Independence and Soverignty of the Republic of Slovenia and the Constitutional Law on the Implementation of the Basic Constitutional Charter. Art.152 of the Constitution of the Republic of Slovenia defined the Bank as the central bank.

The Constitution stipulates that the Bank be independent and responsible directly to the Parliament, which appoints the Governor of the Bank. According to the law the managing bodies of the Bank are the Governing Board and the Governor. The Governing Board is composed of eleven members, whereof six external members are independent experts, proposed by the President of the Republic and appointed by the Parliament. The Governor is President, the Deputy Governor and three Vice-Governors are members of the Governing Board. The Deputy Governor and Vice-Governors are appointed by the Parliament on proposal of the Governor. The external members of the Governing Board, the Governor, the Deputy Governor and Vice-Governors are appointed for a period of six years.

Pursuant to the Law on the Bank of Slovenia the main responsibility of the Bank is to maintain stability of the national currncy and general liquidity of payments within Slovenia and with foreign countries. In order to carry our this task, the Bank regulates the money supply, ensures general liquidity of banks and savings banks, ensures general liquidity in payments abroad, supervises banks and savings banks, issues banknotes and puts coins and banknotes in circulation, guarantees for bank deposits of natural persons and carries out certain financial services for the Republic of Slovenia. The Bank also carries responsibilities and competencies set forth by the Law on Banks and Savings Banks, the Law on Foreing Exchange Transactions, the Law on Credit Trasactions with Foreign Countries and the Law on Prerehabilitation, Rehabilitation, Bankruptcy and Liquidation of Banks and Savings Banks.

The Bank is self governing and independent in its decision-marking and implementation of monetary policy, as well as in the implementation of other tasks and competencies set forth by the Law on the Bank of Slovenia, and by other laws. In the implementation of tasks, the Governing Board and the Governor of the Bank are responsible to the Parliament. The Bank is obliged to submit the financial plan for the current year to the Parliament, at the time it submits the Annual Report for the year ended.

The law also specifically stipulates that the Bank may not grant loans to the Republic of Slovenia higher than 5% of the annual budget or one-fifth of the anticipated budgetary deficit. These loans must be repaid by the end of the fiscal year. Since the establishment of the Bank, the Republic of Slovenia has never taken advantage of this possiblitiy.

	31.12.1996	31.12.1995
Donos na povprečno aktivo (ROA)	1,1%	1,0%
Donos na povprečni kapital (ROE)	10,4%	9,1%
Neto obrestna marža (1)	5,5%	4,9%
Operativni stroški/povprečno aktivo	3,6%	3,8%
Stroški dela/povprečno aktivo	1,9%	2,0%

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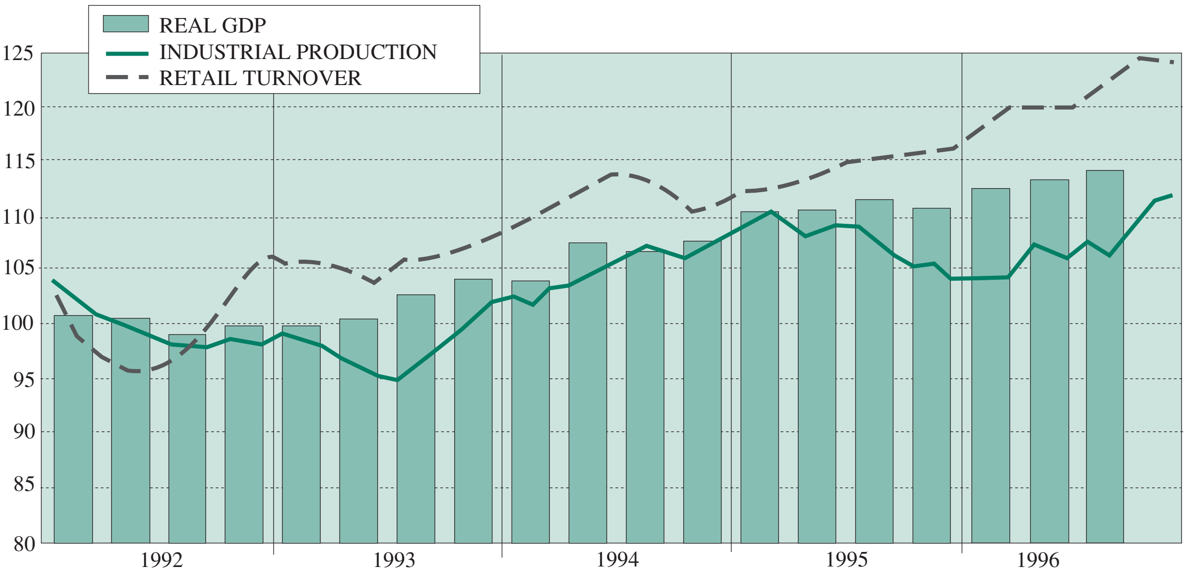
II. MAJOR ECONOMIC DEVELOPMENTS

According to preliminary estimates of the Macroeconomic Institute of the Republic of Slovenia, real ***Gross Domestic Product*** increased at a rate of 3.5%, against 3.9% in 1995. The decline in economic growth was primarily due to slackening of economic activity in the second half of 1995, since the actual growth in the course of 1996 even exceeded 5%. Growth was strongest in construction (8.0% against 9.2% in 1995), and was also notable in agriculture (4.5% against 1.6% in 1995) and trade (4.5% against 4.7% in 1995).

Industrial production increased by 1.0%, against 2.0% in 1995. The moderate growth was likewise due to the low starting position after a fall of nearly 4% in industrial production in the second half of 1995. Between March 1996 and the end of the year, industrial production was growing at about 10% on an annual basis, and at even higher growth rates during the second half of 1996; annual growth between the last quarter of 1996 and the same period of 1995 amounted to 7.1%. At the same time, companies were undergoing restructuring and consolidation processes; redundancies, triggered by slackening of activity in 1995, continued in 1996. In 1996 the number of persons employed was reduced by 7.5%, while productivity grew by 8.6%.

Chart 1: Industrial production, retail turnover, quarterly estimates of real GDP (1992=100, seasonally adjusted)



Source: Statistical Office of RS.

Overall ***employment*** fell by 0.7% - in enterprises and institutions by 2.1%, but increased by 4.5% in the small-scale enterprise sector; it increased by 5.7% in the municipal services sector, by 6.2% in financial institutions and by 4.5% in state administration. Measured by ILO standards, unemployment (in May) amounted to 7.3% against 7.4% in 1995. According to reports of the Central Statistical Office, the average rate of registered unemployed (reflecting the permissive practices of Labour Offices) amounted to 13.9% and increased in the second half of the year.

According to preliminary estimates in November 1996, GDP growth was fuelled by increase in ***domestic final consumption*** by 4.5% and in foreign demand by 1.6%. Due to actually more favourable dynamics in foreign trade than first estimated, the final data are still liable to change. Measured in US Dollars, exports and imports were approximately on the level of 1995, whereas by volume exports increased by 3% and imports remained on the same level.

Within domestic consumption, gross fixed investment prevailed with an increase of 10% (and the corresponding 10.1% of industrial production of capital goods). Structure of investments reflected the still relatively weak process of endogenous restructuring in economy: more than two thirds of all investments were made in the public sector, primarily infrastructure. The share of gross fixed investments in the GDP increased to 22.2%, that of investments over fixed capital consumption to 5.4%.

Domestic private consumption was fuelled by the increase in wages and salaries way in excess of GDP growth. The average net salary increased by 4.2% in real terms, the overall net salaries by 2.4% - due to the decreasing number of employees. The overall compensation (wages and other remunerations) of employees increased by 6.0%. Transfer receipts of households increased by 16.3% in real terms, owing to the increase of the average net receipts and to growth of number of beneficiaries. Household expenditure - measured by sales on the retail market - increased by about 6% in real terms.

Growth of ***personal incomes*** during the year exceeded its average growth in the previous year, showing that incomes policy is still the key problem of Slovenian economic policy. A tight correlation has been observed during the past years between the rate of employment and movements in salaries. In the area of industry with wage growth lower than the average, nominal labour costs exceeded the substantial savings gained from the productivity growth. Growth of salaries was most evident in the public sector (state administration by 5.6%, education by 5.5% and healthcare by 6.3%), in construction (6.0%) and in agriculture (5.7%), i.e. in those industries not very limited by monetary restrictions and not subject to pressure of exchange rate.

Table 1: Expenditure on Gross Domestic Product (in %)

	1992	1993	1994	1995	1996*
1. GROSS DOMESTIC PRODUCT (1=4+5)	100.0	100.0	100.0	100.0	**100,0**
2. Exports of goods and services	63.1	58.5	58.9	55.8	**55.7**
3. Imports of goods and services	56.2	57.9	56.7	57.0	**57.3**
4. Foreign balance (2-1)	**7.0**	**0.6**	**2.2**	**-1.2**	**-1.6**
5. Total domestic consumption (=6+9)	**93.0**	**99.4**	**97.8**	**101.2**	**101.6**
6. Final consumption (=7+8)	75.3	79.4	77.4	78.9	**78.5**
7. Private consumption	54.9	58.3	57.3	58.1	**57.6**
8. Government consumption	20.3	21.1	20.1	20.8	**20.9**
9. Gross investment (=10+11)	17.8	20.0	20.4	22.3	**23.1**
10. Gross fixed investment	18.4	18.7	19.6	21.1	**22.2**
11. Change in stocks	-0	1.3	0.8	1.2	**0.9**
• **Real GDP growth in %**	**-5.5**	**2.8**	**5.3**	**3.9**	**3.5**
• GDP in SIT million	1,017,965	1,435,095	1,845,831	2,202,021	2,500,000
• GDP per capita in SIT	510,076	720,898	928,066	1,107,911	1,255,467

Source: Institute of Macroeconomic Analysis and Development, Statistical Office of RS.
** IMAD estimates, November 1996.*

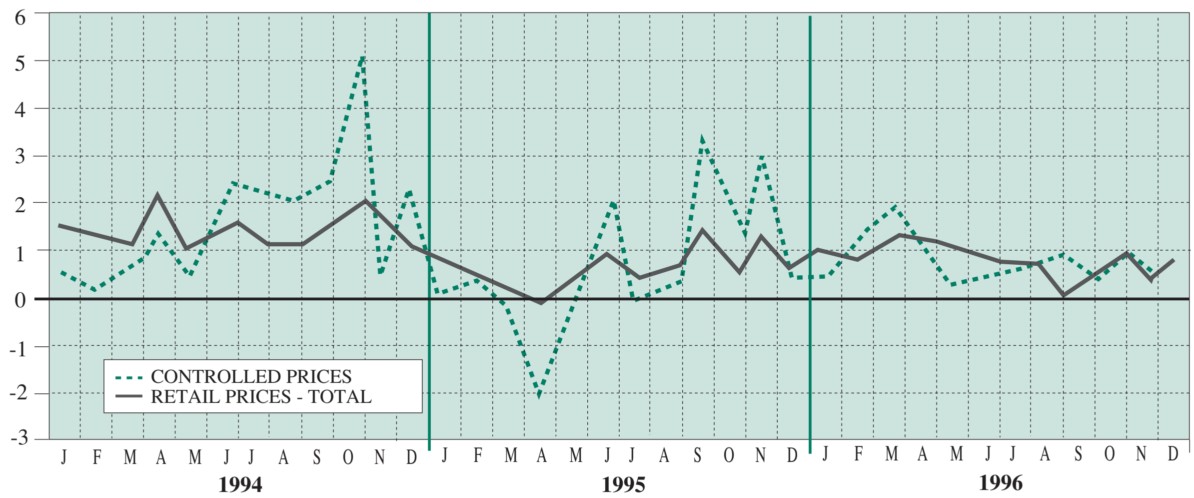
General government (state budget, municipal budgets, obligatory pension and healthcare fund) ended in a slight surplus. Fiscal revenues increased by 13.0% (3% in real terms), expenditure by 12.6%. Employers' contributions grew at a nominal rate of 7.7% - income tax 18.3% and social security contributions 3.9%. Corporate income tax increased by 72.2%. The rate of employers' contributions was reduced in February and in July, and an additional progressive wage bill to be paid by employers introduced in the second half of the year. Its level was more favourable for labour intensive, predominantly export-oriented companies.

Sales tax receipts increased by 17.0%, the customs revenues decreased by 2.0% due to gradual lowering of import duties, in relations with CEFTA countries in particular. Import duties represented only 6.7%, turnover tax 29.6% and personal income taxes 56.2% of government revenues.

On the expenditure side, labour costs and transfers to households increased most (17.0% and 13.5% respectively). Due to positive balance of government finance no borrowing took place but a net repayment of foreign loans. A portion of the August Eurobonds issue proceeds was used for such repayment in December, a total of USD 132 million remained unutilised on the government account with the Bank.

The inflation rate measured by retail prices was 8.8% against 8.6% in 1995. The slight increase is due to the somewhat accelerated growth in the first half of the year, mainly due to increase of controlled prices (electricity, petroleum products and food), and partially due to higher rates of exchange in the second half of 1995. Inflation dynamics slowed down considerably in the second half of the year and amounted to approximately 6%. Within the retail price basket, prices of services and agricultural products increased most (12.8% and 12.9% respectively), while those for non-food industrial products increased by 5.9%. Annual growth rate of industrial producer prices amounted to 5.8% (against 7.9% in 1995), and that of cosumer prices to 9.0%.

Chart 2: Monthly growth rates of retail prices and growth of controlled prices (in %)



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

III. MONETARY POLICY

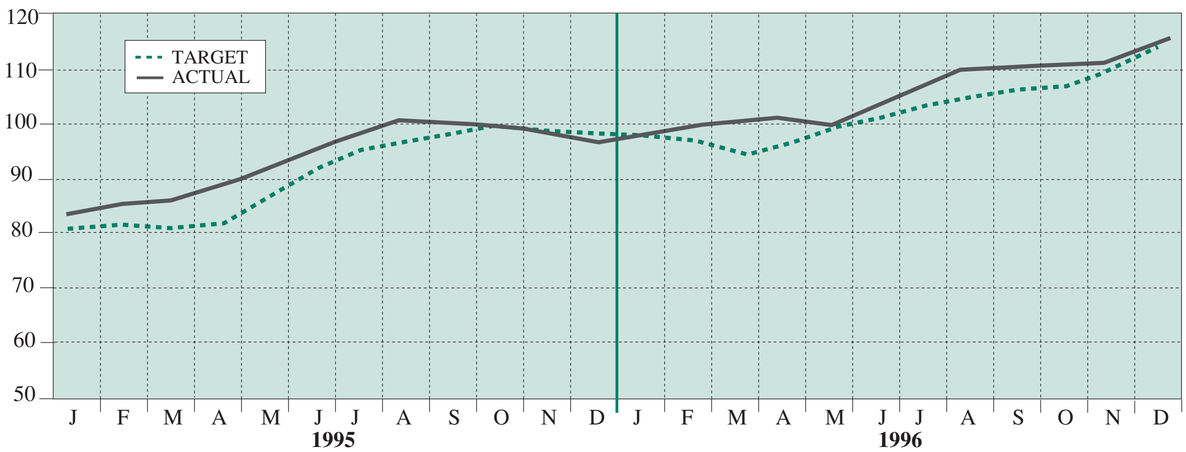
1. Goals and targets

Like in the previous years, the Bank pursued a policy of gradual reduction of inflation, targetted towards further stability of domestic currency. Quantity of money in circulation remained the intermediate target. The Bank supplied money in line with the quantities targeted in M1, determined on the basis of money demand and money multiplier. Exchange rate regime has been that of floating exchange rate; the Bank intervenes on the foreign exchange market within the constraints set by the money target only. The goal of such policy is to gradually bring inflation down to the level of EU countries, and, given appropriate background, carry out the transition to a fixed exchange rate regime.

The circumstances governing the foreign exchange market and enterprise sector have not yet allowed for any change in the policy towards targeting a fixed exchange rate. The net flow into foreign exchange reserves of the banking system amounted to 5.0% compared to GDP, or four times as much as the growth of M1, and just as much as M3 growth. With portfolio investments growing since September 1996, the volume and unpredictability of flows of foreign currencies have been increasing. The Bank will need to pay all its attention to and to be flexible in mastering the monetary effects herewith brought about.

The model of fixed exchange rate introduced by some comparable countries in transition, and the subsequent cumulation of foreign deficit might be acceptable from the point of view of alternative growth incentives that even accelerated economic growth for a certain period of time due to domestic demand fuelled by foreign investments and import of other capital. In view of the small size of Slovenian economy and its limited domestic absorption, substitution of export incentives with import incentives cannot be sustained.

Chart 3: Targeted and actual base money stock (in billion Tolars, three-month averages)



Source: Bank of Slovenia.

The Bank is well aware of the fact that its intermediate target - M1 - influences the final target, price growth, with a lag. It also takes into account that part of the intended effect on prices is achieved through the exchange rate. This, however, functions as the nominal anchor only in relation to prices of products exposed to international competition in domestic and foreign markets. There is no such effect on either prices of products or wage dynamics in other industries, and these are carried over to salaries and production costs respectively in the tradable sector. Under such circumstances, policy of fixed exchange rate is by no means guarantee for disinflation (the experience of some neighbouring countries is a proof hereof); it actually only transfers the costs of lower inflation to the export and trade sectors. Any further reduction of inflation will therefore, above all, depend on co-ordination of the monetary and incomes policies.

Measured by retail price index, no substantial further gains in inflation were realised in 1996 due to price acceleration in non-tradable sectors, whereas industrial producer price index fell from 7.9% to 5.8%. During the second half of 1996 dynamics of retail price growth too were on the level of about 6%. Unlike in the previous years, dynamics in exchange rate were moderate. The exchange rate for German Mark increased by 2.2%, that for the currency basket - additionally influenced by some substantial inter-currency changes - by 6.0%. The real effective exchange rate, measured by relative prices, remained approximately stable during the whole year.

Supply of base money was restrained until May, it increased during summer and remained stable until year end. December 1995 to December 1996, the increase of base money was 16.9%, or 7.5% in real terms. M1 increased by 17.3% (7.8% in real terms). Compared to 1995, growth was somewhat slower (base money 8.1% and M1 10.4%), and substantially less than in the years before; up to 1995 the real growth rate amounted to about 25%.

Table 2: Derivation of base money (in billion Tolars)

	31.12.95	Change in quarter				Change	31.12.96
		I.	II.	III.	IV.		
Base money	**103.5**	**-1.8**	**3.3**	**-0.5**	**15.8**	**16.8**	**120.3**
Bank reserves	38.0	3.4	-3.0	1.4	8.4	10.1	48.1
Currency	59.6	-4.2	6.1	-2.4	7.4	6.8	66.4
Non-banking sector depostis	5.9	-0.9	0.2	0.5	0.0	-0.1	5.8
Creation	**301.0**	**-12.6**	**-21.7**	**85.0**	**8.659.3**	**360.2**	**360,2**
(Net foreign assets)	245.6	-17.6	-5.5	87.3	14.4	78.6	324.1
Foreign assets	250.9	-17.4	-5.5	87.1	14.5	78.7	329.5
Claims on general government (1)	7.1	4.5	-1.0	-17.0	21.6	8.0	15.0
Claims on domestic banks	42.8	-2.8	-12.0	14.5	-27.1	-27.4	15.4
- llombard loans	0.1	0.2	0.0	0.1	-0.1	0.1	0.2
- lliquidity and other loans	26.0	-4.8	-9.4	12.1	-22.3	-24.4	1.6
- repurchase	16.8	1.8	-2.7	2.4	-4.7	-3.2	13.6
Other claims	0.2	3.1	-3.1	0.4	-0.3	0.1	0.3
Withdrawal	**197.5**	**-10.9**	**-25.0**	**85.5**	**-7.2**	**42.4**	**239.9**
Foreign liabilities	5.3	0.2	0.0	-0.2	0.1	0.1	5.4
Foreign currency liabilities	38.6	-9.4	-4.1	29.0	-35.4	-19.9	18.7
Bank of Slovenia bills	126.7	-10.6	-22.2	57.7	26.8	51.8	178.4
- in Tolars	6.6	2.4	-6.1	9.2	4.1	9.7	16.3
- in foreign currency	120.0	-13.0	-16.2	48.6	22.7	42.1	162.1
Net other liabilities	26.9	8.9	1.4	-1.0	1.2	10.5	37.4

Source: Bank of Slovenia.

In 1996 the Bank issued money through foreign exchange transactions and withdrew it by means of Tolar transactions. Compared to the increase of base money by 16.8 billion Tolars, monetisation through net purchase of foreign exchange amounted 47.5 billion Tolars. Net foreign assets grew by as much as 78.6 billion Tolars, but such increase in foreign exchange reserves of the Bank was partially financed by net sales of Bank issued bills (42.1 billion Tolars) and reduced by withdrawals from foreign currency accounts of banks and the Government with the Bank. Net loan repayments accounted for a withdrawal from circulation of 16.6 billion Tolars, reduction of outstanding repos for 5.4 billion Tolars, and the net sale of the Bank issued Tolar bills for 10.5 billion Tolars.

The increasing burden of sterilisation of foreign exchange inflow forced the Bank to speed up adoption of complementary legal and regulatory framework. As of June, the regulation on compulsory liquidity reserves in foreign exchange (foreign exchange minimum) also includes increasing obligatory holdings of foreign exchange denominated Bank of Slovenia bills. As of August and December respectively, obligatory non-interest bearing deposit of 40% in Tolar counter-value is to be paid on any and all drawings under non-trade related loans taken abroad with maturity up to 7 years, and 10% on those with maturity over 7 years (in the latter case domestic banks and the Republic of Slovenia are exempt from the obligation).

Table 3: Derivation of money in circulation (M1) (in billion Tolars)

	31.12.94	Change	31.12.95	Change in quater				Change	31.12.96
				I.	II.	III.	IV.		
Money (M1)	**170.2**	**33.7**	**203.9**	**-16.4**	**17.8**	**-1.3**	**31.1**	**31.2**	**235.1**
Deposits at commercial banks	115.9	24.1	140.0	-12.0	10.8	0.7	23.8	23.3	163.3
- enterprises	49.5	9.3	58.8	-7.4	2.2	2.7	13.8	11.4	70.2
- households	34.7	10.6	45.3	1.8	8.1	-3.3	5.4	11.9	57.2
Deposits at Bank of Slovenia	7.1	-3.1	4.0	-0.1	0.9	0.3	-0.1	1.0	5.0
Currency	47.3	12.7	60.0	-4.2	6.1	-2.4	7.4	6.9	66.8
Increase	**1,164.7**	**308.9**	**1,473.6**	**77.0**	**83.6**	**84.2**	**29.8**	**274.6**	**1,748.1**
(Net foreign assets)	330.7	34.6	365.2	11.4	52.6	55.7	11.4	131.1	496.3
Foreign assets	481.1	71.5	552.6	26.0	19.8	79.7	16.7	142.3	694.9
Claims on general government	260.7	47.8	308.5	5.4	6.5	6.5	6.4	24.7	333.2
Claims on households and enterprises	417.9	183.0	600.9	49.7	56.7	-4.4	8.9	110.9	711.8
- enterprises	326.3	114.1	440.4	33.6	35.3	-11.1	6.3	64.1	504.6
- short-term Tolar loans	136.0	60.0	195.9	10.6	16.2	-2.7	-3.7	20.4	216.4
- long-term Tolar loans	78.7	53.1	131.8	13.7	13.7	-1.5	28.7	54.6	186.4
- Tolar securities	17.4	7.8	25.2	0.4	-0.9	-4.1	1.2	-3.5	21.7
- capital investments	17.5	0.2	17.7	0.7	1.8	-1.0	0.2	1.7	19.4
- foreign currency claims	76.8	-7.0	69.8	8.2	4.6	-1.7	-20.1	-9.1	60.7
- households	91.6	68.9	160.5	16.0	21.3	6.8	2.6	46.8	207.2
- short-term Tolar loans	26.2	7.4	33.6	-0.9	3.8	0.0	2.4	5.2	38.8
- long-term Tolar loans	65.4	61.5	126.9	16.9	17.6	6.8	0.2	41.5	168.4
Claims on other financial institutions	5.0	6.5	11.5	-4.0	0.5	2.4	-2.2	-3.4	8.2
Decrease	**994.4**	**275.2**	**1,269.7**	**93.4**	**65.8**	**85.5**	**-1.3**	**243.4**	**1,513.0**
Foreign liabilities	150.4	36.9	187.4	14.6	-32.7	24.0	5.3	11.3	198.6
Non-monetary deposits	583.9	189.2	773.1	52.9	86.6	51.6	-0.4	190.6	963.7
- in Tolars	317.0	93.6	410.6	35.0	34.1	15.1	18.3	102.4	513.0
- enterprises	137.5	33.7	171.1	14.2	11.4	-2.8	18.6	41.3	212.5
- households	111.6	32.4	144.0	12.0	13.5	9.7	16.4	51.6	195.6
- in foreign currency	266.9	95.6	362.5	17.9	52.5	36.5	-18.7	88.2	450.7
- enterprises	18.8	-3.1	15.7	4.8	4.3	-1.9	0.9	8.1	23.8
- households	224.9	84.0	308.9	22.7	4.5	8.0	15.3	50.5	359.4
Securities	36.2	20.5	56.7	-0.3	-14.0	14.5	-4.8	-4.5	52.1
- in Tolars	22.4	17.2	39.6	-0.5	-14.3	2.7	-0.1	-12.2	27.4
- in foreign currency	13.9	3.2	17.1	0.2	0.4	11.8	-4.7	7.7	24.7
Limited deposits	6.1	-0.3	5.7	0.1	-0.1	-1.7	-0.2	-1.9	3.9
Net other liabilities	217.8	28.9	246.8	26.0	26.0	-2.9	-1.2	47.9	294.6

Source: Bank of Slovenia.

The money multiplier (for M1) was relatively stable during the year, since it increased from 1.86 in 1995 to 1.88. ***M1 supply*** increased by 31.1 billion Tolars. The increase of net foreign assets of the banking system amounted to 131.1 billion Tolars (against 34.6 billion Tolars in 1995 and 179.1 billion Tolars in 1994). Claims on general government increased by 24.7 billion Tolars (against 47.8 billion in 1995), those on enterprises by 64.1 billion Tolars (against 114.1 billion Tolars in 1995) and on households by 46.8 billion Tolars (against 68.9 billion Tolars in 1995). The expansion of domestic credit, loans to households evident in 1995 in particular, persisted until mid 1996; the growth of bank investments to domestic non-banking sectors stopped almost completely, partially also due to investments of banks in securities issued by the Bank. On the other hand, trends in deposits of enterprises and households did not change.

Withdrawals from Tolar sight and time deposits in the banking system (up to formation of M1) amounted to 102.4 billion Tolars (against 93.6 billion Tolars in 1995), those from foreign exchange accounts 88.2 billion Tolars (against 95.6 billion Tolars in 1995) and those pertaining to securities issued by banks and by the Bank -4.5 billion Tolars (against 20.5 billion Tolars in 1995).

2. Interest rates

The Bank endeavoured to influence the conditions decisive for interest rate formation with the goal to reduce fluctuations, as well as the general level of still high interest rates.

Table 4: Interest rates in 1996 (average monthly rates in % p.a.; amounts in billion Tolars)

Month	Interbank Market						Bank of Slovenia rates		Revaluation
	Day		Overnight		Total				
	Amount	Interest rate	Amount	Interest rate	Amount	Interest rate	Repurchase	Short-term loan	
January	68.1	12.5	13.4	12.4	81.4	12.5	10.1	10.0	9.9
February	64.9	14.7	21.0	14.6	85.9	14.7	13.3	10.0	12.0
March	74.5	15.6	18.3	15.3	92.8	15.5	14.1	10.0	12.5
April	69.9	16.6	24.2	16.6	94.1	16.6	16.9	10.9	12.9
May	65.7	18.7	23.3	18.7	89.0	18.7	19.1	12.2	13.8
June	89.1	18.0	18.8	17.9	107.9	18.0	19.0	12.5	12.9
July	71.0	16.7	24.3	16.7	95.3	16.7	20.2	12.5	11.2
August	71.3	13.0	13.0	13.0	84.3	13.0	13.8	12.5	8.6
September	47.5	10.5	15.2	10.4	62.7	10.5	11.5	12.5	6.3
October	49.7	9.9	16.2	9.7	65.9	9.9	10.4	12.5	4.8
November	58.5	11.5	13.3	11.4	71.8	11.5	12.6	11.4	6.3
December	54.1	10.3	12.3	9.4	66.3	10.2	11.4	10.0	6.1

Source: Bank of Slovenia.

The Bank had started introducing measures towards deindexation already in 1995 when it abolished indexation for its instruments with maturities of less than 30 days, and introduced a three-months average of inflation as revaluation clause for all other instruments. The modified indexation system was taken over by commercial banks. In February 1996, the revaluation clause was extended to four months' average, and to six months' average of inflation in December. These measures contributed to a substantial decrease in volatility of nominal interest rates, and any movements thereof became more closely linked with the real rate rather than with current movements of retail price inflation.

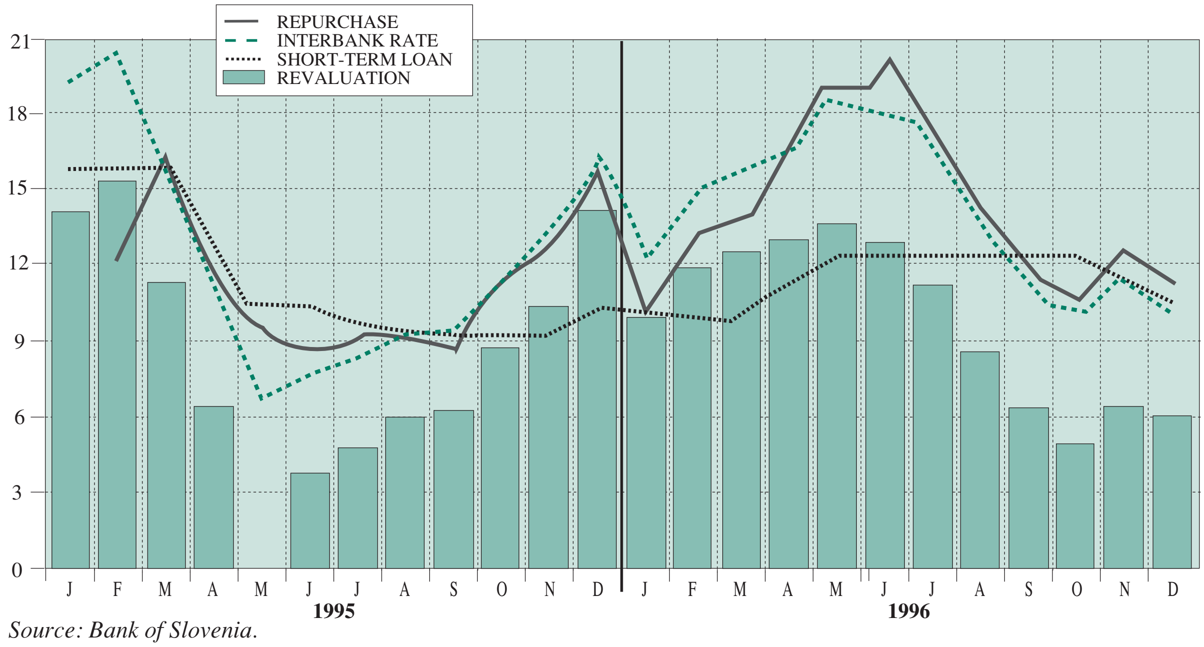
In 1995 the Bank supported the initiative and the subsequent agreement concluded among commercial banks on maximum deposit rates. The bank has closely followed the development in this field, the influence of the agreement on reduction of lending rates and interest margins of commercial banks in particular. Commercial banks intend to further pursue the issue of reduction of interest rates in early 1997.

Bank of Slovenia rates. The discount and lombard rates have remained unchanged (10% and 11% respectively). No transactions have taken place at the discount rate since establishment of the Bank. Lombard loan is not one of key instruments, its actual cost is determined by the prescribed volume of collateral in form of securities. Interest rates for liquidity loans and regular short-term loans increased slightly in the second quarter due to increase of revaluation clause, and decreased towards the end of the year to the level of 1995: 10.5 % and 11.0% for overnight and one day loans, 10.0% for short-term loans. The interest rates of the Bank issued bills were in line with the respective movements of lending rates.

The development of money market rates was similar, except that their oscilation during the year was somewhat higher. Interbank rate increased from 12.5% at the beginning of the year to 18.7% in May, and decreased to 10.2% in December. The repo rate increased from 10.1% to a maximum of 20.2% in July and decreased to 11.4% by December. In December, the "real" rate over indexation of the interbank interest rate was 3.9%, and 5.0% for the repo rate; "real" rates were highest between July and November.

Interest rates of banks for representative time deposits (31 to 90 days) grew from a monthly average of 15.1% in January to 19.2% in May and then gradually decreased to 9.9% in October and 11.2% in December. Average short-term lending rates grew from 23.1% to 27.0% in May and decreased to 18.3% in December. Based upon the first addendum to the Interbank agreement on maximum deposit rates, the "real" deposit rates of commercial banks were reduced in January, for time deposits over 31 days from the average of 6.2% to 4.8%, and remained on that level throughout the year. The average "real" short-term lending rates subsequently decreased during the year from 12.5% in December 1995 to 11.5% in December 1996.

Chart 4: Money market interest rates (average monthly rates in % p.a.)



Source: Bank of Slovenia.

In 1996 the return on deposits in domestic currency was by far more attractive than that on foreign exchange deposits. The revaluation rate for Tolar deposits alone amounted to 9.7% on yearly basis, whereas the exchange rate for German Mark increased by 3.5% only.

3. Monetary policy instruments

Like in the previous years, availability of base money in 1996 was strongly dependent on foreign exchange flows. Foreign exchange surplus of banks subsequently led to a nominal appreciation of the Tolar by the end of the second quarter of the year, and, due to monetary policy measures taken by the Bank of Slovenia, resulted in a very moderate depreciation of the Tolar between August and October. The measures taken by the Bank of Slovenia subdued the influx of foreign exchange, its monetary policy instruments still making it possible for banks to reduce the excess obligatory reserves in foreign exchange. During the second half of the year the Bank was very active in purchasing foreign exchange. The Bank also reduced the volume of its claims based on loans to banks; the volume of its bills sold,on the other hand, increased.

The following instruments had major influence on the volume of base money and on the Tolar exchange rate:

- ***Purchase of foreign exchange.*** The base money growth due to net purchase of foreign exchange amounted to 47.5 billion Tolars; it was primarily due to purchase of foreign exchange with the right to sell foreign exchange to the Bank later by banks, and to purchase foreign exchange based on combined or triple offer (banks can sell foreign exchange to the Bank, partly spot and partly as a swap operation for four weeks, while banks subscribe to foreign currency bills for the same amount) and net purchase of foreign exchange from the Government.

- ***Loans.*** The quantity of money in circulation was reduced by 16.6 billion Tolars, primarily due to reduction of the regular short-term credit quota (supplementary short-term loans not included), and also due to repayment of liquidity loans by banks under rehabilitation.

• ***Repurchase agreements.*** This instrument accounted for reduction of base money of a total of 5.4 billion Tolars. The amount includes the purchase and selling rate differentials.

• ***Sale of bills.*** The Bank withdrew a net of 10.5 billion Tolars through sale of its bills; a major portion thereof is due to sale of bills with warrants and to Tolar bills.

The Bank regulated supply and demand of foreign exchange in the foreign exchange market by means of minimum reserves requirement in foreign exchange (foreign exchange minimum), by obliging banks to balance their claims and liabilities towards foreign persons, and by introduction of a non-interest bearing Tolar deposit on drawdowns under non-trade related loans taken abroad. In addition to the base money offered, the Bank regulated the narrow money M1 by means of obligatory reserves of banks and savings banks, thus keeping the money multiplier stable.

Table 5: Monetary policy instruments (in million Tolars)

	31.12.95	Daily average in quarter 1996				31.12.96
		I.	II.	III.	IV.	
Loans to banks	**26,028**	**16,968**	**15,502**	**18,722**	**11,200**	**1,478**
- Lombard loans	66	285	265	243	265	209
- Short-term loans	18,295	8,892	10,077	15,420	10,279	0
- Liquidity loans	7,667	7,683	5,161	3,060	656	1,269
Repurchase of bills	**16,804**	**17,743**	**15,272**	**17,063**	**16,561**	**13,650**
Repurchase of foreign exchange	**0**	**0**	**2,225**	**2,315**	**0**	**0**
Bank of Slovenia bills	**126,672**	**121,503**	**103,565**	**121,426**	**161,776**	**180,631**
- Tolar bills - banks and savings banks	1,547	514	218	1,495	2,421	6,921
- Twin bills	4,093	3,856	105	434	429	792
- Bills with warrants	983	5,356	6,388	6,338	7,706	8,968
- Foreign currency bills	120,049	112,249	96,854	113,159	151,219	163,950
Government deposits	**7.800**	**1.934**	**5.874**	**14.316**	**10.304**	**0**
Reserves reguirement of banks and savings banks	**37,017**	**39,197**	**41,199**	**42,935**	**43,870**	**44,862**
Foreign exchange minimum of banks (in mio ECU)	**1,586**	**1,684**	**1,759**	**1,818**	**1,870**	**1,875**
Purchase of foreign exchange		**4,486**	**15,730**	**13,587**	**23,522**	
Sale of foreign exchange		**2,338**	**3,124**	**2,121**	**2,081**	

Source: Bank of Slovenia.

Loans to banks

Several instruments were used to provide liquidity to banks: lombard, short-term and liquidity loans. The volume of short-term loans was most significant during the whole year, whereof during the first six months regular short-term loans with monthly utilisation quotas, and in the second half of the year supplementary short-term loans based on Ministry of Finance time deposits with the Bank prevailed. Drawings under special liquidity facilities for banks under rehabilitation gradually diminished; they were repaid in full in December 1996. During the last three months, the Bank took up its activity on the inter bank market in overnight facilities in order to provide some assurance on the market after liquidity trouble of one bank and the subsequent suspension of its operation. The overall volume of such loans decreased substantially during December 1996.

Lombard loan: within the framework of standing lombard facility the Bank provided five-day lombard loans to banks in amounts not higher than 2.5 percent of foreign currency denominated short-term Bank bills or Treasury bills used as collateral. Utilisation of this liquidity facility was limited due to collateral requirement. Interest rate for lombard loans was one percentage point above the Bank discount rate, i.e. 11% p.a. during the whole of 1996. Average daily utilisation of such loans amounted to 264 million Tolars (in 1995 only 72 million), utilisation above the average took place in February, March, May, July and November. Lombard loans accounted for base money growth in amount of 143 million Tolars.

The short-term loan was first made available at the end of 1994 with maturity of one month. It was introduced with the purpose to neutralise the effect of transfer of the Ministry of Finance deposits from banks to the the Bank in the second half of 1995.

Based on the preliminary data on base money, the Bank provides for intra-month liquidity to banks with regular short-term loans with maturity of one month. Should demand for liquidity grow over a longer period of time, then the volume of loans offered can be reduced due to purchase of foreign exchange. It was in 1996 that the Bank for the first time since its introduction availed itself of this mechanism to a major extent.

Regular short-term loans are offered on monthly basis. The amount of such loans granted to a single bank is determined in dependence of its share in the foreign exchange position total of all banks, and of the overall volume of loans offered; the latter is subject to the Bank's revision at least once per month. The p.a. interest rate is pre-specified and was subject to three revisions in 1996: it was increased from 10% to 12% in April, and to 12.5% in May, and reduced to 10% in November.

Within 19 offers made by the Bank, banks drew daily on an average of 2,965 million Tolars, corresponding to 76% of the average volume of regular short-term loans offered during the whole year. The net result was reduction of base money by 5,423 million Tolars. The volume offered varied and was reduced considerably during the year, from the average of 8 billion Tolars in the first quarter, to 0.7 billion Tolars in the last quarter.

Supplementary short-term loans are made available to banks in dependence of the Ministry of Finance time deposits received by the Bank. They are intended to neutralise the effect of transfer of the budget liquidity surplus from banks to the Bank. Maturity of such loan corresponds to that of the relevant deposit and cannot exceed 3 months; interest rate is one percentage point above the time deposit rate. Interest rates for time deposits with the Bank are in line with those of short-term bills with comparable maturities.

A total of 109 supplementary short-term loans were offered during 1996, a daily average of 7,875 million Tolars was drawn upon, with a peak of 20,445 million Tolars in September. The average maturity of such loans was 17 days, the average coverage of supplementary loans granted with the time deposits 97%.

As a rule, the Bank employs ***liquidity loans*** to regulate liquidity of the banking system, and only occasionally for regulation of base money. Special liquidity facilities were offered to banks under rehabilitation, but their volume decreased during the year. All such special facilities were repaid in full before end of the year. Liquidity loans of last resort were available. Overnight liquidity facilities were available in the second half of the year and together with facilities in cooperation with commercial banks introduced in July, they contributed to an easing of tensions on the inter bank market caused by suspension of operation of one bank.

The daily average of liquidity loans granted in 1996 amounted to 4.1 billion Tolars (against 11.2 billion Tolars in 1995), out of which 3.6 billion Tolars to banks under rehabilitation.

Overnight liquidity facilities are offered to net borrowers on the inter bank market. In case demand exceeds the offer, or the interest rates for loans offered are excessively high, then such overnight facilities are offered by the Bank on the evening inter bank market at a uniform interest rate; banks may draw upon such loans in dependence of availability of eligible collateral.

The Bank participated in the evening inter bank market once in the first half of the year, and was constantly present between July and end of the year. The majority of overnight facilities was drawn upon in July (1,611 million Tolars per day, compared to the average daily drawing of 198 million). The applicable interest rate was revised three times - it was increased from 10.5% to 12% in April, to 13% in May, and reduced to 10.5% in October.

A major portion of drawings on *special liquidity facilities by banks under rehabilitation* was due to encashment of contingent liabilities (44.7%). The majority of drawings under such loans took place during the first quarter of 1996. They were repaid in full before end of December. Intra-day facilities account for 30.1% of the total special liquidity facilities granted. There were no drawings under these facilities during the last two months of the year. 14.6% of the average daily drawings were made under facilities granted as credit lines; no such drawing took place during the last three months of the year.

Liquidity facilities of last resort are permanently available to banks in case of unexpected liquidity constraints and are to be employed for payments under due obligations and the fulfilment of compulsory reserves requirement. The interest rate charged is the applicable penalty rate, i.e. the revaluation rate plus 18 percentage points. Only six banks availed themselves of this facility, only one of them for a longer time.

In July 1996, the Bank introduced, in cooperation with commercial banks, *a special facility for banks with liquidity problems* due to unforeseen decline in deposit business and difficulties in access to inter bank market, as well as due to non-availability of securities eligible for the Bank's liquidity loans. Any such bank can receive a liquidity loan of the Bank with participation of one or more commercial banks. The participating bank or banks are required to pledge to the Bank the Bank's bills or Treasury Bills, and the bank in distress any other first class securities or A grade claims to the participating bank.

Twenty-one banks agreed-in-principle to participate in such facilities during a period of nine months against payment of remuneration of 7% p.a. of the amount made available. Even before this agreement was reached, one bank used such model to assist another in July. The participating bank received liquidity facility from the Bank of a daily average of 332 million Tolars.

Repurchase Agreements (REPOS)

The Bank buys its foreign currency bills from banks in auction sales, under the agreement that these bills are to be repurchased by banks after four weeks. It is the most important instrument used in fine-tuning of base money. There was a total of 249 auctions conducted by the Bank in 1996 for purchase of a total of 2,905 million German Marks (260.4 billion Tolars); 83% of the total was realised. Out of the total of 31 banks, 25 participated in auctions at least once. The net effect was absorption of liquidity of 5.4 billion Tolars.

Individual auctions of repos with maturity of four weeks involved between 10 and 20 million German Marks per day; they were based on bids for exchange rate for the German Mark at the time of repurchase. Exchange rate differential is the base for calculation of repo interest rate. The level of repo interest rate was below the inter bank rate during the first quarter of 1996, and was above this rate - with few exceptions - later. The applicable real interest rate over the monthly revaluation rate reached its peak in July (8.1%) and its low in January (0.3%), and the average of 4.1% in 1996.

Banks participating in such auctions undertake the obligation to purchase a certain minimum amount of foreign exchange from companies at the rate of exchange so determined during the first week following such auction. The obligation was set at 151% of auction participation at the beginning of the year, and was reduced to 120% in April.

Bank of Slovenia Bills

The variety of bills offered in 1996 was the same as in 1995. Their terms and conditions were adapted to the Bank’s monetary policy objectives and to the development in interest rates on domestic and foreign money markets. The volume of bills issued increased, mostly due to bills denominated in foreign currencies. The value of Tolar bills subscribed to amounted to 77.7 billion Tolars, redemption thereof to 67.3 billion Tolars and 47 million German Marks (foreign currency part of twin bill). The volume of bills denominated in foreign currencies amounted to 3.6 billion German Marks and 258 million US Dollars, redemption thereof to 3.2 billion German Marks and 255 million US Dollars; the latter amounts were partially used for subscription of new issues of foreign currency denominated bills (2 billion German Marks and 161 million US Dollars).

Tolar bills are securities issued in registered form subscribed by banks with maturity of two, twelve, thirty or sixty days, and by savings banks with maturity of seven, fourteen, and since December also sixty days. Such bills are offered on a permanent basis. Except for the sixty day bill, none are issued in series. Some of the bills had their interest rate changed during the year in dependence of development of interest rates on domestic money market and the monetary policy objectives. Tolar bills subscribed to are deposited on a special account with the Bank, with a respective receipt issued to the bank. The overall purchase volume declined in comparison to 1995 and amounted to 43 billion Tolars, and the volume of redemption to 38 billion Tolars. The subscription of Tolar bills by savings-banks and their redemption accounted for 0.1% of the total.

Twin bills are short-term securities issued in series in bearer form as physical securities. Via banks it is eligible to legal and natural persons. They are composed of a Tolar and a foreign currency part, and can be bought in Tolars at a discount, whith redemption in Tolars and in German Mark. The Tolar and the foreign currency parts can be sold separately on the secondary market. The Tolar part is indexed with the revaluation clause. The real yield on both series of the 1996 seventh issue was 4% on the Tolar part and 2.75% on the foreign currency part respectively.

Beside the two newly issued series, a 1995 series was still available in 1996. A total of 3 billion Tolars was subscribed, a total of 4.3 billion Tolars and 47 million German Marks redeemed in 1996. The instrument accounted for 1.3 billion Tolars of base money provided.

Bills with warrants are short-term securities issued in series in bearer form as physical securities of nominal value of half a million Tolars. They are purchased in Tolars at a discount and bear the p.a. nominal interest. The warrant attached to the security acts as a hedge against inflation and exchange rate depreciation higher than officially projected. Holders of warrants are able to buy new Tolar bills (without additional warrant) or foreign currency bills at a discount. The discount depends on the number of warrant coupons of an individual series presented, on the actual increase in inflation, and on the Bank of Slovenia middle exchange rate compared with the officially projected inflation. Bills with warrants are issued twice a year, each time with maturity of six months. The maturity date of the first issue corresponds to the issue date of the second. Interest rate is determined separately for each issue, so is the maximum number of coupons eligible for discount asserted on new bills. Bills with warrants are sold at auctions. In 1996 the fifth and sixth issue took place, as well as redemption of the fourth and fifth issue.

During 1996, 66,179 lots of bills of the fourth, fifth and sixth issues were sold in the total discounted amount of 31.8 billion Tolars (129% more than in 1995) and a total of 198,678 warrants issued. A total of 25.2 billion Tolars was redeemed, whereof 11.3 billion Tolars worth of the fourth and 13.9 billion Tolars worth of the fifth issue.

Discount in the total of 14 million German Marks, 2.8 million US Dollars and 184.7 million Tolars was asserted against presentation of 114,841 warrants. Discount was asserted in German Marks and US Dollars between May and September, and in Tolars in May and November. A total of 128,758 discount coupons pertaining to the fifth and sixth issues remained outstanding.

Foreign currency bills are negotiable registered securities not issued in series, issued by the Bank since 1992. They are offered on permanent basis and can be purchased by banks and by other legal persons through banks. They are purchased at a discount with German Marks or US Dollars with maturities of two to twelve months. The bills purchased with maturity up to 120 days count as fulfilment-in-proportion of the minimum reserves requirement in foreign exchange, while those with maturity of 180 days and more are eligible for discount. The applicable interest rates follow the development of such rates on the international money markets; accordingly, the interest rate for bills in German Marks was changed eleven times in 1996, and for those in US Dollars nineteen times. Holders of warrants are able to buy new Tolar bills or foreign currency bills at a discount, the reduction depending on the increase in actual inflation and exchange rates compared with the official projection for inflation, and on the number of warrants presented in line with the maximum allowed on relevant issue.

The overall volume of bills denominated in German Marks dropped from initial 1,165.3 million to 897.6 million in June, and increased to a total of 1,586.8 million German Marks by the end of the year. The volume of US Dollar denominated bills increased from initial 135.2 million to 138.3 million by the end of the year, but reached in-between a low of 84.6 million at the end of June. The overall increase of the volume of subscribed foreign currency denominated bills is due to the so-called triple offer, based on which banks subscribed bills with maturity of 180 days, further to subscription of German Mark denominated bills based on asserted discount, as well as due to the regulation obliging banks to fulfil 30% of minimum reserves in foreign exchange with Bank of Slovenia bills with maturity of up to 120 days.

The foreign currency bills subscribed to make banks eligible for most of the monetary policy instruments. They can be used as collateral for most monetary policy instruments: for Lombard loans, for repos in auctions, for liquidity and short-term loans.

Government deposits

Based upon the respective agreement concluded, the Bank accepts time deposits of the government. The conditions for time deposits were changed in 1996 to render more flexibility to the management of liquidity of the budget: the notice period for time deposits was shortened, and time deposits of any number of days made possible.

There was a total of 111 time deposits made with maturity between 2 and 60 days in the total amount of 170.6 billion Tolars. The daily average of deposits amounted to 8,115 million Tolars and was especially high between August and November. Supplementary short-term loans of a daily average of 7,875 million Tolars were drawn upon by banks to compensate for the governmental funds they no longer received in deposit.

Minimum reserves requirement

All banks and savings banks, as well as credit co-operatives are obligated to hold minimum reserves with the Bank. The required reserve ratios on Tolar deposits, loans taken, securities issued and purchased by non-banks, vary depending on denomination of deposits (Tolar versus foreign currencies), maturity of deposits, and residence of depositors. The reserve ratios on Tolar deposits maturity-wise are: 12% on sight deposits and term deposits up to 30 days, 6% on time deposits between 30 days and 3 months, 2% on time deposits between three and six months and 1% on time deposits with maturity between 6 months and 1 year. The average calculated reserves ratio on Tolar deposits amounted to 6.4% (against 6.7% in 1995). The obligatory reserves are remunerated at a symbolic interest rate of 1% p.a.

Tolar deposits increased at an average monthly pace of 1.7% (2.3% in 1995). The overall volume increased from 577.9 billion to 706.0 billion Tolars (31%). Sight deposits and term deposits up to one year grew at a monthly average of 1.4%, while term deposits over one year at a monthly average of 3.3%. Overall growth of term deposits over one year increased by 3.7% and represented an average total of 15.8% in 1996.

The minimum reserves calculated pursuant to the required reserve ratios varied from month to month, from 39.1 billion Tolars in January to 44.9 billion Tolars in December. The amount of calculated reserves grew at a steady pace, except for September when it slightly decreased. The average minimum reserves calculated on deposits up to one year varied from month to month between 7.5 and 7.7 percent. The yearly average amounted to 7.6% compared to 7.7% in 1995. The average ***actual reserves*** were in excess of those calculated by 3.6% (from 0.6 billion Tolars in May to 3.4 billion Tolars in December).

All banks and savings banks may ***utilise their minimum reserves*** for management of their liquidity under the same conditions since July 1995. Half of their minimum reserves are deposited on a special account and available for inter-day utilisation at a pre-specified penalty rate. The monthly average balance on this special account amounted to 20.9 billion Tolars (50% of the total). Remunerations of a total of 11.2 million Tolars were paid in 1996 (against 19.1 million in 1995).

Regulation of supply and demand in foreign exchange market

Banks are required to hold reserves in foreign exchange in form of liquid assets abroad to ensure overall liquidity of payments abroad and to fulfil their obligations to holders of deposits in foreign exchange, both domestic and foreign persons ***(foreign exchange minimum).*** The monthly obligatory foreign exchange minimum is determined in dependence of the volume of payment transactions with foreign countries (35% of the last three months average), the volume of household deposits in foreign exchange (100% of sight deposits, 75% of deposits with maturity up to 3 months, 35% of deposits with maturity between three and 12 months, 5% of deposits with maturity over one year), on the volume of deposits by non-residents (90% of sight deposits, 75% of deposits with maturity up to three months, 35% of deposits with maturity between 3 and 12 months, 5% of deposits with maturity over one year), and since February also on the net sale of foreign cash. End of December 1996, the prescribed foreign exchange minimum covered 86% of all foreign exchange deposits in banks, the actual kept even 102%.

Banks complied with the foreign exchange minimum requirement with appropriate balances on accounts with first-class foreign banks, with cash and foreign cheques in their vaults, with receivables in foreign exchange due from domestic banks and the Bank, with Bank issued foreign exchange denominated bills with maturity up to 120 days, with investments in first-class foreign securities, and with availability of special rights to purchase foreign exchange from the Bank. Due to amendment to this requirement adopted in June, banks were obliged to hold at least 30% of their foreign exchange minimum in form of Bank of Slovenia foreign currency denominated bills by end of 1996.

Foreign exchange minimum holdings increased from 1,586 million ECU in December 1995 to 1,875 million ECU at the end of 1996. The increase is due to growth in foreign exchange deposits and payment transactions with foreign countries. The foreign exchange holdings in excess of those prescribed were at their low in mid-1996 (9.5%) and reached their peak at the end of the year (18.5%).

Banks also have their ***net daily foreign exchange position prescribed*** (i.e. the difference between foreign exchange assets and liabilities in the country and abroad) with a minimum of 75% of the foreign exchange minimum. All banks met this requirement in 1996.

Balancing claims and liabilities to foreign persons. In July 1996 the Bank adopted the obligation for banks to balance any additional liability to foreign persons beyond their position at July 31, 1996 with corresponding assets. Such liabilities comprise any and all liabilities to foreign persons (in Tolars and in foreign currencies) and liabilities under foreign loans taken by domestic legal persons in which banks hold a majority participation.

Restrictions on borrowing abroad. In February 1995 the Bank introduced an interest-free deposit of 40% in Tolar counter-value on all drawdowns under non-trade related loans taken abroad with maturities of less than 5 years; the measure was amended in August by extension of maturity subject to deposit to less than 7 years. In addition, the Bank introduced such 10% deposit on loans with maturity beyond 7 years. Exempt from this measure are loans taken by domestic authorised banks and by the Republic of Slovenia.

Purchase and Sale of Foreign Exchange

The overall interventions of the Bank in the foreign exchange market were more frequent and involved a variety of instruments. The Bank primarily purchased foreign exchange from banks under rehabilitation in connection with redemption of their contingent liabilities. It purchased and sold foreign currencies for foreign currency transactions on behalf of the government; such transactions are governed by the agreement concluded between the two parties pursuant to which the purchase from and sale of foreign currencies to the government are to be in balance during a fiscal year.

Table 6: Purchase and sale of foreign exchange

	1995		1996	
	million DEM	billion SIT	million DEM	billion SIT
Purchase	**295.4**	**24.8**	**784.3**	**70.7**
• From banks in rehabilitation	270.9	22.2	90.2	8.1
• Triple offer (spot and swap)	-	-	296.5	26.6
• Purchase with right to sale	-	-	251.4	22.9
• Other purchases	-	-	1.3	0.1
• Payments for the government	24.5	2.6	144.9	13.0
Sale	**303.1**	**25.1**	**256.6**	**23.2**
• From right to sale	2.5	0.2	0.9	0.1
• For purchase of foreign currency bills	124.2	10.8	4.0	0.4
• From triple offer	-	-	149.3	13.5
• Payments for the government	176.4	14.1	102.4	9.2

Source: Bank of Slovenia.

The following new instruments were made available to all banks in 1996:

The Bank introduced the so-called ***triple offer*** in April. With the triple offer banks can sell foreign exchange to the Bank, partly spot and partly as a swap operation for four weeks, while banks subscribe to foreign exchange bills with maturity of 180 days for the same amount. Based on fifty offers made, banks made spot sales of a total of 147.2 million German Marks, and as a swap operation for a period of 28 days a total of 149.4 million German Marks, and subscribed to a total of 269.5 million German Marks worth of foreign exchange bills. Due to this instrument the amount in excess of foreign exchange minimum prescribed was substantially reduced during summer. The last triple offer was made to banks in early September 1996.

Purchase of foreign exchange with the right to sell foreign exchange to the Bank by banks is the second of the two new instruments. It was first introduced in July. The Bank offered to purchase a certain amount of foreign exchange from banks on a special-offer basis once every month, and gave the right to the actually participating banks to sell additional foreign exchange to the Bank in pre-determined monthly amount within the subsequent six months. Based upon the offer, banks made their bids for the exchange rate at which they were willing to sell foreign exchange to the Bank and purchase export proceeds from companies. By the end of the year, the Bank purchased a total of 251.4 million German Marks for the counter value of 22.9 billion Tolars from two banks; the exchange rate auctioned increased from initial 89.45 Tolars for one German Mark in July to 91.36 Tolars in December. These banks obtained the right to sell an additional total amount of 295 million German Marks to the Bank before May 1997.

The Bank also purchased an amount of US Dollars 1.2 million from one of the banks pursuant to a special decision and in this way actually prevented its illiquidity.

Banks can purchase foreign exchange from the Bank at its selling rate increased for certain percentage points at any time in the form of foreign exchange bills with maturity of 120 days (forward transaction). One bank purchased such foreign exchange in 1996 in amount of 4 million German Marks at the Bank's selling rate plus 1.25 percent.

As banker of the government, the Bank sold 102.4 million German Marks to the Ministry of Finance and purchased 23.4 million German Marks from them. In addition and pursuant to a special agreement, the Bank also purchased 121.5 million German Marks from the Ministry, out of which 42.6 million related to the fiscal year 1995, and 78.9 million to the fiscal year 1996.

Surveillance over implementation of monetary policy measures

The Bank conducts surveillance over implementation of monetary policy measures and over compliance with conditions, rules and regulations determined in its operations in the inter bank market by means of direct inspection and indirect control in banks and savings banks.

Indirect control is a continuous process based on reports and documentation delivered to the Bank pursuant to reporting requirements. Additional control is conducted by means of occasional direct inspections of books and other documentation in banks and savings banks.

Based upon such control and inspections conducted, the Bank stated 21 cases of non-compliance (18 in banks, 3 in credit co-operatives) and issued the relevant penalty decrees pursuant to law and in line with the non-compliance stated (suspension of loans and of purchase of the Bank's bills for a certain period of time, temporary suspension of participation in the Bank's operations in the inter bank market). Besides, the Bank issued a number of warnings and requests for elimination of minor irregularities.

The Bank carried out 37 inspections in foreign exchange offices, out of which 8 on-site inspections in authorised banks and 18 in foreign exchange offices. Based on its findings in foreign exchange offices, the Bank notified the respective district attorneys in 12 cases, the state Inspectorate in one case and the Inland Revenue Office in one case accordingly. It also issued 5 respective penalty decrees to banks.
In addition, the Bank carried out 13 on-site inspections targeted towards operations of banks with foreign countries. As a consequence, the Bank issued 6 penalty decrees in line with non-compliance stated.

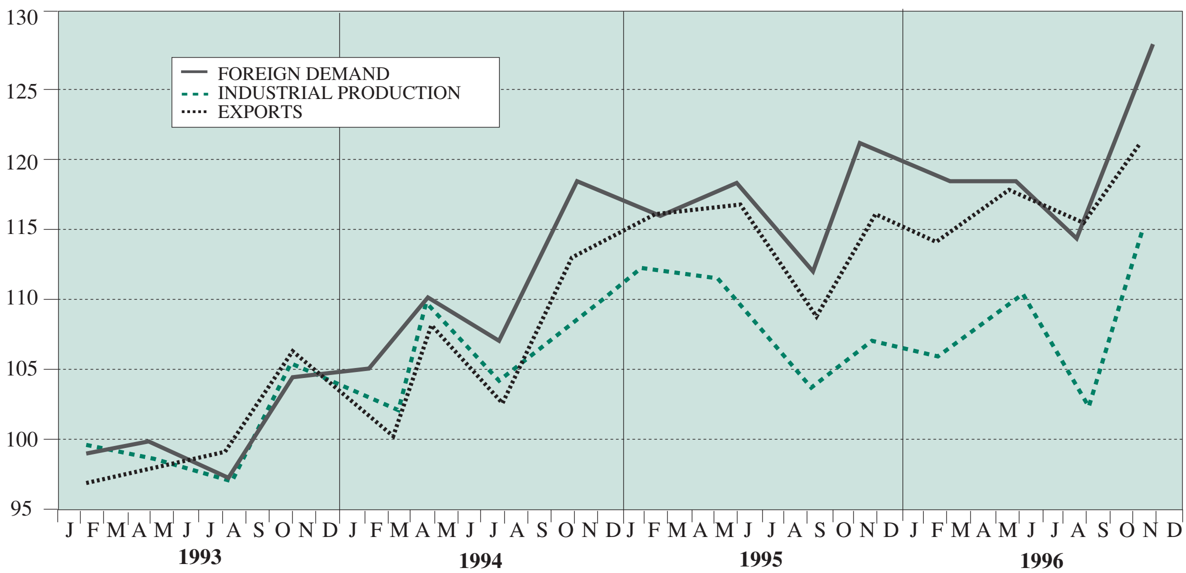
IV. BALANCE OF PAYMENTS, EXCHANGE RATE AND EXTERNAL DEBT

1. Balance of Payments

The current account remained in balance for the second consecutive year; as for capital flows, on the other hand, substantial net capital inflow was characteristic for the fifth consecutive year.

According to preliminary data, ***exports of goods*** amounted to USD 8,306 million (against USD 8,316 million in 1995), and increased by 3% in estimated volume terms. Such development primarily reflects the circumstances governing demand: economic growth declined in eight main economic partner countries from the European Union, with the prospects to recover and revive towards the beginning of 1997. Domestic factors influencing export competitiveness did not change. The real exchange rate had a neutral effect, the relative increase in average labour costs were compensated by redundancies.

Chart 5: Volume import demand of 8 pricipal EU partners, volume of Slovenian exports, industrial production (1993=100)



Source: Statistical Office of RS, BS estimates.

For the first time after 1991, exports to the markets of the European Union (EU) and to the OECD countries declined. Exports to the EU accounted for 65% of the total, those to OECD countries 70%; exports to France and Italy declined, while those to Germany (a share of 30%) remained unchanged. The decline in exports to the European Union amounted to 4% or to 2.5 percentage points; exports to successor countries of the former SFR Yugoslavia, on the other hand, increased by 2.1 percentage points, and those to CEFTA countries by 0.6 percentage points.

According to preliminary data, ***imports of goods*** amounted to USD 9,397 million, representing a 1% decrease from 1995. In volume terms, imports remained on the 1995 level. There were no major changes as regards country of origin.

Due to real growth of domestic incomes and to liberalisation of foreign trade (with CEFTA countries in particular), the stagnation in imports can be regarded as temporary exhaustion after the extraordinary accelerated domestic consumption in 1994 and 1995. Administrative problems in customs clearance upon introduction of the European Single Administrative Document at the beginning of the year, and the expected reduction of customs duties for imports from the EU as of January 1, 1997 contributed to further deterioration of imports.

According to preliminary data, the ***trade deficit*** (exports F.O.B., imports C.I.F.) amounted to USD 1,091 million (against USD 1,176 million in 1995). The trade deficit with the EU amounted to USD 991 million, that with all OECD countries USD 1,404 million. Within the EU, the trade deficit increased most with France (for USD 210 million to 326 million) and Italy (for USD 89 million to 488 million); it decreased, on the other hand, with Austria (for USD 101 million to 283 million). The surplus in trade with Germany increased for USD 200 million to 502 million.

Table 7: Regional structure of foreign trade (in million US Dollars; 1996 provisional)

	Exports					Imports				
	1992	1993	1994	1995	1996	1992	1993	1994	1995	1996
European Union(15)	**4,066**	**3,847**	**4,480**	**5,575**	**5,362**	**3,659**	**4,266**	**5,052**	**6,532**	**6,353**
France	616	528	586	682	598	492	522	613	798	924
Italy	880	756	923	1,212	1,103	839	1,051	1,258	1611	1,591
Germany	1,805	1,798	2,068	2,508	2,544	1,394	1,626	1,734	2,206	2,042
Austria	341	303	373	535	549	500	553	756	919	832
United Kingdom	141	148	208	229	161	74	103	130	190	208
EFTA	**64**	**65**	**75**	**87**	**83**	**107**	**135**	**188**	**237**	**248**
Switzerland	50	52	58	71	68	100	127	154	199	178
OECD (1)	**4,422**	**4,237**	**4,894**	**6,018**	**5,779**	**4,070**	**4,770**	**5,635**	**7,314**	**7,183**
U.S.A.	195	216	250	261	245	167	188	197	291	324
Japan	16	25	18	21	19	88	125	126	157	162
CEFTA	**234**	**261**	**308**	**403**	**450**	**286**	**331**	**451**	**634**	**613**
Countries of former Yugoslavia	**1,508**	**964**	**1,040**	**1,209**	**1,387**	**1,218**	**696**	**584**	**671**	**699**
Croatia	952	739	738	891	859	852	595	498	576	581
CIS member countries	**226**	**298**	**316**	**375**	**390**	**251**	**217**	**169**	**275**	**236**
Other Countries	**290**	**322**	**267**	**307**	**297**	**312**	**483**	**461**	**594**	**664**
TOTAL	**6,681**	**6,083**	**6,828**	**8,316**	**8,306**	**6,141**	**6,501**	**7,304**	**9,492**	**9,397**

Source: Statistical Office of RS.
(1) Not including Czech Republic, Poland and Hungary.

The surplus in trade with successor countries to the former SFR Yugoslavia increased for USD 150 million to 688 million, and that with the CIS countries for USD 54 million to 154 million. The trade deficit with CEFTA countries decreased for USD 68 million to 163 million.

It is for the second consecutive year that trade deficit was not entirely covered by ***surplus in services,*** amounting to USD 786 million (against USD 725 million in 1995).

Receipts from travel amounted to USD 1,222 million, representing a 12% increase against 1995. The number of overnight stays by foreigners increased by almost 5%, the number of border crossings by foreigners (without passengers in transit) by almost 16%. Expenditure by Slovenian residents for trips abroad increased by 9% and amounted to USD 452 million (against USD 413 million in 1995). The number of overnight stays by Slovenians in Croatia increased by 36%.

Surplus in transport services amounted to USD 76 million (against USD 69 million in 1995). Deficit in trade of other services amounted to USD 59 million (against USD 10 million in 1995). The deterioration is due to reduction in volume of construction and assembly services rendered abroad, and to increase in imports of business services.

The ***net income receipts*** amounted to USD 89 million (against USD 147 million in 1995). Capital income, interest in particular, reflects the gradual reduction of interest rates and growth of external debt and that of international reserves. Due to faster growth of external debt than that of international reserves in 1995, caused primarily by succession to a portion of unallocated external debt of the former SFR Yugoslavia owed to foreign private banks, interest outflows increased substantially in 1996. Net expenditure on capital income amounted to USD 57 million against USD 6 million in 1995. Net receipts of labour income amounted to USD 146 million (against USD 153 million). Surplus in ***current transfers*** amounted to USD 24 million (against USD 45 million in 1995).

According to preliminary data, the ***current account*** ended in a surplus of USD 47 million. After a period of high surplus, the current account has practically been in balance for two consecutive years.

The net capital inflow due to ***direct investments*** amounted to USD 180 million (against USD 170 million in 1995). Included in this aggregate, especially from August 1996, is a big portion of ***portfolio investments*** (shares purchased on the market), which renders the information on foreign direct investments inaccurate. It is probable that, compared to the previous year, foreign direct investments deteriorated. The net inflow due to foreign portfolio investments amounted to USD 638 million, the majority thereof due to government bonds issued abroad. According to data on transactions on the Ljubljana Stock Exchange, non-residents purchased securities in total amount of USD 79 million, out of which USD 68 million worth in the last four months of 1996.

Slovenia basically regulated the major part of its relations to foreign London Club creditors of the former SFR Yugoslavia. Out of the total debt outstanding of the former SFR Yugoslavia of USD 5,538 million (USD 4,274 million of principal, USD 1,262 million of interest due unpaid), Slovenia finally agreed to take a share of 18%. Following the acceptance of offer by the creditors to exchange a portion of the outstanding principal amount of each Refinancing Loan held for Slovenian Bonds to be issued, and given the subsequent approval by the Parliament of the Republic of Slovenia, Slovenia issued floating rate amortising bonds due 2006 (Series 1 and 2, denominated in both USD and DEM) in amount of USD 812 million in exchange of the debt under the 1988 New Financing Agreement and the Trade and Deposit Facility Agreement.

Table 8: The Balance of Payments (in million US Dollars; 1996 provisional)

	1992	1993	1994	1995	1996
A. CURRENT ACCOUNT	**926**	**192**	**540**	**-36**	**47**
1. Goods	791	-154	-338	-954	-853
2. Services	180	375	723	725	786
2.1. Transport	-164	57	68	69	76
2.2. Travel	389	429	590	666	769
2.3. Other	-45	-111	65	-10	-59
3. Income	-91	-51	108	147	89
3.1. Labour income	-2	-8	140	153	146
3.2. Investment income	-90	-44	-33	-6	-57
4. Current transfers	46	22	47	45	24
B. CAPITAL ACCOUNT	**...**	**4**	**-4**	**-14**	**-5**
C. FINANCIAL ACCOUNT	**-645**	**-206**	**-541**	**171**	**-30**
1. Direct investment	113	111	131	170	180
2. Portfolio investment	-9	3	-33	-10	638
3. Other investment	-117	-209	3	231	-261
3.1. ASSETS	-158	-314	-136	-373	-402
a) Trade credits	7	93	19	-39	-170
b) Loans	-31	12	-20	-16	-5
c) Currency and deposits: banks	-149	-451	-324	-202	-341
households	9	87	378	25	-74
other sectors	...	-20	-78	7	-27
d) Other assets (1)	6	-35	-111	-149	161
3.2. LIABILITIES	41	104	139	604	141
a) Trade credits (long-term)	-13	-13	-13	-7	12
b) Loans:	33	161	309	586	-12
Bank of Slovenia	-	-14	-5	-4	-3
commercial banks	-9	2	100	226	-178
general government	-17	79	67	131	-72
other sectors	59	95	147	233	241
c) Deposits and other liabilities	21	-44	-157	25	140
4. International reserves (BS)	-633	-111	-642	220	-587
Net errors and omissions	-281	10	5	-120	-12

Source: Bank of Slovenia.
Minus sign (-) indicates imports or surplus of imports over exports in the current account, increases in assets or decreases in liabilities in the capital and financial account, and increases in international reserves of the Bank of Slovenia.
(1) Payments of the Bank of Slovenia to the fiduciary account included.

Obligors are identified for a portion of USD 465 million of the above amount (banks prevail). This is why this amount was recorded in the balance of payments in June (Government Bond Issue) and the foreign liabilities of banks were reduced accordingly (with a claim of the government to banks established in exchange). The remaining portion of the foreign debt of the former SFR Yugoslavia succeeded to is not carried in the balance of payments as transaction. Due to the regulation of the issue, the fiduciary account opened at the beginning of 1994 with Dresdner Bank Luxembourg lost its function; the account was closed and the balance of USD 155 million transferred to the regular accounts of the Bank abroad as part of its foreign exchange reserves.

In August, the Republic of Slovenia issued Eurobonds in amount of USD 325 million. A portion thereof (USD 125 million) was used for redemption prior to due date of the corresponding nominal value of the Floating Rate Amortising Bonds issued in June.

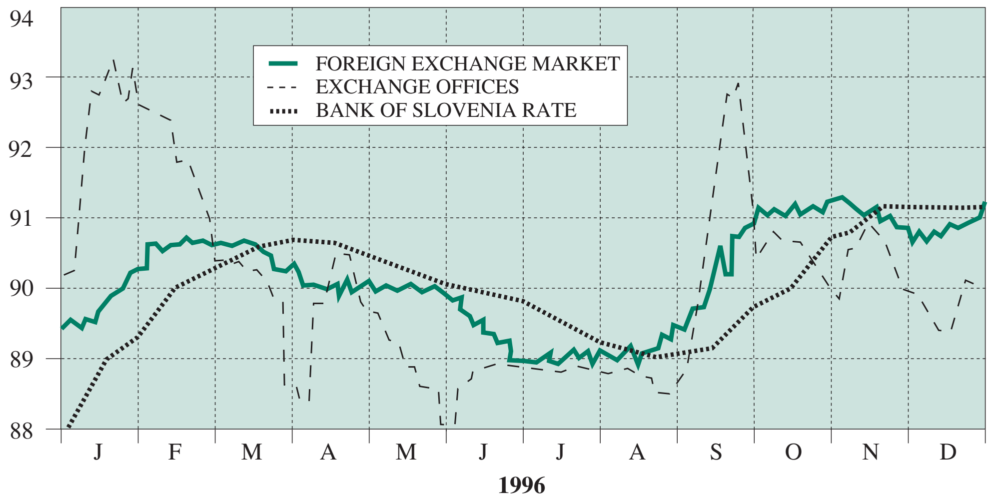
A net repayment of ***financial loans*** of USD 17 million was registered in 1996; this includes the above mentioned reduction of foreign liabilities of banks for USD 465 million and their transformation into liability towards Slovenian government respectively. This reposting excluded, enterprises drew under foreign loans in net amount of USD 241 million and banks USD 282 million; the government, on the other hand, net repaid foreign loans in amount of USD 72 million. Other liabilities of banks - predominantly under ***non-resident accounts*** - increased by USD 140 million, their international reserves ***(currency and deposits)*** by USD 341 million.

Foreign operations and respective operations of the Bank of Slovenia on domestic foreign exchange market resulted in an increase of ***international reserves of the Bank*** by USD 587 million to a total of USD 2,297 million.

2. Exchange Rate

Net ***inflow of foreign exchange*** into the international reserves of the Bank amounted to USD 930 million (against USD 470 million in 1995). Disregarding the above mentioned direct flows of foreign exchange to the government account with the Bank pertaining to government bonds, and the transfer of the balance on the fiduciary account into the international reserves of the Bank, the inflow of foreign exchange amounted to USD 580 million, whereof as much as USD 450 million in the second half of 1996. Such an intensive inflow of foreign exchange substantially increased the supply on the foreign exchange market during this period; net purchase of foreign currencies from enterprises by banks amounted to USD 250 million in the second half of the year (against USD 320 million in the whole 1996, additional USD 100 million of cash were net purchased by foreign exchange bureaux).

Chart 6: The exchange rate of the German Mark in 1996 (in Tolars per 1 DEM)



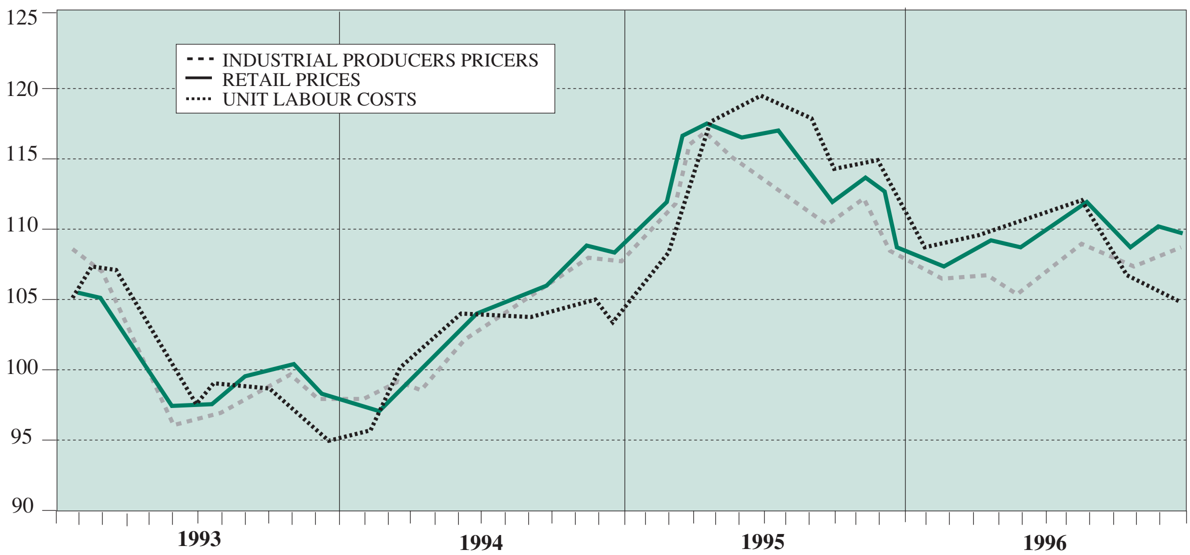
Source: Bank of Slovenia.

Due to net redemption of its foreign currency bills in the first half of the year (USD 250 million), the Bank had no room to intervene in support of exchange rate. In the second half of the year, however, the Bank managed to compensate for the huge pressure on exchange rate with a number of interventions resulting in reduction of supply by enterprises and enhancement of demand by banks. The net amount of USD 500 million of foreign exchange denominated bills issued by the Bank was subscribed between June and December, whereof USD 460 million by banks. Additional source of absorption of foreign exchange (USD 210 million) channelled into the foreign exchange reserves of the Bank was the instrument of the right to repurchase foreign exchange.

As a consequence of the above circumstances, the ***nominal exchange rate*** for German Mark decreased in the first half of 1996, from its peak of 90.7 SIT/DEM end of February, to its low of 88.9 SIT/DEM at the end of June. It picked up during summer and reached the level of 91.2 SIT/DEM at the end of October, then decreased slightly again and reached 91.0 SIT/DEM at the end of the year with an upward trend. Between December 1995 and December 1996 the average increase of the rate of exchange for German Mark amounted to 2.2%. The effective nominal exchange rate of the Slovenian foreign currency basket increased by 6.0%.

The **real effective exchange rate,** measured by relative consumer prices, showed an appreciation of the Tolar of 0.6% on the annual basis, and measured by relative industrial producer prices a depreciation of 0.6%. The best information on competitiveness of Slovenian exporters can be obtained from the effective exchange rate, deflated by relative unit labour costs; for 1996 it shows a 5.2% real depreciation of the Tolar. The increase in industrial productivity (due to layoffs) contributed to such result; the annual growth of unit labour costs amounted to 3%, i.e. less than consumer price growth in the same period. Considered as a problem by the Bank is the fact that - in spite of enormous savings due to higher productivity - labour costs still grow faster than the production itself, and that consequently, the real equilibrium - if reached - imposes inflationary pressure and reduces the effect of monetary policy measures and renders them very costly at the same time.

Chart 7: The real effective exchange rate, various deflators (1993=100)



Source: Bank of Slovenia.
Growth of index indicators growth of value of the Tolar.

3. External Debt and International Reserves

The volume of new loan agreements concluded in 1996 increased by 41.9% compared to 1995, and amounted to USD 1,613 million. Public and publicly guaranteed external debt increased by 107% or USD 427 million, whereof Eurobonds issued by Republic of Slovenia accounted for USD 325 million. Private debt increased by 27.4% or USD 1,186 million. New loans granted by international financial organisations amounted to USD 162 million, loans organised by bank syndicates and granted to Republic of Slovenia, to commercial banks and other legal persons to USD 254 million.

Term structure of new loans was in favour of long-term; 77.2% of all new loans had a maturity over 5 years. As regards their structure by currency, German Mark prevailed with a share of 60.2% of the total.

The total external debt as of December 31, 1996 was USD 4,001 million, against USD 2,970 million as of December 31, 1995. As already mentioned, long-term debt accounted for the major portion of the increase and amounted to USD 3,953 million; short-term debt decreased to USD 48 million and represented a share of 1.1% of total external debt at the end of the year.

Parallel to the increase in external debt, the volume of international reserves also grew and exceeded the total external debt by 1.9% at the end of 1996.

Management of International Reserves

International reserves of the Bank of Slovenia comprise:
- foreign cash and foreign currency deposits abroad,
- first class foreign securities,
- monetary gold,
- reserve position with the International Monetary Fund (IMF),
- Special Drawing Right holdings with the IMF.

In 1996 the Bank's holdings in foreign currencies (foreign cash, deposits abroad and foreign securities) increased from USD 1,802 million to USD 2,279 million. They were partially balanced by liabilities to commercial banks (via balances on foreign currency accounts held with the Bank and the Bank of Slovenia foreign currency bills subscribed to) and the government (via balances on government accounts held with the Bank), the total of these liabilities amounting to USD 1,278 million (against 1,259 million in 1995). The residual reserves unburdened by domestic foreign currency liabilities increased from USD 632 million to 971 million. Other foreign assets of the Bank include balances on the fiduciary accounts in Luxembourg.

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 (allowed are deposits with banks holding a minimum of AA long-term rating by IBCA). Pursuant to the decision by the Governing Board the Bank increased the share of investments in securities, primarily government securities and in this way reduced the credit risk and increased the liquidity of the international reserves.

Overall international liquidity of the country is supplemented by the foreign exchange minimum prescribed for banks by the Bank, and by the requirement imposed on banks to balance their claims and liabilities towards foreign persons. The foreign currency reserves of domestic banks increased from USD 1,624 million to USD 1,838 million.

Table 9: International reserves of Slovenia, foreign currency reserves of the Bank of Slovenia and of domestic banks (in million US Dollars at end of month)

	BANK OF SLOVENIA							TOTAL FOREIGN EXCHANGE RESERVES
	International monetary reserves					Other foreign assets	Foreign exchange	
	Gold	SDRs	Reserve position in IMF	Foreign exchange	Total			
31.12.1995	**0.1**	**0.1**	**19.1**	**1,801.6**	**1,820.8**	**170.1**	**1,624.4**	**3,426.0**
31.01.1996	0.1	0.4	18.0	1,695.0	1,713.4	171.9	1,648.8	3,343.8
29.02.1996	0.1	0.6	26.6	1,602.9	1,630.0	181.0	1,758.5	3,361.4
31.03.1996	0.1	0.5	26.6	1,538.8	1,565.9	179.8	1,839.5	3,378.3
30.04.1996	0.1	0.4	26.4	1,568.7	1,595.5	186.6	1,771.0	3,339.7
31.05.1996	0.1	0.1	30.9	1,498.1	1,529.1	185.6	1,858.0	3,356.1
30.06.1996	0.1	0.1	18.2	1,639.8	1,658.1	30.4	1,919.0	3,558.9
31.07.1996	0.1	0.5	17.3	1,749.3	1,767.2	30.6	2,002.8	3,752.2
31.08.1996	0.1	0.2	10.2	2,283.8	2,294.2	31.2	1,925.8	4,209.6
30.09.1996	0.1	0.2	10.6	2,265.9	2,276.7	31.2	1,913.3	4,179.2
31.10.1996	0.1	0.5	17.5	2,356.7	2,374.6	31.4	1,935.4	4,292.1
30.11.1996	0.1	0.1	16.4	2,390.6	2,407.1	31.5	1,877.4	4,267.9
31.12.1996	**0.1**	**0.1**	**18.5**	**2,278.7**	**2,297.4**	**31.7**	**1,837.8**	**4,116.5**

Source: Bank of Slovenia.

The total international reserves of the Republic of Slovenia (international reserves of the Bank of Slovenia without monetary gold and reserve position with the IMF plus those held by domestic banks) amounted to USD 4,117 million, representing an increase of 20.2% against 1995.

Negotiations with Foreign Creditors

The increase of public and publicly guaranteed external debt was partially due to successful completion of negotiations that regulated the relations of the Republic of Slovenia with foreign creditors of the former SFR Yugoslavia under the 1988 New Financing Agreement, and to the agreement on succession to a portion of debt owed by the former SFR Yugoslavia concluded between the Slovenian and the government of the FR Germany, one of the Paris Club creditors of the former SFR Yugoslavia. Negotiations with the London Club commercial creditors resulted in the exchange of 18% of the debt outstanding held by the qualifying creditors of the former SFR Yugoslavia for new Bonds issued by the Republic of Slovenia. Consequently Slovenian obligors were released from the obligations under the 1988 New Financing Agreement, including its “joint and several liability”. In addition, Nova Ljubljanska banka d.d., Ljubljana purchased a portion of 9.9% of their participation in the deposits under 1988 Trade and Deposit Facility from the qualifying creditors. The negotiations with creditors of the former SFR Yugoslavia under the Alternative Participation Instruments Exchange Agreement are not completed and conclusion of agreement is pending. Slovenia continued its bilateral negotiations on succession to the debt of the former SFR Yugoslavia with members of the Paris Club.

V. BANK SUPERVISION

1. Bank Rehabilitation

Bank of Slovenia issued the decrees on rehabilitation of Ljubljanska banka d.d. and Kreditna banka Maribor d.d. in January 1993 and March 1993 respectively. The rehabilitation process has been conducted under the auspices of the Bank Rehabilitation Agency (BRA), has made substantial progress in 1996 and is getting close to its completion.

Crucial for the rehabilitation process were the amendments to the Constitutional Law adopted in July 1994, pursuant to which Nova Ljubljanska banka d.d. (NLB) and Nova Kreditna banka Maribor d.d. (NKBM) were established. Division of the the balance sheets between the old and the new banks resulted in the old banks' retaining the claims and liabilities towards former SFR Yugoslavia.

Pursuant to the law adopted in October 1995, the BRA DM-denominated government guaranteed rehabilitation bonds with maturity of 30 years and interest rate of 8% p.a. were exchanged for Republic of Slovenia Tolar bonds issued in series with shorter and diversified maturities, not exceeding 15 years, and bearing lower interest depending on maturity. 1/6 of these bonds bear optional revaluation-clause coupons (banks can choose between foreign currency and Tolar revaluation clauses). The so-called I-series of bonds with maturity of 11 years and real interest rate of 5.7% p.a. became marketable in 1996, and has been especially actively traded on the OTC market since autumn.

Initially, the banks under rehabilitation were only able to meet their obligations by making use of the Bank's liquidity loans. Due to liquidity constraints, the banks had a negative cash-flow. Their cash-flow and liquidity improved significantly during 1996; they were actually able to manage their own liquidity during the second half of 1996.

The two banks have been able to comply with most of prudential rules, regulations and requirements imposed on banks by the Bank. The Bank will take their release from rehabilitation process into consideration, provided the banks' adequate liquidity, and compliance as regards exposure to a single borrower, investment in fixed assets and capital investments.

The banks under rehabilitation concluded the year 1996 with high profit, return on assets and equity well above the average. After they have been released from rehabilitation, the now state owned banks are to be privatised.

2. Supervision of Banks and Savings Banks

The Bank supervises banks in accordance with the Law on Banks and Savings Banks. At December 31, 1996 there were 31 domestic banks (out of which 29 operating) and 7 savings banks. The reduction of the total number of banks (against 1995) is due to failure and subsequent bankruptcy of one, and to a merger of two banks. In addition, preparations for the merger of Banka Celje d.d. and Banka Noricum d.d. took place; the merger became effective on January 1, 1997. The number of savings banks remained unchanged.

Out of 29 banks operating in Slovenia, 15 have a full licence (as at December 31, 1996) and 14 are fully owned by domestic persons; 11 banks have a minority foreign participation, 4 have a majority foreign participation (one of them is fully owned by foreign persons). Except for the two banks under rehabilitation, all banks are private banks. Savings banks are fully owned by domestic persons and are private institutions.

The Bank did not issue any new banking licence, and no approval for establishment of a foreign bank representative office in Slovenia in 1996. Approvals were issued for additional activities of banks and savings banks; as evident from above, the Bank issued one approval for a bank merger. There were several approvals issued for participation of foreign investors in domestic banks, for participations of domestic investors exceeding 15% of voting shares, as well as approvals on appointment of presidents and CEOs of banks.

Despite the fact that the new banking act had not been adopted by the Parliament, there was singnificant progress made in the field of bank supervision. Obligatory reporting on major depositors and on Tolar liquidity flows was introduced in July, the requirement for adjustment in term structure of assets with that of liabilities, and so was the special liquidity loan with participation of commercial banks. The Bank adopted a new decree on classification of balance and off-balance sheet items of banks and savings banks on the asset side and issued the respective instructions for its implementation, together with those for restructuring of non-performing loans, effective as of January 1, 1997.

The financial health of Slovenian banking system improved significantly. Domestic banks operated in a stable environment, disrupted only by introduction of liquidation proceedings against Komercialna banka Triglav d.d. in July and its subsequent transformation (end of December) into bankruptcy proceedings. It certainly rendered domestic banks more cautious and slowed down the balance sheet growth of smaller banks until late autumn.

The unaudited balance sheet total of domestic banks amounted to 1,723.7 billion Tolars at December 31, 1996, representing an increase of 14.9% against end of 1995. The most notable increase concerns three banks in majority foreign ownership and is due to increase of their foreign financial resources.

All domestic banks endeavoured to increase or at least to keep their existing market share. Banks have generally restricted their activities to classical banking services, while more sophisticated products and services (such as investment banking) have just begun to emerge. Banks have further spread their automated teller machine network, have introduced new debit and credit cards and some new savings products and schemes.

Savings banks increased their balance sheet total by 14.4% (to 5.1 billion Tolars); together with credit co-operatives (pursuant to the existing legislation the latter are not under the jurisdiction of the Bank, but should be once the new banking act has been adopted) they hold a market share of 1.8%.

According to available unaudited data as of December 31, 1996 (banks are obliged to submit the audited annual financial statements by end of May) the ***profit total*** of domestic banks before tax amounted to 18.7 billion Tolars in spite of the growing competition. The highest profits were realised by the seven biggest banks (measured by balance sheet total) together holding a market share of 70%. Two banks accumulated loss.

Higher profitability of Slovenian banks is owed to higher earnings: net interest income increased by 43.4%, that pertaining to commissions by 20.7%. Banks were able to slightly lower the operating expenditures/average assets ratio from 3.8% to 3.6%.

The net interest margin (net interest income/average gross interest-earning assets) increased from 4.9% to 5.5% owing primarily to a slower decrease of active interest rates compared to decrease of passive interest rates, and partly also to the provision of Law on Penalty Interest Rate and Revaluation Clause introduced in August 1995 pursuant to which financial assets and liabilities with maturities of up to 30 days are not subject to revaluation. In detail, the above developments were the following:

- the share of sight deposits increased and amounted to 13.7%; interest rate for such deposits was reduced on average from 50% of revaluation rate (approx. 4.2%) to a nominal rate of 1.6% p.a.;
- the share of short-term liabilities slightly increased and amounted to 17.1%; interest rate for such deposits decreased from 2% p.a. over the revaluation rate (for Tolar or foreign currency deposits) in 1995 to 0.5% p.a. over the respective revaluation rate;
- the share of foreign currency liabilities increased to 48.3%; the German Mark exchange rate (and therefore the respective revaluation of foreign currency deposits) increased by 3.9% and the Tolar revaluation rate by 9.7%;
- the share of foreign exchange assets of banks increased to 43.3%, primarily due to purchase of the Bank of Slovenia bills;
- interest rates for time deposits between 30 days and 1 year, and for those over 1 year decreased by more than 2%.

The return on assets and equity increased and amounted to 1.1% (an increase of 0.1% against 1995) and 10.4% (an increase of 1.3%) respectively.

Most domestic banks increased their net expenditure on write-offs and provisioning, partially due to requirement by inspectors of the Bank imposed on some of the banks for reclassification of credit to lower grades. Despite such findings on inadequate classification of credits established by on-site inspections, banks generally classified their credit portfolio in a more appropriate way in 1996. The share of doubtful and uncollectible credits increased from 3.9% as of December 31, 1995 to 4.1% as of September 30, 1996, but so did the value adjustments (from 5.3 to 5.6%) and the coverage of credits with doubtful collectibility with respective provisions (for 6.8 percentage points to 54.5% end of 1996). It all points towards higher degree of prudence in lending on the one hand and higher and more adequate provisioning of lower graded credit on the other hand.

Table 10: Some indicators of profitability and efficiency of banks

	31.12.1996	**31.12.1995**
Return on assets (ROA)	1.1%	1.0%
Return on equity (ROE)	10.4%	9.1%
Net interest margin (1)	5.5%	4.9%
Operational cost/average assets	3.6%	3.8%
Labour cost/average assets	1.9%	2.0%

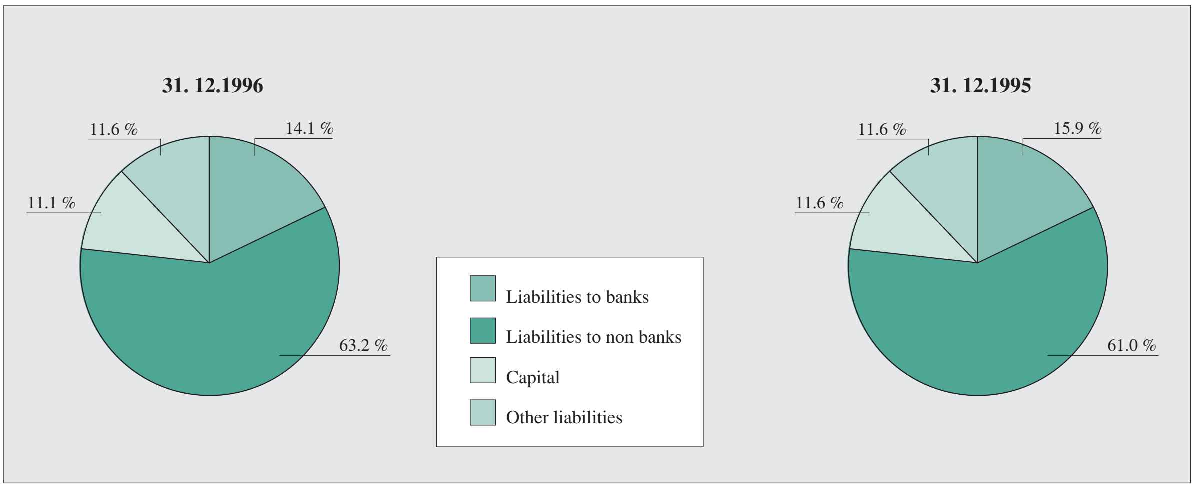
(1) Net interest income (including revaluation) as a percentage of average gross interest-earning assets.

Liabilities to non-banks account for 63.2% in the average ***liability structure of banks,*** showing an increase of 2.2 percentage points against 1995. The share of liabilities to banks and savings banks decreased from 15.9% to 14.1%. The share of capital amounted to 11.1% (198.5 billion Tolars), a decrease of 0.5% against 1995. Capital of banks increased by 12.1%, i.e. less than a half of the increase in the previous period (24.5%) when banks increased the capital pursuant to the Bank's minimum capital requirement needed for the full banking license (compliance was due before end of September 1995).

The share of other liabilities amounted to 11.6%; they include accruals and deferred income (4.7%), other liabilities (2.5%), own securities issued and certificates of deposit (2.4%), provisions for off-balance sheet items and expenditure (1.7%) and general provisions (0.3%).

Banks apparently wanted to keep their existing licenses and fully complied with the minimum capital requirement due before end of September 1995; as a consequence, capital adequacy of domestic banks increased from the average of 20.5% end of 1994 to 21.5% end of 1995, and decreased to 19.9% by end of June 1996 due to higher weighted risk asset growth than that of the banks' own funds. The average capital adequacy ratio of banks is 2.5 times that required; it helps banks to better manage risks and renders a safety cushion against existing and potential non-performing off-balance sheet assets respectively, and allows for further risk asset growth.

Chart 8: Average liabilities structure of banks

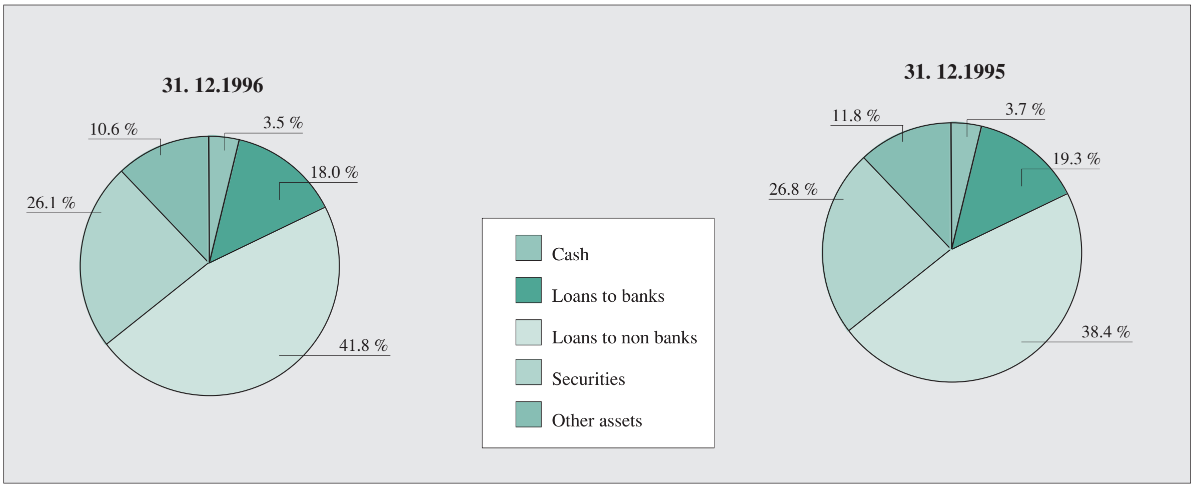


The structure of liabilities to non-bank clients amounting to 1,166.6 billion Tolars had changed from 1995. The share of liabilities to enterprises amounted to 28% (a decrease from 29% in 1994) compared to the share of liabilities to private individuals of 58%. The share of liabilities to the public sector increased from 11% in 1995 to 14%.

Within the average ***asset structure,*** claims on non-banks prevailed with a share of 41.8% (against 38.4% in 1995). Investments in securities (such as Bank of Slovenia bills, bank rehabilitation bonds, governmental and government guaranteed bonds) declined slightly (26.1%), and so did claims on the banking sector with a share of 18.0% (against 19.3% in 1995).

Cash and balances with the central bank amounted to 3.5%. The remaining assets amounted to 10.6% and comprise: 4.3% of other assets, 3.6% of tangible fixed assets, 1.7% of capital investments in connected and unconnected entities, 0.7% of accruals and deferred income, 0.2% of capital subscribed unpaid and own shares and 0.1% of intangible assets.

Chart 9: Average asset structure of banks



Lending to non-banks amounted to a total of 712.8 billion Tolars (an increase of 18.0% and higher than that of balance sheet total), whereof lending to enterprises 64.5% (an increase of 15.9%). Lending to individuals increased by 29.4% (compared to 77.2% increase in 1995); banks evidently still consider lending to individuals less risky. Long-term loans for purchase of cars and other consumption goods prevail.

Most of the loans to enterprises (a total of 459.8 billion Tolars) are short-term (289.5 billion Tolars) and in domestic currency (87%).

Beside regular off-site control, a total of 34 on-site ***examinations*** (28 in banks, 6 in savings banks) were carried out in banks and savings banks, including full-scope examinations, two diagnostic audits and inspections of selected areas of bank activity.

The full-scope examinations covered, among others:

- credit and securities portfolio,
- capital adequacy,
- risk management,
- information technology,
- profitability,
- adequate internal control of procedures,
- internal audit, etc.

Other inspections were targeted towards:

- loans to individuals and individual entrepreneurs,
- loans to enterprises,
- guarantees issued,
- securities portfolio, etc.

Major irregularities detected were the following:

- inadequate classification of claims and inadequate specific provisions for loan losses,
- currency and term mismatch in the balance sheet,
- inadequate diversification of loan portfolio,
- inadequate diversification of depositors,
- low share of stable long-term funding,
- inadequate internal organisation of credit departments (by product not by client),
- inadequate collection of claims due,
- inadequate internal audit,
- non-suspended interest accruals,
- inadequate back-up offices,
- lack of information technology strategy,
- lack of formal work procedures, instructions and control in savings banks.

As a consequence, the Bank recommended that banks and savings banks eliminate such irregularities, and issued the respective decrees accordingly. Banks fully complied in due course.

VI. OTHER SERVICES

1. Banker of the Government

Payment transactions

Pursuant to the central bank Act, the Bank clears payment transactions with foreign countries and any other transactions in foreign currencies for the account of the Republic of Slovenia. The volume of such outward payments amounted to DEM 770.8 million, payments under Letters of Credit DEM 26.3 million and of cash payments DEM 9.4 million. The Bank cleared inward payments of a total of DEM 429.9 million and cash payments of DEM 2.4 million. A total of DEM 102.3 million was sold to and DEM 23.4 million purchased from the users of the budget; drawings under foreign loans and donations account for the difference.

Foreign loans

Pursuant to the central bank Act the Bank acts as paying agent in case of credit arrangements of the Republic of Slovenia with foreign countries. In 1996 the Republic of Slovenia issued Eurobonds in amount of USD 325 million and concluded a loan agreement with a syndicate of foreign banks in amount of DEM 60 million; only part of the loan (DEM 35 million) was drawn before end of the year.

The remaining portion (USD 2.8 million) of the EFSAL loan granted to the Republic by the International Bank for Reconstruction and Development in 1993 was drawn at the beginning of the year.

The Republic of Slovenia duly met all its obligations under foreign loans. Repayments of the principal amounted to USD 402 million. Availing itself of the option stipulated in the Agreement on the Slovenian Debt Exchange concluded with foreign commercial bank creditors of the former SFR Yugoslavia under the 1988 New Financial Agreement, the Republic of Slovenia redeemed in December, i.e. prior to due date, an amount of USD 125 million of the floating rate amortising Bonds issued on June 11, 1996 in exchange of a portion of the debt outstanding.

Fiduciary account

Due to regulation of relations between the Republic of Slovenia and the foreign commercial bank creditors of the former SFR Yugoslavia under the 1988 New Financing Agreement and the Trade and Deposit Facility Agreement, the Republic of Slovenia closed one of the two fiduciary accounts held with Dresdner Bank Luxembourg. The second of the two fiduciary accounts to which Slovenia has made payments under its obligations succeeded to (roughly 60% of total obligations) under the 1975 and 1983 Osimo and Rome Treaties respectively, concluded between the former SFR Yugoslavia and Italy, has remained in place. Payments amounting to USD 5.1 million were made to this account in 1996, making the balance total of USD 28.1 million at the end of the year.

Fiscal stamps and securities

The Bank was in charge of processing and redemption of government bonds and its coupons respectively. It processed a total of 1,374,569 coupons of RS 01 series bonds, and 73,170 of RS 02 series bonds.

Pursuant to the agreement concluded between the Bank and the Ministry of Finance, the Bank prepares the issue and distribution of, and takes in custody fiscal stamps on behalf of and for the account of the Ministry of Finance. Administrative and fiscal stamps of total value of 2.1 billion Tolars were issued, and 230,278,500 different tobacco stamps bearing safety features were distributed in 1996.

2. Payment Systems Reform

During 1996 the project of Payment System Reforms continued in accordance with previous decisions which had defined its strategic and technological framework.

Whereas the new Real Time Gross Settlement (RTGS) System will directly be eligible to credit institutions (banks) only, the bulk clearing subsystems for payments of smaller values will also be eligible to other users with the payments company or clearing house acting as intermediary. In the early stage of implementation of the new payment systems, all banks will have the status of a settlement bank and will therefore have direct access to the system.

Large value payments will be processed pursuant to the standards and via network of S.W.I.F.T. As much as 20 domestic banks are already active users of this telecommunication system, the rest of them are to become so-called Domestic Clearing Participants, meaning that they will be able to use the network for domestic payments only. Supply of software and hardware for RTGS was put out for international tender in September; conclusion of procedure is scheduled for early 1997.

The strategy of migration of payment systems was adopted; six key phases were identified and determined. The ke feature of this strategy is separation of accounts of credit institutions (and their transfer to the Bank) from those of other legal persons (and their transfer to credit institutions).

The project was originally dealt with by separate working groups. They were replaced by a team of experts, some of them fully committed and some working part-time on the project. Members of the team originate in the Bank, the Ministry of Finance, the Agency for Payments and from domestic banks, or are independent experts.

A new payment instrument was developed for payment of a number of public services. The new uniform transfer order will replace more than 40 different transfer orders formerly used.

3. Statistics

The Bank is entrusted with collection of data for the compilation of balance of payments, of monetary and other bank statistics, as well as statistics on financial markets.

The Bank compiles the balance of payments on a monthly and the international investment position on an annual basis, including direct investments of residents abroad and those of non-residents in Slovenia in compliance with recommendations of the International Monetary Fund. Statistics on external debt are prepared pursuant to methodology of the World Bank.

Prepared on a monthly basis are the balance sheet of the Bank, the balance sheet of deposit money banks and the consolidated balance sheet of the banking system (monetary survey). Data on Slovenian monetary aggregates (M1, M2, M3) and their components are also available on a ten-days' basis and as monthly average. The Bank has a project on introduction of statistics on securities market running.

The main aggregates from the above areas are available in the Monthly Bulletin published in Slovenian and in English version. They are also included in the statistical publications of the International Monetary Fund.

Work is underway within the Financial Statistics Department on introduction of a new uniform statistical data base towards attainment of integrity, consistency, timeliness and ready access by all the users.

In early August, Slovenia (the Central Statistical Office, the Ministry of Finance and the Bank) was one of the first 18 countries to subscribe to the Special Data Dissemination Standards (SDDS) offered to International Monetary Fund members on voluntary basis with the purpose to guide member countries in the provision to the public of comprehensive, timely, accessible and reliable economic and financial statistics. Available on the Internet since September 1996 are meta data on Slovenian macroeconomic statistics. These are to be linked via hypertext links to the actual figures listed on the national page in 1997. By subscribing to the SDDS, Slovenia is obliged to fully comply with the following requirements before end of 1998: transparency in methodology and procedures for methodological changes, periodicity and timeliness of compilation of key data, confidentiality.

4. Banknote Issue

As at December 31, 1996 a total of 74.4 billion bank notes corresponding to the value of 71.5 billion Tolars were in circulation, representing an average of 37 bank notes per resident. Compared to 1995, the amount of bank notes in circulation increased by 10.2%, their value by 11.9%. Whereas the number of 1,000 and 5,000 Tolar denominations remained on the level of the previous year, there was a notable increase in number (48%) in that of the 10,000 Tolar denomination. The number of smaller denominations (50, 20, 10) increased slightly. The structure and supply of bank notes fully covered the needs.

23.7 million additional coins in denominations of 5, 2 and 1 Tolar were put in circulation, making a total of 202.4 million coins in circulation as of December 31,1996, and an average of 101 coin per resident. The value total of coins as of December 31, 1996 amounted to 417 million Tolars. The number of coins in circulation increased by 21%, the average per resident by 20%. The need for coins has been decreasing.

On behalf of the Republic of Slovenia, the Bank issued the following memorial coins: one to commemorate 150 years since the first railway was constructed on the territory of Slovenia, one to commemorate 100 years of Olympic games of modern times, and one to commemorate the fifth anniversary of independence of Slovenia. The coins were minted in denominations of 5,000 Tolars (in gold), 500 Tolars (in silver) and 5 Tolars (in CuNiZn alloy). The value total of all memorial coins sold in 1996 amounted to 50.4 million Tolars.

The Bank inspected 1,034 of foreign counterfeit notes detected on the territory of Slovenia in value of 9.5 million Tolars (the majority of such notes were in German Marks, US Dollars and Italian Lira). There were 36 cases of Tolar notes counterfeit detected, produced on colour photocopy machines. The value of such Tolar notes seized amounted to 162,200 Tolars and was negligible.

5. International Relations and Cooperation

The Bank of Slovenia continued to be fairly active in its international relations and cooperation.

As monetary authority and bank regulator, the Bank has been a point of interest to foreign commercial bankers, potential foreign investors, foreign journalists and other foreign delegations ever since it came into being. As a rule, these would call on the Bank's management or its experts in different fields of activity in order to get first hand information on the monetary policy stance, foreign exchange regime and on current developments in the fields of economy and finance, and in the banking system in particular.

The Republic of Slovenia had encharged J.P. Morgan its advisor in obtaining the first ever investment rating, and the Bank of Slovenia's management and its officials actively participated in providing the three world leading credit agencies - IBCA, Moody's Investors Service and Standard & Poor's - with any and all relevant data and information they considered necessary for their extensive evaluation. The credit ratings assigned to the Republic of Slovenia for long term debt - an "A" rating by each of them - were published on May 8, 1996 and are the highest ever assigned to one of the economies in transition.

The three years of participation of Bank of Slovenia's officials in negotiations with foreign creditors of the former SFR Yugoslavia under the 1988 New Financing Agreement with the London Club of commercial banks culminated in the exchange of a portion (18% of the debt outstanding held by the qualifying creditors) of the foreign debt of the former SFR Yugoslavia for new Bonds issued by the Republic of Slovenia, listed on the Luxembourg Stock Exchange. As a result of the consummation of the debt exchange, Slovenian obligors were released from the obligations under the 1988 New Financing Agreement, including its "joint and several liability".

Slovenia made its debut on the international financial markets on July 22, 1996 with a USD 325 million Eurobond issue due 2001, managed by J.P. Morgan Securities Ltd. The Bank of Slovenia's role in the deal wass that of the paying agent.

The Bank of Slovenia has further intensified its good relations and cooperation with all the international financial institutions, whether as member or not, and with the central banks of G 10 countries and Austria, as well as with other central banks throughout the world. The relations and cooperation included but were not limited to exchange of views and experience in different areas of central bank activity and problems facing, like the inflow of foreign capital and its implications on the monetary policy, foreign portfolio and direct investment, money laundering prevention, supervision of banking groups and financial conglomerates, etc. Bank of Slovenia was among the first 18 central banks world-wide to have accepted the IMF Special Dissemination Standards for financial statistics.

The Bank is proud to have hosted the Governor of the National Bank of Belgium, and high officials and specialists of other foreign central banks. It was a privilege and pleasure to have hosted the group of G 10 countries', Austria's, the IMF and the BIS officials responsible of central bank cooperation in June, and to have been able to present to them the Bank's development and achievements, no doubt partially due to their generous assistance, advice and training offered.

Bank of Slovenia has continued to be actively involved in the negotiations on succession to the former SFR Yugoslavia pursuant to the Dayton Agreement under the auspices of the Office of the High Representative in Brussels. Likewise, following the proposal submitted by the Bank for International Settlements, Basle (BIS) dated July 5, 1996 to the central banks of all the successor states to the former SFR Yugoslavia with regard to the assets held in books of the BIS in the name of the central bank of the former SFR Yugoslavia and the participation of the same in the share capital of the BIS, the Bank of Slovenia gave incentives for and organised consultative meetings of the central bank governors involved, and took preparatory actions in support of the decision of the Slovenian Government on acceptance of the said proposal of the BIS taken on September 25, 1996, hoping that a positive final solution might be achieved in the near future. The Bank for International Settlements is the last international financial institution of which the Bank is not yet member. Nevertheless, due to a standing invitation, much to his satisfaction, the Governor has been able to attend the regular monthly meetings of governors and has had the opportunity for valuable exchange of views and consultations with his much more experienced colleagues.

The Bank of Slovenia has had a fruitful and satisfactory cooperation with the Basle Committee on Banking Supervision since early 1993; last June it formally joined the regional group and became member of the Group of Banking Supervisors from Central and Eastern Europe and by doing so strengthened the ties of the existing cooperation.

Before end of 1996, the Bank of Slovenia also formally accepted the invitation to become member of the European Association for Banking History e.V., Frankfurt am Main. The membership becomes effective as of January 1, 1997.

Supportive to Slovenia's endeavours to become member of the Organisation for Economic Co-operation and Development (OECD), Bank of Slovenia's officials have co-operated with the OECD staff, providing them with the relevant data on the macroeconomic management and the development in the banking and financial sector.

The Bank of Slovenia staff actively participated in the preparation of the documentation necessary for the signing of the Association Agreement between the European Union and the Republic of Slovenia in June. The Bank has been following the EU matters and the preparations for the European Monetary Union and introduction of a single European currency very closely, and is grateful to have been given the opportunity for direct contacts with the European Monetary Institute. Within the framework of pre-accession activities of the Republic of Slovenia, the Bank of Slovenia has also made efforts to gradually bring the laws and regulations from its jurisdiction in line with the EU directives.

VII. THE BANK OF SLOVENIA ANNUAL FINANCIAL STATEMENTS

Statement of responsibilities of the Governing Board

The Law on the Bank of Slovenia (íthe Bankí) 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 is responsible for maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Bank and to enable them to ensure that the financial statements comply with Slovenian law. It has a general responsibility for taking such steps as are reasonably open to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

Report of the auditors to the Governing Board of the Bank of Slovenia

We have audited the financial statements set out on pages 48 to 57.

Respective responsibilities of the Governing Board and auditors

As set out on page 46, these financial statements are the responsibility of the Bank's Governing Board. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

We conducted our audit 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 audit provides a reasonable basis for our opinion, given below.

Opinion

In our opinion the financial statements give a true and fair view of the state of the Bank's affairs as at 31 December 1996 and the operating surplus for the year then ended and have been properly prepared in accordance with those International Accounting Standards set out in note 2 and Slovenian law.

KPMG
Chartered Accountants
Authorised Auditors
London

10 April 1997

Statement of income and expenditure

for the year ended 31 December 1996 (expressed in thousands of tolars)

	NOTES	1996	1995
Operating income:			
Income from financial assets		**14,941,300**	12,791,281
Net foreign exchange gain		**8,131,032**	5,200,899
Total income from financial assets	4	**23,072,332**	17,992,180
Expenses on serviced liabilities	5	**9,310,312**	11,039,955
Net investment income		**13,762,020**	6,952,225
Other income	6	**510,546**	533,766
Total operating income		**14,272,566**	7,485,991
Operating expenses	7	**2,328,031**	1,806,206
Provision for bad and doubtful debts		**578,628**	-
Operating surplus available for appropriation		**11,365,907**	5,679,785
Appropriations:			
Transfer to general reserves		**2,311,980**	-
Transfer to foreign exchange reserves		**8,131,032**	5,200,899
Total transfer to reserves	12	**10,443,012**	5,200,899
Provision for transfer of surplus		**922,895**	478,886
Total appropriations		**11,365,907**	5,679,785

The notes on pages 49 to 57 form an integral part of the financial statements.

Balance sheet

at 31 December 1996 (expressed in thousands of tolars)

	NOTES	1996	1995
Assets			
Financial assets	8	**361,495,681**	309,223,928
Fixed assets	9	**1,657,393**	1,389,612
Total assets		**363,153, 074**	310,613,540
Liabilities and reserves			
Serviced liabilities	10	**253,577,666**	219,504,083
Banknotes in circulation	11	**71,440,570**	63,904,039
Provision for transfer of surplus		**922,895**	478,886
Total liabilities			
Reserves	12	**37,211,943**	26,726,532
Total liabilities and reserves		**363,153,074**	310,613,540

These financial statements were approved by the Governing Board on 25 March 1997 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 of 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 and it is supervised by Parliament. The Bank is responsible for the stability of the national currency and for the liquidity of the Slovenian banking system.

2 Accounting standards and conventions

These financial statements have been prepared in accordance with applicable International Accounting Standards (IAS) as promulgated by the International Accounting Standards Committee except as detailed below. These were adopted by the Governing Board at the 90th meeting on 9 May 1995. The statements are prepared under the going concern concept and the historical cost convention amended for the revaluation of certain assets. Accrual accounting has been used to match expenses and revenues.

The Bank does not provide a cash flow statement, since the Governing Board considers that given the nature of its operations it would not provide any meaningful additional information.

3 Specific accounting policies

Income recognition

Interest income is recognised in the income and expenditure account 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

Marketable securities are carried at the lower of 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 are stated at fair value.

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.

Fixed assets

Investment properties located in Austria are carried at fair value and are not depreciated. All other fixed assets are stated at cost and net of depreciation. 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:

	1996	1995
Buildings	**1.3**	1.3
Computers and other equipment	**10 to 33**	10 to 20

Taxation

The Bank is not subject to Slovenian profit taxes.

Reserves

In accordance with the Law on the Bank of Slovenia, net foreign exchange gains are transferred to foreign exchange reserves and are not available for distribution. Any remaining surplus after transfer to the general reserves is appropriated by the Republic of Slovenia.

4 Income from financial assets

	1996 SIT 000's	1995 SIT 000's
Income from foreign currency assets		
Interest on deposits	**9,120,878**	9,095,157
Investment income on marketable securities, net	**1,861,740**	1,115,402
Interest on International Monetary Fund deposits	**31,056**	36,180
Net foreign exchange gain	**8,131,032**	5,200,899
Total	**19,144,706**	15,447,638
Income from domestic currency assets		
Interest on loans to banks	**3,927,626**	2,544,542
Total income from financial assets	**23.072.332**	17.992.180

5 Expenses on serviced liabilities

	1996 SIT 000's	1995 SIT 000's
Expenses on foreign currency liabilities		
Interest on current accounts and deposits	**1,003,808**	180,289
Interest on Bank of Slovenia bills	**6,721,002**	8,259,539
Total	**7,724,810**	8,439,828
Expenses on domestic currency liabilities		
Interest on current accounts and deposits	**208,035**	196,852
Interest on Bank of Slovenia bills	**749,952**	1,914,649
Interest on Republic of Slovenia deposits	**627,515**	488,626
Total	**1,585,502**	2,600,127
Total expenses on serviced liabilities	**9,310,312**	11,039,955

6 Other income

	1996 SIT 000's	1995 SIT 000's
Fees and commissions receivable	**280,163**	453,652
Other income	**230,383**	80,114
Total other income	**510,546**	533,766

BANKA SLOVENIJE

7 Operating expenses

	1996	1995
	SIT 000's	SIT 000's
Staff costs	1,372,195	1,156,207
Commissions and fees for banking services	147,182	88,630
Administration costs	723,538	514,740
Printing and minting costs	1,914	28,976
Other	83,202	17,653
Total operating expenses	**2.328.031**	1.806.206

8 Financial assets

	Repricing period				
	3 months or less	Over 3 months to 1 year	Over 1 year	1996 Total	1995 Total
	SIT 000's	SIT 000's	SIT 000's	SIT 000's	SIT 000's
Foreign currency assets					
Cash and deposits	184,525,707	86,146,445	176,248	270,848,400	225,626,752
Marketable securities	19,404,536	13,413,708	20,567,647	53,385,891	25,420,417
Receivables from the Republic of Slovenia	34,829	1,011,671	5,357,486	6,403,986	6,211,890
International Monetary Fund	2,637,980	-	-	2,637,980	2,419,235
Accrued interest and other assets	1,758,027	607,407	657,079	3,022,513	2,571,012
Total	208,361,079	101,179,231	26,758,460	336,298,770	262,249,306
Domestic currency assets					
Receivables from Succession Fund of the Republic of Slovenia	-	-	8,649,807	8,649,807	8,649,807
Loans to banks	15,248,710	680,379	290,930	16,220,019	37,871,794
Accrued interest and other assets	153,565	17,543	155,977	327,085	453,021
Total	15,402,275	697,922	9,096,714	25,196,911	46,974,622
Total financial assets	223,763,354	101,877,153	35,855,174	361,495,681	309,223,928

Average effective interest rates on financial assets.

	Repricing period				
	3 months or less	Over 3 months to 1 year	Over 1 year	1996 Total	1995 Total
	%	%	%	%	%
Foreign currency assets					
Cash and deposits	3.91	3.45	3.86	3.76	4.71
Marketable securities	4.03	3.46	4.78	4.18	4.59
Receivables from the Republic of Slovenia-	-	-	-	-	–
International Monetary Fund	1.35	-	-	1.35	1.37
Domestic currency assets					
Receivables from Succession Fund of the Republic of Slovenia	-	-	-	-	-
Loans to banks	10.79	12.41	9.99	10.78	13.31

Deposits with other banks and loans to other banks have a carrying amount equal to the principal less specific provisions (1996: SIT 579 million; 1995: SIT mil). Interest is paid on maturity. 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. These concentrations of risk by currency and type of counterparty are as follows at 31 December 1996.

	SIT	DEM	USD	Other	Total
	%	%	%	%	%
Sovereign issuers	**2.48**	**10.46**	**3.22**	**4.44**	20.60
Domestic banks	**4.49**	**0.01**	**0.01**	**-**	4.51
Foreign banks	**-**	**49.73**	**19.54**	**5.62**	74.89
31 December 1996	**6.97**	**60.20**	**22.77**	**10.06**	100.00
31 December 1995	15.19	48.73	25.50	10.58	100.00

Financial assets at 31 December 1996 will mature within the following periods analysed by currency (in SIT 000's):

	SIT	DEM	USD	Other	Total
Up to 1 month	**15,327,183**	**50,876,887**	**40,383,123**	**10,001,516**	116,588,709
1 to 3 months	**75,092**	**72,826,350**	**29,868,476**	**3,259,075**	106,028,993
3 to 12 months	**697,921**	**81,885,027**	**10,661,988**	**7,559,745**	100,804,681
1 year and over	**9,096,715**	**12,049,926**	**1,410,185**	**15,516,472**	38,073,298
31 December 1996	**25,196,911**	**217,638,190**	**82,323,772**	**36,336,808**	361,495,681
31 December 1995	46,974,621	150,682,436	78,840,956	32,725,915	309,223,928

Credit Risk Concentration

All foreign banks have a credit rating of at least AA- as graded by ICBA. Sovereign issuers' exposure consists of OECD countries, the Republic of Slovenia and the Succession Fund of The Republic of Slovenia.

9 Fixed assets

	Land and other buildings	**Computers and equipment**	Total
	SIT 000's	**SIT 000's**	SIT 000's
Cost or valuation			
At 1 January 1996	1,423,083	990,640	2,413,723
Additions	188,695	284,109	472,804
Disposals	(3,015)	(119,846)	(122,861)
At 31 December 1996	**1,608,763**	**1,154,903**	2,763,666
Depreciation			
At 1 January 1996	501,223	522,888	1,024,111
Disposals	(2,708)	(100,735)	(103,443)
Charge for the year	18,132	167,473	185,605
At 31 December 1996	**516,647**	**589,626**	1,106,273
Net book value			
At 31 December 1996	**1,092,116**	**565,277**	1,657,393
At 31 December 1995	921,860	467,752	1,389,612

Included in land and buildings is an amount of SIT 500 million relating to investment properties in Austria. These properties are valued on the basis of an appraisal by the Governing Board substantiated by a multiple of rental earnings and the price at which property transfers are presently taking place in the same neighborhood.

10 Serviced liabilities

	Repricing period				
	Over 3 months or less	Months to 1 year	Over 1 year	1996 Total	1995 Total
	SIT 000's	SIT 000's	SIT 000's	SIT 000's	SIT 000's
Foreign currency liabilities					
Current accounts and deposits	**19,751,613**	**-**	**-**	**19,751,613**	40,338,962
SDR allocation	**5,173,675**	**-**	**-**	**5,173,675**	4,762,758
IMF and other international financial organisations	**-**	**182,583**	**39,801**	**222,384**	522,477
Bank of Slovenia bills	**128,947,351**	**34,341,133**	**-**	**163,288,484**	120,644,706
Accrued interest and other liabilities	**113,272**	**-**	**-**	**113,272**	179,583
Total	**153,985,911**	**34,523,716**	**39,801**	**188,549,428**	166,448,486
Domestic currency liabilities					
Current accounts and deposits	**44,740,454**	**-**	**-**	**44,740,454**	35,051,114
Bank of Slovenia bills	**7,348,712**	**8,950,403**	**-**	**16,299,115**	6,599,457
Republic of Slovenia deposits	**3,324,647**	**-**	**-**	**3,324,647**	10,407,306
Accrued interest and other liabilities	**474,484**	**-**	**189,538**	**664,022**	997,720
Total	**55,888,297**	**8,950,403**	**189,538**	**65,028,238**	53,055,597
Total serviced liabilities	**209,874,208**	**43,474,119**	**229,339**	**253,577,666**	219,504,083

Average effective interest rates on serviced liabilities.

	Repricing period				
	Over 3 months or less	Months to 1 year	Over 1 year	1996 Total	1995 Total
	%	%	%	%	%
Foreign currency liabilities					
Current accounts and deposits	**4.40**	**-**	**-**	**4.40**	4.04
SDR allocation	**-**	**-**	**-**	**-**	-
IMF and other international financial organisations	**-**	**4.51**	**0.00**	**3.70**	4.15
Bank of Slovenia bills	**4.42**	**4.54**	**-**	**4.46**	7.31
Domestic currency liabilities					
Current accounts and deposits	**0.50**	**-**	**-**	**0.50**	0.54
Bank of Slovenia bills	**6.43**	**11.45**	**-**	**9.19**	16.55
Republic of Slovenia deposits	**1.00**	**-**	**-**	**1.00**	4.33

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

The SDR allocation liability carried an interest rate of 3.91% at 31 December 1996, (1995: 3.96%). Interest paid by the Bank is recharged directly to the Republic of Slovenia, thereby giving a nil effective interest rate (see note 8).

Currency concentration and maturity analysis

Financial liabilities at 31 December 1996 will mature within the following periods analysed by currency (in SIT 000's):

	SIT	DEM	USD	Ostalo	Skupaj
Up to 1 month	**54,351,063**	**30,098,347**	**17,888,822**	**4,098,504**	**106,436,736**
1 to 3 month	**1,537,234**	**87,808,167**	**8,910,006**	**8,391**	**98,263,798**
3 to 12 month	**8,950,404**	**27,042,278**	**7,298,855**	**182,583**	**43,474,120**
1 year and over	**189,537**	**–**	**38,573**	**5,174,902**	**5,403,012**
31 December 1996	**65,028,238**	**144,948,792**	**34,136,256**	**9,464,380**	**253,577,666**
31 December 1995	53,055,597	113,953,787	38,278,665	14,216,034	219,504,083

11 Banknotes in circulation

Value of banknotes in circulation by denomination:

		1996	1995
		SIT 000's	SIT 000's
SIT	10	**210,445**	185,720
SIT	20	**207,610**	175,052
SIT	50	**334,148**	298,029
SIT	100	**967,419**	911,579
SIT	200	**809,348**	696,152
SIT	500	**1,323,055**	1,202,018
SIT	1,000	**11,217,023**	11,093,856
SIT	5,000	**31,246,735**	32,268,805
SIT	10,000	**24,714,370**	16,660,510
		71,030,153	63,491,721
Tolar coupons		**410,417**	412,318
Total		**63,904,039**	63,904,039

12 Reserves

	1996	1995
	SIT 000's	SIT 000's
Balance at 1 January	**26,726,532**	21,493,559
Transfer to general reserves	**2,311,980**	-
Transfer to foreign exchange reserve	**8,131,032**	5,200,899
Contributions to the welfare fund	**42,399**	32,074
Balance at 31 December	**37,211,943**	26,726,532
Represented by		
General reserve	**5,550,879**	3,238,899
Foreign exchange reserve	**30,682,966**	22,551,934
Investment properties revaluation	**500,000**	500,000
Welfare fund	**478,098**	435,699
Total reserves	**37,211,943**	26,726,532

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 increase of the general reserve was made from the operating surplus available for appropriation, based on the decision by the Governing Board of the Bank of Slovenia for covering future losses which could result from monetary policy instruments used by the Bank and other risks.

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.

13 Commitments and off balance sheet instruments

Letters of Credit

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

	1996	1995
	SIT 000's	SIT 000's
Foreign currency letters of credit	**8,047,554**	1,481,377

Bills with warrants

The Bank issued SIT 31 billion of bills during 1996 with 198,678 warrants attached. Each bill has a maximum of five warrants attached. The warrants represent a contractual obligation by the Bank to sell SIT, DEM 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 DEM and USD for DEM or USD bills respectively. At year end there were 128,758 issued but unexercised warrants. The future potential discount costs of these warrants are valued at fair value and a provision for the warrants is included as a liability in the accounts. The warrants have a maturity of 12 months from the date of issue.

MEMBERS OF THE GOVERNING BOARD OF THE BANK OF SLOVENIA

dr. France ARHAR, Governor

Samo NUČIČ, Deputy Governor

mag. Janez KOŠAK, Vice Governor

dr. Marko KRANJEC, Vice Governor

Andrej RANT, Vice Governor

dr. Ivan RIBNIKAR, Faculty of Economics, Ljubljana University

dr. Jože MENCINGER, Economic Institute at Faculty of Law, Ljubljana University

dr. Dušan ZBAŠNIK, School of Business and Economics, Maribor University

mag. Velimir BOLE, Economic Institute at Faculty of Law, Ljubljana University

Jurij KLEINDIENST, Kolektor, Idrija

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